Macedonian Bank for Development Promotion AD Skopje

Financial Statements
for the year ended 31 December 2005

Contents

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Report of the auditor to the shareholders of Macedonian Bank for Development Promotion AD Skopje

We have audited the accompanying balance sheet of Macedonian Bank for Development Promotion AD Skopje (the "Bank") as of 31 December 2005 and the related statements of income, changes in equity and cash flows for the year then ended. These financial statements are the responsibility of the directors. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Bank as of 31 December 2004, were audited by another auditor whose report dated 25 March 2005 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of 31 December 2005 and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

19 May 2006

KPMG

KPMG

Skopje

Income Statement

For the year ended 31 December 2005

In thousands of denars	Note	2005	2004
Interest income		126,587	121,520
Interest expense		(33,764)	(29,887)
Net interest income	1	92,823	91,633
Fee and commission income		25,379	18,400
Fee and commission expense		(11,275)	(7,739)
Net fee and commission income	2	14,104	10,661
Net foreign exchange (losses)/gain		(1,714)	1,019
Other operating income	3	752	4,758
Operating income		105,965	108,071
Impairment losses	4	(4,890)	(28,167)
Other operating expenses	5	(42,895)	(42,657)
Operating expenses		(47,785)	(70,824)
Profit for the year		58,180	37,247
Income tax expense	6	(5,650)	(6,088)
Net profit for the year		52,530	31,159

The notes to the financial statements form an integral part of these financial statements.

Balance Sheet

As at 31 December 2005

In thousands of denars	Note	2005	2004
Assets			
Cash and cash equivalents	7	672,717	1,130,648
Loans to other banks	8	1,431,446	905,273
Loans and advances to customers	9	21,956	-
Interest receivable and other assets	10	25,167	15,996
Investments	11	91,724	255,041
Assets acquired through foreclosure procedures	13	-	9,685
Intangible assets	14	216	212
Property and equipment	15	122,938	4,412
Differed tax assets	16	175	-
Total assets		2,366,339	2,321,267
Liabilities			
Other borrowed funds	17	1,088,990	1,195,334
Accruals	18	15,664	12,308
Impairment provisions related to off balance sheet items	19	3,679	2,893
Income tax payable		2,740	4,493
Net liabilities from managed funds	20	127,924	104,021
Other liabilities	21	4,715	5,557
Total liabilities		1,243,712	1,324,606
Share capital		932,400	932,400
Reserves		137,772	33,177
Retained earnings		52,455	31,084
Total shareholders' equity		1,122,627	996,661
Total liabilities and shareholders' equity		2,366,339	2,321,267

The notes to the financial statements form an integral part of these financial statements.

The financial statements set out on pages 2 to 42 were authorised for issue by the Board of Directors on 19 May 2006 and were signed on their behalf by:

Mr. Vojislav Bislimovski
First General Manager

Mrs. Sabina Fakic
Second General Manager

Statement of changes in equity

For the year ended 31 December 2005

In thousands of denars	Share Capital	Reserve	Reserve for security	Retained earnings	Total
Balance at 1 January 2004	932,400	29,234	-	3,868	965,502
Net profit for the year	-	-	-	31,159	31,159
Appropriation to reserve	-	3,943	-	(3,943)	-
Balance at 31 December 2004	932,400	33,177	-	31,084	996,661
Balance at 1 January 2005	932,400	33,177	-	31,084	996,661
Net profit for the year	-	-	-	52,530	52,530
Paid in during the year	-	-	73,436	-	73,436
Appropriation to reserve	-	16,159	-	(16,159)	-
Appropriation to reserve for security	-	-	15,000	(15,000)	-
Balance at 31 December 2005	932,400	49,336	88,436	52,455	1,122,627

The notes to the financial statements form an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2005

In thousands of denars	**Note**	**2005**	**2004**
Operating activities			
Profit before tax		58,180	37,247
Adjustments for non cash items:			
Depreciation of property and equipment	5	4,140	2,883
Amortization of intangible assets	5	82	218
Gain on sale of property and equipment	3	-	(392)
Loss on sale of assets acquired through foreclosure procedures	5	625	-
Interest and similar income	1	(126,587)	(121,520)
Interest expense and similar charges	1	33,764	29,887
Impairment	4	4,890	28,167
Impairment/(release of provision) for off-balance sheet items	5,3	786	(1,391)
Interest and similar income receipts		115,050	119,109
Interest paid		(23,652)	(27,241)
Operating profit before changes in operating assets		67,278	66,967
(Increase)/decrease in operating assets:			
Loans to other banks		(545,372)	509,420
Loans and advances to customers		(7,647)	-
Proceeds from sale of assets acquired through foreclosure procedures		3,596	-
Other assets		7,830	10,671
Increase/(decrease) in operating liabilities:			
Net liabilities from managed funds		23,903	50,833
Other liabilities		(7,598)	3,777
Net cash from operating activities before income tax		(458,010)	641,668
Taxation paid			
Income tax paid		(7,578)	(1,595)
Cash flows from operating activities		(465,588)	640,073
Investing activities			
Acquisition of intangible assets		(86)	(197)
Acquisition of property and equipment		(122,666)	(3,719)
Purchase of financial instruments held-to-maturity		-	(254,681)
Proceeds from financial instruments held-to-maturity		163,317	-
Proceeds from the sale of property and equipment		-	392
Cash flows from investing activities		40,565	(258,205)

Statement of cash flows

For the year ended 31 December 2005

In thousands of denars	**Note**	**2005**	**2004**
Financing activities			
Increase of reserves for security		73,436	-
Repayment of borrowings		(117,012)	(170,611)
Proceeds from borrowings		10,668	495,802
Cash flows from financing activities		(32,908)	325,191
Net (decrease)/increase in cash and cash equivalents		(457,931)	707,059
Cash and cash equivalents at 1 January		1,130,648	423,589
Cash and cash equivalents at 31 December	7	672,717	1,130,648

The notes to the financial statements form an integral part of these financial statements.

Notes to the financial statements

Business background

Macedonian Bank for Development Promotion A.D. Skopje (the Bank) is a state owned joint stock company incorporated in the Republic of Macedonia. The main activities include funding the start up of businesses and the development of small and medium size enterprises, financing exports with loans and issuing financial guarantees.

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

At the end of 2005, with the amendment of the Law for founding of the Macedonian Bank for Development Promotion, a Guarantee fund was formed for issuing financial guarantees towards commercial banks for long-term loans approved by commercial banks to micro, small and medium trading companies, sole traders and craftsmans in the Republic of Macedonia.

Significant accounting policies

a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") promulgated by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB.

b) Basis of preparation

The financial statements are presented in Macedonian denars, rounded to the nearest thousand. The financial statements are prepared on a fair value basis for financial assets available-for-sale, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortised cost or historical cost.

The preparation of financial statement in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The 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 if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Notes to the financial statements

Significant accounting policies

b) Basis of preparation (continued)

Judgments made by management in the application of IFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 29.

In the current year, the Bank has adopted all of the new and revised Standards and Interpretations issued by the IASB and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on 1 January 2005. The adoption of these new revised Standards and Interpretations did not result in changes to the Bank's accounting policies.

The accounting policies, except for the changes in accounting policy (refer note 23), are consistent with those used in the previous year.

At the date of authorisation of these financial statements, the following new Standards Interpretations and amendments to the Standards were in issue but not yet effective and have not been applied in preparing these financial statements:

IFRS 6 Exploration for and Evaluation of Mineral resources. The standard includes a requirement to distinguish between tangible and intangible assets that are used in the exploration for and evaluation of mineral resources, and specifies the level at which impairment testing should be carried out. The Bank does not have any operations that would be affected by the new Standard.

IFRS 7 Financial Instruments: Disclosures. The standard will require increased disclosure in respect of the Bank's financial instruments. It supersedes IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and is applicable to all entities that prepare financial statements in accordance with IFRSs. The Bank considers that the significant additional disclosures required will relate to its financial risk management objectives, policies and processes.

IFRIC 3 Emission Rights. The Interpretation deals with the accounting by a participant for a cap and trade scheme that is operational. The Bank does not have any operations that would be affected by the new Standard.

IFRIC 4 Determining whether an Arrangement contains a Lease. The Interpretation requires certain arrangements to be accounted for as a lease even if they are not in the legal form of a lease. The Bank does not have any operations that would be affected by the new Standard.

Notes to the financial statements

Significant accounting policies

b) Basis of preparation (continued)

IFRIC 5 Rights to interests arising from Decommissioning, restoration and Environmental Rehabilitation Funds. The Interpretation deals with funds created for the purpose of settling decommissioning and similar expenses. The Interpretation is not relevant to the Bank's operations.

IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment. The Interpretation deals with obligations arising from the European Union Directive regulating the collection, treatment, recovery and environmentally sound disposal of waste equipment. The Interpretation is not relevant to the Bank's operations.

IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies. The Interpretation contains guidance on how an entity would restate its financial statements pursuant to IAS 29 in the first year it identifies the existence of hyperinflation in the economy of its functional currency. The Interpretation is not relevant to the Bank's operations.

IFRIC 8 Scope of IFRS 2. The Interpretation clarifies that the accounting standard IFRS 2 Share-based Payment applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. The Interpretation is not relevant to the Bank's operations.

IFRIC 9 Reassessment of Embedded Derivatives. The Interpretation clarifies that the treatment of an embedded derivative is assessed by the entity when the entity first becomes a party to the contract, and that reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract. The Interpretation is not relevant to the Bank's operations.

Amendment to IAS 1 Presentation of Financial Statements – Capital Disclosures. As a complementary amendment arising from IFRS 7 (see above), the Standard will require increased disclosure in respect of the Bank's capital. This amendment will require significantly more disclosures regarding the capital structure of the Bank.

Amendment to IAS 19 Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures. The amendment includes an option for actuarial gains and losses to be recognised in full as they arise, outside of the income statement in a statement of recognised income and expense. The Bank does not have any employee benefit plans that will be affected by the amendment.

Notes to the financial statements

Significant accounting policies

b) Basis of preparation (continued)

Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions. The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item if certain criteria are met. This amendment is not relevant to the Bank's operations, as the Bank does not have any intragroup transactions that would qualify as a hedged item in the financial statements.

Amendment to IAS 39 Financial Instruments: Recognition and Measurement – The Fair Value Option. The amendment restricts the designation of financial instruments as "at fair value through profit or loss". The Bank believes that this amendment should not have a significant impact on the classification of financial instruments, as the Bank should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit or loss.

Amendment to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts – Financial Guarantee Contracts. The amendment requires guarantees that are not insurance contracts to be measured at fair value upon initial recognition. The Bank has not yet completed its analysis of the impact of the amendment.

Amendment to IAS 21 The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation. The amendment clarifies in which circumstances a loan may form part of a reporting entity's net investment in a foreign operation, and the currency in which such an item may be denominated. The Bank currently has no items comprising net investments in foreign operations that will be affected by the amendment.

c) Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to denars at the foreign exchange rate ruling at that date.

Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currency, which are stated at historical cost, are translated to denars at the foreign exchange rate ruling at the date of the transaction.

Notes to the financial statements

Significant accounting policies

c) Foreign currency transactions (continued)

The foreign currencies the Bank deals with are predominantly Euro (EUR) based. The exchange rates used for translation at 31 December 2005 and 2004 were as follows:

	2005 MKD	2004 MKD
1 EUR	61.18	61.31

d) Financial instruments

(i) Classification

Loans and receivables are loans and receivables created by the Bank providing money to a debtor other than those created with the intention of short-term profit taking. Loans and receivables comprise loans and advances to banks and to customers.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity. These include government bills.

Available-for-sale assets are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity. Available-for-sale instruments include equity investments.

(ii) Recognition

The Bank recognises financial assets available-for-sale, loans and receivables and held-to maturity assets on the day they are transferred to the Bank. From this date any gains and losses arising from changes in fair value of the assets are recognised.

(iii) Measurement

Financial instruments are measured initially at cost, including transaction costs.

Subsequent to initial recognition all available-for-sale assets are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities, loans and receivables and financial assets held-to-maturity are measured at amortised cost less impairment losses. Amortized cost is calculated based on the effective interest rate method.

Notes to the financial statements

Significant accounting policies (continued)

d) Financial instruments (continued)

(iii) Measurement (continued)

Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortized based on the effective interest rate of the instrument.

(iv) Fair value measurement principles

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs.

(v) Gains and losses on subsequent measurement

Gains and losses arising from a change in the fair value of the available-for-sale assets are recognised directly in equity.

(vi) Specific instruments

Cash and cash equivalents

Cash and cash equivalents comprise cash balance on hand, demand deposits with banks, cash deposited with the National Bank of the Republic of Macedonia ("NBRM") and short-term highly liquid investments with maturities of three months or less when purchased, including treasury bills eligible for trading on the secondary market.

Investments

Debt investments that the Bank has the intent and ability to hold to maturity are classified as held-to-maturity assets. The other equity investments are classified as available for-sale assets.

Loans and advances to banks and customers

Loans and advances are reported net of allowances to reflect the estimated recoverable amounts calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets) (refer accounting policy j).

Notes to the financial statements

Significant accounting policies (continued)

e) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the balance sheet when the Bank has a legally enforceable right to set off recognised amounts and the transactions are intended to be settled on a net basis.

f) Intangible assets

(i) Owned assets

Intangible assets that are acquired by the Bank are stated at cost less accumulated amortisation and impairment (refer accounting policy j).

(ii) Subsequent expenditure

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

(iii) Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Intangible assets are amortised from the date they are available for use.

The amortisation rates based on the estimated useful lives are as follows:

	2005	**2004**
	%	**%**
Software	25	25

g) Property and equipment

(i) Owned assets

Property and equipment are stated at cost less accumulated depreciation and any impairment loss (refer accounting policy j).

Notes to the financial statements

Significant accounting policies (continued)

g) Property and equipment (continued)

(ii) Subsequent costs

The Bank recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

(iii) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of items of property and equipment. Assets under construction are not depreciated until they are available for use. Depreciation rates, based on the estimated useful lives, are as follows:

	2005	**2004**
	%	**%**
Buildings	2.5	-
Furniture and equipment	20 to 25	20 to 25
Vehicles	25	25

h) 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 organizations 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 the income statement as incurred.

i) Managed funds

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

Notes to the financial statements

Significant accounting policies (continued)

j) Impairment

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

Impairment loss is recognized whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in the income statement.

Loans and advances

Loans and advances are presented net of specific and general allowances for impairment. Specific allowances are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts. General allowances are maintained to reduce the carrying amount of portfolios of similar loans and advances to their estimated recoverable amount at the balance sheet date.

The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties. Increases in the allowance account are recognised in the income statement. When the loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loss is written off directly.

If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write down, the write-down or allowance is reversed through the income statement.

Investments

The recoverable amount of the investments held to maturity, measured at amortised cost is calculated as the present value of expected future cash flows discounted at the original effective interest rate (i.e. effective interest rate at the initial recognition of these financial assets). Investments with short term maturity are not discounted. Any impairment loss is recognised in the income statement.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the income statement.

The recoverable amount of an equity instrument is its fair value.

Notes to the financial statements

Significant accounting policies (continued)

j) Impairment (continued)

Investments (continued)

Where an asset remeasured to fair value directly through equity is impaired, and a write down of the asset was previously recognised directly in equity, the write down is transferred to the income statement and recognised as part of the impairment loss. Where an asset measured to fair value directly through equity is impaired, and an increase in the fair value of the asset was previously recognised in equity, the increase in fair value of the asset recognised in equity is reversed to the extent the asset is impaired. Any additional impairment loss is recognised in the income statement.

If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the income statement.

Property and equipment and intangible assets

The recoverable amount of property and equipment and intangible assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

In respect of property and equipment and intangible assets an impairment loss is reversed when there is an indication that the impairment loss no longer exists and there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

k) Share capital

(i) Dividends

Dividends that relate to the State according to regulations are distributed to the Bank's reserves.

Notes to the financial statements

Significant accounting policies (continued)

l) Income recognition

(i) Interest and similar income

Interest income is recognised in the income statement as it accrues. Interest and similar income includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

(ii) Interest expense and similar charges

Interest expense is recognised in the income statement as it accrues. Interest and similar charges includes the amortization of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

(iii) Net fee and commission income

Fee and commission income arises on financial services provided by the Bank for issuing letters of financial guarantees for short-term export arrangements. Additionally, the Bank obtains letters of guarantees from foreign insurance institutions in amount of 90% to 100% of the issued financial guarantees.

Fee and commission is recognised when the corresponding service is provided.

m) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items taken directly to equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Notes to the financial statements

Significant accounting policies (continued)

n) Comparative information

For more appropriate presentation of transactions, classification of certain items in a current year financial statements differ from a prior year. Consequently presentation of prior year financial statement has been changed where necessary.

Notes to the financial statements

1. Net interest income

In thousands of denars	**2005**	**2004**
Interest and similar income		
Interest and similar income arise from:		
Enterprises	5,712	-
Domestic banks	92,561	101,768
Foreign banks	7,324	5,025
Government and local authorities	20,990	14,727
	126,587	121,520

Interest expense and similar charges	**2005**	**2004**
Interest expense and similar charges arise from:		
Financial institutions	32,344	28,396
Foreign banks	97	97
Government and local authorities	1,323	1,394
	33,764	29,887
Net interest income	92,823	91,633

2. Net fee and commission income

In thousands of denars	**2005**	**2004**
Fee and commission income		
Trust activities	16,900	9,847
Management fee	5,549	6,244
Fee for issuing letter of guarantees	2,400	2,208
Other	530	101
	25,379	18,400
Fee and commission expense		
Trust activities	9,075	5,096
Fee for obtained letter of guarantees	1,777	2,122
Other	423	521
	11,275	7,739
Net fee and commission income	14,104	10,661

The Bank is authorized to act as an agent bank of the Government of Republic of Macedonia disbursing the loans from the Italian Credit line (see note 20) through domestic banks. The Bank charges management fee and commission for this service of 4% (2004: 4% to 5%) per annum on the total amount of the disbursed loans to the final borrowers. On the received funds from the Italian Credit Line, the Bank pays a management commission fee of 1.75% (2004: 1.75%) per annum (refer note 20).

Notes to the financial statements

2. Net fee and commission income (continued)

Part of the management fee in the amount of MKD 4,393 thousand (2004: MKD 1,618 thousand) represents fee income from managing deposits from the KfW credit line. The fee and commission rate is 1% (2004: 1%) per annum, calculated on the average level of the funds placed through the domestic banks. The remainder of the management fee, in the amount of MKD 1,156 thousand (2004: MKD 4,626 thousand) represents fee income from managing the NEPA Foundation. The fee and commission rate is 1.5% (2004: 1.5%) per annum.

Fee for issuing letter of guarantees results from issued letters of guarantees (covering credit risk) for short-term export arrangements. Subsequently, the Bank obtains letters of guarantees from foreign reinsurance institutions (refer note 25).

3. Other operating income

In thousands of denars	**2005**	**2004**
Capital gain	-	392
Release of provision for off-balance sheet items	-	1,391
Income from rights assigned by DEG	100	2,313
Other	652	662
	752	4,758

4. Impairment losses

In thousands of denars	**Note**	**2005**	**2004**
Impairment allowance			
Loans to other banks		-	28,167
Loans and advances to customers		5,455	-
		5,455	28,167
Reversals of impairment allowance			
Loans to other banks		(565)	-
		(565)	-
	12	4,890	28,167

Notes to the financial statements

5. Other operating expenses

In thousands of denars	**2005**	**2004**
Staff costs:		
Net wages and personal income tax	12,262	11,935
Contributions	5,721	5,618
Other staff costs	1,508	1,454
Payments to members of the Management Board	2,207	2,241
Materials and services	7,087	7,241
Depreciation of property and equipment	4,140	2,883
Amortisation of intangible assets	82	218
Rents	2,415	4,372
Representation and marketing costs	1,969	1,655
Costs for business trips	1,719	1,385
Training costs	1,317	1,308
Provision for off-balance sheet items	786	-
Capital loss	625	-
Insurance premium	193	367
Other	864	1,980
	42,895	42,657

Other staff costs comprise of allowances for food, transportation of employees etc.

The average number of employees in 2005 was 26 (2004: 24).

6. Income tax expense

Recognised in the income statement

In thousands of denars		**2005**	**2004**
Current tax expense			
Current year		5,825	6,088
		5,825	6,088
Deferred tax income			
Origination and reversal of temporary differences	16	(175)	-
		(175)	-
Total income tax expense in the income statement		5,650	6,088

Notes to the financial statements

6. Income tax expense (continued)

Reconciliation of effective tax rate

In thousands of denars	**2005**	**2005**	**2004**	**2004**
Profit before tax		58,180		37,247
Income tax using the domestic corporation tax rate	15.0%	8,727	15.0%	5,587
Non-deductible expenses	1.2%	679	1.4%	501
Tax incentives not recognised in the income statement	(6.5%)	(3,756)	-	-
	9.7%	5,650	16.4%	6,088

Notes to the financial statements

7. Cash and cash equivalents

In thousands of denars	**2005**	**2004**
Cash on hand	183	100
Balances with NBRM	1,805	10,229
Current accounts with foreign banks	363,869	772,221
Treasury bills	306,860	348,098
	672,717	1,130,648

Treasury bills are with maturity of 28 days (2004: 28 days) and with effective interest rate of 8.2% to 8.7% (2004: 10%) per annum.

8. Loans to other banks

Product Analysis

In thousands of denars	**Total 2005**	**Short-term 2005**	**Long-term 2005**	**Total 2004**	**Short-term 2004**	**Long-term 2004**
Domestic Banks	1,592,786	164,201	1,428,585	1,067,178	248,043	819,135
Current maturity	-	282,820	(282,820)	-	203,129	(203,129)
Less allowance for impairment	(161,340)	(3,358)	(157,982)	(161,905)	(11,536)	(150,369)
Net loans to other banks	1,431,446	443,663	987,783	905,273	439,636	465,637

Notes to the financial statements

8. Loans to other banks (continued)

Analysis by interest rates

	Effective interest rates 2005	Effective interest rates 2004	*In thousands of denars* 2005	*In thousands of denars* 2004
Loans with fixed interest rate:				
Support of export arrangement	5%	4% to 6%	207,638	272,566
Development promotion of small and medium enterprises	5%	5%	373,078	96,384
Working capital	5%	-	18,353	-
Revolving fund of the Italian credit line	5%	4% to 5%	153,474	-
German - Macedonian fund	5%	5%	76,429	101,554
German credit line	7%, variable if the six-month EURIBOR interest rate exceeds 5.15%	7% to 8%	353,922	596,674
Revolving fund of the German credit	7%, variable if the six-month EURIBOR interest rate exceeds 5.15%	-	67,296	-
Loans with variable interest rate:				
German micro-credit line	three-month EURIBOR increased by 1%	-	342,596	-
			1,592,786	1,067,178
Allowance for impairment			(161,340)	(161,905)
Net loans to other banks			1,431,446	905,273

9. Loans and advances to customers

In 2005 two enterprises, final beneficiaries of the credit lines from the Bank, agreed to take-over the Bank’s receivables from Eksport Import Banka that is currently in bankruptcy procedure. Loans, in the amount of MKD 27,411 thousand bear effective interest from 5% to 8% per annum and maturity until 2011. The Bank has provided allowance for impairment of MKD 5,455 thousand (2004: nil) for these loans.

Notes to the financial statements

10. Interest receivable and other assets

In thousands of denars	**2005**	**2004**
Interest receivable	55	303
Accrued interest	11,503	12,690
Accrued commission from KfW	3,966	2,952
Management fee receivables	4,049	-
Receivables from sold assets acquired through foreclosure procedures	5,429	-
Other assets	165	51
	25,167	15,996

11. Investments

In thousands of denars	**2005**	**2004**
Debt and other fixed-income instruments held-to-maturity		
Government bills	91,364	254,681
	91,364	254,681
Unlisted	91,364	254,681
Equity investments available-for-sale		
Equity investments	367	367
	367	367
Unlisted	367	367
Total investments	91,731	255,048
Less allowance for impairment	(7)	(7)
Net investments	91,724	255,041

Government bills are with effective interest rate of 9.1% to 9.9% (2004: from 8.8% to 9.5%) per annum and with maturity from January until June 2006 (2004: from January until March 2005).

Equity investments before allowance for impairment are carried at cost. There is no market for these investments and there have not been any recent transactions that provide evidence of the current fair value.

Income from debt instruments held-to-maturity is recognised as interest and similar income.

Income from equity investments is recognised in dividend income.

Notes to the financial statements

12. Allowance for impairment

In thousands of denars	Note	2005	2004
Balance on 1 January		161,912	133,745
Impairment losses recognized:			
Additional allowances	4	4,890	28,167
Balance on 31 December		166,802	161,912

The allowance is apportioned as follows:

In thousands of denars	Note	2005	2004
As a reduction of loans to other banks	8	161,340	161,905
As a reduction of loans and advances to customers	9	5,455	-
As a reduction of investments	11	7	7
		166,802	161,912

13. Assets acquired through foreclosure procedures

As at 31 December 2004 assets acquired through foreclosure procedures comprise of three apartments. During 2005 these apartments were sold.

14. Intangible assets

Movements of intangible assets during 2005 are as follows:

In thousands of denars	Software and licences
Cost	
At 1 January 2005	1,503
Additions	86
At 31 December 2005	1,589
Amortization	
At 1 January 2005	1,291
Charge for the year	82
At 31 December 2005	1,373
Carrying amount	
At 1 January 2005	212
At 31 December 2005	216

Notes to the financial statements

14. Intangible assets (continued)

Movements of intangible assets during 2004 are as follows:

In thousands of denars	**Total**
Cost	
At 1 January 2004	1,306
Additions	197
At 31 December 2004	1,503
Amortization	
At 1 January 2004	1,073
Charge for the year	218
At 31 December 2004	1,291
Carrying amount	
At 1 January 2004	233
At 31 December 2004	212

15. Property and equipment

Movements in property and equipment during 2005 are as follows:

In thousands of denars	**Buildings**	**Furniture & equipment**	**Motor Vehicles**	**Total**
Cost				
At 1 January 2005	-	11,574	5,198	16,772
Additions	120,033	2,633	-	122,666
At 31 December 2005	120,033	14,207	5,198	139,438
Depreciation				
At 1 January 2005	-	9,840	2,520	12,360
Charge for the year	1,990	1,031	1,119	4,140
At 31 December 2005	1,990	10,871	3,639	16,500
Carrying amount				
At 1 January 2005	-	1,734	2,678	4,412
At 31 December 2005	118,043	3,336	1,559	122,938

Notes to the financial statements

15. Property and equipment (continued)

Movements in property and equipment during 2004 are as follows:

In thousands of denars	Furniture & equipment	Motor Vehicles	Total
Cost			
At 1 January 2004	10,638	3,873	14,511
Additions	936	2,784	3,720
Disposals	-	(1,459)	(1,459)
At 31 December 2004	11,574	5,198	16,772
Depreciation			
At 1 January 2004	8,198	2,738	10,936
Charge for the year	1,642	1,241	2,883
Disposals	-	(1,459)	(1,459)
At 31 December 2004	9,840	2,520	12,360
Carrying amount			
At 1 January 2004	2,440	1,135	3,575
At 31 December 2004	1,734	2,678	4,412

As at 31 December 2005 the Bank does not have any property, plant and equipment pledged as collateral (2004: none).

16. Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
In thousands of denars	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**
Property and equipment	(143)	-	-	-	(143)	-
Interest receivable and other assets	(402)	-	-	-	(402)	-
Accruals	(199)	-	-	-	(199)	-
Other liabilities	-	-	569	-	569	-
Tax (assets)/liabilities	(744)	-	569	-	(175)	-
Set off of tax	569	-	(569)	-	-	-
Net tax (assets)/liabilities	(175)	-	-	-	(175)	-

Notes to the financial statements

16. Deferred tax assets and liabilities (continued)

Movement in temporary differences during the year

In thousands of denars	Balance 1 Jan 2005	Recognised in income	Recognised in equity	Balance 31 Dec 2005
Property and equipment	-	(143)	-	(143)
Interest receivable and other assets	-	(402)	-	(402)
Accruals	-	(199)	-	(199)
Other liabilities	-	569	-	569
	-	(175)	-	(175)

17. Other borrowed funds

In thousands of denars	Short Term 2005	Long Term 2005	Short Term 2004	Long Term 2004
German credit line (KfW)	-	573,543	-	689,738
German micro - credit line (KfW)	-	378,373	-	379,190
Ministry of Finance	-	137,074	-	126,406
Current maturity	114,709	(114,709)	102,647	(102,647)
	114,709	974,281	102,647	1,092,687

Long term loan from the German credit line - Kreditanstalt für Wiederaufbau (KfW) in the amount of MKD 573,543 thousand (2004: MKD 689,738 thousand) is for extending loans for promotion of small and medium sized enterprises, with an interest rate of six-month EURIBOR plus 1.85% per annum. The loan is repaid in 16 semi-annual instalments with maturity until August 2010.

Long term loan from German micro - credit line (KfW) in the amount of MKD 378,373 thousand (2004: MKD 379,190 thousand) is for promotion and development of micro enterprises with an effective interest rate of 0.75% per annum for the first tranche of MKD 65,576 thousand (2004: MKD 65,717 thousand) and an effective interest rate of 2% per annum for the second tranche of MKD 312,797 thousand (2004: MKD 313,473 thousand). The loan is paid in 61 semi-annual instalments with a repayment period of 40 years including grace period of 10 years. The last instalment is in 2044.

Long term credit from the Ministry of Finance is for crediting of Macedonian residents who permanently returned from Germany and for small and medium sized trade companies. The credit is paid in 40 equal semi-annual instalments with an effective interest rate of 1% per annum with a repayment period of 30 years and grace period of 10 years. The last instalment is due on 30 June 2026.

In November 2005, the Bank has made an agreement for loan with the Council of Europe Development Bank in the amount of EUR 10,000,000 for financing creation and preservation of jobs in small and medium enterprises. The loan is with interest rate of three months EURIBOR plus 0.30% per annum and will be repaid in 20 semi-annual instalments in the period of 10 years. As at 31 December 2005, the Bank did not disburse any funds from this credit line.

Notes to the financial statements

18. Accruals

In thousands of denars	2005	2004
Accrued interest due and payable	3,748	2,425
Accrued interest	11,916	9,883
	15,664	12,308

19. Impairment provisions related to off balance sheet items

In thousands of denars	Note	2005	2004
Balance at 1 January		2,893	4,284
Charge for off balance sheet items	5	786	-
Release of provision for off balance sheet items	3	-	(1,391)
Balance at 31 December	25	3,679	2,893

20. Net liabilities from managed funds

In thousands of denars	2005	2004
Receivables from managed funds	439,546	324,039
Liabilities from managed funds	(567,470)	(428,060)
	(127,924)	(104,021)

The Bank is authorized to act as an agent bank of the Government of the Republic of Macedonia, disbursing the credits from the Italian credit line to the final borrowers through selected commercial banks from the Republic of Macedonia. These funds are disbursed with 5.5 years grace period and should be repaid by the Bank within 15 years repayment period and in 30 equal semi-annual instalments. The Bank pays commission fee of 1.75% on received funds. The Bank is placing the above mentioned funds to the commercial banks with 18 months grace period and repayment in 20 equal quarterly instalments. The Bank bears no credit risk with respect to loans placed through the commercial banks. The net liabilities from managed funds in the amount of MKD 127,924 thousand (2004: MKD 104,021 thousand) reflects the timing difference arising from the mismatching grace period of withdrawal and placement of funds from the above mentioned credit line.

21. Other liabilities

In thousands of denars	2005	2004
Advances received	1,798	1,442
Trade creditors	651	1,992
Fee and commission liabilities	111	668
Accrued fee and commission	1,683	1,295
Other	472	160
	4,715	5,557

Notes to the financial statements

22. Capital and reserves

Share capital	**Ordinary shares**	
In number of shares	**2005**	**2004**
Issued and fully paid at 1 January	300,000	300,000
Issued and fully paid at 31 December	300,000	300,000

At 31 December 2005, the authorised share capital comprised 300,000 ordinary shares (2004: 300,000). Ordinary shares have a par value of MKD 3,108. 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 the meetings of the shareholders of the Bank (2004: one ordinary share). According to the Law for founding of Macedonian Bank for Development Promotion, dividends that relate to the State according to regulations are distributed to the Bank's reserves. All shares rank equally with regard to the Bank's residual assets. All share capital is State owned.

Reserves

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

Reserves for security

Reserves for security are for risk management regarding insurance and reinsurance of receivables based on export arrangements from commercial and non commercial risks, as well as insurance and passive reinsurance of foreign investments in the Republic of Macedonia and investments of domestic entities abroad from non commercial risks. The reserves for security are created by setting aside part of the insurance premiums collected and as appropriation of the retained earning, profit-share of the state. The level of the reserves for security is decided by the Government of the Republic of Macedonia. In 2005, MKD 15,000 thousand have been appropriated from the retained earning to the reserves for security and MKD 73,436 thousand have been paid-in by the Government of the Republic of Macedonia to the reserves for security. In January 2006 additional MKD 82,670 thousand were paid in the reserves for security.

23. Changes in accounting policy

In the current financial year the Bank adopted IAS 39 (revised 2004) Financial Instruments: Recognition and Measurement. The adoption has resulted in the Bank recognising available-for-sale investments (equity investments) at fair value with changes in fair value recognized directly in equity. In 2004 these investments were classified as available-for-sale investment at fair vale with changes in fair value recognized in the income statement.

Notes to the financial statements

23. Changes in accounting policy (continued)

However, the change in accounting policy did not result in any restatement of the opening balance of equity (retained earnings) since the equity investments are carried at cost less impairment due to fact that the equity investments held by the Bank do not have a quoted market price in an active market and their fair value can not be reliably measured.

24. Fair value

Fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing partners in an arm's length transaction. Where available, fair value estimates are made based on quoted market prices. However, no readily available market prices exist for a certain portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing modes as appropriate. Changes in underlying assumptions including discount rates and estimated future cash flows, significantly affects the estimate. Therefore, the calculated fair market estimates cannot be realized in a current sale of the financial instrument.

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

Investments: There is no active market for equity investments and there are no recent transactions, which would provide evidence for their current market value.

Government bills issued from the State, held-to-maturity in the amount of MKD 91,364 thousand (2004: MKD 254,681 thousand) are bought at the initial issuance and are with maturity from January until June 2006, hence their fair value approximates the carrying amount at the balance sheet date.

Other borrowed funds: Bank's long term borrowings are borrowed from financial institutions that offer financial instruments with specific conditions, interest and maturity. There are no similar borrowings on the market. Therefore, the interest rates set by the financial institutions are the market interest rates. The fair value of borrowed funds is estimated as the present value of future cash flows, discounted at interest rates available at the balance sheet date to the Bank for new debt of similar type and remaining maturity. The carrying amount of the borrowed funds at the balance sheet date approximates their fair value.

Notes to the financial statements

25. Commitments and contingencies

The Bank has contingent liabilities arising from issued letters of guarantees for short-term export arrangements. The Bank obtains letters of guarantees from foreign insurance institutions in the amount of 90% to 100% of the guaranteed amount.

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

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

In thousands of denars	**Note**	**2005**	**2004**
Payment guarantees		53,553	134,470
Commitments to lend		36,708	-
Provisions	19	(3,679)	(2,893)
		86,582	131,577

26. Risk management disclosures

This section provides details of the Bank's exposure to risk and describes the methods used by management to control risk. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate risk and equity price risk.

(i) Credit risk

The Bank is subject to credit risk through its lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties or issues guarantees.

The risk that counterparties might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the Bank deals with counterparties of good credit standing, and require collateral.

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the balance sheet. In addition, the Bank is exposed to off balance sheet credit risk through issued letter of guarantees for export credit agreements. The Bank manages the risk of uncollectibility of receivables by obtaining letter of guarantees from foreign insurance institutions in the amount of 90% to 100% of the guaranteed amount (refer note 25).

Notes to the financial statements

26. Risk management disclosures (continued)

(i) Credit risk (continued)

Concentrations of credit risk (whether on or off balance sheet) that arise from financial instruments exist for groups of counterparties when they have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

In 2005, the Bank's assets are significantly concentrated in the following parties: Deutsche Bank, Unibanka, Komercijalna Banka, IK banka, ProCredit banka and Tutunska banka (2004: Deutsche Bank, Comerzbank, Eksport-Import banka, Komercijalna banka, Radobank, SID, Tutunska Banka, NBRM, Repuplic of Macedonia). The above mentioned concentration of assets represents net exposure of MKD 1,365,143 thousand (2004: MKD 2,056,213 thousand) or 58% (2004: 89%) of the Bank's total assets.

(ii) Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Bank has access to a diverse funding base. Funds are raised using a broad range of instruments including borrowings and share capital. 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 to meet 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

26. Risk management disclosures (continued)

Maturities of the financial assets and liabilities

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant maturity groupings based on the original period to the repayment date.

For the year ended 31 December 2005 is as follows:

In thousands of denars	**Up to 1 month**	**1 Month to 3 Months**	**3 Months to 1 Year**	**1 Year to 5 Years**	**Over 5 Years**	**Total**
Assets						
Cash and cash equivalents	672,717	-	-	-	-	672,717
Loans to other banks	82,449	1,518	359,696	933,456	54,327	1,431,446
Loans and advances to customers	-	1,916	7,587	10,819	1,634	21,956
Interest receivable and other assets	13,307	511	6,292	1,488	3,569	25,167
Investments	73,184	-	18,180	-	360	91,724
	841,657	3,945	391,755	945,763	59,890	2,243,010
Liabilities						
Other borrowed funds	-	57,355	57,354	458,834	515,447	1,088,990
Accruals	-	8,234	4,287	3,143	-	15,664
Income tax payables	-	2,740	-	-	-	2,740
Net liabilities from managed funds	-	-	-	-	127,924	127,924
Other liabilities	175	901	3,639	-	-	4,715
	175	69,230	65,280	461,977	643,371	1,240,033
Net liquidity gap	841,482	(65,285)	326,475	483,786	(583,481)	1,002,977

Notes to the financial statements

26. Risk management disclosures (continued)

Maturities of the financial assets and liabilities

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant maturity groupings based on the original period to the repayment date.

For the year ended 31 December 2004 is as follows:

In thousands of denars	Up to 1 month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 5 Years	Over 5 Years	Total
Assets						
Cash and cash equivalents	1,130,648	-	-	-	-	1,130,648
Loans to other banks	42,761	-	396,875	458,930	6,707	905,273
Interest receivable and other assets	15,996	-	-	-	-	15,996
Investments	179,996	54,623	20,062	-	360	255,041
	1,369,401	54,623	416,937	458,930	7,067	2,306,958
Liabilities						
Other borrowed funds	-	45,170	57,477	459,825	632,862	1,195,334
Accruals	-	12,308	-	-	-	12,308
Income tax payables	-	4,493	-	-	-	4,493
Net liabilities from managed funds	-	-	-	-	104,021	104,021
Other liabilities	5,557	-	-	-	-	5,557
	5,557	61,971	57,477	459,825	736,883	1,321,713
Net liquidity gap	1,363,844	(7,348)	359,460	(895)	(729,816)	985,245

Notes to the financial statements

26. Risk management disclosures (continued)

(iii) Market risk

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or re-price 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 reprising characteristics of the various floating rate indices, such as EURIBOR.

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

Financial instruments arranged at fixed interest rate expose the Bank at fair value interest risk, while financial instruments arranged at variable interest rate expose the Bank to cash flow interest risk.

Currency risk

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

26. Risk management disclosures (continued)

Interest rate gap analysis

For the year ended 31 December 2005

In thousands of denars	Note	Total	Floating rate instruments	Fixed rate instruments: Up to 1 month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 5 Years	Over 5 Years	Non interest earning (bearing)
Assets									
Cash and cash equivalents	7	672,717	363,869	306,860	-	-	-	-	1,988
Loans to other banks	8	1,431,446	340,041	82,449	1,518	359,696	593,415	54,327	-
Loans and advances to customers	9	21,956	-	-	1,916	7,587	10,819	1,634	-
Investments	11	91,724	-	73,184	-	18,180	-	-	360
Liabilities									
Other borrowed funds	17	(1,088,990)	(573,543)	-	-	-	-	(515,447)	-
Asset liability gap		1,128,853	130,367	462,493	3,434	385,463	604,234	(459,486)	2,348

Notes to the financial statements

26. Risk management disclosures (continued)

Interest rate gap analysis

For the year ended 31 December 2004

In thousands of denars	**Note**	**Total**	**Floating rate instruments**	**Fixed rate instruments**					**Non interest earning (bearing)**
				Up to 1 month	**1 Month to 3 Months**	**3 Months to 1 Year**	**1 Year to 5 Years**	**Over 5 Years**	
Assets									
Cash and cash equivalents	7	1,130,648	772,221	348,098	-	-	-	-	10,329
Loans to other banks	8	905,273	-	79,854	-	378,348	437,173	6,394	3,504
Investments	11	255,041	-	179,996	54,623	20,062	-	-	360
Liabilities									
Other borrowed funds	17	(1,195,334)	(689,738)	-	-	-	-	(505,596)	-
Asset liability gap		1,095,628	82,483	607,948	54,623	398,410	437,173	(499,202)	14,193

Notes to the financial statements

26. Risk management disclosures (continued)

Currency risk (continued)

	2005				2004			
	MKD	**EUR**	**USD**	**Total**	**MKD**	**EUR**	**USD**	**Total**
Monetary assets								
Cash and cash equivalents	308,848	363,850	19	672,717	358,427	772,221	-	1,130,648
Loans to other banks	-	1,431,446	-	1,431,446	48,725	856,532	16	905,273
Loans and advances to customers	-	21,956	-	21,956	-	-	-	-
Interest receivable and other assets	11,465	13,702	-	25,167	15,693	303	-	15,996
Investments	91,724	-	-	91,724	255,041	-	-	255,041
	412,037	1,830,954	19	2,243,010	677,886	1,629,056	16	2,306,958
Monetary liabilities								
Other borrowed funds	137,074	951,916	-	1,088,990	-	1,195,334	-	1,195,334
Accruals	4,287	11,377	-	15,664	2,424	9,884	-	12,308
Income tax payables	2,740	-	-	2,740	4,493	-	-	4,493
Net liabilities from managed funds	-	127,924	-	127,924	-	104,021	-	104,021
Other liabilities	2,496	2,061	158	4,715	5,557	-	-	5,557
	146,597	1,093,278	158	1,240,033	12,474	1,309,239	-	1,321,713
Net position	265,440	737,676	(139)	1,002,977	665,412	319,817	16	985,245

Notes to the financial statements

27. Related party transactions

According to the Bank's Articles of Association, the supreme body is the Assembly of the Bank. The overall control of the Bank is with the non-executive Board of Directors ("the Managing Board") which is consisted of the representatives of the State, and act on its behalf. Members of the Board of Directors are appointed by the Government of the Republic of Macedonia.

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

Transactions with key management personnel

Total remuneration to the Bank's key management personnel, included in "Other operating expenses" (refer note 5):

In thousands of denars	**2005**	**2004**
Payroll and other short-term contributions	10,768	11,703
	10,768	11,703

28. Subsequent events

On 31 December 2005, amendments to the Income Tax Law have been published in Official gazette Number 120, effective from 1 January 2006. With the amendments, withholding tax on income paid to non-resident legal entities was introduced. Unless regulated by Double Tax Treaty, Macedonian residents making payments to non-resident legal entities on the basis of: dividends, interest, royalties, income from entertainment or sport activities, income from providing management, consulting, financial, technical, administrative, research and development and /or other services, lease of movable or immovable property in the Republic of Macedonia, income from insurance premium on insurance or re-insurance of risks in the Republic of Macedonia, income on telecommunication services between Republic of Macedonia and other countries, should withhold and pay tax. The withholding tax is calculated on the gross income applying tax rate of 15%, except for interest income and income on lease of movable or immovable property in the Republic of Macedonia for which the tax rate is 10%.

Tax rate may be lower if applicable under relevant Double Tax Treaty concluded.

At the end of 2005, with the amendment of the Law for founding of Macedonian Bank for Development Promotion a Guarantee fund was formed. The Guarantee fund will be used for issuing guarantees as collateral for long term loans approved by banks and other financial institutions in the Republic of Macedonia to micro, small and medium traders, sole traders and craftsmen.

Notes to the financial statements

28. Subsequent events (continued)

The exposure of the Guarantee fund towards a single bank can not exceed the amount of the Guarantee fund. The fund guarantees maximum one third of the loans up to EUR 150,000 taking in consideration that the amount of the guarantee can not exceed EUR 35,000. The funds are provided from the Budget of the Republic of Macedonia as non refundable deposit in the amount of MKD 265,000 thousand, domestic and foreign donations, commission income for issued guarantees, income from investments and other sources. The funds of the Guarantee fund are kept at a special account with NBRM. In January 2006, MKD 231,000 thousand have been paid in the Guarantee fund.

29. Accounting estimates and judgements

Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment of credit portfolio

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 income statement the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in a group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Critical accounting judgements in applying the Bank’s accounting policies

No matters requiring the Bank to make critical accounting judgements in applying the Bank’s accounting policies exist at 31 December 2005.