



REPUBLIC OF CROATIA
CROATIAN POST AND ELECTRONIC
COMMUNICATIONS AGENCY

**INSTRUCTIONS ON ACCOUNTING
SEPARATION AND COST ACCOUNTING**

November 2008

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1 Glossary of Terms

Agency – Croatian Post and Electronic Communications Agency

Activity Based Costing (ABC) – a methodology identifying services and products as a sequence of activities, where each uses the organization's resources, thus generating costs. This methodology, based on cost drivers, tracks and allocates costs on the basis of implemented activities and determines clear causal connections between activities, costs and accompanying services that result from them.

Current Cost Accounting (CCA) - a valuation method whereby all accounting costs are valued at their current or current market prices.

CCA/LRIC model – a cost model, whose cost basis is based on current cost accounting and on long run incremental costs as accounting method.

Capital Asset Pricing Model (CAMP) – an approach to setting the price of share capital relating capital value with the accompanying risk which investors must take. CAMP is based on the theory of portfolio, according to which investors are unwilling to take a risk, thus searching for a way to reduce taking the risks concerning separate business activities by creating well-diversified portfolios. Significant implication of having a diversified portfolio is the fact that the risk of a single share may be divided into two components: specific or diversifiable risk, and market or non-diversifiable risk. According to the CAMP approach, the necessary return on investment depends solely on market risk.

Fully Allocated Costs (FAC) - an accounting method whereby all costs created during the provision of products and services are allocated to each of the products and services. Total costs made in providing various services are allocated to these services in the exact ratio of their use.

Gross Replacement Cost (GRC) - the value of new assets, or a part of the telecommunications network which can provide the same level of functionality and capacity as the existing assets, or a part of the telecommunications network, taking into account the changes in technology and the moment of purchasing the equipment.

Historical Cost Accounting (HCA) – a method of cost accounting based on the book cost value, and historical costs.

HCA/FAC model – a cost model, whose cost basis is based on historical cost accounting and which is based on fully allocated costs as an accounting method.

Long Run Incremental Costs (LRIC) – an accounting method of calculation of increment introduction cost, whereby increment may be defined as a product or service, a group of products or services or a production unit. In LRIC method total costs are directly or indirectly allocated to products or services by using cost curves.

Modern Equivalent Asset (MEA) – assets with similar characteristics and technical parameters, as well as similar or larger capacity and possibility than the assets that modern equivalent asset shall replace.

Equal proportionate mark-ups method (EPMU) – a method by which common costs are allocated to services or products proportionally to the incremental costs which have already been allocated to these services or products. This means that for each service a percentage share

in total incremental costs has been calculated, and common costs are allocated to this service in the same percentage.

Indexation – a method by which the value of assets is estimated by using annual price index. Where possible, the incurred price indices shall be asset specific. In case the information on the asset specific index is not available, a more general index is used as a proxy.

Absolute valuation – a method by which current cost of each asset unit is defined, based on regulations and decisions specified in Chapter 5.1 of this Document.

Top-down approach model – this cost model takes as its initial point real costs of the operator registered in accountancy notes or other data bases (General ledger, Fixed Assets register, stale debt book, inventory and management system etc.) as well as real topology and architecture of the telecommunications network.

Net book value/ gross book value (NBV/GBV) method - a method to calculate the net replacement cost by multiplying the gross replacement cost by the ratio of net book value to gross book value

Financial Capital Maintenance – a concept which takes into account the financial capital maintenance of a company and its ability to continue financing its activities. According to this approach, the capital is maintained when the real value of shareholders' capital at the end of the accounting period is at the same level as at the beginning of the period. In accordance with this concept, the profit is realised only when sufficient reservation is made to maintain equal level of purchasing power of initial financial capital.

Historical costs – costs incurred in a previous period, registered in the business accountancy system.

RIO - Reference interconnection offer

RUO - Reference unbundling offer

HT - HT-Hrvatske telekomunikacije d.d.

So called geographic "scorched node" approach – a method to optimize the telecommunications equipment consisting of network topology set up in such a way that changing the location of existing network nodes is not allowed.

Rolling forward methodology – a methodology of calculating the net asset value as the gross asset value less current cost accumulated depreciation

Common Costs - costs that cannot be directly allocated to network components and which are common to one or more activities. costs can therefore only be eliminated by stopping all of the activities to which the costs are common.

Joint Costs - costs, which occur during production of one or more products in fixed proportions irrespective of volume.

WACC - *Weighted average cost of capital*

2 General principles for regulatory accounting

2.1 Regulatory Accounting Principles

(1) Regulatory accounting principles refer to the principles to be applied by HT while implementing the accounting separation and cost accounting obligation. The specified principles shall be implemented in the process of preparation, audit and publication of regulatory financial reports, and keeping accounting records.

(2) Regulatory accounting principles are:

a) Priority

If there is conflict between the requirements of any or all of these principles, the Principles are to be applied in the same order of priority in which they appear in this document.

b) Cost causality

Revenue (including appropriate transfer charges), costs (including appropriate transfer charges), assets and liabilities shall be attributed to network components, wholesale and retail products and services in accordance with the activities which cause the revenues to be earned or costs to be incurred or the assets to be acquired or liabilities to be incurred.

c) Objectivity and Non-discrimination

The allocation of revenue and costs shall be objective and not intended to benefit any product, service, network component or total business of the operator.

d) Consistency of applying regulatory accounting principles

There shall be consistency of applying regulatory accountancy principles from year to year. Where there are changes to the regulatory accounting principles, including allocation methods, transfer charges or general accounting policies that have a material effect on the information reported in the Regulatory Financial Statements, HT is obliged to adjust the parts of the previous year's Regulatory Financial Statement affected by the changes. The change is deemed to have material effect on the regulatory financial statement when certain items in the Regulatory Financial Statement changes by more than 5% compared to the previous value.

e) Application of International Financial Reporting Standards

Unless expressly defined otherwise, International Financial Reporting Standards shall be applied.

f) Transparency

Allocation methods used should be transparent. Costs and revenues, which

are directly allocated to markets, segments and services shall be separately distinguished from those which are apportioned on the basis of cost causality. Methodological and process documentation must be complete and comprehensive.

2.2 Process of preparation, audit and publication of regulatory financial statements

- (3) In accordance with regulatory accounting principles, HT is obligated to prepare regulatory financial statements which shall be audited, and subsequently published in the scope defined by this document in Article 2.2.8. Graph of the timeline of the process of preparation, audit and publication of financial statements is enclosed to this Document in Appendix 1.1.

2.2.1 Draft of regulatory financial statements for the financial year ending on 31 December 2008 drawn up on the basis of HCA/FAC model

- (4) HT shall prepare drafts of the Accounting Document (hereinafter: AD) and the Allocation Methodology Document (hereinafter: AMD) to be used for regulatory reporting purposes. The specified document drafts, together with the HCA/FAC cost accounting Implementation Plan shall be submitted to the Agency for revision by 31 January 2009 by HT. The contents of the Accounting Document and the Allocation Methodology Document are specified in Article 2.2.7 of this Document
- (5) The Agency shall prepare and enclose its comments to the submitted draft documents by 28 February 2009. These must be implemented by HT and submit to the Agency by 31 March 2009 at the latest. In case all the required changes are implemented, the Agency shall issue consent to AD and AMD by 30 April 2009 at the latest.
- (6) From 31 January to 31 March 2009, HT shall take part in numerous Agency workshops to harmonise AD and AMD documents and regulatory financial statements with the legal requirements.
- (7) Draft regulatory financial statements and reports on unit costs for the financial year ending on 31 December 2008 shall be submitted to the Agency by 30 September 2009. The Agency may require additional information from HT regarding accounting separation and cost accounting even after the specified date.
- (8) The Agency shall have quarterly meetings with HT to follow the process of implementation of the HCA/FAC model, and semi-annual meetings during which HT shall report on the progress of the implementation of the HCA/FAC model. The monitoring of the implementation process shall comprise supervision of HT activities pursuant to the Implementation Plan. HT shall submit the Draft Implementation Plan to the Agency by 31 January 2009, and the final version shall be defined in cooperation with the Agency

2.2.2 Regulatory Financial Statements for the financial year ending on 31 December 2009 drawn up on the basis of HCA/FAC model

- (9) In case changes to AD and AMD documents are made, HT is obliged to submit to the Agency a report with the details of the changes to AD and AMD documents and a report on the effects of the changes to AD and AMD documents on regulatory financial statements, with a detailed presentation of the subject changes. HT shall submit the specified reports to the Agency by 31 January 2010. The Agency shall issue its approval of the reports by 28 February 2010, if the changes are acceptable.
- (10) Revised financial statements and reports on unit costs for the financial year ending on 31 December 2009 shall be submitted to the Agency by 30 June 2010. The Agency may require additional information from HT regarding accounting separation and cost accounting after the specified date.
- (11) HT shall publish the revised regulatory financial statements by 31 July 2010.
- (12) The Agency shall hold quarterly meetings with HT to follow the process of implementation of the HCA/FAC model, and semi-annual meetings during which HT shall report on the progress of the implementation of the HCA/FAC model. The monitoring of the implementation process shall comprise supervision of HT activities pursuant to the Implementation Plan, defined in item 8 of Article 2.2.1 of this Document.

2.2.3 Regulatory Financial Statements for the financial year ending on 31 December 2010 drawn up on the basis of the CCA/LRIC method for the purpose of calculating service unit costs, as well as CCA/FAC method for the purpose of accounting separation

- (13) HT shall draw up the draft AD and AMD and submit them to the Agency together with the LRIC/CCA cost accounting Implementation Plan by 30 May 2009, pursuant to item 20 of this Article.
- (14) The Agency shall prepare and enclose its comments to the submitted draft documents by 30 June 2009. HT must implement the required changes and submit the final version of AD and AMD to the Agency by 31 July 2009 at the latest. In case all the required changes are implemented, the Agency shall issue consent to AD and AMD by 30 August 2009.
- (15) In case changes to AD and AMD documents are made, HT is obligated to submit to the Agency a separate report with the details of the changes to AD and AMD documents and a report on the effects of the changes to AD and AMD documents on regulatory financial statements, with a detailed presentation of the subject changes. The report on the effects of changes does not have to contain the changes referring to the change of the HCA method into the CCA method. HT shall submit the specified reports to the Agency by 31 January 2011. The Agency shall issue its approval of the reports by 28 February 2010, if the changes are acceptable

- (16) HT shall finish the CCA/LRIC model by 28 February 2011 and submit the model documents.
- (17) HT shall prepare and submit to the Agency draft regulatory financial statements and reports on unit costs for the financial year ending on 31 December 2010 by 31 March 2011.
- (18) The final revised financial statements and reports on unit costs shall be submitted to the Agency by 30 June 2011. The Agency may require additional information from HT regarding accounting separation and cost accounting after the specified date
- (19) HT shall publish the final revised regulatory financial statement by 31 July 2011.
- (20) In the period between 30 September 2009 and 28 February 2011 quarterly meetings shall be held for the Agency to follow the implementation of the CCA/LRIC model, as well as semi-annual meetings with reports on the progress of the CCA/LRIC model implementation. The monitoring of the implementation process shall comprise supervision of HT activities pursuant to the Implementation Plan. HT shall submit to the Agency a Draft Implementation Plan by 30 May 2009 upon which the final version shall be defined in coordination with the Agency.

2.2.4 Regulatory Financial Statements for the years following 2010 drawn up on the basis of the CCA/LRIC model

- (21) In case changes to AD and AMD documents are made, HT is obligated to submit to the Agency the Changes to the Accounting Document (AD) and the Allocation Methodology Document (AMD) and the Effects of AD and AMD changes on regulatory financial statements by 31 January of every year. The Agency shall issue its approval of the documents by 28 February, if the changes are acceptable
- (22) From 31 January to 31 March, HT shall take part in numerous Agency workshops to fully harmonise AD and AMD documents with the legal requirements.
- (23) Audited regulatory statements and reports on unit costs for the previous year are to be submitted to the Agency by 30 June of each year by HT.
- (24) HT shall publish the final and audited regulatory financial statements by 31 July each year.

2.2.5 Regulatory financial statements audit

(25) The following elements must be defined in the process of regulatory audit:

- Scope and time of the audit,
- Certified Auditor mandate and

- Certified Auditor – a qualified body, independent of HT.

Appointment of the auditor

- (26) As it is the main beneficiary of the information obtained by accounting separation, the Agency shall participate in the process of appointing the certified auditor by retaining the right (not) to approve one.
- (27) HT shall notify the Agency on the appointment of the certified auditor and submit the *Cooperation Agreement* with the certified auditor stipulating auditor's obligations and responsibilities towards the Agency, in accordance with the principles of the Croatian Chamber of Auditors, at least 60 days before the commencement of the audit.
- (28) HT shall notify the Agency, at least 60 days before the commencement of the audit, on contracted audit scope, detailed audit plan and resources and the fee.
- (29) In case of change of the certified auditor, HT shall notify the Agency of any proposed change as soon as the Board reaches the decision on the change of the certified auditor. HT shall submit the *Cooperation Agreement* to be signed with the new certified auditor at least 60 days before the commencement of the audit.
- (30) The audit of regulatory financial reports shall be conducted by persons authorized by the Croatian Chamber of Auditors for conducting audits (hereinafter: Certified Auditors).
- (31) Ht shall bear all the costs of the independent regulatory audit.

Changing the Certified Auditor

- (32) If the audit procedure or the audit report have not been performed or have not been drawn up in accordance with the provisions of this document, the Agency may require the audit to be performed by certified auditors of another audit company at HT's expense.

Restrictions to the Certified Auditor

- (33) An audit firm may not conduct or be entrusted by HT with conducting an audit of the regulatory financial statements if in the current year that audit firm or its affiliated companies earn more than a half of their total income from providing services to HT and its affiliated companies in the Republic of Croatia.
- (34) The same audit firm or its affiliated companies may not simultaneously or in the same year conduct an audit of HT regulatory financial statements and provide consulting services to HT or its affiliated companies.

Responsibilities Certified Auditor

- (35) The certified auditor is obliged to give opinions on whether the regulatory financial statements and cost models have been drawn up in accordance with the existing regulations, including the requirements and recommendations presented in this Document, and contained in all relevant European and Croatian legal and professional standards. The draft opinion of the auditor is enclosed to this Document as Appendix 6.10
- (36) While performing a regulatory audit, the certified auditor is obliged to immediately notify the Agency of any fact
- a) which is a serious violation of laws, regulations, or provisions pursuant to which the HT Operating License has been issued,
 - b) which represents a serious fraud or embezzlement, or
 - c) any other facts and circumstances that could endanger further operation of HT.
- (37) Disclosure of any of the outlined facts made by Certified Auditors shall not be considered a violation of regulations and provisions of contract between the Certified Auditor and HT which refer to the restriction of providing information, and the Auditors shall not bear responsibility of any kind that would otherwise arise in such circumstances.

Additional engagement of the Certified Auditor

- (38) The Agency reserves the right to contact Certified Auditors to discuss procedures to be applied in performing the audit or to discuss the auditors' findings. In case of ambiguities, the Agency shall require from HT and/or the certified auditor additional clarifications.
- (39) The Agency reserves the right to require from HT to instruct the Auditors to perform additional work to substantiate the content of regulatory financial statements and to submit to the Agency a report on the performed additional activities. The Agency reserves the right to select directly the certified auditor for the additional audit.

2.2.5.1 *HT obligations in the audit process*

- (40) HT shall submit to the Agency the audited regulatory financial statements (except the statements for 2008) for the previous year by 30 June each year. These statements have to be signed by the Certified Auditor (natural person) responsible for the audit of HT.

2.2.5.2 *Certified Auditor's obligations in the audit process*

- (41) Where necessary, the Certified Auditor may request a meeting with the Agency before the commencement of the audit or during the audit process.

(42) In order to meet the requirement concerning the share of the audit firm total revenue incurred in the previous from HT, the audit firm must submit to HT data on the total revenue incurred in the previous year and revenues incurred by providing services to T-HT Group in the previous year. HT must submit the specified data to the Agency.

2.2.5.3 The role of Agency in the audit process

(43) Upon the delivery of information on the contracted audit scope, detailed audit plan and resources and the fee, the Agency may organise a meeting with the audit firm, or , if necessary, with the audit firm and HT.

(44) During the evaluation of the harmonisation of the audit process and/or the financial reports with this document, or its well-foundedness on real and objective facts, the Agency has the right to ask for additional clarifications from the Certified Auditor.

2.2.6 Requirements for the level of quality and granularity of accounting records

(45) In order to ensure integrity and accuracy and to demonstrate that market related information has been extracted accurately and harmonized with corporate financial information, HT must use the costs obtained on the basis of the total cost base (including data on business segments not referring to the markets where the operator has significant market power).

(46) HT shall adjust its accounting systems in such a way that they may provide information on costs on Historic Cost Accounting basis (HCA)/fully allocated costs basis (FCA) and/or on Current Cost Accounting (CCA)/Long Run Incremental Cost (LRIC) basis and/or Current Cost Accounting (CCA)/ fully allocated costs basis (FCA) basis. Accounting separation obligation also requires that all costs, revenues, assets and liabilities of each service, segment and/or market to which regulatory obligations apply, be identified on the basis of data from accounting systems.

2.2.7 Content of regulatory financial statements, Accounting documents and Allocation methodology documents

(47) The following regulatory information shall be prepared by HT for relevant markets, segments and services, and published in the scope defined in Article 2.2.8 of this Document:

REGULATORY FINANCIAL STATEMENTS	Profit and loss statement
	Mean capital employed statements
	Reconciliation statements
	Report on unit costs

	Statement of responsibility
	Auditors' opinion
	Report on transfer charges
ACCOUNTING DOCUMENTS	Accounting principles
	Revaluation methods
	Cost model description
	Detailed description of weighted average cost of capital (WACC) calculation
ALLOCATION METHODOLOGY DOCUMENT	Description of cost allocation in the cost model
AD HOC REPORTS UPON AGENCY'S REQUESTS	Additional reports requested by the Agency

Regulatory financial statements templates statements are enclosed in Appendices 6.2; 6.3; 6.5; 6.6; 6.7; and 6.10 of this Document. Examples of additional reports which, among others, may be requested by the Agency, can be found in Appendix 6.8 of this Document.

2.2.8 Publication of regulatory financial statements

(48) HT shall publish the following documents:

- the Accounting document and the Allocation methodology document in the form referring to general description, while specific description of the system shall be prepared only for the Agency;
- Regulatory financial statements:
 - Profit and loss statement,
 - Mean capital employed statements,
 - Reconciliation statements,
 - Statement of responsibility,
 - Auditors' opinion.

The published reports shall contain revenue per market segments, following the European practice (5 wholesale and 1 retail market), and costs and mean capital employed only on aggregated level. Financial statements structure shall follow the templates enclosed to this Document in Appendices 0, 6.4, 6.6 and 6.7;

- official auditor's opinion on financial statements of accounting separation to be found in Appendix 6.10 of this Document, and
- the form of each report to be submitted to the Agency to ensure the interested parts that the Agency provides market regulation on the basis of all relevant information.

2.3 Keeping of accounting records, amendments and corrections to regulatory financial statements

2.3.1 Keeping of accounting records

(49) HT shall file all data based on which regulatory financial statements are prepared, for the period of seven years from the last day of the financial year to which certain regulatory financial statement refers to. This will enable the availability of all information for possible later verification or analysis of trends.

2.3.2 Availability of accounting records for ad-hoc reports

(50) The Agency may request Ad-hoc reports from HT to efficiently follow and ensure the implementation of HT obligations referring to cost orientation and price control. The Agency has made a list of additional information, enclosed in Appendix 6.8 of this Document, serving as an example of reports which might be requested by the Agency while monitoring the implementation of HT obligations. The Agency shall enclose an explanation to each request for additional information, as well as a form of the report and the time limit for the report to be submitted to the Agency.

3 Accounting separation principles

- 1) In order to establish one or more cost categories for a given service, HT shall:
 - establish the costs, revenues, assets and liabilities associated with every service;
 - establish the rules which, amongst others, address the manner in which costs associated with shared activities are distributed between provided services (since the majority of activities will be carried out in the course of providing more than one service or services in more than one market); and
 - document the costs and rules by regulatory financial statements and allocation method documents.

3.1 Allocation method

- 2) Regulatory financial statements must give details of the underlying assumptions for cost allocation and explain the relationship between costs and related cost drivers by presenting:
 - Review of all network components and activities included in the provision of interconnection services and transfer services,
 - Operating costs, depreciation and capital employed for the specified network components,
 - Return on capital employed for the specified network components,
 - Utilization degree for each network component, and
 - total costs for significant network components (operating costs + capital costs).

3.1.1 Revenue allocation

- 3) Usually revenues can be directly allocated to the products or services to which they refer, on the basis of accounting records and billing system information. Where direct allocation on the basis of accounting records or billing system data is not possible, revenues should be allocated on the basis of place where they were generated.

3.1.2 Cost allocation

- 4) Costs shall be allocated to services in accordance with the following categories:
 - a) Direct costs: Costs incurred solely for a particular service or product and recorded in the accounts against the relevant product, service, asset or function.
 - b) Directly allocated costs: Costs incurred solely for a particular service or product but not recorded in the accounts against the relevant product, service, asset or function.

- c) Indirectly allocated costs: Costs which are a part of the total common costs but can be allocated to a particular service or product on the basis of a justified reason and clear relationship. Relationships do not have to be unambiguous and the allocation can be performed in several steps on the basis of defined keys.
- d) Unallocated costs: Costs which are a part of the total common costs and cannot be allocated to a particular service, product, asset or function on the basis of a justified reason and clearly demonstrable relationship.

3.1.3 Cost “cascading” or allocation hierarchy

- 5) Costs may be allocated to services or network components, associated functions or other functions. These may be defined as follows:
 - **Services** – This group contains costs that can be directly identified with a particular service. For this purpose, the term “service” refers both to end-user services (e.g. retail fee for line leasing) and network services (e.g. interconnection services).
 - **Network components** – This group contains costs relating to the various parts of transmission, switching and other network elements and systems. The costs are related to network components which cannot be directly connected to a particular service as they are used in the provision of a number of services.
 - **Associated functions** - this group contains costs of retail and wholesale functions necessary for the provision of services to clients or end users, such as billing, maintenance and user service.
 - **“Other” functions** – this group contains costs of functions which are not related to the provision of a particular service, but are an important part of the business. The examples of such costs include planning, administration and finance costs.
- 6) Cost allocation steps are as follows:
 - 1. allocation of so-called “other” functions to associated functions, network components and services,
 - 2. allocation of associated cost functions costs to network components and services,
 - 3. allocation of network components to services, and
 - 4. grouping of services to markets/segments (as defined for the purpose of accounting separation).
- 7) Allocation methods shall be documented in detail and transparent. All aspects of the cost allocation process, including cost driver definitions and calculations, surveys and techniques of data gathering and methods of establishing value, shall be made available to and subject to review by the Agency.

3.2 Profit and loss statement

- 8) HT shall provide the profit and loss statement for each financial year showing data on revenue, costs and return on employed capital for the relevant segments/markets/services. The profit and loss statement shall be based on the cost base and accounting methods pursuant to Chapter 4 of this Document. The profit and loss statement shall contain standard income and expenditure elements as shown in Appendices 6.2 and 6.6 of this Document.

3.3 Mean capital employment statement

- 9) For the purpose of setting the prices, HT shall use mean capital employed to be calculated as the geometric average of the beginning and the end of the financial year. Templates of mean capital employed statements are enclosed to this Document in Appendices 6.4 and 6.7

3.4 Regulatory reconciliation statement

- 10) In order to ensure consistency of accounting books and legal and regulatory financial statements, HT shall ensure adequate controls and reconciliations procedures and hereby:
- (a) enable the certified auditor and the Agency to conclude that, in their opinion, the cost accounting system complies with the Accounting Documents,
 - (b) enable the regulatory financial statements to be audited and
 - (c) enable a reconciliation of regulatory financial statements to legal financial statements of HT.

3.5 Auditor's opinion (audit report)

- 11) The auditor's opinion shall, at least, include:
- the conclusion of the Auditor,
 - all identified irregularities,
 - recommendations made by the Auditor (with a description of the corresponding effects); and
 - a detailed description of the verification methodology followed.
- 12) The statement of compliance and the audit results must be presented in a form easily accessible by interested parties, in printed or electronic form, and published on HT website.

- 13) HT must fairly present financial statements in accordance with the audit report (*Fairly Presents in Accordance*). Auditor's opinion template is enclosed to this Document in Appendix 6.10

3.6 Report on transfer charges

- 14) As a part of the Report on transfer charges, for which the template is enclosed to this Document in Appendix 6.5, HT shall provide the following:
- retail activities where HT has been designated as the operator with significant market power;
 - Measure unit and scope of the stated activities for the relevant accounting period (for example, the total number of minutes, total number of calls etc.);
 - information on network units charging;
 - units and scope of products in order to identify the total network charge total charge for the activity;
 - Accounting Policies; and
 - current cost evaluation methods.

3.7 Minimum requirements for accounting separation

- 15) The Agency requires HT to establish accounting separation for markets, segments and services, as shown in Table in Appendix 6.9 of this Document. HT shall prepare regulatory financial statements as follows:
- at the level of services within retail segments;
 - at the level of services within segment 3 wholesale markets, (wholesale (physical) access to network infrastructure (including full or shared access) at fixed location;
 - at the level of segment for other wholesale segments.
- 16) While preparing separate accounts, the following steps must be taken into account:
- Identifying markets, segments and services to be separated, for the purpose of providing more detailed information, (e.g. an individual profit and loss statement, a statement of capital employed and information on main cost drivers, such as minutes, access lines and/or full time equivalent or labour costs);

- preparing reconciliation statements by HT (to ensure that the expenses have not been covered twice and that the amounts stated in regulatory statements are the same as the amounts in legal financial reports);
 - defining the manner of allocation of average component/activity cost to specific separated regulatory entities and services;
 - documenting guidelines for the calculation of cost base (HCA/CCA and FAC/LRIC).
- 17) HT shall prepare a list of all internal and external wholesale and retail services which match the corresponding markets, segments and services listed in Appendix 6.9 of this Document. Services provided by HT but not listed in this Document should be assigned to the category “Segment X – other”.
- 18) HT shall prepare a detail description of all internal wholesale, external wholesale and retail services, including activities used in the provision of these services, which support the specified list of services. HT shall submit the specified list for the accounting period ending on 31 December 2008 by 31 January 2009, and by 31 January of each following year, together with drafts of the AD and AMD. HT shall update the list in case new services are introduced or existing services discontinued.
- 19) The costs of universal service shall not be presented separately, but in categories “Other” for related segments.

3.8 Transfer fee

- 20) The transfer fee system must be based on the following assumptions:
- There must be a clear logical basis for the transfer fees used and each fee must be justifiable. Fees must be non-discriminating and there must be transparency of transfer fees in the separate accounts.
 - Transfer fees should be determined as the product of provided service volume and unit fees. The fee should be equivalent to the market price in case the product or service were sold on the external market.
 - For accounting separation purposes it should be assumed that HT’ retail segment pays the same fee for the same incoming service (bought on its own wholesale market) as it would if bought by any other operator.
 - There should be consistency of treatment of transfer fees from year to year. Any change should be consistent, transparent and satisfactory to the Agency.
- 21) There are two principles for setting the transfer prices:

Transfer fee based on external prices

The basic assumption for calculating fees for transfer services is that they must be equal to the market price. Therefore, in case when HT provides certain services both internally and on external wholesale markets, the price of these services should be equivalent to the wholesale price for external customers, or the same as prices stated in the Reference interconnection offer (RIO) and Reference unbundling offer (RUO). Consequently, the internal revenue of the wholesale segment shall equal the wholesale price multiplied by the quantity of services provided to the retail segment.

Transfer fee based on unit cost of service

In case when HT provides transfer services only internally, the transfer fees for services would equal the unit cost of service calculated on the basis of the accounting method and the cost base calculated pursuant to Chapter 4.2 of this Document. Therefore, internal revenues from transfer services would equal the transfer fee multiplied by the volume of transactions in a year.

4 HT obligations concerning cost accounting

4.1 *Cost accounting for the purposes of accounting separation*

- (1) HT draft regulatory financial statements for markets, market segments and services listed in Appendix 6.9 of this Document for the financial year ending on 31 December 2008, should be based on HCA cost base and FAC accounting methodology.
- (2) HT audited regulatory statements for all markets, market segments and services listed in Appendix 6.9 of this Document for the financial year ending on 31 December 2009, should be based on CCA cost base and FAC accounting methodology.
- (3) HT audited regulatory statements for all markets, market segments and services listed in Appendix 6.9 of this Document for the financial year ending on 31 December 2010 and for all following years, should be based on CCA cost base and FAC accounting methodology.

4.2 *Cost accounting methods for the purpose of unit cost calculation*

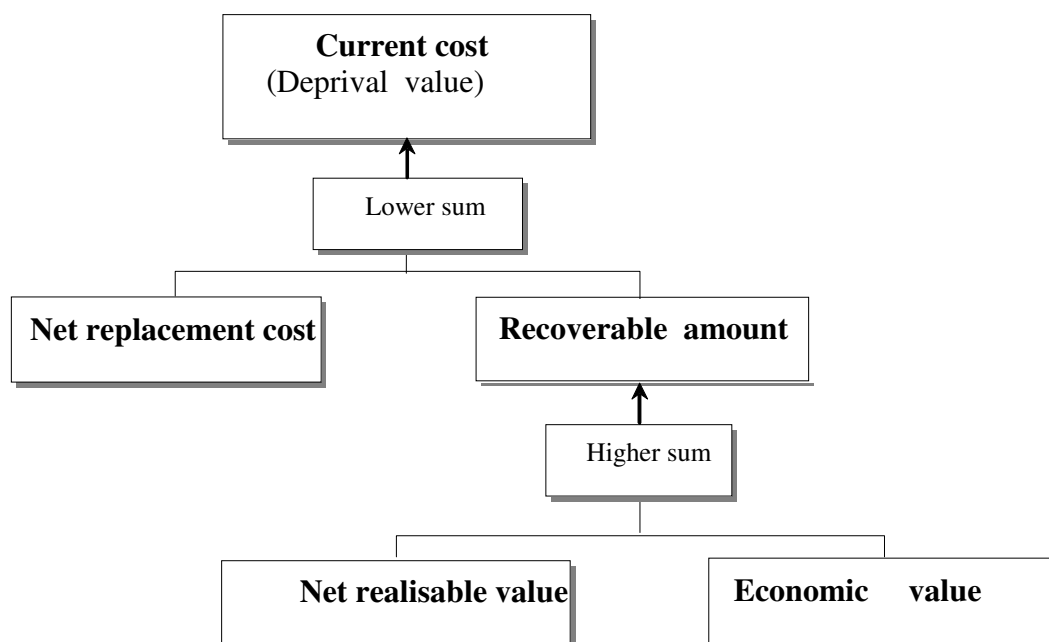
- (4) For the financial year ending on 31 December 2008, HT shall calculate service unit cost on relevant markets and market segments by using HCA cost base and FAC accounting method.
- (5) For the financial year ending on 31 December 2009, HT shall calculate service unit cost on relevant markets and market segments by using HCA cost base and FAC accounting method.
- (6) For the financial year ending on 31 December 2010, and all following financial years, HT shall:
 - a) calculate the unit cost for retail services on relevant markets and market segments by using HCA and CCA cost base, and FAC accounting method, and
 - b) calculate the unit cost for wholesale services on relevant markets and market segments by using CCA cost base and LRIC accounting method.
- (7) The Agency shall subsequently define the list of services on relevant markets and market segments for which HT must calculate unit costs.
- (8) Appendix 6.11 of this Document gives the summary of cost base and accounting method for each relevant market and corresponding market segment, for the financial year ending on 31 December 2010 and every following year.

5 Instructions concerning HT cost accounting system

5.1 Current cost accounting

5.1.1 Basic principles of current cost accounting

- (1) While calculating the current cost of assets, HT is obligated to follow the method shown in the following Figure:



The method of determination of current cost of asset

Where:

- *Net Realisable Value* - the amount, which would be obtained by selling the asset (less sales costs) at current prices,
- *Economic Value* is the net present value of future cash flows that the asset would generate over the unexpired period of use,
- *Net Replacement Cost* is the cost of replacing an existing asset with another asset of similar features and similar age,
- *Recoverable Amount* is the higher amount of the Net Realisable Value and Economic Value, and

- *Deprival Value or current cost of assets* is the amount of loss in case an asset is lost or destroyed. The deprival value is the lower amount of the net replacement cost and recoverable amount.
- (2) When defining the current cost of asset, HT may use only the net replacement cost and disregard the recoverable amount, except in cases of real estate owned by HT, and in case when the net replacement cost is higher than 150% of the asset historical cost.

5.1.2 Gross replacement cost determination instructions

- (3) HT shall apply the following rules when choosing the method of determination of gross replacement cost:
- a) Historical costs may be used when:
 - the assets to be evaluated have low value or short life,
 - the asset is not exposed to significant price changes,
 - there have been no significant technological changes regarding the asset whose value is evaluated, and
 - the effect of asset evaluation per current cost does not reach material levels.
 - b) Indexation method may be used when:
 - there have been no significant technological changes regarding the asset whose value is evaluated,
 - the operator's databases and the fixed assets register provide sufficient accurate information about the asset subject to valuation; and
 - the asset subject to valuation is homogenous in respect of price changes.
 - c) Absolute valuation method shall be used if:
 - the asset subject to valuation is not homogenous in respect of price changes,
 - there have been significant technological changes regarding the asset whose value is evaluated, and
 - the operator's databases and the fixed assets register do not provide sufficient accurate information about the asset subject to valuation.
- (4) HT may apply the indexation method to the following types of assets:
- a) auxiliary systems and reserves managing systems,

- b) office equipment and operating supplies, and
 - c) computer and information equipment.
- (5) Wherever possible, the used price indexes should be specific for each type of asset. In case the information on asset specific index is not available, a more general price index is used as a proxy.
- (6) HT shall use the absolute valuation method for the following types of assets:
- a) ducts and cables,
 - b) real estate,
 - c) switchboard,
 - d) transmission equipment, and
 - e) power supply equipment.

5.1.3 Modern equivalent asset

- (7) Where existing equipment cannot be replaced in the same form (i.e. no direct replacement is available), the replacement cost is derived from the gross replacement cost of modern equivalent assets which are the subject of evaluation. The same goes for assets due to be replaced within a given planned period.
- (8) Since new technologies are usually more efficient and functional than the old ones, the values of modern equivalent assets must reflect the value of assets of equivalent capacity and functionality. Therefore adjustments need to be made to reflect the cost of an asset with the same or similar characteristics.

Adjustments related to modern equivalent assets MEA

- (9) Where the modern equivalent asset differs from the existing asset in terms of operating costs, asset life or type of service provided, this needs to be taken into account when evaluating the asset. These adjustments include:
- a) Operating costs adjustment
- The operating cost of new equipment may be lower than that of the existing equipment. In this case, the cost of the modern equivalent asset shall be reduced by the present value of the additional operating costs incurred during the unexpired life of the current equipment.
- b) Adjustments concerning equipment functionality

New equipment may have higher level of functionality. If so, the cost of the modern equivalent asset shall be reduced taking into account the differences in capacity and/or functionality between the existing assets and its modern equivalent.

c) Adjustments concerning capacity surplus

In case of capacity surplus, i.e. capacity that is not currently used and is not expected to be used in the near future, the estimated value should be lower than the value of equipment in full operating capacity.

- (10) The HT cost accounting system must contain the specification of technologies taken into consideration in defining modern equivalent assets used in asset evaluation.
- (11) The selection of specific modern equivalent assets should be clearly explained and documented, and in case of discrepancies in functionality and capacity between current assets and modern equivalent assets, it is necessary to adjust the cost value with the operating costs, pursuant to item 9 of this Article.

5.1.4 Annual costs of fixed assets

- (12) HT shall calculate annual costs of fixed assets by applying the cost accounting method.
- (13) In accordance with the cost accounting approach, the annual cost of fixed assets is equivalent to the sum of accounting depreciation and the cost of capital (which is the result of multiplying the weighted average cost of capital and net replacement cost).
- (14) To calculate accounting depreciation, HT may use:
- a) the so-called *NBV/GBV* method (net book value/gross book value), and
 - b) the so-called *rolling forward* method.
- (15) The aforementioned methods shall be used consistently. In case of using different methods for the same asset type or class, such doing shall be explained and documented.

5.1.5 Capital maintenance

- (16) HT shall use the financial capital maintenance (FCM) concept as the concept of capital maintenance and the associated adjustments of cost base which should be reimbursed from the revenue in the relevant year.
- (17) With regard to the fact that during the first evaluation of assets by using financial capital maintenance concept in some cases unrealised capital gain or unrealised

capital loss can appear, during the first assets evaluation it is necessary to evaluate assets at the beginning and at the end of the financial year ending on 31 December 2010.

- (18) Considering that the capital cost calculation, whether nominal or real value, has a significant influence on owner's equity, in case the nominal weighted capital cost is used for capital employed, the cost base in cost accounting should not be adjusted for inflation rate.

5.1.6 Other instructions concerning asset valuation

Materiality level for evaluation

- (19) The materiality level in material asset evaluation shall be defined as the higher amount of 0.05% of total value of fixed assets and 0.05% of total revenue from HT regulatory services. Should HT define any other materiality limit, it shall be clearly explained and documented.

Assets under construction

- (20) In case of assets under construction, HT is not allowed to charge depreciation. However, the value of assets under construction may be included in gross value of cost of capital.

Leased equipment

- (21) HT shall include assets under finance lease in its cost base and it shall be depreciated. On the other hand, the financing costs shall not be recorded as operating costs, as they are already included in the cost of capital within the cost base (but the interest part of the financial fee should be included). Any other approach by the operator should be clearly explained, including details on the influence on the cost base.
- (22) Leasing fee for the equipment in operating lease shall be registered as a part of operating costs. The value of such assets shall not be recorded as a part of cost base.

Fully depreciated assets

- (23) The value of fully depreciated assets should not be revalued under current cost accounting since their value has already been recovered through past depreciation. The treatment of these assets should be documented. Any other approach by the operator should be clearly explained and appropriately documented.

5.2 Historical cost accounting

- (24) Under the historical cost accounting method, the gross book value of assets is given by their historical purchase price. Further adjustments of the asset values are not needed.
- (25) Depreciation is charged against an asset's gross book value and the net book value of assets is valued under gross book value less accumulated depreciation.
- (26) The cost base according to the historical cost accounting method is calculated as follows:

$$\text{Cost Base} = \text{Opex} + \text{Depreciation} + \text{WACC} \cdot (\text{NBV}_{\text{AV}} + \text{WC}_{\text{AV}})$$

Where:

Opex = operating costs

Depreciation = depreciation in the reference period (not accumulated depreciation),

NBV_{AV} = Average Net Book Value

WC_{AV} = Average Working Capital

WACC = Weighted Average Cost of Capital.

5.3 Cost allocation principles and procedures

- (27) HT shall adhere to the cost causality principle in cost allocation.
- (28) The principle of causality implies that costs (and revenues) are allocated, directly or indirectly, to the services that "cause" these costs. The principle of cost causality requires operators to:
- a) review and justify the relevance of each item of cost, capital employed and revenue,
 - b) establish and quantify the "driver" that caused each item of cost, capital employed and revenue to arise; and
 - c) use the defined driver to allocate each item of cost, capital employed and revenue to individual report subjects (e.g. business activities, network components or regulatory services)
- (29) Each item of revenue and cost must be allocated to the products and services provided by operators.
- (30) In case it is impossible to allocate the revenues and costs directly to certain report subjects, it is necessary to define specific allocation keys.
- (31) HT shall use the ABC method for allocation of costs on the relevant markets. In case when HT considers any other method more appropriate, such proposal shall be explained and documented.
- (32) The details of the main network components and generally accepted cost drivers in case of fixed telecommunications network, together with the basic non-network activities are shown in Appendix 6.12 to this Document. Should HT want to implement any other cost

driver for some network components from the one shown in Appendix 6.12 to this Document, the explanation to such decision shall be an integral part of the Accounting Documentation.

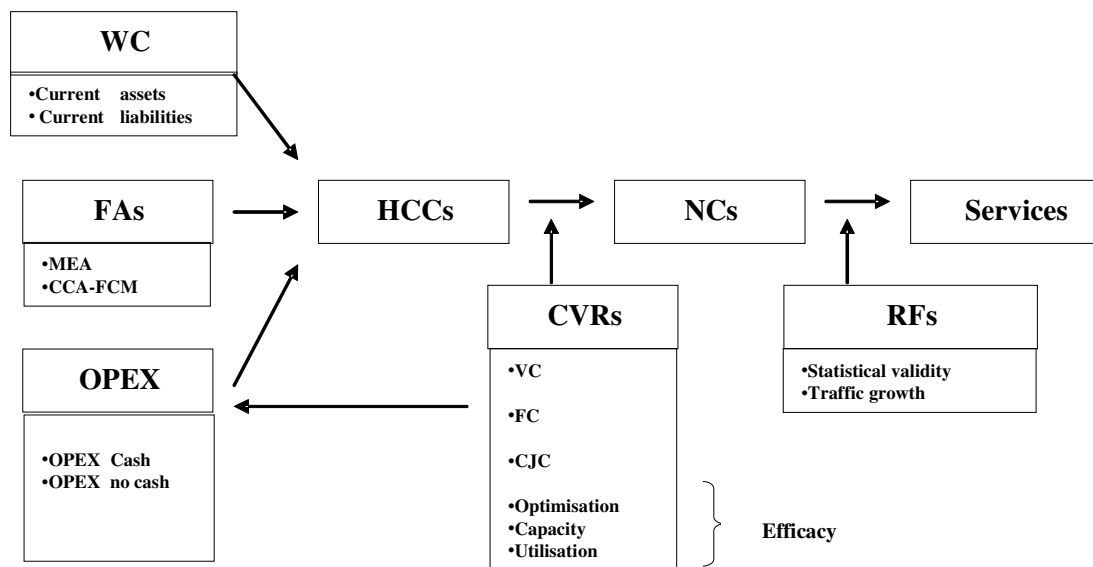
5.4 Instructions for implementation of long run incremental cost method

5.4.1 Characteristics of long run incremental costs method

The top-down model

(33) The cost model developed by HT shall be based on the implementation of the *top-down* approach.

(34) In developing the cost model, HT should follow the principle shown below:



Cost allocation of in a top-down model

Where:

WC = Working Capital

FAs = Fixed Assets

OPEX = Operating Expenditure

CCA-FCM = Adjustments regarding capital maintenance

VC = Variable Costs

FC = Fixed Costs

CJC = Common and Joint Costs

HCCs = Homogenous cost categories

NCs = Network components

CVRs = Cost volume relationship, and

RFs = Routing factors.

- (35) The first step in developing a cost model consists of grouping costs of the similar characteristics into single cost categories, called homogenous cost categories (HCC). Upon identifying homogenous cost categories, the following step is to determine network components (NC). The costs are allocated to network components by using cost volume relationships (VRC) curves (hereinafter: curves), resulting in the amount of the cost per each network component. The final step in the cost model development by using the top-down approach is the distribution of network components to individual services by routing factors.
- (36) When developing cost models, HT should define Network Components, and calculate first long-run incremental costs of network components, then based on these, determine the long-run incremental costs of individual services.

Data required for the development of cost models

- (37) HT cost model must be based on up-to date available data from revised financial statements. Financial, operating and data concerning traffic within the network should refer to the same time period. HT should develop a projection of stated data for two years in advance to ensure that the network capacity can meet the requirements for capacity expansion.

5.4.2 Homogenous cost categories

A required level of granularity

- (38) Each cost category in a cost model must be a homogenous cost category. Homogenous cost category can be characterised by unique cost drivers, price trends and cost curve,
- (39) Capital or operating expenditure with different cost drivers cannot be grouped into the same homogenous cost category,
- (40) Capital or operating expenditure having different price trends cannot be grouped into the same homogenous cost category, and
- (41) Capital or operating expenditure with different underlying cost volume relationship curves cannot be grouped into the same homogenous cost category.

5.4.3 Definition of cost types

- (42) It is necessary to define general cost types within cost models and to categorize homogenous cost categories accordingly. This involves fixed assets, depreciation, operating expenditures and working capital.
- (43) Working capital shall be calculated as current assets less current liabilities. Working capital shall be recorded as annual average value which is equal to average value of working capital at the beginning and at the end of the relevant period.

5.4.4 Network topology

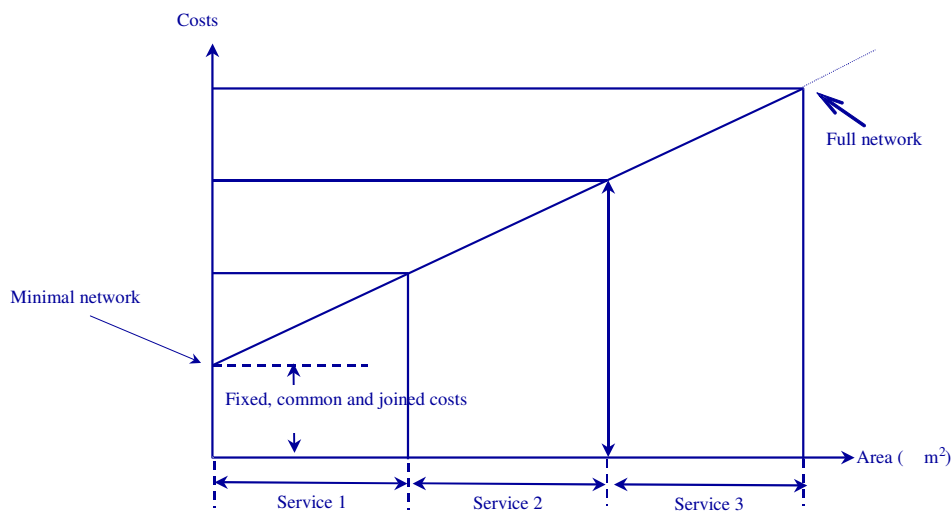
- (44) In determining network topology for the purpose of cost models, HT shall apply the so-called geographical *scorched node* approach.

5.4.5 Equipment optimisation

- (45) In developing cost models, HT shall apply the processes of equipment optimization, when such processes result in lower costs.
- (46) Net realisable value of business premises, which has become surplus due to the implementation of new technologies, should be zero, except in case when it can be proved that there are economic reasons for keeping them.
- (47) HT shall provide justification for the achieved level of network use, and shall make adjustments, taking the following factors into account:
- a) impact of losing users (especially in case of competition development),
 - b) need for business growth,
 - c) need for equipment upgrading as technology develops,
 - d) need to provide satisfactory level of services, and
 - e) distribution or density of users at certain locations.

5.4.6 Cost volume relationships

- (48) The simple cost volume relationship curve is shown in Figure below. The cost driver of the illustrated cost category is space, expressed in square meters. The cost must be allocated to three different services (service 1, 2 and 3). The amounts of cost drivers, or associated areas, are calculated by analysing area occupation which the operator should perform occasionally.



Simple cost volume relationship

Where:

- In case of voice services, the minimum network is defined as the one in which it is possible to receive or make a call from any telephone line connected to the subject network,
- In case of non-voice services, the minimum network is defined as the one which can establish a connection to any connection point to the subject network, and
- Full network is a network designed to carry existing traffic levels. It requires more communication nodes and, as a result, more facilities for housing the equipment.

Cost volume relationships and economy of scale

(49) Cost volume relationships should be of convex shape, taking into account the effects of purchasing power of economy of scale. Should any cost have a linear shape for the purpose of cost model development, HT shall in that case provide and document the appropriate explanation why the purchasing power and economy of scale do not, in that particular case, influence the shape of the cost curve.

Construction of cost curves

(50) For the development of cost models, HT can construct cost curves by applying:

- engineering models,
- statistical analyses and reviews, and

c) interviews and market research.

(51) HT shall submit to the Agency all models and documentation concerning the construction of cost curves.

Dependent and independent homogenous cost categories

(52) All homogenous cost categories must be classified as independent or dependent. In case of dependent homogenous cost categories, their dependency on individual cost drivers must be documented.

5.4.7 Data on network activities and traffic

Data on network traffic

(53) The data on network traffic shall be consistent with the data of the basic year from the revised financial statements and with forecasts for the next two years, to ensure appropriate prediction of capacity by the cost curve.

Calculation of service unit cost

(54) The network segments unit cost shall be calculated by dividing the cost of each network component by corresponding service volume.

(55) The service unit cost is performed by allocating unit cost of network components on the basis of relevant routing factor. The total cost of particular service is the sum of all service costs for each network component, taking into account the utilization of particular network component.

(56) The routing factors shall be based on two year traffic forecast. In the documentation for cost model it is necessary to enclose relevant information and statistical data which confirm the accuracy of supplied traffic forecasts. Routing factors shall be consistent with the supplied traffic forecasts.

5.4.8 Fixed, joint and common costs

(57) The share of common and joint costs shall be presented and documented for each homogenous cost category, and the documentation shall contain explanations based on what the costs are common to.

5.4.9 Addition for joint costs

(58) The Agency proposes that joint costs be allocated by using the Equal proportionate mark-ups method (EPMU).

5.5 Instructions on using fully allocated costs methodology

- (59) The development of cost model with fully allocated costs shall be based on the following steps:
- a) grouping costs into cost categories,
 - b) specifying a detailed list of network components,
 - c) allocation of costs of cost categories to network components,
 - d) allocation of costs of supporting activities, such as support functions (e.g. human resources, IT department, public relations department) and general activities,
 - e) determination of routings factor which reflect the level of utilization of particular network component by particular service,
 - f) calculation of unit cost for each network component by using routing factor, and allocation of unit cost of network components to services provided by the operator.

5.6 Other instructions concerning cost accounting system

5.6.1 Cost accounting depending on daytime/weekday

- (60) The retail prices of telecommunications operators vary depending on the time of day or the day of the week. The variations in prices represent a certain type of capacity charges, or stimulating users to use the network at the time of slower traffic. In case when, for the purpose of market regulation, wholesale fees should reflect the structure of appropriate retail prices, cost oriented wholesale fees shall be defined in such a way that the average value of wholesale fees during the day or week, weighted in reference to the traffic during the day or the week, is the same as the related unit cost.

5.6.2 Requirements related to cost models

- (61) HT shall enable the Agency full access to its cost models at HT business premises, including access to and insight into all parts of the model. In addition, HT shall enable access to all data related to cost models required by the Agency.
- (62) HT shall incorporate functionalities in cost model that provide the possibility to determine the influence on the final model results should any changes occur in:
- a) Equipment price,
 - b) Level of equipment utilization and other network parameters,

- c) Cost of capital,
- d) Traffic volumes,
- e) Depreciation methodology, and
- f) Including/excluding fully depreciated assets,
- g) Asset life and
- h) Price trends.

5.6.3 Cost model documentation

- (63) The cost model description is a part of the Accounting documentation, as stipulated in Article 2.2.7 of this Document, should incorporate:
- a) a list of homogenous cost categories,
 - b) cost drivers for each cost category, and
 - c) a list of network elements and other activities such as the billing system, marketing, human resources, IT etc.
- (64) A document on allocation methodology, as stipulated in Article 2.2.7 of this Document, shall contain a description of services provided by the HT on relevant markets and the description cost allocation method of network components and other activities to the services.
- (65) After developing a cost model, the documentation concerning homogenous cost categories shall contain, for each homogenous cost category, the following:
- the name of the homogenous cost category,
 - the type of costs within the homogenous cost category,
 - homogenous cost category classification to dependent or independent, and
 - cost curve related to each homogenous cost category.
- (66) After developing the cost model, the documentation concerning cost curves shall contain, for each cost curve, the description of:
- cost driver,
 - cost curve form

- the amount of fixed, common and joint costs,
- the method which resulted in cost curve, and
- classification to dependent and independent cost curve.

5.6.4 Audit of the model

- (67) The HT cost model must be audited in accordance with Instruction for audit of regulatory financial statements, stipulated in Article 2.2 of this Document.
- (68) Cost model audit must contain the following elements:
- a) The scope of costs included in the model,
 - b) The scope of costs allocated to particular regulated service,
 - c) Adjustments between data in the model and legal financial statements,
 - d) The accuracy of amounts for operating data, traffic volume, services and technical parameters,
 - e) Methodology concerning calculation of depreciation, cost capitalization, cost allocation and asset evaluation,
 - f) Adjustments between data in the cost model and separated reports,
 - g) Cost curves, and
 - h) Additional information concerning accounting system.

5.7 Instructions on cost of capital calculation

5.7.1 Cost of capital calculation using the method of weighted average cost of capital

- (69) To calculate the cost of capital, the HT shall use the method of weighted average cost of capital (WACC).
- (70) Since the cost base used in cost accounting models does not have to include profit tax, HT shall use the following formula while calculating the weighted average cost of capital:

$$WACC = \frac{E}{E+D} r_E + \frac{D}{E+D} \times r_D + r_E \times \frac{E}{E+D} \times \frac{t_C}{1-t_C}$$

Where:

r_E = return on equity

r_D = return on debt

E = market value of equity

D = market value of debt

t_c = profit tax rate

- (71) HT may propose different amounts of the weighted average cost of capital for different relevant markets, if it shows the justification and practical feasibility of such approach in Accounting documentation.

5.7.2 Gearing ratio

- (72) To define gearing ratio, HT shall use the method of optimal or efficient gearing ratio based on optimal structure of capital defined by the Agency.
- (73) In defining optimal gearing ratio, the Agency shall take into consideration all the data on the gearing ratio of similar telecommunications operators in comparative markets. The Agency shall take into account the market value of debt, and not only book value.

5.7.3 Cost of equity

- (74) In defining the cost of equity, HT shall use the Capital Asset Pricing Model.

5.7.4 Instructions concerning Capital Asset Pricing Model

Return on risk-free investment

- (75) HT shall define the return on risk-free investment on the basis of return on Croatian government stock denominated in HRK adjusted with regard to the bond maturity.
- (76) The maturity of Government bonds, based on which the return on risk-free investment is defined, is 10 years.
- (77) In case when the cost model is based on historical cost accounting, the Agency shall propose that average returns on risk free investment over relevant historical period be taken into account.

Market risk premium

- (78) The Agency believes that Croatian stock market is not big enough or liquid, and does not have a long enough tradition to enable significant evaluation of market risk premium by direct observation. Subsequently, HT should use international comparative values of telecommunications operators in countries similar to Croatia obtained from relevant international financial statements and reports for the purpose of defining market risk premium.

Beta coefficient

- (79) In order to define beta coefficient, HT shall use the bottom-up methodology by using international comparative values.

5.7.5 Cost of debt

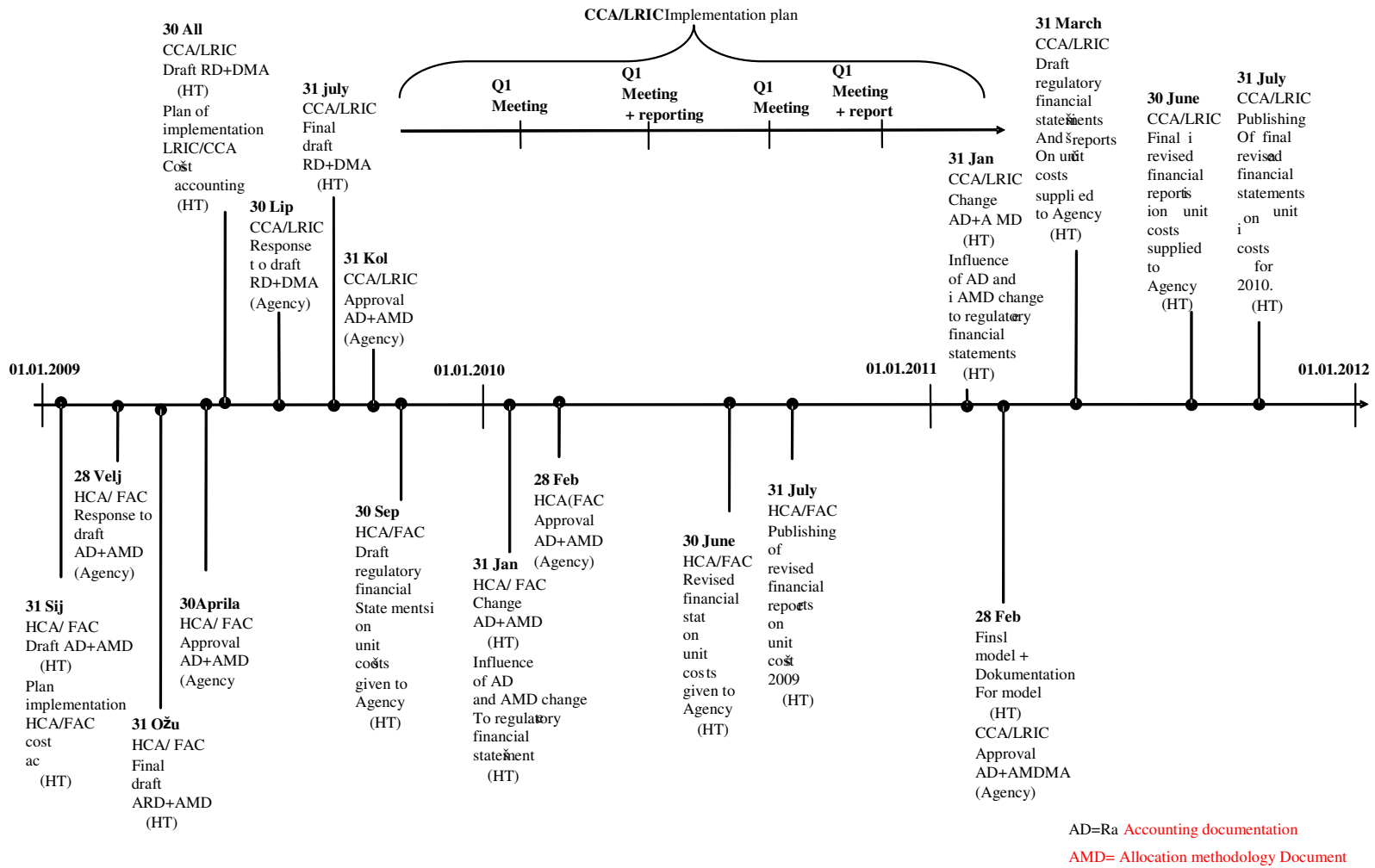
- (80) The method of calculation of indicative level of debt cost should be based on the sum of the return on risk-free investment and premium on specific risks for TH-T, based on HT credit rating or relevant comparative values.

5.7.6 Documentation supporting the cost of capital calculation

- (81) HT shall submit the amount and relevant detailed description of methodology for determination of cost of capital. Such description should enable the Agency to gain a complete understanding of the cost of capital determination by HT, including assumptions, methodology and calculations.
- (82) The description of the cost of capital determination shall be an integral part of accounting documents within timeframes and in accordance with the process of preparation, audit and publication of regulatory financial statements, as stipulated in Article 2.2 of this Document.

6 Appendices

6.1 Timeframes of the process of preparation, audit and publication of financial statements



6.2. Profit and loss statement

PROFIT AND LOSS STATEMENT

Based on historical cost accounting (HCA) and current cost accounting (CCA)
 for the year which ended on xx xx xxxx.

	CURRENT YEAR		PREVIOUS YEAR		% CHANGE per year
	000 HRK	% per line	000 HRK	% per line	
REVENUES					
Internal sales					
- services which are also provided externally					
- services provided only internally					
External sales					
TOTAL INCOME FROM SALE	<hr/>		<hr/>		<hr/>
COSTS					
Costs to other segment /services					
Operating costs					
- Maintenance					
- Spare parts					
- Reservations					
- Finance and Billing					
-Allowance for uncollectible accounts					
- Marketing costs					
- Labour costs					
-Depreciation					
- Services costs					
- Financing costs					
- Other costs (Specified by item)					
- Other costs (total of items below 5%of operating costs)					
Total operating costs (HCA basis)	<hr/>		<hr/>		<hr/>
TOTAL COSTS (HCA basis)	<hr/>		<hr/>		<hr/>
PROFIT (HCA basis)	<hr/>		<hr/>		<hr/>
CCA ADJUSTMENTS					
Retained (profit)/ loss					
Additional depreciation					
Other adjustments					
TOTAL OPERTING COSTS (CCA basis)	<hr/>		<hr/>		<hr/>
PROFIT (CCA basis)	<hr/>		<hr/>		<hr/>
RETURN ON MEAN CAPITAL EMPLOYED AND REVENUE FOR the year XXXXX	<hr/>		<hr/>		<hr/>
RETURN ON SALES	<hr/>		<hr/>		<hr/>

Note 1: This statement is a combination of evaluation according to HCA and CCA basis .The Agency's opinion is that if a certain type of asset has been revalued per CCA base, then these evaluations should be included in the statement, but if the asset has not been revalued, then this statement shows only its HCA value. Should only a certain part of asset be revalued, then the assets should be presented in combination. The individual approach to revaluation methods for certain types of assets are shown in the accounting documentation.

Note 2 : If items over 5% of operating costs are reported in this table, then they should be reported in other tables as well.

6.3 Profit and loss statement (for publication)

PROFIT AND LOSS STATEMENT

BASED ON HISTORICAL COST ACCOUNTING (HCA) AND CURRENT COST ACCOUNTING (CCA)
 For the year xx xx xxxxx.

	CURRENT YEAR			PREVIOUS YEAR			% CHANGE Per year
	000	HRK	% per line	000	HRK	% per line	
REVENUES							
RELEVANT MARKET OF SERVICES OF FIXED PUBLIC TELEPHONE NETWORKS IN THE TERRITORY OF THE REPUBLIC OF CROATIA							
SEGMENT 1 – Access to public telephone network at fix location for private and business users							
SEGMENT 2 – Wholesale access to network infrastructure (including full and shared access at a fixed location)							
RELEVANT MARKET OF INTERCONNECTION IN THE TERRITORY OF THE REPUBLIC OF CROATIA							
SEGMENT 3 – Call origination from the public telephone networks provided at fixed location							
SEGMENT 4 – Call termination in certain public telephone network provided at fixed location							
SEGMENT 5 – Wholesale broadband access							
SEGMENT 6 – Other							
RELEVANT MARKET OF LEASED TELECOMMUNICATIONS LINES IN THE TERRITORY OF THE REPUBLIC OF CROATIA							
SEGMENT 7 – Wholesale terminal segments of leased lines, regardless of technology used for the provision of leased capacity							
SEGMENT 8 – Other							
TOTAL REVENUE FROM SALES							
COSTS							
Operating costs							
-Maintenance							
-Spare parts							
- Reservations							
- Finance and billing							
- Allowance for uncollectible accounts							
- Marketing costs							
- Labour costs							
- Depreciation							
- Services costs							
- Financing costs							
- Other costs (Specified by item)							
- Other costs (Total of items below 5% of operating costs)							
Total operating costs (HCA basis)							
TOTAL COSTS (HCA basis)							
PROFIT (HCA basis)							
CCA ADJUSTMENTS							
Retained profit / loss							
Additional depreciation							
Other adjustments							
TOTAL OPERATING COSTS (CCA basis)							
PROFIT (CCA basis)							
RETURN ON MEAN CAPITAL EMPLOYED AND INCOME FOR the year XXXXX							
RETURN ON SALES INCOME							
Note 1: This statement is the combination of evaluation in accordance with HCA and CCA basis. The Agency's opinion is that if a certain type of asset has been revalued per CCA base, then these evaluations should be included in the statement, but if the asset has not been revalued, then this statement shows only its HCA value. Should only a certain part of asset be revalued, then the assets should be presented in combination. The individual approach to revaluation methods for certain types of assets are shown in the accounting documentation.							
Note 2: If items over 5% of operating costs are reported in this table, then they should be reported in other tables as well.							

6.4 Mean capital employed statement

MEAN CAPITAL EMPLOYED STATEMENT

For the year that ended on xx xx xxxx

	CURRENT YEAR 000 HRK	PREVIOUS YEAR 000 HRK	% CHANGE per year
FIXED ASSETS			
Fixed tangible assets *			
- land and buildings			
- cables and channels			
- Mobile equipment			
- exchange Equipment			
- Other (Specified by item)			
Investments			
TOTAL FIXED ASSETS			
CURRENT ASSETS			
Stocks			
Buyers			
Other			
TOTAL CURRENT ASSETS			
SHORT TERM LIABILITIES			
Liabilities to suppliers in current financial year			
Other suppliers			
Other			
SHORT TERM LIABILITIES			
Total assets less current liabilities			
Reservations for liabilities and costs			
MEAN CAPITAL EMPLOYED			

*Type of assets whose value exceeds 5% of total fixed assets

Note 1: This report is the combination of evaluation according to HCA and CCA basis . The Agency's opinion is that if a certain type of asset has been revalued per CCA base, then these evaluations should be included in the statement, but if the asset has not been revalued, then this statement shows only its HCA value. Should only a certain part of asset be revalued, then the assets should be presented in combination. The individual approach to revaluation methods for certain types of assets are shown in the accounting documentation shown in the accounting documentation

6.5. Report on transfer fees

REPORT ON TRANSFER FEES

For the year ending on xx xx xxxx

RETAIL SERVICE (or other)	WHOLESALE SERVICE	BILLING RATE	BILLING RATE UNIT	SERVICE QUANTITY	TOTAL
SERVICE 1	Wholesale service 1	xx	a	d	$A = a * d$
	Wholesale service 2	xx	b	e	$B = b * e$
	Wholesale service 3	xx	c	f	$C = c * f$
	Wholesale service n	xx	y	z	$Z = y * z$
TOTAL FOR SERVICE 1					$A+B+C+...+Z$

	Retail service 1	Retail Service 2	Retail service 3	Retail Service 4	Retail service 5	Retail service 6	Retail service 7	Retail service 8	Retail service 9	Retail service 10	Retail service 11	Retail service 12	Retail service 13	Retail service 14	Retail service 15	Retail service 16	Market of Fixed public telephone network-wholesale segment	Market Of inter-connecting-segment 1	Market of inter-connecting-segment 2	Market Of inter-connecting-segment 3	Market of leased telecommunication lines segment 1
Retail service 1	■																				
Retail service 2		■																			
Retail service 3			■																		
Retail service 4				■																	
Retail service 5					■																
Retail service 6						■															
Retail service 7							■														
Retail service 8								■													
Retail service 9									■												
Retail service 10										■											
Retail service 11											■										
Retail service 12												■									
Retail service 13													■								
Retail service 14														■							
Retail service 15															■						
Retail service 16																■					
Market of public fixed telephone network - wholesale segment																	■				
Market of interconnection - segment 1																		■			
Market of interconnection - segment 2																			■		
Market of interconnection - segment 3																				■	
Market of leased telecommunications lines - segment 1																					■

6.6 Reconciliation statement – Profit and loss statement

RECONCILIATION STATEMENT- PROFIT AND LOSS STATEMENT

For the year ending on xxxxxx

SEGMENT/MARKET	SALES 000 HRK	OPERATING COSTS 000 HRK	HCA RETURN OR PROFIT BEFORE TAXATION 000 HRK	RETAINED PROFIT/LOSS AND OTHER ADJUSTMENTS 000 HRK	ADDITIONAL 000 HRK
Wholesale segments/markets (to which cost accounting and/or accounting separation applies)					
Retail segments markets (to which cost accounting applies)					
TOTAL MARKETS ON WHICH THE OPERATOR HAS SIGNIFICANT MARKET POWER	_____	_____	_____	_____	_____
Wholesale services/markets					
Retail services/markets					
TOTAL MARKETS ON WHICH THE OPERATOR DOES NOT HAVE SIGNIFICANT MARKET POWER	_____	_____	_____	_____	_____
OTHER SERVICES/MARKETS (e.g. which are not telecommunications services/markets)					
TOTAL	_____	_____	_____	_____	_____
Elimination of inter-business income/expenses					
Interest liability/claims and other compensations					
Allocation of profit from associated firms					
Firms with the minority share					
Affiliated firm profit distribution/ <i>goodwill</i> depreciated to affiliated firms					
Firm with the minority share					
Basic activities profit tax					
Dividend paid and proposed					
Amount without financial assets and investment recorded as current asset					
Non-relevant extra operating costs of core network					
Non-relevant extra operating costs of affiliated firms					
Influence of changes on asset life					
Other					
ADJUSTMENTS (if necessary)	_____	_____	_____	_____	_____
AS STATED IN ANNUAL REPORT	_____	_____	_____	_____	_____

6.7 Reconciled Mean Capital Employed Statement

Consolidated mean capital employed

For the period ending on XX XX XXX

	Current year 000 kn	Previous year 000 kn
Shareholders' funds as in Annual Report		
CCA adjustment		
ADJUSTMENTS		
Interest claims		
Interest payable on long-term bonds		
Proposed (adopted) dividends		
Taxes		
Long-term liabilities		
Current ratio of long-term liabilities		
Deferred tax reserves		
Other relevant items		
Year-end state of CCA capital employed on 31 December		
Initial state of CCA capital employed on 1 January		
Adjustment to the initial capital employed		
Revised initial CCA capital employed on 1 January		
Average CCA capital employed		
Average daily adjustment		
Deferred costs		
TOTAL CCA MEAN CAPITAL EMPLOYED		
Wholesale markets (to which accounting separation /cost accounting applies)		
Retail markets (to which accounting separation applies)		
MEAN CAPITAL EMPLOYED ON MARKETS WITH SIGNIFICANT MARKET POWER		
Subtotal of markets		
NON-REGULATED SERVICES		
- Wholesale services		
- Retail services		
OTHER SERVICES (not telecommunications services)		
Naputci za računovodstveno odvajanje i troškovno računovodstvo		
TOTAL CCA MEAN CAPITAL EMPLOYED		49

6.8 Additional financial information which the Agency may require

ADDITIONAL INFORMATION WHICH ARE NOT A PART OF REGULATORY FINANCIAL STATEMENTS, BUT OF ADDITIONAL ATTACHMENTS	REASON FOR ADDITIONAL REPORT/ATTACHMENT	Publication
Number of employees per market/segment/service	Enables the Agency to understand cost structure and to evaluate efficiency	No
Labour cost per market/segment/service	Enables the Agency to understand cost structure and to evaluate efficiency	No
Modifications of advance payment/time limits	Enables understanding of trends and state	No
Data on client categories	Provides data for price control	No
All data required for RIO Documents which follow separate accounts in accordance with RIO prices for interconnection – FAC/LRIC output data for reports on costs including – quantities of components, carrier billing and admin, own use analysis and retained profit and loss –similar documents shall be required for access network as well.	Enables the Agency to understand the structure of RIO and costs	No
Data concerning the rest of RIO core and access services	Enables the Agency to understand the structure of RIO and costs	No
Analysis and details of various research (sample size, population size, statistically significant results and methodology etc)	Enables the Agency to understand the basis for preparation of regulatory financial statements.	No
Exceptional costs analysis	Enables the Agency to understand the basis for preparation of regulatory financial statements.	No
Analysis of cost categories (used in LRIC model) for network components, increment and relevant part of common cost	Enables understanding of LRIC model development	No
Analysis of total activities of network activity components, increments and relevant share of common cost (LRIC basis)	Combinatorial test analysis, evaluation of approach to extra cost calculation (mark-up)	No
Analysis of cost categories (used in LRIC model) for network components and increments	Enables the Agency the of LRIC model development	No
Total activity analysis for network components and increments	Enables the Agency the understanding and evaluation of relative importance and activity allocation	No

ADDITIONAL INFORMATION WHICH ARE NOT A PART OF REGULATORY FINANCIAL STATEMENTS, BUT OF ADDITIONAL ATTACHMENTS	REASON FOR ADDITIONAL REPORT/ATTACHMENT	Publication
Analysis per asset categories and network activities, annual depreciation and influence of CCA evaluation on cost in a year, for example - HCA depreciation - CCA additional depreciation - Retained profit - Other CCA adjustments	Enables the Agency to understand the importance of assets and transactions related to them	No
CCA report on changes of fixed assets a) transferred gross replacement cost, allowances/writing off/ transfer/referred profit or loss/gross replacement cost for transfer and b) transferred gross depreciation, HCA depreciation, CCA additional depreciation, writing-off, transfers, other trends, retained profit (loss), gross depreciation (to be transferred) per asset categories for HT adjustment with HCA report on trends in fixed assets in financial statements of the Group	Enables the Agency to understand the importance of assets and transactions related to them	No
Total mean capital employed and detailed analysis for all network components	Enables the Agency to understand the manner of preparation of regulatory financial statements	No
Detail analysis of activities of network capital employed for all network components	Enables the Agency to understand the manner of preparation of regulatory financial statements	No
Gross income from calls, discounts and types of fees for tariff models for each segment	Enables the Agency to understand the calculation of net sale to define margin squeeze more easily	No
Gross income, discounts and types of fees for user options for each segment	Enables the Agency to understand the calculation of net sale to define margin squeeze more easily	No
Graphs for various indicators, weighted indexes and combined indicators used by HT to evaluate assets on the basis of current cost base	Enables the Agency the understanding, evaluation and transparency of structure and development of CCA evaluation	No

ADDITIONAL INFORMATION WHICH ARE NOT A PART OF REGULATORY FINANCIAL STATEMENTS, BUT OF ADDITIONAL ATTACHMENTS	REASON FOR ADDITIONAL REPORT/ATTACHMENT	Publication
The estimated economic service life, evaluation and depreciation basis, implemented survey/sample/evaluation index, depreciation based on historical cost accounting (HCA) and current cost accounting (CCA), gross book value in the year of acquisition, gross replacement costs (GRC) and net replacement cost (NRC) per asset category	Enables the Agency to understand, evaluate and make transparent the structure and CCA evaluation development	No
The cost of marketing for 10 biggest campaigns during the financial year, including advertising in press, on radio and TV	Enables the Agency to evaluate and understand the basis for marketing costs allocation	No
Total operating cost and cost of mean capital employed for each group of facilities and their using rate, including relevant usage factors for each network activity and/or subcomponent	Enables the Agency to evaluate and understand the component structure	No
Fixed income (including line leasing) per tariff model package and associated network costs	Enables the Agency to understand and evaluate the basis for income allocation	No
Analysis of profit/loss from asset transfer and additional analysis of each asset transfer	Enables the Agency to understand and evaluate the basis for allocation and distribution of fixed asset sales	No
Engineering/project studies	Enables the Agency to evaluate the efficiency of network and understand CCA evaluation	No

6.9 Accounting separation to markets, segments and services

		P&L	MCES	RS	AO	TF
RELEVANT MARKET OF SERVICES IN FIXED PUBLIC TELEPHONE NETWORKS IN THE TERRITORY OF CROATIA						
SEGMENT 1 – ACCESS TO PUBLIC TELEPHONE NETWORK						
AT FIXED LOCATION FOR PRIVATE AND BUSINESS USERS	R					
Access to public telephone network for private users						
Access to public telephone network for business users						
Connection to network (PSTN/ISDN)						
ADSL access for private users						
SEGMENT 2 – PUBLIC VOICE SERVICE PROVIDED						
ADSL access for business users						
AT FIXED LOCATION FOR PRIVATE AND BUSINESS USERS						
Segment 1- Other	R					
National call for private users						
National call for business users						
International call for private users						
International call for business users						
National call to mobile network						

PLC – Profit and loss statement

MCES - Mean Capital Employed statement

Naputci za računovodstveno odvajanje i troškovno računovodstvo

International call for business users

National call to mobile network

RS - Reconciliation statement
AO - Audit opinion
TF - Transfer fees statement
R – Retail segment
W – Wholesale segment

		PLC	RACE	AR	AO	RTS
RELEVANT MARKET OF INTERCONNECTION IN THE TERRITORY OF THE REPUBLIC OF CROATIA						
SEGMENT 4- CALL ORIGINATION FROM PUBLIC TELEPHONE NETWORKS PROVIDED AT FIXED LOACTIONS	W					
SEGMENT 5- CALL TERMINATION TO A CERTAIN PUBLIC TELEPHONE NETWORK PROVIDED AT FIXED LOCATION	W					
SEGMENT 6 - CALL TRANSFER IN FIXED PUBLIC TELEPHONE NETWORK	W					
SEGMENT 7 - WHOLESALE BROADBAND ACCESS	W					
SEGMENT 8 – OTHER						
RELEVANT MARKET OF LEASED TELECOMMUNICATIONS LINES IN THE TERRITORY OF THE REPUBLIC OF CROATIA						
SEGMENT 9: RETAIL OF LEASED LINES	R					
Leased lines of capacity below 2 Mbs						
Leased lines of capacity above 2 Mbs						
SEGMENT 10 – WHOLESALE TERMINAL SEGMENTS OF LEASED LINES REGARDLESS OF THE TECHNOLOY USED TO PROVIDE LEASED CAPACITY	W					
SEGMENT 11 – WHOLESALE TRANSMISSION SEGMENT OF LEASED LINES REGARDLES OF THE TECHNOLOGY USED TO PROVIDE LEASED CAPACITY	W					
SEGMENT 12 – OTHER						

P&l – Profit and loss account

MCES - Mean Capital Employed statement

RS - Reconciliation statement

Naputci za računovodstveno odvajanje i troškovno računovodstvo

AO - Audit opinion
TF - Transfer fees statement
R – Retail segment
W – Wholesale segment

6.10 Auditor's opinion

Independent auditor's report on the regulatory financial statements on 31 December XXXX

We have audited the enclosed regulatory financial statements of the firm HT – Hrvatske telekomunikacije d.d. (hereinafter: HT), consisting of regulatory financial statements (profit and loss statement, Mean Capital Employed statement, Reconciliation statement, report on unit costs, Statement of responsibility by the company Board, report on transfer fees), accounting document (which include principles, definitions, evaluation methods, description of cost model etc), and the documented description of cost allocation (detailed description of allocation in the cost model without current amounts).

Management's Responsibility for the Regulatory Financial Statements

The company management is responsible for the preparation and objective presentation of financial statements for regulatory purposes and appropriate format pursuant to accounting separation and cost accounting obligation imposed by the Croatian Post and Electronic Communications Agency (hereinafter: HAKOM). The responsibility of the company management includes: definition, conducting, implementation and maintenance of internal controls relevant for the preparation and objective presentation of regulatory financial statements without financially important mistakes which can arise as a result of fraud or error; selecting and implementing appropriate accounting and cost policies; and defining accounting and cost evaluations appropriate to current circumstances.

The auditor's liability

Our responsibility is to express an opinion on the regulatory financial statements based on our audit. The audit was performed in accordance with the accounting separation and cost accounting obligation imposed by HAKOM, which requires that we comply with relevant ethical requirements and plan and perform the audit for the purpose of establishing, with a relevant dose of certainty, that the regulatory financial statements have no financially important mistakes.

The audit involves performing procedures for the purpose of collecting audit evidence of amounts and statements in the regulatory financial statements as follows:

- 1 We have examined the reconciliation of incoming financial data derived from the cost model with audited annual regulatory financial statements,
- 2 We have examined compliance of accounting separation and cost accounting with the HAKOM decision,
- 3 We examined whether the cost model is correct and if it is in compliance with the description in relevant cost accounting documentation.

We are sure that the collected audit evidence are sufficient and make a good basis for auditor's opinion.

Opinion

According to our opinion, the regulatory financial statement by HT gives a fair presentation in all important items, on the day of 31 December XXXX, pursuant to the accounting separation and cost accounting obligation, defined by HAKOM, and in accordance with the accounting documentation.

During the procedure no indicators were found that HT is not in compliance with the accounting separation and cost accounting obligation.

Auditor

Date:

Croatian certified auditor

Address

For and on behalf of the auditor:

Name:

Certified auditor

6.11 Cost base and accounting methodology for the financial year 2010 and the following financial years

Relevant market/ segment	Accounting separation obligation		Calculation of service unit cost	
	Cost base	Accounting methodology	Cost base	Accounting methodology
1 Relevant market of fixed public telephone network service in the territory of the Republic of Croatia				
<i>Market segment:</i> Access to public telephone network at fixed location for private and business users	CCA	FAC	CCA and HCA	FAC
<i>Market segment:</i> Public voice service provided at fixed location for private and business users	CCA	FAC	CCA and HCA	FAC
<i>Market segment:</i> Wholesale access to network infrastructure (including full and shared access) at fixed location	CCA	FAC	CCA	LRIC
2 Relevant market of interconnection in the territory of the Republic of Croatia				
<i>Market segment:</i> Call origination from public telephone networks at fixed location	CCA	FAC	CCA	LRIC
<i>Market segment:</i> Call termination in certain public telephone network at fixed location	CCA	FAC	CCA	LRIC
<i>Market segment:</i> Call transfer in fixed public telephone network	CCA	FAC	CCA	LRIC

<i>Market segment:</i> Wholesale broadband access	CCA	FAC	CCA	LRIC
3 Relevant market of leased telecommunication lines in the territory of the Republic of Croatia				
<i>Market segment:</i> Retail service of line leasing	CCA	FAC	CCA and HCA	FAC
<i>Market segment:</i> Wholesale terminal segments of leased lines	CCA	FAC	CCA	LRIC
<i>Market segment:</i> Wholesale transfer segment of leased lines	CCA	FAC	CCA	LRIC

6.12 Details of main network components and usual cost drivers

Categories of assets and liabilities	Description	Cost drivers
Telephone exchange equipment	Local traffic equipment	Allocation to products and services according to time of use (sec.)
	Tandem telephone exchange equipment	Allocation per time of use (sec.)
	International traffic equipment	Allocation per time of use (sec.)
	Other equipment in telephone exchange	Allocation per equipment used.
Transmission equipment	Transmission equipment sensitive to traffic capacity	Allocation per use of lines and channels

Auxiliary facilities	Cables and wires	Allocation per components in accordance with the amount of cables used for various services
	Local loop equipment	Allocation per additional services in accordance with line use.
	Radio and satellite equipment	Allocation per channel use.
	International maritime cables	Allocation per use.
	Public phones and similar equipment	Direct allocation to service.
	Lines	Lines may be allocated per cables and wires they support or per products, in the same manner as for cables and wires.
	Power supply equipment	Allocation per primary facility groups according to the use of power supply equipment that supports each facility – kW per hour. The assets can be distributed according to products in the same manner as the relevant primary facility groups.
	Network management system	Allocation to the primary facility of the various networks on the basis of systems use which support each facility e.g. time spent on control of local telephone exchange units, transmission units and international units. The costs shall be allocated to products and services in the same manner as associated primary facility groups.