HRVATSKA ELEKTROPRIVREDA GROUP

Consolidated financial statements

As of 31 December 2011

Together with Independent Auditor's Report

Contents

Responsibility for the Consolidated 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 Group 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:

Zlatko Koračević
President of the Board

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

16 April 2012

Independent Auditor's Report

To the Owner of Hrvatska elektroprivreda d.d:

We have audited the consolidated financial statements of the HEP Group (the ‘Group’), which comprise the consolidated statement of financial position as at 31 December 2011 and the related consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management’s Responsibility for the consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. Except as described Matters affecting the opinion paragraph below, 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company’s preparation and fair presentation of the consolidated 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 Group’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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)

Matters affecting the opinion

Prepayments to Hrvatske autoceste d.o.o.

As described in Note 13, the Group advanced HRK 300 million to Hrvatske autoceste d.o.o. in December 2006 for the purchase of electricity facilities on the Croatian motorways within two years from the date of the advance payment. As of the date of these consolidated financial statements, the legal title to these facilities has not yet been transferred to the Group. The Group is the economic beneficiary of the electricity facilities, which it uses for their intended economic purposes in the supply of electricity to customers. As of the date of preparation of these consolidated financial statements, the Group has not classified the advance payment by type of assets used in the Group's business, and we have received no calculation of the economic impact of the reclassification of those assets from prepayments to assets in use and the related depreciation from the Management Board. As a result, we are unable to assess the impact of this matter on the Group's financial statements.

Modified opinion

In our opinion, except for the potential effects of the matters discussed in paragraph above, the consolidated financial statements present fairly, in all material respects, the financial position of the Group at 31 December 2011, the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte d.o.o.

Branislav Vrtačnik, Certified Auditor

Zagreb, 16 April 2012

	Notes	2011 HRK'000	2010 HRK'000 Restated
Revenue from electricity sales	4	10,769,900	10,851,054
Revenue from thermal power sales	4	582,352	569,784
Revenue from gas sales	4	381,177	394,182
Other operating income	4,5	1,340,622	1,127,883
Total operating income		**13,074,051**	**12,942,903**
Electricity purchase cost		(3,259,984)	(2,011,535)
Fuel costs		(2,870,113)	(2,077,105)
Staff cost	6	(1,890,228)	(1,895,205)
Depreciation and amortization expense	10,11	(1,749,518)	(1,721,472)
Other operating expenses	7	(2,850,790)	(3,052,380)
Total operating expenses		**(12,620,633)**	**(10,757,697)**
Profit from operations		**453,418**	**2,185,206**
Financial revenue	8	57,718	91,187
Financial costs	8	(428,989)	(439,224)
Net financial expense		**(371,271)**	**(348,037)**
Profit before tax		**82,147**	**1,837,168**
Income tax expense	9	(85,453)	(401,802)
(Loss) / profit from operations		**(3,306)**	**1,435,366**
Attributable to:			
Equity holder		(14,820)	1,421,303
Non-controlling interest		11,514	14,063
		(3,306)	**1,435,366**

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević — President of the Board

Ivan Matasić — Member of the Board

	Notes	2011 HRK'000	2010 HRK'000 Restated
(Loss) / profit for the year		**(3,306)**	**1,435,366**
Foreign translation differences		1,071	486
Fair valuation adjustment of Janaf shares		(8,921)	7,499
Other comprehensive (loss)/ income		**(7,850)**	**7,985**
Total comprehensive (loss) / income for the year		**(11,156)**	**1,443,351**
Total comprehensive (loss) income attributable to:			
Equity holder		**(23,741)**	1,428,802
Non-controlling interest		12,585	1,443,351
		(11,156)	**1,435,366**

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević | Ivan Matasić

President of the Board | Member of the Board

ASSETS	Notes	31 December 2011	31 December 2010	1 January 2010
		HRK'000	HRK'000	HRK'000
Non-current assets			**Restated**	**Restated**
Property, plant and equipment	10	24,390,612	24,090,370	24,082,799
Capital work in progress	10	3,092,220	3,046,316	3,130,294
Intangible assets	11	57,647	65,010	63,671
Investment property	12	234,760	223,094	202,467
Prepayments for property, plant and equipment	13	427,039	386,055	403,080
Investment in NPP Krško	14	1,754,419	1,754,419	1,754,419
Long-term loan receivables and deposits	16	719	1,183	1,483
Assets held for sale and other investments	17	120,915	162,380	152,997
Other non-current assets	18	107,153	110,973	117,106
Deferred tax assets	9	178,902	159,429	120,351
		30,364,386	**29,999,229**	**30,028,667**
Current assets				
Inventories	19	1,063,520	1,116,671	967,931
Trade receivables	20	1,496,236	1,730,328	1,493,989
Other short-term receivables	21	415,105	144,064	225,459
Cash and cash equivalents	22	407,123	762,157	143,834
		3,381,984	**3,753,220**	**2,831,213**
TOTAL ASSETS		**33,746,370**	**33,752,449**	**32,859,880**

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević — Ivan Matasić

President of the Board — Member of the Board

CAPITAL AND LIABILITIES	Notes	31 December 2011	31 December 2010	1-. January 2010
		HRK'000	HRK'000	HRK'000
			Restated	**Restated**
Share capital	23	19,792,159	19,792,159	19,792,159
Capital reserves	23	(438,957)	(874,074)	(1,889,646)
(Accumulated loss)/ retained earnings	23	(136,262)	816,246	403,018
Equity attributable to equity holder		**19,216,940**	**19,734,331**	**18,305,531**
Non-controlling interest	15	62,847	76,993	91,409
Total equity		**19,279,787**	**19,811,324**	**18,396,940**
Long-term borrowings	24	2,534,489	2,883,554	3,113,467
Long-term liabilities to the state	25	30,466	33,734	59,713
Long-term provisions	27	778,629	799,945	559,017
Bonds issued	28	965,202	1,058,042	1,150,887
Other long-term liabilities	29	5,320,676	5,170,943	4,927,022
Deferred tax liability		-	1,874	-
Total non-current liabilities		**9,629,462**	**9,948,092**	**9,810,106**
Trade payables		2,427,184	1,553,211	2,179,323
Current portion of long-term bonds issued	28	93,380	93,380	46,690
Current portion of long-term borrowings	24	1,174,713	1,184,921	947,747
Short-term borrowings	30	603,163	292,493	767,805
Taxes payable	31	40,755	444,985	171,080
Interest payable		23,191	30,489	64,301
Liabilities to employees	32	127,934	134,226	143,132
Other short-term payables	33	346,801	259,328	332,756
Total current liabilities		**4,837,121**	**3,993,033**	**4,652,834**
TOTAL CAPITAL AND LIABILITIES		**33,746,370**	**33,752,449**	**32,711,054**

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević — President of the Board

Ivan Matasić — Member of the Board

	Share capital	Capital reserves	Retained earnings/ (Accumulated losses)	Equity attributable to the equity holder of the parent	Non-controlling interest	Total equity
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2010, before restatement	**19,792,159**	**(2,038,472)**	**403,016**	**18,156,703**	**91,409**	**18,248,112**
Effect of restatement (Note 3)	-	148,826	-	-	-	148,826
Balance at 1 January 2010, restated	**19,792,159**	**(1,889,646)**	**403,016**	**18,305,529**	**91,409**	**18,396,938**
Allocation of retained earnings	-	1,008,073	(1,008,073)	-	-	-
Profit for the year	-	-	1,421,303	1,421,303	14,063	1,435,366
Translation differences	-	-	-	-	486	486
Other comprehensive income, net, before restatement	-	24,853				
Effect of restatement (Note 3)	-	(17,354)				
Other comprehensive income, net, restated	-	7,499	-	7,499	-	7,499
Total comprehensive income, restated	**-**	**7,499**	**1,421,303**	**1,428,802**	**14,549**	**1,443,351**
Non-controlling interest	-	-	-	-	(16,583)	(16,583)
Distribution of dividend to RWE	-	-	-	-	(12,382)	(12,382)
Balance at 31 December 2010, rastated	**19,792,159**	**(874,074)**	**816,246**	**19,734,331**	**76,993**	**19,811,324**
Allocation of retained earnings	-	444,038	(444,038)	-	-	-
Dividends paid	-	-	(493,376)	(493,376)	-	(493,376)
Losses carried forward – Trgovina Mađarska	-	-	(274)	(274)	-	(274)
Loss for the year	-	-	(14,820)	(14,820)	11,514	(3,306)
Translation differences	-	-	-	-	1,071	1,071
Janaf shares fair value	-	(8,921)	-	(8,921)	-	(8,921)
Total comprehensive income for the year	**-**	**(8,921)**	**(14,820)**	**(23,741)**	**12,585**	**(11,156)**
Non-controlling interest	-	-	-	-	(14,063)	(14,063)
Distribution of dividend RWE	-	-	-	-	(12,668)	(12,668)
Balance 31 December 2011	**19,792,159**	**(438,957)**	**(136,262)**	**19,216,940**	**62,847**	**19,279,787**

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević
President of the Board

Ivan Matasić
Member of the Board

	2011 HRK'000	2010 HRK'000 **Restated**
Cash flows from operating activities		
(Loss)/profit for the year	(3,306)	1,435,366
Income tax expense recognised in profit	85,453	401,802
Net financial expense	371,271	348,037
Gain from real estate fair valuation	(7,676)	(19,865)
Loss on fair value adjustment of derivatives	1,080	1,871
Depreciation and amortization	1,749,518	1,721,472
Increase in provisions for doubtful receivables	403,568	332,139
Increase in provision for inventories	11,330	15,070
(Decrease)/ increase in provisions	(21,316)	240,928
Operating cash flows before movements in working capital	*2,589,922*	*4,476,820*
Increase in trade receivables	(169,476)	(568,478)
Decrease/ (increase) in inventories	41,821	(163,810)
(Increase)/ decrease in other current assets	(285,084)	81,395
Increase/ (decrease) in trade payables	877,038	(600,404)
Increase /(decrease) in other liabilities	156,866	(88,667)
Increase in long-term liabilities	92,160	217,942
Cash generated from operations	**3,303,247**	**3,354,798**
Income taxes paid	(600,873)	(194,454)
Interest paid	(236,874)	(270,324)
NET CASH FROM OPERATING ACTIVITIES	**2,465,500**	**2,890,020**
INVESTING ACTIVITIES		
Interest received	12,979	14,480
Acquisition of Property, Plant and Equipment	(2,132,612)	(1,693,299)
Write off property, plant and equipment	44,311	21,462
(Decrease)/ increase of other assets	(49,467)	48,088
Change in the non-controlling interest and dividend payment to RWE	(26,732)	(28,479)
NET CASH USED IN INVESTING ACTIVITIES	**(2,151,521)**	**(1,637,748)**

	2011	2010
	HRK'000	HRK'000
		Restated
FINANCING ACTIVITIES		
Repayments of bonds issued	(92,840)	(46,155)
Long-term loans raised	793,839	903,857
Repayment of long-term loans	(1,193,750)	(956,881)
Short-term loans raised	997,924	566,692
Repayment of short-term loans	(680,810)	(1,101,462)
Dividends paid to owner	(493,376)	-
NET CASH USED IN FINANCING ACTIVITIES	**(669,013)**	**(633,949)**
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	**(355,034)**	**618,323**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**762,157**	**143,834**
CASH AND CASH EQUIVALENTS AT THE END OF YEAR	**407,123**	**762,157**

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

Signed on behalf of the Company on 16 April 2012 by:

Zlatko Koračević — Ivan Matasić

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 d.d.' or the 'Company') and the subsidiaries listed in Note 36.

HEP d.d. is registered in Zagreb, Ulica grada Vukovara 37. The principal activities of the HEP Group are the 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 generation and distribution of thermal power through the district heating systems in Zagreb and 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 2011, the number of staff employed by the Group was 13,762 (31 December 2010: 13,990).

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.

At 31 December 2011 the total current liabilities exceed the thotal current assets by HRK 1,455,137 thousand. In order to meet the current liquidity requirements in the next period, the Company intends to extend all the existing short-term credit lines and facilities, as well as raise new short-term loans. To carry out the approved 2012 investment plan, the Company plans obtaining new long-term sources of funding. Having in view an increase in electricity prices, the Company expects its operating income to rise during 2012.

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.

HEP d.d. and its subsidiaries continue to provide their services as regulated public services as follows:
electricity generation for tariff-based customers, electricity transmission, electricity distribution and electricity supply for tariff-based customers.

Generation and supply of electricity for eligible customers, (eligibility as described by the group of tariff laws) and trading on the energy market are performed as market activities.

The supply of electricity to eligible customers is performed according to rules governing market relations, which allow negotiating electricity quantities and prices on a free-market basis. Electricity for households and those preferential customers that have not exercised their right to select the electricity supplier or are left without a supplier is supplied as part of the system of obligatory public services.

1. GENERAL (continued)

Energy Laws (continued)

In June 2008, the Government of the Republic of Croatia promulgated a Decision on 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.

The Group has been applying the tariff models since 1 July 2008.

In December 2008, the Law on the Amendments to the Electricity Market Law became effective, under which small customers were obliged to choose their supplier and sign a contract with that chosen supplier by 30 June 2009, which is the date until which they are entitled to receive energy supplied by suppliers of tariff customers.

Small customers failing to select their electricity supplier until the given date will be charged for the supply of electricity based on the balancing electricity price charged to customers who have not selected their supplier either.

According to the new laws, HEP d.d. restructured its operations, by forming separate companies for electricity generation, transmission of electricity, distribution of electricity, electricity supply and electricity trading. HEP d.d. has restructured the Group in accordance with the amended laws.

1. GENERAL (continued)

Governance and management

General assembly

The General assembly consists of the members representing the interests of the HEP d.d.:

Radimir Čaćić	President	Member since 26 January 2012
Đuro Popijač	President	Member from 21 November 2009 until 25 January 2012

Supervisory Board of HEP d.d.

Members of Supervisory Board in 2012, 2011 and 2010:

Nikola Bruketa	President	Member since 23 February 2012
Alen Leverić	Member	Member since 23 February 2012
Ante Ramljak	Member	Member since 23 February 2012
Hubert Bašić	Member	Member since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Jadranko Berlengi	Member	Member since 3 June 2008

Darko Horvat	President	Member from 30 June 2010, President from 30 July 2010 until 23 February 2012
Branimir Horaček	President	Member from 19 November 2009 until 6 May 2010
Dražen Bošnjaković	Member	Member from 19 November 2009 until 22 February 2012
Krešimir Dragić	Member	Member from 19 November 2009 until 22 February 2012
Slavko Konfic	Member	Member from 28 April 2008 until 22 February 2012
Gordana Obran	Member	Member from 19 October 2009 until 22 February 2012
Zvonimir Sabati	Member	Member from 19 October 2009 until 22 February 2012
Jadranko Berlengi	Member	Member from 3 June 2008

1. GENERAL *(continued)*

Management Board in 2012, 2011 and 2010:

Zlatko Koračević	President	Member since 23 February 2012
Zvonko Ercegovac	Member	Member since 23 February 2012
Krunoslava Grgić-Bolješić	Member	Member since 23 February 2012
Rodoljub Lalić	Member	Member since 23 February 2012
Ivan Matasić	Member	Member since 23 February 2012
Tomislav Šerić	Member	Member since 23 February 2012

Leo Begović	President	Member from 25 September 2009 until 22 February 2012
Dubravko Lukačević	Member	Member since 2 November 2009 until 22 February 2012
Snježana Pauk	Member	Member since 2 November 2009 until 22 February 2012
Miljenko Pavlaković	Member	Member since 2 November 2009 until 22 February 2012
Damir Pečvarac	Member	Member since 2 November 2009 until 22 February 2012
Velimir Rajković	Member	Member since 2 November 2009 until 22 February 2012

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Group'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 statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") 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 fair value. The financial statements are presented in thousands of Croatian Kuna (HRK'000), since that is the currency in which the majority of the Group's transactions are denominated.

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 Group's subsidiaries in Croatia and abroad are maintained in accordance with the requirements of the respective local jurisdictions.

The Group's financial statements are prepared in Croatian kuna (HRK).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Adoption of new and revised International Financial Reporting Standards

Standards and Interpretations effective in the current period

The following amendments to the existing standards issued by the International Accounting Standards Board and interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period:

- **Amendments to IFRS 1 "First - time adoption to IFRS"** – limited exemption from Comparative IFRS 7 Financial instruments – Disclosure for first time adopters (effective for annual periods beginning on or after 1 July 2010),

- **Amendments to IAS 24 "Related Party Disclosures"** - simplifying the disclosure requirements for government-related entities and clarifying the definition of a related party (effective for annual periods beginning on or after 1 January 2011),

- **Amendments to IAS 32 "Financial instruments – Presentations"** - accounting for rights issues (effective for annual periods beginning on or after 1 February 2010),

- **Amendments to various standards and interpretations (2010)** resulting from the Annual quality improvement project of IFRS published on 6 May 2010 (IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34, IFRIC 13) primarily with a view to removing inconsistencies and clarifying wording, (amendments are to be applied for annual periods beginning on or after 1 July 2010 or 1 January 2011 depending on standard/interpretation),

- **Amendments to IFRIC 14 "IAS 19 — The Limit on a defined benefit Asset, Minimum Funding Requirements and their Interaction"** - Prepayments of a Minimum Funding Requirement (effective for annual periods beginning on or after 1 January 2011),

- **IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments"** (effective for annual periods beginning on or after 1 July 2010).

The adoption of these amendments to the existing standards and interpretations has not led to any changes in the HEP Group accounting policies.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Standards and Interpretations in issue not yet adopted

At the date of authorisation of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- **IFRS 9 "Financial Instruments",** as amended in 2010, (effective for annual periods beginning on or after 1 January 2013),

- **IFRS 10 "Consolidated Financial Statements"**, published on May 2011, supersedes the previous version of IAS 27 (2008) "Consolidated and Separate Financial Statements", (effective for annual periods beginning on or after 1 January 2013),

- **IFRS 11 "Joint Arrangements"**, published on May 2011, superseded IAS 31 "Interests in Joint Ventures" (effective for annual periods beginning on or after 1 January 2013),

- **IFRS 12 "Disclosure of Interests in Other Entities"**, published on May 2011 (effective for annual periods beginning on or after 1 January 2013),

- **IFRS 13 "Fair Value Measurement"**, published on May 2011 (effective for annual periods beginning on or after 1 January 2013),

- **IAS 27 "Separate Financial Statements" (as amended in 2011),** consolidation requirements previously forming part of IAS 27 (2008) have been revised and are now contained in IFRS 10 "Consolidated Financial Statements", (effective date of IAS 27 (as amended in 2011) for annual periods beginning on or after 1 January 2013),

- **IAS 28 (as amended in 2011) "Investments in Associates and Joint Ventures**" issued. This version supersedes IAS 28 (2003) "Investments in Associates" (effective date of IAS 28 (as amended in 2011) for annual periods beginning on or after 1 January 2013).

- **Amendments to IFRS 1 " First –time Adoption of IFRS"** – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after 1 July 2011),

- **Amendments to IFRS 7 "Financial Instruments - Disclosures"** –Transfer of Financial Assets (effective for annual periods beginning on or after 1 July 2011),

- **Amendments to IAS 1 "Presentation of Financial Statements"** - Revising the way of presenting the other comprehensive income (effective for annual periods beginning on or after 1 July 2012).

- **Amendments to IAS 12 "Income tax"**, - Deferred tax: Recovery of Underlying Assets (effective for annual periods beginning on or after 1 January 2012),

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Standards and Interpretations in issue not yet adopted (continued)

- **Amendments to IAS 19 "Employee Benefits"** - Improvements to the Accounting for Post-Employment Benefits (effective for annual periods beginning on or after 1 January 2013)

HEP Group has elected not to adopt these standards, revisions and interpretations in advance of their effective dates.

The amendments to IFRS 7 increase the disclosure requirements for transactions involving transfers of financial assets. These amendments are intended to provide greater transparency around risk exposures when a financial asset is transferred but the transferor retains some level of continuing exposure in the asset. The amendments also require disclosures where transfers of financial assets are not evenly distributed throughout the period.

The management does not anticipate that these amendments to IFRS 7 will have a significant effect on the Group's disclosures regarding transfers of trade receivables previously affected.

Key requirements of IFRS 9 are described as follows:

- Requires all recognised financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement to be subsequently measured at amortised cost or fair value.

In May 2011, a package of five Standards on consolidation, joint arrangements, associates and disclosures was issued, including IFRS 10, IFRS 11, IFRS 12, IAS 27 (as revised in 2011) and IAS 28 (as revised in 2011).

Key requirements of these five Standards are described below:

IFRS 10 replaces the parts of IAS 27 *Consolidated and Separate Financial Statements* that deal with consolidated financial statements. Under IFRS 10, there is only one basis for consolidation that is control. New definition of control that contains three elements: (a) power over an investee, (b) exposure, or rights, to variable returns from its involvement with the investee, and (c) the ability to use its power over the investee to affect the amount of the investor's returns.

IFRS 11 replaces IAS 31 *Interests in Joint Ventures*. Under IFRS 11, joint arrangements are classified as joint operations or joint ventures, depending on the rights and obligations of the parties to the arrangements. In addition, joint ventures under IFRS 11 are required to be accounted for using the equity method of accounting, whereas jointly controlled entities under IAS 31 can be accounted for using the equity method of accounting or proportionate accounting.

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

Standards and Interpretations in issue not yet adopted (continued)

IFRS 12 is a disclosure standard and is applicable to entities that have interests in subsidiaries, joint arrangements, associates and/or unconsolidated structured entities. In general, the disclosure requirements in IFRS 12 are more extensive than those in the current standards.

IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The Standard defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. The scope of IFRS 13 is broad; it applies to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except in specified circumstances.

The amendments to IAS 1 require additional disclosures to be made in the other comprehensive income section such that items of other comprehensive income are grouped into two categories: (a) items that will not be reclassified subsequently to profit or loss; and (b) items that will be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis.

The amendments to IAS 12 provide an exception to the general principles in IAS 12 that the measurement of deferred tax assets and deferred tax liabilities should reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset. Specifically, under the amendments, investment properties that are measured using the fair value model in accordance with IAS 40 *Investment Property* are presumed to be recovered through sale for the purposes of measuring deferred taxes, unless the presumption is rebutted in certain circumstances.

The amendments to IAS 19 change the accounting for defined benefit plans and termination benefits. The most significant change relates to the accounting for changes in defined benefit obligations and plan assets.

HEP Group has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The management anticipates that the adoption of IFRS 9 “Financial instruments” will have a significant impact on measurement and disclosure of financial instruments and application of IFRS 13 “Fair Value Measurement” will result in more extensive disclosures in the financial statements.

The management anticipates that the adoption of other standards (IFRS 10 “Consolidated Financial Statements”, IFRS 11 “Joint Arrangements” and IFRS 12 “Disclosure of Interests in Other Entities”), revisions and interpretations will have no material impact on the financial statements of Group in the period of initial application.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The basis of the preparation of the Group's financial statement

The financial statements of the Group represent aggregate amounts of the assets, liabilities, capital and reserves, and the results of its operations for the year then ended. All intragroup 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. (it's subsidiaries). A listing of the Group's subsidiaries is provided in Note 36. 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 intragroup transactions, balances, income and expenses are eliminated on consolidation.

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

Reporting currency

Financial statements of Group are prepared in Croatian Kuna (HRK '000).

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 statement of financial position 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. Goodwill is included in net book value of investments and is tested for impairment as part of investment. 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 Group and other parties are engaged in business activities under the joint control; i.e. when strategic financial and business decisions demands unanimous approval of all parties that participate in control.

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 ventures 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 venture has an interest are referred to as jointly controlled entities. The Group reports its interests in jointly controlled entities using full consolidation.

2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

	2011 and 2010
Pension insurance contributions	20%
Health insurance contributions	15%
Employment Fund contribution	1.7%
Occupational injury	0.5%

The Group companies have the obligation to withhold 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 6).

Retirement benefits and jubilee awards

The Group provides benefits to its employees, which include long-service benefits (jubilee awards) and one-off retirement payment. The obligation and the cost of these benefits are determined using the Projected Unit Credit Method. The Projected Unit Credit Method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the interest rate on government bonds where the currency and terms of the Government bonds are consistent with the currency and estimated terms of the benefit obligation. Calculations of the obligation and cost of these benefits are performed by a certified actuary.

Jubilee bonuses

The Company provides long-service benefits (jubilee awards) and retirement benefits to its employees. The long-service benefits range from HRK 1,500.00 to HRK 5,500.00, net, and are provided for a discontinued tenure from 10 to 45 years (under the provisions of the Collective Agreement in effect until 31 December 2010, the long-service benefits amounted from HRK 1,650 to HRK 5,500, net, and were granted for 10 to 40 years of continuous employment with the employer).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Retirement benefits and jubilee awards (continued)

Severance payments

A new Collective Agreement was adopted as of 1 January 2011 (which covers all the HEP Group members), under which the employees are entitled to a retirement benefit to the extent of 1/8 of the average gross monthly salary earned in the period of three months prior to the retirement for each completed year of continuous employment at the employer. The effective date of the Collective is until 31 December 2012.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated 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 recognised within income statement.

Property, plant and equipment in use are depreciated using the straight-line method on the following bases:

Buildings	**2011, 2010 and 2009**
Hydroelectric power plants (Dams, embankments, buildings and other structures and facilities)	20 – 50 years
Thermal power plants (Buildings and other structures)	33 – 50 years
Electricity transmission and distribution plants and facilities (Transmission lines and buildings of transformer stations, switch-yard, dispatch centres and others)	20 – 40 years
Water and steam pipelines and other thermal power generation and transmission plants and facilities	33 years
Gas pipelines	20 - 25 years
Administrative buildings	50 years
Plant and equipment	
Hydroelectric power plants	10 – 33 years
Thermal power plants	6 – 25 years
Electricity transmission plants and facilities (electric parts of transformer stations and transformer; and electric parts of transmission lines)	15 – 40 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
Thermal power stations, hot-water pipelines and other equipment	15 – 30 years
Gas meters and other gas network equipment	5 – 20 years
Other equipment and vehicles	
IT equipment	5 – 20 years
Software licenses	5 years
Telecommunications equipment	5 – 20 years
Motor vehicles	5 – 8 years
Office furniture	10 years

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

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 intended 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.

Any gains or losses arising from the disposal or withdrawal of property, plant and equipment is determined as the difference between the proceeds gains on sale and the carrying amount of the asset and are credited or 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 reporting 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 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, the risks specific to the asset of the 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, trademarks and licenses 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 are properties held to earn rentals and/or for capital appreciation (including property under construction for such purposes). Investment properties are measured initially at cost, including transaction costs. Subsequent to initial recognition, investment properties are measured at fair value. Gains and losses arising from changes in the fair value of investment properties are included in profit or loss in the period in which they arise.

An investment property is derecognised upon disposal or when the investment property is permanently withdrawn from use as well as when no future economic benefits are expected from the disposal. Any gain or loss arising on de-recognition of the property (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognised.

Finance and operating leases

The Group as lessee

The Group has no significant finance lease arrangements and no significant operating lease arrangements were entered during 2011 and 2010. 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 amount less any impairment for doubtful accounts.

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

	2010 and 2011
Ageing of past due	Allowance percentage
31-60 days	1.5%
61-90 days	3%
91-180 days	9%
181-365 days	30%
Over one year	90%

Outstanding receivables claimed through the courts and those included in bankruptcy estate (the debt principal and interest) are fully provided, regardless of the number of past due days, and the provision is charged to expenses.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories comprise mainly of materials and small items and are carried at the lower of cost, determined using the weighted average price less allowance for obsolete and excessive inventories, and net realisable value. The management provides for inventories based on a review of the overall ageing structure of inventories and non-recurring transfers over the years, as well as of individual significant amounts of inventories.

Cost comprises the invoiced amount as well as all other costs directly attributable to brining inventories to their location and the condition of being readily available for use.

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.

Foreign currencies

The individual financial statements of each 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 are 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 reporting 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 date of the statement of financial position. Income and expense items 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 Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of reporting period.

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 are 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 the end of each reporting period 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 end of the reporting period. 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 Group that are traded in an active market are classified as being AFS and are stated at fair value. 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 end of reporting period. 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 the end of each reporting period. 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

Other financial liabilities (including borrowings) are subsequently measured at amortised cost using the effective interest method.

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 (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial liability, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

Derivative financial instruments

The Group entered into an interest rate swap to manage its exposure to interest rate. Further details of derivative financial instruments are disclosed in Note 26.

Derivatives are initially recognised at fair value at the date the derivative contracts are entered into and are subsequently remeasured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

Embedded derivatives

During 2011 and 2010, the Group had no embedded 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 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 the end of each reporting period 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 customers within Croatia. These sales constitute the main source of the Group's operating income.

Revenue from the sale of electricity is recognised according to the best management estimate of the actual energy consumed based on the energy data and tariff items under the cost-recovery models called Electricity Transmission Tariff Model With No Tariff 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. Revenue recognition is based on the Decision of the Croatian Government on the level of tariff items from June 2008 and August 2009 (see Note 1).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue from connection fees

As of 1 January 2010 Group has adopted IFRIC 18 Transfers of Assets from Customers.

IFRIC 18 clarifies the requirements of IFRSs for agreements in which an entity receives from a customer asset (item or property, plant and equipment or cash) that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. When the item of property, plant and equipment transferred from a customer meets the definition of an asset the Company must recognize the asset in its financial statements.

Since 1 January 2010 the connection fees received from customers have been recognized in the income when the fee is received in a moment when customer is connected to grid or in a moment when it has continuous assess to services.

Segmental disclosures

The Group has fully adopted IFRS 8 Operating Segments and presented operating segment disclosures required by the Standard, since it has debt instruments, which are traded in public market.

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

Critical judgments in applying accounting policies

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

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

Useful lives of property, plant and equipment

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

Fair value of financial assets and interest-rate swap

As described in Note 20, the management uses judgment to estimate whether trade and other receivables have suffer an impairment loss. The management believes that the carrying amount of the interest-rate swap approximates its fair value as disclosed in Note 26.

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 decommissioning, 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 Acknowledging 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 Decommissioning 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 decommissioning and disposal of radioactive waste and consumed nuclear fuel of the NPPK.

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

Over / under billed revenue adjustment

After analyzing a number of different methods of approximation (five-year average, a linear approximation, etc.), the Management has decided that the most appropriate is a method of logarithmic regression is the most appropriate. The amount of losses on the network distribution is calculated using the percentage of the function of the logarithmic regression on the total amount of purchased power from the transmission network - the result of the losses of electricity distribution network in the current year in MWh.

The difference between the thus obtained size of losses and over/under billed revenue balance for the current year is calculated.

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Critical judgments in applying accounting policies (continued)

Over / under billed revenue adjustment (continued)

Such difference represents basis for calculation of over / under billed revenue and is multiplied by the average selling prices for households earned in the current year from those without a fixed monthly fee and the result is the difference that increases or decreases the revenues from selling electricity to households (Note 21).

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 judgments used in determining cash receipts and expenditure. There were no impairments of assets of the Group that would result from the projections described above.

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 2011 and 31 December 2010 amounted to HRK 178,902 thousand and HRK 159,429 thousand respectively (see Note 9).

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Critical judgments in applying accounting policies (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 357,632 thousand and HRK 348,425 thousand at 31 December 2011 and 31 December 2010, respectively (see Note 27).

Consequences of certain legal actions

There are a number of legal actions involving the Group, which have arisen from the regular course of their operations. If there is a present obligation as a result of a past event (taking into account all available evidence, including the opinion of law experts) for which is probable that outflow of resources will be required to settle the obligation and if a reliable estimate can be made of the amount of the obligation, provisions are recorded (see Note 27).

Re-measurement of the Janaf shares and investment property at fair value

During 2011 and 2010, the Group remeasured the Jadranski naftovod shares and the investment properties at fair value.

In 2011 and 2010 fair value was determined based on a notification of Central clearing deposit company regarding open balances as of 31 December 2011 and 2010. The market value of the Jadranski naftovod share as at 31 December 2011 was HRK 2,230 (2010: HRK 3,000).

The gain resulting from the fair valuation of the investment property amounts to HRK 7,676 thousand, while a loss of HRK 19,865 thousand was recognised on the fair valuation in 2010 (see Note 5).

Valuation of inventories

During 2011, based on an estimation, the Group made value adjustments for obsolete inventories and materials (material with no turnover in the previous 2 years) according to the ageing structure in the total amount of HRK 11,330 thousand (2010: HRK 15,070 thousand).

3. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Restatement of the value of investment in Nuclear Power Plant Krško

The Company's investment in Nuclear Power Plant Krško was denominated in euro at the transaction date and was subsequently translated at the end of each financial year into kuna. This accounting treatment is not in accordance with IFRSs and, accordingly, the investment had to be restated back to historical cost, which is the euro investment converted to kuna at the transaction date.

The effect of this restatement reflected through an increase in the value of the investment in the Nuclear Power Plant Krško by HRK 131,472 thousand and HRK 148,826 thousand in 2010 and 2009, respectively, and the resulting adjustment made in equity of HRK 131,472 thousand in 2010 and HRK 148,826 thousand in 2009.

The effects of the restatement are as follows:

Effect on investment	**31 December 2010**	**1 January 2010**
	HRK '000	HRK '000
Investment in NPP Krsko, before restatement	1,622,947	1,605,593
Foreign exchange differences recognized in equity	131,472	148,826
Investment in NPP Krsko, as restated	**1,754,419**	**1,754,419**

Effect on reserves	**31 December 2010**	**1 January 2010**
	HRK '000	HRK '000
Reserves, before restatement	(1,005,546)	(2,038,472)
Foreign exchange differences recognized in equity	131,472	(148,826)
Reserves, as restated	**(874,074)**	**(1,889,646)**

Effect on other comprehensive income	**31 December 2010**	**1 January 2010**
	HRK '000	HRK '000
Other comprehensive income, before restatement	**24,853**	**(2,582)**
Change	(17,354)	4,005
Other comprehensive income, net, restated	**7,499**	**1,423**

Due to the restatement of the prior year and as required by IAS 1 Presentation of Financial Statements, the Company has presented balances from earliest period presented, i.e. 1 January 2010. The above restatement has had no impact on the income statement of the Company and the results for the years ended 31 December 2010 and 2011.

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, transmission, distribution and sale of electricity), heating (distribution and sale of heating 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**	
	2011	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
								Restated
Revenue	10,769,900	10,851,054	582,352	569,784	381,177	394,182	11,733,429	11,815,020
Other income allocated to segments	1,234,733	1,065,005	72,768	59,928	33,121	28,657	1,340,622	1,153,590
Income from operations	**766,187**	**2,356,596**	**(314,738)**	**(142,592)**	**1,969**	**(3,091)**	**453,418**	**2,185,206**
Net financial expense							(371,271)	(348,037)
Income tax							(85,453)	(401,802)
Net loss/ (profit)							**(3,306)**	**1,435,366**

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 NPPK, 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.

	Total segment assets		**Total segment liabilities**	
	2011	**2010**	**2011**	**2010**
	HRK'000	HRK'000	HRK'000	HRK'000
		Restated		**Restated**
Electricity	29,095,594	28,409,155	7,350,694	6,995,442
Heating	1,138,791	1,097,458	245,176	220,139
Gas	322,338	319,336	170,566	180,345
Unallocated	3,189,647	3,926,500	6,680,147	6,545,199
Total Group	**33,746,370**	**33,752,449**	**14,446,583**	**13,941,125**

4. SEGMENT INFORMATION (continued)

Information on the largest customers

In 2011 electricity sales amount to HRK 10,769,900 thousand (HRK 10,851,054 thousand in 2010).
Heating energy sales for the year 2011 amount to HRK 582,352 thousand (HRK 569,784 thousand in 2010).

In 2011 gas sales amount to HRK 381,177 thousand (HRK 394,182 thousand in 2010).

Territorial business analysis

The Group operates in Europe, with countries that are members of the European Union and other countries that are not members of the European Union.

Presented below is the territorial analysis of the revenue that the Group generated from continuing operations with external buyers of electric energy:

	2011	**2010**
	HRK'000	**HRK'000**
		Restated
Croatia	10,582,154	10,600,969
European Union member states	27,463	185,373
Other countries –non-European Union member states	160,283	64,712
	10,769,900	**10,851,054**

5. OTHER OPERATING INCOME

	2011	2010
	HRK'000	HRK'000
		Restated
Service for connection to network	249,943	139,245
Income from assets received free of charge	231,908	218,769
Subsequent collection of receivables previously provided against	139,266	134,531
Services rendered	118,859	150,423
Capitalised assets	109,502	112,592
Late-payment interest	93,220	80,126
Reversal of long-term provisions – vacation	64,477	-
Income from sale of materials	52,070	48,512
Income from sale of cross – border transmission capacity	49,997	21,584
Income from electricity in transit – foreign	33,877	45,715
Reversal of long-term provisions for retirement benefits and jubilee awards	26,514	24,449
Reversal of long-term provisions – court costs	23,088	18,144
Income in respect of the electricity bill reminders	21,702	19,462
Income from balancing energy	14,479	4,067
Income in respect of court costs on claims	8,831	7,673
Gains on fair valuation of investment properties	7,676	19,865
Income from reversal of long-term decommissioning provision	-	4,706
Inventory surplus – fixed assets	5,648	870
Income from sale of tangible assets	4,835	1,889
Recovery of receivables previously written off	4,286	2,585
Other	80,444	72,676
	1,340,622	**1,127,883**

In 2011 the Group generated income from grid connection services in the amount of HRK 249,943 thousand (2010: HRK 139,245 thousand) based on IFRIC 18 Transfer of Assets From Customers which became effective in the Republic of Croatia on 1 January 2010 (Official Gazette No. 18/2010).

6. STAFF COSTS

	2011	2010
	HRK'000	HRK'000
		Restated
Net salaries	1,135,278	1,134,137
Taxes and contributions	754,950	761,068
	1,890,228	**1,895,205**

Total staff costs:

	2011	2010
	HRK'000	HRK'000
		Restated
Gross salaries	1,890,228	1,895,205
Reimbursement of costs to employees (Note 7)	143,885	156,673
Employee benefits (Note 7)	108,285	77,055
	2,142,398	**2,128,933**

Directors' and executives remuneration:

	2011	2010
	HRK'000	HRK'000
		Restated
Gross salaries	19,104	18,693
Pension contributions	4,305	4,115
Other receipts	2,185	2,266
	25,594	**25,074**

Reimbursement of costs to employees includes transportation allowances in the amount of HRK 83,925 thousand (2010: HRK 80,158), daily allowances and travelling expenses in the amount of HRK 15,530 thousand (2010: HRK 17.636 thousand), additional health insurance amounting to HRK 15,530 thousand (2010: HRK 17,209 thousand), receipts based on tax inspection in the amount of HRK 1,299 (2010: HRK 15,561 thousand), and other similar expenses.

Employee benefit costs include benefits under the Collective Agreement and consist primarily of Christmas and Easter allowances, solidarity support, jubilee awards, family separation allowances and fieldwork bonuses, holiday bonuses, child benefits and other in the total amount of HRK 85,488 thousand (2010: HRK 54,424 thousand).

7. OTHER OPERATING EXPENSES

	2011 HRK'000	2010 HRK'000 Restated
Maintenance costs (service and material)	669,345	645,098
Provisions for doubtful receivables	403,568	332,139
Gas costs	352,066	355,869
General and administrative expenses	341,278	380,020
Other employee benefits (Note 6)	143,885	156,673
Cost of material	123,038	118,136
Other material employee's rights (Note 6)	108,285	77,055
NPPK – decommissioning expense	106,005	103,854
Contributions to the State	96,524	99,264
Litigation provisions	78,265	75,986
Distributions and concession for water	68,789	74,601
Accrual for unused vacation days	63,900	64,477
Fee for the usage of power plant facilities	48,539	66,115
Write-off of tangible assets	47,854	21,462
Purchase value of sold materials	45,464	40,710
Calculation and collection costs	39,859	34,823
Provisions for retirement bonuses and jubilee awards	35,721	86,762
Fee for gas storage	30,753	-
Insurance premiums	24,607	24,860
Fee for environmental protection	21,217	27,299
Damages and indemnities	16,027	37,449
Provision for delivered electric energy from wind power plants	-	22,031
Provisions according to contracts for damages	-	52,179
Provision for investment in HE Lešće	(39,286)	39,286
Provision for NPPK additional decommissioning costs	(53,838)	53,838
Other	78,925	62,894
	2,850,790	**3,052,380**

8. FINANCIAL REVENUE AND COSTS

	2011	2010
Financial income	HRK'000	HRK'000
		Restated
Foreign exchange gains	41,515	76,707
Interest expense	12,979	14,480
Janaf dividend	3,224	-
Total financial income	**57,718**	**91,187**
Finance costs		
Interest expense	(242,560)	(272,471)
Foreign exchange losses	(160,266)	(167,029)
Amortization of deferred interest	(3,740)	(3,858)
Fair value of interest rate swap	(1,080)	(1,871)
Fair valuation adjustment of Janaf shares	(30,769)	-
Financial expenses	**(438,415)**	**(445,229)**
Less: Capitalised borrowing cost allocated to PPE	9,426	6,005
Total financial expenses	**(428,989)**	**(439,224)**
Net finance expense	**(371,271)**	**(348,037)**

9. INCOME TAX

	2011	2010
	HRK'000	HRK'000
		Restated
Current taxes	104,926	440,880
Deferred tax income relating to the origination and reversal of temporary differences	(19,473)	(39,078)
Income tax expense	**85,453**	**401,802**

Adjustments to deferred tax assets were as follows:

	2011	2010
	HRK'000	HRK'000
		Restated
Balance at 1 January	159,429	120,351
Reversal of deferred tax assets	(29,869)	(21,345)
Deferred tax assets recognised	49,342	60,423
Balance at 31 December	**178,902**	**159,429**

9. INCOME TAX (continued)

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

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

	2011	**2010**
	HRK'000	HRK'000
		Restated
Profit before taxation	82,147	1,837,168
Income tax at the applicable rate of 20%	**16,429**	**367,433**
Non-taxable income and realisation of deferred tax asset previously not recognised	(149,725)	(157,509)
Tax effect of permanent differences	159,920	39,078
Tax effect of losses brought forward	(4,429)	-
Unrecognised deferred tax asset on losses carry forward	63,259	152,800
Tax expense for the year	**85,453**	**401,802**

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 including HEP d.d. reported total tax losses of HRK 1,000,859 thousand (2010: HRK 626,588 thousand), while the Group recorded a total income tax expense of HRK 104,926 thousand (2010: HRK 440,880 thousand) and reported deferred tax assets in the amount of HRK 19,473 thousand for the current year and HRK 39,078 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.

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

Year of loss origination	**Total tax loss reported by the Group**	**Year of expiry**
2007	102,889	2012
2008	194,136	2013
2009	116,099	2014
2010	152,800	2015
2011	434,935	2016
	1,000,859	

As of 31 December 2011 and 2010 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.

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9. INCOME TAX (continued)

The Croatian Tax Authorities have not performed a review of the income tax returns of the Group 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	**Value adjustment of inventory**	**Provisions for jubilee and retirement benefits**	**Litigation provision**	**Depreciation at rates above statutory rates**	**Other**	**Total**
At 1 January 2010	**21,675**	**65,163**	**17,680**	**3,519**	**12,314**	**120,351**
Credited to profit and loss for the year	4,324	12,381	(13,130)	1,335	34,168	39,078
At 31 December 2010	**25,999**	**77,544**	**4,550**	**4,854**	**46,482**	**159,429**
Credited to profit and loss for the year	3,385	1,638	(4,550)	2,081	16,919	19,473
At 31 December 2011	**29,384**	**79,182**	**-**	**6,935**	**63,401**	**178,902**

10. PROPERTY, PLANT AND EQUIPMENT

HRK'000	Land and buildings	Fixtures and equipment	Assets under construction	Total
COST				
At 1 January 2010, restated	**33,624,793**	**32,162,924**	**3,130,294**	**68,918,011**
Restatement 01 January 2010	(211)	211	-	-
Additions	4,997	75,362	1,553,796	1,634,155
Transfers from assets under construction	604,745	1,027,172	(1,631,917)	-
Capitalized borrowing costs	-	-	7,161	7,161
Inventory (shortages) / surplus	(347)	437	428	518
Disposals	(61,172)	(134,031)	(13,446)	(208,649)
At 31 December 2010, restated	**34,172,805**	**33,132,075**	**3,046,316**	**70,351,196**
Restatement 01 January 2011	-	3,305	(49)	3,256
Additions	9,380	67,386	2,029,690	2,106,456
Transfers from assets under construction	759,134	1,196,938	(1,956,072)	-
Capitalized borrowing costs			10,427	10,427
Inventory (shortages) / surplus	5,343	4,146	1,982	11,471
Disposals	(51,995)	(134,329)	(40,074)	(226,398)
At 31 December 2011	**34,894,667**	**34,269,521**	**3,092,220**	**72,256,408**
ACCUMULATED DEPRECIATION				
At 1 January 2010, restated	**21,151,527**	**20,553,391**	**-**	**41,704,918**
Restatement at 01 January 2010	(182)	182	-	-
Transfers	(764)	1,217	-	453
Charge for the year	689,028	1,007,579	-	1,696,607
Disposals	(59,728)	(128,314)	-	(188,042)
Inventory surplus	263	311	-	574
At 31 December 2010, restated	**21,780,144**	**21,434,366**	**-**	**43,214,510**
Restatement at 01 January 2011	-	1,517	-	1,517
Transfers	(2,509)	9,043	-	6,534
Charge for the year	697,423	1,028,908	-	1,726,331
Disposals	(50,173)	(126,279)	-	(176,452)
Inventory surplus	242	894	-	1,136
At 31 December 2011	**22,425,127**	**22,348,449**	**-**	**44,773,576**
CARRYING AMOUNT				
At 31 December 2011	**12,469,540**	**11,921,072**	**3,092,220**	**27,482,832**
At 31 December 2010, restated	**12,392,661**	**11,697,709**	**3,046,316**	**27,136,686**
At 1 January 2010, restated	**12,473,266**	**11,609,533**	**3,130,294**	**27,213,093**

10. PROPERTY, PLANT AND EQUIPMENT (continued)

Disposals from capital work in progress during 2011 in the amount of HRK 40,074 thousand (2010: HRK 13,446 thousand) represent write-offs based on the management estimate 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 wtih a carrying amount of approximately HRK 427,392 thousand (2010: HRK 560,384 thousand) to secure the banking facilities provided to TE Plomin d.o.o.

11. INTANGIBLE ASSETS

	HRK'000
COST	
At 1 January 2010, restated	**542,875**
Transfers	140
Additions	25,937
Disposals	(221)
At 31 December 2010, restated	**568,731**
Transfers	(5,972)
Additions	15,729
Disposals	(2,304)
At 31 December 2011	**576,184**
ACCUMULATED AMORTISATION	
At 1 January 2010, restated	**479,204**
Transfers	57
Charge for the year	24,678
Disposals	(218)
At 31 December 2010, restated	**503,721**
Transfers	(5,972)
Charge for the year	23,078
Disposals	(2,290)
At 31 December 2011	**518,537**
CARRYING AMOUNT	
At 31 December 2011	**57,647**
At 31 December 2010, restated	**65,010**
At 1 January 2010, restated	**63,671**

12. INVESTMENT PROPERTIES

As of 31 December 2011 investment properties comprise properties held for the purpose of generating earnings from rental and or capital appreciation, and are carried at fair value based on market price at the end of reporting period. All the investment properties are owned by the HEP d.d.

At fair value	**31 December 2011**	**31 December 2010**	**1 January 2010**
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Fair value	**223,094**	**202,467**	**211,074**
Depreciation charge for the year	(109)	(187)	(189)
Net gain/(loss) on fair value adjustment	7,676	19,865	(19,748)
Other changes	4,099	949	11,330
Closing balance at fair value	**234,760**	**223,094**	**202,467**

13. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Power facilities – Hrvatske autoceste	300,000	300,000	300,000
JSC Tehnopromexport –TE Sisak	94,299	56,530	59,068
Končar GIM	17,067	17,905	18,257
Litostroj Slovenia	2,891	4,457	8,447
VOITH Siemens, Austria	3,054	3,978	4,955
Končar Inženjering d.d. – HE Lešće	-	1,249	5,169
Končar Inženjering d.d TE Sisak	2,896	-	-
Others	6,832	1,936	7,184
	427,039	**386,055**	**403,080**

In December 2006, the Group advanced a payment to Hrvatske autoceste d.o.o. for the purpose of acquisition of electricity facilities on the Croatian highways within 2 years from the advance payment.

As of the date of these financial statements, the facilities were not transferred to the Group, and an agreement was concluded with Hrvatske autoceste d.o.o. In December 2009, under which the deadline for the takeover of the electricity facilities by the Group has been prolonged for another 2 years.

The Group is the beneficial owner of these facilities, as it uses those assets for their intended economic purpose, which is to supply electricity to customers.

As of the date of issue of these financial statements, the Group has not classified these assets by type, and the economic effect of transfer of these assets from prepayments to tangible assets has not been calculated as well as the related depreciation.

14. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	Restated
Opening balance	1,754,419	1,754,419	1,754,419
	1,754,419	**1,754,419**	**1,754,419**

Investment background

The legal status of the Nuclear Power Plant Krško ("NPPK") 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 NPPK 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 NPPK into a public company, Nuclear Power Plant Krško 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 d.d. from NPPK was cut on 30 July 1998 and was not restored until 19 April 2003.

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 d.d. 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 d.d. 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 d.d. 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.
By the end of 2003, the provisions of the agreement have been implemented according to which HEP d.d. 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 d.d. to NPPK and Slovenia from the past, which do not have any influence on the current business relations.

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

Current status

According to the above stated agreement, the decommissioning of NPPK 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. According to the current programme for the decommissioning of the Nuclear Power Plant Krško and disposal of nuclear waste, HEP d.d. is obliged to pay in the fund EUR 14,250 thousand per year. From 2004 to 2011, the Company disclosed radioactive waste disposal and decommissioning provisions in the amount of HRK 836,161 thousand, which is also the amount it paid onto the Fund's account in the period from 2006 to 2011.

The investment in NEK is accounted for using the equity method and amounts to HRK 1,754,419 thousand. The investment in NEK and the capital reserves of HEP d.d. were increased by accrued foreign exchange losses arisen on translation of the net investment in the period from 2004 to 2010 in the amount of HRK 131,471,749.66. The prior periods were restated to reflect this change.

Extracted financial information

The following table presents the financial information extracted from the financial statements of NPPK as at 31 December 2011 and 2010:

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK'000	HRK'000	HRK'000
Property, plant and equipment	3,022,951	3,089,065	3,063,234
Capital and reserves	3,309,732	3,245,896	3,211,186
Gross sales	1,492,491	1,214,576	1,120,485
Cash flows from operating activities	495,358	313,211	352,970

Liabilities for received electrical energy from NPP Krško as at 31 December 2011 amount to HRK 64,667 thousand (2010: HRK 61,090 thousand). The Company has breakeven from the results for the financial years 2011 and 2010.

15. INVESTMENT IN TPP PLOMIN

In November 1996, HEP d.d. 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 d.d. 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 2011 the distribution of RWE invested equity amounted to HRK 12,668 thousand (2010: HRK 12,382 thousand). The remaining undistributed RWE invested capital amounted to HRK 51 million at 31 December 2011 (2010: HRK 63 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 2011, accrued undistributed interest amounted to HRK 12,611 thousand (2010: HRK 16,078 thousand).

The RWE annual return on invested capital, effectively a preferred dividend, is paid out from net profit of Plomin. The rate for 2011 is 17% as well as for 2010. The amount paid out in 2011 in respect of 2010 profits was HRK 14,063 thousand and in 2010 HRK 16,583 thousand in respect of 2009 profits.

These distributions have priority to HEP d.d. interest in the results of the joint venture and any other payments to HEP d.d.. Since HEP d.d. share has been used to pay RWE interest on capital since 2000, HEP d.d. has not realized any portion of profits earned by Plomin.

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 Group by Plomin d.o.o. HEP d.d. 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.

15. INVESTMENT IN TPP PLOMIN (continued)

	2011	**2010**	**2009**
	HRK '000	HRK '000	HRK '000
Opening balance of non-controlling share	76,993	91,409	106,821
Interest payment	(12,668)	(12,382)	(12,677)
Dividend payment	(14,063)	(16,583)	(19,442)
Share of current year's profit	11,514	14,063	18,578
Correction of tax liabilities through retained earnings	-	-	(1,995)
Exchange differences	1,071	486	124
Closing balance	**62,847**	**76,993**	**91,409**

16. LONG-TERM LOAN RECEIVABLES AND DEPOSITS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Loans given	1,022	1,318	1,794
Current portion of loans given	(167)	(135)	(311)
Short term portion of Long term loans	(136)	-	-
Long-term portion	**719**	**1,183**	**1,483**

Loans given to third parties

	Year loan approved	Repayment period	Loan amount	31 December 2011	31 December 2010	1 January 2010
				HRK'000	HRK'000	HRK'000
					Restated	**Restated**
Town of Pregrada	2006	10 years	1,358	815	950	914
Did d.o.o.	2007	4 years	1,010	207	368	880
Total				**1,022**	**1,318**	**1,794**
Value adjustment				(167)	(135)	(311)
Current portion				(136)	-	-
Non-current portion				**719**	**1,183**	**1,483**

17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Investments available for sale	120,605	162.170	152,797
Other investments	310	210	200
	120,915	**162,380**	**152,997**

17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS (continued)

Changes in investments available for sale are presented below:

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK '000	HRK '000	HRK '000
		Restated	**Restated**
Beginning balance	162,170	152,797	151,374
Fair value adjustment of Jadranski Naftovod d.d.	-	9,373	1,423
Fair valuation adjustment of investments in Jadranski naftovod d.d. presented in income	(41,565)	-	-
	120,605	**162,170**	**152,797**

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK '000	HRK '000	HRK '000
		Restated	**Restated**
Investment in securities:			
Jadranski Naftovod d.d.	120,378	161,943	152,570
Viktor Lenac d.d.	220	220	220
Đuro Đaković d.d.	5	5	5
Kraš d.d.	2	2	2
	120,605	**162,170**	**152,797**
Other investments			
Geopodravina d.o.o.	200	200	200
LNG Hrvatska d.o.o.	110	10	-
	120,915	**162,380**	**152,997**

In December 2008, HEP d.d. acquired 53,981 shares of Jadranski Naftovod d.d. under a decision of the Croatian Government, with a nominal value of HRK 2,700 per share i.e. the total nominal value of HRK 145,748,700. According to the Management Decision, the Jadranski Naftovod shares were designated as available for sale. The shares were subscribed at the Central Depository Agency on 19 March 2009.

17. INVESTMENTS AVAILABLE FOR SALE AND OTHER INVESTMENTS (continued)

In 2011 and 2010 fair value was determined by notification of the central clearing deposit company as of 31 December. The market value of Jadranski naftovod shares as of 31 December 2011 is HRK 2,230 (2010: HRK 3,000). The fair valuation of the investment in Jadranski naftovod as of 31 December 2011 is reduced by HRK 41,565 thousand (2010: increase by 9,373 thousand).

On 1 June 2010 HEP d.d. and Plinacro d.o.o. concluded the Articles of Incorporation of LNG Hrvatska d.o.o., a liquefied natural gas company. In 2011 a decision was made to increase the share capital of LNG Hrvatska d.o.o. from HRK 20 thousand to HRK 220 thousand. HEP d.d. and Plinacro d.o.o. each hold 50 percent of the equity share.

18. OTHER NON-CURRENT ASSETS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK '000
		Restated	**Restated**
Housing loan receivables	38,095	42,890	54,035
Energy efficiency receivables – long-term portion	56,415	51,930	43,391
Accrued cumulative interest – RWE	12,611	16,078	19,577
Other long-term assets	32	75	103
	107,153	**110,973**	**117,106**

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 7.0 %. The amounts owed to the state, which represent 65 % of the value of the sold apartments, are included in non-current liabilities to the state (Note 25). The receivables are secured by mortgages over the sold apartments.
According to the Statute of Plomin, intercalary interest was accrued on all the funds invested by RWE in the period of construction at a rate of 17 percent. The accrued interest balance of EUR 7,536 thousand, equivalent to HRK 55,653 thousand has been recognised as deferred expense subject to straight-line amortisation over a period of 15 years.

Repayment of interest is done along with the repayment of invested funds from RWE Power and it started after the electric power plant was finished. In 2011 the total amount repaid was EUR 502 thousand equivalent to HRK 3,734 thousand (in 2010 EUR 502 thousand, equivalent to HRK 3,650 thousand).

As at 31 December 2011 deferred expense for the interest amounted to EUR 1,675 thousand equivalent to HRK 12,611 thousand (2010: EUR 2,177 thousand, equivalent to HRK 16,078 thousand). The related exchange differences are included in the financial revenue or financial cost for the year in which they arise.

19. INVENTORIES

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK'000	HRK'000	HRK '000
		Restated	**Restated**
Inventories of fuel and other material	644,113	748,065	553,996
Electric materials	187,740	162,486	171,684
Spare parts	212,512	175,536	99,099
Construction material	90,418	83,211	84,454
Other inventories	65,784	73,090	169,345
Impairment of obsolete materials and spare parts	(137,047)	(125,717)	(110,647)
	1,063,520	**1,116,671**	**967,931**

In 2011, the Group estimated the impariment for obsolete inventories of materials (material with no turnover in the last 2 years), in accordance with the ageing structure, at HRK 11,330 thousand (2010: HRK 15,070 thousand).

20. TRADE RECEIVABLES

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK'000	HRK'000	HRK '000
		Restated	**Restated**
Electricity – Corporate customers	1,422,139	1,355,919	1,109,074
Electricity – Households	313,463	336,814	270,576
Heating, gas and services	443,354	446,462	444,020
Foreign sales	35,625	71,530	23,386
Connection to transmission network	-	33,131	-
Other	63,255	61,882	49,818
	2,277,836	**2,305,738**	**1,896,874**
Impairment of bad and doubtful receivables	(781,600)	(575,410)	(402,885)
	1,496,236	**1,730,328**	**1,493,989**

20. TRADE RECEIVABLES (continued)

Ageing analysis of receivables not impaired is as follows:

	31 December 2011 HRK'000	31 December 2010 HRK'000 Restated		1 January 2010 HRK'000 Restated
Not yet due	876,451	1,044,409		
0-30 days	309,826	347,291	Not yet due	775,460
31-60 days	138,013	145,786	0-60 days	343,778
61-90 days	67,558	64,544	61-91 days	109,517
91-180 days	61,198	68,461	91-120 days	49,647
181-365 days	37,075	50,294	121-365 days	152,228
Over 365 days	6,115	9,543	Over 365 days	63,359
	1,496,236	**1,730,328**		**1,493,989**

Movements in impairment allowance were as follows:

	31 December 2011 HRK'000	31 December 2010 HRK'000 Restated	1 January 2010 HRK'000 Restated
At 1 January	**575,410**	**402,876**	**239,989**
Impairment for potential losses on receivables and interest on receivables (Note 7)	403,568	332,139	275,006
Reversal of prior-year provisions	(58,112)	(25,074)	(21,077)
Amounts collected (Note 5)	(139,266)	(134,531)	(91,033)
At 31 December	**781,600**	**575,410**	**402,885**

Management performs review of receivables and recognises impairment of bad and doubtful receivables based on a review of the overall ageing structure of all receivables and of significant individual amounts receivable.

21. OTHER SHORT-TERM RECEIVABLES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
VAT receivable	179,965	27,560	19,555
Prepayments of income tax	138,719	-	5,750
Advances for working capital	13,616	26,196	18,865
Receivables from the State in respect of employees	10,284	6,403	7,950
Interest receivable	2,553	3,564	2,714
Demand and time deposits	4,328	1,735	8,362
Deferred income from the sale of electricity to household	-	-	87,058
Receivables for Government Bonds	-	-	22,641
Other short-term receivables	65,640	78,606	52,564
	415,105	**144,064**	**225,459**

22. CASH AND CASH EQUIVALENTS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Current accounts - HRK	123,916	71,510	61,810
Current accounts - Foreign	92,117	27,352	22,436
Current accounts for special purposes	6,105	5,710	11,407
Petty cash registers - HRK	280	287	418
Deposits due till 90 days	5,120	559,800	13,865
Daily deposits	179,585	97,498	33,898
	407,123	**762,157**	**143,834**

23. CAPITAL AND RESERVES

The share capital was first registered on 12 December 1994 in German Marks (DEM) and amounted to DEM 5,784,832 thousand. On 19 July 1995, the share capital was reregistered in Croatian Kuna in the amount 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.

Accumulated losses in the amount of HRK 136,262 thousand comprise legal reserves in the amount of HRK 167,589 thousand, transferred loss in the amount of HRK 289,031 thousand, profit for the year in the amount of HRK 14,820 thousand. The non-controlling interest attributable to RWE amounts to HRK 62,847 thousand, of which HRK 11,514 thousand represent dividends attributable to the foreign equity holder.

Capital reserves

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Opening balance of reserves, before restatement	-	(1,889,646)	(2,038,472)
Effect of restatement of opening balance	-	-	147,403
Opening balance of reserves, restated	(874,074)	(1,889,646)	(1,891,069)
Transfer from retained earnings	444,038	1,008,073	-
Other comprehensive income, net before restatement	-	24,853	(2,582)
Effect of restatement	-	(17,354)	4,005
Other comprehensive (loss) / income, net	**(8,921)**	**7,499**	**1,423**
	(438,957)	**(874,074)**	**(1,889,646)**

Retained earnings

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Opening balance	816,246	403,018	267,174
Correction of opening balance	(274)	(2)	-
Transfer to reserves	(444,038)	(1,008,073)	-
Dividend paid to the owner	(493,376)	-	-
Profit for the year	(14,820)	1,421,303	135,844
	(136,262)	**816,246**	**403,018**

Based on the Decision the General Shareholders' Assembly of HEP d.d. from 27 June 2011 on the Allocation of the 2010 Profits and Retained Earnings, HRK 444,038 thousand were transferred to reserves and HRK 493,376 thousand were distributed to the owner.

24. LONG-TERM BORROWINGS

	Interest rates	31 December 2011	31 December 2010	1 January 2010
		HRK'000	HRK'000	HRK'000
			Restated	Restated
Domestic bank borrowings	EURIBOR+ (1.00%-6.35%)	1,681,140	1,040,610	1,062,199
Foreign bank borrowings	EURIBOR+ (0.50%-4.74%)	2,042,011	3,010,835	2,929,555
Liabilities to domestic companies	EURIBOR+ 1.95%	-	4,661	13,835
Loan from RWE		8,828	12,369	19,577
Reprogrammed debt		-	-	36,048
Total		**3,731,979**	**4,068,475**	**4,061,214**
Deferred loan origination fees		(22,777)	-	-
Total long-term borrowings		**3,709,202**	**4,068,475**	**4,061,214**
Current portion		(1,174,713)	(1,184,921)	(947,747)
Long-term portion		**2,534,489**	**2,883,554**	**3,113,467**

Loans from domestic banks are secured by bills of exchange and promissory notes. Loans from foreign banks are partly secured by state guarantees (the EBRD loans in the amount of EUR 4,400,000 and EUR 24,000,000, and a Deutsche Bank loan in the amount of EUR 100,000,000) and the total assets of Plomin.

New sources of funds

For the purpose of financing the investments and operations in 2011, HEP d.d. concluded two long-term loan agreements during 2011, involving a loan of EUR 150 million with a consortium of banks (Privredna banka Zagreb d.d., Raiffeisenbank Austria d.d. and Zagrebačka banka d.d.) and a loan of EUR 20 million with Hrvatska poštanska banka d.d. The maturity of both loans is 7 years. At 31 December 2011 the consortium loan balance was EUR 84 million, whereas the bilateral loan was fully utilised and amounted to EUR 20 million.

In November 2011 a long-term loan agreement was concluded with the European Restructuring and Development Bank and a syndicate of banks for a loan of EUR 123.2 million. The loan funds are intended to finance the construction of Hydro Power Plant Ombla near Dubrovnik. The loan tranches mature in 12 and 15 years, including the utilisation period of 4 years.

24. LONG-TERM BORROWINGS (continued)

Loans in use

During 2011 the utilisation of the long-term loan approved by KfW Entwicklungsbank in the amount of EUR 50 million for the financing of the projects of subsidiaries HEP ESCO d.o.o and HEP Obnovljivi izvori energije d.o.o . The key lending terms and conditions are as follows: 5-year utilisation period; quarterly repayment of principal over a period of 10 years following the expiry of the utilisation period. At 31 December 2011 the KfW loan balance was EUR 2.5 million, of which EUR 47.5 million were unutilised. At the time of the conclusion of the agreement with KfW, which was in late 2008, a Financial Grant Agreement was concluded with the Government of the Federal Republic of Germany, under which HEP d.d. received a GEF grant in the amount of EUR 0.6 million. The total balance utilized as of 31 December 2011 was EUR 0.58 million.

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

2012	1,174,713
2013	798,638
2014	481,798
2015	383,611
2016	324,188
After 2016	**569,031**
Total	**3,731,979**

The covenants, as defined in the applicable loan agreements, specifically require the Group to meet certain prescribed levels of the following ratios based on consolidated financial statements: operating ratio, debt service coverage, internal cash generation, tangible net worth capital, and net borrowing. As at 31 December 2011 all the covenants were met.

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

Currency	**31 December 2011**	**31 December 2010**	**1 January 2010**
		Restated	**Restated**
USD	-	-	7,083
EUR	495,587	549,223	548,245

25. LONG-TERM LIABILITIES TO THE GOVERNMENT

The long-term debt to the Government in the amount of HRK 30,466 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 d.d. has no liability to remit the funds, unless and until they are collected from the employee.

26. 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 of approximately 1.7263 % at 31 December 2011 (2010: approximately 1.2019 %).

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 2011 was EUR 5,113 thousand (2010: EUR 10,226 thousand). The fair value of the interest rate swap contract, representing a future obligation, at 31 December 2011 amounted to HRK 850 thousand (2010: HRK 2,875 thousand). The related deferred tax asset at 31 December 2011 amounted to HRK 170 thousand (2010: HRK 575 thousand).

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

	31 December 2011	**31 December 2010**	**1 January 2010**
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Long-term portion (Note 29)	-	672	3,513
Current portion (Note 33)	850	2,203	2,771
	850	**2,875**	**6,284**

27. LONG-TERM PROVISIONS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Litigation provision	217,621	162,443	145,335
Provision for retirement bonuses	314,081	302,157	233,949
Provision for jubilee awards	43,551	46,268	53,900
Provision for the de-commissioning of thermal power plants	100,044	93,121	92,280
NPPK - decommission	-	-	4,932
Provision for NPPK decommissioning (long-term)	-	53,838	-
Provision according to damages contract	80,800	80,800	28,621
Provision for electricity purchased from wind power plants	22,532	22,031	-
Provision for investment in HE Lešće	-	39,287	-
	778.629	**799,945**	**559,017**

The thermal power plant decommissioning provision in the amount of HRK 100,044 thousand represents a discounted value of the estimated decommissioning costs of the Group's thermal power plants.

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

HRK'000	Legal actions	Retirement bonuses	Jubilee awards	Decommissioning - NPPK	Decommissioning of TPPs	Other	Total
At 1 January 2011	**162,443**	**302,157**	**46,268**	**53,838**	**93,121**	**142,118**	**799,945**
New provisions made	78,267	31,692	4,287	-	6,923	500	121,669
Decrease in provisions (amounts paid)	(21,906)	(20,023)	(6,977)	-	-	-	(48,906)
Decrease in provision on valuation	(1,183)	670	(758)	(53,838)	-	(39,286)	(94,395)
At 31 December 2011	**217,621**	**314,081**	**43,551**	**-**	**100,044**	**103,332**	**778,629**

Legal cases provision

The provision for legal actions refers to cases where possible outcome has been determined as uncertain or negative and was recognised in the total amount of HRK 217,621 thousand. The most important court case provided against is the one of HEP Proizvodnja d.o.o. for a dispute with Zagrebački Holding (the 2010 provision amounted to HRK 19,075 thousand, while the total provisions were HRK 84,821, and refers to suit for reimbursement of waste water treatment plant).

27. LONG-TERM PROVISIONS (continued)

Retirement bonuses and jubilee awards

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

	Retirement benefits	**Jubilee awards**	**Total**
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
At 1 January 2011	**302,157**	**46,268**	**348,425**
Cost of services	10,859	2,237	13,096
Interest expenses	20,418	2,781	23,199
Benefits paid	(20,023)	(6,977)	(27,000)
Actuarial gains/(losses)	670	(758)	(88)
At 31 December 2011	**314,081**	**43,551**	**357,632**

The following assumptions were used in preparing the calculations:

- The termination rate is from 0% to 6.49% percent and is based on the statistical fluctuation rates for the Company in the period from 2005 to 2011.
- The probability of death by age and sex is based on Croatian Mortality Tables 2000 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 will grow at 0.7% in other years..
- The present value of the obligation was determined using a 7.3% discount rate for HEP d.d. and HEP Proizvodnja d.o.o., and 7.2% for other companies within the Group.

28. ISSUED BONDS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Nominal value of bonds	1,200,000	1,200,000	1,200,000
Cumulative repayment	(140,070)	(46,690)	-
Discount value	(1,348)	(1,888)	(2,423)
Current portion of bonds	(93,380)	(93,380)	(46,690)
	965,202	**1,058,042**	**1,150,887**

Bonds in the amount of HRK 500,000 thousand, issued in 2006, are due in 2013, and bear interest at a fixed rate of 5.00 percent. Bonds in the amount of HRK 700,000, issued at the end of 2007, are repayable in 15 semi-annual installments, commencing three years from the date of issue, and bear interest at a fixed rate of 6.50 percent. The HEP d.d. bonds are listed on the Zagreb Stock Exchange.

29. OTHER NON-CURRENT LIABILITIES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Deferred income	4,617,155	4,753,554	4,683,583
Long term liabilities for assets financed by clearing debt	701,012	414,938	239,926
Long-term debt under interest rate swap (Note 26)	850	672	3,513
Other	1,659	1,779	-
	5,320,676	**5,170,943**	**4,927,022**

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, which applies to contracts for connection to the network concluded by 31 December 2009. After 1 January 2010 the connection fee is recognized as income in the amount of funds received from the customer in the period when the customer is connected to the grid or when permanent access to the delivery of the service is given (based on the decision of the Committee on the Interpretation the Financial Reporting Standards in the Republic of Croatia from 11 January 2011 (Official Gazette No. 18/2010).

At 31 December 2011 the Group reported a liability in the amount of HRK 701,012 thousand respect of a clearing debt (2010: HRK 414,938 thousand) regarding a payment under a letter of credit on the basis of the consent of the Ministry of Finance with the use of the funds pursuant to an interbank agreement. As there is no other document that would regulate the relationship between the HEP Group and the Ministry of Finance regarding the clearing debt, it has not been clearly defined as either a loan or a government grant.

30. SHORT-TERM BORROWINGS

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Borrowings from domestic banks and foreign banks, denominated in various currencies on the following terms:	592,778	282,252	761,320
Interest rates ranging from EURIBOR + (1.50 – 5.90%)	-	-	-
Interest rates on Ministry of Finance Treasury Bills + (1.00 – 2%)	-	-	-
Secured by bills of exchange	-	-	-
Borrowings from domestic companies on the following terms:	2,806	2,805	2,805
Secured by bills of exchange		-	-
Current portion of RWE loan	7,579	7,436	3,680
	603,163	**292,493**	**767,805**

During 2011, the Group used short-term loans from domestic banks for working capital purposes and for the settlement of trade payables. In addition to the prolongation of current loans arranged during 2011, the Group also concluded new credit lines for the purpose of keeping financial stability.

31. LIABILITIES FOR TAXES AND CONTRIBUTIONS

	31 December 2011	31 December 2010	1 January 2010
	HRK '000	HRK '000	HRK'000
		Restated	**Restated**
Liabilities for income tax	-	357,228	116,563
Utility and other fees	12,680	25,596	28,573
Contributions on salaries	23,205	23,953	24,217
Liabilities for custom	2,239	20,153	5
Contributions and taxes for benefits in kind	1,984	14,880	-
Other	647	3,175	1,722
	40,755	**444,985**	**171,080**

32. LIABILITIES TO EMPLOYEES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Net salaries	78,074	81,133	77,334
Contributions	40,363	41,953	46,614
Other	9,497	11,140	19,184
	127,934	**134,226**	**143,132**

33. OTHER PAYABLES

	31 December 2011	31 December 2010	1 January 2010
	HRK'000	HRK'000	HRK'000
		Restated	**Restated**
Deferred income and received advances for connections	193,125	110,538	-
Deferred income for other advances received	15,538	7,214	7,117
Accrued expenses for unused vacation days	63,900	64,477	-
Deferred income from sale of el. energy to households	10,905	-	-
Liabilities for renewable sources	8,017	16,446	228,351
Decommissioning NPPK accrued expenses	-	5,023	41,645
Other accrued expenses	3,203	9,459	5,464
Current portion of the liability under interest rate swap (Note 26)	850	2,203	2,771
Other payables	51,263	43,968	47,408
	346,801	**259,328**	**332,756**

Value adjustment of receivables from Households as at 31 December 2011 was calculated by using logarithmic curve with losses on the supply network of 8.3%, while for the year ended 31 December 2010 the percent of loss was 8.74%. The result is increase of liabilities and decrease of revenue in the amount of HRK 11,285 thousand in the respect to the previous year.

34. RELATED PARTY TRANSACTIONS

The Group has a 50% ownership in the capital of NPPK (**NE Krško d.o.o.).**

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

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

	31 December 2011	**31 December 2010**
	HRK'000	HRK'000
		Restated
NE Krško d.o.o.		
Liabilities for purchased electricity	64,667	61,090
Cost of purchased electricity	737,565	594,612

34. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue		Purchases	
HRK'000	**2011**	**2010**	**2011**	**2010**
Enterprises controlled by the Government				
Hrvatske Željeznice	108,259	123,627	9,279	16,260
INA-Industrija nafte	121,110	135,772	1,419,311	1,480,394
Prirodni plin	-	134	1,011,225	427,615
Plinacro	1,975	1,102	34,296	38,508
Hrvatske telekomunikacije	83,937	77,854	27,400	29,382
Croatia osiguranje	6,481	6,181	16,924	15,842
Hrvatska pošta	22,062	21,115	54,523	51,251
Hrvatske šume	5,785	6,572	12,113	13,784
Jadrolinija	727	1,107	787	603
Narodne novine	2,855	2,081	6,236	5,667
Croatian Radio & Television	12,441	12,763	1,079	1,124
Plovput	551	543	230	163
Croatia Airlines	788	807	2	110
Petrokemija Kutina	9,428	8,311	46	133
Ministry of Foreign Affairs	563	621	-	-
Ministry of Defense	17,597	31,172	-	-
Ministry of Interior	24,862	25,621	-	-
Elementary and secondary schools	79,120	78,697	-	-
Judicial institutions	10,506	10,563	-	-
Colleges and universities	30,649	29,715	3,160	4,869
Legislative, executive and other bodies of the Republic of Croatia	29,169	48,470	5,848	7,648
Health institutions and organisations	81,711	92,427	3,502	4,027
Other users	70,472	109,474	15,883	14,202
TOTAL	**721,048**	**824,729**	**2,621,844**	**2,111,582**

34. RELATED PARTY TRANSACTIONS (continued)

HRK'000	Receivables 31 December 2011	Receivables 31 December 2010	Payables 31 December 2011	Payables 31 December 2010
Enterprises controlled by the Government				
Hrvatske Željeznice	22,615	34,957	866	3,238
INA-Industrija nafte	14,709	8,483	206,061	210,541
Prirodni Plin	-	7	371,656	76,652
Plinacro	351	32	4,380	9,631
Hrvatske telekomunikacije	8,092	8,761	8,179	8,879
Croatia osiguranje	582	668	-	-
Hrvatska pošta	3,380	3,156	4,568	4,637
Hrvatske šume	1,262	2,017	1,288	925
Jadrolinija	57	242	761	561
Narodne novine	284	246	1,790	1,397
Croatian Radio & Television	2,006	2,233	231	143
Plovput	64	68	49	49
Croatia Airlines	149	150	-	64
Petrokemija Kutina	266	668	-	-
Ministry of Defense	4,209	4,531	-	-
Ministry of Interior	7,286	7,442	-	-
Elementary and secondary schools	15,096	15,135	-	-
Judicial institutions	2,599	2,983	-	-
Colleges and universities	4,136	4,516	-	-
Legislative, executive and other bodies of the Republic of Croatia	5,183	7,038	-	-
Health institutions and organizations	35,810	34,970	-	-
Other users	5,842	16,245	11,008	9,888
TOTAL	**133,978**	**154,548**	**610,837**	**326,605**

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

35. CONTINGENT LIABILITIES AND COMMITMENTS

Legal actions

In 2011, the Group established a provision for legal actions estimated to be ruled against HEP d.d.

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 2011, 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 thousand1,670,904 thousand (2010: HRK 1,986,175 thousand).
Most significant investments refers to investments in HEP Proizvodnja d.o.o., HEP Operator Prijenosnog Sustava d.o.o. and HEP Operator Distribucijskog Sustava d.o.o

Environmental matters

HEP Group monitors and analyses the environmental impact of its business activities on an on-going basis. The key impact indicators comprise emissions of pollutants into air and the quantity of production waste, which HEP reports to the competent institutions, local self-government units and public stakeholders on a regular and timely basis. The staffs engaged in environmental and nature protection undergo training and seminars and workshops where they receive information about the obligations and measures provided in the applicable environmental laws and regulations.

There is an environmental expenditure monitoring system (RETZOK) at the Group which monitors all investments in environmental and nature protection.

The Group is in the process of performing analyses and achieving readiness with respect to compliance with the requirements imposed by EU legislation in terms of more stringent pollutant emission limits and reduced greenhouse gas emissions, the greenhouse gas emission trading scheme, integrated environmental permitting system, as well as the system of ecologically important areas and corridors (the National Ecological Network).

Investments in environmental protection and energy efficiency projects at the level of the entire HEP Group have been substantiated before the Environmental Protection Fund, resulting in a more favourable correction factor and, consequently, reduced fees for pollutant emissions by 50 percent (approximately HRK 15.2 million).

36. SUBSIDIARIES

As at 31 December 2011, 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 plants production
HEP-Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	50	Electricity generation
APO d.o.o., environmental services	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
Buško Blato d.o.o.	BiH	100	Maintenance of hydro power plants
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
HEP-Trgovina d.o.o. Brežice	Slovenia	100	Purchase and sale of electrical energy
HEP- Magyarorszag Energia KFT	Hungary	100	Purchase and sale of electrical energy

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.

37. FINANCIAL INSTRUMENTS

Capital risk management

The Group 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 24 and 28, 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 yearend can be presented as follows:

(HRK'000)	**31 December 2011**	**31 December 2010**
Debt	5,393,724	5,512,390
Cash and cash equivalents	(407,123)	(762,157)
Net debt	4,986,601	4,750,233
Equity	19,279,787	19,811,324
Net debt to equity ratio	**25%**	**23%**

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 2011**	**31 December 2010**
Financial assets		
Loans and receivables (including cash and cash equivalents)	2,768,999	3,022,637
Other non-current assets	107,153	111,029
Financial liabilities		
Non-current liabilities	5,524,548	5,672,893
Current liabilities	3,569,029	2,713,686

37. 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**	
	31 December 2011 *(in '000)*	**31 December 2010** *(in '000)*	**31 December 2011** *(in '000)*	**31 December 2010** *(in '000)*
European Union (EUR)	16,101	88,390	548,280	573,176
USD	109	34	48,716	75,315

37. 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.

	2011 HRK'000	**2010** HRK'000
EUR change impact		
Profit or loss	400,753	350,872
USD change impact		
Profit or loss	28,288	38,853

37. FINANCIAL INSTRUMENTS (continued)

Interest rate risk management

The Group is exposed to interest rate risk as it borrows funds at floating interest rates.
The Group's exposures to interest rates on financial assets and financial liabilities are shown in section of this note, 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 date of the statement of financial position.. For floating rates, the analysis is prepared assuming the amount of liability outstanding at the reporting 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 2011 would decrease/increase by HRK 19,597 thousand (2010: HRK 21,153 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 73% in 2011 (2010: 77%); 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 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.

37. 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**	**1 - 3 months**	**3 -12 months**	**1 - 5 years**	**Over 5 years**	**Total**
	%	*(HRK'000)*	*(HRK'000)*	*(HRK'000)*	*(HRK'000)*	*(HRK'000)*	*(HRK'000)*
2011							
Non-interest bearing		1,242,119	861,593	367,414	399,238	5,788	2,876,152
Variable interest rate instruments	5,00%	22	43	149	-	-	214
Total		**1,242,141**	**861,636**	**367,563**	**399,238**	**5,788**	**2,876,366**
2010							
Non-interest bearing		1,096,670	1,424,595	194,103	396,981	21,317	3,133,666
Variable interest rate instruments	5.00%	23	46	196	105	-	370
Total		**1,096,693**	**1,424,641**	**194,299**	**397,086**	**21,317**	**3,134,036**

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.

37. FINANCIAL INSTRUMENTS (continued)

Liquidity and interest rate risk tables (continued)

Maturity of non-derivative financial liabilities

	Weighted average effective interest rate	**Less than 1 month**	**1 - 3 months**	**3 -12 months**	**1 - 5 years**	**Over 5 years**	**Total**
	%	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'000)
2011							
Non-interest bearing		1,436,563	1,082,085	452,560	726,027	2,618	3,699,853
Variable interest rate instruments	4.37%	71,634	395,827	1,367,154	3,547,752	684,184	6,066,551
Fixed interest rate instruments	5.60%	8,437	-	178,950	1,037,917	112,162	1,337,466
Total		**1,516,634**	**1,477,912**	**1,998,664**	**5,311,696**	**798,964**	**11,103,870**
2010							
Non-interest bearing		784,785	792,584	839,403	441,593	15,824	2,874,189
Variable interest rate instruments	3.57%	43,200	571,673	982,759	2,539,715	451,013	4,588,360
Fixed interest rate instruments	5.93%	8,766	-	186,200	1,111,980	204,721	1,511,667
Total		**836,751**	**1,364,257**	**2,008,362**	**4,093,288**	**671,558**	**8,974,216**

The Group has access to financing facilities, the total unused amount of which is HRK 2,090,982 thousand at the reporting 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 1,7263 % at 31 December 2011 (2010: 1.2019 %), as disclosed in detail in Note 26.

37. FINANCIAL INSTRUMENTS (continued)

	Weighted average effective interest rate	Less than 1 month	1 - 3 months	3 -12 months	1 - 5 years	Over 5 years	Total
	%	(HRK'00)	(HRK'000)	(HRK'000)	(HRK'000)	(HRK'00)	(HRK'000)
31 December 2011							
Variable interest rate instruments	1.7263%	-	-	698	-	-	698
Fixed interest rate instruments	5.39%	-	-	(2,178)	-	-	(2,178)
Total		**-**	**-**	**(1,480)**	**-**	**-**	**(1,480)**
31 December 2010							
Variable interest rate instruments	1.2019%	-	-	1,108	476	-	1,584
Fixed interest rate instruments	5.39%	-	-	(4,969)	(2,136)	-	(7,105)
Total		**-**	**-**	**(3,861)**	**(1,660)**	**-**	**(5,521)**

Fair value of financial instruments

Valuation methods or assumptions in determining fair value

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 (excluding derivative instruments) is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments.
- fair value of derivative instruments is calculated using the listed price. Where such prices are not available, the analysis uses discounted cash flows using the current yield curve for the period of the instruments under optional derivatives, while the optional derivative used models for pricing options. Forward currency contracts are valued using quoted forward exchange rates and yield curves derived from quoted interest rates for contracts with similar maturity. Interest rate swaps are valued at the present value of estimated future cash flows and discounted based on the current yield curve derived from quoted interest rates.

37. FINANCIAL INSTRUMENTS (continued)

Fair value measurements recognized in the statement of financial position

The table below analyzes the financial instruments remeasured subsequently at fair value, classified into three groups depending on the availability of indicators of fair value:
Level 1 observable indicators - indicators of fair value derived from (unadjusted) prices quoted in active markets for identical assets and liabilities are identical
Level 2 observable indicators - indicators of fair value derived from data other than quoted prices from Level 1 for observable assets or liabilities (i.e. their prices) or indirectly (derived from the price), and
Level 3 indicators - indicators derived from valuation techniques using as input data on the assets or liabilities that are not based on available market data (unobservable input).

The indicators of fair value recognized in the balance

	1st level	**2nd level**	**3rd level**	**Total**
	HRK'000	HRK'000	HRK'000	HRK'000
2011				
Assets available for sale	120,915	-	-	**120,915**
Interest swap liability (current and noncurrent portion)	-	850	-	**850**
2010				
Assets available for sale	162,380	-	-	**162,380**
Interest swap liability (current and noncurrent portion)	-	2,875	-	**2,875**

38. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved by the Board and authorised for issue on 16 April 2012.

Signed on behalf of the Management Board on 16 April 2012:

Zlatko Koračević

President of the Board

Ivan Matasić

Member of the Board