Croatian Telecom Inc.

Consolidated financial statements

31 December 2016

Contents

Responsibility for the consolidated financial statements

Pursuant to the Croatian Accounting Act in force, the Management Board is responsible for ensuring that consolidated financial statements are prepared for each financial year in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union ("EU") give a true and fair view of the financial position and results of Croatian Telecom Inc. and its subsidiaries (the "Group") for that period.

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

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

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

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

The accompanying consolidated financial statements were approved for issuance by the Management Board on 8 February 2017.

Croatian Telecom Inc.
Roberta Frangeša Mihanovića 9
10000 Zagreb
Republic of Croatia

8 February 2017

On behalf of the Group,

Hrvatski Telekom
Hrvatski Telekom d.d.
Zagreb
CEO

Mr. Davor Tomašković
President of the Management Board (CEO)

Ms. Marija Felkel
Member of the Management Board and CHRO

Mr. Josef Thürriegl
Member of the Management Board and CFO

Mr. Boris Batelić
Member of the Management Board and CCO

Mr. Boris Drilo
Member of the Management Board and CTIO

Ms. Nataša Rapaić
Member of the Management Board and COO Residential

Mr. Saša Kramar
Member of the Management Board and COO Business

Independent Auditor's Report

To the Shareholders and Management Board of Hrvatski Telekom d.d.:

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Hrvatski Telekom d.d. (the "Company") and its subsidiaries (together – the "Group") as at 31 December 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted in European Union ("IFRS").

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at 31 December 2016;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report.

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

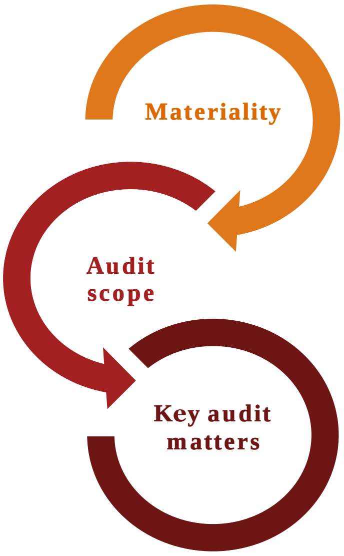
Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

PricewaterhouseCoopers d.o.o., Ulica kneza Ljudevita Posavskog 31, 10000 Zagreb, Hrvatska
T: +385 (1) 6328 888, F:+385 (1)6111 556, www.pwc.com/hr

Our audit approach

Overview



- Overall materiality for consolidated financial statements: HRK 68 million, which represents 2.5% of Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA).

- We conducted audit work at four legal entities in Croatia (Hrvatski Telekom, Combis, Iskon and Optima).
- Our audit scope addressed 99% of the Group's revenues and 99% of the Group's absolute value of underlying profit.

- Capitalisation of content rights
- Contingent liabilities and regulatory claims
- Impairment testing of goodwill

How we tailored our Group audit scope

We designed our audit by determining materiality and assessing the risks of material misstatement in the consolidated financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the consolidated financial statements as a whole.

Overall materiality for consolidated financial statements	HRK 68 million (2015: HRK 67 million)
How we determined it	2.5% EBITDA. EBITDA is operating profit adjusted for depreciation, amortisation, impairment of property, plant and equipment and intangible assets.
Rationale for the materiality benchmark applied	We consider EBITDA to be the key metric in the industry of the Group, and it is the benchmark against which the performance of the Group is most commonly measured by shareholders.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the Key audit matter
Capitalisation of content rights *Refer to note 2.4.e (Summary of accounting policies) and note 15 (Intangible assets). The Group consolidated statement of financial position includes capitalised intangible assets of HRK 1,738 million, which includes capitalised content rights of HRK 192 million.* We focused on this area because of the significance of the costs capitalised and the fact that there is judgement involved. There are two main risks that we addressed in our audit: (1) the risk of whether the criteria required for capitalisation of such costs have been met, and (2) the risk that management's estimate of future consideration from content contracts is not reasonable.	We obtained a detailed analysis of capitalised content contracts in current and prior periods, and reconciled these amounts to prior year information and current year general ledger. No significant reconciling differences were identified. We have tested a sample of costs capitalised in the period by review of related contracts and invoices to assess whether they have been appropriately capitalised in line with the Group's accounting policy. In addition, we assessed the reasonableness of assumptions (estimated number of future customers and discount rate) used for measurement of future consideration. We compared the future customers estimate to historical data, and considered the consistency of the future growth rate assumptions with management's business plans. We also compared the discount rate used to market information. We identified no significant variances. Overall, we found that the costs were capitalised in line with the Group's accounting policy, and management's assumptions were reasonable.

Key audit matter	How our audit addressed the Key audit matter
Contingent liabilities and regulatory claims *Refer to note 2.3 (Significant accounting judgements, estimates and assumptions), note 27 (Provisions for other liabilities and charges) and note 32 (Contingencies).* We focused on this area because the Group is exposed to a significant number of legal, regulatory and competition claims. Consequently, management makes judgements about the future outcomes and amounts of contingent liabilities which may arise from such matters.	The Group has developed an internal methodology to ensure appropriate identification, reporting, assessment and quantification of legal, regulatory, and competition matters. We assessed the design and consistency of application of such methodology by performing the following procedures: - we gained an understanding of the status of each significant claim and historical outcomes of previous similar cases, - we evaluated the Group's assessment of the nature of litigation and claims by discussing the most significant cases with the Group's management and in-house legal counsel, and - we read related correspondence and obtained external confirmations from relevant third party legal representatives regarding certain material cases. Based on the evidence obtained, while noting the inherent uncertainty with such legal and regulatory matters, we agree with management's assessment of the likelihood of future material cash outflows arising from these matters. We determined that the matters assessed as probable to result in future cash outflows have been recorded as provisions, while the matter assessed as possible to result in future cash outflows has been appropriately disclosed.
Impairment testing of goodwill *Refer to note 2.3 (Significant accounting judgements, estimates and assumptions) and note 15 (Intangible assets). The Group statement of financial position includes goodwill of HRK 252 million.* The Group is required to, at least annually, test goodwill for impairment. We focused on this area because management's assessment of the 'fair value less costs of disposal' of the related cash-generating units involves significant judgement about future results of the business, particularly those relating to the cash flow forecast (revenue projections and growth rates) and the applied discount rate.	In the evaluation of the assumptions as disclosed in note 2.3 as well as methodologies used (discounted cash flow model) by management, we used internal valuation experts to assist us in evaluating the methodology used and underlying assumptions. We discussed with management their estimate of future cash flow forecasts, and the process by which they were drawn up. We tested the mathematical accuracy of underlying calculations, and we compared the cash-flow forecasts to approved budgets. We noted no significant exceptions. We compared current year actual results with prior year forecasts as an indication of the quality of the forecasting process. We found no significant differences, but noted that management did adjust future forecasts for changes in market trends.

Key audit matter	How our audit addressed the Key audit matter
Impairment testing of goodwill (continued) We specifically focused on the goodwill related to the Optima cash-generating unit (carrying value at balance sheet date is HRK 90 million) due to the historically small difference between the carrying amount and fair value less costs of disposal. The remaining goodwill balance at the balance sheet date related to cash-generating units for which the Group assessed there is substantial headroom.	We evaluated and challenged the discount rate used by comparing the rates used to comparable organisations and market information. We also reviewed management's sensitivity analysis on the key assumptions to ascertain the extent of change in those assumptions that either individually or collectively would cause the goodwill to be impaired. We found that the post-tax discount rate used by management was consistent with market data, and the growth rate assumption was consistent with historical results and did not exceed the industry forecasts. We agree with management's assessment that no significant impairment to the carrying amount of goodwill was identified, based on available evidence.

Other information

Management is responsible for the other information. The other information comprises the Consolidated Annual Report of the Group, which includes the Management Report and Corporate Governance Statement (but does not include the consolidated financial statements and our auditor's report thereon).

Our opinion on the consolidated financial statements does not cover the other information, including the Management Report and Corporate Governance Statement.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the Management Report and Corporate Governance Statement, we also performed procedures required by the Accounting Act in Croatia. Those procedures include considering whether the Management Report includes the disclosures required by Article 21 and 24 of the Accounting Act, and whether the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

Based on the work undertaken in the course of our audit, in our opinion:

- the information given in the Management Report and the Corporate Governance Statement for the financial year for which the consolidated financial statements are prepared is consistent, in all material respects, with the consolidated financial statements;
- the Management Report has been prepared in accordance with the requirements of Article 21 and 24 of the Accounting Act; and
- the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

In addition, in light of the knowledge and understanding of the Group and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the Management Report and Corporate Governance Statement. We have nothing to report in this respect.

Responsibilities of management and those charged with governance for the consolidated financial statements

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

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Tamara Maćašović.

PricewaterhouseCoopers d.o.o.

PricewaterhouseCoopers d.o.o.
Ulica kneza Ljudevita Posavskog 31, Zagreb
8 February 2017

TM

Tamara Maćašović
Member of the Management Board and
Certified Auditor

Consolidated statement of comprehensive income
For the year ended 31 December 2016

	Notes	2016 HRK million	2015 HRK million
Revenue	4	6,970	6,919
Other operating income	5	159	98
Merchandise, material and energy expenses	6	(1,354)	(1,272)
Service expenses	7	(743)	(710)
Employee benefits expenses	9	(987)	(1,023)
Work performed by the Group and capitalised		101	88
Depreciation, amortization and impairment of non-current assets	8	(1,497)	(1,492)
Other expenses	10	(1,410)	(1,409)
Operating profit	4	**1,239**	**1,199**
Finance income	11	64	53
Finance costs	12	(144)	(88)
Finance costs – net		(80)	(35)
Share of profit of investments accounted for using the equity method	18	3	4
Profit before income tax		**1,162**	**1,168**
Income tax expense	13	(234)	(227)
Profit for the year		**928**	**941**
Items that may be subsequently reclassified to comprehensive income			
Change in value of available for sale financial assets		(1)	2
Other comprehensive income for the year, net of tax		**(1)**	**2**
Total comprehensive income for the year, net of tax		**927**	**943**

Consolidated statement of comprehensive income (continued)

For the year ended 31 December 2016

	Notes	2016 HRK million	2015 HRK million
Profit attributable to:			
Equity holders of the Company		934	925
Non-controlling interest		(6)	16
		928	941
Total comprehensive income arisen from continuing operations attributable to:			
Equity holders of the Company		933	927
Non-controlling interest		(6)	16
		927	943
Earnings per share			
Basic and diluted, from continuing operations attributable to equity holders of the Company during the year	14	HRK 11.40	HRK 11.30

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

Signed on behalf of the Company on 8 February 2017:

Hrvatski Telekom
Hrvatski Telekom d.d.
Zagreb

Mr. Davor Tomašković
President of the Management Board (CEO)

Ms. Marija Felkel
Member of the Management Board and CHRO

Mr. Josef Thürriegl
Member of the Management Board and CFO

Mr. Boris Batelić
Member of the Management Board and CCO

Mr. Boris Drilo
Member of the Management Board and CTIO

Ms. Nataša Rapaić
Member of the Management Board and COO Residential

Mr. Saša Kramar
Member of the Management Board and COO Business

Consolidated statement of financial position
As at 31 December 2016

	Notes	31 December 2016 HRK million	31 December 2015 HRK million
ASSETS			
Non-current assets			
Intangible assets	15	1,738	1,651
Property, plant and equipment	16	5,576	5,558
Investment property	17	44	57
Investments accounted for using the equity method	18	377	399
Available-for-sale financial assets	19	949	591
Trade and other receivables	21	121	98
Bank deposits	23	26	43
Deferred income tax asset	13	59	46
Total non-current assets		**8,890**	**8,443**
Current assets			
Inventories	20	111	110
Trade and other receivables	21	1,328	1,214
Prepayments	22	261	272
Income tax prepayments		-	7
Available-for-sale financial assets	19	46	78
Bank deposits	23	1,143	780
Cash and cash equivalents	23	2,676	3,175
Total current assets		**5,565**	**5,636**
TOTAL ASSETS		**14,455**	**14,079**

Consolidated statement of financial position
As at 31 December 2016

	Notes	31 December 2016 HRK million	31 December 2015 HRK million
EQUITY AND LIABILITIES			
Issued capital and reserves			
Issued share capital	28	9,823	9,823
Legal reserves	29	491	444
Fair value reserves		3	4
Retained earnings	30	1,567	1,193
Total		**11,884**	**11,464**
Non-controlling interest		163	177
Total issued capital and reserves		**12,047**	**11,641**
Non-current liabilities			
Provisions for other liabilities and charges	27	42	56
Borrowings	36	262	279
Employee benefit obligations	26	12	12
Deferred income	25	19	2
Other liabilities	24	148	143
Finance lease	36	42	11
Deferred income tax liability	13	36	45
Total non-current liabilities		**561**	**548**
Current liabilities			
Trade payables and other liabilities	24	1,615	1,701
Income tax payable		23	-
Provisions for other liabilities and charges	27	91	82
Finance lease	36	13	4
Deferred income	25	89	103
Borrowings	36	16	-
Total current liabilities		**1,847**	**1,890**
Total liabilities		**2,408**	**2,438**
TOTAL EQUITY AND LIABILITIES		**14,455**	**14,079**

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

Signed on behalf of the Group on 8 February 2017:

Mr. Davor Tomašković
President of the Management Board (CEO)

Mr. Josef Thürriegl
Member of the Management Board and CFO

Consolidated statement of cash flows
For the year ended 31 December 2016

	Notes	2016 HRK million	2015 HRK million
Operating activities			
Profit before income tax		1,162	1,168
Depreciation, amortization and impairment of non-current assets	8	1,497	1,492
Interest income	11	(19)	(19)
Interest expense	12	93	59
Gain on disposal of assets	5,10	(35)	(11)
Other net financial loss (gain)	11,12	6	(6)
Share of profit of joint venture	18	(3)	(4)
(Increase) / decrease in inventories	20	(1)	9
(Increase) / decrease in receivables and prepayments		(142)	20
(Decrease) / increase in payables and accruals		(149)	13
Increase in employee benefit obligations	26	-	1
Decrease in provisions		(12)	(44)
Other non-cash items		(19)	12
Cash generated from operations		2,378	2,690
Interest paid		(78)	(64)
Income tax paid		(225)	(260)
Net cash flows from operating activities		**2,075**	**2,366**
Investing activities			
Payments for non-current assets		(1,173)	(990)
Proceeds from sale of non-current assets		55	25
Purchase of available-for-sale financial assets and deposits		(1,018)	(616)
Proceeds from sale of available-for-sale financial assets and deposits		972	974
Purchase of secured deposits (reverse REPO arrangements)	23	(2,207)	(1,407)
Proceeds from secured deposits (reverse REPO arrangements)	23	1,608	1,438
Interest received		18	18
Dividend received	18	3	-
Net cash flows used in investing activities		**(1,742)**	**(558)**
Financing activities			
Dividends paid	30	(491)	(573)
Repayment of radio frequency spectrum, content and ECI contracts		(294)	(212)
Other financial repayments		(30)	(34)
Repayment MCL		(8)	(8)
Repayment of lease liability and borrowings	28	(10)	(4)
Net cash flows used in financing activities		**(833)**	**(831)**
Net increase in cash and cash equivalents		(500)	977
Cash and cash equivalents as at 1 January		3,174	2,192
Exchange gains on cash and cash equivalents		2	6
Cash and cash equivalents as at 31 December	23	**2,676**	**3,175**

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

Consolidated statement of changes in equity
For the year ended 31 December 2016

	Issued share capital HRK million (Note 28)	Legal reserves HRK million (Note 29)	Fair value reserves HRK million	Retained earnings HRK million (Note 30)	Total HRK million	Non-Controlling interest HRK million	Total equity HRK million
Balance as at 1 January 2015	**8,883**	**409**	**2**	**1,816**	**11,110**	**166**	**11,276**
Profit for the year	-	-	-	925	925	16	941
Other comprehensive income for the year	-	-	2	-	2	-	2
Total comprehensive income for the year	-	-	2	925	927	16	943
Dividends paid to equity holders of the Company (Note 30)	-	-	-	(573)	(573)	-	(573)
Capital increase	940	35	-	(975)	-	-	-
Value of conversion rights of MCL	-	-	-	-	-	(8)	(8)
Increase of share capital based on pre-bankruptcy settlement agreement	-	-	-	-	-	3	3
Balance as at 31 December 2015	**9,823**	**444**	**4**	**1,193**	**11,464**	**177**	**11,641**
Profit for the year	-	-	-	934	934	(6)	928
Other comprehensive income for the year	-	-	(1)	-	(1)	-	(1)
Total comprehensive income for the year	-	-	(1)	934	933	(6)	927
Dividends paid to equity holders of the Company (Note 30)	-	-	-	(491)	(491)	-	(491)
Increase in legal reserves based on transfer from retained earnings	-	47	-	(47)	-	-	-
Value of conversion rights of MCL	-	-	-	-	-	(8)	(8)
Prior period correction of error from HT d.d. Mostar (Note 18)	-	-	-	(22)	(22)	-	(22)
Balance as at 31 December 2016	**9,823**	**491**	**3**	**1,567**	**11,884**	**163**	**12,047**

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

1 Corporate information

Croatian Telecom Inc. (“HT” or the “Company”) is a joint stock company whose majority shareholder is Deutsche Telekom Europe B.V. with a 51% holding. Deutsche Telekom Europe B.V. is 100% owned by Deutsche Telekom Europe Holding B.V. Deutsche Telekom Europe Holding B.V is 100% owned by Deutsche Telekom Europe Holding GmbH which is 100% owned by Deutsche Telekom AG. Thus, Deutsche Telekom AG is the ultimate controlling parent.

The registered office address of the Company is Roberta Frangeša Mihanovića 9, Zagreb, Croatia.

The total number of employees of the Group as at 31 December 2016 was 4,656 (31 December 2015: 4,951).

The principal activities of the Group are described in Note 4.

The consolidated financial statements for the financial year ended 31 December 2016 were authorized for issue in accordance with a resolution of the Management Board on 8 February 2017. These consolidated financial statements are subject to approval of the Supervisory Board as required by the Croatian Company Act.

2.1. Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the EU. The consolidated financial statements also comply with the Croatian Accounting Act on consolidated financial statements, which refers to IFRS as endorsed by the EU.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets (Note 19), as disclosed in the accounting policies hereafter.

The Group’s consolidated financial statements are presented in Croatian Kuna (“HRK”) which is the Group’s presentation currency. All amounts disclosed in the consolidated financial statements are presented in millions of HRK if not otherwise stated.

The consolidated financial statements include the financial statements of Croatian Telecom Inc. and the following subsidiaries comprise together HT Group (”Group”):

		Ownership interest	
Entity	Country of Business	31 December 2016	31 December 2015
Combis d.o.o.	Republic of Croatia	100%	100%
Iskon Internet d.d.	Republic of Croatia	100%	100%
KDS d.o.o.	Republic of Croatia	100%	100%
E-tours d.o.o.	Republic of Croatia	100%	100%
Optima Telekom d.d. /i/	Republic of Croatia	19.02%	19.02%

2.1. Basis of preparation (continued)

/i/ Control over Optima was obtained through transfer of managerial rights in accordance with the agreement with Zagrebačka banka d.d., the single largest shareholder of Optima.

The Croatian Competition Agency has conditionally allowed the concentration of HT and determined a set of measures with regard to management and control over Optima, among which is the implementation of a so called ''Chinese wall'' between Optima's and HT employees, in relation to all sensitive business information with the exception of reporting of financial data necessary for consolidation.

The control of HT over Optima is limited to a period of four years, up to 18 June 2018. Upon the expiration of the four-year period it is automatically terminated, without the possibility of extension. On the expiry of the three years, HT is required to commence the process of selling all of its Optima shares, during which HT will have the right to sell Optima shares held by Zagrebačka banka as well.

Set out below is summarised financial information for Optima Telekom d.d. The amounts disclosed are before intercompany eliminations including purchase price fair value allocation on consolidation level.

Summarised statement of financial position	31 December 2016 HRK million	31 December 2015 HRK million
Current assets	103	105
Current liabilities	115	114
Current net assets	**(12)**	**(9)**
Non-current assets	528	576
Non-current liabilities	320	356
Non-current net assets	**208**	**220**
Net assets	**196**	**211**
Accumulated non-controlling interest	163	177

Summarised statement of comprehensive income	31 December 2016 HRK million	31 December 2015 HRK million
Revenue	454	438
Profit for the period	(7)	20
Other comprehensive income	-	-
Total comprehensive income	**(7)**	**20**
Profit allocated to non-controlling interest	(6)	16
Dividends paid to non-controlling interest	-	-

2.1. Basis of preparation (continued)

Summarised statement of cash flows	31 December 2016 HRK million	31 December 2015 HRK million
Cash flow from operating activities	60	62
Cash flow from investing activities	(36)	(36)
Cash flow from financing activities	(35)	(32)
Net decrease in cash and cash equivalents	**(11)**	**(6)**

2.2. Changes in accounting policies and disclosures

The accounting policies adopted are consistent with those of the previous financial year unless otherwise stated and disclosed.

(a) New and amended standards adopted by the Group

The Group has adopted the following new and amended standards for their annual reporting period commencing 1 January 2016 which were endorsed by the European Union and which are relevant for the Group's financial statements:

- Accounting for Acquisitions of Interests in Joint Operations – Amendments to IFRS 11.
- Disclosure Initiative - Amendments to IAS 1.
- Annual Improvements to IFRSs 2012-2014 Cycle comprising changes to four standards (IFRS 5, IFRS 7, IAS 19, IAS 34).

The adoption of the improvements did not have any impact on the current period or any prior period and is not likely to affect future periods.

(b) New standards and interpretations not yet adopted

Certain new standards and interpretations have been published that are not mandatory for 31 December 2016 reporting periods and have not been early adopted by the Group. None of these standards and interpretations are expected to have significant effect on the Group's financial statements, except for the following standards:

- *IFRS 9 Financial instruments and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)*

IFRS 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities and introduces new rules for hedge accounting.

The Group assessed the impact of the new standard IFRS 9 on its financial statements as follows:

- The Group does not expect any impact from the new classification, measurement and derecognition rules on the Group’s financial assets and financial liabilities.

2.2. Changes in accounting policies and disclosures (continued)

(b) New standards and interpretations not yet adopted (continued)

- There will also be no impact on the Group's accounting for financial liabilities, as the new requirements only affect the accounting for financial liabilities that are designated at fair value through profit or loss and the Group does not have any such liabilities.
- The new hedging rules will not impact the Group since it does not have any hedging arrangements.
- The new impairment model is an expected credit loss (ECL) model which may result in the earlier recognition of credit losses. The Group has not yet assessed how its impairment provisions would be affected by the new rules.

The Group plans to adopt the standard on its effective date.

- *IFRS 15 Revenue from contracts with customer and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)*

The IASB has issued a new standard for the recognition of revenue. This will replace international accounting standard (IAS) 18 which covers contracts for goods and services, and IAS 11 which covers construction contracts. The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

The Group plans to adopt the standard on its effective date with prospective application. Like many other telecommunications companies, the Group currently expects this standard to have a significant impact on the Group's financial statements, primarily in respect of the following changes (depending on the business model):

- In the case of multiple-element arrangements (such as mobile contract plus handset) with subsidized products delivered in advance, a larger portion of the total remuneration is attributable to the component delivered in advance (mobile handset), requiring earlier recognition of revenue. This will lead to the recognition of what is known as a contract asset – a receivable arising from the customer contract that has not yet legally come into existence – in the statement of financial position. As a result, the Group expects higher revenue from the sale of goods and merchandise, and lower revenue from the provision of services.
- Future capitalization and allocation of the expenses for sales commissions (customer acquisition costs) over the estimated customer retention period.
- Increase in total assets on first-time adoption due to the capitalization of contract assets and customer acquisition costs.

The Group's operations and information systems are complex, and the Group is currently implementing new accounting policies, developing estimates and adjusting processes to comply with this new standard. Such effort is expected to be finalised mid-2017. As a result, at this time, it is not possible to make a reasonable quantitative estimate of the effects of this new standard on the Group's current revenue recognition policies.

2.2. Changes in accounting policies and disclosures (continued)

(b) New standards and interpretations not yet adopted (continued)

- *IFRS 16 Leases (effective for annual periods beginning on or after 1 January 2019)*

The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. IFRS 16 eliminates the classification of leases as either operating leases of finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model

  - IFRS 16 will result in the recognition of almost all leases on the balance sheet. The standard removes the current distinction between operating and financing leases and requires recognition of an asset (the right to use the leased item) and a financial liability to pay rentals for virtually all lease contracts. An optional exemption exists for short-term and low-value leases.
  - The income statement will also be affected because the total expense is typically higher in the earlier years of a lease and lower in later years. Additionally, operating expense will be replaced with interest and depreciation, so key metrics like EBITDA will change.
  - Operating cash flows will be higher as cash payments for the principal portion of the lease liability are classified within financing activities. Only the part of the payments that reflects interest can continue to be presented as operating cash flows.

The Group is currently assessing the impact of this new standard on its financial statements. The Group plans to adopt the standard on its effective date and when endorsed by the European Union. Please refer to note 31 a) for operating lease commitments.

2.3. Significant accounting judgments, estimates and assumptions

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

Provisions and contingencies

The Group is exposed to a number of legal cases and regulatory proceedings and ownership dispute over distributive telecommunication infrastructure that may result in significant outflow of economic resources or derecognition of related assets. The Group uses internal and external legal experts to assess the outcome of each case and makes judgments as to if and in what amount provisions need to be recorded in the financial statements as explained further in Notes 27 and 32. Changes in these judgments could have a significant impact on the financial statements of the Group.

Impairment of non-financial assets

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

The fair value less costs of disposal calculation is based on available data from binding sales transactions in an arm's length transaction of similar assets or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the financial plan covering a mid-term period. The cash flows beyond the planning period are extrapolated using appropriate growth rates. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash inflows and the growth rate used for extrapolation purposes. Further details including carrying values and effects on the result of the period are given in Notes 15 and 16.

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

Useful lives of assets

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

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

	Increase / decrease in %	Effect on profit post tax HRK million
Year ended 31 December 2016	+10	108
	-10	(103)
Year ended 31 December 2015	+10	107
	-10	(103)

Impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment. The recoverable amounts of cash-generating units have been determined based on fair value less cost of disposal calculations. These calculations require the use of estimates (Note 15). Management believes that no reasonably possible change in any of the key assumptions would cause the carrying value of the business and residential cash-generating units to materially exceed their recoverable amount. In case of cash-generating unit Optima Telekom, a reasonably possible change in certain key assumptions when viewed separately (such as decrease of revenue growth by 10%, increase of costs by 10% or change in capex and revenue ratio) with all other variables held constant, could result in an impairment charge of up to HRK 89 million.

Intangible assets with an indefinite life

In arriving at the conclusion that the acquired brand has an indefinite life, the Group considered the fact that the brand represents a whole business segment and relates to an operator with proven and sustained demand for its products and services in a well-established market. The brand has historically been supported through spending on consumer marketing and promotion. The Group considered other factors such as the ability to continue to protect the legal rights that arise from the brand name indefinitely and the absence of any competitive factors that could limit the life of the brand name. The Group expects continued economic benefits from the acquired brand in the future. However, a strategic decision to withdraw marketing support from the brand or the weakening in the brand's appeal through changes in customer preferences might result in an impairment charge in the future. Also, reasonable change in certain key assumptions (such as change of revenues by 10% and change in royalty relief rate by 0.1%) could result in an impairment charge of up to HRK 10 million.

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, share of profit and loss from associate and joint venture, interest expense on borrowings, gains and losses on the sale of available-for-sale financial assets and foreign exchange gains and losses on all monetary assets and liabilities denominated in foreign currency.

b) Business Combinations and Goodwill

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group, and are deconsolidated from the date that control ceases.

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

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

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

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

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

2.4. Summary of accounting policies (continued)

b) Business Combinations and Goodwill (continued)

Purchases of subsidiaries from parties under common control

Purchases of subsidiaries from parties under common control are accounted for using the predecessor values method. Under this method the consolidated financial statements of the combined entity are presented as if the businesses had been combined from the beginning of the earliest period presented or, if later, the date when the combining entities were first brought under common control. The assets and liabilities of the subsidiary transferred under common control are at the predecessor entity's carrying amounts.

The predecessor entity is considered to be the highest reporting entity in which the subsidiary's IFRS financial information was consolidated. Related goodwill inherent in the predecessor entity's original acquisitions is also recorded in these consolidated financial statements. Any difference between the carrying amount of net assets, including the predecessor entity's goodwill, and the consideration for the acquisition is accounted for in these consolidated financial statements as an adjustment to reserves within equity.

c) Investment in associate

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

When the Group's share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate. Unrealized gains on transactions between the Group and its associate are eliminated to the extent of the Group's interest in the associate. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

d) Investment in joint venture

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

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

When the Group's share of losses in a joint venture equals or exceeds its interest in the joint venture, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the joint venture. Unrealized gains on transactions between the Group and its joint venture are eliminated to the extent of the Group's interest in the joint venture. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

2.4. Summary of accounting policies (continued)

e) Intangible assets

Intangible assets are measured initially at cost. Intangible assets are recognized in the event that the future economic benefits that are attributable to the assets will flow to the Group, and that the cost of the asset can be measured reliably. After initial recognition, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. Intangible assets are amortised on a straight-line basis over the best estimate of their useful life. The amortization method is reviewed annually at each financial year-end.

Amortization of the telecommunication licence commences when the licence is acquired and ready for use, with the amortization period being the term of the licence.

The Group recognizes costs of content as an intangible asset at the inception of the related contract. The Group determined that the following conditions have to be met for capitalization of content provider contracts: contract duration must be longer than one year, cost must be determined or determinable, contracted rights must be continuous and costs under the contract are unavoidable. Assets recognized under these contracts will be amortized over the contract period. Content contracts which do not meet the criteria for capitalization are expensed and presented in ‘other expenses’ in the statement of comprehensive income.

The Group capitalizes rights of servitude and rights of way related to the Electronic Communication Infrastructure (ECI) as intangible assets according to criteria for acquired rights at the moment of signing the contract for rights of servitude or receiving certificate for right of way. The Group presents the acquired rights as intangible assets and financial liability as the acquired rights, and related cost is capitalized for the period of 3 years. The cost is the amount of one-off fee paid at entering into the arrangement and any other fees which are considered to be unavoidable. The non-cancellable term of the contract is three years, as it is assumed that this payment is unavoidable due to the fact that there will be no significant changes in technology and topology in that time period, and the Group cannot change its routes or find other locations for ECI in a shorter time period. In 2016, the Group changed its estimate used in this accounting policy by revising the estimated liability and useful life of ECI assets to a consistent period of three years from each balance sheet date (rather than from the moment of signing the contract for rights of servitude or receiving certificate for right of way). As a result, this change in estimate had the following impact on the balance sheet of the Group: intangible assets increased by HRK 39 million and liability increased by HRK 39 million as of 31 December 2016. Unwinding of accrued interest is recognized as an interest expense and is presented within other financial income/expense.

Useful lives of intangible assets are as follows:

Licences and rights	
Radio frequency spectrum in 2100 MHz frequency band	15 years
Radio frequency spectrum in 900/1800 MHz frequency bands	13 years
Radio frequency spectrum in 800 MHz frequency band	11-12 years
Right of servitude for Distributive Telecommunication Infrastructure (DTI)	3 years
Software, content and other assets	2-5 years
Customer base	7 years
Brand	Indefinite
Long-term customer contracts	1.5-7 years

Assets under construction are not amortised.

2.4. Summary of accounting policies (continued)

e) Intangible assets (continued)

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

Impairment for goodwill is determined by assessing the recoverable amount, based on fair value less cost of disposal, of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount of the cash-generating unit (group of cash-generating units) to which goodwill has been allocated, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods. The Group performs its annual impairment test of goodwill as at 31 December. Please see Note 15 for more details.

f) Property, plant and equipment

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

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

Subsequent expenditure on an asset that meets the recognition criteria to be recognized as an asset or an addition to an asset is capitalized, while maintenance and repairs are charged to expense when incurred.

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
Customer premises equipment (CPE)	7 years
Tools, vehicles, IT, office and other equipment	4-15 years

Land and assets under construction are not depreciated.

Useful lives, 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.

2.4. Summary of accounting policies (continued)

f) Property, plant and equipment (continued)

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.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within ‘Other expenses’ in the statement of comprehensive income.

g) Investment property

Investment property, principally comprising business premises and land, is held for long-term rental yields or appreciation and is not occupied by the Group. Investment property is treated as a long-term investment unless it is intended to be sold in the next year and a buyer has been identified in which case it is classified within current assets.

Investment property is carried at historical cost less accumulated depreciation and provision for impairment. Depreciation of buildings is calculated using the straight-line method to allocate their cost over their estimated useful lives of 10 to 50 years (2015: 10 to 50 years).

Subsequent expenditure is capitalised only when it is probable that future economic benefits associated with it will flow to the Company and the cost can be measured reliably. All other repairs and maintenance costs are charged to the statement of comprehensive income when incurred. If an investment property becomes owner-occupied, it is reclassified to property, plant and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

h) Impairment of assets

Impairment of non-financial assets

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

Impairment of trade receivables

A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the underlying arrangement. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments as well as historical collections are considered indicators that the trade receivable is impaired. Provisions for impairment are measured according to the collection best estimate. Receivables are written-off in the case when the debtor is liquidated or ceased its business activities; when the legal case is lost by the final court decision or in the case of lapse of receivables.

2.4. Summary of accounting policies (continued)

h) Impairment of assets(continued)

Impairment of available-for-sale financial assets

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

i) 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 inventory impairment immediately.

j) 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 collection is expected after one year the receivables are presented as non-current assets. Receivables are stated at the fair value of the consideration given and are carried at amortised cost, after provision for impairment.

k) Foreign currencies

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

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

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

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

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

2.4. Summary of accounting policies (continued)

l) Leases

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

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

Finance leases are capitalised at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short-term and long-term payables. Each lease payment is allocated between the liability and finance cost. The property, plant and equipment acquired under finance leases is depreciated over the asset's useful life or over the shorter of the asset's useful life and the lease term if there is no reasonable certainty that the Group will obtain ownership at the end of the lease term.

m) Taxation

The income tax charge is based on profit for the year and includes deferred taxes. Deferred taxes are calculated using the balance sheet 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 Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred income tax liabilities are provided on taxable temporary differences arising from investments in subsidiaries, associates and joint arrangements, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future. Generally the Group is unable to control the reversal of the temporary difference for associates.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2.4. Summary of accounting policies (continued)

m) Taxation (continued)

Deferred tax assets are recognized to the extent that it is probable that future taxable profit (or reversing deferred tax liabilities) will be available against which the temporary differences can be utilized.
Deferred tax assets and liabilities are not discounted and are classified as non-current assets and liabilities in the statement of financial position. Deferred tax assets are recognized when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised.
Current and deferred taxes 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.

n) Employee benefit obligations

The Group provides other long-term employee benefits (Note 26). These benefits include retirement payments. The defined benefit obligation is calculated annually by independent actuary using a projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation.

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

The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of plan assets. This cost is included in employee benefit expense in the statement of comprehensive income.

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

o) Revenue recognition

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

Revenue from fixed telephony includes revenue from activation fees, monthly fees, calls placed by fixed line subscribers and revenue from additional services in fixed telephony.

Revenue from wholesale services includes interconnection services for domestic and international carriers, and revenue from usage of network by other operators.

2.4. Summary of accounting policies (continued)

o) Revenue recognition (continued)

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

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

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

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

Revenue from the sales of electricity is recognized at fair value in the period when service is provided to customers.

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

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

Revenue from ICT includes revenue from restructuring business processes, application management services, technology infrastructure and system maintenance and the design and development of complex IT systems to a client's specifications (design and build) and WEB hosting. For bundled offer arrangements, revenue recognition for each of the elements 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 deliverable).

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

2.4. Summary of accounting policies (continued)

o) Revenue recognition (continued)

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

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

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

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

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

p) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, demand deposits, corporate commercial papers 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. Investments that are classified as cash and cash equivalents are held only as means of settling liabilities and not as an investment.

q) Borrowings

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

Mandatory convertible loan (MCL) is classified as equity and it is recognized at its nominal value which approximates its fair value.

2.4. Summary of accounting policies (continued)

r) Financial assets

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

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

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

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

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

Securities obtained under agreements to resell (“reverse REPO agreements”) are essentially guarantees or collateral for money held with banks and are not recorded in the balance sheet. The related amounts held by banks are recorded as secured deposits for maturities over three months or as cash equivalents for maturities under three months.

s) Provisions

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

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

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

2.4. Summary of accounting policies (continued)

s) Provisions (continued)

Levies and charges, such as taxes other than income tax or regulatory fees based on information related to a period before the obligation to pay arises, are recognised as liabilities when the obligating event that gives rise to pay a levy occurs, as identified by the legislation that triggers the obligation to pay the levy. If a levy is paid before the obligating event, it is recognised as prepayment.

t) Contingencies

Contingent assets are not recognized in the financial statements. They are disclosed when an inflow of economic benefits is probable.

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

u) Share-based payments

The cost of cash-settled and equity-settled transactions is measured initially at fair value at the grant date using a binomial model, further details of which are given in Note 38. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability for cash-settled and equity-settled transactions are recognised in equity. The liability is remeasured to fair value at each statement of financial position date up to and including the settlement date with changes in fair value recognized in the statement of comprehensive income.

v) Events after reporting period

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

w) 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.

x) Dividend distribution

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

y) Earnings per share

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

z) Contributed equity

Ordinary shares are classified as equity. Shares held by the Company are disclosed as treasury shares and deducted from contributed equity.

3 Business combinations

In 2014, the Group acquired voting shares in Optima Telekom d.d. (Optima) through pre-bankruptcy settlement. Shares with a value of HRK 52 million were acquired directly through court decision by converting receivables into equity share as of 18 June 2014. An additional interest was acquired through the Mandatory Convertible Loan (MCL) instrument in the amount of HRK 69 million, as of 9 July 2014, hereby was converted into Optima equity pursuant to Management Board decision as of 23 July 2014 and approval of the Supervisory Board. These two transactions are treated as a single transaction in these consolidated financial statements.

The Group's total share in Optima amounts to 19.02% as of 31 December 2016 (31 December 2015: 19.02%). Control over Optima was obtained through transfer of managerial rights in accordance with the agreement with Zagrebačka banka d.d., the single largest shareholder of Optima.

The Croatian Competition Agency has conditionally allowed the concentration of HT with Optima based on the proposed financial and operational restructuring plan of Optima within the pre-bankruptcy settlement procedure. The Croatian Competition Agency has determined a set of measures defining the rules of conduct for a participant in concentration with regard to management and control over Optima, among which is the implementation of a so called ''Chinese wall'' between Optima's and HT employees, in relation to all sensitive business information with the exception of reporting of financial data necessary for consolidation.

The control of HT over Optima is limited to a period of four years starting 18 June 2014. Upon the expiration of the four-year period it is automatically terminated, without the possibility of extension. On the date of expiry of the third year, HT is required to commence the process of selling all of its Optima shares, during which HT will have the right to sell Optima shares held by Zagrebačka banka as well.

4 Segment information

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

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

The Business Segment includes marketing, sales and customer services, focused on providing mobile and fixed line telecommunications, electricity 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 segment 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.

The Optima Telekom segment includes the contribution of all Optima Telekom's functions to Group financial results following the same reporting structure as used for other operating segments, except revenue details that are only reported in the whole amount on the Miscellaneous revenue line. According to the restrictions introduced by the regulator, access to Optima Telekom revenue information is limited.

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

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

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

Fully owned subsidiaries Iskon Internet, Combis, KDS and E-tours are consolidated within the respective operating segments to which they relate.

4 Segment information (continued)

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

Year ended 31 December 2015	Residential HRK million	Business HRK million	Network and Support functions HRK million	Optima Telekom consolidated HRK million	Total HRK million
Net revenue	3,776	2,718	-	425	6,919
Mobile revenue	*1,782*	*949*	-	-	*2,731*
Fixed revenue	*1,958*	*1,090*	-	*425*	*3,473*
System solutions revenue	-	*659*	-	-	*659*
Miscellaneous revenue	*36*	*20*	-	-	*56*
Usage related direct costs	(212)	(197)	-	(92)	(501)
Income and losses on accounts receivable	(35)	(23)	-	(3)	(61)
Contribution margin I	3,529	2,498	-	330	6,357
Non-usage related direct costs	(529)	(778)	-	(4)	(1,311)
Segment result (contribution margin II)	3,000	1,720	-	326	5,046
Other income	-	-	96	2	98
Other operating expenses	(411)	(377)	(1,557)	(108)	(2,453)
Depreciation, amortization and impairment of non-current assets	-	-	(1,401)	(91)	(1,492)
Operating profit	**2,589**	**1,343**	**(2,862)**	**129**	**1,199**
Year ended 31 December 2016					
Net revenue	3,749	2,780	-	441	6,970
Mobile revenue	*1,870*	*951*	-	-	*2,821*
Fixed revenue	*1,840*	*1,079*	-	441	*3,360*
System solutions revenue	-	*677*	-	-	*677*
Miscellaneous revenue	*39*	*73*	-	-	*112*
Usage related direct costs	(211)	(221)	-	(95)	(527)
Income and losses on accounts receivable	(8)	(21)	-	(3)	(32)
Contribution margin I	3,530	2,538	-	343	6,411
Non-usage related direct costs	(594)	(822)	-	(8)	(1,424)
Segment result (contribution margin II)	2,936	1,716	-	335	4,987
Other income	-	-	157	2	159
Other operating expenses	(389)	(371)	(1,550)	(100)	(2410)
Depreciation, amortization and impairment of non-current assets	-	-	(1,401)	(96)	(1,497)
Operating profit	**2,547**	**1,345**	**(2,794)**	**141**	**1,239**

4 Segment information (continued)

Revenue by geographical area

	2016 HRK million	2015 HRK million
Republic of Croatia	6,526	6,554
Rest of the world	444	365
	6,970	**6,919**

The majority of the Group's assets are located in Croatia.

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

5 Other operating income

	2016 HRK million	2015 HRK million
Gain from sale of non-current assets	36	13
Rental income	31	27
Income from penalties and damage compensations	16	12
Other income	76	46
	159	**98**

6 Merchandise, material and energy expenses

	2016 HRK million	2015 HRK million
Cost of goods sold	1,116	1,078
Energy costs	102	104
Energy sales costs	92	48
Cost of raw material and supplies	29	31
Arrangement sales cost	15	11
	1,354	**1,272**

7 Service expenses

	2016 HRK million	2015 HRK million
Domestic interconnection	242	298
International interconnection	284	202
Other services	217	210
	743	**710**

8 Depreciation, amortization and impairment of non-current assets

	2016 HRK million	2015 HRK million
Depreciation	884	903
Amortization	533	566
	1,417	1,469
Impairment loss	80	23
	1,497	**1,492**

Notes 15, 16 and 17 disclose further details on amortization and depreciation expense and impairment loss.

9 Employee benefits expenses

	2016 HRK million	2015 HRK million
Gross salaries without contribution	593	604
Taxes, contribution and other payroll costs	168	177
Contribution from gross salaries	145	148
Redundancy expenses (Note 27)	80	91
Long-term employee benefits	1	3
	987	**1,023**

10 Other expenses

	2016 HRK million	2015 HRK million
Licence cost	315	324
Maintenance services	287	311
Rent (Note 31)	151	134
Advertising	120	114
Selling commission	106	99
Contract workers	114	79
Provision of trade receivables – net (Note 21)	32	61
Call centre and customer care support	45	49
Postal expenses	37	40
Non-income taxes and contribution	37	39
Education and consulting	31	33
Discounts granted to customers	14	14
Daily allowances and other costs of business trips	13	13
Insurance	12	11
Expenses related to customers acquisition	10	4
Provisions for charges and risks	9	(1)
Expenses from penalties and damage compensations	7	8
Write down of inventories	5	6
Loss on disposal of fixed assets	1	1
Other operating charges	64	70
	1,410	**1,409**

11 Finance income

	2016 HRK million	2015 HRK million
Interest income	19	19
Foreign exchange gains	33	34
Income from sale of bonds	12	-
	64	**53**

12 Finance cost

	2016 HRK million	2015 HRK million
Interest expense	93	59
Foreign exchange loss	44	17
Other	7	12
	144	**88**

13 Income tax expense

a) Tax on profit

	2016 HRK million	2015 HRK million
Current tax expense	256	227
Deferred tax expense	(22)	-
	234	**227**

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

	2016 HRK million	2015 HRK million
Profit before tax	1,162	1,168
Income tax at 20% (domestic rate)	232	234
Tax effect of:		
Income not subject to tax	(3)	(1)
Expenses not deductible for tax purposes	6	4
Tax effects of tax loss carry forward for which no deferred income tax asset was recognised	(7)	(11)
Other	3	1
Impact of the tax rate reduction /i/	3	-
	234	**227**
Effective tax rate	20.14%	19.43%

/i/The reduction of Croatia's income tax rate from 20% to 18% will be effective from 1 January 2017. As a result, the relevant deferred tax balances have been remeasured.

The Group utilized a tax incentive in previous periods in respect of reinvesting profit and increasing the share capital in the same amount. If subsequently the capital that was increased by reinvested profit is decreased, this may result in a future tax liability for the Group. The Group believes a future tax liability will not arise in this regard. Issued share capital was increased in 2015 in the amount of HRK 940 million (Note 28).

13 Income tax expense (continued)

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

Deferred tax assets and liabilities recognized in:	31 December 2016	(charged) / credited in 2016	31 December 2015	(charged) / credited in 2015	31 December 2014
	HRK million	HRK million	HRK million	HRK million	HRK million
Statement of comprehensive income					
Non-tax deductible provisions	11	(4)	15	(6)	21
Property, plant and equipment write down	32	20	12	1	11
Accrued interest on legal cases	1	(1)	2	(1)	3
Other	15	(2)	17	1	16
	59	13	46	(5)	51
Other comprehensive income					
Actuarial gains and losses	-	-	-	-	-
Deferred income tax asset	**59**	13	**46**	(5)	**51**
Statement of comprehensive income					
Past service costs			-	-	-
Purchase price allocation	33	(9)	42	(5)	47
	33	(9)	42	(5)	47
Other comprehensive income					
Actuarial gains and losses	3	-	3	-	3
Deferred income tax liability	**36**	(9)	**45**	(5)	**50**

13 Income tax expense (continued)

Deferred tax assets have been recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets have not been discounted. Out of total deferred tax assets, current portion amounts to HRK 23 million.

Deferred tax asset arises on the property, plant and equipment impairment, on provision of impairment of receivables and inventories (materials, merchandise), and related to accruals and provisions and other temporary differences.

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 six years. The limitation period of six years starts with the year that follows the year of submission of tax declarations, i.e. 2018 for the 2016 tax liability.

The Group has not recognised deferred income tax assets of HRK 14 million in respect of losses amounting to HRK 80 million that can be carried forward against future taxable income. These losses relate to subsidiaries of the Group for which it is uncertain whether there will be sufficient future taxable profits to realise these deferred income tax assets.

In 2015, the tax authorities started conducting a supervision review of HT's corporate tax and VAT returns for the year ended 2014. This review by the tax authorities is still on-going.

Losses expires in:	HRK million
2017	48
2018	32
	80

14 Earnings per share

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

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

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

	2016	2015
Profit for the year attributable to ordinary equity holders of the Company in HRK million	934	925
Weighted average number of ordinary shares for basic earnings per share	81,884,604	81,884,604
	HRK 11.40	**HRK 11.30**

15 Intangible assets

	Licences	Software	Goodwill	Other assets	Assets under construction	Total
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
As at 1 January 2015						
Cost	593	3,090	252	1,022	44	5,001
Accumulated amortization and impairment losses	(231)	(2,533)	-	(515)	-	(3,279)
Net book value	**362**	**557**	**252**	**507**	**44**	**1,722**
Year ended 31 December 2015						
Opening net book value	362	557	252	507	44	1,722
Additions	-	182	-	218	97	497
Transfers	-	56	-	1	(57)	-
Amortization charge	(35)	(294)	-	(237)	-	(566)
Impairment loss	-	(2)	-	-	-	(2)
Net book value	**327**	**499**	**252**	**489**	**84**	**1,651**
As at 31 December 2015						
Cost	494	3,297	252	1,241	84	5,368
Accumulated amortization and impairment losses	(167)	(2,798)	-	(752)	-	(3,717)
Net book value	**327**	**499**	**252**	**489**	**84**	**1,651**
Year ended 31 December 2016						
Opening net book value	327	499	252	489	84	1,651
Additions	2	169	-	330	110	611
Transfers	-	60	-	24	(65)	19
Amortization charge	(36)	(236)	-	(261)	-	(533)
Impairment loss	-	(10)	-	-	-	(10)
Net book value	**293**	**482**	**252**	**582**	**129**	**1,738**
As at 31 December 2016						
Cost	497	3,361	252	1,300	129	5,539
Accumulated amortization and impairment losses	(204)	(2,879)	-	(718)	-	(3,801)
Net book value	**293**	**482**	**252**	**582**	**129**	**1,738**

15 Intangible assets (continued)

The intangible assets of the Group as at 31 December 2016 include five licences for use of the radio frequency spectrum (Notes 2.4. e) and 37 b)).

Assets under construction primarily relate to software and the various licences for the use of software.

Intangible assets with indefinite useful life consist of brand name related to Optima Telekom d.d. Carrying value as at 31 December 2016 is HRK 61 million (31 December 2015 HRK 61 million).

Additions of intangible assets

Major additions in 2016 relate to capitalised content costs in the amount of HRK 195 million, application, system and network technology software and user licences in the amount of HRK 169 million and capitalised cost of electronic communication infrastructure in amount of HRK 125 million.

Impairment loss

During 2016, the Group recognized an impairment loss for intangible assets of HRK 10 million (2015: HRK 2 million).

Disposal of intangible assets

The disposal of intangible assets primarily relates to the disposal of capitalized content costs in gross amount of HRK 288 million and software HRK 170 million (2015: HRK 100 million).

Impairment testing of goodwill

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

	31 December 2016 HRK million	31 December 2015 HRK million
Residential	55	55
Business	107	107
Optima Telekom consolidated	90	90
	252	**252**

The key assumptions used for fair value less cost of disposal calculations are as follows:

	Optima Telekom consolidated		Residential		Business	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015	31 December 2016	31 December 2015
Growth rate	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Discount rate	9.79%	10.06%	8.93%	10.03%	8.93%	10.03%

15 Intangible assets (continued)

The recoverable amount of a CGU is determined based on fair value less cost of disposal calculations. The key assumptions reflect past experience and expectations of market development, particularly the development of revenue, market share, customer acquisition and retention cost, capital expenditures and growth rate. The growth rate does not exceed the long-term average growth rate for the industry in which the CGU operates. The weighted average growth rate is used to extrapolate cash flows beyond the budgeted period and post-tax discount rate is applied to the cash flow projections. The costs of central functions (Management and Administration) have been allocated between the segments for the purpose of impairment testing based on internal secondary cost allocation, using defined planed internal products. Forecast period is 10 years.

Impairment testing of brand

Optima has registered the name and trade mark “Optima” as intellectual property rights. Brand is an indefinitive – lived asset, and it is tested for impairment annually using the Relief from Royalty method. The brand value represents the net present value of the projected brand earnings, discounted using the after-tax discount rate on projected cash flows. The net present value calculation comprises both the explicit five and a half year projections and the terminal period, as this reflects the brands ability to create revenues in perpetuity. The growth rate of projected cash flows and the discount rate used is the same as the key assumptions utilised in the impairment testing of goodwill (reflected above).

16 Property, plant and equipment

	Land and buildings	Telecom plant and machinery	Tools, vehicles, IT and office equipment	Assets under construction	Total
	HRK million	HRK million	HRK million	HRK million	HRK million
As at 1 January 2015					
Cost	2,239	12,482	1,009	318	16,048
Accumulated depreciation and impairment losses	(1,229)	(8,476)	(814)	(8)	(10,527)
Net book value	**1,010**	**4,006**	**195**	**310**	**5,521**
Year ended 31 December 2015					
Opening net book value	1,010	4,006	195	310	5,521
Additions	14	520	38	401	973
Transfers	6	214	12	(232)	-
Disposals	(10)	-	(2)	(2)	(14)
Depreciation charge	(86)	(746)	(69)	-	(901)
Impairment loss	-	(20)	-	(1)	(21)
Net book value	**934**	**3,974**	**174**	**476**	**5,558**
As at 31 December 2015					
Cost	2,242	12,626	1,036	485	16,389
Accumulated depreciation and impairment losses	(1,308)	(8,652)	(862)	(9)	(10,831)
Net book value	**934**	**3,974**	**174**	**476**	**5,558**
Year ended 31 December 2016					
Opening net book value	934	3,974	174	476	5,558
Additions	24	606	28	339	997
Transfers	27	334	21	(390)	(8)
Disposals	(18)	(1)	-	-	(19)
Depreciation charge	(80)	(734)	(68)	-	(882)
Impairment loss	-	(70)	-	-	(70)
Net book value	**887**	**4,109**	**155**	**425**	**5,576**
As at 31 December 2016					
Cost	2,274	12,967	978	426	16,645
Accumulated depreciation and impairment losses	(1,387)	(8,858)	(823)	(1)	(11,069)
Net book value	**887**	**4,109**	**155**	**425**	**5,576**

16 Property, plant and equipment (continued)

Included within assets under construction of the Group are major spare parts of HRK 60 million (31 December 2015: HRK 16 million), net of an impairment provision of HRK 0 million (31 December 2015: HRK 1 million).

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

The Group does not have any material property, plant and equipment held for disposal.

Additions of property, plant and equipment

Major additions in 2016 relate to infrastructure and network equipment.

Impairment loss

In 2016, the Group recognized an impairment loss on property, plant and equipment of HRK 70 million (2015: HRK 21 million) mostly relating to change of customer premises equipment due to transfer to newer technology. The recoverable amount of that equipment is its estimated fair value less costs of disposal, which is based on the best information available to reflect the amount that the Group could obtain, at the statement of financial position date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. The fair value measurement is categorised within level 3 under IFRS13 categorisation. The impaired asset is used jointly by residential and business segments.

Disposal of property, plant and equipment

The disposal of the property, plant and equipment primarily relates to the disposal of telecom switches and devices, old tools, IT, office equipment and vehicles in the gross amount of HRK 731 million (2015: HRK 650 million).

Ownership over ducts

Although 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 to the share capital at the foundation of the Company on 1 January 1999, according to other Croatian legislation, part of the Group's infrastructure that is 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 a major portion of these assets 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 claims of ownership over these assets by the local authorities (the City of Zagreb), may have a material effect on the financial statements in the case that HT will not be able to prove its ownership rights for such ducts. However, HT management believes the likelihood of occurrence of such circumstances is remote. Therefore, no adjustments were made to these financial statements in respect of this matter.

The net book value of all the Group's ducts as at 31 December 2016 is HRK 857 million (31 December 2015: HRK 812 million).

16 Property, plant and equipment (continued)

Leased assets

Equipment includes the following amounts where the Group is a lessee under a finance lease:

	31 December 2016 HRK million	31 December 2015 HRK million
Cost	84	48
Accumulated depreciation	(19)	(13)
Net book value	**65**	**35**

17 Investment property

	HRK million
As at 1 January 2015	
Cost	101
Accumulated depreciation	(45)
Net book value	**56**
Year ended 31 December 2015	
Opening net book value	56
Additions	3
Depreciation charge	(2)
Net book value	**57**
As at 31 December 2015	
Cost	104
Accumulated depreciation	(47)
Net book value	**57**
Year ended 31 December 2016	
Opening net book value	57
Additions	-
Transfers to property, plant and equipment	(11)
Depreciation charge	(2)
Net book value	**44**
As at 31 December 2016	
Cost	83
Accumulated depreciation	(39)
Net book value	**44**

The Group has classified unoccupied buildings and undeveloped land as investment property.

18 Investments accounted for using the equity method

The net book value of investments accounted for using the equity method comprises (financial information for 2016 represents estimations as HT d.d Mostar and HP d.o.o. Mostar did not issue their financial statements up to the date of issuing consolidated financial statements of HT Group):

	31 December 2016 HRK million	31 December 2015 HRK million
Joint venture HT d.d. Mostar:		
As at 1 January	397	393
Prior period correction of error	(22)	-
Share of profit	3	4
Dividends paid	(3)	-
As at 31 December	375	397
Associate HP d.o.o. Mostar:		
As at 1 January	2	2
Share of (loss) / profit	1	(1)
(Impairment loss) / reversal of impairment loss	(1)	1
As at 31 December	2	2
	377	**399**

a) Investment in joint venture:

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

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

The Group's share in HT d.d. Mostar profit for the year ended 31 December 2016 is recognized in the statement of comprehensive income in the amount of HRK 3 million (2015: HRK 4 million). In 2016, HT adjusted net book value of investment in HT d.d. Mostar for HRK 22 million related to correction of the Group's share in HT d.d. Mostar profits in prior periods as a result of misstatement of deferred subsidised customer costs in HT d.d, Mostar financial statements.

In 2016, HT received dividend from HT d.d. Mostar in the amount of HRK 3 million (2015: nil).

b) Investment in associate:

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

18 Investments accounted for using the equity method (continued)

Summarised financial information for investments accounted for using the equity method is as follows:

Summarised statement of financial position:	31 December 2016 HRK million	31 December 2015 HRK million
	Estimated	Actual
Joint venture HT d.d. Mostar:		
Current		
Cash and cash equivalents	100	41
Other current assets	231	231
Total current assets	**331**	**272**
Financial liabilities	1	1
Other current liabilities	294	252
Total current liabilities	**295**	**253**
Non-current		
Non-current assets	**1,234**	**1,343**
Financial liabilities	10	11
Other liabilities	16	28
Total non-current liabilities	**26**	**39**
Net assets	**1,244**	**1,323**
Associate HP d.o.o. Mostar:		
Current		
Cash and cash equivalents	12	11
Other current assets	26	31
Total current assets	**28**	**42**
Financial liabilities	-	-
Other current liabilities	16	15
Total current liabilities	**16**	**15**
Non-current		
Non-current assets	**73**	**58**
Financial liabilities	-	-
Other liabilities	1	2
Total non-current liabilities	**1**	**2**
Net assets	**84**	**83**

18 Investments accounted for using the equity method (continued)

Summarised statement of comprehensive income:	2016 HRK million	2015 HRK million
Joint venture HT d.d. Mostar:		
Revenue	809	807
Depreciation and amortisation	(223)	(240)
Interest income	5	8
Interest expense	-	(1)
Pre-tax profit	(48)	9
Income tax expense	-	(3)
Net income	(48)	6
Dividends received	3	-
Associate HP d.o.o. Mostar:		
Revenue	95	95
Depreciation and amortisation	(3)	(3)
Interest income	1	1
Interest expense	-	-
Pre-tax gain / (loss)	2	(4)
Income tax expense	-	-
Net income	2	(4)
Dividends received	-	-

18 Investments accounted for using the equity method (continued)

Reconciliation of summarised financial information	31 December 2016 HRK million	31 December 2015 HRK million
Joint venture HT d.d. Mostar		
Opening net assets 1 January	1,323	1,313
Profit for the period	9	6
Prior period correction of error	(57)	
Dividends paid	(8)	-
Foreign currency translation	(23)	4
Closing net assets	1,244	1,323
Interest in joint venture 39.10%	487	517
Foreign currency translation	8	-
Impairment	(120)	(120)
Carrying value	375	397
Associate HP d.o.o. Mostar		
Opening net assets 1 January	83	86
Profit / (loss) for the period	2	(4)
Foreign currency translation	-	1
Closing net assets	85	83
Interest in associates 30.29%	26	25
Foreign currency translation	1	1
Impairment	(25)	(24)
Carrying value	2	2

19 Available-for-sale financial assets

Available-for-sale financial assets, at fair value, include the following:

Issuer	*Credit rating*	*Currency*	*Maturity*	31 December 2016 HRK million	31 December 2015 HRK million
Domestic bond:					
Government Republic of Croatia	BB+	HRK	8 February 2017	35	36
Foreign bonds:					
Government of Netherland	AAA	EUR	15 July 2025	-	145
Government of France	AA	EUR	25 May 2024	-	86
Government of Germany	AAA	EUR	15 May 2023	-	83
Government of Germany	AAA	EUR	4 September 2022	-	83
Government of Austria	AA+	EUR	20 October 2025	-	79
Government of Germany	AAA	EUR	15 February 2025	-	76
Government of Netherland	AAA	EUR	15 April 2016	-	76
Deutsche Telekom	BBB+	EUR	3 April 2020	946	-
Other				14	5
				995	**669**
Non-current				949	591
Current				46	78
				995	**669**

Interest rate on domestic bond is 4.75%. Interest rate on foreign bond is 0.049%.

The estimated fair value of investments in bonds at 31 December 2016 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 belongs to level 1 under the financial instruments fair value hierarchy category. There were no classification changes among financial instruments fair value hierarchy categories in 2016.

20 Inventories

	31 December 2016 HRK million	31 December 2015 HRK million
Merchandise	86	82
Inventories and spare parts	25	28
	111	**110**

21 Trade and other receivables

	31 December 2016 HRK million	31 December 2015 HRK million
Trade receivables	95	70
Other receivables	26	28
Non-current	121	98
Trade receivables	1,276	1,162
Other receivables	52	52
Current	1,328	1,214
	1,449	**1,312**

During 2013, the Group entered into several prebankruptcy settlements with its debtors which stipulate that part of reported current trade receivables is converted to non-current receivables (HRK 32 million) with maturities up to 5 years.

The aging analysis of trade receivables is as follows:

	Total	Neither past due nor impaired	Past due but not impaired				
			< 30 days	31-60 days	61-90 days	91-180 days	>180 days
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
31 December 2016	1,276	894	278	40	17	36	11
31 December 2015	1,162	914	136	42	19	43	8

21 Trade and other receivables (continued)

As at 31 December 2016, trade receivables with a nominal value of HRK 1,068 million (31 December 2015: HRK 1,117 million) were deemed impaired and fully provided for, and refer to mainly receivable past-due over 180 days.

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

	2016 HRK million	2015 HRK million
As at 1 January	1,117	1,150
Charge for the year (Note 10)	90	120
Unused amounts reversed (Note 10)	(58)	(59)
Receivables written-off	(81)	(94)
As at 31 December	**1,068**	**1,117**

22 Prepayments

Prepayments mainly consist of prepaid liabilities for concession fees towards regulator in amount of HRK 177 million (2015: HRK 177 million).

23 Cash and cash equivalents and bank deposits

a) Cash and cash equivalents

Cash and cash equivalents comprise the following amounts:

	31 December 2016 HRK million	31 December 2015 HRK million
Cash on hand and balances with banks	1,261	2,057
Commercial papers	982	-
Time deposits with maturity less than 3 months	433	754
Secured deposits (reverse REPO agreements)	-	364
	2,676	**3,175**

23 Cash and cash equivalents and bank deposits (continued)

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

	31 December 2016 HRK million	31 December 2015 HRK million
HRK	1,175	1,693
EUR	1,406	1,613
USD	76	79
BAM	19	18
GBP	-	2
	2,676	**3,405**

c) Time deposits with maturities more than 3 months

	31 December 2016 HRK million	31 December 2015 HRK million
Foreign bank	-	230
Domestic banks	-	1
	-	**231**

d) Guarantee deposits

	Current		Non-current	
	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Foreign bank	11	17	26	43
Domestic banks	1	-	-	-
	12	**17**	**26**	**43**

23 Cash and cash equivalents and bank deposits (continued)

e) Secured deposits (reverse REPO agreements)

Issuer	*Currency*	*Maturity*	31 December 2016 HRK million	31 December 2015 HRK million
Reverse REPO agreements (Note 34 g)):				
Erste Steiermärkische Bank d.d.	HRK	27 January 2016	-	177
Raiffeisen Bank Austria d.d.	HRK	18 April 2016	-	117
Erste Steiermärkische Bank d.d.	HRK	22 February 2016	-	90
Raiffeisen Bank Austria d.d.	HRK	14 January 2016	-	74
Raiffeisen Bank Austria d.d.	HRK	1 February 2016	-	74
Erste Steiermärkische Bank d.d.	HRK	16 January 2017	160	-
Raiffeisen Bank Austria d.d.	HRK	14 February 2017	118	-
Erste Steiermärkische Bank d.d.	HRK	23 January 2017	157	-
Erste Steiermärkische Bank d.d.	HRK	24 January 2017	172	-
Raiffeisen Bank Austria d.d.	HRK	24 March 2017	79	-
Raiffeisen Bank Austria d.d.	HRK	9 May 2017	76	-
Raiffeisen Bank Austria d.d.	HRK	18 May 2017	75	
Erste Steiermärkische Bank d.d.	HRK	28 April 2017	82	-
Erste Steiermärkische Bank d.d.	HRK	5 May 2017	127	-
Erste Steiermärkische Bank d.d.	HRK	21 April 2017	85	-
			1,131	**532**

Interest rates at 31 December 2016 on reverse REPO agreements range up to 0.35%.

24 Trade payables and other liabilities

	31 December 2016 HRK million	31 December 2015 HRK million
Content contracts	52	60
ECI contracts	79	36
Licence for radio frequency spectrum	9	15
Other	8	32
Non-current	148	143
Trade payables	1,278	1,279
Content contracts	164	175
VAT and other taxes payable	29	69
Payroll and payroll taxes	64	65
Liabilities related to pre-bankruptcy settlements	-	29
ECI contracts	45	34
Licence for radio frequency spectrum	9	8
Other	26	42
Current	1,615	1,701
	1,763	**1,844**

25 Deferred income

	31 December 2016 HRK million	31 December 2015 HRK million
Connection fee	-	2
Deferred equipment rental income	19	-
Non-current	19	2
Prepaid vouchers	45	61
Connection fee	-	1
Other	44	41
Current	89	103
	108	**105**

26 Employee benefit obligations

Long-term employee benefits include retirement payments in accordance with the collective agreement. Jubilee awards were discontinued during 2014. 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 in the period in which they occur.

Long-term employee benefits include a compensation for the employees described in Note 38.

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

	2016 HRK million	2015 HRK million
As at 1 January	12	8
LTIP – Variable II (Note 38)	3	3
Current portion of employee benefits obligations (Note 27)	(3)	-
Service costs	1	3
Benefit paid	(1)	(1)
Actuarial gains	-	(1)
As at 31 December	**12**	**12**
Retirement	2	2
LTIP – Variable II	10	10
	12	**12**

As at 31 December 2016, the current portion of the provision for LTIP programme amounts to HRK 3 million.

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

	2016 in %	2015 in %
Discount rate (annually)	3.00	4.15

27 Provisions for other liabilities and charges

	Legal claims	Asset retirement obligation	Redundancy	Variable salary	Unused vacation	Total
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
As at 1 January 2016	28	28	4	70	8	138
Additions	15	-	80	94	4	193
Utilisation	(17)	-	(67)	(96)	(7)	(187)
Reversals	(6)	(13)	-	(2)	-	(21)
Current portion of employee benefits obligations (Note 26)	-	-	-	3	--	3
Interest costs	-	7	-	-	-	7
As at 31 December 2016	**20**	**22**	**17**	**69**	**5**	**133**
Non-current	20	22	-	-	-	42
Current	-	-	17	69	5	91
	20	**22**	**17**	**69**	**5**	**133**

27 Provisions for other liabilities and charges (continued)

a) Legal claims

As at 31 December 2016, the Group has provided estimated amounts for several legal actions and claims that management has assessed as probable to result in outflow of resources of the Group.

b) Asset retirement obligation

Asset retirement obligation primarily exists in the case of telecommunications structures constructed on third parties' properties. The Group carries out a revision of the necessary provisions every year.

c) Redundancy

Redundancy expenses and provisions include the amount of gross severance payments and other related costs for employees whose employment contracts are terminated during 2016.

28 Issued share capital

Authorised, issued, fully paid and registered share capital:

	31 December 2016 HRK million	31 December 2015 HRK million
81,888,535 ordinary shares without par value	9,823	9,823

The number of shares in issue remained unchanged between 1 January 1999 and 31 December 2016.

In 2016 the Group did not acquire any of its own shares (2015: nil). The Group holds 2,966 of its own treasury shares as at 31 December 2016.

Issued share capital increased in 2015 by amount of HRK 940 million due to partial reinvestment of profit for the year 2014 in accordance with provisions of the related tax regulations (Note 13).

29 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 share 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 share capital of the Group. These reserves are not distributable.

30 Retained earnings

In 2016, the Group paid a dividend of HRK 6.00 per share (2015: HRK 7.00) for a total of HRK 491 million (2015: HRK 573 million).

31 Commitments

a) Operating lease commitments

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

Operating lease charges:

	2016 HRK million	2015 HRK million
Current year expense (Note 10)	151	134

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

	31 December 2016 HRK million	31 December 2015 HRK million
Within one year	149	137
Between 1 and 5 years	341	381
Greater than 5 years	133	148
	623	**666**

The contracts relate primarily to property leases and car leases.

b) Capital commitments

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

	31 December 2016 HRK million	31 December 2015 HRK million
Intangible assets	108	100
Property, plant and equipment	554	964
	662	**1,064**

32 Contingencies

At the time of preparation of these consolidated financial statements, there are outstanding claims against the Group. In the opinion of the management, the settlement of these cases will not have a material adverse effect on the financial position of the Group, except for certain claims for which a provision was established (Note 27).

The Group vigorously defends all of its legal claims and potential claims, including regulatory matters, third party claims and employee lawsuits. There is no history of significant settlements in Croatia under either the Competition Law or imposed by Misdemeanour Courts. Due to the lack of relevant practice and due to the fact that the proceedings are still in progress, the Group is not able to determine the possible outcome of these cases.

Competition Agency proceedings regarding retransmission of football games

Competition Authority initiated, ex officio, by its decision dated 3 January 2013, formal proceedings against HT relating to potential abuse of dominant position in the market of distribution of premium sport content due to the fact that ArenaSport channels and premium sport content (such as Croatian national league – MAXtv Prva liga, UEFA Champions League and UEFA Europe League) are available only through MAXtv service.

The proceeding is pending.

The pecuniary fine pursuant to the Competition Act is limited to up to 10% of yearly turnover of the Company in the last year for which financial reports have been concluded. Also, according to the Agency´s practice, the fine is usually connected with up to 30% of the turnover acquired from the services provided on the relevant market. On the basis of the results for 2016, 30% of the revenue of MAXtv services would amount to HRK 105 million.

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 16), on 16 September 2008, the Company received a lawsuit filed by the Zagreb Holding Ltd. branch Zagreb Digital City (“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 of up to HRK 390 million plus interest.

This law suit is based on a claim that HT is using DTI owned by the City of Zagreb without any remuneration.

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

32 Contingencies (continued)

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

On 4 August 2015 the second instance County Court of Varaždin accepted HT's remedy and returned the case back to the first instance court proceeding within which the plaintiff will need to justify its right to file a claim before the court (i.e. to raise an action/ locus standi) as well as to justify and substantially evidence his claim against HT – what kind of DTI, where/ on which location, how and during what period was used by HT.

In June 2016, the plaintiff raised its claim for the additional amount of HRK 90 million; that is fee for usage of the DTI system in the area of Zagreb for period as of June 20, 2011 until June 20, 2012, as to avoid statute of limitation for this period. Therefore, the claim amounts now altogether to HRK 480 million, plus interest.

Based on the merit and development of the above legal proceedings, the Company concluded that the likelihood of an obligation arising from these legal cases is remote and that there was no need to present a provision related to these cases in these financial statements.

33 Balances and transactions with related parties

The transactions disclosed below primarily relate to transactions with the companies owned by DTAG. The Group enters into transactions in the normal course of business on an arm's length basis. These transactions included the sending and receiving of international traffic to/from these companies during 2016 and 2015. Further, DTAG provided technical assistance services to the Group of HRK 7 million (2015: HRK 13 million).

The main transactions with related parties during 2016 and 2015 were as follows:

	Revenue		Expenses	
	2016	2015	2016	2015
Related party:	HRK million	HRK million	HRK million	HRK million
Ultimate parent				
Deutsche Telekom AG, Germany	82	49	127	126
Joint venture				
HT d.d. Mostar, Bosnia and Herzegovina	7	6	6	4
Subsidiaries of ultimate parent				
Telekom Deutschland GmbH, Germany	16	10	12	11
T-Mobile Austria GmbH, Austria	3	2	3	1
T-Systems International GmbH, Germany	4	3	14	6
Magyar Telekom Nyrt., Hungary	6	6	5	3
Slovak Telecom a.s., Slovakia	13	4	-	-
Others	14	12	10	8
	145	**92**	**177**	**159**

33 Balances and transactions with related parties (continued)

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

	Receivables		Payables	
	31 December 2016	31 December 2015	31 December 2016	31 December 2015
Related party:	HRK million	HRK million	HRK million	HRK million
Ultimate parent				
Deutsche Telekom AG, Germany	21	3	159	117
Subsidiaries of ultimate parent				
Telekom Deutschland GmbH, Germany	-	-	3	2
Magyar Telekom, Hungary	1	2	1	-
Slovak Telecom a.s., Slovakia	10	-	-	-
T-Systems International GmbH, Germany	-	-	6	2
Others	4	4	2	1
	36	**9**	**171**	**122**

At the year end the Group purchased commercial paper of ultimate parent in the amount of HRK 982 millions (Note 23).

The Federal Republic of Germany is both a direct and an indirect shareholder and holds approximately 32 percent of the share capital of DTAG. Due to the average attendance at the shareholders' meetings, the Federal Republic of Germany represents a solid majority at the shareholders' meetings of DTAG, although it only has a minority shareholding, making DTAG a dependant company of the Federal Republic of Germany. Therefore, the Federal Republic of Germany and the companies controlled by the Federal Republic of Germany or companies over which the Federal Republic of Germany can exercise a significant influence are classified as related parties of DTAG, and consequently of the Group as well.

The Group did not execute as part of its normal business activities any transactions that were individually material in the 2016 or 2015 financial year with companies controlled by the Federal Republic of Germany or companies over which the Federal Republic of Germany can exercise a significant influence.

33 Balances and transactions with related parties (continued)

Compensation of the members Supervisory Board

The chairman of the Supervisory Board receives remuneration in the amount of 1.5 times of the average net salary of the employees of the Company paid in the preceding month. To the deputy chairman, remuneration is the amount of 1.25 times 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, remuneration is the amount of 1.5 times 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, remuneration is the amount of 1.25 times 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, remuneration is the amount of 1.25 times 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 2016, the Group paid a total amount of HRK 0.8 million (2015: HRK 0.8 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 2016, the total compensation paid to key management personnel of the Group amounted to HRK 38 million (2015: HRK 38 million). Key management personnel include members of the Management Boards of the Company and its subsidiaries and the operating directors of the Company, who are employed by the Group.

Compensation paid to key management personnel includes:

	2016 HRK million	2015 HRK million
Short-term benefits	38	38
	38	**38**

34 Financial risk management objectives and policies

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

a) Credit risk

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

The Group does not guarantee obligations of other parties.

The Group considers that its maximum exposure is reflected by the amount of debtors (Note 21) net of provisions for impairment recognized at the statement of financial position date.

Additionally, the Group is exposed to risk through cash deposits in the banks. As at 31 December 2016, the Group had business transactions with seventeen banks (2015: twenty one banks). The Group held cash and deposits in nine banks almost exclusively. For five domestic banks with foreign ownership, the Group received guarantees for deposits placed from parent banks which have a minimum rating of BBB+ or guarantees in form of low-risk government securities. The management of this risk is focused on dealing with the most reputable banks in foreign and domestic ownership in 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 2016 HRK million	31 December 2015 HRK million
Trade receivables for rendered telecom services to domestic customers	768	824
Trade receivables for rendered telecom services to foreign customers	45	19
Other trade receivables	81	71
Current	**894**	**914**
Trade receivables from prebankruptcy settlements	32	36
Trade receivables for merchandise sold	63	32
Other receivables	26	30
Non-current	**121**	**98**

Other current receivables are neither past due nor impaired.

The credit quality of all other financial assets (see Note 35): the total carrying amount as at the balance sheet date is considered neither past due nor impaired.

34 Financial risk management objectives and policies (continued)

b) Liquidity risk

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

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

The amounts disclosed in the table are the contractual undiscounted cash flows:

31 December 2016	Less than 3 months HRK million	3-12 months HRK million	1-5 years HRK million	>5 years HRK million
Trade and other payables	1,430	13	-	-
Capitalized content rights	58	169	69	-
Finance lease	-	13	44	1
Bank borrowings	3	21	120	151
Capitalized ECI rights	15	46	87	53
Liabilities from pre-bankruptcy settlement	-	-	-	-
Issued bond	2	10	69	8
Other liabilities	20	10	58	24

31 December 2015	Less than 3 months HRK million	3-12 months HRK million	1-5 years HRK million	>5 years HRK million
Trade and other payables	1,488	5	10	12
Capitalized rights	55	160	79	-
Finance lease	-	5	10	1
Bank borrowings	3	9	113	180
Capitalized ECI rights	10	29	43	34
Liabilities from pre-bankruptcy settlement	-	31	-	-
Issued bond	1	3	64	24
Other liabilities	-	8	49	22

34 Financial risk management objectives and policies (continued)

c) Interest rate risk

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

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

	Increase/ decrease in basis points	Effect on profit post tax HRK million
Year ended 31 December 2016		
HRK	+100	16
	-100	(16)
EUR	+100	19
	-100	(19)
Year ended 31 December 2015		
HRK	+100	9
	-100	(9)
EUR	+100	10
	-100	(10)

34 Financial risk management objectives and policies (continued)

d) Foreign currency risk

The Group’s functional currency is the Croatian Kuna. 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 and equivalents, receivables and payables are made in foreign currency, primarily in Euro. The purpose of these deposits is to hedge foreign currency denominated liabilities and liabilities indexed to foreign currencies from changes in the exchange rate. The following table demonstrates the sensitivity to a reasonably possible change in the Euro exchange rate, with all other variables held constant, of the Group’s profit post tax due to changes in the fair value of monetary assets and liabilities.

	Increase/ decrease in EUR rate	Effect on profit post tax HRK million
Year ended 31 December 2016	+3%	62
	-3%	(62)
Year ended 31 December 2015	+3%	36
	-3%	(36)

e) Fair value estimation

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

f) Capital management

The primary objective of the Group’s capital management is to ensure business support and maximise shareholder value. The capital structure of the Group comprises of issued share capital, reserves and retained earnings and totals HRK 12,047 million as at 31 December 2016 (31 December 2015: HRK 11,641 million).

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2016 and 31 December 2015 (Notes 28 and 30).

34 Financial risk management objectives and policies (continued)

g) Accepted collaterals

Accepted collaterals for reverse REPO affairs include:

	Credit rating	31 December 2016 HRK million	31 December 2015 HRK million
Foreign bonds:			
Government of Germany	AAA	156	-
Government of Austria	AA+	797	764
Government of France	AA	200	154
		1,153	**918**

All above stated values are fair market values. The accepted collateral is level 1 under IFRS13 categorisation.

h) Offsetting

The following financial assets and financial liabilities are subject to offsetting:

	Trade receivables		Trade payables	
	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Gross recognised amounts	106	66	240	185
Offsetting amount	(60)	(54)	(60)	(54)
	46	**12**	**180**	**131**

35 Financial instruments

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

	Carrying amount		Fair value	
	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Financial assets:				
Cash and cash equivalents	2,676	3,175	2,676	3,175
Guarantee deposits, current	12	17	12	17
Time deposits	-	231	-	231
Available-for-sale assets, non-current	949	591	949	591
Available-for-sale assets, current	46	78	46	78
Secured deposits	1,131	532	1,131	532
Guarantee deposits, non-current	26	43	26	43
Trade receivables – current and non-current	1,371	1,232	1,371	1,232

Fair value of financial assets other than available-for-sale assets are classified as level 3 fair value in the fair value hierarchy due to inclusion of an unobservable inputs such as counterparty credit risk. Available-for sale assets belong to level 1 (Note 19). The fair values in level 3 of the fair value hierarchy were estimated to be equal to their carrying amount.

36 Borrowings

	Carrying amount		Fair value	
	31 December 2016 HRK million	31 December 2015 HRK million	31 December 2016 HRK million	31 December 2015 HRK million
Bank borrowings	198	208	198	208
Issued bond	64	71	64	71
Finance lease	42	11	42	11
Non-current	**304**	**290**	**304**	**290**
Bank borrowings	9	-	9	-
Issued bond	7	-	7	-
Finance lease	13	4	13	4
Current	**29**	**4**	**29**	**4**
Total	**333**	**294**	**333**	**294**

The fair value of borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates, and they belong to level 2 under financial instruments fair value hierarchy category, except for the bond which is level 1. The weighted average interest rate for borrowings amounts to 4.53% at 31 December 2016 (31 December 2015: 4.54%).

36 Borrowings (continued)

Currency breakdown of financial liabilities

	31 December 2016 HRK million	31 December 2015 HRK million
HRK	64	72
EUR	198	207
	262	**279**

Issued bond

Pursuant to the prebankruptcy settlement, the issued bonds are debt securities with multiple maturities. In the period from 30 May 2014 to 30 May 2017 the Group will pay semi-annual interest at interest rate of 5.25% per year, and principal will be repaid from 30 May 2017 to 30 May 2022.

Finance lease liability breakdown

	31 December 2016 HRK million	31 December 2015 HRK million
Commitments in relation to finance lease are payable as follows:		
Within one year	13	5
Later than one year but not later than five years	44	10
Later than five years	1	1
Minimum lease payments	**58**	**16**
Future finance changes	(2)	(1)
Recognised as a liability	**56**	**15**
The present value of finance lease liabilities is as follows:		
Within one year	13	4
Later than one year but not later than five years	42	10
Later than five years	1	1
Minimum lease payments	**56**	**15**

37 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. In the meantime, four Amendments to the Law on Electronic Communications entered into force and were published in the Official Gazette No. 90/11, 133/12, 80/13 and 71/14. Pursuant to Article 32 of the Law on Electronic Communications, the Company is entitled to provide the following electronic communication services based on the general authorisation which was last updated on 3 November 2015:

- 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),
- premium rate and freephone 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 in the Republic of Croatia, and
- other services.

On 26 February 2013 the Croatian Regulatory Authority for Network Industries (HAKOM) issued to the Company special authorization to perform account reconciliation of accounts for the provision of electronic communications services in maritime for a period of 10 years i.e. till 26 February 2023.

In accordance with HAKOM’s decision of 23 September 2015, the Company was designated as the Universal services provider in the Republic of Croatia for a period of four years with the obligation to provide following universal services during the mentioned period:

- access to the public communications network and publicly available telephone services at a fixed location, allowing for the voice communications, 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 as well as the technological feasibility,
- setting up of public pay telephones or other publicly available access points for the public voice service 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 or other publicly available access points for the public voice service and their accessibility for disabled persons,
- special measures for disabled persons, including access to services under 1 and 2 above, including the access to emergency services, equivalent to that enjoyed by other end-users, and
- special pricing systems adjusted to the needs of the socially disadvantaged groups of end-users, that comprise the service under item 1 above.

37 Authorization for Services and Applicable Fees

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, the Company shall continue to provide the service on commercial basis.

b) Authorization for usage of radio frequency spectrum

HAKOM issued to the Company the following licenses for use of the radio frequency spectrum for public mobile electronic communications networks:

- licence for the use of radio frequency spectrum in 900 MHz and 1800 MHz frequency bands with the validity from 1 December 2011 until 18 October 2024,
- licence for the use of radio frequency spectrum in 2100 MHz frequency band with the validity from 1 January 2010 until 18 October 2024,
- licence for the use of radio frequency spectrum in 800 MHz frequency band with the validity from 29 October 2012 until 18 October 2024,
- licence for the use of radio frequency spectrum in 800 MHz frequency band with the validity from 6 November 2013 until 18 October 2024, and
- licence for the use of radio frequency spectrum in 1800 MHz frequency band with the validity from 22 December 2013 until 18 October 2024.

HAKOM also issued to the Company licences for the use of radio frequency spectrum for satellite services (DTH services) with the validity from 12 August 2015 until 11 August 2020.

c) Fees for providing electronic communications services

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

In 2016, the Group paid the following fees:

- the fees for the use of addresses, numbers and radio frequency spectrum pursuant to the ordinance passed by the Ministry of the maritime affairs, transport and infrastructure (in favour of State budget, Official Gazette No. 154/08, 28/09, 97/10, 92/12, 62/14, 147/14, 138/15 and 77/16)
- fees for the use of assigned radiofrequency spectrum pursuant to the Decision on the selection of the preferred bidder of November 6, 2013 and
- the fees for use of addresses, numbers, radio frequency 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 No. 122/15).

37 Authorization for Services and Applicable Fees (continued)

d) Audiovisual and electronic media services

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

Also, the Group (as the operator of public communication network) is obliged to pay a fee in the amount of 0.8% of the total annual gross income generated in previous calendar year by performing transmission and/or retransmission of audiovisual programmes and their parts through public communication network, including internet and cable distribution for the purpose of the implementation of the National Programme.

Pursuant to the Law on Electronic Media, which entered into force on 29 December 2009, the Group 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.

Licences are not issued to all members of the Group.

e) Electronic communications infrastructure and associated facilities

The Company, as the infrastructure operator, is obligated to pay fees for the right of way in amount that the Company contracted with land owners or accordance with the Law on Electronic Communications. The fees for the right of way are defined by the Ordinance on Certificate and Fees for the Right of Way (Official Gazette No. 152/11 and 151/14) that was adopted by HAKOM in December 2011 and became 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.

f) Supply of electricity

Croatian Energy Regulatory Agency (HERA) has reissued a licence for energy activities relating to supply of electricity to the Company on 16 October 2016 for a period of five years.

38 Share-based and non share-based payment transactions

Long-term incentive plans, HT Variable II 2013, HT Variable II 2014 and Lead to Win 2015 and Lead to Win 2016 currently exist at Group level.

Lead to Win is a new DT model of performance management for Executives adapted for the local needs and it integrates target management, performance and potential review (PPR) and succession management. This model is based on clear and transparent link between performance rating and rewards for short term incentive STI, LTI (Long term incentive) and SMP (Share matching Plan), based on DT share. Eligibility and grant-value depend on individual performance and MG (Management Group) level (MG1 – MG3), and MG1 represents the highest level managerial positions.

LTI plan, as a part of Lead to Win model is a global Deutsche Telekom Group's (DT Group) 2016, Group-wide compensation instrument. The aim of the 2016 LTI is to enhance willingness to take on entrepreneurial responsibility and identification with DT Group and thus boost the Group's value in the medium to long-term. This leads to a greater balance of management and shareholder interests. The term of the 2016 LTI shall cover the period from 1 January 2016 to 31 December 2019.

HT Variable II 2012 ended on 31 December 2015, and the Supervisory Board has determined final target achievement of 11,5%. In accordance to this achievement, in June 2016 the awarded amount was paid to participants.

HT Variable II 2013 and HT Variable II 2014 are cash-based plans with four equally weighted performance parameters that cannot be changed during plan duration. Two targets are financial KPIs, adjusted Earnings Per Share (EPS) and adjusted operating Return On Capital Employed (ROCE), third and fourth targets are customer and employee satisfaction. Duration of the plan is four years effective from 1 January every year.

Upon expiry of the term of the plan, the HT Supervisory Board shall determine whether each of the targets has been achieved. Based on the findings of the HT Supervisory Board, the HT Management Board determines and announces the level of target achievement.

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

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.

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

LTI as part of Lead to Win Program 2015 and 2016 are also cash based plan, and awarded amount depends on MG (Management Group) to which positions of participant belongs and on individual performance. Participants can be only those who meet at least performance rating 3 (score range is from 1 to 5). Based on this the amount shall be from 10% to 30% of the annual target salary depending on MG and on individual performance rating. The relevant amount will be converted into a number of phantom shares in DTAG divisible by four and awarded to the future plan participant in the form of shares The number of phantom shares is linked to four equally weighted success parameters. The target values of the success parameters are set at the beginning of the four-year plan term, and at the end, the total number of received phantom shares, that is dependent on the achievement of defined targets, will be converted into a cash amount to be paid to participants of the plan. An interim value shall be determined for each annual tranche. The plan currency is euros, and four defined success parameters are DT parameters.

Success parameters are: ROCE (Return on Capital Employed), Adjusted EPS (Earnings per Share), Customer satisfaction and Employee satisfaction. The success parameters have a target achievement corridor of between 0% and 150% and the shares awarded (basic number) correspond to target achievement of 100%.

The DTAG Supervisory Board determines the target achievement after the end of each year of the plan period. Based on the levels determined, the DTAG Board of Management determines the target achievement for the plan participants On this basis, the responsible bodies or committees of the participating companies shall take the necessary measures for these companies.

The (Matching Share Plan) MSP is program under which the participant can receive HT shares on expiry of a four-year period. The participant is obliged to invest an amount from 10% to a maximum 33.33% of the paid out gross annual variable salary to HT shares. The participant is granted one additional HT share for each share, under condition that he/she held them continuously for a period of at least four years from the date of purchase (vesting period).

As a part of Lead to Win Program 2015 and 2016, Share Matching Plan was introduced for managers in Managements Groups MG1, MG2 and MG3. The share matching plan is a long-term voluntary compensation instrument, which makes the executives co-owners of the DT and enables them to benefit from the success of the DT share. The amount of the voluntary personal investment is between 10% and a third of the gross payment amount of the Short Term Incentive payment for previous year. The term of the 2016 SMP shall cover the period from July 1, 2016 to June 30, 2020. The shares in DTAG purchased as part of the voluntary personal investment are locked for the entire period and labelled with a corresponding lock indicator. At the end of the plan term the plan participant will be granted DTAG shares free of charge. The ratio between the number of shares purchased as part of the voluntary personal investment and the number of matching shares will depend on the personal performance of the plan participant.

Employee services are recognized as expenses on a pro rata basis over the vesting period. The Group is measuring value of employee services, indirectly, by reference to the fair value of the equity instruments granted. The fair value of the equity instruments granted is measured at grant date by using observable market price.

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

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

	2016 HRK million	2015 HRK million
Expenses	(1)	(2)
	(1)	**(2)**

39 Auditor's fees

The auditors of the Group's financial statements have rendered services of HRK 5 million in 2016 (2015: HRK 4.8 million). Services rendered in 2016 and 2015 mainly relate to audits and reviews of the financial statements and audit of financial statements prepared for regulatory purposes.

40 Events after reporting period

In January 2017, the Group signed a Sale and Purchase agreement to acquire majority shareholding in Crnogorski Telekom AD Podgorica from Magyar Telekom NYRT Hungary. The transaction will be executed through purchase of a SPV entity which holds 76.5283% shares of Crnogorski Telekom AD. Since the entities involved in this transaction are all part of the DT Group, the Group intends to record all assets acquired, liabilities assumed and any non-controlling interest in the acquire using the predecessor accounting method. The fair value of consideration transferred in this transaction was HRK 933 million. Preliminary estimate of net assets of Crnogorski Telekom AD at acquisition date amounts to HRK 1,143 million.