



Financial statements and Independent Auditors' Report

Kosovo Energy Corporation J.S.C.

31 December 2007

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# Independent Auditors' Report

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To the Management and shareholders of

Kosovo Energy Corporation J.S.C.

We have audited the accompanying financial statements of the Kosovo Energy Corporation J.S.C. (further referred to as "the Company" or "KEK") which comprise of the Balance sheet as at 31 December 2007, and the Statement of income, Statement of changes in equity and Statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes, included on pages 5 to 26.

### *Management's responsibility for financial statements*

The management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### *Auditor's responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. Except as disclosed in the following paragraphs, we conducted our audit in accordance with the International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Basis for qualified opinion*

As it is disclosed in Note 4 to the accompanying financial statements, at 31 December 2007, the net carrying value of Company's property, plant and equipment amounts EUR 212,652 thousands. The Company's property, plant and equipment are carried at their cost or valuation less accumulated depreciation and accumulated impairment losses. The balance of impairment provision account at 31 December 2007 amounts to EUR 134,281 thousands. As it is disclosed in Note 2.5 to the accompanying financial statements, the accounting policy adopted in respect of the impairment provision on assets subject to depreciation, requires from the management to perform "impairment" test on an annual basis. We were not able to assure ourselves that such test has been performed over the significant items of Company's property, plant and equipment as of the balance sheet dates. Therefore, we were not able to satisfy ourselves with the net carrying amount of the Company's property, plant and equipment as at 31 December 2007.

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 to possible future ownership claims.

As it is further disclosed in Note 6 to the accompanying financial statements, at 31 December 2007, the Company's stock amounts EUR 11,357 thousands, net of provision for slow moving and obsolete items in the amount of EUR 26,461 thousands. Such provision was initially recognized in the Company's accounts as of 01 January 2005 and remained unchanged up to the date of this report. There is no updated detailed analysis of the Company's slow – moving and obsolete stock performed as of 31 December 2007. Therefore, we were unable to obtain reasonable assurance for the appropriateness of the stock provision balance as of 31 December 2007.

As it is further disclosed in Note 7 to the accompanying financial statements, at 31 December 2007, included into the total Company's trade and other receivables, the balance of trade receivables amounts to EUR 17,241 thousands, net of provision for impairment amounting EUR 265,937 thousands. We were not able, applying standard and alternative audit procedures, to verify the existence and validity of this balance as of the balance sheet date.

As it is further disclosed in the Note 12 to the accompanying financial statements, at 31 December 2007, the balance of provision for ash dumps amounts EUR 30,000 thousands. The provision was initially established as of 01 January 2005 based on the results from the financial due diligence performed by independent accountants. Owing to the lack of sufficient appropriate analysis supporting the amount accounted for, we were unable to obtain reasonable assurance as for the appropriateness of the provision balance as of 31 December 2007.

As it is further disclosed in Notes 2.4 and 2.15 to the financial statements, the major part of the total depreciation charge recognized in the Company's current profit & loss relates to items of property, plant and equipment existing at 01 January 2005 (the opening balance sheet date) which are carried in the Company's accounts at their appraised values determined by the independent professional valuers.

For taxation purposes, the Kosovo Income Tax regulation requires the use of historical cost as a basis for calculating the depreciation charge. According to the accepted accounting framework, the difference between the carrying amounts of the items of property, plant and equipment and their tax base represents taxable or deductible temporary difference, thus creating deferred tax liabilities / assets and accordingly deferred tax expense / benefit.

The Company has not recognized any deferred tax liabilities or assets and accordingly deferred tax expense or benefit in its financial statements as of and for the year ended 31 December 2007 neither and due to the lack of sufficient reliable evidence we were not able to make our own assessments.

*Opinion*

In our opinion, except for the matters discussed in the preceding paragraphs, the financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2007, and its financial performance, changes in equity and its cash flows for the year then ended in accordance with the International Financial Reporting Standards.

*Emphasis of matter*

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

As it is disclosed in the Note 2.1 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 foreseeable future so as to enable the Company to continue with its business operations.



**Grant Thornton,**

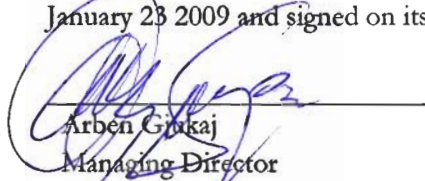
Skopje,  
February 03 2009

Financial statements  
31 December 2007

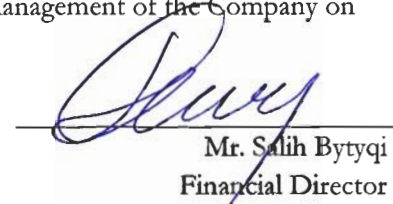
## Balance sheet

	Notes	At 31 December 2007	(000 EUR) At 31 December 2006
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	4	212,652	210,922
Other intangible assets	4	109	56
		<b>212,761</b>	<b>210,978</b>
<b>Current assets</b>			
Inventories	6	11,357	11,623
Trade and other receivables, net	7	34,879	23,422
Cash and cash equivalents	8	4,903	9,901
		<b>51,139</b>	<b>44,946</b>
<b>Total assets</b>		<b>263,900</b>	<b>255,924</b>
<b>Equity and liabilities</b>			
<b>Equity</b>			
Share capital	9	25	25
Reserves		687,794	687,794
Accumulated (Losses)		(601,435)	(565,266)
<b>Total equity</b>		<b>86,384</b>	<b>122,553</b>
<b>Liabilities</b>			
<b>Non – current liabilities</b>			
Borrowings	10	10,000	10,000
Deferred grants	11	54,724	32,565
Provisions	12	30,000	30,000
		<b>94,724</b>	<b>72,565</b>
<b>Current liabilities</b>			
Borrowings	10	10,340	-
Trade and other liabilities	13	54,169	47,699
Accrued expenses	14	18,283	13,107
		<b>82,792</b>	<b>60,806</b>
<b>Total liabilities</b>		<b>177,516</b>	<b>133,371</b>
<b>Total equity and liabilities</b>		<b>263,900</b>	<b>255,924</b>

These financial statements have been approved by the Board of Management of the Company on January 23 2009 and signed on its behalf by,

  
Arben Gjakaj  
Managing Director

06.04.2009

  
Mr. Salih Bytyqi  
Financial Director

06.04.2009

See accompanying notes to the financial statements

Financial statements  
31 December 2007

## Income statement

	Notes	(000 EUR)	
		Year ended 31 December 2007	2006
<b>Operating income</b>			
Sales	15	133,292	117,632
Other operating income	16	5,512	20,011
Income from grants	17	16,982	16,977
		<b>155,786</b>	<b>154,620</b>
<b>Less: Operating (expenses)</b>			
Depreciation	4	(26,228)	(26,854)
Staff costs	18	(41,687)	(41,171)
Electricity and other utilities	19	(69,802)	(43,020)
Maintenance costs	20	(5,221)	(6,214)
Materials and supplies		(11,921)	(15,009)
Loss from impairment of receivables	7	(21,725)	(30,101)
Other operating expenses	21	(15,390)	(18,501)
<b>(Loss) from operations</b>		<b>(36,188)</b>	<b>(26,250)</b>
Financial income	22	249	280
Financial (expenses)	22	(325)	(4)
<b>(Loss) before tax</b>		<b>(36,264)</b>	<b>(25,974)</b>
Income tax expense	23	-	-
<b>(Loss) for the year</b>		<b>(36,264)</b>	<b>(25,974)</b>

See accompanying notes to the financial statements

Financial statements  
31 December 2007

## Statement of changes in equity

	Share Capital	Reserves	Accumulated (losses)	(000 EUR) Total
At 01 January 2006	25	738,337	(568,855)	169,507
(Loss) for the year	-	-	(25,974)	(25,974)
Transfer of assets to KOST (see Notes 4, 5 and 8)	-	(50,915)	29,345	(21,570)
Disposal of assets (see Note 4)	-	(18)	218	200
Additionally identified assets (see Notes 4 and 8)	-	390	-	390
<b>At 31 December 2006</b>	<b>25</b>	<b>687,794</b>	<b>(565,266)</b>	<b>122,553</b>
At 01 January 2007	25	687,794	(565,266)	122,553
(Loss) for the year	-	-	(36,264)	(36,264)
Release of impairment on assets disposed off (see Note 4)	-	-	95	95
<b>At 31 December 2007</b>	<b>25</b>	<b>687,794</b>	<b>(601,435)</b>	<b>86,384</b>

See accompanying notes to the financial statements



Financial statements  
31 December 2007

## Statement of cash flows

	Notes	(000 EUR)	
		Year ended 31 December 2007	2006
<b>Operating</b>			
Net (loss) before income tax		<b>(36,264)</b>	<b>(25,974)</b>
<i>Adjusted for:</i>			
Depreciation		26,228	26,854
Income from grants		(16,982)	(16,977)
Allowance for bad and doubtful debts		21,437	29,756
Income from written off pension fund liabilities		-	(18,220)
Net carrying value of disposed assets		163	303
<i>Operating profit before working capital changes:</i>		<b>(5,418)</b>	<b>(4,258)</b>
<i>Changes in working capital:</i>			
Inventory		266	(4,211)
Trade and other receivables		(32,894)	(39,576)
Trade and other liabilities		11,646	7,263
		<b>(26,400)</b>	<b>(40,782)</b>
<b>Investing</b>			
Purchase of property, plant and equipment		(28,079)	(25,252)
		<b>(28,079)</b>	<b>(25,252)</b>
<b>Financing</b>			
Grants received		39,141	37,566
Loan received		10,340	-
		<b>49,481</b>	<b>37,566</b>
<b>Net change in cash and cash equivalents</b>		<b>(4,998)</b>	<b>(28,468)</b>
Cash and cash equivalents at beginning as stated		9,901	38,369
<b>Cash and cash equivalents at end</b>	<b>8</b>	<b>4,903</b>	<b>9,901</b>

See accompanying notes to the financial statements

# Notes to the financial statements

## **1 General**

Kosovo Energy Corporation J.S.C. (“the Company” or “KEK”) is shareholding Company incorporated in Kosovo and registered with the Provisional Business Registration under Reg.No. 70325399 dated December 27, 2005. The Company is founded following the transformation of the former Publicly Owned Enterprise “Korporata Energjetike e Kosoves” (“KEK”) and under the provisions of UNMIK Regulation No. 2001/6 from 8 February 2001. The address of its registered head office is: Mother Teresa Street No. 36, 10 000 Prishtina, Kosovo. The total number of the Company’s employees at 31 December 2007 is 7,499 (2006: 7,404 persons).

The Company’s initial registered capital amounts Euro 25 thousands. The Company’s books have been opened as of 01 January 2005 based on the Financial Due Diligence Report as at 01 January 2005 issued by the consortium consisting of Deloitte Central Europe Limited, Wolf Theiss and American Appraisal Hungary (the “Consortium”), as well as the results from the appraisal performed by independent qualified valuers - American Appraisal Hungary.

The Company is 100% subsidiary of Kosovo Energy Corporation Holding J.S.C.

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

The Company’s current operational structure consists of the corporate headquarters and the following divisions:

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

Notes to the financial statements (continued)  
Accounting policies (continued)

## **2 Accounting policies**

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

### **2.1 Basis of preparation**

These financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS). The financial statements have been prepared under the historical cost convention, modified for the presentation of the property, plant and equipment at their valuation.

Preparation of these financial statements requires use of estimates and assumptions that have an effect on the disclosed amounts of assets and liabilities, 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. Even though 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 as of and for the years ended 31 December 2007 and 2006. Current and comparative data are expressed in thousands of Euros (000 EUR) unless otherwise stated.

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 foreseeable 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.

### **2.2 Adoption of new and revised Standards**

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

#### *Standards, amendments and interpretations effective in 2007 but not relevant*

The following standards, amendments and interpretations to published standards are mandatory for accounting periods beginning on or after 1 January 2007 but they are not relevant to the Company's operations:

- IFRS 4 - Insurance contracts,
- IFRIC 7 - Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies,
- IFRIC 9 - Re-assessment of embedded derivatives.

Notes to the financial statements (continued)  
Accounting policies (continued)

Adoption of new and revised Standards (continued)

*Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company*

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the Company's accounting periods beginning on or after 1 January 2007, but the Company has not early adopted them:

- IAS 23 (Amendment) - Borrowing costs (effective from 1 January 2009). The Company will apply IAS 23 (Amended) from 1 January 2009 but is currently not applicable to the Company as there are no qualifying assets.
- IFRS 8 - Operating segments (effective from 1 January 2009). The Company will apply IFRS 8 from 1 January 2009. The expected impact is still being assessed in detail by management, but it appears likely that the number of reportable segments, as well as the manner in which the segments are reported, will change in a manner that is consistent with the internal reporting provided to the chief operating decision-maker.
- IFRIC 11 - IFRS 2 – Group and treasury share transactions (effective from 1 March 2007). IFRIC 12 is not relevant to the Company's operations because the Company does not have any share transaction.
- IFRIC 12 - Service concession arrangements (effective from 1 January 2008). IFRIC 12 is not relevant to the Company's operations because the Company does not provide for public sector services.
- IFRIC 13 - Customer loyalty programmes (effective from 1 July 2008). IFRIC 13 is not relevant to the Company's operations because the Company does not operate any loyalty programmes.
- IFRIC 14 - IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction (effective from 1 January 2008). The Company will apply IFRIC 14 from 1 January 2008, but it is not expected to have any impact on the Company's accounts.

### **2.3 Foreign currency transactions**

Foreign currency transactions are translated into the reporting currency using 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.

### **2.4 Property, plant and equipment**

Property, plant and equipment existing at 01 January 2005 – the effective date of valuation, are carried at valuation, determined by external independent valuers, less subsequent accumulated depreciation and accumulated provision for impairment. All other property, plant and equipment are stated at historical cost less accumulated depreciation. Historical cost includes expenditures that are directly attributable to the acquisition of the items.

Notes to the financial statements (continued)  
Accounting policies (continued)

Property, plant and equipment (continued)

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.

Increases in the carrying amount arising on the 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:

Land in mines	6 – 50 years
Buildings	10 – 50 years
Industrial Heavy Equipment	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 the 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.

## 2.5 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.

## 2.6 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.

Notes to the financial statements (continued)  
Accounting policies (continued)

### **2.7 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.

### **2.8 Trade and other receivables**

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, 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 the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments (more than 30 days overdue) are considered indicators that the trade receivable is impaired.

The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Assets with a short maturity are not discounted.

The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the income statement within 'selling and marketing costs'. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against 'selling and marketing costs' in the income statement.

### **2.9 Inventory**

**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.

### **2.10 Cash and cash equivalents**

Cash and cash equivalents comprise of 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.

### **2.11 Equity**

#### **Share capital**

Share capital is determined using the nominal value of shares that have been issued.

#### **Reserves**

Reserves represent difference between the registered share capital and the value of net assets as determined by independent valuation at the date of Company incorporation.

Notes to the financial statements (continued)  
Accounting policies (continued)

### **2.12 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.

### **2.13 Retirement benefit costs**

The Company makes no provision and has no obligation for employee pensions over and above the contributions paid into the state pension plan, Kosovo Pension Saving Trust (KPST).

### **2.14 Trade and Other Payables**

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

### **2.15 Current and deferred income tax**

The current income tax charge is calculated on the basis of the tax law enacted at the balance sheet date.

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 amounts in the financial statements. Deferred income tax is determined using a tax rate that has been enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income 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 liabilities or assets at 31 December 2006.

### **2.16 Revenue and expense recognition**

**Revenue** from sale of electricity comprises of 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 recognized in the income statement upon utilization of the service or at the date of the origin.

### **2.17 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 Company 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.

Notes to the financial statements (continued)  
Accounting policies (continued)

**2.18 Provisions**

A provision is recognized 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.

**2.19 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.

**2.20 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.



## Notes to the financial statements (continued)

**3 Financial risk management**

The Company's risk management is carried out by the Board of Directors. Risk management is focused on the unpredictability of markets and seeks to minimize any potential adverse effects over the Company's business performance.

**3.1 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.

**3.2 Liquidity risk**

Prudent liquidity risk management implies maintaining sufficient cash then, availability of funds through adequate credit facilities and ability to collect timely, within the terms established the amounts due from the customers. Due to the dynamic nature of the Company's business, the management aims to maintain flexible funds by keeping committed credit lines available.

**3.3 Cash flow and fair value of interest rate risk**

The Company takes on exposure to effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The Company's management is primarily responsible for daily monitoring of the net interest rate risk position and it sets limits to reduce the potential of interest rate mismatch. There is significant concentration of interest – bearing funds borrowed from local financial institutions at the balance sheet date. Fluctuations in market interest rates under which, the funds are borrowed could have adverse effect over the Company's financial performance. At the same time, the Company has no significant placements of its assets in time deposits and highly liquid securities, bearing additional interest income.

**3.4 Market risk**

The Company has not entered into any hedging transactions to cover its exposure to price movements arising from the purchases of energy.

**3.5 Interest credit risk**

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

**3.6 Capital risk management**

When managing capital, the Company's objectives are to safeguard its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Company may increase or return capital to shareholders or sell assets to reduce debt.

**3.7 Fair value estimation***Trade and other receivables and payables*

Nominal value, less provision for impairment of trade and financial receivables, as well as nominal value of trade liabilities are assumed to approximate their fair values due to their short-term nature.

The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the market interest rate at the reporting date.

Notes to the financial statements (continued)  
As of and for the years ended 31 December 2007 and 2006  
(All amounts are expressed in Euro thousands, unless otherwise stated)

#### 4 Property, plant and equipment and other intangible assets

	Land and forest	Land in mines	Buildings	Industrial Heavy Equipment	Other Equipment	Construct. in progress	Total	Other intangibles (Software)
<b>At 01 January 2006</b>								
Cost or Valuation	64,206	12,557	151,325	265,138	3,602	9,245	506,073	818
Accumulated depreciation	-	(2,363)	(34,775)	(69,118)	(1,047)	-	(107,303)	(122)
Accumulated impairment	(45,232)	(2,344)	(39,076)	(72,522)	(1,137)	(3,005)	(163,316)	(623)
<b>Net carrying amount</b>	<b>18,974</b>	<b>7,850</b>	<b>77,474</b>	<b>123,498</b>	<b>1,418</b>	<b>6,240</b>	<b>235,454</b>	<b>73</b>
<b>At 31 December 2006</b>								
Cost or Valuation	61,702	15,512	113,225	267,352	4,093	4,962	466,846	818
Accumulated depreciation	-	(3,950)	(33,719)	(83,159)	(1,343)	-	(122,171)	(139)
Accumulated impairment	(44,452)	(2,344)	(21,455)	(63,097)	(1,044)	(1,361)	(133,753)	(623)
<b>Net carrying amount</b>	<b>17,250</b>	<b>9,218</b>	<b>58,051</b>	<b>121,096</b>	<b>1,706</b>	<b>3,601</b>	<b>210,922</b>	<b>56</b>
<b>At 31 December 2007</b>								
Cost or Valuation	63,102	15,512	116,029	281,602	4,801	13,545	494,591	892
Accumulated depreciation	-	(5,722)	(39,197)	(101,455)	(1,907)	-	(148,281)	(160)
Accumulated impairment	(44,452)	(2,344)	(21,455)	(63,030)	(1,018)	(1,359)	(133,658)	(623)
<b>Net carrying amount</b>	<b>18,650</b>	<b>7,446</b>	<b>55,377</b>	<b>117,117</b>	<b>1,876</b>	<b>12,186</b>	<b>212,652</b>	<b>109</b>

Notes to the financial statements (continued)  
As of and for the years ended 31 December 2007 and 2006  
(All amounts are expressed in Euro thousands, unless otherwise stated)

Property, plant and equipment and other intangible assets (continued)

*Movements during the year 2006*

	Land and forest	Land in mines	Buildings	Industrial Heavy Equipment	Other Equipment	Construct. in progress	Total	Other intangibles (Software)
Opening net carrying amount –restated	18,974	7,850	77,474	123,626	1,418	5,900	235,242	73
Additions	-	-	797	2,247	670	362	4,076	-
Donations	-	2,955	2,065	14,980	308	1,258	21,566	-
Transfer to KOSTT JSC	(1,724)	-	(14,948)	(5,243)	(293)	(814)	(23,022)	-
Disposals	-	-	(8)	(81)	(14)	-	(103)	-
Internal transfers	-	-	-	3,095	10	(3,105)	-	-
Depreciation for the year	-	(1,587)	(7,329)	(17,528)	(393)	-	(26,837)	(17)
<b>Closing net carrying amount</b>	<b>17,250</b>	<b>9,218</b>	<b>58,051</b>	<b>121,096</b>	<b>1,706</b>	<b>3,601</b>	<b>210,922</b>	<b>56</b>

*Movements during the year 2007*

Opening net carrying amount –restated	17,250	9,218	58,051	121,096	1,706	3,601	210,922	56
Additions	-	-	322	637	716	1,141	2,816	74
Donations	1,400	-	2,484	13,391	26	7,888	25,189	-
Disposals	-	-	(6)	(10)	(11)	(41)	(68)	-
Internal transfers	-	-	5	367	31	(403)	-	-
Depreciation for the year	-	(1,772)	(5,479)	(18,364)	(592)	-	(26,207)	(21)
<b>Closing net carrying amount</b>	<b>18,650</b>	<b>7,446</b>	<b>55,377</b>	<b>117,117</b>	<b>1,876</b>	<b>12,186</b>	<b>212,652</b>	<b>109</b>

Notes to the financial statements (continued)  
As of and for the years ended 31 December 2007 and 2006  
(All amounts are expressed in Euro thousands, unless otherwise stated)

Property, plant and equipment and other intangible assets (continued)

*Disposal of assets*

During 2007, the Company disposed off part of its property, plant and equipment out of use, the net carrying value of which amounted to EUR 68 thousands. For the amount of EUR 159 thousands, related to the assets' cost less accumulated depreciation, the Company charged its current profit & loss (see Note 21) and for the released accumulated impairment, amounting EUR 95 thousands, the Company has increased its retained earnings. For the remaining of EUR 4 thousands charged its employees receivable account.

*In - kind donations*

During 2007, the Company received in - kind donations totaling EUR 25,189 thousands (2006: EUR 21,566 thousands) accounted for through deferred grant account. The related depreciation on these assets for 2007 charged to the current profit and loss in the amount of EUR 3,030 thousands (2006: EUR 977 thousands) has caused release of equal amount from the balance of deferred grants (see Notes 11 and 17).

*Assets rendered under operating lease*

Included in to the balance of property, plant and equipment at 31 December 2007, amount of EUR 1,559 thousands (2006: EUR 1,940 thousands) represents assets rendered under operating lease terms to several organizational units separated from the Company during 2006, as well as to other entities. Following are the details of net carrying value of assets leased:

Description	Net carrying amount	
	2007	2006
Buildings	1,113	1,282
Industrial Heavy Equipment	421	620
Other Equipment	24	37
Construction in progress	1	1
	<b>1,559</b>	<b>1,940</b>

At 31 December 2007 and 2006, there are no items of property, plant and equipment, pledged as guarantee on any liability.

*Movement of accumulated impairment*

	2007	2006
Balance, 01 January	134,376	163,939
Release of provision for assets transferred to KOSTT	-	(29,345)
Release of provision for assets disposed off	(95)	(218)
<b>Balance, 31 December</b>	<b>134,281</b>	<b>134,376</b>

Notes to the financial statements (continued)  
 As of and for the years ended 31 December 2007 and 2006  
 (All amounts are expressed in Euro thousands, unless otherwise stated)

## 5 Financial instruments by categories

The carrying amounts of the Company's financial assets and liabilities as recognised at the balance sheet date of the reporting periods under review may also be categorised as follows.

31 December 2007	Loans and receivables	Total
<b>Assets</b>		
Trade and other receivables	34,879	34,879
Cash and cash equivalents	4,903	4,903
	<b>39,782</b>	<b>39,782</b>
	Other financial liabilities	Total
<b>Liabilities</b>		
Borrowings	20,340	20,340
Trade and other liabilities	72,452	72,452
	<b>92,792</b>	<b>92,792</b>
<b>31 December 2006</b>		
	Loans and receivables	Total
<b>Assets</b>		
Trade and other receivables	23,422	23,422
Cash and cash equivalents	9,901	9,901
	<b>33,323</b>	<b>33,323</b>
	Other financial liabilities	Total
<b>Liabilities</b>		
Borrowings	10,000	10,000
Trade and other liabilities	60,806	60,806
	<b>70,806</b>	<b>70,806</b>

## 6 Inventories

	2007	2006
Materials and consumables	25,226	25,610
Lignite	547	547
Fuel	922	1,336
Spare parts	5,419	5,912
Other	5,704	4,679
	<b>37,818</b>	<b>38,084</b>
Less: Provision for slow moving and obsolete stock	(26,461)	(26,461)
	<b>11,357</b>	<b>11,623</b>

During 2006, part of inventories, amounting EUR 452 thousands, were transferred to KOSTT JSC. The Company's reserves have been reduced accordingly (see also Note 9).

### *Provision for slow moving and obsolete stock*

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 as of that date. As of 31 December 2007 the balance of provision for slow moving and obsolete stock is not changed compared with year 2006.

Notes to the financial statements (continued)  
As of and for the years ended 31 December 2007 and 2006  
(All amounts are expressed in Euro thousands, unless otherwise stated)

## 7 Trade and other receivables

	2007	2006
<b>Trade receivables</b>		
Local customers	279,273	252,898
Foreign customers	3,905	3,842
	<b>283,178</b>	<b>256,740</b>
Less: Provision for impairment	(265,937)	(244,500)
	<b>17,241</b>	<b>12,240</b>
<b>Other current receivables</b>		
Advances to suppliers	15,969	9,664
Non - interest bearing loans	1,151	1,151
Advances to employees	517	366
Excise tax refundable	1	1
	<b>17,638</b>	<b>11,182</b>
	<b>34,879</b>	<b>23,422</b>

The movement in the impairment provision is as follows:

	2007	2006
Balance, 01 January	244,500	214,745
Charge for the year	21,437	29,755
<b>Balance, 31 December</b>	<b>265,937</b>	<b>244,500</b>

In addition to the total impairment charge for 2007 and due to their entire non - recoverability, the Company wrote off part of its non - interest bearing loans in the amount of EUR 288 thousands (2006: EUR 346 thousands).

## 8 Cash and cash equivalents

	2007	2006
Current accounts with Banks	4,872	9,871
Cash on hand	31	30
	<b>4,903</b>	<b>9,901</b>

Current accounts with banks are non – interest bearing.

## 9 Equity

### *Share capital*

At 31 December 2007 and according to the Provisional Business Registration issued by the UNMIK administration dated 27 December 2005 under Business Reg. No. 70325399, total subscribed capital amounts to EUR 25,000 at the date of registration. It comprises of 25,000 ordinary shares at 1 (one) Euro per share. The sole Company's shareholder is Kosovo Energy Corporation Holding J.S.C.

### *Reserves*

Reserves which at 31 December 2007 and 2006 amounts EUR 687,794 thousands have been initially accounted for in the Company's books as difference between the registered share capital and the value of Company's net assets as determined by independent valuation at the date of its incorporation as JSC. Included into the total reserves the amount of EUR 60,304 thousands (2006: same) represents surplus related to valuation of property, plant and equipment as of 01 January 2005 (the opening balance sheet date).

Notes to the financial statements (continued)  
 As of and for the years ended 31 December 2007 and 2006  
 (All amounts are expressed in Euro thousands, unless otherwise stated)

## Equity (continued)

The components of the reserve account for the periods considered are as follows:

	Revaluation surplus	Other reserves	Total
<b>At 01 January 2006</b>	<b>62,512</b>	<b>675,825</b>	<b>738,337</b>
Transfers of assets to KOSTT JSC:			
- Property, plant and equipment (Note 4)	(2,208)	(48,273)	(50,481)
- Inventories (Note 6)	-	(452)	(452)
Additionally Identified assets (Note 4)	-	390	390
<b>At 31 December 2006 and 2007</b>	<b>60,304</b>	<b>627,490</b>	<b>687,794</b>

**10 Borrowings**

	2007	2006
<b>Non - current</b>		
<i>Non - interest bearing funds borrowed from state authorities</i>		
- <u>Kosovo Consolidated Budget</u> (face amount: EUR 10,000; Maturity: December 31 2008)	10,000	10,000
	<b>10,000</b>	<b>10,000</b>
<b>Current</b>		
<i>Overdrafts on bank's current account</i>		
- <u>Raiffeisen Bank</u> (ST loan limit at EUR 10,000; maturing on July 31 2008; Interest at 6m Euribor+5.5%)	10,340	-
	<b>10,340</b>	<b>-</b>
<b>Total borrowings</b>	<b>20,340</b>	<b>10,000</b>

**11 Deferred grants**

Movements in the deferred grant account are as follows:

	2007	2006
<b>At 01 January 2006-as stated</b>	<b>32,565</b>	<b>14,704</b>
Restatement	-	(824)
<b>At 01 January 2006-restated</b>	<b>32,565</b>	<b>13,880</b>
Additions in property, plant and equipment (Note 4)	25,189	21,566
Amortized during the year (Notes 4 and 17)	(3,030)	(977)
Transfer of donated assets to KOSTT	-	(1,904)
<b>Balance, 31 December</b>	<b>54,724</b>	<b>32,565</b>

Following are grant components received during the years considered:

	2007	2006
Property, plant and equipment (Note 4)	25,189	21,566
Income for recovering operating expenses (Note 17)	13,952	16,000
	<b>39,141</b>	<b>37,566</b>

Notes to the financial statements (continued)  
As of and for the years ended 31 December 2007 and 2006  
(All amounts are expressed in Euro thousands, unless otherwise stated)

## 12 Provisions

The balance of Company's provisions which at 31 December 2007 and 2006 amounts to EUR 30,000 thousands entirely relates to provision for ash dumps. This amount has been initially recognized as of 01 January 2005 based on the results from the financial due diligence performed by an independent accountant - Deloitte Central Europe Limited.

## 13 Trade and other liabilities

	2007	2006
<b>Trade creditors</b>		
Local suppliers	28,657	18,484
Foreign suppliers	9,496	14,997
	<b>38,153</b>	<b>33,481</b>
<b>Other current liabilities</b>		
VAT payables	57	99
Broadcasting tax	2,107	1,241
Income tax payables	7,881	7,881
Salaries to employees	3,031	2,863
Excise duties	1,440	1,440
Customers' advances	622	370
Other payables	878	324
	<b>16,016</b>	<b>14,218</b>
	<b>54,169</b>	<b>47,699</b>

Part of the Company's trade payables are secured with guarantees issued by Raiffeisen Bank the limit of which at 31 December 2007 amounts to EUR 1,550 thousands. The Bank charges monthly fee at 4% p.a for the instruments issued (see also Note 24).

## 14 Accrued expenses

	2007	2006
Accrued concession fees	2,678	5,816
Obligation from means for Investment A3	12,555	4,391
Lost of court disputes	2,900	2,900
Other accrued liabilities	150	-
	<b>18,283</b>	<b>13,107</b>

### *Obligation from means for Investment A3*

This balance represents unspent cash received through means of grant from the Kosovo Consolidated Budget (KCB). During the year ended 31 December 2007 the Company received additional grant in the total amount of EUR 38,079 thousand (2006: EUR 21,276 thousand) and made payments from these funds to its suppliers for purchased assets, in the total amount of EUR 29,915 thousand (2006: EUR 26,625 thousand).



Notes to the financial statements (continued)  
 As of and for the years ended 31 December 2007 and 2006  
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**15 Sales**

	2007	2006
<b>Sales of electricity</b>		
Consumers (10 kV, 35 kV and 0,4kV)	39,152	34,256
Industrial customers	11,244	3,140
Householders	66,474	63,418
Export of electricity	10,307	6,778
	<b>127,177</b>	<b>107,592</b>
<b>Other sales</b>		
Income from re-connection services	4,075	7,135
Sales of coal	218	896
Other	1,822	2,009
	<b>6,115</b>	<b>10,040</b>
	<b>133,292</b>	<b>117,632</b>

**16 Other operating income**

	2007	2006
Court decision on behalf of KEK	3,651	-
Pension fund liabilities	1,407	18,220
Other	454	1,791
	<b>5,512</b>	<b>20,011</b>

**17 Income from grants**

	2007	2006
<i>Income for recovering operating expenses (Note 11)</i>		
Electricity imported	11,451	11,600
Repairs and maintenance	730	1,278
Other	1,771	3,122
	<b>13,952</b>	<b>16,000</b>
Released from deferred income from grants (Notes 4 & 11)	3,030	977
	<b>16,982</b>	<b>16,977</b>

**18 Staff cost**

	2007	2006
Net salaries	31,517	31,090
Contributions and tax	6,178	6,217
Other	3,992	3,864
	<b>41,687</b>	<b>41,171</b>

Notes to the financial statements (continued)  
 As of and for the years ended 31 December 2007 and 2006  
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**19 Electricity and other utilities**

	2007	2006
Electricity	47,860	24,820
Fuel	7,400	9,491
Gas and water	1,146	1,141
Transmission and exchange of electricity	13,396	7,568
	<b>69,802</b>	<b>43,020</b>

**20 Maintenance costs**

	2007	2006
Repairs	4,841	5,432
Current maintenance	380	782
	<b>5,221</b>	<b>6,214</b>

**21 Other operating expense**

	2007	2006
Transport services	2,935	2,635
Insurance expenses	2,372	2,273
Concessions fee	1,754	1,703
Lost court dispute	1,610	-
Licenses	1,004	-
Outsourcing services (surface excavation)	432	1,412
Damages	178	878
Management fees	-	3,055
Coal Analysis's	-	735
Net carrying value of assets disposed off (Note 4)	159	303
Other expenses	4,946	5,507
	<b>15,390</b>	<b>18,501</b>

**22 Financial result, net**

	2007	2006
<b>Finance income</b>		
Interest income on overdue balances	249	280
<b>Finance costs</b>		
Interest expense on delayed payments	(325)	(4)
<b>Finance (costs) / income, net</b>	<b>(76)</b>	<b>276</b>

Notes to the financial statements (continued)  
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## 23 Income tax expense

The charge for the year can be reconciled to the profit per 2007 income statement as follows:

	2007	2006
Loss before income tax	(36,264)	(25,974)
Tax at rate of 20%	(7,253)	(5,195)
Expenditure not allowable for income tax purposes	-	-
Income not taxable for income tax purposes	-	-
Unrecognized tax losses carries forward	7,253	5,195
	-	-

According to the UNMIK Regulation No. 2004/51, enforced on 01 January 2005, the Company is required to pay income tax at a rate of 20% on the taxable profit, as calculated in the annual Income Tax Return Statement.

The Company incurred loss from its operations for 2007 and 2006 thus has no income tax liability for the periods considered.

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 2007 and previous years 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 earning taxable profits.

## 24 Commitments and contingencies

### Litigations

At 31 December 2007, legal proceedings raised against the Company amount to EUR 6,278 thousands (2006: EUR 5,745 thousand). No provision has been made as of the balance sheet date, as the Company's legal department indicates that it is unlikely that any significant loss will arise.

### Bank guarantees

During July 2007 the Company entered into Trade Finance Credit Line Agreement with Raiffeisen Bank for issuance of guarantees the initial limit of which was set at EUR 5,000 thousands. At 31 December 2007 the guarantee limit amounts to EUR 1,550 thousands and the amount of guarantees issued was 1,532 thousands.

### Mineral rights

The Company has received an exploration license over the current mining areas and the process of obtaining an exploration license over a new mining area is ongoing. It is likely that granting the exploitation license for a new mine will be accompanied by clauses 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.

### Site re-allocations

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

Notes to the financial statements (continued)  
As of and for the years ended 31 December 2007 and 2006  
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## **25 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 tones 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.

## **26 Technological losses**

The Company incurs substantial technical and trade losses of electrical power in its operations. Technical losses arise upon the 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 2007, to amount to 48 % (2006: 48%) of the total electricity supplied.