

**PUBLIC UTILITY  
“ELEKTROMREŽA SRBIJE”**

**Financial Statements  
For the Year Ended December 31, 2007 and  
Independent Auditors’ Report**

## **PUBLIC UTILITY “ELEKTROMREŽA SRBIJE”**

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*Translation of the auditors' report issued in the Serbian language*

## **INDEPENDENT AUDITORS' REPORT**

### **To the Managing Board of the Public Utility "Elektromreža Srbije," Beograd**

We have audited the accompanying financial statements (page 4 to 31) of the Public Utility "Elektromreža Srbije," Beograd (hereinafter: the "Company") which comprise the balance sheet as of December 31, 2007, and the related income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. The financial statements for the year ended December 31, 2006 were audited by another auditor whose report dated June 26, 2007 expressed a qualified opinion due to fact that the auditor did not physically observe the inventory count at December 31, 2005 the inability to determine the impairment of property, plant and equipment, as well as the non-existence of long-term provisions for retirement and other employee benefits.

#### *Management's Responsibility for the Financial Statements*

The management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting regulations of the Republic of Serbia. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and the Law on Accounting and Auditing of the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

(Continued)

## **INDEPENDENT AUDITORS' REPORT**

### **To the Managing Board of the Public Utility "Elektromreža Srbije," Beograd (Continued)**

#### *Basis for Qualified Opinion*

The Company did not assess and provide evidence of tests for impairment of certain assets as of December 31, 2007, i.e., whether the recoverable amount of such assets is less than its carrying amount presented in the financial statements, in accordance with the IAS 36 "Impairment of Assets." In the course of 2008, the Company engaged an independent appraiser to value property, plant and equipment. As of the issuance date of this report, the valuation was still in progress. Accordingly, we were unable to satisfy ourselves as to the effects contingent on the aforementioned appraisal on the Company's financial statements prepared for the year ended December 31, 2007.

As disclosed in Note 3.4 to the financial statements, the Company did not perform actuarial valuation in order to determine the present value of employees' accumulated entitlements to retirement benefits and jubilee awards, as required under IAS 19 "Employee Benefits." As a result, the respective provisions included in the Company's financial statements for 2007 were not calculated in accordance with IAS 19. Accordingly, we could not satisfy ourselves as to the potential effects thereof on the Company's financial statements for the year ended December 31, 2007.

#### *Qualified Opinion*

In our opinion, except for the effects on the financial statements of the matters referred to in the preceding paragraphs, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2007, and its financial performance, changes in equity and cash flows for the year then ended, in accordance with the accounting regulations of the Republic of Serbia.

#### *Emphasis of Matter*

Without further qualifying our opinion, we draw attention to the following matters:

- a) As disclosed in Note 2.1 to the financial statements, these financial statements include only the receivables, payables, results of operations, changes in equity and cash flows of the Company, without those of its subsidiaries: Elektroistok – Izgradnja d.o.o., Beograd and Elektroistok – Projektni biro d.o.o., Beograd. Equity investments in subsidiaries are recognized at cost in the accompanying financial statements. The Company's consolidated financial statements provide a better insight into the Company's financial position. According to the Law on Accounting and Auditing (Official Gazette of the Republic of Serbia no. 46 of June 2, 2006), the Company is under obligation to prepare the consolidated financial statements and submit them to the National Bank of Serbia, Center for Creditworthiness Assessment by the end of April 2008.
- b) As disclosed in Note 16 to the financial statements, the Company is in the process of registration its rights of use over the property assumed from the Public Enterprise "Elektroistok," as well as other entities within the Public Enterprise – Electric Power Industry of Serbia. As of this report issuance date, the aforementioned rights are still vested in these public enterprises.

(Continued)

**INDEPENDENT AUDITORS' REPORT**

**To the Managing Board of the Public Utility "Elektromreža Srbije," Beograd (Continued)**

*Emphasis of Matter (Continued)*

- c) As disclosed in Note 2 to the financial statements, the accompanying financial statements were prepared by applying the IASs which were in effect as of December 31, 2002 and the accounting regulations of the Republic of Serbia based on them. The Company's management assesses IASs, IFRSs and interpretations the application of which was prescribed pursuant to the February 12, 2008 Decision enacted by the Minister of Finance of the Republic of Serbia and once the standards and interpretations with reference to the Company's activities have been established, the Company intends to apply them in preparing the financial statements for the period beginning January 1, 2008. With regards to the provisions contained in the newly-adopted and amended standards and interpretations which relate to the application date and the provisions with reference to the disclosure of comparative figures, upon their adoption and application by the Company, certain reclassification of data presented in the accompanying financial statements for the year 2007 might be required, as these will be used as comparative figures in the Company's financial statements for the year 2008.

Belgrade, May 8, 2008

Miroslav Tončić  
Certified Auditor

**INCOME STATEMENT**  
**Year Ended December 31, 2007**  
**(thousands of RSD)**

	<u>Note</u>	<u>2007</u>	<i>Audited by another Auditor</i> <u>2006</u>
<b>OPERATING INCOME</b>			
Sales	5	5,566,329	4,678,889
Own work capitalized		28,001	27,298
Other operating income	6	<u>133,313</u>	<u>184,805</u>
		<u>5,727,643</u>	<u>4,890,992</u>
<b>OPERATING EXPENSES</b>			
Cost of commercial goods sold		(4,038)	(3,601)
Cost of materials	7	(335,936)	(305,475)
Staff costs	8	(1,382,889)	(1,292,781)
Depreciation, amortization and provisions	9	(1,850,026)	(1,840,558)
Other operating expenses	10	<u>(1,012,395)</u>	<u>(675,231)</u>
		<u>(4,585,284)</u>	<u>(4,117,646)</u>
<b>Profit from operations</b>		1,142,359	773,346
Finance income	11	535,639	1,118,249
Finance expenses	12	(501,902)	(532,425)
Other income	13	262,685	108,146
Other expenses	14	<u>(1,165,006)</u>	<u>(590,408)</u>
<b>PROFIT BEFORE TAXATION</b>		273,775	876,906
Income taxes	15	(28,285)	(29,971)
Deferred tax expense	15	<u>15,928</u>	<u>109,428</u>
<b>NET PROFIT</b>		<u>261,418</u>	<u>956,363</u>

The accompanying notes form an integral part of these financial statements.

The financial statements of the Public Utility "Elektromreža Srbije" were approved by the management and submitted to the National Bank of Serbia on February 28, 2008.

Signed on behalf of the Company:

Miloš Milanković  
General Manager

Jovan Ećimović  
Chief Financial Officer

Mirjana Krstić  
Head of Accounting

**BALANCE SHEET**  
**As at December 31, 2007**  
**(thousands of RSD)**

	<u>Notes</u>	<u>December 31, 2007</u>	<u>December 31, 2006</u>
<b>ASSETS</b>			
<b>Non-current assets</b>			
Intangible assets	16	40,558	38,455
Property, plant and equipment	16	40,885,607	39,709,690
Equity investments	17	105,017	141,080
Long-term financial placements	18	<u>1,432,075</u>	<u>1,629,028</u>
		<u>42,463,257</u>	<u>41,518,253</u>
<b>Current assets</b>			
Inventories	19	505,096	453,201
Accounts receivable	20	1,558,191	941,548
Short-term financial placements	21	1,287,820	245,507
Cash and cash equivalents	22	323,283	1,401,917
Value added tax and prepayments	23	<u>175,636</u>	<u>85,940</u>
		<u>3,850,026</u>	<u>3,128,113</u>
<b>Total assets</b>		<u><u>46,313,283</u></u>	<u><u>44,646,366</u></u>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity</b>			
State-owned capital	24	30,506,506	30,506,506
Other capital	24	33,582	33,582
Retained earnings	24	337,216	956,363
Accumulated loss	24	<u>-</u>	<u>(544,900)</u>
		<u>30,877,304</u>	<u>30,951,551</u>
<b>Long-term provisions</b>	25	<u>64,700</u>	<u>89,624</u>
<b>Non-current liabilities</b>			
Long-term borrowings	26	7,859,086	6,605,159
Other long-term liabilities	27	<u>1,642,320</u>	<u>1,242,178</u>
		<u>9,501,406</u>	<u>7,847,337</u>
<b>Current liabilities</b>			
Short-term financial liabilities	28	1,143,881	880,766
Accounts payable	29	646,128	714,706
Value added tax and other duties payable	30	36,138	102,210
Other current liabilities and accruals	31	<u>2,032,664</u>	<u>2,033,182</u>
		<u>3,858,811</u>	<u>3,730,864</u>
<b>Deferred tax liabilities</b>	15	<u>2,011,062</u>	<u>2,026,990</u>
<b>Total equity and liabilities</b>		<u><u>46,313,283</u></u>	<u><u>44,646,366</u></u>
<b>OFF-BALANCE SHEET ITEMS</b>	33	<u>6,027,451</u>	<u>6,078,074</u>

The accompanying notes form an integral part of these financial statements.

**STATEMENT OF CHANGES IN EQUITY**  
**Year Ended December 31, 2007**  
**(thousands of RSD)**

	<u>State-Owned Capital</u>	<u>Other Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Loss</u>	<u>Total</u>
Balance, January 1, 2006	30,386,828	33,582	-	(544,900)	29,875,510
Increase in capital	119,678	-	-	-	119,678
Profit for the year	-	-	1,127,400	-	1,127,400
	<u>30,506,506</u>	<u>33,582</u>	<u>1,127,400</u>	<u>(544,900)</u>	<u>31,122,588</u>
Balance, December 31, 2006	<u>30,506,506</u>	<u>33,582</u>	<u>1,127,400</u>	<u>(544,900)</u>	<u>31,122,588</u>
Balance, January 1, 2007	30,506,506	33,582	1,127,400	(544,900)	31,122,588
Opening balance adjustment	-	-	(171,037)	-	(171,037)
Restated opening balance	<u>30,506,506</u>	<u>33,582</u>	<u>956,363</u>	<u>(544,900)</u>	<u>30,951,551</u>
Profit for the year	-	-	261,418	-	261,418
Dividends paid to shareholders	-	-	(291,250)	-	(291,250)
Profit allocated to severance pays pursuant to the Managing Board Decision	-	-	(44,415)	-	(44,415)
Loss absorption	-	-	(544,900)	544,900	-
Balance, December 31, 2007	<u>30,506,506</u>	<u>33,582</u>	<u>337,216</u>	<u>-</u>	<u>30,877,304</u>

The accompanying notes form an integral part of  
these financial statements.

**CASH FLOW STATEMENT**  
**Year Ended December 31, 2007**  
**(Thousands of RSD)**

	<u>2007</u>	<u>2006</u>
<b>CASH FLOWS FROM OPERATIONS</b>		
<b>Cash provided by operating activities</b>	5,537,259	5,100,880
Cash receipts from customers	5,263,834	4,823,524
Interest received	259,098	160,823
Other receipts from operating activities	14,327	116,533
<b>Cash used in operating activities</b>	(3,647,755)	(2,985,527)
Cash paid to suppliers	(1,140,215)	(1,533,815)
Cash paid to and on behalf of employees	(1,459,778)	(849,164)
Interest paid	(208,813)	(213,736)
Income taxes paid	(28,270)	-
Other duties paid	(810,679)	(368,812)
<i>Net cash provided by / (used in) operating activities</i>	<u>1,889,504</u>	<u>2,115,353</u>
<b>CASH FLOWS FROM INVESTING ACTIVITY</b>		
<b>Cash provided by investing activities</b>	29,777	1,997
Sale of shares and equity investments (net inflows)	380	-
Sale of intangible assets	431	1,997
Interest received	25,466	-
Dividends received	3,500	-
<b>Cash used in investing activities</b>	(2,436,186)	(815,515)
Purchase of intangible assets, property, plant and equipment	(1,391,018)	(815,515)
Other financial placements (net outflows)	(1,045,168)	-
<i>Net cash used in investing activities</i>	<u>(2,406,409)</u>	<u>(813,518)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITY</b>		
<b>Cash used in financing activities</b>	(550,912)	(335,059)
Long- and short-term loans and other liabilities (net outflows)	(259,662)	(335,059)
Dividends paid	(291,250)	-
<i>Net cash used in financing activities</i>	<u>(550,912)</u>	<u>(335,059)</u>
<b>NET CASH (DECREASE)/INCREASE</b>	(1,067,817)	966,776
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	1,401,917	579,837
<b>Foreign exchange gains and losses on translation</b>	<u>(10,817)</u>	<u>(144,696)</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u><u>323,283</u></u>	<u><u>1,401,917</u></u>

The accompanying notes form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

All amounts are expressed in thousands of RSD, unless otherwise stated

1. ACTIVITY

Pursuant to Article 171, paragraph 1 of the Energy Law (“Official Gazette of RS,” number 84/04), the Government of the Republic of Serbia enacted a Decision number 023-397/2005-1 on establishment of the Public Utility “Elektromreža Srbije” (hereinafter: the “Company”) involved in electricity transmission and transmission system operation, at the meeting held on January 27, 2005 (“Official Gazette of RS,” number 12/2005).

The RS Government’s Decision on the Company’s establishment stipulates that the instruments of labor and establishment are comprised of the assets and liabilities contributed by the Public Enterprise – Electric Power Industry of Serbia (“Javno preduzeće Elektroprivreda Srbije,” hereinafter: “JP EPS”) as initial investments upon the establishment of the Public Enterprise “Elektroistok,” Beograd, as well as assets and liabilities which this enterprise acquires in its business activities. These assets and liabilities are determined in the balance sheet as of December 31, 2004.

The Company was entered in the Business Register pursuant to the Decision executed by the Serbian Business Registers Agency number BD 80469/2005, whereby the conditions necessary for the commencement of the Company’s activities were created, starting July 1, 2005 in accordance with the Decision on Establishment.

The Company’s name is: the Public Utility “Elektromreža Srbije” (“Javno preduzeće Elektromreža Srbije”) or the abbreviated name: “JP EMS, Beograd.”

The Company is domiciled in Belgrade at the street address Kneza Miloša number 11.

The Company’s registration number is 20054182 and its tax identification number is 103921661.

**Activity**

The Company’s principal activity is the transmission of the entire available electricity to the distribution areas, transmission system operation and organizing the electricity market.

The Company is in possession of the license necessary to perform the electricity-related activities:

1. The trade in electricity for the purpose of supply market, number 312-277/2006- L-I,
2. Trade in electricity for the purpose of managing electricity market 312-278/2006- L-I
3. Trade in electricity for the purpose of organization of electricity market 312-58-2006-L-1

**Ownership Structure** –The assets used by the Company are state-owned. The worth of state capital recognized in the amount of assets made available to the Company, as adjusted for the amounts of the realized net profit and loss (the principle of preservation of financial capital).

**Company’s Management** - is comprised of the Managing Board consisting of 9 members, the Supervisory Board of 5 members and General Manager appointed by the RS Government. In the Company’s headquarters located in Belgrade, there are 3 Divisions and 5 Sectors. Company’s management in 2007, is comprised of the 6 employees in accordance with Managing Board: General Manager, procurator of General Manager, manager of Department for transfer of electricity, manager of Department for managing electricity market, manager of Department for managing transfer system, manager of Department for electricity market works, procurator of manager of Department for managing electricity market.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***1. ACTIVITY (Continued)**

**Managing Board** – by means of its decisions, it ensures the realization of all targets defined in the Company’s Statutes and is responsible for the achievement of technical, technological and economic unity of the electricity system.

**Supervisory Board** – exercises supervision over the Company’s operations and work, reviews the annual reports, calculations and proposals for profit distribution.

**General Manger** – represents and acts in the name of the Company, organizes and manages the work process and coordinates the business activities of the Company; he is answerable for the regulatory compliance, proposes the basis for the business policies, the operation programs and development plans to the Managing Board, executes the decisions enacted by the Managing Board.

At Decemebr 31, 2007, the Company had 1,331 employee (December 31, 2006: 1,379 employees).

**2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS****2.1. Basis of Preparation and Presentation of Financial Statements**

Pursuant to the Law on Accounting and Auditing (Official Gazette of the Republic of Serbia no. 46 of June 2, 2006), legal entities and enterprises incorporated in Serbia are required to maintain their books of account, to recognize and value assets and liabilities, income and expenses, and to present, submit and disclose financial statements in conformity with the prevailing legislation and professional rules which include: the Framework for the Preparation and Presentation of Financial Statements (the “Framework”), International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), as well as the related interpretations representing an integral part of these standards.

Pursuant to its Decision numbered 011-00-738-2003-01 of December 30, 2003, the Republic of Serbia Ministry of Finance determined and issued the Framework and IAS that were applied as of December 31, 2002, and upon which both the previous and the newly-enacted Law on Accounting and Auditing were based.

The amendments to the IAS, as well as the newly-issued IFRS and the related interpretations issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee, upon the aforementioned date, were officially adopted pursuant to a Decision enacted by the Ministry of Finance of the Republic of Serbia with reference to the issuance of International Financial Reporting Standards (number 401-00-11/2008-16) and published in the Official Gazette of the Republic of Serbia number 16 of February 12, 2008 and, therefore could not be applied in the preparation of the accompanying financial statement of the Company for the year 2007.

The Company’s management assesses the standards and interpretations the application of which is required under the February 12, 2008 Decision of the Ministry of Finance, and once the standards and interpretations relevant to the Company’s activities have been adopted, intends to apply them in the preparation of the financial statements for the period beginning January 1, 2008.

In accordance with the aforementioned, and with regards to the potentially material effects of the departures of the accounting regulations of the Republic of Serbia and IAS, in effect as of December 31, 2002 (officially published and whose application was legally prescribed in the Republic of Serbia prior to February 12, 2008), from the newly-issued IFRS and amended IAS, the accompanying financial statements cannot be described as having been prepared in accordance with IFRS and IAS.

**NOTES TO THE FINANCIAL STATEMENTS**

**December 31, 2007**

*All amounts are expressed in thousands of RSD, unless otherwise stated*

**2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS (Continued)**

**2.1. Basis of Preparation and Presentation of Financial Statements (Continued)**

In addition, the accompanying financial statements are presented in the format prescribed under the “Guidelines on the Prescribed Form and Content of the Financial Statements of Enterprises, Cooperatives and Entrepreneurial Ventures” (Official Gazette of the Republic of Serbia, no. 114 of December 22, 2006). Such statements represent the complete set of financial statements as defined under the law, which differ from those defined under the provisions of IAS 1, “Presentation of Financial Statements” and differ in some respects, from the presentation of certain amounts as required under the aforementioned standard.

In the preparation of the accompanying financial statements, the Company has adhered to the accounting policies described in Note 3 which are in conformity with the accounting and tax regulations prevailing in the Republic of Serbia.

The Company’s financial statements are stated in thousands of dinars (RSD). The dinar is the official reporting currency in the Republic of Serbia.

These financial statements include only the receivables, payables, results of operations, changes in equity and cash flows of the Company, without those of its subsidiaries: Elektroistok – Izgradnja d.o.o., Beograd and Elektroistok – Projektni biro d.o.o., Beograd. According to the Law on Accounting and Auditing, the Company is under obligation to prepare consolidated financial statements and submit them to the National Bank of Serbia, Center for Creditworthiness Assessment by the end of April 2008.

**2.2. Use of Estimates**

The presentation of the financial statements requires from the Company’s management to make best estimates and reasonable assumptions that effect: the assets and liabilities amounts, the disclosure of contingent liabilities and receivables as of the date of preparation of the financial statements, as well as the income and expenses arising during the accounting period. These estimations and assumptions are based on information available to us, as of the date of preparation of the financial statements. However, actual results may vary from these estimates.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies applied to the preparation of these financial statements are presented in the text hereunder.

**3.1. Revenues**

Revenue is measured at the fair value of the consideration received or receivable, when such amount of revenue can be measured reliably, net of any trade discounts and value added tax.

Revenues associated with the sale of electricity, the transmission system operation and organization of the electricity market are recognized in the period in which such activities are realized.

Interest income is credited the income statement in the accounting period to which it relates.

**NOTES TO THE FINANCIAL STATEMENTS**

**December 31, 2007**

*All amounts are expressed in thousands of RSD, unless otherwise stated*

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**3.2. Effects of Foreign Currency Translation**

Monetary and non-monetary items of assets and liabilities denominated in foreign currencies are translated into euros at the official exchange rates prevailing on the Interbank Market, at the date of each transaction. As of the financial statements preparation date, monetary items are presented at the average exchange rate, while adjustments are recognized in the income statement.

**3.3. Cost of Borrowings**

Borrowings are recognized as an expense when incurred, regardless of their use.

**3.4. Employee Benefits**

Employee compensation, as well as all types of benefits that the Company provides to employees pursuant to the Collective Bargaining Agreement and labor agreement, are recognized as expenses of the period in which the employee worked, and also as liabilities, upon the deduction of each amount that has already been paid.

Pursuant to the effective collective bargaining agreement, the Company is obligated to pay a severance payment either in an amount equal to 1.67 minimal, monthly salaries earned in the Company in the month preceding the severance payment month, or in the amount set by the relevant law, whichever is more favorable for employee. Pursuant to the Labor Law (Official Gazette of the Republic of Serbia, No. 24 as of March 15, 2005 and 61/05), the Company is obligated to settle the severance payments amounting to, at least, 3 average salaries. In addition, the Company is liable to discharge anniversary awards for 10, 20 and 30 years of continued service with the Company, where the aforementioned anniversary awards are payable in the amount of 0.56, 1.12 and 1.67 monthly salaries earned in the Company paid for the three months preceding the anniversary award.

The Company did not perform the actuarial valuation of the present value of these legal and statutory obligations of the Company and therefore the respective provisions are not included in the accompanying financial statements.

**3.5. Provisions**

Provisions for pending litigations are charged to expenses in accordance with the management's best estimates of the expenditures required to settle such obligations.

**3.6. Donations**

The value of donated assets is initially recorded as deferred income from donations, presented under liabilities in the balance sheet, and subsequently, is credited to the income statement in the period in which the costs related to the consumption of the donated assets are recognized.

The cash donations that cover one accounting period and are intended to cover the Company's expenses, or to increase its income, are recognized as income when received.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2007***All amounts are expressed in thousands of RSD, unless otherwise stated***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.7. Taxes and Contributions****Current Income Taxes**

Current income tax represents an amount that is computed and paid in accordance with the effective Republic of Serbia Income Tax Law.

In the Republic of Serbia, income tax is payable at the rate of 10% on the tax base reported in the annual corporate income tax return as reduced by any applicable tax credits. The taxable base stated in the income tax return includes the profit shown in the statutory statement of income, as adjusted for differences that are specifically defined under statutory tax rules.

The tax regulations effective in the Republic of Serbia do not envisage that any tax losses of the current period be used to recover taxes paid within a specific carryback period. However, any current year losses may be used to reduce or eliminate taxes to be paid in future periods, but only for duration of no longer than ten ensuing years.

**Deferred Income Taxes**

Deferred tax liabilities are recognized in the amount of future income tax liabilities arising from the difference between the carrying value of property, plant and equipment and their value (cost) as recognized in the corporate tax return. There are no other temporary differences arising from the difference between the tax base of receivables and payables and their carrying value.

Deferred tax assets are recognized for all deductible temporary differences, and the tax effects of income tax losses and credits are available for carryforward, to the extent that it is probable that taxable profit will be available, against which the deductible temporary differences and the tax loss/credits of the carryforwards can be utilized.

**Indirect Taxes and Contributions**

Indirect taxes and contributions include property taxes and various other taxes and contributions paid in accordance with republic and municipal laws.

**3.8. Fair Value**

In the Republic of Serbia, sufficient market experience, stability and liquidity do not exist for the purchase and sale of financial assets or liabilities, for which published market information is neither readily, nor reliably available. Accordingly, fair value cannot readily be determined in the absence of an active market, as required under IFRS. In the opinion of management, the reported carrying amounts are the most valid and useful reporting values under the present market conditions. For the purposes of the determination of fair value, future cash flows are discounted to the net present value, by applying a discount rate equal to the contractual interest rate, which equalizes the net present value and nominal value. An allowance is recognized in the amount of the estimated risk that the carrying value of the asset will not be realized.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.9. Property, Plant and Equipment**

Items of plant and equipment shall be initially measured at its cost. The cost of an item of property, plant and equipment comprises its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The items of self-constricted assets are recognized at cost, on condition that it does not exceed the market value. The item received as donation is recognized at fair value and is stated as deferred donation income.

The borrowing costs incurred during the period of financing the acquisition of intangible assets are recognized as expenses.

Additional investments or improvements made to property and equipment, whose objective is to extend the useful life of assets, or to increase the capacity of equipment, or the quality of products, or are related to the adoption of new production processes and thus considerably decrease the operation costs, also increase the carrying value of such assets.

The gain or loss arising from on the sale or disposal of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

**3.10. Depreciation and Amortization**

Property, plant, equipment and intangible assets are depreciated and amortized over their useful life.

The estimated useful lives and depreciation rates in use for the major classes of property, plant and equipment are as summarized below:

	<u>Rate %</u>
Buildings	1.50% - 2.00%
Equipment for substations	4.00% - 5.56%
Overhead lines	2.86% - 4.00%
Vehicles	14.30%

The amortization and depreciation period and rates are verified at each accounting period end.

**3.11. Intangible Assets**

Intangible assets are stated at cost. After initial recognition, intangible assets are stated at cost, less accumulated amortization and any impairment losses.

The amortization of intangible assets is computed on a straight-line basis in order to fully write off the cost of the assets over their estimated useful lives. The applied amortization rates amounts to 20.00%.

The amortization period and method are reviewed at the end of each reporting year.

**NOTES TO THE FINANCIAL STATEMENTS**

**December 31, 2007**

*All amounts are expressed in thousands of RSD, unless otherwise stated*

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**3.12. Inventories**

Inventories shall be measured at the lower of cost and net realisable value.

The cost of inventories shall be assigned by using the weighted average cost formula.

Cost includes purchase value, import duties and other non-refundable taxes, transport, handling and other expenses directly attributable to inventories acquisition, as decreased for trading discounts, rebates and similar items. The net realizable value is the price at which inventories may be realized throughout the normal course of business, after allowing for the costs of realization.

Provisions charged to “Other expenses” are made where appropriate in order to reduce the value of inventories to the management’s best estimate of net realizable value, i.e., based on the documented decrease in the realizable value of inventories.

**3.13. Financial Instruments**

Financial assets and financial liabilities or equity instruments are recognized in the Company's balance sheet on the date upon which the Company becomes a counterparty to the contractual provisions of a specific financial instrument.

Financial assets cease to be recognized when the Company loses control of the contractual rights governing such instruments, which occurs when the rights of use of such instruments have been realized, expired, abandoned, and/or ceded. Financial liabilities cease to be recognized when the Company fulfills the obligations, or when the contractual repayment obligation has either been cancelled or has expired.

*Long-term Financial Placements*

Long-term financial placements comprise the equity investments in subsidiaries and related parties, as well as commercial banks. The equity investments in subsidiaries are stated at cost which represents the fair value of the consideration paid. Equity investments in other related parties are stated at cost in the amount of investments made.

*Accounts Receivable*

Accounts receivable are stated at their nominal values as reduced by the appropriate allowances for estimated irrecoverable amounts. The Company calculates impairment of receivables for all accounts receivable more than 60 days past due, i.e., for the receivables which are not collected until the final date set for the bringing in the foreign currency in the country. The Company makes allowance for impairment of receivables from legal entities towards which the liabilities exist on various grounds.

*Financial Liabilities*

Financial liabilities are stated at nominal value, as increased by the amount of interest expense as defined under the respective contracts.

*Accounts Payable*

Accounts payable are stated at the amount of the disbursements received.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.14. Fees for Electricity Transmission and Transmission System Operation**

With a view to improve the economic relations and financial trends, the Agreement was closed between the Company and JP EPS for the year 2007 which regulates the criteria and level of prices of electricity transmission and transmission system operation, as well as the manner and time schedules for the settlement of services rendered.

**4. ERROR CORRECTION**

The Company restated the balance of its accumulated gains disclosed in the balance sheet as of December 31, 2006 for the amount of understated income taxes for the year 2006 for the amount of RSD 2,989 thousand and for the amount of increase of deferred tax liabilities in the amount RSD 168,049 thousand based on the status change.

**5. SALES**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Revenues from electricity transmission, transmission system operation and capacity allocation	5,508,989	4,654,254
Other revenues from the sale of products and services	57,340	24,635
	<u>5,566,329</u>	<u>4,678,889</u>

**6. OTHER OPERATING INCOME**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Income from donations	113,445	83,956
Income from insurance claims	8,703	86,843
Other operating income	11,165	14,006
	<u>133,313</u>	<u>184,805</u>

**7. COST OF MATERIALS**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Materials	133,196	138,692
Spare parts	57,837	45,373
Smalls tools and fixtures	35,044	36,125
Office equipment and other materials	48,894	29,392
Fuel and energy	60,965	55,893
	<u>335,936</u>	<u>305,475</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***8. STAFF COSTS**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Gross salaries and compensations	1,066,647	1,005,617
Taxes and contributions on salaries paid by employer	202,310	182,811
Costs of service agreements	262	99
Author's right fees	391	695
Considerations paid to private individuals based on other contracts	5,091	579
Remunerations to the Management and Supervisory Board members	8,028	4,117
Business trip fees and prediems	57,246	52,567
Other staff costs	42,914	46,296
	<u>1,382,889</u>	<u>1,292,781</u>

**9. DEPRECIATION, AMORTIZATION AND PROVISIONS**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Depreciation and amortization	1,799,070	1,775,867
Provisions for litigations (Note 25)	50,956	64,691
	<u>1,850,026</u>	<u>1,840,558</u>

**10. OTHER OPERATING EXPENSES**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Transport	79,509	39,775
Maintenance	302,514	231,108
Rentals	7,798	3,922
Fair exhibition	404	12
Marketing and advertising	5	4,161
Cost of research	1,163	1,757
Other non-material services	181,453	90,446
Other non-production services	104,833	19,063
Entertainment	13,238	14,570
Insurance premiums	146,482	126,969
Bank charges	4,724	4,126
Taxes	156,499	131,737
Membership fees	6,613	4,180
Other	7,160	3,405
	<u>1,012,395</u>	<u>675,231</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***10. OTHER OPERATING EXPENSES (Continued)**

The cost of other non-material services in the amount of RSD 181,453 thousand relate to the transmission services rendered in accordance with CEE CBT Clearing and Settlement Agreement (hereinafter: the “CBT Agreement”), signed by and between the companies domiciled in the Southeast Europe, as well as services rendered to the related party - Electricity Coordinating Center (Elektrokoordinacioni centar d.o.o.).

The costs of non-production services of RSD 104,833 thousand relate to the consultant fees arising from the Electric Power Emergency Reconstruction Project from 2007.

**11. FINANCE INCOME**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Finance income from the parent and subsidiary entities	3,500	-
Interest received	359,254	208,589
Foreign exchange gains	37,060	906,325
Foreign currency clause gains	134,747	-
Other finance income	1,078	3,335
	<u>535,639</u>	<u>1,118,249</u>

**12. FINANCE EXPENSES**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Interest expenses	378,561	304,661
Foreign exchange losses	22,620	215,465
Foreign currency clause losses	59,895	-
Other finance expenses	40,826	12,299
	<u>501,902</u>	<u>532,425</u>

Interest expenses relate to the interest accrued on long-term loans in the amount of RSD 375,849 thousand and interest expenses relating to the reschedule of taxes and contributions payable in the amount of RSD 1,581 thousand.

Other finance expenses relate to the fees arising from the loan approved by the European Bank for Reconstruction and Development.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated*

## 13. OTHER INCOME

	Year Ended December 31,	
	2007	2006
Gains on the sale of intangible assets, property, plant and equipment	1,119	6,928
Gains on the sale of equity investments and long-term securities	269	-
Proceeds from the sale of material	13,363	80
Surpluses	23,646	592
Collected receivables previously written off	169	-
Write-off of liabilities	219	-
Release of long-term provisions	74,175	14,887
Gains on remeasurement of long-term financial placements and securities available-for-sale	6,738	-
Inventory count surpluses	979	-
Income from reconciliation of receivables and short-term financial placements	11,727	2,613
Rentals	2,337	-
Income arising from the final CBT calculation for 2006	104,495	-
Penalty due from JP EPS	14,519	-
Reschedule of income due from JP EPS	-	36,099
Foreign currency loan reschedule	-	33,318
Other income	8,930	13,629
	<u>262,685</u>	<u>108,146</u>

## 14. OTHER EXPENSES

	Year Ended December 31,	
	2007	2006
Loss on sale and disposal of intangible assets, property, plant and equipment	104,166	87,267
Shortages	10,181	90
Direct write-off of receivables	115	469
Loss on disposal of inventories of material and goods	490	2,469
Other not mentioned expenses	19,580	9,176
Impairment of property, plant and equipment	-	2,168
Impairment of inventories of materials and goods	-	2,938
Impairment of receivables and short-term financial placements	965,991	209,439
Other expenses	64,483	276,392
	<u>1,165,006</u>	<u>590,408</u>

Impairment of receivables relates to the receivables due from the Public Enterprise - Electric Power Industry of Serbia (“JP EPS”) arising from the access to and the use of transmission network, which are more than 60 days past due and amount to RSD 422,566 thousand, the allowance for impairment of receivables from JP EPS, dating from 2007 incurred on the grounds of CBT Agreement in the amount of RSD 372,511 thousand, the allowance for impairment of receivables from JP EPS associated with the accrued penalty of RSD 151,360 thousand and impairment of other receivables of RSD 19,554 thousand.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***15. INCOME TAXES****a) Components of Income Tax**

	<b>Year Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Current income taxes	(28,285)	(29,971)
Deferred income taxes	15,928	109,428
	<u>(12,357)</u>	<u>79,457</u>

**b) Numerical reconciliation between the tax expense and the product of accounting results multiplied by the applicable tax rate**

	<b>2007</b>	<b>2006</b>
Profit before taxation	<u>273,775</u>	<u>876,907</u>
Income tax at the statutory tax rate of 10%	27,378	87,691
Net capital losses	6,840	-
Tax effects of unrecognized income and expenses	22,352	39,422
Used, but not recognized tax credits arising from capital expenditures	(28,285)	(29,971)
Used tax loss carryforward	-	(67,171)
Deferred tax expense	<u>(15,928)</u>	<u>(109,428)</u>
	<u>12,357</u>	<u>79,457</u>

**c) Deferred tax assets / liabilities**

Deferred tax liabilities, aggregating to RSD 2,011,062 thousand as of December 31, 2007 entirely relate to temporary differences arising from depreciation of property, plant and equipment for tax purposes.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

All amounts are expressed in thousands of RSD, unless otherwise stated

## 16. PROPERTY, PLANT, EQUIPMENT AND INTANGIBLE ASSETS

	Land	Buildings	Plant, Equipment and Other Assets	Construction in Progress	Total	Intangible Assets
<b>Cost</b>						
Balance, January 1, 2007	110,682	49,019,040	62,026,740	5,890,934	117,047,396	46,108
Additions	-	26,205	390,078	3,010,669	3,426,952	7,877
Transfer from Construction in progress	1,206	791,083	1,522,522	(2,314,811)	-	-
Transfers from related parties	-	117,231	-	-	117,231	-
Sale and disposal	-	(134,972)	(177,961)	(9,940)	(322,873)	-
Transfer to inventories	-	-	(92,456)	(311,164)	(403,620)	-
Balance, December 31, 2007	<u>111,888</u>	<u>49,818,587</u>	<u>63,668,923</u>	<u>6,265,688</u>	<u>119,865,086</u>	<u>53,985</u>
<b>Accumulated</b>						
<b>Depreciation/Amortization</b>						
Balance, January 1, 2007	8,371	33,963,568	43,067,444	298,323	77,337,706	7,653
Charge for the year	-	629,562	1,163,734	-	1,793,296	5,774
Depreciation accumulated in assets transferred from other entities within EMS	-	72,785	-	-	72,785	-
Sale and disposal	-	(15,491)	(107,790)	-	(123,281)	-
Transfer to inventories	-	165	(71,827)	(29,365)	(101,052)	-
Balance, December 31, 2007	<u>8,371</u>	<u>34,650,589</u>	<u>44,051,561</u>	<u>268,958</u>	<u>78,979,479</u>	<u>13,427</u>
<b>Net Book Value</b>						
December 31, 2007	<u>103,517</u>	<u>15,167,998</u>	<u>19,617,362</u>	<u>5,996,730</u>	<u>40,885,607</u>	<u>40,558</u>
January 1, 2007	<u>102,311</u>	<u>15,055,472</u>	<u>18,959,296</u>	<u>5,592,611</u>	<u>39,709,690</u>	<u>38,455</u>

In accordance with the Law on Public Enterprises of the Republic of Serbia, the Company has the right of use over the state-owned assets. In accordance with the RS Government Decision on Establishment, the Company can not sell or acquire buildings or other immovables, plant and equipment to be used in electricity transmission and transmission system operation, without the previously obtained consent from the Republic of Serbia Government.

The right to use the assets assumed from the Public Enterprise “Elektroistok” and other public entities within JP EPS, has not been transferred to the Company and is still vested in these public enterprises.

The greatest portion of investments in fixed assets relates to funds used for the power transmission lines and substations.

The fixed assets located on the territory of Kosovo and Metohia are not used in the electricity transmission process and are not included in the net value of the Company’s fixed assets.

Advances for fixed assets as of December 31, 2007 amounted to RSD 81,931 thousand and relate to advances paid for investments of RSD 61,312 thousand and advances for the purchase of fixed assets of RSD 20,619 thousand.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated*

## 17. EQUITY INVESTMENTS

	% Share	December 31, 2007	December 31, 2006
<b>Equity investments in related parties:</b>			
- Elektroistok - Izgradnja d.o.o., Beograd	100%	71,940	115,204
- Elektroistok Projektni biro d.o.o., Beograd	100%	28,526	31,429
- Electricity Coordinating Center	25%	5,246	-
- JP Elektromreža Srbije - Kosovo		236,026	236,026
		<u>341,738</u>	<u>382,659</u>
Impairment of the equity investment in Elektroistok - Izgradnja d.o.o. Beograd		(3,778)	(13,999)
Allowance for impairment (Electricity Coordinating Center)		(443)	(418)
Allowance for impairment of Public Utility Elektromreža Srbije		(236,026)	(236,026)
		<u>(240,247)</u>	<u>(250,443)</u>
<b>Equity investments in banks:</b>			
- Panonska banka a.d., Novi Sad	Immaterial	-	111
- Privredna banka a.d., Beograd	Immaterial	162	146
Equity investments in other entities	Immaterial	3,364	8,607
		<u>105,017</u>	<u>141,080</u>

The company “Elektroistok – Izgradnja” d.o.o., Beograd deals with the construction of electric power structures, devices, power lines and plants, and the company “Elektroistok – Projektni biro” d.o.o., Beograd designs electric power structures and devices. Both subsidiaries represent the organizational parts of the Public Enterprise “Elektroistok,” Beograd, which separated on June 30, 2005 and became separate legal entities. In 2007, the capital of the company „Elektroistok – Izgradnja“ d.o.o., Beograd decreased due to the cessation at no compensation of fixed assets in favor of the Public Utility Elektromreža Srbije in the amount of RSD 43,264 thousand. In 2007, the capital of the company “Elektroistok – Projektni biro” d.o.o., Beograd decreased for the same reason by RSD 2,902 thousand.

The entity - Electricity Coordinating Center, a Limited Liability Company from Belgrade (EKC) is involved in consulting services in the field of regulating and calculating the power realized. This company was established in 1993 and operated as a coordinator of the regulatory and computation block of the Public Enterprise - Electric Power Industry of Serbia (Elektroprivreda Srbije), the Power Utility of the Republic of Macedonia (Elektroprivreda Makedonije), the Power Utility of the Republic of Montenegro and the Power Utility of the Republic of Srpska (Elektroprivreda Republike Srpske). The aforementioned Public Enterprises are the founders of the Electricity Coordinating Center with 25% equity investments. From December 1, 2007, the function of EKS has been performed by the Public Utility Elektromreža Srbije, whereas the Electricity Coordinating Center assumed the consulting services in the field of regulations and calculation of energy.

Equity investment in the Public Utility Elektromreža Srbije amounting to RSD 236,026 thousand relates to the founding investments of JP EPS in the Kosovo 2100MW Project and TSU Priština Project. Pursuant to the RS Government Decision, based on the split-off balance as of June 30, 2005 these investments were transferred to the Public Utility Elektromreža Srbije in full. Due to the uncertainty over the availability of future economic benefits arising on these placements at December 31, 2007, the aforementioned placements were provided for in full.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated*

## 18. LONG-TERM FINANCIAL PLACEMENTS

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Term deposits with banks	5,600	5,600
Long-term housing loans to employees	72,875	30,650
Other long-term financial placements	1,020	840
	<u>79,495</u>	<u>37,090</u>
Rescheduled receivables from JP EPS	1,591,937	1,836,909
Current portions of rescheduled receivables	(239,357)	(244,971)
	<u>1,352,580</u>	<u>1,591,938</u>
	<u>1,432,075</u>	<u>1,629,028</u>

The funds deposited with banks relate to the assets which collateralize guarantees obtained. These assets mature on December 31, 2008.

The portion of rescheduled receivables from the Power Utility of the Republic of Serbia of RSD 837,000 thousand relate to receivables arising on the split-off balance as of December 31, 2004 between the Company and JP EPS. The rescheduled portion of receivables is to be repaid in monthly installments over the period of 15 years. Interest is accrued by applying the discount rate set by the National Bank of Serbia, where the first installment falls due on June 30, 2006. The second portion of rescheduled receivables relates to the amounts due from the Public Enterprise Elektroistok and the JP EPS reconciled as of June 1, 2005. The aforementioned receivables in the amount of RSD 516,000 thousand are to be repaid over the period of 5 years, where the first installment fell due on January 31, 2007. From January 1, 2007, the interest is accrued monthly by applying the discount rate of the National Bank of Serbia along with the maturities of the principal.

## 19. INVENTORIES

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Material	326,674	278,709
Spare parts	175,435	180,690
Tools and fixtures	141,287	105,208
Goods in warehouse	11	5
Retail goods	741	941
Advances paid	17,087	15,596
	<u>661,235</u>	<u>581,149</u>
Less: Allowance for impairment		
- inventories	(155,711)	(127,545)
- advances paid	(428)	(403)
	<u>505,096</u>	<u>453,201</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***20. ACCOUNTS RECEIVABLE**

	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Accounts receivable:		
- parent company and subsidiaries	43,162	2,202
- domestic	2,539,471	1,071,156
- foreign	41,486	66,245
Interest receivables	189,693	128,779
Other receivables	<u>55,572</u>	<u>31,446</u>
	2,869,384	1,300,828
Allowance for impairment:		
- accounts receivable	(1,157,365)	(358,640)
- interest receivables	(151,360)	-
- other receivables	<u>(2,468)</u>	<u>(640)</u>
	<u>1,558,191</u>	<u>941,548</u>

Out of the total domestic accounts receivable, the receivables from JP EPS aggregate to RSD 2,515,319 thousand. The total receivables from JP EPS relate to receivables for the services of electricity transmission and transmission system operation in the amount of RSD 1,814,978 thousand and the receivables arising from cross-border electricity transmission in accordance with CBT agreement in the amount of RSD 700,341 thousand. The receivable arising on the cross-border electricity transmission performed in accordance with CBT Agreements are provided for in full.

**21. SHORT-TERM FINANCIAL PLACEMENTS**

	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Portion of long-term loan maturing within a year	242,652	245,507
Term deposits with domestic banks	<u>1,045,168</u>	-
	<u>1,287,820</u>	<u>245,507</u>

The portion of long-term loans maturing within a year in the amount of RSD 239,357 thousand relate to the current portion of the long-term receivables from JP EPS based on the rescheduled receivables included in the split-off balance between the Company and JP EPS as of December 31, 2004.

Term deposits placed with domestic banks are associated with deposits placed for the period shorter than a year at an interest rate fluctuating between 5.5% and 6% annually.

**22. CASH AND CASH EQUIVALENTS**

	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Dinar current accounts	24,587	27,557
Allocated cash and letters of credit	6,051	2,229
Cash in hand	2,491	2,429
Foreign currency accounts	288,463	1,367,597
Other cash and cash equivalents	<u>1,691</u>	<u>2,104</u>
	<u>323,283</u>	<u>1,401,916</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***23. VALUE ADDED TAXES AND PREPAYMENTS**

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Value added tax	844	1,547
Prepayments	<u>174,792</u>	<u>84,393</u>
	<u>175,636</u>	<u>85,940</u>

Out of the total prepayments as of December 31, 2007, an amount of RSD 107,385 thousand relates to the receivables for the uninvoiced income for the electricity transit.

**24. CAPITAL****State-Owned Capital**

The Company’s core capital is state-owned and is inscribed upon the establishment of the Company as a difference between the book value of assets and liabilities assumed from Public Enterprise "Elektroistok" and JP EPS. The state-owned capital is registered with the Serbian Business Registers Agency on July 1, 2005 in the amount of EUR 516,602,312. The registration was performed pursuant to the appraisal of the state-owned capital contributed in kind. The appraisal was performed by the local certified appraiser and comprises the assets of the Public Enterprise “Elektroistok” and other public entities within Public Utility “Elektroprivreda Srbije” as of December 31, 2004.

**Other Capital**

Other capital presented in the Company’s balance sheet as of December 31, 2007 relates to the Company’s own non-business resources transferred upon the first time application of the newly-adopted accounting regulations of the Republic of Serbia at January 1, 2004.

**Distribution of Profit**

On August 8, 2007, the Company’s Managing Board enacted a Decision with reference to the distribution of profit presented in the financial statements for the year ended December 31, 2006. Pursuant to the aforesaid Decision, profit was to absorb the loss incurred in the prior periods in the amount of RSD 544,900 thousand; an amount of RSD 61,674 thousand was to be allocated to severance pays and the amount of RSD 291,250 thousand was to be paid as dividends owed to the RS Government as the founder.

**25. LONG-TERM PROVISIONS**

Long-term provisions in the amount of RSD 64,700 thousand as of December 31, 2007 entirely relate to provisions for liabilities contingent on litigations filed against the Company in the amount assessed by the Company’s Legal Department (Note 34). The movements on long-term provisions in 2007 and 2006 were as follows:

	<u>2007</u>	<u>2006</u>
Balance, beginning of year	89,624	41,345
Charge for the year (Note 9)	50,956	64,691
Provisions used	<u>(75,880)</u>	<u>(16,412)</u>
	<u>64,700</u>	<u>89,624</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated*

## 26. LONG-TERM BORROWINGS

	<u>Principal in Currency</u>	<u>Maturity Date</u>	<u>Interest Rate and Manner of Repayment</u>	<u>December 31, 2007</u>	<u>December 31, 2006</u>
<i>1. Foreign borrowings</i>					
1.1. European Investment Bank	EUR 17,000,000	January 20, 2027	2,3% p.a., annually	1,347,015	20,418
2. Long-term loans preagreed with the Deposit Insurance Agency					
2.1 International Bank for Reconstruction and Development IBRD	EUR 20,052,291	December 15, 2031	Semiannual EURIBOR	1,650,330	1,697,934
2.2 European Investment Bank EIB	EUR 2,279,252	October 17, 2016	Semiannual EURIBOR	180,599	180,061
2.3 Kapital Hilfe					
2.3.1 Invest banka	EUR 48,560,108	March 22, 2041	2,3% p.a., semiannually	3,872,713	3,873,630
2.3.2 Vojvođanska banka	EUR 11,293,901	March 22, 2041	2,3% p.a., semiannually	900,786	901,042
				<u>7,951,443</u>	<u>6,673,085</u>
Current portions of long-term borrowings (Note 28)				<u>92,357</u>	<u>67,926</u>
				<u><u>7,859,086</u></u>	<u><u>6,605,159</u></u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***26. LONG-TERM BORROWINGS (Continued)*****1. Foreign Loans******1.1 Loan from the European Investment Bank***

Based on the Agreement on funding the project of operating the electric power system of Serbia and Montenegro, entered by an between Serbia and Montenegro, on one side, and the European Investment Bank, on the other, signed on August 31, 2002, JP EPS was approved a framework loan of EUR 59 million. On December 21, 2006, an Agreement between JP ERS and the Company was closed, based on which all rights and liabilities related to this loan are transferred to the Public Utility Elektromreža Srbije. The loan is to be drawn in tranches at the Company's requests, where the total loan funds must be disbursed in no more than 9 tranches of EUR 3 million. The limit for the use of the framework loan approved is set to be June 30, 2008. The loan is to be repaid in semiannual installments maturing on May 10 and November 10 in the period between May 10, 2010 and November 10, 2027 at variable interest rate.

***2. Long-Term Loan Preagreed with the Deposit Insurance Agency******2.1 Loan from the International Bank for Reconstruction and Development***

The loan from the International Bank for Reconstruction and Development was initially approved to the Electric Power Industry of Serbia (JP EPS). In accordance with the Loan Agreement between the Socialist Republic of Yugoslavia and the International Bank for Reconstruction and Development as of December 17, 2001, the total liabilities of the Company arising from the loan principal, interest and other expenses accrued by the end of 2001 represent the principal of the new loan, repaid to the RS Government. On May 17, 2006, JP EPS entered into an Agreement on reschedule of liabilities with the Deposit Insurance Agency, which regulates the liabilities to the Republic of Serbia arising from the loan reschedule. In accordance with the aforementioned Agreement a portion of liability of 81% of debt was transferred to the Public Utility Elektromreža Srbije. The aforementioned debt is rescheduled over the period until December 15, 2031. The repayment is to be executed in semiannual annuities, the first one being due on June 15, 2006 at a variable interest rate.

***2.2 Loan from the European Investment Bank***

The loan from the European Investment Bank was initially approved to the Public Enterprise “Elektroistok.” In conformity with the Law on the Debt of the Federal Republic of Yugoslavia towards the European Union, the loan was rescheduled in 2001 to the amount of EUR 2,065,511. On April 12, 2006, the Public Utility Elektromreža Srbije as the legal successor of the Public Enterprise Elektroistok, closed an Agreement governing the liabilities towards the Republic of Serbia. Based on the aforementioned Agreement, the loan principal was increased by interest accrued by October 17, 2005 in the amount of EUR 222,742 which was discharged by the Republic of Serbia. The related grace period lasts 10 years, and the loan is payable in 5 equal annual installments starting from October 17, 2012. The interest rate is variable and is calculated semiannually.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***26. LONG-TERM BORROWINGS (Continued)****3. Loan from Kapital Hilfe Bank**

The loan from Kapital Hilfe Bank was approved to the Public Enterprise “Elektroistok” by the Federal Republic of Germany in 1974. The loan was realized through Invest banka a.d., Beograd and Vojvođanska banka a.d., Novi Sad. The grace period lasted from 1992 to December 31, 2005.

*a) Invest banka a.d., Beograd*

On April 12, 2006, the Company entered into an Agreement on debt reschedule with the Deposit Insurance Agency. In accordance with the aforementioned Agreement, the Company’s liabilities related to this loan as of December 31, 2005 amounted to EUR 49,033,292 (EUR 46,825,100 of the principal, EUR 2,208,192 of the related interest). The loan is to be repaid in semiannual annuities commencing from September 22, 2014, accruing interest at the rate of 2.3% per annum. The loan falls due on March 22, 2041.

*b) Vojvođanska banka a.d., Novi Sad*

On December 29, 2006, the Company entered into the Agreement on Reschedule of Liabilities towards the Republic of Serbia with the Deposit Insurance Agency. According to the aforementioned Agreement, the Company’s liabilities arising from this loan as of September 22, 2006 amounted to EUR 11,405,597 (EUR 10,884,349 of the principal, EUR 521,247 of the related interest). The loan is to be repaid in semiannual annuities starting from September 22, 2018, at an interest rate of 2.3% annually. The loan matures on March 22, 2041.

**27. OTHER LONG-TERM LIABILITIES**

	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Long-term borrowings from JP EPS	2,605,800	2,005,687
Reschedule of public duties payable	45,013	48,538
Other long-term liabilities	-	793
	<u>2,650,813</u>	<u>2,054,225</u>
Current portion of long-term liabilities	(1,004,730)	(807,832)
Current portions of rescheduled public duties payable	(3,478)	(4,455)
Current portions of other long-term liabilities	(285)	(553)
	<u>(1,008,493)</u>	<u>(812,840)</u>
	<u><u>1,642,320</u></u>	<u><u>1,242,178</u></u>

The liabilities to JP EPS relate to the drawn portion of the borrowings from the European Bank for Reconstruction and Development (EBRD). The loan was approved on October 25, 2001 as agreed between JP EPS and EBRD for the purposes of realization of the Electric Power Emergency Reconstruction Project. The total amount of loan amounts to EUR 100,000,000 out of which EUR 60,400,000 relates to the Company. The loan is to be repaid in semi-annual annuities starting from September 1, 2005. The interest is accrued at the variable rate and the loan matures on March 7, 2016.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***27. OTHER LONG-TERM LIABILITIES (Continued)**

Reschedule of public duties payable relate to the taxes and contribution payable for salaries, tax on the financial transactions and other public duties as of December 31, 2004 which have been rescheduled and are now payable in 120 monthly installments at the rate equaling the discount rate set by the National Bank of Serbia. Upon the payment of the last installment, the Company is entitled to write-off 30% liabilities arising from interest accrued prior to September 30, 2004.

**28. SHORT-TERM FINANCIAL LIABILITIES**

	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Portion of long-term loans maturing within a year (Note 26)	92,357	67,926
Portion of other long-term liabilities maturing within a year (Note 27)	1,008,493	812,840
Other short-term financial liabilities	43,031	-
	<u>1,143,881</u>	<u>880,766</u>

**29. ACCOUNTS PAYABLE**

	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Accounts payable:		
- parent and subsidiary entities	38,300	36,997
- other related parties	6,442	-
- domestic	271,142	87,702
- foreign	1,875	397
Other liabilities	167,304	518,584
Advances	161,065	71,026
	<u>646,128</u>	<u>714,706</u>

**30. VALUE ADDED TAX AND OTHER DUTIES PAYABLE**

	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Value added tax	30,102	35,645
Income tax expense	-	29,971
Other public duties	6,036	36,594
	<u>36,138</u>	<u>102,210</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated*

## 31. OTHER CURRENT LIABILITIES AND ACCRUALS

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Gross salaries and compensations	34,386	163,419
Other liabilities	339,592	332,357
Donations received	1,552,187	1,408,532
Other accruals	106,499	128,874
	<u>2,032,664</u>	<u>2,033,182</u>

Movements in deferred income derived from donations received in 2007 were as follows:

	<u>2007</u>	<u>2006</u>
Balance, beginning of year	1,408,532	1,446,458
Credit for the year	257,100	45,961
Transfer to revenue	(113,445)	(83,956)
Other	-	69
Balance, end of year	<u>1,552,187</u>	<u>1,408,532</u>

## 32. OFF-BALANCE SHEET ITEMS

	<u>2007</u>	<u>2006</u>
Estimated war damage	5,732,610	5,715,521
Written off equity investments of banks in bankruptcy	48,974	48,974
Other off-balance sheet items	245,867	313,579
	<u>6,027,451</u>	<u>6,078,074</u>

## 33. CONTINGENT LIABILITIES AND COMMITMENTS

**Litigations**

At December 31, 2007, the estimated amount of litigations filed against the Company amounted to RSD 64,700 thousand. The amounts contingent on the resolution of such legal suits may be increased by the penalty inters accrued until the final resolution of litigations, i.e., until the settlement date. At December 31, 2007, the Company made provisions for potential losses contingent on these legal suits in the amount of RSD 64,700 thousand. The Company's management assesses that the litigations for which no provisions have been formed will not have adverse effects on the Company.

## 34. RELATED PARTY TRANSACTIONS

Subsidiaries	<u>Equity Investments in Related Parties</u>	<u>Receivables</u>	<u>Payables</u>	<u>Sales Revenue</u>	<u>Acquisition Expenses</u>
„Elektroistok –Projektni biro“	68,162	47	11,281	460	156,752
„Elektroistok – Izgradnja“	28,526	43,115	27,019	414	317,448
<b>Total</b>	<u>96,668</u>	<u>43,162</u>	<u>38,300</u>	<u>874</u>	<u>474,200</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2007

*All amounts are expressed in thousands of RSD, unless otherwise stated***35. OPERATING RISKS***Foreign Currency Risk*

The Company is exposed to the foreign currency risk due to the fluctuations in foreign currencies, given the fact that a number of the Company’s activities, such as acquisitions, reconciliation of trade receivables and payables are carried out as foreign currency transactions. In addition, a significant portion of the Company’s borrowings is denominated in foreign currencies. In the absence of an active market, the Company does not use financial hedging instruments in an effort to diminish its foreign exchange exposure.

*Credit Risk*

The Company is exposed to credit risk in case its debtors fail to perform their obligations. The Company’s exposure to credit risk is limited to the carrying value of accounts receivable and other receivables. Accounts receivable relate to a great number of customers transacting with the Company at usual terms, and thus, the individual concentrations of credit risk are not considered significant. Accounts and other receivables are presented in the accompanying financial statements net of allowances for bad and doubtful receivables, which are estimated by the Company’s management based on historical experience and present economic conditions.

*Taxation Risks*

The Republic of Serbia tax legislation is subject to varying interpretations, and legislative changes occur frequently. The fiscal periods remain open to review by the tax and customs’ authorities with respect to tax liabilities for a period of five years.

**36. EXCHANGE RATES**

The official exchange rates for major currencies used in the translation of balance sheet components denominated in foreign currencies, into dinars were as follows:

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
USD	53.7267	59.9757
EUR	79.2362	79.0000

**37. POST BALANCE SHEET EVENTS***New Tariff System*

At January 1, 2008, a new tariff system came into force which the Government of the Republic of Serbia adopted in the course of 2006 (the tariff system was adopted as approved by the Republic of Serbia Government – “Official Gazette of RS,” number 1, as of January 5, 2007). This tariff system regarding the access and use of the electricity transmission system sets out the tariff elements and rules for calculation of the price for the access and use of the electricity transmission system, as well as the manner of such calculations.

**NOTES TO THE FINANCIAL STATEMENTS**

**December 31, 2007**

*All amounts are expressed in thousands of RSD, unless otherwise stated*

**37. POST BALANCE SHEET EVENTS (Continued)**

***Valuation of property, plant and equipment***

As of March 6, 2008, the Company entered into an Agreement number 132 with the Faculty of Economics in Belgrade (the Scientific and Research Center) providing for the appraisal of property, plant and equipment in the Public Utility "Elektromreža Srbije" as of January 1, 2008.

***Amendments of the Existing IAS and IFRS***

As further disclosed in Note 2 to the financial statements, on February 12, 2008, the Ministry of Finance enacted a new Decision with regards to the issuance of International Financial Reporting Standards, determining the translation of the effective IAS and IFRS, delivered by the IASCF, which created the conditions and imposed the obligation to apply IAS and IFRS.