

**PUBLIC ENTERPRISE,  
ELEKTROPRIVREDA SRBIJE**

**Consolidated Financial Statements  
For the Year Ended December 31, 2004  
and Independent Auditor's Report**

**PUBLIC ENTERPRISE, ELEKTROPRIVREDA SRBIJE**

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## INDEPENDENT AUDITOR'S REPORT

### To the Board of Directors of the Public Enterprise, Elektroprivreda Srbije

1. We have audited the accompanying consolidated balance sheet of the Public Enterprise Elektroprivreda Srbije (Electric Power Company of Serbia, hereinafter: "the Enterprise" or "EPS") as of December 31, 2004, and the related consolidated statements of income, changes in equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Enterprise's management. Our responsibility is to express an opinion on these consolidated financial statements, based on our audit.
2. Except as described in paragraphs 3 to 6, we conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
3. Own work capitalized as recognized in the consolidated income statement for the year ended December 31, 2004 includes the amount of Dinar 1,284,925 thousand mainly relating to the internally produced spare parts in a consolidated public enterprise, which are recognized at standard cost. We were not provided with a detailed calculation of standard and we were therefore unable to verify whether adjustments, if any, are required to reflect actual costs.
4. As disclosed in Notes 3.2 and 15 to the accompanying consolidated financial statements, the Enterprise recognized the deemed cost of property, plant and equipment as of January 1, 2004 at fair value based on a valuation performed by an independent appraiser. The net carrying value of property, plant and equipment as of January 1, 2004 is stated in the amount of Dinar 6,490,563 thousand less than the amount determined by the independent appraiser. We were not provided with an analysis of the difference and we were therefore unable to verify whether adjustments, if any, are necessary to reflect property, plant and equipment at fair value.
5. As disclosed in Note 18 to the accompanying consolidated financial statements, inventories of materials and spare parts as of December 31, 2004 totaled Dinar 7,152,785 thousand and Dinar 6,285,031 thousand, respectively, net of allowances in the amount of Dinar 212,668 thousand. No provision has been made for excessive, and obsolete items of inventories in certain consolidated subsidiaries in the total amount of Dinar 8,526,904 thousand. As we have not been provided with an appropriate analysis of the qualitative and other relevant characteristics (of obsolete or excessive items) of these inventories, we are unable to satisfy ourselves as to the amount needed, if any, to write down inventories to their net realizable value.

## INDEPENDENT AUDITOR'S REPORT (continued)

### To the Board of Directors of the Public Enterprise, Elektroprivreda Srbije (continued)

6. As disclosed in Note 29 to the accompanying consolidated financial statements, other current liabilities and accruals include deferred income from donations received in the amount of Dinar 13,121,080 thousand as of December 31, 2004. Owing to the nature of the Enterprise's records on the donations received, based on documentation and information made available to us, we were unable to satisfy ourselves as to the valuation and completeness of the balance of the deferred income as of December 31, 2004, and the amount of Dinar 793,288 thousand recorded in the statement of income for the year ended December 31, 2004 as amortization of deferred income.
7. In accordance with the relevant regulations of the Republic of Serbia on mining and environmental protection, the Enterprise has an obligation to restore the coal quarry sites upon the completion of quarrying operations. The accompanying consolidated financial statements do not include the related land restoration provisions. We were unable to quantify the effects of the matter on the accompanying consolidated financial statements, since no assessment of the required future costs related to restoration was available.
8. As disclosed in Note 15 to the accompanying consolidated financial statements, the carrying value of land in the amount of Dinar 6,295,864 thousand as of December 31, 2004 is based on the cost determined in accordance with the previously effective accounting regulations of the Republic of Serbia, and was not a subject of fair valuation by an independent appraiser upon the Enterprise's transition to IFRS. Based on the documentation and information made available to us, we were unable to quantify the potential effects of this matter on the carrying value of land as of December 31, 2004.
9. As disclosed in Note 10 to the accompanying consolidated financial statements, land expropriation expenses recorded in the statement of income for the year ended December 31, 2004 amounted to Dinar 1,071,757 thousand. As the Enterprise will have future economic benefits from quarries on the expropriated land, in our opinion, these expenses should have been capitalized and amortized to the statement of income in the line with the consumption of the estimated resources. We were unable to quantify the effects of this matter on the accompanying consolidated financial statements.
10. The accompanying consolidated financial statements do not include provisions for long-term employment benefits with respect to employee retirement and jubilee awards in accordance with IAS 19 "Employee Benefits". We were unable to quantify the effects of the departure from IAS 19 on the accompanying consolidated financial statements.
11. The accompanying consolidated financial statements do not include the financial statements of certain subsidiaries whose primary business activities are not directly involved in the generation and distribution of electrical power. Total unaudited assets and liabilities of the subsidiaries as of December 31, 2004 amounted to Dinar 2,378,347 thousand and Dinar 1,022,855 thousand the results of their operations for the year then ended amounted to Dinar 121,007 thousand.
12. As disclosed in Note 19 to the accompanying consolidated financial statements, the net receivables from the non-consolidated subsidiaries located in the Autonomous Province of Kosovo and Metohija totaled Dinar 806,805 thousand as of December 31, 2004. In our opinion, these receivables should have been provided for in full. Accordingly, trade receivables as of December 31, 2004 and the result of operations for the year then ended are overstated by the amount of Dinar 806,805 thousand.
13. The accompanying consolidated financial statements do not include adequate disclosures as required by IAS 12 "Income Taxes", IAS 24 "Related Party Disclosures" and IAS 16 "Property, Plant and Equipment". The Enterprise has not provided disclosures in respect of an explanation of the relationship between income tax and accounting profit, the amounts of and expiry dates of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognized in the balance sheet, related parties and transactions with related parties, and capital expenditure commitments.

## INDEPENDENT AUDITOR'S REPORT (continued)

### To the Board of Directors of the Public Enterprise, Elektroprivreda Srbije (continued)

14. Certain information presented in the statement of cash flows is not reconciled with the amounts presented in the Enterprise's balance sheet as of December 31, 2004, as well as in the statements of income and changes in equity for the year then ended, accordingly, we do not express an opinion on the statement of cash flows.
15. In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary, had we been able to satisfy ourselves as to the matters described in paragraphs 3 to 6 and except for the effects on the consolidated financial statements of the matters referred to in paragraphs 7 to 13, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of Public Enterprise Elektroprivreda Srbije as of December 31, 2004, and the consolidated results of its operations and changes in equity for the year then ended, in accordance with the Accounting Regulations of the Republic of Serbia.

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

16. As disclosed in Note 2 to the consolidated financial statements, the Serbian Accounting Regulations require adoption of International Financial Reporting Standards ("IFRS") from January 1, 2004. In order to comply with the new regulations, the Enterprise made adjustments to the consolidated balances sheet as of December 31, 2003, which are disclosed in Note 4 to the consolidated financial statements. The Serbian Accounting Regulations the Serbian Accounting Regulations do not require presentation of comparative information as of and for the year ended December 31, 2003 which is departure from the requirements of IAS "Presentation of Financial Statements" and IFRS 1 "First-time Adoption of International Financial Reporting Standards", In addition, the Serbian Accounting Regulations requires presentation of financial statements in a prescribed format.
17. There are substantial uncertainties that affect the Company's accounting, financial position and operations. These uncertainties include, among other things, the future course of events and final resolution of issues concerning unconsolidated subsidiaries situated in the Autonomous Province of Kosovo and Metohija (see Note 1 to the consolidated financial statement), the suspended construction of the uncompleted power plants (see Note 15 to the consolidated financial statements), significant liabilities in respect of borrowings whose repayment has been suspended or significantly amended after the introduction of UN sanctions in 1992 (see Notes 25 and 27 to the consolidated financial statements), the breach of covenants and compliance with loan agreements (see Note 25 to the consolidated financial statements), significant potential damages in respect of various litigation (see Note 31 to the consolidated financial statements) and other assumptions and factors influencing the Company's decision to not record liabilities in respect of the use of mineral resources (see Note 31 to the consolidated financial statements). The ultimate resolution of uncertainties may result in future accounting adjustments and those adjustments could be material to the Company's financial position and results of operations.
18. As disclosed in Note 23 to the consolidated financial statements, the amounts of the state-owned capital of the consolidated public enterprises have not been inscribed in the appropriate Commercial Court jurisdictions.
19. As disclosed in Note 36 to the consolidated financial statements, the Enterprise will relinquish control over the consolidated subsidiary for the management of the power transmission grid – Elektroistok. In addition, assets in the total amount of Dinar 2,661,763 thousand will be transferred from the Enterprise to the new enterprise for the management of the power transmission grid.
20. As disclosed in Note 36 to the consolidated financial statements, in April 2005, the Enterprise settled its liabilities to creditors from the Czech Republic with substantial amounts of write offs.



Deloitte revizija d.o.o.

Belgrade

June 16, 2005

**PUBLIC ENTERPRISE ELEKTROPRIVREDA SRBIJE**

**CONSOLIDATED STATEMENT OF INCOME**  
**Year Ended December 31, 2004**  
**(Thousands of Dinars)**

	<b>Notes</b>	<b>2004</b>
<b>OPERATING INCOME</b>		
Revenue	5	71,713,350
Own-work capitalized		3,188,886
Increase in the inventories of work in progress and finished goods		68,129
Other operating income	6	2,988,179
		<u>77,958,544</u>
<b>OPERATING COSTS AND EXPENSES</b>		
Cost of goods sold		131,122
Cost of material, energy and fuel	7	14,970,825
Staff costs	8	21,535,206
Depreciation, amortization and provisions	9	18,144,315
Other operating expenses	10	15,392,915
		<u>70,174,383</u>
<b>NET OPERATING INCOME</b>		7,784,161
Finance income	11	6,084,516
Finance expenses	12	(10,491,043)
Other income	13	2,956,084
Other expenses	14	(13,475,717)
<b>LOSS BEFORE TAXATION</b>		(7,141,999)
Income tax		(13)
<b>NET LOSS</b>		<u>(7,142,012)</u>

The accompanying notes on the following pages  
are an integral part of these consolidated financial statements

These consolidated financial statements were approved by the management and the Board of Directors  
of the Public Enterprise, Elektroprivreda Srbije, Beograd on April 25, 2005

Signed on behalf of the Public Enterprise, Elektroprivreda Srbije, Beograd:

Vladimir Đorđević, Ph.D.  
General Director

Ratko Bogdanović  
Director of Finance

Dragan Jonkić  
Director of Accounting

**CONSOLIDATED BALANCE SHEET**  
**As of December 31, 2004**  
**(Thousands of Dinars)**

	<u>Notes</u>	<u>2004</u>
<b>ASSETS</b>		
<b>Non-current assets</b>		
Intangible assets	15	1,966,829
Property, plant and equipment	15	422,676,002
Equity investments	16	1,400,818
Non-current receivables and placements	17	992,225
		<u>427,035,874</u>
<b>Current assets</b>		
Inventories	18	14,985,865
Accounts receivable and other current receivables	19	16,741,187
Short-term financial placements	20	1,900,417
Cash and cash equivalents	21	6,456,417
Prepayments and estimated receivables	22	190,434
		<u>40,274,320</u>
<b>Total assets</b>		<u><u>467,310,194</u></u>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
State-owned capital	23	378,066,867
Other capital funds	23	1,657,807
Accumulated losses		(35,169,340)
		<u>344,555,334</u>
<b>Non-current liabilities</b>		
Provisions	24	459,920
Non-current interest bearing borrowings	25	40,907,703
Other non-current liabilities	26	7,191,644
		<u>48,559,267</u>
<b>Current liabilities</b>		
Current interest-bearing borrowings and other current financial liabilities	27	20,827,272
Trade liabilities	28	8,393,582
Taxes and other duties payable		1,415,137
Other current liabilities and accruals	29	24,088,306
Deferred tax liabilities	30	19,471,296
		<u>74,195,593</u>
<b>Total equity and liabilities</b>		<u><u>467,310,194</u></u>

The accompanying notes on the following pages  
are an integral part of these consolidated financial statements.

**PUBLIC ENTERPRISE ELEKTROPRIVREDA SRBIJE**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

**Year Ended December 31, 2004**

**(Thousands of Dinars)**

	<b>State-Owned Capital</b>	<b>Other Capital Funds</b>	<b>Accumulated Loss</b>	<b>Total</b>
Balance, beginning of year, after the IFRS transition adjustments (Note 4)	378,066,867	1,657,807	(34,804,180)	344,920,494
Decrease in deferred tax liabilities	-	-	8,013,651	8,013,651
Decrease in deferred tax assets	-	-	(1,309,697)	(1,309,697)
Net loss	-	-	(7,142,012)	(7,142,012)
Other	-	-	72,898	72,898
Balance, end of year	<u>378,066,867</u>	<u>1,657,807</u>	<u>(35,169,340)</u>	<u>344,555,334</u>

The accompanying notes on the following pages  
are an integral part of these consolidated financial statements.



**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**Year Ended December 31, 2004**  
**(Thousands of Dinars)**

	<u>2004</u>
<b>Cash flows from operating activities</b>	
Sales and advances from customers	56,512,371
Other operating inflows	4,309,204
Extraordinary items	989,674
Payments to suppliers	(12,997,235)
Payments to and behalf of employees	(22,302,109)
Interest paid	(52,475)
Income tax paid	(119)
Other taxed and duties paid	(13,403,928)
Other operating outflows	<u>(2,246,494)</u>
<i>Net cash from operating activities</i>	<u>10,808,889</u>
<b>Cash flows from investing activities</b>	
Sales of property, plant and equipment and intangible assets, net	561
Other financial placements (net inflows)	10,008
Interest received	5,278,318
Purchases of property, plant and equipment and intangible assets, net	(10,833,627)
Other financial placements (net outflows)	(113,735)
Interest paid	<u>(1,363,606)</u>
<i>Net cash used in investing activities</i>	<u>(7,022,081)</u>
<b>Cash flows from financing activities</b>	
Short-term and long-term borrowings (net inflows)	621,505
Other short-term and long-term liabilities	41,070
Short-term and long-term borrowings and other liabilities (net inflows)	<u>(4,604)</u>
<i>Net cash from financing activities</i>	<u>657,971</u>
<b>Net increase in cash and cash equivalents</b>	4,444,779
<b>Cash and cash equivalents, beginning of year</b>	<u>2,011,638</u>
<b>Cash and cash equivalents, end of year</b>	<u><u>6,456,417</u></u>

The accompanying notes on the following pages are an integral part of these consolidated financial statements.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004**

**1. GENERAL INFORMATION**

In accordance with the provisions of the Law regulating the Electric Power Industry in the Republic of Serbia (Official Gazette of the Republic of Serbia numbered 45/91), the Elektroprivreda Srbije, a public enterprise for the generation, transmission and distribution of electrical power and coal ("EPS" or "the Enterprise") was established, as an organizational entity into which are joined, all of the electric power generation entities doing business in the Republic of Serbia.

The Public Enterprise Elektroprivreda Srbije has twenty-two subsidiary enterprises that are involved in the generation of electrical power in hydroelectric power plants and thermal power plants, in the transmission and management of the transmission system, distribution and management of the distribution system, the sale of electrical power and mining of coal.

The Public Enterprise Elektroprivreda Srbije has control over all of its subsidiary companies except over the public enterprises situated in the autonomous region of Kosovo and Metohija (namely, the Public Enterprise for the Generation of Thermoelectric Power, TE Kosovo, the Public Enterprise for the Production, Processing and Transport of Coal, Kosovo, and the Public Enterprise for the Distribution of Electrical Power, Elektrokosmet, Priština). In June of 1999, the parent enterprise lost management control over the aforementioned entities situated in the autonomous region of Kosovo which as of that date has been under the administrative jurisdiction of the international community.

The primary goals of the future energy policy have been defined under the provisions of the Law on Power and Energy enacted on July 24, 2004 (See Official Gazette of the Republic of Serbia numbered 84/04). Based in the Law, on February 8, 2005, the Government of the Republic of Serbia enacted a Decision on the Foundation of the Public Enterprise for Power Distribution and Management of the Electrical Power System, Elektromreža Srbije, and the Decision on the Foundation of the Public Enterprise for the Generation, Distribution and Trade of Electrical Energy (See Official Gazette of the Republic of Serbia numbered 12/05).

Pursuant to the Decision of the Government of the Republic of Serbia with respect to the Foundation of the Public Enterprise for Power Distribution and Management of the Electrical Power System, Elektromreža Srbije ("EMS"), on July 7, 2005, EPS will relinquish control over its subsidiary enterprise, the Public Enterprise for the Distribution of Electrical Power, Elektroistok. The assets required for operations of EMS are to be formed from the assets of the Public Enterprise, Elektroistok, and partially from the assets held by EPS for the management of the power transmission grid (Note 36).

On July 1, 2003, as a part of EPS' reorganization plan, the public enterprise involved in subterranean coal excavation, the Resavica Coal Mine was separated from the EPS organization.

**Registered Name**

The Enterprise's legal, registered name is the Public Enterprise Elektroprivreda Srbije, with unlimited liability. The official abbreviated name of the Enterprise is: JP EPS sa p.o.  
Tax identification number: 100001409  
Registration number: 07033591

**Registered Address**

Carice Milice 2,  
11001 Belgrade  
Serbia and Montenegro

**Legal Registration**

Pursuant to Decision numbered Fi. 14410/91, the Enterprise was registered with the Commercial Court of Belgrade.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

1. ACTIVITY (Continued)

**Activity**

EPS' principal business activities are involved in the generation of electrical power and heat, the transmission and distribution of electricity, the management of the electrical power system, as well as in the mining, processing and transport of coal.

EPS also provides services in the following areas: the design, construction and maintenance of technical systems and electrical power system constructions, and other constructions within the domain of activities of the Public Enterprise, which also involve the distribution of electrical power and coal, scientific research activities with respect to the electrical power industry, geological research and testing, energy trading and distribution under the domain of the Public Enterprise, and the navigation of ships through hydroelectric power station canals onto the public, navigable waterways.

**Organizational Structure**

EPS is an electrical power company with a vertical organizational structure. In addition to the headquarters, there are twenty-two public entities that comprise the Public Enterprise Elektroprivreda Srbije: seven are involved in the generation of electrical power, three entities mine, process and transport coal, one entity transmits power, whereas eleven entities distribute the electrical power that is generated. As of June 1999, EPS is no longer in control over its operations on Kosovo, and thus can no longer utilize or manage those power capacities.

- The related public enterprises that are engaged in electrical power generation activities are:
  1. Thermoelectric Plant, Nikola Tesla, Obrenovac
  2. Thermoelectric Plant, Kostolac, Kostolac
  3. Thermoelectric Plant, Kosovo, Obilić
  4. Thermoelectric Plant, Panonske elektrane, Novi Sad
  5. Hydroelectric Plant, Đerdap, Kladovo
  6. Hydroelectric Plant, Drinske hidroelektrane, Bajina Bašta
  7. Hydroelectric Plant, Limske hidroelektrane, Nova Varoš
  
- The related public enterprises that are engaged in coal mining activities are:
  8. Coal Mine Kolubara, Lazarevac
  9. Coal Mine Kostolac, Kostolac
  10. Coal Mine Kosovo, Obilić
  
- The related public enterprise that is engaged in the transmission of electrical power is:
  11. Elektroistok, Belgrade
  
- The public enterprises that are engaged in electrical power distribution are:
  12. Elektrodistribucija Beograd, Belgrade
  13. Elektrošumadija Kragujevac, Kragujevac
  14. Elektrodistribucija Niš, Niš
  15. Elektrodistribucija Vranje, Vranje
  16. Elektrodistribucija Leskovac, Leskovac
  17. Elektrodistribucija Užice, Užice
  18. Elektrosrbija Kraljevo, Kraljevo
  19. Elektrotimok Zaječar, Zaječar
  20. Elektromorava Požarevac, Požarevac
  21. Elektrovojvodina Novi Sad, Novi Sad
  22. Elektrokosmet Priština, Priština

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

1. **ACTIVITY (Continued)**

**Form of Ownership**

The Public Enterprise EPS operates as government-owned entity. The value of the state-owned capital portion of the Enterprise's assets is recognized in an amount equal to the value of the assets transferred to EPS, as adjusted for the amount of realized gains or incurred losses.

**The EPS' Governing Bodies** comprise of a Board of Directors (eleven members), a Supervisory Board (five members) and of a General Director appointed by the Government of the Republic of Serbia. Within the EPS headquarters situated in Belgrade, there are ten main offices (or "Directorates") and four administrative "Centers." The management of EPS is comprised of the directors of the Directorates and Centers, the directors of the public entities, and the individuals who perform the managerial responsibilities and activities in accordance with the EPS by-laws regulating the internal organization and systematization of its public enterprises. EPS' Board of Directors appoints and relieves from duty the president and the members of the Board of Directors as well as the general managers of other public enterprises within the EPS system.

**Board of Directors**

By its resolutions, the EPS' Board of Directors guides the implementation of business objectives for which the enterprise was established, and is responsible for the execution of the technical, technological and economic synergy of the entire electrical power system.

**Supervisory Board**

The Supervisory Board oversees the work and operations of EPS and its public entities and enterprises, or the entities which it sets up, and it reviews their financial statements and annual reports, providing recommendations thereupon with respect to profit distributions.

**General Director**

The General Director legally represents EPS and organizes and manages the Enterprise's activities, enacts decisions and is responsible for the Enterprise's adherence and conformity with legal regulations. Further, the General Director makes recommendations to the Board of Directors with respect to the general business policies, operating and development plans, and carries out the decisions enacted by the Board of Directors.

As of December 31, 2004, EPS had 48,340 employees.

2. **BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS**

The consolidated financial statements have been prepared in accordance with the accounting regulations of the Republic of Serbia as well as with the accounting policies disclosed in Note 3.

In accordance with the Law on Accounting and Auditing, the enterprises incorporated in the Republic of Serbia are required to maintain their books of account, to prepare and present financial statements for the year ended December 31, 2004, in accordance with the accounting principles defined by the International Financial Reporting Standards (IFRS). In accordance with the "Guidelines on the Contents of the Chart of Account for Enterprises" (See Official Gazette of the Republic of Serbia no. 53/04), the Company made reclassifications in its books of account to comply with the newly-enacted statutory chart of accounts for enterprises and prepared its consolidated financial statements in accordance with the IFRS.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS**

Due to fact that the financial statement for the year ended December 31, 2004, are the subject of valuation and harmonization with the IFRS, the Company's management, following the requirements of the Serbian Accounting Regulations, and IFRS 1 "First-time Adoption of International Financial Reporting Standards", determined its IFRS transition date to be January 1, 2004. The adjustments to the Enterprise's balance sheet as of January 1, 2004 are presented in Note 4. As this date has been elected as an IFRS transition date, the Company's management anticipates that the first set of IFRS fully compliant financial statements would be issued as of and for the year ended December 31, 2005.

The consolidated financial statements are presented in accordance with the "Guidelines and Prescribed Form of the Contents of the Chart of Account for Enterprises" (See Official Gazette of the Republic of Serbia no. 75 of June 30, 2004).

In accordance with the "Guidelines on the Prescribed Form and Content of the Financial Statements of Enterprises, Cooperatives and Entrepreneurs" (See Official Gazette of the Republic of Serbia no. 75/04), the Enterprise has not presented comparative information for the year ended December 31, 2003.

The consolidated financial statements are stated in thousands of dinars. The dinar is the official reporting currency in the Republic of Serbia.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**3.1. Principles of Consolidation**

The consolidated financial statements represent the consolidation of the financial statements of twenty public enterprises joined in EPS. The intercompany balances and transactions between those enterprises have been eliminated in the consolidation process.

The financial statements of three enterprises situated in the Autonomous Province of Kosovo and Metohija have not been incorporated into the consolidated financial statements as of and for the year ended December 31, 2004, due to the fact that the Enterprise's management no longer has administrative and managerial control over the business of those entities.

The financial statements of subsidiary companies whose activities are not related to the generation, transmission and distribution of electrical power, have not been incorporated into the accompanying consolidated financial statements. Investments in those companies are stated at cost in these financial statements.

**3.2. Property, Plant, Equipment and Intangible Assets**

Property, plant and equipment are initially recognized at cost. The components of cost include: prices billed by suppliers net of discounts, import duties and other non-refundable taxes, as well as all other directly attributable costs of bringing assets to working condition for their intended use.

Internally generated items of property, plant and equipment are recognized at cost, if their cost is lower than market value. The cost of internally, or self-constructed property, plant and equipment does not include interest, administrative and other overheads.

Upon the transition to IFRS as of January 1, 2004, an appraisal of property, plant and equipment has been performed by an independent appraiser and the value of property, plant and equipment has been adjusted to fair value. The appraised value of property, plant and equipment as of January 1, 2004, in accordance with the IFRS 1, has been recognized as their deemed cost for the purposes of preparation of the opening balance sheet in accordance with IFRS. The effects of the valuation of property, plant and equipment were recorded to accumulated losses brought forward from previous years.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

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

**3.2. Property, Plant, Equipment and Intangible Assets (Continued)**

Repairs and maintenance are expensed as incurred and are presented as operating expenses.

The costs of the reconstruction of, and improvements to existing assets, which increase the capacity, improve quality or re-purpose such assets are capitalized.

Gains on the disposal of property and equipment are credited directly to "Other income," whereas any losses arising on the disposal of property, plant and equipment are charged to "Other expenses."

Intangible assets are stated at cost which includes import duties and other non-refundable taxes, as well as all other directly attributable costs, net of discounts and rebates.

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

**3.3. Depreciation and amortization**

The depreciation of property, plant and equipment and the amortization of intangible assets are computed on a straight-line basis for each individual item of property, plant, equipment and intangible assets in order to fully write off the cost of the assets over their estimated useful lives. The estimated useful lives of property, plant and equipment were determined by a certified appraiser for the assets recorded as of January 1, 2004.

Depreciation and amortization are calculated at cost or at the revalued amount of property, plant, equipment and intangible assets. Calculation of depreciation and amortization begins in the following month subsequent to which the assets have been placed into service.

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

	<b>Years</b>	<b>Rates (%)</b>
Building of hydroelectric power plants	62 - 73	1.61% - 1.37%
Buildings of thermal power plants	35 - 45	2.86% - 2.22%
Buildings for electrical power transmission	25 - 35	4.00% - 2.86%
Buildings of coal mines	28 - 37	3.57% - 2.70%
Business premises excluding the administrative and other buildings for office space, hotel management and tourism	70 - 85	1.43% - 1.18%
Equipment of hydroelectric power plants	35 - 45	2.86% - 2.22%
Equipment of thermal power plants	8 - 15	12.50% - 6.67%
Equipment in the area of electrical power transmission	18 - 25	5.56% - 4.00%
Equipment of coal mines	15 - 20	6.67% - 5.00%
Transportation equipment, excluding the aforementioned equipment	8 - 15	12.50% - 6.67%
Equipment for the maintenance of business and other premises	5 - 10	20.00% - 10.00%
Other equipment	5-8	20.00% - 12.50%

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

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

**3.4. Impairment of Property, Plant and Equipment**

At each balance sheet date, the Enterprise's management estimates the existence of any indication that the value of property, plant and equipment has become impaired based on review and consideration of internal and external sources of information.

If there is any indication that such assets have become impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset cannot be estimated, the recoverable amount of the cash generating unit, the public enterprise, is estimated.

As of December 31, 2004, according to assessment of the Enterprise's management, there were no indications that property, plant and equipment were impaired.

**3.5. Inventories**

Inventories are comprised of raw materials and supplies (primary and auxiliary), spare parts, tools and work-in-progress and finished product inventories.

Inventories are stated at the lower of cost and net realizable value. Cost includes the invoiced value, import duties and other non-refundable taxes, transportation costs, handling and all other costs directly attributable to the acquisition of inventories, net of discounts, rebates and other similar items.

Cost is computed using the weighted-average method. The weighted average of cost is calculated upon each new delivery of inventories.

The cost of work-in-progress and finished goods is formed based upon the cost of direct materials, cost of employee compensation and production overheads, including purchasing and technical management overheads, in the amounts necessary to bring the inventories to their specific location and condition as of balance sheet date.

Tools and inventories are fully written off when issued into use.

Allowances, which are charged to "Other expenses," are established when assessed as appropriate to reduce the value of inventories to their net realizable value, or when there are identified instances of impairment.

**3.6. Financial Instruments**

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

Initially, financial assets and liabilities are recognized at cost which represents the fair value of the consideration provided (assets) or received (liabilities).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Financial Instruments (Continued)

*Equity Investments*

Equity investments in non-consolidated subsidiaries and other equity investments are stated at cost.

*Non-current Receivables and Placements*

Non-current receivables and placements are initially recognized at cost and subsequent to recognition are based upon:

- fair value, if such assets are held for sale,
- amortized costs, if such assets have fixed maturities,
- cost, if such assets have no fixed maturities.

The differences between the carrying amount of assets, and subsequent measurements are recognized as a gain or loss in the profit or loss for the period.

*Short-Term Receivables and Placements*

Short-term receivables include accounts receivable and other receivables, as well as short-term placements with non-consolidated subsidiary companies, the short-term deposits with banks and other short-term financial investments.

Accounts receivable with respect to the sale of electrical power and other products or services, are stated at invoiced value. The invoiced interest associated with the sale of products and services is recognized as "Finance Income," and is recorded as income in the period it is accrued.

Other receivables and placements are measured at amortized cost.

*Impairment of Financial Assets*

At each balance sheet date, an evaluation of objective evidence is performed by an analysis of the expected cash inflows, in the following manner:

- individually for significant assets, or
- based on a portfolio of similar financial assets which are not individually identified as being impaired.

The estimation of the collectibility or recoverability of accounts receivable with respect to the sale of electrical power is based upon the particular groups of debtors. An allowance is recorded for the outstanding receivables from legal entities that have not been collected within a period of sixty days from their original maturities. Exceptionally, for those debtors, the estimation of collectibility may be performed on an individual basis. The Company does not record an allowance for receivables from the legal entities which are concurrently its suppliers or creditors.

An allowance in the full amount is provided for the receivables that are the subject of pending legal proceedings. A direct write-off of receivables is taken upon the conclusion of legal proceedings or in accordance with relevant management decision.

*Financial Liabilities*

Financial liabilities are initially recognized at the value of the consideration received. Upon initial recognition, financial liabilities are measured at the initially recognized amount, less repayments of principal, plus accrued interest and less any write-off approved by the creditor. The interest liabilities associated with financial liabilities are charged to profit or loss for the period, and are stated under "Other short-term liabilities and accruals."



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

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

**3.7. Provisions**

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

**3.8. Donations**

The value of donated assets is initially recorded as deferred income from donations, as stated within liabilities in the balance sheet, and subsequently, is credited to the Statement of Income in the period in which the costs related to the consumption of the assets received from donations are recognized.

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

**3.9. Income Taxes**

Current income tax represents the amounts calculated in accordance with the provisions of the Republic of Serbia Law on Corporate Income Tax.

The income tax for the year ended December 31, 2004 is payable at the rate of 12.33% on the tax base reported in the annual corporate income tax return. The taxable base includes the profit stated in the statutory statement of income, as adjusted for differences that are specifically defined under the tax rules of Republic of Serbia. The income tax rate for fiscal periods beginning on or after January 1, 2005 is 10%.

The Republic of Serbia tax regulations do not allow any tax losses of the current period to 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.

Tax effects with respect to the temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases, are disclosed as either deferred tax assets or deferred tax liabilities.

Deferred tax assets are recognized in instances in which management anticipates that profits will be available in future periods.

Deferred tax liabilities are recognized for all taxable temporary differences.

In its relevant tax decision, the Republic of Serbia Tax Authority approved the tax consolidation scheme for the Public Enterprise, Elektroprivreda Srbije and its subsidiaries, as effective commencing on the financial year ended December 31, 2003. The approved tax consolidation scheme is to be applied during the ensuing five years.

**3.10. Indirect Taxes and Contributions**

Indirect taxes and contributions include property taxes and various other taxes, contributions and fees paid pursuant to the applicable republic and municipal tax regulations. These taxes are stated under "Other expenses."

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

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

**3.11. Revenues and Expenses**

Revenues with respect to the sale of electrical power are recognized in the period in which the electrical power is delivered.

Revenues from services rendered are recognized in the period in which such services are performed.

Income from sales of goods is recognized when the risk and rewards associated with the rights of ownership are transferred to the customer, which is considered to be upon the delivery of products to the customer.

Income is measured at the fair value of the consideration received or that will be received, less any effective discounts and sales taxes.

**3.12. Effects of Foreign Currency Translation**

Transactions denominated in foreign currencies are translated into dinars at the official exchange rates prevailing at the date of each transaction.

Assets and liabilities denominated in foreign currencies are translated at the balance sheet date by applying the official rates of exchange prevailing on that date.

The net foreign exchange gains or losses arising upon translation of transactions during the year and on the re-translation of the balance sheet items denominated in foreign currencies, are credited or debited as appropriate, to the Statement of Income.

**3.13. Correction of Fundamental Errors**

Fundamental errors occur as a consequence of a variety of reasons, such as, mathematical errors, or errors with respect to the application of accounting policies, the inappropriate interpretation of facts, or are caused by oversights, and are subsequently adjusted by the restatement of the opening balance of retained earnings or accumulated loss. Immaterial errors are recognized in the Statement of Income as they are incurred.

**3.14. 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 not readily nor reliably available. Accordingly, fair value cannot readily be determined in the absence of an active market, as required under IFRS. 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.

**PUBLIC ENTERPRISE ELEKTROPRIVREDA SRBIJE**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**4. OPENING BALANCE SHEET ADJUSTMENTS WITH RESPECT TO THE FIRST-TIME ADOPTION OF IFRS**

The following is a reconciliation of equity components as of December 31, 2003, before transition adjustments to the new Accounting Regulations of the Republic of Serbia, and such components as of January 1, 2004 after the transition adjustments:

	<b>State-owned Capital</b>	<b>Other Capital Funds</b>	<b>Revaluation Reserves</b>	<b>Accumulated Losses</b>	<b>Total</b>
Balance, December 31, 2003					
before the transition adjustments:	236,705,561	-	162,055,767	(202,200,361)	196,560,967
The transition adjustments:					
- Release of revaluation reserves	162,055,767	-	(162,055,767)	-	-
- Release of deferred revaluation income	-	-	-	12,232,909	12,232,909
- Transfer from non-operating assets	-	1,673,371	-	92,727	1,766,098
- Effects of the valuation of property, plant and equipment	168,434	-	-	189,314,947	189,483,381
- Adjustments of interest liabilities on refinanced borrowings	-	-	-	(636,349)	(636,349)
- Write-off of intangibles, property, plant and equipment	-	-	-	(31,384,643)	(31,384,643)
- Provision for current and non-current receivables from the Resavica Coal Mine	-	-	-	(1,166,527)	(1,166,527)
- Provision for the property, plant and equipment in the Autonomous Province of Kosovo and Metohija	-	-	-	(1,412,038)	(1,412,038)
- Recognition of deferred tax liabilities	-	-	-	(27,484,947)	(27,484,947)
- Adjustments to the opening balance of state-owned capital	(20,883,797)	-	-	20,883,797	-
- Recognition of deferred tax assets	-	-	-	1,309,697	1,309,697
- Inventory count surplus	-	-	-	676,424	676,424
- Recognition of property, plant and equipment	-	-	-	5,817,389	5,817,389
- Provision for inventories classified under PP&E	-	-	-	(412,289)	(412,289)
- Provision for interest receivable from customers	-	-	-	(243,260)	(243,260)
- Reversal of allowances for other receivables	-	-	-	328,630	328,630
- Provision for long-term placements in the Autonomous Province of Kosovo and Metohija	-	-	-	(320,261)	(320,261)
- Other	20,902	(15,564)	-	(200,025)	(194,687)
	<u>378,066,867</u>	<u>1,657,807</u>	<u>-</u>	<u>(34,804,180)</u>	<u>344,920,494</u>
Balance, January 1, 2004					
After the transition adjustments:	<u>378,066,867</u>	<u>1,657,807</u>	<u>-</u>	<u>(34,804,180)</u>	<u>344,920,494</u>

**5. REVENUE**

	<b>Thousands of Dinars</b>
	<b>2004</b>
Sale of electricity	65,958,585
Sale of coal	2,463,705
Sale of engineering steam and gas	1,236,424
Rendering of services	1,259,119
Fees for the transit of electricity through the Republic of Serbia	416,086
Other	379,431
	<u>71,713,350</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

6. OTHER OPERATING INCOME

	<b>Thousands of Dinars</b>
	<b>2004</b>
Income from donations	793,288
New customer connection fees	1,160,098
Rental income	37,585
Other operating income	997,208
	<u>2,988,179</u>

7. COST OF MATERIALS, ENERGY AND FUEL

	<b>Thousands of Dinars</b>
	<b>2004</b>
External electricity purchases	2,837,083
Materials for maintenance and spare parts	7,208,026
Oil derivatives	2,899,093
Natural gas	806,678
External coal purchases	310,106
Office and general administrative supplies	226,878
Other	682,961
	<u>14,970,825</u>

8. STAFF COSTS

	<b>Thousands of Dinars</b>
	<b>2004</b>
Gross employee compensations	16,801,106
Contributions payable by the employer	3,507,993
Employee termination and retirement benefits	37,938
Jubilee awards	148,823
Employee commuting costs	715,164
Other staff costs	324,182
	<u>21,535,206</u>

9. DEPRECIATION, AMORTIZATION AND PROVISIONS

	<b>Thousands of Dinars</b>
	<b>2004</b>
Depreciation and amortization	17,872,368
Increase in provisions	271,947
	<u>18,144,315</u>

**PUBLIC ENTERPRISE ELEKTROPRIVREDA SRBIJE**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**10. OTHER OPERATING EXPENSES**

**Thousands of Dinars**  
**2004**

Insurance premiums	1,323,788
Public water utility fees	1,075,246
Municipal land utility fee	549,125
Fees for use of environmental resources	319,042
Property tax	266,800
Other indirect taxes, contributions and fees	244,824
Expropriation	1,071,757
Maintenance and repair services	4,964,544
Telecommunications	366,623
Transportation	171,866
Rent	330,874
Research	185,815
Utilities	222,693
Student and youth organizations	386,180
Bank fees and charges	475,093
Other services	1,395,884
Discounts to customers for timely settlements	599,303
Court fees	126,015
Sponsorships and donations	93,417
Other	1,224,026
	15,392,915

**11. FINANCE INCOME**

**Thousands of Dinars**  
**2004**

Interest income	4,619,169
Foreign exchange gains	1,229,257
Other finance income	236,090
	6,084,516

Interest income primarily relates to the interest charged to customers for late settlements at the legally-prescribed penalty interest rates.

**12. FINANCE EXPENSES**

**Thousands of Dinars**  
**2004**

Interest expense	2,705,356
Foreign exchange losses	7,651,719
Other finance expenses	133,968
	10,491,043

**PUBLIC ENTERPRISE ELEKTROPRIVREDA SRBIJE**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**13. OTHER INCOME**

**Thousands of Dinars**  
**2004**

Gains on the sale of property, plant, equipment and intangible assets	81,838
Collections of receivables previously provided for and written off	2,069,966
Write-off of liabilities	66,778
Inventory count surpluses	308,574
Prior year income	145,704
Other	283,224
	<u>2,956,084</u>

**14. OTHER EXPENSES**

**Thousands of Dinars**  
**2004**

Losses on the disposal and retirement of property, plant, equipment, and intangible assets	542,962
Inventory count shortages	50,865
Write-off of receivables	683,320
Losses on impairment of:	
- accounts receivable and other current receivables	9,332,355
- other assets	279,620
Prior year expenses	993,310
Staff costs of the employees of the non-consolidated public enterprises located in Kosovo and Metohija	1,472,213
Other	121,072
	<u>13,475,717</u>

**15. PROPERTY, PLANT, EQUIPMENT AND INTANGIBLE ASSETS**

**Thousands of Dinars**  
**2004**

<b>Property, plant and equipment</b>	
Land	6,295,864
Buildings	207,584,571
Investment property	112,437
Plant and equipment	172,194,139
Construction in progress	35,133,225
	<u>421,320,236</u>
Advances for property, plant and equipment	1,355,766
	<u>422,676,002</u>
 <b>Intangible Assets</b>	
	<u>1,966,829</u>

The carrying value of land is recognized at the amounts based on the previously-effective accounting regulations prevailing in the Republic of Serbia, and has not been the subject of a valuation by an independent appraiser.

Advances for property, plant and equipment are stated net of allowances for impairment in the amount of Dinar 83,632 thousand as of December 31, 2004.

**PUBLIC ENTERPRISE ELEKTROPRIVREDA SRBIJE**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**15. PROPERTY, PLANT, EQUIPMENT AND INTANGIBLE ASSETS (Continued)**

The movements in the balances of property, plant and equipment and intangible assets during the year ended December 31, 2004 are summarized in the following table.

	<b>Land</b>	<b>Buildings</b>	<b>Investment Property</b>	<b>Plant and Equipment</b>	<b>Construction in Progress</b>	<b>Total</b>	<b>Intangible Assets</b>
Balance, beginning of the year, before the transition adjustments	6,154,117	472,414,234	-	383,261,281	42,263,355	904,092,987	35,221,096
The transition adjustments:							
- Effects of valuation	-	36,703,853	-	162,069,590	(9,398,360)	189,375,083	-
- Recognition of assets	-	2,664,283	-	3,153,106	-	5,817,389	-
- Transfer of non-operating assets	11,075	1,809,206	-	319,104	75,661	2,215,046	-
- Reclassifications between the classes	(752)	(305,967)	233,830	40,065	347,147	314,323	(314,323)
- Transfer to long-term placements	-	-	-	-	-	-	(320,261)
- Write-offs	443	(2,310,609)	-	(1,506,513)	(12,202)	(3,828,881)	(32,137,693)
- Physical verification surpluses	-	1,710,286	-	67,165	-	1,777,451	-
- Recognition of and adjustments to assets from donations	-	(23,577)	-	367,077	318,037	661,537	-
- Reclassifications to and from inventories	-	-	-	(35,253)	109,503	74,250	-
- Other	-	353,280	-	(499,121)	22,453	(123,388)	224
Balance, beginning of the year, after the transition adjustments	6,164,883	513,014,989	233,830	547,236,501	33,725,594	1,100,375,797	2,449,043
Additions	75,512	909,672	-	1,677,555	12,731,016	15,393,755	155,738
Transfers	66,987	1,393,916	-	9,073,165	(10,433,728)	100,340	(100,340)
Disposals	(1,911)	(1,024,773)	-	(2,885,733)	(363,675)	(4,276,092)	(23,250)
Reclassifications from inventories	-	-	-	-	23,300	23,300	-
Other	(1,198)	16,846	-	146,002	(107,175)	54,475	(28,674)
Balance, end of the year	<u>6,304,273</u>	<u>514,310,650</u>	<u>233,830</u>	<u>555,247,490</u>	<u>35,575,332</u>	<u>1,111,671,575</u>	<u>2,452,517</u>
<b>Accumulated depreciation and amortization</b>							
Balance, beginning of the year, before the transition adjustments	-	332,993,145	-	343,187,741	6,024	676,186,910	1,376,399
The transition adjustments:							
- Effects of valuation	-	(31,268,627)	-	31,168,317	(5,963)	(106,273)	-
- Transfer of non-operating assets	-	527,454	-	117,345	-	644,799	-
- Reclassifications between the classes	-	(151,771)	118,421	(20,355)	-	(53,705)	53,705
- Write-offs	-	(2,160,749)	-	(1,458,843)	-	(3,619,592)	(962,339)
- Physical verification surpluses	-	1,065,436	-	35,591	-	1,101,027	-
- Recognition of and adjustments to assets from donations	-	(29,434)	-	(484,905)	-	(514,339)	-
- Provision for assets located in Kosovo and Metohija	8,409	618,843	-	784,786	-	1,412,038	-
- Provision for spare parts classified under PP&E	-	-	-	-	412,289	412,289	-
- Reclassifications to and from inventories	-	-	-	(33,171)	-	(33,171)	-
- Other	-	343,611	-	92	29,818	373,521	(479)
Balance, beginning of the year, after the transition adjustments	8,409	301,937,908	118,421	373,296,598	442,168	675,803,504	467,286
Charge for the year	-	6,043,235	2,972	11,806,980	-	17,853,187	19,181
Reclassifications	-	(578,954)	-	578,954	-	-	-
Disposals	-	(520,301)	-	(2,273,552)	-	(2,793,853)	(779)
Other	-	(155,809)	-	(355,629)	(61)	(511,499)	-
Balance, end of the year	<u>8,409</u>	<u>306,726,079</u>	<u>121,393</u>	<u>383,053,351</u>	<u>442,107</u>	<u>690,351,339</u>	<u>485,688</u>
<b>Net book value</b>							
as of December 31, 2004	<u>6,295,864</u>	<u>207,584,571</u>	<u>112,437</u>	<u>172,194,139</u>	<u>35,133,225</u>	<u>421,320,236</u>	<u>1,966,829</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**15. PROPERTY, PLANT, EQUIPMENT AND INTANGIBLE ASSET (Continued)**

As of January 1, 2004, the Enterprise de-recognized intangible assets which did not meet the recognition criteria under IAS 38 "Intangible Assets."

As of January 1, 2004, the Enterprise recognized an additional hydro electric plant, "Derdap 2" in the total amount of Dinar 5,817,389 thousand, comprised of buildings totaling Dinar 2,664,283 thousand and plant and equipment totaling Dinar 3,153,106 thousand, based on the Minutes of the 68th National Assembly of Serbia and Montenegro and the Romanian Commission held on the dates of November 18-20, 2003.

Construction in progress and intangible assets as of December 31, 2004 include the amounts of Dinar 11,893,686 thousand and Dinar 1,752,290 thousand, respectively relating to the construction expenses of a new thermoelectric plant, TE-TO Kolubara B within the Public Enterprise, Thermoelectric Plant, Nikola Tesla, Obrenovac. Also, non-current receivables and placements include Dinar 625,865 thousand representing investments in the joint construction of the Rovni Water Accumulation Basin situated on the Jablanica River, which is planned for use by the new "Kolubara B" power plant once it is completed. The thermoelectric plant construction ceased, and the completion of this project is dependent upon the decisions of the Government of Republic of Serbia. In addition, construction in progress as of December 31, 2004 includes various projects in the total amount of Dinar 3,742,289 thousand, for which no significant progress for completion has been made in the prior years. The aforementioned amounts of construction in progress are based on fair values as determined by the independent appraiser as of January 1, 2004. The final outcome of these projects is highly dependent upon the future plans of the management of the Enterprise and the decisions of the Government of the Republic of Serbia.

**16. EQUITY INVESTMENTS**

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b>2004</b>
	<hr/>
Equity investments in unconsolidated subsidiaries	878,570
Other equity investments	707,638
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	1,586,208
Allowances for the impairment	(185,390)
	<hr/>
	<u>1,400,818</u>

The equity investments in unconsolidated subsidiaries as of December 31, 2004 relate to the subsidiaries of the consolidated public enterprises whose primary business activities are not involved in electric power generation, transmission or distribution (i.e., hotels, restaurants and auxiliary services).



**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**17. NON-CURRENT RECEIVABLES AND PLACEMENTS**

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b>2004</b>
	<hr/>
Non-current receivables from the Resavica Coal Mine	403,871
Rescheduled accounts receivable	2,423,878
Joint investment in the water accumulation basin, Rovni	635,002
Other long-term placements and receivables	704,430
	<hr/>
	4,167,181
Allowances for the impairment of:	
- Non-current receivables from the Resavica Coal Mine	(403,871)
- Rescheduled accounts receivable	(2,331,592)
- Other long-term placements and receivables	(439,493)
	<hr/>
	(3,174,956)
	<hr/>
	992,225
	<hr/> <hr/>

Interests in the joint investment in the Rovni water accumulation basin on the Jablanica River are associated with the investments that are slated for use by the new power plant to be constructed within the Thermoelectric Plant Nikola Tesla, Obrenovac ("Kolubara B"). During past years, there has been no significant progress in the construction of this plant and the final outcome of the project is highly dependent upon the future decision of the Government of the Republic of Serbia.

Based on the relevant resolutions of the EPS Board of Directors, in order to improve collections of accounts receivable, the Enterprise reschedules its overdue accounts receivable from select customers to be repaid in monthly installments over periods of up to ten years at an interest rate of 1% per annum which is to be adjusted if the retail price index exceeds the annual rate of 12.68%; in which instance the interest rate is then adjusted to the amount of the annual increase in the retail price index. In view of the significant uncertainties with respect to the recoverability and collection of these receivables, as of December 31, 2004, they have been for the most part, provided for in the full amount of the outstanding receivable balances.

**18. INVENTORIES**

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b>2004</b>
	<hr/>
Material	7,152,785
Spare parts	6,285,031
Tools and consumables	251,177
Work in progress and finished goods	274,543
Goods for resale	857
Advances to suppliers	1,402,667
	<hr/>
	15,367,060
Allowance for:	
- slow excessive and obsolete inventories	(212,668)
- advances to suppliers	(168,527)
	<hr/>
	(381,195)
	<hr/>
	14,985,865
	<hr/> <hr/>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**19. ACCOUNTS RECEIVABLE AND OTHER CURRENT RECEIVABLES**

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b>2004</b>
	<hr/>
Accounts receivable:	
- non-consolidated subsidiaries located in Kosovo and Metohija	806,805
- other non-consolidated subsidiaries	237,178
- domestic customers	37,820,713
- foreign customers	3,153,060
- the Resavica Coal Mine	808,929
Interest receivable	51,938
Receivables from employees	607,966
Other receivables	1,194,454
	<hr/>
	44,681,043
Allowances for bad and doubtful receivables from:	
- non-consolidated subsidiaries	(5,483)
- domestic customers	(24,144,749)
- foreign customers	(2,631,932)
- the Resavica Coal Mine Resavica	(808,929)
- other receivables	(348,763)
	<hr/>
	(27,939,856)
	<hr/>
	16,741,187
	<hr/> <hr/>

The terms and tariffs associated with the supply of electrical energy to customers are regulated by the relevant decisions of the EPS' Board of Directors, which subsequently, are approved by the Government of the Republic of Serbia.

Foreign accounts receivable are primarily comprised of the receivables from electric power enterprises situated in the former Yugoslav republics, which have been provided for in the full amounts.

**PUBLIC ENTERPRISE ELEKTROPRIVREDA SRBIJE**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**20. SHORT-TERM FINANCIAL PLACEMENTS**

	<b>Thousands of Dinars</b> <b>December 31,</b> <b>2004</b>
Short-term deposits with banks	1,504,996
Non-interest bearing loans to unconsolidated subsidiaries	308,218
Other	96,837
	1,910,051
Allowances for impairment	(9,634)
	1,900,417

**21. CASH AND CASH EQUIVALENTS**

	<b>Thousands of Dinars</b> <b>December 31,</b> <b>2004</b>
Current accounts:	
- in dinars	5,012,722
- in foreign currencies	1,025,705
Cash cover deposits for letters of credit	334,020
Cash on hand and other cash equivalents	83,970
Unavailable funds	176,360
	6,632,777
Allowance	(176,360)
	6,456,417

Unavailable funds relate to current accounts held with certain U.S. banks which were frozen upon the introduction of the UN sanctions against the Federal Republic of Yugoslavia in 1992, and the current accounts with domestic banks which are presently undergoing bankruptcy and liquidation proceedings. These balances have been provided for in full.

**22. PREPAYMENTS AND ESTIMATED RECEIVABLES**

	<b>Thousands of Dinars</b> <b>December 31,</b> <b>2004</b>
Receivables for power exchanges and lending with other foreign electric power distribution systems abroad	165,681
Other	24,753
	190,434

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**23. EQUITY**

**State-Owned Capital**

State-owned capital represents the sum of the state-owned capital of the consolidated public enterprises which are equal to the initial contributions as adjusted by revaluation using the retail price index up to December 31, 2000, and by the IFRS transition adjustments as of January 1, 2004.

The amounts of the state-owned capital of the consolidated public enterprises have not been inscribed in the appropriate Commercial Court jurisdictions.

**Other Capital Funds**

Other capital stated in the amount of Dinar 1,657,807 thousand as of December 31, 2004 relates to the consolidated public enterprises' sources of non-operating assets, that were transferred upon the transition to IFRS, in accordance with the provisions of IFRS 1, "First-Time Adoption of International Financial Reporting Standards" and the Serbian Accounting Regulations.

**24. PROVISIONS**

Provisions in the amount of Dinar 459,920 thousand as of December 31, 2004 relate to provisions made for the estimated outflows of funds that may arise upon the conclusion of the pending legal proceedings that have been filed against the Enterprise.

Movements in this provision during the year ended December 31, 2004 were as follows:

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b><u>2004</u></b>
Balance, beginning of year	261,629
Charged to the statement of income	271,947
Used during the year	(33,861)
Realized to the statement of income	<u>(39,795)</u>
Balance, end of year	<u><u>459,920</u></u>

The newly-enacted Law on Electric Power Industry (See Official Gazette RS 70/04) and the Decree of the Government of the Republic of Serbia on the Establishment of a Public Enterprise Engaged in the Generation, Distribution and Trade of Electric Energy, effective as of July 1, 2005, defines the new organizational structure of the Enterprise. No provision for the resulting restructuring has been recognized in these financial statements due to the lack of a formal, detailed restructuring plan, based upon which, the amount of the corresponding provision could be measured reliably.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004

## 25. NON-CURRENT INTEREST-BEARING BORROWINGS

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b>2004</b>
<i>Loans in foreign currencies:</i>	
Liabilities with respect to refinanced loans originated prior to 1990 from:	
- the Paris Club of Creditors	25,508,494
- the London Club of Creditors	1,371,059
- the International Bank for Reconstruction and Development (IBRD)	2,119,652
- the European Investment Bank (EIB)	195,880
- the Government of the Russian Federation via domestic banks currently in bankruptcy	2,649,711
Loans received from foreign governments originated after 1990:	
- PR China via domestic banks currently in bankruptcy	2,682,193
- the Russian Federation via domestic banks currently in bankruptcy	558,979
- the Republic of Poland	1,819,514
The European Bank for Reconstruction and Development (EBRD)	514,399
Kreditanstalt für Wiederaufbau (KfW)	3,809,251
The Republic of Serbia Development Fund	903,198
Other	30,184
	<u>42,162,514</u>
<i>Loans in dinars:</i>	
Ministry of Finance of the Republic of Serbia	1,899,090
Domestic banks currently in bankruptcy	348,852
Other	8,637
	<u>2,256,579</u>
Amounts due within one year:	
- in dinars	(102,827)
- in foreign currencies	(3,408,563)
	<u>(3,511,390)</u>
	<u>40,907,703</u>

Repayments of the refinanced loans originated prior to 1990, which were drawn down through various domestic banks, and the related interest were frozen and discontinued upon the introduction of the United Nations' Sanctions against the F.R. of Yugoslavia in 1992.

In December 2001, the negotiations between the Government of the Federal Republic of Yugoslavia and the Paris Club of Creditors resulted in a significant write-off of liabilities (of principal, interest and penalty interest up to March 22, 2002) in the amount of 51%, with the possibility of an additional write-off in three years of up to a maximum level of 66.67%, in addition to a pre-agreed, substantial rescheduling of past debts. The Law on the Regulation of the Relations between the Federal Republic of Yugoslavia and the Legal Entities and Banks Situated on the Territory of the Federal Republic of Yugoslavia, Which Were Originally the Principal Debtors or Guarantors to the Paris and/or London Club Group of Creditors, was enacted on July 4, 2002 (the "Law", also See Official Gazette of the Federal Republic of Yugoslavia numbered 36/2002). In accordance with the aforesaid Law, the Enterprise is under an obligation to repay the loans from the Paris and London Club of Creditors to the domestic banks through which the borrowings were originally drawn down, under terms that are not to be less favorable than those delineated under the agreements entered into with the foreign creditors. Based on a reconciliation of the amounts with the National Bank of Serbia (NBS), the Enterprise determined the new carrying value of the loans from the Paris Club of Creditors as of March 22, 2002, which reflects a write-off in the amount of 51% of the loans originated from the members of the Paris Club of Creditors with which individual bilateral agreements on such write-downs have been executed. Pursuant to Paragraph 5 of the Law, the domestic banks are obligated to draft and execute new agreements with their debtors so as to determine the appropriate amount and terms of settlement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 2004**25. NON-CURRENT INTEREST-BEARING BORROWINGS (continued)**

As of the date of these consolidated financial statements, no settlement agreements have been concluded for the loans totaling Dinars 24,583,180 thousand, due to the fact that such loans were granted through the banks that are presently undergoing bankruptcy proceedings. On January 23, 2003, the Supreme Court of Serbia and Montenegro effectively nullified Paragraph 5 of the aforementioned Law (See Official Gazette of the Federal Republic of Yugoslavia no. 7/2003).

The liabilities connected with these loans are to be repaid in semi-annual installments in the period from 2005 to 2024, at interest rates ranging from 0.5% to 6.25% (depending upon the individual members of the Paris Club of Creditors, and the currency in which the loans are denominated). Sixty percent of the interest accrued in the first five years of the loan repayment schedule is capitalized to principal.

Liabilities originating from the London Club of Creditors are carried at their principal amounts outstanding as of 1992, and the interest accruals were based on the latest available information on interest rates. As of the date of these consolidated financial statements, it is not possible to determine with certainty the valuation and maturity of the Enterprise's related liabilities, and the effects of the write-offs, if any, approved by the London Club of Creditors. As of December 31, 2004, the liabilities on these loans are mainly included in the loan amounts due within one year.

In accordance with the Agreement entered into between the Government of the Federal Republic of Yugoslavia and the IBRD dated December 17, 2001, the total amount of liabilities for principal, interest and other expenses accrued up to the end of 2001, represents the principal of a new loan denominated in euros, which is to be repaid in semi-annual installments in the period from June 15, 2005 to December 15, 2031 and carries a variable interest rate.

Loans from the Government of the Republic of Poland, that were realized through Vojvodjanska banka A.D., Novi Sad in 2003 are repayable in 28, semi-annual installments, having an applicable grace period of two years at an annual interest rate of 0.75 percent.

The EBRD Loan extended in 2001 in the amount of EUR 100 million, is repayable in semi-annual installments in the period from September 7, 2005 to March 7, 2016 at an annual interest rate equal to EURIBOR + 1%. The loan draw-down period expires on June 30, 2005.

In 2003, the EBRD extended another loan to EPS in the amount of EUR 60 million, repayable in semi-annual installments in the period from March 7, 2008 to September 7, 2018 at an annual interest rate equal to EURIBOR + 1%. As of December 31, 2004, no funds were drawn against the aforementioned loan.

In accordance with the financial and debt covenants of its loan agreements with the EBRD, the Enterprise is under an obligation to comply with the maximum or minimum operating ratios. The Enterprise is not in compliance with certain debt covenants of the EBRD loan agreement. However, the management of the Enterprise believes, based on discussions with the EBRD representatives, that non-compliance with such loan covenants will not result in any immediate action by the EBRD, which would have a material effect on the Enterprise's financial position, or which might require that the loans be transferred from non-current to current liabilities.

The long-term loan extended by the KFW is repayable in semi-annual installments in the period from December 30, 2004 to June 30, 2013 at an annual interest rate equal to the effective EURIBOR rate.

The loan granted by the Republic of Serbia Development Fund is repayable in quarterly installments in the period from March 31, 2003 to December 31, 2007 and was granted at an annual interest rate of 4%.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**25. NON-CURRENT INTEREST-BEARING BORROWINGS (continued)**

In accordance with the Law on the Settlement of the Liabilities of the Government of the Republic of Serbia towards the National Bank of Serbia (See Official Gazette RS No 135/04), the Enterprise's liabilities on its issued short-term securities totaling Dinars 1,899,090 thousand have been transformed into long-term liabilities towards the Republic of Serbia, with maturities on December 31, 2006, December 31, 2007 and December 31, 2010, in the amounts of Dinars 289,185 thousand, Dinars 578,371 thousand and Dinars 1,031,534 thousand, respectively.

Loan repayments to foreign creditors, for loans disbursed through domestic banks which are presently undergoing bankruptcy proceedings, and the other loans from these banks, have been at a standstill since 1992, upon the introduction of UN sanctions, or specifically from the beginning of 2002, when the bankruptcy proceedings against these banks were initiated. The Enterprise's management has performed accruals with respect to interest and related finance charges on the these loans. However, the final reconciliation of these liabilities may have a material effect on the Enterprise's consolidated financial statements, which presently cannot be determined with certainty.

The maturities of the Enterprise's long-term loans at December 31, 2004 are as provided below:

	<b>Thousands of Dinars</b> <b>December 31,</b> <b>2004</b>
From one to five years	6,468,457
Over five years	34,439,246
	<u>40,907,703</u>

The Enterprise's long-term loans are denominated in the following foreign currencies, and are as follows:

	<b>Thousands of Dinars</b> <b>December 31,</b> <b>2004</b>
EUR	21,805,617
USD	7,018,636
CHF	6,281,505
JPY	3,646,875
Other	1,318
	<u>38,753,951</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**26. OTHER NON-CURRENT LIABILITIES**

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b>2004</b>
	<hr/>
Rescheduled public income liabilities	7,049,901
Rescheduled liabilities with respect to fees for environmental use and protection of water resources	973,931
Other rescheduled liabilities	48,938
Other	114,251
	<hr/>
	8,187,021
Amounts due within one year:	
- rescheduled public income liabilities	(679,537)
- rescheduled liabilities for fee on environmental use and protection of water resources	(307,529)
- other rescheduled liabilities	(1,247)
- other	(7,064)
	<hr/>
	(995,377)
	<hr/>
	7,191,644
	<hr/> <hr/>

Rescheduled public income liabilities relate to taxes and social security contributions on employee compensation, and turnover taxes, which have been rescheduled to be repaid in 120 monthly installments at an annual interest rate equal to the National Bank of Serbia discount rate. Upon the repayment of the last installment, the Enterprise retains the right to receive a write-off of such liabilities in an amount equal to 30% of the interest accrued up to September 30, 2003.

Liabilities with respect to fees for environmental use and protection of water resources have been rescheduled in accordance with the Agreement entered into between the Enterprise and the Government of the Republic of Serbia. These liabilities are repayable in monthly installments over a period of five years. The liabilities shall increase in the instance that the annual retail price index exceeds 12 percent.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
December 31, 200427. CURRENT INTEREST-BEARING BORROWINGS AND  
OTHER CURRENT FINANCIAL LIABILITIES

	<b>Thousands of Dinars December 31, 2004</b>
<i>In foreign currencies</i>	
Current portion of long-term loans:	3,408,563
Non-current loans due within one year from:	
- creditors from the Czech Republic	6,518,008
- creditors from the Republic of Poland	3,094,321
- domestic banks	142,259
- domestic banks in bankruptcy	1,845,271
- Kapital Hilfe, Germany	3,252,307
- other	184,234
	<u>18,444,963</u>
<i>Liabilities in dinars:</i>	
Current portion of non-current loans	102,827
Current portion of other non-current liabilities	995,377
Non-current loans from domestic banks in bankruptcy due within one year from:	65,000
Short-term loans from domestic banks in bankruptcy	35,000
Other	52,084
	<u>1,250,288</u>
Other short-term liabilities:	
- to banks in bankruptcy	1,106,579
- to other banks	25,442
	<u>1,132,021</u>
	<u><u>20,827,272</u></u>

In cooperation with the Republic of Serbia Ministry of Finance and of the Economy, a plan has been drafted for the settlement of EPS' debt to its foreign creditors from the Czech Republic and Poland, which has been adopted by the Government of the Republic of Serbia. In accordance with the plan, the settlement terms should not be less favorable to EPS than the terms outlined under the relevant agreement with the Paris Club of Creditors.

After the balance sheet date, in accordance with the Republic of Serbia approval mentioned above, the EPS Board of Directors enacted a resolution to fully repay the liabilities with respect to the loans and commercial financing arrangements provided by creditors from the Czech Republic in the amount of USD 48.5 million (Note 36).

The repayments of loans originally disbursed through the domestic banks in bankruptcy, and the loans from these banks have been at a standstill since the introduction of the UN Sanctions against the F.R. of Yugoslavia introduced in 1992, and since January 2002 when the liquidation and bankruptcy proceedings of these banks were initiated. The Enterprise's management performed accruals with respect to interest and the related finance charges on these loans. However, the final reconciliation of these liabilities may have a material effect on the Enterprise's consolidated financial statements, which presently cannot be determined with certainty.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**28. TRADE LIABILITIES**

	<b>Thousand of Dinars</b> <b>December 31,</b> <b>2004</b>
	<u>                    </u>
Advances received	306,659
Trade payables:	
- non-consolidated subsidiaries	514,634
- domestic suppliers	5,320,529
- foreign suppliers	1,986,476
Other	<u>265,284</u>
	<u><u>8,393,582</u></u>

A portion of EPS' liabilities to its foreign suppliers will be covered from loans extended to the Enterprise.

The Enterprise is involved in negotiations with the insurance company, Dunav osiguranje A.D., Beograd with respect to a write off in the amount of Dinar 194 million.

**29. OTHER CURRENT LIABILITIES AND ACCRUALS**

	<b>Thousand of Dinars</b> <b>December 31,</b> <b>2004</b>
	<u>                    </u>
Amounts borrowed from the Ministry of Finance the Republic of Serbia	1,572,741
Interest and financing costs accrued	7,511,989
Accrued salaries	628,752
Taxes and contributions on salaries payable	523,828
Liabilities for power exchange and borrowings from foreign electric power distribution systems	191,424
Other liabilities	90,553
Deferred income from donations	13,121,080
Accrued turnover taxes	142,668
Other accruals	<u>305,271</u>
	<u><u>24,088,306</u></u>

Based on an agreement entered into with the Republic of Serbia Ministry of Finance in 2001, the Enterprise received loans from the Government in order to support finance of its maintenance and sanitation activities. In 2002, the Enterprise repaid the amount of Dinar 1.5 billion of the total initial amount of Dinar 3.1 billion. This loan was granted with a maturity term of up to December 31, 2001 at an interest rate based on the National Bank of Serbia prime rate. For the period from December 31, 2001 to December 31, 2004, the accrued interest liabilities on these loans amounted to Dinar 787,627 thousand.

The interest and financing accrued as of December 31, 2004 include the interest on loans received from creditors from the Czech Republic in the amount of Dinar 1,088,673 thousand.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**29. OTHER CURRENT LIABILITIES AND ACCRUALS (Continued)**

In the past years, the Enterprise has received funds on the basis of financial and technical assistance from international donors in the European Union, Switzerland, Japan and from international organizations, which were initially recognized as deferred income. All of these contracts and agreements have been ratified by the Federal Parliament. The recognition of income is performed on systematic basis during the useful economic life of the corresponding assets in the period in which the corresponding expenses associated with the use of such assets are recorded.

Movements in the balance of deferred income from donations were as follows during the year ended December 31, 2004:

	<b>Thousands of Dinars</b>
	<b>December 31,</b>
	<b>2004</b>
	<u>                    </u>
Balance, beginning of year, before adjustments:	4,568,034
Adjustments	<u>1,175,876</u>
Balance, beginning of year, after adjustments:	5,743,910
Donations received	8,278,660
Transferred to the Statement of Income	(793,288)
Other	<u>(108,202)</u>
Balance at the end of year:	<u><u>13,121,080</u></u>

**30. DEFERRED TAX LIABILITIES**

Deferred tax liabilities in the amount of Dinar 19,471,296 thousand as of December 31, 2004 relate to the temporary differences on property, plant and equipment and intangible assets. The decrease in deferred tax liabilities in the year ended December 31, 2004, is primarily due to the decrease in the income tax rate from 14% (as of December 31, 2003) to 10% (the enacted income tax rate in effect as of January 1, 2005).

**31. CONTINGENT LIABILITIES**

**Litigation**

As of December 31, 2004, the estimated amount of potential damages arising from litigation filed against the Enterprise totaled Dinar 2,909,878 thousand. The amount of potential final losses arising on litigation may be increased by the penalty interest up to the date of the conclusion of such legal proceedings, or up to the date of final settlement.

As of December 31, 2004, the Enterprise recognized a provision for potential losses arising from litigation in the amount of Dinar 459,920 thousand. The Enterprise's management judges that the remainder of the proceedings filed against Enterprise, for which a corresponding provision has not been made, will not have a material effect on the financial results of the Enterprise.

**Liabilities with Respect to Fees for the Use of Mineral Resources**

As of December 31, 2004, the consolidated subsidiaries engaged in the mining and production of coal did not include the liabilities with respect to the fees for the use of mineral resources pursuant to the applicable regulations of the Republic of Serbia (See Official Gazette RS 28/02). The Enterprise's management believes that corresponding accruals should not be made given that payments on the same basis are being made for environmental protection purposes.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**31. CONTINGENT LIABILITIES (Continued)**

**Environmental Protection**

The Enterprise's Business Plan determines the amount of EPS' investment in environmental protection (installation of desulphurization equipment, disposal of ash and coal mining scrap, stabilization of the terrain and land surrounding dams, protection of underground waters and similar natural resources). A corresponding provision has not been made in the books, since EPS' management believes that all future expenses will be directly attributed to assets purchased for purposes of the environmental protection.

**32. NET FOREIGN CURRENCY POSITION AND FOREIGN EXCHANGE RISK**

The Enterprise enters into international transactions with respect to the purchase of equipment and the settlement of sales revenue and expenses. In addition, a significant portion of the Enterprise's borrowings is denominated in foreign currency. The foreign currency position of the Enterprise as of December 31, 2004 is as follows:

	<b>Thousands of Dinars</b> <b>December 31,</b> <b>2004</b>
Assets	3,079,513
Liabilities	<u>(67,060,823)</u>
Net liabilities	<u><u>(63,981,310)</u></u>

The Enterprise does not enter into hedging transactions so as to reduce these risks.

**33. INTEREST RATE RISK**

The exposure to interest rate risk comprises the possibility that the value of the Enterprise's term debt will fluctuate due to changes in market interest rates. As of December 31, 2004, the Enterprise's total interest-bearing loans equaled Dinar 67,741,700 thousand, representing 65 percent of the Enterprise's total liabilities.

**34. CREDIT RISK**

The Enterprise is exposed to credit risk in the instance in which its customers fail to perform their obligations. The Enterprise's exposure to credit risk is limited to the carrying value of accounts receivable and other receivables. The accounts receivable correspond to a significant number of customers and have normal credit terms, and thus, the individual concentrations of credit risk are not considered significant. Accounts and other receivables are presented in the accompanying consolidated financial statements net of allowances for bad and doubtful receivables, which are estimated by the Enterprise' management based on historical experience and present economic conditions.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2004**

**35. LOSSES OF ELECTRICAL POWER**

Throughout the normal course of business, the Enterprise incurs substantial technical and non-technical losses of electrical power. Technical losses arise upon the transmission of electrical power, as well as from its conversion from one voltage to another. Non-technical losses represent the electricity consumed by customers, which the Enterprise is unable to identify and invoice. For the year ended December 31, 2004, the management of the Enterprise has estimated the total loss of electric power to amount to 10.8 billion, of which the technical loss is 7.3 billion and the non – technical loss represents Dinar 3.5 billion.

**36. POST-BALANCE SHEET DATE EVENTS**

*Separation of the Public Enterprise Elektroistok From EPS*

Pursuant to the Decision of the Government of the Republic of Serbia with respect to the Foundation of the Public Enterprise for Power Distribution and Management of the Electrical Power System, Elektromreža Srbije (“EMS”), on July 1, 2005, EPS will relinquish control over its subsidiary enterprise, the Public Enterprise for the Distribution of Electrical Power, Elektroistok. The assets required for operations of EMS are to be formed from the assets of the Public Enterprise, Elektroistok, and partially from the assets held by EPS for the management of the power transmission grid.

On June 16, 2005, the EPS’ Board of Directors entered a Resolution with respect to the Transfer of assets to Elektroistok, Beograd in the total amount of Dinar 1,795,673 thousand, whereas Elektroistok, Beograd is to transfer to the Enterprise, assets in the amount of Dinar 31,736 thousand. In addition the Enterprise's management believes that additional assets in the amount of Dinar 866,090 thousand will be transferred to the newly established enterprise.

*Settlement of Liabilities to the Creditors from the Czech Republic*

As of December 31, 2004 the Enterprise’ liabilities with respect to loans extended by creditors from the Czech Republic amounted of Dinar 6,518,008 thousand, and interest liabilities on the loans amounted to Dinar 1,088,673 thousand. On April 25, 2005, an agreement on the settlement of debt was entered among the parties which delineated the amount of total liabilities at the settlement date (including both interest and penalty interest) to be Dinars 2,809,872 thousand (as at the USD exchange rate as of balance sheet date), subsequent to the approved write-offs by the creditors along with the corresponding obligation of the Enterprise to repay the remainder of the liabilities without further delay. On April 26, 2005 the Enterprise effected the payment in accordance with the agreed amount of the obligation.

**37. EXCHANGE RATES**

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

	<b>In Dinars</b> <b>December 31,</b> <b>2004</b>
USD	57.9355
EUR	78.8850