HRVATSKA ELEKTROPRIVREDA GROUP

Consolidated financial statements

For the year ended 31 December 2007

Together with Independent Auditor's Report

Contents

Responsibility for the financial statements

Pursuant to the Croatian Accounting Law, the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB") which give a true and fair view of the state of affairs and results of the Group for that period.

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

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

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

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

Signed on behalf of the Management Board:

Ivan Mravak
President of the Board

HEP d.d.
Ulica grada Vukovara 37
10000 Zagreb
Republic of Croatia

11 April 2008

Independent Auditor's Report

To the Owner of HEP d.d.:

We have audited the accompanying consolidated financial statements of the HEP Group (the 'Group'), which comprise the consolidated balance sheet as at 31 December 2007 and the related consolidated statement of income, consolidated statements of changes in equity and of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. 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.

Auditor's 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. 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 entities' 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.

Independent Auditor's Report (continued)

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2007, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of matter

Without qualifying our opinion, we draw attention to Note 2 to the financial statements, discussing the accounting policies for revenue recognition The current regulatory framework did not provide details of allocation of the rewards pertaining to the electricity generation activity. In accordance with the Law on the Amendments to the Energy Law from December 2004, a model for determining the tariff systems for different customers was developed in December 2006, the application of which was postponed to 2007. The Group has applied the model in the preparation of the financial statements for the year ended 31 December 2007.

Deloitte d.o.o.

Branislav Vrtačnik, Certified Auditor

Zagreb, 11 April 2008

Consolidated Income Statement - HEP Group
For the year ended 31 December 2007

	Notes	2007 HRK'000	2006 HRK'000
Revenue from electricity sales		8,739,188	8,747,024
Revenue from thermal power sales		450,941	457,850
Revenue from gas sales		235,534	242,312
Other operating income	5	1,389,835	800,071
Total operating income		**10,815,498**	**10,247,257**
Electricity purchase cost		(2,504,385)	(2,029,292)
Fuel costs		(2,504,597)	(1,775,474)
Staff cost	6	(1,645,229)	(1,575,249)
Depreciation and amortization expense		(1,592,366)	(1,781,069)
Other operating expenses	7	(2,364,116)	(2,685,525)
Total operating expenses		**(10,610,693)**	**(9,846,609)**
Profit from operations		**204,805**	**400,648**
Finance revenue	8	97,930	104,394
Finance costs	8	(195,744)	(186,922)
Net financial loss		**(97,814)**	**(82,528)**
Profit before tax		**106,991**	**318,120**
Income tax expense	9	(80,985)	(76,242)
Profit from operations		**26,006**	**241,878**
Attributable to:			
Equity holder		3,814	216,870
Minority interest		22,192	25,008
		26,006	**241,878**

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

Signed on behalf of the Company on 11 April 2008 by:

Ivan Mravak — President of the Board

Darko Dvornik — Member of the Board

Consolidated Balance Sheet – HEP Group
As at 31 December 2007

ASSETS	Notes	31 December 2007	31 December 2006
		HRK'000	HRK'000
Non-current assets			
Property, plant and equipment	10	22,587,104	21,533,623
Capital work in progress	10	3,021,148	2,600,388
Intangible assets	11	85,715	73,689
Investment property	12	73,462	81,320
Prepayments for tangible assets	13	490,609	429,775
Investment in NPP Krško	14	1,609,752	1,613,901
Long-term loan receivables and deposits	16	2,449	3,124
Other non-current assets	17	107,519	110,563
Deferred tax assets	9	62,477	129,071
		28,040,235	**26,575,454**
Current assets			
Inventories	18	1,079,826	955,450
Trade receivables	19	1,227,288	1,323,312
Other short-term receivables	20	556,322	321,832
Cash and cash equivalents	21	166,512	159,599
		3,029,948	**2,760,193**
TOTAL ASSETS		**31,070,183**	**29,335,647**

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

Signed on behalf of the Company on 11 April 2008 by:

Ivan Mravak — President of the Board

Darko Dvornik — Member of the Board

CAPITAL AND LIABILITIES	Notes	31 December 2007	31 December 2006
		HRK'000	HRK'000
Share capital	22	19,792,159	19,792,159
Capital reserves	22	(2,035,736)	(2,031,587)
Retained earnings	22	256,690	252,876
Equity attributable to equity holder		**18,013,113**	**18,013,448**
Minority interest	15	122,064	137,670
Total equity		**18,135,177**	**18,151,118**
Long-term borrowings	23	2,928,740	3,128,904
Long-term liabilities to the state	24	66,061	69,225
Long-term provisions	26	511,317	967,832
Liabilities under securities	27	1,196,590	497,670
Other long-term liabilities	28	3,792,602	3,173,701
Total non-current liabilities		**8,495,310**	**7,837,332**
Trade payables		2,579,830	1,711,008
Current portion of long-term borrowings	23	612,485	650,599
Short-term borrowings	29	905,449	386,313
Taxes payable		123,987	181,832
Interest payable		42,646	43,408
Liabilities to employees	30	108,843	185,560
Other payables	31	66,456	188,477
Total current liabilities		**4,439,696**	**3,347,197**
TOTAL CAPITAL AND LIABILITIES		**31,070,183**	**29,335,647**

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

Signed on behalf of the Company on 11 April 2008 by:

Ivan Mravak
President of the Board

Darko Dvornik
Member of the Board

Consolidated Statement of Changes in Equity - HEP Group

For the year ended 31 December 2007

	Share capital	Capital reserves	Retained earnings/ (Accumulated losses)	Equity attributable to the equity holder of the Parent	Minority interest	Total equity
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Balance at 31 December 2005	**19,792,159**	**(2,013,364)**	**41,070**	**17,819,865**	**153,579**	**17,973,444**
Restatement in respect of NP Krško	-	(11,196)	-	(11,196)	-	(11,196)
Balance at 1 January 2006	**19,792,159**	(2,024,560)	41,070	17,808,669	153,579	17,962,248
Minority interest	-	-	(5,064)	(5,064)	(27,879)	(32,943)
Distribution of dividend to RWE	-	-	-	-	(12,473)	(12,473)
Profit for the year	-	-	216,870	216,870	25,008	241,878
Exchange differences	-	(7,027)	-	(7,027)	(565)	(7,592)
Balance at 31 December 2006	**19,792,159**	**(2,031,587)**	**252,876**	**18,013,448**	**137,670**	**18,151,118**
Minority interest	-	-	-	-	(25,008)	(25,008)
Distribution of dividend to RWE	-	-	-	-	(12,540)	(12,540)
Profit for the year	-	-	3,814	3,814	22,192	26,006
Exchange differences	-	(4,149)	-	(4,149)	(250)	(4,399)
Balance at 31 December 2007	**19,792,159**	**(2,035,736)**	**256,690**	**18,013,113**	**122,064**	**18,135,177**

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

Signed on behalf of the Company on 11 April 2008 by:

Ivan Mravak — President of the Board

Darko Dvornik — Member of the Board

	2007 HRK'000	2006 HRK'000
Cash flows from operating activities		
Profit for the year	26,006	241,878
Income tax expense recognised in profit or loss	80,985	76,242
Net financial loss	97,814	82,528
Deferred tax (assets)/liabilities	(66,563)	33,537
Gains on derivatives	591	2,525
Depreciation and amortisation	1,592,366	1,781,069
Impairment loss on fixtures and equipment	-	-
(Decrease)/increase in provisions for doubtful receivables	(17,878)	10,074
(Decrease)/increase in provisions	(456,515)	95,510
Operating cash flows before movements in working capital	*1,256,806*	*2,323,363*
Decrease/(increase) in trade receivables	113,902	(29,573)
(Increase) in inventories	(124,376)	(12,018)
(Increase)/decrease in other current assets	(240,636)	119,742
Increase in trade payables	868,822	116,056
(Decrease) in other liabilities	(122,352)	65,015
(Decrease)/increase in liabilities to employees	(76,717)	46,754
(Decrease)/increase in tax liabilities	(56,974)	18,377
Increase in long-term liabilities	615,737	439,765
Cash generated from operations	**2,234,212**	**3,087,481**
Income taxes paid	(14,423)	(109,779)
Interest paid	(173,955)	(160,118)
NET CASH FROM OPERATING ACTIVITIES	**2,045,834**	**2,817,584**
INVESTING ACTIVITIES		
Interest received	4,150	5,140
Profit distributions from subsidiaries	49,366	5,061
Disposal of property, plant and equipment	35,744	28,179
Increase in property, plant and equipment	(3,077,040)	(2,769,553)
Decrease/(increase) in other non-current assets	14,003	(372,678)
Change in minority interest	(15,606)	(15,909)
NET CASH USED IN INVESTING ACTIVITIES	**(2,989,383)**	**(3,119,760)**
FINANCING ACTIVITIES		
Repayments of borrowings	(1,921,194)	(1,684,810)
New bank loans raised	2,943,647	2,042,906
NET CASH FROM FINANCING ACTIVITIES	**1,022,453**	**358,096**

NET INCREASE IN CASH AND CASH EQUIVALENTS	**78,904**	**55,920**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**159,599**	**168,543**
Effect of changes in exchange rates	(71,991)	(64,864)
CASH AND CASH EQUIVALENTS AT END OF YEAR	**166,512**	**159,599**

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

Signed on behalf of the Company on 11 April 2008 by:

Ivan Mravak — Darko Dvornik

President of the Board — Member of the Board

1. GENERAL

Hrvatska elektroprivreda Group (the ‘Group’) consists of the parent company Hrvatska elektroprivreda d.d., Zagreb (‘HEP’, the ‘Parent Company’ or the ‘Company’) and the subsidiaries listed in Note 31.

HEP d.d. is registered in Zagreb, Ulica grada Vukovara 37. The principal activities of HEP Group are the generation, transmission and distribution of electricity, and the control of the electric power systems. In addition to these main activities, HEP Group deals with the production and distribution of thermal power through the district heating systems in Zagreb in Osijek, and the distribution of gas in Osijek and Đakovo.

All the Group's activities are governed by applicable laws, regulations and decisions issued by the Croatian Government.

At 31 December 2007, the number of staff employed by the Group was 14 269 (31 December 2006: 14 336).

These financial statements are presented in Croatian Kuna (HRK) since that is the currency in which the majority of the Group’s transactions are denominated.

Energy Laws

On 3 December 2004, the Croatian Parliament ratified the amendments to the following laws: The Energy Law, the Law on Electricity Market and the Law on the Regulation of Energy Activities.

The subsidiaries and HEP d.d. continue their regulated activities as public services companies for tariff-based customers: production of electricity, transmission of electricity, distribution of electricity, organizing electricity market and supplying of electricity to tariff-based customers.

Production and supply of electricity to eligible buyers and trading on the energy market are done as market activities.

Supply of electricity for eligible customers (corporate customers) is performed according to rules governing market relations, which allow these customers to purchase electricity in a free market. Tariff-based customers are supplied with electricity in the system of obligatory public services in accordance with prices from the tariff system for electricity.

1. GENERAL (continued)

According to the Law on the Amendments to the Energy Law from December 2004, the Croatian Energy Regulatory Agency ("CERA") was to prepare a methodology for determining the tariff systems for different customers within two years.

In December 2006, the CERA published the tariff models for regulated electricity activities: The Electricity Generation Tariff Model, with the exemption of eligible customers, with no tariff item amounts; The Electricity Transmission Tariff Model, with no tariff item amounts. The Electricity Distribution Tariff Model, with no tariff amounts; and the Electricity Supply Tariff Model, with the exemption of eligible customers, with no tariff amounts.

According to the new laws, HEP restructured its operations, by forming separate companies, for electricity generation, transmission, distribution, power supply management, and electricity market management, all of which commenced their respective business activities on 1 July 2002. HEP is obligated to adjust the organization of the Group in accordance with these amended laws.

Law on the Privatisation of HEP d.d.

The Law on the Privatisation of Hrvatska Elektroprivreda d.d. was passed on 25 March 2002. According to the Law, the privatisation of HEP is to be carried out as follows: 7% of its shares are to be transferred to Croatian war veterans without consideration, 7% of the shares will be sold to the Company's present and former employees, minimum 15% of the shares will be sold by way of public offering first to the Croatian citizens and then to domestic and foreign legal entities. The remaining shares will be sold in the capital markets. The Republic of Croatia will retain direct ownership over 51% of HEP's shares until the admission of the Republic of Croatia to the European Union. After the admission, separate laws may be passed to further privatise the shares held by the state. To date, HEP remains fully owned by the Republic of Croatia and the privatisation process has still not yet begun.

Governance and management

Assembly of HEP d.d

The Assembly consists of the members representing the interests of the HEP Group:

Miljenko Pavlaković, B.Sc.Econ.	President	Member since February 2008
Vladimir Vranković, B.E.E.	President	Member since 2004 until February 2008

1. GENERAL (continued)

Supervisory Board of HEP d.d.

Members of Supervisory Board:

Leo Begović, B.E.E.	President	Member since 28 April 2008
Professor Krešimir Ćosić, D.Sc.	Member	Member since 28 April 2008
Dasenko Baldasari, B.E.E.	Member	Member since 28 April 2008
Luciano Delbianco, D.Sc.	Member	Member since 28 April 2008
Zdenko Jurčić, B.L.L..	Member	Member since 28 April 2008
Slavko Konfic	Member	Member since 28 April 2008

Members of Supervisory Board in 2007:

Željko Tomšić, M.Sc.	President	Member since 2006 until March 2008
Professor Krešimir Ćosić, D.Sc.	Member	Member since 2004 until March 2008
Dasenko Baldasari,B.E.E.	Member	Member since 2004 until March 2008
Luciano Delbianco, D.Sc.	Member	Member since 2004 until March 2008
Zdenko Jurčić, B.L.L..	Member	Member since 2004 until March 2008
Franc Ferenčak, eng.	Member	Member since 2004 until March 2008

Management Board

mr. sc. Ivan Mravak	President	Member since 2004
Željko Kljaković-Gašpić, B.E.E.	Member	Member since 1 March 2008
Darko Dvornik, D.Sc.	Member	Member since 1 March 2008
Stjepan Tvrdinić, B.E.E.	Member	Member since 18 March 2008
Željko Tomšić, M.Sc.	Member	Member since 29 April 2008
Nikola Rukavina, B.E.E.	Member	Member since 29 April 2008

Management Board 2007

Ante Despot, B.E.E.	Member	Member from 2004 until 29 February 2008
Ivica Toljan, M.Sc.	Member	Member from 2004 until 29 February 2008
Ivo Čović, B.E.E.	Member	Member from 2004 until 29 February 2008
Kažimir Vrankić, M.Sc.	Member	Member from 2004 until 29 February 2008
Velimir Lovrić, M.Sc.	Member	Member from 2006 until 29 February 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Groups's principal accounting policies which have been applied consistently in the current year and with the prior year, is set out below.

Presentation of the financial statements

The financial statemetns have been prepared in accordance with International Financial Reporting Standards as published by the International Accounting Standards Board.

The financial statements have been prepared on the historical cost basis, except for certain financial instruments that are presented at revalued amounts. The financial statements are presented in thousands of Croatian Kuna (HRK'000), since that is the currency in which the majority of the Comopany's transactions are denominated.
The financial statements have been prepared under the going-concern assumption.

Basis of accounting

The Group maintains its accounting records in the Croatian language, in Croatian kuna and in accordance with Croatian law and the accounting principles and practices observed by enterprises in Croatia. The accounting records of the Company's subsidiaries in Croatia and abroad are maintained in accordance with the requirements of the respective local jurisdictions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Adoption of new and revised International Financial Reporting Standards

Standards and Interpretations effective in the current period

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on 1 January 2007:

IFRS 7 *Financial Instruments: Disclosures* effective for annual reporting periods beginning on or after 1 January 2007, and the consequential amendments to IAS 1 *Presentation of Financial Statements*.

The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments and management of capital (see note 36).

Four Interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are:
IFRIC 7 *Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies* (effective date annual periods beginning on or after 1 March 2006)
IFRIC 8 *Scope of IFRS* 2 (effective date annual periods beginning on or after 1 May 2006)
IFRIC 9 *Reassessment of Embedded Derivatives* (effective date annual periods beginning on or after 1 June 2006) ; and
IFRIC 10 *Interim Financial Reporting and Impairment (*effective date annual periods beginning on or after 1 November 2006). The adoption of the new Interpretations has not resulted in changes to the accounting policies of Hrvatska elektroprivreda.

Standards and Interpretations in issue not yet adopted

At the date of authorisation of these financial statements, the following Interpretations and Standards were in issue but not yet effective:

IAS 23 (Revised) *Borrowing Costs* (effective for accounting periods beginning on or after 1 January 2009);

IFRS 8 *Operating Segments* (effective for accounting periods beginning on or after 1 January 2009); and

IFRIC 13 *Customer Loyalty Programmes* (effective for accounting periods beginning on or after 1 July 2008).

IFRIC 11 *IFRS 2: Group and Treasury Share Transactions* (effective 1 March 2007);

IFRIC 12 *Service Concession Arrangements* (effective 1 January 2008)*;*

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Adoption of new and revised International Financial Reporting Standards (continued)

IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective 1 January 2008). The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group.

Basis of the preparation of the Group financial statements

The financial statements of the Group represent aggregate amounts of the Company's assets, liabilities, capital and reserves at 31 December 2007, and the results of its operations for the year then ended. All internal balances and transactions have been eliminated.

Principles and methods of consolidation

The consolidated financial statements incorporate the financial statements of HEP d.d. and entities controlled by HEP d.d. (its subsidiaries). A listing of the Group’s subsidiaries is provided in Note 31. Control is achieved where HEP d.d. has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group’s equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority’s share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority’s interest in the subsidiary’s equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Investments in subsidiaries

Subsidiary undertakings are those companies in which the Company (as parent) has control or otherwise has power to exercise control over financial and operational policies of the investee. Investments in subsidiaries are presented in the balance sheet at cost adjusted by any changes in the Company's share in the net assets of a subsidiary subsequent to acquisition, and less any impairment of an individual investment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments in associates

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting except when classified as held for sale in accordance with IFRS 5 *Non-current Assets Held For Sale and Discontinued Operations*. Investments in associates are carried in the consolidated balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate) are not recognised, unless the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable net assets of the associate at the date of acquisition is recognised as goodwill. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable net assets of the associate at the date of acquisition is credited to profit and loss in the period of acquisition.

Where the Group transacts with its associate, profits and losses are eliminated to the extent of the Group's interest in the relevant associate.

Investments in jointly controlled entities

Jointly controlled entities are entities where control is shared with other parties through contractual arrangements and are included in the Group accounts using the method of proportionate consolidation.

Where a group entity undertakes its activities under joint venture arrangements directly, the Group's share of jointly controlled assets and any liabilities incurred jointly with other venturers are recognised in the financial statements of the relevant entity and classified according to their nature. Liabilities and expenses incurred directly in respect of interests in jointly controlled assets are accounted for on an accrual basis. Income from the sale or use of the Company's share of the output of jointly controlled assets, and its share of joint venture expenses, are recognised when it is probable that the economic benefits associated with the transactions will flow to/from the Company and their amount can be measured reliably.

Joint venture arrangements that involve the establishment of a separate entity in which each venturer has an interest are referred to as jointly controlled entities. The Group reports its interests in jointly controlled entities using proportionate consolidation. The Group's share of the assets, liabilities, income and expenses of jointly controlled entities are combined with the equivalent items in the consolidated financial statements on a line-by-line basis. Where the Group transacts with its jointly controlled entities, unrealised profits and losses are eliminated to the extent of the Group's interest in the joint venture.

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Reporting currency

The Company's and the Group's financial statements are prepared in Croatian kuna (HRK). As at 31 December 2007, the official exchange rates for EUR 1 and USD 1 were HRK 7.33 and HRK 4.99, respectively (at 31 December 2006: EUR 1 = HRK 7.34 and USD 1 = HRK 5.58). Average middle exchange rate of CNB in year 2007 was EUR 1 = 7.34 and USD 1 = 5.37. (In year 2006 EUR 1 = 7.32 and USD 1 = 5,84).

Retirement and other employee benefit costs

The Group has no defined post-retirement benefit plans for its employees or management in Croatia or abroad. Accordingly, no provision for these costs has been included.

Legal pension and health insurance contributions are paid on behalf of the Group's employees in the Republic of Croatia. This obligation applies to all staff hired on the basis of employment contract. The contributions are paid at a certain percentage determined on the basis of gross salary.

	2007	**2006**
Pension insurance contributions	20%	20%
Health insurance contributions	15%	15%
Employment Fund contribution	1.7%	1.7%
Occupational injury	0.5%	0.5%

The Group companies have the obligation to withold the pension insurance contributions from the employees' gross salaries.

Contributions on behalf of the employer and the employees are recognised as cost in the period in which they are incurred (see Note 7).

The Group provides employees with jubilee and one off retirement awards. The obligation and costs of these benefits are determined using a projected unit credit method. The Projected Unit Credit Method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The pension obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the interest rate on high-quality corporate bonds quoted in the Republic of Croatia where the currency and terms of the government bonds are consistent with the currency and estimated terms of the benefit obligation.

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment

Property, plant and equipment are carried at cost less accmulated depreciation and any impairment losses, except for land, which is carried at cost.

The estimated useful lives, residual values and depreciation methods are reviewed at each year end, with the effect of any changes in estimate.

Fixed assets in use are depreciated using the straight-line method on the following bases:

Buildings	**2007**	**2006**
Hydroelectric power plants (Dams, embankments, buildings and other structures and facilities)	20 – 50 years	20 – 50 years
Thermal power plants (Buildings and other structures)	33 – 50 years	33 – 50 years
Electricity transmission and distribution plants and facilities (Transmission lines and buildings of transformer stations, switch-yard and dispatch centers)	20 – 40 years	8 – 33 years
Water and steam pipelines and other thermal power generation and transmission plants and facilities	33 years	33 years
Gas pipelines	20 - 25 years	20 - 25 years
Administrative buildings	50 years	50 years
Plant and equipment		
Hydroelectric power plants	10 – 33 years	10 – 25 years
Thermal power plants	6 – 25 years	6 – 25 years
Electricity transmission plants and facilities (electric parts of transformer stations and transformers; and electric parts of transmission lines)	15 – 40 years	8 – 33 years
Electricity distribution plants and facilities (electric parts of transformer stations and transformers, electric parts of distribution lines, measuring instruments, meters and other equipment)	8 – 40 years	8 – 33 years
Thermal power stations, hot-water pipelines and other equipments	15 – 30 years	15 – 30 years
Gas meters and other gas network equipment	5 – 20 years	5 – 20 years
Other equipment and vehicles		
IT equipment	5-20 years	3 – 20 years
Software licences	5 years	5 years
Telecommunications equipment	5 – 20 years	5 – 20 years
Motor vehicles	5 – 8 years	5 – 8 years
Office furniture	10 years	15 years

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

In 2007, the Company reviewed the useful lives of its non-current assets as provided in IAS 16. Considering the development of new technologies, as well as the global practice in estimating the useful lives of power plants and structures, the Company established that the useful lives of the canals, hydro power plants, production equipment at the power plants, transformer stations and grids should be extended. A decrease in the useful life of office furniture from 15 to 10 years was suggested.

The initial cost of property, plant and equipment contain the purchase price, including all customs duties and non-refundable taxes and all costs directly attributable to bringing an asset to the condition and location for its indended use.

Expenditures incurred after the property, plant and equipment have been put into use are charged to expense the period in which they are incurred.

In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard performance, the expenditures are capitalised as an additional cost of property, plant and equipment. Costs eligible for capitalization include costs of periodic, planned significant inspections and overhauls necessary for further operation.

The gain or loss arising from disposal or withdrawal of property, plant and equipment is determined as the difference between the gains on sale and the carrying amount of the asset and are credited and charged, respectively, to the income statement.

Impairment of tangible and intangible assets

Items of tangible and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is charged to the income statement.

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

The net selling price is the amount obtainable from the sale of an asset in an arm's length transaction less the cost of disposal, while value in use is the present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the relevant cash-generating unit.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is land or a building other than an investment property carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Intangible assets

Intangible fixed assets include patents, trade marks and licences and are carried at cost less accumulated amortisation. Amortisation is provided on a straight-line basis over a period from 5 to 20 years.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investment property

Investment properties, which is property held to earn rentals and/or for capital appreciation, are stated at cost, less accumulated depreciation and impairment losses, if any. Cost consists of invoiced amount plus all other direct costs attributable to bringing an asset to its intended use.

Depreciation is charged so as to write off the cost or valuation of the assets over their estimated useful lives, using the straight-line method, on the following basis:

Flats	50 years

Finance and operating leases

The Group has no finance lease arragements and no significant operating lease agreements were entered into during 2007 and 2006. Amounts payable under operating leases are recognised as expense on a straight-line basis over the term of the relevant lease, unless there is another systematic basis that would be more representative of the time pattern of the user's benefit.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Trade debtors and prepayments

Trade receivables are carried at invoiced amounts. Since 1 July 2002, the subsidiary HEP Distribucija d.o.o. has been providing electricity distribution services, keeping record and collecting the related receivables from tariff-based customers, and HEP Opskrba d.o.o. has been providing electricity distribution services to eligible customers for the account of HEP d.d. since 26 February 2003.

The risk of collectability of receivables from the sale of electricity is borne by HEP d.d., and an allowance for bad and doubtful receivables is made based on the estimate of HEP's management. All trade debtors in bankruptcy and receivables claimed through court are fully written off.

Management provides for doubtful receivables based on a review of the overall ageing of all receivables and a specific review of significant individual amounts receivable.

As the collectability of certain receivables over a longer term is not certain, the Company makes an allowance for unrecoverable amounts, based on a reasonable estimate and past experience, in order to write down or write off those amounts as follows:

Ageing of past due	Write down in percentage
61 – 90 days	5%
91-120 days	10%
121-365 days	20%
Over one year	100%

Outstanding receivables claimed through court and those not included in bankruptcy estate (the principal debt and intrest) are fully written off, reglardless of the number of past due days. Such write-offs are charged to value adjustment of assets and credited to the allowance account on short-term receivables.

Inventories

Inventories consist mainly of material and small inventory, and are carried at the lower of weighted average cost less value adjustment for obsolete and excessive inventories and net realisable value. Management provides for doubtful receivables based on a review of the overall ageing of all receivables and a specific review of significant individual amounts receivable.
Cost includes invoiced price and other costs directly attributable to brining inventories to their present location and condition.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits with banks and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the statement of income in the period in which they are incurred. Short-term borrowings and supplier loans are recorded at original amount granted less repayment. Interest expense is charged to income statement on an accrual basis. In 2007, the borrowing costs of a short-term club bridge loan, which was used to finance investments until the receipt of funds under issued bonds, were added to the costs of the assets.

Foreign currencies

The individual financial statements of each Company and the Group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group entity are expressed in Croatian kunas (HRK), which is the functional currency of the Company and the presentation currency for the consolidated financial statements. In preparing the financial statements of the individual Group entities, transactions in currencies other than the entity's functional currency (foreign currencies) are translated to the functional currency of the entity at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated to the functional currency of the entity at the year-end rates. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period as finance cost except for differences arising on the retranslation of non-monetary assets available for sale, in respect of which gains and losses are recognised directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are expressed in Croatian kuna using exchange rates prevailing at the balance sheet date. Income and expense items (together with the corresponding figures) are translated at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising on the year-end translation, if any, are classified as equity and recognised in the Group's foreign currency translation reserve. Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's and the Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised on the basis of taxable temporary differences on investments in subsidiaries and associates and joint ventures, unless the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. The measurement of deferred tax liabilities and assets reflects the amount in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Taxation (continued)

Current and deferred tax for the period

Current and deferred tax are recognised as an expense or income in profit or loss, except when they relate to items credited or debited directly to equity, in which case the tax is also recognised directly in equity, or where they arise from the initial accounting for a business combination.

In the case of a business combination, the tax effect is taken into account in calculating goodwill or in determining the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost.

Financial assets

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into as "assets available for sale" and "loans and receivables". The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Income is recognised on an effective interest basis for debt instruments.

Financial assets available for sale

Unlisted shares held by the Company and the Group that are traded in an active market are classified as being AFS and are stated at fair value. Fair value is determined in the manner described in Note 24. Gains and losses arising from changes in fair value are recognised directly in equity in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is included in profit or loss for the period.

Dividends on AFS equity instruments are recognised in profit or loss when the Group's right to receive the dividends has been established.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

The fair value of AFS financial assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the balance sheet date. The change in fair value attributable to translation differences that result from a change in amortised cost of the asset is recognised in profit or loss, and other changes are recognised in equity.

Loans and receivables

Trade receivables, loans, and other receivables with fixed or regular payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

With the exception of AFS equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of AFS equity securities, any increase in fair value subsequent to an impairment loss is recognised directly in equity.

Investments

Investments in immaterial non-consolidated companies are generally recorded at cost less provisions for any impairment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial liabilities

Financial liabilities are classified as other financial liabilities.

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs.

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or have expired.

Derivative financial instruments

During 2007 and 2006, the Company had no derivative financial instruments.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of discounting is material, the amount of the provision is the present value of the expenditures expected to be required to settle the obligation. Where discounting is used, the increase in provisions that reflects the passage of time is recognized as interest expense.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates in the preparation of the financial statements

The preparation of financial statements in conformity with International Reporting Financial Standards, as published by the International Accounting Standards Board requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingencies. The significant areas of estimation used in the preparation of the accompanying financial statements relate to employee benefits, useful lives of property, plant and equipment, impairment of assets and determination of fair values of assets and liabilities, and estimated decommissioning costs. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effect of any changes in estimates will be recorded in the financial statements, when determinable.

Revenue recognition

Revenue is earned primarily from the sale of electricity to households, industrial and other users within Croatia. These sales constitute the main source of the Group's operating income.

Electricity sales are recognised based on the management's best estimate of the actual consumption of the energy delivered to customers.

Interest income is recognised on an accrual basis, by reference to the principal settled and at the effective interest rate applied. The Company revised its estimate with respect to recognition of interest in 2007, as the analysis of collected amounts revealed that the difference between interest accrued and interest collected is insignificant.

Segmental disclosures

The Group has opted not to present any segmental information, since the equity instruments of the Group are not traded on public markets.

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

Critical judgements in applying accounting policies

In the application of the accounting policies, which are described in Note 2, the management made certain judgements that had a significant impact on the amounts reported in the financial statements (irrespective of the underlying estimates referred to below).

These judgements are provided in detail in the accompanying notes. However, the critical judgements relate to the following areas:

Useful lives of property, plant and equipment

As described in Note 2, the Company reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period.

During the financial year, as a result of the changes in depreciation rates, the depreciation charge was decreased by HRK 228,375 thousand.

Fair value of financial assets and interest-rate swap

As described in Note 19, the management uses judgement to estimate whether trade and other receivables have sufferred an impairment loss. The management believes that the carrying amount of the interest-rate swap approximates its fair value as disclosed in Note 25.

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Provisions for environmental protection

The exact scope of activities or technologies to be applied has not been specified by the applicable laws or regulations. In determining the level of provisions for environmental protection and decomissioning, the management relies on the prior experience and its own interpretation of the current laws and regulations. Pursuant to Article 4.1 of the Law on Acknowledgeing the Contract between the Government of the Republic of Croatia and the Government of the Republic of Slovenia on Regulating the Status and other Legal Relations in Respect of Investments in, Exploitation and Decomissioning of, the Nuclear Power Plant Krško (Official Gazette No. 9/2002), the Croatian Government issued on 28 April 2006 a decree on the payment of the funds for the decomissioniong and disposal of radioactive waste and consumed nuclear fuel of the NPP Krško.

The decomissioning costs of thermal power plants represent the discounted value of the estiamted decommissioning costs of the Group's thermal power plants.

Impairment of non-current assets

The impairment calculation requires the estimate of the value in use of the cash generating units. Value in use is measured using the discounted cash flow projections. The most significant variables in determining cash flows are discount rates, time values, the period of cash flow projections, as well as assumptions and judgements used in determining cash receipts and expenditure. There were no impairments of assets of the Company that would result from the projections described above.

The Company engaged an independent firm to appraise the fair value of NPP Krško d.o.o. as of 31 December 2007. In determining the fair value, all technical and technological, as well as economic and market characteristics of the power plant were taken into account. Accordingly, the fair value represents the discounted free cash flow as a free net category (the difference between income and expenses) attributable to the investors. The appraised fair value of the NPP Krško was significantly higher than its carrying amount and, as a result, the provision of HRK 263,181 thousand, included in the balance sheet as at 31 December 2006, was reversed and credited to income in the current year.

Availability of taxable profits against which the deferred tax assets could be recognised

A deferred tax asset is recognized only to the extent that it is probable that the related tax benefit will be realized. In determining the amount of deferred taxes that can be recognised are required, which are based on the probable quantification of time and level of future taxable profits, together with the future tax planning strategy. The carrying amounts of deferred tax assets at 31 December 2007 and 31 December 2006 amounted to HRK (66,563) thousand and HRK 33,537 thousand, respectively (see Note 9).

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Actuarial estimates used in determining the retirement bonuses

The cost of defined benefits is determined using actuarial estimates. Actuarial estimates involve assumptions about discount rates, future salary increases and the mortality or fluctuation rates. Because of the long-term nature of those plans, there is uncertainty surrounding those estimates. Provisions for jubilee awards and retirement bonuses amounted to HRK 230,161 thousand and HRK 291,023 thousand at 31 December 2007 and 31 December 2006, respectively (see Note 26).

Consequences of certain legal actions

There is a number of legal actions involving the Group, which have arisen from the regular course of their operations. The management makes estimates when the probable outcome of the legal action has been estimated, and the provisions are recognised on a consistent basis (see Note 26).

The principal accounting policies applied in the preparation of the financial statements for the year 2007 are consistent with those applied in the prior year, unless stated otherwise.

4. SEGMENT INFORMATION

The Group generates income from its operations in a single geographical area – the Republic of Croatia.

The Group's reportable segments are separated as follows: electricity (generation, distribution and sale of electricity), heating (distribution and sale of thermal power), and gas (distribution and sale of gas).

Each segment's operating profit or loss includes all revenue and expenses directly attributable to the reporting business segments. Information about segment financial income/expense and income tax is not provided on a segment level, as the segments are disclosed based on operating profit.

	Electricity		**Heating**		**Gas**		**Group**	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Revenue	10,057,069	9,484,425	502,094	509,383	256,335	253,449	10,815,498	10,247,257
Result from operations	**308,142**	**482,094**	**(101,858)**	**(70,631)**	**(1,479)**	**(10,815)**	**204,805**	**400,648**
Finance cost							(97,814)	(82,528)
Income tax							(80,985)	(76,242)
Net profit							**26,006**	**241,878**

Segment assets consist primarily of property, plant and equipment, receivables, cash and inventories. Segment liabilities consist of trade and other payables. Non-segment assets and liabilities consist of assets and liabilities that cannot be reasonably attributed to the reporting business segments.

Total unallocated assets include investments in NPP Krško, a part of property, plant and equipment, and unallocated financial assets. Total unallocated liabilities include long-term loans, short-term loans and various other liabilities.

4. SEGMENT INFORMATION (continued)

	Total segment assets		Total segment liabilities	
	2007	**2006**	**2007**	**2006**
	HRK'000	HRK'000	HRK'000	HRK'000
Electricity	25,865,750	25,517,213	7,047,886	6,071,091
Heating	1,005,080	794,523	278,341	194,198
Gas	272,134	261,747	154,305	144,091
Unallocated	3,927,219	2,762,164	5,454,474	4,775,149
Group	**31,070,183**	**29,335,647**	**12,935,006**	**11,184,529**

5. OTHER OPERATING INCOME

	2007	**2006**
	HRK'000	HRK'000
Income from reversal of long-term provisions for NPP Krško	263,181	-
Services performed	230,460	158,176
Income from capitalized assets	186,125	144,451
Income from assets received free of charge	137,662	141,215
Income from lease of electricity sale facilities	61,793	5,930
Income from reversal of long-term provisions for retirement benefits and jubilee awards	61,498	-
Income from reversal of long-term litigation provision	55,838	10,680
Late-payment interest	54,787	56,447
Collection of receivables previously provided against	52,421	51,399
Income from electricity in transit – foreign revenues	51,266	46,980
Income from reversal of long-term provisions – decommissioning of thermal power plants	43,014	11,100
Income from sale of tangible assets	29,719	9,009
Recovery of written-off receivables	15,954	19,269
Income from reversal of provisions under Collective Agreement	15,549	-
Gain on settlement/forgiven debt	12,764	8,789
Inventory surplus	2,314	1,149
Other	115,490	135,477
	1,389,835	**800,071**

During 2007, the Company reversed the provision of HRK 263,181 thousand for the investment in NPP Krško as a result of the appraisal of the fair value of NPP Krško.

6. STAFF COSTS

	2007	2006
	HRK'000	HRK'000
Net salaries	984,349	950,845
Taxes and contributions	660,880	624,404
	1,645,229	**1,575,249**

Total staff costs:

	2007	2006
	HRK'000	HRK'000
Gross salaries	1,645,229	1,575,249
Reimbursement of costs to employees (Note 7)	145,851	147,056
Employee benefits (Note 7)	112,758	183,149
	1,903,838	**1,905,454**

Directors' and executives remuneration:

	2007	2006
	HRK'000	HRK'000
Gross salaries	7,792	6,684
Pension contributions	1,478	1,115
Benefits in kind	1,095	824
	10,365	**8,623**

Reimbursement of costs to employees includes commutation allowances in the amount of HRK 80,477 thousand (2006: HRK 78,460), daily allowances and travelling expenses in the amount of HRK 29,619 thousand (2006: HRK 33,755 thousand), additional health insurance amounting to HRK 14,974 thousand (HRK 16,019 thousand) and other similar expenses.

Employee benefit costs include benefits under Collective Agreement and consists primarily of Christmas and Easter allowance, solidarity support, jubilee awards, family separation allowances and fieldwork bonuses, holiday bonuses, child benefits and other in the total amount of HRK 56,895 thousand (2006: HRK 59,971 thousand) and early retirement incentives in the amount of HRK 48,329 thousand (2006: HRK 119,433 thousand).

7. OPERATING EXPENSES

	2007	2006
	HRK'000	HRK'000
Maintenance costs	536,803	761,682
General and administrative expenses	470,800	448,295
Gas costs	199,069	209,907
Other employee benefits (Note 6)	112,758	183,149
Cost of material	160,851	157,094
Reimbursement of costs to employees (Note 6)	145,851	147,056
NPP Krško – decommissioning	104,448	105,424
NPP Krško – valuation of investment	-	84,942
Provisions for bad and doubtful receivables	119,896	61,474
Write-off of bad debt	23,355	17,312
Contributions to the State	71,236	64,104
Water levies	54,989	49,846
Write-off of tangible and intangible assets	38,997	31,581
Insurance costs	26,207	25,550
Litigation provision	15,968	27,869
Provisions for retirement bonuses and jubilee awards	884	11,752
Research and development	20,056	18,768
Restructuring costs	1,807	9,921
Disposal of equity investment	6,220	-
Other operating expenses	253,921	269,799
	2,364,116	**2,685,525**

8. FINANCE REVENUE AND COSTS

	2007	2006
Financial income	HRK'000	HRK'000
Interest income	4,150	5,140
Foreign exchange gains	93,189	91,668
Fair value of intrest rate swap	591	2,525
Other	-	5,061
Total financial income	**97,930**	**104,394**
Finance costs		
Interest expense	(170,276)	(156,437)
Foreign exchange losses	(21,789)	(26,804)
Amortization of deferred interest	(3,679)	(3,681)
Total financial expenses	**(195,744)**	**(186,922)**
Net finance loss	**(97,814)**	**(82,528)**

9. INCOME TAX

	2007	2006
	HRK'000	HRK'000
Current taxes	14,422	109,779
Deferred tax expense/(income) relating to the origination and reversal of temporary differences	66,563	(33,537)
Income tax expense	**80,985**	**76,242**

9. INCOME TAX (continued)

Adjustments to deferred tax assets were as follows:

	2007	2006
Balance at 1 January	129,071	95,533
Restatement - HROTE	(32)	-
Reversal of deferred tax assets	(70,033)	(4,177)
Deferred tax assets recognised	3,471	37,715
Balance at 31 December	**62,477**	**129,071**

Deferred tax assets have arisen on provisions for jubilee awards and regular retirement benefits not recognised for tax purposes, provisions for trade debtors – households, provisions for the NPP Krško and provisions for legal actions.

The reconciliation between income tax and profit reported in the income statement is set out below:

	2007	**2006**
	HRK'000	HRK'000
Profit before taxation	106,991	318,120
Income tax at the applicable rate of 20%	**21,398**	**63,624**
Tax disallowable expense/(income) – permanent differences	(25,479)	5,797
Tax effect	(66,562)	-
Tax effect of losses brought forward	(1,362)	(7,353)
Tax effect of Group entities operating with loss	152,990	14,174
Tax expense for the year	**80,985**	**76,242**

The Group and its subsidiaries are subject to income tax separately, according to the tax laws and regulations of the Republic of Croatia. Other subsidiaries in the Group reported total tax losses of HRK 587,003 thousand (2006: HRK 243,336 thousand), while the Group recorded a total income tax expense of HRK 15,101 thousand (2006: HRK 109,779 thousand) and reported deferred tax assets in the amount of HRK 62,477 thousand for the current year and HRK 129,071 thousand for prior years.

Tax losses are available for carry forward and offsetting against the tax base in future taxation periods until their expiration as prescribed by law, which is 5 years following the year in which the tax losses were incurred.

9. INCOME TAX (continued)

Tax losses reported by the Group and their expiry are presented below:

Year of loss origination	Total tax loss reported by the Group	Year of expiry
2003	45,401	2008
2004	23,233	2009
2005	67,646	2010
2006	68,250	2011
2007	382,473	2012
	587,003	

9. INCOME TAX (continued)

As of 31 December 2007 the Group did not recognise deferred tax assets arising from tax losses carried forward at certain subsidiaries because the availability of future taxable profit against which the unused tax losses can be utilized is not certain.

The Croatian Tax Authorities have not performed a review of the income tax returns of the Company and its subsidiaries. In accordance with local regulations, the Tax Authority may at any time inspect the books and records of any Group company within 3 years following the year in which the tax liability is reported and may impose additional tax assessments and penalties. The Group management is not aware of any circumstances that may give rise to a potential material liability in this respect.

The following table summarizes the movement in deferred tax assets during the year:

HRK'000	**Unbilled revenue**	**Provisions for jubilee and retirement benefits**	**Value adjustment – NPP Krško**	**Litigation provision**	**Depreciation at rates above statutory rates**	**Other**	**Total**
At 1 January 2007	**24,864**	**56,120**	**34,168**	**11,103**	**1,190**	**1,626**	**129,071**
Restatement - HROTE	**-**	**(32)**	**-**	**-**	**-**	**-**	**(32)**
Credited to profit and losss for the year	(24,864)	(5,318)	(34,168)	(2,841)	581	48	(66,562)
At 31 December 2007	**-**	**50,770**	**-**	**8,262**	**1,771**	**1,674**	**62,477**

10. PROPERTY, PLANT AND EQUIPMENT

HRK'000	Land and buildings	Fixtures and equipment	Assets under construction	Total
COST				
At 1 January 2006	**30,647,496**	**26,633,857**	**1,994,594**	**59,275,947**
Transfers	927	18,427	-	19,354
Additions	-	-	2,738,493	2,738,493
Transfers from assets under construction	816,120	1,322,660	(2,138,780)	-
Exchange differences	-	-	10,456	10,456
Disposals	(52,968)	(286,664)	(4,375)	(344,007)
At 1 January 2007	**31,411,575**	**27,688,280**	**2,600,388**	**61,700,243**
Restatement - HROTE	-	(1,473)	-	(1,473)
Transfers	(44,470)	11,535	4,699	(28,236)
Additions	-	-	3,037,226	3,037,226
Transfers from assets under construction	1,037,966	1,655,033	(2,692,999)	-
Exchange differences	-	-	74,833	74,833
Disposals	(89,265)	(225,186)	(2,999)	(317,450)
At 31 December 2007	**32,315,806**	**29,128,189**	**3,021,148**	**64,465,143**
ACCUMULATED DEPRECIATION				
At 1 January 2006	**18,717,809**	**17,378,473**	**-**	**36,096,282**
Transfers	6,330	23,952	-	30,282
Charge for the year	728,150	1,028,937	-	1,757,087
Impairment losses	1,048	-	-	1,048
Value adjustment of additions	393	-	-	393
Eliminated on disposal	(50,986)	(267,874)	-	(318,860)
At 1 January 2007	**19,402,744**	**18,163,488**	**-**	**37,566,232**
Restatement - HROTE	-	(791)	-	(791)
Transfers	(32,284)	33,471	-	1,187
Charge for the year	671,107	895,189	-	1,566,296
Impairment losses	-	-	-	-
Value adjustment of additions	2,776	9,759	-	12,535
Eliminated on disposal	(71,543)	(217,025)	-	(288,568)
At 31 December 2007	**19,972,800**	**18,884,091**	**-**	**38,856,891**
CARRYING AMOUNT				
At 31 December 2007	**12,343,006**	**10,244,098**	**3,021,148**	**25,608,252**
At 31 December 2006	**12,008,831**	**9,524,792**	**2,600,388**	**24,134,011**

10. PROPERTY, PLANT AND EQUIPMENT (continued)

Disposals from capital work in progress during 2007 in the amount of HRK 2,999 thousand (2006: HRK 2,383 thousand) represent write-offs based on the estimate of management that no future economic benefits will be derived from those assets.

Due to political developments in Croatia since 1990, certain local municipal land registers have not been fully established. The company is in the process of registering, through the local courts in Croatia, its title to land and buildings. To date, no claims have been made against the company concerning its title to these assets.

The Group has pledged property, plant and equipment having a carrying amount of approximately HRK 959,361 thousand (2006: HRK 1,092,354 thousand) to secure the banking facilities provided to TE Plomin d.o.o.

11. INTANGIBLE ASSETS

	HRK'000
COST	
At 1 January 2006	**614,482**
Transfers	(30,523)
Additions	23,410
Disposals	(84,757)
At 1 January 2007	**522,612**
Transfers	(7,800)
Additions	38,600
Disposals	(7,663)
At 31 December 2007	**545,749**
ACCUMULATED AMORTISATION	
At 1 January 2006	**539,302**
Transfers	(26,990)
Charge for the year	21,274
Disposals	(84,663)
At 1 January 2007	**448,923**
Transfers	(4,480)
Charge for the year	23,254
Disposals	(7,663)
At 31 December 2007	**460,034**
CARRYING AMOUNT	
At 31 December 2007	**85,715**
At 31 December 2006	**73,689**

12. INVESTMENT PROPERTY

	Residential buildings	Recreational facilities	Total
	HRK'000	HRK'000	HRK'000
COST			
At 1 January 2006	**84,749**	**39,368**	**124,117**
Additions	6,457	1,198	7,655
Disposals	(3,865)	-	(3,865)
At 1 January 2007	**87,341**	**40,566**	**127,907**
Transfers	-	810	810
Additions	1,026	188	1,214
Disposals	(8,541)	-	(8,541)
At 31 December 2007	**79,826**	**41,564**	**121,390**
ACCUMULATED DEPRECIATION			
At 1 January 2006	**25,655**	**19,350**	**45,005**
Transfers	8	(206)	(198)
Charge for the year	1,735	973	2,708
Disposals	(928)	-	(928)
At 1 January 2007	**26,470**	**20,117**	**46,587**
Transfers	-	397	397
Charge for the year	1,620	1,004	2,624
Disposals	(1,680)	-	(1,680)
At 31 December 2007	**26,410**	**21,518**	**47,928**
CARRYING AMOUNT			
At 31 December 2007	**53,416**	**20,046**	**73,462**
At 31 December 2006	**60,871**	**20,449**	**81,320**

As of 31 December 2007 and 2006 investment property includes flats held for sale and recreational facilities held for use by the employees of the Group. Currently, management is in process of estimating fair value of investment property.

13. PREPAYMENTS FOR FIXED ASSETS

Prepayments made by the Group to its suppliers amounted to HRK 490,609 thousand at 31 December 2007. The largest prepayment balances in 2006 comprised HRK 300,000 thousand, made for electricity facilities along the highways and advances for projects of assets under construction in amount of HRK 148,050 thousand.

14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Opening balance	1,613,901	1,620,928
Negative exchange difference (charged to capital reserves)	(4,149)	(7,027)
	1,609,752	**1,613,901**

Investment background

The legal status of the Nuclear Power Plant Krško ("NPP Krško") was regulated by inter-republic agreement dating back to 1970 and various agreements between the founders from 1974 and 1982. Pursuant to the stated agreements, the Company had a 50% interest in the NPP Krško in Slovenia, the other 50% was held by ELES GEN d.o.o., Ljubljana, the legal successor of the Slovenian power utility.

In 1998, the Slovene government passed a decree transforming the Nuclear Power Plant Krško into a public company, NPPK d.o.o. ("NPPK"), and nationalizing the nuclear power plant. Additionally, due to operational disputes, which include disagreements on energy prices to be charged and approval of annual budgets, the supply of power to HEP from NPPK was cut on 31 July 1998 and was not restored until 19 April 2003. The absence of power from NPPK has been compensated by increased generation from other HEP generation facilities and increased imports.

In late 2001, the Governments of the Republic of Croatia the Republic of Slovenia signed an agreement governing the status and other legal relations in connection with their respective investment in NPPK, usage and decommissioning, as well as a partnership agreement between HEP and ELES GEN. This agreement was ratified by the Croatian parliament during 2002, and it come into effect as at 11 March 2003, following the ratification by the Slovene parliament on 25 February 2003.

The agreement acknowledges the ownership rights of HEP in the newly formed company, Nuklearna elektrana Krško d.o.o. ('NPPK') in respect to its 50% holding in NPPK, which were previously denied. Both parties have agreed to extend the useful life of the power plant at least to the year 2023. The agreement also regulates that the produced electricity is supplied 50:50 to both contracting parties, and that the price of the electricity supplied is determined based on total production cost.

HEP started to receive electricity from NPPK on 19 April 2003, and expects to receive 2,550 GWh annually up to 2023, representing 16% of electricity consumption in Croatia.

14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO (continued)

By the end of 2003, the provisions of the agreement have been implemented according to which HEP and NPPK waive mutual receivables for damages and withdraw all claims arising there from up to 30 June 2002, including the disputed liabilities for electricity purchase and amounts due with respect to the previously calculated contribution for financing the decommissioning of the power plant and funds to cover the losses from previous years. After implementing the changes, the capital of NPPK as at 31 December 2003 amounted to SIT 84.7 billion (approximately: HRK 2.8 billion). Still there are some outstanding off-balance receivables from HEP to NPPK and Slovenia from the past, which do not have any influence on the current business relations.

Current status

According to the above stated agreement, the decommissioning of NPP will be a joint obligation of both parties. Each party will provide half of the funds necessary to prepare the decommissioning plan and to cover the cost of implementation of the plan. In addition, each party will form a separate fund to allocate the funds for this purpose in the amounts estimated by the decommissioning plans. When the Croatian parliament accepts the decommissioning programme (including radioactive waste disposal), it is expected that a Croatian fund for gathering decommissioning funds and for nuclear waste management will be incorporated. The amount of annual payments to be made to the Fund will be determined taking into account the decommissioning programme. In the period 2004 to 2007, the Company made a provision for decommissioning costs amounting to HRK 427,385 thousand, and paid HRK 137,109 on the separate account in 2006 and HRK 148,172 in 2007. The decomissioning provision at the year-end amounts to HRK 142,105 thousand (Note 26).

14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO (continued)

The investment in NPPKis accounted for using the equity method and amounts to HRK 1,609,753 thousand. The negative foreign exchange difference arising on recalculating the capital from the company's investment amounting to HRK 4,148 thousand was charged to capital reserves.

Extracted financial information

The following table presents the financial information extracted from the financial statements of NPPK as at 31 December 2007 and 2006:

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Property, plant and equipment	3,188,505	3,228,201
Capital and reserves	3,219,505	3,227,802
Gross sales	945,820	869,186
Net profit	490	1,900
Cash flows from operating activities	133,442	266,567

Until 2007, the Company valued its investment in NE Krško d.o.o. by comparing the difference between the price of electricity supplied from the NE Krško d.o.o., plus decommisioning costs and loan expense in respect of the NPP Krško, and the electricity imported, on one hand, and 1/19 of the investment value, on the other hand and charging the lower of the two prices to expense. In 2007, the Company engaged an idependent firm that appraised the fair value of the investment in NE Krško d.o.o. In determining the fair value, all technical and technological, as well as economic and market characteristics of the power plant were taken into account. Accordingly, the fair value represents the discounted free cash flow as a free net category (the difference between income and expenses) attributable to the investors.

15. INVESTMENT IN PLOMIN

In November 1996, HEP entered into a Joint Venture Agreement with RWE Energie Aktiengesellschaft, Germany ('RWE') regarding the completion and operation of TPP Plomin II. Consequently, a joint venture, TE Plomin d.o.o. ('Plomin') was formed in December 1996, with each partner holding 50 % of the equity of the new entity. A number of agreements were entered into, which regulate the relationship between the joint venture partners and their respective relationships with the new groups.

In accordance with the 1996 Asset Contribution Agreement, HEP contributed property, plant and equipment previously acquired for the project valued (by Croatian valuation experts) at DEM 50,000 thousand (HRK 179,138 thousand) as a contribution in kind to Plomin. Of this amount, HRK 50 thousand was allocated as share capital, while HRK 179,088 thousand was allocated to reserves. In accordance with the Joint Venture Agreement, RWE contributed an equal amount of cash over the period of construction. The initial cash contribution of HRK 50 thousand was allocated as share capital and the remainder to reserves. The RWE capital contributed is distributed back to RWE over the term of the joint venture of 15 years, starting from the date of operation of the power plant at 30 April 2000.

In 2007 the distribution of RWE invested equity amounted to HRK 12,540 thousand (2006: HRK 12,473 thousand). The remaining undistributed RWE invested capital amounted to HRK 110 million at 31 December 2007 (2006: HRK 113 million).

Under the Statute of Plomin, RWE is entitled to an annual return during the term of the joint venture of 14% to 17% on invested capital (based on the actual number of hours of peak exploitation during the year). The invested capital includes RWE undistributed equity contribution as the unpaid portion of the accrued cumulative interest earned on investment during construction.

During the period of construction, the accrued cumulative interest on the RWE capital amounted to HRK 54,717 thousand (EUR 7,536 thousand) and is payable on a straight-line basis during the period of exploitation. At 31 December 2007, accrued undistributed interest amounted to HRK 26,988 thousand (2006: HRK 30,752 thousand).

The RWE annual return on invested capital, effectively a preferred dividend, is paid out from net profit of Plomin. The rate in 2007 and 2006 was 17%. The amount paid out in 2007 in respect of 2006 profits was HRK 25,008 thousand and in 2006 HRK 27,879 thousand in respect of 2005 profits. In 2005, HRK 37,499 thousand was paid in respect of 2004 profits.
These distributions have priority to HEP's interest in the results of the joint venture and any other payments to HEP. Since HEP's share has been used to pay RWE interest on capital since 2000, HEP has not realized any portion of profits earned by Plomin.

15. INVESTMENT IN PLOMIN (continued)

The joint venture partners entered into a number of agreements necessary for power plant operations, including: operation and maintenance agreements, a joint use and supply agreement and a power purchase agreement ('PPA'). The PPA agreement regulates the sale of electric energy to the Company by Plomin d.o.o. HEP is obliged to purchase all energy produced by TE Plomin d.o.o. at prices calculated in accordance with specified formulas in the PPA, which are designed to cover all costs of operations of Plomin, and ensure the guaranteed return on capital to RWE.

In these financial statements, the Group has presented its interest in TE Plomin using the method of full consolidation.

16. LONG-TERM LOAN RECEIVABLES AND DEPOSITS

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Loans given	3,107	3,799
Current portion of loans given	(658)	(675)
Long-term portion	**2,449**	**3,124**

Loans to third entities:

	Year loan approved	Currency	Loan amount	31 December 2007	31 December 2006
Town of Sisak	2005	3 years	4,810	134	1,737
Town of Pregrada	2006	10 years	1,358	1,358	1,358
Vrni d.o.o.	2007	3 years	247	247	-
Did d.o.o.	2007	4 years	1,010	968	-
Others				400	704
Total				**3,107**	**3,799**
Current portion				(658)	(675)
Long-term portion				**2,449**	**3,124**

17. OTHER NON-CURRENT ASSETS

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Housing loan receivables	63,761	69,246
Calculated intercalary interest – RWE	26,988	30,752
Other non-current assets	16,770	10,565
	107,519	**110,563**

Prior to 1996, the Group had sold apartments it owned to its employees, the sale of which were governed by the laws of the Republic of Croatia. This property was generally sold on credit, and the related housing receivables, which are secured and bear interest at rates below market, are repayable on a monthly basis over periods of 20-35 years. Receivables for sold flats were transferred to new subsidiaries as of 1 July 2002. The housing receivables are shown in the financial statements at their discounted net present values, determined using an interest rate of 6.3 %. The state payable which represents 65% of the value of sold apartments is recorded in non-current liabilities to the state (Note 24). The receivables are secured by mortgages over the sold apartments.

Calculated intercalary interest towards RWE represents deferred interest on the funds invested by RWE in the period between the initial capital contribution and the start of operation of TPP Plomin. This amount is depreciated over 15 years.

18. INVENTORIES

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Inventories of fuel and other material	592,713	495,506
Electric materials	205,083	195,377
Spare parts	175,599	168,989
Construction material	91,915	86,057
Other inventories	14,516	9,521
	1,079,826	**955,450**

19. TRADE RECEIVABLES

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Electricity – Corporate customers	790,954	838,546
Electricity – Households	296,155	399,953
Heating, gas and services	392,167	349,117
Foreign sales	52,244	43,211
Other	13,781	28,376
	1,545,301	**1,659,203**
Allowance for bad and doubtful receivables	(318,013)	(335,891)
	1,227,288	**1,323,312**

Ageing analysis of receivables not impaired

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Not yet due	636,755	609,990
0-60 days	502,423	597,473
61-90 days	40,998	34,216
91-120 days	16,339	19,794
121-365 days	30,773	61,839
	1,227,288	**1,323,312**

19. TRADE RECEIVABLES (continued)

Movements in impairment allowance were as follows:

	31 December 2007 HRK'000	31 December 2006 HRK'000
At 1 January	**335,891**	**325,816**
Restated	10,401	-
At 1 January	**346,292**	**325,816**
Provisions for potential losses (Note 7)	119,896	61,474
Reversal of prior-year provisions	(95,754)	-
Amounts collected (Note 5)	(52,421)	(51,399)
At 31 December	**318,013**	**335,891**

20. OTHER SHORT-TERM RECEIVABLES

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Demand and time deposits	96,053	49,468
VAT receivable	145,275	132,299
Income tax prepayments	75,996	22,467
Receivables for Government bonds	22,563	22,650
Receivables from the State in respect of employees	10,452	12,942
Interest receivable	2,996	3,238
Accrued electricity sales – households	91,059	-
Other short-term receivables	111,928	78,768
	556,322	**321,832**

Accrued electricity sales at 31 December 2007 amounted to HRK 91,059 thousand (2006: HRK 124,323 thousand, see Note 28). In 2007, HRK 215,381 thousand were credited to income based on the underestimated electricity sales to households. The estimate is based on the calculation of losses determined using a logarithmic regression on the distribution level (HEP ODS) and the average electricity price for households without a permanent monthly fee.

21. CASH AND CASH EQUIVALENTS

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Giro accounts - Kunas	130,627	125,016
Petty cash registers - Kunas	590	763
Giro accounts – Foreign	29,823	15,290
Special purposes giro accounts	5,416	18,506
Special purposes giro accounts – postal payments	56	24
	166,512	**159,599**

22. CAPITAL AND RESERVES

The original registration of share capital on 12 December 1994 was made in German Marks (DEM 5,784,832 thousand). On 19 July 1995, the share capital was reregistered in Croatian Kuna in the value of HRK 19,792,159 thousand. The share capital consists of 10,995,644 ordinary shares, with a nominal value of HRK 1,800 each.

In 2005, 2006 and 2007, the value adjustment of the investment in NPP Krško in respect of exchange differences in the amount of HRK 63,556 thousand, HRK 7,028 thousand and HRK 4,148 thousand, respectively, was charged to equity.

At 31 December 2007, the exchange differences on NPP Krško amounted to HRK 144,666 thousand.

Retained earnings in the amount of HRK 256,690 thousand comprise prior year profits in the amount of HRK 124,363 thousand, legal reserves in the amount of HRK 106,321 thousasnd, profit for the year in the amount of HRK 26,006 thousand, of which HRK 3,814 and HRK 22,192 thousand represent dividends attributable to the foreign equity holder. The minority interest attributable to RWE amounts to HRK 122,064 thousand.

23. NON-CURRENT BORROWINGS

	Interest rates	**31 December 2007** HRK'000	**31 December 2006** HRK'000
Domestic bank borrowings	EURIBOR+ (1.00%-2.0%)	1,029,153	1,052,119
Foreign bank borrowings	EURIBOR+ (0.50%-1.50%)	2,190,377	2,247,248
Liabilities to domestic companies	EURIBOR+ 1.95%	32,365	50,215
Liabilities to foreign companies (taken up via domestic banks)	EURIBOR+1.5 %	-	3,339
Loan from RWE		26,988	30,753
Rescheduled debt		262,342	395,829
Total long-term borrowings		**3,541,225**	**3,779,503**
Current portion		(612,485)	(650,599)
Long-term portion		**2,928,740**	**3,128,904**

23. NON-CURRENT BORROWINGS (continued)

Loans from domestic banks are secured by bills of exchange and promissory notes. Loans from foreign banks are partly secured by state guarantees (loan for the project of special state care, and IBRD loan) and total assets of Plomin.

During the year, around EUR 46 million out of a long-term loan of EUR 200 million, based on the underlying agreement concluded in 2005, was used for the financing of the L Block at Thermal Power and District Heating Plant Zagreb and Hyrdoelectric Power Plant Lešće. The undrawn balance at 31 December 2007 amounted to EUR 63.9 million. The loan expires in February 2009.

The loan agreement, concluded with the International Bank for Reconstruction and Development, for a loan of EUR 24 million to finance the Toplinarstvo Project, became effective in April 2007. The undrawn loan balance at 31 December 2007 amounted to EUR 16.4 million. The loan expires on 30 June 2010.

The loan agreement, concluded with the International Bank for Reconstruction and Development, for a loan of EUR 4.4 million to finance the implementation of the Energy Efficiency Project via HEP – ESCO, was concluded in 2003. The undrawn balance at 31 December 2007 was EUR 3.5 million.

The annual principal repayment schedule for the following five years is as follows:

	Amount
2008	612,485
2009	872,641
2010	549,347
2011	498,040
2012	397,151
Thereafter	**611,561**
Total	**3,541,225**

23. NON-CURRENT BORROWINGS (continued)

The covenants, as defined in the applicable loan agreements, specifically require the Company to meet certain prescribed levels of the following ratios: operating ratio, debt service coverage, internal cash generation, tangible net worth, and net borrowing.

The analysis of long-term borrowings in various foreign currencies is provided below (in ‘000):

Currency	31 December 2007	31 December 2006
USD	40,845	56,249
EUR	453,486	468,073

Rescheduled debt

The status of rescheduled debt is presented below:

	Amount
Rescheduled Paris Club debt	156,404
Rescheduled London Club debt	105,938
Total rescheduled debt	**262,342**

Paris Club Debt

The rescheduling of the majority of the Paris Club debt was finalized in 1998.

For the purpose of rescheduling of the remaining Paris Club Debt, the Croatian Government singed on 16 December 2005 a bilateral agreement with the Italian Government in connection with the debt consolidation according to the Law on the Methods and Conditions for the Settlement of Loan and Other Debts with the Paris Club Member Governments (Official Gazette No. 34/1996). Following the ratification in the Parliament and the publication of the Agreement in the Official Gazette No. 01/06, the Company concluded an agreement with Erste & Steiermärkische Bank d.d., Rijeka on 31 January 2006. Under the loan agreement, 51.78 % of the total loan debt principal (EUR 999,719.99) was paid on 15 February 2006, together with all accrued interest, in order to align the terms and conditions applicable to this debt with other Paris Club Loans. The remaining portion of 48.22 % of the loan principal, or EUR 925,399.35, will be repaid by the Group in seven semi-annual instalments, with a regular interest equal to 6-month EURIBOR + 0.50%.
The last instalment under the rescheduled Paris Club Debt is due on 31 July 2009.

During 2007, interest was charged at fixed or variable rates, determined by reference to interest rates on short-term loans in the respective country of the lender, and ranged from 5.23 % to 7.90 % at 31 December 2007 (2006: 3.00% to 7.90%).

23. NON-CURRENT BORROWINGS (continued)

London Club Debt

The rescheduling agreements for the London Club debt, which comprised 29 loans in a variety of currencies, resulted in all principal and interest being translated into US dollars at 30 June 1997 using the Croatian National Bank official rate as at that date. These rescheduled loans have a variable interest rate (six-month LIBOR + 13/16%), and the principal is repayable as follows:

- Loan repayments originally due from 1 August 1996 onwards are repayable in 20 semi-annual installments, commencing 31 January 2000, with a final maturity at 31 July 2010.

24. LONG-TERM LIABILITIES TO THE GOVERNMENT

The long-term debt to the Government in the amount of HRK 66,061 thousand relates to the obligation arising on the sale of housing units to employees under the Government program, which was discontinued in 1996. According to the law regulating housing sales, 65% of the proceeds from the sale of apartments to employees were payable to the state at such time as the proceeds were collected. According to the law, HEP has no liability to remit the funds, unless and until they are collected from the employee.

25. DERIVATIVE FINANCIAL INSTRUMENTS

Interest rate swap

The Group has one interest rate swap contract which hedges the Group's exposure to variable interest rate debt. Under the contract, the six-month interest rate payable by the Company is fixed at 5.39%, while the swapped interest rate is equal to the six-month EURIBOR rate, approximately 4.709 % at 31 December 2007 (2006: approximately 3.851 %).

Contract settlements are payable every six months. The contract matures on 25 October 2012. The notional principal amount of the interest rate swap contract at 31 December 2007 was EUR 25,565 thousand (2006: EUR 30,678 thousand). The fair value of the interest rate swap contract, representing a future obligation, at 31 December 2007 amounted to HRK 4,702 thousand (2006: HRK 9,589 thousand). The related deferred tax asset at 31 December 2007 amounted to HRK 940 thousand (2006: HRK 1,918 thousand).

The non-current and the current portions of the obligation are presented below:

	31 December 2007	**31 December 2006**
	HRK'000	HRK'000
Long-term portion (Note 28)	1,384	2,408
Current portion (Note 31)	3,318	7,181
	4,702	**9,589**

26. LONG-TERM PROVISIONS

	31 December 2007	**31 December 2006**
	HRK'000	HRK'000
Litigation provision	57,647	97,105
Provision for retirement bonuses	179,169	233,300
Provision for jubilee awards	50,992	57,723
Thermal power plant decomissioning provision	73,719	123,010
Other provisions	7,685	7,684
Provision for NPP Krško – decommissioning	142,105	185,829
Provision for NPP Krško – valuation of investment	-	263,181
	511,317	**967,832**

The thermal power plant decomissioning provision in the amount of HRK 73,719 thousand represents a discounted value of the estimated decomissioning costs of the Group's thermal power plants.

26. LONG-TERM PROVISIONS (continued)

Movements in the present value of defined benefit obligations in the current period were as follows:

HRK'000	Legal actions	Retirement bonuses	Jubilee awards	NPPK valuation	Decomissioning - NPPK	Decomissioning of TPPs	Other	Total
At 1 January 2007	**97,105**	**233,300**	**57,723**	**263,181**	**185,829**	**123,010**	**7,685**	**967,833**
New provisions made	13,595	-	1,189	-	104,448	4,823	-	124,055
Decrease in provisions (amounts paid)	(10,291)	(1,249)	(6,945)	-	(148,172)	(11,100)	-	(177,757)
Decrease in provision on valuation	(42,762)	(52,882)	(975)	(263,181)	-	(43,014)	-	(402,814)
At 31 December 2007	**57,647**	**179,169**	**50,992**	**-**	**142,105**	**73,719**	**7,685**	**511,317**

26. LONG TERM PROVISIONS (continued)

Movements in the present value of defined benefit obligations in respect of employee benefits during the current period were as follows:

	Retirement benefits HRK'000	**Jubilee awards** HRK'000	**Total** HRK'000
At 1 January 2007	**233,300**	**57,723**	**291,023**
Cost of services	15,997	4,287	20,284
Interest expenses	12,739	2,986	15,725
Benefits paid	(1,249)	(6,945)	(8,194)
Actuatrial gains/(losses)	(81,618)	(7,059)	(88,677)
At 31 December 2007	**179,169**	**50,992**	**230,161**

The following assumptions were used in preparing the calculations:

- The rates of withdrawal are based on statistical data on employees' mobility at the Company for the period 1999-2007. From the withdrawal experience we assumed a decreasing with age the turnover rate. Thus, a turnover rate for 30 years of age was estimated at 3%, for 31 to 40 years of age 2%, for 41-50 of age 1,3% and for 51 to 60 years of age 0.3%.
- The probability of death by age and sex is based on Croatian Mortality Tables 2004 published by the Croatian Statistical Bureau. It is assumed that the population of employees of the Company represents average with respect to mortality and health status.
- We assumed the annual salary growth of 3%
- The average tas rate applied in calculating the termination benefits was 25%.
- The present value of the obligation was determined using a 7 % discount rate.

27. LIABILITIES UNDER CORPORATE BONDS

The preparations for the issue of the first corporate bonds of Hrvatska elektroprivreda d.d. in the amount of HRK 500,000,000 started in early 2006. The reasons for HEP's participation on the domestic capital market, in addition to a reduced level of foreign debt, is mainly in the diversification of the sources of funding, decreasing the currency risk exposure, eliminating the risk of movements in EURIBOR in the following medium term, as well as the fact that this would be the first step towards attracting investors, who will definitely play a significant role in the future stages of the HEP privatisation process.

The issue was arranged by a consortium of Privredna banka Zagreb d.d., Raiffeisenbank Austria d.d. and Zagrebačka banka d.d. Zagreb. The bonds were issued on 29 November 2006, with a coupon intrest of 5.00%, semi-annual payment of principal, and the issue price of 99.534 %. The bonds mature on a one-off basis, seven years from the date of issuance (2013). The funds are intended for the implementation of the 2006 capital investment plan. On 1 December 2006, the HEP bond was included in the First Quotation of the Zagreb Stock Echange, and has been actively traded on the secondary market ever since.

Around the middle of 2007, activities were initiated to issue corporate bonds of Hrvatska elektroprivreda d.d. in the amount of HRK 700,000,000. The reasons for HEP's participation on the domestic capital market, in addition to a reduced level of foreign debt, is mainly in the diversification of the sources of funding, decreasing the currency risk exposure, eliminating the risk of movements in EURIBOR in the following medium term, as well as attracting potential investors.

The issue was arranged by a consortium of Privredna banka Zagreb d.d., Raiffeisenbank Austria d.d. and Zagrebačka banka d.d. Zagreb, with Erste&Steiermärkische bank d.d. and Societe Generale-Splitska banka d.d. acting as co-arrangers. The bonds were issued on 7 December 2007, with a coupon intrest of 6.50%, semi-annual payment of principal, and the issue price of 99.805 %. The bond principal will be repaid in 15 installments on a semi-annual basis, commencing on the third year from the date of issue. The last installment is due on 7 December 2017. The funds have been reduced by the actual investments in 2007. On 28 December 2007, the HEP bonds were included in the First Quotation of the Zagreb Stock Echange, and have been actively traded on the secondary market ever since.

	31 December 2007	**31 December 2006**
	HRK'000	HRK'000
Nominal value of bonds	1,200,000	500,000
Discount	(3,410)	(2,330)
	1,196,590	**497,670**

28. OTHER NON-CURRENT LIABILITIES

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Deferred income	3,791,218	3,171,293
Long-term debt under interest rate swap (Note 25)	1,384	2,408
	3,792,602	**3,173,701**

Deferred revenue is related to fixed assets contributed by customers and others without charge. The revenue is recognized into income over the same periods as the related assets are amortized.

29. SHORT-TERM BORROWINGS

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Borrowings from domestic banks and branch offices of foreign banks, denominated in various currencies on the following terms:	898,873	379,630
Interst rates ranging from EURIBOR + (0.245 – 1.15%%)	-	-
Interest rates on Ministry of Finance Treasury Bills + (1.90 – 2.65%)	-	-
- Secured by bills of exchange	-	-
Borrowings from domestic companies on the following terms:	2,896	2,993
Interest rate 7.25%	-	-
- Secured by bills of exchange	-	-
Current portion of RWE loan	3,680	3,690
	905,449	**386,313**

During 2007, the Group used short-term loans from domestic banks for working capital purposes and for the settlement of trade payables.

30. LIABILITIES TO EMPLOYEES

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Provisions for obligations under Collective Agreement	5,305	24,948
Net salaries	62,478	59,974
Contributions	36,834	38,314
Termination bonuses	4,226	62,324
	108,843	**185,560**

In 2004, the Supreme Court of the Republic of Croatia decided that the Collective Agreement between the Management Board of HEP and the Union was terminated unfoundedly. HEP filed an appeal to the decision, which was rejected. Based on the principle of prudence, the Company recorded a provision of HRK 288,809 thousand in 2003 in respect of total costs of additional benefits to employees, including interest (Note 26). In 2004, 2005, 2006 and 2007, HRK 161,757 thousand, HRK 99,239 thousand, HRK 1,171 thousand, and HRK 2,620 thousand, respectively, were paid to employees, and the remaining portion will be settled in 2008. Based on the estimates, a provision of HRK 15,549 thousand was reversed.

31. OTHER PAYABLES

	31 December 2007	31 December 2006
	HRK'000	HRK'000
Deferred income and received advances	12,222	9,917
Current portion of the liability under interest rate swap (Note 22)	3,318	7,181
Accrued expenses	7,448	7,477
Adjustment of electricity sales for unbilled revenue	-	124,323
Other payables	43,468	39,579
	66,456	**188,477**

32. RELATED PARTY TRANSACTIONS

The Group has a 50% interest in the capital of the joint venture NE Krško d.o.o.

The produced electric energy at NPP Krško is delivered to HEP at 50% of total produced quantities at a price which is determined in accordance with the total production costs of NE Krško d.o.o.

Receivables and payables, and income and expenditure arisen from related party transactions are presented in the table below:

	31 December 2007	31 December 2006
	HRK'000	HRK'000
NE Krško d.o.o.		
Liabilities for purchased electricity	40,077	36,988
Cost of purchased electricity	469,029	428,453

33. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue		Purchases	
HRK'000	**2007**	**2006**	**2007**	**2006**
Enterprises controlled by the Government				
Hrvatske Željenznice	80,357	84,359	14,261	17,146
INA-Industrija nafte	119,744	150,627	2,202,838	1,443,910
Hrvatske telekomunikacija	46,480	52,151	33,859	37,318
Croatia osiguranje	3,691	4,217	17,769	17,936
Hrvatska pošta	14,014	16,031	31,629	33,972
Hrvatske šume	4,876	5,589	12,196	10,906
Jadrolinija	977	1,074	473	775
Narodne novine	1,513	2,217	6,122	4,714
Croatian Radio & Television	19,169	19,086	1,590	1,098
Plovput	357	481	157	160
Croatia Airlines	580	739	244	479
Petrokemija Kutina	13,879	28,132	6	8
Ministry of Foreign Affairs	639	3,820	-	-
Ministry of Defence	35,027	42,589	-	-
Ministry of Interior	22,277	20,286	20	5
Elementary and secondary schools	62,318	62,748	141	56
Judicial institutions	22,842	20,982	243	214
Colleges and universities	36,503	40,764	16,128	14,651
Legislative, executive and other bodies of the Republic of Croatia	62,986	62,964	9,256	9,299
Health institutions and organisations	126,585	131,916	7,544	8,845
Other users	97,673	136,148	4,659	3,393
TOTAL	**772,487**	**886,920**	**2,359,135**	**1,604,885**

33. RELATED PARTY TRANSACTIONS (continued)

HRK'000	Receivables 31 December 2007	Receivables 31 December 2006	Payables 31 December 2007	Payables 31 December 2006
Enterprises controlled by the Government				
Hrvatske Željeznice	12,024	16,386	5,959	2,473
INA-Industrija nafte	3,743	24,544	396,745	287,949
Hrvatske telekomunikacija	5,473	5,781	4,972	7,203
Croatia osiguranje	297	527	2,195	2,068
Hrvatska pošta	1,737	1,914	3,265	3,257
Hrvatske šume	476	684	2,367	5,570
Jadrolinija	161	113	550	842
Narodne novine	189	287	2,690	1,074
Croatian Radio & Television	1,528	2,619	256	153
Plovput	42	84	96	32
Croatia Airlines	50	73	375	557
Petrokemija Kutina	690	770	-	-
Ministry of Foreign Affairs	92	105	-	-
Ministry of Defence	5,672	5,784	-	-
Ministry of Interior	4,376	4,336	-	-
Elementary and secondary schools	9,441	9,522	-	-
Judicial institutions	1,321	2,002	-	-
Colleges and universities	4,482	3,536	-	-
Legislative, executive and other bodies of the Republic of Croatia	5,040	7,138	-	-
Health institutions and organisations	37,010	47,804	-	-
Other users	12,799	9,276	13,443	19,161
TOTAL	**106,640**	**143,285**	**432,913**	**330,339**

Under the Croatian energy laws, the Company is an elligible gas buyer, for whom gas prices differ from the market ones.

34. CONTINGENT LIABILITIES AND COMMITMENTS

Legal actions

In 2007, the Group established a provision for legal actions estimated to be ruled against HEP.

The Group has long-term financial investments in the territory of Bosnia and Herzegovina, and Serbia which in 1994 had a historical cost of HRK 1,243,970 thousand. At the time of the transformation of the Company into a joint stock company in 1994, this amount was excluded from the net asset value.

Operating commitments

As at 31 December 2007, as part of its investing activities, the Group has concluded contracts under which the construction of a number of significant facilities and other investments has commenced but has not been completed. The unrealised contract value for most significant projects amounts to approximately HRK 557,568 thousand (2006: HRK 348,485 thousand).

Environmental matters

The principal activities of the Group are generation, transmission and distribution of electricity, and the control of the electric power systems.

In addition to these main activities, the HEP Group deals with the production and distribution of thermal power through the district heating systems in Zagreb in Osijek, and the distribution of gas in Osijek and Đakovo. These principal business activities can have inherent effects on the environment in terms of emissions into soil, water and air. The environmental effects of the Company's and Group's activities are monitored by local management and environmental authorities.

Croatia requested membership to the European Union. As part of the succession process environmental regulations similar to those at other EU countries might be introduced in Croatia. Such environmental regulations might have an impact on environmental liabilities for the Group.

35. SUBSIDIARIES

As at 31 December 2007, the Group had the following subsidiaries:

Subsidiary	Country	Interest in (%)	Main activity
HEP-Proizvodnja d.o.o.	Croatia	100	Electricity generation and heating
HEP-Operator prijenosnog sustava d.o.o.	Croatia	100	Electricity transmission
HEP-Operator distribucijskog sustava d.o.o.	Croatia	100	Electricity distribution
HEP Opskrba d.o.o.	Croatia	100	Electricity supply
HEP-Toplinarstvo d.o.o.	Croatia	100	Thermal power generation and distribution
HEP-Trgovina d.o.o.	Croatia	100	Electrical energy trading and optimization of power plats production
HEP-Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	50	Electricity generation
Agencija za posebni otpad d.o.o.	Croatia	100	Special waste management
HEP ESCO d.o.o.	Croatia	100	Financing of energy efficiency projects
Plomin Holding d.o.o.	Croatia	100	Development of infrastructure in area around Plomin
Teppo d.o.o.	Croatia	75	In liquidation
Buško Blato d.o.o.	BiH	100	Maintenance of hydro power plants
HEP-Telecom d.o.o.	Croatia	100	Telecommunications
HEP-Odmor i rekreacija d.o.o.	Croatia	100	Accommodation and recreation services
HEP-NOC Velika	Croatia	100	Accommodation and training
HEP-Obnovljivi izvori energije d.o.o.	Croatia	100	Electricity generation

The majority of these subsidiaries were created for the purpose of reorganization and re-structuring the core business activities driven by the new energy legislation, which came into effect as of 1 January 2002, as indicated in Note 1.

36. FINANCIAL INSTRUMENTS

Capital risk management

The Company manages its capital to ensure that it will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Company consists of debt, which includes the borrowings and issued bonds disclosed in Note 20, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, legal and other reserves and retained earnings.

Gearing ratio

The Group's risk management committee reviews the capital structure on a semi-annual basis. As part of this review, the committee considers the cost of capital and the risks associated with each class of sources of funding. The gearing ratio at the year end can be presented as follows:

(HRK'000)	**31 December 2007**	**31 December 2006**
Debt	5,643,264	4,663,486
Cash and cash equivalents	(166,512)	(159,599)
Net debt	5,476,752	4,503,887
Equity	18,013,113	18,013,448
Net debt to equity ratio	**30%**	**25%**

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 2 to the financial statements.

Categories of financial instruments

(HRK'000)	**31 December 2007**	**31 December 2006**
Financial assets		
Loans and receivables (including cash and cash equivalents)	2,442,413	2,237,642
Other non-current assets	107,519	110,563
Financial liabilities		
Non-current liabilities	4,803,876	4,346,398
Current liabilities	3,827,211	2,696,598

36. FINANCIAL INSTRUMENTS (continued)

Financial risk management objectives

The Group's Treasury function provides services to the business, co-ordinates access to domestic and international financial markets, monitors and manages the financial risks relating to the operations of the Group through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

Market risk

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates and interest rates (see below). Market risk exposures are supplemented by sensitivity analysis. There has been no change to the Group's exposure to market risks or the manner in which it manages and measures the risk.

Foreign currency risk management

The Group undertakes certain transactions denominated in foreign currencies. Hence, exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilising forward foreign exchange contracts.

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Assets		**Liabilities**	
(in '000)	**31 December 2007** *(u tisućama)*	**31 December 2006** *(u tisućama)*	**31 December 2007** *(u tisućama)*	**31 December 2006** *(u tisućama)*
Europska Unija (EUR)	7.222	5.882	541.277	514.314
USD	-	-	72.747	74.724

36. FINANCIAL INSTRUMENTS (continued)

Foreign currency sensitivity analysis

The Group is mainly exposed to the changes of euro (EUR) and US dollar (USD). The following table details the Group's sensitivity to a 10% increase and decrease in the HRK against EUR and USD. 10% is the sensitivity rate used when reporting foreign currency risk internally to key management personnel and represents Management's assessment of the reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated receivables and liabilities and adjusts their translation at the period end for a 10% change in foreign currency rates. The sensitivity analysis includes external loans where the denomination of the loan is in a currency other than the currency of the lender or the borrower. A positive/negative number below indicates an increase in profit and other equity where HRK strengthens 10% against the relevant currency. For a 10% weakening of the HRK against the relevant currency, there would be an equal effect, but the balance would be negative.

	2007. godina u tisućama kuna	**2006. godina** u tisućama kuna
EUR change impact		
Profit or loss	391.202	373.447
USD change impact		
Profit or loss	36.267	41.684

36. FINANCIAL INSTRUMENTS (continued)

Interest rate risk management

The Group is exposed to interest rate risk as it borrow funds at floating interest rates. The Group's exposures to interest rates on financial assets and financial liabilities are detailed in Note 36, the liquidity risk management. The Group manages this risk by maintaining an appropriate mix between fixed and floating rate borrowings, by the use of interest rate swap contracts.

Interest rate sensitivity analysis

The sensitivity analysis has been determined based on the interest rate exposure of the Group to financial instruments at the balance sheet date. For floating rates, the analysis is prepared assuming the amount of liability outstanding at the balance sheet date was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents Management's assessment of the reasonably possible change in interest rates.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the Group's:

- Profit for the year ended 31 December 2007 would decrease/increase by HRK 19,628 thousand (2006; HRK 20,302 thousand), based on exposure to interest rate risk. This is mainly attributable to the Group's exposure to interest rates on its variable rate borrowings, which accounted for 71 % in 2007 (2006: 88 %); and
- the Group's sensitivity to interest rates has decreased during the current period mainly due to the reduction in variable rate of debt instruments.

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group is the sole provider of electric energy in the Republic of Croatia. As such, it has a public responsibility to provide services to all users, and locations within the country, irrespective of credit risk associated with particular customers. Trade receivables, net, consist of a large number of customers, spread across diverse industries and geographical areas.

The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The Group defines counterparties as having similar characteristics if they are related entities. Credit risk with respect to trade receivables is primarily related to domestic corporate receivables, specifically where services are provided to economic concerns, which are in a difficult financial position. Overdue receivables from households are limited due to Group's ability to disconnect such customers from the power supply network.

Except as detailed in the following table, the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Group's maximum exposure to credit risk without taking account of the value of any collateral obtained.

38. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Management Board, which has built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements. The Company manages liquidity risk by maintaining adequate reserves, banking facilities and other sources of financing, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

Liquidity and interest rate risk tables

The following table details the remaining period to contractual maturity for the Group's non-derivative financial assets. The tables below have been drawn up based on the undiscounted cash flows of the financial assets including interest that will be earned on those assets except where the Group anticipates that the cash flow will occur in a different period.

Maturity of non-derivative financial assets

	Weighted average effective interest rate %	**Less than 1 month** (HRK'000)	**1 - 3 months** (HRK'000)	**3 -12 months** (HRK'000)	**1 - 5 years** (HRK'000)	**Over 5 years** (HRK'000)	**Total** (HRK'000)
31 December 2007							
Non-interest bearing		1,116,058	683,741	256,809	444,342	45,875	2,546,825
Variable interest rate instruments	5.29%	60	141	451	1,020	-	1,672
Fixed interest rate instruments	4.01%	140	-	199	731	764	1,834
Total		**1,116,258**	**683,882**	**257,459**	**446,093**	**46,639**	**2,550,331**
31 December 2006							
Non-interest bearing		1,108,589	669,935	34,371	485,748	45.763	2,344,406
Fixed interest rate instruments	5.12%	-	301	2,242	1,781	-	4,324
Total		**1,108,589**	**670,236**	**36,613**	**487,529**	**45,763**	**2,348,730**

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay.

38. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management (continued)

Liquidity and interest rate risk tables (continued)

Maturity of non-derivative financial liabilities

	Weighted average effective interest rate %	**Less than 1 month** (HRK'000)	**1 - 3 months** (HRK'000)	**3 -12 months** (HRK'000)	**1 - 5 years** (HRK'000)	**Over 5 years** (HRK'000)	**Total** (HRK'000)
31 December 2007							
Non-interest bearing	-	963,284	1,616,729	320,750	9,418	11,581	2,921,762
Variable interest rate instruments	5.46%	223,130	399,808	1,048,753	2,199,651	710,561	4,581,903
Fixed interest rate instruments	5.37%	13,627	216	93,162	889,622	1,045,809	2,042,436
Total		**1,200,041**	**2,016,753**	**1,462,665**	**3,098,691**	**1,767,951**	**9,546,101**
31 December 2006							
Non-interest bearing	-	825,155	804,932	658,634	9,321	12,243	2,310,285
Variable interest rate instruments	4.43%	237,378	212,860	723,068	2,171,012	992,761	4,337,079
Fixed interest rate instruments	5.14%	8,622	1,154	50,773	529,780	537,550	1,127,879
Total		**1,071,155**	**1,018,946**	**1,432,475**	**2,710,113**	**1,542,554**	**7,775,243**

The Group has access to financing facilities, the total unused amount which is HRK 742,902 thousand at the balance sheet date. The Group expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

Maturity of derivative financial liabilities

The Group has an interest rate swap, which it uses to hedge its exposure to variable rate debt. Based on the underlying agreement, the six-month interest rate payable by the Company is fixed at 5.39 %, whereas the swap rate is equal to six-month EURIBOR, or approximated at 4.709 % at 31 December 2007 (2006: 3.851 %), as disclosed in detail in Note 22.

38. FINANCIAL INSTRUMENTS (continued)

	Weighted average effective interest rate %	**Less than 1 month** (HRK'000)	**1 - 3 months** (HRK'000)	**3 -12 months** (HRK'000)	**1 - 5 years** (HRK'000)	**Over 5 years** (HRK'000)	**Total** (HRK'000)
31 December 2007							
Variable interest rate instruments	4.709%	-	6,170	5,553	22,154	-	33,878
Fixed interest rate instruments	5.39%	-	(7,063)	(6,357)	(25,358)	-	(38,778)
Total		**-**	**(893)**	**(804)**	**(3,204)**	**-**	**(4,901)**
31 December 2006							
Variable interest rate instruments	3.85%	-	4,666	6,806	32,115	1,856	45,443
Fixed interest rate instruments	5.39%	-	(5,341)	(7,791)	(36,759)	(2,125)	(52,016)
Total		**-**	**(675)**	**(985)**	**(4,644)**	**(269)**	**(6,573)**

Fair value of financial instruments

The fair values of financial assets and financial liabilities are determined as follows:

The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets is determined with reference to quoted market prices.

The fair value of other financial assets and financial liabilities is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.

39. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board and authorised for issue on 11 April 2008.

Signed on behalf of the Management Board on 11 April 2008:

Ivan Mravak	Darko Dvornik
President of the Board	**Member of the Board**