

**Sofiyska Voda AD**  
**Consolidated Financial Statements**  
**For the year ended 31 December 2010**  
**With independent auditors' report**



KPMG Bulgaria OOD  
45/A, Bulgaria Boulevard  
Sofia 1404  
Bulgaria

Telephone +359 (2) 9697 300  
Telefax +359 (2) 9805 340  
E-mail bg-office@kpmg.com  
Internet www.kpmg.bg

## INDEPENDENT AUDITORS' REPORT

To the shareholders of  
"Sofiyska Voda" AD

### Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of "Sofiyska voda" AD ("the Company") as set out on pages 1 to 53, which comprise the statement of financial position as at 31 December 2010, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

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

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

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



### *Opinion*

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Company as at 31 December 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

### **Report on Other Legal and Regulatory Requirements**

*Annual report of the activities of the Company prepared in accordance with the requirements of article 33 of the Accountancy Act*

As required under the Accountancy Act, we report that the historical financial information disclosed in the annual report of the activities of the Company, prepared by Management as required under article 33 of the Accountancy Act, is consistent, in all material aspects, with the financial information disclosed in the audited consolidated financial statements of the Company as of and for the year ended 31 December 2010. Management is responsible for the preparation of the annual report of the activities of the Company which was approved by the Board of directors of the Company on 24 March 2011.

Krassimir Hadjidinev  
*Director*

KPMG Bulgaria OOD  
Sofia, 30 March 2011

Antoaneta Boycheva  
*Registered auditor*



## **Contents**

|  |       |
|--|-------|
| Consolidated Statement of financial position   | 2-3   |
| Consolidated Statement of comprehensive income | 4     |
| Consolidated Statement of changes in equity    | 5-6   |
| Consolidated Statement of cash flows           | 7-8   |
| Notes to the consolidated financial statements | 10-53 |

## **Independent auditors' report**

## Consolidated statement of financial position

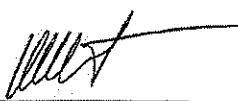
| As at 31 December<br><i>In thousands of BGN</i> | Note | 2010           | 2009           |
|---|------|----------------|----------------|
| <b>Assets</b>                                   |      |                |                |
| Property, plant and equipment                   | 15   | 17,114         | 16,651         |
| Intangible assets                               | 16   | 195,238        | 166,778        |
| Deferred tax assets                             | 22   | 6,197          | 5,168          |
| Long-term receivables                           |      | 154            | 84             |
| <b>Total non-current assets</b>                 |      | <b>218,703</b> | <b>188,681</b> |
| Inventories                                     | 17   | 2,020          | 1,807          |
| Trade and other receivables                     | 18   | 32,292         | 31,841         |
| Tax receivables                                 |      | 972            | 140            |
| Cash and cash equivalents                       | 19   | 17,961         | 16,479         |
| <b>Total current assets</b>                     |      | <b>53,245</b>  | <b>50,267</b>  |
| <b>Total Assets</b>                             |      | <b>271,948</b> | <b>238,948</b> |


## Consolidated statement of financial position (continued)

As at 31 December

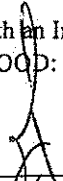
| <i>In thousands of BGN</i>                     | <i>Note.</i> | <b>2010</b>    | <b>2009</b>    |
|--|--------------|----------------|----------------|
| Share capital                                  | 20           | 8,884          | 8,884          |
| Reserves                                       | 20           | (4,075)        | (4,619)        |
| Retained earnings                              |              | 49,229         | 36,155         |
| <b>Total capital and reserves</b>              |              | <b>54,038</b>  | <b>40,420</b>  |
| <b>Liabilities</b>                             |              |                |                |
| Interest bearing loans and borrowings          | 21           | 135,491        | 134,583        |
| Liabilities under finance leases               | 21           | 1,035          | 1,275          |
| Deferred tax liabilities                       | 22           | 1,416          | 1,698          |
| Liabilities for retirement compensation        | 27           | 772            | 598            |
| Financing for non-current assets               |              | 1,063          | 355            |
| Long-term liabilities to Municipality of Sofia |              | 6,440          | 5,635          |
| <b>Total non-current liabilities</b>           |              | <b>146,217</b> | <b>144,144</b> |
| Interest bearing loans and borrowings          | 21           | 8,948          | 3,959          |
| Liabilities under finance leases               | 21           | 704            | 746            |
| Tax liabilities                                | 25           | 1,161          | 327            |
| Payables to related parties                    | 30           | 714            | 9,351          |
| Trade and other payables                       | 23           | 48,689         | 31,538         |
| Financial instruments                          |              | 8,599          | 7,399          |
| Provisions                                     | 24           | 2,695          | 740            |
| Liabilities for retirement compensation        | 27           | 183            | 324            |
| <b>Total current liabilities</b>               |              | <b>71,693</b>  | <b>54,384</b>  |
| <b>Total liabilities</b>                       |              | <b>217,910</b> | <b>198,528</b> |
| <b>Total equity and liabilities</b>            |              | <b>271,948</b> | <b>238,948</b> |


The notes on pages 10 to 53 are an integral part of these consolidated financial statements.

  
 Ivan Ivanov  
 General Commercial Proxy

  
 Miroslav Mitkov  
 Financial Controller

 In accordance with an Independent Auditors' Report:  
 KPMG Bulgaria OOD:

  
 Krassimir Hadjidiyev  
 Director

  
 Antoaneta Boicheva  
 Registered Auditor


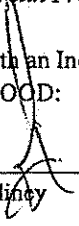
## Consolidated statement of comprehensive income


For the year ended 31 December  
In thousands of BGN

|  | Note  | 2010            | 2009           |
|--|-------|-----------------|----------------|
| Revenue  | 6     | 118,069         | 109,476        |
| Other income   | 7     | 4,668           | 3,654          |
| Revenue from construction  | 8     | 48,048          | 44,193         |
|  |       | <u>170,785</u>  | <u>157,323</u> |
| Expenses for materials   | 9     | (9,902)         | (9,036)        |
| Expenses for hired services  | 10    | (26,701)        | (25,480)       |
| Depreciation and amortization  | 15,16 | (23,721)        | (13,143)       |
| Salaries, remuneration and other personnel benefits                        | 11    | (14,611)        | (13,717)       |
| Social security contributions and other social expenses                    | 11    | (3,409)         | (4,137)        |
| Other operating expenses   | 12    | (14,210)        | (22,534)       |
| Expenses for construction  | 8     | (48,048)        | (44,193)       |
| <b>Profit from operating activities</b>                                    |       | <u>30,183</u>   | <u>25,083</u>  |
| Finance income   | 13    | 52              | 4,901          |
| Finance expense  | 13    | (12,515)        | (11,704)       |
| <b>Net Financing expense</b>   |       | <u>(12,463)</u> | <u>(6,803)</u> |
| <b>Profit before tax</b>   |       | 17,720          | 18,280         |
| Income tax expense   | 14    | (3,021)         | (1,990)        |
| <b>Net profit for the year</b>   |       | <u>14,699</u>   | <u>16,290</u>  |
| <b>Other comprehensive income</b>  |       |                 |                |
| Net change in fair value of cash flow hedges transferred to profit or loss |       | (1,201)         | (5,075)        |
| Deferred tax on other comprehensive income                                 | 22    | 120             | 508            |
| <b>Other comprehensive income for the period, net of income tax</b>        |       | <u>(1,081)</u>  | <u>(4,567)</u> |
| <b>Total comprehensive income for the period</b>                           |       | <u>13,618</u>   | <u>11,723</u>  |

The notes on pages 10 to 53 are an integral part of these consolidated financial statements.

  
 Ivan Ivanov  
 General Commercial Proxy

  
 Miroslav Mitkov  
 Financial Controller
In accordance with an Independent Auditors' Report:  
KPMG Bulgaria OOD:
  
 Krassimir Hadjidimov  
 Director

  
 Antoaneta Boicheva  
 Registered Auditor

## Consolidated statement of changes in equity

In thousands of BGN

|  | Note | Share capital | Hedging reserve | Legal reserve | Retained earnings | Total equity |
|--|------|---------------|-----------------|---------------|-------------------|--------------|
| Balance at 1 January 2009                                    |      | 8,884         | (2,091)         | 399           | 21,505            | 28,697       |
| <b>Total comprehensive income for the period</b>             |      |               |                 |               |                   |              |
| Profit or loss   |      | -             | -               | -             | 16,290            | 16,290       |
| <b>Other comprehensive income</b>                            |      |               |                 |               |                   |              |
| Net change in fair value of cash flow hedges, net of tax     |      | -             | (4,567)         | -             | -                 | (4,567)      |
| Total other comprehensive income                             |      | -             | (4,567)         | -             | -                 | (4,567)      |
| Total comprehensive income for the period                    |      | -             | (4,567)         | -             | 16,290            | 11,723       |
| <b>Transactions with owners, recorded directly in equity</b> |      |               |                 |               |                   |              |
| Change in the reserves                                       |      | -             | -               | 1,640         | (1,640)           | -            |
| <b>Total transactions with owners</b>                        |      | -             | -               | 1,640         | (1,640)           | -            |
| Balance at 31 December 2009                                  | 20   | 8,884         | (6,658)         | 2,039         | 36,155            | 40,420       |



## Consolidated statement of changes of equity (continued)

| <i>In thousands of BGN</i>                               | Note | Share capital | Hedging reserve | Legal reserve | Retained earnings | Total equity |
|--|------|---------------|-----------------|---------------|-------------------|--------------|
| Balance at 1 January 2010                                |      | 8,884         | (6,658)         | 2,039         | 36,155            | 40,420       |
| <b>Total comprehensive income for the period</b>         |      | -             | -               | -             | 14,699            | 14,699       |
| <i>Other comprehensive income</i>                        |      | -             | -               | -             | -                 | -            |
| Net change in fair value of cash flow hedges, net of tax |      | -             | (1,081)         | -             | -                 | (1,081)      |
| Total other comprehensive income                         |      | -             | (1,081)         | -             | -                 | (1,081)      |
| Total comprehensive income for the period                |      | -             | (1,081)         | -             | 14,699            | 13,618       |
| Transactions with owners, recorded directly in equity    |      | -             | -               | -             | (1,625)           | -            |
| Change in the reserves                                   |      | -             | -               | 1,625         | (1,625)           | -            |
| <b>Total transactions with owners</b>                    |      | -             | -               | 1,625         | (1,625)           | -            |
| Balance at 31 December 2010                              | 20   | 8,884         | (7,739)         | 3,664         | 49,229            | 54,038       |

The notes on pages 10 to 53 are an integral part of these consolidated financial statements.

Ivan Ivanov

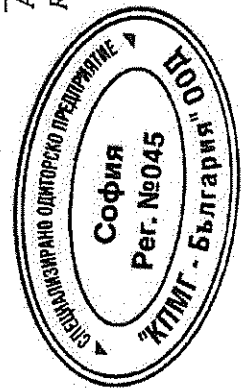
General Commercial Proxy

In accordance with an Independent Auditors' Report:  
KPMG Bulgaria OOD

Krassimir Hadjijidingov  
Director

Митрослав Милков  
Financial Controller

Андоанета Воичева  
Registered Auditor



## Consolidated statement of cash flows

For the year ended 31 December

In thousands of BGN

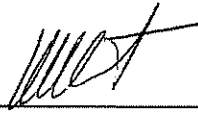
|   | Note | 2010            | 2009            |
|---|------|-----------------|-----------------|
| <b>Cash flow from operating activities</b>          |      |                 |                 |
| Profit for the period                               |      | 14,699          | 16,290          |
| <i>Adjustments for:</i>                             |      |                 |                 |
| Depreciation expenses                               | 15   | 3,143           | 2,288           |
| Amortisation of intangible assets                   | 16   | 20,577          | 10,855          |
| Net finance expense                                 | 13   | 12,464          | 6,803           |
| Impairment losses on trade receivables              | 12   | 9,387           | 8,274           |
| Write-down of inventory                             | 12   | 154             | 17              |
| Expenses for scrapping of materials                 | 12   | 5               | 5               |
| Expenses for scrapping of non-current assets        | 12   | 50              | 19              |
| Gain on sale of non-current assets                  |      | (19)            | (6)             |
| Gain on revaluation of financial instruments        |      | -               | -               |
| Income tax expenses                                 | 14   | 2,423           | 1,990           |
|   |      | <u>62,883</u>   | <u>46,535</u>   |
| Change in provision for retirement compensation     | 27   | (229)           | 313             |
| Change in provisions accrued during the year        | 24   | 1,293           | 489             |
| Change in inventories                               |      | (526)           | 81              |
| Change in trade and other receivables               |      | (10,622)        | (10,676)        |
| Change in trade and other payables                  |      | 424             | 14,938          |
| Income tax paid                                     |      | (2,611)         | (2,579)         |
| <b>Net cash flow from operating activities</b>      |      | <u>50,612</u>   | <u>49,101</u>   |
| <b>Cash flow from investment activities</b>         |      |                 |                 |
| Acquisition of property, plant and equipment        |      | (3,669)         | (7,733)         |
| Acquisition of intangible non-current assets        |      | (39,344)        | (42,135)        |
| Proceeds from sales of non-current assets           |      | 30              | 10              |
| Interest received                                   |      | -               | 679             |
| Interest paid                                       |      | (10,690)        | (11,829)        |
| <b>Net cash used in investing activities</b>        |      | <u>(53,673)</u> | <u>(61,008)</u> |
| <b>Cash flow from financing activities</b>          |      |                 |                 |
| Receipts of loans and borrowings                    |      | 10,110          | 22,520          |
| Repayment of loans and borrowings                   |      | (4,518)         | (4,056)         |
| Payment of finance lease liabilities                |      | (1,090)         | (1,145)         |
| Payment for transaction costs                       |      | 41              | (15)            |
| <b>Net cash from (used in) financing activities</b> |      | <u>4,543</u>    | <u>17,304</u>   |

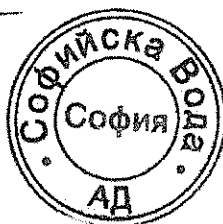
Consolidated statement of cash flows (continued)

For the year ended 31 December

| <i>In thousands of BGN</i>                       | <i>Note</i> | <b>2010</b>   | <b>2009</b>   |
|--|-------------|---------------|---------------|
| <b>Net increase in cash and cash equivalents</b> |             | 1,482         | 5,397         |
| Cash and cash equivalents at 1 January           |             | 16,479        | 11,082        |
| <b>Cash and cash equivalents at 31 December</b>  | <i>19</i>   | <b>17,961</b> | <b>16,479</b> |

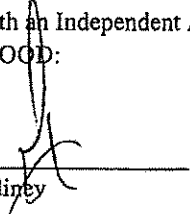
The notes on pages 10 to 53 are an integral part of these consolidated financial statements.

  
Ivan Ivanov  
General Commercial Proxy




  
Miroslav Mitkov  
Financial Controller

In accordance with an Independent Auditors' Report:  
KPMG Bulgaria OOD:

  
Krassimir Hadjidinev  
Director



  
Antoaneta Boicheva  
Registered Auditor

|   | Page  |   | Page  |
|---|-------|---|-------|
| 1. Reporting entity                                     | 10    | 17 Inventories  | 32-33 |
| 2. Basis of preparation                                 | 10    | 18. Trade and other receivables   | 33    |
| 3. Significant accounting policies                      | 11-21 | 19. Cash and cash equivalents   | 34    |
| 4. Defining the fair value                              | 22    | 20. Share capital and reserves  | 34    |
| 5. Financial risk management                            | 22-24 | 21. Interest-bearing loans and borrowings                                   | 35-36 |
| 6. Revenue  | 25    | 22. Deferred tax assets and liabilities                                     | 36-37 |
| 7. Other income   | 25    | 23. Trade and other payables  | 38    |
| 8. Revenue from and expense for construction            | 26    | 24. Provisions  | 39    |
| 9. Expenses for materials                               | 26    | 25. Tax liabilities   | 40    |
| 10. Expenses for hired services                         | 26    | 26. Financial instruments   | 40-44 |
| 11. Salaries, remuneration and other personnel benefits | 27    | 27. Liabilities for retirement compensation                                 | 45-46 |
| 12. Other expenses                                      | 27    | 28. Contingent liabilities  | 47    |
| 13. Finance income and finance expenses                 | 27-28 | 29. Obligations for acquisition of property, plant, and equipment           | 48    |
| 14. Income tax expense                                  | 28    | 30. Related parties   | 49-52 |
| 15. Property, plant and equipment                       | 29-30 | 31. Concession contract   | 52-53 |
| 16. Intangible assets                                   | 31-32 | 32. Subsequent events after the date of the statement of financial position | 53    |

## 1. Reporting entity

Sofiyska Voda AD (the Company) is a company registered in Sofia City Court on 28 December 1999 under company case № 16172/1999 / №54111, p.557, registration. 1, page 20 and registered as per the Public Register Act in the Public Register to the Registry Agency under uniform identification code 130175000.. The address of the registered office of the Company is Bulgaria, Sofia , bl. Mladost 4, 1 Business Park Sofia Str, building 2A. The Company is 77.10% owned by United Utilities (Sofia) BV and 22.90% owned by Vodosnabdiavane u Kanalizatsia EAD.

The Group's business is the provision of water and wastewater services in the Municipality of Sofia, including managing and maintenance of the public assets which represent part of the watermain and wastewater-treatment system in Sofia and also design, construction, financing and managing of new assets.

On 23 December 1999 Sofiyska Voda AD signed a Concession Contract through which the Municipality of Sofia granted to the Concessionaire (Sofiyska Voda AD) a specific right for use of the public assets and exclusive permission to provide the Services within the Concession Area for a period of 25 years. The Services include the provision of water, sewerage and wastewater treatment services.

## 2. Basis of preparation

### (a) Statement of compliance

The consolidated financial statements for 2010 have been prepared in accordance with the International Financial Reporting Standards (IFRS), which are approved by the International Accounting Standards Board (IASB) and adopted by the European Commission.

The consolidated financial statements for the year ended 31 December, 2010 were approved by the Board of Directors on 30 March 2011.

### (b) Basis of measurement

The consolidated financial statements have been prepared on historical cost basis except for the financial instruments, which are stated at fair value (see "Significant accounting policy" - 3(b)) and the liability from the defined benefit pension plan, stated at present value (see "Significant accounting policy" - 3(i)).

### (c) Functional and presentation currency

The consolidated financial statements have been prepared in Bulgarian leva (BGN), which is the Group's functional currency. All financial information presented in BGN has been rounded to the nearest thousand.

### (d) Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected. In particular, information about significant areas of estimate uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognized in the consolidated financial statements are described in the following notes:

- Note 6- Revenues;
  - Note 21 – Reporting of lease contracts;
  - Note 16 –Reporting of an intangible asset "Concession right";
- Information about significant areas of estimate uncertainty that are expected to have considerable effect in the following financial year is described in the following notes:
- Note 27 - Determining of the liabilities on defined benefit pension plan
  - Note 24 and 28 - Provisions and contingent liabilities
  - Note16 - Amortization of the intangible asset "Concession right"

### 3. Significant accounting policies

The significant accounting policies set out below have been applied consistently in all reported periods. Certain comparative numbers have been reclassified so that they meet the presentation for the current period.

#### (a) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Group at exchange rates stated by the Central Bank at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate stated by the central bank at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the period.

Non-cash assets and liabilities denominated in foreign currencies, which are accounted for at fair value, are turned into the functional currency at the rate of the date of the fair value determination. Foreign exchange differences are accounted for in profit and loss.

From 1997 to the date of the consolidated financial statements approval, the exchange rate of the Bulgarian lev (BGN) has been fixed against the Euro (EUR). The exchange rate is BGN 1.95583 / EUR 1.0.

#### (b) Financial Instruments

##### (i) *Non-derivative financial assets*

The Group initially recognizes loans and receivables and deposits on the date they originated. All other financial assets are recognized initially on the trade date on which the Group becomes a party to the contractual provisions of the instrument.

The Group derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Group has the following non-derivative financial instruments: loans and receivables.

##### *Loans and receivables*

Loans and receivables are financial assets with fixed or determinable payments, which are not quoted in an active market. Such assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to the initial recognition loans and receivables are measured at their amortized cost, by using the effective interest rate method, less any impairment losses.

Cash and cash equivalents comprise cash balances, current accounts and call deposits with initial maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

**3. Significant accounting policies (continued)**

**(b) Financial Instruments (continued)**

*(ii) Non-derivative financial liabilities*

The Group initially recognizes subordinated liabilities on the date that they are originated. All other financial liabilities are recognized initially on the trade date at which the Group becomes a party to the contractual provisions of the instrument. The Group derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The Group has the following non-derivative financial liabilities: loans and trade and other liabilities. Such financial liabilities are initially recognized at fair value plus any directly attributable transaction costs. After the initial recognition those financial liabilities are measured at their amortized cost, by using the effective interest rate method.

*(iii) Share capital*

*Ordinary shares*

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects. The equity of the Group is presented at historical cost as at the date of registration.

*(iv) Derivative financial instruments, including hedging reporting*

The Group holds financial instruments to hedge its interest rate risk exposures.

On initial designation of the hedge, the Group formally documents the relationship between the hedging instruments and hedged items, including the risk management objectives and strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship.

The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be "highly effective" in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125 per cent. For a cash flow hedge of a forecast transaction, the transaction should be highly probable to occur and should present an exposure to variations in cash flows that could ultimately affect reported net income.

Financial instruments are recognized initially at fair value; attributable transaction costs are recognized in profit or loss as incurred. Subsequent to initial recognition, financial instruments are measured at fair value, and changes therein are accounted for as described below.

**3. Significant accounting policies (continued)**

**(b) Financial Instruments (continued)**

*Cash flow hedging*

When a financial instrument is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the financial instrument is recognized in other comprehensive income and presented in the hedging reserve in equity.

The amount recognized in other comprehensive income is removed and included in profit or loss in the same period as the hedged cash flows affect profit or loss under the same line item in the statement of comprehensive income as the hedged item. Any ineffective portion of changes in the fair value of the financial instrument is recognized immediately in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated, exercised, or the designation is revoked, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognized in other comprehensive income and presented in the hedging reserve in equity remains there until the forecast transaction affects profit or loss. When the hedged item is a non-financial asset, the amount recognized in other comprehensive income is transferred to the carrying amount of the asset when the asset is recognized. If the forecast transaction is no longer expected to occur, then the balance in other comprehensive income is recognized immediately in profit or loss. In other cases the amount recognized in other comprehensive income is transferred to profit or loss in the same period that the hedged item affects profit or loss.

**(c) Property, plant and equipment**

**(i) Recognition and measurement**

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. (see note 3(h)).

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labor, and the relative proportional part of the indirect costs; any other costs directly attributable to bringing the assets to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and capitalized borrowing costs. Purchased software, that is essential for the functioning of the purchased equipment, is capitalized as part of the equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognized net within other income in profit or loss. When revalued assets are sold, the amounts included in the revaluation reserve are transferred to retained earnings.

**Subsequent costs**

The cost of replacing a part of an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.



3. Significant accounting policies (continued)

(c) Property, plant and equipment (continued)

(ii) Depreciation

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value. Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives for the current and comparative periods are as follows:

|                                 |            |
|---------------------------------|------------|
| • Buildings                     | 25 years   |
| • Plant and equipment           | 5-25 years |
| • Vehicles – automobiles        | 5-10 years |
| • Vehicles – trucks             | 12.5 years |
| • Improvements of leased assets | 10 years   |

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

(d) Intangible assets

*IFRIC 12* „Concession service agreement”

As stated in Note 3, Sofiyska Voda AD is a party in a concession contract with the Municipality of Sofia, and as a result a specific right emerges for the Group granting it the use of public assets, and also an exclusive right to render water supply and sewerage services within the concession area – the territory of the Municipality of Sofia. Taking into account the concession contract with the Municipality of Sofia, the requirements of IFRIC 12 have been applied, and consequently an intangible asset “concession right” has been recognized in the financial statements of the Group, based on Sofiyska Voda’s right to make revenue from the water supply, sewerage and waste water treatment services it provides to the customers on the territory of the concession.

(i) Intangible asset “concession right”

The intangible asset “concession right” is recognized at acquisition cost less accumulated amortization and impairment losses (see accounting policy 3 (h)).

The intangible asset “concession right” arises in relation to the Concession Agreement, which sets Sofiyska Voda’s right of use of public assets in order to deliver the services of water supply, sewerage and waste water treatment within the concession area.

This is a complex right of use in its essence and by exercising it the separate components of an intangible asset (Concession right) have emerged. These components differ in type and function which is the reason for calculating their amortization depending on the useful life of each.

The Municipality of Sofia – has the ownership rights on all the existing public assets, but the concessionaire has exclusive and specific right to use the existing public assets.

The ownership rights of any new assets are transferred to the Municipality of Sofia at the time of their acquisition by the concessionaire or the beginning of their operation. The Group does not receive any payments from the Municipality of Sofia related to the acquisition or construction of new public assets. The improvements in the public assets are capitalized and represented as improvements in the intangible asset “concession right”.

### 3. Significant accounting policies (continued)

#### (d) Intangible assets (continued)

##### (ii) Other intangible assets

Other intangible assets, acquired by the Group, that have limited useful life, are stated at acquisition cost less accumulated amortization and impairment losses.

##### (iii) Subsequent expenditure

Subsequent expenditure on intangible assets is capitalised only when they meet the recognition criteria for intangible assets, that is when it is probable that they lead to future economic benefits and the expenditure can be measured reliably. All other expenditure is expensed as incurred.

##### (iv) Amortisation

Amortisation is charged to the Statement of comprehensive income on a straight-line basis over the estimated useful lives of intangible assets that are reported separately. Assets are depreciated from the month following the month of putting the assets into operation.

The estimated useful lives are as follows:

##### *Components of the intangible asset "concession right"*

- |                                       |  |
|---------------------------------------|--|
| • Plant and equipment                 | 5-25 years   |
| • Water network improvements          | 25 years (or the period remaining until the end of the Concession Agreement) |
| • Improvements of other public assets | 10 years   |

##### *Other intangible assets*

- |                                 |            |
|---------------------------------|------------|
| • capitalised development costs | 6.67 years |
| • other intangibles             | 6.67 years |
| • software                      | 10 years   |

All amortisation methods, useful life and residual value are reviewed at every reporting date.

#### (e) Leased assets

Leases in terms of which the Group assumes substantially all the risks and benefits of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are operating leases and, except for investment property, the leased assets are not recognized in the Group's statement of financial position.

#### (f) Inventories

Inventories are measured at the lower of cost and net realisable value.

The cost of inventories is based on weighted average cost.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

**3. Significant accounting policies (continued)**

**(g) Assets under construction**

The cost of the assets under construction includes all expenses directly related to specific projects and the relevant portion of fixed and variable production costs, resulting from the contracts made by the Group.

**(h) Impairment**

**(i) Financial Assets**

A financial asset is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Group on terms that the Group would not consider otherwise, or indications that a debtor or issuer will enter bankruptcy. In addition a proof of impairment of security investment is a substantial or continuous drop in its fair value below its acquisition value.

The Group considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables that are not individually significant are collectively assessed for impairment by grouping together receivables with similar risk characteristics.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgments as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

The impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. The impairment loss is recognized in profit and loss and results in decrease of the receivables. Whenever a subsequent event reduces the impairment loss, the decrease in impairment loss is reversed through profit or loss.

**(ii) Non-financial assets**

The carrying amounts of the Group's non-financial assets, inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable value is estimated. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable value is estimated annually on the same date.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For assets that cannot be tested individually, they are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups (the cash – generating unit).

### 3. Significant accounting policies (continued)

#### (ii) Non-financial assets (continued)

The corporate assets of the Group do not generate separate cash flows. If there are indications that a corporate asset is impaired, the recoverable amount is the one of the cash-generating units group it belongs to.

An impairment loss is recognized if the carrying amount of an asset or a cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit and loss. Impairment losses recognized in respect of cash-generating units are allocated in such way as to reduce the carrying amount of the assets within the unit proportionally.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

#### (i) Employee benefits

##### (i) Defined contribution plan

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. The Government of Bulgaria is responsible for providing pensions in Bulgaria under a defined contribution pension plan. The Group's contributions to the defined contribution pension plan are recognized as an employee benefit expense in profit or loss in the periods during which services are rendered by employees.

##### (ii) Defined benefit plan

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value.

The Group has obligation to pay certain amounts to each employee who retires with the Group in accordance with Art. 222, § 3 of the Labour Act. According to these regulations in the LC, when a labour contract of a Group's employee, who has acquired a pension right, is ended, the Group is obliged to pay him compensations amounted to two gross monthly salaries. If the employee's length of service in the Group equals to or is greater than 10 or more years, as at retirement date, then the compensation amounts to six gross monthly salaries.

As at the reporting date the management estimates the amount of such expenses based on a report prepared by a qualified actuary using the projected unit credit method. In note 27 the charged amount is stated, and also the main assumptions used for the estimate.

The Group recognizes all actuarial profits and losses arising from the defined benefits plans as employee expenses in profit and loss.

##### (iii) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. The Group recognizes as a liability the undiscounted amount of the expenses for annual paid leave that is expected to be paid to employees for the services provided during and prior to the reporting period.

A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

3. Significant accounting policies (continued)

(i) Defined benefits plans (continued)

(iv) Termination benefits

Termination benefits are recognized as an expense when the Group has officially undertaken the obligation, stated in a detailed plan, to terminate the labor contract before the retirement date or to give compensation upon termination resulting from an offer for voluntary redundancy.

Benefits on voluntary termination are recognized as an expense if the Group has presented an official offer that is to be accepted with high probability and the number of volunteers can be assessed reliably.

If any compensation is due for a period longer than 12 months after the end of the reporting period, it is discounted to its present value.

(v) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

The Group recognises as a liability the undiscounted amount of the estimated costs related to annual leave expected to be paid in exchange for the employee's service for the period completed.

(j) Provisions

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Adding interest on the discounted value is recognized as financial expense.

*Legal liabilities provision*

Legal liabilities provisions are included in the Group's consolidated financial statements as a result of existing legal liabilities on court actions concerning past events. Evaluation of the provision is carried out by the legal advisors of the Group based on all the facts and circumstances related to the expected cash outflows resulting from a hypothetical court decision in other party's favor.

*Compensation provision for using private municipality property, managed by "Vodosnabdyavane i kanalizatsiya" EAD, where pressure increase installations are situated.*

In the annual financial statements of the Group there is a provision for compensation for using private municipality property rooms, managed by "Vodosnabdyavane i kanalizatsiya" EAD, where pressure increase installations are situated. Those rooms will be used in the period from 6 October 2000 until the date the Municipality council adopts a resolution of the emerged legal relation in 2011. The reason for the provision is the existing agreement between the parties that is coordinated and deposited to the Sofia Municipality Council. It provides for the payment of a compensation, which by expert opinion amounts to BGN 554 thousand. The estimate is made by an independent expert, recruited by "ViK" EAD.

*Provision for constructive liabilities as per Contract for purchase of carbon credits*

In the annual financial statements of the Group there is a provision for constructing liabilities, deriving from the Contract between the Group and EBRD dated 20 September 2007 for the purchase of carbon credits. The provision is based on the clause "production deficiency", i.e. at the date of the financial statements the project is failing to provide the minimal quantities of emission reductions, as envisaged per contract, and consequently expenses on substitution will arise for the period of the contract, which does not depend on the unproduced quantities and amounts to BGN 663 thousand.

3. Significant accounting policies (continued)

(k) Revenue

(i) Goods sold and rendered services

Revenue from services rendered is recognized in proportion to the stage of completion of the deal at the reporting date. The stage of completion is assessed by reference to surveys of work performed.

The revenue from water supply, sewerage and waste water treatment services are realized by the Group as per the Concession Contract and the effective legislation, in particular the Law of Regulation of the water supply and sewerage services (LRWSSS) and the relevant subordinate legislation. As per art.5 of LRWSSS, the prices of the water supply and sewerage services rendered are subject to regulation by the State Commission for Energy and Water Regulation (SCEWR). Within the period of the approved Business Plan 2009-2013 the Group files in and justifies price change applications, which are revised and approved by SCEWR in their Decisions. The interest income for overdue receivables is calculated as per the regulations on the legal interest rate (base rate + 10%)

(ii) Construction contracts

The negotiated revenue includes the initially negotiated amount plus all the changes in the negotiated works, counter claims, bonuses, as to the extent they are expected to bring revenue that can be measured reliably. When the result from a construction contract can be defined reliably, the revenues and expenses are recognized based upon the stage of completion. On each construction contract the management estimates the result of the execution. When the results of the contract cannot be defined reliably then the revenue is recognized up to the amount of the expenses on the contract that is expected to be reimbursed. Any expected loss is immediately recognized in profit and loss.

Construction contracts bring revenues related to the investments in public assets – improvement and construction of new components of the water supply and sewerage system against the right to invoice and charge the customers for the service at the prices approved by State Commission for Energy and Water Regulation (SCEWR). In consequence the Group is recognizing an intangible asset “concession right” against crediting revenue from construction contracts upon termination of the works.

(iii) Revenue from carbon emissions

Revenue from sale of carbon emissions is recognized on the basis of verified quantity of emissions reduction under methane gas capture and electricity production at Koubratovo Wastewater Plant.

(l) Payments on leasing contracts

Payments on operating leases are recognized in profit and loss on a straight-line basis over the period of the lease. Any additional payments made are recognized in profit and loss as an inseparable part of the total lease expenses for the contractual period. The minimum lease installments on finance leases are split between financial expenses and decrease in payables. The financial expenses are allocated for each period within the lease term so that a constant period interest rate is obtained for the remaining part of the contract. The conditional lease payments are accounted for by revising the minimal lease payments for the remaining part of the contract, when the lease correction is confirmed.

(m) Determining whether an arrangement contains a lease

At inception of an arrangement, the Group determines whether such an arrangement is or contains a lease. A specific asset is the subject of a lease if fulfillment of the arrangement is dependent on the use of that specified asset. An arrangement conveys the right to use the asset if the arrangement conveys to the Group the right to control the use of the underlying asset.

At inception or upon reassessment of the arrangement, the Group separates payments and other consideration required by such an arrangement into those for the lease and those for other elements on the basis of their relative fair values. If the Group concludes for a finance lease that it is impracticable to separate the payments reliably, an asset and a liability are recognized at an amount equal to the fair value of the underlying asset. Subsequently the liability is reduced as payments are made and an imputed finance charge on the liability is recognized using the Group's incremental borrowing rate.

**3. Significant accounting policies (continued)**

**(n) Finance income and expenses**

Finance income comprises interest income from funds invested (including financial assets available for sale), income from dividends, profit from the sale of financial assets available for sale, changes in the fair value of financial assets, accounted for at fair value in profit or loss, profit from transactions in foreign currencies, profit from hedging instruments, recognized in profit or loss. Interest income is recognized as it accrues in profit or loss, using the effective interest method. Income from dividends is recognized as at the date the Group's right of receiving the payment has been confirmed. In the case of tradable securities, it is the date when they lose the right of receiving the last dividend.

Finance expenses comprise interest expense on borrowings, expenses resulting from increase in liabilities due to being one period closer to the date for realizing the provisions, dividends on preferential shares classified as liabilities, changes in the fair value of financial assets, accounted for at fair value in profit or loss, devaluation of the financial assets and loss from hedging instruments, recognized in profit or loss. All borrowing costs that cannot be directly related to the acquisition, construction or production of an asset, meeting the requirements for capitalization of interest, are recognized in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

**(o) Income tax**

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognized for temporary differences from the initial recognition of assets or liabilities in a transaction that affects neither accounting nor taxable profit nor loss. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets or the tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

When calculating its current and deferred taxes the Group is using the accounting base as described in note 2 above.

3. Significant accounting policies (continued)

(p) New standards and interpretations not yet adopted

Some new standards, amendments to standards and interpretations that will be effective for financial periods beginning after 1 January 2010 have not been applied in preparing these consolidated financial statements. The Group management does not expect that those changes will affect the Financial Statements.

*IASB/IFRIC documents not yet endorsed by EC:*

Management believes that it is appropriate to disclose that the following revised standards, new interpretations and amendments to current standards, which are already issued by the International Accounting Standards Board (IASB), are not yet endorsed for adoption by the European commission, and therefore are not taken into account in preparing these financial statements. The actual effective dates for them will depend on the endorsement decision by the EC.

- IFRS 9 *Financial Instruments (issued November 2009 and Additions to IFRS 9 issued October 2010)* has an effective date 1 January 2013 and could change the classification and measurement of financial instruments. The extent of the potential impact has not been determined.
- Amendments to IFRS 7 *Financial Instruments: Disclosures* (issued October 2010) has an effective date 1 July 2011 – not expected to have a significant impact on the financial statements of the Group.
- Amendments to IAS 12 *Deferred Tax: Recovery of Underlying Assets* (issued December 2010) has an effective date 1 January 2012 – not expected to have a significant impact on the financial statements of the Group.
- Amendments to IFRS 1 *Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters* (issued December 2010) has an effective date 1 July 2012 – not expected to have a significant impact on the financial statements of the Group.

Improvements to IFRSs 2010 (issued April 2010), various effective dates, generally 1 January 2011 - not expected to have a significant impact on the financial statements of the Group.



#### 4. Defining the fair value

Some of the accounting policies of the Group require defining of the fair value of financial and non-financial assets and liabilities. Fair values are determined for reporting purposes based on the methods listed below. Whenever applicable, in the relevant notes additional information is given relating to the assumptions made when defining the fair value of a specific asset or liability.

(i) *Trade and other receivables*

The fair value of trade and other receivables, except for uncompleted construction, is defined as present value of the future cash flow, discounted at the market interest rate as at the reporting date.

(ii) *Financial instruments*

The fair value of interest swaps is based on broker quotes. They have been tested for reasonableness by discounting the future cash flows based on the conditions in each separate contract and the market interest rates for similar financial instruments as at the evaluation date. The fair value reflects the credit risk of the financial instrument and comprises corrections for credit risk reporting whenever appropriate.

(iii) *Non-derivative financial obligations*

The fair value is calculated on the basis of the present value of future cash flows of principal and interest, discounted by the market interest rate as at the reporting date. In respect of financial leases, the market interest rate is calculated based on similar lease agreements.

#### 5. Financial risk management

The Group has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk;
- operational risk.

This note presents information about the Group's exposure to each of the risks listed above, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

##### **Risk management framework**

The Board of Directors has the overall responsibility for the establishment and supervision of the Group's risk management. The Board has established a Risk Management Committee which is obliged to report regularly its actions to the Board of Directors.

The Group's risk management policies are established to identify and analyze the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Group's board is being assisted by the internal audit department. Internal audit undertakes both planned and unplanned inspections of the risk management procedures and the results are reported to the board.

## 5. Financial risk management (continued)

### *Credit risk*

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. It arises from the Group's receivables from customers and investment in financial instruments.

#### (i) *Trade receivables*

The credit risk exposure of the Group results from the individual characteristics of the different clients. This exposure also depends on the risk of nonpayment common to the utility sector. The Group is a monopolist in rendering its services on the territory of Sofia Municipality and as at 31 December 2010 the active clients of the Group are 562,035 (2009 – 560,700). Based on the analyses of the Group, the services rendered have low price elasticity. The prices are regulated by the State Energy and Water Regulation Commission. The Group does not require guarantees from its customers in relation to the services rendered.

### *Liquidity risk*

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses.

The Group performs a financial planning process, which will meet the payment of current expenses and liabilities for a period of 30 days, including its financial liabilities. This planning excludes the potential effect of unplanned circumstances, which cannot be foreseen under normal circumstances.

As the Group's business activities are related to regular deliveries and payments from clients, the liquidity risk control is mainly comprised of the following components:

- careful planning of all cash outflows based on monthly forecasts;
- payment conditions with clients, which are executed within a month – special payment schedules are negotiated and there are penalties in case of delay;

### *Market risk*

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

The Group undertakes periodical analysis on the macroeconomic environment in the country and in depth analysis on specific macro-indicators, which are presented to the Board of Directors. The Board of Directors has the responsibility for evaluation of future risks that the Group faces, including information on the interest rates. If the market conditions worsen hedging instruments will be used.

The Group manages its interest risk and in 2008 has signed a swap contract, in order to hedge its risk exposure to changes in the six-month Euribor.

## 5. Financial risk management (continued)

### *Operational risk*

Operational risk is the risk of direct or indirect losses, originating from a wide range of reasons related to the processes, personnel, technologies and infrastructure of the Group, and also from external factors different from credit, market and liquidity risks. For example those originating from legal and regulatory requirements and common standards of corporate behavior. Operational risks may arise from all of the Group's operations.

The goal of the Group is to manage the operational risk so that there is a balance among avoiding financial loss, harming the goodwill of the Group and cost efficiency and avoiding control procedures that restrict initiatives and creativity.

The main responsibility for developing and applying operational risk controls is assigned to the management. It is supported by the development of common Group standards for operational risk management in the following areas:

- requirements for appropriate segregation of duties, including independent transaction authorization
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation on procedures and control
- requirements for periodical estimation of the operational risks and controls adequacy and the procedures for coping with identified risks
- reporting requirements related to operational losses and proposed remedial actions
- development of contingency plans
- training and professional development
- ethical and business standards
- risk reduction, including insurance whenever effective

The compliance with the Group standards is supported by a periodical review programme, initiated by internal audit. The results of the reviews are discussed with the business unit management they relate to, and summaries are presented to the audit committee and the top management.

### *Capital management*

The Board of Directors' policy is to maintain a strong capital base so as to maintain customers' and creditors' confidence and to sustain future development of the business.

The purpose of the Board of Directors is to maintain a balance between the higher return which may result from higher indebtedness levels and the benefits and security of a strong capital position. The return on equity in 2010 is 27.20% (2009: 67.51%).

There were no changes in the Group's approach to capital management during the year. The Group was not the subject to equity requirements enforced by external authorities.

According to the second additional amendment to the Concession contract, signed on 19 March, 2008, the return on capital must be at least 17 %.

## 6. Revenue

| <i>In thousands of BGN</i>               | 2010           | 2009           |
|--|----------------|----------------|
| Income from water supply                 | 79,690         | 72,648         |
| Income from sewerage                     | 13,996         | 14,018         |
| Income from waste water treatment        | 18,503         | 16,396         |
| Interest income from overdue receivables | 3,770          | 4,196          |
| Income from service sales                | 2,968          | 2,917          |
| Invoiced income related to ISPA          | (858)          | (699)          |
|  | <u>118,069</u> | <u>109,476</u> |

According to an agreement dated 22/06/2007 between Sofiyska Voda AD and Sofia Municipality, and in connection with granted funds through Financial Memorandum ISPA 2000 BG 16 P PE 001, signed between European Commission and Republic of Bulgaria, the Group is obliged to include in the price of the offered service of water – supply, sewerage and purification of waste waters all the necessary yearly funds for repayment of the loan that was received from the European Investment Bank project, amounting to EUR 8,775 thousand (15 % of project's amount).

The beneficiary of the loan from the European Investment Bank is the Municipality of Sofia. The Group is obliged to collect the amounts mentioned above for the repayment of the loan.

The State Energy and Water Regulatory Commission (SEWRC) has approved these necessary amounts for repayment of the loan to be included in the price of provided water-supply and sewerage service.

In 2010 all the revenues, which are to be transferred for repayment of this EIB loan amount to BGN 858 thousand (2009: BGN 699 thousand).

In the agreement stated above dated 22/06/2007 a provision is made that at the receipt of the relevant notification the amounts collected by the Group from its customers, in accordance with the approved by the State Energy and Water Regulatory Commission (SEWRC) price component, will be transferred to the Ministry of Environment and Waters (MoEW) to a special bank account opened for the loan. At the meetings that took place in the middle of 2009 between the Group, the Municipality of Sofia, the Ministry of Environment and Waters and the Ministry of Finance it was discussed that the acquisition of EIB funds should start in 2010, but in 2010 the Group did not receive any notifications related to that or to any future loan installments or due dates. Consequently, as at the date of the preparation of this consolidated financial statement a special bank account has not been opened yet as well.

## 7. Other income

The total value of other income for 2010 is BGN 4,668 thousand (2009: BGN 3,654 thousand). The major revenues are: from sale of carbon emissions and amount to BGN 1,519 thousand (2009 –2,293 thousand); from imposing sanctions for industrial discharges with above the standard concentration of fixed pollutants amounting to BGN 656 thousand (2009: BGN 893 thousand); revenues from sale of inventories to subcontractors for repair works – BGN 297 thousand. (2009: BGN 209 thousand) and sale of "green energy", amounting to BGN 1,476 thousand.

8. Revenue from and Expense for construction

| <i>In thousands of BGN</i>   | <i>Note</i>  | 2010          |               |          | 2009          |               |          |
|------------------------------|--------------|---------------|---------------|----------|---------------|---------------|----------|
|                              |              | Revenue       | Expenses      | Profits  | Revenue       | Expenses      | Profits  |
| Objects                      |              |               |               |          |               |               |          |
| Water supply                 |              | 22,941        | 22,941        | -        | 20,305        | 20,305        | -        |
| Potable water treatment      |              | 849           | 849           | -        | 3,262         | 3,262         | -        |
| Sewerage                     |              | 13,295        | 13,295        | -        | 12,744        | 12,744        | -        |
| Waste water treatment        |              | 4,965         | 4,965         | -        | 2,263         | 2,263         | -        |
| House connections and meters |              | 5,998         | 5,998         | -        | 5,619         | 5,619         | -        |
| <b>Total</b>                 | <b>16,32</b> | <b>48,048</b> | <b>48,048</b> | <b>-</b> | <b>44,193</b> | <b>44,193</b> | <b>-</b> |

9. Expenses for materials

| <i>In thousands of BGN</i>    | 2010         | 2009         |
|-------------------------------|--------------|--------------|
| Electricity                   | 2,994        | 2,935        |
| Fuels and lubricants          | 1,527        | 1,339        |
| Water for technological needs | 1,583        | 1,545        |
| Chemicals                     | 1,686        | 1,200        |
| Plumbing materials            | 1,605        | 1,078        |
| Other                         | 507          | 939          |
|                               | <b>9,902</b> | <b>9,036</b> |

10. Expenses for hired services

| <i>In thousands of BGN</i>                    | 2010          | 2009          |
|---|---------------|---------------|
| Annual water tax                              | 4,823         | 4,928         |
| Repairs and maintenance of non-current assets | 5,364         | 5,028         |
| Insurance                                     | 1,354         | 1,301         |
| Rent  | 1,034         | 1,272         |
| Other services                                | 14,126        | 12,951        |
|   | <b>26,701</b> | <b>25,480</b> |

Other expenses for hired services include:

|                          | 2010          | 2009          |
|--------------------------|---------------|---------------|
| Security                 | 4,848         | 4,878         |
| Water – meters reading   | 1,686         | 1,322         |
| Couriers                 | 916           | 868           |
| Printing services        | 734           | 716           |
| Technical services       | 1,374         | 1,095         |
| Consultancy              | 286           | 382           |
| Asphalt covering         | 608           | 625           |
| SEWRC fee                | 431           | 462           |
| Sterilization            | 23            | 25            |
| Communication            | 315           | 333           |
| Annual software licenses | 520           | 348           |
| Hired transportation     | 344           | 414           |
| Other                    | 2,041         | 1,483         |
|                          | <b>14,126</b> | <b>12,951</b> |

11. Salaries, remuneration and other personnel benefits

| <i>In thousands of BGN</i>                   | Note | 2010          | 2009          |
|--|------|---------------|---------------|
| Salaries and remuneration                    |      | 14,611        | 13,717        |
| Pensions and social security expenses        |      | 1,913         | 2,309         |
| Social expenses                              |      | 32            | 40            |
| Expenses for additional pension contribution |      | 286           | 255           |
| Retirement compensation                      | 27   | (21)          | 313           |
| Voucher expenses                             |      | 1,199         | 1,220         |
|  |      | <u>18,020</u> | <u>17,854</u> |

The salary expenses include an accrual for unused annual paid leave in the amount of BGN 188 thousand (2009: BGN 515 thousand). The pension and social security expenses include an accrual for social and health security on unused annual paid leave in the amount of BGN 51 thousand (2009: BGN 104 thousand). The amount of the retirement compensation includes the recognized actuarial loss, determined when calculating the present value of the pension liability obligation for personnel (see note 27) in accordance with the option stated in paragraph 95 of IAS 19 "Employee benefits". The average number of personnel is 1,199 employees (2009: 1,194 employees).

12. Other expenses

| <i>In thousands of BGN</i>                          | 2010          | 2009          |
|---|---------------|---------------|
| Impairment of receivables                           | 9,387         | 8,274         |
| Write down of inventories to net realizable value   | 154           | 17            |
| One-off taxes                                       | 124           | 134           |
| Scrapping of non-current assets                     | 50            | 19            |
| Expenses as per Contract with Municipality of Sofia | -             | 12,200        |
| Fines   | 547           | 208           |
| Accrued provisions expenses                         | 2,206         | 489           |
| Others  | 1,742         | 1,193         |
|   | <u>14,210</u> | <u>22,534</u> |

13. Finance income and finance expenses

| <i>In thousands of BGN</i>   | 2010            | 2009            |
|--|-----------------|-----------------|
| Interest income  | 194             | 108             |
| Interest income from discounting of a trade liability as per Contract with Municipality of Sofia                   | 2               | 4,360           |
| Effect from guarantee discounts  | (22)            | 60              |
| Interest income from SWAP transactions   | -               | 464             |
| Net foreign exchange gains   | (122)           | (91)            |
| Financial income   | <u>52</u>       | <u>4,901</u>    |
| Interest expenses for Loan "A" based on effective interest rate method calculations                                | (2,310)         | (2,769)         |
| Interest expenses for Loan "B" based on effective interest rate method calculations                                | (5,086)         | (6,611)         |
| Interest expenses for Loan "C" based on effective interest rate method calculations                                | (42)            | (68)            |
| Finance charges on finance leases  | (146)           | (127)           |
| Interest expenses on retirement compensation liabilities   | (54)            | (54)            |
| Effect from guarantee discounts  | (27)            | (32)            |
| Interest expenses from discounting trade payables as per agreement between Sofiyska Voda and Municipality of Sofia | (1,101)         | -               |
| Other financial expenses   | (32)            | (32)            |
| Interest expenses on SWAP transactions   | (3,717)         | (2,011)         |
| Financial expenses   | <u>(12,515)</u> | <u>(11,704)</u> |
| Net finance expenses   | <u>(12,463)</u> | <u>(6,803)</u>  |

13. Finance income and finance expenses (continued)

The financial income and expenses listed above include interest income and expenses that are not recognised at fair value in profit and loss.

|   | 2010     | 2009     |
|---|----------|----------|
| Total interest income from financial assets     | 194      | 108      |
| Total interest expense on financial liabilities | (12,429) | (11,618) |

14. Income tax expense

| <i>In thousands of BGN</i>                              | <i>Note</i> | 2010           | 2009           |
|---|-------------|----------------|----------------|
| <b>Current taxes</b>                                    |             |                |                |
| Corporate income tax for the year                       |             | (3,620)        | (2,450)        |
| <b>Deferred taxes</b>                                   |             |                |                |
| Change in unrecognized deductible temporary differences | 22          | 1,191          | 460            |
| <b>Tax Act - principal</b>                              |             | (592)          | -              |
| Total tax expenses                                      |             | <u>(3,021)</u> | <u>(1,990)</u> |

Taxes recognized in other comprehensive income

| <i>In thousands of BGN</i> | 2010           |            |                | 2009           |            |                |
|----------------------------|----------------|------------|----------------|----------------|------------|----------------|
|                            | Before tax     | Tax income | After tax      | Before tax     | Tax income | After tax      |
| Cash flow hedges           | (1,201)        | 120        | (1,081)        | (5,075)        | 508        | (4,567)        |
|                            | <u>(1,201)</u> | <u>120</u> | <u>(1,081)</u> | <u>(5,075)</u> | <u>508</u> | <u>(4,567)</u> |

Reconciliation of effective tax rate

| <i>In thousands of BGN</i>                         | 2010   |               | 2009   |               |
|--|--------|---------------|--------|---------------|
| Net profit   |        | 14,699        |        | 16,290        |
| Total tax expenses                                 |        | <u>3,021</u>  |        | <u>1,990</u>  |
| Profit before tax                                  |        | <u>17,720</u> |        | <u>18,280</u> |
| Income tax using the domestic corporation tax rate | 10%    | 1,772         | 10%    | 1,828         |
| Expenses not recognized for tax purposes           | 7.05%  | 1,249         | 0.89%  | 162           |
| Net current income tax expense                     | 17.05% | <u>3,021</u>  | 10.89% | <u>1,990</u>  |

15. Property, plant and equipment

| <i>In thousands of BGN</i>       | Land and buildings | Plant and equipment | Vehicles | Leasehold improvements | Assets under construction | Total    |
|----------------------------------|--------------------|---------------------|----------|------------------------|---------------------------|----------|
| <b>Cost</b>                      |                    |                     |          |                        |                           |          |
| Balance at 1 Jan 2009            | 453                | 10,556              | 8,530    | 910                    | 310                       | 20,759   |
| Acquisitions                     | -                  | -                   | -        | -                      | 7,734                     | 7,734    |
| Disposals                        | -                  | (631)               | (246)    | -                      | -                         | (877)    |
| Transfers                        | 95                 | 6,880               | 957      | 103                    | (8,035)                   | -        |
| Balance at 31 Dec 2009           | 548                | 16,805              | 9,241    | 1,013                  | 9                         | 27,616   |
| Balance at 1 Jan 2010            | 548                | 16,805              | 9,241    | 1,013                  | 9                         | 27,616   |
| Acquisitions                     | -                  | -                   | -        | -                      | 3,677                     | 3,677    |
| Disposals                        | -                  | (245)               | (228)    | -                      | -                         | (473)    |
| Transfers                        | 177                | 2,870               | 562      | 23                     | (3,632)                   | -        |
| Balance at 31 Dec 2010           | 725                | 19,430              | 9,575    | 1,036                  | 54                        | 30,820   |
| <b>Depreciation</b>              |                    |                     |          |                        |                           |          |
| Depreciation as at 1 Jan 2009    | (56)               | (4,878)             | (4,093)  | (481)                  | -                         | (9,508)  |
| Depreciation charge for the year | (10)               | (1,173)             | (1,011)  | (94)                   | -                         | (2,288)  |
| Depreciation on disposals        | -                  | 626                 | 205      | -                      | -                         | 831      |
| Balance as at 31 Dec 2009        | (66)               | (5,425)             | (4,899)  | (575)                  | -                         | (10,965) |
| Depreciation as at 1 Jan 2010    | (69)               | (5,422)             | (4,899)  | (575)                  | -                         | (10,965) |
| Depreciation charge for the year | (18)               | (1,946)             | (1,076)  | (102)                  | -                         | (3,142)  |
| Depreciation on disposals        | -                  | 181                 | 220      | -                      | -                         | 401      |
| Balance as at 31 Dec 2010        | (87)               | (7,187)             | (5,755)  | (677)                  | -                         | (13,706) |



15 Property, plant and equipment (continued)

| <i>In thousands of BGN</i> | Land and buildings | Plant and equipment | Vehicles | Leasehold improvements | Assets under construction | Total  |
|----------------------------|--------------------|---------------------|----------|------------------------|---------------------------|--------|
| <b>Carrying amounts</b>    |                    |                     |          |                        |                           |        |
| At 1 January 2009          | 397                | 5,678               | 4,437    | 429                    | 310                       | 11,251 |
| At 31 December 2009        | 482                | 11,380              | 4,342    | 438                    | 9                         | 16,651 |
| At 1 January 2010          | 482                | 11,380              | 4,342    | 438                    | 9                         | 16,651 |
| At 31 December 2010        | 638                | 12,243              | 3,820    | 359                    | 54                        | 17,114 |

*Acquisitions*

The most significant tangible assets, acquired in 2010 amount to BGN 3,330 thousand (2009: BGN 7,677 thousand) and are listed below:

| <i>In thousands of BGN</i>                    | 2010         | 2009         |
|---|--------------|--------------|
| CHP generator                                 | 188          | 5,181        |
| Transportation vehicles                       | 697          | 1,367        |
| Laboratory equipment                          | 378          | -            |
| Electricity Dispatching Board in WTP Bistrisa | 217          | -            |
| ERP hardware                                  | 455          | -            |
| External data storage                         | 400          | -            |
| Other equipment                               | 995          | 1,130        |
|   | <u>3,330</u> | <u>7,678</u> |

*Assets pledged as collateral*

The Group has pledged all its present and future non-current assets in respect of secured bank loan "A".

A specific pledge on the leased vehicles has been set up in favor of the lesser. These are automobiles and construction machines with a carrying amount of BGN 1,739 thousand (2009: BGN 2,023 thousand).

**16. Intangible assets**

*In thousands of BGN*

|                           | Development costs | Software | Concession right | Assets under construction – Concession right | Assets under construction - other | Total    |
|---------------------------|-------------------|----------|------------------|--|-----------------------------------|----------|
| <i>Book value</i>         |                   |          |                  |  |                                   |          |
| Balance as at 1 Jan 2009  | 20,899            | 13,532   | 123,531          | 30,509                                       | 112                               | 188,583  |
| Acquisitions              | -                 | -        | -                | 44,193                                       | 534                               | 44,727   |
| Transfers                 | 118               | 416      | 49,393           | (49,393)                                     | (534)                             | -        |
| Balance as at 31 Dec 2009 | 21,017            | 13,948   | 172,924          | 25,309                                       | 112                               | 233,310  |
| Balance as at 1 Jan 2010  | 21,017            | 13,948   | 172,924          | 25,309                                       | 112                               | 233,310  |
| Acquisitions              | -                 | -        | -                | 48,049                                       | 997                               | 49,046   |
| Disposals                 | -                 | -        | (8)              | -  | -                                 | (8)      |
| Transfers                 | 24                | 520      | 45,359           | (45,359)                                     | (544)                             | -        |
| Balance as at 31 Dec 2010 | 21,041            | 14,468   | 218,275          | 27,999                                       | 565                               | 282,348  |
| <i>Amortization</i>       |                   |          |                  |  |                                   |          |
| Balance as at 1 Jan 2009  | (18,158)          | (7,911)  | (29,608)         | -  | -                                 | (55,677) |
| Amortization for the year | (1,074)           | (1,372)  | (8,409)          | -  | -                                 | (10,855) |
| Balance as at 31 Dec 2009 | (19,232)          | (9,283)  | (38,017)         | -  | -                                 | (66,532) |
| Balance as at 1 Jan 2010  | (19,232)          | (9,283)  | (38,017)         | -  | -                                 | (66,532) |
| Amortization for the year | (665)             | (1,395)  | (18,518)         | -  | -                                 | (20,578) |
| Balance as at 31 Dec 2010 | (19,897)          | (10,678) | (56,535)         | -  | -                                 | (87,110) |
| <i>Carrying amounts</i>   |                   |          |                  |  |                                   |          |
| At 1 January 2009         | 2,741             | 5,621    | 93,923           | 30,509                                       | 112                               | 132,906  |
| At 31 December 2009       | 1,785             | 4,665    | 134,907          | 25,309                                       | 112                               | 166,778  |
| At 1 January 2010         | 1,785             | 4,665    | 134,907          | 25,309                                       | 112                               | 166,778  |
| At 31 December 2010       | 1,144             | 3,790    | 161,740          | 27,999                                       | 565                               | 195,238  |

In 2010 the Company applied accelerated amortization on the Goodwill, part of the intangible asset Concession right, as in 2010 the asset is completely amortized. As a result of the altered intangible asset amortization assessment the intangible assets amortization costs for the period 2011 - 2025 will decrease by BGN 441 thousand a year.

## 16. Intangible assets (continued)

### Acquired assets

The major acquisitions of intangible assets in 2010 relate to the Concession right and amount to BGN 45,358 thousand (2009: BGN 49,393 thousand). The main components are listed below:

| <i>In thousands of BGN</i>                 | 2010          | 2009          |
|--|---------------|---------------|
| Water supply network and house connections | 19,214        | 19,626        |
| Water Waste Treatment Plant Koubratovo     | 5,318         | 15,523        |
| Sewerage and house connections             | 15,252        | 10,564        |
| Hydrants                                   | 2,080         | 1,403         |
| Water meters                               | 1,773         | 1,180         |
| Other improvements                         | 1,721         | 1,097         |
|  | <u>45,358</u> | <u>49,393</u> |

### Assets under construction

As at 31 Dec 2010 the major intangible assets under construction which relate to Concession Right amount to BGN 27,790 thousand (2009: BGN 25,142 thousand). The most significant of them and are listed below:

| <i>In thousands of BGN</i>   | 2010          | 2009          |
|--|---------------|---------------|
| Second stage of strengthening of Beli Iskar Dam  | 381           | 381           |
| Waste Water Treatment Station  | 397           | 757           |
| Construction of water main system, water-main net model and DMA zones for reduction of unaccounted for water | 12,614        | 8,732         |
| Chlorinating stations  | 415           | 271           |
| Construction of sewerage mains and sewerage model  | 10,125        | 9,051         |
| Potable Water Treatment Stations   | 734           | 3,397         |
| Impounding Structures  | 3,124         | 2,553         |
|  | <u>27,790</u> | <u>25,142</u> |

### Assets pledged as collateral

The Group has pledged all its present and future non-current assets in respect of secured bank loan "A".

### Capitalized borrowing costs

The amount of borrowing costs capitalized during the period is BGN 22,981.73. The capitalization rate used to determine the amount of borrowing costs eligible for capitalization is 5.44%.

## 17. Inventories

| <i>In thousands of BGN</i>         | 2010         | 2009         |
|------------------------------------|--------------|--------------|
| Spare parts and consumables        | 3,165        | 2,798        |
| Impairment to net realizable value | (1,145)      | (991)        |
|                                    | <u>2,020</u> | <u>1,807</u> |

### Inventories pledged as collateral

The Group has pledged all its present and future movables in respect of secured bank loan "A", including raw materials and inventories.

17. Inventories (continued)

Stock write-down

| <i>In thousands of BGN</i>                 | 2010  | 2009 |
|--|-------|------|
| Balance at 1 January                       | 991   | 973  |
| Accrual of stock write-down of inventories | 154   | 18   |
| Reversed write-down of wasted inventories  | -     | -    |
| Reversed write-down of used inventories    | -     | -    |
| Written off stock provision                | -     | -    |
| Balance at 31 December                     | 1,145 | 991  |

18. Trade and other receivables

| <i>In thousands of BGN</i>             | Note | 2010     | 2009     |
|--|------|----------|----------|
| Trade and other receivables            |      | 69,079   | 63,361   |
| Impairment losses on trade receivables |      | (39,193) | (34,369) |
| Related parties receivables            | 30   | -        | 50       |
| Court receivables                      |      | 3,538    | 1,684    |
| Impairment losses on court receivables |      | (3,361)  | (1,599)  |
|  |      | 30,063   | 29,127   |
| Other receivables                      |      | 764      | 51       |
| Prepayments                            |      | 1,465    | 2,663    |
|  |      | 2,229    | 2,714    |
|  |      | 32,292   | 31,841   |

In 2010 receivables with 5-year validity period that was completed, amounting to BGN 2,800 thousand. (2009: BGN 1,548 thousand), have been written off. For detailed information about changes in receivables' impairment see note 26 - *Financial Instruments*.

*Accounts receivable pledged as collateral*

The Group has pledged all its accounts receivable, to be collected in the future in any local currency bank account, general receivables accounts from any party and insurance receivables related to any account receivable under the requirements of bank loan "A".

By a bailment contract signed by the Group in relation to bank loan "C", current and future receivables of the Group amounting at a minimum of EUR 200 thousand have been pledged as collateral.

The Group's exposure to interest rate risk and the sensitivity analysis of all financial assets and liabilities are reported in Note 26 - *Financial Instruments*.

*Prepayments include:*

| <i>In thousands of BGN</i>   | 2010  | 2009  |
|--|-------|-------|
| Insurance  | 1,125 | 1,054 |
| Licenses   | 101   | 71    |
| Subscriptions  | 38    | 12    |
| Advance payment on waste water preliminary mechanical treatment facilities | -     | 1,186 |
| Other  | 201   | 340   |
|  | 1,465 | 2,663 |

19. Cash and cash equivalents

*In thousands of BGN*

|  | 2010          | 2009          |
|--|---------------|---------------|
| Cash on hand   | 49            | 45            |
| Local currency   | 32            | 31            |
| Foreign currency   | 17            | 14            |
| Cash at banks  | 17,912        | 16,434        |
| Local currency   | 17,597        | 13,772        |
| Foreign currency   | 315           | 2,662         |
| Cash and cash equivalents in the statement of cash flows | <u>17,961</u> | <u>16,479</u> |

*Cash at banks pledged as collateral*

The Group has pledged all its bank accounts under the requirements of a bank loan "A". These accounts will be used for collection of cash from accounts receivable plus any insurance claims payable to the Group in relation to insurance against losses and potential damages.

The Group's exposure to Interest rate risk and the sensitivity analysis of all financial assets and liabilities are stated in Note 26.

20. Share capital and reserves

*In thousands of shares*

|                                       | Ordinary shares |              |
|---------------------------------------|-----------------|--------------|
|                                       | 2010            | 2009         |
| Issued at 1 January                   | 8,884           | 8,884        |
| Issued as at 31 December – fully paid | <u>8,884</u>    | <u>8,884</u> |

As at 31 December 2010 the Group's share capital includes 8,884,435 ordinary shares (2009: 8,884,435). All shares have a nominal value of BGN 1. Shareholders in the Group as at 31 December 2010 are:

- United Utilities (Sofia) BV – 6,850,000 ordinary shares (77.1 %);
- Vodospobdyavane i kanalizatsia AD - 2,034,435 ordinary shares (22.9 %).

With a pledged endorsement dated 19 December 2000 in favor of the bank which provided secured bank loan "A", 6,850,000 ordinary shares have been pledged and this fact is inscribed in the shareholders' book based on a contract for pledge of shares.

The holders of ordinary shares possess dividend rights and voting rights at the Group's General Shareholders Meeting of one vote for each share in their possession. All shares rank equally with regard to the Group's residual assets.

*Legal reserves*

Legal reserves represent 10% of the profit after tax in accordance with the requirements of art. 246 of the Bulgarian Commercial Act.

*Hedge Reserves*

Hedge reserve includes the effective part of the net change in fair value of instruments hedging cash flows related to hedge deals, which have not occurred yet

## 21. Interest-bearing loans and borrowings

This note provides information on the contractual terms of the Group's interest-bearing loans and borrowings, which are accounted for at amortized cost. For further information on the Group's exposition to interest, currency and liquidity risk, see note 26.

| <i>In thousands of BGN</i>     | 2010           | 2009           |
|--------------------------------|----------------|----------------|
| <b>Non-current liabilities</b> |                |                |
| Loans at nominal value         | 137,087        | 136,475        |
| Amortization                   | (1,596)        | (1,892)        |
| Loans at amortized cost        | <u>135,491</u> | <u>134,583</u> |
| Finance lease liabilities      | 1,035          | 1,275          |
|                                | <u>136,526</u> | <u>135,858</u> |
| <b>Current liabilities</b>     |                |                |
| Loans at nominal value         | 9,498          | 4,517          |
| Amortization                   | (550)          | (558)          |
| Loans at amortized cost        | <u>8,948</u>   | <u>3,959</u>   |
| Finance lease liabilities      | 704            | 746            |
|                                | <u>9,652</u>   | <u>4,705</u>   |

In accordance with the loan agreement 'A' the Group has the obligation to maintain an Annual Debt Service Coverage Ratio (ADSCR) of 1.3:1. The ADSCR should show that at any Calculation Date (31 December) the Free Cash Flow for the twelve month period immediately preceding such Calculation Date divided by the aggregate amount of principal and interest payments falling due and payable during such period should be 1.3:1.

In accordance with the Amended and Restated Loan Agreement (ARLA) the calculation of the annual debt service coverage ratio is calculated by the bank by the means of a model based on the actual and estimated values as at the date of preparation. As per the latest version of the model the estimated annual ADSCR for 2010 is 2.38:1.

The Group has the obligation of submitting the verified annual consolidated financial statements within 120 calendar days of the beginning of the year to the bank. The bank updates the calculations of the ratio in a new version of their model.

### Terms and debt repayment schedule

| <i>In thousands of BGN</i> | Currency | Nominal interest rate | Maturity | 31 December 2010 |                | 31 December 2009 |                |
|----------------------------|----------|-----------------------|----------|------------------|----------------|------------------|----------------|
|                            |          |                       |          | Nominal value    | Book value     | Nominal value    | Book value     |
| Loan „A”                   | EUR      | 1.75 % + 6m EURIBOR   | 2023     | 74,381           | 72,494         | 68,327           | 66,290         |
| Loan „B”                   | EUR      | 5.95% + 6m EURIBOR    | 2015     | 71,117           | 70,859         | 71,117           | 70,706         |
| Loan „C”                   | EUR      | 2.50% + 3m EURIBOR    | 2013     | 1,087            | 1,086          | 1,549            | 1,546          |
| Finance lease liabilities  |          |                       |          | 1,739            | 1,739          | 2,021            | 2,021          |
|                            |          |                       |          | <u>148,324</u>   | <u>146,178</u> | <u>143,014</u>   | <u>140,563</u> |

21. Interest-bearing loans and borrowings (continued)

Finance lease liabilities

The financial lease liabilities are due as follows:

|                                | Future minimum<br>lease payments | Interest   | Present value of<br>future lease<br>payments | Future minimum<br>lease payments | Interest   | Present value of<br>future lease<br>payments |
|--------------------------------|----------------------------------|------------|--|----------------------------------|------------|--|
| <i>In thousands of<br/>BGN</i> | 2010                             | 2010       | 2010   | 2009                             | 2009       | 2009   |
| Less than 1 year               | 817                              | 113        | 704  | 869                              | 123        | 746  |
| Between 1 and 2<br>years       | 666                              | 70         | 596  | 913                              | 78         | 835  |
| 2 to 5 years                   | 490                              | 51         | 439  | 516                              | 76         | 440  |
|                                | <u>1,973</u>                     | <u>234</u> | <u>1,739</u>                                 | <u>2,298</u>                     | <u>277</u> | <u>2,021</u>                                 |

22. Deferred tax assets and liabilities

The net deferred tax assets are recognized in the consolidated financial statements. The reporting of the existing deferred assets and liabilities is presented below:

|                                    | Assets       | Liabilities    | Net          | Assets       | Liabilities    | Net          |
|------------------------------------|--------------|----------------|--------------|--------------|----------------|--------------|
| <i>In thousands of BGN</i>         | 2010         | 2010           | 2010         | 2009         | 2009           | 2009         |
| Property, plant and equipment      | -            | (1,416)        | (1,416)      | -            | (1,698)        | (1,698)      |
| Inventories                        | 114          | -              | 114          | 99           | -              | 99           |
| Trade receivables                  | 4,255        | -              | 4,255        | 3,448        | -              | 3,448        |
| Provisions                         | 271          | -              | 271          | 74           | -              | 74           |
| Accrual for unused paid leave      | 46           | -              | 46           | 108          | -              | 108          |
| Non-current personnel income       | 96           | -              | 96           | 92           | -              | 92           |
| Current personnel income           | 156          | -              | 156          | 130          | -              | 130          |
| Hedging instruments                | 860          | -              | 860          | 740          | -              | 740          |
| Financing from EBRD                | 28           | -              | 28           | -            | -              | -            |
| Trade payables                     | 371          | -              | 371          | 477          | -              | 477          |
| Deferred tax assets/ (liabilities) | <u>6,197</u> | <u>(1,416)</u> | <u>4,781</u> | <u>5,168</u> | <u>(1,698)</u> | <u>3,470</u> |

In determining the current and deferred taxes the Group has adopted as an accounting basis that stated in Significant accounting policies - Note 3. The deferred tax for 2010 is calculated by using the tax rate applicable to the Group which is the effective income tax rate for 2010 - 10%.

## 22. Deferred tax assets and liabilities (continued)

| Changes throughout the year        |                                    | <i>In thousands of BGN</i>          |   |   |                                  |   |                                   |
|------------------------------------|------------------------------------|-------------------------------------|---|---|----------------------------------|---|-----------------------------------|
|                                    | Balance as at<br>1 January<br>2009 | Recognized<br>in profit<br>and loss | Recognized in<br>other<br>comprehensive<br>income | Balance as<br>at 31<br>December<br>2009 | Recognized in<br>profit and loss | Recognized in<br>other<br>comprehensive<br>income | Balance as at 31<br>December 2010 |
| Property, plant and equipment      | (1,840)                            | 142                                 | -   | (1,698)                                 | 282                              | -   | (1,416)                           |
| Inventories                        | 97                                 | 2                                   | -   | 99                                      | 15                               | -   | 114                               |
| Trade receivables                  | 2,857                              | 591                                 | -   | 3,448                                   | 807                              | -   | 4,255                             |
| Provisions                         | 254                                | (180)                               | -   | 74                                      | 197                              | -   | 271                               |
| Accrual for unused paid leave      | 94                                 | 14                                  | -   | 108                                     | (62)                             | -   | 46                                |
| Non-current personnel income       | 75                                 | 17                                  | -   | 92                                      | 4                                | -   | 96                                |
| Current personnel income           | 91                                 | 39                                  | -   | 130                                     | 26                               | -   | 156                               |
| Hedging instruments                | 232                                | -                                   | 508   | 740                                     | -                                | 120   | 860                               |
| Financing from EBRD                | -                                  | -                                   | -   | -                                       | 28                               | -   | 28                                |
| Trade payables                     | 642                                | (165)                               | -   | 477                                     | (106)                            | -   | 371                               |
| Deferred tax assets/ (liabilities) | 2,502                              | 460                                 | 508   | 3,470                                   | 1,191                            | 120   | 4,781                             |



23. Trade and other payables

| <i>In thousands of BGN</i>                                | 2010          | 2009          |
|---|---------------|---------------|
| Trade payables  | 30,399        | 12,717        |
| Guarantees  | 1,962         | 1,788         |
| Trade payables  | <u>32,361</u> | <u>14,505</u> |
| Payables to employees                                     | 3,174         | 3,248         |
| Social security payables                                  | 390           | 700           |
| Trade payables as per Contract with Municipality of Sofia | 1,435         | 1,850         |
| Payables for water usage tax                              | 4,813         | 4,918         |
| Other payables and accruals                               | 6,516         | 6,317         |
| Other liabilities   | <u>16,328</u> | <u>17,033</u> |
|   | <u>48,689</u> | <u>31,538</u> |

Other payables and accruals include:

| <i>В хиляди лева</i>                                      | 2010         | 2009         |
|---|--------------|--------------|
| Insurance   | 587          | 1,124        |
| ISPA  | 2,420        | 1,562        |
| Advance payment on Emissions Reduction Purchase Agreement | 2,093        | 3,613        |
| Others  | 1,416        | 18           |
|   | <u>6,516</u> | <u>6,317</u> |

The Group's exposure to Interest rate risk and the sensitivity analysis of all financial assets and liabilities are stated in Note 26 – Financial Instruments

24. Provisions

| <i>In thousands of BGN</i>  | 2010         | 2009       |
|---|--------------|------------|
| Provision for court liabilities   | 1,478        | 740        |
| Provision of rent of rooms for hydrophores  | 554          | -          |
| Provision for constructive liabilities as per Contract for purchase of carbon credits | 663          | -          |
|   | <u>2,695</u> | <u>740</u> |

In addition to note 3 j the following summary can be made:

**Regarding the provision for court liabilities** – provisions are made for legal claims of contractual nature – indemnification of claimed damage due to emergencies related to assets, operated by the Company, claims for refunds of amounts paid for assets construction, as well as claims for refund of asserted unduly paid bills.

Another group of legal cases that are provisioned for are ones of labor legislative character and most often relate to potential payments of unemployment indemnifications to ex-employees in case the court pronounces the termination of the employment illegal.

Yet another group form the provisions related to the imposing of administrative sanctions, mostly due to possible violations connected with the Company's prevailing situation on the market. The most significant amounts for provisions for court liabilities are related to the last group and to a part of the claims for indemnification of damage. Generally it is expected that some of the cases related to the provisions accrued will end by the end of 2011, although there is a possibility that some will continue in the next financial year.

**Regarding the provision for rent of rooms for hydrophores** - by decision No 137/17.03.2011 of Sofia Municipal Council an agreement between the Company and ViK EAD was approved. The agreement is for the payment of a compensatory indemnification for the use of assets owned by ViK EAD by Sofiyska Voda AD until 30 September 2010. By the same decision the Sofia Municipal Council stated that an additional compensatory indemnification for the use of assets owned by ViK EAD by Sofiyska Voda AD during the period 1 October 2010 – 17 March 2011 is not due and will not be sought. The approved by the Sofia Municipal Council agreement is to be signed and the provisioned amount to be transferred.

**Regarding the provision for constructive liabilities as per Contract for purchase of carbon credits** – in general, the payment of the provisioned amount is possible in the last year of the contract (2012) when all facts will be clear, in particular whether the Company will continue being unable to produce the contracted volumes of carbon emissions. It is expected that in 2011 Sofiyska Voda AD will initiate a renegotiation with the European Bank for Reconstruction and Development in order to describe adequately the real volumes of emissions, which can be produced. This would result in decreasing the risk of the Company being unable to produce the contracted volumes of carbon emissions.

The change in provisions throughout the year is presented below:

| <i>In thousands of BGN</i>  | Balance at 1<br>January 2010 | Provisions<br>made<br>during the<br>year | Provisions<br>used<br>during the<br>year | Cancelled<br>provisions<br>during the<br>year | Discount<br>effect | Balance at<br>31<br>December<br>2010 |
|---|------------------------------|--|--|---|--------------------|--------------------------------------|
| Provision for court liabilities   | 740                          | 1,478                                    | (250)                                    | (490)   | -                  | 1,478                                |
| Provision for constructive liabilities as per Contract for purchase of carbon credits | -                            | 663                                      | -  | -   | -                  | 663                                  |
| Provision of rent of rooms for hydrophores  | -                            | 554                                      | -  | -   | -                  | 554                                  |
|   | <u>740</u>                   | <u>2,695</u>                             | <u>(250)</u>                             | <u>(490)</u>                                  | <u>-</u>           | <u>2,695</u>                         |

25. Tax liabilities

| <i>In thousands of BGN</i> | 2010         | 2009       |
|----------------------------|--------------|------------|
| Corporate tax liability    | 1,032        | -          |
| Other tax liabilities      | 129          | 327        |
|                            | <u>1,161</u> | <u>327</u> |

26. Financial instruments

Credit risk

The carrying amount of the financial instruments represents the maximum credit exposure. This maximum credit exposure at the balance sheet date is:

| <i>In thousands of BGN</i>  | Book value<br>31 December 2010 | Book value<br>31 December 2009 |
|-----------------------------|--------------------------------|--------------------------------|
| Trade and other receivables | 30,217                         | 29,245                         |
| Loans to related party      | -                              | 50                             |
| Cash and cash equivalents   | 17,961                         | 16,479                         |
|                             | <u>48,178</u>                  | <u>45,774</u>                  |

The cost of the trade receivables by client type reflects the maximum credit exposure as at the reporting date and amounts to:

| <i>In thousands of BGN</i> | Cost<br>31 December 2010 | Cost<br>31 December 2009 |
|----------------------------|--------------------------|--------------------------|
| State budget organizations | 655                      | 829                      |
| Commercial customers       | 7,121                    | 6,361                    |
| Domestic population        | 52,910                   | 47,488                   |
| Other customers            | 12,085                   | 10,501                   |
|                            | <u>72,771</u>            | <u>65,179</u>            |

26. Financial instruments (continued)

The time aging structure of trade receivables of the Group at the balance sheet date is:

| <i>In thousands of BGN</i>   | 2010          |                 | 2009          |                 |
|------------------------------|---------------|-----------------|---------------|-----------------|
|                              | Cost          | Impairment      | Cost          | Impairment      |
| Not yet due                  | 16,799        | -               | 15,490        | -               |
| Overdue 30 days              | 3,532         | (382)           | 3,654         | (183)           |
| Overdue from 31 to 120 days  | 7,472         | (1,231)         | 7,264         | (868)           |
| Overdue from 121 to 210 days | 5,841         | (2,396)         | 5,236         | (1,954)         |
| Overdue from 211 to 270 days | 2,870         | (2,360)         | 2,987         | (2,510)         |
| Overdue from 271 to 360 days | 4,296         | (4,224)         | 3,838         | (3,743)         |
| Overdue more than 1 year     | 31,961        | (31,961)        | 26,710        | (26,710)        |
|                              | <u>72,771</u> | <u>(42,554)</u> | <u>65,179</u> | <u>(35,968)</u> |

Group's receivables impairment at the report date, including court receivables impairment is:

| <i>In thousands of BGN</i>             | 2010            | 2009            |
|--|-----------------|-----------------|
| Balance in the beginning of the period | (35,968)        | (29,242)        |
| Accruals during the period             | (9,386)         | (8,274)         |
| Cancelled                              | -               | -               |
| Written-off                            | 2,800           | 1,548           |
| Balance in the end of the period       | <u>(42,554)</u> | <u>(35,968)</u> |

Liquidity risk

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the impact of netting agreements:

31 December 2010

| <i>In thousands of BGN</i>                  | Book value     | Contracted cash flows | Up to 1 year    | Between 1 - 2 years | Between 2 - 5 years | More than 5 years |
|---|----------------|-----------------------|-----------------|---------------------|---------------------|-------------------|
| <b>Non-derivative financial liabilities</b> |                |                       |                 |                     |                     |                   |
| Loan „A“ (1.75% + 6 month EURIBOR)          | 72,494         | (88,399)              | 4,722           | (22,582)            | (21,497)            | (49,042)          |
| Loan „B“ (5.95% +6 month EURIBOR)           | 70,859         | (92,949)              | (5,136)         | (10,286)            | (77,527)            | -                 |
| Loan „C“ (2.5% + 3 month EURIBOR)           | 1,086          | (1,138)               | (465)           | (673)               | -                   | -                 |
| Liabilities to related parties              | 714            | (714)                 | (714)           | -                   | -                   | -                 |
| Finance lease liabilities                   | 1,739          | (1,973)               | (817)           | (667)               | (489)               | -                 |
| Trade and other payables                    | 48,689         | (48,689)              | (48,689)        | -                   | -                   | -                 |
|   | <u>195,581</u> | <u>(233,862)</u>      | <u>(51,099)</u> | <u>(34,208)</u>     | <u>(99,513)</u>     | <u>(49,042)</u>   |
| <b>Derivative financial liabilities</b>     |                |                       |                 |                     |                     |                   |
| SWAP Contracts for interest risk hedging    | 8,599          | (8,599)               | (8,599)         | -                   | -                   | -                 |
|   | <u>8,599</u>   | <u>(8,599)</u>        | <u>(8,599)</u>  | <u>-</u>            | <u>-</u>            | <u>-</u>          |

26. Financial instruments (continued)

Liquidity risk  
31 December 2009

| <i>In thousands of BGN</i>                  | Book value     | Contracted cash flows | Up to 1 year    | Between 1 - 2 years | Between 2 - 5 years | More than 5 years |
|---|----------------|-----------------------|-----------------|---------------------|---------------------|-------------------|
| <b>Non-derivative financial liabilities</b> |                |                       |                 |                     |                     |                   |
| Loan „A” (1.75% +6 month EURIBOR)           | 66,291         | (83,840)              | 16,029          | (18,699)            | (32,339)            | (48,831)          |
| Loan „B” (5.95% +6 month EURIBOR)           | 70,707         | (97,077)              | (4,944)         | (9,902)             | (82,231)            | -                 |
| Loan „C” (2.5% +3 month EURIBOR)            | 1,546          | (1,641)               | (504)           | (915)               | (222)               | -                 |
| Liabilities to related parties              | 9,351          | (9,351)               | (9,351)         | -                   | -                   | -                 |
| Finance lease liabilities                   | 2,021          | (2,299)               | (869)           | (913)               | (517)               | -                 |
| Trade and other payables                    | 27,014         | (27,014)              | (27,014)        | -                   | -                   | -                 |
|   | <u>176,930</u> | <u>(221,222)</u>      | <u>(26,653)</u> | <u>(30,429)</u>     | <u>(115,309)</u>    | <u>(48,831)</u>   |
| <b>Derivative financial liabilities</b>     |                |                       |                 |                     |                     |                   |
| SWAP Contracts for interest risk hedging    | 7,398          | (7,398)               | (7,398)         | -                   | -                   | -                 |
|   | <u>7,398</u>   | <u>(7,398)</u>        | <u>(7,398)</u>  | -                   | -                   | -                 |

Currency risk

|                                       | 31 December 2010 |            |              | 31 December 2009 |             |              |
|---------------------------------------|------------------|------------|--------------|------------------|-------------|--------------|
|                                       | EUR '000         | GBP '000   | USD '000     | EUR '000         | GBP '000    | USD '000     |
| Trade payables                        | (4,222)          | (1)        | (653)        | (4,747)          | (15)        | (653)        |
| Interest-bearing loans and borrowings | (73,873)         | -          | -            | (70,836)         | -           | -            |
| Gross Balance Exposure                | <u>(78,095)</u>  | <u>(1)</u> | <u>(653)</u> | <u>(75,583)</u>  | <u>(15)</u> | <u>(653)</u> |

The following significant exchange rates are applied during these periods:

|       | Average period FX rate |          | FX rate at balance sheet date |         |
|-------|------------------------|----------|-------------------------------|---------|
|       | 2010                   | 2009     | 2010                          | 2009    |
| USD 1 | 1.4779                 | 1.405526 | 1.59386                       | 1.36409 |
| GBP 1 | 2.2823                 | 2.197192 | 2.3926                        | 2.16353 |

Sensitivity Analysis

A 10 % increase of the exchange rate at 31 December in relation to the currencies shown below would increase (decrease) the capital and profit or losses with the amounts written below. The analysis makes the assumptions that all other variables; especially the interest rates are fixed. The analysis for 2009 is done on the same basis.

| <i>In thousands of BGN</i> | Statement of comprehensive income | Statement of comprehensive income |
|----------------------------|-----------------------------------|-----------------------------------|
|                            | 31 December 2010                  | 31 December 2009                  |
| USD                        | (97)                              | (92)                              |
| GBP                        | -                                 | (3)                               |

**26. Financial instruments (continued)**

A 10 % decrease of BGN against the above stated currencies as at 31 December would have the same, as amounts, but opposite effect, making the same assumption that all other variables are fixed

Bulgaria operates under the conditions of a Currency board. The exchange rate of BGN is currently fixed at 1.95583 BGN for 1 EUR. Most deals, not undertaken in BGN are carried out in EUR.

**Interest rate risk**

*Profile*

As at the date of reporting the interest rate profile of financial instruments is:

| <i>In thousands of BGN</i>                  | 2010             | 2009             |
|---|------------------|------------------|
| <b>Instruments on a fixed rate basis</b>    |                  |                  |
| Financial assets                            | 17,912           | 16,434           |
| Financial liabilities                       | (288)            | (125)            |
|   | <u>17,624</u>    | <u>16,309</u>    |
| <b>Instruments on a floating rate basis</b> |                  |                  |
| Financial assets                            | 30,217           | 29,245           |
| Financial liabilities                       | (145,890)        | (140,439)        |
|   | <u>(115,673)</u> | <u>(111,194)</u> |

**Interest rate risk**

**Sensitivity analysis against the fair value of instruments with fixed interest rate**

The Group has not accrued financial assets and liabilities with fixed interest rate at fair value, accounted through profits and loss in the Statement of comprehensive income. The Group is a party to financial instruments contracts (Interest swaps) as hedge instruments according the fair value hedging model. Therefore, the change of the interest rates for the period between the signing of the SWAP contracts and the reporting date does not result in any profit or loss.

**Sensitivity analysis against the fair value of instruments with variable interest rate**

A change of the interest rates by 100 basis points on 31 December would increase / decrease the equity and profit or loss with the amounts below. An assumption is made during the analysis that all other variables, especially the currency exchange rates are relatively constant. For 2009 the analysis is made on the same basis.

| <i>Effects in thousands of BGN</i>                  | <b>Profit or loss</b>            |                                  | <b>Equity</b>                    |                                  |
|---|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
|   | <b>100 basis points increase</b> | <b>100 basis points decrease</b> | <b>100 basis points increase</b> | <b>100 basis points decrease</b> |
| <b>31 December 2010</b>                             |                                  |                                  |                                  |                                  |
| Financial assets with floating interest rate        | 301                              | (301)                            | -                                | -                                |
| Financial liabilities with floating interest rate   | (1,507)                          | 1,507                            | -                                | -                                |
| Financial instrument hedging the interest rate risk | 1,495                            | (1,495)                          | -                                | -                                |
| Cash flow sensitivity (net)                         | <u>289</u>                       | <u>(289)</u>                     | -                                | -                                |

26. Financial instruments (continued)

31 December 2009

|   |         |         |   |   |
|---|---------|---------|---|---|
| Financial assets with floating interest rate        | 292     | (292)   | - | - |
| Financial liabilities with floating interest rate   | (1,404) | 1,404   | - | - |
| Financial instrument hedging the interest rate risk | 1,314   | (1,314) | - | - |
| Cash flow sensitivity (net)                         | 202     | (202)   | - | - |

Fair values compared to book values

The fair values of financial assets and liabilities, as well as their book values are stated in the Statement of financial position as follows:

| <i>In thousands of BGN</i>   | 31 December 2010 |                  | 31 December 2009 |                  |
|------------------------------|------------------|------------------|------------------|------------------|
|                              | Book value       | Fair value       | Book value       | Fair value       |
| Trade and other receivables  | 30,217           | 30,217           | 29,211           | 29,211           |
| Cash and cash equivalents    | 17,961           | 17,961           | 16,479           | 16,479           |
| Loans from related parties   | (70,859)         | (70,859)         | (136,998)        | (136,998)        |
| Loan „A”                     | (72,494)         | (72,494)         | -                | -                |
| Loan „B”                     | (1,086)          | (1,086)          | (1,546)          | (1,546)          |
| Trade and other payables     | (48,689)         | (48,689)         | (27,014)         | (27,014)         |
| Payables to related party    | (714)            | (714)            | (9,351)          | (9,351)          |
| Payables on financial lease  | (1,739)          | (1,739)          | (2,021)          | (2,021)          |
| Hedging financial instrument | (8,599)          | (8,599)          | (7,398)          | (7,398)          |
|                              | <u>(156,002)</u> | <u>(156,002)</u> | <u>(138,638)</u> | <u>(138,638)</u> |

As at 31 December 2010 the Group has liabilities on loan „A” and loan “B” at an amortized value of BGN 72,494 thousand and BGN 70,859 thousand. With a SWAP transaction letter agreement from 12 November 2008 the Group fixed its exposure to the six-month EURIBOR for the previously stated loans, as concerning loan “A” the fixed interest rate is 3.694%, and concerning loan “B” the fixed interest rate is 3.650% until 2013 (for the period of the approved Business Plan 2009-2013). Both contracts are for a 5-years period.

**27. Liabilities for retirement compensation**

*Present value of the liability for payment of defined benefit scheme for retirement*

| <i>In thousands of BGN</i>  | <b>2010</b> | <b>2009</b> |
|---|-------------|-------------|
| Present value of the liability on 1 January   | 922         | 751         |
| Interest expense  | 54          | 54          |
| Current labour cost   | 117         | 120         |
| Actuarial loss  | 112         | 193         |
| Restructuring effect  | -           | -           |
| Paid compensations to retired employees   | (250)       | (196)       |
| Present value of the liability on 31 December   | <u>955</u>  | <u>922</u>  |
| Liability recognized in the Statement of financial position as at 31 December, including: | 955         | 922         |
| Short – term liabilities for retirement compensation                                      | 183         | 324         |
| Long – term liabilities for retirement compensation                                       | 772         | 598         |

*Expenses recognized in the income statement*

| <i>In thousands of BGN</i> | <b>2010</b> | <b>2009</b> |
|----------------------------|-------------|-------------|
| Current labor cost         | 117         | 120         |
| Interest expense           | 54          | 54          |
| Actuarial loss             | 112         | 193         |

**Actuarial assumptions**

|                                       | <b>2010</b> | <b>2009</b> |
|---------------------------------------|-------------|-------------|
| Discount rate at 31 December          | 5.74%       | 6.5%        |
| Salary increase (annual for 10 years) | 3%          | 3.5%        |
| Employee turnover                     | 12.5%       | 12.5%       |

The actuarial assumptions for death rates are based on the National Statistics Institute's population mortality tables. For the purposes of the discounting effective annual interest rate  $i = 5.74\%$  is used. This rate is based on analysis of the offered long-term investment instruments on the Bulgarian stock market (securities, municipality bonds, etc.).



27. Liabilities for retirement compensation (continued)

*Actuarial assumptions*

|   |   |   |
|---|---|---|
| <i>In thousands of BGN</i>                          | <b>100 basis points<br/>increase of salaries<br/>growth</b>   | <b>100 basis points<br/>decrease of<br/>salaries growth</b>   |
| Effect on the liability for retirement compensation | 15  | (15)  |
| <i>In thousands of BGN</i>                          | <b>100 basis points<br/>increase of interest<br/>growth</b>   | <b>100 basis points<br/>decrease of<br/>interest growth</b>   |
| Effect on the liability for retirement compensation | (16)  | 16  |
| <i>In thousands of BGN</i>                          | <b>100 basis points<br/>increase of employee<br/>turnover</b> | <b>100 basis points<br/>decrease of employee<br/>turnover</b> |
| Effect on the liability for retirement compensation | (24)  | 24  |
| <i>In thousands of BGN</i>                          | <b>100 basis points<br/>increase of mortality rate</b>        | <b>100 basis points<br/>decrease of mortality<br/>rate</b>    |
| Effect on the liability for retirement compensation | (8)   | 8   |

## 28. Contingent liabilities

### (a) *Bank guarantees*

On 7 December 2010 a good performance bank guarantee No. 02502-1063911PEE is issued in relation to the contractual obligations of Sofiyska Voda AD as per the Concession Agreement. It amounts to USD 750 thousand and is issued by Societe Generale S.A., Paris, valid until 7 December 2011.

On 26 October 2010 a bank guarantee issued by Sofiyska Voda AD in favour of the National Electric Company EAD has been renewed and the amount increased to BGN 19 thousand (the amount is revised on annual basis according to the electricity consumption volumes from the previous year). The change is effective as of 30 January 2011 and the guarantee will be valid until 29 January 2012.

After revision of the guarantee deposit amount in favour of Energy System Operator (ESO) on 1 April 2009, in 2010 the Group has not received any notification letters that request additional funds to be transferred to the special account in Alianz Bank Bulgaria AD. As at 31 December 2010 the balance of this account amounts to BGN 8,900.

### (b) *Infrastructure*

In accordance with a contract dated 08 July 2005 between the Republic of Bulgaria, presented by the Minister of the Economy and Energy (the State) and Business Park Sofia EOOD and Lindner AG, Germany (the Investor), the State will finance the construction and rehabilitation of elements of the technical infrastructure within the boundaries of "Sofia Park" project. In accordance with this contract Business Park Sofia EOOD and Lindner AG, Germany are obliged to make investments in project "Sofia Park" in compliance with an approved investment plan, which includes buildings, roads and technical infrastructure. The total amount of the state participation under the conditions of the contracts is BGN 13,650 thousand, including water main infrastructure in the amount of BGN 6,103 thousand.

A decision of the Commission for Protection of Competition from October 2005 states that the State financial obligations will not represent state aid only if within three months from the construction of the new water main infrastructure, the Concession Agreement is annexed with the aim to recover the amount of the water main infrastructure expenditure from "Sofiyska Voda" AD to the National Budget.

The Group has made an appeal to the Supreme court against the decision of the Commission for Protection of Competition. The final decision of the Supreme court (dated 07 June 2007) rejects the appeal of "Sofiyska Voda" AD.

The construction works on the water-main and sewerage system, related to the decisions of both the Commission for Protection of Competition and the Supreme Court have been completed and commissioned, however no services have been rendered yet and consequently no obligation has arisen for the Group, pursuant to the agreement with the Municipality of Sofia for reimbursement of equivalent claims related to the Concession Agreement.

At present the reimbursement of the prestations has not been calculated, despite the fact that the infrastructure was put into operation. The Municipality of Sofia (MoS) has made a commitment that the necessary documents will be handed in as soon as the internal rules and procedure for the transfer from the MoS to Sofiyska Voda AD of public assets for operation in correspondence with the procedure provided for in the Concession Agreement are finished. This is expected to happen in the period until 31 May 2011. After the documents are received, both parties – Municipality of Sofia and Sofiyska Voda AD - will calculate the prestation amount due in conformity with the formula stated in the Annex to the Second Additional Agreement to the Concession Contract.

## 29. Obligations for the acquisition of property, plant and equipment

As per the Concession Agreement with Sofia Municipality on 23 December 1999, the Group must implement a minimum capital investment during the first 15 years, as from the date this contract – amounting to not less than 150 million USD, based on the investment plan for the Concession period. Non-fulfilment of 75% (in value) of these capital investments, based on the investment plan for a period of two consecutive years may result in termination of the Concession Agreement by the Grantor.

This article from the contract has been amended with a Second additional annex to the Concession Agreement, signed on 19 January 2009. According to this additional annex to the Concession Agreement, a precondition for termination is a 75% non-fulfilment of the projected and approved investments by the State Commission for Energy and Water Regulation, in two consecutive years, during the same regulatory period and provided that the prices to allow for those investments have been approved by the Regulator.

In its decision Nr: BP-008/ 09.10.2008 the State Commission for Energy and Water Regulation approved the Business Plan of Sofiyska Voda for the second regulatory period 2009 – 2013. This decision also approved the proposed Investment programme of Sofiyska Voda AD amounting to BGN 240 million.

The investment obligations of Sofiyska Voda AD are presented below:

| <i>In thousands of BGN</i> | 2011   | 2012   | 2013   | Total   |
|----------------------------|--------|--------|--------|---------|
| Business Plan obligations  | 41,676 | 43,028 | 51,052 | 135,756 |

The above investment commitment considerably exceeds the Group's obligations as per the Concession Agreement amended by First and Second Additional Agreements, which obligations are shown in the table below. The obligations under the Concession Agreement are included in the amounts of the obligations as per the approved Business Plan.

| <i>In thousands of BGN</i>                 | 2011   | 2012   | 2013   | Total  |
|--|--------|--------|--------|--------|
| Including Concession Agreement obligations | 13,550 | 10,775 | 11,419 | 35,744 |

The Investment Program of Sofiyska Voda AD has been prepared in compliance with the Business Plan technical parameters, including: the forecast consumption volumes, the unaccounted-for-water (UFW) reduction programme, capital maintenance and reconstruction of the water mains needs, construction of new service connections and in order to achieve the long-term key performance indicators for the water and sewerage service levels. The implementation of the Investment Program will be financed by bank credit, ISPA financing and own funds.

The implementation of the above mentioned investments is dependent on the prices of the services, rendered by the Group. In the Business Plan, approved by SCEWR, there is an assumption for the period 2010-2013 of annual water supply service price increase by 10% and annual sewerage and waste water treatment services price increase by 15%, or an annual 11.5% increase of the complex service price on average. Sofiyska Voda AD can implement the full capacity of its investment program only if the above mentioned projected increases are approved by SCEWR.

As notified in the note 32 as of 01 February 2011 the Group is already applying new complex price with increase from the previous year of 9.4%. Owing to circumstances beyond Sofiyska Voda's control, for the first time within the period of Business Plan 2009-2013, the tariff increase was adopted with a month's delay.

Given that price level, the Group investments planned for the year of 2011 amount to BGN 41.6 million.

### 30. Related parties

The Group has a related party relationship with its parent company – “United Utilities UU (Sofia) B.V.”, which holds 77,10% of the Group’s shares, as well as with the other companies in the Group.

The amount of the transactions and the receivables and payables to related parties are announced in Note 30 to the Consolidated Financial Statements of the Group for 2010.

#### *Change of ownership of Sofiyska Voda AD*

As per shares sales contract dated 12 June 2010 a few daughter companies of United Utilities International Ltd sell their shares in Sofiyska Voda AD’s major shareholder United Utilities UU (Sofia) BV to Veolia Water UK or its representative. Veolia Water UK nominates Veolia Voda S.A., address of headquarters Rue d’ Anjou, 52 – Paris 75008, to acquire all United Utilities International Ltd’s shares in United Utilities UU (Sofia) BV.

As per shares sales contract dated 29 October 2010, the European Bank for Reconstruction and Development sold its indirect share in United Utilities UU (Sofia) BV to a daughter company of United Utilities International Ltd and now it does not indirectly own any shares in Sofiyska Voda AD and is now just a creditor of the Group.

As per the amended and restated shares sales contract dated 5 November 2010, Veolia Voda S.A. acquired 100% of the shares of United Utilities UU (Sofia) BV, owned by daughter companies of United Utilities UK AD.

The transfer of all shares of United Utilities UU (Sofia) BV to Veolia Voda S.A. was completed on 9 November 2010. The change in the ownership of United Utilities UU (Sofia) BV does not need the agreement of Municipality of Sofia as per art.26 of the Concession Agreement, as far as it does not affect the existence and activity of United Utilities (Sofia) BV and the company continues being the major shareholder of Sofiyska Voda AD.

The ultimate parent company is Veolia Voda S.A.

The following transactions have taken place during 2010

30. Related parties (continued)

| Related party<br><i>In thousands of<br/>BGN</i> | Relation  | Transactions during the year                             | Balance as at 31 December 2010 |  |
|---|---|--|--------------------------------|--|
|   |   |  | Receivables                    | Payables   |
| United Utilities UU<br>(Sofia) BV               | Controls 77.10% of the<br>shares of "Sofiyska<br>Voda" AD | Loan provided<br>-<br>Accrued interest<br>5,087<br>Other |                                | 70,859<br>Liability for loan<br>received at<br>amortized cost<br>44<br>Other trade<br>payables |
| Veolia Voda S.A.                                | United Utilities UU<br>(Sofia) BV                         | Technical services rendered<br>669                       |                                | 669  |
| Vodosnabdyavane i<br>Kanalizatsia EAD           | Controls 22.90% of the<br>shares of Sofiyska Voda<br>AD   | Rent<br>16   | -                              | 1  |
|   |   | Total:   | <u>0</u>                       | <u>71,573</u>  |

30. Related parties (continued)

The Group has a related party relationship with its parent company – “United Utilities UU (Sofia) B.V.”, which holds 77.10% of the Group’s shares, as well as with the other companies in the Group.

The following transactions have taken place during 2009

| Related party<br><i>In thousands of<br/>BGN</i>  | Relation   | Transactions during the year  | Balance as at 31 December 2009 |   |
|--|--|---|--------------------------------|---|
|  |  |   | Receivables                    | Payables  |
| United Utilities UU (Sofia) BV                   | Controls 77.10% of the shares of “Sofiyska Voda” AD  | Loan provided<br>-<br>Accrued interest<br>6,611<br>Other                          |                                | 70,707<br>Liability for loan received at amortized cost<br>44<br>Other trade payables |
| United Utilities International Ltd               | Controls 50% of the shares of United Utilities UU (Sofia) BV and 50% of the shares of United Utilities – Europe Holdings BV” | Services rendered under a contract for technical services<br>1,544<br>Other<br>50 | 50                             | 5,966   |
| United Utilities – Europe Holdings BV            | Controls 50% of the shares of United Utilities UU (Sofia) BV   |   |                                | 3,341   |
| European Bank for Reconstruction and Development | Controls 50% of the shares of United Utilities – Europe Holdings BV  | Accrued interest<br>2,769   |                                | 66,291<br>Liability for loan received at amortized cost                               |
| Vodosnabdyavane i Kanalizatsia EAD               | Controls 22.90% of the shares of Sofiyska voda AD  | Rent<br>16  | -                              | -   |
|  |  | Total:  | <u>50</u>                      | <u>146,349</u>  |

### 30. Related parties (continued)

#### *Transactions with directors and officers on key positions*

The Group has relationship of a related party with directors and officers on key positions. The total amount of the accounted remunerations, included in personnel expenses and in hired services are as follows:

| <i>In thousands of BGN</i>             | 2010      | 2009      |
|--|-----------|-----------|
| Remuneration of the Board of Directors | 72        | 72        |
|  | <u>72</u> | <u>72</u> |

### 31. Concession contract

On 23 December 1999 Sofiyska Voda AD signed a Concession Contract with the Municipality of Sofia, which is effective as of 6 October 2000, after all the preliminary conditions have been satisfied.

As per the Concession Contract the Municipality of Sofia grants and Sofiyska Voda AD receives:

- a specific right to use public assets;
- an exclusive right to render water supply and sewerage services within the concession area.

Sofiyska Voda AD has the right to invoice the customers and to collect the amounts for its benefit and at its expense. The risk of non-collected receivables is completely at its risk.

There is no contractual payment for the 25-year period of the concession.

As per Annex 5 to the Concession Agreement during the first 15 years Sofiyska Voda AD is obliged to reach the amount of USD 153 million of investments. After that period no further investments are specified.

After the Law for Regulating the Water and Sewerage Services became effective in 2006, Sofiyska Voda's operations are directly regulated by the State Commission for Energy and Water Regulation (SCEWR). More precisely, what is under regulation is the prices of the services and their quality, assessed by the so-called "key-point indicators" (KPI). In order to reach the level of services, 5-year business plans are prepared (after the 3-year one for the period 2006-2008), and they bind the price of the services, the investment program and the KPIs by issued by SCEWR Ordinances and Instructions.

In relation to that the process of renegotiation of the Concession Contract aiming to harmonize it with the new legislation starts. The negotiations end in January 2009 and in compliance with the amendments in the Concession Contract, the levels of investments are set in the business plans, which are preliminarily coordinated with the Municipality of Sofia.

Business plan 2006-2008 was approved in 2007. In the end of October 2008 Business plan 2009-2013 was approved, which envisages achieving of the compulsory levels of services for the period and an investment program of BGN 240 million.

Failure to achieve at least 75% of the total of investments set in the Business plan for two consecutive years with approved prices of services or double failure to meet the levels of services, acknowledged by a penalty decree issued by SCEWR and accompanied by a proposal to Municipality of Sofia (MoS) would be legal grounds for the initiation of a concession termination procedure by MoS.

For the period since the beginning of the Concession until the end of 2010 the amount of investments made is BGN 298,241 thousand. For 2010 the implementation of the business plan is amounting to BGN 52,579 thousand (2009: 52,462 thousand), of which BGN 48,048 thousand (2009: BGN 44,193 thousand) represent investments in improvements on old public assets or acquiring new ones, which leads to recognizing revenue from construction (see Note 8).

### **31. Concession contract (continued)**

Among 54 and 18 months before the expected expiration date of the Concession Contract Sofiyska Voda AD and the Municipality of Sofia are due to commit a mutual verification of the public assets. No later than 24 months before that date the parties agree on the way of handing in the assets and the operations.

As of the 15<sup>th</sup> Contractual year until the end of the period Sofiyska Voda AD is due to transfer 1% of its annual distributable profit to a special account. The amount accumulated in that account is transferred to the Municipality of Sofia on the date of the expiration of the Concession Contract in return for a "certificate of transfer back" in form additionally agreed between the parties. The accumulated in the special account amount covers completely Sofiyska Voda AD's liabilities.

Regarding the special right to use public assets and to render services of water supply, sewerage and waste water treatment to the consumers within the concession territory, a intangible asset called concession right has been recognized, and as at 31 December 2010 its book value amounts to BGN 161,740 thousand (2009: BGN 134,907 thousand). In 2010 within the value of the intangible asset concession right interest expenses amounting to BGN 23 thousand (2009: BGN 44 thousand) have been capitalized.

### **32. Subsequent events after the date of the statement of financial position**

#### *(a) Approval of the new tariff*

By decision № II-04 from 31.01.2011 the State Commission for Energy and Water Regulation approved new prices for the services provided by the Group. As of 1 February 2011 the price for the combined water, wastewater and treatment services in the City of Sofia is BGN 1.40 per cubic meter (excluding VAT). The increase is 9.4 %.



# ANNUAL REPORT

## SOFIYSKA VODA AD

2010

### FINANCIAL REVIEW

Financially, 2010 was a successful year for Sofiyska Voda AD. The profit from the operating activities for the year is BGN 30.0 million (as compared to BGN 25.0 million in 2009).

The revenue for 2010 from main charges amounts to BGN 112.2 million, which is 9% above the figure for the previous year - BGN 103.1 million. The main reason for that is the tariff increase, effective as from January 1<sup>st</sup>, 2010. The Company's total revenue for 2010 is BGN 170.7 million and is 8% above the revenue in the previous year (in 2009 – BGN 157.3million). The construction revenue in 2010 is BGN 48.0million (BGN 44.2 million in 2009).

In accordance with the Agreement signed on September 21<sup>st</sup>, 2007 between Sofiyska Voda AD and the Carbon Fund established with the EBRD for sale of reduced carbon emissions, in 2010 based on the prepared monitoring reports, an income amounting to BGN 1.5 million was recognized. For 2009 the sum was BGN 2,293 million.

At the end of 2009 the co-generator was commissioned at the WWTP Kubratovo and as a result of it for the first time in 2010 there was revenue from green energy sale amounting to BGN 1.5 million.

The Company's 2010 operating costs amount to BGN 140.6million (BGN 132.2 million – in 2009). The specified sum includes construction costs at the amount of BGN 48.0 million resulting from the application of IFRIC 12 and these costs offset the construction revenue specified above.

There is a 37% decrease in the other 2010 operating costs specified in detail in Note 12 of the separate financial statements. The main reason for that is the charged provision of BGN 12.2 million in 2009 in accordance with the agreement signed with the Municipality of Sofia.

The 2010 depreciation and amortization costs are BGN 23.7 million. This is 81% above the costs accrued in 2009 (BGN 13.1 million) and it is as a result of the double amount of the investments made over the last two years and also the commissioning of key company assets at the end of 2009 and the beginning of 2010.

The interest charges throughout the year are in line with the budgeted as a result of the signed in 2008 contracts for fixing the six-month Euribor under the two main loan agreements.

The 2010 revenue is BGN 4.8 million less compared to 2009. The main reason for that is the interest revenue from discounting under the debt to the Municipality of Sofia charged in 2009 (BGN 4.4 million) and no such discounting in 2010.

As a result of the above factors the profit after depreciation and interests for 2010 is BGN 17.7 million, which is BGN 0.56 million less than the profit for the previous 2009.

### FINANCIAL INSTRUMENTS

The Company's policy regarding financial risk, as well as its exposure to tariff, credit and liquidity risk are described in detail in the notes to the 2010 Financial Statements.

The Company used derivative financial instruments in order to hedge its interest rate risk exposure.

With SWAP contracts dated 12.11.2008, the Company executed two interest rate hedges:

With ING Bank a contract was signed to fix the six-month Euribor under the Senior loan with EBRD of 3.694% for a 5-year period

With Citibank a contract was signed to fix the six-month Euribor under the Subordinate loan of 3.650% for a 5-year period

In order to report the two contracts in the financial statements, hedge accounting is applied. Following their impairment, the effect in the 2010 financial statements is a financial liability to the total amount of BGN 8.6 million.

## **EVENTS FOLLOWING THE BALANCE SHEET DATE**

All significant events after the Balance Sheet date and their effects on the Company's activity are listed in Note 32 to the 2010 Separate Financial Statements.

## **CUSTOMER SERVICE**

The customer service improvement based on the application of best practices and new technological solutions continues to be a strong tendency for Sofiyska Voda AD. This also influences the customers' satisfaction with Company's entire activity – 88.3% for 2010, which is 7.5 % above the previous year level.

### **Customer relationship**

#### **Call Centre**

The 24/7 Call Centre of Sofiyska Voda AD has 16 lines, on which operators receive 1,300 calls on average per day. In 2010 the incoming calls are 10% more as compared to 2009. 491,000 incoming calls were answered in the Call Centre in 2010.

#### **Customer Service Centres**

The nine Customer Service Centres (CSC) of Sofiyska Voda AD are located in various parts of the city. In 2010 total of 511,000 customers visited the CSCs, 380,000 of them to pay their water bills. Compared to the previous year the number of the cash payments in the CSCs is reduced due to the increased number of the payment ways and places, but as a whole the number of the visits to the CSCs remain stable.

#### **Internet services**

In 2010 there were more than 1,000,000 registered visits to the webpage of the Company. 28,129 water meter self-readings were submitted by customers, which is more than twice the 2009 figure. 7,500 were the inquiries sent via the website, 6,434 of them requesting a reply. All replies were sent within 1 business day.

Two innovations were introduced on the webpage of the Company throughout the year:

- Option for access to the electronic copy of the invoices for the website registered users.
- 24-hour online information in real time about the unplanned (emergency) water supply interruptions.

#### **Information to customers about planned water supply interruptions**

The implementation of investment or operating activities for the WSS network and services improvement in many cases requires temporary interruption of the water supply. With the changes made on the web site all customers can

find updated information about current and planned interruptions. In addition there is a system in place for regular notifying of customers about all coming planned interruptions via mass media, notices left at the entrance of the building or the service for automatic notification via electronic message. Information letters are also sent to the affected by the interruption customers providing information about the Company's investment projects.

## **Water meter services, billing and debt collection**

### **Water meter replacement**

The accurate metering of the water supplied to customers is of key importance both for ensuring the Company revenue and for the good service as a whole. 7,706 revenue water meters were installed in 2010. It is important to note that a special priority was given to the devices with big diameter, the main part of them in blocks of flats. 2,800 of the replaced devices were with diameter exceeding  $\phi 40$ .

### **Water Meter reading**

In 2010 the water meter reading model from previous years was used – reading of the individual water meters and revenue water meters in blocks of flats on a quarterly basis, and the revenue water meters of the commercial and administrative customers – on a monthly basis. The customers receive information about the period of the visit of the meter readers from notices put up in a visible place in the block of flats, from the CSCs, the Company web-page and the Call Centre in order to be able to ensure access for the meter reading. In 2010, 82.04% of the water meters, subject to reading, were read compared to 81.05% in 2009. The success rate in the extra-urban area for 2010 is 69.42% compared to 57.99% in 2009. The success rate in terms of the large consumers read by the meter readers of Sofiyska Voda AD for 2010 is 93.83% compared to 92.59% in the previous year.

### **Billing**

6,350,600 invoices were issued over the reporting period, by 1.97% more as compared to 2009. The invoices issued after actual meter reading were more than 2,205,000.

### **Cash collection**

Sofiyska Voda AD puts great effort in enhancing cash collection by offering various ways for bill payment by customers or deferred payment schemes for accumulated debts. In addition, new initiatives for debt collection were undertaken by the company in 2010 and two specialized companies were involved in this process. The cases referred for settlement by the court increased many times. As a result the collection rate (revenue compared to billed volumes) has risen from 92.2% to 93.72%.

### **Non-regulated business**

Sofiyska Voda AD has continued to successfully develop its activity for providing additional services to its customers. In 2010 the total number of the installed water meters was 21,457, and the tested water meters – 3,493. The revenue from non-regulated water meter services (individual water meter testing and installation) was BGN 1,131,893, which is 23% higher compared to 2009. The total revenue from advertising amounted to BGN 145,640, which is 48% more than the one in 2009.

## **OPERATIONS AND MAINTENANCE**

### **Water Resource Management**

The constant monitoring of the water volumes supplied to the Concession area is the basis for the water management realized by Sofiyska Voda AD.

Water supplied in 2010:

Total water volume abstracted from all potable water sources - 219,912,551 m<sup>3</sup>

Including to the Municipality of Samokov - 6,145,366 m<sup>3</sup>

To the Municipality of Sofia – 214,057,548 m<sup>3</sup>

Industrial water – 9,773,393 m<sup>3</sup>

The monitoring data show that as compared to 2000 the Company has achieved an actual reduction on the water volumes used for water supply to the Concession area.

The potable water supplied in 2010 as compared to 2000 has decreased by 52.6 million m<sup>3</sup> or 19.74%.

The water volumes supplied to the Concession area in 2010 have decreased as compared to 2009 by 4.5 million m<sup>3</sup> or 2.08%.

### **Unaccounted for water reduction**

In 2010 the total losses reduction of about 6.4 million m<sup>3</sup> was reported for the water supply system Sofia compared to 2009, which is a reduction from 58.76% to 57.04%. The small percentage decrease is due to the continuing decrease of the billed water volumes (985 thousand m<sup>3</sup> less compared to 2009).

The reduction of UFW remains one of the main priorities of Sofiyska Voda AD, as it contributes to the preservation of water resources. In 2010 the Company managed to keep and further improve the progress achieved in 2009 in a wide range of activities related to the reduction of UFW:

- **Constant monitoring of the supplied water volumes**

The programme for constant monitoring of the DMZ/DMA zones has continued. The water network was split into 29 zones for management of the water demand (DMZs) and one zone - the impounding structures. The DMZs were then split into smaller water metering areas – total 191 DMAs with consumers, 80 DMAs with strategic water mains and 49 DMAs with reservoirs. The DMAs are separated with 530 boundary stop valves. About 380 metering devices were installed across the network and they are connected with the SCADA system (data supervision, management, control and collection) and/or the telemetry system.

- **DMA programme**

The DMA programme encompasses constant monitoring of the water metering zones – boundaries, metering, improvement and optimization of the zones, monitoring and management of the metering devices and data loggers, maintenance of the telemetry system. About 96% of the DMAs were established and metering is done. In 2010, 16% of the DMAs were tested, 6 new DMAs were established, 14 new water meter shafts were constructed, 58 boundary stop valves were replaced, and 137 metering devices with data loggers were installed. All pressure reducing valves are connected with the Telemetry system through the installed data loggers.

- **Water demand survey**

In 2010 Sofiyska Voda AD renewed the project for water demand survey though studying the profile of the demand of the different types of customers – large industrial enterprises and different types of residential buildings. Within the frames of the survey the consumption at the sites is registered through data loggers for a period of one week. 60 sites were studied in 2010.

- **Pressure management**

The activity that most seriously influences the decrease in both the number of the registered leaks across the network and the physical potable water losses is the pressure reduction project. 39 new reducing valves were installed in 2010 and 35 of them are in operation. 20 of the specified reducing valves are combined (they are used for pressure reduction and metering of the water volumes). 38 new shafts for reducing valves were constructed. 30 new pressure metering areas (PMA) are in operation.

24 hydrophores were installed in 2010 under the pressure reduction programme, and 18 of them were new (in blocks of flats where there has been none).

Systems for dynamic pressure management, including controllers with preliminarily defined profile for functioning of the reducing valves, and systems for dynamic control in real time using critical point data were also tested in 2010.

- **Leak Detection**

The leak detection activities continued and 2,550 hidden leaks were detected and repaired in 2010.

- **Implementation of investment projects for replacement of water mains, house water connections and stop valves and other elements on the network**

In 2010 Sofiyska Voda AD reconstructed 40,160 meters of water distribution network. Also large-scale projects for reconstruction of impounding structures were implemented as the total length of the reconstructions was 8,337 m. The projects include both water mains and sewers and rehabilitation of sections of the impounding water mains under the Relining technology.

Over the reporting period 2,556 house water connections were replaced and 476 new ones were constructed, 820 stop valves and 198 hydrants were installed, and 2 pumping stations were fully reconstructed.

- **Revenue water meter replacement and installation**

The key project for the installation/replacement of revenue meters continued and 7,706 revenue water meters were installed in 2010.

A pilot project for remote meter reading was also implemented in 2010. For the first time in Bulgaria the results from testing different systems for remote reading of revenue water meters presented on the market in the country were compared. Six different technologies were tested under the project, of them two fixed systems and four walk by/drive by reading systems. 106 revenue meters were covered by the project, and the installation of water meters and modules was done in the period May – July 2010, and the tests of the system functioning – in the period July – September 2010. All materials (including the water meters, radio-modules and other components of the systems) were ensured free of charge by the suppliers for the purposes of the pilot project. Following the conclusions made, Sofiyska Voda AD is preparing a tender procedure for delivery of a remote reading system.

In order to decrease the commercial losses Sofiyska Voda AD implemented a project for installation of water meters at the fountains in Sofia in 2010, and now it is continuing its activity under the project for installing water meters at the public taps in the city. Clarifying the use, operation and consumption payment issues for these socially useful sites will have an immediate impact on the UFW reduction.

## **Quality of the water supplied**

The reports for 2010 of the Sofia Regional Inspection on Public Health Protection and Control, which conducts an independent supervision on the water quality, show that the quality of the potable water in Sofia meets the requirements of the Bulgarian legislation which is harmonized with the Potable Water European Directive.

For 2010 according to the results of the water quality monitoring, the percentage compliance of the samples taken across the water system is: 90.7% under physical and chemical parameters; 87% under chemical parameters, and 100 % compliance for the samples under hydro-biological parameters.

A large amount of activity was performed in 2010 for the maintenance of the quality parameters of the filtered water, among them mechanical treatment and disinfection of the facilities along the route of the water in PWTP Bistritsa and PWTP Pancharevo, construction and automation of potable water disinfection plants and on-line monitoring of the quality parameters in the service reservoirs on the territory of the Concession area.

The Laboratory Testing Complex (LTC) of Sofiyska Voda AD implements the Company plans for monitoring of surface and potable water, wastewater and sludge in terms of taking samples from water and sludge and analyzing the microbiological, physical and chemical and hydro-biological parameters. Over the reporting period the LTC successfully took part in 21 international programmes for interlaboratory comparative tests for microbiological,

physical and chemical parameters, which is an independent confirmation of the accuracy and reliability of the test methods used in the LTC and the high qualification and competence of the employees.

### **Laboratory Testing Complex**

The activities implemented by the LTC in 2010 are mainly connected with the fulfillment of the plans for monitoring of potable and ground water as well as wastewaters and sludge; obtaining and maintenance of accreditation; development of new methods for analysis of pesticides and halogenized hydrocarbons in the potable water; process control, improving the traceability and transparency of the activities performed and ensuring confidentiality of the analytical results regarding the samples of internal and external customers of the LTC; development and improvement of the implemented system for quality management based on the BDS EN ISO 17025;

In 2010, 7,180 potable water samples were analyzed by Potable Water Section of the LTC under 122,014 parameters, and 8,977 wastewater samples were analysed in Wastewater Section of the LTC under 77,206 parameters.

On 09.02.2010 the LTC was issued the accreditation certificate from the Executive Agency Bulgarian Accreditation Services in compliance with the requirements of BDS EN ISO 17025. The scope of the accreditation encompasses the activities for taking samples from potable and surface water and wastewater for 99 parameters.

The obtaining of the accreditation allowed the LTC to offer laboratory services to external customers.

Over the reporting period the LTC developed new methods for determining the contents of potential organic pollutants in the potable water - pesticides and halogenized hydrocarbons, and methods for precise determination of the elements in the samples of sludge.

In 2010 two internal audits were held of the quality management system in the LTC, and auditors certified under BDS EN ISO 17025 and independent controller from the Executive Agency Bulgarian Accreditation Services took part in them. No quality deviations and non-compliances regarding the activities performed in the LTC were found.

Each sample received in the LTC is given a unique identification number and then registered in the laboratory information management system with controlled levels of access to the information. This ensures confidentiality and reliability in terms of the results for the samples analyzed under the requests of the internal and external customers.

In 2010 the LTC took part in various international programmes for interlaboratory comparative tests in line with the requirements for the maintenance of the accreditation for all test methods within the scope of the accreditation and proving the competence of the employees in the LTC. The results achieved allowed the LTC to not only receive unproblematic prolongation of the validity of the accreditation certificate but also develop and introduce new methods for water analysis – for determining a number of halogenized hydrocarbons and pesticides.

### **Water Supply**

#### **Water Network Management**

In 2010 the Company strongly focused on preventive activities related to network inspection and installation of stop valves in order to reduce the areas of water supply interruptions and improve the water network operation.

These activities, as well as the whole strategy for reduction of unaccounted-for water, led to a certain reduction of emergency activities – 6,430 failures on water distribution mains. The removal of these failures led to 4,994 single cases of water supply interruption.

A major part of the emergency activity over the last years is the aim to reduce the leak removal time. As at the end of last year, we achieved a level of 1.2 days on average for all failures, which is the best achievement since the introduction of this indicator.

#### **Emergency water supply interruptions in 2010**

6,430 failures, 4,994 water supply interruptions

## Planned water supply interruptions in 2010

225 planned interruptions, 515,539 affected households

## Sewerage

The sewerage network on the territory of the Municipality of Sofia includes 1,554 km of public assets and more than 500 km of assets with unclear status (as per the TDA of 2003). The majority of the surrounding territories of Sofia, as well as some areas in the city, do not have a central sewerage network. Implementing the Business Plan 2009 – 2013 Sofiyska Voda AD observes the priorities of the Municipality of Sofia for the construction of sewers. The projects for the extension of the sewerage network over the last two years are one of the focuses of the company's investment programme.

The organization for the maintenance of the sewerage network is carried out through proactive methods - video diagnostics of sites and preventive cleaning, as well as reactive activities - cleaning, repair works and rehabilitation of pipelines.

### Operation and maintenance activities on the sewerage system

| Activity                       | Measure      | Performance 2008 | Performance 2009 | Performance 2010 |
|--------------------------------|--------------|------------------|------------------|------------------|
| Cleaning of street sewers      | meters       | 340,481          | 341,225          | 214,343          |
| Cleaning of gullies            | number       | 35,818           | 31,415           | 320              |
| Cleaning of manholes           | number       | 4,289            | 4,747            | 2,827            |
| Installation of grids (covers) | number       | 1,797            | 1,104            | 968              |
| Unclogged service connections  | number       | 1,661            | 1,988            | 1,802            |
| Unclogged service connections  | meters       | 31,270           | 40,019           | 36,596           |
| Sludge transportation          | cubic meters | 3,030            | 4,079            | 1,302            |

The programme for proactive maintenance of the sewerage network was updated in 2010 as the focus was on the preventive maintenance of sections with worse operational parameters. As a result of it, a part of the activities for cleaning street sewers was optimized as this change led to the decrease in the number of the blocked house connections during the year.

## Wastewater treatment

In 2010 a total of 147.4 million m<sup>3</sup> of wastewater from the sewerage network of Sofia was treated in Kubratovo Wastewater Treatment Plant (WWTP). The treated volume of wastewater is about 84% of the average daily capacity of the plant (480,000 m<sup>3</sup>/day). With the implementation of the investment projects for expansion of the sewerage network of the capital city, it is expected that in the coming four years the treatment plant's capacity will be close to the designed one.

Over the reporting period, Sofiyska Voda AD optimized the control on work processes and strictly followed all legislative requirements related to wastewater treatment. In line with the requirements of the Surface Water Discharge

permit, issued by the Danube Region Water Basin Directorate, and the Concession Agreement, the Laboratory Testing Complex, the Wastewater Sector at Kubratovo WWTP conducts continuous monitoring of the quality indicators of treated wastewater and sludge generated in the treatment process.

### Quality of the treated wastewater

On a daily basis, analysis is carried out of the indicators Biological Oxygen Demand (BOD<sub>5</sub>), Chemical Oxygen Demand (COD) and Suspended Solids (SS) of the treated wastewater at the outlet of WWTP.

In 2010, a total of 1,095 samples were taken for analysis of treated wastewater. The limit values of water quality as per the requirements of the Discharge permit are as follows:

BOD<sub>5</sub> – 25 mg O<sub>2</sub>/l

COD – 125 mg O<sub>2</sub>/l

SS – 35 mg/l

The average values of the samples are below the levels recommended of the emissions for quality of discharged water as the annual compliance level achieved is 97.5%.

### Sludge Treatment and Utilization

The sludge produced from wastewater treatment is stabilized in four anaerobic digesters. The sludge treated in the digesters is mechanically dewatered to produce a 'sludge cake' with dry solids content of about 25%.

In 2010 Sofiyska Voda AD continued to provide the stabilized sludge to be used in agriculture for soil fertilization. The Company has all permits required for the sludge utilization on agricultural lands.

| Sludge from WWTP Kubratovo | 2007     | 2008     | 2009     | 2010     |
|----------------------------|----------|----------|----------|----------|
| Produced                   | 48,647 t | 73,402 t | 76,130 t | 89,383 t |
| Used in agriculture        | 37,403 t | 49,635 t | 68,029 t | 54,577 t |

The control of waste produced in WWTP Kubratovo, including the dewatered sludge, is carried out in accordance with the requirements of the Waste Management Act. Sofiyska Voda AD inspects and submits the reports required to the Ministry of Environment and Water.

### Electrical and Mechanical Maintenance

In 2010 Sofiyska Voda AD successfully implemented the annual plan for preventive maintenance of the Company's facilities, as a result of which the time ratio for emergency works versus general works decreased from 12% in 2009 to 10% in December 2010. The reduction of the number of emergency works was due to the used since the beginning of 2010 high-tech equipment to diagnose the Company's facilities (vibration measuring device, thermographic camera, laser measuring device), which identifies potential damages before they become failures.

In parallel with the operational activities, two important projects were completed for increasing the security of power supply to sites which are strategic for the Company – in Bistritsa PWTP a third alternative power supply source was introduced from generator section (450 kVA), and in the area of Zli Kamak Operation Chamber (critical gate of Iskar impounding structure) a kiosk switchgear providing double power supply to the site was restored.



## **Reduced Carbon Emission Sales Agreement**

According to the agreement concluded on September 21<sup>st</sup>, 2007 between Sofiyska Voda AD and the Carbon Fund established with the EBRD the project for selling reduced carbon emissions continued in 2010. Over the period 116,000 tonnes of CO<sub>2</sub> equivalent reduced emissions were generated and it is expected that they would be transferred to the purchaser in May 2011.

## **INVESTMENTS 2010**

In 2010 the execution of the five-year Business Plan 2009-2013 continued, in which Sofiyska Voda AD planned investments amounting to a total of BGN 240 million (an average of BGN 48 million per annum). The actual amount of investments made in 2010 was a total of BGN 52,579,435.92. The 2010 capital expenditure falls into the following categories:

Water supply – BGN 23.6 million

Potable water treatment – BGN 1.5 million

Sewerage – BGN 13.3 million

Wastewater treatment – BGN 5.4 million

Service connections, water meters – BGN 6 million

Customer service – BGN 2.77 million

### **The main projects in 2010:**

- Construction of a 6 158 m long rising main from the PS to Zhelyava reservoir – cast iron  $\phi$  125 and PEHD  $\phi$  140 mm and a new PS.
- Rehabilitation of a 900 m long section,  $\phi$  1200, of III water ring main along Spravedlivost St. in Moderno Predgradie residential quarter.
- Construction of a fence of the of the sanitary restricted area of Konyovitsa reservoir
- Construction of a separate sewerage system with a sewerage pumping station and water main in Benkovski residential quarter.
- Construction of a separate sewerage system with a sewer pumping station and water main in Illiantsi residential quarter.
- Construction of main sewer branches I and II and water mains in Simeonovo residential quarter.
- Design, delivery, installation and commissioning of facilities for mechanical treatment in Kubratovo Wastewater Treatment Plant: rough and fine screens, compactors and grit classifiers.

## **ENVIRONMENT AND SUSTAINABLE DEVELOPMENT**

As a company providing water supply and sewerage services on the territory of the Municipality of Sofia, the activity of Sofiyska Voda AD is closely linked to ecology and environmental protection. Sustainable development principles are founding for each aspect of the Company's operation. The achievement of balance between economic growth, environmental protection and improvement and social development is an inseparable part of Sofiyska Voda's business strategy.

The preventative and long-term protection of natural resources, energy saving, harmful emission reduction as well as better use of the raw materials and fuels are key company tasks. The implementation of a result-orientated ecological policy is accompanied by a number of benefits: cleaner water, protection of the surface and ground water, better public health, safer and more responsible waste management, less harm to forests, valleys, water basins and parks.

The investments in ecology and modern technologies improve the economic efficiency and increase the Company's productivity. The investment activity of Bulgaria's biggest WSS operator Sofiyska Voda AD is environmental as a whole. The regulation and management of the water and water resource and the activities across the water network result in water loss reduction and hence in saving this valuable natural resource. The introduction of best practices in the sewerage network operation and maintenance, the construction of new sewers and the provision of more and more efficient and high-quality wastewater treatment is the Company's priority in view of improving the condition of water sources. The more efficient wastewater management results in savings, and better quality of water means lower operating costs. Enhancing the awareness of Sofia's residents of efficient water use issues is a crucial aspect of the Company's work towards applying the sustainable development principles.

The policy of Sofiyska Voda AD on environmental protection reflects the awareness of its main ecological responsibilities, definition of the ecological objectives and planning of the activities connected with environmental protection and improvement. The ecological objectives of the company are as follows: reduction of the impact on environment as a result of water abstraction from nature, protection and improvement of the quality of the surface and ground water sources, constant water supply with high quality to customers, reduction in the consumption of electrical power, fuels and chemicals, reduction of the waste generation, exchange and provision of information to customers, employees and other interested parties regarding the environmental protection issues.

In order to achieve its ecological objectives, Sofiyska Voda AD made an environmental impact assessment regarding all current and future activities of the company. The potentially important aspects and environmental impacts were identified, and procedures for prevention and mitigation of the environmental impact and ecological plans were developed.

In compliance with the requirements of the normative documents in 2010 Sofiyska Voda AD continued to work for establishment and construction of sanitary restricted areas (SRAs) around the water sources. In line with the order of the Ministry of Environment and Water (MoEW), a procedure is under way for issuing a deed of public state property of the first band of the SRA of Iskar Dam. The project drawn up for the Sanitary Restricted Area of Kokalyane dam (weir) was submitted to the MoEW and a procedure for establishment of SRA was started.

The maintenance of the environmental management system ensuring the execution of activities for minimizing the risk of pollution, the efficient use of resources and enhancement the company's efficiency continued in 2010. In November 2010, Sofiyska Voda successfully passed another audit for the system implementation. Sofiyska Voda was certified under ISO 14001:2004 (BNS – 2005), an international standard of a system on environmental management at the end of 2008.

During the reporting period another *Environmental Protection Report* was published. The report provides detailed information regarding the activities of Sofiyska Voda AD and clearly states the set ecological objectives of the company. A key element of the report is the message to our customers that the water is a valuable resource and should always be used reasonably. The report is made public and distributed via printed copies and the company's internet site.

#### **Waste management program**

In connection with the prolongation of the permit for management of waste-related activities in 2010, the Waste Management Program of the Company for 2011-2014 had to be updated. The Program covers all kinds of identified waste which can be generated as a result of the activities performed by Sofiyska Voda AD. It includes the methods of temporary storage, transportation and hand over of waste to licensed companies for its further utilization in line with the relevant legislation.

#### **Maintenance and update of acts and permits register**

In 2010 the update of the law register continued in compliance with the amendments to the acts and the new legislation in the field of environmental protection. The register of the permits issued to Sofiyska Voda AD was also maintained in accordance with the ecological legislation. Their update and implementation was ensured.

### Separate waste collection

In 2010 Sofiyska Voda AD put efforts into the implementation of the system for separate waste collection. Containers were provided at all company's premises. With the contract signed with Ecopack AD for collection and transportation of the waste - paper, plastic and glass, conditions were ensured for separate waste collection.

### Green energy production

In 2010, the Wastewater Treatment Plant Kubratovo produced 15,287.9 MWh of green energy. The production is based on a co-generation technology for the utilization of biogas, the waste product generated in the process of sludge treatment at the plant. The co-generation installation is a project of Sofiyska Voda AD at the amount of BGN 5 million and it was officially commissioned in December 2009. The project is part of the activities for reducing the carbon emissions in line with the Emission Reduction Purchase Agreement between Sofiyska Voda AD, the Carbon Fund of the European Bank for Reconstruction and Development and the government of the Netherlands.

## HEALTH AND SAFETY AT WORK

A key factor for Sofiyska Voda's performance is the maintenance and continuous improvement of the Occupational Health and Safety Management System.



In November 2010 a second control external audit of the Occupational Health and Safety Administration System under BS OHSAS 18001:2007 was carried out by the auditors of TUF NORD. The audit was completed without any ascertained non-compliances. Four recommendations for the potential improvement of the system were made and three best practices achieved so far were marked.

### Lost Time Incidents

Four occupational accidents were reported and investigated over the year. Two of the accidents were with our employees during their commuting to work and the reasons were the poor meteorological conditions or public transport problems. The other two accidents were in the course of work.

*Total number of the accidents, including the accidents during commuting to work.*

| 2009                             |                   | 2010                             |                   |
|----------------------------------|-------------------|----------------------------------|-------------------|
| Number of occupational accidents | Lost working days | Number of occupational accidents | Lost working days |
| 6                                | 134               | 4                                | 92                |

| Comparative analysis 2009-2010         |   | In percent |
|--|---|------------|
| Number of occupational accidents       |  | 33 %       |
| Lost days as a result of the accidents |  | 31%        |

## **No Lost Time Incidents**

Over the year, the following incidents were reported:

- one incident without injuries;
- 51 incidents without injuries but with property damage;
- 3 transport incidents without injury but with property damage which was our fault.

## **HUMAN RESOURCE MANAGEMENT**

In its policy and practice Sofiyska Voda AD develops and applies contemporary forms of human resource management with the awareness that these factors are of extreme importance for business development and achievement of high results. The achievement and maintenance of a balance between the interests of the employer and the workforce are based on compliance with the legislation, following high budget discipline and social partnership with the trade unions.

Human resource management is developed by applying a complex of policies and procedures planned in advance so that the whole management team is involved in the process.

### **Remuneration and benefits**

In March 2010 an annual bonus was paid amounting to 8% of the gross remuneration of each employee for the previous year in line with the approved bonus scheme of the company.

As of April 1<sup>st</sup>, 2010 the salaries of the employees in the company were increased by 0.6% in accordance with the established practice of the company for indexation of the basic remuneration with the inflation rate officially announced by the National Statistical Institute.

In the second half of 2010 the positions were assessed and position grading was made. Based on it the analysis and the adjustment of the salaries are improved which optimizes the expenses and encourages the motivation of the employees.

### **Involvement**

Employee turnover in 2010 stayed within the acceptable limits of 1 - 2% compared to about 8% on average for the country. This is also an indirect indicator for the attitude of the employees to the company as an employer.

The level of the sick leaves is also low – it stayed permanently under 3%. Our analysis shows that the tendency for decrease over the year is also due to the active policy for use of the paid annual leaves.

The objective to reduce the number of the unused annual paid leaves to 5 days on average per employee was achieved at the end of 2010. Besides the organizational impact, it also affects positively the financial results.

### **Training and development**

Over the year induction trainings were also held for the newly appointed employees with the purpose of their quick and easy adapting to the new environment and getting acquainted with the values, culture and structure of Sofiyska Voda AD.

In 2010 the company implemented a project under the EU Operational Program for Human Resource Development. Within the project 9 trainings in leadership skills, customer service and work with specialized software were conducted. 263 employees took part in the trainings.

The internship program of Sofiyska Voda was held for a ninth consecutive year. It started on July 1<sup>st</sup>, 2010 for a period of three months. The program "Challenge the Future" allows students and young specialists to participate professionally in the work process in different directorates of the company as well as to identify future employees,

find talented people and generate new ideas. In 2010 the company accepted 21 students. After the internship program was completed seven of the trainees remained to work in the company and develop professionally in it.

In compliance with the policy for awarding individual and team achievements of the employees in Sofiyska Voda AD, 27 employees and four teams were awarded in 2010 with the Golden Star award.

The company implements an extensive social program, agreed with its social partners, that has a positive impact on the relations with the employees, their motivation and makes them stay in the company.

## **RESEARCH AND DEVELOPMENT ACTIVITY**

Sofiyska Voda AD does not carry out such activity.

## **BOARD OF DIRECTORS**

In 2010 Sofiyska Voda AD had 7 members in the Board of Directors. The representatives of Vodospribyavane i Kanalizatsia EAD were Kamen Manev, Georgi Takev and Nikolay Aleksandrov.

Marion Price, Leslie Bell, Steven Fraser, Andrew Prescott and Iliana Tsanova were members in the BoD as representatives of United Utilities.

In reference to the change in the ownership of the United Utilities (Sofia) BV on November 9<sup>th</sup>, 2010, on December 1<sup>st</sup>, 2010 the change of the members was registered in the Trade Register with the Registry Agency - Marion Price, Leslie Bell, Steven Fraser, Andrew Prescott and Iliana Tsanova were replaced by Etienne Marie Patrice Petit, Gyorgy Palko, Bruno Daniel Paul Roche and Ferenc Szucs.

None of the new members has ever had shares or options for shares in Sofiyska Voda AD.

## **RELATED PARTIES**

The Company has a related party relationship with its parent company – United Utilities UU (Sofia) BV, which owns 77.10% of Sofiyska Voda AD's shares, as well as with the other companies of the economic group. The amount of the transactions and the sum of the receivables and debts to the related parties are announced in Note 30 to the separate financial statements of the Company for 2010.

### **Change in the shareholders of Sofiyska Voda AD**

1. As per the share purchase agreement dated 12.06.2010, a few subsidiaries of United Utilities PLC (UU PLC) agreed to sell their shares in United Utilities (Sofia) BV (the majority shareholder in Sofiyska Voda AD) to Veolia Water UK PLC ("Veolia") or its nominee. Veolia decided that Veolia Voda SA, with address: Rue d' Anjou, 52 – Paris 75008, will acquire all the shares of UU PLC in United Utilities (Sofia) BV.
2. As per the share purchase agreement dated 29.10.2010, the European Bank for Reconstruction and Development (EBRD) sold indirectly its share in United Utilities (Sofia) BV to a subsidiary of UU PLC and thus indirectly it no longer owns shares in Sofiyska Voda AD, and remains in the project only as a creditor of the company.
3. As per the amended and restated share purchase agreement dated 05.11.2010, Veolia Voda acquired 100% of the shares of United Utilities (Sofia) BV, owned by subsidiaries of United Utilities PLC.

The transfer of all shares of United Utilities (Sofia) BV to Veolia Voda was finalized on November 9<sup>th</sup>, 2010. The change in the ownership of United Utilities (Sofia) BV did not require the approval of the

Municipality of Sofia as Grantor in compliance with the provision of art.26 of the Concession Agreement, as far as it does not affect the existence and activity of United Utilities (Sofia) BV and the company continues to be the majority shareholder in Sofiyska Voda AD.

#### **FORECAST FOR 2011 AND BUSINESS PLAN 2009 - 2013**

The expectations of the Company management are that 2011 will be another successful year for Sofiyska Voda AD. According to the budget prepared and approved by the Board of Directors for 2011 the earnings before interests, taxes, depreciation and amortization is expected to be BGN 56.7 million, and before taxes – BGN 24.9 million.

With its Decision № II-04 dated 31.01.2011 the State Energy and Water Regulatory Commission approved the prices proposed for the services provided by Sofiyska Voda AD needed for the achievement of the objectives set in the Business Plan of the Company. In this way, as from February 1<sup>st</sup>, 2011 the combined price of BGN 1.40 (without VAT) has become effective for the domestic customers in Sofia. This one-month delay in the approval of the prices by the SEWRC reflects the budgeted revenue for 2011 – in practice the company is deprived of billed volumes at the amount of about BGN 0.7 million. The revenue expected from main charges for 2011 is BGN 124.1 million, which is by 9.6 million above the figure in 2010.

The prices for 2011 were formed in compliance with the Instructions on the price formation for the water supply and sewerage services at price regulation through upper price limit published on the web site of the SEWRC.

The amount of the investments for the third regulatory year from the five-year Business Plan is expected to be BGN 41.6 million. In the meantime, following the instruction given with the above Decision Sofiyska Voda is to submit by April 30th, 2011 a revised Business plan with updated investment programme to it. The process of agreeing the accurate project parameters with the Company shareholders is under way and the ad hoc working group has already started to work under it.

Miroslav Mitkov

/Finance Controller/

Ivan Ivanov

/General Commercial Proxy/