

**NIS А.D. – Naftna industrija Srbije**

**Novi Sad**

**Financial Statements for the year ended December 31, 2010**

Novi Sad, February 22, 2011

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## BALANCE SHEET

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **ASSETS** | Notes | **December 31, 2010** |  | **December 31, 2009** |
| **Non-current assets** |  |  |  | *(Adjusted)* |
| Intangible assets | 7 | 4,835,761 |  | 4,792,744 |
| Property, plant and equipment | 8 | 98,014,391 |  | 84,132,509 |
| Investment property | 9 | 1,393,170 |  | 499,974 |
| Investments in equity instruments | 10 | 2,578,753 |  | 2,918,864 |
| Other long term investments | 11 | 1,504,268 |  | 3,390,069 |
|  |  | **108,326,343** |  | **95,734,160** |
| **Current assets** |  |  |  |  |
| Inventories | 12 | 33,999,967 |  | 23,056,296 |
| Non-current assets held for sales |  | - |  | 135,649 |
| Trade receivables | 13 | 12,945,719 |  | 11,390,933 |
| Receivables for overpaid income tax | 13 | - |  | 41,689 |
| Short term financial investments | 14 | 2,513,880 |  | 875,839 |
| VAT and prepaid expenses | 16 | 3,940,358 |  | 4,145,248 |
| Cash and cash equivalents | 15 | 10,595,830 |  | 8,671,501 |
| Deferred tax assets | 17 | 4,804,904 |  | - |
|  |  | **68,800,658** |  | **48,317,155** |
|  |  |  |  |  |
| **Total assets** |  | **177,127,001** |  | **144,051,315** |
| Off-balance sheet assets | 18 | 88,793,346 |  | 151,211,899 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **LIABILITIES** |  |  |  |  |
| **Equity** |  |  |  |  |
| Share capital | 19.1. | 87,128,024 |  | 87,128,024 |
| Reserves |  | 889,424 |  | 889,424 |
| Revaluation reserves |  | 39 |  | 39 |
| Unrealized gains from securities | 19.2. | 48,417 |  | 130,243 |
| Unrealized losses from securities | 19.2. | (49,236) |  | (28,172) |
| Retained earnings (loss) |  | (40,997,954) |  | (55,836,391) |
|  |  | **47,018,714** |  | **32,283,167** |
| **Long-term provisions and liabilities** |  |  |  |  |
| Long-term provisions | 20 | 18,501,540 |  | 16,040,464 |
| Long-term loans | 21 | 26,645,540 |  | 34,733,451 |
| Other long-term liabilities | 22 | 22,281,614 |  | 5,920,227 |
|  |  | **67,428,694** |  | **56,694,142** |
| **Short-term liabilities** |  |  |  |  |
| Short-term financial liabilities | 23 | 21,805,638 |  | 18,566,832 |
| Trade and other payables | 24 | 24,944,688 |  | 23,367,446 |
| Other short-term liabilities | 25 | 6,394,456 |  | 3,884,567 |
| Liabilities for VAT and other taxes and deffered income | 26 | 7,456,869 |  | 7,323,145 |
| Income tax liabilities |  | 619,407 |  | - |
|  |  | **61,221,058** |  | **53,141,990** |
| Deferred tax liabilities | 17 | 1,458,535 |  | 1,932,016 |
| **Total liabilities** |  | **177,127,001** |  | **144,051,315** |
| Off-balance sheet liabilities | 18 | 88,793,346 |  | 151,211,899 |

Notes from the page 7 to 84 are the part of these Financial Statements.

**STATEMENT OF INCOME**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **For the year ended**  **December 31,** | | | |
|  | Notes | **2010** |  | | **2009** |
| **Operating income** |  |  | |  | *(Adjusted)* |
| Sales | 27 | 161,148,850 | |  | 118,375,584 |
| Work performed by the entity and capitalized |  | 2,906,606 | |  | 724,015 |
| Increase in the value of finished goods and work in progress |  | 5,357,982 | |  | (1,195,209) |
| Other operating income | 28 | 126,085 | |  | 370,795 |
|  |  | 169,539,523 | |  | 118,275,185 |
| **Operating expenses** |  |  | |  |  |
| Cost of goods sold |  | (5,384,481) | |  | (6,008,675) |
| Cost of material | 29 | (95,345,034) | |  | (68,609,999) |
| Cost of salaries, benefits and other personnel expenses | 31 | ( 21,269,895) | |  | (19,834,025) |
| Depreciation and provisions | 30 | (8,383,146) | |  | (13,951,527) |
| Other operating expenses | 32 | (12,967,108) | |  | (11,971,665) |
|  |  | ( 143,349,664) | |  | (120,375,891) |
|  |  |  | |  |  |
| **Net operating income (loss)** |  | **26,189,859** | |  | **(2,100,706)** |
|  |  |  | |  |  |
| Financial income | 33 | 6,311,641 | |  | 11,121,612 |
| Financial expenses | 34 | (19,112,780) | |  | (15,878,008) |
| Other income | 35 | 5,204,757 | |  | 5,858,173 |
| Other expenses | 36 | ( 6,555,506) | |  | (38,520,547) |
|  |  |  | |  |  |
| **Income (loss) before income tax** |  | **12,037,971** | |  | **( 39,519,476)** |
|  |  |  | |  |  |
| **Income tax** | 37 | 4,446,410 | |  | 1,883,365 |
| Income tax expense | 37 | (831,975) | |  | - |
| Deferred tax income (expenses) | 17 | 5,278,385 | |  | 1,883,365 |
| **Net Profit (Loss) for the period** |  | **16,484,381** | |  | **(37,636,111)** |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Basic earnings (loss) per share** |  |  |  |  |
| - from continuing operations | 38 | 0.10 |  | (0.57) |
| - from discontinuing operations |  | - |  | - |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Diluted earnings (loss) per share** |  |  |  |  |
| - from continuing operations |  | - |  | - |
| - from discontinuing operations |  | - |  | - |

Notes from the page 7 to 84 are the part of these Financial Statements.

**CASH FLOW STATEMENT**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **For the year ended**  **December 31,** | | |
|  |  | **2010.** |  | **2009.** |

|  |  |  |  |
| --- | --- | --- | --- |
| **Cash flows from operating activities** |  |  |  |
| Sales and advances received | 253,910,032 |  | 182,348,503 |
| Interest from operating activities | 571,050 |  | 2,298,682 |
| Other inflow from operating activities | 126,085 |  | 370,795 |
| *Cash inflow from operating activities* | 254,607,167 |  | 185,017,980 |
|  |  |  |  |
| Payments and prepayments to suppliers | (118,935,078) |  | (81,664,906) |
| Salaries, benefits and other personal expenses | (20,576,855) |  | (18,802,105) |
| Interest paid | (3,002,155) |  | (3,017,776) |
| Income tax paid | (197,907) |  | (306,234) |
| Payments for other public revenues | (94,104,572) |  | (63,608,466) |
| *Cash outflow from operating activities* | (236,816,567) |  | (167,399,487) |
|  |  |  |  |
| **Net cash inflow from operating activities** | **17,790,600** |  | **17,618,493** |
|  |  |  |  |
| **Cash flows from investing activities** |  |  |  |
| Proceeds from sale of intangible assets and property, plant and equipment | 45,850 |  | 6,953 |
| *Cash inflow from investing activities* | 45,850 |  | 6,953 |
|  |  |  |  |
| Purchase of shares (net outflow) | (173,772) |  | - |
| Purchase of intangible assets, property, plant and equipment | (17,739,476) |  | (9,469,672) |
| *Cash outflow from investing activities* | (17,913,248) |  | (9,469,672) |
|  |  |  |  |
| **Net cash outflow from investing activities** | **(17,867,398)** |  | **(9,462,719)** |
|  |  |  |  |
| **Cash flows from financing activities** |  |  |  |
| Proceeds from long term and short term borrowings | 11,761,406 |  | 75,907,523 |
| Proceeds from other long term and short term liabilities | 15,709,941 |  | 6,094,682 |
| *Cash inflow from financing activities* | 27,471,347 |  | 82,002,205 |
|  |  |  |  |
| Outflows from long term, short term and other liabilities | (25,529,860) |  | (85,522,238) |
| *Cash outflow from financing activities* | (25,529,860) |  | (85,522,238) |
|  |  |  |  |
| **Net cash inflow (outflow) from financing activities** | **1,941,487** |  | **(3,520,033)** |
|  |  |  |  |
| **Net cash flows** | **1,864,689** |  | **4,635,741** |
| **Cash and cash equivalents at beginning of period** | **8,671,501** |  | **3,989,794** |
| Currency translation gains on cash and cash equivalents | 880,359 |  | 143,915 |
| Currency translation losses on cash and cash equivalents | (820,719) |  | (97,949) |
| **Cash and cash equivalents at end of period** | **10,595,830** |  | **8,671,501** |

Notes from the page 7 to 84 are the part of these Financial Statements.

**STATEMENT OF CHANGES IN EQUITY**

For year ended December 31, 2010

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Share capital** |  | **Other capital** |  | **Reserves** |  | **Revaluation reserves** |  | **Unrealised gains from securities** |  | **Unrealised losses from securities** |  | **Accumulated loss** |  | **Total** |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Balance as at January 1, 2009** | 81,530,220 |  | 5,597,804 |  | 889,424 |  | 60,783 |  | 136,760 |  | (33,169) |  | (18,200,280) |  | **69,981,542** |
| Total increase in previous period | - |  | 20 |  | - |  | - |  | - |  | - |  | (37,636,111) |  | **-** |
| Total decrease in previous period | (20) |  | - |  | - |  | (60,744) |  | (6,517) |  | 4,997 |  | - |  | **(37,698,375)** |
| **Balance as at**  **December 31, 2009** | **81,530,200** |  | **5,597,824** |  | **889,424** |  | **39** |  | **130,243** |  | **(28,172)** |  | **(55,836,391)** |  | **32,283,167** |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Balance as at January 1, 2010** | **81,530,200** |  | **5,597,824** |  | **889,424** |  | **39** |  | **130,243** |  | **(28,172)** |  | **(55,836,391)** |  | **32,283,167** |
| Total increase in previous period | - |  | - |  | - |  | - |  | - |  | (21,064) |  | 14,838,437 |  | **14,735,547** |
| Total decrease in previous period | - |  | - |  | - |  | - |  | (81,826) |  | - |  | - |  | **-** |
| **Balance as at**  **December 31, 2010** | **81,530,200** |  | **5,597,824** |  | **889,424** |  | **39** |  | **48,417** |  | **(49,236)** |  | **(40,997,954)** |  | **47,018,714** |

Notes from the page 7 to 84 are the part of these Financial Statements.

**STATISTICAL ANNEX**

For year ended December 31, 2010

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **GENERAL INFORMATION ON COMPANY** | **2010.** |  | **2009.** |  |  |
| 1. Number of months of operations | 12 |  | 12 |  |  |
| 2. Code identifying the company’s size (1to3). | 3 |  | 3 |  |  |
| 3. Code identifying the company’s ownership structure (1to5). | 4 |  | 4 |  |  |
| 4. Number of foreign persons, who may be natural persons or legal entities, holding a share in capital. | 235 |  | 1 |  |  |
| 5. Average number of employees based on employee position as at each months end. | 10,583 |  | 11,925 |  |  |
|  |  |  |  |  |  |
| **MOVEMENTS WITHIN INTANGIBLE ASSETS, PROPERTY, PLANT AND EQUIPMENT, AND BIOLOGICAL ASSETS/ GROSS** | **Gross** |  | **Accumulated Depreciation** |  | **Net** |
| **1. Intangible assets** |  |  |  |  |  |
| 1.1 Balance as at beginning of the year | 7,172,908 |  | 2,380,164 |  | 4,792,744 |
| 1.2. Additions (purchases) during the year | 362,134 |  | - |  | 362,134 |
| 1.3. Disposals during the year | 91,336 |  | - |  | 319,117 |
| 1.4. Revaluation | - |  | - |  | - |
| 1.5. Balance as at year end | 7,443,706 |  | 2,607,945 |  | 4,835,761 |
| **2. Property, Plant and Equipment, and Biological Assets** | - |  | - |  | - |
| 2.1. Balance as at beginning of the year | 135,305,850 |  | 50,673,367 |  | 84,632,483 |
| 2.2. Additions (purchases) during the year | 24,610,794 |  | - |  | 24,610,794 |
| 2.3. Disposals during the year | 2,208,407 |  | - |  | 9,835,716 |
| 2.4. Revaluation | - |  | - |  | - |
| 2.5. Balance as at year end | 157,708,237 |  | 58,300,676 |  | 99,407,561 |
|  |  |  |  |  |  |
| **INVENTORIES** | **2010.** |  | **2009.** |  |  |
| 1. Stock of material | 17,828,344 |  | 13,055,225 |  |  |
| 2. Work in progress | 6,586,856 |  | 2,375,837 |  |  |
| 3. Finished goods | 6,995,641 |  | 5,900,842 |  |  |
| 4. Merchandise | 1,855,957 |  | 615,345 |  |  |
| 5. Non-current assets available–for-sale | - |  | 135,649 |  |  |
| 6. Prepayments | 733,169 |  | 1,109,047 |  |  |
| **Total** | 33,999,967 |  | 23,191,945 |  |  |
|  |  |  |  |  |  |
| **EQUITY** |  |  |  |  |  |
| Share capital | 81,530,200 |  | 81,530,200 |  |  |
| - foreign capital | 41,735,436 |  | 41,580,402 |  |  |
| Stakes of a limited liability company | - |  | - |  |  |
| - foreign capital | - |  | - |  |  |
| Stakes of members of a partnership or limited partnership | - |  | - |  |  |
| - foreign capital | - |  | - |  |  |
| State owned capital | - |  | - |  |  |
| Socially owned capital | - |  | - |  |  |
| Stakes in cooperatives | - |  | - |  |  |
| Other equity | 5,597,824 |  | 5,597,824 |  |  |
| Total | 87,128,024 |  | 87,128,024 |  |  |
| **SHARE CAPITAL** |  |  |  |  |  |
| 1. Ordinary Shares |  |  |  |  |  |
| 1.1. Number of ordinary shares | 163,060,400 |  | 163,060,400 |  |  |
| 1.2. Face value of ordinary shares - Total | 81,530,200 |  | 81,530,200 |  |  |
| 2. Preference shares | - |  | - |  |  |
| 2.1. Number of preference shares | - |  | - |  |  |
| 2.2. Face value of preference shares - Total | - |  | - |  |  |
| **TOTAL – Face value of shares** | 81,530,200 |  | 81,530,200 |  |  |

**STATISTICAL ANNEX (continued)**

For year ended December 31, 2010

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2010.** |  | **2009.** |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **RECEIVABLES AND PAYABLES** |  |  |  |  |  |
| 1. Receivables from sales (Balance at year end) | 12,516,389 |  | 10,897,695 |  |  |
| 2. Payables from operations (Balance at year end) | 24,387,131 |  | 22,913,284 |  |  |
| 3. Receivables from insurance companies for compensation for damage during the year (debit turnover less opening balance) | 69,394 |  | 92,457 |  |  |
| 4. VAT – previous tax (annual amount as per tax declarations) | 20,548,652 |  | 15,448,508 |  |  |
| 5. Payables from operations (credit turnover less opening balance) | 298,263,823 |  | 190,697,521 |  |  |
| 6. Net salaries and fringe benefits payable (credit turnover less opening balance) | 13,469,946 |  | 9,870,081 |  |  |
| 7. Tax on salaries and fringe benefits charged to employees payable (credit turnover less opening balance) | 2,001,371 |  | 1,173,193 |  |  |
| 8. Contribution on salaries and fringe benefits charged to employees payable (credit turnover less opening balance) | 2,425,589 |  | 2,334,261 |  |  |
| 9. Dividends, share in profit and personal earnings of the employer payable (credit turnover less opening balance) | 7,736,314 |  | - |  |  |
| 10. Fees for services rended by natural persons payable (credit turnover less opening balance) | 337,402 |  | 166,482 |  |  |
| 11. VAT liability (annual amount as per tax declarations) | 35,540,703 |  | 27,986,525 |  |  |
| **Total** | 417,296,714 |  | 281,580,007 |  |  |
|  |  |  |  |  |  |
| **OTHER COSTS AND EXPENSES** |  |  |  |  |  |
| 1. Cost of fuel and energy | 1,680,326 |  | 2,153,560 |  |  |
| 2. Cost of salaries and fringe benefits (gross) | 13,871,982 |  | 13,204,806 |  |  |
| 3. Cost of taxes and contributions on salaries and fringe benefits charged to employer | 2,413,378 |  | 2,347,732 |  |  |
| 4. Cost of fees for services rendered by natural persons (gross) | 401,010 |  | 194,879 |  |  |
| 5. Cost of fees for members of management and supervisory boards (gross) | 21,132 |  | 4,084 |  |  |
| 6. Other personal fees and expenses | 4,562,395 |  | 4,082,526 |  |  |
| 7. Production services cost | 6,494,122 |  | 6,496,271 |  |  |
| 8. Rental costs | 218,729 |  | 196,662 |  |  |
| 9. Rental costs/Land | 610 |  | 7,710 |  |  |
| 10. Research and development costs | 351,105 |  | 246,342 |  |  |
| 11. Cost of depreciation | 6,864,311 |  | 6,699,996 |  |  |
| 12. Insurance premium costs | 375,446 |  | 666,860 |  |  |
| 13. Payment operations costs | 180,261 |  | 794,346 |  |  |
| 14. Membership fees | 62,583 |  | 56,597 |  |  |
| 15. Taxes | 1,773,984 |  | 1,972,847 |  |  |
| 16. Contributions | 19 |  | - |  |  |
| 17. Interest payable | 3,084,263 |  | 2,878,394 |  |  |
| 18. Interest payable and a portion of financial expenses | 3,084,263 |  | 2,889,521 |  |  |
| 19. Interest payable on bank loans and loans from other financial organizations | 2,996,611 |  | 2,590,543 |  |  |
| 20. Cost of humanitarian, cultural, health, educational, scientific and religious purposes, environmental protection and sports purposes | 72,484 |  | 70,911 |  |  |
| **Total** | 48,509,014 |  | 47,554,587 |  |  |

**STATISTICAL ANNEX (continued)**

For year ended December 31, 2010

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2010.** |  | **2009.** |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **OTHER REVENUE** |  |  |  |  |  |
| 1. Sales of merchandise | 6,086,301 |  | 6,218,470 |  |  |
| 2. Revenues from premiums, subventions, grants, recourses, compensations and tax returns | 2,979 |  | 5,810 |  |  |
| 3. Revenues from conditional donations | - |  | - |  |  |
| 4. Revenues from land-rental fees | 1,167 |  | 2,526 |  |  |
| 5. Membership fees | - |  | 5,810 |  |  |
| 6. Interest receivable | 1,410,976 |  | 2,299,165 |  |  |
| 7. Interest receivable incurring from accounts and deposits with banks and other financial organizations | 347,017 |  | 166,912 |  |  |
| 8. Revenues from dividends and share in profit | - |  | 11,555 |  |  |
| **Total** | 7,848,440 |  | 8,710,248 |  |  |
|  |  |  |  |  |  |
| **OTHER INFORMATION** |  |  |  |  |  |
| 1. Excise duty liability (as per annual calculation of excise duty) | 57,388,780 |  | 51,113,697 |  |  |
| 2. Custums and other import duties calculated (Annual Total as per calculation) | 17,767,562 |  | 12,688,533 |  |  |
| 3. Capital subsidies and other government grants for the construction and purchase of fixed assets and intangible assets | - |  | - |  |  |
| 4. Govermnment grants as premiums, recourses and coverage of running operating costs | - |  | - |  |  |
| 5. Other Government grants | - |  | - |  |  |
| 6. Forein donations and other non-returnable funds, received either in cash or in kind from foreign legal and/or natural persons | - |  | - |  |  |
| 7. Personal earnings of the enterprener from net profit (To be completed ONLY by enterpreners) | - |  | - |  |  |
| **Total** | 75,156,342 |  | 63,802,230 |  |  |

1. **GENERAL INFORMATION**

NIS a.d. – Naftna Industrija Srbije, Novi Sad (hereinafter “the Company”) was incorporated in accordance with the resolution of Government of Republic of Serbia on 7 July 2005 as the successor of five state owned companies of “Javno Preduzece Naftna Industrija Srbije (hereinafter “JP NIS”). Also, in accordance with the Decision of the Government of Republic of Serbia, it has been concluded that assets and liabilities belonging to JP NIS are the monetary and non-monetary stake in the Company.

On 24 December 2008, ownership structure was changed in accordance with Sales Purchase Agreement signed between Gazprom Neft and the Government of Republic of Serbia. The new ownership structure was registered in the Central Depository and Clearing House on February 2, 2009 as shown below:

* 51% of share capital held by Gazprom Neft, Saint Petersburg, Russian Federation
* 49% of share capital held by Government of Republic of Serbia, Ministry for industry and privatization.

According to the Law on free shares and the Government’s Decision on the distribution of free shares to the citizens of Serbia and NIS employees, the ownership structure of the Company has been changed on January 6, 2010. Ownership structure after these disbursement was:

* Gazprom Neft JSC 51.0%
* The Government of The Republic of Serbia 29.9%
* The citizens of The Republic of Serbia 14.7%
* Employees and ex employees 4.4%

Listing and Quotation Committee of the Belgrade Stock Exchange has on 23 August 2010 issued decision on admission of shares on listing A - Prime Market of Belgrade Stock Exchange. In accordance with this decision first trade with NIS shares was on 30 August 2010.

The Company operates in energy sector predominantly in Serbia and its main activities are:

* Refining and trade of oil and petrochemical products
* Exploration, development and production of crude oil, petroleum products and gas
* Trade of liquid petrol gas.

The address of the Company’s registered office is in Novi Sad, no.12 Narodnog fronta Street. The number of employees was 10.041 on December 31, 2010 (December 31, 2009: 11.084 employees).

These Financial statements have been approved by CEO.

1. **BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS**

The Company has prepared these financial statements in accordance with the Law on Accounting and Auditing of the Republic of Serbia published in Official Gazette of the Republic of Serbia (no. 46/2006 and 111/2009), which requires full scope of IFRS to be applied, and the regulations issued by the Ministry of Finance of the Republic of Serbia. Due to the difference between these two regulations, these financial statements differ from IFRS in the following respects:

* The financial statements are prepared in format prescribed by the Ministry of Finance of the Republic of Serbia, which does not comply with IAS 1 – “Presentation of Financial Statements” requirements.
* “Off-balance sheet assets and liabilities” are recorded on the face of the balance sheet. Such items do not meet the definition of either an asset or a liability under IFRS
* The Company has not consolidated the financial statements of its subsidiaries as in accordance with the Law of Accounting and Auditing of the Republic of Serbia the consolidated financial statements for the current year are required to be filed up to the end of April the following year. These investments are accounted for on a cost basis. Under International Financial Reporting Standards, stand alone financial statements of a Company which has subsidiaries are only allowed if consolidated financial statements are also prepared and issued at the same time.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 3.

1. **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES**

The principal accounting policies applied in the preparation of these financial statements are set out below. The policies are consistent to the policies applied in the financial statements for the year ended December 31, 2009.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Basis of preparation and presentation of finacial statements**

*New and amended standards and interpretations mandatory for the first time for the financial year beginning 1 January 2010 but not currently relevant to the Company (although they may affect the accounting for future transactions and events)*

* *IFRIC 17 ’Distribution of non-cash assets to owners’ (effective on or after 1 July 2009).* The interpretation was published in November 2008. This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends. IFRS 5 has also been amended to require that assets are classified as held for distribution only when they are available for distribution in their present condition and the distribution is highly probable.
* *IFRIC 18 ‘Transfers of assets from customers’, effective for transfer of assets received on or after 1 July 2009.* This interpretation clarifies the requirements of IFRSs for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must then use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services (such as a supply of electricity, gas or water). In some cases, the entity receives cash from a customer that must be used only to acquire or construct the item of property, plant, and equipment in order to connect the customer to a network or provide the customer with ongoing access to a supply of goods or services (or to do both)*.*
* *IFRIC 9, ‘Reassesment of embedded derivatives and IAS 39, Financial instruments: Recognition and measurement’, effective 1 July 2009*. This amendment to IFRIC 9 requires an entity to assess whether the embedded derivative should be separated from a host contract when the entity reclassifies a hybrid financial asset out of the ‘fair value through profit or loss’ category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significalnty change the cash flows of the contract. If the entity is unable to made this assessment, the hybrid instrument must remain classified as at fair value through profit or loss in its entirety.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

**3.1. Basis of preparation and presentation of finacial statements (continued)**

* + *IFRIC 16, ‘Hedges of a net investment in a foreign operation’ effective 1 July 2009.* This amendment states that, in a hedge of a net investment in a foreign operation, qualifying hedging instruments may be held by any entity or entities within the group, including the foreign operations itself, as long as the designation, documentation and effectiveness requirements of IAS 39 that relate to a net investment hedge are satisfied. In particular, the group should clearly document its hedging strategy because of the possibility of different designations at different levels of the group*.*
  + *IAS 38 (amendment), ‘Intangible assets’, effective 1 January 2010.* The amendment clarifies guidance in measuring the fair value of an intangible asset acquired in a business combination and permits the grouping of intangible asset as a single asset if each asset has similar useful economic lives.
  + *lAS 1 (amendment), Presentation of financial statements’.* The amendment clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting penod) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time.
  + *lAS 36 (amendment) ‘Impairment of assets’, effective 1 January 2010.* The amendment clarifies that the largest cash-generating unit (or group of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment, as defined by paragraph 5 of IFRS 8, Operating segments’ (that is, before the aggregation of segments with similar economic characteristics).
  + *IFRS 2 (amendments), ‘Group cash-settled share-based payment transactions’, effective form 1 January 2010*. In addition to incorporating IFRIC 8, Scope of IFRS 2 and IFRIC 11, ‘IFRS 2— Group and treasury share transactions’, the amendments expand on the guidance in FRIC 11 to address the classification of group arrangements that were not covered by that interpretation.
  + *IFRS 5 (amendment), ‘Non-current assets held for sale and discontinued operations*. The amendment clarifis that IFRS 5 specifies the disclosures required in respect of non current assets (or disposal groups) classified as held for sale or discontinued operations. It also clarifies that the general requirement of IAS 1 still apply in particular paragraph 15 (to achieve a fair presentation) and paragraph 125 (sources of estimation uncertainty) of lAS 1.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

**3.1. Basis of preparation and presentation of finacial statements (continued)**

*New standards, amendments and interpretations issued but not effective for the financial year beginning 1 January 2010 and not early adopted:*

* + *IFRS 9, ‘Financial instruments’, issued in November 2009.* This standard is the first step in the process to replace lAS 39, ‘Financial instruments, recognition and measurement IFRS 9 introduces new requirements for classifying and measuring financial assets and is likely to affect the Company’s accounting for its financial assets. The standard is not applicable until 1 January 2013 but is available for early adoption. However, the standard has not yet been endorsed by the EU. The Company is yet to assess IFRS 9’s full impact. However, initial indications are that it may affect the Company’s accounting for its debt available-for-sale financial assets, as IFRS 9 only permits the recognition of fair value gains and losses in other comprehensive income if they relate to equity investments that are not held for trading. Fair value gains and losses on available-for-sale debt investments, for example, will therefore have to be recognised directly in profit or loss. In the current reporting period, the Company recognised 102,890 RSD of such gains in other comprehensive income.
  + *Classification of rights Issues’ (amendment to lAS 32), issued in October 2009.* The amendment applies to annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment addresses the accounting for rights issues that are denominated in a currency other than the functional currency of the issuer, provided certain conditions are met, such rights issues are now classified as equity regardless of the currency in which the exercise price is denominated. Previously, these issues had to be accounted for as derivative liabilities, The amendment applies retrospectively in accordance with lAS 8 ‘Accounting policies, changes in accounting estimates and errors’, The Company will apply the amended standard from I January 2011.
  + *IFRIC 19, ‘Extinguishing financial liabilities with equity instruments’, effective 1 July 2010.* The interpretation clarifies the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability (debt for equity swap). It requires a gain or loss to be recognised in profit or loss, which is measured as the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued. If the fair value of the equity instruments issued cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished. The Company will apply the interpretation from 1 January 2011, subject to endorsement by the EU.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

**3.1. Basis of preparation and presentation of finacial statements (continued)**

* + *Amendments to IFRIC 14 „Prepayments of a minimum funding requirement“.* The amendments correct an unintended consequence of IFRIC 14, ‘lAS 19 - the limit on a defined benefit asset, minimum funding requirements and their interaction’. Without the amendments, entities are not permitted to recognise as an asset some voluntary prepayments for minimum funding contributions. This was not intended when IFRIC 14 was issued, and the amendments correct this. The amendments are effective for annual periods beginning 1 January 2011. Earlier application is permitted. The amendments should be applied retrospectively to the earliest comparative period presented. The Company will apply these amendments for the financial reporting period commencing on 1 January 2011.
  1. **Going concern**

The financial statements are prepared in accordance with going concern concept, which assumes that the Company will be able to continue to operate in foreseeable future. As of 31 December, 2010 the Company’s current assets exceed current liabilities by 2,774,696 RSD (as of 31 December, 2009 there was deficiency by 4,824,835 RSD ), and the Company incurred profit for the year ended December 31, 2010 in the amount of 16,484,381 RSD (2009, loss of 37,636,111 RSD ). The management believes that they will ensure enough available funds to settle liabilities when they are due.

The new management has succeeded in restructuring borrowings from the banks from short-term to medium and long-term during 2009. Also, the Company is considered as significant subsidiary of Gazprom Neft Group which implies access to the Group’s financial arrangements.

* 1. **Comparative figures**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **Reclassification** | |  |
|  | **December 31,  2009.** | *Investment in Angola* | *Amortization of investment in Angola* | **December 31,  2009.** *(Adjusted)* |
|  |  |  |  |  |
| Property, plant and equipment | 83,221,228 | 911,281 | - | 84,132,509 |
| Other long term investments | 4,301,350 | (911,281) | - | 3,390,069 |
| **Net assets** | **32,283,167** | - | - | **32,283,167** |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Year ended**  **December 31, 2009.** | | **Year ended**  **December 31, 2009.** | | |
|  |  |  |  | (A*djusted*) |
| Amortization and depreciation | 12,698,952 | - | 1,252,575 | 13,951,527 |
| Other operating expenses | 13,224,240 | - | (1,252,575) | 11,971,665 |
| **Net Loss** | **37,636,111** | **-** | **-** | **37,636,111** |

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Segment reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Executive committee.

* 1. **Foreign currency translation**

1. *Functional and presentation currency*

All amounts in these financial statements are presented in Serbian dinars (“RSD”), that is the functional and presentation currency of the Company.

1. *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of the transaction or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the end of the period exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses that relate to borrowings, cash and cash equivalents and other monetary assets and liabilities are presented in the income statement within “financial income or expenses“.

* 1. **Intangible assets**

1. *Licenses and rights*

Separately acquired licenses are shown at historical cost. Licenses have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of licences over their estimated useful lives.

Licenses and rights include Upstream Exploration rights which are amortised over the exploration period as per the terms of the relevant licences (1 to 20 years).

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Intangible assets**

1. *Computer software*

These include primarily the costs of implementing the (SAP) computer software program. Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

These costs are amortised over their estimated useful lives (1 to 29 years).

* 1. **Exploration for and evaluation of mineral resources**

1. *Exploration and evaluation expenditure*

During the exploration period, oil and natural gas exploration and evaluation expenditures are capitalized, until it is proved that oil and gas reserves are sufficient to justify the cost of exploration. Geological and geophysical costs as well as costs directly associated with an exploration are capitalized as incurred. Exploration property leasehold acquisition costs are capitalized within intangible assets and amortised over the period of the license or in relation to the progress of the activities if there is a substantial difference.

1. *Development expenditure*

Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of commercially proven development wells is capitalized and shows as construction in progress assets according to its nature. When development is completed, it is transferred to production assets. No depreciation and/or amortization is charged during development.

1. *Oil and gas production assets*

Oil and gas properties consist of aggregated exploration and evaluation tangible assets and development expenditures associated with the production of proved reserves.

1. *Production – share agreement and buy-back contracts*

Oil and gas reserves related to production-sharing agreements and buy-back contracts are determined on the basis of contractual clauses related to repayment of costs incurred for the exploration, development and production activities executed through the use of Company’s technologies and financing (cost oil) and the Company’s share of production volumes not destined to cost recovery (profit oil). Revenues from the sale of the production entitlements against both cost oil and profit oil are accounted for on an accrual basis whilst exploration, development and production costs are accounted for according to the policies mentioned above.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Exploration for and evaluation of mineral resources (continued)**

1. *Production – share agreement and buy-back contracts (continued)*

The company’s share of production volumes and reserves representing the profit oil includes the share of hydrocarbons which corresponds to the taxes to be paid, according to the contractual agreement, by the national government on behalf of the Company.

As a consequence the Company has to recognise at the same time an increase in taxable profit, through increase of revenues, and tax expense.

1. *Depreciation/amortization*

Oil and gas properties/intangible assets are depleted using the unit-of-production method. Unit-of production rates are based on proved developed reserves, which are oil, gas and other mineral reserves estimated to be recovered from existing facilities using current operating methods. Oil and gas volumes are considered produced once they have been measured through meters at custody transfer or sales transaction points at the outlet valve on the field storage tank.

1. *Impairment – exploration and evaluation assets*

The exploration property leasehold acquisition costs are tested for impairment when facts and circumstances indicate impairment. For the purposes of assessing impairment, the exploration property leasehold acquisition costs subject to testing are grouped with existing cash-generating units (CGUs) of production fields that are located in the same geographical region corresponding to each license.

1. *Impairment – proved oil and gas properties and intangible assets*

Proven oil and gas properties and intangible assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset’s fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Property, plant and equipment**

On 1 July 2005, the date of foundation of the Company, Property, plant and equipment were valued at market value by independent appraisal. Revaluation reserves for the excess of fair value against historical value were cancelled against share capital as at 1 January 2006.

Since the date of foundation, Property, plant and equipment are stated at cost less accumulated depreciation and provision for impairment, where required. Cost includes expenditure that is directly attributable to the acquisition of the items.

Property, plant and equipment in progress are stated at cost.

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

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

|  |  |  |
| --- | --- | --- |
| Description |  | Useful lives |
|  |  |  |
| Buildings |  | 10 - 50 |
| Machinery and Equipment: |  |  |
| - Production equipment |  | 7 - 25 |
| - Furniture |  | 5 - 10 |
| - Vehicles |  | 7 - 20 |
| - Computers |  | 5 - 10 |
| Other PP&E: |  | 5 - 50 |
|  |  |  |

The assets’ residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset’s carrying amount is written down immediately to its recoverable amount if the asset’s carrying amount is greater than its estimated recoverable amount (note 35 and 36).

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are recognised within "Other income/expenses", in the income statement. (notes 35 and 36).

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Impairment of non-financial assets**

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

* 1. **Investment property**

Investment property is a property held to earn rentals or for capital appreciation or both.

Investment properties principally comprise of business facilities and apartments rented to Company’s current and former employees.

Land give under operating lease is classified and accounted for as investment property when the rest of the definition of investment property is met.

Investment property is carried at fair value, representing open market value based on active market prices, adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. Changes in fair values are recorded in the income statement as part of other income (note 35).

Subsequent expenditure is capitalized only when it is probable that future economic benefits associated with it will flow to the Company and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to property, plant and equipment, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

* 1. **Construction contracts**

Construction contract is defined by IAS 11 as a contract specifically negotiated for the construction of an asset. Contract costs are recognized as expenses in the period in which they are incurred.

When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable.

When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Variations in contract work, claims and incentive payments are included in contract revenue to the extent that may have been agreed with the customer and are capable of being reliably measured.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Construction contracts (continued)**

The Company uses the ‘percentage-of-completion method’ to determine the appropriate amount to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. They are presented as inventories, pre-payments or other assets, depending on their nature.

The Company presents as an asset the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceed progress billings. Progress billings not yet paid by customers and retention are included within ‘trade and other receivables’.

The Company presents as a liability the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

* 1. **Investments in subsidiaries**

Investments in subsidiaries are measured using the cost method, whereby these investments are recognized at cost without any changes in value of investments originating from the results. If there are indications that the value of investment has decreased at the balance sheet date, the assessment of the recoverable value of investment is being performed.

If the recoverable value is less than book value, book value is reduced to its recoverable value and impairment loss of investment is recognized as expense.

* 1. **Long – term financial assets**

The Company classifies its financial assets in the following categories: loans and receivables and available for sale.

The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Long – term financial assets (continued)**
     1. **Financial assets’ presentation**

1. *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. The Company’s loans and receivables comprise ‘trade and other receivables’.

1. *Available for sale financial assets*

Available for sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

* + 1. **Recognition and measurement**

Regular purchases and sales of investments are recognised on trade-date – the date on which the Company commits to purchase or sell the asset. Loans and receivables are carried at amortised cost using the effective interest method.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Company establishes fair value by using valuation techniques. These include the use of recent arm’s length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

Available-for-sale investments are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss for the year as finance income. Dividends on available-for-sale equity instruments are recognised in profit or loss for the year as finance income when the Company’s right to receive payment is established and it is probable that the dividends will be collected. All other elements of changes in the fair value are recognised in equity until the investment is derecognised or impaired at which time the cumulative gain or loss is reclassified from equity to finance income in profit or loss for the year (note 33 and 34).

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Long – term financial assets (continued)**
     1. **Impairment of financial assets**

*(а) Assets carried at amortised cost*

The Company assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a ‘loss event’) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The criteria that the Company uses to determine that there is objective evidence of an impairment loss include:

* Significant financial difficulty of the issuer or obligor;
* A breach of contract, such as a default or delinquency in interest or principal payments;
* The Company, for economic or legal reasons relating to the borrower’s financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
* It becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
* The disappearance of an active market for that financial asset because of financial difficulties; or observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  + Adverse changes in the payment status of borrowers in the portfolio; and
  + National or local economic conditions that correlate with defaults on the assets in the portfolio.

The Company first assesses whether objective evidence of impairment exists.

For loans and receivables category, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate. The asset’s carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Company may measure impairment on the basis of an instrument’s fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor’s credit rating), the reversal of the previously recognised impairment loss is recognised in the income statement.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Long – term financial assets (continued)**
     1. **Impairment of financial assets (сontinued)**

*(b) Assets classified as available for sale*

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the Company uses the criteria refer to (a) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss — measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss — is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

Impairment testing of trade receivables is described in note 3.15.

* 1. **Inventories**

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises cost of raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs.

Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

Spare parts which are used in production are stated at cost, less any impairment for obsolete, damaged and slow-moving spare parts more than 12 months.

* 1. **Non-current assets (or disposal groups) held-for-sale**

Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through a continuing use.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Trade receivables**

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets. Alternatively, trade receivables are stated as long term.

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments (more than 90 days for state controlled companies and more than 60 days overdue for other customers) are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset’s carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in the income statement within ‘other expenses’ (note 36). When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amount previously written off are credited to ‘other income’ in the income statement (note 35).

* 1. **Cash and cash equivalents**

Cash and cash equivalents includes cash in hand, cash in banks, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

* 1. **Off balance sheet assets and liabilities**

Off balance sheet assets/liabilities include: consignment stock, material received from third parties for further processing and other assets not owned by the Company, as well as receivables/payables relating to collaterals received/given such as guarantees and other warrants.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Share capital**

The Company is registered as open joint stock company. Ordinary shares are classified as share capital.

* 1. **Other capital**

Other capital in total refers to the Company’s capital above the amount estimated and registered as at May 31, 2005. It was recognized as other capital.

* 1. **Reserves**

Reserves were established in the past in accordance with the previous Law on Enterprises. In accordance with this Law the Company was required to allocate 5% of profits until the reserves reached the amount defined by Company’s Act and at least 10% of the share capital.

* 1. **Earnings per share**

The Company calculates and discloses the basic earnings per share. Basic earnings per share is calculated by dividing the net income that belongs to shareholders, the owners of ordinary shares of the Company, by the weighted average number of ordinary shares issued during the period (note 38).

* 1. **Provisions**

Provisions for environmental restoration, asset retirement obligation, restructuring costs and legal claims are recognised when: the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditure expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as cost of provision.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Borrowings**

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalized as a prepayment for liquidity services and amortized over the period of the facility to which it relates.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

* 1. **Trade payables**

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

* 1. **Current and deferred income tax**

The tax expense for the period comprises current and deferred tax. Tax is recognized in the income statement, except to the extent that it relates to items recognized directly in equity. In that case deferred tax liability is recognized in equity as well.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in Serbia, where the Company operates and generates taxable profit. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Current and deferred income tax (continued)**

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

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

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

* 1. **Employee benefits**

1. *Pension obligations*

The Company operates a defined contribution pension plan. The Company pays contributions to publicly administered pension insurance plans on a mandatory basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

1. *Other employee benefit schemes*

The Company provides jubilee, retirement and miscellaneous allowances in accordance with Collective Labour Agreement. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age or the completion of a minimum service period.

*Jubilee awards*

Payment of jubilee awards is determined as number of monthly salaries based on number of completed years of services for every employee, as it is show in table below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Minimum years of service** |  |  | **Number of monthly** |
|  | **in the Company** |  |  | **salaries** |
|  | | |  |  |
| 10 | | |  | 1 |
| 20 | | |  | 2 |
| 30 | | |  | 3 |
| 35 | | |  | 3,5 |
| 40 | | |  | 4 |

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Employee benefits (continued)**

*Retirement allowances*

The Company has to pay to every employee at his/her retirement, allowance in amount, maximum of:

* three monthly salaries over the last month preceding the month of the employee’s retirement, or
* three average monthly salaries in the Company, if it is higher.

The expected costs of these benefits are accrued over the period of employment.

The defined benefit obligation is valued annually by independent qualified actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability. Actuarial gains and losses arising from experience adjustments, and changes in actuarial assumptions, are charged or credited to income over the expected average remaining working lives of the related employees for retirement allowance and charged or credited to income statement in full amount for jubilee awards and allowances for miscellaneous allowances.

*Termination benefits*

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are discounted to present value.

1. *Profit-sharing and bonus plans*

The Company recognizes a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the Company’s shareholders after certain adjustments. The Company recognizes a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Revenue recognition**

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company’s activities. Revenue is shown net of value-added tax, excise duty, returns, rebates and discounts after eliminating sales within the Company.

The Company recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Company’s activities as describe below. The amount of the revenue is not considered to be reliably measurable until all contingences relating to the sale have been resolved. The Company bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

1. *Sales of goods – wholesale*

The Company manufactures and sells Oil and Petrochemical products and Liquid Natural Gas in the wholesale market. Sales of goods are recognised when the Company has delivered products to the wholesaler. Delivery does not occur until the products have been shipped to the specified location, the risks of obsolescence and loss have been transferred to the wholesaler, and either the wholesaler has accepted the products in accordance with the sales contract, the acceptance provisions have lapsed, or the Company has objective evidence that all criteria for acceptance have been satisfied.

Sales are recorded based on the price specified in the sales contracts, net of the estimated volume discounts and returns at the time of sale. Accumulated experience is used to estimate and provide for the discounts and returns. The volume discounts are assessed based on anticipated annual purchases. No element of financing is deemed present as the sales are made with a credit term of 90 days for state owned companies and 60 days for other companies, which is consistent with the market practice.

1. *Sales of goods – retail*

The Company operates a chain of Petrol Stations in Serbia. Sales of goods are recognised when a Company sells a product to the customer. Retail sales are usually in cash, fuel coupons or by credit card.

1. *Sales of services*

The Company sells oil engineering services. These services are provided on a time and material basis or as a fixed price contract, with contract terms generally accepted in the industry.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Revenue recognition (continued)**

1. *Sales of services (continued)*

Revenue from time and material contracts, typically from delivering engineering services, is recognised under the percentage of completion method. Revenue is generally recognized at the contractual rates. For time contracts, the stage of completion is measured on the basis of as labour hours are delivered as a percentage of total hours to be delivered. For material contracts, the stage of completion is measured on the basis of and direct expenses are incurred as a percentage of the total expenses to be incurred.

Revenue from fixed-price contracts for delivering of engineering services is also recognised under the percentage-of-completion method. Revenue is generally recognised based on the services performed to date as a percentage of the total services to be performed.

If circumstances arise that may change the original estimates of revenues, costs or extent of progress toward completion, estimates are revised. These revisions may result in increases or decreases in estimated revenues or costs and are reflected in income in the period in which the circumstances that give rise to the revision become known by management.

1. *Interest income*

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Company reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

1. *Income from work performed by entity and capitalized*

Income from work performed by entity and capitalized relates to capitalization of costs of own products and services.

1. *Dividend income*

Dividend income is recognised when the right to receive payment is established.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Leases**

1. *Leases: Accounting by lessee*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

The Company leases certain property, plant and equipment. Leases of property, plant and equipment, where the Company has substantially all the risks and rewards of ownership, are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment, acquired under finance leases, is depreciated over the shorter of the useful life of the asset and the lease term.

1. *Leases: Accounting by lessor*

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment, or series of payments, the right to use an asset for an agreed period of time.

When assets are leased out under a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income.

Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

When assets are leased out under an operating lease, the asset is included in the balance sheet based on the nature of the asset.

Lease income is recognised over the term of the lease on a straight-line basis.

* 1. **Dividend distribution**

Dividend distribution to the Company’s shareholders is recognised as a liability in the period in which the dividends are approved by the Company’s shareholders.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES (continued)**

* 1. **Capitalisation of borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of assets that [are not carried at fair value and that] necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets, if the commencement date for capitalisation is on or after 1 January 2009. Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

The Company capitalises borrowing costs that could have been avoided if it had not made capital expenditure on qualifying assets. Borrowing costs capitalised are calculated at the company’s average funding cost (the weighted average interest cost is applied to the expenditures on the qualifying assets), except to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset. Where this occurs, actual borrowing costs incurred less any investment income on the temporary investment of those borrowings are capitalized.

1. **Critical accounting estimates and judgments**

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

* 1. **Critical accounting estimates and assumptions**

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results.

1. *Income tax*

The Company is obliged to pay income tax. The company recognizes liability for the expected effects of issues arising from the audit, according to the assessment of whether there will be additional taxes. If the final outcome of the effects of these issues on income taxes is different from the original amount booked, it will affect both current and deferred income taxes and provision for deferred tax assets and liabilities in the period in which the difference is identified.

1. *Revenue recognition*

The Company uses the percentage-of-completion method in accounting for its sales of services. Use of the percentage-of-completion method requires the Company to estimate the services performed to date as a proportion of the total services to be performed.

**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (continued)**

* 1. **Critical accounting estimates and assumptions (continued)**

1. *Employee benefits*

The present value of the employee benefit obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for employee benefits include the discount rate. Any changes in these assumptions will impact the carrying amount of obligations.

The Company determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the employee benefits obligations. In determining the appropriate discount rate, the Company considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension liability.

* 1. **Critical judgments in applying entity’s accounting policies**

1. *Impairment of available for sale financial assets*

The Company follows the guidance of IAS 39 to determine when an available for sale financial asset is impaired. This determination requires significant judgment. In making this judgment, the Company evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost; and the financial health of and short-term business outlook for the investee, including factors such as industry and sector performance, changes in technology and operational and financing cash flow.

1. *Financial crisis*

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. The uncertainties in the global financial markets have also led to bank failures and bank rescues in the United States of America, Western Europe, Russia and elsewhere. Indeed the full extent of the impact of the ongoing financial crisis is proving to be impossible to anticipate or completely guard against.

Management is unable to reliably estimate the effects on the Company's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Company’s business in the current circumstances.

**4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (continued)**

**4.2. Critical judgments in applying entity’s accounting policies (continued)**

1. *Financial crisis (continued)*

**Impact on liquidity:**

The volume of wholesale financing has significantly reduced since September 2008. Such circumstances may affect the ability of the Company to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions.

**Impact on customers/ borrowers:**

Debtors of the Company may be affected by the lower liquidity situation which could in turn impact their ability to repay the amounts owed. Deteriorating operating conditions for customers [or borrowers] may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management have properly reflected revised estimates of expected future cash flows in their impairment assessments.

1. *Valuation of property measured at fair value*

The fair value of investment property accounted for using the fair value model in accordance with IAS 40 is updated to reflect market conditions at the end of the reporting period. Fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm’s length transaction. A “willing seller” is not a forced seller prepared to sell at any price. The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition. In the absence of current prices in an active market, the Company considers information from a variety of sources, including:

* current prices in an active market for properties of different nature, condition or location, adjusted to reflect those differences;
* recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
* discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.

1. **FINANCIAL RISK MANAGEMENT**
   1. **Financial risk factors**

The Company’s activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk. The Company’s overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company’s financial performance. The Company uses financial instruments to hedge certain risk exposures.

Risk management is carried out by a financial department within the Function for Economics, Finance and Accounting (further „FEPA“) under policies approved by the Board of Directors. The Company financial department identifies, evaluates and hedges financial risks in close co-operation with the Company’s operating units.

1. *Market risk*
2. Foreign exchange risk

The Company operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to USD and EUR. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities at the balance sheet date.

Management has set up a policy to manage its foreign exchange risk against its functional currency. In order to manage its foreign exchange risk arising from future transactions and recognised assets and liabilities, the responsible persons in financial department within the FEPA Function negotiate the best rates for purchasing foreign currency to be contracted on a daily basis depending on the rate of that day. The Company purchases foreign currencies through the SPOT and Forward rates (for future obligations that are expected to be settled in the period longer than 2 days and no longer than 15 days). Sum of carrying values of financial assets and liabilities denominated in foreign currencies are shown in table below

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Financial Assets** | | | **Financial Liabilities** | | | | |
|  | **31 December**  **2010** |  | **31 December**  **2009** |  | **31 December**  **2010** |  | **31 December**  **2009** | |
|  |  |  |  |  |  |  | |  | |
| EUR | 18,986,712 |  | 11,697,752 |  | 32,545,207 |  | | 23,747,982 | |
| JPY | - |  | - |  | 495,430 |  | | - | |
| CHF | 39 |  | - |  | - |  | | - | |
| USD | 5,888,917 |  | 4,087,470 |  | 57,545,448 |  | | 47,162,296 | |

At 31 December 2010, if the currency had weakened/strengthened by 10% against the EUR and USD with all other variables held constant, post-tax profit for the year would have been 552,622 RSD (2009: 402,980 RSD) lower/higher, mainly as a result of foreign exchange losses/gains on translation of Euro-denominated trade receivables, trade payables and foreign exchange losses/gains on translation of Euro and USD denominated borrowings.

**5. FINANCIAL RISK MANAGEMENT (continued)**

**5.1. Financial risk factors (continued)**

(a) *Market risk (continued)*

1. Commodity Price risk

The Company’s primary activity as a refiner creates two types of commodity price exposures; crude oil and oil products price levels which affect the value of inventory and refining margins which in turn affect the future cash flows of the business.

In the case of price risk the level of exposure is determined by the amount of priced inventory carried at the end of the reporting period. In periods of sharp price decline, as the Company policy is to report its inventory at the lower of historic cost and net realisable value, results are affected by the reduction in the carrying value of the inventory. The extent of the exposure relates directly to the level of stocks and rate of price decrease.

Refining margin exposure relates to the price of oil products determined by the Ministry of Energy.

1. Cash flow and fair value interest rate risk

As the Company has no significant interest-bearing assets, the Company’s income and operating cash flows are substantially independent of changes in market interest rates.

The Company’s income and operating cash flows are substantially independent of changes in market interest rates. Borrowings issued at variable rates expose the Company to cash flow interest rate risk, while borrowings issued at fixed rates expose the Company to fair value interest rate risk. Depending on the levels of net debt at any given period of time, any change in the base interest rates (EURIBOR or LIBOR), has a proportionate impact on the Company’s results. At December 31, 2010 if interest rates on foreign currency denominated borrowings, with floating intrest rate, had been 1% higher / lower with all other variables held constant, pre-tax profit for the year would have been 595,850 RSD (2009: RSD 591,047 RSD) lower / higher, mainly as a result of higher/lower interest expense on floating rate borrowings.

1. *Credit risk*

Credit risk is managed on the Company’s level basis. Credit risk arises from cash and cash equivalents, deposits with banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding receivables and committed transactions.

Banks are ranked only in the case of acceptance of collateral claims on various grounds, as well as the total exposure banks to the Company. Second criteria is applicable for domestic banks.

Since the acquisition, wholesale customers are selected based on the assessment of the credit quality of the customer, taking into account its financial position, past experience and other factors. Individual risk limits are set based on internal ratings in accordance with limits set by the management. The utilisation of credit limits is regularly monitored.

Sales to retail customers are settled in cash or using credit cards.

The Company has provided for receivables from customers, which have exceeded their credit limits or went into liquidity problems (note 13).

**5. FINANCIAL RISK MANAGEMENT (continued)**

**5.1. Financial risk factors (continued)**

1. *Liquidity risk*

Cash flow forecasting is performed as aggregated at the Company’s level. The Company’s finance function monitors rolling forecasts of the Company’s liquidity requirements to ensure It has sufficient cash to meet operational needs while maintaining sufficient headroom on its undrawn committed borrowing facilities at all times so that the Company does not breach borrowing limits or covenants (where applicable) on any of its borrowing facilities. Such forecasting takes into consideration the Company’s debt financing plans, covenant compliance, compliance with internal balance sheet ratio targets and, if applicable external regulatory or legal requirements .— for example, currency restrictions.

Surplus cash held by the Company over and above balance required for working capital management are invested as surplus cash in time deposits.

The table below analyses the Company’s non-derivative financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet to the contractual maturity date. Derivative financial liabilities are included in the analysis if their contractual maturities are essential for an understanding of the timing of the cash flows. The amounts disclosed in the table are the contractual undiscounted cash flows.

Comparative information has been restated as permitted by the amendments to IFRS 7 for the liquidity risk disclosures.

The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances as the impact of discounting is not significant.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **As at December 31,**  **2010** | **Less than 1 month** |  | **1 - 3**  **months** |  | **3 -1**  **year** |  | **1-5**  **years** |  | **Over 5 years** |  | **Total** |
| Borrowings | 346,701 |  | 1,452,860 |  | 19,968,859 |  | 26,213,039 |  | 22,623,579 |  | 70,605,038 |
| Financial lease liabilities | 3,310 |  | 6,618 |  | 29,788 |  | 86,788 |  | - |  | 126,504 |
| Trade payables | 21,843,011 |  | 11,984,987 |  | 116,397 |  | - |  | - |  | 33,944,395 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **As at December 31,**  **2009** | **Less than 1 month** |  | **1 - 3**  **months** |  | **3 -1**  **year** |  | **1-5**  **years** |  | **Over 5 years** |  | **Total** |
| Borrowings | - |  | - |  | 5,178,734 |  | 42,477,750 |  | 11,448,237 |  | 59,104,722 |
| Financial lease liabilities | 3,225 |  | 6,485 |  | 27,984 |  | 114,557 |  | - |  | 152,251 |
| Trade payables | 16,171,089 |  | 5,686,501 |  | 48,678 |  | - |  | - |  | 21,906,268 |

**5. FINANCIAL RISK MANAGEMENT (continued)**

* 1. **Capital risk management**

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

In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

Consistent with others in the industry, the Company monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including ‘current and non-current borrowings’ as shown in the balance sheet) less cash and cash equivalents. Total capital is calculated as ‘equity’ as shown in the balance sheet plus net debt.

The gearing ratios at December 31, 2010 and December 31, 2009 were as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **31 December**  **2010** |  | **31 December**  **2009** |
|  |  |  |  |
| Total borrowings (notes 21, 22 and 23) | 70,605,038 |  | 59,104,722 |
| Less: cash and cash equivalents (note 15) | (10,595,830) |  | (8,671,501) |
| **Net debt** | **60,009,208** |  | **50,433,221** |
|  |  |  |  |
| Total equity | 47,018,714 |  | 32,283,167 |
|  |  |  |  |
| **Gearing ratio** | 1.28 |  | 1.56 |

* 1. **Fair value estimation**

The fair value of financial instruments traded in active markets (such as available for sale securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Company is the current bid price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments

1. **SEGMENT INFORMATION**

Operating segments, are segments whose operating results are regularly reviewed by the Chief Operating Decision Maker („CODM“). In Company, Executive Committee is seen as CODM.

As of December 31, 2010 business activities of the Company are organized into five operating segments (with the change of business structure in 2010 Oil field services become the new reportable segment):

1. Exploration and production of oil and natural gas,
2. Production of oil products - Refining,
3. Oil and oil products trading,
4. Bloc Oil field services
5. Other – administration.

The reportable segments derive their revenue in following manner:

1. Exploration and production of oil and natural gas derive its revenue from sale of crude oil and gas to Refinery and Srbijagas
2. Refining segments derives its revenue from sale of oil derivatives to NIS trade segment
3. Oil and derivatives trading derives revenue from retail and wholesale activities consistent with the policy described in 3.28.
4. Bloc Oil field services derives revenue from drilling services, constructing and services of geophysical measurement and transportation services.

Reportable segments results for year ended December 31, 2010 in accordance with bussines structure valid at December 31, 2010 are shown in the following table:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Exploration and production** |  | **Oil field services** |  | **Refining** |  | **Trade** |  | **Other** |  | **Total** |
|  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Segment revenue | 73,738,878 |  | 9,701,895 |  | 163,312,877 |  | 211,107,264 |  | 10,800,727 |  | 468,661,641 |
| Inter-segment revenue | 57,190,252 |  | 8,707,271 |  | 151,024,922 |  | 74,914,378 |  | 7,285,295 |  | 299,122,118 |
| Total revenue | **16,548,626** |  | **994,624** |  | **12,287,955** |  | **136,192,886** |  | **3,515,432** |  | **169,539,523** |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Operating income (expenses) | 38,759,193 |  | (3,020,299) |  | (6,731,034) |  | 1,526,090 |  | (4,344,091) |  | 26,189,859 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Financial income (expenses) | 631,213 |  | 7,836 |  | (168,270) |  | 1,880,385 |  | (15,152,303) |  | (12,801,139) |
| Other income (expenses) | (218,167) |  | 487,647 |  | 30,209 |  | (1,172,603) |  | (477,835) |  | (1,350,749) |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Profit / loss before tax | 39,172,239 |  | (2,524,816) |  | (6,869,095) |  | 2,233,872 |  | (19,974,229) |  | 12,037,971 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Deferred tax | - |  | - |  | - |  | - |  | 5,278,385 |  | 5,278,385 |
| Income tax expense | - |  | - |  | - |  | - |  | (831,975) |  | (831,975) |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Net profit / (loss) | **39,172,239** |  | **(2,524,816)** |  | **(6,869,095)** |  | **2,233,872** |  | **(15,527,819)** |  | **16,484,381** |

**6. SEGMENT INFORMATION (continued)**

Reportable segments results for the year ended December 31, 2010 in accordance with bussines structure valid at December 31, 2009 are shown in the following table:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Exploration and production** |  | **Refining** |  | **Trade** |  | **Other** |  | **Total** |
|  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| Segment revenue | 83,440,773 |  | 163,312,877 |  | 211,107,264 |  | 10,800,727 |  | 468,661,641 |
| Inter-segment revenue | 65,897,523 |  | 151,024,922 |  | 74,914,378 |  | 7,285,295 |  | 299,122,118 |
| Total revenue | **17,543,250** |  | **12,287,955** |  | **136,192,886** |  | **3,515,432** |  | **169,539,523** |
|  |  |  |  |  |  |  |  |  |  |
| Operating income (expenses) | 35,738,894 |  | (6,731,034) |  | 1,526,090 |  | (4,344,091) |  | 26,189,859 |
|  |  |  |  |  |  |  |  |  |  |
| Financial income (expenses) | 639,049 |  | (168,270) |  | 1,880,385 |  | (15,152,303) |  | (12,801,139) |
| Other income (expenses) | 269,480 |  | 30,209 |  | (1,172,603) |  | (477,835) |  | (1,350,749) |
|  |  |  |  |  |  |  |  |  |  |
| Profit / (loss) before tax | 36,647,423 |  | (6,869,095) |  | 2,233,872 |  | (19,974,229) |  | 12,037,971 |
|  |  |  |  |  |  |  |  |  |  |
| Deferred tax | - |  | - |  | - |  | 5,278,385 |  | 5,278,385 |
| Income tax expense | - |  | - |  | - |  | (831,975) |  | (831,975) |
|  |  |  |  |  |  |  |  |  |  |
| Net profit / (loss) | **36,647,423** |  | **(6,869,095)** |  | **2,233,872** |  | **(15,527,819)** |  | **16,484,381** |

Reportable segments results for the year ended December 31, 2009 are shown in the following table:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Exploration and production** |  | **Refining** |  | **Trade** |  | **Other** |  | **Total** |
|  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| Segment revenue | 57,247,745 |  | 99,450,735 |  | 102,035,196 |  | 3,889,514 |  | 262,623,190 |
| Inter-segment revenue | 45,423,805 |  | 87,585,110 |  | 7,502,649 |  | 3,836,441 |  | 144,348,005 |
| Total revenue | 11,823,940 |  | 11,865,625 |  | 94,532,547 |  | 53,073 |  | 118,275,185 |
|  |  |  |  |  |  |  |  |  |  |
| Operating income (expenses) | 6,465,403 |  | 3,103,067 |  | (10,912,117) |  | (757,059) |  | (2,100,706) |
|  |  |  |  |  |  |  |  |  |  |
| Financial income (expenses) | 235,351 |  | 92,199 |  | 1,233,911 |  | (6,317,857) |  | (4,756,396) |
| Other income (expenses) | (3,398,682) |  | (10,019,078) |  | (15,152,150) |  | (4,092,464) |  | (32,662,374) |
|  |  |  |  |  |  |  |  |  |  |
| Profit / (loss) before tax | 3,302,072 |  | (6,823,812) |  | (24,830,356) |  | (11,167,380) |  | (39,519,476) |
|  |  |  |  |  |  |  |  |  |  |
| Income tax expense | - |  | - |  | - |  | 1,883,365 |  | 1,883,365 |
|  |  |  |  |  |  |  |  |  |  |
| Net profit / (loss) | **3,302,072** |  | **(6,823,812)** |  | **(24,830,356)** |  | **(9,284,015)** |  | **(37,636,111)** |

**6. SEGMENT INFORMATION (continued)**

Sales among operating segment are performed in accordance with a transfer pricing decision. Measurement of revenues from external parties is consistent with the one from Income statement.

Assets and liabilities of operating segments as of December 31, 2010 in accordance with bussines structure valid at the same date are presented in the following table:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Exploration and production** |  | **Oil field services** |  | **Refining** |  | **Trade** |  | **Other** |  | **Total** |
|  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| ***Assets*** | 30,433,074 |  | 7,765,691 |  | 74,665,749 |  | 32,569,271 |  | 31,693,216 |  | 177,127,001 |
|  |  |  |  |  |  |  |  |  |  |  |  |
| ***Liabilites*** | (11,597,999) |  | (1,345,711) |  | (23,261,474) |  | (10,445,114) |  | (83,457,989) |  | (130,108,287) |
|  |  |  |  |  |  |  |  |  |  |  |  |
| ***Net assets*** | 18,835,075 |  | 6,419,980 |  | 51,404,275 |  | 22,124,157 |  | (51,764,773) |  | 47,018,714 |

Assets and liabilities of operating segments as of December 31, 2010 in accordance with bussines structure valid at December 31, 2009 are presented in the following table:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Exploration and production** |  | **Refining** |  | **Trade** |  | **Other** |  | **Total** |
|  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| ***Assets*** | 38,198,765 |  | 74,665,749 |  | 32,569,271 |  | 31,693,216 |  | 177,127,001 |
|  |  |  |  |  |  |  |  |  |  |
| ***Liabilites*** | (12,943,710) |  | (23,261,474) |  | (10,445,114) |  | (83,457,989) |  | (130,108,287) |
|  |  |  |  |  |  |  |  |  |  |
| ***Net assets*** | 25,255,055 |  | 51,404,275 |  | 22,124,157 |  | (51,764,773) |  | 47,018,714 |

Assets and liabilities of operating segments as of December 31, 2009 are presented in the following table:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Exploration and production** |  | **Refining** |  | **Trade** |  | **Other** |  | **Total** |
|  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| ***Assets*** | 42,788,016 |  | 58,488,104 |  | 26,144,747 |  | 16,630,448 |  | 144,051,315 |
|  |  |  |  |  |  |  |  |  |  |
| ***Liabilites*** | (9,912,949) |  | (26,074,015) |  | (8,925,799) |  | (66,855,385) |  | (111,768,148) |
|  |  |  |  |  |  |  |  |  |  |
| ***Net assets*** | 32,875,067 |  | 32,414,089 |  | 17,218,948 |  | (50,224,937) |  | 32,283,167 |

Analysis of the Company’s revenue per main products and services is given in the following table:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Sale of oil and oil products | 157,811,032 |  | 113,719,465 |
| Sale of services and other sales | 3,337,818 |  | 4,656,119 |
|  | 161,148,850 |  | 118,375,584 |

**6. SEGMENT INFORMATION (continued)**

**Other segment information**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010.** |  | **2009.** |

|  |  |  |  |
| --- | --- | --- | --- |
| *Depreciation:* |  |  | *(Adjusted)* |
| Exploration and production | 3,361,914 |  | 3,811,890 |
| Oil field services\* | 220,434 |  | - |
| Refining | 2,005,250 |  | 2,589,828 |
| Trade | 685,176 |  | 1,156,823 |
| Other | 591,538 |  | 394,210 |
|  | **6,864,311** |  | **7,952,751** |

\* reportable segment structure were chaged in the second half of 2010. Technically it is not possible to allocate the costs incurred before the segregation of Oil field services bloc as a new reporting segment.

Impairment loss on property, plant and equipment in the net amount of 721,679 RSD (2009: 16,089,664 RSD) was generated on Cash Generating Units (CGU) Retail and Wholesale, within reportable segment Trade.

*Impairment loss on property, plant and equipment incurred in 2010:*

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | **December 31,**  **2010** |
| Land |  |  | 13,423 |
| Buildings |  |  | 196,009 |
| Machinery and equipment |  |  | 293,495 |
| Construction in progress |  |  | 217,333 |
| Other PP&E |  |  | 1,419 |
|  |  |  | **721,679** |

*Impairment loss on property, plant and equipment incurred in 2009:*

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Refining** |  | **Trade** |  | **Other** |  | **Total** |
|  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Buildings |  | 1,250,127 |  | 6,018,753 |  | 57,682 |  | 7,326,562 |
| Machinery and equipment |  | 5,454,497 |  | 534,036 |  | 16,682 |  | 6,005,215 |
| Construction in progress |  | 1,258,936 |  | 1,498,951 |  | - |  | 2,757,887 |
|  |  |  |  |  |  |  |  |  |
|  |  | 7,963,560 |  | 8,051,740 |  | 74,364 |  | 16,089,664 |

1. **INTANGIBLE ASSETS**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Concessions, patents, licenses and rights** |  | **Intangible assets under construction** |  | **Other intangibles** |  | **Total** |
|  |  |  |  |  |  |  |  |  |  |
| **At January 1, 2009** |  |  |  |  |  |  |  |  |  |
| Cost |  |  | 405,353 |  | 4,874,833 |  | 757,093 |  | 6,037,279 |
| Accumulated depreciation and impairment |  |  | (114,737) |  | (142,279) |  | (326,783) |  | (583,799) |
| **Net book amount** |  |  | **290,616** |  | **4,732,554** |  | **430,310** |  | **5,453,480** |
|  |  |  |  |  |  |  |  |  |  |
| **Year ended December 31, 2009** |  |  |  |  |  |  |  |  |  |
| Opening net book amount |  |  | 290,616 |  | 4,732,554 |  | 430,310 |  | 5,453,480 |
| Additions |  |  | 26,214 |  | 804,696 |  | - |  | 830,910 |
| Transfer from CIP |  |  | 435,285 |  | (680,782) |  | 245,497 |  | - |
| Depreciation (note 30) |  |  | (14,558) |  | - |  | (217,432) |  | (231,990) |
| Impairment charge (note 36) |  |  | (1,749) |  | (1,556,014) |  | (24,740) |  | (1,582,503) |
| Disposals |  |  | - |  | (8,086) |  | - |  | (8,086) |
| Other transfers |  |  | - |  | - |  | 330,933 |  | 330,933 |
| **Closing net book amount** |  |  | **735,808** |  | **3,292,368** |  | **764,568** |  | **4,792,744** |
|  |  |  |  |  |  |  |  |  |  |
| **At December 31, 2009** |  |  |  |  |  |  |  |  |  |
| Cost |  |  | 840,638 |  | 4,998,747 |  | 1,333,523 |  | 7,172,908 |
| Accumulated depreciation and impairment |  |  | (104,830) |  | (1,706,379) |  | (568,955) |  | (2,380,164) |
| **Net book amount** |  |  | **735,808** |  | **3,292,368** |  | **764,568** |  | **4,792,744** |
|  |  |  |  |  |  |  |  |  |  |
| **Year ended December 31, 2010** |  |  |  |  |  |  |  |  |  |
| Opening net book amount |  |  | 735,808 |  | 3,292,368 |  | 764,568 |  | 4,792,744 |
| Additions |  |  | - |  | 362,134 |  | - |  | 362,134 |
| Transfer from CIP |  |  | 181,819 |  | (3,448,963) |  | 3,267,144 |  | - |
| Transfer from PP&E |  |  | (4,769) |  | (11,169) |  | 29,702 |  | 13,764 |
| Depreciation (note 30) |  |  | (76,107) |  | - |  | (207,810) |  | (283,917) |
| Disposals |  |  | (113) |  | (1) |  | (48) |  | (162) |
| Other transfers |  |  | (142,949) |  | (48,803) |  | 142,949 |  | (48,803) |
| **Closing net book amount** |  |  | **693,689** |  | **145,566** |  | **3,996,506** |  | **4,835,761** |
|  |  |  |  |  |  |  |  |  |  |
| **At December 31, 2010** |  |  |  |  |  |  |  |  |  |
| Cost |  |  | 878,120 |  | 1,843,860 |  | 4,721,726 |  | 7,443,706 |
| Accumulated depreciation and impairment |  |  | (184,431) |  | (1,698,294) |  | (725,220) |  | (2,607,945) |
| **Net book amount** |  |  | **693,689** |  | **145,566** |  | **3,996,506** |  | **4,835,761** |

Other intangible assets as of December 31, 2010 in amount 3,996,506 RSD mostly relates to investment in SAP system in amount 3,840,765 RSD.

Amortization for the year ended December 31, 2010 in the amount of 283,917 RSD (2009: 231,990 RSD) is included in Operating expenses in the Income statement (note 30).

1. **PROPERTY, PLANT AND EQUIPMENT**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Land** |  | **Buildings** |  | **Machinery and equipment** |  | **Construction in Progress** |  | **Other PP&E** |  | **Investments in other PP&E** |  | **Advances to suppliers** |  | **Total** |
| *(Adjusted)* |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **At January 1, 2009** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost | 10,807,843 |  | 49,896,837 |  | 53,217,535 |  | 8,680,271 |  | 89,452 |  | 110,630 |  | 172,719 |  | 122,975,287 |
| Accumulated depreciation and impairment | - |  | (8,560,357) |  | (16,534,224) |  | (612,936) |  | (8) |  | (360) |  | (75,044) |  | (25,782,929) |
| **Net book amount** | **10,807,843** |  | **41,336,480** |  | **36,683,311** |  | **8,067,335** |  | **89,444** |  | **110,270** |  | **97,675** |  | **97,192,358** |
| **Year ended December 31, 2009** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Opening net book amount | 10,807,843 |  | 41,336,480 |  | 36,683,311 |  | 8,067,335 |  | 89,444 |  | 110,270 |  | 97,675 |  | 97,192,358 |
| Additions | - |  | - |  | - |  | 6,227,405 |  | - |  | - |  | 5,384,262 |  | 11,611,667 |
| Transfer from CIP | 401,738 |  | 3,674,778 |  | 1,447,318 |  | (5,523,857) |  | 23 |  | - |  | - |  | - |
| Other transfers | - |  | 2,240,957 |  | 20,790 |  | (187,362) |  | - |  | - |  | (544,639) |  | 1,529,746 |
| Disposals | (210) |  | (34,374) |  | (61,721) |  | (343,780) |  | (71) |  | - |  | 2,197 |  | (437,959) |
| Depretiation (note 30) | - |  | (3,517,558) |  | (4,099,707) |  | - |  | - |  | (103,316) |  | - |  | (7,720,581) |
| Impairment charge (note 36) | (723,950) |  | (6,727,643) |  | (6,778,126) |  | (3,629,949) |  | (43,877) |  | - |  | (3,730) |  | (17,907,275) |
| Transferred to disposal group classified as held for sale | - |  | (33,124) |  | (102,323) |  | - |  | - |  | - |  | - |  | (135,447) |
| **Closing net book amount at December 31,** | **10,485,421** |  | **36,939,516** |  | **27,109,542** |  | **4,609,792** |  | **45,519** |  | **6,954** |  | **4,935,765** |  | **84,132,509** |
| **At December 31, 2009** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost | 11,209,371 |  | 55,763,533 |  | 53,911,498 |  | 8,709,106 |  | 89,396 |  | 110,630 |  | 5,012,342 |  | 134,805,876 |
| Accumulated depreciation and impairment | (723,950) |  | (18,824,017) |  | (26,801,956) |  | (4,099,314) |  | (43,877) |  | (103,676) |  | (76,577) |  | (50,673,367) |
| **Net book amount** | **10,485,421** |  | **36,939,516** |  | **27,109,542** |  | **4,609,792** |  | **45,519** |  | **6,954** |  | **4,935,765** |  | **84,132,509** |
| **Year ended December 31, 2010** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Opening net book amount | 10,485,421 |  | 36,939,516 |  | 27,109,542 |  | 4,609,792 |  | 45,519 |  | 6,954 |  | 4,935,765 |  | 84,132,509 |
| Additions | - |  | - |  | - |  | 14,322,530 |  | - |  | - |  | 9,444,345 |  | 23,766,875 |
| Transfer from CIP | 65,706 |  | 7,274,440 |  | 1,616,169 |  | (8,956,850) |  | 535 |  | - |  | - |  | - |
| Transfers within PP&E | - |  | (1,735,307) |  | 1,006,429 |  | 685,001 |  | 43,877 |  | - |  | - |  | - |
| Other transfers | - |  | 562,404 |  | (423,993) |  | - |  | - |  | - |  | - |  | 138,411 |
| Disposals and advances paid used | (579) |  | (5,763) |  | (40,920) |  | (162,459) |  | - |  | - |  | (1,667,690) |  | (1,877,411) |
| Depretiation (note 30) | - |  | (3,239,131) |  | (3,335,029) |  | - |  | - |  | (6,234) |  | - |  | (6,580,394) |
| Adjust.of depreciat. on impaired property(note 36) | - |  | (273,123) |  | - |  | - |  | - |  | - |  | - |  | (273,123) |
| Impairment charge (note 36) | (13,423) |  | (503,581) |  | (376,299) |  | (48,838) |  | (1,426) |  | - |  | - |  | (943,567) |
| Transfer from intangible assets | - |  | 259 |  | - |  | (14,023) |  | - |  | - |  | - |  | (13,764) |
| Transfer from investment property | - |  | (455,926) |  | - |  | - |  | - |  | - |  | - |  | (455,926) |
| Transferred to disposal group classified as held for sale | - |  | 28,390 |  | 92,384 |  | - |  | 7 |  | - |  | - |  | 120,781 |
| **Closing net book amount at December 31,** | **10,537,125** |  | **38,592,177** |  | **25,648,283** |  | **10,435,154** |  | **88,512** |  | **720** |  | **12,712,420** |  | **98,014,391** |
| **At December 31** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost | 11,274,498 |  | 62,752,974 |  | 55,498,519 |  | 13,801,387 |  | 89,938 |  | 110,630 |  | 12,787,121 |  | 156,315,067 |
| Accumulated depreciation and impairment | (737,373) |  | (24,160,797) |  | (29,850,236) |  | (3,366,233) |  | (1,426) |  | (109,910) |  | (74,701) |  | (58,300,676) |
| **Net book amount** | **10,537,125** |  | **38,592,177** |  | **25,648,283** |  | **10,435,154** |  | **88,512** |  | **720** |  | **12,712,420** |  | **98,014,391** |

**8. PROPERTY, PLANT AND EQUIPMENT (continued)**

The most significant investments in 2010 in amount of 23,766,875 RSD mostly relate to investments in MHC/DHT project (investments in construction of a Mild Hydrocracking Complex and Hydrofinishing in Pančevo Oil Refinery) amounted 2,882,742 RSD. Balance of advances paid to supplier, related to the same project, as of December 31, 2010 amounted to 6,589,809 RSD.

Accrual for asset retirement of active wells for the year ended December 31, 2010 in amount of 2,636,353 RSD is recognized under property, plant and equipment (note 20).

Depreciation expense for the year ended December 31, 2010 in the amount of 6,580,394 RSD (2009: 7,720,581 RSD) is recorded under operating expenses in the income statement (note 30).

Machinery and equipment include the following amounts where the group is a lessee under a finance lease:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Cost capitalised - finance leases | 200,440 |  | 207,762 |
| Accumulated depreciation | (47,983) |  | (29,181) |
| Net book amount | **152,457** |  | **178,581** |

According to Revised IAS 23 – “Borrowing costs”, in 2010 the Company has capitalized borrowing costs for construction of qualifying assets as part of its purchased value in the amount of 317,506 RSD (2009: 26,158 RSD).

Impairment loss in the amount of 721,679 RSD was generated on Cash Generating Units CGU’s, Retail (in amount 1,161,382 RSD) and Wholesale (reversal of impairment in amount 439,703 RSD) after impairment test performed by independent valuator.

The recoverable amount of a CGU is equal to value-in-use amount. Weighted Average Cost of Capital („WACC“) rate used in calculation of value-in-use is 15%.

In impairment assessment of plant property and equipment, the management considered whether assets relating to Pancevo refinery anmounting to 28,364,679 RSD which are included in Refinery segment shall be considered separately for the purposes of calculation of the recoverable amount and impairment loss, if any or shall be aggregatted with the Upstream assets amounting 26,539,178 RSD which are included in the Exploration and Production segment. Management considered both requirements of IFRS8 Segment Reporting and guidance relating to identifying cash generating unit included in IAS 36 Impairment of assets and the interrelation of these requirements in light of the specific circumstances in which both refinery and explorations operate . Management concluded that although NIS Executive committee regularly reviews operating results of five business segments (as discussed in note 6) and Refinery and Exploration and Production are separately reportable segments, the cash flows of these segments are highly interdependent and cannot be separated for the purposes of calculation of the recoverable amount.

**8. PROPERTY, PLANT AND EQUIPMENT (continued)**

The main circumstances supporting non-separability of cashflows were:

- the oil pipeline infrastructure in the Central European region is distinctly limited. One pipeline exists currently which runs from the primary NIS producing fields in the north-west of Serbia directly to the Pancevo refinery in the east of Serbia. No pipelines exist which would enable the crude production to be exported, nor are there rail facilities in close proximity to the producing fields.

- management’s ability to make independent decisions regarding the disposition of the outputs from the NIS Upstream operating segment based on SPA commitments and political environment.

As a result aforementioned assets and recoverable amount were assessed on aggregate basis. No impairment loss was recognised.

1. **INVESTMENT PROPERTY**

Investment properties are valued at the balance sheet date at fair value, which comprising of market value of investment property.

Movements on the account were as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **At January 1st** | **499,974** |  | **738,953** |
| Fair value gains (note 35) | 575,786 |  | 172,648 |
| Fair value losses (note 36) | (138,716) |  | (505,044) |
| Transfer from PP&E | 455,926 |  | 93,850 |
| Disposal and write-off | - |  | (433) |
| Transfer from asset held for sale | 200 |  | - |
| **At December 31** | **1,393,170** |  | **499,974** |

The following amounts have been recognized in the income statement:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| Rental income (note 28) | 91,379 |  | 173,181 |

As at December 31, 2010 investment properties in amount of 1,393,170 RSD (December 31, 2009,: 499,974 RSD) mostly relate to apartments and business facilities given to long-term lease, are valued at fair value on balance sheet date.

1. **INVESTMENTS IN EQUITY INSTRUMENTS**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| Investments in subsidiaries | 3,488,730 |  | 3,314,960 |
| Investments in other related parties | 90,183 |  | 116,835 |
| Investments in other legal entities and other securities available for sale | 2,389,139 |  | 3,834,789 |
| *Less:* Provision | (3,389,299) |  | ( 4,347,720) |
|  | **2,578,753** |  | **2,918,864** |

1. **INVESTMENTS IN EQUITY INSTRUMENTS (continued)**
2. *Investments in subsidiary*

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| In shares | 3,436,185 |  | 3,262,486 |
| In stakes | 52,545 |  | 52,474 |
|  | 3,488,730 |  | 3,314,960 |
| *Less:* Provision | (1,173,167) |  | (762,175) |
|  | **2,315,563** |  | **2,552,785** |

Investments in subsidiariy as at December 31, 2010 relate to the following companies:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Company** | **Investment** |  | **Impairment** |  | **Net book value** |  | **Share %** |
|  |  |  |  |  |  |  |  |
| О Zone а.d. Belgrade, Serbia | 3,436,185 |  | (1,172,263) |  | 2,263,922 |  | 100 |
| Jadran-Naftagas d.o.o. Banja Luka, BiH | 71 |  | - |  | 71 |  | 66 |
| NIS Oil Trading, Frankfurt, Germany | 24,147 |  | - |  | 24,147 |  | 100 |
| Svetlost, Bujanovac, Serbia | 17,045 |  | - |  | 17,045 |  | 51 |
| NIS Оversiz, Moscow, Russia | 9,856 |  | - |  | 9,856 |  | 100 |
| Ranis, Moscow region, Russia | 522 |  | - |  | 522 |  | 51 |
| Jubos, Bor, Serbia | 904 |  | (904) |  | - |  | 51 |
| NIS Investments, London, Great Britain | - |  | - |  | - |  | 100 |
|  | **3,488,730** |  | **(1,173,167)** |  | **2,315,563** |  | **-** |

Movements on the account:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| **As at January 1st** | 3,314,960 |  | 3,314,960 |
| Other movements | 173,770 |  | **-** |
| *Less:* provision | (1,173,167) |  | (762,175) |
| **As at December 31st** | **2,315,563** |  | **2,552,785** |

**10. INVESTMENTS IN EQUITY INSTRUMENTS (continued)**

1. *Investments in subsidiary (continued)*

New investments in subsidiaries in 2010 in the amount of 173,770 RSD relate to:

1. additional investment in O Zone a.d., Belgrade in accordance with The General director’s decisions dated February 10, 2009 and January 12, 2010 in the amount of 173,699 RSD in order to increase efficiency and improve operations.
2. co-founding "Jadran - Naftagas d.o.o., Banja Luka, the limited company for research and oil production in the Republic of Srpska in accordance with the Decision brought by The Management Board of the Company on November 9, 2010. The total capital of the newly-founded company on December 31, 2010 amounts to 2,000 Bosnian Convertible Marks (BAM), and the share of the Company in this capital is 66%.

Movement on provision for investments in subsidiary:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **As at January 1st** | (762,175) |  | (131,887) |
| Provision for Impairment: |  |  |  |
| - О Zone а.d. Belgrade, Serbia | (410,992) |  | (629,384) |
| - Jubos, Bor, Serbia | - |  | (904) |
| **As at December 31st** | **(1,173,167)** |  | **(762,175)** |

In 2010 The Company recorded the provision for impairment of the investment in subsidiary O Zone a.d. Beograd in the amount of RSD 410.992 (note 36) taking into account that the subsidiary continued its operations with loss in 2010.

1. *Investments in other related parties*

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| In shares | 72,592 |  | 97,999 |
| In stakes | 17,591 |  | 18,836 |
|  | 90,183 |  | 116,835 |
| *Less:* Provision | (13,148) |  | (14,393) |
|  | **77,035** |  | **102,442** |

**10. INVESTMENTS IN EQUITY INSTRUMENTS (continued)**

*b) Investments in other related parties (continued)*

Investments in associates as at December 31, 2010 relate to the following companies:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Company** | **Investment** |  | **Impairment** |  | **Net book value** |  | **Share %** |
|  |  |  |  |  |  |  |  |
| Eurol International Ltd, Bermuda | 2,999 |  | (2,999) |  | - |  | 50.00 |
| Маcо nafta Skоpje, Macedonia | 4,269 |  | - |  | 4,269 |  | 49.00 |
| NIS Jugopetrol SPA, Milan | 10,149 |  | (10,149) |  | - |  | 50.00 |
| RDS Naftagas Ltd, London | - |  | - |  | - |  | 50.00 |
| SPC Pinki, Belgrade, Zemun | 72,592 |  | - |  | 72,592 |  | 46.16 |
| Prokons, Subotica | 174 |  | - |  | 174 |  | 20.15 |
|  | **90,183** |  | **(13,148)** |  | **77,035** |  |  |

Movements on the account:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| **As at January 1st** | 116,835 |  | 98,770 |
| Exchange differences and other movements | (25,407) |  | 18,065 |
| Write off | (1,245) |  | - |
| Less: provision | (13,148) |  | (14,393) |
| **As at December 31st** | **77,035** |  | **102,442** |

Movement on provision for investments in associates:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **As at January 1st** | (14,393) |  | (11,394) |
| Provision for Impairment: |  |  |  |
| - Eurol International Ltd, Bermuda (note 36) | - |  | (2,999) |
| Write off | 1,245 |  | - |
| **As at December 31st** | **(13,148)** |  | **(14,393)** |

**10. INVESTMENTS IN EQUITY INSTRUMENTS (continued)**

1. *Investment in other legal entities and other available for sale financial assets:*

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| In shares | 2,134,095 |  | 3,579,750 |
| In stakes | 23,822 |  | 23,822 |
| Other | 231,222 |  | 231,217 |
|  | 2,389,139 |  | 3,834,789 |
| *Less:* Provision | (2,202,985) |  | (3,571,152) |
|  | **186,154** |  | **263,637** |

Investments in other legal entities as at December 31, 2010 relate to the following companies:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Company** | **Investment** |  | **Impairment** |  | **Net book value** |  | **Share %** |
|  |  |  |  |  |  |  |  |
| HIP Petrohemija а.d, Pančevo | 1,682,522 |  | (1,682,522) |  | - |  | 20.51 |
| MSK а.d., Kikinda | 265,507 |  | (265,507) |  | - |  | 10.10 |
| Linde Gas Serbia а.d, Bečej | 112,376 |  | - |  | 112,376 |  | 12.44 |
| Luka Dunav а.d, Pančevo | 23,962 |  | - |  | 23,962 |  | 3.36 |
| Komercijalna bank а.d, Belgrade | 18,076 |  | - |  | 18,076 |  | 0.08 |
| Jubmes bank а.d, Belgrade | 13,394 |  | - |  | 13,394 |  | 0.38 |
| Centralna kooperativna bank, Skopje, Macedonia | 6,867 |  | - |  | 6,867 |  | 0.63 |
| Politika a.d., Belgrade | 5,301 |  | - |  | 5,301 |  | 0.85 |
| Dunav osigruanje а.d., Belgrade | 2,914 |  | - |  | 2,914 |  | 0.59 |
| Other legal entities | 258,220 |  | (254,956) |  | 3,264 |  | - |
|  | **2,389,139** |  | **(2,202,985)** |  | **186,154** |  | **-** |

Available for sale financial assets include the following:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| *Listed securities, quoted on BELEX:* |  |  |  |
| - Ownership securities | 179,198 |  | 256,681 |
| *Unlisted securities:* |  |  |  |
| - Ownership securities | 6,956 |  | 6,956 |
|  |  |  |  |
|  | **186,154** |  | **263,637** |

**10. INVESTMENTS IN EQUITY INSTRUMENTS (continued)**

*c) Investment in other legal entities and other available for sale financial assets (continued)*

The movements in available for sale financial assets:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| **As at January 1st** | 263,637 |  | 792,641 |
| Increase (decrease) |  |  | (343,321) |
| Fair value adjustments and other movements | (77,483) |  | (19,668) |
| Impairment | - |  | (176,990) |
| Other movements | - |  | 10,975 |
| **As at December 31st** | **186,154** |  | **263,637** |

Movement of provision for available for sale financial assets:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **As at January 1st** | (3,571,152) |  | (3,227,831) |
| Provision for Impairment: |  |  |  |
| - HIP Petrohemija а.d., Pančevo | - |  | (310,995) |
| - Other legal entities | - |  | (23,693) |
| Write-off of investment in Metalusko Sircetni kompleks a.d. Kikinda (decrease of nominal value of investments) | 1,368,172 |  | - |
| Transfers and other movements | (5) |  | (8,633) |
| **As at December 31st** | **(2,202,985)** |  | **(3,571,152)** |

For other investments traded in active markets, fair value is determined by reference to the current market value at the close of business at the balance sheet date.

1. **OTHER LONG TERM INVESTMENTS**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Rescheduled receivables | 8,040,906 |  | 10,031,434 |
| Long term loans to employees | 1,443,233 |  | 1,769,402 |
| Buildings leased at financial leasing | 153,415 |  | 159,387 |
| Investments in Crni Vrh – O zone | 1,616,295 |  | 1,616,295 |
| Other long term financial assets | 755,989 |  | 649,481 |
|  | 12,009,838 |  | 14,225,998 |
| *Less provision:* |  |  |  |
| - rescheduled receivables | (8,040,906) |  | (8,447,998) |
| - buildings in financial lease | (99,664) |  | (129,232) |
| - investments in Crni Vrh – O Zone | (1,616,295) |  | (1,616,295) |
| - other long term financial assets | (748,705) |  | (642,405) |
|  | (10,505,570) |  | (10,835,929) |
| **Total – net** | **1,504,268** |  | **3,390,069** |

1. **OTHER LONG TERM INVESTMENTS (сontinued)**

Long term loans relate to receivables from customers as of December 31, 2010 in amount of 8,040,906 RSD relates to:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Total** |  | **Long term** |  | **Current portion** |
|  |  |  |  |  |  |
| **Rescheduled receivables** |  |  |  |  |  |
| - HIP Petrohemija | 9,019,590 |  | 6,614,366 |  | 2,405,224 |
| - RTB Bor | 1,426,540 |  | 1,426,540 |  | - |
| - ЈАТ | 202,028 |  | - |  | 202,028 |
|  | 10,648,158 |  | 8,040,906 |  | 2,607,252 |
| *Less*: provision | (8,747,064) |  | (8,040,906) |  | (706,158) |
| **Total – net** | **1,901,094** |  | **-** |  | **1,901,094** |

* + - * 1. Receivables from HIP Petrohemija, Pančevo in amount of 9,019,590 RSD relate to rescheduled receivables. Management has assessed that these receivables are not collectible in the amount of 7,118,496 RSD while remaining portion in the amount of 1,901,094 RSD is secured by pledge right on debtor’s assets.
        2. Receivables from RTB Bor in the amount of 1,426,540 RSD is fully provided per management assessment, as a consequence of non collectability since 2004.

Other long term financial assets as of December 31, 2010 in amount 755,989 RSD, mostly, in amount 674,094 RSD, relates to investment in HIP Petrohemija, Pancevo for construction of facility for waste water treatment, fully provided in previous years.

Rescheduled receivables provision movement table:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **As at January 1st** | (8,447,998) |  | (1,549,730) |
| Provision for impairment (note 36) | - |  | (6,840,424) |
| Reversal of impairment (note 35) | 156,579 |  | - |
| Colected impaired receivables (note 35) | 55,844 |  | - |
| Write off | 589,665 |  | - |
| Reconciliation of long-term investments (note 35) | 182,804 |  | - |
| Foreign exchange losses | (778,972) |  | - |
| Transfers and other movements | 201,172 |  | (57,844) |
|  |  |  |  |
| **As at December 31st** | **(8,040,906)** |  | **(8,447,998)** |

1. **OTHER LONG TERM INVESTMENTS (continued)**

Long-term loans to employees of the Company as at December 31, 2010 amounted to 1,443,233 RSD (December 31, 2009: 1,769,402 RSD) relate to interest-free loans or loans at an interest rate of 0.5% and 1.5% given to employees for the purpose of solving housing problems. These loans are repaid by monthly installments.

The Company's management believes that the carrying value of the loans to employees correspondents to their value at the market. The fair value of the loans to employees is based on cash flows discounted at market interest rate at which the Company could obtain long-term borrowings and which corresponds to marked interest rate for similar financial instruments in the current reporting period - 6.5% (2009: 6.5% per year).

The maximum exposure to the credit risk at the reporting date is the nominal value of loans given to employees. This credit risk exposure is limited, as the repayment of these loans is provided automatically when the salaries are being paid.

None of the loans is overdue or impaired.

1. **INVENTORIES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Raw materials | 19,319,424 |  | 14,215,098 |
| Spare parts | 3,089,881 |  | 3,407,247 |
| Tools | 120,241 |  | 120,147 |
| Work in progress | 6,586,856 |  | 2,375,837 |
| Finished goods | 6,995,641 |  | 5,900,842 |
| Merchandise | 1,925,793 |  | 677,604 |
|  | 38,037,836 |  | 26,696,775 |
|  |  |  |  |
| Advances | 1,297,110 |  | 1,708,451 |
| *Less provision:* |  |  |  |
| - for inventories | (4,771,037) |  | (4,749,526) |
| - for advances | (563,942) |  | (599,404) |
|  | (5,334,979) |  | (5,348,930) |
| **Total inventories – net** | **33,999,967** |  | **23,056,296** |

1. **INVENTORIES (continued)**

Movement on inventory provision is as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **At January 1st** | (5,348,930) |  | (1,569,786) |
| Provision for impaired inventories charged to the period | (54,383) |  | (4,039,478) |
| Provision reversed | 60,548 |  | 164,282 |
| Writte off | 27,970 |  | 96,052 |
| Other | (20,184) |  | - |
| **At December 31** | **(5,334,979)** |  | **(5,348,930)** |

1. **TRADE AND OTHER RECEIVABLES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Trade receivables |  |  |  |
| - domestic | 16,054,686 |  | 18,778,375 |
| - foreign | 1,291,755 |  | 1,677,505 |
| - related parties | 1,192,453 |  | 721,942 |
|  | 18,538,894 |  | 21,177,822 |
|  |  |  |  |
| Receivables from specific operations | 8,037,783 |  | 5,292,519 |
|  |  |  |  |
| Interest receivables | 4,922,863 |  | 4,099,968 |
| Receivables from employees | 112,592 |  | 120,431 |
| Other receivables | 7,437,431 |  | 7,518,505 |
|  | 12,472,886 |  | 11,738,904 |
|  |  |  |  |
|  | 39,049,563 |  | 38,209,245 |
| *Less provision:* |  |  |  |
| - trade receivables | (6,022,505) |  | (10,280,128) |
| - receivables from specific operations | (7,971,114) |  | (5,224,781) |
| - interest and other receivables | (12,110,225) |  | (11,313,403) |
|  | (26,103,844) |  | (26,818,312) |
| **Total receivables – net** | **12,945,719** |  | **11,390,933** |
|  |  |  |  |
| **Receivables for overpaid income tax** | **-** |  | **41,689** |

Receivables from specific operations as of December 31, 2010 in amount of 8,037,783 RSD (December 31, 2009: 5,292,519 RSD) mostly relate to doubtfull receivables with due date in 2005, in amount 6.111.290 RSD (Beobanka a.d. in amount 2,569,410 RSD; Srbijagas a,d, in amount of 2,487,575 RSD and Industrija stakla Pancevo a.d. in amount of 1,054,305 RSD). These receivables are fully provided for as at December 31, 2010.

1. **TRADE AND OTHER RECEIVABLES (continued)**

Trade receivables as of December 31, 2010 in amount 5,306,107 RSD from state controlled companies that are less than three months past due and trade receivables from other companies that are less than two months past due are not considered impaired, except for receivables from a number of independent customers for whom there is no recent history of default, amounted to 129,960 RSD (December 31, 2009: 2,017,923 RSD).

The ageing analysis of trade receivables is as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Up to 3 months | 13,232,787 |  | 8,895,203 |
| Over 3 months | 5,306,107 |  | 12,282,619 |
|  | **18,538,894** |  | **21,177,822** |

As of December 31, 2010 trade receivables in amount of 6,022,505 (December 31, 2009: 10,280,128 RSD) were either impaired or provided for. The individually impaired receivables mainly relate to customers which are assessed as unexpected to be collected. The ageing of receivables provided for is as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Up to 3 months | 846,358 |  | 15,432 |
| Over 3 months | 5,176,147 |  | 10,264,696 |
|  | **6,022,505** |  | **10,280,128** |

The carrying amounts of the Company’s trade and other receivables are denominated in the following currencies:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| RSD | 37,622,691 |  | 36,412,372 |
| EUR | 228,573 |  | 218,516 |
| USD | 1,197,914 |  | 1,578,335 |
| GBP | 317 |  | - |
| RUB | 22 |  | 22 |
| CHF | 46 |  |  |
|  | **39,049,563** |  | **38,209,245** |

**13. TRADE AND OTHER RECEIVABLES (continued)**

Movements on the Company’s provision for impairment of trade receivables and other receivables are as follows::

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **At January 1st** | (26,818,312) |  | (26,596,772) |
| Provision for impaired receivables | (2,271,195) |  | (3,648,464) |
| Written off | 2,732,214 |  | 2,622,324 |
| Unused amounts reversed | 567,492 |  | 622,703 |
| Transfers | - |  | 181,897 |
| Other | (314,043) |  | - |
| **At December 31** | **(26,103,844)** |  | **(26,818,312)** |

Other movement on the Company’s provision for impairment of trade receivables and other receivables in amount of 314,043 RSD mostly relate to impairment of intrest receivables in amount of 288,814 RSD, without effect on proft and loss.

Expenses for written off and provided for receivables is included in ‘other expenses/other income in the income statement (notes 35 and 36). Amounts charged to the allowance account are generally written off, when there is no expectation of recovering additional cash.

The concentration of credit risk related to the receivables is not significant as the Company has a large number of not related buyers with individually small amounts of debts. Accordingly, the Company believes that it is not necessary to make additional provision due to credit risk, which exceeds the provision already recognized due to the receivables impairment. Therefore, the maximum exposure to the credit risk at the reporting date equals to the net book value of the each type of receivables. The carrying value of accounts receivables, net of a provision for impairment equals to their fair value.

1. **SHORT TERM FINANCIAL INVESTMENTS**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Short term loans and investments | 506,784 |  | 544,607 |
| Short term loans and investments – related parties | 1,139 |  | 16,266 |
| Current portion of long term investments | 2,710,873 |  | 1,950,830 |
| Other short term financial investments | 1,242 |  | 501 |
|  | 3,220,038 |  | 2,512,204 |
| *Less:* provision | (706,158) |  | (1,636,365) |
| **Total short term financial investments – net** | **2,513,880** |  | **875,839** |

Current portion of long term investments (receivables) as of December 31, 2010 in the amount of 2,710,873 RSD (December 31, 2009: 1,950,830 RSD), mostly relate to current portion of rescheduled receivables in the amount of 2,607,252 RSD, They are provided for in the amount of 706,158 RSD (December 31, 2009: 1,636,365 RSD), note 11.

1. **SHORT TERM FINANCIAL INVESTMENTS (continued)**

Movement table of provision for short term financial investments:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |
|  |  |  |  |
| **At January 1st** | (1,636,365) |  | (119,251) |
| Provision for impairment | (461,759) |  | (1,602,926) |
| Write off | 1,530,541 |  | - |
| Тransfer and other movements | (161,978) |  | - |
| Decrease relate on foreign exchange diferences and other movements | 23,403 |  | 85,812 |
| **At December 31** | **(706,158)** |  | **(1,636,365)** |

1. **CASH AND CASH EQUIVALENTS**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
| Cash in bank | 10,485,780 |  | 8,432,299 |
| Cash in hand | 33,512 |  | 149,445 |
| Other cash equivalents | 76,538 |  | 89,757 |
|  | **10,595,830** |  | **8,671,501** |

As at December 31, 2010 short term bank deposits in amount 10.205.106 RSD (December 31, 2009: 7.618.081 RSD) represent short term deposits in banks with due date within 30 days are presented in line cash in bank.

1. **VAT AND PREPAID EXPENSES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Prepayment for VAT | 670,892 |  | 362,814 |
| Prepaid expenses | 35,478 |  | 33,372 |
| Not invoiced revenue | 1,150,066 |  | 1,052,423 |
| Excise duty | 842,064 |  | 986,447 |
| Employees benefits for housing loans and other prepayments | 1,241,858 |  | 1,710,192 |
| **Total** | **3,940,358** |  | **4,145,248** |

Prepayment for VAT as of December 31, 2010 in the amount of 670,892 RSD is VAT on incoming invoices accounted for in current period, while its deduction will come in the following accounting period.

Revenue not invoiced as of December 31, 2010 in the amount of 1,150,066 RSD (December 31, 2009: 1,052,423 RSD) mostly relates to receivables from Noble Clean Fuels in the amount of 1,143,245 RSD for current period sales of gasoline components for which the Company did not issue invoices.

1. **DEFERRED TAX ASSETS AND LIABILITIES**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Carrying value vs Tax base** | |  | **Total** |
| *Deferred tax liabilities* |  |  | |  |
| **As at January 1st , 2009** | 3,815,381 |  | | 3,815,381 |
| Charged on Income statement | (1,883,365) |  | | (1,883,365) |
| **As at December 31st,2009** | **1,932,016** |  | | **1,932,016** |
| Charged on Income statement | (473,481) |  | | (473,481) |
| **As at December 31st,2010** | **1,458,535** |  | | **1,458,535** |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  | **Investment credit** |  | **Total** |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| *Deferred tax assets* |  |  |  |  |  |
| **As at January 1st , 2009** |  |  | - |  | - |
| Charged on Income statement |  |  | - |  | - |
| **As at December 31st,2009** |  |  | - |  | - |
| Charged on Income statement |  |  | (4,804,904) |  | (4,804,904) |
| **As at December 31st,2010** |  |  | **(4,804,904)** |  | **(4,804,904)** |

Deferred income tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefit through the future taxable profits is probable.

The Company has recognized deferred tax assets in 2010 arising from unused tax credits that can be reversed depending on future results in the amount of 4,804,904 RSD, while total unused tax credits as at December 31, 2010 amount to 6,074,084 RSD (December 31, 2009: 4,802,588 RSD). Recognition was based on the five-year business plan and the certainty of transferred credits reversal. In future periods the Company expects significant investments and current tax credits on that basis.

1. **DEFERRED TAX ASSETS AND LIABILITIES**

Investment credit is incurred as 20% of capital investments made up to 31 December 2010.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Tax Credit**  **Оrigination** |  | **Tax Credit**  **Reversal** |  | **December 31,**  **2010** |  | **December 31, 2009** |
| 2005 |  | 2015 |  | 43,053 |  | 54,597 |
| 2006 |  | 2016 |  | 444,137 |  | 491,096 |
| 2007 |  | 2017 |  | 2,184,630 |  | 2,204,491 |
| 2008 |  | 2018 |  | 710,607 |  | 729,153 |
| 2009 |  | 2019 |  | 1,311,823 |  | 1,325,566 |
| 2010 |  | 2020 |  | 1,379,834 |  | - |
| **Total** |  |  |  | **6,074,084** |  | **4,804,903** |

1. **OFF BALANCE SHEET ASSET AND LIABILITIES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Issued warranties and bills of exchange | 66,564,991 |  | 131,982,082 |
| Received warranties and bills of exchange | 7,304,718 |  | 5,684,192 |
| Properties in ex-Republics of Yugoslavia | 5,463,024 |  | 5,421,435 |
| Receivables from companies from ex-Yugoslavia | 4,867,507 |  | 4,096,875 |
| Third party merchandise in NIS warehouses | 4,035,255 |  | 3,436,067 |
| Assets for oil fields liquidation in Angola | 557,851 |  | 591,248 |
| **Total** | **88,793,346** |  | **151,211,899** |

1. **EQUITY**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Share capital** |  | **Other capital** |  | **Reserves** |  | **Revaluation reserves** |  | **Unrealised gains from securities** |  | **Unrealised losses from securities** |  | **Accumulated loss** |  | **Total** |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Balance as at January 1, 2009** | 81,530,220 |  | 5,597,804 |  | 889,424 |  | 60,783 |  | 136,760 |  | (33,169) |  | (18,200,280) |  | **69,981,542** |
| Income |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| - Loss | - |  | - |  | - |  | - |  | - |  |  |  | (37,636,111) |  | (37,636,111) |
| - Gains/ losses from securities | - |  | - |  | - |  | - |  | (6,517) |  | 4,997 |  | - |  | (1,520) |
| Reversal of Revaluation Reserves | - |  | - |  |  |  | (60,744) |  | - |  | - |  | - |  | (60,744) |
| Increase (decrease) through transfers and other changes, equity | (20) |  | 20 |  | - |  | - |  | - |  | - |  | - |  | - |
| **Balance as at December 31, 2009** | **81,530,200** |  | **5,597,824** |  | **889,424** |  | **39** |  | **130,243** |  | **(28,172)** |  | **(55,836,391)** |  | **32,283,167** |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Balance as at January 1, 2010** | 81,530,200 |  | 5,597,824 |  | 889,424 |  | 39 | |  | | 130,243 | |  | | (28,172) |  | (55,836,391) |  | **32,283,167** | |
| Income |  |  |  |  |  |  | |  | |  | |  |  |  | |  |  |  |  |
| - Profit | - |  | - |  | - |  | | - | |  | | - |  | - | |  | 16,484,381 |  | 16,484,381 |
| - distribution of profit recorded before 2009 (note 25) | - |  | - |  | - |  | | - | |  | | - |  | - | |  | (1,645,944) |  | (1,645,944) |
| - Gains/ losses from securities | - |  | - |  | - |  | | - | |  | | (81,826) |  | (21,064) | |  | - |  | (102,890) |
| **Balance as at December 31, 2010** | **81,530,200** |  | **5,597,824** |  | **889,424** |  | | **39** | |  | | **48,417** |  | **(49,236)** | |  | **(40,997,954)** |  | **47,018,714** |

**19.1. SHARE CAPITAL**

Share capital represent share capital of publicly listed company. As per Sale and Purchase Agreement dated on 24 December 2008, there was a change in ownership of the Company, registered at the Central register for securities as of 2 February 2009. Ownership structure was as follows:

* 51% of share capital in the ownership of Gazprom Neft, St Petersburg, Russia;
* 49% of share capital is owned by the Serbian Government, Ministry of Industry and privatization.

In accordance with the Law on disbursment of free shares and Decision enacted by the Government of Serbia at January 6, 2010, citizens of Serbia received shares of NIS, and ownership structure after disbursement was:

* Gazprom Neft JSC 51.0%
* Governement of Republic of Serbia 29.9%
* Serbian citizens 14.7%
* Employees and ex-employees 4.4%

Listing and Quotation Committee of the Belgrade Stock Exchange has on 23 August 2010 issued decision on admission of shares on listing A - Prime Market of Belgrade Stock Exchange. In accordance with this decision first trade with NIS shares was on 30 August 2010.

The structure of the share capital as at December 31, 2010 was:

|  |  |  |  |
| --- | --- | --- | --- |
| **Shareholders** | **Number of shares** |  | **Structure in %** |
| Gazprom Neft | 83,160,800 |  | 51.0 |
| Republic of Serbia | 48,719,344 |  | 29.9 |
| Societe Generale Custody account | 752,661 |  | 0.5 |
| BDD M&V Investments | 223,202 |  | 0.1 |
| Unicredit bank Custody account | 220,000 |  | 0.1 |
| ZB Invest doo | 201,871 |  | 0.1 |
| Societe Generale Custody account | 190,330 |  | 0.1 |
| Hypo Custody account | 157,976 |  | 0.1 |
| Citadel financial advisory | 103,503 |  | 0.1 |
| Dunav RE a.d. | 103,502 |  | 0.1 |
| Other | 29,227,211 |  | 17.9 |
|  | **163,060,400** |  | **100.0** |

**19.1. SHARE CAPITAL (continued)**

According to Sales and Purchase Agreement, as long as Serbian Government holds 10% of voting rights, its positive vote is required for:

* Adoption of financial statements and audit report
* Changes in Act of incorporation
* Capital increase and decrease
* Status changes
* Acquiring and disposal of the Company’s assets with great value in accordance with applicable Low.
* Changes of registered business seat and activity
* Termination of the Company

**19.2. UNREALISED GAINS (LOSSES) FROM SECURITIES**

Unrealized gains/losses as of December 31, 2010 in the amount of 48,417 RSD and 49,236 RSD (December 31, 2009: 130,243 RSD and 28,172 RSD, respectivaly) resulted from positive/negative effect of estimated values of financial assets available for sale which fair value changes effects are reflected in equity.

Structure of unrealized gains from sale of assets available for sale:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Luka Dunav a.d. Pančevo | 8,602 |  | 78,060 |
| Linde Gas Serbia a.d. Bečej | 23,486 |  | 23,487 |
| Komercijalna bank a.d. Belgrade | 11,136 |  | 13,012 |
| SPC Pinki a.d. Zemun | - |  | 8,507 |
| Jubmes bank a.d. Belgrade | 5,193 |  | 7,177 |
| **Total** | **48,417** |  | **130,243** |

Structure of unrealized losses from sale of assets available for sale:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Politika a.d. Belgrade | (24,150) |  | (23,316) |
| Bank Postanska Stedionica a.d. Belgrade | (4,508) |  | (2,760) |
| Dunav osigruanje a.d.o, Belgrade | (3,678) |  | (2,096) |
| SPC Pinki a.d. Zemun, Belgrad | (16,900) |  | - |
| **Total** | **(49,236)** |  | **(28,172)** |

1. **LONG – TERM PROVISIONS**

Movements on the long-term provisions were as follow:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Environmental restoration provision** |  | **Environmental protection** |  | **Employees benefits**  **provision** |  | **Legal cases provisions** |  | **Total** |
| **Balance as at January 1, 2009** | **1,980,718** |  | **-** |  | **1,869,589** |  | **3,995,908** |  | **7,846,215** |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Charged (credited) to Income statement | 455,265 |  | **-** |  | 3,603,530 |  | 1,940,161 |  | 5,998,956 |
| Adjustments on property, plant and equipement | 2,864,951 |  | **-** |  | - |  | - |  | 2,864,951 |
| Release of provision (note 35) | (7,100) |  | **-** |  | (662,558) |  | - |  | (669,658) |
| Settlement | - |  | **-** |  | - |  | - |  | - |
| **As at December 31, 2009** | **5,293,834** |  | **-** |  | **4,810,561** |  | **5,936,069** |  | **16,040,464** |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Charged (credited) to Income statement (note 30) | 345,421 |  | 962,968 |  | 210,446 |  | - |  | 1,518,835 |
| Adjustments on property, plant and equipement | 2,636,353 |  | - |  | - |  | - |  | 2,636,353 |
| Release of provision (note 35) | - |  | **-** |  | - |  | (606,448) |  | (606,448) |
| Settlement | - |  | - |  | (291,633) |  | (796,031) |  | (1,087,664) |
| **As at December 31, 2010** | **8,275,608** |  | **962,968** |  | **4,729,374** |  | **4,533,590** |  | **18,501,540** |

1. *Environmental restoration provision*

Based on previous experience on similar actions, management estimates future cash outflows for restoration of natural resources (land) on oil and gas wells. Provision for asset retirement of active wells for the year ended December 31, 2010 in amount of 2,636,353 RSD is recognized against property, plant and equipment.

1. *Environmental protection*

In accordance with domestic legislation, Company has obligation related to environmental protection. At balance sheet date Company recorded amount of 962,968 RSD for environmental protection, based on management assessment of costs necessary for cleaning up of sites and remediation of polluted facilities of the Company.

1. *Legal claims provisions*

The Company’s assessment is that the outcome of all legal cases will not lead to material losses above the amount already provided as of December 31, 2010. The Company assesses the probability of negative outcomes of legal cases, as well as the amounts of probable or reasonable estimated losses including management judgment after consideration of information such as notifications, settlements, legal department estimates, available facts, identification of potential responsible parties and their possibilities to contribute in problem solving, as well as their previous experience.

1. **LONG – TERM PROVISIONS (continued)**
2. *Employee benefits provision*

Provision for Employee benefits includes:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| Retirement allowances | 976,273 |  | 1,007,687 |
| Jubilee awards | 3,657,173 |  | 3,697,572 |
| Other benefits in accordance with acquired rights | 95,928 |  | 105,302 |
|  | **4,729,374** |  | **4,810,561** |

The principal actuarial assumptions used were as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Discount rate | 6% |  | 6.5% |
| Future salary increases | 6% |  | 6% |
| Future average years of service | 18.23 |  | 17.7 |

1. **LONG TERM LOANS**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Domestic | 22,162,259 |  | 19,590,473 |
| Foreign | 24,244,622 |  | 20,272,435 |
|  | 46,406,881 |  | 39,862,908 |
| Current portion of long-term loans | (19,761,341) |  | (5,129,457) |
| **Total** | **26,645,540** |  | **34,733,451** |

1. **LONG TERM LOANS (continued)**

The maturity of non-current loans was as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| Between 1 and 2 years | 14,747,653 |  | 9,530,561 |
| Between 2 and 5 years | 4,758,228 |  | 18,591,704 |
| Over 5 years | 7,139,659 |  | 6,611,186 |
|  | **26,645,540** |  | **34,733,451** |

The carrying amounts of the Company’s loans are denominated in the following currencies:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |
| RSD | 2,941 |  | 4,871,441 |
| EUR | 9,900,092 |  | 11,313,045 |
| USD | 36,009,703 |  | 23,302,211 |
| JPY | 494,145 |  | 376,211 |
|  | **46,406,881** |  | **39,862,908** |

The carrying amounts and fair value of the non-current borrowings are equal as they are received under market conditions.

The Company repays for its loans in accordance with agreed dynamics, i.e. determined annuity plans. The Company has both fixed and floating interest rates stipulated with the creditors. Floating interest rates are connected with Euribor and Libor, which sensitivity analysis is shown in the note 5.1 (a).

Management expects that the Company will be able to fulfill its obligations within agreed timeframe.

1. **LONG TERM LOANS (continued)**

The carrying amounts of the Company’s long term loans as of December 31, 2010 and December 31, 2009:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Creditor** |  | **Currency** |  | **December 31,**  **2010** |  | **December 31, 2009** |
|  |  |  |  |  |  |  |
| ***Domestic long term loans*** |  |  |  |  |  |  |
| Alfa bank Srbija, Belgrade |  | USD |  | 6,920,531 |  | 5,271,551 |
| NLB bank, Novi Sad (London club) |  | USD |  | 49,678 |  | 44,799 |
| NLB bank, Novi Sad (Paris club) |  | USD |  | 513,656 |  | 444,673 |
| NLB bank, Novi Sad (Paris club) |  | JPY |  | 494,145 |  | 376,211 |
| Erste bank, Novi Sad (London club) |  | USD |  | 4,725 |  | 4,261 |
| Erste bank, Novi Sad (Paris club) |  | EUR |  | 463,078 |  | 431,111 |
| Erste bank, Novi Sad (Paris club) |  | USD |  | 290,997 |  | 250,870 |
| Hypo Alpe Adria Bank, Belgrade |  | EUR |  | 768,379 |  | 1,176,236 |
| Piraeus bank, Belgrade |  | USD |  | 5,391,054 |  | 4,868,106 |
| Privredna bank, Pančevo (Paris club) |  | EUR |  | 239,395 |  | 225,694 |
| Privredna bank, Pančevo (Paris club) |  | USD |  | 1,679,068 |  | 1,465,489 |
| Government of Republic of Serbia (IBRD) |  | EUR |  | 4,789,655 |  | 4,561,041 |
| Government of Republic of Serbia, Agency for deposit assurance |  | USD |  | 554,957 |  | 467,096 |
| Other loans |  | RSD |  | 2,941 |  | 3,335 |
|  |  |  |  | **22,162,259** |  | **19,590,473** |
| ***Foreign long term loans*** |  |  |  |  |  |  |
| Moskow bank, Russian Federation |  | USD |  | 7,928,020 |  | 3,336,425 |
| EFG NEF BV, Holland |  | USD |  | 4,522,248 |  | 3,042,019 |
| Erste Bank, Holland |  | EUR |  | 3,164,946 |  | 4,314,996 |
| VUB (Bank Intesa), Slovakia |  | USD |  | 3,964,010 |  | 3,336,425 |
| NBG Bank, Greece |  | USD |  | 2,248,855 |  | 2,369,682 |
| NBG Bank, Greece |  | EUR |  | 474,639 |  | 603,967 |
| Sinohem , Great Britain |  | USD |  | 1,941,904 |  | 3,268,921 |
|  |  |  |  | **24,244,622** |  | **20,272,435** |
|  |  |  |  |  |  |  |
| *Less* current portion of long-term loans |  |  |  | (19,761,341) |  | (5,129,457) |
|  |  |  |  |  |  |  |
|  |  |  |  | **26,645,540** |  | **34,733,451** |

1. **OTHER LONG-TERM LIABILITIES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| Liabilities to Parent | 22,193,617 |  | 5,804,462 |
| Liabilities for financial lease | 86,788 |  | 114,557 |
| Other long-term liabilities | 1,209 |  | 1,208 |
|  | **22,281,614** |  | **5,920,227** |

1. *Liabilities to parent*

As at December 31, 2010 other long-term liabilities to the Parent in the amount of 22,193,617 RSD (EUR 210,369,623) relate to borrowings from JSC Gazprom Neft, with respect to its obligation, from Sales and Purchase Agreement signed on 24 December 2008, to approve borrowing facility for financing of Program for reconstruction and modernization of technology capacities. Total investments amount to EUR 500 million and should be finalized not later than 31 December 2012. Instalments are quarterly starting from December 2012 until May 15, 2023.

1. *Liabilities for financial lease*

Long-term lease liabilities as of December 31, 2010 in the amount of 86,788 RSD (2009: 114,557 RSD) are effectively secured, as the rights to the leased asset revert to the lessor in the event of default.

Minimum finance lease payments payable:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **December 31, 2010** |  | **December 31,**  **2009** |
|  |  |  |  |  |
| End of period no later than one year |  | 46,755 |  | 37,694 |
| End of period later than one year and no later than 5 years |  | 94,285 |  | 133,874 |
|  |  |  |  |  |
| Future finance charges on finance leases |  | (14,536) |  | (19,317) |
|  |  |  |  |  |
| Present value of finance lease liabilities |  | 126,504 |  | 152,251 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **December 31, 2010** |  | **December 31,**  **2009** |
|  |  |  |  |  |
| End of period no later than one year |  | 39,716 |  | 37,694 |
| End of period later than one year and no later than 5 years |  | 86,788 |  | 114,557 |
|  |  |  |  |  |
| Present value of finance lease liabilities |  | 126,504 |  | 152,251 |

1. **SHORT TERM FINANCIAL LIABILITIES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| Short term loans | 2,004,540 |  | 13,388,074 |
| Current portion of long term loans | 19,761,341 |  | 5,129,457 |
| Current portion of financial lease | 39,716 |  | 37,694 |
| Current portion of other long term loans | - |  | 11,583 |
| Other short term liabilities | 41 |  | 24 |
|  | **21,805,638** |  | **18,566,832** |

1. **TRADE AND OTHER PAYABLES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| Advances received | 2,061,165 |  | 1,007,016 |
| Trade payables: |  |  |  |
| - domestic | 2,129,440 |  | 1,741,997 |
| - foreign | 647,824 |  | 16,708,415 |
| Trade payables – parents and subsidiaries | 3,436 |  | 22,577 |
| Trade payables – other related parties | 19,475,154 |  | 3,358,787 |
| Liabilities from other operations | 70,113 |  | 74,482 |
| Liabilities from specific operations | 557,556 |  | 454,172 |
|  | **24,944,688** |  | **23,367,446** |

As at December 31, 2010 payables to other related parties in the amount of 19,475,154 RSD (December 31, 2009: 3,358,787 RSD) mostly relate to liabilities for delivered crude oil by Gazprom Neft Trading, Austria in the amount of 19,376,889 RSD (December 31, 2009: 3,244,473 RSD).

1. **OTHER SHORT-TERM LIABILITIES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| Liabilities for unpaid wages and salaries, gross | 1,488,610 |  | 567,083 |
| Liabilities to employees | 32,650 |  | 32,784 |
| Liabilities for interest – domestic | 333,193 |  | 408,222 |
| Liabilities for dividends | 3,772,308 |  | 2,126,363 |
| Participation of employees in profit | 147 |  | 147 |
| Liabilities towards Management and supervising boards members | - |  | 167 |
| Unused holiday accrual | 649,308 |  | 653,518 |
| Other liabilities | 118,240 |  | 96,283 |
|  | **6,394,456** |  | **3,884,567** |

1. **OTHER SHORT-TERM LIABILITIES (continued)**

In June 2010, the majority shareholder withdraw suite and acknowledged liability for dividend distribution from 2008 profit in accordance with the Decision adopted by Shareholders on January 29, 2009. The Decision was adopted before the acquisition of shares by Gazpromneft and relates to distribution of dividends to companies controlled by the Government of the Republic of Serbia at that time the sole shareholder of NIS a.d. The additional liability for dividends in the amount of 1.645.944 thousand RSD was formed towards the Government of the Republic of Serbia in accordance with the decision.

1. **LIABILITIES FOR VAT AND OTHER TAXES AND DEFERRED INCOME**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
|  |  |  |  |
| Liabilities for VAT | 1,630,155 |  | 593,094 |
| Liabilities for excise | 2,291,828 |  | 2,074,755 |
| Liabilities for taxes and custom duties | 476,089 |  | 240,822 |
| Other liabilities for taxes and contributions | 648,227 |  | 147,858 |
| Non-invoiced liabilities | 600,911 |  | 1,857,544 |
| Other accruals | 1,809,659 |  | 2,409,072 |
|  | **7,456,869** |  | **7,323,145** |

As at December 31, 2010 non-invoiced liabilities in amount of 600.911 RSD, mostly relate to received goods or services performed in period in year ended December 31, 2010 but not invoiced by suppliers (December 31, 2009 1,857,544 RSD related to non-invoiced equipment from IAG International).

Other accruals as of December 31, 2010 in the amount of 1,809,659 RSD (December 31, 2009: 2,409,072 RSD) mostly relate to accrual for premiums in the amount of 391,269 RSD, share of employees in profit for year 2010 in accordance with collective agreement in amount of 660,970 RSD and deferred purchase costs in the amount of 149,090 RSD.

1. **OPERATING INCOME**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Sales |  |  |  |
| - domestic | 136,951,627 |  | 102,775,008 |
| - foreign | 15,597,541 |  | 15,170,288 |
|  | 152,549,168 |  | 117,945,296 |
|  |  |  |  |
| Revenue from sales to subsidiaries and other related parties | 8,599,682 |  | 430,288 |
|  | **161,148,850** |  | **118,375,584** |

1. **OTHER OPERATING INCOME**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Rental income | 91,379 |  | 173,181 |
| Revenue from royalties | 6,193 |  | 45,925 |
| Other operating income | 28,513 |  | 151,689 |
|  | **126,085** |  | **370,795** |

1. **COST OF MATERIAL**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Cost of raw materials | 92,591,256 |  | 65,236,250 |
| Cost of office and other material | 1,073,452 |  | 1,220,189 |
| Other fuel and energy expenses | 1,680,326 |  | 2,153,560 |
|  | **95,345,034** |  | **68,609,999** |

1. **DEPRECIATION AND PROVISIONS**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | *(Adjusted)* |
| Depreciation expenses | 6,864,311 |  | 7,952,571 |
| Provision for : |  |  |  |
| - asset retirement obligation and environmental protection | 1,308,389 |  | 455,265 |
| - salaries and employees benefits | 210,446 |  | 3,603,530 |
| - legal cases | - |  | 1,940,161 |
|  | **8,383,146** |  | **13,951,527** |

1. **COST OF SALARIES, BENEFITS AND OTHER PERSONNEL EXPENSES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Wages and salaries (gross) | 13,871,982 |  | 13,204,806 |
| Taxes and contributions on wages and salaries paid by employer | 2,413,378 |  | 2,347,732 |
| Cost for temporary service agreement | 352,258 |  | 183,486 |
| Cost of other temporary service agreements | 48,753 |  | 11,386 |
| Fees paid to management and supervisory board members | 21,132 |  | 4,084 |
| Cost for employees termination payments | 3,029,814 |  | 2,894,498 |
| Other personal expenses and benefits | 1,532,578 |  | 1,188,033 |
|  | **21,269,895** |  | **19,834,025** |

Termination costs in the amount of 3,029,814 RSD relate to costs incurred in relation to voluntary leave program issued on 15 July 2009 - ’’Program 750’’. Based on Sale and Purchase Agreement the Company is able to propose voluntary termination of employment, only if it pays one off severance payment to every employee in the amount of EUR 750 per year of working service. Total number of employees who accepted the termination of employment in 2010 is 1,237 (2009:1.238 employees).

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Average number of people employed | 10,583 |  | 11,925 |

1. **OTHER OPERATING EXPENSES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Production services | 1,863,928 |  | 1,165,772 |
| Transportation services | 1,671,865 |  | 1,421,960 |
| Maintenance | 1,148,825 |  | 1,042,914 |
| Rental costs | 207,283 |  | 196,662 |
| Fairs | 4,476 |  | 4,562 |
| Advertising and representation costs | 352,733 |  | 176,997 |
| Research costs | 351,105 |  | 246,342 |
| Cost of other services | 893,906 |  | 988,487 |
| Costs of non production services | 2,066,085 |  | 1,952,775 |
| Representation costs | 131,691 |  | 95,517 |
| Insurance premium | 375,446 |  | 666,860 |
| Bank charges | 180,261 |  | 794,346 |
| Cost of custom duties, property taxes and other taxes | 1,773,984 |  | 1,972,847 |
| Mineral extraction tax | 1,375,187 |  | 575,762 |
| Cost of legal and consulting services | 181,335 |  | 260,925 |
| Administrative and other taxes | 144,742 |  | 176,981 |
| Other | 244,256 |  | 231,956 |
|  | **12,967,108** |  | **11,971,665** |

Cost of non-production services for year ended December 31, 2010 in the amount of 2,066,085 RSD (2009: 1,952,775 RSD) mostly relate to costs incurred for: use of service companies (security and cleaning companies) in the amount of 1,147,154 RSD, as cost of project management in the amount of 234,465 RSD, sertification and supervision costs in amount 114.983 RSD.

1. **FINANCIAL INCOME**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Financial income – parent, subsidiaries and other related parties | - |  | 548 |
| Interest income | 1,410,976 |  | 2,298,682 |
| Foreign exchange gains | 4,763,942 |  | 8,722,547 |
| Other financial income | 136,723 |  | 99,835 |
|  | **6,311,641** |  | **11,121,612** |

1. **FINANCIAL EXPENSES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Financial expenses – parent, subsidiaries and other related parties | - |  | 11,127 |
| Interest expenses | 3,084,263 |  | 2,878,394 |
| Foreign exchange losses | 16,024,453 |  | 12,931,255 |
| Other financial expenses | 4,064 |  | 57,232 |
|  | **19,112,780** |  | **15,878,008** |

1. **OTHER INCOME**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Gains on disposal: |  |  |  |
| - property, plant and equipment | 15,659 |  | 55,986 |
| - materials | 6,511 |  | 9,968 |
| Surpluses | 178,656 |  | 52,201 |
| Receivables written off and collected | - |  | 29,403 |
| Write off of payables | 88,866 |  | 720,394 |
| Cancellation of long-term provisions | 606,448 |  | 18,125 |
| Gains from collected penalty interest | 55,469 |  | 77,603 |
| Gain on calculation of present value of housing loans | - |  | 2,186,767 |
| Gains from re-activation of oil wells | - |  | 449,392 |
| Gain from settlement with SAP WB | - |  | 394,131 |
| Overpaid excise | - |  | 210,675 |
| Adjustment of accrued bonuses | 749,479 |  | - |
| Adjustment of investments in Angola | 770,534 |  | 169,364 |
| Capitalization of oil wells | 254,773 |  | - |
| Reconciliation of long-term investments | 182,804 |  | - |
| Adjustment of amortization on impaired property | 179,022 |  | - |
| Fair value gains on investment property | 575,786 |  | 172,648 |
| *Reversal of impairment losses on:* |  |  |  |
| - intangibles | - |  | 243 |
| - property, plant and equipment | 1,876 |  | - |
| - long-term financial investments and AFS financial assets | 156,579 |  | - |
| - inventories | 118,842 |  | 263,368 |
| - receivables and short-term financial investments | 623,336 |  | 646,421 |
| - other properties | 6,327 |  | 13,166 |
| Other | 633,790 |  | 388,318 |
|  | **5,204,757** |  | **5,858,173** |

1. **OTHER EXPENSES**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Losses on disposal |  |  |  |
| - property, plant and equipment | 35,538 |  | 3,537 |
| - apartment given to financial lease | - |  | 54,659 |
| Shortages | 137,294 |  | 197,697 |
| Write off of receivables | 14,042 |  | 3,658 |
| Write off of inventories | 7,633 |  | 16,639 |
| Fines, penalties and damages | 34,240 |  | 157,087 |
| Humanitarian and sponsorships | 181,616 |  | 167,225 |
| Reconciliation to PV for restitution of liquidated wells | - |  | 639,447 |
| Loss on sale of materials | - |  | 346,176 |
| Adjustment of investments in Angola | 458,133 |  | 74,779 |
| Property adjustment | 273,123 |  | - |
| Correction of deferred revenue | 115,918 |  | - |
| *Impairment*: |  |  |  |
| - intangible assets | - |  | 1,582,503 |
| - property, plant and equipment | 943,567 |  | 17,907,275 |
| - asset held for sale | 11,341 |  | - |
| - investment property | 138,716 |  | 505,044 |
| - investments in subsidiaries | 410,992 |  | 570,669 |
| - investments in related parties | - |  | 2,999 |
| - of AFS | - |  | 511,678 |
| - of resheduled long term receivables | - |  | 6,840,424 |
| - other long-term investments | - |  | 30,974 |
| - inventories | 93,580 |  | 2,875,970 |
| - short term investments | 461,759 |  | 1,602,926 |
| - advances paid | 31,383 |  | - |
| - receivables | 2,271,195 |  | 3,648,464 |
| Other | 935,436 |  | 780,717 |
|  | **6,555,506** |  | **38,520,547** |

1. **INCOME TAX**

Components of income tax expense:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Income tax related to period | 831,975 |  | - |
| Deferred tax income for period | (5,278,385) |  | (1,883,365) |
|  | **(4,446,410)** |  | **(1,883,365)** |

The tax on the Company’s profit before tax differs from the theoretical amount that would arise using the weighed average tax rate applicable to the Company’s profits as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| **Profit (loss) before tax** | 12,037,971 |  | (39,519,476) |
| Tax expense (income) at applicable tax rate (10%) | 1,203,797 |  | (3,951,948) |
|  |  |  |  |
| *Tax effect of:* |  |  |  |
| Expense not deductible in determining taxable profit (tax loss) | 1,089,016 |  | 3,238,421 |
| Tax losses for which no deferred income tax assets was recognised | (713,527) |  | 713,527 |
| Use of tax credit | (789,643) |  | - |
| ***Тotal income tax expense*** | **789,643** |  | - |
| Adjustment of prior year tax expense | 42,332 |  | - |
|  |  |  |  |
|  | **831,975** |  | - |

1. **EARNING PER SHARE**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **For the year ended**  **December 31,** | | |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
| Net income (loss) | 16,484,381 |  | (37,636,111) |
| Weighted average number of shares outstanding | 163,060,400 |  | 65,871,934 |
| **Basic Earning per share** | **0.10** |  | **(0.57)** |

1. **RELATED PARTIES TRANSACTIONS**

The majority owner of the Company is Gazprom Neft, St Petersburg, Russian Federation, that owns 51% shares of the Company. The remaining 49% of shares are quoted on the Stock Exchange and are owned by various shareholders.

The Company was engaged in business transactions with its related entities during 2010 and 2009. The most significant transactions with related parties in the aforementioned periods related to supply/delivery of crude oil, geophysical research and interpretation services, and travel services.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |
| *Advances* |  |  |  |
| O Zone a.d. Belgrade, Serbia | 115 |  | 40,456 |
| NIS Oil Trading, Frankfurt, Germany | - |  | 52,757 |
|  | 115 |  | 93,213 |
| *Receivables* |  |  |  |
| O Zone a.d. Belgrade, Serbia | 216,034 |  | 219,456 |
| NIS Oil Trading, Frankfurt, Germany | - |  | 102,565 |
| Svetlost, Bujanovac, Serbia | 34,845 |  | 25,741 |
| NIS Oversiz, Moscow, Russia | 1,031 |  | 22 |
| Ranis, Moscow area, Russia | 28,799 |  | 28,669 |
| Gazprom Neft Trading, Austria | - |  | 556,892 |
|  | 280,709 |  | 933,345 |
|  |  |  |  |
| **Total receivables:** | **280,824** |  | **1,026,558** |

|  |  |  |  |
| --- | --- | --- | --- |
| *Liabilities* |  |  |  |
| O Zone a.d. Belgrade, Serbia | (5,125) |  | (17,060) |
| NIS Oil Trading, Frankfurt, Germany | - |  | (45,962) |
| Svetlost, Bujanovac, Serbia | (4) |  | (4) |
| Gazprom Neft Trading, Austria | (19,376,889) |  | (3,011,316) |
| Gazprom Neft, St Petersburg, Russia | (22,262,027) |  | (5,804,462) |
|  | (41,644,045) |  | (8,878,804) |
| *Advances received* |  |  |  |
| O Zone a.d. Belgrade, Serbia | - |  | (7) |
| NIS Oil Trading, Frankfurt, Germany | - |  | (4) |
| Svetlost, Bujanovac, Serbia | (18) |  | (18) |
|  | (18) |  | (29) |
| **Total liabilities:** | (41,644,063) |  | (8,878,833) |
|  |  |  |  |
| **Liabilities, net:** | **(41,363,239)** |  | **(7,852,275)** |

1. **RELATED PARTIES TRANSACTIONS (continued)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | | **For the year ended**  **December 31,** | | |
|  |  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| *Sales* |  |  |  |
| O Zone a.d. Belgrade, Serbia | 8,351 |  | 7,129 |
| NIS Oil Trading, Frankfurt, Germany | - |  | 1,792,125 |
| Gazprom Neft Trading, Austria | 550,277 |  | 294,408 |
| Svetlost, Bujanovac, Serbia | 3,965,019 |  | 2,512,047 |
|  | 4,523,647 |  | 4,605,709 |
| *Other operating income* |  |  |  |
| O Zone a.d. Belgrade, Serbia | 552 |  | 1,752 |
|  | 552 |  | 1,752 |
| *Cost of material* |  |  |  |
| Gazprom Neft Trading, Austria | (79,065,104) |  | - |
|  | (79,065,104) |  | - |
| *Cost of salaries, benefits and other personnel expenses* |  |  |  |
| O Zone a.d. Belgrade, Serbia | (100,641) |  | (60,052) |
|  | (100,641) |  | (60,052) |
| *Other operating expenses* |  |  |  |
| O Zone a.d. Belgrade, Serbia | (5,008) |  | (36,115) |
| Gazprom Neft Trading, Austria | - |  | (5,917,545) |
| Gazprom Neft, St Petersburg, Russia | (129,106) |  | - |
|  | (134,114) |  | (5,953,660) |
|  |  |  |  |
|  | **(74,775,660)** |  | **(1,406,251)** |

|  |  |  |  |
| --- | --- | --- | --- |
| *Financial income* |  |  |  |
| O Zone a.d. Belgrade, Serbia | - |  | 727 |
| NIS Oil Trading, Frankfurt, Germany | - |  | 4,205 |
| Ranis, Moscow area, Russia | - |  | 3,148 |
| Gazprom Neft Trading, Austria | - |  | 146,969 |
|  | - |  | 155,049 |
| *Financial expenses* |  |  |  |
| O Zone a.d. Belgrade, Serbia | (213) |  | (11,131) |
| NIS Oil Trading, Frankfurt, Germany | - |  | (4,028) |
| Ranis, Moscow area, Russia | - |  | (2) |
| Gazprom Neft Trading, Austria | - |  | (233,157) |
| Gazprom Neft, St Petersburg, Russia | (339,688) |  | - |
|  | (339,901) |  | (248,318) |
|  |  |  |  |
|  | **(339,901)** |  | **(93,269)** |

1. **RELATED PARTIES TRANSACTIONS (continued)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | | **For the year ended**  **December 31,** | | |
|  |  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| *Other income* |  |  |  |
| O Zone a.d. Belgrade, Serbia | 7,755 |  | 4,862 |
| NIS Oil Trading, Frankfurt, Germany | 42,744 |  | - |
|  | 50,499 |  | 4,862 |
| *Other expenses* |  |  |  |
| O Zone a.d. Belgrade, Serbia | (414,032) |  | (800,694) |
| Svetlost, Bujanovac, Serbia | (156) |  | (1,317) |
|  | (414,188) |  | (802,011) |
|  |  |  |  |
|  | **(363,689)** |  | **(797,149)** |

*Key management compensation*

Key management represents: Management Board, Executive Board, Supervisory Board and Heads of Departments. Management compensation paid in 2010 and 2009 are shown in table below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | **For the year ended**  **December 31,** | | |
|  |  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| Salaries and other compensations | 118,914 |  | 70,621 |
|  |  |  |  |
|  | 118,914 |  | 70,621 |

1. **RELATED PARTIES TRANSACTIONS (continued)**

Transactions with state controlled institution and companies:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Receivables** | | |  | **Advances** | | |
|  | **December 31, 2010** |  | **December 31, 2009** |  | **December 31, 2010** |  | **December 31, 2009** |
| Airport Nikola Tesla | 13,470 |  | 9,307 |  | - |  | - |
| JAT Airways | 301,330 |  | 152,056 |  | - |  | 13 |
| HIP Petrohemija | 1,116,183 |  | 605,633 |  | - |  | - |
| EPS Elektrovojvodina | 21,336 |  | 4,892 |  | 442 |  | 208 |
| MUP Republic of Serbia | 492,680 |  | 335,356 |  | 198 |  | - |
| RTB BOR Group | 2,022,461 |  | 1,981,689 |  | 31,453 |  | 31,453 |
| Srbijagas | 5,278,026 |  | 6,337,810 |  | - |  | 362 |
| Telekom Srbija | 42,133 |  | 35,452 |  | 47 |  | 190 |
| Heating companies (sum) | 461,111 |  | 1,283,834 |  | 499 |  | - |
| Road companies (sum) | 4,519 |  | 6,092 |  | - |  | 2,300 |
| Army of Serbia | 203,757 |  | 233,995 |  | - |  | 439 |
|  | 9,957,006 |  | 10,986,116 |  | 32,639 |  | 34,965 |

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Liabilities** |  | **Advances received** |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **December 31, 2010** |  | **December 31, 2009** |  | **December 31, 2010** |  | **December 31, 2009** |
| Airport Nikola Tesla | 304 |  | 222 |  | - |  | - |
| JAT Airways | - |  | 9 |  | 99 |  | 92 |
| HIP Petrohemija | 98,264 |  | 114,314 |  | 447 |  | 261 |
| EPS Elektrovojvodina | 1,312 |  | 240 |  | - |  | 6 |
| MUP Republic of Serbia | 17 |  | 20 |  | 72 |  | 86 |
| RTB BOR Group | - |  | 207 |  | 395 |  | 1,603 |
| Srbijagas | 267,519 |  | 272,053 |  | 12,804 |  | 23,759 |
| Telekom Srbija | 3,694 |  | 11,244 |  | 56 |  | - |
| Heating companies (sum) | 2,616 |  | 808 |  | 29,399 |  | 11,444 |
| Road companies (sum) | 35 |  | - |  | 310 |  | 3 |
| Army of Serbia | 2,113 |  | 560 |  | 318 |  | 116 |
|  | 375,874 |  | 399,677 |  | 43,900 |  | 37,370 |

1. **RELATED PARTIES TRANSACTIONS (continued)**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Income** |  | **Expenses** |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Year ended December 31,** | | | | | | |
|  | **2010** |  | **2009** |  | **2010** |  | **2009** |
| Airport Nikola Tesla | 68,028 |  | 59,058 |  | (4,953) |  | (5,868) |
| JAT Airways | 1,901,013 |  | 1,400,334 |  | (53) |  | (14) |
| HIP Petrohemija | 8,174,852 |  | 3,547,685 |  | (74,488) |  | (156,715) |
| EPS Elektrovojvodina | 99,940 |  | 3,161 |  | (599,998) |  | (487,255) |
| MUP Republic of Serbia | 1,130,710 |  | 651,238 |  | (936) |  | (24) |
| RTB BOR Group | 973,434 |  | 628,840 |  | (81) |  | (808) |
| Srbijagas | 8,402,753 |  | 5,945,319 |  | (239,596) |  | (1,148,591) |
| Telekom Srbija | 167,067 |  | 114,125 |  | (203,029) |  | (185,323) |
| Heating companies (sum) | 3,182,925 |  | 5,756,130 |  | (59,854) |  | (46,758) |
| Road companies (sum) | 41,713 |  | 4,780,785 |  | (146,042) |  | (47,677) |
| Army of Serbia | 1,284,037 |  | 1,020 |  | (7,263) |  | (3,317) |
|  | 25,426,472 |  | 22,887,695 |  | (1,336,293) |  | (2,082,350) |

1. **CONTINGENT LIABILITIES**

*Legal claims*

At December 31, 2010 the Company appears in many legal cases as a defendant. For legal proceedings for which is possible to make a reliable estimate of the obligation the Company has made provisions in the amount of 4,533,590 RSD (December 31, 2009,: 5,936,069 EUR) (note 20).

For litigation where it is not possible to reliably estimate of the dispute or amount of obligations The Company has not made provisions. The most significant legal cases is initiated by Housing Cooperative „Stambena zadruga Rafinerija“ against the Company. It is arisen from the debt from financing of apartments for MUP Serbia. The current value of the dispute is approximately EUR 630 million. In 2010. the Commercial Court in Belgrade ruled in favor of the Company reject entirely the claim. Housing cooperatives appealed the Commercial Court of Appeal and the appeal procedure is in progress.

Management does not anticipate that any material liabilities will arise from the outcome of above mentioned litigations. In addition, in accordance with SPA, Republic of Serbia is obliged to unconditionally withdraw all claims against the Company initiated by institutions of companies owned by government.

1. **CONTINGENT LIABILITIES (continued)**

*Transfer of property ownership*

In accordance with SPA, Republic of Serbia as the seller is obliged to provide written consent for the transfer of ownership and the right to use property registered with the NIS Registry of fixed assets as at 31 December 2007. year.

Until December 31, 2010 Republic of Serbia made 13 conclusions allowing the ownership transfer in Company favor (1.635 buildings and 515 parcels, on which such facilities are located, or a total of 2150 real estate, which makes up 25% of the total Company’s assets).

*Environmental protection*

At balance sheet date management of the Company raised a long term environmental provison of 962.968 RSD, based on an internal assestment of Nis compliance with environmental legislation of the Republic of Serbia.

According to SPA, the Company engaged an independent consultant in December 2009 to assess Company’s compliance with environmental legislation of the Republic of Serbia and with international regulations.

D'Appolonia’s report has not been completed yet.

Management consider that, based on the current environmental legislation, the costs associated with environmental issues will not be significantly higher than those provided for already. Should D'Appolonia’s report show noncompliance with environmental legislation of the Republic of Serbia which management has not provided for already, additional provision might need to be made.

1. **TAX RISKS**

Tax laws of Republic of Serbia are subject to different interpretations and frequent amendments. Tax authorities’ interpretation of Tax laws may differ to those made by the Company’s management. As result, some transactions may be disputed by tax authorities and the Company may have to pay additional taxes, penalties and interests. Tax liability due date is five years. Tax authorities have rights to determine unpaid liabilities within five years since the transaction date. Management has assessed that the Company has paid all tax liabilities as of December 31, 2010.

1. **COMMITMENTS**
2. *Sales and Purchase Agreement*

The Company is committed under Sales and Purchase Agreement to:

• comply with a Social program as follows:

* + - The salaries of NIS’ employees shall be modified annually at the rate of the annual variation in the index reflecting the cost of living in Republic of Serbia;
    - In the period to 31 December 2012 , NIS shall not terminate the employment of its employees against their will on the basis of technological or organizational changes;
    - NIS may propose termination of employment, provided that a onetime dismissal wage is paid to the employee in the amount of EUR 750 for every served year of employment;

• invest in modernization of the Company an amount of Euro 547 million over a four year period;

• distribute dividends for 4 consecutive years in 15% of net profit of the Company;

• maintain level of exploration and production of crude oil at least to 2020, not to cease with refining activities, to maintain level of production of oil derivatives for Serbian market, to maintain the market share in trade of oil derivatives up to the level in 2008;

• conduct modernization and reconstruction of the Company.

1. *Leases*

Minimum lease payments under non-cancellable operating lease by lessor:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| End of period no later than one year | 105,314 |  | 71,798 |
| End of period later than one year and no later than five years | 37,675 |  | 4,138 |
| End of period later than five year | - |  | 895 |
|  | **142,989** |  | **76,831** |

Minimum lease payments under non-cancellable operating lease by lessee:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2010** |  | **2009** |

|  |  |  |  |
| --- | --- | --- | --- |
| End of period no later than one year | 80,468 |  | 72,228 |
| End of period later than one year and no later than five years | 18,370 |  | 86,790 |
| End of period later than five year | - |  | - |
|  | **98,838** |  | **159,018** |

1. **EVENTS AFTER THE BALANCE SHEET DATE**
2. *Decision on free import of oil and petroleum products*

On January 1, 2011 Serbian Government has adopted a decision on the abolition of customs restrictions and introducing the free import of oil and petroleum products, based on the on Central European Free Trade Agreement (CEFTA), as well as the Decision on free pricing of petroleum products in the market of the Republic of Serbia.

1. *Publishing takeover bid to minority shareholders by the Gazprom Neft*

According to the Sales and Purchase Agreement, Gazprom Neft announced offer to acquire share of minority shareholders and 31,180,256 ordinary shares, making a total of 19.12% of the common shares. The offer would be valid for 45 days from the date of publication (until March 16, 2011). The offered price per share is 506,48 RSD.

|  |  |  |
| --- | --- | --- |
| **Novi Sad, 22.02.2011** |  |  |
|  |  |  |
| **The person responsible for the preparation of financial statements** | **М.P.** | **Legal representative** |
|  |  |  |