Ericsson Nikola Tesla d.d.

Consolidated Financial Statements and Auditor’s report
31 December 2016

Contents

Profile of the Parent Company and its subsidiaries (the Group)

History and incorporation

Ericsson Nikola Tesla d.d. (the Parent Company) is a Croatian company with over sixty five years of continuous operations. It is a leading supplier and exporter of specialized telecommunications equipment, ICT solutions, software and services in Central and Eastern Europe.

The Parent Company was founded as a result of the privatisation of the enterprise Nikola Tesla - Poduzeće za proizvodnju telekomunikacijskih sistema i uređaja, po.

Ericsson Nikola Tesla d.d. has prepared these consolidated financial statements for the Parent Company, its four active subsidiaries (of which two are domiciled in Croatia, one in Bosnia and Herzegovina and one in Kosovo), and two inactive subsidiaries domiciled in Croatia.

Principal activities

The principal activities of the Group are research and development of telecommunications software and services, design, testing and integration of total communications solutions, managed services, and supply and maintenance of communications solutions and systems, primarily to customers in the Republic of Croatia, and Bosnia and Herzegovina, and several customers in Central and Eastern Europe as well as towards companies within the Ericsson Group.

Ericsson Nikola Tesla d.d. is a joint stock company incorporated in Croatia. The headquarters of the Parent Company are in Zagreb, Krapinska 45.

Profile of the Parent Company and its subsidiaries (the Group) (continued)

Supervisory Board, Management Board and executive management

The Supervisory Board

The Supervisory Board members during 2016 and up to the release of these consolidated statements were:

Roland Nordgren	Reappointed on 31 May 2016	Chairman
Ignac Lovrek	Reappointed on 2 June 2015	Member; Vice-Chairman
Vidar Mohammar	Appointed on 2 June 2015	Member
Dubravko Radošević	Reappointed on 27 May 2014	Member
Zvonimir Jelić	Reappointed on 8 July 2014	Member and employees' representative

The Management Board

The Management Board has one member:

Gordana Kovačević	Reappointed on 1 January 2015	President

Executive management

As at 31 December 2016, the executive management comprised:

Gordana Kovačević	President
Branko Dronjić	Head, ITTE OPS Croatia
Damir Bušić	Director, Commercial Management (including Legal)
Dario Runje	Head, RAN Competence Domain
Dragan Fratrić	Director, General Services
Goran Ožbolt	Director, Sales and Marketing for Tele2 and Alternative Operators
Grga Mrkonjić	Director, Sales and Marketing for HT
Hrvoje Benčić	Director, Engagement Practices and ETK Customer Operations
Ivan Barać	Director, Sales & Marketing for CIS Market
Jagoda Barać	Director, Sales and Marketing for Neighboring Countries
Marijana Đuzel	Director, HR
Milan Živković	Director, Strategy and Business Development
Miroslav Kantolić	Director, Sales and Marketing for VIPnet
Patrick Gerard Martin	Director, Research and Development Center
Patrik Wahlgren	Director, Finance
Snježana Bahtijari	Director, Communication
Tihomir Šicel	Business Excellence Manager

Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual consolidated financial statements

The Management Board is required to prepare consolidated financial statements for each financial year which give a true and fair view of the financial position of the Group and of the results of its operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such consolidated financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; make judgements and estimates that are reasonable and prudent; and prepare the consolidated financial statements on a going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the business situation of the Group together with the annual consolidated financial statements, following which the Supervisory Board is required to approve the annual consolidated financial statements which will be presented to the General Assembly of Shareholders.

The consolidated financial statements set out on pages 10 to 61 were authorised by the Management Board on 21 April 2017 for issue to the Supervisory Board and are signed below.

Gordana Kovačević
President
Ericsson Nikola Tesla d.d.
Krapinska 45
10000 Zagreb
Croatia

ERICSSON
Ericsson Nikola Tesla d.d.
Krapinska 45
HR-10 000 Zagreb
CROATIA 39

pwc

Independent Auditor's Report

To the Shareholders and Management Board of Ericsson Nikola Tesla d.d.:

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Ericsson Nikola Tesla 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 and other explanatory information.

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.

Our audit approach

Overview

- Overall materiality for consolidated financial statements as a whole: HRK 12 million, which represents 0.75% of total revenue.

- We conducted audit work at 3 legal entities in 2 countries (Croatia and Bosnia & Herzegovina).
- Our audit scope addressed 99% of the Group's revenues and 100% of the Group's absolute value of underlying profit.

- Recognition of revenue from sale of goods
- De-recognition of receivables with off balance sheet financing

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, if any, both individually and in aggregate on the consolidated financial statements as a whole.

Overall materiality for consolidated financial statements as a whole	HRK 12 million (2015: HRK 8.5 million)
How we determined it	0.75% of total revenues
Rationale for the materiality benchmark applied	We consider revenue to be the benchmark against which the performance of the Group is most commonly measured by the shareholders. In addition, majority of the sales and purchases are realised from internal Ericsson Group transactions and are subject to transfer pricing arrangements.

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
Recognition of revenue from sale of goods *Refer to Note 1 of the financial statements under heading "Recognition of revenues" and Note 24 (Accrued charges and deferred revenue).* We focused on revenue recognition because the customer payments set in the contracts usually do not align with timing of revenue recognition criteria. Revenue from delivery of goods is mostly recognised upon approved acceptance test by a customer.	We assessed the consistency of the application of the revenue recognition policy by performing following procedures: - We tested the design and operating effectiveness of the controls (including IT controls) over revenue systems across the Group to determine the extent of reliance on the automated controls and overall IT environment. - We checked that revenue had been recognised at the correct time by testing a sample of transactions and contracts, and comparing the timing of revenue recognition to approved client acceptance tests. - We also tested on a sample basis the appropriateness of deferred revenue transactions by reference to the delivery status of the related contracts and timing of invoices. No exceptions were noted from our testing.

Key audit matter	How our audit addressed the Key audit matter
De-recognition of receivables with off balance sheet financing *See note 2(b) of the financial statements under heading "De-recognition of receivables with off-balance sheet financing"* In 2016, the Group entered into several new customer contracts in the foreign market with total revenue amount of HRK 141 million. We focused on this area because of the significance and complexity of these contracts. The contracts include long-term payment terms, securing related receivable through a separate insurance contract, and a supplier credit financing structure. As part of such contracts, the Group also issued guarantees to the financing bank for risk of non-performance by the insurance company. Based on a detail analysis of the related accounting criteria, management of the Group concluded it was appropriate to de-recognize a portion of related receivables, and reflect the financing component as an off-balance sheet transaction.	We performed the following testing in respect of these transactions: - We considered each transaction separately by carefully reading the specific contract terms. - We obtained external confirmations on a sample basis from the customer and the financing bank related to the Group's initial receivables and the de-recognised proportion which confirmed the outstanding receivables and payables arising from these transactions. - We assessed and formed our own view on management's analysis of the de-recognition criteria of financial assets. We considered whether there was transfer to third parties of contractual rights to receive cash flows and transfer of risk (primarily consisting of late payment risk and credit risk). We determined that these transactions were recorded and presented consistently with the related requirements of the accounting standards (IFRS).

Other information

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

Our opinion on the consolidated financial statements does not cover the other information, including the General Report and Social Report, comprising 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 General Report and Social Report, comprising Corporate Governance Statement, we also performed procedures required by the Accounting Act in Croatia. Those procedures include considering whether the General Report and Social Report include 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 General Report and Social Report, comprising 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 General Report and Social Report have 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 General Report and Social Report, comprising 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 International Financial Reporting Standards as adopted in the European Union, 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 independent 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 independent 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 independent 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 independent 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
21 April 2017

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

	Notes	**2016** **HRK ‘000**	**2015** **HRK ‘000**
Sales revenue	*3, 4*	1,591,602	1,364,258
Cost of sales		(1,401,797)	(1,187,023)
Gross profit		189,805	177,235
Selling expenses		(44,153)	(49,066)
Administrative expenses		(33,548)	(33,121)
Other operating income		4,658	4,489
Other operating expenses		(3,179)	(8,168)
Operating profit		113,583	91,369
Finance income	*7*	5,826	1,761
Finance expense	*7*	(582)	(199)
Finance income – net		5,244	1,562
Profit before tax		118,827	92,931
Income tax	*8*	(8,083)	(1,582)
Profit for the year		110,744	91,349
Other comprehensive income - items that may be subsequently reclassified to profit or loss:			
Currency translation differences		(49)	(17)
Total comprehensive income for the year		**110,695**	**91,332**
Earnings per share (HRK)	*9*	83,34	68,74

The notes set out on pages 16 to 61 form an integral part of these consolidated financial statements.

Consolidated statement of financial position
as at 31 December 2016

	Notes	**2016** **HRK '000**	**2015** **HRK '000**
ASSETS			
Non-current assets			
Property, plant and equipment	*10*	122,897	137,667
Intangible assets	*11*	7,285	6,532
Loans and receivables	*12*	81,160	19,235
Deferred tax assets	*8*	14,250	-
Other non-current assets		40	40
Total non-current assets		225,632	163,474
Current assets			
Inventories	*13*	9,796	21,187
Trade receivables	*14*	174,952	131,800
Receivables from related parties	*25(c)*	88,858	113,949
Other receivables	*15*	14,325	3,396
Income tax receivables		1,172	1,204
Financial assets at fair value through profit or loss	*16*	62,993	53,917
Prepayments and accrued income		5,671	1,744
Cash and cash equivalents	*17*	224,725	233,195
Total current assets		582,492	560,392
TOTAL ASSETS		808,124	723,866

The notes set out on pages 16 to 61 form an integral part of these consolidated financial statements.

Consolidated statement of financial position (continued)
as at 31 December 2016

	Notes	**2016** **HRK ‘000**	**2015** **HRK ‘000**
EQUITY AND LIABILITIES			
Equity			
Share capital	*18(a)*	133,165	133,165
Treasury shares		(1,630)	(3,434)
Legal reserves	*18(c)*	6,658	6,658
Retained earnings		148,686	171,539
Total equity		286,879	307,928
Non-current liabilities			
Interest-bearing borrowings	*19*	8,962	-
Other non-current liabilities	*20*	24,288	12,345
Employee benefits	*21(a)*	8,560	9,060
Total non-current liabilities		41,810	21,405
Current liabilities			
Payables to related parties	*25(c)*	73,215	40,087
Interest-bearing borrowings		-	32
Trade and other payables	*22*	156,413	164,477
Income tax payable		21,659	-
Provisions	*23*	16,011	10,003
Accrued charges and deferred revenue	*24*	212,137	179,934
Total current liabilities		479,435	394,533
Total liabilities		521,245	415,938
TOTAL EQUITY AND LIABILITIES		808,124	723,866

The notes set out on pages 16 to 61 form an integral part of these consolidated financial statements.

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

	Share capital HRK '000	Treasury shares HRK '000 Note 18 (b)	Legal reserves HRK '000	Retained earnings HRK '000	Total HRK '000
As at 1 January 2015	133,165	(8,462)	6,658	204,105	335,466
Changes in equity for 2015					
Total comprehensive income	-	-	-	91,332	91,332
Dividend distribution for 2015, Note 18 (d)	-	-	-	(119,593)	(119,593)
Purchases of treasury shares, Note 18 (b)	-	(4,062)	-	-	(4,062)
Share-based payments, Note 21 (b)	-	6,840	-	(6,840)	-
Sale of treasury shares, Note 21 (b)		2,250		(398)	1,852
Equity-settled transactions, Note 21 (b)	-	-	-	2,933	2,933
Total contributions by and distributions to owners of the parent recognised directly in equity	-	5,028	-	(123,898)	(118,870)
As at 31 December 2015	133,165	(3,434)	6,658	171,539	307,928
As at 1 January 2016	-	-	-	-	
Changes in equity for 2016					
Total comprehensive income	-	-	-	110,695	110,695
Dividend distribution for 2015, Note 18(d)	-	-	-	(132,846)	(132,846)
Purchases of treasury shares, Note 18(b)	-	(1,140)	-	-	(1,140)
Share-based payments, Note 21 (b)	-	2,087	-	(2,087)	-
Sale of treasury shares, Note 21 (b)	-	857	-	123	980
Equity-settled transactions, Note 21 (b)	-	-	-	1,262	1,262
Total contributions by and distributions to owners of the parent recognised directly in equity	-	1,804	-	(133,548)	(131,744)
As at 31 December 2016	133,165	(1,630)	6,658	148,686	286,879

The notes set out on pages 16 to 61 form an integral part of these consolidated financial statements.

Consolidated statement of cash flows

for the year ended 31 December 2016

	Notes	**2016**	**2015**
		HRK '000	**HRK '000**
Cash flows from operating activities			
Profit before tax		*118,827*	*92,931*
Adjustments for:			
Depreciation and amortisation	*5,10,11*	48,734	51,851
Impairment losses and reversals		16,398	2,748
Net increase in provisions	*23*	18,999	10,560
Gain on sale of property, plant and equipment		(102)	(240)
Net (gain)/loss on remeasurement of financial assets		(2,033)	21
Amortisation of discount		(657)	(69)
Interest income		(3,346)	(3,833)
Interest expense	*7*	582	199
Unrealised foreign exchange (gains)/losses, net		(5,322)	2,073
Equity-settled transactions	*6*	1,262	2,933
		193,342	159,174
Changes in working capital:			
In receivables		(75,303)	23,799
In inventories		11,391	9,759
In payables		60,289	52,793
Cash generated from operations		*189,719*	*245,525*
Interest paid		(582)	(198)
Income taxes paid		(2,100)	(2,181)
Net cash from operating activities		***187,037***	***243,146***
Cash flows from investing activities			
Interest received		2,753	2,945
Dividends received		212	-
Proceeds from sale of property, plant and equipment		83	355
Purchases of property, plant and equipment, and intangible assets		(37,488)	(64,212)
Deposits with financial institutions - net		(19,846)	66
Purchases of financial assets at fair value through profit and loss		(89,000)	(92,000)
Proceeds from sale of financial assets at fair value through profit and loss		81,745	82,142
Net cash used in investing activities		***(61,541)***	***(70,704)***

The notes set out on pages 16 to 61 form an integral part of these consolidated financial statements.

Consolidated statement of cash flows (continued)
for the year ended 31 December 2016

	Notes	**2016**	**2015**
		HRK '000	**HRK '000**
Cash flows from financing activities			
Purchase of treasury shares	*18(b)*	(1,140)	(4,062)
Dividends paid	*18(d)*	(132,846)	(119,715)
Net cash used in financing activities		***(133,986)***	***(123,777)***
Effects of exchange rate changes on cash and cash equivalents		20	(2,433)
Net (decrease)/increase in cash and cash equivalents		(8,470)	46,232
Cash and cash equivalents at the beginning of the year		233,195	186,963
Cash and cash equivalents at the end of the year	*17*	**224,725**	**233,195**

The notes set out on pages 16 to 61 form an integral part of these consolidated financial statements.

Notes to the consolidated financial statements

1 Significant accounting policies

Reporting entity

Ericsson Nikola Tesla d.d. (the Parent Company) is a joint stock company incorporated and domiciled in Croatia. The address of its registered office is Krapinska 45, 10000 Zagreb, the Republic of Croatia. The Parent Company's shares are listed on the Public Joint Stock Company listing on the Zagreb Stock Exchange. Ericsson Nikola Tesla d.d. has prepared these consolidated financial statements as at 31 December 2016 and for the year then ended for the Parent Company, its four active subsidiaries (of which two are domiciled in Croatia, one in Bosnia and Herzegovina and one in Kosovo), and two inactive subsidiaries domiciled in Croatia (together "the Group"). A summary of the Group's principal accounting policies is set out below.

Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards adopted by the European Union (IFRS). These consolidated financial statements also comply with the Croatian Accounting Act in effect on the date of issue of these consolidated financial statements. These consolidated financial statements are a translation of the official statutory IFRS consolidated financial statements.

Basis of preparation

The consolidated financial statements are prepared on the historical cost basis, with the exception of financial instruments which are carried at fair value. These comprise derivative financial instruments and financial assets and liabilities at fair value through profit or loss. The accounting policies have been consistently applied to all periods presented in these consolidated financial statements.

The preparation of consolidated financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods. Judgements made by executive management in the application of IFRSs that have significant effect on the consolidated financial statements and estimates are discussed in Note 2.

Going concern

The executive management have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going concern basis in preparing its consolidated financial statements.

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures

(a) New and amended standards adopted by the Group

The Group has adopted the following 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:

- Clarification of Acceptable Methods of Depreciation and Amortisation – Amendments to IAS 16 and IAS 38.
- Disclosure Initiative - Amendments to IAS 1.
- Annual Improvements to IFRSs 2012-2014 Cycle comprising changes to four standards (IFRS 5, IFRS 7, IFRS 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) Standards and interpretations issued but not yet effective

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 is expected to have a 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 o rafter 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 Management Board of the Group assessed the impact of the new standard IFRS 9 on its financial statements as follows:

- Following the changes approved by IASB in July 2014, the Group does not expect any impact from the new classification, measurement and derecognition rules on its financial assets and financial liabilities.
- 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 impairment model is an expected credit loss (ECL) model which may result in earlier recognition of credit losses. The Group has not yet assessed how the new rules would affect its impairment provisions.

The Management Board plans to adopt the standard on its effective date.

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) Standards and interpretations issued but not yet effective (continued)

IFRS 15 Revenue from contracts with customers 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 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.

Key changes to current practice are:

- Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements.
- Revenue may be recognised earlier than under current standards if the consideration varies for any reasons (such as for incentives, rebates, performance fees, royalties, success of an outcome, etc.) – minimum amounts must be recognised if they are not at significant risk of reversal.
- The point at which revenue can be recognised may shift: some revenue which is currently recognised at a point in time at the end of a contract may have to be recognised over the contract term and vice versa.
- There are new specific rules on licenses, warranties, non- refundable upfront fees and consignment arrangements, to name a few; and
- As with any new standard, there are also increased disclosures.

Entities will have a choice of full retrospective application, or prospective application with additional disclosures.

At this stage, the Group is not able to estimate the impact of the new rules on the Group's financial statements; it will make more detailed assessments of the impact over the next twelve months. The Management Board plans to adopt the standard on its effective date.

IFRS 16 Leases (effective for annual periods beginning on or after 1 January 2019, early adoption is permitted only if IFRS 15 is adopted at the same time)

IFRS 16 will affect primarily lessee accounting and 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.

1 Significant accounting policies (continued)

Changes in accounting policies and disclosures (continued)

(b) Standards and interpretations issued but not yet effective (continued)

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.

Lessor accounting will not change significantly. Some differences may arise as a result of the new guidance on the definition of a lease. In accordance with IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

At this stage, the Group is not able to estimate the impact of the new standard on the Group’s financial statements; it will make more detailed assessments of the impact over the next twelve months. The Management Board plans to adopt the standard on its effective date and when endorsed by the European Union.

1 Significant accounting policies (continued)

Functional and presentational currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment where the entity operates ('the functional currency'). The consolidated financial statements are presented in Croatian kuna (HRK), which is the Parent Company's functional and the Group's presentation currency.

Property, plant and equipment

Items of property, plant and equipment are shown at cost or deemed cost, less accumulated depreciation and impairment losses.

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group and the cost of the item can be measured reliably. All other expenditure on repairs and maintenance is expensed as incurred. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Land is not depreciated. Depreciation on other assets is provided on a straight-line basis to allocate their cost over the estimated economic useful life of the assets. The estimated useful lives are as follows:

	Useful lives
Buildings	5 - 30 years
Plant and equipment	2 - 10 years
Other	5 - 7 years

The depreciation method, useful lives and residual values are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing proceeds with carrying amount, and are included in the consolidated statement of comprehensive income.

1 Significant accounting policies (continued)

Intangible assets

Intangible assets are stated on initial recognition at cost and subsequently at cost less accumulated amortisation and impairment losses.

Amortisation is provided on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets include acquired computer software, and are amortised on a straight-line basis over their useful life of 2 - 4 years. Cost associated with maintaining computer software is recognised as an expense as incurred.

Impairment of assets

a) Impairment of non-financial assets

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

b) Impairment of financial assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired.

A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

Financial instruments

The Group classifies its financial assets in the following categories: loans and receivables, and at fair value through profit or loss. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

(a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance

1 Significant accounting policies (continued)

Financial instruments (continued)

(a) Loans and receivables (continued)

sheet date. These are classified as non-current assets. The Group's loans and receivables comprise 'trade and other receivables', 'deposits' and 'cash and cash equivalents' in the balance sheet.

Loans and receivables are carried at amortised cost using the effective interest method.

(b) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorised as held for trading unless they are categorised as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non-current.

Regular way purchases and sales of financial assets are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions and references to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

Trade and other receivables

Receivables are initially recognised at the fair value of consideration given and are carried at amortised cost, using the effective interest rate. Receivables are written down to their estimated realisable value through an impairment allowance.

Service contract work-in-progress is stated at cost plus profit recognised to date less a provision for foreseeable losses and less progress billings on long-term contracts. Cost includes all expenditure related directly to specific projects and an allocation of fixed and variable overheads incurred in the Group's contract activities based on budgeted capacity.

Cash and cash equivalents

Cash comprises cash held at banks and on hand. Cash equivalents include demand deposits and time deposits with maturities up to three months.

Trade and other payables

Trade and other payables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate.

1 Significant accounting policies (continued)

Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of other inventories is based on the First In First Out (FIFO) principle and includes expenditures incurred in acquiring the inventories and bringing them to their existing location and condition. In case of manufactured inventories the cost includes materials, labour and related overhead, and expenditure incurred in acquiring the inventories and bringing them to their existing location and condition. Slow-moving and obsolete inventories have been written down to their estimated realisable value.

Share capital

Share capital is stated in HRK at nominal value.

Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds. Where the Parent Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the equity holders until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the equity holders.

Income tax

The tax expense for the period is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognised in the consolidated statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Parent Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised by using the balance sheet liability method on temporary differences arising between tax basis of assets and liabilities and their carrying amount in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction does not affect either accounting or taxable profit or loss. Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the balance sheet. Deferred tax assets are recognised when it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. At each balance sheet date, the Group reassesses unrecognised deferred tax assets and the carrying amount of deferred tax assets.

1 Significant accounting policies (continued)

Income tax (continued)

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. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the balance sheet date.

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

Foreign currencies

Transactions denominated in foreign currencies are translated into functional currency at the rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currency at the balance sheet date have been translated to functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising from translation are included in the consolidated statement of comprehensive income. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to functional currency at foreign exchange rates ruling at the dates the values were determined. Non-monetary assets and items that are measured in terms of “historical cost of a foreign currency” are not retranslated.

Items included in the financial statements of each of the Group’s entities are measured using the currency of the primary economic environment where the entity operates (‘the functional currency’). The consolidated financial statements are presented in Croatian kuna (HRK), which is the Parent Company’s functional and the Group’s presentation currency.

The results and financial position of all Group entities with a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
(ii) income and expenses for each income statement are translated at average exchange rates; and
(iii) all resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations are taken into other comprehensive income. When a foreign operation is sold, exchange differences that were recorded in equity are reclassified from other comprehensive income to the income statement as part of the gain or loss on sale.

1 Significant accounting policies (continued)

Recognition of revenues

Sales revenue represents the value of goods and services supplied to customers during the period, excluding value added taxes, trade discounts and rebates. Revenue is recognized with reference to all significant contractual terms when the product or service has been delivered, when transfer of risk has occurred, when the revenue amount is fixed or determinable, and when collection is reasonably assured. Specific contractual performance and acceptance criteria may impact the timing and amounts of revenue recognized.

The Group uses 3 main contract types with end customers as follows:

- Delivery-type contracts: Contracts for delivery of a product or a combination of products to form a whole or a part of a network as well as delivery of stand-alone products. Medium-size and large delivery type contracts generally include multiple elements. Such elements are normally standardized types of equipment or software as well as services such as network rollout.

  Revenue is recognized when risks and rewards have been transferred to the customer, normally stipulated in the contractual terms of trade. For delivery-type contracts that have multiple elements, revenue is allocated to each element based on relative fair values.

- Construction-type contracts: Contracts where the Group supplies to a customer a complete network, which to a large extent is based upon new technology or includes major components which are specifically designed for the customer.

  Revenues from construction-type contracts are recognized according to the stage of completion, using either the milestone output method or cost incurred method. Long-term construction contracts are assessed on a contract by contract basis and reflected in the consolidated statement of comprehensive income by recording revenue and related costs in line with contract activity.

- Service contracts: Contracts for various services such as: training, consulting, engineering, installation, and multi-year managed services.

  Revenue is generally recognized when the services have been provided. Revenue for fixed price service contracts covering longer periods is recognized pro rata over the contract period.

The majority of the Group's products and services are sold under delivery-type contracts including multiple elements, such as base stations, base station controllers, mobile switching centers, routers, microwave transmission links, various software products and related installation and integration services. Such contract elements generally have individual item prices in agreed price lists per customer.

The profitability of individual contracts is periodically assessed, and provisions for any estimated losses are made immediately when losses are probable.

1 Significant accounting policies (continued

Employee benefits

a) Long-term service benefits

The Group provides employees with jubilee and one-off retirement awards. The obligation and costs of these benefits are determined by using the 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. The 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.

b) Share-based payments

The Group operates an equity-settled, share-based compensation plan allowing the employees to receive shares according to internal policy. The fair value of the employee services received in exchange for the grant of the shares is recognised as an expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the shares. The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares granted. At each balance sheet date, the Parent Company revises its estimates of the number of shares that are expected to become granted. It recognises the impact of the revision of original estimates, if any, in the consolidated statement of comprehensive income, with a corresponding adjustment to equity. When distributed upon vesting date, treasury shares are credited at average purchase cost and recorded against retained earnings.

c) Bonus plans

The Group recognises a liability and an expense for bonuses as a provision where contractually obliged or where there is past practice that has created a constructive obligation.

Provisions

A provision is recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) 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 balance sheet date and adjusted to reflect the current best estimate. The most significant provisions in the consolidated financial statements are provisions for warranty claims, penalty claims and litigation. If the effect is material and if the obligation is expected to be settled in a period of over 12 months, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. A provision for warranties is recognised when the underlying products or services are sold. The provision is based on historical warranty data and a weighting of all possible outcomes against their associated probabilities. The increase in the provision due to passage of time is recognised as interest expense.

Interest income

Interest income is recognised using the effective interest method. When a loan and receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loan and receivables is recognised using the original effective interest rate.

1 Significant accounting policies (continued)

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Management Board that makes strategic decisions.

Borrowings

Borrowings are initially recognized at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated statement of comprehensive income over the period of the borrowings using the effective interest method.

Government grants

Grants from the government are recognised at their fair value where there is reasonable assurance that the grant will be received and the group will comply with all attached conditions.
Government grants relating to costs are deferred and recognised in the statement of comprehensive income over the period necessary to match them with the costs that they are intended to compensate.
Government grants relating to property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to the statement of comprehensive income on a straight-line basis over the expected lives of the related assets and presented within “other income”.

Leases

Leases on terms in which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition, the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that type of asset, although the depreciation period must not exceed the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases, and the leased assets under such contracts are not recognized on the balance sheet. Payments made under operating leases (net of any incentives received from the lessor) are recognized in the consolidated statement of comprehensive income on a straight-line basis over the term of the lease.

Dividend distribution

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

1 Significant accounting policies (continued)

Consolidation and Goodwill

Subsidiaries are all entities (including structured 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 de-consolidated 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 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. Acquisition related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of identifiable acquiree's net assets.

Goodwill is initially measured as excess of the aggregate of the consideration transferred and the fair value of non-controlling interest in the acquiree and acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired. If this is lower than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the consolidated statement of comprehensive income.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

2 Critical accounting estimates and judgements

Accounting estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions 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.

(a) Impairment losses on loans and receivables

The Group reviews its receivables to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in the consolidated statement of comprehensive income, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and receivables before the decrease can be identified with an individual loan or receivable in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a Group, or national or local economic conditions that correlate with parameters relevant to assets in the Group.

2 Critical accounting estimates and judgements (continued)

(b) Derecognition of receivables with off-balance sheet financing

In 2016, the Group entered into several new customer contracts in the foreign market. The contracts include delivery of equipment and sale of services with 15% up-front payment while remaining 85% have deferred payment terms up to 54 months.

The Group financed the sale of equipment through a Supplier credit arrangement. The arrangement includes:

i) matching cash receipts from customer with payments to the bank, ii) assignation of insurance policy to the bank, and iii) ceding future cash receipts from the customer to the bank through special purpose accounts secured by special purpose deposits (Note 12).

By transferring to the bank its contractual right to receive the cash flows, the Group transferred the financial asset to the bank. In terms of de-recognition criteria, the Group analysed transfer of risk and rewards of the receivable, specifically related to credit risk and late payment risk.

The Credit risk is shifted from international customer to the risk from domestic insurance company default which is considered as significant transfer in credit risk. The Group issued guarantees to the financing bank for risk of non-performance by the insurance company which is disclosed in Note 20. The issued guarantee for non-performance of the insurance company is recognized initially at fair value and subsequently at the higher of the unamortized balance of the initial fair value and the best estimate of expenditure required to settle the obligation under the guarantee.

Late payment risk was transferred based on the fact that the special purpose deposit covers the late payment charges and/or history of payments with the customer do not historically evidence late payment risk as substantial to the agreement.

Having transferred the right to cash flows and substantially all the risk and rewards relating to 90% of receivables, management concluded that it was appropriate to de-recognize 90% of the related receivables from the balance sheet. The remaining 10% of the receivables remain on the balance sheet as long term receivables from the customer (Note 12) and a 10% of the related financing liability to the bank is recorded as borrowings (Note 19).

Following de-recognition, the residual difference between interest receivable from the customer and interest payable to the bank represents separate liability recognized at fair value and is disclosed in Note 20.

2 Critical accounting estimates and judgements (continued)

(c) Revenue recognition

The Group recognises revenues upon delivery of goods or service which may not always align with the timing of issuing invoices to customer since their timing is set in the contract. Revenues are recognised upon approved acceptance test by the customer. Consequently, the Group recognises deferred revenue (Note 24) and unbilled revenue (Note 14).

3 Sales revenue

	2016 HRK '000	2015 HRK '000
Sales revenue from products	410,030	304,580
Sales revenue from services	1,181,572	1,059,678
	1,591,602	1,364,258

4 Segment reporting

The Group has determined the operating segments based on the reports reviewed by the Management Board that are used to make strategic decisions. The Management Board assesses the performance of the operating segments based on a measure of adjusted Operating profit. The measurement basis excludes the effects of gains/losses on operating exchange rate differences and administration expenses.

When determining the operating segments, the Group has looked at which market and to what type of customers the Group's products are aimed, and through what distribution channels they are sold, as well as to commonality regarding technology, research and development.

To best reflect the business focus and to facilitate comparability with Ericsson Group, three operating segments are reported:

- Networks include products and solutions for mobile and fixed broadband access, core networks, and transmission.
- Professional Services include managed services, consulting and systems integration, customer support and network rollout services.
- Support Solutions provide enablers and applications for operators.

The Group management does not monitor assets and liabilities by segments and therefore this information is not disclosed.
Revenues determined based on the geographic location of customers are disclosed in this note. The Group’s assets are located in Croatia and Bosnia & Herzegovina.

	2016	**2015**
	HRK ‘000	**HRK ‘000**
Sales revenue in domestic market	268,842	293,513
Sales revenue in Russia, Belarus, Kazakhstan, Georgia, Moldova and Armenia	283,801	58,173
Sales revenue to Ericsson, Note 25 (a)	872,369	821,428
Sales revenue in Bosnia and Herzegovina, Montenegro and Kosovo	149,338	176,685
Other export sales revenue	17,252	14,459
	1,591,602	1,364,258

4 Segment reporting (continued)

	Networks		Professional services		Support solutions		Unallocated		**Total**	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
	HRK '000	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Sales revenue -- net	776,480	613,439	779,259	705,134	35,863	45,685	-	-	1,591,602	1,364,258
Operating profit/(loss)	47,210	33,260	91,888	85,533	1,169	4,489	(26,684)	(31,913)	113,583	91,369
Finance income									5,826	1,761
Finance expense									(582)	(199)
Profit before tax									118,827	92,931
Income tax									(8,083)	(1,582)
Profit for the year									**110,744**	**91,349**

5 Expenses by nature

	2016	**2015**
	HRK '000	**HRK '000**
Changes in contract work in progress (Note 13)	11,353	9,782
Material and external services [(1)]	662,329	508,944
Personnel expenses (Note 6)	753,260	716,765
Depreciation and amortisation (Notes 10,11)	48,734	51,851
Less reclassifications in material and external services:		
(Other income)/other operating expenses	3,822	(18,132)
	1,479,498	1,269,210

[1)] Including audit fee expenses of HRK 597 thousand (2015: HRK 567 thousand).

6 Personnel expenses

	2016	2015
	HRK '000	HRK '000
Net salaries	393,455	371,445
Taxes and contributions	316,954	296,104
Other payroll-related costs	41,589	46,283
Equity-settled transactions (Note 21 (b))	1,262	2,933
	753,260	716,765

Personnel expenses include HRK 118,376 thousand (2015: HRK 108,419 thousand) of defined pension contributions paid or payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries (Gross I).

Other payroll-related costs mainly relate to termination benefits in the amount of HRK 10,562 thousand (2015: HRK 13,411 thousand), and to transportation expenses and vacation accrual cost.

As at 31 December 2016, the total number of employees was 2,949 (2015: 2,789).

7 Finance income and expense

Finance income

	2016	2015
	HRK '000	HRK '000
Interest income (Note 7 (a))	3,346	3,833
Net gains from remeasurement of financial assets at fair value through profit or loss (Note 7 (b))	2,283	99
Amortization of discount	-	69
Net foreign exchange gain/(loss)	197	(2,240)
	5,826	1,761

Finance expense

	2016	2015
	HRK '000	HRK '000
Interest expense	582	199
	582	199

7 Finance income and expense *(continued)*

7 (a)

	2016 HRK ‘000	2015 HRK ‘000
Interest income		
- on loans to customers	1,320	665
- on debt securities	-	210
- on term deposits	95	734
- on other receivables	1,931	2,224
	3,346	3,833

7 (b)

	2016 HRK ’000	2015 HRK ’000
Net gains from remeasurement of financial assets at fair value through profit or loss		
- Equity securities	1,908	34
- Investment in investment funds	346	201
- Debt securities	29	(136)
	2,283	99

8 Income tax expense

Income tax has been calculated on the taxable income at statutory tax rates applicable to profits in the respective countries.
Income tax expense recognised in the consolidated statement of comprehensive income comprises:

	2016 HRK '000	2015 HRK '000
Current income tax expense	(22,333)	(1,582)
Total deferred tax expense	14,250	-
Total income tax expense	(8,083)	(1,582)

Deferred tax from tax losses

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through future taxable profits is probable. The Group did not recognise deferred income tax assets of HRK 337 thousand (2015: HRK 8,450 thousand) in respect of cumulative tax losses amounting to HRK 1,872 thousand (2015: HRK 42,251 thousand) that can be carried forward against future taxable income.

Tax incentives included in the tax returns from 2011 till 2014 were inspected by the Ministry of Science and Education and consequently tax loss adjusted.
A tax loss may be carried forward for five years subsequent to the year in which it was incurred. The availability of tax losses against future periods, subject to review by the Ministry of Finance, is as follows:

	HRK '000
Tax loss for 2012 – expires 31 December 2017	147
Tax loss for 2015 – expires 31 December 2020	65
Tax loss for 2016 – expires 31 December 2021	1,660
	1,872

8 Income tax expense (continued)

Effective tax rate reconciliation

The tax on the profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

	2016 HRK '000	2015 HRK '000
Profit before tax	118,827	92,931
Tax calculated at domestic tax rates applicable to profits in the respective countries	24,080	18,510
Tax effects of:		
Expenses not deductible for tax purposes	7,628	1,913
Recognition of previously unrecognized temporary differences	(14,250)	-
Tax incentives	(856)	(750)
Utilisation of tax losses	(8,519)	(18,091)
Tax charge	8,083	1,582
Effective tax rate	5.3%	1.7%

Ministry of Science and Education has not accepted the requests submitted in 2016 for Research and Development Tax incentives, since the legal basis for the allocation of the previous program for Research and Development Tax incentives, expired on 31 December 2015. The new program of Tax incentives for research and development projects for the period up to the year 2020 has not yet entered into force. As soon as the program is approved, the Ministry of Science and Education plans to notify users.

Tax incentives include only part of additional tax allowances for certain expenditure totalling HRK 856 thousand (2015: HRK 750 thousand) which meets research and development incentives definitions under Croatian tax legislation. The underlying research and development expenditure is included in cost of sales.

The Croatian Income Tax Act is subject to different interpretations and changes in respect of certain expenses which reduce the tax base. The Management Board's interpretation of the law relating to these transactions and activities of the Company may be disputed by the relevant authorities. The Tax Authority may take a different view in interpreting the laws and judgments, and it is possible that those transactions and activities that have not been disputed in the past may be disputed now. The Tax Authority may carry out a tax audit within three years from the year in which the income tax liability for a certain financial period was established.

8 Income tax expense (continued)

Deferred tax from other temporary differences

During 2016, the Group re-evaluated the potential for utilization of certain existing temporary differences for which deferred tax assets had not been previously recognized based on the uncertainty of their utilization. In view of the changed circumstances, the Group recognized deferred tax assets in the amount of HRK 14,250 thousand relating to temporary differences arising from:

- Accrued interest expenses;
- Impairment of receivables;
- Accrued expenses from contracts;
- Warranty provisions and
- Provisions for jubilee awards and retirement.

	Impairments, provisions and accrued expenses HRK '000
As at 31 December 2015	**-**
Tax credited to the Income statement	14,250
Tax charged to the Income statement	-
As at 31 December 2016	**14,250**

9 Earnings per share

	2016	**2015**
Profit for the year (HRK '000)	110,744	91,349
Weighted Average Number of Shares Outstanding at the year-end	1,328,809	1,328,811
Earnings per share (HRK)	83,34	68,74

Basic and fully diluted earnings per share are the same since the Parent Company does not have any dilutive potential ordinary shares.

10 Property, plant and equipment

	Land and buildings HRK '000	Plant and equipment HRK '000	Other HRK '000	Total HRK '000
As at 1 January 2015				
Cost or valuation	158,598	349,148	328	508,074
Accumulated depreciation	(112,968)	(259,162)	(229)	(372,359)
Net book amount	**45,630**	**89,986**	**99**	**135,715**
Year ended 31 December 2015				
Opening net book amount	45,630	89,986	99	135,715
Additions	1,769	50,756	-	52,525
Disposals	-	(61)	-	(61)
Depreciation charge	(2,998)	(47,506)	(8)	(50,512)
Closing net book amount	44,401	93,175	91	137,667
As at 31 December 2015				
Cost or valuation	160,367	378,541	328	539,236
Accumulated depreciation	(115,966)	(285,366)	(237)	(401,569)
Net book amount	**44,401**	**93,175**	**91**	**137,667**
Year ended 31 December 2016				
Opening net book amount	44,401	93,175	91	137,667
Additions	1,797	31,259	-	33,056
Disposals	-	(40)	-	(40)
Depreciation charge	(2,955)	(44,823)	(8)	(47,786)
Closing net book amount	**43,243**	**79,571**	**83**	**122,897**
As at 31 December 2016				
Cost or valuation	162,164	389,183	328	551,675
Accumulated depreciation	(118,921)	(309,612)	(245)	(428,778)
Net book amount	**43,243**	**79,571**	**83**	**122,897**

As at 31 December 2016, the Group had contracts totalling HRK 2,673 thousand (2015: HRK 7,171 thousand) related to future equipment purchases.

Depreciation expense of HRK 45,276 thousand (2015: HRK 47,241 thousand) has been charged in cost of sales, HRK 1,426 thousand (2015: HRK 1,953 thousand) in selling expenses and HRK 1,084 thousand (2015: HRK 1,318 thousand) in administrative expenses.

10 Property, plant and equipment *(continued)*

The Group acts as a lessor under operating leases, mainly in respect of land and buildings. Property leased to others with a carrying value of HRK 12,786 thousand (2015: HRK 14,548 thousand) is included within land and buildings. These assets are depreciated at the same depreciation rates as other buildings. Subsequent renewals are negotiated with the lessee. No contingent rents are charged. Portions of the property which is held for rental could not be sold separately or leased out separately under finance lease. Consequently, the IAS 40 criteria for separate investment property recognition are not met.

Future minimum lease payments under non-cancellable operating leases in the aggregate and for each of the following periods are:

	2016	**2015**
	HRK '000	**HRK '000**
Less than one year	3,271	3,320
Between one and five years	1,635	1,660
	4,906	4,980

11 Intangible assets

The movement on intangible assets in the year ended 31 December 2016 may be analysed as follows:

	Application software HRK '000	Goodwill HRK '000	Total HRK '000
As at 1 January 2015			
Cost or valuation	7,973	4,173	12,146
Accumulated amortization	(6,665)	-	(6,665)
Net book amount	**1,308**	**4,173**	**5,481**
Year ended 31 December 2015			
Opening net book amount	1,308	4,173	5,481
Additions	2,390	-	2,390
Amortization charge	(1,339)	-	(1,339)
Closing net book amount	2,359	4,173	6,532
As at 31 December 2015			
Cost or valuation	10,363	4,173	14,536
Accumulated amortization	(8,004)	-	(8,004)
Net book amount	**2,359**	**4,173**	**6,532**
Year ended 31 December 2016			
Opening net book amount	2,359	4,173	6,532
Additions	1,701	-	1,701
Amortization charge	(948)	-	(948)
Closing net book amount	3,112	4,173	7,285
As at 31 December 2016			
Cost or valuation	12,064	4,173	16,237
Accumulated amortization	(8,952)	-	(8,952)
Net book amount	**3,112**	**4,173**	**7,285**

(a) Application software

Amortisation of HRK 898 thousand (2015: HRK 1,252 thousand) has been charged in cost of sales, HRK 28 thousand (2015: HRK 52 thousand) in selling expenses and HRK 22 thousand (2015: HRK 35 thousand) in administrative expenses.

(b) Goodwill

In September 2014, Group signed business unit transfer agreements by which the Group acquired a business from Hrvatski Telekom d.d. The agreements included transfer of 641 employees, supplier contracts, organisational structure, activities and operational processes. The business comprises of acquired assets and assumed liabilities to employees.

12 Loans and receivables

	2016 HRK '000	2015 HRK '000
Deposits with financial institutions, denominated in foreign currency	28,117	7,316
Non-current receivables from foreign customers, denominated in foreign currency	42,889	4,213
Loans given, Note 2b	10,119	-
Non-current receivables from domestic customers, denominated in HRK	2,922	4,384
Receivables for sold apartments		
- denominated in foreign currency	-	5,178
- denominated in HRK	606	632
Total loans and receivables	84,653	21,723
Impairment allowance on loans and receivables	(3,493)	(2,488)
	81,160	19,235

Deposits with financial institutions in the amount of HRK 23,959 thousands (2015: nil) are used as a collateral for Supplier credit arrangement disclosed in note 2b), with interest rate from 0.75% to 2% and maturing in year 2022.

The rest of the deposits with financial institutions of HRK 4,159 thousand (2015: HRK 7,316 thousand) are placed as guarantee deposits for housing loans provided to the employees with a remaining maturity of over three years.

Loans and receivables from customers are partially secured with bank guarantees and letters of credit. The current portion of the non-current receivables is classified under current assets.

Non-current portion of foreign and domestic loans and receivables from customers:

Due	2016 HRK '000	2015 HRK '000
2017	-	1,200
2018	33,661	5,003
2019	9,214	2,394
2020	8,017	-
2021	5,038	-
	55,930	8,597

Receivables for sold apartments are shown net of amounts due from the Croatian state, which was collected in 2016. Housing loans to employees are linked to the counter value of euro, repayments are made by deduction from monthly salary and the loans are secured with collateral on the house or apartment. Receivables for sold apartments and housing loans provided to a limited number of employees bear fixed interest rates of up to 5% per annum.

13 Inventories

	2016 HRK '000	2015 HRK '000
Raw materials	466	539
Contract work in progress	9,788	21,141
Total inventories	10,254	21,680
Impairment allowance	(458)	(493)
	9,796	21,187

Slow-moving or obsolete inventories have been written down to their estimated realisable value through an impairment allowance. The impairment allowance is included within other operating expenses in the consolidated statement of comprehensive income.

14 Trade receivables

	2016 HRK '000	2015 HRK '000
Foreign trade receivables	102,847	52,114
Current portion of non-current foreign receivables	18,452	4,750
Total current foreign receivables	121,299	56,864
Domestic trade receivables	64,088	77,596
Current portion of non-current domestic receivables	-	-
Total current domestic receivables	64,088	77,596
Impairment allowance on receivables	(10,435)	(2,660)
	174,952	131,800

Included in trade receivables is HRK 7,841 thousand (2015: HRK 9,526 thousand) of unbilled revenue.

Movements in impairment allowance on loans and receivables were as follows:

	2016 HRK '000	2015 HRK '000
As at 1 January	7,477	10,053
Provision for receivables impaired during the year	21,571	5,438
Impact of discounting non current receivables	3,135	-
Receivables written off during the year as uncollectible	(11,112)	(5,129)
Unused amounts reversed	(4,901)	(2,816)
Amortisation of discount	(657)	(69)
As at 31 December (1)	15,513	7,477

1) Including impairment provision for receivables from related parties of HRK 1,585 thousand (2015: HRK 2,330 thousand)

15 Other receivables

	2016 HRK ‘000	2015 HRK ‘000
Receivables from employees	944	1,172
Accrued interest receivable	103	248
Advances given	11,976	-
Other receivables	1,302	1,976
	14,325	3,396

16 Financial assets at fair value through profit or loss

	2016 HRK ‘000	2015 HRK ‘000
Financial assets at fair value through profit or loss		
- Equity securities	1,951	251
- Investment in open-ended investment funds	61,042	53,666
	62,993	53,917

17 Cash and cash equivalents

	2016 HRK ‘000	2015 HRK ‘000
Cash and demand deposits	224,725	118,669
Term deposits originated by the Group, with original maturity up to 3 months	-	114,526
	224,725	233,195

18 Equity

(a) Share capital

As at 31 December 2016, the share capital is represented by 1,331,650 (2015: 1,331,650) of authorised, issued and fully paid ordinary shares, with a total registered value of HRK 133,165 thousand (2015: HRK 133,165 thousand). The nominal value of one share is HRK 100 (2015: HRK 100). The holders of the ordinary shares are entitled to receive dividends as declared at the General Assembly and are entitled to one vote per share at the General Assembly.

The shareholders as at 31 December are:

	2016	2016	2015	2015
	Number of shares	**% held**	**Number of shares**	**% held**
Telefonaktiebolaget LM Ericsson	653,473	49,07	653,473	49,07
Small shareholders	676,682	50,82	674,795	50,68
Treasury shares	1,495	0,11	3,382	0,25
	1,331,650	100,00	1,331,650	100,00

(b) Treasury shares

These shares are initially held as “treasury shares” and are regularly granted to key management and other employees as a part of the share-based program established during 2004, as described in Note 21 (b). During 2016, the Parent Company acquired 1,000 (2015: 4,022) of its own shares, for a total amount of HRK 1,140 thousand (2015: HRK 4,062 thousand), paid from the 2008 net income as decided by the General Assembly held on 26 May 2009.

Movements in treasury shares are as follows:

	2016 Number of shares	2015 Number of shares
As at 1 January (Note 18 (a))	3,382	3,080
Purchased during the year	1,000	4,022
Distributed during the year	(2,887)	(3,720)
As at 31 December (Note 18 (a))	1,495	3,382

(c) Legal reserves

A legal reserve in the amount of 5% of total share capital was formed during previous periods by appropriation of 5% of net profit per annum up to a cap of 5% of share capital. The legal reserve may be used to cover losses if the losses are not covered by current net profit or if other reserves are not available. The Group recorded the required level of legal reserves in 2000 and no further allocation to legal reserves is required. Legal reserves up to 5% of total share capital are not distributable.

18 Equity (continued)

(d) Proposed dividend

Dividends payable are not accounted for until they have been ratified at the General Assembly of shareholders. On 31 May 2016, the General Assembly approved a regular dividend in respect of 2015 of HRK 20.00 per share, and additional extraordinary dividend of HRK 80.00 per share, totalling HRK 132,846 thousand.

Cash dividends authorised and paid for previous years were as follows:

	2016 HRK '000	2015 HRK '000
HRK 100.00 per share for 2015	132,846	-
HRK 90.00 per share for 2014	-	119,593
Prior year dividend pay out	-	122
	132,846	119,715

19 Interest bearing borrowings

	2016 HRK '000	2015 HRK '000
Borrowings, Note 2b)	8,954	-
Other long-term loans	8	-
	8,962	-

20 Other non-current liabilities

	2016 HRK '000	2015 HRK '000
Accounts payable	2,400	3,600
NPV discount	(358)	(513)
Total accounts payable /i/	2,042	3,087
Deferred revenue /i/	14,341	9,258
Liabilities for issued guarantee, Note 2b)	782	-
Other non-current liabilities, Note 2b)	7,123	-
	24,288	12,345

/i/ The non-current portion of deferred revenue of HRK 14,341 thousand (2015: HRK 9,258 thousand) from Ericsson Services d.o.o. (ESK) relates to the five-year managed services contract with Hrvatski Telekom.

21 Employee benefits

(a) Long-term service benefits

The Group does not operate any pension schemes or other retirement benefit schemes for the benefit of any of its employees or management. In respect of all of the personnel, such social payments as required by the authorities are paid. These contributions form the basis of social benefits payable out of the Croatian Pension Insurance Institute to the Croatian employees upon their retirement. Additionally, during 2001 the Parent Company signed an Annex to the Union Agreement based on which employees are entitled to a benefit upon early retirement.

However, the Group pays a one-time benefit amounting to HRK 8,000 for each employee who retires. Additionally, the Group pays jubilee awards in respect of each 5 years of service, of an employee, starting from the 10^{th} year and ending in the 40^{th} year. The principal actuarial assumptions used to determine retirement and jubilee obligations as at 31 December 2016 were a 6% discount rate (2015: 6%) and a 4.17% (2015: 3.97%) rate of average employment turnover.

Movements in long-term service benefits were as follows:

	2016 Jubilee awards	2016 Retirement	2016 Total	2015 Jubilee awards	2015 Retirement	2015 Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
As at 1 January	7,308	1,752	9,060	4,945	678	5,623
Obligation created during the year	933	338	1,271	4,061	1,171	5,232
Obligation fulfilled during the year	(917)	(33)	(950)	(1,188)	(40)	(1,228)
Obligation reversed during the year	(253)	(568)	(821)	(510)	(57)	(567)
As at 31 December	7,071	1,489	8,560	7,308	1,752	9,060

(b) Share-based payments

During 2004, the Parent Company established its Loyalty program, a share-based scheme under which management and other employees are entitled to receive the shares conditional on the employee completing certain years of service (the vesting period) from the grant date.

In addition, the Parent Company also grants treasury shares to senior management and other employees as a bonus arrangement under its Award program.

The treasury shares are distributed to eligible employees upon ratification at the General Assembly.

Part of share based programme from 2014 relate to the right of employee to purchase certain shares, which are settled according to fair value relevant at the date of the purchase. Based on this programme, the Parent Company sold to its employees 841 shares (2015: 1,605) and received compensation in the amount of HRK 980 thousands (2015: HRK 1,852 thousand). The difference between the purchase price of the shares and selling price received from the employee in the amount of HRK 123 thousand (2015: HRK 398 thousand) has been recognised within retained earnings.

21 Employee benefits (continued)

(b) Share-based payments (continued)

Movements in shares under the Award and Loyalty programs are as follows:

	2016 Number of shares	**2015 Number of shares**
As at 1 January	4,557	9,016
Granted	-	-
Exercised	(2,887)	(4,320)
Expired	(373)	(139)
As at 31 December	1,297	4,557

Vesting conditions for shares granted under Loyalty program are two to five years of service.

The fair value of service received in return for shares granted is measured by reference to the observable market price of shares at the grant date.

	Number of granted shares	**Weighted average fair value per share at grant date**
		HRK
Reversal in 2015 of shares granted in 2011-2013	139	1,373,20
Reversal in 2016 of shares granted in 2011-2013	373	1,373,20

During 2016, the Group recognised HRK 1,262 thousand (2015: HRK 2,933 thousand) of expenses in respect of share-based payments, which are included in personnel expenses as disclosed in Note 6.

22 Trade and other payables

	2016 HRK '000	**2015 HRK '000**
Trade payables	33,707	33,048
Liabilities to employees	92,982	95,707
Other current liabilities	29,724	35,722
	156,413	164,477

23 Provisions

Movements in provisions were as follows:

	Warranty reserve	Penalty reserve	Termination benefits	Other reserve	Total
	HRK '000	HRK '000	HRK'000	HRK'000	HRK '000
As at 1 January 2015	4,789	4,632	1,652	-	11,073
Additional provisions	2,082	519	11,091	-	13,692
Unused provisions reversed	(229)	(2,903)	-	-	(3,132)
Provisions used during the year	(1,214)	(463)	(9,953)	-	(11,630)
As at 31 December 2015	**5,428**	**1,785**	**2,790**	-	**10,003**
As at 1 January 2016	5,428	1,785	2,790	-	10,003
Additional provisions	8,568	-	10,471	497	19,536
Unused provisions reversed	(129)	(408)	-	-	(537)
Provisions used during the year	(2,322)	(902)	(9,767)	-	(12,991)
As at 31 December 2016	**11,545**	**475**	**3,494**	**497**	**16,011**

The warranty reserve is established to cover the expected warranty claims on products sold during the year. The penalty reserve is created to cover the expected claims from customers in respect of delays in deliveries of products and services having occurred during the year. Reversal of warranty reserves relates to expired warranties and reversal of penalty reserve relates to waived or expired obligations.

24 Accrued charges and deferred revenue

	2016	2015
	HRK ‘000	HRK ‘000
Advances from domestic customers	96	3,995
Advances from foreign customers	19,780	12,808
Deferred revenue	104,905	87,928
Accrued charges for unused holidays	21,933	25,069
Accrued charges in respect of service contracts	31,337	21,315
Other accrued charges	34,086	28,819
	212,137	179,934

Deferred revenue represents amounts due to customers under contracts for work not performed but invoices issued or cash received and thus present a liability to perform a service or delivery.
Accrued charges in respect of service contracts mainly represent costs incurred for which no invoice has been received from supplier or other external contractor at the balance sheet date.

25 Balances and transactions with related parties

For the purposes of these consolidated financial statements, parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence over the other party in making financial and operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The Group is a related party to the Ericsson Group via the 49.07% (2015: 49.07%) shareholding by Telefonaktiebolaget LM Ericsson, which is also the ultimate parent of the Ericsson Group.

The Group has related-party relationships with Telefonaktiebolaget LM Ericsson, Ericsson Group subsidiaries and associates, the Supervisory Board, the Management Board and other executive management.

(a) Key transactions with the related parties

Major transactions with the Ericsson Group companies may be summarised as follows:

	Telefonaktiebolaget LM Ericsson		Other Ericsson Group consolidated companies		Total	
	2016 HRK ‘000	2015 HRK ‘000	2016 HRK ’000	2015 HRK ’000	2016 HRK ’000	2015 HRK ’000
Sales of goods and services						
Sales revenue	-	-	872,369	821,428	872,369	821,428
Other income	-	-	22,526	47,099	22,526	47,099
	-	-	894,895	868,527	894,895	868,527
Purchases of goods and services						
Licences	3,523	2,688	20,890	15,687	24,413	18,375
Technical cooperation fee	-	-	-	-	-	-
Cost of sales	-	-	372,459	234,932	372,459	234,932
	3,523	2,688	393,349	250,619	396,872	253,307

The sales of goods and services transactions have been directly negotiated between the involved parties and agreed on an individual basis. The Group pays licence fees on sales of wireline products, sales of services, corporate trade mark licences and technical cooperation fees. The licence fee is paid as a percentage of sales of wireline products and solutions, and sales of services, per product sold.

25 Balances and transactions with related parties *(continued)*

(b) Key management compensation

The key management include the executive management listed on page 2, comprising the Management Board member and directors of the main organisational units.

	2016 HRK '000	2015 HRK '000
Salaries and other short-term employee benefits	22,619	22,222
Other long-term benefits	17	4
	22,636	22,226

The members of the executive management and the Supervisory Board held 4,627 ordinary shares at the year-end (2015: 4,540 shares).
In addition, the Group paid remuneration totalling HRK 357 thousand (2015: HRK 337 thousand) to the Supervisory Board during 2016.

(c) Year-end balances arising from sales and purchases of goods and services

Year-end balances arising from key transactions with Ericsson Group companies may be summarised as follows:

	Receivable		Payable	
	2016 HRK '000	2015 HRK '000	2016 HRK '000	2015 HRK '000
Main shareholder				
Telefonaktiebolaget LM Ericsson (LME)	-	-	1,699	-
Ericsson Group consolidated companies				
Ericsson AB (EAB)	35,648	54,430	67,106	33,520
Ericsson Services d.o.o. (ESK)	23,934	34,158	10	-
Ericsson GMBH Group (EDD)	7,648	2,439	990	1,302
Ericsson Ltd. Madrid, Spain (ETL)	2,805	4,429	-	-
Ericsson AG, Switzerland (EAS)	2,123	394	-	-
Ericsson Communications Co. Ltd., China (CBC)	2,015	173	182	165
Ericsson Inc, USA (EUS)	1,869	834	154	-
Ericsson Telecom S.S.De C.V.(TEM)	1,433	997	-	-
Ericsson AB (ESE)	1,225	1,362	-	-
Ericsson Telecomunicazioni SPA, Italy (TEI)	1,175	474	52	-
Other Ericsson Group companies	8,983	14,259	3,022	5,100
	88,858	113,949	73,215	40,087

The Group recorded a non-current receivable (Note 12) of HRK 2,042 thousand (2015: HRK 3,086 thousand) and a non-current portion of deferred revenue of HRK 14,341 thousand (2015: HRK 9,258 thousand) and current portion of deferred revenue of HRK 1,700 thousand (2015: HRK 3,380 thousand) from Ericsson Services d.o.o. (ESK) relating to the five-year managed services contract with Hrvatski Telekom.

26 Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, interest rate risk, and price risk), credit risk and liquidity risk. Exposure to currency, interest rate and credit risk arises in the normal course of the Group's business. Risk management is carried out by a treasury department and its principal role is to actively manage investment of excess liquidity as well as financial assets and liabilities, and to manage and control financial risk exposures. The Group also has a customer finance function with the main objective to find suitable third-party financing solutions for customers and to minimize recourse to the Group. Risk management policies that relate to financial instruments can be summarised as follows:

(a) Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Group is exposed to US dollars and to the euro, as a substantial proportion of receivables and foreign revenues are denominated in these currencies. Risk management relies on attempts to match, as much as possible, revenues in each currency with the same currency expenditure. The Group may enter into foreign currency forward contracts to hedge economically its exposure to currency risk arising on operating cash flows.

As at 31 December 2016, if the euro and US dollar had weakened/strengthened by 1% (2015: 1%) against the Croatian kuna, with all other variables held constant, the net result after tax for the reporting period would have been HRK 2,730 thousand higher/lower (2015: HRK 1,633 thousand), mainly as a result of foreign exchange losses/gains on translation of cash, cash equivalents, deposits, trade payables, customer receivables and customer financing denominated in euro.

The Group continues to focus on securing natural hedges and active currency management and to minimise impacts from currency moves. The Group's exposure to foreign currencies is shown in the following table.

26 Financial risk management (continued)

(a) Currency risk (continued)

The tables below present the currency analysis and resulting gap.

2016

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	4,159	73,831	-	77,990	3,170	81,160
Trade and other receivables	118,336	72,935	1,876	193,147	86,160	279,307
Financial assets at fair value through profit or loss	-	-	-	-	62,993	62,993
Cash and cash equivalents	124,313	37,844	166	162,323	62,402	224,725
	246,808	**184,610**	**2,042**	**433,460**	**214,725**	**648,185**
Interest-bearing borrowings	-	8,954	-	8,954	8	8,962
Trade and other payables	62,825	18,700	284	81,809	193,766	275,575
	62,825	**27,654**	**284**	**90,763**	**193,774**	**284,537**
Currency gap	**183,983**	**156,956**	**1,757**	**342,696**	**20,951**	**363,648**

2015

	EUR	USD	Other currency	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Loans and receivables	11,151	4,213	-	15,364	3,871	19,235
Trade and other receivables	141,465	8,914	2,171	152,550	97,799	250,349
Financial assets at fair value through profit or loss	-	-	-	-	53,917	53,917
Cash and cash equivalents	157,497	28,116	5,676	191,289	41,906	233,195
	310,113	**41,243**	**7,847**	**359,203**	**197,493**	**556,696**
Interest-bearing borrowings	39	-	-	39	-	39
Trade and other payables	38,865	6,558	115	45,538	171,371	216,909
	38,904	**6,558**	**115**	**45,577**	**171,371**	**216,948**
Currency gap	**271,209**	**34,685**	**7,732**	**313,626**	**26,122**	**339,748**

26 Financial risk management (continued)

(b) Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. As the Group mainly has its customer financing at a fixed interest rate and only a small portion of customer financing is affected by possible changes in market interest rates, the risk of fluctuating market interest rates is considered low. The Group also has deposits in financial institutions at a variable interest rate.

As at 31 December 2016:

- if the effective EUR interest rate on EUR deposits had increased/decreased by 1% (2015: 1%) on an annual level, the net result due to changes in EUR deposits after tax for the reporting period would have been HRK 33 thousand higher/lower (2015: HRK 59 thousand);

- if the effective HRK interest rate on HRK deposits had increased/decreased by 1% (2015: 1%) on an annual level, the net result due to changes in investment funds after tax for the reporting period would have been HRK 488 thousand higher/lower (2015: HRK 429 thousand).

The following table presents the annual average interest rates exposure of financial assets and liabilities.

	2016 Average interest rates	**2015 Average interest rates**
	%	**%**
Loans and receivables	2.60	2.78
Trade and other receivables	-	0.19
Financial assets at fair value through profit or loss	-	-
Cash and cash equivalents	0.21	0.61

26 Financial risk management (continued)

(b) Interest rate risk (continued)

The tables below present the interest rate repricing analysis and resulting gap.

2016

	Non-interest-bearing	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total	Fixed interest
	HRK ‘000	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**
Loans and receivables	48,447	-	1,023	1,812	1,155	4,765	57,202	23,958
Trade and other receivables	279,327	(20)	-	-	-	-	279,307	-
Financial assets at fair value through profit or loss	62,993	-	-	-	-	-	62,993	-
Cash and cash equivalents	-	224,725	-	-	-	-	224,725	-
	390,767	**224,705**	**1,023**	**1,812**	**1,155**	**4,765**	**624,227**	**23,958**
Interest-bearing borrowings	8,962	-	-	-	-	-	8,962	-
Trade and other payables	275,575	-	-	-	-	-	275,575	-
	284,537	**-**	**-**	**-**	**-**	**-**	**284,537**	**-**
Interest rate gap	**106,230**	**224,705**	**1,023**	**1,812**	**1,155**	**4,765**	**339,690**	**29,958**

2015

	Non-interest-bearing	Up to 1 month	1 - 3 months	3 - 12 months	1 - 5 years	Over 5 years	Total	Fixed interest
	HRK ‘000	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**	**HRK ‘000**
Loans and receivables	3,087	-	-	-	8,832	7,316	19,235	-
Trade and other receivables	245,117	-	1,285	2,828	1,119	-	250,349	3,463
Financial assets at fair value through profit or loss	53,917	-	-	-	-	-	53,917	-
Cash and cash equivalents	6,543	112,126	114,526	-	-	-	233,195	68,953
	308,664	**112,126**	**115,811**	**2,828**	**9,951**	**7,316**	**556,696**	**72,416**
Interest-bearing borrowings*	-	-	-	39	-	-	39	-
Trade and other payables	216,909	-	-	-	-	-	216,909	-
	216,909	**-**	**-**	**39**	**-**	**-**	**216,948**	**-**
Interest rate gap	**91,755**	**112,126**	**115,811**	**2,789**	**9,951**	**7,316**	**339,748**	**72,416**

* include interest payable of HRK 7 thousand

26 Financial risk management *(continued)*

(c) Price risk

The Group has insignificant exposure to debt securities price risk due to low investments and all classified on the balance sheet at fair value through profit or loss (investments funds).

(d) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. Significant risk is associated with high level of customer finance receivables.
The internal directives to manage the credit risks have been tightened during 2015 with the implementation of updated credit management framework and implementation of credit evaluation tools to manage credit risks.

Credit Management function within the Group Treasury has been established to further assist the Group in managing its credit risk exposure. New customers are only accepted on satisfactory completion of a detailed credit check of the customer and a review of the related country risk. Outstanding credit arrangements are monitored on a quarterly or annual basis depending on risk category. Impairment losses are calculated by discounting of receivables. Additionally, there is credit concentration risk as the Group has a significant portion of receivables outstanding from a small number of customers. As at 31 December 2016, the five largest customers represent 48% of total net trade receivables (2015: 65%). The Group considers that its maximum exposure to credit risk is reflected in the amount of trade receivables (Notes 12 and 14) and other receivables (Note 15), net of provision for doubtful receivables. Ageing analysis of these receivables is within the maturity analysis table shown further in this note.

Letters of credit are used as a method for securing payments from customers operating in certain markets, in particular in markets with unstable political and/or economic environments. By having banks confirming the letters of credit, the political and commercial credit risk exposures are mitigated.
Prior to the approval of new facilities reported as customer finance, an internal credit risk assessment is conducted in order to assess the credit rating (for political and commercial risk) of each transaction. A reassessment of the credit rating for each customer finance facility is made on a regular basis.

The Group defines customer financing as any credit period longer than 179 days. According to Group's policies and directives, the customer financing needs to be approved by the Supervisory Board. The Group is working closely with Croatian Bank for Reconstruction and Development (HBOR) and partnership banks to secure risk mitigation.
Provisions related to customer finance risk exposures are only made when they are reliably measurable and where, after the financing arrangement has become effective, certain events occur which are expected to have a significant adverse impact on the borrower's ability and/or willingness to service the outstanding debt. These events can be political (normally outside the control of the borrower) or commercial, e.g. the borrower's deteriorating creditworthiness.
Security arrangements for customer finance facilities normally include pledges of equipment and pledges of certain of the borrower's assets. If available, third-party risk coverage may also be arranged. "Third-party risk coverage" means that a financial payment guarantee covering the credit risk has been issued by a bank, an export credit agency or other financial institution. It may also be a credit risk transfer under the so-called "sub-participation arrangement" with a bank, whereby the credit risk and the funding is taken care of by the bank for the part covered by the bank. A credit risk cover from a third party may also be issued by an insurance company.

26 Financial risk management *(continued)*

(d) Credit risk *(continued)*

The following tables provide an ageing detail of current and overdue amounts in respect of all customer loans and receivables as at 31 December 2016.

Table 1

		Payment due date for total customer loans and receivables				
	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	**Total**
2016	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Foreign receivables	2,848	62,407	56,044	43,065	9,943	**174,307**
Domestic receivables	1,761	59,450	2,877	523	-	**64,611**
Receivables from related parties *	8,027	77,588	4,827	2,400	-	**92,842**
	12,636	**199,445**	**63,748**	**45,988**	**9,943**	**331,760**

*include non-current portion of domestic receivables in the amount of HRK 2,400 thousand

2015						
Foreign receivables	1,056	49,625	6,182	-	4,213	**61,076**
Domestic receivables	1,383	64,568	10,064	783	-	**76,798**
Receivables from related parties	10,324	101,448	8,030	3,600	-	**123,402**
	12,763	**215,641**	**24,276**	**4,383**	**4,213**	**261,276**

*include non-current portion of domestic receivables in the amount of HRK 3,600 thousand

Table 2

	Ageing of total due customer loans and receivables				
	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	**Total**
2016	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Foreign receivables	2,656	192	-	-	**2,848**
Domestic receivables	1,677	84	-	-	**1,761**
Receivables from related parties	6,750	1,040	120	117	**8,027**
	11,083	**1,316**	**120**	**117**	**12,636**
2015					
Foreign receivables	881	164	11	-	**1,056**
Domestic receivables	384	115	-	884	**1,383**
Receivables from related parties	7,567	1,839	252	667	**10,325**
	8,832	**2,117**	**263**	**1,552**	**12,764**

26 Financial risk management *(continued)*

(d) Credit risk *(continued)*

Table 3

	Payment due date for total customer loans and receivables (in respect of accounts with any portion falling due)				
	Due balance	Up to 3 months	3 months to 1 year	1 to 3 years	**Total**
2016	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Foreign receivables	2,848	19,357	624	-	**22,829**
Domestic receivables	1,761	13,145	2,007	-	**16,913**
Receivables from related parties	8,027	68,745	4,827	-	**81,599**
	12,636	**101,247**	**7,458**	**-**	**121,341**
2015					
Foreign receivables	1,056	28,475	5,875	-	**35,406**
Domestic receivables	1,383	6,586	-	-	**7,969**
Receivables from related parties	10,324	92,360	1,200	6,830	**110,714**
	12,763	**127,421**	**7,075**	**6,830**	**154,089**

Table 4

	Past due but not impaired customer loans and receivables				
	Up to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	**Total**
2016	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Foreign receivables	2,656	192	-	-	**2,848**
Domestic receivables	1,677	84	-	-	**1,761**
Receivables from related parties	3,635	294	84	-	**4,013**
	7,968	**570**	**84**	**-**	**8,622**
2015					
Foreign receivables	870	174	-	-	**1,044**
Domestic receivables	384	115	-	-	**499**
Receivables from related parties	4,175	924	-	87	**5,186**
	5,429	**1,213**	**-**	**87**	**6,729**

26 Financial risk management *(continued)*

(e) Liquidity risk

Liquidity risk, also referred to as funding risk, is the risk that an enterprise will encounter difficulty in raising funds to meet commitments associated with financial instruments. As the Group has no significant commitments in financial instruments, the risk lies only in its daily operations. The Group has a strong focus on its cash flow with daily updates on actual development and monthly updated forecasts. The Group's maturity profile demonstrates the strong liquidity position of the Group and therefore the risk is considered low. The table below presents the maturity analysis and resulting gap.

The Group has a revolving credit facility with our core banks should an extraordinary liquidity need arise. At 31 December 2016, the facility remained untapped.

2016	**Up to 1 month**	**1 - 3 months**	**3 - 12 months**	**1 - 5 years**	**Over 5 years**	**Total**
	HRK '000	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Loans and receivables	10	5,070	13,853	57,947	4,280	81,160
Trade and other receivables	142,599	43,166	92,758	784	-	279,307
Current financial assets	62,993	-	-	-	-	62,993
Cash and cash equivalents	224,725	-	-	-	-	224,725
	430,327	**48,236**	**106,611**	**58,731**	**4,280**	**648,185**
Interest-bearing borrowings	-	-	-	8,962	-	8,962
Trade and other payables	164,134	83,373	3,780	24,288	-	275,575
	164,134	**83,373**	**3,780**	**33,250**	**-**	**284,537**
Maturity gap	**266,193**	**(35,137)**	**102,831**	**25,481**	**4,280**	**363,648**

2015	**Up to 1 month**	**1 - 3 months**	**3 - 12 months**	**1 - 5 years**	**Over 5 years**	**Total**
	HRK '000	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**	**HRK '000**
Loans and receivables	-	-	-	11,919	7,316	19,235
Trade and other receivables	129,830	97,987	20,624	1,908	-	250,349
Current financial assets	53,917	-	-	-	-	53,917
Cash and cash equivalents	233,195	-	-	-	-	233,195
	416,942	**97,987**	**20,624**	**13,827**	**7,316**	**556,696**
Interest-bearing borrowings	-	-	39	-	-	39
Trade and other payables	184,658	18,262	4,044	9,945	-	216,909
	184,658	**18,262**	**4,083**	**9,945**	**-**	**216,948**
Maturity gap	**232,284**	**79,725**	**16,541**	**3,882**	**7,316**	**339,748**

*include interest payable of HRK 7 thousand

26 Financial risk management *(continued)*

(f) Fair value estimation

Financial assets at fair value through profit and loss are carried at fair value at the balance sheet date. The fair value is estimated by reference to their quoted active market price at the balance sheet date which represents Level 1 input (Note 17).

A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. There are no financial assets derived from level 2 inputs which represent different valuation techniques based on observable market data or from level 3 inputs which represent different valuation techniques based on no observable market data.

The Group's principal financial instruments not carried at fair value are cash and cash equivalents, trade receivables, other receivables, non-current loans and receivables, trade and other payables and interest-bearing borrowings. The fair values of financial instruments together with carrying amounts as shown in the balance sheet are as follows:

	Carrying amount 2016 HRK '000	Fair value 2016 HRK '000	Unrecognised gain/(loss) 2016 HRK '000	Carrying amount 2015 HRK '000	Fair value 2015 HRK '000	Unrecognised gain/(loss) 2015 HRK '000
Loans and receivables	81,160	82,617	1,457	19,235	18,290	(945)
Trade and other receivables	279,307	279,275	(32)	250,348	250,257	(91)
Financial assets at fair value through profit or loss	62,993	62,993	-	53,917	53,917	-
Cash and cash equivalents	224,725	224,725	-	233,195	233,195	-
Interest-bearing borrowings	(8,962)	(8,962)	-	(32)	(39)	(7)
Trade and other payables	(275,575)	(275,575)	-	(216,909)	(216,909)	-
	363,648	365,073	1,425	339,754	338,711	(1,043)

The fair value of loans and receivables and the fair value of interest-bearing borrowings are calculated based on the Management's best estimate of discounted expected future principal and interest cash flows, using the market-related rate for a similar instrument at the balance sheet date as a discount rate. Fair values and carrying amounts are not significantly different as the loans and receivables were granted at market rates, which were not substantially different from market rates at the end of the reporting year. Current financial assets are stated at fair value that is based on quoted prices at the balance sheet date without any deduction for transaction costs.

The carrying amount of cash and cash equivalents and of bank deposits reflects fair value due to the short-term maturity of these financial instruments. Similarly, the amortised cost carrying amounts of trade receivables and payables with remaining life of less than one year and which are all subject to normal trade credit terms reflect fair values. The following interest rates were used for determining fair values, which are based on available market rates for similar financial instruments:

	2016	2015
Loans and receivables	1.40%	1.50%

26 Financial risk management (continued)

(g) Capital management

The Group’s objectives when managing capital are:

- To safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders;
- To provide adequate requirements for capital resources, as far as possible, by the retention of profit;
- To maintain a prudent balance sheet with adequate component of cash and short-term assets, as well as equity and other investments; and
- To secure adequate back-up funding facilities should a need arise.

The Group is generating sufficient cash from operations to fund liabilities as they become due, finance customers when required and budgeted investments, and pay dividends.

The Group monitors capital using the statutory minimum capital requirement. Shareholders’ equity is disclosed in Note 18 to the consolidated financial statements