

**Macedonian Bank for Development
Promotion AD Skopje**

**Financial Statements
for the year ended
31 December 2009**

Contents

Independent Auditors' report

Financial Statements

| | |
|-----------------------------------|---|
| Statement of financial position | 1 |
| Statement of comprehensive income | 2 |
| Statement of changes in equity | 3 |
| Statement of cash flows | 4 |
| Notes to the financial statement | 5 |



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Independent Auditors' report to the shareholders of Macedonian Bank for Development Promotion AD Skopje

We have audited the accompanying financial statements of Macedonian Bank for Development Promotion AD Skopje ("the Bank"), which comprise the statement of financial position as at 31 December 2009, the statements of comprehensive income, changes in equity and cash flows for the year than ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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



Independent Auditors' report

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2009, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Macedonia Ltd

KPMG Macedonia Ltd

28 April 2010

Skopje

Statement of financial position

As at 31 December

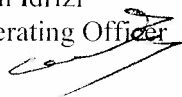
In thousands of denars

| | <i>Note</i> | 2009 | 2008 |
|--|-------------|------------------|------------------|
| Assets | | | |
| Cash and cash equivalents | 14 | 299,674 | 210,350 |
| Placement with other banks | 15 | 201,871 | 310,884 |
| Loans and advances to banks | 16 | 3,062,615 | 2,171,917 |
| Loans and advances to customers | 17 | 316 | - |
| Investment securities | 18 | - | 166,608 |
| Current tax assets | | 829 | - |
| Property and equipment | 19 | 112,040 | 115,406 |
| Intangible assets | 20 | 1,010 | 1,827 |
| Other assets | 21 | 12,867 | 12,901 |
| Total assets | | <u>3,691,222</u> | <u>2,989,893</u> |
| Liabilities | | | |
| Borrowed funds | 22 | 1,956,013 | 1,314,717 |
| Impairment provisions related to off balance sheet items | 23 | 3,069 | 2,519 |
| Current tax liabilities | | - | 2,556 |
| Other liabilities | 25 | 8,209 | 5,206 |
| Total liabilities | | <u>1,967,291</u> | <u>1,324,998</u> |
| Equity | | | |
| Share capital | 26 | 1,193,792 | 932,400 |
| Retained earnings | | 51,611 | 100,826 |
| Other reserves | | 478,528 | 631,669 |
| Total equity | | <u>1,723,931</u> | <u>1,664,895</u> |
| Total liabilities and equity | | <u>3,691,222</u> | <u>2,989,893</u> |

The notes on pages 5 – 57 are an integral part of these financial statements.

These financial statements set out on pages 1 to 57 were approved by the Supervisory Board on 28 April 2010 and were signed on its behalf by:

Mr. Kenan Idrizi
Chief Operating Officer



Mr. Dragan Martinovski
Chief Executive Officer



Statement of comprehensive income

For the year ended 31 December

In thousands of denars

| | <i>Note</i> | 2009 | 2008 |
|--|-------------|-----------------|-----------------|
| Interest income | 8 | 126,931 | 167,281 |
| Interest expense | 8 | <u>(24,450)</u> | <u>(37,895)</u> |
| Net interest income | | <u>102,481</u> | <u>129,386</u> |
| Fee and commission income | 9 | 30,820 | 11,758 |
| Fee and commission expense | 9 | <u>(12,456)</u> | <u>(2,951)</u> |
| Net fee and commission income | | <u>18,364</u> | <u>8,807</u> |
| Net foreign exchange gain/loss | | (6,153) | 5,067 |
| Other operating income | 10 | <u>1,623</u> | <u>4,570</u> |
| | | <u>(4,530)</u> | <u>9,637</u> |
| Operating income | | 116,315 | 147,830 |
| Net impairment loss on financial assets | 16,17,21 | (6,500) | 5,308 |
| Personnel expenses | 11 | (25,272) | (22,834) |
| Depreciation and amortisation | 19,20 | (6,838) | (6,340) |
| Other expenses | 12 | <u>(18,558)</u> | <u>(11,704)</u> |
| Profit before income taxes | | 59,147 | 112,260 |
| Income tax expense | 13 | <u>(111)</u> | <u>(11,359)</u> |
| Profit for the period | | <u>59,036</u> | <u>100,901</u> |
| Other comprehensive income for the period | | <u>-</u> | <u>-</u> |
| Total comprehensive income for the period | | <u>59,036</u> | <u>100,901</u> |

The notes on pages 5 - 57 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December

| <i>In thousands of denars</i> | Share Capital | Reserve | Reserve for security | Guarantee fund | Retained earnings | Total |
|--|------------------|---------|-------------------------|-------------------|----------------------|-----------|
| Balance at 1 January 2008 | 932,400 | 140,550 | 173,121 | 237,019 | 80,904 | 1,563,994 |
| Total comprehensive income for the period | | | | | | |
| Profit for the period | - | - | - | - | 100,901 | 100,901 |
| Total comprehensive income for the period | - | - | - | - | 100,901 | 100,901 |
| Transactions with owners, recorded directly in equity | | | | | | |
| Contributions by and distributions to owners | | | | | | |
| Appropriation to reserve | - | 68,485 | - | - | (68,485) | - |
| Appropriation to reserve for security | - | - | 5,000 | - | (5,000) | - |
| Appropriation to guarantee fund | - | - | - | 7,494 | (7,494) | - |
| Total contributions by and distributions to owners | - | 68,485 | 5,000 | 7,494 | (80,979) | - |
| Balance at 31 December 2008 | 932,400 | 209,035 | 178,121 | 244,513 | 100,826 | 1,664,895 |
| Balance at 1 January 2009 | 932,400 | 209,035 | 178,121 | 244,513 | 100,826 | 1,664,895 |
| Total comprehensive income for the period | | | | | | |
| Profit for the period | - | - | - | - | 59,036 | 59,036 |
| Total comprehensive income for the period | - | - | - | - | 59,036 | 59,036 |
| Transactions with owners, recorded directly in equity | | | | | | |
| Contributions by and distributions to owners | | | | | | |
| Appropriation to reserve | - | 86,372 | - | - | (86,372) | - |
| Appropriation to guarantee fund | - | - | - | 16,879 | (16,879) | - |
| Appropriation to reserve for security | - | - | 5,000 | - | (5,000) | - |
| Appropriation to reserves | - | 30,000 | (30,000) | - | - | - |
| Increase of share capital | 261,392 | - | - | (261,392) | - | - |
| Total contributions by and distributions to owners | 261,392 | 116,372 | (25,000) | (244,513) | (108,251) | - |
| Balance at 31 December 2009 | 1,193,792 | 325,407 | 153,121 | - | 51,611 | 1,723,931 |

The notes on pages 5 - 57 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December

| <i>In thousands of denars</i> | <i>Note</i> | 2009 | 2008 |
|---|-----------------|------------------|------------------|
| Cash flows from operating activities | | | |
| Profit for the period | | 59,036 | 100,901 |
| Adjustments for: | | | |
| Depreciation and amortisation | <i>19,20</i> | 6,838 | 6,340 |
| Net impairment loss on financial assets | <i>16,17,21</i> | 6,500 | (5,308) |
| Impairment provision for off balance sheet items | | 550 | (1,596) |
| Net interest income | <i>8</i> | (102,481) | (129,386) |
| Income tax | | 111 | 11,359 |
| | | <u>(29,446)</u> | <u>(17,690)</u> |
| Change in placements with other banks | | 109,013 | 151,638 |
| Change in loans and advances to banks | | (884,261) | (129,686) |
| Change in loans and advances to customers | | (16,753) | - |
| Change in other assets | | 383 | (3,782) |
| Change in other liabilities | | 3,003 | 394 |
| | | <u>(818,061)</u> | <u>874</u> |
| Interest received | | 129,787 | 161,655 |
| Interest paid | | (22,360) | (51,272) |
| Income tax paid | | (3,496) | (13,010) |
| Net cash used in operating activities | | <u>(714,130)</u> | <u>98,247</u> |
| Cash flows from investing activities | | | |
| Acquisition of property and equipment | <i>19</i> | (2,644) | (1,847) |
| Acquisition of intangible assets | <i>20</i> | (11) | (405) |
| Proceeds from investment securities | | 166,903 | - |
| Acquisition of investment securities | | - | (166,608) |
| Net cash used in investing activities | | <u>164,248</u> | <u>(168,860)</u> |
| Cash flows from financing activities | | | |
| Repayment of borrowed funds | | (123,365) | (237,841) |
| Proceeds from borrowed funds | | 762,571 | 62,360 |
| Net cash from financing activities | | <u>639,206</u> | <u>(175,481)</u> |
| Net increase / (decrease) in cash and cash equivalents | | 89,324 | (246,094) |
| Cash and cash equivalents at 1 January | | 210,350 | 456,444 |
| Cash and cash equivalents at 31 December | <i>14</i> | <u>299,674</u> | <u>210,350</u> |

The notes on pages 5 - 57 are an integral part of these financial statements.

Notes to the financial statements

1. Reporting entity

Macedonian Bank for Development Promotion AD Skopje (“the Bank”) is a state owned joint stock company incorporated and domiciled in the Republic of Macedonia.

The address of the Bank’s registered office of the Bank is as follows:

St. Veljko Vlahovic 26
1000 Skopje
Republic of Macedonia

The main activities include funding the start up of businesses and the development of small and medium size enterprises, financing exports with loans and issuing financial guarantees.

Also in accordance with the amendment of the Law for founding of the Macedonian Bank for Development Promotion in 2009, the Bank has transferred the funded Guarantee fund for issuing financial guarantees towards commercial banks for long-term loans approved by commercial banks to micro, small and medium trading companies, sole traders and craftsman in the Republic of Macedonia, to share capital.

Loans are granted through participating banks in the Republic of Macedonia which bear the ultimate risk of collection of the receivables.

2. Basis of preparation

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs), as issued by the International Accounting Standards Board (IASB).

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following:

- financial instruments at fair value through profit or loss are measured at fair value;
- available-for-sale financial assets are measured at fair value.

(c) Functional and presentation currency

These financial statements are presented in Macedonian denars (“MKD” or “denars”), which is the Bank’s functional currency. Except as indicated, financial information, presented in MKD has been rounded to the nearest thousand.

Notes to the financial statements

2. Basis of preparation (continued)

(d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS, requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, 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 recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in notes 4 and 5.

(e) Changes in accounting policies

Effective 1 January 2009 the Bank has changed its accounting policies in the following areas:

- Presentation of financial statements

Presentation of financial statements

The Bank applies revised IAS 1 Presentation of Financial Statements (2007), which became effective as of 1 January 2009. As a result, the Bank presents in the statement of changes in equity all owner changes in equity, whereas all non-owner changes in equity are presented in the statement of comprehensive income.

Comparative information has been re-presented so that it also is in conformity with the revised standard. Since the change in accounting policy only impacts presentation aspects, there is no impact on earnings per share.

(f) Other accounting developments

(i) *Disclosures pertaining to fair values and liquidity risk for financial instruments*

The Bank has applied Improving Disclosures about Financial Instruments (Amendments to IFRS 7), issued in March 2009, that require enhanced disclosures about fair value measurements and liquidity risk in respect of financial instruments.

Notes to the financial statements

2. Basis of preparation (continued)

(f) Other accounting developments (continued)

(i) *Disclosures pertaining to fair values and liquidity risk for financial instruments (continued)*

The amendments require that fair value measurement disclosures use a three-level fair value hierarchy that reflects the significance of the inputs used in measuring fair values of financial instruments. Specific disclosures are required when fair value measurements are categorized as Level 3 (significant unobservable inputs) in the fair value hierarchy. The amendments require that any significant transfers between Level 1 and Level 2 of the fair value hierarchy be disclosed separately, distinguishing between transfers into and out of each level.

Furthermore, changes in valuation techniques from one period to another, including the reasons therefore, are required to be disclosed for each class of financial instruments.

Further, the definition of liquidity risk has been amended and it is now defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The amendments require disclosure of a maturity analysis for non-derivative and derivative financial liabilities, but contractual maturities are required to be disclosed for derivative financial liabilities only when contractual maturities are essential for an understanding of the timing of cash flows. For issued financial guarantee contracts, the amendments require the maximum amount of the guarantee to be disclosed in the earliest period in which the guarantee could be called.

Revised disclosures in respect of liquidity risk are included in note 4.

The application of the amended requirements did not have any impact on the Bank's financial statements, except as explained in note 2 (e), which addresses change in accounting policies.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, except as explained in note 2(e), which addresses change in accounting policies.

(a) Foreign currency transactions

Transactions in foreign currencies are translated to denars at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to denars at the exchange rate at that date.

Notes to the financial statements

3. Significant accounting policies (continued)

(a) Foreign currency transactions (continued)

The foreign currency gain or loss on monetary items is the difference between amortised cost in denars at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to denars at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss.

The foreign currencies the Bank deals with are predominantly Euro (EUR). The exchange rates used for translation at 31 December 2009 and 2008 were as follows:

| | 2009 | 2008 |
|-------|-------------|-------------|
| | MKD | MKD |
| 1 EUR | 61.17 | 61.41 |

(b) Interest

Interest income and expense are recognised in the profit and loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability.

The calculation of the effective interest rate includes all fees and points paid or received, transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Interest income and expense presented in the statement of comprehensive income include:

- interest on financial assets and liabilities at amortised cost calculated on an effective interest rate basis;
- interest on available-for-sale investment securities calculated on an effective interest basis.

Notes to the financial statements

3. Significant accounting policies (continued)

(c) Fees and commission

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fee and commission income arises on financial services provided by the Bank for issuing letters of financial guarantees for short-term export arrangements. Additionally, the Bank obtains letters of guarantees from foreign insurance institutions in amount of 85% to 90% of the issued financial guarantees. Fee and commission income is recognised as the related services are performed.

Fees and commission income and expense are recognised as the services are performed.

(d) Income tax expense

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

According the changes in Income Tax Law, from 1 January 2009, entities are obliged to calculate and pay income tax on non-deductible expenses and on paid dividends and other distributions from profit. Tax rate is 10% (2008: 10%).

Basis for calculation of income tax on non-deductable expenses is the amount of non-deductible expenses determined in accordance with Income Tax Law, reduced by the amount of tax credit and tax exemptions and incentives.

Notes to the financial statements

3. Significant accounting policies (continued)

(d) Income tax expense (continued)

Basis for calculation of income tax on paid dividends and other distributions for profit is the amount of paid dividends and other distributions from profit made during the current year. Taxation on dividends, i.e. dividends' advances paid in cash, is in the moment of payment of dividend.

In 2008 the methodology for calculation of income tax was different. Tax basis was profit adjusted for certain income and expenses and tax exemptions and incentives.

Deferred tax is recognised 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 recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the 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 against current tax assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised for 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 utilised. 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 realised.

Notes to the financial statements

3. Significant accounting policies (continued)

(e) Financial assets and liabilities

(i) Recognition

The Bank initially recognises loans and advances, placement with other banks and borrowings on the date that they are originated. All other financial assets and liabilities are initially recognised on the trading date at which the Bank becomes a party to the contractual provisions of the instrument.

(ii) Classification

See accounting policies 3(h), (i) and (j).

(iii) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability in the statement of financial position. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

(iv) Offsetting

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

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions.

Notes to the financial statements

3. Significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

(v) *Amortised cost measurement*

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

(vi) *Fair value measurement*

The determination of fair values of financial assets and financial liabilities is based on quoted market prices for financial instruments traded in active markets. For all other financial instruments fair value is determined by using valuation techniques. Valuation techniques include net present value techniques, the discounted cash flow method, comparison to similar instruments for which market observable prices exist, and valuation models.

(vii) *Identification and measurement of impairment*

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

The Bank considers evidence of impairment at specific asset level. All individually significant financial assets are assessed for specific impairment.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Notes to the financial statements

3. Significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

(vii) Identification and measurement of impairment (continued)

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

(f) Cash and cash equivalents

Cash and cash equivalents include cash balance on hand, demand deposits with banks, cash deposited with the National Bank of the Republic of Macedonia (“NBRM”) and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments, including treasury bills that can be traded on the secondary market.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(i) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

(g) Investment securities

Investment securities are initially measured at fair value plus, in case of investment securities not at fair value through profit or loss, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held to maturity or available for sale.

Notes to the financial statements

3. Significant accounting policies (continued)

(g) Investment securities (continued)

(i) *Held-to-maturity*

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity, and which are not designated as at fair value through profit or loss or as available for sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method.

A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available for sale, and would prevent the Bank from classifying investment securities as held to maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- sales or reclassifications after the Bank has collected substantially all of the asset's original principal;
- sales or reclassifications attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

(ii) *Available-for-sale*

Available-for-sale investments are non-derivative investments that are designated as available for sale or are not classified as another category of financial assets. Unquoted equity securities whose fair value cannot reliably be measured are carried at cost. All other available-for-sale investments are carried at fair value.

Interest income is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss.

Other fair value changes are recognised in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to profit or loss as a reclassification adjustment.

A non-derivative financial asset may be reclassified from the available-for-sale category to the loans and receivables category if it otherwise would have met the definition of loans and receivables and if the Bank has the intention and ability to hold that financial asset for the foreseeable future or until maturity.

Notes to the financial statements

3. Significant accounting policies (continued)

(h) Property and equipment

(i) *Recognition and measurement*

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, 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 capitalised borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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

The gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item of property and equipment, and are recognised within other income or other expenses in profit or loss.

(ii) *Subsequent costs*

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

(iii) *Depreciation*

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

The depreciation rates based on the estimated useful lives for the current and comparative period are as follows:

| | % |
|-------------------------|---------|
| Buildings | 2.5 |
| Furniture and equipment | 10 - 25 |
| Vehicles | 25 |

The depreciation method, estimated useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

Notes to the financial statements

3. Significant accounting policies (continued)

(i) Intangible assets

(i) *Recognition and measurement*

Intangible assets acquired by the Bank are stated at cost less accumulated amortisation and accumulated impairment losses.

(ii) *Subsequent expenditure*

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(iii) *Amortisation*

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use, since this most closely reflects the expected pattern of consumption of future economic benefits embodied in the asset.

The amortisation rates based on the estimated useful lives for the current and comparative period are as follows:

| | % |
|-----------------------|----|
| Software and licenses | 25 |

The amortisation method, estimated useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

(j) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial 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 amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses in respect of cash-generating units are allocated to reduce the carrying amount of the other assets in the unit (group of units) on a *pro rata* basis.

Notes to the financial statements

3. Significant accounting policies (continued)

(j) Impairment of non-financial assets (continued)

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.

Impairment losses recognised 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 amortisation, if no impairment loss had been recognised.

(k) Provisions

A provision is recognised if, as a result of a past event, the Bank 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, where appropriate, the risks specific to the liability.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Bank from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract.

Before a provision is established, the Bank recognises any impairment loss on the assets associated with that contract.

Notes to the financial statements

3. Significant accounting policies (continued)

(l) Employee benefits

(i) *Defined contribution plans*

The Bank contributes to its employees' post retirement plans as prescribed by the national legislation. Contributions, based on salaries, are made to the national organisations responsible for the payment of pensions.

There is no additional liability in respect of these plans. Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss when they are due.

(ii) *Short-term 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 if the Bank 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.

(iii) *Other long-term employee benefits*

In accordance with local regulations the Bank pays two average salaries to its employees at the moment of retirement and anniversary awards in accordance with the General collective agreement. The employee benefits are discounted to determine their present value. There is no additional liability in respect of post retirement.

(m) Managed funds

Assets and liabilities managed on a fee basis on behalf of the banks and the Government of the Republic of Macedonia are included in the statement of financial position on a net basis. Net liability position as reported in the statement of financial position reflects timing difference in collection of receivables or settlement of liabilities on behalf of the banks and the Government of the Republic of Macedonia.

Notes to the financial statements

3. Significant accounting policies (continued)

(n) Share capital and reserves

(i) Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity.

(ii) Dividends

The dividends that belong to the State as sole owner according to regulations is distributed to the Bank's reserves.

(o) Segment reporting

An operating segment is a component of the Bank that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Bank's other components, whose operating results are reviewed regularly by the Managing Board to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

Notes to the financial statements

3. Significant accounting policies (continued)

(p) New standards and interpretations not yet adopted

The following new Standards and Interpretations are not yet effective for the year ended 31 December 2009, and have not been applied in preparing these financial statements:

- Amendments to IFRS 2 *Share-based Payment - Group Cash-settled Share-based Payment Transactions* (effective for annual periods beginning on or after 1 January 2010). The amendments to the Standard require that an entity receiving goods or services in a share-based payment transaction that is settled by any other entity in the group or any shareholder of such an entity in cash or other assets to recognise the goods or services received in its financial statements. Previously group cash-settled share-based payment transactions were not addressed directly in IFRS 2.

The amendments to IFRS 2 are not relevant to the Bank's financial statements as the Bank does not have any share-based compensation plans.

- Revised IFRS 3 *Business Combinations* (effective for annual periods beginning on or after 1 July 2009). The scope of the revised Standard has been amended and the definition of a business has been expanded. The revised Standard also includes a number of other potentially significant changes including:
 - All items of consideration transferred by the acquirer are recognised and measured at fair value as of the acquisition date, including contingent consideration.
 - Subsequent change in contingent consideration will be recognized in profit or loss.
 - Transaction costs, other than share and debt issuance costs, will be expensed as incurred.
 - The acquirer can elect to measure any non-controlling interest at fair value at the acquisition date (full goodwill), or at its proportionate interest in the fair value of the identifiable assets and liabilities of the acquire, on a transaction-by-transaction basis.

Revised IFRS 3 is not relevant to the Bank's financial statements as the Bank does not have any interests in subsidiaries that will be affected by the revisions to the Standard.

- IFRS 9 *Financial Instruments* (effective for annual periods beginning on or after 1 January 2013, early adoption is permitted).

This Standard replaces the guidance in IAS 39, *Financial Instruments: Recognition and Measurement*, about classification and measurement of financial assets. The Standard eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivable.

Notes to the financial statements

3. Significant accounting policies (continued)

(p) New standards and interpretations not yet adopted (continued)

Financial assets will be classified into one of two categories on initial recognition:

- financial assets measured at amortized cost; or
- financial assets measured at fair value.

A financial asset is measured at amortized cost if the following two conditions are met: the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and, its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

Gains and losses on remeasurement of financial assets measured at fair value are recognised in profit or loss, except that for an investment in an equity instrument which is not held for trading, IFRS 9 provides, on initial recognition, an irrevocable election to present all fair value changes from the investment in other comprehensive income (OCI). The election is available on an individual share-by-share basis. No amount recognised in OCI is ever reclassified to profit or loss at a later date.

The Bank is currently in the process of evaluating the potential effect of this Standard. Given the nature of the Bank's operations, this Standard is expected to have a pervasive impact on the Bank's financial statements.

- Revised IAS 24 *Related Party Disclosure* (effective for annual periods beginning on or after 1 January 2011).

The amendment exempts government-related entity from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with (a) a government that has control, joint control or significant influence over the reporting entity; and (b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity. The revised Standard requires specific disclosures to be provided if a reporting entity takes advantage of this exemption.

The revised Standard also amends the definition of a related party which resulted in new relations being included in the definition, such as, associates of the controlling shareholder and entities controlled, or jointly controlled, by key management personnel.

The Bank has not yet completed its analysis of the impact of the revised Standard.

Notes to the financial statements

3. Significant accounting policies (continued)

(p) New standards and interpretations not yet adopted (continued)

- Revised IAS 27 *Consolidated and Separate Financial Statements* (effective for annual periods beginning on or after 1 July 2009). In the revised Standard the term minority interest has been replaced by non-controlling interest, and is defined as "the equity in a subsidiary not attributable, directly or indirectly, to a parent". The revised Standard also amends the accounting for non-controlling interest, the loss of control of a subsidiary, and the allocation of profit or loss and other comprehensive income between the controlling and non-controlling interest.

Revised IAS 27 is not relevant to the Bank's financial statements as the Bank does not have any interests in subsidiaries that will be affected by the revisions to the Standard.

- Amendment to IAS 32 *Financial Instruments: Presentation – Classification of Rights Issues* (effective for annual period beginning on or after 1 February 2010). The amendment requires that rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments.

The amendments to IAS 32 are not relevant to the Bank's financial statements as the Bank has not issued such instruments at any time in the past.

- Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items* (effective for annual periods beginning on or after 1 July 2009). The amended Standard clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. In designating a hedging relationship the risks or portions must be separately identifiable and reliably measurable; however inflation cannot be designated, except in limited circumstances.

The amendments to IAS 39 are not relevant to the Bank's financial statements as the Bank does not apply hedge accounting.

- *IFRS for Small and Medium-sized Entities* (The IFRS for SMEs does not contain an effective date; instead, it will take effect from a date determined by the national regulator in each jurisdiction). The IFRS for SMEs is intended to facilitate financial reporting by small and medium-sized entities (SMEs) that want to use international standards by providing an accounting standard suitable for them. It is a simplified and slimmed-down version of full IFRSs and is available for entities that do not have public accountability. It will be up to the national regulators and legislators to decide who is permitted or required to IFRS for SMEs in each jurisdiction.

IFRS for SMEs simplifies the recognition and measurement requirements compared to full IFRSs in some areas and excludes topics not considered relevant for SMEs and removes the more complex option in certain areas in which full IFRSs allow more than one accounting option.

Notes to the financial statements

3. Significant accounting policies (continued)

(p) New standards and interpretations not yet adopted (continued)

An entity follows either the requirements of the IFRS for SMEs in full or else uses full IFRSs. The only exception is that an entity applying the IFRS for SMEs can choose for financial instruments to apply either the provisions of the IFRS for SMEs, or the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement and the disclosure requirements of the IFRS for SMEs.

IFRS for SMEs is not relevant for the Bank, because the Bank is an entity with public accountability.

- Amendment to IFRIC 14 IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (effective for annual period beginning on or after 1 January 2011). The amendment of IFRIC 14 addresses the accounting treatment for prepayments made when there is also a minimum funding requirements (MFR). Under the amendments, an entity is required to recognize certain prepayments as an asset on the basis that the entity has a future economic benefit from the prepayment in the form of reduced cash outflows in future years in which MFR payments would otherwise be required.

The amendments to IFRIC 14 is not relevant to the Bank's financial statements as the Bank does not have any defined benefit plans with minimum funding requirements.

- IFRIC 17 *Distributions of Non-cash Assets to Owners* (effective prospectively for annual periods beginning on or after 15 July 2009). The Interpretation applies to non-reciprocal distributions of non-cash assets to owners acting in their capacity as owners. In accordance with the Interpretation a liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity and shall be measured at the fair value of the assets to be distributed. The carrying amount of the dividend payable shall be remeasured at each reporting date, with any changes in the carrying amount recognised in equity as adjustments to the amount of the distribution. When the dividend payable is settled the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable shall be recognised in profit or loss.

As the Interpretation is applicable only from the date of application, it will have no impact on the financial statements for periods prior to the date of adoption of the Interpretation. Further, since it relates to future dividends that will be at the discretion of the board of directors/shareholders, it is not possible to determine the effects of application in advance.

- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* (effective for annual periods beginning on or after 1 July 2010). The Interpretation clarifies that equity instruments issued to a creditor to extinguish all or part of a financial liability in a 'debt for equity swap' are consideration paid in accordance with IAS 39.41.

Notes to the financial statements

3. Significant accounting policies (continued)

(p) New standards and interpretations not yet adopted (continued)

The initial measurement of equity instruments issued to extinguish a financial liability is at the fair value of those equity instruments, unless that fair value cannot be reliably measured, in which case the equity instrument should be measured to reflect the fair value of the financial liability extinguished. The difference between the carrying amount of the financial liability (or part of the financial liability) extinguished and the initial measurement amount of equity instruments issued should be recognized in profit or loss.

The Bank did not issue equity to extinguish any financial liability during the current period. Therefore, the Interpretation will have no impact on the comparative amounts in the Bank's financial statements for the year ending 31 December 2009. Further, since the Interpretation can relate only to transactions that will occur in the future, it is not possible to determine the effects of application in advance.

Improvements to International Financial Reporting Standards 2009, released by the IASB in April 2009, introduced 15 amendments to 12 standards that result in accounting changes for presentation, recognition or measurement purposes. These improvements are not applicable for annual periods beginning before 1 July 2009 and are not expected to have a significant impact on the financial statements of the Bank.

4. Financial risk management

(a) Introduction and overview

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

- credit risk
- liquidity risk
- market risks

This note presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

Risk is the probability that some activity or event will have direct negative influence on the Bank's profit and/or own funds, or to cause some difficulties in the achievement of Bank's goals. The risk is properly managed when is identified, understand, estimated, monitored and controlled. The main elements of the risk management process of the Bank are clearly determined organisation structure, identification, measurement, monitoring and control, as well as appropriate use of the instruments for protection and reduction of certain risks.

Notes to the financial statements

4. Financial risk management (continued)

(a) Introduction and overview (continued)

Risk management framework

Risk Management Committee determines and implements policies for identifying and managing certain risk, gives proposals for their revision and performs monitoring and evaluation of the effectiveness of the whole process of risk management. The Supervisory Board approves the policies for identifying and managing the risks and follows their implementation. Risk management policies enable identification, measurement, monitoring and control of the appropriate risk and provide reasonable security that the Bank activities are in the right position for achievement of Bank's objectives and it is in compliance with the applicable rules and law regulation, as well as with the approved limits of exposures from the Supervisory Board. The limits of exposure to separate risks are subject to revision, depending of the internal and external conditions in which the Bank operates at least once a year. Additionally, the Managing Board of the Bank determines and follows the policies for identification, measurement, monitoring and internal controls of the risk management process. Taking into consideration that the risk management process is important for each employee in the Bank, trainings are conducted, with the aim of creating constructive environment, where all employees will understand their duties and obligation.

The Internal Audit undertakes both regular and ad-hoc reviews of the internal controls, policies and procedures for identifying and risk management of separate risks.

The risk management process is in compliance with the Bank's strategy for identifying and risk management.

(b) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk exposure principally arises from the Bank's loans and advances, but also there are other sources of credit risk such as guarantee, credit insurance of receivables, placements with banks and other positions that are included in the balance and off-balance Bank's evidence.

Management of credit risk

Management of credit risk is part of the integrated process for management with all financial risks on which the Bank is exposed. Clearly defined organisation structure is the key element of credit risk management process that provides credit risk exposure to be in the limits determined by the Supervisory Board.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Management of credit risk (continued)

The Supervisory Board approves individual credit exposures greater than 10% of the Bank's own funds, and also the credit exposure to each bank participant over 25% from Bank's own fund. The exposures less than these limits are approved by the Credit Committee and Insurance Committee.

The Bank has established internal grading system in the process of analysing/approving the credit risk exposures to banks participant, which has influence on determining the credit limits, and on the process of measurement of the risk and consequently on the determining the amount and the quality of the collateral.

The measurement of the credit risk is performed on individual basis, and the main indicators for credit risk are the exposure, the probability of bankruptcy, the probability for decreased credit worthiness, the probability of collection of written of receivables etc.

The Department for loans and guarantees, the Insurance Department and the Treasury and Liquidity Department follow all credit exposures in accordance with the prescribed limits.

The Management Board is responsible for performing control over the credit risk exposures and therefore has implemented internal acts, in which the internal limits are determined, with the purpose to help in the control and management of the risk. Namely, the controlling process has the purpose to minimise the risk influence over the capital and the profit in accordance with the strategic objectives of the Bank.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Management of credit risk (continued)

Regular audits of Credit department's processes are undertaken by the Internal Audit.

Exposure to credit risk

| <i>In thousands of denars</i> | <i>Note</i> | Placements with other banks | | Loans and advances to banks | | Loans and advances to customers | | Investment securities | |
|--------------------------------------|-------------------------|--|-------------|--|-------------|--|-------------|----------------------------------|-------------|
| | | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 |
| Carrying amount | <i>15,16, 17,18</i> | 201,871 | 310,884 | 3,062,615 | 2,171,917 | 316 | - | - | 166,608 |
| Assets at amortised cost | | | | | | | | | |
| Individually impaired | | | | | | | | | |
| Grade A | | - | - | 345,025 | - | - | - | - | - |
| Grade B | | - | - | - | 366,133 | - | - | - | - |
| Grade C | | - | - | - | - | - | - | - | - |
| Grade D | | - | - | - | - | - | - | - | - |
| Grade E | | - | - | 85,038 | 85,575 | 56,500 | 36,709 | - | - |
| Gross amount | | - | - | 430,063 | 451,708 | 56,500 | 36,709 | - | - |
| Allowance for impairment | | - | - | (113,042) | (125,539) | (56,500) | (36,709) | - | - |
| Carrying amount | | - | - | 317,021 | 326,169 | - | - | - | - |
| Neither past due nor impaired | | | | | | | | | |
| Grade A | | 201,871 | 310,884 | 2,745,594 | 1,845,748 | 316 | - | - | 166,608 |
| Carrying amount | | 201,871 | 310,884 | 2,745,594 | 1,845,748 | 316 | - | - | 166,608 |
| Total carrying amount | | 201,871 | 310,884 | 3,062,615 | 2,171,917 | 316 | - | - | 166,608 |

Impaired loans and securities

Impaired loans and securities are loans and securities for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according the contractual terms of the loan / securities agreement(s). These loans are graded A to E in the Bank's internal credit risk grading system.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Past due but not impaired loans

Loans and securities where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

Allowances for impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures.

Provision

The Bank calculates provision which represent estimate of incurred losses in off-balance sheet exposure. The Bank estimates is there a risk for potential losses for its off-balance positions exposure to credit risk (issued guarantees), when these conditions are fulfil:

- The Bank has present obligation as result of past event;
- There is a possibility for outflow of resources
- There is a reliably estimate of the amount that will be needed for settlement of the liability.

Write-off policy

The Bank writes off a loan / security balance (and any related allowances for impairment losses) when the Supervisory Board determines that the loans / securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

Notes to the financial statements

4. Financial risk management (continued)

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of individually impaired assets by risk grade.

| <i>In thousands of denars</i> | Loans and advances to banks | | Loans and advances to customers | |
|-------------------------------|-----------------------------|----------------|---------------------------------|----------|
| | Gross | Net | Gross | Net |
| 31 December 2009 | | | | |
| Individually impaired | | | | |
| Grade A | 345,025 | 317,021 | - | - |
| Grade B | - | - | - | - |
| Grade C | - | - | - | - |
| Grade D | - | - | - | - |
| Grade E | 85,038 | - | 56,500 | - |
| Total | <u>430,063</u> | <u>317,021</u> | <u>56,500</u> | <u>-</u> |
| 31 December 2008 | | | | |
| Individually impaired | | | | |
| Grade A | - | - | - | - |
| Grade B | 366,133 | 326,169 | - | - |
| Grade C | - | - | - | - |
| Grade D | - | - | - | - |
| Grade E | 85,575 | - | 36,709 | - |
| Total | <u>451,708</u> | <u>326,169</u> | <u>36,709</u> | <u>-</u> |

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

The Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk at the reporting date is shown below:

| <i>In thousands of denars</i> | <i>Note</i> | Placements with other banks | | Loans and advances to banks | | Loans and advances to customers | | Investment securities | | |
|----------------------------------|------------------|------------------------------------|-------------|------------------------------------|-------------|--|-------------|------------------------------|-------------|--|
| | | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 | |
| Carrying amount | <i>15,16, 17</i> | 201,871 | 310,884 | 3,062,615 | 2,171,917 | 316 | - | - | 166,608 | |
| Concentration by sector | | | | | | | | | | |
| Government | | - | - | - | - | 316 | - | - | 166,608 | |
| Banks | | 201,871 | 310,884 | 3,062,615 | 2,171,917 | - | - | - | - | |
| Concentration by location | | | | | | | | | | |
| EU countries | | 91,760 | 310,884 | - | - | - | - | - | - | |
| Republic of Macedonia | | 110,111 | - | 3,062,615 | 2,171,917 | 316 | - | - | 166,608 | |
| | | 201,871 | 310,884 | 3,062,615 | 2,171,917 | 316 | - | - | 166,608 | |

Concentration by location for loans and advances is measured based on the location of the borrower. Concentration by location for investment securities is measured based on the location of the issuer of the security.

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities that are settled by delivering cash or another financial asset.

Management of liquidity risk

The Bank'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 or risking damage to the Bank's reputation.

Notes to the financial statements

4. Financial risk management (continued)

(c) Liquidity risk (continued)

Department for treasury and liquidity receives information from other departments regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future operations. Department for treasury and liquidity maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities and placements with other banks, to ensure that sufficient liquidity is maintained within the Bank.

The daily liquidity position and market conditions are regularly monitored. All liquidity policies and procedures are subject to review and approval by Supervisory Board of the Bank. Monthly reports on Bank's liquidity are regularly submitted to NBRM.

Exposure to liquidity risk

The Bank has access to different sources of funds. Funds are raised with borrowings and share capital. This enhances funding flexibility, limits dependence on any one source of funds and generally lowers the cost of funds. The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities.

In addition the Bank holds a portfolio of liquid assets as part of its liquidity risk management strategy.

Residual contractual maturities of financial liabilities

| <i>In thousands of denars</i> | <i>Note</i> | Carrying amount | Gross nominal inflow / Less than (outflow) | 1 month | 1-3 months | 3 months to 1 year | 1-5 years | More than 5 years |
|-----------------------------------|-------------|------------------------|---|-----------------|-------------------|---------------------------|------------------|--------------------------|
| 31 December 2009 | | | | | | | | |
| <i>Non-derivative liabilities</i> | | | | | | | | |
| Borrowed funds | 22 | 1,956,013 | (1,956,013) | (9,996) | (29,165) | (46,313) | (872,472) | (998,067) |
| Other liabilities | 25 | 8,209 | (8,209) | (4,785) | (47) | (3,377) | - | - |
| | | <u>1,964,222</u> | <u>(1,964,222)</u> | <u>(14,781)</u> | <u>(29,212)</u> | <u>(49,690)</u> | <u>(872,472)</u> | <u>(998,067)</u> |
| 31 December 2008 | | | | | | | | |
| <i>Non-derivative liabilities</i> | | | | | | | | |
| Borrowed funds | 22 | 1,314,717 | (1,314,717) | (28,506) | (31,126) | (68,122) | (214,728) | (972,235) |
| Other liabilities | 25 | 5,206 | (5,206) | (562) | (2,556) | - | (2,088) | - |
| Unrecognised loan commitments | 27 | - | (59) | (59) | - | - | - | - |
| | | <u>1,319,923</u> | <u>(1,319,982)</u> | <u>(29,127)</u> | <u>(33,682)</u> | <u>(68,122)</u> | <u>(216,816)</u> | <u>(972,235)</u> |

Notes to the financial statements

4. Financial risk management (continued)

(c) Liquidity risk (continued)

The previous table shows the undiscounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The Bank's expected cash flows on these instruments vary significantly from this analysis.

The Gross nominal inflow / (outflow) disclosed in the previous table is the contractual, undiscounted cash flow on the financial liability or commitment.

To manage the liquidity risk arising from financial liabilities, the Bank holds liquid assets comprising cash and cash equivalents and investment securities for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements. Hence, the Bank believes that it is not necessary to disclose a maturity analysis in respect of these assets to enable users to evaluate the nature and extent of liquidity risk.

(d) Market risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Bank'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 optimising the return on risk.

Exposure to interest rate risk – non-trading portfolios

The risk of interest rates change in portfolio of banks activities is the risk of loss as a result of unfavourable interest rates changes that affect the Bank's activities. This is the most significant market risk.

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. In the case of floating rate assets and liabilities, the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as EURIBOR and different types of interest.

Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies. The Bank places loans at equal terms to all participating banks and for each credit line appropriate interest margin for the Bank is predetermined.

Asset-liability risk management activities are conducted in the context of the Bank's sensitivity to interest rate changes. In decreasing interest rate environments, margins earned will narrow as liabilities interest rates will decrease with a lower percentage compared to assets interest rates. However, the actual effect will depend on various factors, including stability of the economy, environment and level of the inflation.

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

A summary of the Bank's interest rate gap position on non-trading portfolios is as follows:

| <i>In thousands of denars</i> | <i>Note</i> | Carrying amount | Less than 1 month | 1- 3 months | 3-12 months | 1-5 years | More than 5 years |
|---------------------------------|-------------|------------------------|--------------------------|--------------------|--------------------|------------------|--------------------------|
| 31 December 2009 | | | | | | | |
| Cash and cash equivalents | <i>14</i> | 299,674 | 230,073 | 69,601 | - | - | - |
| Placement with other banks | <i>15</i> | 201,871 | 201,871 | - | - | - | - |
| Loans and advances to banks | <i>16</i> | 3,062,615 | 82,140 | 68,588 | 723,723 | 2,085,270 | 102,894 |
| Loans and advances to customers | | 316 | 316 | - | - | - | - |
| Other assets | <i>21</i> | 12,867 | 5,409 | 71 | 3,905 | 2,022 | 1,460 |
| | | <u>3,577,343</u> | <u>519,809</u> | <u>138,260</u> | <u>727,628</u> | <u>2,087,292</u> | <u>104,354</u> |
| Borrowed funds | <i>22</i> | 1,956,013 | 9,996 | 29,165 | 46,313 | 865,326 | 1,005,213 |
| Other liabilities | <i>25</i> | 8,209 | 4,785 | 47 | 3,377 | - | - |
| | | <u>1,964,222</u> | <u>14,781</u> | <u>29,212</u> | <u>49,690</u> | <u>865,326</u> | <u>1,005,213</u> |
| | | <u>1,613,121</u> | <u>505,028</u> | <u>109,048</u> | <u>677,938</u> | <u>1,221,966</u> | <u>(900,859)</u> |
| 31 December 2008 | | | | | | | |
| Cash and cash equivalents | <i>14</i> | 210,350 | 210,350 | - | - | - | - |
| Placement with other banks | <i>15</i> | 310,884 | 310,884 | - | - | - | - |
| Loans and advances to banks | <i>16</i> | 2,171,917 | 86,570 | 33,270 | 299,886 | 1,696,207 | 55,984 |
| Other assets | <i>22</i> | 12,901 | 4,487 | 123 | 587 | 5,000 | 2,704 |
| | | <u>2,706,052</u> | <u>612,291</u> | <u>33,393</u> | <u>300,473</u> | <u>1,701,207</u> | <u>58,688</u> |
| Borrowed funds | <i>22</i> | (1,314,717) | (28,506) | (31,126) | (68,122) | (214,728) | (972,235) |
| Other liabilities | <i>25</i> | (5,206) | (562) | (2,556) | - | (2,088) | - |
| | | <u>(1,319,923)</u> | <u>(29,068)</u> | <u>(33,682)</u> | <u>(68,122)</u> | <u>(216,816)</u> | <u>(972,235)</u> |
| | | <u>1,386,129</u> | <u>583,223</u> | <u>(289)</u> | <u>232,351</u> | <u>1,484,391</u> | <u>(913,547)</u> |

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios include a 1% parallel fall or rise in all yield curves.

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

| <i>In thousands of denars</i> | Gain/loss for the period |
|--------------------------------|-------------------------------------|
| 2009 | |
| At 31 December | |
| Interest income (1% increase) | 22,260 |
| Interest income (1% decrease) | (22,260) |
| Interest expense (1% increase) | 11,817 |
| Interest expense (1% decrease) | (11,817) |
| 2008 | |
| At 31 December | |
| Interest income (1% increase) | 18,084 |
| Interest income (1% decrease) | (18,084) |
| Interest expense (1% increase) | (11,735) |
| Interest expense (1% decrease) | 11,735 |

Exposure to currency risk – non-trading portfolios

The Bank is exposed to currency risk through transactions in foreign currencies. The Bank ensures that the net exposure is kept to an acceptable level by buying or selling foreign currency at spot when necessary to address short-term imbalances. The Denar is pegged to the Euro and the monetary projections envisage stability of the exchange rate of the Denar against Euro.

Currency risk is risk from loss due to the changes in the inter currency exchange rates and/or change in the value of Denar compared to the value of other foreign currencies. The Bank established systems for identifying, measuring, monitoring and controlling the currency risk on which the Bank is exposure in its operations, including all activities and transactions which in the balance and off-balance evidence are recorded in foreign currency and in Denar with FX clause.

Macedonian Bank for Development and Promotion has established policy with which is possible the funds from foreign sources to be placed in the same currency or in Denar with FX clause.

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to currency risk – non-trading portfolios (continued)

The measurement of the currency risk is performed the relation between aggregate foreign exchange position and the Bank's own fund. In the policy for managing of currency risk this internal limit is defined, which are different from the one prescribed by the law, since according to the Law for establishment of Macedonian Bank for Development and Promotion the procedures for open foreign currency position are not applicable to the Bank.

Monitoring of this risk on a regular basis provides safety for the Supervisory and Managing Board that the established system for control operates properly.

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

The Bank's exposure to foreign currency risk is as follows:

| <i>In thousands of denars</i> | 2009 | | | | 2008 | | | |
|-------------------------------|----------------|------------------|------------|------------------|----------------|------------------|---------------|------------------|
| | MKD | EUR | USD | Total | MKD | EUR | USD | Total |
| Cash and cash equivalents | 151,644 | 147,945 | 85 | 299,674 | 156,576 | 31,907 | 21,867 | 210,350 |
| Placements with other banks | - | 201,871 | - | 201,871 | - | 310,884 | - | 310,884 |
| Loans and advances to banks | - | 3,062,615 | - | 3,062,615 | - | 2,171,917 | - | 2,171,917 |
| Loans and advances to other | - | 316 | - | 316 | - | - | - | - |
| Investment securities | - | - | - | - | 166,608 | - | - | 166,608 |
| Other assets | 5,233 | 7,634 | - | 12,867 | 153 | 12,748 | - | 12,901 |
| | <u>156,877</u> | <u>3,420,381</u> | <u>85</u> | <u>3,577,343</u> | <u>323,337</u> | <u>2,527,456</u> | <u>21,867</u> | <u>2,872,660</u> |
| Borrowed funds | 152,298 | 1,803,715 | - | 1,956,013 | 150,872 | 1,163,845 | - | 1,314,717 |
| Other liabilities | 2,731 | 5,478 | - | 8,209 | 490 | 4,716 | - | 5,206 |
| | <u>155,029</u> | <u>1,809,193</u> | <u>-</u> | <u>1,964,222</u> | <u>151,362</u> | <u>1,168,561</u> | <u>-</u> | <u>1,319,923</u> |
| Net exposure | <u>1,848</u> | <u>1,611,188</u> | <u>85</u> | <u>1,613,121</u> | <u>171,975</u> | <u>1,358,895</u> | <u>21,867</u> | <u>1,552,737</u> |
| Unrecognised loan commitments | - | - | - | - | - | (59) | - | (59) |
| Net FX exposure | <u>1,848</u> | <u>1,611,188</u> | <u>85</u> | <u>1,613,121</u> | <u>171,975</u> | <u>1,358,836</u> | <u>21,867</u> | <u>1,552,678</u> |

Notes to the financial statements

4. Financial risk management (continued)

(e) Capital management

Regulatory capital

The Bank's lead regulator NBRM sets and monitors capital requirements for the Bank as a whole. The Bank is directly supervised by the local regulators.

In implementing capital adequacy requirements NBRM requires the Bank to maintain a prescribed ratio of 8% of own funds to sum of total risk-weighted assets. Total risk-weighted assets are sum of credit risk-weighted assets and sum of capital requirements for currency risk.

Bank's own funds are a sum of core capital, supplementary capital, less deductions, as follows:

- Core capital, which includes ordinary and non cumulative preference shares, share premium, bank reserves allocated from net profit that serve for covering losses arising from risks the Bank faces in its operations, retained earnings not encumbered by any future obligations, stated in the statement of financial position and confirmed by a Decision of the Bank's Shareholders' Assembly or accumulated loss from previous year, profit for the year if confirmed by the certified auditor, after deductions for loss for the year, licenses, patents, goodwill and other trademarks, treasury shares and the difference between the amount of the required allowance for impairment in accordance with the risk classification and allocated allowance for impairment and allowance for impairment calculated according the Decision for credit risk management.
- Supplementary capital, which includes cumulative preference shares, share premium less the amount of purchased treasury cumulative preference shares, hybrid capital instruments and subordinated liabilities issued by the Bank.
- The total of core capital and supplementary capital is reduced by the Bank's capital investments in banks and financial institutions exceeding 10% of the capital of such institutions, subordinated instruments and other investments in other banks or other financial institutions where the Bank holds more than 10% of the capital and other deductions.

When determining the amount of own funds, the bank shall observe the following restrictions:

- The amount of the supplementary capital cannot exceed the amount of the core capital.
- The sum of the nominal value of subscribed and paid-in ordinary shares, the share premium of such shares and the amount of reserves and the retained earnings, less the deductions from the core capital and supplementary capital previously described, should exceed the sum of other positions which are part of the Bank's core capital.

Notes to the financial statements

4. Financial risk management (continued)

(e) Capital management (continued)

The amount of subordinated instruments which are part of the supplementary capital is not to exceed 50% of the amount of core capital.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank and its individually regulated operations have complied with all externally imposed capital requirements throughout the period.

There have been no material changes in the Bank's management of capital during the period.

The Bank's own funds position at 31 December was as follows:

| <i>In thousands of denars</i> | 2009 | 2008 |
|--|------------------|------------------|
| Core capital | | |
| Ordinary share capital | 1,193,792 | 932,400 |
| Reserves | 325,407 | 209,035 |
| Less patents, licenses, goodwill and other trademarks | (203) | (363) |
| Total | <u>1,518,996</u> | <u>1,141,072</u> |
| Supplementary capital | | |
| Revaluation reserve | - | - |
| Total | <u>-</u> | <u>-</u> |
| Gross guarantee capital | 1,518,996 | 1,141,072 |
| Less Bank's capital investments in banks and other financial institutions | - | - |
| Guarantee capital | <u>1,518,996</u> | <u>1,141,072</u> |
| Risk-weighted assets | | |
| Risk-weighted assets | 4,834,796 | 2,101,250 |
| Risk-weighted off-balance sheet items | 174,697 | 19,036 |
| Less Bank's capital investments in banks and other financial institutions | - | - |
| Total risk-weighted assets | <u>5,009,493</u> | <u>2,120,286</u> |
| Capital ratios | | |
| Total guarantee capital expressed as a percentage of sum of total risk-weighted assets | 30.3% | 53.8% |

Notes to the financial statements

4. Financial risk management (continued)

(e) Capital management (continued)

Capital allocation

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation, by Supervisory Board.

5. Use of estimates and judgements

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

These disclosures supplement the commentary on financial risk management (see note 4).

Key sources of estimation uncertainty

Allowances for impairment losses on loans and advances

Assets accounted for at amortised cost are evaluated for impairment on a basis described in accounting policy 3(g)(vii).

The Bank reviews its loan portfolio to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the profit and loss the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in a group.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Notes to the financial statements

5. Use of estimates and judgements (continued)

Allowance for impairment of available for sale equity investments

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

Determining fair values

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy 3(g)(vi). For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

Critical accounting judgments in applying the Bank's accounting policies

Critical accounting judgements made in applying the Bank's accounting policies include:

Financial asset and liability classification

The Bank's accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances:

- In classifying financial assets as held-to-maturity, the Bank has determined that it has both the positive intention and ability to hold the assets until their maturity date as required by accounting policy 3(j)(i).

Notes to the financial statements

6. Operating segments

The Bank has only one reportable segment.

Products, services and major customers

The main activity of the Bank is funding the start up of businesses and the development of small and medium size enterprises, financing exports with loans and issuing financial guarantees through participant banks. The revenue of the Bank comprises of revenue from participant banks which bear the ultimate risk of collection of the receivables.

Geographical areas

In presenting information on the basis of geographical areas, revenue is based on the geographical location of customers and assets are based on geographical location of the assets.

Geographical information

| <i>In thousands of denars</i> | Republic of Macedonia | Europe | Other | Total |
|--------------------------------|----------------------------------|---------------|--------------|--------------|
| 2009 | | | | |
| Net external revenues/(losses) | 157,827 | (35,359) | - | 122,468 |
| Non-current assets* | 113,050 | - | - | 113,050 |
| 2008 | | | | |
| Net external revenues/(losses) | 158,206 | (10,376) | - | 147,830 |
| Non-current assets* | 117,233 | - | - | 117,233 |

* Includes property and equipment and intangibles assets.

Notes to the financial statements

7. Financial assets and liabilities

Accounting classifications and fair values

The table below sets out the Bank's classification of each class of financial assets and liabilities, and their fair values.

| <i>In thousands of denars</i> | <i>Note</i> | Loans and receivables | Held-to- maturity | Other amortised cost | Total carrying amount | Fair value |
|---------------------------------|-------------|----------------------------------|------------------------------|---------------------------------|----------------------------------|-------------------|
| 31 December 2009 | | | | | | |
| Cash and cash equivalents | 14 | 299,674 | - | - | 299,674 | 299,674 |
| Placements with other banks | 15 | 201,871 | - | - | 201,871 | 201,871 |
| Loans and advances to banks | 16 | 3,062,615 | - | - | 3,062,615 | 3,062,615 |
| Loans and advances to customers | 17 | 316 | - | - | 316 | 316 |
| Other assets | 21 | 12,867 | - | - | 12,867 | 12,867 |
| | | <u>3,577,343</u> | <u>-</u> | <u>-</u> | <u>3,577,343</u> | <u>3,577,343</u> |
| Borrowed funds | 22 | - | - | 1,956,013 | 1,956,013 | 1,956,013 |
| Other liabilities | 25 | - | - | 8,209 | 8,209 | 8,209 |
| | | <u>-</u> | <u>-</u> | <u>1,964,222</u> | <u>1,964,222</u> | <u>1,964,222</u> |
| 31 December 2008 | | | | | | |
| Cash and cash equivalents | 14 | 210,350 | - | - | 210,350 | 210,350 |
| Placements with other banks | 15 | 310,884 | - | - | 310,884 | 310,884 |
| Loans and advances to banks | 16 | 2,171,917 | - | - | 2,171,917 | 2,171,917 |
| Investment securities | 18 | - | 166,608 | - | 166,608 | 166,608 |
| Other assets | 21 | 12,901 | - | - | 12,901 | 12,901 |
| | | <u>2,706,052</u> | <u>166,608</u> | <u>-</u> | <u>2,872,660</u> | <u>2,872,660</u> |
| Borrowed funds | 22 | - | - | 1,314,717 | 1,314,717 | 1,314,717 |
| Other liabilities | 25 | - | - | 5,206 | 5,206 | 5,206 |
| | | <u>-</u> | <u>-</u> | <u>1,319,923</u> | <u>1,319,923</u> | <u>1,319,923</u> |

Notes to the financial statements

7. Financial assets and liabilities (continued)

Loans and advances to banks: The Bank is the only development bank in the Republic of Macedonia. There are no similar financial instruments on the market. Therefore, the interest rates that the Bank sets for these financial instruments are the market interest rates. The carrying amount of the loans at the reporting date approximates their fair value.

Borrowed funds: Bank's long term borrowings are borrowed from financial institutions that offer financial instruments with specific conditions, interest and maturity. There are no similar borrowings on the market. Therefore, the interest rates set by the financial institutions are the market interest rates. The carrying amount of the borrowed funds at the reporting date approximates their fair value.

Notes to the financial statements

8. Net interest income

| <i>In thousands of denars</i> | 2009 | 2008 |
|---------------------------------|----------------|----------------|
| Interest income | | |
| Cash and cash equivalents | 32,372 | 30,419 |
| Placements with other banks | 1,760 | 21,476 |
| Loans and advances to banks | 92,324 | 114,093 |
| Loans and advances to customers | 475 | 1,293 |
| Total interest income | <u>126,931</u> | <u>167,281</u> |
| Interest expense | | |
| Borrowed funds | <u>24,450</u> | <u>37,895</u> |
| Total interest expense | <u>24,450</u> | <u>37,895</u> |
| Net interest income | <u>102,481</u> | <u>129,386</u> |

9. Net fee and commission income

| <i>In thousands of denars</i> | 2009 | 2008 |
|--|---------------|---------------|
| Fee and commission income | | |
| Trust activities | 18,192 | 2,597 |
| Management fee | 4,119 | 5,471 |
| Letter of guarantees issued | 8,342 | 3,557 |
| Other | 167 | 133 |
| Total fee and commission income | <u>30,820</u> | <u>11,758</u> |
| Fee and commission expense | | |
| Lending | 2,448 | - |
| Letter of guarantees obtained ceded to reinsurer | 9,365 | 2,405 |
| Other | 643 | 546 |
| Total fee and commission expense | <u>12,456</u> | <u>2,951</u> |
| Net fee and commission income | <u>18,364</u> | <u>8,807</u> |

The Bank is authorized to act as an agent bank of the Government of the Republic of Macedonia disbursing the loans from the Italian Credit Line, Self-employment Project and Sustainable Energy Project financed by the International Bank for Reconstruction and Development (IBRD) through domestic banks.

Notes to the financial statements

9. Net fee and commission income (continued)

Part of the management fee in the amount of MKD 3,557 thousand (2008: MKD 4,506 thousand) represents fee income from managing funds from the KfW credit line. The remainder of the management fee, in the amount of MKD 562 thousand (2008: MKD 965 thousand) represents fee income from managing the NEPA Foundation.

Fee and commission income for financial guarantees arise from issued letters of guarantees for short-term export arrangements. Fee and commission expense arise from financial guarantees from foreign reinsurers (see note 27).

10. Other operating income

| <i>In thousands of denars</i> | 2009 | 2008 |
|---|--------------|--------------|
| Release of impairment provision for off-balance sheet items | - | 1,596 |
| Other | 1,623 | 2,974 |
| | <u>1,623</u> | <u>4,570</u> |

11. Personnel expenses

| <i>In thousands of denars</i> | 2009 | 2008 |
|--|---------------|---------------|
| Wages and salaries | 15,858 | 13,588 |
| Compulsory social security obligations | 8,178 | 6,607 |
| Payments to the members of the Supervisory Board | 814 | 681 |
| Other staff costs | 422 | 1,958 |
| | <u>25,272</u> | <u>22,834</u> |

Other staff costs comprise of collective agreement expenses (compensation for annual holiday, anniversary awards).

Notes to the financial statements

12. Other expenses

| <i>In thousands of denars</i> | 2009 | 2008 |
|--|---------------|---------------|
| Materials and services | 12,133 | 8,729 |
| Costs for business trips | 720 | 799 |
| Representation and marketing costs | 4,288 | 410 |
| Insurance premiums | 415 | 264 |
| Training costs | 357 | 209 |
| Impairment provision for off balance sheet items | 550 | - |
| Other | 95 | 1,293 |
| | <u>18,558</u> | <u>11,704</u> |

13. Income tax expenses

| <i>In thousands of denars</i> | 2009 | 2008 |
|-------------------------------|-------------|---------------|
| Current tax expense | | |
| Current year | 111 | 11,359 |
| | <u>111</u> | <u>11,359</u> |

Reconciliation of effective tax rate

| <i>In thousands of denars</i> | 2009 | 2009 | 2008 | 2008 |
|--|-------------|-------------|-------------|-------------|
| Profit before income tax | % | 59,147 | % | 112,260 |
| Income tax using the domestic corporation tax rate | 0.00 | - | 10.00 | 11,266 |
| Non-deductible expenses | 0.20 | 111 | 0.10 | 133 |
| Total income tax expense | 0.20 | 111 | 10.10 | 11,359 |

According the changes in Income Tax Law, from 1 January 2009, the Bank calculates and pays income tax on non-deductible expenses using tax rate of 10%. In 2008 the methodology for calculation of income tax was different. Tax base was profit adjusted for certain income and expenses and tax exemptions and incentives.

Notes to the financial statements

14. Cash and cash equivalents

| <i>In thousands of denars</i> | 2009 | 2008 |
|--------------------------------------|----------------|----------------|
| Cash on hand | 23 | 75 |
| Balances with NBRM | 2,138 | 92,434 |
| Current accounts with foreign banks | 78,430 | 31,994 |
| Current accounts with domestic banks | 1 | 21,780 |
| Government bills | 69,600 | - |
| Treasury bills | 149,482 | 64,067 |
| | <u>299,674</u> | <u>210,350</u> |

15. Placements with other banks

| <i>In thousands of denars</i> | 2009 | 2008 |
|-------------------------------|----------------|----------------|
| Placements with foreign banks | 201,871 | 310,884 |
| | <u>201,871</u> | <u>310,884</u> |

16. Loans and advances to banks

| <i>In thousands of denars</i> | 2009 | 2008 |
|---|------------------|------------------|
| Loans and advances to banks at amortised cost | 3,062,615 | 2,171,917 |
| | <u>3,062,615</u> | <u>2,171,917</u> |

Notes to the financial statements

16. Loans and advances to banks (continued)

Loans and advances to banks at amortised cost

| <i>In thousands of denars</i> | Gross amount | Impairment allowance 2009 | Carrying Amount | Gross amount | Impairment allowance 2008 | Carrying amount |
|---|------------------|------------------------------|------------------|------------------|------------------------------|------------------|
| Support of export arrangement | 209,992 | (24,469) | 185,523 | 165,733 | (27,388) | 138,345 |
| Development promotion of small and medium enterprises | 1,155,575 | (32,650) | 1,122,925 | 1,030,231 | (43,174) | 987,057 |
| Working capital | 26,766 | (54) | 26,712 | 37,862 | (742) | 37,120 |
| German – Macedonian fund | 2,894 | - | 2,894 | 7,133 | (130) | 7,003 |
| German credit line | 35,260 | (34,649) | 611 | 44,417 | (35,112) | 9,305 |
| German micro-credit line | 819,006 | (13,620) | 805,386 | 794,212 | (15,085) | 779,127 |
| Council of Europe Development Bank | 157,403 | (7,600) | 149,803 | 217,868 | (3,908) | 213,960 |
| Global Environment Facility | 2,915 | - | 2,915 | - | - | - |
| European Investment Bank (EIB) | 762,846 | - | 762,846 | - | - | - |
| Loans for liquidity given to banks participant | 3,000 | - | 3,000 | - | - | - |
| | <u>3,175,657</u> | <u>(113,042)</u> | <u>3,062,615</u> | <u>2,297,456</u> | <u>(125,539)</u> | <u>2,171,917</u> |

Allowances for impairment

| <i>In thousands of denars</i> | 2009 | 2008 |
|---|----------------|----------------|
| Specific allowances for impairment | | |
| Balance at 1 January | 125,539 | 136,207 |
| Impairment loss for the year | | - |
| Change for the year | 54,883 | |
| Release of impairment | (67,384) | (10,668) |
| Effect of foreign currency movements | 4 | - |
| Balance at 31 December | <u>113,042</u> | <u>125,539</u> |

Notes to the financial statements

17. Loans and advances to customers

| <i>In thousands of denars</i> | 2009 | 2008 |
|---|-----------------|-----------------|
| Loans and advances to customers at amortised cost | 56,816 | 36,709 |
| Less specific allowance for impairment | <u>(56,500)</u> | <u>(36,709)</u> |
| | <u>316</u> | <u>-</u> |

Allowances for impairment

| <i>In thousands of denars</i> | 2009 | 2008 |
|-------------------------------|-------------|-------------|
|-------------------------------|-------------|-------------|

Specific allowances for impairment

| | | |
|------------------------------|---------------|---------------|
| Balance at 1 January | 36,709 | 31,349 |
| Impairment loss for the year | | |
| Charge for the year | <u>19,791</u> | <u>5,360</u> |
| Balance at 31 December | <u>56,500</u> | <u>36,709</u> |

18. Investment securities

| <i>In thousands of denars</i> | 2009 | 2008 |
|--|-------------|----------------|
| Held-to-maturity investment securities | <u>-</u> | <u>166,608</u> |
| | <u>-</u> | <u>166,608</u> |

Held-to-maturity investment securities with fixed interest rate

| <i>In thousands of denars</i> | 2009 | 2008 |
|-------------------------------|-------------|----------------|
| Government bills | <u>-</u> | <u>166,608</u> |
| | <u>-</u> | <u>166,608</u> |

Notes to the financial statements

19. Property and equipment

| <i>In thousands of denars</i> | Buildings | Furniture & equipment | Motor vehicles | Total |
|-------------------------------|------------------|----------------------------------|-----------------------|----------------|
| Cost | | | | |
| Balance at 1 January 2008 | 120,584 | 18,865 | 5,198 | 144,647 |
| Acquisitions | - | 1,847 | - | 1,847 |
| Disposals and write-offs | - | (175) | - | (175) |
| Balance at 31 December 2008 | <u>120,584</u> | <u>20,537</u> | <u>5,198</u> | <u>146,319</u> |
| Balance at 1 January 2009 | 120,584 | 20,537 | 5,198 | 146,319 |
| Acquisitions | - | 1,414 | 1,230 | 2,644 |
| Disposals and write-offs | - | - | - | - |
| Balance at 31 December 2009 | <u>120,584</u> | <u>21,951</u> | <u>6,428</u> | <u>148,963</u> |
| Depreciation | | | | |
| Balance at 1 January 2008 | 8,012 | 12,467 | 5,048 | 25,527 |
| Depreciation for the period | 3,014 | 2,397 | 150 | 5,561 |
| Disposals | - | (175) | - | (175) |
| Balance at 31 December 2008 | <u>11,026</u> | <u>14,689</u> | <u>5,198</u> | <u>30,913</u> |
| Balance at 1 January 2009 | 11,026 | 14,689 | 5,198 | 30,913 |
| Depreciation for the period | 3,015 | 2,776 | 219 | 6,010 |
| Balance at 31 December 2009 | <u>14,041</u> | <u>17,465</u> | <u>5,417</u> | <u>36,923</u> |
| Carrying amounts | | | | |
| Balance at 1 January 2008 | <u>112,572</u> | <u>6,398</u> | <u>150</u> | <u>119,120</u> |
| Balance at 31 December 2008 | <u>109,558</u> | <u>5,848</u> | <u>-</u> | <u>115,406</u> |
| Balance at 31 December 2009 | <u>106,543</u> | <u>4,486</u> | <u>1,011</u> | <u>112,040</u> |

As at 31 December 2009 the Bank does not have any property pledged as collateral (2008: none).

Notes to the financial statements

20. Intangible assets

| <i>In thousands of denars</i> | Software and licences |
|-------------------------------|----------------------------------|
| Cost | |
| Balance at 1 January 2008 | 4,431 |
| Acquisitions | 405 |
| Balance at 31 December 2008 | <u>4,836</u> |
| Balance at 1 January 2009 | 4,836 |
| Acquisitions | 11 |
| Balance at 31 December 2009 | <u>4,847</u> |
| Amortisation | |
| Balance at 1 January 2008 | 2,230 |
| Amortisation for the period | 779 |
| Balance at 31 December 2008 | <u>3,009</u> |
| Balance at 1 January 2009 | 3,009 |
| Amortisation for the period | 828 |
| Balance at 31 December 2009 | <u>3,837</u> |
| Carrying amounts | |
| Balance at 1 January 2008 | <u>2,201</u> |
| Balance at 31 December 2008 | <u>1,827</u> |
| Balance at 31 December 2009 | <u>1,010</u> |

21. Other assets

| <i>In thousands of denars</i> | 2009 | 2008 |
|--|---------------|---------------|
| Prepaid expenses | 415 | 1,079 |
| Management fee receivables | 1,684 | 2,284 |
| Fee and commission receivables | 6,851 | - |
| Receivables from sold assets acquired through foreclosure procedures | 3,917 | 4,346 |
| Other | - | 5,192 |
| | <u>12,867</u> | <u>12,901</u> |

Notes to the financial statements

21. Other assets (continued)

Allowances for impairment of other assets

| <i>In thousands of denars</i> | 2009 | 2008 |
|---|-------------|-------------|
| Specific allowances for impairment | | |
| Balance at 1 January | 843 | 843 |
| Impairment loss for the year | | |
| Change for the year | 790 | - |
| Release of impairment | (1,580) | - |
| Balance at 31 December | <u>53</u> | <u>843</u> |

22. Borrowed funds

This note provides information about the contractual terms of the Bank's interest-bearing loans and borrowings. For more information about the Bank's exposure to interest rate and foreign currency refer to note 4.

| <i>In thousands of denars</i> | 2009 | 2008 |
|-------------------------------|------------------|------------------|
| Borrowed funds | <u>1,956,013</u> | <u>1,314,717</u> |
| | <u>1,956,013</u> | <u>1,314,717</u> |

Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

| <i>In thousands of denars</i> | Currency | Nominal interest rate | Year of maturity | 2009 Carrying amount | 2008 Carrying amount |
|--|-----------------|--------------------------------------|-------------------------|-----------------------------|-----------------------------|
| German credit line (KfW) | EUR | six-month EURIBOR + 1.85% | 2003-2010 | 36,297 | 95,860 |
| German micro - credit line (KfW) second tranche | EUR | 0.75%-2.00% | 2014-2044 | 378,344 | 379,823 |
| German micro - credit line (KfW) third tranche | EUR | 2.00% | 2017-2037 | 469,135 | 470,910 |
| Ministry of Finance | MKD | 1.00% | 2011-2031 | 152,298 | 150,872 |
| Council of Europe Development Bank (CEB) | EUR | three-month EURIBOR plus 0.28% | 2009-2013 | 157,053 | 217,252 |
| European Investment Bank (EIB) | EUR | 1.00% | 2011-2015 | 762,886 | - |
| | | | | <u>1,956,013</u> | <u>1,314,717</u> |

Notes to the financial statements

22. Borrowed funds

Terms and debt repayment schedule

Borrowed funds for German micro - credit line (KfW) second tranche, German micro - credit line (KfW) third tranche and European Investment Bank (EIB) are secured with the guarantees from the Republic of Macedonia. German credit line (KfW) and borrowing from Council of Europe Development Bank (CEB) are secured with the guarantees from the Government of the Republic of Macedonia.

23. Impairment provisions related to off balance sheet items

| <i>In thousands of denars</i> | <i>Note</i> | 2009 | 2008 |
|--|-------------|---------------------|---------------------|
| Balance at 1 January | | 2,519 | 4,115 |
| Provisions / (release) during the year | 10, 12 | <u>550</u> | <u>(1,596)</u> |
| Balance at 31 December | | <u><u>3,069</u></u> | <u><u>2,519</u></u> |

24. Net liabilities from managed funds

| <i>In thousands of denars</i> | 2009 | 2008 |
|--------------------------------|--------------------|--------------------|
| Receivables from managed funds | 1,326,969 | 1,026,684 |
| Liabilities from managed funds | <u>(1,326,969)</u> | <u>(1,026,684)</u> |
| | <u><u>-</u></u> | <u><u>-</u></u> |

The Bank is authorized to act as an agent bank of the Government of the Republic of Macedonia, disbursing the credits from the Italian credit line, funds from the Republic of Macedonia for Self - employment Project and the funds from IBRD for the Sustainable Energy Project to the final borrowers through selected commercial banks from the Republic of Macedonia.

25. Other liabilities

| <i>In thousands of denars</i> | 2009 | 2008 |
|-------------------------------|---------------------|---------------------|
| Insurance premium | 1,325 | 709 |
| Suppliers payable | 1,927 | 544 |
| Other | <u>4,957</u> | <u>3,953</u> |
| | <u><u>8,209</u></u> | <u><u>5,206</u></u> |

Notes to the financial statements

26. Capital and reserves

| <i>Share capital</i> <i>In number of shares</i> | Ordinary shares | |
|--|------------------------|----------------|
| | 2009 | 2008 |
| Issued and fully paid at 1 January | 300,000 | 300,000 |
| Issued during the year | 84,103 | - |
| Issued and fully paid at 31 December | <u>384,103</u> | <u>300,000</u> |

As at 31 December 2008, the authorized share capital comprised 300,000 ordinary shares. Ordinary shares have a par value of MKD 3,108 thousand. In October 2009 according to the changes in the Law for establishing the Macedonian Bank for Development Promotion guarantee fund was transferred to share capital. New 84,103 shares were issued with par value of MKD 3,108 thousand each.

The State as sole shareholder is entitled to receive dividends as declared from time to time and is entitled to one vote per share at the meetings of the shareholders of the Bank. According to the Law for establishing the Macedonian Bank for Development Promotion, dividends that relate to the State are distributed to the Bank's reserves. All shares rank equally with regard to the Bank's residual assets. All share capital is State owned.

Reserves

The Bank's reserves consist of allocation of profit and can be used for loss recovery. Such reserves can not be distributed to the shareholders as dividends, except in the case of the Bank's liquidation.

Reserves for Security

According to the Law for establishing the Macedonian Bank for Development Promotion the Bank should maintain reserves for securities. Reserves for security are for risk management regarding insurance and reinsurance of receivables based on export arrangements from commercial and non commercial risks, as well as insurance and passive reinsurance of foreign investments in the Republic of Macedonia and investments of domestic entities abroad from non commercial risks. The Bank does not have insurance and passive reinsurance of foreign investments in the Republic of Macedonia.

Notes to the financial statements

26. Capital and reserves (continued)

Guarantee fund

In accordance with the amendment of the Law for founding of the Macedonian Bank for Development Promotion in 2009, the Bank transferred guarantee fund for issuing financial guarantees towards commercial banks for long-term loans approved by commercial banks to micro, small and medium trading companies, sole traders and craftsman in the Republic of Macedonia, to share capital. The guarantees issued from the guarantee fund up to the date when the Law get in force, are liabilities of the Bank.

27. Contingencies

The Bank has contingent liabilities arising from issued letters of guarantees for short-term export arrangements. The Bank obtains letters of guarantees from foreign insurance institutions in the amount of 85% to 90% (2008: 70% to 90%) of the guaranteed amount.

These commitments and contingent liabilities have off balance-sheet credit risk because only commission and accruals for probable losses are recognised in the statement of comprehensive income until the commitments are fulfilled or expire. Many of the contingent liabilities and commitments will expire without being advanced in whole or in part. Therefore, the amounts do not represent expected future cash flows.

| <i>In thousands of denars</i> | <i>Note</i> | 2009 | 2008 |
|--|-------------|----------------|----------------|
| Payment guarantees | | 177,776 | 113,280 |
| Commitments to lend | | - | 59 |
| Impairment provisions related to off-balance sheet items | 23 | <u>(3,069)</u> | <u>(2,519)</u> |
| | | <u>174,707</u> | <u>110,820</u> |

28. Related parties

Sole owner of the Bank is the Government of the Republic of Macedonia.

The Bank can not approve loans and extend guarantees to the State, to public enterprises or to institutions funded by the State's budget.

Notes to the financial statements

28. Related parties (continued)

Transactions with government institutions

At the year end the transactions with government institutions, identified as related parties, were as follows:

(i) *Investment securities from related parties*

| <i>In thousands of denars</i> | Government institutions | |
|--|--------------------------------|----------------|
| | 2009 | 2008 |
| Investment securities at 1 January | 166,608 | - |
| Proceeds from investment securities | (168,608) | - |
| Acquisition of investment securities | - | 166,608 |
| Investment securities outstanding at 31 December | <u>-</u> | <u>166,608</u> |

(ii) *Borrowed funds from related parties*

| <i>In thousands of denars</i> | Government institutions | |
|------------------------------------|--------------------------------|----------------|
| | 2009 | 2008 |
| Borrowed funds at 1 January | 150,872 | 149,475 |
| Accrued interest | 1,426 | 1,397 |
| Borrowed funds at 31 December | <u>152,298</u> | <u>150,872</u> |
| Interest expense on borrowed funds | <u>1,742</u> | <u>1,427</u> |

(iii) *Other transactions with related parties*

| <i>In thousands of denars</i> | Government institutions | |
|---|--------------------------------|-------------|
| | 2009 | 2008 |
| Cash and cash equivalents | 69,600 | - |
| Other liabilities – deferred income from government grant | 815 | 815 |
| Interest income | 14,145 | - |
| Fee and commission income | 3,557 | 2,597 |

(iv) *Key management personnel compensation*

| <i>In thousands of denars</i> | 2009 | 2008 |
|-------------------------------|---------------|--------------|
| Short-term employee benefits | 14,069 | 8,604 |
| | <u>14,069</u> | <u>8,604</u> |

Notes to the financial statements

29. Subsequent events

No material events subsequent to the reporting date have occurred which require disclosure in the financial statements.