

Universal Investment Bank AD Skopje

Financial Statements
for the year ended
31 December 2010

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Independent auditors' report to the shareholders of Universal Investment Bank AD Skopje

We have audited the accompanying financial statements of Universal Investment Bank AD Skopje ("the Bank"), which comprise the statement of financial position as at 31 December 2010, the statements of comprehensive income, changes in equity and cash flows for the year 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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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.



Opinion

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

KPMG Macedonia DOO

KPMG Macedonia DOO
4 April 2011
Skopje

Statement of financial position

As at 31 December

In thousands of denars

	Note	2010	2009
Assets			
Cash and cash equivalents	15	2,246,471	1,823,904
Loans and advances to banks	16	447,603	756,398
Loans and advances to customers	17	5,841,872	5,166,850
Investment securities	18	872,066	1,446,450
Property and equipment	19	290,224	283,224
Intangible assets	20	112,702	73,572
Current tax assets		-	1,440
Other assets	21	128,816	84,151
Total assets		<u>9,939,754</u>	<u>9,635,989</u>
Liabilities			
Deposits from banks and other financial institutions	22	420,274	938,390
Deposits from customers	23	8,108,885	7,260,594
Other borrowed funds	24	131,604	192,415
Subordinated liabilities	25	263,174	270,878
Impairment provisions related to off balance sheet items	26	5,933	7,353
Other liabilities	27	70,968	60,346
Total liabilities		<u>9,000,838</u>	<u>8,729,976</u>
Equity	28		
Share capital		545,987	545,987
Share premium		510,387	510,387
Retained earnings		(175,011)	(207,914)
Other reserves		57,553	57,553
Total equity		<u>938,916</u>	<u>906,013</u>
Total liabilities and equity		<u>9,939,754</u>	<u>9,635,989</u>

The notes on pages 5 - 59 are an integral part of these financial statements.

These financial statements set out on pages 1 to 59 were approved by the Supervisory Board on 4 April 2011 and were signed on its behalf by the Managing Board of the Bank:


Mr. Kosta Mitrovski



Mr. Svetozar Popov



Mr. Delco Krstev



Statement of comprehensive income

For the year ended 31 December

<i>In thousands of denars</i>	<i>Note</i>	2010	2009
Interest income	8	783,573	826,393
Interest expense	8	<u>(410,163)</u>	<u>(416,485)</u>
Net interest income		373,410	409,908
Fee and commission income	9	192,984	163,308
Fee and commission expense	9	<u>(79,301)</u>	<u>(72,564)</u>
Net fee and commission income		113,683	90,744
Net foreign exchange gain		34,248	34,719
Other operating income	10	<u>24,404</u>	<u>30,332</u>
		58,652	65,051
Operating income		545,745	565,703
Net impairment loss on financial assets	17, 18, 21	(42,034)	(45,415)
Personnel expenses	11	(197,562)	(171,581)
Depreciation and amortisation	19,20	(32,962)	(47,123)
Other expenses	12	<u>(240,284)</u>	<u>(221,341)</u>
Profit before income tax		32,903	80,243
Income tax expense	13	<u>-</u>	<u>(1,388)</u>
Profit for the period		<u>32,903</u>	<u>78,855</u>
Basic and diluted earnings per share	14	62	149

The notes on pages 5 - 59 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December

In thousands of denars

Balance at 1 January 2009

Total comprehensive income for the period

Profit for the period

Other comprehensive income, net of income tax

Total comprehensive income for the period

Balance at 31 December 2009

Balance at 1 January 2010

Total comprehensive income for the period

Profit for the period

Other comprehensive income, net of income tax

Total comprehensive income for the period

Balance at 31 December 2010

	Share capital	Share premium	Other Reserves	Revaluation reserve for investment securities available-for-sale	Retained earnings	Total
Balance at 1 January 2009	545,987	510,387	60,168	(2,615)	(286,769)	827,158
Total comprehensive income for the period	-	-	-	-	78,855	78,855
Profit for the period	-	-	-	-	78,855	78,855
Other comprehensive income, net of income tax	-	-	-	-	-	-
Total comprehensive income for the period	-	-	-	-	78,855	78,855
Balance at 31 December 2009	545,987	510,387	60,168	(2,615)	(207,914)	906,013
Balance at 1 January 2010	545,987	510,387	60,168	(2,615)	(207,914)	906,013
Total comprehensive income for the period	-	-	-	-	32,903	32,903
Profit for the period	-	-	-	-	32,903	32,903
Other comprehensive income, net of income tax	-	-	-	-	-	-
Total comprehensive income for the period	-	-	-	-	32,903	32,903
Balance at 31 December 2010	545,987	510,387	60,168	(2,615)	(175,011)	938,916

The notes on pages 5 - 59 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>	2010	2009
Cash flows from operating activities			
Profit for the period		32,903	78,855
Adjustments for:			
Depreciation and amortisation	19,20	32,962	47,123
Net Gain on sale of property and equipment		(1,278)	(680)
Net Loss on sale of assets acquired through foreclosure procedure		-	(620)
Net impairment loss on financial assets	17,18,21	42,034	45,415
Impairment provision for off balance sheet items	10	(1,420)	(2,351)
Net interest income	8	(373,410)	(409,908)
Dividend income	10	(1,310)	(5,224)
Other non cash adjustments		(568)	-
Income tax expense	13	-	1,388
		<u>(270,087)</u>	<u>(246,002)</u>
Obligatory reserves with the NBRM		24,316	(176,038)
Change in loans and advances to banks		298,027	(254,582)
Change in loans and advances to customers		(722,138)	630,988
Change in assets acquired through foreclosure procedure		-	620
Change in other assets		(39,233)	819
Change in deposits from banks and other financial institutions		(518,274)	(292,786)
Change in deposits from customers		883,396	1,253,160
Change in other liabilities and impairment provision related to off balance sheet items		<u>10,622</u>	<u>2,984</u>
		(333,371)	919,163
Interest received		728,668	754,250
Interest paid		(454,779)	(369,841)
Income tax paid		-	(13,485)
Net cash used in operating activities		<u>(59,482)</u>	<u>1,290,087</u>
Cash flows from investing activities			
Acquisition of property and equipment	19	(39,699)	(64,926)
Proceeds from the sale of property and equipment	19	3,701	731
Acquisition of intangible assets	20	(41,816)	(64,917)
Proceeds from investment securities		12,282,292	6,984,118
Acquisition of investment securities		(11,637,065)	(8,328,646)
Dividends received		<u>1,310</u>	<u>5,224</u>
Net cash used in investing activities		<u>568,723</u>	<u>1,468,416</u>
Cash flows from financing activities			
Proceeds from other borrowed funds		637,156	56,725
Repayment of other borrowed funds		(698,374)	(100,978)
Proceeds from subordinated liabilities		-	244,693
Net cash from financing activities		<u>(61,218)</u>	<u>200,440</u>
Net increase in cash and cash equivalents		448,023	22,111
Cash and cash equivalents at 1 January		<u>1,353,848</u>	<u>1,331,737</u>
Cash and cash equivalents at 31 December	15	<u><u>1,801,871</u></u>	<u><u>1,353,848</u></u>

The notes on pages 5 - 59 are an integral part of these financial statements.

Notes to the financial statements

1. Reporting entity

Universal Investment Bank AD Skopje (“the Bank”) is a joint stock company incorporated and domiciled in the Republic of Macedonia.

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

St. Maksim Gorki 6
1000 Skopje
Republic of Macedonia

The Bank is licensed to perform all banking activities in accordance with the law. The main activities include commercial lending, receiving of deposits, payment operation services in the country and abroad, foreign exchange deals, trust activities and other services.

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

(d) Use of estimates and judgments

The preparation of financial statements 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.

Notes to the financial statements

2. Basis of preparation (continued)

(d) Use of estimates and judgments (continued)

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 note 5.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

(a) Foreign currency transactions

Transactions in foreign currencies are translated to Macedonian denars at the exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to Macedonian denars at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in Macedonian 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 Macedonian denars at the spot 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) and United States Dollars (USD).

The exchange rates used for translation at 31 December 2010 and 2009 were as follows:

	2010	2009
	MKD	MKD
1 EUR	61,51	61.17
1 USD	46,31	42.66

Notes to the financial statements

3. Significant accounting policies (continued)

(b) Interest

Interest income and expense are recognised in the profit or 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. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

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 include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in the profit or loss include:

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

Fair value changes on other financial assets and liabilities carried at fair value through profit or loss, are presented in net income from other financial instruments at fair value through profit or loss in the statement of comprehensive income.

(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 fees and commission income, including financial services provided by the Bank in respect of foreign currency settlements, guarantees, letters of credit, domestic and foreign payment operations and other services, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised as an income at the moment of payment.

Other fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

Notes to the financial statements

3. Significant accounting policies (continued)

(d) Dividends

Dividend income is recognised when the right to receive income is established. Dividends are reflected as a component of net trading income, or dividend income based on the underlying classification of the equity instrument.

(e) Lease payments made

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

(f) Income tax expense

In the Republic of Macedonia a new tax regime had become effective according which the base for income tax computation had been shifted from the profit before taxes to the income “distribution” concept. “Distributions” are split into two components:

- Tax on any dividend distribution – i.e. the tax base is the dividend paid;
- Tax on non deductible items – i.e. the tax base is the non deductible items specified in the tax rulebook less any allowable tax credits. The tax on non deductible items is paid each month in monthly advance installments based on the previous fiscal year computation of such non deductible differences. At year end a final tax computation is prepared with a final tax settlement.

As such, the new income tax regime provokes certain implications on the presentation of the tax in the financial statements which are summarized below:

(i) Tax on dividend distribution:

Tax on dividend distribution is considered to be income tax within scope of International Accounting Standards - Tax on Income (“IAS 12”).

The timing of recognition of this type of income tax is to be consistent with the underlining dividend liability recognition (i.e., recognized when the dividend is paid and/or declared). As such no provisions are required for income tax arising from dividend distribution until the dividend is declared and/or paid.

When the tax on dividend distribution arises on interim (advance) dividend paid before the year end, the income tax charge is recognized and presented in the Statement of comprehensive income after profit and loss before tax as income tax expense.

Notes to the financial statements

3. Significant accounting policies (continued)

(f) Income tax expense (continued)

When the tax on dividend distribution arises from retained earnings, it is recognized and presented in the Statement of changes in equity.

(ii) Tax on non deductible items:

Tax on non deductible items is not income tax and is out of scope of IAS 12. Accordingly, such tax expense is presented within the operating results see note 12, and related tax payable/receivable is presented within the other assets/other liabilities in the statement of financial position.

Recognition of tax provisions:

In case of tax contingencies, provisions are made in line with International Accounting Standards – Provisions, Contingent Liabilities and Contingent Assets adopted in the Republic of Macedonia (“IAS 37”).

Such provisions are not presented as deferred tax assets or deferred tax liabilities, but as other assets or other liabilities.

Recognition/reversal of such tax provisions (that is not income taxes) is presented within the other expenses/other income.

(g) Financial assets and liabilities

(i) Recognition

The Bank initially recognises loans and advances, deposits and borrowings on the date at which they are originated at cost. Regular way purchases and sales of financial assets are recognised on the trade date at which the Bank commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is initially measured at fair value plus (for an item not subsequently measured at fair value through profit or loss) transaction costs that are directly attributable to its acquisition or issue.

(ii) Classification

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

Notes to the financial statements

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(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 is 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 by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

(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.

Notes to the financial statements

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(vi) Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

Assets are measured at a bid price; liabilities are measured at an asking price.

(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.

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. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

Notes to the financial statements

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(vii) Identification and measurement of impairment (continued)

The Bank considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and advances and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified.

Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

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.

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. The cumulative loss that is removed from other comprehensive income and recognised in 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

The Bank writes off certain loans and advances and investment securities when they are determined to be uncollectible (see note 4).

Notes to the financial statements

3. Significant accounting policies (continued)

(h) 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 three months or less, 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.

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 future.

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.

(j) Investment securities

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

(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.

Notes to the financial statements

3. Significant accounting policies (continued)

(j) Investment securities (continued)

(i) Held-to-maturity (continued)

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 recognized 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)

(k) 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.

Notes to the financial statements

3. Significant accounting policies (continued)

(k) Property and equipment (continued)

(iii) Depreciation (continued)

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

	2010	2009
	<i>%</i>	
Buildings	2.5	2.5
Equipment	14,3 - 25	20 - 25

Depreciation methods, useful lives and residual value are reviewed at each financial year-end and adjusted if appropriate. Estimates in respect of certain items of property and equipment were revised in 2010 (see note 19).

(l) 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 intangible assets, from the date that it is available for use since this most closely reflects the expected pattern of consumption of the 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:

	2010	2009
	<i>%</i>	
Software	10	20
Rights and licences	10	20

Notes to the financial statements

3. Significant accounting policies (continued)

(l) Intangible assets (continued)

(iii) Amortisation (continued)

Amortisation methods, estimated useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. Estimates in respect of certain items of intangible assets were revised in 2010 (see note 20).

(m) Leased assets – lessee

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

Other leases are operating leases and the leased assets are not recognised on the Bank's statement of financial position.

(n) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable 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.

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.

Notes to the financial statements

3. Significant accounting policies (continued)

(o) Deposits, borrowed funds, debt securities issued and subordinated liabilities

Deposits, borrowed funds, debt securities issued and subordinated liabilities are the Bank's sources of debt funding.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument.

Deposits, borrowed funds, debt securities issued and subordinated liabilities are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective interest method, except where the Bank chooses to carry the liabilities at fair value through profit or loss.

(p) 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.

(q) 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.

Notes to the financial statements

3. Significant accounting policies (continued)

(q) Employee benefits (continued)

(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 or profit-sharing plans 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 jubilee awards. The employee benefits are discounted to determine their present value. There is no additional liability in respect of post retirement.

(r) Share capital and reserves

(i) Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of equity instruments are recognised as a deduction from equity.

(ii) Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, which includes directly attributable costs, is recognised as a deduction from equity.

Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold subsequently the amount received is recognised as an increase on equity, and the resulting surplus or deficit of the transaction is transferred to/from share premium.

(iii) Dividends

Dividends are recognised as a liability in the period in which they are declared.

Notes to the financial statements

3. Significant accounting policies (continued)

(s) Earnings per share

The Bank presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

(t) 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.

(u) New standards and interpretations not yet adopted

The following new Standards and Interpretations are not yet effective for the year ended 31 December 2010, and have not been applied in preparing these financial statements:

- IFRS 9 Financial Instruments issued in 2009 (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.

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.

Notes to the financial statements

3. Significant accounting policies (continued)

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

Gains and losses on re-measurement 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.

- IFRS 9 *Financial Instruments* issued in 2010 (effective for annual periods beginning on or after 1 January 2013, early adoption is permitted).

The 2010 additions to IFRS 9 replace the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*, about classification and measurement of financial liabilities and the derecognition of financial assets and financial liabilities.

The Standard retains almost all of the existing requirements from IAS 39 on the classification and measurement of financial liabilities and for derecognition of financial assets and financial liabilities.

The Standard requires that the amount of change in fair value attributable to changes in the credit risk of a financial liability designated at initial recognition as fair value through profit or loss, be presented in other comprehensive income (OCI), with only the remaining amount of the total gain or loss included in profit or loss. However, if this requirement creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change is presented in profit or loss. Amounts presented in OCI are not subsequently reclassified to profit or loss but may be transferred within equity.

Derivative financial liabilities that are linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, are required to be measured at fair value under IFRS 9.

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.

Notes to the financial statements

3. Significant accounting policies (continued)

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

- IFRS 7 *Disclosures - Transfers of Financial Assets* (effective for annual periods beginning on or after 1 July 2011, earlier application is permitted).

The Amendments require disclosure of information that enables users of financial statements:

- to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and
- to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets.

The Amendments define "continuing involvement" for the purposes of applying the disclosure requirements.

When applied, it is expected that the amendment to IFRS 7 will increase the current level of disclosure of financial assets.

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

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.

Revised IAS 24 is not relevant to the Bank's financial statements as the Bank is not a government-related entity and the revised definition of a related party is not expected to result in new relations requiring disclosure in the financial statements.

Notes to the financial statements

3. Significant accounting policies (continued)

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

- 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 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 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.

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 2010. 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.

Notes to the financial statements

3. Significant accounting policies (continued)

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

Improvements to International Financial Reporting Standards 2010, released by the IASB in May 2010, introduced eleven amendments to six standards and to one interpretation that result in accounting changes for presentation, recognition or measurement purposes. These improvements are not applicable for annual periods beginning before 1 July 2010 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 management framework

The Managing Board has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Managing Board has established the Asset and Liability Committee ("ALCO"), Credit Committee and the Supervisory Board has established Risk Management Committee which is responsible for developing and monitoring Bank's risk management policies in their specified areas. All committees report regularly to the Managing Board and Supervisory Board respectively.

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

The Bank's Risk Management Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank and the Bank's compliance with the requirements of the NBRM related to the risk management. The Bank's Risk Management Committee is assisted in these functions by the Internal Audit. The Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

Notes to the financial statements

4. Financial risk management (continued)

(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, and arises principally from the Bank's loans and advances to customers and other banks, issued guarantees and letters of credits and investment securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual debtor's default risk, country and sector's risk).

Management of credit risk

The Managing Board has delegated responsibility for the management of credit risk to its Credit Committee that approves all credit exposures up to EUR 250 thousand. All credit exposures over EUR 250 thousand must be approved by the Supervisory Board. Separate Bank's Credit departments (Department for Corporate Loans, Department for Retail loans and Credit Card Department) in close cooperation with Risk Management Department are responsible for oversight of the Bank's credit risk, including:

- *Formulating credit policies*, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- *Reviewing and assessing credit risk*. Credit departments assess all credit exposures in excess of designated limits, prior to facilities being committed to customers.
- *Limiting concentrations of exposure* to geographies and industries (for loans and advances), and by issuer, credit rating assessment by respective institutions, market liquidity and country (for investment securities).
- *Banks's credit risk gradings* in order to categorise exposures according to the degree of risk of financial loss faced and to focus management on the risks. The risk grading system is used in determining where impairment losses may be required. The current risk grading framework consists of six grades reflecting various degrees of risk of default and the availability of collateral.
- *Reviewing compliance* with agreed exposure limits, including those for industries, country risk and product types. Regular reports for the credit exposure, risk grading and allowance for impairment are provided to the Risk Management Committee, and appropriate corrective action is taken.

Credit departments are required to implement credit policies and procedures and in assistance with the Risk Management Department are responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risks in its portfolios.

Regular audits of Credit departments' processes are performed by the Internal Audit.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Exposure to credit risk

<i>In thousands of denars</i>	<i>Note</i>	Loans and advances to customers		Loans and advances to banks		Investment securities	
		2010	2009	2010	2009	2010	2009
Carrying amount	<i>16,17,18</i>	5,841,872	5,166,850	447,603	756,398	872,066	1,446,450
Assets at amortised cost							
Individually impaired							
Grade A		659,552	3,294,553	-	-	12,199	11,670
Grade B		532,000	347,885	-	-	-	-
Grade C		134,181	310,029	-	-	-	-
Grade D		123,545	89,329	-	-	-	-
Grade E		159,806	119,498	-	-	2,496	2,496
Gross amount		1,609,084	4,161,294	-	-	14,695	14,166
Allowance for impairment		(329,386)	(294,366)	-	-	(1,372)	(1,372)
Carrying amount		1,279,698	3,866,928	-	-	13,323	12,794
Collectively impaired:							
Grade A		4,315,522	1,227,839	-	-	-	-
Gross amount		3,833,151	1,227,839	-	-	-	-
Allowance for impairment		(13,230)	(3,355)	-	-	-	-
Carrying amount		4,302,292	1,224,484	-	-	-	-
Past due but not impaired							
Past due comprises of:							
0-45 days		91,734	-	-	-	-	-
Neither past due nor impaired							
Grade A		168,148	75,438	447,603	756,398	858,743	1,433,656
Carrying amount – amortised cost		168,148	75,438	447,603	756,398	858,743	1,433,656
Total carrying amount		5,841,872	5,166,850	447,603	756,398	872,066	1,446,450

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 to 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.

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider.

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, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-off policy

The Bank writes off a loan/ investment debt security balance (and any related allowances for impairment) 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. The Bank can also write off a loan/security balance (and any related allowances for impairment) on the base of a court decision when all other means for collection had expired.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

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

	Loans and advances to customers	
<i>In thousands of denars</i>	Gross	Net
31 December 2010		
Individually impaired		
Grade A	659,552	640,202
Grade B	532,000	477,846
Grade C	134,181	100,296
Grade D	123,545	61,355
Grade E	159,806	-
Total	1,609,084	1,279,698
31 December 2009		
Individually impaired		
Grade A	3,367,393	3,350,979
Grade B	347,885	312,157
Grade C	310,029	232,057
Grade D	89,329	44,575
Grade E	119,498	-
Total	4,234,134	3,939,768

The Bank holds collateral against loans and advances to customers in the form of mortgage, movable property, other registered securities over assets, cash deposits, lien over shares, guarantees, etc. Estimates of fair value are based on the value of collateral assessed at the time of lending. Collateral generally is not held over loans and advances to banks. Collateral usually is not held against investment securities, and no such collateral was held at 31 December 2010 or 2009.

According the Credit policy, depending on pledged collateral the Bank has the following types of loans:

- Mortgage loans;
- Loans with lien of movable property;
- Lombard loans with pledged shares;
- Loans with pledged shares;
- Loans with L/Gs;
- Loans covered by cash deposit;
- Other types of loans, including rights of tangible and intangible assets with determined price.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

An estimate of the fair value of collateral and other security enhancements held against financial assets is shown below:

<i>In thousands of denars</i>	Loans and advances to customers		Loans and advances to banks	
	2010	2009	2010	2009
Against individually impaired				
Property and equipment	3,170,501	2,379,340	-	-
Other	1,131,240	2,386,283	-	-
Against collectively impaired				
Property and equipment	1,330,888	795,448	-	-
Against neither past due nor impaired				
Other	2,207,465	795,448	447,603	756,398
Total	7,840,094	6,356,519	447,603	756,398

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>	Loans and advances to customers		Loans and advances to banks		Investment securities	
		2010	2009	2010	2009	2010	2009
Carrying amount	<i>16, 17, 18</i>	5,841,872	5,166,850	447,603	756,398	872,066	1,446,450
Concentration by sector							
Corporate		2,979,884	2,557,971	-	-	7,618	-
Bank		-	-	447,603	756,398	864,448	400,639
Retail		2,842,480	2,589,818	-	-	-	-
Public sector		19,508	19,061	-	-	-	1,045,811
		5,841,872	5,166,850	447,603	756,398	872,066	1,446,450
Concentration by location							
EU countries		79,070	61,747	407,601	756,398	2,132	1,964
Republic of Macedonia		5,762,802	5,094,010	40,002	-	869,934	1,444,486
Other		-	11,093	-	-	-	-
		5,841,872	5,166,850	447,603	756,398	872,066	1,446,450

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.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Cash and cash equivalents

The Bank held cash and cash equivalents of MKD 2,246,471 thousand at 31 December 2010 (2009: MKD 1,823,904 thousand) which represents its maximum credit exposure on these assets. The cash and cash equivalents are held with the central bank, domestic banks and foreign financial institution counterparties which are rated BBB to AA, based on rating agency Standard & Poor's ratings.

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with 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.

Treasury and Dealing Department receive 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 business. Treasury and Dealing Department then maintain a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, 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 ALCO. Daily reports cover the liquidity position of the Bank. Liquidity reports are submitted monthly to the NBRM.

Exposure to liquidity risk

The Bank has access to a diverse funding base. Funds are raised using a broad range of instruments including deposits 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. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required meeting business goals and targets set in terms of the overall Bank strategy.

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

Notes to the financial statements

4. Financial risk management (continued)

(c) Liquidity risk (continued)

Residual contractual maturities of financial liabilities

<i>In thousands of denars</i>	<i>Note</i>	Carrying amount	Gross nominal inflow / (outflow)	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	More than 5 years
31 December 2010								
<i>Non-derivative liabilities</i>								
Deposits from banks and other financial institutions	22	420,274	(420,274)	(47,320)	(8,500)	(346,871)	(17,583)	-
Deposits from customers	23	8,108,885	(8,108,885)	(3,611,726)	(1,297,649)	(2,789,370)	(376,664)	(33,476)
Other borrowed funds	24	131,604	(131,604)	(11,346)	-	(29,435)	(89,285)	(1,538)
Subordinated liabilities	25	263,174	(263,174)	-	(17,154)	-	-	(246,020)
Other liabilities	27	70,968	(70,968)	(47,303)	(7,733)	(6,426)	(9,506)	-
Unrecognised loan commitments	29	395,673	(395,673)	(43,450)	(55,010)	(292,377)	(4,836)	-
		<u>9,390,578</u>	<u>(9,390,578)</u>	<u>(3,761,145)</u>	<u>(1,386,046)</u>	<u>(3,464,479)</u>	<u>(497,874)</u>	<u>(281,034)</u>
31 December 2009								
<i>Non-derivative liabilities</i>								
Deposits from banks and other financial institutions	22	938,390	(938,390)	(210,630)	(32,250)	(464,834)	(221,500)	(9,176)
Deposits from customers	23	7,260,594	(7,260,594)	(2,332,943)	(1,819,528)	(2,680,721)	(427,402)	-
Other borrowed funds	24	192,415	(192,415)	(3,808)	(9,474)	(44,176)	(133,402)	(1,555)
Subordinated liabilities	25	270,878	(270,878)	(26,185)	-	-	-	(244,693)
Other liabilities	27	60,346	(60,346)	(39,646)	(3,332)	(7,343)	(10,025)	-
Unrecognised loan commitments	29	465,895	(465,895)	(86,989)	(70,694)	(283,265)	(24,947)	-
		<u>9,188,518</u>	<u>(9,188,518)</u>	<u>(2,700,201)</u>	<u>(1,935,278)</u>	<u>(3,480,339)</u>	<u>(817,276)</u>	<u>(255,424)</u>

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. For example, demand deposits from customers are expected to remain a stable, instead to be withdrawn in one month.

The Gross nominal inflow / (outflow) disclosed in the previous table represents the contractual, undiscounted cash flows relating to the principle and interest on the financial liability or commitment.

Notes to the financial statements

4. Financial risk management (continued)

(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.

Management of market risks

Exposure to interest rate risk – non-trading portfolios

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 the savings rate, LIBOR 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.

Asset-liability risk management activities are conducted in the context of the Bank's sensitivity to interest rate changes. In general, the Bank is asset sensitive because of the majority of the interest-earning assets and liabilities, the Bank has the right simultaneously to change the interest rates. 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 2010							
Cash and cash equivalents	15	2,246,471	1,801,871	-	6,151	438,449	-
Loans and advances to banks	16	447,603	447,603	-	-	-	-
Loans and advances to customers	17	5,841,872	287,181	346,055	1,644,624	2,523,885	1,040,127
Investment securities	18	872,066	858,743	-	-	-	13,323
Other assets	21	128,816	40,710	8,712	51,539	27,855	0
		<u>9,536,828</u>	<u>3,436,108</u>	<u>354,767</u>	<u>1,702,314</u>	<u>2,990,189</u>	<u>1,053,450</u>
Deposits from banks and other financial institutions	22	(420,274)	(47,320)	(8,500)	(346,871)	(17,583)	-
Deposits from customers	23	(8,108,885)	(3,611,727)	(1,297,648)	(2,789,370)	(376,664)	(33,476)
Other borrowed funds	24	(131,604)	(11,346)	-	(29,435)	(89,285)	(1,538)
Subordinated liabilities	25	(263,174)	(17,154)	-	-	-	(246,020)
Other liabilities	27	(70,968)	(47,303)	(7,733)	(6,426)	(9,506)	-
		<u>(8,994,905)</u>	<u>(3,734,850)</u>	<u>(1,313,881)</u>	<u>(3,172,102)</u>	<u>(493,038)</u>	<u>(281,034)</u>
		<u>541,922</u>	<u>(298,743)</u>	<u>(959,114)</u>	<u>(1,469,788)</u>	<u>2,497,151</u>	<u>772,416</u>
31 December 2009							
Cash and cash equivalents	15	1,823,904	1,354,977	-	6,162	462,765	-
Loans and advances to banks	16	756,398	225,284	445,784	85,330	-	-
Loans and advances to customers	17	5,166,850	302,437	409,766	1,320,363	2,085,513	1,048,771
Investment securities	18	1,446,450	1,045,811	-	387,844	-	12,795
Other assets	21	84,151	29,905	6,249	18,625	29,372	-
		<u>9,277,753</u>	<u>2,958,414</u>	<u>861,799</u>	<u>1,818,324</u>	<u>2,577,650</u>	<u>1,061,566</u>
Deposits from banks and other financial institutions	22	(938,390)	(210,630)	(32,250)	(464,834)	(221,500)	(9,176)
Deposits from customers	23	(7,260,594)	(2,332,943)	(1,819,528)	(2,680,721)	(427,402)	-
Other borrowed funds	24	(192,415)	(3,808)	(9,474)	(44,176)	(133,402)	(1,555)
Subordinated liabilities	25	(270,878)	(26,185)	-	-	-	(244,693)
Other liabilities	27	(60,346)	(39,646)	(3,332)	(7,343)	(10,025)	-
		<u>(8,722,623)</u>	<u>(2,613,212)</u>	<u>(1,864,584)</u>	<u>(3,197,074)</u>	<u>(792,329)</u>	<u>(255,424)</u>
		<u>555,130</u>	<u>345,202</u>	<u>(1,002,785)</u>	<u>(1,378,750)</u>	<u>1,785,321</u>	<u>806,142</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>Effect in thousands of denars</i>	Profit / loss for the period
2010	
Interest income (1% increase)	89,924
Interest income (1% decrease)	(89,924)
Interest expense (1% increase)	87,876
Interest expense (1% decrease)	(87,876)
2009	
Interest income (1% increase)	79,766
Interest income (1% decrease)	(79,766)
Interest expense (1% increase)	85,290
Interest expense (1% decrease)	(85,290)

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.

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>	2010					2009					
	MKD	EUR	USD	Other	Total	MKD	EUR	USD	CHF	Other	Total
Cash and cash equivalents	652,984	1,442,619	64,947	85,921	2,246,471	642,282	999,929	96,856	23,272	84,837	1,823,904
Loans and advances to banks	40,002	92,336	315,265	-	447,603	-	451,419	304,979	-	-	756,398
Loans and advances to customers	2,190,551	3,559,837	91,484	-	5,841,872	2,053,468	3,030,290	83,092	-	-	5,166,850
Investment securities	869,934	-	2,132	-	872,066	1,056,641	387,845	1,964	-	-	1,446,450
Other assets	120,186	5,309	3,294	27	128,816	79,444	3,250	1,389	-	68	84,151
	3,873,657	5,100,101	477,122	85,948	9,536,828	3,831,835	4,872,733	488,280	23,272	84,905	9,277,753
Deposits from banks and other financial institutions	75,102	332,177	12,995	-	420,274	543,300	382,587	12,503	-	-	938,390
Deposits from customers	3,275,791	4,296,456	465,114	71,524	8,108,885	2,713,805	3,995,181	476,399	22,099	75,209	7,260,594
Other borrowed funds	128,162	3,442	-	-	131,604	1,740	190,675	-	-	-	192,415
Subordinated liabilities	-	263,174	-	-	263,174	-	270,878	-	-	-	270,878
Other liabilities	46,387	24,259	164	158	70,968	46,661	13,168	247	81	270	60,346
	3,525,442	4,919,508	478,273	71,682	8,994,905	3,305,506	4,852,489	489,149	22,180	75,479	8,722,623
Net exposure	348,215	180,593	(1,151)	14,266	541,923	526,329	20,244	(869)	1,092	9,426	555,130
Loan commitments	(395,673)	-	-	-	(395,673)	(465,895)	-	-	-	-	(465,895)
Net FX exposure	(47,458)	180,593	(1,151)	14,266	146,250	60,434	20,244	(869)	1,092	9,426	89,235

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 15% 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.

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

Notes to the financial statements

4. Financial risk management (continued)

(e) Capital management (continued)

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 were no significant changes in the Bank's approach to capital management during the year.

As at 31 December 2010 the Bank is in compliance with the prescribe ratio.

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 own funds. The process of allocating capital to specific operations and activities is monitored independently of those responsible for the operation, by the Supervisory Board.

5. Key sources of estimation uncertainty

Allowances for impairment losses on loans and advances

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

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.

The Bank's 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. Key sources of estimation uncertainty (continued)

Allowances for impairment losses on loans and advances (continued)

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired loans and advances and held-to-maturity investment securities, but the individual impaired items cannot yet be identified. In assessing the need for collective loan loss allowances, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic condition. The accuracy of the allowances depends on how well these estimate future cash flows for specific counterparty allowances and the model assumptions and parameters used in determining collective allowances.

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:

Valuation of financial instruments

The fair value measurements is disclosed in the accounting policy 3(g)(vi).

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1: Quoted market price (unadjusted) in an active market for an identical instrument;

Notes to the financial statements

5. Key sources of estimation uncertainty (continued)

Determining fair values (continued)

Valuation of financial instruments (continued)

Level 2: Valuation techniques based on observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data;

Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation.

This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised:

<i>In thousands of denars</i>	<i>Note</i>	Level 1	Level 2	Level 3	Total
31 December 2010					
Investment securities	18	13,323	-	-	-
		<u>13,323</u>	<u>-</u>	<u>-</u>	<u>-</u>
31 December 2009					
Investment securities	18	387,845	-	-	387,845
		<u>387,845</u>	<u>-</u>	<u>-</u>	<u>387,845</u>

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 "trading", the Bank has determined that it meets the description of financial assets held for trading.
- In designating financial assets or liabilities at fair value through profit or loss, the Bank has determined that it has met one of the criteria for this designation.
- 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.

Details of the Bank's classification of financial assets and liabilities are given in note 7.

Notes to the financial statements

6. Operating segments

The Bank has two operational segments, as described below, which are the Bank's strategic business units. The strategic business units offer different products and services and are managed separately based on the Bank's management structure. Supervisory Board reviews at least monthly Management report that obtains information regarding the business. The following summary describes the operations in the Bank's reportable segments:

Corporate Banking (legal entities) – Includes the following: different loans' products for corporate clients, issuing business credit cards, payment operations in the country and abroad for residential and non-residential legal entities, operations on foreign exchange market, interbanking borrowings, brokerage services, trade with securities issued by the State etc.

Retail Banking (individuals) – Includes the following activities: different types of loans for individuals, issuing debit and credit cards, payment operations in the country and abroad for residential and non-residential individuals, brokerage services, safe renting, operations on foreign exchange market etc.

Also, the Bank has activities regarding services of POS terminal network and ATMs that were not specified in the above mentioned activities.

Notes to the financial statements

6. Operating segments (continued)

Information about operating segments

2010

<i>In thousands of denars</i>	Retail Banking	Corporate Banking	Total
External revenue			
Net interest income	4,984	368,426	373,410
Net fee and commission income	58,258	55,425	113,683
Other operating income	14,305	35,584	49,889
Total segment revenue	<u>77,547</u>	<u>459,435</u>	<u>536,982</u>
Other material non-cash items:			
Impairment losses on financial assets	(31,906)	(10,103)	(42,009)
Reportable segment profit before income tax	<u>(265,613)</u>	<u>326,049</u>	<u>60,436</u>
Reportable segment assets	3,198,467	6,325,846	9,524,313
Reportable segment liabilities	5,970,000	3,030,838	9,000,838

2009

<i>In thousands of denars</i>	Retail Banking	Corporate Banking	Total
External revenue			
Net interest income	80,205	329,703	409,908
Net fee and commission income	13,903	76,841	90,744
Other operating income	5,732	29,781	35,513
Total segment revenue	<u>99,840</u>	<u>436,325</u>	<u>536,165</u>
Other material non-cash items:			
Impairment losses on financial assets	(5,380)	(39,869)	(45,249)
Reportable segment profit before income tax	<u>31,091</u>	<u>233,303</u>	<u>264,394</u>
Reportable segment assets	2,641,081	6,631,734	9,272,815
Reportable segment liabilities	5,841,635	2,876,212	8,717,847

Notes to the financial statements

6. Operating segments (continued)

Information about operating segments (continued)

Reconciliations of reportable segment revenues, profit or loss and assets and liabilities

<i>In thousands of denars</i>	2010	2009
Revenues		
Total revenue for reportable segments	536,982	536,165
Unallocated amounts	8,763	29,538
Total revenue	545,745	565,703
Profit or loss		
Total profit or loss for reportable segments	60,436	264,394
Unallocated amounts:		
Depreciation and amortisation	(32,962)	(47,123)
Other	5,429	(137,028)
Profit before income tax	32,903	80,243
Assets		
Total assets for reportable segments	9,524,313	9,272,815
Other unallocated amounts	415,441	363,174
Total assets	9,939,754	9,635,989
Liabilities		
Total liabilities for reportable segments	9,000,838	8,717,847
Other unallocated amounts	-	12,129
Total liabilities	9,000,838	8,729,976

Notes to the financial statements

6. Operating segments (continued)

Information about operating segments (continued)

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	OECD countries less European OECD countries	Other	Total
2010					
External revenues	443,399	(6,025)	(6,525)	114,896	545,745
Non-current assets*	402,923	-	-	-	402,923
2009					
External revenues	491,285	(21,815)	(4,096)	100,329	565,703
Non-current assets*	356,796	-	-	-	356,796

* 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 carrying amount and fair values of the Bank's financial assets and financial liabilities:

<i>In thousands of denars</i>	<i>Note</i>	Loans and receivables	Held to maturity	Available-for- sale	Other amortised cost	Total carrying amount	Fair value
31 December 2010							
Cash and cash equivalents	15	2,246,471	-	-	-	2,246,471	2,246,471
Loans and advances to banks	16	447,603	-	-	-	447,603	447,603
Loans and advances to customers	17	5,841,872	-	-	-	5,841,872	5,841,872
Investment securities	18	-	858,743	13,323	-	872,066	872,066
Other assets	21	-	-	-	128,816	128,816	128,816
		8,535,946	858,743	13,323	128,816	9,536,828	9,536,828
Deposits from banks and other financial institutions							
Deposits from customers	22	-	-	-	420,274	420,274	420,274
Other borrowed funds	23	-	-	-	8,108,885	8,108,885	8,108,885
Subordinated liabilities	24	-	-	-	131,604	131,604	131,604
Other liabilities	25	-	-	-	263,174	263,174	263,174
	26	-	-	-	70,968	70,968	70,968
		-	-	-	8,994,905	8,994,905	8,994,905
31 December 2009							
Cash and cash equivalents	15	1,823,904	-	-	-	1,823,904	1,823,904
Loans and advances to banks	16	756,398	-	-	-	756,398	756,398
Loans and advances to customers	17	5,166,850	-	-	-	5,166,850	5,166,850
Investment securities	18	-	1,045,811	400,639	-	1,446,450	1,446,450
Other assets	21	-	-	-	84,151	84,151	84,151
		7,747,152	1,045,811	400,639	84,151	9,277,753	9,277,753
Deposits from banks and other financial institutions							
Deposits from customers	22	-	-	-	938,390	938,390	938,390
Other borrowed funds	23	-	-	-	7,260,594	7,260,594	7,260,594
Subordinated liabilities	24	-	-	-	192,415	192,415	192,415
Other liabilities	25	-	-	-	270,878	270,878	270,878
	26	-	-	-	60,346	60,346	60,346
		-	-	-	8,722,623	8,722,623	8,722,623

Notes to the financial statements

8. Net interest income

In thousands of denars

	2010	2009
Interest income		
Cash and cash equivalents	10,558	9,576
Loans and advances to banks	31,664	23,609
Loans and advances to customers	673,361	734,341
Investment securities	67,990	58,867
Total interest income	<u>783,573</u>	<u>826,393</u>

Interest expense

Deposits from banks and other financial institutions	38,531	55,820
Deposits from customers	339,133	324,416
Other borrowed funds	7,227	10,040
Subordinated liabilities	25,272	26,209
Total interest expense	<u>410,163</u>	<u>416,485</u>
Net interest income	<u>373,410</u>	<u>409,908</u>

9. Net fee and commission income

In thousands of denars

	2010	2009
Fee and commission income		
Loans and credit cards	58,152	40,302
Payment operations in the country	73,383	64,816
Payment operations abroad	27,023	23,369
Commitments and contingencies	11,577	11,511
Brokerage	326	642
Trust activities	-	546
Other	22,523	22,122
Total fee and commission income	<u>192,984</u>	<u>163,308</u>
Fee and commission expense		
Credit cards	57,371	53,449
Payment operations within the country	13,581	10,752
Payment operations abroad	7,962	7,884
Other	387	479
Total fee and commission expense	<u>79,301</u>	<u>72,564</u>
Net fee and commission income	<u>113,683</u>	<u>90,744</u>

Notes to the financial statements

10. Other operating income

<i>In thousands of denars</i>	<i>Note</i>	2010	2009
Dividends on available-for-sale equity securities		1,310	5,224
Release of impairment provision related to off balance sheet items	26	1,420	2,351
Rental income		2,327	2,409
Capital gain on sale of assets acquired through foreclosure procedure		-	620
Capital gain on sale of equipment		1,442	680
Other		17,905	19,048
		<u>24,404</u>	<u>30,332</u>

11. Personnel expenses

<i>In thousands of denars</i>	2010	2009
Wages and salaries	132,996	116,461
Compulsory contributions	57,513	53,454
Other staff costs	7,053	1,666
	<u>197,562</u>	<u>171,581</u>

12. Other expenses

<i>In thousands of denars</i>	2010	2009
Materials and services	91,499	78,829
Rents	63,698	65,431
Insurance premiums of deposits	40,625	34,627
Marketing and advertisement costs	17,690	18,849
Penalties, court and administrative expenses	3,601	2,792
Other	23,171	20,813
	<u>240,284</u>	<u>221,341</u>

Notes to the financial statements

13. Income tax expense

Current tax expense

In thousands of denars

	2010	2009
Current year	-	1,388
	<u>-</u>	<u>1,388</u>

Reconciliation of effective tax rate

In thousands of denars

	2010	2010	2009	2009
Profit before income tax		<u>32,903</u>		<u>80,243</u>
Income tax using the domestic corporation tax rate	-	-	-	-
Non-deductible expenses	-	-	1.7%	1,388
Tax exempt revenue	-	-	-	-
Total income tax expense	<u>-</u>	<u>-</u>	<u>1.7%</u>	<u>1,388</u>

14. Basic and diluted earnings per share

The calculation of basic and diluted earnings per share at 31 December 2010 was based on the profit attributable to ordinary shareholders of MKD 32,903 thousand (2009: MKD 78,855 thousand) and a weighted average number of ordinary shares outstanding of 530,445 (2009: 530,445), calculated as follows:

Profit attributable to ordinary shareholders

In thousands of denars

	2010	2009
Net profit for the period	<u>32,903</u>	<u>78,855</u>
Net profit attributable to ordinary shareholders	<u>32,903</u>	<u>78,855</u>

Weighted average number of ordinary shares

Number of shares

	2010	2009
Issued ordinary shares at 1 January	<u>530,445</u>	<u>530,445</u>
Weighted average number of ordinary shares at 31 December	<u>530,445</u>	<u>530,445</u>

Notes to the financial statements

15. Cash and cash equivalents

<i>In thousands of denars</i>	2010	2009
Cash on hand	269,263	254,728
Balances with the National Bank of Republic of Macedonia	449,396	449,691
Current accounts with foreign banks	336,224	408,040
Current accounts with local banks	20,627	26,841
Placement with banks with maturity up to 3 months	726,316	214,502
Other short term highly liquid investments	45	46
Total cash and cash equivalents for the cash flow statement	<u>1,801,871</u>	<u>1,353,848</u>
Obligatory reserves with the NBRM	438,449	462,765
Restricted deposits	<u>6,151</u>	<u>7,291</u>
	<u>2,246,471</u>	<u>1,823,904</u>

At 31 December 2010 cash and cash equivalents included MKD 300,146 thousand (2009: MKD 340,810 thousand) as obligatory reserve requirement in MKD and MKD 438,449 thousand (2009: MKD 462,765 thousand) as obligatory reserve in foreign currency requirement.

The funds from obligatory reserve in foreign currency and restricted deposits are not available for the Bank's daily business and are excluded in preparation of the cash flow statements.

16. Loans and advances to banks

<i>In thousands of denars</i>	2010	2009
Loans and advances to banks	<u>447,603</u>	<u>756,398</u>
	<u>447,603</u>	<u>756,398</u>

Loans and advance to banks as at 31 December 2010 and 31 December 2009 represent repo transactions with First Investment Bank Sofija, with securities as collateral.

17. Loans and advances to customers

<i>In thousands of denars</i>	2010	2009
Loans and advances to customers at amortised cost	<u>5,841,872</u>	<u>5,166,850</u>
	<u>5,841,872</u>	<u>5,166,850</u>

At 31 December 2010 MKD 3,564,012 thousand (2009: MKD 2,855,864 thousand) of loans and advances to customers are expected to be recovered more than 12 months after the reporting date.

Notes to the financial statements

17. Loans and advances to customers (continued)

<i>In thousands of denars</i>	2010	2009
Corporate customers:		
Principal	3,004,016	2,634,626
Interest	22,136	22,862
Public sector:		
Principal	15,145	19,019
Interest	43	42
Other:		
Principal	2,477	2,966
Interest	13	14
Retail customers:		
Principal		
Housing	268,541	108,708
Consumer	1,645,670	1,647,229
Car	25,397	26,570
Credit cards	300,537	308,148
Other	799,885	598,493
Interest	21,550	23,054
Non resident customers:		
Principal	79,069	72,840
Total gross loans and advances to customers	<u>6,184,479</u>	<u>5,464,571</u>
Allowance for impairment	<u>(342,607)</u>	<u>(297,721)</u>
Total loans and advances to customers	<u><u>5,841,872</u></u>	<u><u>5,166,850</u></u>

Allowances for impairment

<i>In thousands of denars</i>	2010	2009
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Specific allowances for impairment

Balance at 1 January	294,366	259,034
Impairment loss for the year:		
Charge for the year	<u>35,011</u>	<u>35,332</u>
Balance at 31 December	<u><u>329,377</u></u>	<u><u>294,366</u></u>

Collective allowances for impairment

Balance at 1 January	3,355	-
Impairment loss for the year:		
Charge for the year	<u>9,875</u>	<u>3,355</u>
Balance at 31 December	<u><u>13,230</u></u>	<u><u>3,355</u></u>
Total allowance for impairment	<u><u>342,607</u></u>	<u><u>297,721</u></u>

Notes to the financial statements

18. Investment securities

<i>In thousands of denars</i>	2010	2009
Held-to-maturity investment securities	858,743	1,045,811
Available-for-sale investment securities	<u>13,323</u>	<u>400,639</u>
	<u><u>872,066</u></u>	<u><u>1,446,450</u></u>

Held-to-maturity investment securities with fixed interest rate

<i>In thousands of denars</i>	2010	2009
Treasury Bills	<u>858,743</u>	<u>1,045,811</u>
	<u><u>858,743</u></u>	<u><u>1,045,811</u></u>

Available-for-sale investment securities

<i>In thousands of denars</i>	2010	2009
Government Bills	-	387,845
Available-for-sale equity securities	<u>13,323</u>	<u>12,794</u>
	<u><u>13,323</u></u>	<u><u>400,639</u></u>

Allowances for impairment

<i>In thousands of denars</i>	2010	2009
Specific allowances for impairment		
Balance at 1 January	1,372	-
Impairment loss for the year:		
Charge for the year	<u>-</u>	<u>1,372</u>
Balance at 31 December	<u><u>1,372</u></u>	<u><u>1,372</u></u>

Notes to the financial statements

19. Property and equipment

<i>In thousands of denars</i>	Buildings	Equipment	Assets under construction	Total
Cost				
Balance at 1 January 2009	179,167	191,956	9,773	380,896
Acquisitions	1,248	15,749	47,929	64,926
Transfers	-	7,662	(7,662)	-
Disposals and write-offs	-	(741)	-	(741)
Balance at 31 December 2009	<u>180,415</u>	<u>214,626</u>	<u>50,040</u>	<u>445,081</u>
Balance at 1 January 2010	180,415	214,626	50,040	445,081
Acquisitions	1,237	30,487	7,975	39,699
Disposals and write-offs	-	(12,158)	-	(12,158)
Balance at 31 December 2010	<u>181,652</u>	<u>232,955</u>	<u>58,015</u>	<u>472,622</u>
Depreciation and impairment losses				
Balance at 1 January 2009	29,615	91,606	-	121,221
Depreciation for the period	4,488	36,838	-	41,326
Disposals and write-offs	-	(690)	-	(690)
Balance at 31 December 2009	<u>34,103</u>	<u>127,754</u>	<u>-</u>	<u>161,857</u>
Balance at 1 January 2010	34,103	127,754	-	161,857
Depreciation for the period	4,526	25,750	-	30,276
Disposals and write-offs	-	(9,735)	-	(9,735)
Balance at 31 December 2010	<u>38,629</u>	<u>143,769</u>	<u>-</u>	<u>182,398</u>
Carrying amounts				
Balance at 1 January 2009	<u>149,552</u>	<u>100,350</u>	<u>9,773</u>	<u>259,675</u>
Balance at 31 December 2009	<u>146,312</u>	<u>86,872</u>	<u>50,040</u>	<u>283,224</u>
Balance at 31 December 2010	<u>143,023</u>	<u>89,186</u>	<u>58,015</u>	<u>290,224</u>

There were no capitalised borrowing costs related to the acquisition of property and equipment during the year (2009: nil).

As at 31 December 2010 the Bank does not have any property pledged as collateral (2009: none).

Operating leases

The Bank leases business premises under operating leases. The leases are cancellable and typically run for a shorter period.

19. Property and equipment (continued)

Change in the accounting estimates

During the year ended 31 December 2010 the Bank has changed the useful life of certain property and equipment. As a result the useful life of these property and equipment has increased and resulted with decrease of the depreciation rate for servers from 25% to 16.7%, pos-terminals from 25% to 16.7%, network equipment from 25% to 14.3-25%, office furniture and other equipment from 20% to 14.3% respectively.

The effect of these changes on depreciation expense, in current and future periods is as follows:

	2010	2011	2012
Decrease in the depreciation expense	12,503	9,033	1,222

20. Intangible assets

<i>In thousands of denars</i>	Software	Rights and licences	Assets under development	Total
Cost				
Balance at 1 January 2009	24,768	16,385	-	41,153
Acquisitions	4,071	2	60,844	64,917
Balance at 31 December 2009	28,839	16,387	60,844	106,070
Balance at 1 January 2010	28,839	16,387	60,844	106,070
Acquisitions	4,064	15,337	22,415	41,816
Balance at 31 December 2010	32,903	31,724	83,259	147,886
Amortisation and impairment losses				
Balance at 1 January 2009	16,235	10,466	-	26,701
Amortisation for the period	3,562	2,235	-	5,797
Balance at 31 December 2009	19,797	12,701	-	32,498
Balance at 1 January 2010	19,797	12,701	-	32,498
Amortisation for the period	1,295	1,391	-	2,686
Balance at 31 December 2010	21,092	14,092	-	35,184
Carrying amounts				
Balance at 1 January 2009	8,533	5,919	-	14,452
Balance at 31 December 2009	9,042	3,686	60,844	73,572
Balance at 31 December 2010	11,811	17,632	83,259	112,702

Notes to the financial statements

20. Intangible assets (continued)

Change in the accounting estimates

During the year ended 31 December 2010 the Bank has changed the useful life of software and licences. As a result the useful life of software and licences has increased and resulted with decrease of the depreciation rate from 20% to 10%.

The effect of these changes on depreciation expense, in current and future periods is as follows:

	2010	2011	2012	Later
Decrease in the depreciation expense	4,839	4,159	2,361	1,895

21. Other assets

<i>In thousands of denars</i>	2010	2009
Advance payments for interest on UNI bonus deposits	3,554	15,221
Prepaid rents	18,488	20,259
Asset acquired through foreclosure procedure	44,077	8,019
Advances given	4,926	2,053
Trade receivables	2,197	1,292
Other advance payments and advances given	12,593	9,347
Other	42,981	27,960
	<u>128,816</u>	<u>84,151</u>

Allowances for impairment

<i>In thousands of denars</i>	2010	2009
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Specific allowances for impairment

Balance at 1 January	10,037	4,681
Impairment loss for the year:		
Charge for the year	<u>(2,852)</u>	<u>5,356</u>
Balance at 31 December	<u>7,185</u>	<u>10,037</u>

Prepaid rents relate to the lease of the business premises for the Bank's branches in Strumica and Kochani. The total rent according the lease agreement was paid in advance in 2000, covering lease period of 20 years.

Notes to the financial statements

22. Deposits from banks and other financial institutions

<i>In thousands of denars</i>	2010	2009
Domestic banks		
Term deposits	761	761
Current deposits	4,498	571
Restricted deposits	12,829	11,818
Foreign banks		
Term deposits	123,379	-
Current deposits	3,171	126,546
Other financial institutions		
Term deposits	257,702	752,972
Current deposits	17,934	45,722
	<u>420,274</u>	<u>938,390</u>

23. Deposits from customers

<i>In thousands of denars</i>	2010	2009
Retail customers:		
Term deposits	4,825,250	5,023,502
Current deposits	1,054,022	859,866
Corporate customers:		
Term deposits	716,843	783,777
Current deposits	1,511,550	592,650
Public sector		
Current deposits	1,220	799
	<u>8,108,885</u>	<u>7,260,594</u>

At 31 December 2010 MKD 427,723 thousand (2009: MKD 427,402 thousand) of deposits from customers are expected to be settled more than 12 months after the reporting date.

Notes to the financial statements

24. Other 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.

Terms and conditions of outstanding loans were as follows:

<i>In thousands of denars</i>	Currency	Nominal interest rate	Year of maturity	2010		2009	
				Face value	Carrying amount	Face value	Carrying amount
Unsecured loans	EUR	5.5%	2010-2012	-	-	3,038	3,038
Unsecured loans	EUR	4.5%	2012	3,442	3,442	16,563	16,563
Unsecured loans	EUR	5%	2007-2015	116,141	116,141	151,506	151,506
Unsecured loans	EUR	4-5%	2012-2014	12,021	12,021	21,308	21,308
Total				<u>131,604</u>	<u>131,604</u>	<u>192,415</u>	<u>192,415</u>

Long term loans in the amount of MKD 119,583 thousand (2009: MKD 171,107 thousand) represent borrowed funds from Macedonian bank for development and promotion AD Skopje. Loans are repaid on a quarterly basis.

Long term loans in the amount of MKD 12,021 thousand (2009: MKD 21,308 thousand) are from Ministry of Finance of the Republic of Macedonia. Loans are repaid on a quarterly basis.

25. Subordinated liabilities

<i>In thousands of denars</i>	2010	2009
Subordinated loan	<u>263,174</u>	<u>270,878</u>
	<u>263,174</u>	<u>270,878</u>

The Subordinated loan from First Investment Bank Sofija was granted with an interest rate of 14%, and maturity of 7 years. The above liabilities will, in the event of winding-up of the Bank, be subordinated to the Bank's shareholders, holders of hybrid instruments and other creditors.

26. Impairment provisions related to off balance sheet items

<i>In thousands of denars</i>	2010	2009
Balance at 1 January	7,353	9,704
Recoveries	<u>(1,420)</u>	<u>(2,351)</u>
Balance at 31 December	<u>5,933</u>	<u>7,353</u>

Notes to the financial statements

27. Other liabilities

<i>In thousands of denars</i>	2010	2009
Liabilities for lost court cases		-
Liabilities related to trust activities	7,263	7,263
Suppliers payable	13,781	12,349
Accrued expenses	11,361	12,148
Fee and commission	3,720	3,565
Other taxes and contributions	14	525
Other	34,829	24,496
	<u>70,968</u>	<u>60,346</u>

28. Capital and reserves

Share capital

<i>In number of shares</i>	Ordinary shares		Cumulative preference shares	
	2010	2009	2010	2009
On issue at 1 January	530,445	530,445	15,542	15,542
On issue at 31 December	530,445	530,445	15,542	15,542

At 31 December 2010 the authorised share capital comprised 530,445 ordinary shares (2009: 530,445). Ordinary shares have a par value of MKD 1,000 (2009: MKD 1,000). All issued shares are fully paid.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings of the Bank. (2009: one vote per share) All shares rank equally with regard to the Bank's residual assets.

The preference shares are non-voting but have a priority over, a certain percentage of the par value of the shares (dividends), and have a priority of collection in the case of the Bank's liquidation.

The following shareholders have an interest exceeding 5% of the Bank's issued voting share capital:

	% of voting share capital	
	2010	2009
Ivaylo Moutaftchiev, Republic of Bulgaria	37.51 %	37.51 %
Tzeko Minev, Republic of Bulgaria	37.51%	37.51%

Notes to the financial statements

28. Capital and reserves (continued)

Statutory reserve

Under local statutory legislation, the Bank is required to set aside 15 percent of its net profit for the year in a statutory reserve until the level of the reserve reaches 1/5 of the court registered capital. Until achieving the minimum required level the statutory reserve could only be used for loss recovery. When the minimum level is reached, the statutory reserve can also be used for distribution of dividends, based on a decision of the shareholders' meeting, but only if the amount of the dividends for the current business year has not reached the minimum for distribution as prescribed in the Trade Company Law or by the Bank's Statute.

Dividends

No dividends were declared and paid by the Bank for the year ended 31 December 2010 and 2009. After 31 December 2010 no dividends were proposed by the Supervisory Board of the Bank. No dividend liabilities have been provided for at the end of the year in its statement of financial position.

29. Contingencies

The Bank provides financial guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period of up to one year. Expirations are not concentrated in any period.

The contractual amounts of commitments and contingent liabilities are set out in the following table by category.

<i>In thousands of denars</i>	<i>Note</i>	2010	2009
Guarantees			
in MKD		280,321	182,577
in foreign currency		79,371	78,102
Letters of credit in foreign currency		29,700	13,780
Loan commitments		395,673	465,895
Provisions	26	(5,933)	(7,353)
		<u>779,132</u>	<u>733,001</u>

Notes to the financial statements

29. Contingencies (continued)

These commitments and contingent liabilities have off balance sheet credit risk because only organisation fees and accruals for probable losses are recognised in the balance sheet 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.

30. Related parties transactions

According to the Banking Law persons related to the Bank are the following: persons with special rights and responsibilities and persons related thereto, shareholders with qualified holding in the Bank (direct or indirect ownership of at least 5% of the total number of shares or the issued voting shares in a Bank or which makes it possible to exercise a significant influence in the Bank) and entities related thereto and responsible persons of those shareholders – legal entities.

The Bank approves loans, extends guarantees attracts and takes deposits and loans from enterprises and banks to which it is related.

The volumes of related party transactions at the year end are as follows:

(i) Loans and advances to related parties

<i>In thousands of denars</i>	Key management personnel of the Bank and with them related parties	
	2010	2009
Loans outstanding at 1 January	20,295	11,934
Loans issued during the year	19,031	23,724
Loan repayments during the year	(20,945)	(15,363)
Loans outstanding at 31 December	18,381	20,295
Specific allowance for impairment	(78)	(44)
Interest income earned	1,706	1,154

Notes to the financial statements

30. Related parties transactions (continued)

(ii) Deposits from related parties

<i>In thousands of denars</i>	Entities related with persons which exercise significant influence over the Bank		Key management personnel of the Bank and with them related parties	
	2010	2009	2010	2009
Deposits at 1 January	198,168	383,338	31,432	14,745
Deposits received during the year	730,698	390,852	244,722	153,900
Deposits repaid during the year	(766,696)	(576,022)	(241,113)	(137,213)
Deposits at 31 December	162,170	198,168	35,041	31,432
Interest expense on deposits	2,663	7,790	3,435	1,389

(iii) Other transactions with related parties

<i>In thousands of denars</i>	Entities related with persons which exercise significant influence over the Bank		Key management personnel of the Bank and with them related parties	
	2010	2009	2010	2009
Cash and cash equivalents	37,106	25,812	-	-
Loans to other banks	432,625	756,398	18,381	-
Other assets	560	487	556	12
Subordinated liabilities	263,174	270,878	-	-
Trade and other payables	2,055	1,997	2	2
Commitments and contingences	3,109	3,385	4,895	4,785
Interest income	43,617	20,713	1,706	1,154
Interest expense	27,936	26,335	3,435	-
Fee and commission income	732	344	63	53
Fee and commission expense	26,885	22,875	-	-
Other income	956	2,365	113	122
Other expenses	679	-	18,111	18,113

(iv) Key management personnel compensation

<i>In thousands of denars</i>	2010	2009
Short-term employee benefits	45,030	35,712
	<u>45,030</u>	<u>35,712</u>

31. Subsequent events

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