Financial statements and independent auditors’ report

Korporata Energjetike e Kosoves

31 December 2005

Content

Independent auditors' report

To the Kosovo Trust Agency and
The Management of Korporata Energjetike e Kosoves

We were engaged to audit the accompanying financial statements of the Korporata Energjetike e Kosoves (further referred to as "the Company" or "KEK") as of and for the year ended 31 December 2005 and included on pages 5 to 23. These financial statements are the responsibility of the Company's management.

The financial statements of the Company as of and for the year ended 31 December 2004 were audited by another auditor whose report dated 13 July 2005 expressed qualified opinion on those statements in respect of the stock's quantities and related provision for obsolescence, than in respect of the provision for impairment loss of the property, plant and equipment, and in respect of the accuracy of the estimate for the pension fund liabilities and related disclosures.

We did not observe the counting of the physical inventories as of 31 December 2005, since that date was prior to the time we were initially engaged as auditors for the Company. Owing to the nature of the Company's records, we were unable to satisfy ourselves as to inventory quantities by other audit procedures.

Furthermore and as it is disclosed in the Note 4 to the accompanying financial statements, at 31 December 2005, the Company's stock amounts 7,864 thousand Euros, net of provision for slow moving and obsolete items in the amount of 27,026 thousand Euros. The provision was initially established as of 31 December 2003 at a level of 80% from the stock balance at that date and is based on management estimations. In the absence of systematic updated detailed analysis of slow – moving and obsolete stock, we were unable to obtain reasonable assurance as for the accuracy of the provision balance as of 31 December 2005.

As it is further disclosed in the Note 3 to the accompanying financial statements, at 31 December 2005, the net carrying value of Company's property, plant and equipment amounts 337,413 thousand Euros. Items of property, plant and equipment are carried at their revalued amounts less subsequent accumulated depreciation. Revaluation was accounted for in the Company's accounts based on valuation performed by independent qualified valuers, the effective date of which was 31 December 2002. As of 01 January 2005, the Company has carried another independent valuation, the results of which showed that the net carrying value of the property, plant and equipment exceeds their fair market value by 101,886 thousand Euros. The Company did not recognize any provision for impairment of its property, plant and equipment based upon the results of the independent valuation, both as of 01 January 2005 and 31 December 2005. Accordingly, we were not able to obtain reasonable assurance as to the carrying amount of the Company's property, plant and equipment at the balance sheet date.

Furthermore and at the balance sheet date, the ownership status over the majority of the Company's property, plant and equipment is still unresolved and uncertainties exist in respect of possible future ownership claims.

As it is further disclosed in the Note 5 to the accompanying financial statements, at 31 December 2005, the balance of the outstanding trade and other receivables amounts 34,112 thousand Euros, net of provision for impairment amounting 237,647 thousand Euros. We were not able to verify the accuracy of the trade debtor's balance, applying standard and alternative audit procedures, as of the balance sheet date. Furthermore and due to the lack of sufficient appropriate analysis for the recoverability of the trade debtor's balance, we were not able to satisfy ourselves for the adequacy of the impairment provision balance as of 31 December 2005.

As it is further disclosed in the Note 10 to the accompanying financial statements, at 31 December 2005, the balance of the Company's pension fund liabilities amounts 19,959 thousand Euros. These are initially accounted for in the Company's accounts based upon independent actuarial valuation as of 31 December 2004. Currently, a new actuarial valuation has been undertaken for the purpose of determining the pension fund liabilities as of 31 December 2005. Since the final outcome of this valuation, as of the date of this report, is still not determined, the balance of the Company's pension fund liabilities as of 31 December 2005 cannot be considered finalized. Accordingly, we were unable to satisfy ourselves as to the accuracy of the pension liability's balance at the balance sheet date.

As it is disclosed in the Note 11 and further in the Note 21 to the accompanying financial statements, at 31 December 2005, included in the total outstanding trade and other payables, the amount of 26,334 thousand Euros represents the balance of the Company's VAT payables. The Company calculated and paid its VAT liabilities, for the fiscal year ended 31 December 2005, based on collected cash from its customers. This is not in compliance with the related VAT regulation in Kosovo, which requires outgoing VAT to be calculated based upon the total consideration payable for the taxable supply. Furthermore, the Company's VAT records and accounts have been inspected for various periods. There is no written exemption issued to date by the local tax authorities, justifying the method applied by the Company, as well as any formal documentation of the status of Company's VAT payables. Hence there is a risk that the Company's VAT payables can be higher and penalties and interest can be applied for late payment. Accordingly, we were not able to obtain reasonable assurance as to the accuracy of the balance of VAT payables at 31 December 2005.

Due to the matters discussed in the preceding paragraphs, we are not in the position to and we do not express an opinion on the Company's financial statements as of and for the year ended 31 December 2005.

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

As it is disclosed in the Note 2 to the accompanying financial statements, these financial statements have been prepared on the assumption that the Company will continue as a going concern. Currently, the Company's operations are largely dependent and supported by various grant funds. Management considers that sufficient outside funds will be also available in the forcible future so as to enable the Company to continue with its business operations.

Furthermore, various legal actions and claims may be asserted in the future against the Company based upon possible long – term obligations that existed prior to the establishing of UNMIK administration on the territory of Kosovo. At the date of issuance of these financial statements, the outcome of these matters cannot be determined with sufficient reliability and no provision has been recognized regarding such long – term obligations at the balance sheet date.

As it is disclosed in the Note 24 to the accompanying financial statements, subsequent to the balance sheet date and up to the issuance of these financial statements, the Company is in the final stage of transformation process of its business operations into two new holding companies – KEK JSC and Transco JSC, the legal incorporation of which, is expected to be completed by the end of 2006.

Grant Thornton,

Skopje,
07 September 2006

Balance sheet

	Notes	2005	2004
		(Amounts in 000 Euros) At 31 December	
Assets			
Non-current assets			
Property, plant and equipment	**3**	**337,413**	351,737
		337,413	351,737
Current assets			
Inventories	**4**	**7,864**	6,537
Trade and other receivables	**5**	**34,112**	32,711
Cash and cash equivalents	**6**	**38,369**	11,356
		80,345	50,604
Total assets		**417,758**	402,341
Shareholders' equity			
Share capital	**7**	**675,485**	675,485
Accumulated (losses)		**(482,392)**	(443,455)
Total shareholders' equity		**193,093**	232,030
Liabilities			
Non – current liabilities			
Borrowings	**8**	**10,000**	-
Deferred income from grants	**9**	**107,119**	102,251
Pension fund liabilities	**10**	**16,939**	20,214
		134,058	122,465
Current liabilities			
Trade and other payables	**11**	**68,158**	40,390
Accrued expenses	**12**	**22,449**	7,456
		90,607	47,846
Total liabilities		**224,665**	170,311
Total liabilities and shareholders' equity		**417,758**	402,341

These financial statements have been approved by the Board of Directors on September 6, 2006 and signed on its behalf by,

Mr. Paul Nellis
(signed)
Chairman of the Board of Directors

Mr. Timothy Murphy
(signed)
Executive Director Finance

Statement of income

	Notes	(Amounts in 000 Euros) Years ended 31 December 2005	2004
Operating income			
Energy revenues	**13**	**112,284**	106,034
Other operating income		**1,452**	2,190
		113,736	108,224
Operating (expenses)			
Depreciation	**3**	**(33,100)**	(33,866)
Staff costs	**15**	**(38,646)**	(39,283)
Energy purchases	**16**	**(33,220)**	(35,615)
Maintenance	**17**	**(4,162)**	(25,930)
Materials and consumables		**(13,257)**	(16,039)
Other operating expenses	**18**	**(19,923)**	(15,512)
Provision for doubtful accounts	**5**	**(57,307)**	(60,714)
(Loss) from operations		**(85,879)**	(118,735)
Grants	**14**	**46,679**	78,660
Financial result, net	**19**	**263**	85
(Loss) before tax		**(38,937)**	(39,990)
Income tax	**20**	**-**	-
(Loss) for the year		**(38,937)**	(39,990)

Statement of changes in equity

(Amounts in 000 Euros)

	Share capital	Accumulated (Losses)	Total
At 01 January 2004	**675,485**	**(445,205)**	**230,280**
Correction of impairment of granted assets (Note 9)	-	41,740	41,740
Net (loss) for the year	-	(39,990)	(39,990)
At 31 December 2004 / 01 January 2005	**675,485**	**(443,455)**	**232,030**
Net (loss) for the year	-	(38,937)	(38,937)
At 31 December 2005	**675,485**	**(482,392)**	**193,093**

Statement of cash flows

	Notes	(Amounts in 000 Euros) Years ended 31 December 2005	2004
Operating			
Net loss before income tax		**(38,937)**	(39,990)
Adjustments for:			
Depreciation	**3**	**33,100**	33,866
Grants	**14**	**(46,679)**	(78,660)
Write off of property, plant and equipment	**3**	**441**	611
Operating (loss) before working capital changes		***(52,075)***	*(84,173)*
Changes in operating assets and liabilities:			
Inventory	**4**	**(1,327)**	1,410
Trade and other receivables	**5**	**(1,401)**	13,248
Trade and other liabilities	**10,11,12**	**39,486**	10,355
		(15,317)	(59,160)
Investing			
Acquisition of property, plant and equipment	**3**	**(19,217)**	(22,493)
		(19,217)	(22,493)
Financing			
Grants received	**9**	**51,547**	88,963
Loan received	**8**	**10,000**	-
		61,547	88,963
Net change in cash and cash equivalents		**27,013**	7,310
Cash and cash equivalents at beginning	**6**	**11,356**	4,046
Cash and cash equivalents at end	**6**	**38,369**	11,356

Notes to the financial statements
31 December 2005

1 General

Korporata Energjetike e Kosoves ("the Company" or "KEK") was established in the year 1999 by the United Nations Mission Interim in Kosovo (UNMIK) in accordance with Regulation No. 1999/12 and commenced its operation in June, 1999.
The address of its registered head office is as follows: Mother Teresa Street No.36, 10 000 Prishtina, Kosovo. The total number of Company's employees at 31 December 2005 is 8,353 persons (2004: 8,476 persons).

The Company is a publicly owned legal entity, administered by Kosovo Trust Agency (KTA) since June 2002.

The Company's principal activities are generation, transmission and distribution of electricity, as well as mining activities on extraction of lignite used in its thermal power plants.

KEK's operational structure consists of the corporate headquarters and the following divisions:

- Coal Production Division;
- Electricity Production Division;
- Transmission and dispatch Division;
- Network Division;
- Supply Division;
- Human Resources Division;
- Business Support Division;
- Corporate Services and
- Internal Audit Office.

2 Accounting policies

Following are the principal accounting policies adopted in the preparation of these financial statements:

Basis of preparation

These financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements have been prepared under the historical cost convention, as modified by the revaluation of the property, plant and equipment.

Preparation of these financial statements requires usage of estimates and assumptions, that have an effect on the disclosed amounts of assets and liabilities, further on, on disclosures related to contingent assets and liabilities as of the financial statements date, as well as on the disclosed amounts of revenues and costs during the reporting period. Besides the fact that these estimates are based on the best judgment of ongoing events and activities made by the Company's Management, the achieved results might, eventually, differ from such estimates.

Estimations made are evaluated continuously and are based on historical experience and other factors, including the expectations of future events believed to be reasonable within the given circumstances.

These financial statements are prepared for the years ended 31 December 2005 and 2004. Current and comparative data are expressed in thousands of Euros (000 EUR) unless otherwise stated. Where necessary, comparative figures have been adjusted to conform with changes in presentation for the year.

These financial statements have been prepared on the assumption that the Company will continue as a going concern. The Company’s operations are largely dependent and supported by various grant funds. Management considers that sufficient outside funds will be also available in the forcible future so as to enable the Company to pay its debts as they fall due and do not reflect the adjustments, which would be required to the value of assets and maturity of liabilities if this were not the case.

Foreign currency transactions

Foreign currency transactions are translated into the reporting currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

Property, plant and equipment

Property, plant and equipment originated in the periods prior to 31 December 2002 – the effective date of revaluation, are carried at revalued amounts, determined by external independent valuers, less subsequent depreciation. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset. All other property, plant and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset’s carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Property, plant and equipment (continued)
Increases in the carrying amount arising on revaluation of items of property, plant and equipment are credited to the reserves within the shareholders' equity. Decreases that offset previous increases of the same asset are charged against other reserves directly in equity; all other decreases are charged to the income statement. Each year the difference between depreciation based on the revalued carrying amount of the asset charged to the income statement and depreciation based on the asset's original cost is transferred from 'other reserves' to 'retained earnings'.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

Buildings	20 – 50 years
Machinery	10 – 15 years
Vehicles	6 – 7 years
Furniture, fittings and equipment	5 – 7 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement. When revalued assets are sold, the amounts included in other reserves are transferred to retained earnings.

Impairment of non – financial assets
Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

Financial assets and liabilities
Financial assets and liabilities carried on the balance sheet include cash, cash equivalents, receivables and liabilities. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies included in this note. The Company classifies its financial instruments as assets, liabilities or equity in accordance with the substance of the related contractual arrangement. Interest, gains and losses relating to financial instruments classified as assets or liabilities are reported as income or expense, respectively. Financial instruments are offset when the Company has a legally enforceable right to offset and intends to settle either on a net basis or to realize the asset and settle the liability simultaneously.

Fair value of financial assets and liabilities. The carrying amounts reflected in the accompanying balance sheets of cash and cash equivalents, receivables and current liabilities approximate their respective fair values due to the relatively short-term maturity of these financial instruments.

Financial risk management
Credit risk. The Company has no significant concentrations of credit risk with any single counter party. The maximum exposure to credit risk is represented by the carrying amount of each asset in the balance sheet.

Market risk. The Company has no entered into any hedging transactions to cover its exposure to price movements arising from the purchases of energy.

Interest rate risk. The Company does not enter into interest rate currency swap contracts since it does not have any interest bearing loans denominated in foreign currency.

Inventories
Materials and spare parts – Materials and spare parts principally relate to power plant, transmission and distribution network maintenance and are valued at the lower of cost and net realizable value, the cost being determined using the weighted average method. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Materials and spare parts are expensed or capitalized to plant, as appropriate, when installed. A provision for slow moving materials and spare parts is accounted for the financial statements.

Lignite – The Company extracts its coal, which is used in the production process for the generation of electricity at its thermal power plants, from the two mines it operates. Lignite stocks are stated at cost, which comprises direct costs of extraction and an appropriate portion of those overheads that have been incurred in extracting it.

Trade and other receivables
Trade receivables are carried at invoiced amounts less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the trade receivable is impaired.

Cash and cash equivalents
Cash and cash equivalents comprise cash at bank and in hand. For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

Share capital
The Company is publicly – owned legal entity without shares.

Borrowings
Borrowings, consisting of long-term non – interest bearing loans granted by the Kosovo Consolidated Budget, are carried at the proceeds received, net of transaction costs incurred.

Income tax
Income tax expense represents the sum of the tax currently payable and deferred tax.
The tax currently payable is calculated and paid in accordance with UNMIK regulation No. 2002/3. Final tax on profit at a rate of 20% are payable based on the annual profit shown in the statutory statement of income as adjusted for items, which are non-assessable or disallowed. According to the current tax legislation, Tax losses may be carried forward to be set of the next five years following the year in which the tax loss was incurred.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used in determination of deferred income tax. Deferred tax is charged or credited in the income statement except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

The Company has not recognized any deferred tax liability or asset at 31 December 2005 and 2004, as there are no temporary differences existing at those dates.

Post-retirement benefits and severance payments
The Company operates a defined benefit pension scheme providing pensions to employees. The cost of providing benefits under the scheme is determined using the projected unit credit actuarial valuation method. Actuarial gains and losses, resulting from changes in actuarial assumptions, are recognized as income or expense immediately.

Government grants
Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.
Government grants relating to costs are deferred and recognized in the income statement over the period necessary to match them with the costs that they are intended to compensate.
Government grants relating to the purchase of property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to the income statement on a straight-line basis over the expected lives of the related assets.

Provisions
A provision is recognised when the Company has a present obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of provision is the present value of the expenditures expected to be required to settle the obligation.

Revenue and expense recognition
Revenue from sale of electricity comprises the invoiced value of electricity supplied. Billings for electricity sale are made every month within the first five (5) days of the month following the month in which the consumption of electricity was performed.

Operating expenses are recognised in the income statement upon utilisation of the service or at the date of the origin.

Commitments and contingencies

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognized in the financial statements but disclosed when an inflow of economic benefits is probable. The amount of a contingent loss is recognized as a provision if it is probable that future events will confirm that, a liability incurred as at the balance sheet date and a reasonable estimate of the amount of the resulting loss can be made.

Subsequent events

Post-year-end events that provide additional information about a company's position at the balance sheet date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

(All amounts are expressed in thousands of Euros, unless otherwise stated)

3 Property, plant and equipment

	Land	Land in mines	Buildings	Equipment	Construction in progress	Total
At 31 December 2004						
Cost or Revaluation	45,248	3,140	109,890	259,114	8,669	426,061
Accumulated Depreciation	-	(796)	(23,690)	(49,838)	-	(74,324)
Net carrying amount	45,248	2,344	86,200	209,276	8,669	351,737
Year ended 31 Dec.2005						
Opening net carrying amount	45,248	2,344	86,200	209,276	8,669	351,737
Additions	-	17	5,207	8,368	5,625	19,217
Disposals	-	-	(30)	(402)	(9)	(441)
Internal transfers	-	-	3,570	1,864	(5,434)	-
Depreciation for the year	-	(398)	(7,757)	(24,945)	-	(33,100)
Closing net carrying amount	45,248	1,963	87,190	194,161	8,851	337,413
At 31 December 2005						
Cost or Revaluation	45,248	3,157	118,637	268,944	8,851	444,837
Accumulated Depreciation	-	(1,194)	(31,447)	(74,783)	-	(107,424)
Net carrying amount	**45,248**	**1,963**	**87,190**	**194,161**	**8,851**	**337,413**

Items of property, plant and equipment subject to initial revaluation as of 31 December 2002, are shown in the Company's register at revalued amounts, net of any accumulated depreciation. Land is valued at estimated market price at the date of valuation at overall rate of 2.5 Euros per square meter.

Subsequent to initial revaluation effective 31 December 2002 and included in the Company's books, as of 01 January 2005, the Company has undertaken another independent appraisal of its property, plant and equipment. The results of this valuation showed that the carrying value of the property, plant and equipment, at the date of valuation, exceeds their fair market value by 101,886 thousand Euros. The Company did not recognize any provision for impairment of its property, plant and equipment based upon the results of the independent valuation, both as of 01 January 2005 and 31 December 2005.

Included into total amount of additions for 2005, the amount of 14,704 thousand Euros relate to items of property, plant and equipment received through Grant (see Note 9). The related depreciation charge, which refers to these assets in amount of 9,836 thousands Euros is presented in income statement account also as amortization of deferred grants (see Note 9 and 14).

There are no items of property, plant and equipment, pledged as guarantee on funds borrowed, as of the balance sheet date.

Currently, the Company is in the process of establishing ownership title over the majority of its properties.

4 Inventories

(All amounts are expressed in thousands of Euros, unless otherwise stated)

	2005	2004
Materials and consumables	**24,107**	23,597
Lignite	**733**	919
Fuel	**2,372**	1,925
Spare parts	**4,170**	3,941
Other	**3,508**	3,853
	34,890	34,235
Provision for slow moving and obsolete stock	**(27,026)**	(27,698)
	7,864	6,537

The provision for slow moving and obsolete items of stock was initially established at a level of 80% from the stock balance as of 31 December 2003 (excluding lignite and fuel inventories) and is based on management estimations. No updated systematic and detailed analysis has been made to support the appropriateness of the provision established as of the balance sheet date.

5 Trade and other receivables

	2005	2004
Trade receivables		
Domestic trade receivables	**266,838**	206,457
Foreign trade receivables	**131**	2,672
	266,969	209,129
Less: Provision for impairment	**(237,647)**	(180,340)
	29,322	28,789
Other current receivables		
Advances from suppliers	**4,512**	1,984
Receivables from employees	**277**	244
Excise tax refundable	**1**	1,163
Other	**-**	531
	4,790	3,922
	34,112	32,711

The Company's provisioning policy is based on ageing structure of the outstanding balance of its trade receivables, applying certain pre – determined percentages for calculation of the impairment provision as follows:

Period	Percentage
Up to 30 days	0%
30 to 60 days	25%
60 – 90 days	75%
Over 90 days	100%

The movement in the impairment provision is as follows:

	2005	2004
Balance, 01 January	**180,340**	127,829
Charge for the year	**57,307**	60,714
Less: write offs	**-**	(8,203)
Balance, 31 December	**237,647**	180,340

6 Cash and cash equivalents

	2005	2004

Current accounts with Banks	**38,359**	11,304
Cash on hand	**10**	52
	38,369	11,356

Current accounts with banks are non – interest bearing.

7 Share capital

The Company is registered with the Provisional Business Registration issued by the UNMIK administration dated October 06 2000 under Reg.No. 80248059.

The initial capital, set at EUR 675,485 thousand, was calculated by taking the sum of the carrying value of the capital accounts per Company's statutory records at the date of its establishment.

Following the process of legal and operational transformation of the Company and according to the amended UMNIK Reg.No. 2005/12, during the end of 2005, two new legal entities, organized as a joint stock companies, were incorporated - Kosovo Energy Corporation (KEK) JSC and Transmission System and Market Operator (Transco) JSC.

As of 27 December 2005, KEK JSC was registered with Business Reg.No. 70325399.

8 Borrowings

During 2005, the Company has borrowed loan facilities in amount of 10,000 thousands Euros for the purpose to finance its business activities and operation. Loan was provided by Kosovo Consolidated Budget, with maturity no lather than 31 December 2008. The loan is non – interest bearing and no property were pledged as a collateral of these funds.

9 Deferred income from grants

Deferred income relates to grants donated by the European Agency for Reconstruction and Kosovo Trust Agency during the years ended 31 December 2005 and 2004 for the reconstruction of the power network.

Movement in the deferred income from grants is as follows:

	2005	2004
Balance, 01 January	**102,251**	133,688
Additions in property, plant and equipment (Note 3)	**14,704**	20,170
Impairment of assets received under grants	**-**	(41,740)
Amortized during the year (Notes 3 and 14)	**(9,836)**	(9,867)
Balance, 31 December	**107,119**	102,251

Deferred income from grants (continued)

Following are grant components received during the years ended 31 December 2005 and 2004:

(All amounts are expressed in thousands of Euros, unless otherwise stated)

	2005	2004
Property, plant and equipment (Note 3)	**14,704**	20,170
Income for recovering operating expenses (Note 14)	**19,929**	52,035
Income for working capital requirements (Note 14)	**16,914**	16,758
	51,547	88,963

10 Employee benefits, Pensions and other Post employment benefits

Retirement, Disability and/or Death Pension Find is a pension fund for early retired, disables and beneficiaries of missing employees of KEK or to beneficiaries of former employees who died in line of duty. The pension provided under this Plan is a Defined Benefit Pension with limited number of year's entitlement.

The following are the eligible participants in the Plan:
- *Category A*: Those whose employment is terminated because they have reached age 60 or completed 35 years of service with KEK and have or do not have a benefit entitlement agreement with KEK (monthly pension of EUR 105);
- *Category B*: Employees who have terminated their employment by reason of a qualifying disability and have an existing pension Benefit entitlement agreement with KEK, or those that may suffer a qualifying disability (monthly pension of EUR 105);
- *Category C*: The beneficiaries of former employees who have died in line of duty (monthly pension of EUR 295);
- *Category D*: Beneficiaries of missed former employees (monthly pension of EUR 153); and
- *Category E*: Beneficiaries of former employees who died during the 1999 conflict (EUR 100).

Retirement benefits: Employees are entitled to a lump-sum payment upon retirement. The retirement benefit is equal to 3 monthly salaries. In the case of early retirement, the retirement benefit is equal to 5 monthly salaries.

Disability Benefits: Employees are entitled to disability benefits, when they are no longer able to work due to sickness or accident, upon medical verification of the disability that entitles them to disability benefits from social security. The disability benefit is equal to 2 monthly salaries.

Death Benefits: The death benefit is paid in the case of death of an employee or his/her family member. The benefit is equal to 2 monthly salaries or 4 monthly salaries in the case of death in the workplace.

The Company engaged an actuary to evaluate the present value of outstanding pension obligations, as of 31 December 2004 and 2003, but the scope did not extend to the evaluation of the plan assets.

The following assumptions were used in the calculations:
Discount rate 4,5%
Rate of salary increase 3%
Rate of fixed pension benefit increase 0%
Expected long-term rate of return on plan assets 0%
Normal retirement age is of 60 and pension payments made for 60 months only.

Employee benefits, Pensions and other Post employment benefits (continued)

(All amounts are expressed in thousands of Euros, unless otherwise stated)

As of the date of this report, an independent actuarial valuation is in the process of performing, the preliminary results of which are still unknown.

The amount arising from KEK's obligation in respect of its defined benefit plan as at 31 December is as follows:

	2005	2004
Present value of funded obligation	**19,959**	24,712
Fair value of plan assets	**-**	(1,733)
	19,959	22,979

At 31 December 2005 and 2004, the total pension fund liability is divided in long-term and short-term portion as follows:

	2005	2004
Long-term portion	**16,939**	20,214
Current portion (Note 12)	**3,020**	2,765
	19,959	22,979

11 Trade and other payables

	2005	2004
Trade creditors		
Domestic supliers	**12,048**	8,267
Foreign supliers	**6,443**	3,440
	18,491	11,707
Other current liabilities		
Advances received	**377**	593
Salaries related liabilities	**3,085**	3,222
VAT payables	**26,334**	22,417
Excise	**1,186**	1,186
Broadcasting tax	**17,827**	415
Other	**858**	850
	49,667	28,683
	68,158	40,390

VAT payables, the balance of which, at 31 December 2005, amounts 26,334 thousand Euros, are calculated and paid based on collected cash from customers. The related local VAT regulation requires outgoing VAT to be calculated based upon the total consideration payable for the taxable supply.

12 Accrued expenses

	2005	2004
Accrued liabilities for pension fund (Note 10)	**3,020**	2,765
Accrued concession fees	**6,354**	4,691
Obligation from means for Investment A3	**9,740**	-
Other	**3,335**	-
	22,449	7,456

13 Sales

	2005	2004
Electric power sold		

Notes to the financial statements (continued)
As of and for the years ended 31 December 2005 and 2004
(All amounts are expressed in thousands of Euros, unless otherwise stated)

Consumers (10 kV, 35 kV and 0,4kV)	**32,905**	33,119
Industrial customers	**3,131**	2,672
Householders	**64,322**	67,326
Export of electricity	**5,132**	-
	105,490	103,117
Other		
Sales of coal	1,484	581
Other income	5,310	2,336
	6,794	2,917
	112,284	106,034

14 Grants

	2005	2004
Income for recovering operating expenses (Note 9)		
Electricity imported	**10,433**	15,818
Repairs and maintenance	**4,282**	19,173
Other	**5,214**	17,044
	19,929	52,035
Working capital requirements (Note 9)	**16,914**	16,758
Released from deferred income from grants (Note 3)	**9,836**	9,867
	46,679	78,660

15 Staff cost

	2005	2004
Net salaries	**32,066**	30,099
Contributions and tax	**5,677**	4,864
Increase in pension fund liability	**-**	3,567
Other	**903**	753
	38,646	39,283

16 Energy purchased

	2005	2004
Electricity	**19,880**	26,006
Liquid fuel	**8,837**	8,149
Gas and water	**1,198**	1,460
Exchange of electric power	**3,305**	-
	33,220	35,615

17 Maintenance

	2005	2004

(All amounts are expressed in thousands of Euros, unless otherwise stated)

Repairs	**2,328**	24,748
Current maintenance	**1,834**	1,182
	4,162	25,930

18 Other operating expenses

	2005	2004
Management fee	**5,937**	2,226
Insurance expenses	**2,423**	1,810
Damages	**2,478**	168
Transport services	**2,013**	581
Marketing	**66**	17
Other expenses	**7,006**	10,710
	19,923	15,512

19 Financial result, net

	2005	2004
Interest income on overdue balances	**276**	85
Interest expense on delayed payments	**(13)**	-
Total financial income, net	**263**	85

20 Income tax

The charge for the year can be reconciled to the profit per 2005 and 2004 income statements as follows:

	2005	2004
Loss from operating activities before income tax	**(38,937)**	(39,990)
Tax at statutory income tax rate of 20%	**7,787**	7,998
Tax on expenditure not allowable for income tax purposes	**-**	(1,041)
Tax on income not taxable for income tax purposes	**-**	2,989
Unrecognized tax losses carries forward	**-**	(9,946)
	-	-

Commencing 01 April 2002 and in accordance with UNMIK Reg.No. 2002/3, the Company is required to pay tax at a rate of 20% on the taxable profit as calculated under this regulation.

Tax losses may be carried forward to be set of the next five years following the year in which the tax loss was incurred. During 2005 and 2004 the Company has incurred tax losses. No provision for deferred tax on past losses or timing differences has been made due to the uncertainty as to when or if the Company will start to earn taxable profits.

21 Contingencies and commitments

Litigations

At 31 December 2005, legal proceedings raised against the Company amount in total 6,531 thousand Euros (2004: 5,267 thousand Euros). No provision has been made as of the balance sheet date, as professional advice indicates that it is unlikely that any significant loss will arise.

Long – term debt
Various legal actions and claims may be asserted in the future against the Company based upon possible long – term obligations that existed prior to the establishing of UNMIK administration on the territory of Kosovo. At the date of issuance of these financial statements, the outcome of these matters cannot be determined with sufficient reliability and no provision has been recognized regarding such long – term obligations at the balance sheet date.

Mineral rights
The Company has received an exploration license over the current mining areas and for exploration license over a new mining area is still in ongoing procedure. It is likely that the granting of the exploitation license for new mine will be accompanied by conditions requiring the rehabilitation and removal of contaminated materials. Work will be undertaken during the next years to evaluate the extent of this problem however it represents a potential liability which has not been accounted for in these financial statements.

Tax liabilities
Company's books and records have been audited by the tax authorities for income tax and VAT purposes in a number of occasions in respect of various fiscal periods. No formal determination has been issued by the tax authorities in respect of additional taxes and/or penalties were imposed. Hence, the tax liabilities may not be considered finalized and additional taxes and/or penalties might be imposed during future audits.

Commitments
KEK plans to develop a new coalmine, which would require the relocation of occupants of approximately 400 houses in Hade village. The amount estimated to be paid for such relocation is approximately Euro 36 million.

22 Mineral reserves

The Company has made an estimation of the reserves and resources within its historical license areas at the end of 2003. The relevant governmental authority, the Directorate of Mines and Minerals, has confirmed these.

The Company has applied for an exploration license over a new area of 834 hectares that extends to the north of the existing mines. This has not yet been granted but the application secures the Company's rights to the reserves in the area, which are considered to be approximately 700 million tonnes of exploitable lignite. A feasibility study will be carried out to demonstrate the economic viability of extracting these reserves and this will be used to apply for an extraction license.

23 Technological losses

In its operations the Company incurs substantial technical and trade losses of electrical power. Technical losses arise upon transmission of electrical power as well as from one voltage to another.

Trade losses represent electricity consumed by customers, which the Company fails to identify and invoice. Management estimates total technological losses of electric power, for the year ended 31 December 2005, to amount 50.9 % of the total electricity supplied.

24 Subsequent events

Subsequent to the balance sheet date and prior to the issuance of these financial statements, the Company is still in the process of transforming its business activities toward the newly incorporated holding companies – KEK JSC and Transco JSC. The management expects that the whole process will be completed during 2006.