HRVATSKA ELEKTROPRIVREDA d.d., ZAGREB

Unconsolidated annual financial statements

together with Independent Auditor's Report

for the year 2016

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Responsibility for the unconsolidated Financial Statements

The Management Board of the company Hrvatska Elektroprivreda d.d., Zagreb, Ulica grada Vukovara 37, (hereinafter: "the Company") is responsible for ensuring that the unconsolidated annual financial statements for the year 2016, are prepared in accordance with the Accounting Act (Official Gazette No 78/15, 120/16) and International Financial Reporting Standards, to give a true and fair view of the financial position, the results of operations, changes in equity and cash flows of the Company for that period.

After making enquiries, the Board has a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, the Board has adopted the going concern basis in preparing the unconsolidated financial statements of the Company.

In preparing the unconsolidated annual financial statements, the Management is responsible for:

- selection and consistent application of suitable accounting policies in accordance with the applicable financial reporting framework;
- giving reasonable and prudent judgments and estimates; and
- using the going concern basis of accounting, unless it is inappropriate to presume so.

The Management is responsible for keeping the proper accounting records, which at any time with reasonable certainty present the financial position, the results of operations, changes in equity and cash flows of the Company, and also their compliance with the Accounting Act and the International Financial Reporting Standards. The Management is also responsible for safe keeping the assets of the Company and also for taking reasonable steps for prevention and detection of fraud and other irregularities.

Signed for and on behalf of the Management Board:

Tomislav Rosandić Member	Zvonko Ercegovac Member	Saša Dujmić Member	Perica Jukić President

Hrvatska elektroprivreda d.d.
Ulica grada Vukovara 37
10000 Zagreb
Republic of Croatia
28 April 2017

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of the company Hrvatska elektroprivreda d.d.

Report on the audit of the unconsolidated annual financial statements

Opinion

We have audited the unconsolidated annual financial statements of the company Hrvatska elektroprivreda d.d., Zagreb, Ulica grada Vukovara 37 (the “Company") for the year ended 31 December 2016, which comprise the Statement of financial position (Balance Sheet) as at 31 December 2016, Income Statement, Statement of other comprehensive income, Statement of changes in equity and Statement of cash flows of the Company for the year then ended, and Notes to the unconsolidated financial statements, including a summary of significant accounting policies and other explanations.

In our opinion, the accompanying unconsolidated annual financial statements give a true and fair view of the financial position of the Company as at 31 December 2016, and of its financial performance and cash flows of the Company for the year then ended in accordance with the Accounting Act and the International Financial Reporting Standards (the “IFRS").

Basis for Opinion

We conducted our audit in accordance with Accounting Act, Audit Act and International Auditing Standards (ISAs). Our responsibilities under those standards are further described in our Independent Auditor’s report under section Auditor’s responsibilities for the audit of the unconsolidated annual financial statements. We are independent of the Company in accordance with the Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter

As described in the Note 28 to the unconsolidated financial statements, at 31 December 2016, the Company stated clearing debt liability in the amount of HRK 863,450 thousand (31 December 2015: HRK 842,162 thousand) regarding a payment under a letter of credit on the basis of the Consent of the Ministry of Finance for the use of funds pursuant to an interbank agreement. As there is no other document that would regulate the relationship between the Company and the Ministry of Finance regarding the clearing debt, until the issuance of our Independent Auditor’s Report it has not been clearly defined whether it relates to a loan or a some other legal transaction. Our opinion has not been modified in this respect.

Emphasis of matter (continued)

As described in the Note 29 to the unconsolidated financial statements, provisions of the Water Management Act that came into force on 1 January 2010, raised a question on the ownership and legal status of the Company's property - reservoirs and ancillary facilities, used for generation of electricity from hydropower plants. Pursuant to the Water Act those property is defined as "Public water resources in general use as the property in ownership of the Republic of Croatia". The Republic of Croatia initiated several proceedings for registration of title to those properties, part of which were ruled in favour of the Republic of Croatia, part of them were rejected by the relevant courts, and part of them are in still in progress. The Company has filed a motion to the Constitutional Court for review of the constitutionality of Article 23 Paragraph 4 of the Water Act and for the cancelation of the same. During 2015, the Ministry of Agriculture has initiated the procedure for amendment and change of the Water Act, and the Ministry of Economy has also submitted its consent to the initiative of the Company for change and amendment of the Water Act. During 2016 and 2017, the Company continued activities with relevant Ministries and Institutions on the above-mentioned issue. Our opinion has not been modified in this respect.

The Company's accompanying unconsolidated financial statements are prepared in accordance with International Financial Reporting Standards and the requirements of Croatian laws and regulations, and the Company's investments in subsidiaries and associates are stated at cost. The Company has also prepared consolidated financial statements for the Company and its subsidiaries compiled on 28 April 2017. For a better understanding of the Company and the Group as a whole, users should read the annual consolidated financial statements together with these unconsolidated annual financial statements.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the unconsolidated annual financial statements for the current period. These matters were addressed in the context of our audit of the unconsolidated annual financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. We have determined the matters described below to be the key audit matters to be communicated in our Independent Auditor's report:

Valuation of investments in subsidiaries and joint ventures

As at 31 December 2016 investments in subsidiaries were determined in the amount of HRK 9,132,618 thousand. As there are some impairment indicators for individual companies, the Company's Management Board was required to assess the value of investments in subsidiaries for which there are impairment indicators. Determining the value of individual investments in subsidiaries requires the Company's Management to make significant estimates of future cash flows and associated discount rates and growth rates based on estimates of future business of the companies.

Related disclosures in the unconsolidated annual financial statements

See Notes 2, 15, 16 and 35 in the accompanying unconsolidated annual financial statements.

Key Audit Matters (continued)

Audit procedures

We have:

- assess the reasonableness of the key assumptions used in the valuation model for valuation of investments in subsidiaries and joint ventures, and in particular the projections of operating cash flows, discount rates and long-term growth rates estimates.
- compare the key assumptions with external information and the estimates, made by ourselves.
- test the mathematical accuracy of the valuation model for valuation of investments in subsidiaries and joint ventures.
- test the sensitivity of the valuation model for valuation of investments in subsidiaries and joint ventures regarding the change of key assumptions.

We have also assessed the adequacy of the Company's disclosure of investments in subsidiaries and joint ventures.

The results of our tests were satisfactory. We agree that the assumptions used in the valuation model, including the discount rate and the fact that there was no impairment of the value of subsidiaries, are appropriate.

Contingent liabilities and court disputes

Since the Company is exposed to significant legal claims, we have focused our attention on this area. According to that, the Management Board estimates future outcomes and amounts of contingent liabilities that may arise as a result of these claims.

Related disclosures in the unconsolidated annual financial statements

See Notes 2, 3 and 29 in the accompanying unconsolidated annual financial statements.

Audit procedures

We have:
- obtain the understanding of the status of any significant claim and the historical outcomes of previous similar cases
- obtain the statements of all external legal representatives for all material proceedings
- analyse the assessment of the nature of disputes and claims by discussing the most significant cases with the Company's management and the internal legal department

Based on the collected evidence, taking into account inherent uncertainty in legal issues, we agree with the Company's management's assessment of the likelihood of future significant outflows related to these issues. We have found that issues that are likely to become future outflows are stated as provisions.

Furthermore, we assessed the adequacy of the Company's disclosure regarding Contingent liabilities and court disputes. The results of our tests were satisfactory.

Other Information in the Annual Report

The Management is responsible for other information. Other information includes information included in the Annual report, but do not include the unconsolidated annual financial statements and our Independent auditor's report on them.

Our opinion on the unconsolidated annual financial statements does not include other information, except to the extent explicitly stated in the part of our Independent auditor's report, entitled Report on compliance with other legal or regulatory requirements, and we do not express any form of assurance conclusion thereon.

In connection with our audit of the unconsolidated annual financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the unconsolidated annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. In this sense, we do not have anything to report.

Responsibilities of the Management and Those Charged with Governance for the unconsolidated annual financial statements

The Management is responsible for the preparation of unconsolidated annual financial statements that give a true and fair view in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of unconsolidated annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the unconsolidated annual financial statements, the Management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the audit of the unconsolidated annual financial statements

Our objectives are to obtain reasonable assurance about whether the unconsolidated annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these unconsolidated annual financial statements.

Auditor's Responsibilities for the audit of the unconsolidated annual financial statements (continued)

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the unconsolidated annual financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.
- Conclude on the appropriateness of the Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the unconsolidated annual financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the unconsolidated annual financial statements, including the disclosures, and whether the unconsolidated annual financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and that we will communicate with them all relationships and other matters that may reasonably be considered to influence our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the unconsolidated annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our Independent Auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our Independent Auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Compliance with Other Legal or Regulatory Requirements

The Management is responsible for the preparation of the Management report as part of the Annual report of the Company. We are obliged to express an opinion on the compliance of the Management report as part of the Annual report of the Company with the unconsolidated annual financial statements of the Company. In our opinion, based on our audit of the unconsolidated annual financial statements of the Company, information in the Management report as part of the Annual report of the Company for the year ended 31 December 2016, are in accordance with the financial information stated in the unconsolidated annual financial statements of the Company set out on pages 8 to 95 on which we expressed our opinion as stated in the section Opinion above.

In our opinion, based on the work that we performed during the audit, the Company's Management report for 2016, which is an integral part of the Annual report for 2016 is prepared in accordance with the Accounting act.

Based on the knowledge and understanding of the Company and its environment obtained while performing the audit, we have not found that there are material misstatements in the Company's Management report for 2016, which is an integral part of the Company's Annual report for 2016.

In our opinion, based on the work that we performed during the audit, the Statement that code of corporate governance is applied, included in the Annual report for 2016, is in accordance with the requirements of article 22, paragraph 1, points 3 and 4 of the Accounting Act.

The Statement that code of corporate governance is applied, included in the Annual report for 2016, includes information from article 22, paragraph 1, points 2, 5 and 6 of the Accounting Act.

The Management is responsible for the preparation of unconsolidated annual financial statements for the year ended 31 December 2016 in prescribed form based on the Statute of structure and content of annual financial statements (Official Gazette 95/16) and in accordance with other regulations governing the operations of the Company ("Standard unconsolidated annual financial statements"). Financial information presented in Company's standard unconsolidated annual financial statements are in accordance with the information presented in the Company's unconsolidated annual financial statements given on pages 8 to 95 on which we expressed our opinion as stated in the section Opinion above.

The engagement partner on the audit of unconsolidated annual financial statements of the Company for 2016, resulting in this Independent auditor's report is Irena Jadrešić, certified auditor.

In Zagreb, 28 April 2017

BDO Croatia d.o.o.
Trg J. F. Kennedy 6b
10000 Zagreb

Zdenko Balen, Management Board member	Irena Jadrešić, Certified auditor

	Note	2016 In HRK'000	2015 In HRK'000
Revenue from electricity sales	4	6,012,610	6,073,195
Revenue from electricity sales-related companies	33	126,965	67,812
Revenue from sale of gas	4	1,106,876	1,298,352
Revenue from sale of gas to HEP- Plin – related company	4,33	128,938	167,124
Operating income – related companies	33	319,829	286,576
Income from sale		***7,695,218***	***7,893,059***
Other operating income	5	172,705	499,648
Total operating income		**7,867,923**	**8,392,707**
Electricity purchase cost	6	(1,957,758)	(2,108,770)
Electricity supplies – related companies	33	(584,920)	(464,428)
Costs of gas sold	34	(1,244,014)	(1,352,038)
Staff cost	7	(86,110)	(89,101)
Depreciation and amortization costs	11,12	(63,125)	(96,558)
Costs of fees and services - related companies	33	(2,598,170)	(2,526,392)
Other operating expenses	8	(468,529)	(477,429)
Total operating expenses		**(7,002,626)**	**(7,114,716)**
Operating profit		**865,297**	**1,277,991**
Financial income		988,646	1,124,158
Financial expenses		(348,460)	(601,129)
Net profit from financial activities	9	**640,186**	**523,029**
Profit before taxation		**1,505,483**	**1,801,020**
Corporate income tax expense	10	(181,664)	(176,681)
Profit for the year		**1,323,819**	**1,624,339**

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

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić Management Board member	Zvonko Ercegovac Management Board member	Saša Dujmić Management Board member	Perica Jukić President of the Management Board

	2016 In HRK'000	2015 In HRK'000
Profit for the year	**1,323,819**	**1,624,339**
Other comprehensive income		
Net gain from AFS financial assets	39,456	45,889
Net other comprehensive income to be reclassified to profit/ (loss) in subsequent periods	39,456	45,889
Other comprehensive income, net	**39,456**	**45,889**
Total comprehensive income for the year, net	**1,363,275**	**1,670,228**

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

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić Management Board member	Zvonko Ercegovac Management Board member	Saša Dujmić Management Board member	Perica Jukić President of the Management Board

ASSETS	Note	31 Dec 2016 In HRK'000	31 Dec 2015 In HRK'000
Non-current assets			
Property, plant and equipment	11	623,875	1,410,174
Assets under construction	11	717,961	447,646
Intangible assets	12	57,745	22,244
Investment property	13	15,433	14,487
Prepayments for property, plant and equipment	14	7,206	21,454
Investment in NE Krško	15	1,754,419	1,754,419
Investment and receivables from TE Plomin	16	249,975	252,201
Investment in subsidiaries	35	7,199,111	6,032,580
Available-for-sale and other investments	17	289,558	245,838
Long-term loans and deposits	18	28,830	28,476
Receivables on long-term leases from related parties	33	16,279,407	13,239,929
Receivables on long-term loans from related parties	18, 33	63,329	79,129
Receivables on sub-leases from related parties	19	672,733	897,024
Other receivables	20	666	776
Derivative financial instruments	26	-	70,900
Deferred tax assets	10	19,727	31,431
Total non-current assets		**27,979,975**	**24,548,708**
Current assets			
Inventories	21	605,412	753,624
Trade receivables	22	320,061	309,963
Derivative financial assets	26	96,196	-
Current portion of long-term receivables from related companies for rental	33	1,083,937	1,057,217
Current portion of long-term loans from related parties	18,19	260,881	148,223
Other short-term receivables	23	105,538	131,966
Receivables from related companies	33	2,692,696	6,180,063
Cash and cash equivalents	24	2,366,100	1,951,873
Total current assets		**7,530,821**	**10,532,929**
TOTAL ASSETS		**35,510,796**	**35,081,637**

EQUITY AND LIABILITIES	Note	31 Dec 2016	31 Dec 2015
		In HRK'000	In HRK'000
Share capital	25	19,792,159	19,792,159
Revaluation reserves	25	140,292	100,836
Retained earnings	25	5,649,310	4,932,491
Total equity		**25,581,761**	**24,825,486**
Liabilities under issued bonds	26	3,606,173	4,223,883
Long-term loan liabilities	27	654,682	923,161
Other long-term liabilities	28	909,524	939,287
Long-term provisions	29	212,605	211,589
Deferred tax liabilities		26,007	21,816
Total non-current liabilities		**5,408,991**	**6,319,736**
Trade payables	30	630,250	681,827
Current portion of long-term bonds issued	26	586,601	93,380
Current portion of long-term loans	27	408,711	383,525
Short-term loans		-	-
Taxes and contributions		76,595	114,512
Interests payable		42,568	45,692
Liabilities toward related companies	33	2,758,202	2,578,573
Liabilities to employees	31	6,104	21,061
Other short-term liabilities	32	11,013	17,845
Total current liabilities		**4,520,044**	**3,936,415**
TOTAL EQUITY AND LIABILITIES		**35,510,796**	**35,081,637**

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

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić Management Board member	Zvonko Ercegovac Management Board member	Saša Dujmić Management Board member	Perica Jukić President of the Management Board

	Share capital	Revaluation reserves	Retained earnings	Total
	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 1 January 2015	**19,792,159**	**54,947**	**3,328,974**	**23,176,080**
Profit for the year	-	-	1,624,339	1,624,339
Other comprehensive income	-	45,889	-	45,889
Total comprehensive income	-	*45,889*	*1,624,339*	*1,670,228*
Merger effects	-	-	(20,822)	(20,822)
Balance at 31 December 2015	**19,792,159**	**100,836**	**4,932,491**	**24,825,486**
Profit for the year	-	-	1,323,819	1,323,819
Other comprehensive income	-	39,456	-	39,456
Total comprehensive income	-	*39,456*	*1,323,819*	*1,363,275*
Merger effects	-	-	-	0
Dividend paid	-	-	(607,000)	(607,000)
Balance at 31 December 2016	**19,792,159**	**140,292**	**5,649,310**	**25,581,761**

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

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić Management Board member	Zvonko Ercegovac Management Board member	Saša Dujmić Management Board member	Perica Jukić President of the Management Board

	2016	2015
	In HRK'000	In HRK'000
Cash flows from operating activities		
Profit for the year	1,323,819	1,624,339
Corporate income tax expense recognized in profit	181,664	176,681
Net (profit) from financial activities	(640,186)	(523,029)
Depreciation of property, plant and equipment and intangible asset	63,125	96,558
(Decrease)/increase in provisions	1,016	(11,282)
Fair value of property investment	(946)	(598)
Impairment of receivables	5,283	738
Operating cash flows before movements in working capital	*933,775*	*1,363,407*
(Increase)/decrease in trade receivables	(15,381)	39,705
Decrease/(increase) in receivables from related companies	2,650,498	(1,254,160)
Decrease/(increase) in inventories	148,212	(80,345)
(Increase) in other current assets	(44,472)	(95,481)
(Decrease)/increase in trade payables	(51,577)	120,013
(Decrease) in other liabilities	(5,856)	(16,195)
Increase/(decrease) in liabilities to subsidiaries	179,629	(86,018)
Cash generated from / (used in)/ operations	**3,794,828**	**(9,074)**
Corporate income tax paid	(223,413)	(341,799)
Interest paid	(244,604)	(281,842)
NET CASH GENERATED FROM / (USED IN) OPERATING ACTIVITIES	**3,326,811**	**(632,715)**

	2016	2015
	In HRK'000	In HRK'000
INVESTING ACTIVITIES		
Interest receipts	161,631	196,620
Dividends from related companies	431,710	628,703
Sale of tangible assets to related companies	(79,324)	199,403
Increase in the share capital of the subsidiary	(70,000)	-
Acquisition of property, plant and equipment	(360,114)	(211,672)
Cost of acquisition of other non-current assets	92,275	(21,917)
Collection of loan receivables from related companies	(2,156,831)	607,719
NET CASH (USED IN) / GENERATED FROM INVESTING ACTIVITIES	**(1,980,653)**	**1,398,856**
FINANCING ACTIVITIES		
Dividend payment	(607,000)	-
Repayments of bonds issued	(93,380)	(2,900,335)
Receipts from bonds issued	-	3,703,533
Long-term loans received	147,623	66,722
Repayments of long-term loans	(379,174)	(414,846)
Repayments of short-term loans	-	-
NET CASH (USED IN) / GENERATED FROM FINANCING ACTIVITIES	**(931,931)**	**455,074**
NET INCREASE IN CASH AND CASH EQUIVALENTS	414,227	1,221,215
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	**1,951,873**	**730,658**
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	**2,366,100**	**1,951,873**

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

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić Management Board member	Zvonko Ercegovac Management Board member	Saša Dujmić Management Board member	Perica Jukić President of the Management Board

1. GENERAL

Founding and development

Hrvatska elektroprivreda d.d. Zagreb (hereinafter: HEP d.d. or the Company) is registered in Zagreb with its headquarters at Ulica Grada Vukovara 37. The Company's principal activities are the generation, transmission and distribution of electricity. Since 1 July 2002 it began operating with subsidiary companies as the sole owner of companies that are engaged in the generation, transmission, distribution, supply and trade of electricity, and the distribution and supply of thermal power through the district heating systems in Zagreb, Osijek and Sisak as well as the distribution and supply of gas in the regions of Osijek-Baranja, Požega-Slavonia and Virovitica-Podravina counties.

HEP d.d. sells electricity to customers who have chosen HEP Opskrba as their supplier and HEP Opskrba is responsible for tariff customer supplies and receiving payment from customers.

A new Law on the Electricity Market adopted in February 2013 determined further restructuring and adjustments of operations of HEP Group with European Union directives and guidelines.

Pursuant to the provisions of the Electricity Act (Official Gazette 22/2013) the Company as the ruling company within a vertically integrated organisation and the owner of the transmission system, separated the transmission operator system in accordance with the provisions of the Act.

At the start of July 2013, amendments were conducted to the HEP Operator Prijenosnog Sustava (now: Croatian Transmission System Operator d.o.o., abbreviated: HOPS d.o.o.) for the purpose of dividing it in accordance with the ITO model and pursuant to the Electricity Act and a decision by the HEP d.d. Assembly to select a model of an "independent transmission operator."

All these activities were conducted by the Company in accordance with valid laws, regulations and decisions by the Government of the Republic of Croatia (RH).

As at 31 December 2016 HEP d.d. employed 428 employees (2015: 440).

Business subjects that are part of the HEP Group are listed in the Note 35, while transactions with related parties are described in the Note 33 to the unconsolidated financial statements.

Leases

During restructuring process, property, plant and equipment and intangible assets are leased to subsidiaries of the Company at carrying value. Leases of property, plant and equipment and intangible assets are classified as finance leases since all the risks and awards of the ownership are transferred to the lessee. Maturity date of lease is equal to remaining useful depreciation life of leased assets. Lease liabilities are stated with the related companies within long-term liabilities. Leases bears interests to the extent that the Company has acquired funds by external financing for construction of the corresponding asset. The fair value of leases has not been estimated due to the specific organization of the HEP Group and with the aim of disclosing underlying assets at their original carrying value at which they were acquired by the Group.

Consequently, for a better understanding of the Company, the accompanying financial statements should be read in conjunction with the consolidated financial statements of the HEP Group.

1. GENERAL (continued)

Revenue recognition

All revenue related to the sale and supply of electricity to HEP Opskrba customers are transferred from HEP Opskrba.

The company HEP Operator distribucijskog sustava d.o.o. recognizes revenue for delivered electricity to household customers based on energy data of realized sales to customers and the amounts of tariff items based on the method of cost recovery in accordance with the Methodology for determining the amount of tariff items for electricity supply in the context of universal service and the Management Board decision on the amount of tariff items for electricity from 1 October 2013, and from 1 January 2015 of the Croatian Energy Regulatory Agency (hereinafter: "HERA") on the amount of tariff items for electricity supply in the context of universal service.
From the entry into force of the Act on Amendments to the Electricity Market Act, the tariffs for electricity supply within the universal service are provided by the supplier who has the obligation to provide the public service.

The company HEP Operator distribucijskog sustava d.o.o. recognizes revenue for delivered electricity to enterprise customers based on energy data of realized sales to customers and the amounts of tariff items in accordance with the Methodology for determining the amount of tariff items for a guaranteed supply of electricity and with Decision of the Croatian Energy Regulatory Agency on the amount of tariff items for a guaranteed supply of electricity.

Subsidiaries Hrvatski operator prijenosnog sustava d.o.o. and HEP Operator distribucijskog sustava d.o.o. recognizes revenue in the amount of delivered and transferred electricity based on energy data of realized sales to customers and the amounts of tariff items based on the method of cost recovery according to the Tariff System for power transmission, without the amount of tariff items and Tariff System for Electricity Distribution, without the amounts of tariff items. Revenue recognition is based on the Government Decree on tariff item dated April 2012 and Decisions on the amount of tariff items for electricity distribution and the Decision on the amount of tariff items for electricity transmission made by HERA on 4 December 2015, with effect from 1 January 2016.

The company HEP Proizvodnja d.o.o. recognizes revenue for the amount of electricity produced based on the fees according to energy data on delivered electricity and realized costs for the production of electricity increased by profit made on sale of electricity to end customers, network operators for the loss of electricity and the wholesale market.

1. GENERAL (continued)

General assembly

The General assembly consists of the members representing the interests of one shareholder – the Republic of Croatia:

Ivan Vrdoljak	Member	Member since 21 November 2012 until 3 March 2016
Tomislav Panenić	Member	Member since 4 March 2016 until 25 January 2017
Zdravko Marić	Member	Member since 26 January 2017

Supervisory Board

Members of the Supervisory Board in 2016

Nikola Bruketa	President	President since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Igor Džajić	Member	Member since 19 September 2012
Mirko Žužić	Member	Member since 19 September 2012
Juraj Bukša	Member	Member since 5 June 2014
Dubravka Kolundžić	Member	Member since 1 June 2015

Members of the Supervisory Board in 2015

Nikola Bruketa	President	President since 23 February 2012
Žarko Primorac	Member	Member since 23 February 2012
Ivo Uglešić	Member	Member since 23 February 2012
Igor Džajić	Member	Member since 19 September 2012
Mirko Žužić	Member	Member since 19 September 2012
Juraj Bukša	Member	Member since 5 June 2014
Jadranko Berlengi	Member	Member since 3 June 2008 to 31 May 2015
Dubravka Kolundžić	Member	Member since 1 June 2015

1. GENERAL (continued)

Management Board

Management Board in 2016

Perica Jukić	President	Member since 12 September 2014
Zvonko Ercegovac	Member	Member since 23 February 2012
Tomislav Rosandić	Member	Member since 2 January 2015
Saša Dujmić	Member	Member since 4 December 2014

Management Board in 2015

Perica Jukić	President	Member since 10 May 2013, President since 12 September 2014
Zvonko Ercegovac	Member	Member since 23 February 2012
Željko Štromar	Member	Member since 16 December 2013 to 31 March 2015
Tomislav Rosandić	Member	Member since 2 January 2015
Saša Dujmić	Member	Member since 4 December 2014

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the Company’s significant accounting policies which have been applied consistently in the current and previous years is set out below.

Presentation of financial statements

a) Unconsolidated financial statements

The unconsolidated financial statements for 2016 have been prepared in accordance with the Accounting Act (Official Gazette 75/15, 120/16), the International Financial Reporting Standards (‘’IFRS’’), as well as in accordance with the Ordinance on the structure and content of annual financial statements (Official Gazette 95/16).

Exceptionally, in order to have a more appropriate presentation of the financial statements and to eliminate possible obscurity and misinterpretations, the Company deviated from the specific requirements of IFRS 11 "Joint Operations" (Note 15).

Management believes that the financial statements present fairly the financial position, financial performance and cash flows.

The financial statements have been prepared on the historical cost basis, except for certain financial instruments that are presented in revalued amounts. The financial statements are presented in thousands of Croatian Kuna (HRK ‘000) as the Company’s functional currency.

The financial statements have been prepared with the application of the basic accounting assumption of the occurrence of a business event and the assumption of the going concern concept.

b) Consolidated financial statements

The Company has prepared these financial statements in accordance with Croatian legislative regulations.

The Company has also prepared consolidated financial statements for the Company and its subsidiaries, which together with the Company comprise the Group, as at 31 December 2016 and for the year then ended. The consolidated financial statements have been prepared in accordance with IFRS and were approved by the Management Board on 28 April 2017. In the consolidated financial statements, subsidiaries (listed in the Note 35) – in which the Company has more than half of voting rights or in some other way controls their business, have been entirely consolidated. These financial statements should be read in conjunction with the consolidated financial statements of the HEP Group as at and for the year ended 31 December 2016, in order to obtain complete information about the Group’s financial position, the results of its operations and changes to the Group’s financial position overall.

Basis of accounting

The Company maintains its accounting records in the Croatian language, in Croatian Kuna and in accordance with Croatian legislation and the accounting principles and practices observed by enterprises in Croatia.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Adoption of new and revised International Financial Reporting Standards

Standards and Interpretations effective in the current period

- Amendments to IAS 19 Defined Benefit Plans: Employee Contributions – IAS 19 requires subjects to consider employee or third party contributions in accounting defined earning.
- Annual Improvements to IFRSs 2012–2014 Cycle
  - IFRS 5 Non-current Assets Held for Sale and Discontinued Operations
  - IFRS 7 Financial Instruments: Disclosures (with consequential amendments to IFRS 1)
  - IAS 19 Employee Benefits
  - IAS 34 Interim Financial Reporting

The effective date of the amendments is 1 January 2016. Earlier application is allowed.

- Annual Improvements 2010-2012 Cycle, these amendments are effective in EU for accounting periods beginning on or after 1 February 2015, with earlier application permitted. They include:
  - IFRS 2 Share-based Payment,
  - IFRS 3 Business Combinations,
  - IFRS 8 Operating Segments,
  - IFRS 13 Fair Value Measurement,
  - IAS 16 Property, Plant and Equipment and IAS 38 Intangible assets,
  - IAS 24 Related Party Disclosures;
  - Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exception (issued in December 2014)
  - Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations (issued in May 2014)
  - Amendments to IAS 1 Disclosure Initiative (issued in December 2014)
  - Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation (issued in May 2014)
  - Amendments to IAS 16 and IAS 41 Agriculture: Bearer Plants (issued in June 2014)
  - Amendments to IAS 27 Equity Method in Separate Financial Statements (issued in August 2014)

The application of the above-mentioned standards had no influence on the unconsolidated financial statements of the Company for 2016.

New and revised IFRSs issued by the IASB but not effective

- IFRS 9 Financial Instruments – in July 2014, IASB issued a final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments replacing IAS 39 Financial Instruments: Recognition and measurement and all other preceding versions IFRS 9. IFRS 9 is effective for the annual period beginning on or after 1 January 2018, earlier applications are permitted. The application of this standard will have negligible affect the classification and measurement of financial instruments.
- IFRS 15 Revenue from Contracts with Customers - IFRS 15 was issued in May 2014 and represents a new model in five steps that relate to revenue that results from contracts with customers. The Standard replaces IAS 11 and IAS 18. Standard is effective for the annual period beginning on or after 1 January< 2018, earlier applications are permitted.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

- The Standard allows a modified transfer model which does not require retroactive modifications. The Management performs detailed analysis on its possible effects on the Company`s financial statements.

New and revised IFRSs issued by the IASB but not yet adopted by the EU

The following standards and amendments to the existing standards have not been adopted by the EU yet:

- IFRS 14 Regulatory Deferral Accounts – this standard relates to subjects that operate on regulated markets and are applying IFRS for the first time. IFRS 14 is effective for the annual period beginning on or after 1 January 2016. The European Commission has decided not to implement this standard due to the fact that only small number of companies was within the scope of the standard.
- IFRS 16 Leases – the standard brings a new comprehensive model of identification of arrangements which have leases and their accounting treatment on the side of lessor and lessee. The standard will replace IAS 17 and interpretations of IFRIC 4, SIC 15 and SIC 27. IFRS 16 is effective for the annual period beginning on or after 1 January 2019. Earlier applications are permitted, but this is conditioned with the application of IFRS 15 unless already adopted. This standard brings significant changes to the accounting model of the lessee. Consequently, assets and liabilities will be recognised in the financial statements of the lessee in most contract that were formerly recognised as operating lease. This will result in an increase of assets and liabilities. The Management Board plans detailed analysis in the coming periods to determine effects on the financial statements of the Company.
- Amendments to IFRS 2 – classification and measurement of share based payment transactions (issued in June 2016).
- Amendments to IFRS 4 – Application of IFRS 9 Financial instruments with IFRS 4 Insurance agreements (issued in June 2016).
- Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (issued in September 2014).
- Clarifications to IFRS 15 Revenue from Contracts with Customers (issued in April 2016).
- Amendments to IAS 7 – part of its disclosure initiative (issued in January 2016)
- Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealised Losses (issued in January 2016).
- Amendments to IAS 40 – Transfer of real estate investments (issued December 2016.)
- Annual Improvements 2014-2016 Cycle (issued December 2016). They include:
  - IFRS 1 First application of IFRS,
  - IFRS 12 Disclosure of interests in other entities,
  - IFRS 28 Investments in associates and joint ventures

Amendments which relate to IFRS 12 are effective for periods starting on 1 January 2017, while amendments to IFRS 1 and IAS 28 are effective for the annual period beginning on or after 1 January 2018.

- IFRIC 22 Foreign currency transactions and advance considerations (issued December 2016).

Except where otherwise stated, the Company's management anticipates that the application of the above standards, amendments and interpretations, except for IFRS 16 as stated above, will have no material impact on the financial statements in the period of initial application.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments in subsidiaries

A subsidiary company is a company in which the Company (Parent company) has control over, meaning that it manages the financial and business policies by participating in the decision making regarding financial and business policies of the subsidiary. Investments in subsidiaries are stated at the end of the reporting period impaired for individual investment.

Investments in associates

Associates are companies in which the Company 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.

Investments in Associates are stated at cost with impairment value.

Investments in joint arrangements

In accordance with IFRS 11, Joint arrangements are classified as:

- joint operations - whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement
- joint venture - whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement.

In classification of investments in joint operations, the Company considers:

- The structure of joint operation,
- Legal form of the joint operation structured through separate legal entities,
- Contracting conditions of joint operations,
- All other facts and circumstances (including any other contractual arrangements).

Interest in joint ventures are measured using equity method.

In the consolidated financial statements the Company recognizes its investment in NE Krško d.o.o. as joint operation through its share of assets, liabilities, income and expenses in accordance with its contractual rights and obligations.

As described in the Note 15, in the unconsolidated financial statements the Company deviated from the specific requirements of IFRS 11 "Joint Operations" and recognizes its investment in NE Krško d.o.o. using equity method.

Reporting currency

The Company's financial statements are stated in Croatian Kuna.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits

The Company has no defined post-retirement benefits for its employees or Management. Accordingly, no provision for these costs has been included. Legal pension and health insurance contributions are paid on behalf of the Company's employees. This obligation applies to all employees hired on the basis of employment contract. The contributions are paid at a certain percentage determined on the basis of gross salary.

	2016
Pension insurance contributions	20%
Health insurance contributions	15%
Employment Fund contribution	1.7%
Occupational injury	0.5%

The Company has the obligation to withhold the pension insurance contributions from the employees' gross salaries. Contributions on behalf of the employer and the employees are recognized as cost in the period in which they incurred (Note 7).

Retirement allowances and jubilee awards

The Company pays employees jubilee awards and one-time severance payments upon retirement. The liabilities and expenses for these payments are determined with the application of the projected unit credit method. By using projected unit credit method, each period of seniority is observed as the basis for additional units of eligibility to allowances and each unit is measured separately until the realization of final liabilities. This liability is determined at the present value of projected future cash outflow with the application of the discount rate which is similar to the interest rate of State bonds in Croatia released on the market where the currency and maturity is in accordance with the currency and estimated duration of liabilities for the payment of these allowances. Liabilities and the costs of these allowances were calculated by a certified actuary.

Jubilee awards

The Company provides long-service benefits (jubilee awards) and retirement benefits to its employees. The long-service benefits range from HRK 1,500 to HRK 5,500, net, and are provided for tenure from 10 to 45 years of continuous employment with the employer.

Severance payments

A new Collective Agreement was adopted as of 1 July 2016 (which covers all of the HEP Group companies), under which the employees are entitled to a severance payment in the extent of 60% of the average gross monthly salary earned in the period of three months prior to termination of the employment contract, for each completed year of continuous employment at the employer. The effective date of the Collective contract is until 31 December 2017.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (hereinafter: PPE)

Property, plant and equipment are measured 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 method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

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

	2016 and 2015
Buildings	20-50 years
Office and IT equipment	5-20 years
Vehicles	5 years
Office furniture	10 years

The cost of PPE comprises its purchase price, including import duties and non-refundable taxes and any directly attributable costs of bringing an asset to its working condition and location necessary for it to be capable of operating as intended by Management. Expenditures incurred after PPE have been put into operation are normally charged to profit or loss in the period in which the costs 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 PPE beyond its originally assessed standard performance, the expenditures are capitalized as an additional cost of PPE. 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 retirement of any item of PPE is determined as the difference between the sale proceeds and the carrying amount of the asset and are recognized and is recognized as an expense or income in the income statement.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment (continued)

Impairment of PPE and intangible assets

At each reporting date, the Company reviews the carrying amounts of its PPE 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 Company 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 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 that asset for which the estimates of future cash flows have not been adjusted.

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 recognized immediately as expenditure, unless the relevant asset is 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, in a way that the increased carrying amount does not exceed the carrying amount that would have been determined, if no impairment loss would have been recognized for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognized as income, unless the relevant asset is carried at estimated value, in which case the reversal of the impairment loss is treated as a revaluation increase.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets

Non-current intangible assets include patents and licenses and are carried at cost less accumulated amortization. Non-current intangible assets are amortized on a straight-line basis over their useful life of 5 years.

Investment property

Investment properties are properties held for the purposes of earning rentals and/or capital appreciation, including property under construction for such purposes. Investment properties are measured initially at cost, including transaction costs. Subsequently, 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 for the period in which they arise.

An investment property is derecognized upon sale or retirement and when no future economic benefits are expected from its disposal. Any gain or loss arising on derecognition of the property (calculated as the difference between the net sale proceeds and the carrying amount of the asset) is included in profit or loss in the period in which the property is derecognized.

Finance and operating leases

The Company as lessee

The Company has no significant finance lease arrangements and there were no new significant operating lease arrangements concluded during 2016 and 2015. Operating lease payments are recognized as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

The Company as lessor

Property, plant and equipment and intangible assets are leased out by Company to related companies based on the carrying amount (except for HOPS as of 1 July 2013). Leases of property, plant and equipment and intangible assets are classified as finance leases since all the risks and awards of the ownership are transferred to the lessee. Maturity date of lease is equal to remaining useful depreciation life of leased assets.

The leases bear interest to the extent that the Company has acquired external financing to construct the underlying assets. These properties are stated at cost in order to present the underlying assets at their carrying value at which the Company initially recognized them.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Trade receivables and prepayments

Trade receivables are carried at cost less any impairment for bad and doubtful receivables.

The Management carries out impairment of bad and doubtful receivables based on review of the aging structure of all receivables as well as a review of significant individual amounts included in the receivables.

Given the uncertainty that some of receivables will be collected over longer period, the Company carries out impairment of unrecoverable amounts, based on a reasonable estimate and past experience as follows:

	2016 and 2015
Receivables ageing structure	Impairment percentage
31 - 60 days	1.5%
61 - 90 days	3%
91 - 180 days	9%
181 - 365 days	30%
Over one year	90%

Receivables for which legal proceedings have been initiated and receivables from entities in bankruptcy and pre-bankruptcy settlement proceedings (principal and interests) are impaired in their full amount by debiting expenses, regardless of the overdue period.

Inventories

Inventories comprise material and small inventory and are carried at lower of cost and net realisable value. The Management carries out inventories write-off based on review of the ageing structure of all inventories as well as a review of significant individual amounts of inventories.

From 2013, inventories include CO_2 emission rights. After Croatia joined to the European system for greenhouse gas emissions trading (EU ETS), Hrvatska elektroprivreda as an electricity and thermal energy generator, is obligated to purchase greenhouse gas emission units in the amount corresponding to verified emissions of CO_2 generated from the fossil fuel combustion in thermal power plants, as a result of which CO_2 is emitted.

Companies are obligated to have defined quantities of CO_2 emission rights at 30 April (yearly cycle). Due to withdrawal of IFRIC 3 *Emission Rights* and insufficient provisions of IFRS, the Company has analysed different accounting models for CO_2 emission rights, and among other EFRAG discussion papers. Occasionally, the Company trades with CO_2 emission rights. Due to that the Company recognize these emission rights as inventory.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

From April 2014, inventories include gas stock held for trading on the wholesale market and are stated at lower of cost and net realizable value. The Company measures inventories based on the weighted average price (Note 21).

Inventory costs for quantities of gas for direct delivery to customers are calculated using method of specific identification.

Cost comprise invoiced amount as well as all other costs directly attributable to bringing inventories to their present location and condition.

Cash and cash equivalents

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

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 recognized as an expense in the period in which they incurred.

Interest expense is recognized on an accrual basis.

Foreign currencies

Separate financial statements of the Company are presented in the currency of the primary economic environment in which the entity operates (its functional currency).

In the financial statements of the Company, transactions in foreign currencies are translated to the functional currency of the entity at the applicable exchange rates prevailing on the dates of transactions. At each reporting date, monetary balances denominated in foreign currencies are retranslated to the functional currency of the entity at the applicable exchange rates prevailing at the end of the year. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the applicable exchange rates prevailing on the date when the fair value was determined. Non-monetary items that are carried at historical cost in foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on their retranslation, are stated as profit or loss in the period in which they incurred. Exchange differences arising on retranslation of non-monetary assets carried at fair value are stated as profit or loss, except for exchange differences arising on the retranslation of non-monetary assets available for sale, for which gains and losses are recognized directly in equity. For such non-monetary items, any exchange gains or losses arising from retranslations are also recognized directly in equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Taxation

Corporate income tax expense represents the sum of the current tax liability and deferred taxes.

Current tax

Current tax liability is based on taxable profit for the year. Taxable profit differs from profit for the year as stated in the statement of comprehensive income because of items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's current tax liability is calculated using tax rates that have been enacted or substantively enacted by the end of the 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 statement of financial position liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized 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 utilized. Such assets and liabilities are not recognized if the temporary differences arise from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in transactions that affect neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and adjusted to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the tax 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 will be settled or asset realized, based on 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 tax consequences that would follow from the manner in which the Company 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

Deferred tax is recognized as an expense or income in the statement of comprehensive income, except when relate to items credited or debited directly to equity, in which case the deferred tax is also recognized directly in equity, or when the tax is arising from initial recognition of accounting for a business combination.

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

Financial assets

Investments are recognized and derecognized on the date of transaction. Financial assets are initially measured at fair value, increased by transaction costs, except for those financial assets classified at fair value through profit or loss.

Financial assets are classified as Available-for-sale, at fair value through profit or loss 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 amortized cost of financial asset and of allocation interest income over the relevant period. The effective interest rate is the rate that 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.

Available-for-sale financial assets (AFS)

Shares held by the Company that are traded in an active market are classified as Available-for-sale financial assets and are measured at fair value. Gains and losses arising from changes in fair value are recognised in revaluation reserve through other comprehensive income, except for impairment losses, interests calculated using the effective interest method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss for the period. Where the investment is disposed or impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is recognized in profit for the period.
Dividends, i.e. profit shares on equity instruments are recognized as profit or loss when the Company's right to receive the dividends has been established.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

The fair value of available-for-sale financial assets denominated in a foreign currency is determined in that foreign currency and translated at the exchange rate prevailing at the end of the reporting period.

Loans and receivables

Trade receivables, loans, and other receivables with fixed or determinable payments and that are not quoted in an active market, are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized 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 when 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 affected. For financial assets carried at amortized cost, the amount of the impairment is the difference between the assets carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced for the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the impairment account. When a trade receivable is considered uncollectible, it is written off through the impairment account. Subsequent recoveries of amounts previously written-off are credited to impairment account. Changes in the carrying amount of the impairment account are recognized 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 objectively related to an event occurring after the impairment was recognized, previously recognized impairment losses are reversed through the profit or loss to the extent that the carrying amount of the investment, at the date when the impairment is reversed, does not exceed what the amortized cost would have been if the impairment has not been recognized.

In respect of AFS equity instruments, any increase in fair value subsequent to an impairment loss is recognized directly in revaluation reserve.

Investments

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial liabilities

Financial liabilities, including loans and borrowings, are subsequently measured at amortized cost by applying the effective interest method.

The effective interest method is a method of calculating the amortized cost of financial liability and of allocating interest expense over the relevant period. Effective interest rate is the rate that discounts estimated future cash payments (including all fees and points paid and 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 Company derecognizes financial liabilities only when the Company's liabilities are settled, cancelled or they expire. The difference between the carrying amount of derecognized financial liability and consideration paid and payable is recognized in profit or loss.

Derivative financial instruments

The Company entered into a cross currency swap agreement in order to manage its exposure to exchange rate risk. Further details on derivative financial instruments are disclosed in the Note 26.

Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently re-measured to their fair value at the end of each reporting period.

The Company brought Decision on measurement of the fair value of the cross-currency swap according to the calculation of Mark-to-market ("MTM") value prepared by business banks. Profit or loss arising from fair value measurement is recognized in profit and loss.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Provisions

Provisions are recognized when the Company 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 obligation. Provisions are reviewed at the end of each reporting period and adjusted to reflect the present best estimate. Where the effect of discounting is materially significant, the amount of the provision is the present value of the expenses expected to be required to settle the obligation. When discounting is used, increase in provisions that reflects the passage of time is recognized as interest expense.

Use of estimates in preparation of the financial statements

Preparation of the financial statements in conformity with International Financial Reporting 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 contingent liabilities. Estimates used in preparation of these financial statements relate to employee benefits, impairment of assets, determination of fair values of assets and liabilities and estimated decommissioning costs. Future events may occur which could cause changes in the assumptions used for making these estimates. The effect of any changes in estimates will be recorded in the financial statements, when determinable.

Revenue recognition

Revenue is realized primarily from the sale of electricity to households, industrial and other customers within the Republic of Croatia who chose HEP Opskrba d.o.o. as supplier, the sale of electricity to related company and in the market, and compensation for administrative services for Group companies.

3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

Critical judgments when applying accounting policies

When applying accounting policies described in the Note 2, the Management made certain judgments that had a significant impact on the amounts stated in the financial statements (independently of those shown below). These judgments are provided in detail in the accompanying notes and the most significant relate to the following:

Useful lives of property, plant and equipment

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

Fair value of financial assets

As described in the Note 22, Management uses judgment to estimate whether trade and other receivables have suffered an impairment loss.

Provisions for environment 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, 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 on 28 April 2006 issued a decree on the payment of funds for the decommissioning and disposal of radioactive waste and consumed nuclear fuel of the NPPK. Pursuant to Article 10, Par. 3 of the Law on the fund to finance the decommissioning and disposal of radioactive waste and consumed nuclear fuel from the Krško Nuclear Power Plant (Official Gazette107/2007), on 24 December 2008 the Croatian government adopted an Ordinance on the amount, timeframe and method of payment of funds to finance the decommissioning and disposal of radioactive waste and consumed nuclear fuel from the Krško Nuclear Power Plant (Official Gazette 155/08) (Note 15).

Impairment of non-current assets

The impairment calculation requires the estimate of value in use of the cash generating units. That value 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 inflows and outflows. The Company did not have any impairments arisen from above mentioned projections.

Availability of taxable profits for which deferred tax assets could be recognized

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that the related tax benefit will be realised against future taxable profits. Measurement of the amount of deferred taxes that can be recognised, requires a significant level of judgement which is based on the probable quantification of the time and level of future taxable profits, together with the future tax planning strategy. Carrying amount of deferred tax assets as at 31 December 2016 amounted to HRK 19,727 thousand, as at 31 December 2015 to HRK 31,431 thousand (Note 10).

3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

Actuarial estimates used in determining severance payments and jubilee awards

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 regarding those estimates. Provisions for jubilee awards and severance payments amounted to HRK 12,379 thousand as at 31 December 2016, and to HRK 9,543 thousand as at 31 December 2015 (Note 29).

Consequences of certain court disputes

The Company is a subject to number of court disputes arising from operating activities. Provisions are made 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 for court disputes as at 31 December 2016 amounts to HRK 178,595 thousand, and as at 31 December 2015: HRK 180,415 thousand (Note 29).

Accounting of NEK joint operation

As described in the Note 5, joint operation in NEK is recognized in the financial statements by using the equity method (in 2014 the Company recognizes its share in assets, liabilities, revenues and expenses of NEK in its financial statements).

The application of the requirements of IFRS 11 has resulted in a number of issues and concerns, as well as misinterpretation by some of users of the financial statements.

In its consolidated financial statements, the Company applies the method of joint management of assets and liabilities and reports share of the Company in each asset and each liability, income and expense in accordance with IFRS 11.

4. SALES REVENUE

REVENUE FROM ELECTRICITY SALES

	2016 In HRK'000	2015 In HRK'000
Income from the sale of electricity to HEP ODS-u	1,790,010	2,476,573
Income from the sale of electricity to HEP Elektra d.o.o.	339,789	-
Income from the sale of electricity to customers of HEP Opskrba d.o.o.	2,408,514	2,447,239
Income from invoiced electricity for covering losses	639,179	649,792
Income from balancing energy	1,095	3,277
Income from the sale of electricity abroad	790,799	489,218
Income from the sale of electricity in the country	43,224	7,096
	6,012,610	**6,073,195**

INCOME FROM GAS SUPPLY ON THE WHOLESALE MARKET

By a Decision of the Government of the Republic of Croatia in April 2014, HEP d.d. was defined as a gas supplier on the wholesale market in a period until April 2017. Pursuant to the above Decision from the Croatian Government, the Company has rented 70% of warehouse capacities in underground gas storage facilities.

HEP d.d. as a supplier on the wholesale market sells gas as public service and under regulated conditions to local suppliers for household customers, and is obligated to provide secure and reliable gas supply.

Income from gas supply – unrelated companies in 2016 amounts to HRK 1,106,876 thousand (2015: HRK 1,298,352 thousand). Income from gas supply – related companies in 2016 amounts to HRK 128,938 thousand (2015: HRK 167,124 thousand)

5. OTHER OPERATING INCOME

	2016 In HRK'000	2015 In HRK'000
Receivables collected and impaired in previous years	21,562	30,837
Interest on arrears from customers	12,849	26,927
Income from services	12,355	29,219
Income from the sale of tangible assets	29,021	49,411
Income from reversal of long-term provisions	1,820	21,335
Write-off of liabilities	-	1,231
Income in respect of court resolution (Note 15)	-	328,926
Increase in shares of HEP Toplinarstvo d.o.o.	45,397	-
Income from connection fees	35,710	-
Other operating income	13,991	11,762
	172,705	**499,648**

6. COST OF ELECTRICITY

	2016 In HRK'000	2015 In HRK'000
Cost of electricity	1,957,758	2,108,770
	1,957,758	**2,108,770**

Cost of electricity refers to purchases outside the wholesale system and system of sales to final customers.

7. STAFF COSTS

	2016 In HRK'000	2015 In HRK'000
Net salaries	48,654	50,308
Taxes and contributions from salaries	25,069	25,755
Contributions on salaries	12,387	13,038
	86,110	**89,101**

7. STAFF COSTS (continued)

Total staff costs:

	2016 In HRK'000	**2015** In HRK'000
Gross salaries	86,110	89,101
Reimbursement of costs to employees (Note 8)	5,904	5,879
Material rights of employees (Note 8)	1,667	2,643
	93,681	**97,623**

Reimbursement of costs to employees includes commuting costs in the amount of HRK 1,977 thousand (2015: HRK 2,119 thousand), daily allowances and travelling expenses in the amount of HRK 2,032 thousand (2015: HRK 1,964 thousand) and other similar expenses.

Employee material rights include retirement bonuses for early retirement, jubilee awards and appropriate assistance.

Remuneration for members of the Management Board and executive directors of the Company:

	2016 In HRK'000	**2015** In HRK'000
Gross salaries	7,210	6,903
Benefits in kind	922	1,015
Contributions for pension insurance	1,626	1,583
	9,758	**9,501**

Remuneration for members of the Supervisory Board of the Company:

	2016 In HRK'000	**2015** In HRK'000
Fees	192	192
Taxes and contributions	194	203
Other costs	18	17
	404	**412**

8. OTHER OPERATING EXPENSES

	2016 In HRK'000	**2015** In HRK'000
Impairment for bad and doubtful accounts	13,546	40,710
Costs for HEP d.d. from de-commissioning NEK	107,196	108,681
Costs pursuant to services within subsidiary companies	32,199	32,232
Costs of services	98,922	91,039
Purchase of CO2 emission units	125,078	118,174
Taxes, contributions and allowances	8,750	8,298
Bank fees, payment operations fees and charges for loans	7,780	5,470
Benefits in kind (Note 7)	1,536	1,796
Travel allowance and transport costs (Note 7)	4,009	4,083
Insurance premiums	7,171	7,461
Write-off of uncollected receivables	1,216	-
Shares value adjustments	4,980	-
Other material rights of employees (Note 7)	2,026	2,643
Costs of material	17,218	5,596
Provisions for severance packages and other staff costs	2,836	-
Provisions for unused vacations	845	-
Provisions for legal disputes	-	954
Unwritten-off value of disposed equipment	1,385	15,351
Compensation for damages	1,092	10,623
Other operating costs	30,744	24,318
	468,529	**477,429**

9. FINANCIAL INCOME AND EXPENSES

	2016 In HRK'000	2015 In HRK'000
Financial income		
Interest	161,631	196,620
Foreign currency exchange gains	98,929	29,966
Dividend from subsidiary and associated companies	614,215	893,703
Income from dividend	7,176	3,094
Fair value of cross-currency swap (Note 26)	74,921	-
Income from stock market trading	29,286	-
Other financial income	2,488	775
Total financial income	**988,646**	**1,124,158**
Financial expenses		
Interests	(243,232)	(281,841)
Foreign exchange losses	(82,414)	(156,241)
Fair value of cross-currency swap	-	(12,449)
Bond repurchase	-	(147,829)
Fair value of shares	-	(1,002)
Expenses from stock market trading	(14,392)	-
Other financial expenses	(8,422)	(1,767)
Total financial expenses	**(348,460)**	**(601,129)**
Capitalised borrowing costs	-	-
Financial expenses recognized in the statement of comprehensive income	**(348,460)**	**(601,129)**
Net profit from financial activities	**640,186**	**523,029**

10. CORPORATE INCOME TAX EXPENSE

Pursuant to tax legislation and regulations in RH the Company is subject to taxes. The tax base is determined as the differences between amounts of income and expenses in the period and increased for expenses that a non-deductible. The income tax rate is 20%.

	2016 In HRK'000	2015 In HRK'000
Current tax	169,960	188,433
Deferred tax expense relating to the origination and reversal of temporary differences	11,704	(11,752)
Corporate income tax	**181,664**	**176,681**

Adjustments of deferred tax assets are shown as follows:

	2016 In HRK'000	2015 In HRK'000
Balance at 1 January	31,431	19,679
Increase in deferred tax assets	(11,704)	11,752
Balance at 31 December	**19,727**	**31,431**

Deferred tax assets have arisen from tax unrecognized provisions for jubilee awards, severance payments and other staff costs, value adjustments of investment material inventory, doubtful receivables and deferred tax assets for tax loss carried forward.

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

	2016 In HRK'000	2015 In HRK'000
Profit before tax	1,505,483	1,801,020
Tax based on tax rate in Croatia (20%)	**301,097**	**360,204**
Tax unrecognised (income) / expenses	(119,433)	(179,325)
Tax effect of losses carried forward	-	(4,198)
Tax expense for the year	**181,664**	**176,681**
Effective tax rate	12%	10%

Reduction of the profit tax rate in Croatia from 20% to 18% comes into effect from 1 January 2017. As a result of the change in the tax rate, the relevant positions of deferred taxes have been re-calculated.

10. CORPORATE INCOME TAX EXPENSE (continued)

The effects of non-deductible (income) / expense consist of income from dividends, reversed receivables impairment, Stated aid for education and reduction of profit for other income.

In recent years Croatian Tax Authorities have not performed a review of the corporate income tax returns of the Company, except the short monitoring in 2013. In accordance with local regulations, Tax Authority may at any time inspect the books and records of companies within 3 years following the year in which the tax liability is reported and may impose additional tax liabilities and penalties. The Company's Management is not aware of any circumstances that could lead to a potential material liability in this respect.

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

	31 Dec 2015	Difference in corporate income tax rate	(Debited)/ credited to the income statement	**31 Dec 2016**
	In HRK'000	In HRK'000	In HRK'000	In HRK'000
Provisions for jubilee awards and retirement bonuses	**1,908**	(191)	510	**2,227**
Fair value adjustment - JANAF	**6,154**	(615)	0	**5,539**
Unrecognised tax value adjustment of receivables and interest	**1,520**	(152)	(170)	**1,198**
Provisions for costs of wind power plants	**4,326**	(432)	0	**3,894**
Provisions for Swap fair value adjustment	**16,375**	(1,638)	(8,932)	**5,805**
Other	**1,148**	(115)	31	**1,064**
	31,431	**(3,143)**	**(8,561)**	**19,727**

11. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Fixtures and equipment	Assets under construction	Total
	In HRK'000	In HRK'000	In HRK'000	In HRK'000
COST				
At 1 January 2015	**973,123**	**1,779,727**	**328,465**	**3,081,315**
Additions	16,457	20,184	145,989	182,630
Transfer to related companies	(463,192)	(325,664)	(13,953)	(802,809)
Disposals	(57)	(8,544)	(12,855)	(21,456)
At 31 December 2015	**526,331**	**1,465,703**	**447,646**	**2,439,680**
Additions	100	65,184	284,449	349,733
Transfer to related companies	(174,535)	(870,116)	(14,134)	(1,058,785)
Disposals	(179)	(15,017)	-	(15,196)
At 31 December 2016	**351,717**	**645,754**	**717,961**	**1,715,432**
ACCUMULATED DEPRECIATION				
At 1 January 2015	**223,392**	**450,353**	**-**	**673,745**
Depreciation costs for the year	24,196	66,295	-	90,491
Disposals	(57)	(6,291)	-	(6,348)
Impairment	(107,050)	(68,978)	-	(176,028)
At 31 December 2015	**140,481**	**441,379**	**-**	**581,860**
Depreciation costs for the year	5,716	43,169	-	48,885
Disposals	0	(14,266)	-	(14,266)
Impairment	(51,771)	(191,112)	-	(242,883)
At 31 December 2016	**94,426**	**279,170**	**-**	**373,596**
CARRYING AMOUNT				
At 31 December 2016	**257,291**	**366,584**	**717,961**	**1,341,836**
At 31 December 2015	**385,850**	**1,024,324**	**447,646**	**1,857,820**
At 1 January 2015	**749,731**	**1,329,374**	**328,465**	**2,407,570**

11. PROPERTY, PLANT AND EQUIPMENT (continued)

The Company is in the process of registering ownership of property at municipal courts in the Republic of Croatia. To this date no disputes have been lodged related to the Company's ownership.

Investments in progress at 31 December 2016 in the Company amounted to HRK 717,961 thousand and the most significant relate to investment in the EDM/ECM projects amounting to HRK 92,637 thousand, investments in preparatory works for the construction of the TE-Plomin power plant amount to HRK 219,730 thousand, investments in preparatory works for the construction of the HE Ombla power plant amount to HRK 45,807 thousand, cogeneration plants on forest biomass BE-TO Sisak in the amount of HRK 133,678 thousand and BE-TO Osijek in the amount of HRK 111,045 thousand.

12. INTANGIBLE ASSETS

	Patents and licences In HRK'000
COST	
At 1 January 2015	**81,072**
Additions	11,876
Transfer between related companies	-
Disposals	-
At 31 December 2015	**92,948**
Additions	10,382
Transfer between related companies	39,359
Disposals	(5,623)
At 31 December 2016	**137,066**
ACCUMULATED DEPRECIATION	
At 1 January 2015	**64,637**
Depreciation costs for the year	6,067
Impairment	-
Disposals	-
At 31 December 2015	**70,704**
Depreciation costs for the year	14,240
Impairment	(5,623)
Disposals	-
At 31 December 2016	**79,321**
NET CARRYING AMOUNT	
At 31 December 2016	**57,745**
At 31 December 2015	**22,244**
At 1 January 2015	**16,435**

13. INVESTMENT PROPERTY

As of 31 December 2016, investment property comprise properties held for the purposes of earning rentals and/or capital appreciation, and are carried at fair value by reference to the best management estimate. The fair value comprises estimated market price at the end of the reporting period. All investment properties owned by the Company are stated at fair value.

	31 Dec 2016 In HRK'000	**31 Dec 2015** In HRK'000
Investment properties	15,433	14,487
	15,433	**14,487**

14. PREPAYMENTS FOR PROPERTY, PLANT AND EQUIPMENT

	31 Dec 2016 In HRK'000	**31 Dec 2015** In HRK'000
Đuro Đaković Holding d.d.	2,754	19,787
JSC Tehnopromexport –Te	59	56
Litostroj Slovenija	85	160
Voith Austrija	16	16
Prepayments within the Group for connections	4,246	830
Other	46	605
	7,206	**21,454**

15. INVESTMENT IN THE NUCLEAR POWER PLANT KRŠKO

Investment background

Legal status of the Nuclear Power Plant Krško ("NE Krško") was regulated by inter-republic (between Slovenia and Croatia) 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 NE Krško in Slovenia, the other 50% was held by ELES d.o.o., Ljubljana, the legal successor of the Slovenian power utility.

In 1998, the Slovene government passed a decree transforming the NE Krško into a public company, NE KRŠKO d.o.o. ("NEK"), 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 NEK was cut off 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 NEK, usage and decommissioning, as well as a partnership agreement between HEP d.d. and ELES GEN d.o.o. This agreement was ratified by the Croatian parliament during 2002, and it came into force at 11 March 2003, following the ratification by the Slovenian 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. ('NEK') in respect to its 50% holding in NEK, 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 real production cost.

The Agreement was also clearly defined obligation towards the Croatian half of disposal of radioactive waste and used nuclear fuel from NEK. Each country/government has an obligation to provide half of the funds necessary to prepare the decommissioning plan and cost of the program. Each side will allocate fund for this purpose into a separate fund in the amounts estimated by the decommissioning program. According to the current program of decommissioning and disposal of radioactive waste and spent nuclear fuel, HEP d.d. is a contributor to the Fund in the amount of EUR 14,250 thousand per year.

HEP d.d. started to receive electricity from NEK on 19 April 2003, and expects to receive 2,700-2,950 GWh annually up to year 2023, representing 15% 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 NEK 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 NEK as at 31 December 2003 amounted to SIT 84.7 billion (approximately: HRK 2.8 billion).

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

Current status

Payments to the Fund for Decommissioning of NEK

Based on the Regulation on the amount, time and manner of payment of funds for the decommissioning and disposal of radioactive waste and used nuclear fuel of NEK, adopted by the Croatian Government on 24 December 2008, in the period from 2006 to 2016 HEP d.d. made payments to the Fund for Decommissioning of NEK in the amount of HRK 1,375,530 thousand. The amount of payment is determined by the Program of decommissioning from 2004. Actual annual liability in the amount of EUR 14,250 thousand is payable quarterly.

Extension of useful life of NEK

After NEK has obtained from the Slovenian nuclear safety administration a safety license to operate without any limitations in 2012, at the end of 2014 HEP and GEN Energija d.o.o. adopted a decision to extend the operational life of the plant until 2043. The decision to extend the operating life of NEK for 20 years was preceded with an investment feasibility study of long-term investments in the power plant.

Resolution of an international arbitration dispute

The Company has acquired the right to compensation for damages claimed from the Republic of Slovenia for undelivered electricity from NEK in the period from 1 July 2002 to 18 April 2003 in the amount of HRK 328,926 thousand (Note 5).

Compensation was paid in December 2015 and January 2016.

Accounting of NEK joint operation

Joint operation in NEK is recognized in the financial statements by using the equity method. The application of the requirements of IFRS 11 has resulted in a number of issues and concerns, as well as misinterpretation by some of users of the financial statements.

In order to eliminate possible concerns of individual government agencies (FINA, the Ministry of Finance, Central Bureau of Statistics, etc.) on the information in the separate financial statements of the Company, and in accordance with the provisions of IAS 1, point 19 and point 20, the Management Board adopted a decision to change that policy.

In its consolidated financial statements, the Company applies the method of joint management of assets and liabilities and reports share of the Company in each asset and each liability, income and expense in accordance with IFRS 11.

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

Financial effect from deviation

Income statement for the year ended 31 December 2016

	HRK'000 **HEP d.d.**	HRK'000 **NEK d.o.o.**	HRK'000 **HEP d.d. + NEK d.o.o.**
Total operating income	**7,867,923**	**5,813**	**7,873,736**
Total operating expenses	**(7,002,626)**	**(3,132)**	**(7,005,758)**
Operating profit	**865,297**	**2,681**	**867,978**
Net profit from financial activities	**640,186**	**(983)**	**639,203**
Profit before taxation	**1,505,483**	**1,698**	**1,507,181**
Corporate income tax expense	(181,664)	**-**	(181,664)
Profit for the year	**1,323,819**	**1,698**	**1,325,517**

Income statement for the year ended 31 December 2015

	HRK'000 **HEP d.d.**	HRK'000 **NEK d.o.o.**	HRK'000 **HEP d.d. + NEK d.o.o.**
Total operating income	**8,392,707**	**4,977**	**8,397,684**
Total operating expenses	**(7,114,716)**	**(6,583)**	**(7,121,299)**
Operating profit	**1,277,991**	**(1,606)**	**1,276,385**
Net profit from financial activities	**523,029**	**1,606**	**524,635**
Profit before taxation	**1,801,020**	**-**	**1,801,020**
Corporate income tax expense	(176,681)	**-**	(176,681)
Profit for the year	**1,624,339**	**-**	**1,624,339**

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

Financial effect from deviation (continued)

Balance sheet as at 31 December 2016

	31 Dec 2016		**31 Dec 2016**
	HRK'000	HRK'000	HRK'000
ASSETS	**HEP d.d.**	**NEK d.o.o.**	**HEP d.d. + NEK d.o.o.**
Non-current assets			
Property, plant and equipment	623,875	1,200,993	1,824,868
Financial assets	1,754,419	(1,667,912)	86,507
Other non-current assets	25,601,681	-	25,601,681
Total non-current assets	**27,979,975**	**(466,919)**	**27,513,056**
Current assets	**7,530,821**	**553,689**	**8,084,510**
TOTAL ASSETS	**35,510,796**	**86,770**	**35,597,566**
EQUITY AND LIABILITIES			
Total equity	**25,581,761**	**1,698**	**25,583,459**
Non-current liabilities	**5,408,991**	**35,854**	**5,444,845**
Current liabilities	**4,520,044**	**49,218**	**4,569,262**
TOTAL EQUITY AND LIABILITIES	**35,510,796**	**86,770**	**35,597,566**

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

Financial effect from deviation (continued)

Balance sheet as at 31 December 2015

	31 Dec 2015		**31 Dec 2015**
	HRK'000	HRK'000	HRK'000
ASSETS	**HEP d.d.**	**NEK d.o.o.**	**HEP d.d. + NEK d.o.o.**
Non-current assets			
Property, plant and equipment	1,410,950	1,137,262	2,548,212
Financial assets	1,754,419	(1,687,198)	67,221
Other non-current assets	21,383,339	-	21,383,339
Total non-current assets	**24,548,708**	**(549,936)**	**23,998,772**
Current assets	**10,532,929**	**658,880**	**11,191,809**
TOTAL ASSETS	**35,081,637**	**108,944**	**35,190,581**
EQUITY AND LIABILITIES			
Total equity	**24,825,486**	**-**	**24,825,486**
Non-current liabilities	**6,319,736**	**32,223**	**6,351,959**
Current liabilities	**3,936,415**	**76,721**	**4,013,136**
TOTAL EQUITY AND LIABILITIES	**35,081,637**	**108,944**	**35,190,581**

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

Extract from financial statements

In table below is shown an extract from financial statements of NEK in full (100%) amounts at 31 December 2016 and 2015:

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Property, plant and equipment	2,400,731	2,270,953
Capital and reserves	3,339,824	3,374,393
Gross sales	1,229,413	1,372,011
Cash flow from operating activities	137,363	662,485
Profit for the year	3,396	-

16. INVESTMENT IN THE TE PLOMIN

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Investment in TE Plomin d.o.o.	179,088	179,188
Long-term receivables	-	-
Receivables for long-term lease	73,014	75,140
	252,102	**254,328**
Current portion (Note 33)	(2,127)	(2,127)
	249,975	**252,201**

In November 1996, HEP d.d. entered into a Joint Venture Agreement with RWE Energie Aktiengesellschaft, Germany (‘RWE’) regarding the completion and operation of TE Plomin II. Consequently, a joint venture, TE Plomin d.o.o. (‘TE Plomin’) was formed in December 1996, with each partner holding 50% of the equity of the new entity.

Agreement between HEP d.d. and RWE expired in May 2015 in accordance with its provisions since HEP decided to exercise its right related to the possibility that 15 years after start of production, HEP can takeover RWE’s shares in TE Plomin d.o.o..
Joint Venture Agreement from 1996 with RWE expired in May 2015. Company signed with RWE termination of Joint Venture Agreement for TE Plomin II and the Agreement on the transfer of shares in TE Plomin II., and it became sole owner of the company TE Plomin d.o.o.

The Company paid all liabilities to RWE.

Extract from financial statements

In table below is shown an extract from financial statements of TE Plomin at 31 December 2016 and 2015:

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Property, plant and equipment	257,646	205,779
Capital and reserves	182,089	181,584
Gross sales	626,734	645,363
Operating profit	9,902	15,911
Net profit	2,901	3,357
Cash flows from operating activities	76,278	115,347

17. AVAILABLE-FOR-SALE AND OTHER INVESTMENTS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Available-for-sale investments	288,493	244,773
Other investments	1,065	1,065
	289,558	**245,838**

Movements on available-for-sale investments are presented below:

	2016	2015
	In HRK'000	In HRK'000
Opening balance	**244,773**	**191,158**
Fair value of investments through equity	43,648	54,131
Fair value of investments through income statement	-	(1,002)
Investments in shares	-	486
Investments in Bonds	72	-
Closing balance	**288,493**	**244,773**

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Investments in securities:		
Jadranski Naftovod d.d.	286,099	242,915
Viktor Lenac d.d.	177	115
Đuro Đaković d.d.	5	5
Kraš d.d.	4	3
Pevec d.d.	555	312
Jadran d.d.	364	364
Industrogradnja grupa d.d.	490	490
Optima Telekom d.d,	296	223
Institut IGH d.d,.	172	98
Međimurje beton d.d.	153	154
HTP Korčula	71	59
Lanište d.o.o.	72	-
Other	35	35
	288,493	**244,773**

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

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Other investments:		
Geopodravina d.o.o.	200	200
LNG Hrvatska d.o.o.	865	865
	1,065	**1,065**

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. By Decision of the Management Board, shares of Jadranski Naftovod were classified as available for sale. Transfer of shares was registered at Central Depository Agency on 19 March 2009.

In 2016 and 2015 fair value was determined by a market value from Zagreb Stock Exchange as of 31 December. The market price of one share of Jadranski Naftovod as of 31 December 2016 was HRK 5,300 and as of 31 December 2015 was HRK 4,500. By fair valuation of the investment in Jadranski Naftovod as of 31 December 2016 total amount of investment was increased by HRK 43,184 thousand (2015: increased by HRK 54037 thousand). The fair valuation in 2016 and 2015 was recognised through equity (revaluation reserves). For 18% (2015: 20%) of the increase in the value of investments, reserves were decreased and the deferred tax liability increased.

On 1 June 2010, HEP d.d. and Plinacro d.o.o. had concluded the Articles of Incorporation of LNG Hrvatska d.o.o., *a liquefied natural gas company*. Recapitalization was conducted in 2011 and subscribed capital was increased from HRK 20 thousand to HRK 220 thousand and in 2012 to HRK 1,730 thousand. HEP d.d. has a 50% stake in the company, and Plinacro d.o.o. has other 50%. As registered at Commercial court, on 4 February 2013 LNG Hrvatska d.o.o. was recapitalized by Plinacro d.o.o. in the amount of HRK 22,600 thousand. Subscribed capital of LNG Hrvatska d.o.o. is stated in the amount of HRK 24,330 thousand.

18. LONG TERM LOANS AND DEPOSITS

Loans given to non-related parties:

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
City Pregrada	122	259
City Dubrovnik	2,512	2,707
LNG Hrvatska d.o.o.	54,596	25,840
Current portion	(28,400)	(330)
	28,830	**28,476**

Loans given to related parties:

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
HEP-Toplinarstvo d.o.o.	79.000	94.800
HEP- Opskrba d.o.o	129	129
	79,129	**94,929**
Current portion	(15,800)	(15,800)
	63,329	**79,129**

These loans were issued with the following terms:

Beneficiary	Year loan approved	Interest rate	Repayment period	Loan amount	31 Dec 2016	31 Dec 2015
				In HRK'000	In HRK'000	In HRK'000
HEP-Toplinarstvo d.o.o.	2007	4%	15 years with the grace period of 5 years	158,000	79,000	94,800
HEP-Opskrba d.o.o.	2007	1-month ZIBOR+3.5 %	4 years	1,010	129	129
Total				**159,010**	**79,129**	**94,929**

19. RECEIVABLES FROM SUB-LOANS FROM RELATED COMPANIES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
HEP ESCO d.o.o. – long-term portion	55,337	55,350
HOPS d.o.o.	834,077	973,767
	889,414	**1,029,117**
Current portion	(216,681)	(132,093)
	672,733	**897,024**

Sub-loans

HEP d.d. and KfW Entwicklungsbank concluded an agreement in 2008. The loan contract amounted to EUR 50 million to finance projects by subsidiary companies - HEP ESCO and HEP Obnovljivi izvori energije d.o.o. The basic terms of the loan are: 5-year period of use, quarterly repayment of the principal over a period of 10 years after the expiry of the period of use. An amendment signed to the loan contract in November 2013 marked the completion of negotiations with KFW Bank to reschedule the location of the loan funds to a new project by HEP-a d.d. and HEP ESCO and HEP Obnovljivi izvori energije d.o.o. The period of use was extended from 31 December 2013 to 31 December 2017. Receivables for sub-loans to HEP-ESCO d.o.o. are based on contracts between HEP d.d. and financial institutions intended to finance energy efficiency projects. HEP d.d. issued the funds from the purpose loan for a sub-loan to HEP-ESCO d.o.o. under the same terms. Considering that bonds were released from the said funds for other loans, temporarily returned loans to finance the said projects, receivables for sub-loans are now classified with the same commercial terms as the bonds issued. As at 31 December 2012 a lease agreement with Hrvatski Operator prijenosnog sustava d.o.o. was cancelled for the lease of property, plant and equipment for the amount of the property which in accordance with the provisions of the Law on the Electricity Market is necessary to conduct the business of transmission and the assets were transferred to the ownership of Hrvatski Operator prijenosnog sustava d.o.o. The unpaid portion of the loan that financed Hrvatski Operator prijenosnog sustava d.o.o. assets, closed all Hrvatski Operator prijenosnog sustava d.o.o. liabilities based on a lease agreement and transferred to long-term loan liabilities under the same terms that the Company has for contracts with banks.

20. OTHER RECEIVABLES

Housing loans

As at 31 December 2016 receivables from housing loans amounted to HRK 666 thousand (2015: HRK 776 thousand) and other receivables as at 31 December 2016 amounts to HRK 21 thousand.

Prior to 1996, the Company had sold apartments/flats in its ownership to its employees, the sale of which was regulated by the laws of Republic of Croatia. These flats were usually sold on credit, and the related receivables, which are secured and bear interest at rates below market, are repayable on a monthly basis over periods of 20-35 years. The housing loan receivables are stated in the financial statements at their discounted net present values, determined using an interest rate of 7.0%. The liability to the State, which represent 65% of the value of sold apartments, is included in other non-current liabilities (Note 28). The receivables are secured by mortgages over the sold apartments.

21. INVENTORIES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Inventories of gas for wholesale	379,488	439,951
CO2 emission units	222,957	297,128
Inventories of investment materials	2,026	15,476
Inventories of other materials	941	1,069
	605,412	**753,624**

22. TRADE RECEIVABLES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Trade receivables in the country	260,087	136,309
Trade receivables of gas on the wholesale market	140,207	274,862
Receivables for electricity from abroad	55,296	29,038
	455,590	440,209
Impairment of receivables	(135,529)	(130,246)
	320,061	**309,963**

22. TRADE RECEIVABLES (continued)

Aging structure of unimpaired trade receivables in 2016 and 2015:

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Undue	285,830	285,818
Up to 30 days	26,906	13,216
31-60 days	1,893	2,454
61-90 days	737	1,659
91-180 days	2,097	5,858
181-365 days	2,586	958
More than 365 days	12	-
	320,061	**309,963**

Movements in impairments were as follows:

	2016	2015
	In HRK'000	In HRK'000
Balance at 1 January	130,246	129,508
Impairment of trade receivables	5,283	2,474
Reversal of impairments	-	(1,736)
Balance at 31 December	**135,529**	**130,246**

23. OTHER SHORT-TERM RECEIVABLES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Receivables for corporate income tax	29,034	76,987
Advance payments to suppliers	5,272	4,531
Receivables for interest	283	702
Receivables for interest from companies with participating interests	1,434	-
Receivables from the state	69	118
Receivables for deposits	50,574	26,088
Prepaid costs	14,435	10,676
Other receivables	4,437	12,864
	105,538	**131,966**

24. CASH AND CASH EQUIVALENTS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Short-term term deposits (daily)	441,547	116,503
Current accounts – Foreign currency	162,970	403,170
Current accounts - HRK	380,491	185,986
Current accounts for special purposes	921	926
Deposits with a maturity up to 90 days	1,304,847	1,245,279
Investment funds	75,322	-
Petty cash - HRK	2	9
	2,366,100	**1,951,873**

25. EQUITY 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.

Reserves

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Opening balance	100,836	54,947
Other comprehensive income/(loss), JANAF	39,456	45,889
	140,292	**100,836**

Retained earnings

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Opening balance	4,932,491	3,328,974
Merger effects	-	(20,822)
Dividends paid	(607,000)	-
Profit for the year	1,323,819	1,624,339
	5,649,310	**4,932,491**

On 15 May 2015, subsidiary APO d.o.o., was merged to the Company.

26. LIABILITIES FOR ISSUED BONDS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Nominal value of bonds in the country issued in 2007	92,946	186,410
Discounted value	84	(84)
Current maturity on bonds	(93,030)	(93,380)
	-	**92,946**
Value of bonds issued abroad in 2012	498,617	3,008,746
Bond repurchase (83.37%)	0	(2,806,955)
Exchange differences	(5,046)	296,826
Current portion of bonds	(493,571)	0
Bonds issued in 2012	**-**	**498,617**
Nominal value of bonds from 2015 issued abroad	3,656,047	3,703,533
Exchange differences	(37,511)	3,455
Discounted value	7,892	(50,941)
	3,626,428	**3,656,047**
Accrued bond expenses	(20,255)	(23,727)
Bonds issued in 2015	**3,606,173**	**3,632,320**
Total liabilities for issued bonds	**3,606,173**	**4,223,883**

Bonds issued in the Republic of Croatia

Bonds issued at the end of 2007 amounting to HRK 700,000 thousand are repayable in 15 semi-annual instalments, commencing three years from the date of issue, and are bearing fixed interest of 6.50 percent. The bonds are listed on the Zagreb Stock Exchange.

26. LIABILITIES FOR ISSUED BONDS (continued)

Bonds issued abroad

In November 2012, the Company has issued bonds in the amount of USD 500,000 thousand. Bonds have maturity of 5 years and are bearing fixed annual interest of 6%. Bonds are listed at Luxembourg stock - exchange and they are actively traded.

Cross currency swap

In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company has concluded cross currency swap agreement, by which liability upon issued bonds abroad in USD is converted in EUR for all period of bond duration, respectively until its outermost maturity date at 9 November 2017.
According to the cross-currency swap agreement from 2012, annual interest rate paid by the Company semi-annually is fixed and amounts to 6.53% (include swap cost).

Refinancing

In October 2015, bonds issued in 2012 were refinanced from the new bond issue and repaid 83.37% of the principal respectively USD 416,852 thousand. The amount of outstanding principal on bonds issued in 2012, on 31 December 2016 amounted to USD 83,148 thousand.

Cross currency swap agreement from 2012 is applicable for outstanding principal until its outermost maturity date at 9 November 2017.

The new bond issue

In October 2015, the Company issued new corporate bonds in the amount of USD 550,000 thousand with maturity of 7 years, fixed interest rate of 5.875% per annum and the issue price of 98.594%.

Bonds issued in 2015, are mainly used for the repurchase of 83.37% of the bonds issued in 2012 (i.e. the repurchase of USD 416,852 thousand). The remaining issue is intended to finance the Company's business. Bonds are listed at Luxembourg stock - exchange and they are actively traded.

Cross currency swap

In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company has concluded cross currency swap agreement, by which liability upon issued bonds abroad in USD is converted in EUR for all period of bond duration, respectively until its outermost maturity date at 23 October 2022.
According to the agreement from 2015, annual interest rate paid by the Company semi-annually is fixed and amounts to 4.851% (weighted interest rate include swap cost).

26. LIABILITIES FOR ISSUED BONDS (continued)

Derivative financial instruments

Cross currency swap

In order to reduce exposure to currency risk, i.e. hedge against fluctuations in USD exchange rate, the Company has concluded cross currency swap agreements, by which liabilities upon issued bonds abroad in 2012 and 2015 in USD are converted in EUR for all period of bond duration, respectively until its outermost maturity date.

The purpose of the cross-currency swap agreement is to reduce currency risk and recommendations of the credit agencies about the importance of strategic management of currency risks to reduce their impact on the business performance of the Company.

According to the agreement from 2012., annual interest rate paid by the Company semi-annually is fixed and amounts to 6.53%, and according to the agreement from 2015. amounts to 4,851% (weighted interest rate).

The Company measures the fair value of the cross-currency swap according to the calculation of Mark-to-market ("MTM") value, according to official banks calculation for the reporting period.

A positive "MTM" value is recorded as a receivable respectively it is formed financial income for the period, and negative "MTM" value is recorded as a liability and it is formed financial expense of the reporting period.

After a final maturity of derivative financial instruments, subject receivables or liabilities will be debited to the expense or credited to the income of the Company.

On 31 December 2016, using this measuring method, the Company stated fair value of assets by bonds issued in 2012 in the amount of HRK 96,196 thousand (31 December 2015: HRK 70,900 thousand).

On 31 December 2016, using this measuring method, the Company stated fair value of liabilities by bonds issued in 2015 in the amount of HRK 32,251 thousand (31 December 2015: HRK 81,876 thousand). (Note 28).

27. LONG-TERM LOAN LIABILITIES

	Interest rates	31 Dec 2016 In HRK'000	31 Dec 2015 In HRK'000
Domestic bank loans	Floating	827,728	1,219,772
Foreign bank loans	Fixed	237,817	90,296
Total long-term loan liabilities		**1,065,545**	**1,310,068**
Deferred loan originated fees		(2,152)	(3,382)
Total long-term loan liabilities		**1,063,393**	**1,306,686**
Current portion		(408,711)	(383,525)
Long-term portion – HEP		**654,682**	**923,161**
Total liabilities for long-term loans		**654,682**	**923,161**

In 2016, the Company contracted loans with domestic and foreign banks with floating and fixed interest rates ranging from 0.47% to 2.58%

Loans from domestic banks are secured by bills of exchange and promissory notes. At 31 December 2016, the Company doesn't have any liabilities covered by *sovereign loan guarantees*.

New financing sources

For the financing of the investment plan and the regular operations in 2016 the Company used own funds and funds from loans in use.

Loans in use

During 2016, the Company still had available funds from long-term loan approved in 2008 by KfW Entwicklungsbank in the amount of EUR 50,000 thousand for the financing of energy efficiency and renewable energy projects. As of 31 December 2016, KfW loan balance was EUR 31,5 million, and the amount of EUR 18,5 million were unutilised.

27. LONG-TERM LOAN LIABILITIES (continued)

Annual principal repayment schedule of long-term loans in next five years is stated as follows:

	Amount
	In HRK'000
2017	408,712
2018	428,889
2019	135,469
2020	58,137
2021	34,338
	1,065,545

Loans from domestic banks are secured by bills of exchange and promissory notes, except for one club loan for which the Company is obliged to meet the required level of financial indicators (covenants) on annual and semi-annual basis: tangible net worth, EBITDA to net finance charges, total net borrowings to tangible net worth.

The primary goal related to risks resulting from covenants is to protect the Company from possible defaults, respectively early maturity of loan liabilities.

The agreed covenants are monitored and calculated based on the projected Balance sheet and the Income statement. The Company prepares preliminary calculations of the covenants in the upcoming mid-term period, and is following their trends.

If the projections accounted at the end of the financial year shows that the Company could be in breach of covenants, the Company is obligated to inform the bank regarding the possibility of a breach (event of default) and timely request a waiver from the bank.

In the event that the bank does not approve the "waiver", the possible scenario is an early maturity of the debt, which represents liquidity risk for the Company.

The Management believes that in the case of breach of covenants, the Company can obtain a "waiver" from the creditors, given that timely payment of liabilities to financial institutions represent priority obligation of the Company and the Company has never been late in payment of liabilities to financial institutions.

Therefore, the Management estimates that possibility of early maturity of loan liabilities due to breach of covenant, as well as Company's exposure to credit risk, liquidity risk and market risk, which would result from a possible non-compliance with covenants is minimal.

27. LONG-TERM LOAN LIABILITIES (continued)

For the purpose of providing solvency reserves for the following mid-term period, the Company has concluded with domestic banks multi-purpose overdraft agreements in the total amount of HRK 1,0 billion. Funds from agreed overdrafts the Company may use as short-term loans, as well as for issuance of guarantees, letters of credit and letters of intention in accordance with the HEP Group needs.

During 2016, due to good liquidity, the Company did not conclude short-term loans from preapproved mid-term multipurpose overdraft agreements. Also, the Company has signed reverse factoring agreement in the amount of EUR 50 million with maturity until 31 December 2017.

As of 31 December 2016, the Company has available the amount of up to HRK 699,3 million from short-term financing sources.

After the balance sheet date, the Government of the Republic of Croatia issued a consent on the basis of which the overdrafts of banks were prolonged for 3 years and the total amount of available short-term funds amounts to HRK 1,392 million.

28. OTHER NON-CURENT LIABILITIES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Long-term liabilities for assets financed from clearing debt	863,450	842,162
Cross currency swap (Note 26)	32,251	81,876
Long-term liabilities to the State	878	923
Other	12,945	14,326
Other non-current liabilities	**909,524**	**939,287**

Clearing debt

At 31 December 2016, the Company stated clearing debt liability in the amount of HRK 863,450 thousand (2015: HRK 842,162 thousand) regarding a payment under a letter of credit on the basis of the Consent of the Ministry of Finance for the use of funds pursuant to an interbank agreement. As there is no other document that would regulate the relationship between the Company and the Ministry of Finance regarding the clearing debt, it has not been clearly defined whether it relates to a loan or a government grant.

Long-term liabilities to the State in the amount of HRK 878 thousand (2015: HRK 923 thousand) relate to the sale of apartments to employees in accordance with the State program that 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 allocate the funds until they are collected from the employee.

29. PROVISIONS

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Provisions for severance payments and jubilee awards	12,379	9,543
Provisions for court disputes	178,595	180,415
Other provisions	21,631	21,631
Total provisions	**212,605**	**211,589**

Provisions for court disputes

Provisions for court disputes relate to cases where possible outcome has been determined as uncertain or negative. Total amount of provisions for court disputes as at 31 December 2016 amounts to HRK 178,595 thousand (2015: HRK 180,415 thousand). Most significant provision relate to the litigation related to HE Peruča (hydropower plant Peruča) which started in 1995, for which a first Instance ruling was issued in 2012 and was ruled in favour of the plaintiff. Litigation case value amounts to HRK 330,000 thousand, and provisions are recorded at 50% of case value, i.e. HRK 165,000 thousand. Other significant provisions relate to Kartner sparkass amounting to HRK 9,903 thousand.

Water Management Act

According to an interpretation by the State Attorney's Office, *Water Management Act* that came into force on 4 January 1996 and the new *Water Management Act* that came into force on 1 January 2010, bring into question the property-legal status of the asset for electricity production from the hydro-power plant because the land on which the hydro-power plants was constructed is classified as 'Public Water Resources' which by its legal nature is considered to be real estate for common use owned by the Republic of Croatia and cannot be the subject of ownership of a physical or legal entity. There are currently several out of court settlement procedures between HEP d.d. and Republic of Croatia relating the right of registering ownership of hydro power plants in favour of Republic of Croatia. There is no uniform case law regarding this issue.

The Company has disputed the interpretation of the Water Management Act as aforementioned property was included in balance sheet of the Group during ownership transformation and therefore cannot be subject to laws that came into force after transition was conducted. This interpretation by the Company is in accordance with the Decision by the Croatian Constitutional Court, Ref. No. U-III-3049/2007. Also, it is necessary to take into account the overall electro-energy security in the Republic of Croatia, and the fact that the Company has constructed and invested significant funds in these facilities, that the Company maintains the mentioned facilities and is the owner of all equipment necessary for the management and functionality of the said hydroelectric power plants.

The Company has filed a motion to the Constitutional Court to institute proceedings to review the constitutionality of Article 23 Paragraph 4 of the Water Management Act with the Constitution and upon conclusion of the procedure to annul the said provision.

29. PROVISIONS (continued)

In addition, during 2015 the Ministry of Agriculture initiated a procedure for amending and change of the Water Act. As part of this process, and bearing in mind all the above, the Company has submitted suggestion for amendment and change of the provisions of the Water Act with the aim of clarifying the property-ownership rights and ownership of the Republic of Croatia on electricity production facilities built by legal entities in majority ownership of the Republic of Croatia. The Ministry of Economy has also sent its consent to the initiative of the Company for amending and change of the Water Act.

In 2016 and 2017, the Company continued its activities in order to address the issue of ownership of hydroelectric power plants and reported to the Ministry of Environmental Protection and Energy on the mentioned issue.

Movements in long-term provisions are stated as follows:

	Retirement bonuses HRK '000	**Jubilee awards** HRK '000	**Court disputes** HRK '000	**Other provisions** HRK '000	**Total** HRK '000
At 1 January 2015	**10,392**	**1,145**	**189,703**	**21,631**	**222,871**
Additional provisions	-	148	954	-	1,102
Decrease in provisions based on payment	(616)	(177)	(10,242)	-	(11,035)
Decrease in provisions based on estimate	(1,349)	-	-	-	(1,349)
At 31 December 2015	**8,427**	**1,116**	**180,415**	**21,631**	**211,589**
Additional provisions	2,652	184	652	-	3,488
Decrease in provisions based on payment	-	-	(920)	-	(920)
Decrease in provisions based on estimate	-	-	(1,552)	-	(1,552)
At 31 December 2016	**11,079**	**1,300**	**178,595**	**21,631**	**212,605**

29. PROVISIONS (continued)

Movements in the present value of the defined employee's benefits during the current period were as follows:

	Retirement bonuses	**Jubilee awards**	**Total**
	HRK '000	HRK '000	HRK '000
At 1 January 2015	**10,392**	**1,145**	**11,537**
Cost of services	377	81	458
Interest expense	317	41	358
Benefits paid	(616)	(177)	(793)
Past service cost	703	121	824
Actuarial gain/(loss)	(2,746)	(95)	(2,841)
At 31 December 2015	**8,427**	**1,116**	**9,543**
Cost of services	505	97	602
Interest expense	288	33	321
Benefits paid	-	(114)	(114)
Past service cost	55	17	72
Actuarial gain/(loss)	1,804	151	1,955
At 31 December 2016	**11,079**	**1,300**	**12,379**

Provisions for retirement bonuses and jubilee awards are based on calculations by a certified actuary.

The following assumptions were used in preparing the calculations:

- The termination rate is 4.86% and is based on the statistical fluctuation rates for the Company in the period from 2006 to 2016.
- The probability of death by age and sex is based on 2010-2012 Croatian Mortality Tables published by the Croatian Bureau of Statistics. It is assumed that the population of employees of the Company represents average with respect to mortality and health status.
- It is assumed that there will be no annual salary growth.

Present value of the obligation was determined using a 2.8% discount rate.

30. TRADE PAYABLES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Domestic trade payables	471,085	512,196
Foreign trade payables	8,975	18,110
Liabilities toward suppliers for electricity within EU and abroad	138,308	139,330
Liabilities toward suppliers within the EU	11,882	12,191
	630,250	**681,827**

31. LIABILITIES TO EMPLOYEES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Net salaries	3,841	4,027
Contributions	2,057	2,370
Other liabilities	206	14,664
	6,104	**21,061**

32. OTHER LIABILITIES

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Accrued expenses for unused vacations	3,868	3,023
Accrued expenses for severance payments	-	807
Accrued expenses to HAC	2,122	-
Accrued default interest	492	500
Liabilities for insurance premiums	4,531	13,515
	11,013	**17,845**

33. RELATED PARTY TRANSACTIONS

Related party transactions relate to subsidiaries in sole ownership of the Company and to NE Krško d.o.o. where HEP d.d. has a 50% ownership.

Related party transactions are stated as follows:

/i/ Company's revenues arise from re-invoiced income of related companies for electricity sales (except for universal service to households), accounting, legal and other similar services, as well as based on the lease of business premises. The amount of these revenues from related companies is determined on the basis of the following sizes: the value of assets of related company, the cost of employees and the total cost of the related company.

/ii/ Interest on long-term lease of property, plant and equipment and intangible assets are charged to tenants based on loans that were used for construction of those assets and are stated as interest income from related companies.

/iii/ Costs with related companies arise from rendered services of production, transmission and distribution of electricity. Costs for services of transmission and distribution and losses in distribution network are invoiced on a monthly basis in accordance with the provisions and tariffs set by the Croatian Energy Regulatory Agency ("HERA").

/iv/ Short-term receivables from related companies arise from the sale of fuel, materials and spare parts, for the electricity sold by the company HEP Operator distribucijskog sustava d.o.o., HEP Elektra d.o.o. and HEP Opskrba d.o.o., for the cost of the Company's common functions as well as for investments in progress financed by the Company. After completion of the construction, those assets are transferred to related companies as a finance lease.

/v/ Long-term receivables from related companies arise from financial lease of property, plant and equipment to related companies. Lease is paid monthly according to depreciation of leased assets, increased by interests from long-term loans by which the assets were financed. The Company also has receivables from related companies for apartments sold to employees.

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

33. RELATED PARTY TRANSACTIONS (continued)

	2016	**2015**
	In HRK'000	In HRK'000
Operating income		
Income from the sale of electricity to companies	24,073	12,404
Income from the sale of electricity HEP Energija d.o.o. Ljubljana	65,954	17,500
Income from the sale of electricity HEP Trgovina d.o.o. Belgrade	15,284	21,097
Income from the sale of electricity HEP Trade d.o.o. Mostar	21,654	124
Income from the sale of electricity to HOPS – compensation program	-	16,687
Income from the sale of electricity – related companies	**126,965**	**67,812**
Income from the sale of gas to HEP plin – related company	**128,938**	**167,124**
Income from conducting administrative services	158,793	152,803
Income from lease of business premises	14,415	9,417
Income from the sale of CO2 emission units	125,078	110,188
Other income	21,543	14,168
Operating income – related companies	**319,829**	**286,576**
	575,732	**521,512**
Financial income		
Income from interest on lease of property	116,347	141,475
Income from interest on loans to related companies	38,988	82,037
	155,335	**223,512**
Expenses for electricity supplies – related companies		
TE Plomina d.o.o.	449,945	458,122
HEP Energija d.o.o. Ljubljana	1,614	3
HEP Trgovina Beograd d.o.o.	561	5,027
HEP Trade d.o.o. Mostar	132,800	727
HOPS d.o.o.	-	549
	584,920	**464,428**

33. RELATED PARTY TRANSACTIONS (continued)

	2016 In HRK'000	2015 In HRK'000
Expenses		
- HEP Proizvodnja d.o.o. - fee for electricity generation	2,040,752	2,161,351
- HEP Opskrba d.o.o. - fee for supply of electricity	41,804	43,008
Purchase of electricity from OIE	330,319	255,210
HEP Trgovina d.o.o. trading fee for electricity and gas	14,075	11,124
HEP Opskrba plinom d.o.o. gas supply fee	5,902	5,058
HEP Operator distribucijskog sustava d.o.o. – for losses in transmission grid	92,995	-
Costs based on electricity balancing	33,962	50,499
HEP ODS – impairment of receivables	38,361	-
Other	-	142
	2,598,170	**2,526,392**

Costs from balancing energy in 2016 in the amount of HRK 33,962 thousand (2015: HRK 50,499 thousand) are realised based on sales/purchase of energy balancing pursuant to the valid Rules of balancing of the Energy System.

Long-term receivables	31 Dec 2016 In HRK'000	31 Dec 2015 In HRK'000
Receivables for assets in long-term lease		
HEP Operator distribucijskog sustava d.o.o.	8,086,042	6,889,940
HEP Proizvodnja d.o.o.	8,219,593	6,371,366
HEP Toplinarstvo d.o.o.	754,294	745,212
HEP Upravljanje imovinom d.o.o.	114,027	112,457
HEP Plin d.o.o.	157,101	144,681
HEP Noc d.o.o.	12,104	12,484
HEP Opskrba d.o.o.	3,248	4,231
HEP Trgovina d.o.o.	1,061	755
HEP Esco d.o.o.	2,092	1,987
HEP Obnovljivi izvori energije d.o.o.	-	-
Program Sava d.o.o.	314	325
-HEP Opskrba plinom d.o.o.	237	301
-HEP Elektra d.o.o.	1,211	-
	17,351,324	**14,283,739**

33. RELATED PARTY TRANSACTIONS (continued)

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Receivables for sold flats		
- HEP Operator distribucijskog sustava d.o.o.	6,610	7,353
- HEP Proizvodnja d.o.o.	4,048	4,386
- Hrvatski operator prijenosnog sustava d.o.o.	1,215	1,457
- HEP Toplinarstvo d.o.o.	147	211
	12,020	**13,407**
	17,363,344	**14,297,146**
Current portion of lease	(1,083,937)	(1,057,217)
Receivables for long-term lease – related companies	**16,279,407**	**13,239,929**

Receivables for long-term loans – related companies (See Note 18)	31 Dec 2016	31 Dec 2016
	In HRK'000	In HRK'000
HEP-Toplinarstvo d.o.o.	79,000	94,800
HEP-Opskrba d.o.o.	129	129
	79,129	**94,929**
Current portion	(15,800)	(15,800)
	63,329	**79,129**
Total long-term receivables	**16,342,736**	**13,319,058**

33. RELATED PARTY TRANSACTIONS (continued)

Short-term receivables	**31 Dec 2016** In HRK'000	**31 Dec 2015** In HRK'000
Receivables from HEP Operator distribucijskog sustava d.o.o. for sold electricity and interest	14,742	277,777
Receivables from HEP Operator distribucijskog sustava d.o.o. for losses on distribution grid	119,948	85,459
Receivables from HEP Elektra d.o.o. for sold electricity	220,754	-
Receivables from HEP Opskrba d.o.o. for sold electricity and interest	500,155	456,977
Receivables from Hrvatski operator prijenosnog sustava d.o.o. losses on distribution network	25,620	37,047
Receivables from HEP Energija d.o.o. Ljubljana	16,441	9,203
Receivables from HEP Trade d.o.o. Belgrade for sold electricity	1,615	3,007
Receivables from HEP Trade d.o.o. Mostar for sold electricity	860	-
Receivables from HEP Opskrba d.o.o. for balancing energy	-	2,837
	900,135	**872,307**
Costs of common functions		
HEP Proizvodnja d.o.o.	1,750	604
HEP Operator distribucijskog sustava d.o.o.	8,131	6,634
HEP Toplinarstvo d.o.o.	3,542	1,232
HEP Plin d.o.o.	9,372	12,843
HEP Upravljanje imovinom d.o.o.	1,579	9,720
HEP Trgovina d.o.o.	1,212	2,066
HEP Opskrba d.o.o.	2,545	2,679
HEP NOC	186	11
HEP ESCO d.o.o.	664	659
Program Sava d.o.o.	901	1,180
HEP Telekomunikacije d.o.o.	163	1,342
Opskrba plinom d.o.o.	303	541
Hrvatski centar za čistiju proizvodnju	276	-
HEP Elektra d.o.o.	495	-
	31,119	**39,511**

33. RELATED PARTY TRANSACTIONS (continued)

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Short-term receivables for lease of long-term assets		
HEP Proizvodnja d.o.o.	41,357	39,026
HEP Toplinarstvo d.o.o.	23,565	8,260
HEP Operator distribucijskog sustava d.o.o.	62,200	288,464
HEP Plin d.o.o.	12,275	33,394
HEP Upravljanje imovinom d.o.o.	1,122	22,247
HEP NOC	9,434	9,967
HEP Trgovina d.o.o.	43	61
HEP Opskrba d.o.o.	258	205
HEP Esco d.o.o.	76	98
Program Sava d.o.o.	15	-
HEP Opskrba plinom d.o.o.	8	-
HEP Elektra d.o.o.	104	-
	150,457	**401,722**
Other short-term receivables	**231,443**	**168,713**

33. RELATED PARTY TRANSACTIONS (continued)

Receivables for paid investments and other receivables	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
HEP Proizvodnja d.o.o.	356,635	2,389,041
Hrvatski operator prijenosnog sustava d.o.o.	57,375	84,223
HEP Operator distribucijskog sustava d.o.o.	458,665	1,439,150
HEP Toplinarstvo d.o.o.	83,217	86,563
HEP Plin d.o.o	36,591	39,339
HEP ESCO d.o.o.	786	1,028
HEP Noc d.o.o.	919	840
HEP Upravljanje imovinom d.o.o.	-	34,332
HEP Opskrba d.o.o.	17,937	450
Program Sava d.o.o.	8,705	8,736
HEP Telekomunikacije d.o.o.	-	1
HEP Opskrba plinom d.o.o.	42	41
Plomin Holding d.o.o.	1,350	1,350
Hrvatski centar za čistiju proizvodnju	1,192	1,192
	1,023,414	**4,086,286**
Receivables for sold investment and other materials		
HEP Operator distribucijskog sustava d.o.o.	313,473	313,473
HEP Proizvodnja d.o.o.	-	257,847
HEP Plin d.o.o.	2,680	2,680
HEP Toplinarstvo d.o.o.	99	99
	316,252	**574,099**
Other receivables		
HEP Plin d.o.o.	18,240	18,195
HEP Noc d.o.o.	15,793	13,564
	34,033	**31,759**
Receivables from TE Plomin d.o.o.		
- current portion of long-term receivables (Note 16)	2,127	2,127
- other receivables	532	532
	2,659	**2,659**
Receivables for short-term loans		
HEP Trade d.o.o. Beograd	2,296	2,313
HEP KS sh.p.k. Priština	888	694
	3,184	**3,007**
	2,692,696	**6,180,063**

33. RELATED PARTY TRANSACTIONS (continued)

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Short-term liabilities		
- HEP Opskrba fees for supply of electricity	4,341	11,339
- HEP Proizvodnja d.o.o. – fees for production of electricity	640,743	603,632
- HEP Opskrba fees for supplies from OIE	41,848	24,553
- HEP Trgovina for trading fee	1,362	134
Liabilities for energy balancing	10,627	-
- HEP Opskrba plinom d.o.o.	1,081	987
-HEP Operator distribucijskog sustava d.o.o.– liabilities for losses on distribution network	85,693	-
-HEP Proizvodnja – liabilities from HEP d.d. based on the cession agreement	966,235	966,235
- Other	9,621	21,436
	1,761,551	**1,628,316**

33. RELATED PARTY TRANSACTIONS (continued)

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
Other liabilities		
- Liabilities toward HEP ODS d.o.o. – payments for connections	183,381	193,309
- for monetary funds paid into the treasury	217,229	632,616
- Liabilities toward HEP Elektra d.o.o. for cash funds	485,162	-
- Liabilities toward other companies paid into the treasury	20,339	50,784
	906,111	**876,709**
- TE Plomin d.o.o. for electricity delivered	90,334	73,418
- HEP Energija d.o.o. Ljubljana for electricity delivered	206	-
-HEP MagyarorszagEnergiaKft for electricity delivered	-	130
	90,540	**73,548**
Total short-term liabilities	**2,758,202**	**2,578,573**

Transactions with NE Krško d.o.o. are shown as follows:

	31 Dec 2016	31 Dec 2015
	In HRK'000	In HRK'000
NE Krško d.o.o.		
Liabilities for purchased electricity	52,444	62,497
Costs of purchased electricity	609,026	664,425

33. RELATED PARTY TRANSACTIONS (continued)

	Sales revenue		Purchase costs	
	2016	**2015**	**2016**	**2015**
	HRK '000	HRK '000	HRK '000	HRK '000
Companies in majority ownership by the State				
INA-Industrija nafte d.d.	92,876	86,922	1,258,033	1,536,463
Hrvatske Željeznice	70,858	71,784	-	-
Croatia osiguranje d.d.	-	-	93	225
Hrvatska pošta d.d.	3	1	15,564	16,447
Croatian Ministry od Defence	-	-	-	-
Hrvatske šume d.o.o.	510	-	2,346	2,607
Narodne novine d.d.	894	1,241	122	163
Hrvatska radio televizija	4,934	5,941	73	67
Plinacro d.o.o.	-	-	106,519	79,132
Plovput d.d.	43	-	-	-
Croatia Airlines d.d.	454	426	-	-
Petrokemija Kutina d.d.	14,212	16,971	-	-
Ministry of the Interior	9,566	-	-	-
Elementary and high schools	9,389	9,914	-	-
Judicial institutions	2,601	86	-	-
Colleges and universities	6,182	4,709	641	366
Legislative, executive and other bodies of Republic of Croatia	4,526	4,578	-	-
Health institutions and organizations	37,356	34,898	-	-
Other users	103	1,175	5,347	14,173
Prirodni plin d.o.o.	-	-		-
HROTE d.o.o.	25,160	30,605	40,075	81,978
	279,667	**269,251**	**1,428,813**	**1,731,621**

33. RELATED PARTY TRANSACTIONS (continued)

	Amount of receivables		Amount of liabilities	
	31 Dec 2016	**31 Dec 2015**	**31 Dec 2016**	**31 Dec 2015**
	In HRK'000	In HRK'000	In HRK'000	In HRK'000
Companies in majority ownership by the State				
INA-Industrija nafte d.d.	-	-	112,899	128,506
Croatia osiguranje d.d.	-	-	28	47
Hrvatska pošta d.d.	-	-	1,315	1,419
Narodne novine d.d.	-	-	14	7
HROTE d.o.o.	1,924	2,220	3,120	5,071
Others	72	92	37,458	26,020
	1,996	**2,312**	**154,834**	**161,070**

34. CONTINGENT LIABILITIES AND COMMITMENTS

Court disputes

The Company has long-term investments in Bosnia and Herzegovina and Serbia in the amount of HRK 1,243,970 thousand. During the Company's transition in 1994 into a shareholding company, this amount was excluded from the net assets value.

The Company has long-term investments in immovable assets in the territory of Bosnia and Herzegovina and Montenegro in the amount of HRK 722 thousand, which is excluded from the net asset value.

Operating commitments

As part of regular investment activities, at 31 December 2016 the Company had concluded agreements for investments in various facilities and equipment that has commenced but has not been completed. In 2016, the value of the most significant contracted investments in progress amounted to HRK 126,947 thousand (2014: HRK 351,387 thousand).

The Company also has shares in HEP - Proizvodnja d.o.o, HEP- Toplinarstvo d.o.o., HEP ESCO d.o.o. and HEP Upravljanje imovinom d.o.o., which have recorded operational losses and the Company is ready to facilitate the necessary funds to enable these companies to continue operations and execute all their due liabilities.

Environmental and nature protection

HEP d.d. continuously monitors and analyses impact of its business operations to the environment. The most important indicators of that impact are emissions of air pollutants and the quantity of industrial waste and ensures timely and objective reporting to the relevant institutions, local government and the public. The Company reports on its impact on the environment, economy and society within the framework of non-financial sustainability reports prepared under the GRI-Global Reporting Initiative guidelines and publishes them on its website http://www.hep.hr/o-hep-grupi/publikacije/izvjesca-o-odrzivosti/1401. Employees involved in environmental and nature protection are going through additional trainings, seminars and workshops where they are informed of the obligations and activities resulting from legal regulations in the areas of environmental and nature protection.

The Company's environmental expenditure monitoring system (RETZOK) introduced in 2004, monitors all investments for the environmental and nature protection.

34. CONTINGENT LIABILITIES AND COMMITMENTS (continued)

A request has been submitted to the Ministry of Environmental and Nature Protection (today: the Ministry of Environment and Energy) to unify environmental protection conditions (environmental permits).
All nine of the HEP's plants with power inputs >50 MWt have come up with solutions on the unified environmental and energy protection (environmental permit solutions) - TE Plomin 1, TE Plomin 2, TE Rijeka, TE-TO Zagreb, EL-TO Zagreb, TE-TO Sisak, KTE Jertovec, TE-TO Osijek and Pogon Osijek HEP-Toplinarstvo.

The CO_2 emissions trading system was officially set up pursuant to the Decision of the Management Board of HEP d.d. under which, obligations, responsibilities and deadlines for meeting obligations for individual departments and companies within HEP's emission trading system are set. Croatian Environment Agency has opened nine "Accounts" of plant operators in the EU Greenhouse Gas Inventory. HEP successfully fulfilled its legal obligations for submission of emission units to the EU Greenhouse Gas Inventory for 2015 and for 2016 HEP entered information verifying CO_2 emission, which were after confirmation by Croatian officials submitted onto all nine Accounts of plant operators with the relevant quantities that corresponded the verified CO_2 emissions.

In 2016, non-financial sustainability report for 2015 for the HEP Group in accordance with Global Reporting Initiative (GRI 4) guidelines is finished. Sustainability Report was published on the website of HEP in Croatian and English language. Implementation of Environment management system in accordance with ISO 14001 in HEP's generation facilities is finished in 2015 and during 2016 internal audits were carried out at HEP-Proizvodnja d.o.o. and HEP-ODS d.o.o., as well as recertification procedures in facilities where it was necessary to extend the certificates.

In 2016, it is continued establishment of environmental information system (INFOZOK) with a goal of unifying data relating to environmental and nature protection. INFOZOK is upgraded with modules for data collection about usage and monitoring of water quality and managing data on environmental permits.

Gas supply at wholesale market

By a Decision of the Government of the Republic of Croatia in April 2014, HEP d.d. was defined as a gas supplier on the wholesale market in a period until April 2017. Pursuant to the above Decision from the Croatian Government, the Company has rented 70% of warehouse capacities in underground gas storage facilities.

In the period from 1 April 2014 to 31 March 2015 the Company agreed rent of capacities of 3.600 million kWh, in the period of 1 April 2015 to 31 March 2016, the Company agreed rent of capacities of rent of 3.550 million kWh, and in the period from 1 April 2016 to 31 March 2017 the Company agreed rent of capacities of 3.500 million kWh, respectively 60% of warehouse capacities in underground gas storage facilities.

HEP d.d. as a supplier on the wholesale market sells gas as public service and under regulated conditions to local suppliers for household customers, and is obligated to provide secure and reliable gas supply.

35. SUBSIDIARIES

As at 31 December 2016 the Company had the following subsidiaries in its ownership:

Subsidiary	Country	Ownership interest in %	Principal activity
HEP-Proizvodnja d.o.o.	Croatia	100	Electricity generation and heating
Hrvatski operator prijenosnog sustava d.o.o.	Croatia	100	Electricity transmission
HEP-Operator distribucijskog sustava d.o.o.	Croatia	100	Electricity distribution
HEP ELEKTRA d.o.o.	Croatia	100	Electricity supply
HEP Opskrba d.o.o.	Croatia	100	Electricity supply
HEP–Toplinarstvo d.o.o.	Croatia	100	Thermal power generation and distribution
HEP–Plin d.o.o.	Croatia	100	Gas distribution
TE Plomin d.o.o.	Croatia	100	Electricity generation
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
CS Buško Blato d.o.o.	BiH	100	Maintenance of hydro power plants
HEP–Upravljanje imovinom d.o.o.	Croatia	100	Accommodation and recreation services
HEPNOC Velika	Croatia	100	Accommodation and training
HEP –Trgovina d.o.o.	Croatia	100	Electrical energy trading and optimization of power plants production
HEP Energija d.o.o. Ljubljana	Slovenia	100	Electricity trading
HEP -MagyarorszagEnergiaKft	Hungary	100	Electricity trading
HEP- Trade d.o.o. Mostar	BIH	100	Electricity trading
HEP KS sh.p.k, Priština	Kosovo	100	Electricity trading
HEP- Trade d.o.o. Beograd	Serbia	100	Electricity trading
Program Sava d.o.o.	Croatia	100	Spatial planning, design, construction and supervision
HEP Opskrba plinom d.o.o.	Croatia	100	Gas distribution
HEP-Telekomunikacije d.o.o.	Croatia	79,94	Telecommunication services
Hrvatski centar za čistiju proizvodnju	Croatia	100	Teaching and counseling in the field of cleaner production and environmental management systems

The majority of these subsidiaries were founded for the purpose of reorganization and restructuring of the core business activities driven by the new energy legislation, which came into force as of 1 January 2002 (Note 1). The company HEP-Telekomunikacije d.o.o. was founded in 2013 and HEP-Opskrba plinom d.o.o. in 2014. In 2014 the company HEP- RVNP d.o.o. changed its name to Program Sava d.o.o. za usluge. In 2015, the company APO d.o.o., for environmental protection was merged with the Company and the company HEP OIE d.o.o. was merged to the company HEP Proizvodnja d.o.o. The ownership of the company HEP NOC Velika in 2015 was transferred to HEP Operator distribucijskog sustava d.o.o.

In November 2016 was founded HEP-ELEKTRA d.o.o., which was created by the status change of division from the HEP-Operator distribucijskog sustava d.o.o.

35. SUBSIDIARIES (continued)

Movements on investments are stated as follows:

	2016 In HRK'000	2015 In HRK'000
Balance at 1 January	6,032,580	5,325,094
Hrvatski operator prijenosnog sustava d.o.o.	193,912	-
Investment in Hrvatski operator prijenosnog sustava d.o.o. from reinvested profit	189,680	265,000
HEP-Operator distribucijskog sustava d.o.o.- capital reserves	605,280	444,304
HEP-Operator distribucijskog sustava d.o.o. –transfer of shares in HEP ELEKTRA d.o.o.	(20)	-
HEP ELEKTRA d.o.o. – founder deposit	20	-
HEP Toplinarstvo d.o.o.- capital reserves	54,935	-
HEP-Telekomunkacije d.o.o.- capital reserves	57,604	-
Plomin Holding d.o.o.- decrease in shares	(4,980)	-
HEP Upravljanje imovinom d.o.o.- increase in stock capital	70,000	-
NOVENERG d.o.o.- founder deposit	-	380
APO - merger	-	(2,198)
TE Plomin – takeover of shares from RWE	100	-
Balance at 31 December	**7,199,111**	**6,032,580**

	31 Dec 2016 In HRK'000	31 Dec 2015 In HRK'000
HEP - Proizvodnja d.o.o.	40	40
Hrvatski operator prijenosnog sustava d.o.o.	4,369,916	3,986,324
HEP - Operator distribucijskog sustava d.o.o.	1,764,960	1,159,700
HEP - Opskrba d.o.o.	20	20
HEP -Toplinarstvo d.o.o.	730,816	675,881
HEP - Plin d.o.o.	20	20
HEP ESCO d.o.o.	3,920	3,920
HEP – Upravljanje imovinom d.o.o.	70,020	20
HEP-Trgovina d.o.o.	20	20
Program Sava d.o.o.	20	20
HEP-Telekomunikacije d.o.o.	258,799	201,195
Plomin Holding d.o.o.	20	5,000
HEP Opskrba plinom d.o.o.	20	20
NOVENERG d.o.o.	380	380
Hrvatski centar za čistiju proizvodnju	20	20
HEP Elektra d.o.o.	20	-
TE Plomin	100	-
	7,199,111	**6,032,580**

36. FINANCIAL RISK MANAGEMENT

Capital risk management

The Company manages its capital to ensure that it will be able to continue as a going concern while maximizing the return to stakeholders through the optimization of the debt and equity balance. The capital structure of the Company consists of debt, which includes loans and issued bonds disclosed in the Notes 26 and 27, cash and cash equivalents and equity attributable to Owners of the parent, comprising of share capital, legal and other reserves and retained earnings.

Gearing ratio

The Management monitors and reviews the equity structure on a semi-annual basis. As part of this review, the Management considers the cost of equity and the risks associated with each class of equity. The gearing ratio at the year-end can be presented as follows:

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Debt	5,256,167	5,623,949
Cash and cash equivalents	(2,366,100)	(1,951,873)
Net debt	2,890,067	3,672,076
Equity	25,581,761	24,825,486
Net debt to equity ratio	**11%**	**15%**

Significant accounting policies

Details on significant accounting policies and methods adopted, including criteria for recognition and basis for measurement of each class of financial assets, financial liabilities and equity instruments are disclosed in the Note 2 to the unconsolidated financial statements.

Categories of financial instruments

	31 Dec 2016	**31 Dec 2015**
	In HRK'000	In HRK'000
Financial assets		
Available-for-sale	289,558	245,838
At fair value through profit or loss	96,196	70,900
Loans and receivables (including cash and cash equivalents)	6,749,536	9,691,524
Other non-current assets	17,044,965	14,245,334
Financial liabilities		
At fair value through profit or loss	32,251	81,876
Non-current liabilities	5,138,128	6,004,455
Current liabilities	4,433,477	3,797,012

36. FINANCIAL RISK MANAGEMENT (continued)

Categories of financial instruments (continued)

Other assets mostly relate to long-term loan receivables from related companies for lease of property.

Financial risk management objectives

The Company'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 Company 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 management

The activities of the Company are primarily exposed to the financial risk of exchange rate and interest rates fluctuations (see below). Market risk exposure is monitored and managed through sensitivity analysis. There have been no changes in the Company's exposure to market risks or in the manner in which the Company manages and measures the risk.

Foreign currency risk management

The Company undertakes certain transactions denominated in foreign currencies and thus the Company is exposed to foreign currency risk. Foreign currency risk exposure is managed within approved policy parameters utilizing cross currency swap contracts.

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

	Assets		**Liabilities**	
	31 Dec 2016	**31 Dec 2015**	**31 Dec 2016**	**31 Dec 2015**
	In HRK'000	In HRK'000	In HRK'000	In HRK'000
European Union EUR	195,258	179,994	716,260	747,354
USD	10,034	10,407	2	226

36. FINANCIAL RISK MANAGEMENT (continued)

Foreign currency sensitivity analysis

The Company is mainly exposed to the changes of EUR and USD currency. The following table details the Company's sensitivity to a 10% increase and decrease in the Croatian Kuna against the 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 foreign currency denominated receivables and liabilities and adjustments of 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 components 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.

	2016	**2015**
	HRK'000	HRK'000
EUR change effect		
Gain or loss	393,762	433,182
USD change effect		
Gain or loss	(7,192)	(7,118)

36. FINANCIAL RISK MANAGEMENT (continued)

Interest rate risk management

The Company is exposed to interest rate risk as it borrows funds at both fixed and floating interest rates. The Company's exposure to interest rates on financial assets and financial liabilities is explained in the liquidity risk management section. The Company manages this risk by maintaining an appropriate mix between fixed and floating interest rate in its loan portfolio.

Interest rate sensitivity analysis

The sensitivity analysis has been determined only for financial instruments with floating interest rate, based on the Company's exposure at the end of the reporting period. For floating interest rates, the analysis is prepared assuming that the amount of outstanding liability at the date of the consolidated statement of financial position, 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 Company's profit for the year ended 31 December 2016 would decrease by HRK 2,301 thousand (2015: HRK 3,811 thousand) based on exposure to interest rate risk. This is mainly attributable to the Group's exposure to interest rates on its floating interest rate loans representing 15,55% of all interest-bearing loans (2015: 21,4%); and
- the Group's sensitivity to interest rates would decrease during current period mainly due to decrease in floating interest rate.

Credit risk management

Credit risk refers to the risk that counterparty will fail to meet its contractual obligations resulting in financial loss to the Company. The Company is the largest provider of electric energy in the Republic of Croatia. As such, it has public responsibility to provide services to all customers, and at all locations within the country, irrespective of credit risk associated with particular customer. Net trade receivables, consist of a large number of customers, spread across diverse industries and geographical areas.

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

Carrying amount of financial assets presented in the unconsolidated financial statements, less losses arising from impairment, represents the Company's maximum exposure to credit risk without taking into account the value of any collateral obtained.

36. FINANCIAL RISK MANAGEMENT (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 Company's short, medium and long-term funding and liquidity management requirements. The Company manages liquidity risk by maintaining adequate reserves, loans from banks, and other sources of financing, and 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 Company’s non-derivative financial assets. The tables below have been drawn up based on the undiscounted cash flows of the financial assets, including interest to be earned on those assets except where the Company 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
31 Dec 2016							
Interest free		3,591,316	1,221,921	290,226	437,174	0	5,540,637
Floating interest	1.51%	35,923	20,323	95,572	232,038	0	383,856
Fixed interest	5.02%	0	9,806	138,648	68,893	534,612	751,959
Fixed interest	6.50%	100,595	201,190	898,498	4,801,134	12,176,359	18,177,776
Total		**3,727,834**	**1,453,240**	**1,422,944**	**5,539,239**	**12,710,971**	**24,854,228**
31 Dec 2015							
Interest free		3,074,224	1,764,866	1,741,348	1,921,787	68,923	8,571,148
Floating interest	1.51%	10,505	20,787	93,859	136,422	-	261,573
Fixed interest	5.21%	-	9,807	54,198	302,207	455,733	821,945
Fixed interest	6.50%	100,548	201,096	897,048	4,794,768	9,435,486	15,428,946
Total		**3,185,277**	**1,996,556**	**2,786,453**	**7,155,184**	**9,960,142**	**25,083,612**

36. FINANCIAL RISK MANAGEMENT (continued)

Liquidity risk management (continued)

Maturity of non-derivative financial liabilities

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

	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
31 Dec 2016							
Interest free		2,139,553	1,205,696	87,893	875,104	32,251	4,340,497
Floating interest	2.09%	70,981	29,634	297,689	693,488	-	1,091,792
Fixed interest	4.84%	-	-	834,282	952,781	3,850,940	5,638,003
Total		**2,210,534**	**1,235,330**	**1,219,864**	**2,521,373**	**3,883,191**	**11,070,292**
31 Dec 2015							
Interest free		1,682,085	1,377,143	246,864	938,364	-	4,244,456
Floating interest	2.31%	73,876	30,315	308,418	863,662	-	1,276,271
Fixed interest	5.03%	-	-	316,375	1,438,377	4,066,660	5,821,412
Total		**1,755,961**	**1,407,458**	**871,657**	**3,240,403**	**4,066,660**	**11,342,139**

The Company has access to sources of financing. The total unused amount at the end of the reporting period was HRK 1,595,051 thousand. The Company expects to meet its other obligations from operating cash flows and proceeds from matured financial assets.

36. FINANCIAL RISK MANAGEMENT (continued)

Fair value of financial instruments

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

- The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets is determined with reference to quoted market prices.
- The fair value of other financial assets and financial liabilities is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.
- Fair value of derivative instruments is calculated using the listed price. Where such prices are not available, the analysis uses discounted cash flows by applying the current yield curve for the period of non-derivative instruments.

Fair value measurements recognized in the statement of financial position

The table below analyses the financial instruments subsequently measured at fair value, classified within 3 groups according to IFRS 13:

1. Level 1 inputs – inputs are quoted prices in active market for identical assets or liabilities, that the entity can access at the measurement date
2. Level 2 inputs – are inputs other than quoted market prices included within Level 1, that are observable for the asset or liability either directly or indirectly, and
3. Level 3 inputs – inputs are unobservable inputs for the asset or liability

The measurement of fair value of cross currency swap is tied to the Mark-to-market value ("MTM") according to the calculation from the banks and the change in fair value in subsequent period is recognized through profit or loss.

36. FINANCIAL RISK MANAGEMENT (continued)

	1st level HRK '000	2nd level HRK '000	3rd level HRK '000	Total HRK '000
2016				
Available-for-sale assets	289,558	-	-	**289,558**
Derivative financial assets	-	-	96,196	**96,196**
Derivative financial liabilities	-	-	32,251	**32,251**
Investment property	-	15,433	-	**15,433**
2015				
Available-for-sale assets	245,838	-	-	**245,838**
Derivative financial assets	-	-	70,900	**70,900**
Derivative financial liabilities	-	-	81,876	**81,876**
Investment property	-	14,487	-	**14,487**

37. OTHER DISCLOSURES

The auditors of HEP Group's financial statements provided services in the amount of HRK 730 thousand (in 2015: HRK 730 thousand). Services in 2016 and 2015 mainly relate to audit costs, review of condensed interim financial information and audits of regulatory reports prepared for regulatory needs.

Fees for tax consultancy amounted to HRK 134 thousand in 2016 (2015: HRK 31 thousand).

38. EVENTS AFTER THE UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION DATE / (UNCONSOLIDATED BALANCE SHEET DATE)

After the unconsolidated statement of financial position date / (unconsolidated balance sheet) date, there were no events relevant to be published in the unconsolidated financial statements of the Company for 2016.

39. APPROVAL OF THE FINANCIAL STATEMENTS

These unconsolidated financial statements were approved by the Management Board and authorized for issue on 28 April 2017.

Signed on behalf of the Company on 28 April 2017:

Tomislav Rosandić Management Board member	Zvonko Ercegovac Management Board member	Saša Dujmić Management Board member	Perica Jukić President of the Management Board