

OIL INDUSTRY OF SERBIA, NOVI SAD

**Consolidated Financial Statements
Year Ended December 31, 2007 and
Independent Auditors' Report**

CONTENTS	Page
Independent Auditors' Report	1 - 4
Consolidated Financial Statements:	
Consolidated Income Statement	5
Consolidated Balance Sheet	6
Consolidated Statement of Changes in Equity	7
Consolidated Cash Flow Statement	8
Notes to the Consolidated Financial Statements	9 - 45

Translation of the auditors' report issued in the Serbian language

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Assembly of the Oil Industry of Serbia, Novi Sad

We have audited the accompanying consolidated financial statements (pages 5 to 45) of the Oil Industry of Serbia, Novi Sad (the "Company" or "NIS") and its subsidiaries, which comprise the consolidated balance sheet as at December 31, 2007 and the related consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of the significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with the accounting regulations of the Republic of Serbia. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and the Law on Accounting and Auditing of the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

(Continued)

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Assembly of the Oil Industry of Serbia, Novi Sad (Continued)

Basis for Qualified Opinion

As disclosed in Note 4 to the consolidated financial statements, the Company charged the effects of error adjustments in the amount of RSD 495,453 thousand to the opening balance of retained earnings in the current year, which is a departure from IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" requiring that materially significant errors relating to subsequently determined prior period income and expenses be stated as the adjustment to retained earnings at the beginning of the current year, while the comparative information included in the prior period financial statements is restated accordingly.

As disclosed in Note 3.4 to the consolidated financial statements, with the exception of one subsidiary, the Company did not perform an actuarial valuation in order to determine the present value of accumulated employee retirement benefits and jubilee awards, or did it prepare a calculation of short-term employee benefits payable as in the parent company so in its subsidiaries, which is a departure from the provisions of IAS 19, "Employee Benefits." As a result, the accompanying consolidated financial statements do not include complete provisions and liabilities thereof. Accordingly, we were unable to satisfy ourselves as to the potential effects of the aforementioned liabilities and provisions on the Company's consolidated financial statements for the year 2007.

As disclosed in Note 13 to the consolidated financial statements, intangible assets stated as of December 31, 2007 in the amount of RSD 3,173,305 thousand include investments of RSD 1,952,683 thousand made during the year, most of which relate to the investments in the business software SAP, including the cost of standard support, consulting services and employee training. Based on the documentation made available, we were unable to satisfy ourselves as to the nature of services performed and we were therefore unable to satisfy ourselves whether the Company fully identified the investments which do not qualify for recognition and measurement defined by the provisions of IAS 38 "Intangible Assets – Recognition and Measurement" and which should be charged to net profit for the year.

As disclosed in Note 14 to the consolidated financial statements, at December 31, 2007, property, plant and equipment were stated in the amount of RSD 101,655,744 thousand include investments in progress and advances in the amount of RSD 10,178,319 thousand, containing the inventories of investment material of RSD 1,634,733 thousand. Due to the nature of accounting records available, we were unable to satisfy ourselves as to the nature of inventories of investment material stated or to determine whether such inventories qualify for measurement and recognition as delineated under IAS 16 "Property, Plant and Equipment."

As disclosed in Note 17 to the consolidated financial statements, other long-term investments stated at December 31, 2007 in the net amount of RSD 6,039,966 thousand include long-term loans to employees in the net amount of RSD 2,523,159 thousand and apartments rented to employees with the option of subsequent repurchase, in the net book value of RSD 896,081 thousand, which were valued at the amounts of outstanding receivables and at market value, respectively. In our opinion, such accounting treatment is not in accordance with the requirements of IAS 39, "Financial Instruments: Recognition and Measurement," whereby long-term loans and receivables are measured at their amortized cost using the effective interest rate method. Based on the Company's accounting records, we were unable to quantify the effects of the aforementioned departure from IAS 39 on the accompanying consolidated financial statements.

(Continued)

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Assembly of the Oil Industry of Serbia, Novi Sad (Continued)

Basis for Qualified Opinion (Continued)

As disclosed in Note 18 to the consolidated financial statements, inventories stated at December 31, 2007 in the net amount of RSD 31,542,211 thousand include obsolete and slow-moving items. Since the Company does not possess reliable aging analysis of inventories, we were unable to quantify their potential impairment. In addition, inventories of materials, goods, finished products and work in progress include the significant amount of internal profit included in inventories. Due to the Company's methodology for cost price calculation and a lack of accounting records supporting the required data, we were unable to determine the effects of potential adjustments to the accompanying consolidated financial statements.

As disclosed in Note 25 to the consolidated financial statements, based on the internal estimates of the Company's management, as of December 31, 2007 the provision for the restoration and re-cultivation of degraded natural environment amounted to RSD 831,365 thousand. Pursuant to the documentation made available to us, we were unable to satisfy ourselves whether the methodology used in the computation of the aforementioned provision is in accordance with the requirements of IAS 37 "Provisions, Contingent Liabilities and Contingent Assets." In addition, due to the nature of technological processes, the Company potentially caused environmental pollution in the previous period and could expect citizens' claims and criminal charges by the relevant governmental authorities. The Company did not recognize a provision for costs of neutralizing the consequences of environmental contamination, as required by IAS 37 "Provisions, Contingent Liabilities and Contingent Assets."

As disclosed in Note 27 to the consolidated financial statements, other long-term liabilities as of December 31, 2007, amounted to RSD 888,272 thousand, where the amount of RSD 714,235 thousand represents liabilities to other legal entities related to the Agreement on Joint Construction and Mutual Relationship with respect to co-financing the construction of tourist center, Crni Vrh (signed on August 17, 1995). The Company did not determine maturities for the aforementioned liabilities nor did it accrue the related interest, which departs from the requirements of IAS 32 – "Financial Instruments: Disclosure and Presentation" and IAS 39 – "Financial Instruments: Recognition and Measurement".

As disclosed in Notes 19 and 29 to the consolidated financial statements, as of December 31, 2007 accounts receivable and accounts payable amounted to RSD 17,433,309 thousand and RSD 31,797,074 thousand, respectively and included domestic accounts receivable (RSD 24,649,830 thousand) and interest receivables (RSD 4,121,106 thousand), as well as accounts payable (RSD 29,048,413 thousand). Based on the documentation made available to us, the accrual testings and independent confirmations received from certain creditors and debtors, significant differences were identified as compared with the balances recorded in the Company's books of account. Up to the date of these financial statements, the Company's management has not reconciled these amounts and accordingly, we are unable to satisfy ourselves whether these receivables and liabilities are fairly stated as of December 31, 2007.

As of December 31, 2007, deferred tax assets of RSD 489,416 thousand, deferred tax liabilities of RSD 64,211 thousand and income taxes for the year then ended amounted to RSD 587,679 thousand. Based on the documentation made available to us, we were unable to satisfy ourselves as to the computation of deferred taxes in accordance with IAS 12, "Income Taxes", or to quantify the potential effects on the accompanying consolidated financial statements. In addition, the accompanying consolidated financial statements do not include disclosures required under IAS 12, "Income Taxes."

Certain information presented in the consolidated cash flow statement has not been reconciled with the amounts stated in the Company's consolidated balance sheet as of December 31, 2007, or with those in the consolidated income statement and consolidated statement of changes in equity for the year then ended. Based on the information made available, and given the complexity of internal balances in the Company, we were unable to separate inflows and outflows derived from internal transactions and, therefore, we do not express an opinion on the Company's consolidated cash flow statement for the year ended December 31, 2007.

(Continued)

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Assembly of the Oil Industry of Serbia, Novi Sad (Continued)

Qualified Opinion

In our opinion, except for the effects of the possible adjustments associated with the uncertainties and limitations on the performance of the audit procedures referred to in the preceding paragraphs, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company and subsidiaries as of December 31, 2007, and its financial performance and changes in equity for the year then ended, in accordance with the accounting regulations of the Republic of Serbia.

Emphasis of Matter

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

- a) The Company is neither in possession of all documentation necessary to prove ownership over all assets and property, nor has it fully separated assets and liabilities with the former NIS members. The management believes that the issues of ownership over assets, split-offs with the former NIS members, as well as the matter of regulating relations with the state agencies of the Republic of Serbia arising thereof, will be successfully resolved, i.e., that the Company will not experience significant difficulties in proving its ownership titles.
- b) As disclosed in Note 33 to the consolidated financial statements, at December 31, 2007, the aggregate of potential monetary damages arising from court and administrative proceedings in which the Company has been named a defendant party, amounted to RSD 8,728,218 thousand without the effects of potential penalties for which the Company formed provisions in the amount of RSD 125,896 thousand. Although it is not possible to predict the final outcome of other litigations with any certainty, the Company's management does not anticipate unfavorable outcome of materially significant proceedings and, accordingly, no additional provisions were included by these consolidated financial statements. In addition, the worth of lawsuits which the Company filed against third parties amounts to RSD 8,094,108 thousand, the litigations which either have not been disclosed in the accompanying consolidated financial statements or for which the corresponding allowance for impairment has not been provided for.
- c) As disclosed in Note 2 to the accompanying consolidated financial statements, these consolidated financial statements were prepared by applying the IAS which were in effect as of December 31, 2002 and the accounting regulations of the Republic of Serbia based on them. The Company's management assesses IAS, IFRS and interpretations the application of which was prescribed pursuant to the February 12, 2008 Decision enacted by the Minister of Finance of the Republic of Serbia and once the standards and interpretations with reference to the Company's activities have been established, the Company intends to apply them in preparing the consolidated financial statements for the period beginning January 1, 2008. With regards to the provisions contained in the newly-adopted and amended standards and interpretations which relate to the application date and the provisions with reference to the disclosure of comparative figures, upon their adoption and application by the Company, certain reclassification of data presented in the accompanying consolidated financial statements for the year 2007 might be required, as these will be used as comparative figures in the Company's financial statements for the year 2008.

Belgrade, May 9, 2008

Žarko Mijović
Certified Auditor

CONSOLIDATED INCOME STATEMENT
Year Ended December 31, 2007
(thousands of RSD)

	<u>Notes</u>	<u>2007</u>	<u>2006</u>
OPERATING INCOME			
Sales of goods, products and services	5	159,575,484	153,914,556
Own-work capitalized		481,626	340,992
Decrease of value of inventories		(185,332)	(1,895,963)
Other operating income		379,214	302,588
		<u>160,250,992</u>	<u>152,662,173</u>
OPERATING EXPENSES			
Cost of commercial goods sold		(52,300,826)	(55,202,965)
Cost of materials	6	(67,292,884)	(58,583,857)
Staff costs	7	(16,216,585)	(13,967,827)
Depreciation, amortization and provisions	13, 14, 25	(6,112,278)	(6,434,163)
Other operating expenses	8	(11,065,890)	(9,498,820)
		<u>(152,988,463)</u>	<u>(143,687,632)</u>
PROFIT FROM OPERATIONS		7,262,529	8,974,541
Finance income	9	9,963,143	9,382,021
Finance expenses	10	(7,954,556)	(7,444,366)
Other income	11	3,252,233	7,870,423
Other expenses	12	(6,680,661)	(12,301,292)
PROFIT BEFORE TAX		5,842,688	6,481,327
Income taxes			
- deferred tax benefits		1,915	-
- current tax expense		(587,679)	(212,985)
PROFIT FOR THE YEAR		<u>5,256,924</u>	<u>6,268,342</u>
Net profit/(loss) attributable to:			
- equity holders of the Parent Company		5,258,296	6,271,489
- minority interests		(1,372)	(3,147)
		<u>5,256,924</u>	<u>6,268,342</u>

The accompanying notes on the following pages
are an integral part of these consolidated financial statements.

Approved by, and signed on behalf of NIS A.D. Novi Sad:

Miloš Saramandić
General Manager

Emil Živkov
Head of Accounting

CONSOLIDATED BALANCE SHEET
As at December 31, 2007
(thousands of RSD)

	Note	December 31, 2007	December 31, 2006
ASSETS			
Non-current assets			
Intangible assets	13	3,173,305	1,319,292
Property, plant and equipment	14	101,655,744	101,902,051
Investment property	15	777,584	738,953
Equity investments	16	1,141,641	1,346,212
Other long-term financial placements	17	6,039,966	5,676,067
		<u>112,788,240</u>	<u>110,982,575</u>
Current assets			
Inventories	18	31,542,211	25,171,275
Non-current assets held for sale		-	53,397
Accounts receivable	19	17,433,309	14,688,307
Short-term financial placements	20	2,968,343	2,674,810
Cash and cash equivalents	21	1,862,109	2,751,678
Value added tax and prepayments	22	1,922,350	732,669
Deferred tax assets		489,416	487,631
		<u>56,217,738</u>	<u>46,559,767</u>
Total assets		<u>169,005,978</u>	<u>157,542,342</u>
EQUITY AND LIABILITIES			
Equity			
Share capital	24	81,530,220	81,530,220
Other capital		5,597,839	5,593,691
Reserves		484,601	140,125
Revaluation reserves		1,946,549	248,433
Retained earnings		9,527,567	5,805,764
Translation reserves		(305)	446
Capital attributable to majority shareholders		99,086,471	93,318,679
Minority interest		17,634	14,693
		<u>99,104,105</u>	<u>93,333,372</u>
Long-term provisions and liabilities			
Long-term provisions	25	974,600	1,574,481
Long-term borrowings	26	12,753,407	18,639,798
Other long-term liabilities	27	888,272	792,786
		<u>14,616,279</u>	<u>21,007,065</u>
Current liabilities			
Short-term financial liabilities	28	13,057,106	11,805,674
Accounts payable	29	31,797,074	24,453,384
Other current liabilities and accruals	30	5,118,809	4,086,262
Value added tax and other taxes and duties payable	31	4,653,658	2,788,986
Income taxes payable		594,736	63,048
Deferred tax liabilities		64,211	4,551
		<u>55,285,594</u>	<u>43,201,905</u>
Total equity and liabilities		<u>169,005,978</u>	<u>157,542,342</u>
Off-balance sheet items	32	<u>43,947,429</u>	<u>62,292,947</u>

The accompanying notes on the following pages
are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2007
(thousands of RSD)

	Share Capital	Other Capital	Reserves	Revaluation Reserves	Retained Earnings	Translation Reserves	Capital Attributable to Majority Shareholders	Minority Interest	Total
Balance, January 1, 2006	22,424,616	220,973	710,113	63,506,565	1,055,830	-	87,918,097	(954)	87,917,143
Opening balance adjustment (Note 4)	-	-	-	9,219	263,702	-	272,921	-	272,921
Changes in the scope of consolidation	-	(47)	-	-	19,978	446	20,377	18,794	39,171
Deferred taxes	-	-	-	-	442,836	-	442,836	-	442,836
Effects of reconciliation of capital in accordance with the Serbian Business Registers Agency Decision	59,105,604	5,372,912	(710,068)	(63,287,692)	(480,756)	-	-	-	-
Fair value adjustment of long-term financial placements	-	-	-	61,368	(7)	-	61,361	-	61,361
Disposal of property, plant and equipment	-	-	-	(39,397)	39,397	-	-	-	-
Reactivation of retired fixed assets	-	-	-	1,164	-	-	1,164	-	1,164
Transfers	-	-	140,024	-	(140,024)	-	-	-	-
Dividends declared	-	-	-	-	(1,687,716)	-	(1,687,716)	-	(1,687,716)
Net profit for the year	-	-	-	-	6,271,489	-	6,271,489	(3,147)	6,268,342
Other	-	(147)	56	(2,794)	21,035	-	18,150	-	18,150
Balance, December 31, 2006	81,530,220	5,593,691	140,125	248,433	5,805,764	446	93,318,679	14,693	93,333,372
Balance, January 1, 2007	81,530,220	5,593,691	140,125	248,433	5,805,764	446	93,318,679	14,693	93,333,372
Opening balance adjustment (Note 4)	-	-	(45)	(56,327)	(495,453)	-	(551,825)	1,897	(549,928)
Effects of the fair value adjustment of long-term financial placements	-	-	-	215,201	-	-	215,201	-	215,201
Increase in equity	-	-	-	-	-	-	-	2,517	2,517
Transfers	-	-	344,578	-	(344,578)	-	-	-	-
Dividends declared	-	-	-	-	(689,155)	-	(689,155)	-	(689,155)
Net profit for the year	-	-	-	-	5,258,296	-	5,258,296	(1,372)	5,256,924
Recalculation effects	-	-	-	-	-	(751)	(751)	(101)	(852)
Appraisal of property and construction in progress	-	-	-	1,604,741	-	-	1,604,741	-	1,604,741
Tax effects of appraising property and construction in progress	-	-	-	(65,499)	-	-	(65,499)	-	(65,499)
Profit distribution	-	-	-	-	(7,361)	-	(7,361)	-	(7,361)
Other	-	4,148	(57)	-	54	-	4,145	-	4,145
Balance, December 31, 2007	81,530,220	5,597,839	484,601	1,946,549	9,527,567	(305)	99,086,471	17,634	99,104,105

The accompanying notes on the following pages
are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT
Year Ended December 31, 2007
(thousands of RSD)

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities		
Cash receipts from customers	317,694,140	202,866,450
Interest received	2,066,565	1,537,025
Extraordinary items	9,651,595	6,899,387
Cash paid to suppliers	(212,863,455)	(137,206,896)
Cash paid to, and on behalf of employees	(13,557,775)	(10,447,831)
Interest paid	(3,679,784)	(1,257,392)
Non-income taxes and other duties paid	(564,131)	(145,592)
Outflows based on extraordinary items	(92,851,772)	(59,761,440)
<i>Net cash provided by operating activities</i>	<u>5,895,383</u>	<u>2,483,711</u>
Cash flows from investing activities		
Proceeds from the sale of shares and equity investments	398,943	571
Sale of equipment	1,762,716	834,419
Other financial placements (net inflows)	237,379	35,461
Interest received	154,959	76,721
Dividends received	902	-
Purchase of shares and equity investments	-	(35,409)
Purchases of property, plant and equipment and intangible assets	(6,879,109)	(5,822,837)
Other financial placements (net outflows)	(14,283)	(2,925,323)
<i>Net cash used in investing activities</i>	<u>(4,338,493)</u>	<u>(7,836,397)</u>
Cash flows from financing activities		
Increase in capital	1,744	8,711
Net increase in long-term and short-term borrowings	3,753,009	6,801,960
Net increase in other long-term and short-term liabilities	61,558	1,901,692
Net decrease in long-term and short-term borrowings	(4,287,353)	(2,995,761)
Financial leases (net outflows)	(46,161)	(88,814)
Dividends paid	(1,965,293)	(139,321)
<i>Net cash (used in)/ provided by financing activities</i>	<u>(2,482,496)</u>	<u>5,488,467</u>
Net (decrease)/increase in cash and cash equivalents	(925,606)	135,781
Cash and cash equivalents, beginning of year	2,751,678	2,297,534
Foreign exchange gains on the translation of cash and cash equivalents	911,346	648,634
Foreign exchange losses on the translation of cash and cash equivalents	(875,309)	(330,271)
Cash and cash equivalents, end of year	<u>1,862,109</u>	<u>2,751,678</u>

The accompanying notes on the following pages
are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***1. GENERAL INFORMATION**

Naftna Industrija Srbije A.D., Novi Sad (the Oil Industry of Serbia, a Shareholding Company from Novi Sad, hereinafter: the “Company” or “NIS”) was originally established after World War II when the research and production of oil and natural gas, as well as the oil derivatives distribution and trade, started. The Company was organized in accordance with the Government of the Republic of Serbia Decision number 05/023-4377/2005-1 as of July 7, 2005 on the foundation of the Shareholding Company for research, production, processing, trade and distribution of oil and oil derivatives, and research and production of natural gas, NIS A.D., Novi Sad (Official Gazette of the Republic of Serbia 74/2005). NIS is one of the three legal successors of the Public Enterprise, Oil Industry of Serbia (“JP NIS”), Novi Sad pursuant to the Law on Abrogation of the Law on Founding a Public Company for Exploration, Production and Distribution of Oil and Natural Gas (Official Gazette of the Republic of Serbia, number 74/2005) and pursuant to their Founding Act, assumed the rights, liabilities, assets, employees, documentation and contracts of the economic entity the Public Company for Exploration, Production and Distribution of Oil and Natural Gas (NIS JP). The distribution of rights, assets and liabilities of NIS JP to the newly founded established companies was executed on July 1, 2005 and the Company was registered on October 1, 2005.

The Company operates in accordance with the regulations set by the Government of the Republic of Serbia, dealing with oil derivatives and gas sales prices conformed to the fluctuation in the price of the crude oil on the World Market. The By-law also prescribes that NIS is obliged to enable the use of all its capacities for oil refining under equal conditions to the interested parties entered in the Court Register as entities involved in oil and oil derivatives distribution, under the same or comparable circumstances.

The Head Office is located in Novi Sad, 12 Narodni Front Street. The Company had 12,603 employees at December 31, 2007 (December 31, 2006: 12,928 employees).

2. BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION**2.1. Scope of the Consolidated Financial Statements**

The consolidated financial statements include the financial statements of the parent company – NIS A.D., Novi Sad and the following domestic and foreign subsidiaries:

<u>Subsidiary</u>	<u>% of Equity Interests</u>
1 O Zone a.d., Beograd	100.00%
2 NIS Oil Trading, Frankfurt, Germany	100.00%
3 NIS Oversiz d.o.o., Moscow, Russian Federation	100.00%
4 Jubos d.o.o., Bor	51.00%
5 Svetlost d.o.o., Bujanovac	51.32%
6 Ranis, Moscow area, Russia	51.00%

All intercompany balances and transactions between the aforelisted subsidiaries have been eliminated upon consolidation.

The assets and liabilities of entities located abroad have been translated in the local currency by applying the official exchange rate effective as of the consolidated balance sheet date. The income statement and cash flows were translated by applying the average exchange rate. Any adjustments arising from translation are presented within translation reserves.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

2. BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.1. Scope of the Consolidated Financial Statements (Continued)

Given that in the opinion of the Company, related parties: 1) Doge SPA, Milano, 2) Euro International Ltd, Bermuda, 3) RDS, London, did not undertake any transactions in the course of 2006 and 2007, the financial statements of the aforementioned entities are not included in the accompanying consolidated financial statements of the Company.

The consolidated financial statements of the Company for the first time include the consolidated financial statements of the entity Ranis, Moscow Area, Russia. In the management's opinion, the results of operations of the aforementioned entity realized in the period until January 1, 2007 were not materially significant for the consolidated financial statements, and were therefore not included in the consolidated financial statements of the previous period.

2.2. Basis of Preparation and Presentation of Consolidated Financial Statements

Pursuant to the Law on Accounting and Auditing (Official Gazette of the Republic of Serbia no. 46 of June 2, 2006), legal entities and enterprises incorporated in Serbia are required to maintain their books of account, to recognize and value assets and liabilities, income and expenses, and to present, submit and disclose financial statements in conformity with the prevailing legislation and professional rules which include: the Framework for the Preparation and Presentation of Financial Statements (the "Framework"), International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), as well as the related interpretations representing an integral part of these standards.

Pursuant to its Decision numbered 011-00-738-2003-01 of December 30, 2003, the Republic of Serbia Ministry of Finance determined and issued the Framework and IAS that were applied as of December 31, 2002, and upon which both the previous and the Law on Accounting and Auditing from 2006 were based.

The amendments to the IAS, as well as the newly-issued IFRS and the related interpretations issued by the International Accounting Standards Board and the International Financial Reporting Interpretations Committee, upon the aforementioned date, were officially adopted pursuant to a Decision enacted by the Ministry of Finance of the Republic of Serbia with reference to the issuance of International Financial Reporting Standards (number 401-00-11/2008-16) and published in the Official Gazette of the Republic of Serbia number 16 of February 12, 2008 and, therefore could not be applied in the preparation of the accompanying financial statement of the Company for the year 2007.

The Company's management assesses the standards and interpretations the application of which is required under the February 12, 2008 Decision of the Ministry of Finance, and once the standards and interpretations relevant to the Company's activities have been adopted, intends to apply them in the preparation of the financial statements for the period beginning January 1, 2008.

In accordance with the aforementioned and with regards to the potentially material effects of the departures of the accounting regulations of the Republic of Serbia and IAS, in effect as of December 31, 2002 (officially published and whose application was legally prescribed in the Republic of Serbia prior to February 12, 2008), from the newly-issued IFRS and amended IAS, the accompanying financial statements cannot be described as having been prepared in accordance with IFRS and IAS.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

2. BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.2. Basis of Preparation and Presentation of Consolidated Financial Statements (Continued)

In addition, the accompanying financial statements are presented in the format prescribed under the "Guidelines on the Prescribed Form and Content of the Financial Statements of Enterprises, Cooperatives and Entrepreneurial Ventures" (See Official Gazette of the Republic of Serbia, no. 114 of December 22, 2006). Such statements represent the complete set of financial statements as defined under the law, which differ from those defined under the provisions of IAS 1, "Presentation of Financial Statements," and differ in some respects, from the presentation of certain amounts as required under the aforementioned standard.

In the preparation of the accompanying financial statements, the Company adhered to the accounting policies described in Note 3 which are in conformity with the accounting and tax regulations prevailing in the Republic of Serbia.

The Company's financial statements are stated in thousands of dinars (RSD). The dinar is the official reporting currency in the Republic of Serbia.

2.3. Comparative Figures

In order to conform the presentation of figures to the current reporting period, certain reclassifications have been made to the amounts reported in the consolidated financial statements for the year ended December 31, 2006.

2.4. Use of Estimates

The presentation of the consolidated financial statements requires the Company's management to make best estimates and reasonable assumptions that effect: the assets and liabilities amounts, the disclosure of contingent liabilities and receivables as of the date of preparation of the financial statements, as well as the income and expenses arising during the accounting period. These estimations and assumptions are based on information available to us, as of the date of preparation of the financial statements. However, actual results may vary from these estimates.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Income and Expense Recognition

Income is measured at the fair value of the consideration received or receivable, net of discounts and value added tax. Income from sales is recognized when the risk and rewards associated with the right of ownership are transferred to the customer, which is considered to be the date upon which products are delivered to the customer.

At the time when income is recognized, the related expenditure is also recognized (as per the "matching principle").

Interest income and interest expense are credited or charged to the income statement in the accounting period to which it relates, with the exception of interest for which is certain that will not be collected.

Income from dividends is recorded at the moment of right to dividend realization.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.2. Foreign Exchange Gains and Losses

Assets and liabilities' components denominated in foreign currencies are translated into dinars at the official exchange rates prevailing at the balance sheet date.

Foreign currency transactions are translated into dinars at the official exchange rates in effect at the date of each transaction.

Foreign exchange gains or losses arising upon the translation of assets, liabilities and transactions are credited or debited as appropriate, to the income statement.

3.3. Taxes and Contributions

Income Tax Expense

Current Income Taxes

Current income tax represents an amount that is calculated and paid in accordance with the effective Republic of Serbia Income Tax Law.

Income tax is payable at the rate of 10% on the tax base reported in the annual corporate income tax return. The taxable base stated in the income tax return includes the profit shown in the statutory statement of income, as adjusted for differences that are specifically defined under statutory tax rules.

The tax regulations in the Republic of Serbia do not envisage that any tax losses of the current period be used to recover taxes paid within a specific carryback period. However, any current year losses may be used to reduce or eliminate taxes to be paid in future periods, but only for duration of no longer than ten ensuing years.

Deferred Income Taxes

Deferred income taxes are provided using the balance sheet liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying values in the financial statements. The currently-enacted tax rates or the substantively-enacted rates at the balance sheet date are used to determine the deferred income tax amount. Deferred tax liabilities are recognized on all taxable temporary differences. Deferred tax assets are recognized for all deductible temporary differences, and the tax effects of income tax losses and credits are available for carryforward, to the extent that it is probable that taxable profit will be available, against which the deductible temporary differences and the tax loss/credits of the carryforwards can be utilized.

Deferred income taxes are either charged or credited to the income statement, except in so far as they relate to items that are directly credited or charged to capital, and in that instance, the deferred taxes are then also recognized under equity.

Indirect Taxes and Contributions

Indirect taxes and contributions include property taxes and various other taxes and contributions paid, pursuant to effective republic and municipal regulations.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Employee Benefits***a) Taxes and Contributions Made to the Employee Social Security and Insurance Funds*

In accordance with regulatory requirements, the Company is obligated to pay contributions to tax authorities and to various state social security funds that guarantee social security insurance benefits to employees. These obligations involve the payment of taxes and contributions on behalf of the employee, by the employer, in an amount computed by applying the specific, legally-prescribed rates. The Company is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to the applicable government funds. These taxes and contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

b) Obligations for Employee Jubilee Awards and Retirement Benefits

In accordance with the Collective Bargaining Agreement, the Company is obligated to pay retirement benefits in an amount equal to three monthly salaries earned by the employee in the month preceding his/her retirement, which is not to be less than three average salaries in the Company at the time of the employee's retirement.

In addition, the Company is obligated to pay jubilee awards depending on an employee's continued service with the Company and its legal predecessors in the amount of one to four average salaries earned by the employee in the month preceding the month of payment in accordance with the following schedule:

<u>Years of Service</u>	<u>Number of Average Salaries</u>
10	1
20	2
30	3
35	3.5
40	4

With the exception of one subsidiary, the Company neither formed a provision for employee benefits paid upon regular retirement nor for jubilee awards as required by IAS 19, "Employee Benefits."

c) Voluntary Retirement

Pursuant to its Decision regarding the stimulant measures aimed to decrease the headcount, the Company's the Board of Directors determined one-time termination benefits for voluntary redundancy according to the following schedule:

<u>Number of Months up to Fulfillment of Retirement Condition</u>	<u>Amount of Termination Benefit as per Service Year</u>
up to 12 months	4 salaries
from 12 to 24 months	6 salaries
from 24 to 36 months	8 salaries
from 36 to 48 months	10 salaries
from 48 to 60 months	12 salaries
over 60 months	14 salaries

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Employee Benefits (Continued)***c) Voluntary Retirement (Continued)*

Payments for voluntary retirements are charged to the current period results in the amount of one-time termination benefits calculated pursuant to the aforementioned methodology in the moment when the Company can with certainty determine the number and the total value of severance pays.

d) Participation of Employees in Profit Distribution

Pursuant to the Collective Bargaining Agreements, the NIS employees are entitled to participate in a company-sponsored profit distribution program stipulating that such participation in profit may not be lower than 10% of the amount of profit earned. The employees share in profit is charged to the net profit for the year.

3.5. Provisions

Provisions are made and recognized when the Company has a legal and pending obligation originating in previous events, and when it is probable that the expenditure of revenue-generating funds will be required upon the settlement of such liabilities, and when one can reasonably estimate the amount of the liability. The Company believes that it has no liabilities for environmental protection, actual or contingent, not basis for provision regarding this issue.

3.6. Property, Plant and Equipment, and Intangible Assets

In accordance with the new accounting regulations applicable in the Republic of Serbia, the cost of property and equipment as of December 31, 2003 is treated as a deemed cost as at January 1, 2004, and equals the tax base used in the computation of depreciation for tax purposes.

In 2005, the Company engaged an independent appraiser to determine the value of property, plant and equipment as of January 1, 2005 in accordance with IAS 16 "Property, Plant and Equipment." In the subsidiary O Zone a.d., Beograd the appraisal was performed at January 1, 2007. Positive appraisal effects relating to the valuation performed in the aforesaid subsidiary were credited to revaluation reserves, while the negative appraisal effects were charged to the profit for the year.

Additions to property and equipment are recorded at cost. Cost represents the prices billed by suppliers together with all costs incurred in bringing new fixed assets into use, net of discounts.

Subsequent expenditure such as modification to property, plant and equipment, or adaptation is recognized as an increase in the cost of the respective assets, when it is probable that future economic benefits, in excess of the originally assessed standard of performance will flow to the Company, and when the cost can reliably be measured.

Repairs and maintenance are expensed as incurred and are stated under "Operating expenses."

Intangible assets mainly include concessions, software and licenses for computer applications.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.7. Investment Property**

Investment property is property held to earn rental income and/or for capital appreciation, and is stated at fair value at the balance sheet date. Gains or losses arising due to changes in the fair value of investment property are included in profit or loss for the period in which they arise.

3.8. Depreciation and Amortization

Depreciation and amortization are individually charged for each property, plant and equipment, and intangible asset with the exception of tools and small inventory which are written off as a group. The individual calculation of depreciation and/or amortization involves the write-off of either one item of fixed assets, or several items of fixed assets from the same group, which have been placed into use in the same month.

The depreciation of property, plant and equipment is computed on a straight-line basis in order to fully write off the cost of such assets over their estimated useful lives. Depreciation is computed onto the cost or revalued amount of property, plant and equipment, as well as assets that have been placed into use during the year using the straight-line method.

Depreciation and amortization rates in use for the major classes of property, plant and equipment and intangible assets are as summarized below:

Buildings	1.5 – 7.2%
Equipment:	
Reservoirs and concrete pipelines	2 – 16%
Vehicles (trucks and automobiles)	14 – 33%
Laboratory equipment and measurement instruments	11 – 20%
Other machines	3 – 33%
Small tools and fixtures	3 – 14%
Furniture	10 – 33%
Computers	12.5 – 25%
Software	20%

3.9. Inventories*Inventories of Raw Material, Spare Parts and Small Tools and Fixtures*

The cost of raw materials, spare parts, tools and fixtures are stated at cost. The cost includes the invoiced value, transport, customs and other attributable expenses. Small tools are fully written off when issued into use.

Work-in-Progress and Finished Goods

The inventories are stated at the lower of cost and net realizable value. The net realizable value is the price at which inventories can be realized throughout the normal course of business, after allowing for the costs of realization.

The cost of work-in-progress and finished goods inventories includes all production-related costs and an attributable portion of production overheads.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.9. Inventories (Continued)***Goods*

Goods in wholesale are stated at wholesale prices as decreased by wholesale margins or at cost as increased by excise duties.

The inventories of goods in retail sale are carried at retail prices decreased for margins, value added tax and other fees calculated at the moment of the oil derivative sales transaction.

At the end of the accounting period, the value of inventories in wholesale and retail sale is adjusted to cost through the allocation of the recorded price variances, which is calculated on an average basis between the cost of goods sold and the inventories held at the year-end.

In the event of price movements, the prices of goods held for retail and wholesale trade are adjusted to the newly effective prices. The effects of price-leveling are charged or credited to the cost of goods sold.

Provisions that are charged to other expenses, are made where appropriate in order to reduce the value of inventories to management's best estimate of net realizable value. Inventories that are found to be of a damaged or of a substandard quality are written off in full.

3.10. Financial Instruments

Financial assets and liabilities are recognized on the internal balance sheet at the moment in which the Company has become a party to the contractual provisions of a particular financial instrument.

Financial assets cease to be recognized when the Company loses control of the contractual rights governing such instruments, which occurs when the rights of use of such instruments have been realized, expired, abandoned, and/or ceded. Financial liabilities cease to be recognized when the Company fulfills the obligations, or when the contractual repayment obligation has either been cancelled or has expired.

Equity Investments

Equity investments are comprised of stakes in the equity of subsidiaries, securities available-for-sale relating to the equity investments in banks and other legal entities, as well as trading securities.

Subsidiaries represent legal entities in which the Company holds an ownership interest of more than 50 percent, or more than one half of the voting rights, or in which the Company can exercise control of financial and operating policies.

Investments in the equity of subsidiaries are initially valued at cost determined by an independent appraiser, for the purpose of the Company's foundation. If there is objective evidence that an impairment loss on investments has been incurred, estimation of recoverable amount of investment is performed and potential impairment losses are recognized in the income statement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.10. Financial Instruments (Continued)***Equity Investments (Continued)*

Securities available for sale (equity investments in banks and other legal entities) for which an active market and reliable market values exist are measured at fair value. The fair value is defined as an amount at which an asset can be exchanged, or a liability settled, between knowledgeable willing parties in an arm's-length transaction. Unrealized gains and losses arising from changes in the fair value sale are recognized within revaluation reserves and included in the income statement when impairment in value has arisen.

Trading securities encompass equity investments in the equity of other legal entities measured by applying the appraised cost method performed by an independent appraiser (for equity investments for which no reliable market information exists) or at fair value (for the equity investments for which reliable market information does exist). Trading securities are classified within current assets based on the Decisions enacted by the Board of Directors of the Company with reference to the sale of these equity investments.

Other Long-Term Financial Investments

Other long-term financial investments include long-term loans based on rescheduling of debt of domestic legal entities, loans approved to employees based on extended residential loans and receivables based on repurchase of apartments, which are available for repurchase. Long-term loans granted to employees are stated in the amount of funds granted. Apartments rented to employees, which may be a subject of repurchase by employees are measured at market value of apartments.

Accounts Receivable and Other Current Receivables

Accounts receivable are stated at invoiced values less any allowance for impairment. In accordance with the NIS accounting policy, provision was made for domestic customers and placements that are more than 60-days past due, receivables for liquid oil gas, delivered goods and resources to domestic consumers in the category "distance heating system" (heating plants) and consumers financed from the budget more than 90-day past due and foreign receivables and placements that are more than 180-days past due. A write-off of uncollected receivables is performed either pursuant to a court order, or based on a settlement agreed between the parties involved, or otherwise, on the basis of a resolution of the Company's Board of Directors.

Cash and Cash Equivalents

Cash and cash equivalents comprise cash and balances on current bank accounts, and demand deposits.

Financial Liabilities

Financial liabilities are classified in accordance with the respective contractual provisions governing such instruments.

Borrowings from banks and suppliers are initially measured at the amount of the loan disbursements received, and are subsequently stated at the amortized cost that is computed based on the contractual interest rate, which approximates effective interest rate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.10. Financial Instruments (Continued)

Accounts Payable

Accounts payable are initially measured at the amount of the funds received, and are subsequently stated at amortized cost that is computed based on the contractual interest rate, which approximates effective interest rate.

3.11. Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all risks and rewards of ownership to the Company. All other leases are classified as operating leases.

Assets held under finance leases are recognized as assets of the Company at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation.

Rentals payable under operating leases are recognized on a straight-line basis over the term of the relevant lease.

3.12. Fair Value

It is a policy of the Company to disclose the fair value information of those components of assets and liabilities for which published or quoted market prices are readily available, and of those for which the fair value may be materially different than their recorded amounts. In the Republic of Serbia, sufficient market experience, stability and liquidity do not exist for the purchase and sale of receivables and other financial assets or liabilities, for which published market prices are presently not readily available. As a result of this, fair value cannot readily or reliably be determined in the absence of an active market.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

4. OPENING BALANCE ADJUSTMENTS

	Effects for the Year 2007	
	Retained Earnings as of	
	January 1,	January 1,
	2007	2006
	<u>5,805,764</u>	<u>1,055,830</u>
Effects of error correction		
Tax calculated on prior period profit	(502,115)	-
Adjustment in the calculation of crude oil cost	(24,707)	-
Cost of provisions for employee benefits	(19,401)	-
Reconciliation of equity of a subsidiary with data registered with the Serbian Business Registers Agency	56,372	-
Change in the consolidation scope	1,884	-
Liabilities from previous years	(2,724)	-
Interest expenses from previous years	-	(689,894)
Income from surpluses of crude oil in previous years	-	676,508
Liabilities from previous years (Duferco)	-	(576,829)
Provision for inventories under legal proceedings	-	(48,890)
Initially filling of oil pipeline – valuation	-	1,398,695
Reconciliation of internal balances	-	(375,659)
Adjustment of expenses based on successfulness in oil research	-	304,526
Employee share in profit	-	(327,019)
Other error adjustments	<u>(4,762)</u>	<u>(97,736)</u>
Total adjustments	<u>(495,453)</u>	<u>263,702</u>
Retained earnings, January 1, 2007, after adjustments	<u><u>5,310,311</u></u>	<u><u>1,319,532</u></u>

The opening balance adjustments as of January 1, 2007 relate to the following:

- The adjustment of taxes in the amount of RSD 502,115 thousand represents the adjustment to the calculation of income taxes based on the Decision issued by the Tax Administration for the year 2006. In 2007, the Company paid in the aforementioned taxes and ever since it has been involved in legal proceedings with the Tax Administration carried before the Supreme Court regarding the methodology of calculating income taxes which had not been resolved until the date of issuing these consolidated financial statements.
- The adjustment to the cost of crude oil of RSD 24,707 thousand represents the correction of an error which occurred in calculating the value of crude oil.
- The adjustment to the cost of provisions for employee benefits amounting to RSD 19,401 thousand relates to the adjustments for employee benefits dating from prior period.
- The adjustment to do with the reconciliation of equity of a subsidiary with data registered with the Serbian Business Registers Agency amounting to RSD 56,372 thousand is associated with the reconciliation of the amount of capital in O Zone a.d., Beograd as recorded in its business books and the amount entered in the Business Register which leads to the adjustment of revaluation reserve, retained earnings and reserves.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***4. OPENING BALANCE ADJUSTMENTS (Continued)**

- The adjustment arising from the change in the scope of consolidation amounting to RSD 1,884 thousand represent the adjustment due to the inclusion of the financial statements of the subsidiary Ranis, Moscow Area, Russia into the Company's consolidated financial statements.
- The adjustment arising from prior period liabilities of RSD 2,724 thousand is associated with adjustments arising from the subsequently identified liabilities dating from prior period.

The opening balance adjustments as of January 1, 2006 relate to the following:

- The interest related expenses from previous years of RSD 689,894 thousand relate to the interests accrued in the period between 2001 and 2005, mostly accrued on long-term borrowings.
- The income from crude oil surpluses from the previous years of RSD 676,508 thousand mostly relate to the supplies of RSD 305,775 thousand, recorded in the books pursuant to the notice received from JANAF d.d., the Republic of Croatia, on the established quantities of oil from previous years and errors found in measuring of received crude oil of RSD 370,733 thousand.
- Other expenses in the amount of RSD 576,829 thousand relate to liabilities to the entity Duferco, Italy, assumed from the entity Sartid from Smederevo are settled in accordance with December 1, 2005 Decision of the Government of the Republic of Serbia.
- The allowances for the value of crude oil supplies located in JANAF relate to the value adjustment to the average purchase cost in the amount of RSD 1,398,695 thousand.
- The amount of RSD 375,659 thousand relates to adjustments arising from the internal reconciliation of receivables and payables within NIS.
- The activation of an oil rig dating from prior period and amounting to RSD 304,526 thousand represents the adjustment to the amount of fixed assets based on putting in operation assets which were previously charged to the income statement.
- The distribution of profit to employees based on the share in profit in the amount of RSD 327,019 thousand represents the adjustment of costs for employee share in profit from the year 2005.

5. SALES OF GOODS, PRODUCTS AND SERVICES

	Year Ended December 31,	
	2007	2006
Sale of products, goods and services on:		
- domestic market	149,212,692	146,874,303
- foreign market	10,362,792	7,040,253
	<u>159,575,484</u>	<u>153,914,556</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

6. COST OF MATERIALS

	Year Ended December 31,	
	2007	2006
Production material	63,214,168	53,512,006
Other material	1,512,793	2,178,260
Electricity	616,656	594,718
Fuel and energy	1,949,267	2,298,873
	<u>67,292,884</u>	<u>58,583,857</u>

7. STAFF COSTS

	Year Ended December 31,	
	2007	2006
Net salaries and benefits	6,171,438	5,650,671
Contributions paid by the employees	2,815,443	2,537,351
Contributions paid by the employer	1,760,949	1,511,795
Subcontractors' fees	54,463	13,527
Remunerations to the members of Board of Directors and Supervisory Board	82,964	61,504
Incentive severance payments	1,184,359	1,359,460
Retirement benefits and jubilee awards	268,636	256,536
Travel expenses and per diems	344,612	324,467
Voluntary pension insurance	330,414	313,081
Transportation of employees	317,530	323,608
Financial assistance to employees and members of their families	138,885	64,781
Temporary and seasonal employees	813,257	635,205
Participation of employees in profit sharing	809,645	697,087
Other considerations paid to employees based on the Board of Directors Decision	1,006,079	-
Other payments to and on behalf of employees	117,911	218,754
	<u>16,216,585</u>	<u>13,967,827</u>

Incentive severance payments of RSD 1,184,359 thousand relate to one-off retirement payments made to 716 Company employees for their voluntary retirement in 2007. The voluntary redundancy program implementation was carried out pursuant to the Board of Directors' Decisions on stimulant measures aiming to reduce the headcount in NIS A.D. dated February 23, 2006, and Amendments to the Decision as of September 15, 2006 and May 24, 2007 (Note 3.4c).

Other payments to and on behalf of employees paid in accordance with the Decision of the Board of Directors represent the write-off of short-term receivables from employees based on the loans for heating, winter food and books extended in accordance with the Decision of the Company's Board of Directors dated December 27, 2007 whereby these loans were converted into earnings of these employees.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***8. OTHER OPERATING EXPENSES**

	Year Ended December 31,	
	2007	2006
Production related costs	166,602	419,702
Quality control	164,947	147,681
Telecommunications	271,272	224,106
Transportation	870,443	708,141
Maintenance	1,560,527	1,779,089
Rent	136,997	221,604
Advertising and marketing	460,126	434,705
Research costs	172,703	61,574
Refining of waste waters	173,001	151,629
Consultant	741,304	307,853
Other production services	732,942	894,643
Other non-production services	890,607	748,497
Entertainment	169,850	178,970
Insurance premiums	699,454	645,185
Bank charges	251,156	322,178
Costs of the use of city construction land	433,489	363,085
Cost of the use of public property	163,451	104,884
Indirect taxes and contributions	2,329,174	1,397,602
Cost of acquisition of plane tickets	145,132	50,140
Other	532,713	337,552
	<u>11,065,890</u>	<u>9,498,820</u>

Other indirect taxes and contributions of RSD 2,329,174 thousand primarily relate to various taxes and fees levied on the oil production (concessions) in Angola in the amount of RSD 1,240,674 thousand.

9. FINANCE INCOME

	Year Ended December 31,	
	2007	2006
Interest income	2,687,181	1,386,194
Foreign exchange gains	7,110,355	7,838,125
Other finance income	165,607	157,702
	<u>9,963,143</u>	<u>9,382,021</u>

10. FINANCE EXPENSES

	Year Ended December 31,	
	2007	2006
Interest expenses	2,135,553	2,479,528
Foreign exchange losses	5,207,260	4,859,760
Other finance expenses	611,743	105,078
	<u>7,954,556</u>	<u>7,444,366</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

11. OTHER INCOME

	Year Ended December 31,	
	2007	2006
Write-off of liabilities	512,156	1,274,965
Collected receivables previously written off and the release of allowance for impairment (Note 23)	1,861,774	5,804,810
Penalties, rewards and damages collected	130,220	115,837
Inventory count surpluses	172,646	157,812
Gains on the sale of equity investments and long-term securities	3,040	567
Gains on the sale of property, plant and equipment	55,479	26,220
Sale of material	9,555	9,959
Other income	507,363	480,253
	<u>3,252,233</u>	<u>7,870,423</u>

12. OTHER EXPENSES

	Year Ended December 31,	
	2007	2006
Losses on disposal of property and equipment	458,657	924,428
Inventory count shortages and write-off of inventories	367,458	740,225
Write-off of receivables	341,897	147,765
Impairment of receivables (Note 23)	2,869,097	9,085,584
Impairment of fixed assets (Note 14)	178,837	882,277
Effects of fair value adjustment of equity investments	20,778	-
Humanitarian, cultural, educational and sport expenses	321,932	257,061
Fines, penalties and damages	372,820	104,418
Property, investment property and equipment negative appraisal effects (Notes 14 and 15)	1,488,424	-
Other expenses	260,761	159,534
	<u>6,680,661</u>	<u>12,301,292</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

13. INTANGIBLE ASSETS

	Patents, Licenses and Similar Rights	Other Intangible Assets	Investments in Progress and Advances	Total
Cost				
Balance, January 1, 2006	446,864	137,326	164,069	748,259
Additions	7,197	60,858	874,643	942,698
Transfers	2,210	33,647	(35,857)	-
Transfer to leasehold improvements	-	(4,139)	-	(4,139)
Disposals	(691)	-	-	(691)
Foreign exchange fluctuations	(12,737)	-	-	(12,737)
Balance, December 31, 2006	<u>442,843</u>	<u>227,692</u>	<u>1,002,855</u>	<u>1,673,390</u>
Accumulated Amortization				
Balance, January 1, 2006	141,907	19,424	142,279	303,610
Charge for the year	21,956	27,921	-	49,877
Other	1,136	(525)	-	611
Balance, December 31, 2006	<u>164,999</u>	<u>46,820</u>	<u>142,279</u>	<u>354,098</u>
Net Book Value:				
- December 31, 2006	<u>277,844</u>	<u>180,872</u>	<u>860,576</u>	<u>1,319,292</u>
- January 1, 2006	<u>304,957</u>	<u>117,902</u>	<u>21,790</u>	<u>444,649</u>

	Patents, Licenses and Similar Rights	Other Intangible Assets	Investments in Progress and Advances	Total
Cost				
Balance, January 1, 2007	442,843	227,692	1,002,855	1,673,390
Opening balance adjustments	665	-	-	665
Additions	3,821	1,186	1,947,676	1,952,683
Activations (Note 14)	96,378	361,631	(454,151)	3,858
Transfers	(103,792)	103,792	-	-
Sale and disposal	(26,217)	-	-	(26,217)
Balance, December 31, 2007	<u>413,698</u>	<u>694,301</u>	<u>2,496,380</u>	<u>3,604,379</u>
Accumulated Amortization				
Balance, January 1, 2007	164,999	46,820	142,279	354,098
Opening balance adjustments	665	-	-	665
Charge for the year	23,634	75,287	-	98,921
Sale and disposal	(23,421)	-	-	(23,421)
Transfers	(82,654)	82,654	-	-
Other changes	-	811	-	811
Balance, December 31, 2007	<u>83,223</u>	<u>205,572</u>	<u>142,279</u>	<u>431,074</u>
Net Book Value:				
- December 31, 2007	<u>330,475</u>	<u>488,729</u>	<u>2,354,101</u>	<u>3,173,305</u>
- January 1, 2007	<u>277,844</u>	<u>180,872</u>	<u>860,576</u>	<u>1,319,292</u>

Opening balance adjustments relate to the reconciliation of values with analytical records of intangible assets.

Construction in progress and advances at December 31, 2007 of RSD 2,354,101 thousand mostly refer to the acquisition of financial and accounting information system SAP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

14. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings	Equipment and Other Assets	Construction in Progress and Advances	Total
Cost					
Balance, January 1, 2006	10,325,943	48,884,361	42,135,198	10,961,967	112,307,469
Changes in the scope of consolidation	-	31,893	1,996	1,161	35,050
Additions	146,190	76,992	356,893	6,875,558	7,455,633
Transfers	91,254	2,051,244	4,996,019	(7,138,517)	-
Transfer to other non-current assets	-	(1,091,246)	-	-	(1,091,246)
Disposals	(58)	(744,113)	(980,622)	(152,150)	(1,876,943)
Sales	-	(219,718)	(3,010)	-	(222,728)
Surpluses	-	150,200	-	-	150,200
Balance, December 31, 2006	10,563,329	49,139,613	46,506,474	10,548,019	116,757,435
Accumulated Depreciation					
Balance, January 1, 2006	-	3,092,382	6,081,714	78,653	9,252,749
Impairment of construction in progress (Note 12)	-	-	-	882,277	882,277
Charge for the year	-	1,968,816	3,335,896	-	5,304,712
Disposals	-	(332,589)	(193,419)	(78,653)	(604,661)
Transfer to other non-current assets	-	(43,524)	-	-	(43,524)
Surpluses	-	50,184	13,647	-	63,831
Balance, December 31, 2006	-	4,735,269	9,237,838	882,277	14,855,384
Net Book Value:					
- December 31, 2006	10,563,329	44,404,344	37,268,636	9,665,742	101,902,051
- January 1, 2006	10,325,943	45,791,979	36,053,484	10,883,314	103,054,720
	Land	Buildings	Equipment and Other Assets	Construction in Progress and Advances	Total
Cost					
Balance, January 1, 2007	10,563,329	49,139,613	46,506,474	10,548,019	116,757,435
Opening balance adjustment	-	(18,912)	67,510	-	48,598
Addition	-	36,351	24,264	5,712,425	5,773,040
Transfers	22,261	345,891	3,484,539	(3,852,691)	-
Transfer to intangible assets (Note 13)	-	-	-	(3,858)	(3,858)
Sale and disposals	-	(346,397)	(97,329)	-	(443,726)
Surpluses and shortages	-	17,958	3,732	-	21,690
Positive appraisal effects	949,752	654,989	-	-	1,604,741
Negative appraisal effects (Note 12)	-	(95,859)	-	(1,377,799)	(1,473,658)
Other	-	138,638	(1,124)	(2,914)	134,600
Balance, December 31, 2007	11,535,342	49,872,272	49,988,066	11,023,182	122,418,862
Accumulated Depreciation					
Balance, January 1, 2007	-	4,735,269	9,237,838	882,277	14,855,384
Opening balance adjustment	-	31,488	17,110	-	48,598
Charge for the year	-	2,023,222	3,777,095	-	5,800,317
Sale and disposal	-	(66,922)	(28,968)	(675)	(96,565)
Activations and transfers	-	80,776	36,832	(117,608)	-
Impairment (Note 12)	-	4,183	93,785	80,869	178,837
Surpluses and shortages	-	9,606	(1,175)	-	8,431
Foreign exchange fluctuations	-	-	(4)	-	(4)
Other	-	(31,880)	-	-	(31,880)
Balance, December 31, 2007	-	6,785,742	13,132,513	844,863	20,763,118
Net Book Value:					
- December 31, 2007	11,535,342	43,086,530	36,855,553	10,178,319	101,655,744
- January 1, 2007	10,563,329	44,404,344	37,268,636	9,665,742	101,902,051

Opening balance adjustments relate to the reconciliation with the values found in the analytical records of fixed assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

15. INVESTMENT PROPERTY

	December 31, 2007	December 31, 2006
Balance, January 1	738,953	1,146,789
Additions	-	144,363
Transfer to non-current assets	-	(163,163)
Sale and disposal	-	(389,036)
Transfer from non-current assets held for sale	53,397	-
Change in fair value – appraisal effects (Note 12)	(14,766)	-
	<u>777,584</u>	<u>738,953</u>

16. EQUITY INVESTMENTS

	December 31, 2007	December 31, 2006
Equity investments in:		
- subsidiaries	7,808	14,915
- associates	4,539	4,526
- banks	360,833	257,282
- other legal entities	2,376,943	2,686,407
	<u>2,750,123</u>	<u>2,963,130</u>
Allowance for impairment of equity investments (Note 23):		
- subsidiaries	(5,122)	(11,394)
- banks	(225,204)	(224,470)
- other legal entities	(1,378,156)	(1,381,054)
	<u>(1,608,482)</u>	<u>(1,616,918)</u>
	<u>1,141,641</u>	<u>1,346,212</u>

The equity investments in subsidiaries are presented in the following table:

	% Interest	December 31, 2007	December 31, 2006
Doge SPA, Milan	100%	4,048	10,149
Eurol International Ltd, Bermuda	50%	2,686	2,999
RDS, London	50%	1,074	1,245
Ranis, Moscow Area, Russia	51%	-	522
		<u>7,808</u>	<u>14,915</u>
Allowance for impairment		<u>(5,122)</u>	<u>(11,394)</u>
		<u>2,686</u>	<u>3,521</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

16. EQUITY INVESTMENTS (Continued)

The equity investments in related parties are presented in the following table:

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
Mako Nafta Skopje, Macedonia	4,282	4,269
Prokons d.o.o., Subotica	257	257
	<u>4,539</u>	<u>4,526</u>

The equity investments in banks were as follows:

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
NLB Continental banka a.d., Novi Sad	10,525	10,525
Privredna banka a.d., Pančevo	22,596	7,532
Komercijalna banka a.d., Beograd	67,942	6,940
JUBMES a.d., Beograd	36,540	6,432
Panonska banka a.d., Novi Sad	-	2,343
Vojvođanska banka a.d., Novi Sad	-	300
Sileks banka a.d., Skopje	6,887	6,867
Banks in liquidation	<u>216,343</u>	<u>216,343</u>
	360,833	257,282
Allowance for impairment	<u>(225,204)</u>	<u>(224,470)</u>
	<u>135,629</u>	<u>32,812</u>

The equity investments in other legal entities were as follows:

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
HIP Petrohemija a.d., Pančevo	2,250,245	2,590,720
Linde Carbo Dioxid a.d., Bečej	112,376	88,263
Dunav osiguranje a.d.o., Beograd	13,489	6,591
Other	833	833
	<u>2,376,943</u>	<u>2,686,407</u>
Allowance for impairment	<u>(1,378,156)</u>	<u>(1,381,054)</u>
	<u>998,787</u>	<u>1,305,353</u>

The long-term financial placements to HIP Petrohemija a.d., Pančevo stated at December 31, 2007 in the amount of RSD 2,250,245 thousand relate to rescheduled receivables from HIP Petrohemija a.d., Pančevo, which were converted into share capital of HIP Petrohemija a.d., Pančevo pursuant to the October 17, 2006 Agreement on Investments of Rights – receivables.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

17. OTHER LONG-TERM FINANCIAL PLACEMENTS

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Long-term loans to employees	2,590,965	2,255,631
Apartments held for repurchase	896,081	1,229,761
Other	<u>7,220,121</u>	<u>5,087,830</u>
	10,707,167	8,573,222
Allowance for impairment (Note 23)		
- long-term loans to employees	(38,564)	-
- other	<u>(2,623,297)</u>	<u>(1,512,997)</u>
	(2,661,861)	(1,512,997)
Current portion of long-term loans (Note 20)		
- long-term loans to employees	(29,242)	-
- other	<u>(1,976,098)</u>	<u>(1,384,158)</u>
	<u>(2,005,340)</u>	<u>(1,384,158)</u>
	<u>6,039,966</u>	<u>5,676,067</u>

Housing loans and receivables for apartment repurchase are stated in the amount RSD 2,590,965 thousand and refer to the loans approved to employees for the housing purposes, as well as to the apartments given to employees with the repurchase option. The loans extended for the purposes of improving housing conditions as well as those for apartment repurchase have a 20-year maturities, an annual interest rate of 0.5% and a currency clause (EUR). The loans for repurchase of apartments are interest-free and are extended for the period of 40 years and revalued at the retail price growth index.

The apartments intended for repurchase are stated in the amount of RSD 896,081 thousand relating to the Company's apartments used by the employees entitled, on different grounds, to repurchase the aforementioned apartments under more favorable conditions.

Other long-term financial placements

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
HIP Petrohemija a.d., Pančevo	1,920,403	2,455,578
RTB Bor	1,426,540	1,426,540
JAT, Beograd	1,467,863	750,280
JP Srbijagas, Novi Sad	2,246,461	-
Concessions in Angola	130,348	403,428
Other placements	<u>28,506</u>	<u>52,004</u>
	7,220,121	5,087,830
Current portions	(1,976,098)	(1,384,158)
Allowance for impairment (Note 23)	<u>(2,623,297)</u>	<u>(1,512,997)</u>
	<u>2,620,726</u>	<u>2,190,675</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***17. OTHER LONG-TERM FINANCIAL PLACEMENTS (Continued)**

Other long-term investments to HIP Petrohemija a.d., Pančevo are stated in the amount of RSD 1,920,403 thousand and relate to rescheduling of receivables from HIP Petrohemija a.d., Pančevo pursuant to the Agreement on Loan Rescheduling dated December 29, 2006 amounting to RSD 1,463,582 thousand. The abovementioned rescheduling involves the receivables of RSD 2,046,042 thousand (EUR 24,628,161) at September 30, 2006, due in 36 monthly installments between April 1, 2007 and March 31, 2010, payable at the official EUR rates effective at the repayment date, but no less than the installment amount translated in dinars at the Agreement date. Other long-term placements to HIP Petrohemija a.d., Pančevo amounting to RSD 456,821 thousand (USD 8,502,684) relate to the investments from previous years for which an allowance for impairment was fully provided for.

Other long-term investments to RTB Bor of RSD 1,426,540 thousand relate to long-term loan approved in the previous years. During 2004, the Company made an Agreement on Loan Rescheduling with RTB Bor whereby the aggregate of Company liabilities amounted to RSD 1,426,540 thousand. Pursuant to this Agreement the repayment is due over a period of 3 years in equal monthly installments from January 1, 2005, where interest is computed and paid at the legal penalty rate. The Company reported the receivable to the Privatization Agency for the purpose of collecting debt from the privatization income as in accordance with the Law on Privatization. The receivable was fully provided for, where the allowance for impairment was charged to the profit for the current year in an amount of RSD 1,228,644 thousand.

Other long-term financial placements of RSD 1,467,863 thousand are comprised of receivables from JAT, Beograd incurred in previous years based on jet fuel sale. On October 11, 2006, the Company signed a rescheduling protocol of the receivables stated as of August 31, 2006 when the total amount of liability was set at EUR 9,497,219. In accordance with the aforementioned protocol, the loan repayment is executed in 24 equal monthly installments, with the first one due on April 15, 2007. The interest rate for the period between August 31, 2006 and April 15, 2007 is calculated at monthly EURIBOR as increased by 4% annually. At December 21, 2007, a protocol on reschedule of balances as of November 30, 2007 was signed in the aggregate amount of EUR 12,589,400. In accordance with the aforesaid protocol, the debt repayment will be realized in 24 equal monthly installments where the first one is due on April 30, 2007. In the period from November 30, 2007 until April 30, 2008, the interest is calculated in the amount of a one month EURIBOR as increased by 2% annually.

Long-term financial placements stated in the amount of RSD 2,246,461 thousand relate to receivables from the Public Enterprise Srbijagas, Novi Sad which entered in a Rescheduling Agreement with the Company on July 16, 2007 in the aggregate amount of EUR 29,041,239. In accordance with the agreement signed, the debt is to be settled in 48 equal installments at the EUR average exchange rate as of the settlement date, which is not to be less than the dinar counter value calculated as of the debt reschedule date and where the first installment is due on December 1, 2007. The aforementioned receivables accrue interest at the rate of monthly EURIBOR increased by 1.5%.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

18. INVENTORIES

	December 31, 2007	December 31, 2006
Materials	15,341,343	9,289,801
Spare parts	3,269,088	3,838,711
Small tools and fixtures	198,989	315,248
Work in progress	916,853	444,592
Finished goods	6,344,558	7,026,858
Goods for resale	5,273,079	4,296,102
	<u>31,343,910</u>	<u>25,211,312</u>
Advances to:		
- domestic suppliers	757,349	518,850
- foreign suppliers	685,052	797,419
	<u>1,442,401</u>	<u>1,316,269</u>
Allowance for impairment (Note 23):		
- inventories	(449,732)	(881,036)
- advances to suppliers	(794,368)	(475,270)
	<u>(1,244,100)</u>	<u>(1,356,306)</u>
	<u>31,542,211</u>	<u>25,171,275</u>

The breakdown of inventories assigned under pledge lien is given in the following table:

Pledge Number	Pledgee	Legal Grounds for Pledge Lien	Amount of Impairment of Pledgee's Receivable	Item Assigned under Pledge Lien	Amount in t	Value as of December 31, 2007 in EUR	Storage Place
7/05	Unicredit bank a.d., Beograd	Agreement No. 45-473 as of August 5	EUR 10,767,921	Crude oil - REB	24,000	11,266,205	Pančevo
				Components for motor oil	8,262	2,584,017	Novi Sad
				Dizel fuel – D2	9,091	2,843,294	Pančevo
					7,580	3,819,837	Pančevo
1248/05	Unicredit bank a.d., Beograd	Agreement IV 940/04 as of June 1, 2004, Agreement no. P 362/04 and Annex 4 to the Agreement dated July 22, 2005	EUR 7,395,235	Crude oil - REB	24,000	11,266,205	Pančevo
					8,262	2,584,017	Novi Sad
				Components for motor oil	9,091	2,843,294	Pančevo
1653/05	Hipo Alpe – Adria – Bank, a.d., Beograd	Agreement no. I8296/2004 as of December 7, 2004	USD 10,000,000	Motor oil MB 95	1,800	799,687	Novi Sad
				Components for motor oil	4,100	1,282,313	Novi Sad
1655/05	Hipo Alpe – Adria – Bank, a.d., Beograd	Agreement no. I1944/04 as of December 6, 2004	USD 10,000,000	Motor oil MB 95	4,800	2,524,301	Pančevo
				Components for motor oil	19,000	5,942,425	Pančevo
1343/05	Unicredit bank a.d., Beograd	Agreement no. IV 319/05 as of March 1, 2005	USD 3,000,000	Components for motor oil	9,091	2,843,294	Pančevo
3534/06	Piraeus Atlas Banka a.d., Beograd	Agreement no. 45/454 as of June 2, 2006	EUR 10,000,000	Components for motor oil	12,200	3,815,662	Pančevo or Novi Sad
316/06	Piraeus Atlas Banka a.d., Beograd	Pledge Agreement as of January 13, 2006	EUR 15,000,000	VGO – vacuum gas oil	40,000	10,574,668	Pančevo or Novi Sad
				Crude oil	12,000	5,633,103	Pančevo or Novi Sad
				Lubricant S	8,600	2,219,481	Pančevo or Novi Sad
						<u>72,841,803</u>	

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***18. INVENTORIES (Continued)**

At December 31, 2007, the Company had no liabilities arising on the aforementioned loan agreements where the pledge lien provided established by these agreements expired. The process of removing pledges against the forgoing assets recorded in the adequate Pledge Registers is underway.

19. ACCOUNTS RECEIVABLE

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Trade receivables:		
- domestic	24,649,830	24,160,067
- foreign	3,036,556	2,446,838
	<u>27,686,386</u>	<u>26,606,905</u>
Receivables from specific operations	3,838,973	4,256,512
Interest receivables	4,121,106	2,980,322
Receivables from employees	520,128	165,897
Other receivables	9,034,399	9,106,862
	<u>17,514,606</u>	<u>16,509,593</u>
Allowance for impairment (Note 23):		
- trade receivables	(12,070,174)	(13,746,854)
- receivables from specific operations	(3,774,872)	(4,077,413)
- interest and other receivables	(11,922,637)	(10,603,924)
	<u>(27,767,683)</u>	<u>(28,428,191)</u>
	<u>17,433,309</u>	<u>14,688,307</u>

Other receivables of RSD 9,034,399 thousand include the receivables from Tecra d.o.o., Beograd of RSD 782,128 thousand based on assumed liabilities of this entity to Hypo-Alpe-Adria Bank a.d., Beograd, as well as the receivables from previous periods from GP Rad, Beograd of RSD 4,759,747 thousand, as well as receivables for the property located on the territory of the former SFRY republics and receivables for war damages caused in NATO bombing aggregating to RSD 1,363,195 thousand, for which an allowance for impairment was fully provided for.

20. SHORT-TERM FINANCIAL PLACEMENTS

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Short-term loans	139,830	205,387
Trading securities	1,053,427	1,033,105
Current portions of long-term borrowings	2,005,340	1,384,158
Other short-term financial placements	746,167	1,749,190
	<u>3,944,764</u>	<u>4,371,840</u>
Allowance for impairment (Note 23):		
- short-term domestic loans	(19,454)	(680,937)
- current portions	(71,367)	(71,367)
- trading securities	(694,316)	(673,538)
- other short-term financial placements	(191,284)	(271,188)
	<u>(976,421)</u>	<u>(1,697,030)</u>
	<u>2,968,343</u>	<u>2,674,810</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

21. CASH AND CASH EQUIVALENTS

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
Current accounts:		
- in dinars	914,562	1,340,262
- in foreign currency	792,490	947,593
Cash in hand:		
- in dinars	36,350	15,508
- in foreign currency	779	237
Appropriated financial assets and letters of credit	111,389	86,925
Securities and cash equivalents	6,539	355,643
Other	-	5,510
	<u>1,862,109</u>	<u>2,751,678</u>

22. VALUE ADDED TAX AND PREPAYMENTS

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
Prepaid value added taxes	1,348,694	246,096
Prepaid expenses	212,722	6,426
Accrued income	-	115,053
Other prepayments	360,934	365,094
	<u>1,922,350</u>	<u>732,669</u>

23. MOVEMENTS IN PROVISIONS

	Equity Investments and Long-Term Financial Placements (Notes 16 and 17)	Inventories (Note 18)	Accounts Receivable (Note 19)	Short-Term Financial Placements (Note 20)	Total
Balance, January 1, 2007	3,129,915	1,356,306	28,428,191	1,697,030	34,611,442
Charged to the Income Statement (Note 12)	1,228,686	315,069	1,325,342	-	2,869,097
Release of provision (Note 11)	(56,465)	(277,272)	(786,650)	(741,387)	(1,861,774)
Foreign exchange fluctuations	(25,145)	(12,219)	(243,598)	-	(280,962)
Other	(6,648)	-	(178,989)	20,778	(164,859)
Write-offs	-	(137,784)	(776,613)	-	(914,397)
Balance, December 31, 2007	<u>4,270,343</u>	<u>1,244,100</u>	<u>27,767,683</u>	<u>976,421</u>	<u>34,258,547</u>

24. SHARE CAPITAL

The Company's founding capital represents the share capital of the closed shareholding entity, expressed as the total monetary and non-monetary stake of the Government of the Republic of Serbia. The registered capital amounted to EUR 993,786 thousand as of May 31, 2005.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

25. LONG-TERM PROVISIONS

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Long-term provision for the restoration and re-cultivation of degraded environment	831,365	670,210
Long-term employee benefits	17,339	-
Long-term provisions for litigation	<u>125,896</u>	<u>904,271</u>
	<u>974,600</u>	<u>1,574,481</u>

Long-term provisions stated in the amount of RSD 17,339 thousand at December 31, 2007 relate to provisions formed for long-term employee benefits payable in a Company's subsidiary relating to retirement benefits and jubilee awards.

The assumptions used for the purpose of determining the present value of liabilities arising from long-term employee benefits were as follows:

	<u>December 31, 2007</u>
Discount rate	10%
Expected salary growth rate	3%

Long-term provisions for litigations stated in the amount of RSD 125,896 thousand as of December 31, 2007 pertain to the provisions formed against the losses contingent on the on-going legal suit with Energoprojekt Visokogradnja a.d., Beograd in the amount of RSD 51,885 thousand and on the litigation with the Tax Administration of RSD 74,011 thousand.

The movements on provisions were as follows:

	<u>Recultivation and Sanation of Degraded Environment</u>	<u>Employee Benefits</u>	<u>Litigations</u>	<u>Total</u>
Balance, January 1, 2006	534,113	-	-	534,113
Charge for the year	(1,095)	-	-	(1,095)
Additional provisions formed in the period	<u>137,192</u>	<u>-</u>	<u>904,271</u>	<u>1,041,463</u>
Balance, December 31, 2006	<u>670,210</u>	<u>-</u>	<u>904,271</u>	<u>1,574,481</u>
Balance, January 1, 2007	670,210	-	904,271	1,574,481
Opening balance adjustment (Note 4)	-	19,401	-	19,401
Used provisions	-	(2,062)	(830,260)	(832,322)
Additional provisions formed in the period	<u>161,155</u>	<u>-</u>	<u>51,885</u>	<u>213,040</u>
Balance, December 31, 2007	<u>831,365</u>	<u>17,339</u>	<u>125,896</u>	<u>974,600</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

26. LONG-TERM BORROWINGS

	December 31, 2007	December 31, 2006
Long-term borrowings:		
- Paris Club of Creditors	3,272,530	3,566,614
- London Club of Creditors	299,299	416,106
- domestic	5,979,720	6,400,500
- foreign	5,265,895	10,189,281
	<u>14,817,444</u>	<u>20,572,501</u>
Other	3,571	155,691
	<u> </u>	<u> </u>
Current portions of long-term borrowings (Note 28)	(2,067,608)	(2,088,394)
	<u> </u>	<u> </u>
	<u>12,753,407</u>	<u>18,639,798</u>

The review of long-term borrowings is presented in the following table:

<u>Creditor</u>	<u>Interest Rate</u>	<u>Currency</u>	<u>Amount in Currency</u>	<u>December 31, 2007</u>	<u>December 31, 2006</u>
Paris Club of Creditors					
Privredna banka a.d., Pančevo	5.375% p.a.	USD	23,170,945	1,244,898	1,398,513
Privredna banka a.d., Pančevo	5.5 % p.a.	EUR	2,484,508	196,863	197,547
Erste banka a.d., Novi Sad	USD LIBOR + 4.923+0.5% p.a.	USD	3,821,642	205,324	215,749
Erste banka a.d., Novi Sad	EURIBOR+2.93+0.5%	EUR	808,126	64,032	60,974
Erste banka a.d., Novi Sad	5.50%	EUR	1,207,906	95,710	90,366
Erste banka a.d., Novi Sad	5.9% p.a.	EUR	2,554,840	202,436	190,388
NLB Continental banka a.d., Ljubljana	5.38%	USD	4,654,079	250,048	278,422
NLB Continental banka a.d., Ljubljana	6M LIBOR + 0.5% p.a.	JPY	538,192,853	258,333	271,860
NLB Continental banka a.d., Ljubljana	6M LIBOR + 0.5% p.a.	USD	2,312,857	124,262	138,326
Vojvodanska banka a.d., Novi Sad	5.5 % p.a.	EUR	7,958,786	630,624	724,469
				<u>3,272,530</u>	<u>3,566,614</u>
London Club of Creditors					
Erste banka a.d., Novi Sad	3.75% p.a.	USD	1,507,212	80,978	135,594
Erste banka a.d., Novi Sad	6.75% p.a.	USD	63,853	3,431	3,830
Komercijalna banka a.d., Beograd	3.75% p.a.	USD	435,161	23,380	52,198
NLB Continental banka a.d., Ljubljana	3.75% - 6.75% god.	USD	671,371	36,071	40,266
Vojvodanska banka a.d., Novi Sad	5.5 % p.a.	EUR	1,443,220	114,355	131,373
Vojvodanska banka a.d., Novi Sad	5.5 % p.a.	USD	764,687	41,084	52,845
				<u>299,299</u>	<u>416,106</u>
Other long-term borrowings					
Vojvodanska banka a.d., Novi Sad					
- Republic of Serbia	-	USD*	4,023,896	216,190	241,336
International Bank for Reconstruction and Development (IBRD) - Republic of Serbia	**	EUR	51,655,265	4,092,967	4,342,164
	3M EURIBOR + 2.75%				
Hypo-Alpe-Adria Bank a.d., Beograd	p.a.	EUR	21,083,333	1,670,563	1,817,000
				<u>5,979,720</u>	<u>6,400,500</u>
Other foreign long-term borrowings					
Sinochem International Oil Company Limited, London	6M LIBOR + 0.7% p.a.	EUR	97,976,476	5,263,967	7,345,281
RIEF, Holandija	3M EURIBOR + 1.4% p.a.	EUR	-	-	1,659,000
EFG NEF BV Holandija	3M EURIBOR + 1.6% p.a.	EUR	-	-	1,185,000
Komercijalna banka a.d., Budva	9% p.a.	EUR	24,336	1,928	-
				<u>5,265,895</u>	<u>10,189,281</u>
				<u>14,817,444</u>	<u>20,572,501</u>

* Clearing Dollars

** In accordance with the Law on certification of the agreement between the Federal Republic of Yugoslavia and IBRD

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***26. LONG-TERM BORROWINGS (Continued)**

The repayment of refinanced long-term loans (Paris and London Club of Creditors) realized prior to 1990 through domestic banks, and the respective interest, was frozen after the UN sanctions were imposed in May 1992.

In December 2001, the negotiations between the Republic of Serbia Government and the Paris Club of Creditors resulted in significant reduction in liabilities (the principal, interest and penalty interest accrued as of March 22, 2002) of 51% new principal with the option of additional write-off of liabilities in the ensuing three years capped at 66.67% principal. The negotiations between the Government of the Republic of Serbia and the London Club of Creditors resulted in significant reduction of liabilities (the principal, interest and penalty interest accrued as of September 30, 2004) by 62% the new principal. The Law Governing the Relations between the Federal Republic of Yugoslavia and Legal Entities and Banks within the Territory of the Federal Republic of Yugoslavia Being the Original Debtors or Guarantors toward the Paris Club and London Club Creditors came in effect on July 4, 2002 (Official Gazette of the Federal Republic of Yugoslavia number 36/2002). In conformity with the aforementioned law the Company was obliged to repay the loans, approved by the Paris and London Club of Creditors, to domestic banks under no less favorable conditions than those defined by the Agreement signed with the foreign creditors.

Paris Club of Creditors

In the previous years, the Company performed a write-off of 51% of the new principal of borrowings from the members of the Paris Club of Creditors as of March 22, 2002, with whom individual agreements on such write-offs had been signed, and reconciled the amount of new principal based on communications and annuity plans forwarded by the National Bank of Serbia.

The liabilities arising on a borrowing from the Paris Club of Creditors are repayable in semi-annual installments in the period between September 22, 2008 and March 22, 2024 at an interest rate fluctuating within semi-annual LIBOR as increased by 0.5% annually to 5.9% (dependent on the Paris Creditor Club member country and loan currency). Sixty percent of the interest accrued in the first five years of the loan repayment is capitalized and ascribed to the principal. The liabilities to Vojvodanska banka A.D., Novi Sad are to be settled semi-annually in the period between October 1, 2006 and October 1, 2013.

The liabilities to Vojvodanska banka A.D., Novi Sad stated as of December 31, 2007 of RSD 630,624 thousand relate to the refinanced foreign currency loans, received from the Paris Club of Creditors. NIS became the Paris Club of Creditors' debtor when it assumed the liabilities by signing the September 19, 1991 Agreement signed with Metanolsko-sirčetni kompleks, Kikinda. On October 14, 2003, NIS entered into contract with Vojvodanska banka A.D., Novi Sad undertaking the obligation to settle the liabilities arising from loans extended by the Paris Club of Creditors, pursuant to The Law Governing the Relations between the Federal Republic of Yugoslavia and Legal Entities and Banks within the Territory of the Federal Republic of Yugoslavia Being the Original Debtors or Guarantors toward the Paris Club and London Club Creditors. The liabilities of the Company to the Bank as of March 22, 2002 amounted to EUR 13,285,105.62, where the initial principal amounted to 7,287,523.14 EUR, and the agreed regular interest and penalty interest amounted to EUR 1,734,559.03 and EUR 4,263,023.45, respectively. The interest is computed at an annual rate of 5.5% as of March 22, 2002 and is attributed to the principal. At March 31, 2006, the Company signed a new agreement with Vojvodanska banka A.D., Novi Sad number P-02/2006 whereby 51% of the principal was written off as of March 22, 2002 of EUR 6,775,404 and the new repayment program was agreed. The repayment is due within 7 years; the annuities are repaid semi-annually starting on October 1, 2006. The interest remained at the rate of 5.5% annually.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***26. LONG-TERM BORROWINGS (Continued)***Paris Club of Creditors (Continued)*

The liability to Privredna banka A.D., Pančevo of RSD 1,441,761 thousand (USD 23,170,945 and EUR 2,484,508) relates to discharging the liabilities to the Paris Club of Creditors. The loan is being rescheduled as of March 22, 2002 and repaid in semi-annual installments until March 22, 2024. The repayment of the principal commences on September 22, 2008. In accordance with the agreement, 60% interest due in the period between March 23, 2002 and March 22, 2005, will be capitalized and paid in 14 equal and consecutive semi-annual installments, where the first and the last installment are due on September 22, 2007 and September 22, 2014, respectively. The remaining 40% of the interest is settled when due.

London Club of Creditors

The liability to Erste banka A.D., Novi Sad stated as of December 31, 2007 in the amount of RSD 80,978 thousand originates in the Agreement number 15/06-710 and is repayable in 7 semi-annual installments whereas the first and last one are due on September 30, 2006 and September 30, 2009, respectively. The liability of RSD 3,431 thousand relates to the Agreement number 1092/02 and is repayable in 30 equal monthly installments commencing from May 1, 2010 until November 1, 2024.

The liability towards Komercijalna banka A.D., Beograd of RSD 23,380 thousand as stated at December 31, 2007 arises from the Loan Rescheduling Agreement within the London Club of Creditors. The principal is payable in six-monthly installments due on Jun 20 and December 20 every year. The liabilities fully mature on December 20, 2008.

The liability to NLB Continental banka AD., Novi Sad amounted to RSD 36,071 thousand (USD 671,371). The interest is paid semi-annually starting from May 1, 2005. The first and last installment are due on May 1, 2010 and November 1, 2024, respectively.

At December 31, 2007, the long-term liabilities of RSD 155,439 thousand (EUR 1,443,220 and USD 764,687) relate to the refinanced loans realized through Vojvodanska banka A.D., Novi Sad. Pursuant to the Debt Assumption Agreement signed with Metanolsko-sirćetni kompleks, Kikinda on September 19, 1991, NIS became a debtor of the London Club of Creditors. On October 24, 2003, NIS signed an agreement with Vojvodanska banka A.D., Novi Sad on settling the obligations arising on loans extended by the creditors of the London Club as provided by the Law Governing the Relations between the Federal Republic of Yugoslavia and Legal Entities and Banks within the Territory of the Federal Republic of Yugoslavia Being the Original Debtors or Guarantors toward the Paris Club and London Club Creditors. The NIS's liability to the Bank as of March 22, 2002 amounted to EUR 1,469,071.09 and USD 840,281.26 pursuant to the Debt Assumption Agreement. The Agreement also provides that the interest liabilities are a matter of further reconciliation between the National Bank of Serbia (NBS) and the London Club Creditors. At March 31, 2006, NIS entered into a new Agreement with Vojvodanska banka A.D., Novi Sad, number L-02/2006, whereby a write-off of the 51% principal at March 31, 2004 in the amount of EUR 1,495,666, i.e., USD 792,475, as well as a new repayment program were agreed. The newly-determined repayment date falls within 7 years, where semi-annual annuities mature as of October 1, 2006. The interest remained at 5.5% annual rate.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***26. LONG-TERM BORROWINGS (Continued)***Other Domestic Loans*

The liabilities to the International Bank for Research and Development (IBRD) of RSD 4,092,967 thousand (EUR 51,655,265) as of December 31, 2007 arose from the guarantee based Agreement on ceding rights. The Agreement was signed on May 30, 2005 by the Republic of Serbia, NLB Continental bank A.D., Novi Sad, as a guarantor, and NIS Naftagas, as a debtor. According to this agreement the debtor is no longer liable to the International Bank for Research and Development (IBRD), but that it undertakes the obligation to pay the aforementioned amount to the Republic of Serbia. The Agreement is supplemented with an Annex in 2006. Pursuant to this Annex, the aggregate liabilities of NIS arising on the loan principal were translated from USD into EUR 46,444,901. This amount is increased by EUR 8,872,185, which is the total of the two principal installments the Republic of Serbia paid to the International Bank for Research and Development (in 2005) and the related interest charged for the period between January 8, 2002 and December 15, 2005.

The liabilities based on a loan from Vojvođanska banka A.D., Novi Sad of RSD 216,190 thousand (4,023,896 clearing dollars) as of December 31, 2007, relate to the loan extended for the purpose of gas line network construction in 1991 that would lead through the Socialist Federative Republic of Yugoslavia. At December 30, 2005, Vojvođanska banka A.D., Novi Sad transferred its receivable entirely to the Republic of Serbia. Accordingly, the amount of the loan has not been repaid nor has the interest been charged.

The borrowings from Hypo-Alpe-Adria Bank A.D., Beograd, amounting to RSD 1,670,563 thousand was approved on July 25, 2006, with the grace period expiring on July 31, 2007. The repayment of these borrowing falls due from August 31, 2007 and July 31, 2012.

Other Foreign Borrowings

The liability to Sinochem International Oil Company Limited, London of RSD 5,263,967 thousand at December 31, 2007, originates in the October 11, 2004 Deed of Arrangement. Sinochem sold and delivered crude oil to the Company in the period between 1991 and 1998. The Company is paying this principal in 16 equal semi-annual installments (Jun 30 and December 31) until December 31, 2011, whereas the first installment was paid on Jun 30, 2004.

As of December 31, 2007 and 2006, the maturities of long-term liabilities were as follows:

	December 31, 2007	December 31, 2006
Up to one year	2,067,608	2,088,394
From one to two years	2,095,659	5,072,222
From two to three years	2,072,553	2,255,850
From three to four years	2,088,783	2,228,990
From four to five to four years	638,791	2,245,964
From five to ten years	361,999	1,926,436
Over ten years	5,492,051	4,754,645
	<u>14,817,444</u>	<u>20,572,501</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***27. OTHER LONG-TERM LIABILITIES**

	December 31, 2007	December 31, 2006
Srbijagas A.D., Novi Sad	296,135	296,135
FAM, Kruševac	71,777	71,777
Oil refinery, Belgrade	90,153	90,153
Energoprojekt visokogradnja A.D., Beograd	167,271	167,271
RTB Bor	88,899	88,899
Finance lease liabilities	58,159	26,993
Other	<u>162,451</u>	<u>86,933</u>
	934,845	828,161
Current portions (Note 28)	<u>(46,573)</u>	<u>(35,375)</u>
	<u><u>888,272</u></u>	<u><u>792,786</u></u>

Other long-term liabilities mostly, in the amount of RSD 714,235 thousand relate to the payables to legal entities based on the Agreement on Joint Construction and mutual relationships with reference to cofinancing the construction of Tourist Center "Crni Vrh" closed on August 17, 1995. The contractor for the job was the entity NIS Jugopetrol, where the remaining contractual parties paid in the funds to the account of NIS Jugopetrol. The aforementioned liabilities pertained to amounts paid by other legal entities – signatories of the cofinancing agreement. The construction of the Tourist Center "Crni Vrh" has been temporarily suspended.

28. SHORT-TERM FINANCIAL LIABILITIES

	December 31, 2007	December 31, 2006
Current portion of:		
- long-term loans (Note 26)	2,067,608	2,088,394
- other long-term liabilities (Note 27)	46,573	35,375
Short-term loans approved by domestic banks	199,000	4,953,812
Short-term loans approved by foreign banks	8,529,777	2,528,000
Other short-term financial liabilities	<u>2,214,148</u>	<u>2,200,093</u>
	<u><u>13,057,106</u></u>	<u><u>11,805,674</u></u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***28. SHORT-TERM FINANCIAL LIABILITIES (Continued)**

The review of all short-term loans is given in the table below:

	Interest Rate	Currency	Amount in Currency	December 31, 2007	December 31, 2006
Short-term loans approved by domestic banks					
Alpha bank a.d., Beograd	Bank's regular interest	RSD		199,000	-
Vojvodanska banka a.d., Novi Sad	5.5% p.a.	RSD		-	201,922
Komercijalna banka a.d., Beograd	7.1% p.a.	RSD		-	300,952
Unicredit bank a.d., Beograd	1M EURIBOR + 3.75% p.a.	RSD		-	2,080,938
Banca Intesa a.d., Beograd	3M EURIBOR + 3% p.a.	RSD		-	790,000
Piraeus Bank a.d., Beograd	3M EURIBOR + 2.75% p.a.	RSD		-	1,580,000
				<u>199,000</u>	<u>4,953,812</u>
Short-term loans approved by foreign banks					
EFG NEF BV, Holandija	3 mesečni EURIBOR + 1.1% p.a.	EUR	41,000,000	3,248,684	-
RI Eastern European Finance BV, Holandija	EURIBOR+1.6% p.a.	EUR	34,650,000	2,745,535	-
Alpha Bank, London	3 mesečni EURIBOR + 2.7% p.a.	EUR	12,000,000	950,834	-
	EURIBOR+1.1% p.a.	EUR	20,000,000	1,584,724	-
West LB, London	6M EURIBOR + 3.05% p.a.	EUR	20,000,000	-	1,580,000
LHB Bank AG Frankfurt	3M EURIBOR + 3% p.a.	EUR	12,000,000	-	948,000
				<u>8,529,777</u>	<u>2,528,000</u>
				<u>8,728,777</u>	<u>7,481,812</u>

Other short-term financial liabilities of RSD 2,214,148 thousand mainly relate to non-interest-bearing loans approved by the Republic of Serbia Ministry of Finance for the purpose of incentive severance pays to employees within the restructuring process in NIS a.d, Novi Sad.

29. ACCOUNTS PAYABLE

	December 31, 2007	December 31, 2006
Trade payables:		
- domestic	4,596,393	5,284,240
- foreign	24,452,020	16,475,102
	<u>29,048,413</u>	<u>21,759,342</u>
Liabilities from specific operations	1,000,882	1,962,328
Advances received from domestic customers	1,680,160	716,487
Advances received from foreign customers	78	3,880
Received deposits and retainers	-	231
Other accounts payable	67,541	11,116
	<u>31,797,074</u>	<u>24,453,384</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***30. OTHER SHORT-TERM LIABILITIES AND ACCRUALS**

	December 31, 2007	December 31, 2006
Gross salaries payable	1,543,041	504,436
Liabilities to employees	20,020	22,571
Interest liabilities – domestic	970,720	1,207,911
Dividends payable	689,372	1,260,922
Other liabilities	156,941	31,266
Participation of employees in profit sharing	809,645	697,087
Other accruals	929,070	362,069
	<u>5,118,809</u>	<u>4,086,262</u>

31. VALUE ADDED TAX AND OTHER DUTIES PAYABLE

	December 31, 2007	December 31, 2006
VAT payable based on the difference between calculated VAT and previous tax	1,910,621	983,929
Excise duties	1,435,379	1,675,155
Customs duties	1,114,832	-
Other taxes, contributions and other duties payable	192,826	129,902
	<u>4,653,658</u>	<u>2,788,986</u>

32. OFF-BALANCE SHEET ITEMS

	December 31, 2007	December 31, 2006
Bills of exchange and guarantees issued	31,816,225	50,670,003
Bills of exchange and guarantees received	961,970	826,686
Loan collaterals	3,324,774	3,324,774
Property in the Republic of Croatia	5,419,459	5,419,459
Third-party goods held in warehouses	2,070,380	1,364,029
Other off-balance sheet items	-	367,050
Resources for the lock-up of fields in Angola	354,621	320,946
	<u>43,947,429</u>	<u>62,292,947</u>

Bills of exchange issued in the amount of RSD 31,816,225 thousand mostly relate to the bills of exchange issued in order to collateralize long- and short-term domestic and foreign loans.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***33. COMMITMENTS AND CONTINGENT LIABILITIES**

	December 31, 2007	December 31, 2006
Commitment for contracted investments	1,030,023	1,942,156
Commitment for contracted other purchases	683,852	22,704,000
	<u>1,713,875</u>	<u>24,646,156</u>

Commitment for contracted investments

The commitments for contracted investments relate to the purchase of finance and accounting information system – SAP.

Commitment for contracted other purchases

The commitments for contracted other purchases relate to commitments arising from the agreement on industrial consulting with the entity Shell Personnel Services B.V., Holland.

Litigation

At December 31, 2007, the aggregate of potential monetary damages arising from litigations in which the Company has been named a defendant party, amounted to RSD 8,728,218 thousand, exclusive of penalty interest, if any. The Company made provisions for four such litigations of RSD 125,896 thousand (Note 25). Although it is not possible to predict the final outcome of such litigations with any certainty, the Company's management does not expect unfavorable outcome of materially significant proceedings and, accordingly, no additional provisions were recorded in these financial statements. In addition, the worth of lawsuits the Company filed against third parties amounts to RSD 8,094,108 thousand, the litigations which either have not been disclosed in the accompanying financial statements or for which the corresponding allowance for impairment has been recorded.

34. TAXATION RISKS

The Republic of Serbia tax legislation is subject to different interpretations and changes occur frequently. The interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Company may not coincide with that of the management. As a result, transactions may be challenged by tax authorities and the Company may be assessed additional taxes, penalties and interest. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for five years.

35. FINANCIAL RISK MANAGEMENT

The Company's activities are exposed to various financial risks, including the market risk, currency risk and interest rate risk. The basic characteristics of such exposure involve the following types of risk:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

35. FINANCIAL RISK MANAGEMENT (Continued)

Credit Risk

The Company's exposure to credit risk is primarily associated with accounts receivable, other long-term investments to customers with respect to reschedule of receivables and various placements to employees.

At December 31, 2007 a significant concentration of credit risk exists in the following legal entities, and is primarily associated with the long-term and short-term financial placements and receivables.

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
JP Srbijagas, Novi Sad	6,703,067	4,672,279
HIP Petrohemija a.d., Pančevo	5,273,806	3,164,829
Rudarsko-topioničarski basen, Bor	2,593,426	1,603,547
Metanolsko sirćetni kompleks a.d., Kikinda	1,335,991	1,459,338
Jat Airways, Beograd	1,655,149	1,210,631
Hipol hemijska industrija a.d., Odžaci	449,260	723,442
Elektroprivreda Srbije	673,790	632,824
Army of the Republic of Serbia	142,662	451,092
Trizon group, Beograd	344,578	344,577
Beogradsko preduzeće za puteve, Beograd	91,850	213,121
Total	<u>19,263,579</u>	<u>14,475,680</u>

The remaining portion of the Company's accounts receivable is not under significant concentration of credit risk, given that this exposure is diversified over a large number of customers.

Foreign Exchange Risk

The majority portion of the Company's foreign transactions, as well as borrowings and placements are performed and presented in foreign currency. Accordingly, the Company is exposed to the market risk impacted by movements in foreign currency exchange rates. The Company does not have policies and procedures to reduce these risks to the minimum.

Interest Rate Risk

The Company's principal exposure to movements in interest rates relates to other long-term investments, short-term financial placements, as well as long-term and short-term loans. The Company does not have policies and procedures to reduce these risks to the minimum.

36. RELATED PARTY TRANSACTIONS

a) Transactions with subsidiaries

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
BALANCE SHEET		
Equity investments		
- Ranis, Russia	-	522
- Doge SPA, Milan	4,048	10,149
- Eurol International Ltd, Bermuda	2,686	2,999
- Jugopetrol Investments Ltd. (RDS) London	1,074	1,245
	<u>7,808</u>	<u>14,915</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

36. RELATED PARTY TRANSACTIONS (Continued)

a) Transactions with subsidiaries (Continued)

	<u>December 31, 2007</u>	<u>December 31, 2006</u>
BALANCE SHEET		
Allowance for impairment of equity investments		
- Doge SPA, Milano	(4,048)	(10,149)
- Eurol International Ltd, Bermuda	-	-
- Jugopetrol Investments Ltd. (RDS), London	<u>(1,074)</u>	<u>(1,245)</u>
	<u>(5,122)</u>	<u>(11,394)</u>
	<u>2,686</u>	<u>3,521</u>

The Company had no other transactions with subsidiaries.

b) Transactions with other related parties

In the regular course of business, the Company enters into transactions with related parties, the most significant of which is HIP Petrohemija a.d., Pančevo.

The receivables and payables as of the balance sheet date, as well as income and expenses relating to the periods under review are included in the following balance sheet items:

	<u>December 31, 2007</u>
BALANCE SHEET	
Equity investments	2,250,245
Allowance for impairment of equity investments	<u>(1,371,527)</u>
	878,718
Other long-term placements	1,920,403
Allowance for impairment of other long-term placements	(456,821)
Current portions of other long-term placements	<u>(650,481)</u>
	813,101
Receivables	<u>2,993,407</u>
Interest receivables	<u>327,547</u>
Total receivables	<u>5,012,773</u>
Advances from customers	<u>2</u>
Accounts payable	<u>1,479,538</u>
Interest payables	<u>37,382</u>
Total liabilities	<u>1,516,922</u>
NET RECEIVABLES	<u>3,495,851</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

All amounts expressed in thousands of RSD, unless otherwise stated.

36. RELATED PARTY TRANSACTIONS (Continued)

b) Transactions with other related parties (Continued)

	Year Ended December 31, 2007
INCOME STATEMENT	
Income	
Sale of products, goods and services	5,494,874
Finance income	79,349
Total income	5,574,223
Expenses	
Cost of material	698,987
Other operating expenses	154,803
Finance expenses	37,222
Total expenses	891,012
NET PROFIT	4,683,211

37. POST BALANCE SHEET EVENTS

Voluntary Retirement

In 2008, 255 employees volunteered to leave the Company based on the voluntary retirement program. The realization of the voluntary retirement program was executed in accordance with the Decision on the extension of the Decision of the Board of Directors on the incentives for the decrease of the headcount in NIS throughout 2008, dated February 8, 2008. According to the aforementioned program, the amount of RSD 359,559 thousand calculated is not final, given that the application of employees is in progress, and due to the fact that calculation was performed based on the January and February salary average.

The aforementioned number of employees applied successively, so the majority of employees applied for retirement after the adoption of the financial statements. Therefore, the management was not able to determine the structure and position of employees, i.e., determine the exact number and amount of funds necessary.

Sale of Equity Investments in DDOR Novi Sad a.d., Novi Sad

Based on the sale of shares of DDOR Novi Sad a.d., Novi Sad as of October 15, 2007, the block of shares in the Company's ownership was joined to the shares of the Development Fund of the Republic of Serbia based on the public announcement of the Deposit Insurance Agency. The Agreement on joining the shares number 1459 was signed on October 25, 2007, setting forth that all joined shares be sold at the same price. On November 30, 2007, the Deposit Insurance Agency entered into the Purchase and Sale Agreement for the shares in DDOR Novi Sad a.d., Novi Sad with the purchaser Fondiaria Sai, Italy. The agreed-upon purchase price amounted to EUR 124.8774. The shares were deposited on January 30, 2008 in accordance with the instructions on share depositing issued to the broker Sinergy capital d.o.o., Beograd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2007

*All amounts expressed in thousands of RSD, unless otherwise stated.***37. POST BALANCE SHEET EVENTS (Continued)***Agreement between the Governments of the Republic of Serbia and Russian Federation and the Company Privatization*

The Governments of the Republic of Serbia and of the Russian Federation, aiming to increase the energy security by ensuring a continuous gas and oil deliveries from the Russian Federation into the Republic of Serbia, their transit into the third world countries, production of oil derivatives located on the territory of the Republic of Serbia and their realization, agreed, among other things, on the reconstruction and modernization of the technological complex belonging the Company. Based on the forgoing, an Agreement was drafted between the RS Government and the Government of the Russian Federation regarding the cooperation in the field of oil and gas industry submitted for the adoption to the National Assembly of the Republic of Serbia. The Protocol on the basic terms of purchase of the Company shares by OAO „Gazprom njeft“ in the amount of 51% of the initial capital, was signed in Moscow on January 25, 2008. According to the aforementioned Protocol, the signatories of the Agreement came to an understanding with reference to the basic principles and procedures for the purchase of 51% shares of the Company by “Gazprom njefta.” The basic Agreement will be closed by December 31, 2008 at the latest. However, until the issuance of these financial statements, the aforementioned Agreement and Protocol had not been ratified by the Assembly of the Republic of Serbia and as such have not been executed.

38. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of balance sheet components denominated in foreign currencies, into dinars were as follows:

	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
EUR	79.2362	79.0000
USD	53.7267	59.9757

INCOME STATEMENT
Year Ended December 31, 2007
(thousands of RSD)

	Compound Income Statement	Internal Balance and Adjustments	Adjusted Income Statement
OPERATING INCOME			
Sales of goods, products and services	252,082,021	(92,506,537)	159,575,484
Own-work capitalized	560,550	(78,924)	481,626
(Decrease)/Increase of value of inventories	(187,822)	2,490	(185,332)
Other operating income	382,423	(3,209)	379,214
	<u>252,837,172</u>	<u>(92,586,180)</u>	<u>160,250,992</u>
OPERATING EXPENSES			
Cost of commercial goods sold	(127,627,575)	75,326,749	(52,300,826)
Cost of materials	(82,724,438)	15,431,554	(67,292,884)
Staff costs	(14,620,727)	(1,595,858)	(16,216,585)
Depreciation and amortization and provisions	(5,884,662)	(227,616)	(6,112,278)
Other operating expenses	(14,456,406)	3,390,516	(11,065,890)
	<u>(245,313,808)</u>	<u>92,325,345</u>	<u>(152,988,463)</u>
PROFIT FROM OPERATIONS	7,523,364	(260,835)	7,262,529
Finance income	10,298,437	(335,294)	9,963,143
Finance expenses	(8,491,798)	537,242	(7,954,556)
Other income	5,359,990	(2,107,757)	3,252,233
Other expenses	(7,976,960)	1,296,299	(6,680,661)
PROFIT BEFORE TAX	6,713,033	(870,345)	5,842,688
Income taxes			
- current tax expense	(274,874)	(312,805)	(587,679)
- deferred tax benefits /(expenses)	(57,747)	59,662	1,915
PROFIT FOR THE YEAR	<u>6,380,412</u>	<u>(1,123,488)</u>	<u>5,256,924</u>
Net profit/(loss) attributable to:			
- equity holders of the Parent Company	6,381,784	(1,123,488)	5,258,296
- minority interests	(1,372)	-	(1,372)
	<u>6,380,412</u>	<u>(1,123,488)</u>	<u>5,256,924</u>

BALANCE SHEET
As at December 31, 2007
(thousands of RSD)

	Compound Balance Sheet	Internal Balance and Adjustments	Adjusted Balance Sheet
ASSETS			
Non-current assets			
Intangible assets	2,612,399	560,906	3,173,305
Property, plant and equipment	100,810,139	845,605	101,655,744
Investment property	2,444,084	(1,666,500)	777,584
Equity investments	1,306,290	(164,649)	1,141,641
Other long-term financial placements	5,846,245	193,721	6,039,966
	<u>113,019,157</u>	<u>(230,917)</u>	<u>112,788,240</u>
Current assets			
Inventories	30,782,753	759,458	31,542,211
Non-current assets held for sale	-	-	-
Accounts receivable	16,997,217	436,092	17,433,309
Short-term financial placements	1,873,177	1,095,166	2,968,343
Cash and cash equivalents	1,862,109	-	1,862,109
Value added tax and prepayments	2,395,571	(473,221)	1,922,350
Deferred tax assets	489,416	-	489,416
	<u>54,400,243</u>	<u>1,817,495</u>	<u>56,217,738</u>
Total assets	<u>167,419,400</u>	<u>1,586,578</u>	<u>169,005,978</u>
EQUITY AND LIABILITIES			
Equity			
Share capital	81,550,656	(20,436)	81,530,220
Other capital	5,597,839	-	5,597,839
Reserves	484,601	-	484,601
Revaluation reserves	1,665,070	281,479	1,946,549
Translation reserves	-	(305)	(305)
Minority interests	-	17,634	17,634
Retained earnings	11,163,179	(1,635,612)	9,527,567
	<u>100,461,345</u>	<u>(1,357,240)</u>	<u>99,104,105</u>
Long-term provisions and liabilities			
Long-term provisions	923,587	51,013	974,600
Long-term borrowings	12,702,418	50,989	12,753,407
Other long-term liabilities	910,157	(21,885)	888,272
	<u>14,536,162</u>	<u>80,117</u>	<u>14,616,279</u>
Current liabilities			
Short-term financial liabilities	13,113,657	(56,551)	13,057,106
Accounts payable	29,515,938	2,281,136	31,797,074
Other current liabilities and accruals	4,798,336	320,473	5,118,809
Value added tax and other taxes and duties payable	4,653,658	-	4,653,658
Income taxes payable	276,093	318,643	594,736
Deferred tax liabilities	64,211	-	64,211
	<u>52,421,893</u>	<u>2,863,701</u>	<u>55,285,594</u>
Total equity and liabilities	<u>167,419,400</u>	<u>1,586,578</u>	<u>169,005,978</u>