Komercijalna banka A.D. Skopje

Financial Statements
for the year ended 31 December 2005

Contents

Income Statement

For the year ended 31 December 2005

In thousands of denars	**Note**	**2005**	**2004**
Interest income		2,051,710	1,744,292
Interest expense		(564,852)	(482,010)
Net interest income	1	1,486,858	1,262,282
Fee and commission income		780,586	690,716
Fee and commission expense		(85,622)	(71,581)
Net fee and commission income	2	694,964	619,135
Dividend income		1,021	11,197
Net trading income		2,880	-
Net foreign exchange gain		126,575	104,362
Other operating income	3	73,997	183,429
Operating income		2,386,295	2,180,405
Impairment losses	4	(458,770)	13,413
Other operating expenses	5	(1,508,859)	(1,451,000)
Operating expenses		(1,967,629)	(1,437,587)
Share of loss from associate	16	(11,880)	-
Profit for the year		406,786	742,818
Income tax expense	6	(49,648)	(42,628)
Net profit for the year		357,138	700,190
Basic earnings per share (denars)	27	190	374
Diluted earnings per share (denars)	27	177	347

Balance Sheet

As at 31 December 2005

In thousands of denars	Note	2005	2004
Assets			
Cash and cash equivalents	7	4,575,575	3,263,111
Financial assets at fair value through profit and loss	8	7,257	9,997
Placements with, and loans to, banks	9	15,965,414	14,556,464
Loans and advances to customers	10	12,929,685	11,853,237
Interest receivable and other assets	11	722,050	178,739
Income tax receivable		60,859	-
Investments	12	389,721	847,291
Investment property	14	55,307	102,575
Assets acquired through foreclosure procedures	15	707,811	952,736
Investment in associate	16	33,258	-
Intangible assets	17	44,159	31,378
Leasehold improvements		13,051	5,392
Property and equipment	18	1,411,358	1,478,325
Deferred tax asset	19	1,104	1,472
Advances for property and equipment		20,189	13,837
Total assets		36,936,798	33,294,554
Liabilities			
Deposits from banks and other financial institutions	20	519,768	254,766
Amounts owed to other depositors	21	30,567,187	27,518,111
Other borrowed funds	22	1,377,533	1,298,875
Accruals	23	103,328	67,284
Impairment provisions related to off balance sheet items	24	206,727	112,234
Income tax payable		-	31,140
Other liabilities	25	127,973	119,797
Total liabilities		32,902,516	29,402,207
Share capital		2,014,067	2,014,067
Share premium		16,523	16,253
Reserves		1,556,542	1,078,665
Retained earnings		447,150	783,362
Total shareholders' equity		4,034,282	3,892,347
Total liabilities and shareholders' equity		36,936,798	33,294,554

These financial statements set out on pages 1 to 53 were approved by the Board of Directors on 27 February 2006 and were signed on its behalf by:

Mr. Hari Kostov	Mr. Lazar Cvetkovski
First Director General	Second Director General

Statement of changes in equity

For the year ended 31 December 2005

In thousands of denars	**Share Capital**	**Share premium**	**Own shares**	**Revaluation reserve**	**Statutory Reserves**	**Retained earnings**	**Total**
Balance at 1 January 2004	2,014,067	16,209	-	109,674	960,578	240,097	3,340,625
Net profit for the year	-	-	-	-	-	700,190	700,190
Dividends to shareholders	-	-	-	-	-	(157,248)	(157,248)
Own shares acquired	-	-	(932)	-	-	-	(932)
Own shares sold	-	44	932	-	-	-	976
Increase due to acquisition of KB-Broker AD Skopje	-	-	-	43	8,370	323	8,736
Balance at 31 December 2004	2,014,067	16,253	-	109,717	968,948	783,362	3,892,347
Balance at 1 January 2005	2,014,067	16,253	-	109,717	968,948	783,362	3,892,347
Net profit for the year	-	-	-	-	-	357,138	357,138
Appropriation to statutory reserve	-	-	-	-	500,000	(500,000)	-
Dividends to shareholders	-	-	-	-	-	(193,350)	(193,350)
Own shares acquired	-	-	(41,366)	-	-	-	(41,366)
Own shares sold	-	270	19,243	-	-	-	19,513
Balance at 31 December 2005	2,014,067	16,523	(22,123)	109,717	1,468,948	447,150	4,034,282

Statement of cash flows

For the year ended 31 December 2005

In thousands of denars	**Note**	**2005**	**2004**
Operating activities			
Profit before tax		406,786	742,818
Adjustments for non cash items:			
Depreciation of property and equipment	5	152,965	144,879
Amortization of intangible assets	5	12,519	12,206
Gain on sale of property and equipment	3	(11,530)	(22,702)
Loss on sale of property and equipment		936	-
Loss on sale of assets acquired through foreclosure procedure		22,259	10,033
Decrease in fair value of investment property	5	1,542	17,132
Decrease in value of assets acquired through foreclosure procedure	5	-	115,677
Impairment losses	4	458,770	(13,413)
Provision for off-balance sheet items	5	94,493	48,138
Interest income	1	(2,051,710)	(1,744,291)
Interest expense	1	564,852	482,010
Net trading income		(2,880)	-
Dividends income		(1,021)	(11,197)
Share of loss from associate	16	11,880	-
Interest receipts		1,814,652	1,771,678
Interest paid		(528,808)	(443,373)
Operating profit before changes in operating assets		945,705	1,109,595
(Increase)/decrease in operating assets:			
Financial assets at fair value through profit and loss		5,620	(9,997)
Placements with, and loans to, banks		(1,408,950)	(2,428,336)
Loans and advances to customers		(1,767,702)	(1,936,965)
Proceeds from sale of assets acquired through foreclosure procedures		281,894	60,201
Other assets		(43,102)	(46,005)
Increase/(decrease) in operating liabilities:			
Deposits from banks and other financial institutions		265,002	(346,101)
Amounts owed to other depositors		3,049,076	3,108,340
Other liabilities		4,235	13,401
Net cash from operating activities before income tax		1,331,778	(475,867)
Taxation paid			
Income tax (paid)/received		(141,279)	(12,730)
Cash flows from operating activities		1,190,499	(488,597)

Statement of cash flows continued

For the year ended 31 December 2005

In thousands of denars	**Note**	**2005**	**2004**
Investing activities			
Acquisition of intangible assets		(25,300)	(7,357)
Acquisition of property and equipment		(91,332)	(237,988)
Leasehold improvements		(7,659)	-
Proceeds from the sale of property and equipment		11,384	29,555
Proceeds from the sale of intangible assets		-	2,120
Proceeds from investments		453,484	917,137
Dividends received		811	11,060
Investments in associates		(45,138)	-
Cash flows from investing activities		296,250	714,527
Financing activities			
Own shares sold		19,513	976
Dividends paid		(189,409)	(154,853)
Own shares acquired		(41,366)	(932)
Net increase/(decrease) in borrowings		78,658	(200,955)
Cash flows from financing activities		(132,604)	(355,764)
Effect of changes in allowance for impairment in cash and cash equivalents	4	(41,681)	17,806
Net increase/(decrease) in cash and cash equivalents		1,312,464	(112,028)
Cash and cash equivalents at 1 January		3,263,111	3,375,139
Cash and cash equivalents at 31 December	7	4,575,575	3,263,111

Notes to the financial statements

Significant accounting policies

a) Business background

Komercijalna Banka A.D. Skopje ("the Bank") is a joint stock company incorporated and domiciled in the Republic of Macedonia. The Bank is listed on the Macedonian Stock Exchange under the ID code KMB. The Bank is licensed to perform all banking activities and the main activities include commercial lending, receiving of deposits, foreign exchange deals, payment operation services in the country and abroad and retail banking services. In addition, it provides trade finance facilities to companies for export and import purposes.

b) 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.

c) 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 held-for-trading and for available-for-sale assets, 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 except for revaluation of certain property and equipment.

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts if 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 judgments 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 revise if the revision affects both current and future periods.

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 35.

Notes to the financial statements

Significant accounting policies continued

c) Basis of preparation continued

The accounting policies, except for the changes in accounting policy (refer note 28), are consistent with those used in the previous year.

d) Basis of accounting for investment in associate

(i) Associates

Associates are those entities in which the Bank has significant influence, but not control, over the financial and operating policies. The financial statements include the Bank's share of total recognized gains and losses of associates on an equity accounting basis, from the date that the significant influence commences until the date that the significant influences ceases. When the Bank's share of losses exceeds its interest in an associate, the Bank's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extend that the Bank has incurred legal or constructive obligations or made payments on behalf of an associate.

(ii) Transactions eliminated

Unrealised gains arising from transactions with the associate are eliminated to the extent of the Bank's interest in the enterprise. Unrealised gains arising from transactions with associate are eliminated against the investment in the associate. Unrealised losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

e) 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 continued

e) Foreign currency transactions continued

The foreign currencies the Bank deals with are predominantly Euro (EUR) and United States Dollars (USD) 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
1 USD	51.86	45.07

f) Financial instruments

(i) Classification

Trading instruments are those that the Bank principally holds for the purpose of short-term profit taking. These include government bonds and equity investments.

Originated 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. Originated loans and receivables comprise loans and advances to Groups and customers and government bills purchased at original issuance.

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 debt related investments.

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 held for trading and available-for-sale 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.

Held-to-maturity assets and originated loans and receivables are recognized on the day they are transferred to the Bank.

Notes to the financial statements

Significant accounting policies continued

f) **Financial instruments continued**

(iii) ***Measurement***

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

Subsequent to initial recognition all trading instruments and 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, originated loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortized cost is calculated based on the effective interest rate method. 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 trading instruments are recognised in the income statement.

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. In 2004 secondary market for treasury bills was still not established. In 2004 the Bank classified the treasury bills as investments held-to-maturity.

Notes to the financial statements

Significant accounting policies continued

f) Financial instruments continued

(vi) Specific instruments continued

Investments

Investments that the Bank holds for the purpose of the short-term profit taking are classified as trading instruments.

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

Investment property is stated at fair value determined annually by a registered valuer. Fair value is based on current prices in an active market for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognized in the income statement. Rental income from investment property is accounted for as described in accounting policy l.

When an item of property and equipment (refer accounting policy h) becomes an investment property following a change in its use, any difference arising at the date of transfer between the carrying amount of the item and its fair value is recognized directly in equity if it is a gain. Upon a disposal of the item, the gain is transferred to retained earnings. Any loss is recognized in the income statement immediately.

Loans and advances to banks and customers

Loans and advances originated by the Bank are classified as originated loans and receivables. Loans and advances are reported net of allowances to reflect the estimated recoverable amounts (refer accounting policy j).

g) Intangible assets

(i) Owned assets

Intangible assets that are acquired by the Bank are stated at cost less accumulated amortisation.

Items of intangible assets were restated in prior years by applying official indices to cost and to accumulated amortisation. The restatement was allocated to revaluation reserve.

(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.

Notes to the financial statements

Significant accounting policies continued

g) Intangible assets continued

(iii) Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Assets are not amortised until they are brought into use.

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

	2005	**2004**
	%	**%**
Software	20	20

h) Property and equipment

(i) Owned assets

Items of property and equipment are stated at cost or valuation less accumulated depreciation.

Items of property and equipment were restated in prior years by applying official indices to cost and to accumulated depreciation. The restatement was allocated to revaluation reserve.

(ii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property and equipment that is accounted for separately, is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is 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 are not depreciated until they are brought into use. Depreciation rates, based on the estimated useful lives, are as follows:

	2005	**2004**
	%	**%**
Buildings	2.5	2.5
Furniture and equipment	10 to 25	10 to 25

Notes to the financial statements

Significant accounting policies continued

i) 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.

j) Impairment

The carrying amounts of the Bank's assets, other than deferred tax assets (refer accounting policy m), 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.

Originated loans and advances

Originated 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.

Financial assets remeasured to fair value directly through equity

The recoverable amount of an equity instrument is its fair value. The recoverable amount of debt instruments remeasured to fair value is calculated as the present value of expected future cash flows discounted at the current market rate of interest.

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.

Notes to the financial statements

Significant accounting policies continued

j) Impairment continued

Financial assets remeasured to fair value directly through equity continued

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 impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down shall not be reversed through the income statement.

k) Share capital

(i) Preference share capital

Preference share capital that is non-redeemable is classified as equity.

(ii) Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity. Repurchased shares are classified as treasury shares and presented as a deduction from total equity.

(iii) Dividends

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

l) Income recognition

(i) Interest and similar income

Interest and similar 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. Interest of doubtful collectibility is credited to a suspense account and excluded from interest income. The closing balance on the suspense account is netted in the balance sheet against accrued interest receivable. Suspended interest is written off when there is no longer any realistic prospect of it being recovered. The amount of collected interest previously provided for is recognised in the income statement upon its collection.

Notes to the financial statements

Significant accounting policies continued

l) Income recognition continued

(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) Fee and commission income

Fee and commission income arises on financial services provided by the Bank including foreign currency settlements, guarantees, letters of credit, credit facilities, domestic and foreign payment operations and other services.

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

(iv) Net trading income

Net trading income includes gains and losses arising from disposals and changes in the fair value of financial assets and liabilities held for trading.

(v) Dividend income

Dividend income is recognised in the income statement on the date that the dividend is declared.

(vi) Rental income

Rental income from investment property is recognized in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognized as an integral part of the total rental income.

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.

Notes to the financial statements

Significant accounting policies continued

m) Income tax continued

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

1. Net interest income

In thousands of denars	**2005**	**2004**
Interest and similar income		
Interest and similar income arise from:		
Citizens	296,525	245,536
Enterprises	875,797	837,305
Banks and financial institutions	393,471	376,752
Government and local authorities	47,937	21,935
Impairment losses	(60,621)	(51,210)
Recoveries of interest previously provided for	498,601	313,974
	2,051,710	1,744,292

Interest expense and similar charges	**2005**	**2004**
Interest expense arise from:		
Citizens	364,999	327,829
Enterprises	113,853	67,795
Banks and financial institutions	60,401	66,160
Government and local authorities	25,599	20,226
	564,852	482,010
Net interest income	1,486,858	1,262,282

2. Net fee and commission income

In thousands of denars	**2005**	**2004**
Fee and commission income		
Lending operations	90,704	74,914
Payment operations		
in the country	304,970	263,795
abroad	193,821	182,199
Letters of credit and guarantees	74,632	82,512
Brokerage fees	32,815	15,690
Other	83,644	71,606
	780,586	690,716

Notes to the financial statements

2. Net fee and commission income continued

In thousands of denars	2005	2004
Fee and commission expense		
Payment operations		
in the country	25,303	18,033
abroad	43,901	34,561
Brokerage fees	422	277
Other	15,996	18,710
	85,622	71,581
Net fee and commission income	694,964	619,135

3. Other operating income

In thousands of denars	2005	2004
Capital gains	11,530	22,702
Rental income	4,223	5,346
Income upon successful court cases	7,420	106,532
Other	50,824	48,849
	73,997	183,429

Income upon successful court case in 2004 results from a resolution of a court dispute which the Bank had with the Ministry of Finance, and a decision of the Supreme Court of the Republic of Macedonia ruling in favor of the Bank.

4. Impairment losses

In thousands of denars	Note	2005	2004
Impairment allowance			
Cash and cash equivalents		41,681	-
Loans and advances to customers		638,158	66,983
Investments		4,296	-
Other assets		12,936	17,247
	13	697,071	84,230
Reversals of impairment allowance			
Cash and cash equivalents		-	(17,806)
	13	-	(17,806)
Recoveries			
Recoveries on loans and advances previously written-off		(238,301)	(79,837)
		458,770	(13,413)

Notes to the financial statements

5. Other operating expenses

In thousands of denars	**2005**	**2004**
Staff costs:		
Wages and salaries	423,527	388,339
Contributions	208,351	193,644
Other staff costs	84,642	74,273
Compensation benefits	74,495	36,535
Materials and services	200,157	188,050
Depreciation of property and equipment	152,965	144,879
Amortisation of intangible assets	12,519	12,206
Insurance premiums	138,506	119,795
Provisions for off-balance sheet items	94,493	48,138
Administration and marketing costs	71,462	76,506
Capital loss	23,195	10,033
Tax and contributions	5,709	6,687
Penalties	1,796	3,885
Decrease in fair value of investment property	1,542	17,132
Decrease in value of asset acquired through foreclosure procedure	-	115,677
Other	15,500	15,221
	1,508,859	1,451,000

Compensation benefits to the Managing Board, management, and the employees in 2005 of MKD 74,495 thousand comprise of appropriation of the net profit for 2005 in the amount of MKD 35,000 thousand, as provided for upon a decision brought by the Bank's Managing Board and appropriation of the net profit for 2004 in the amount of MKD 39,495 thousand, approved at the Annual meeting of the Bank held on 23 March 2005. In 2004 MKD 36,535 thousand represent compensation benefits to the Managing Board, management, and the employees as appropriation of the net profit for 2003, approved at the Annual meeting of the Bank held on 24 March 2004.

The number of employees, calculated on the basis of average effective working hours in 2005 was 1,222 (2004: 1,202). As at 31 December 2005, the Bank has 1,245 (31 December 2004: 1,300) employees.

Notes to the financial statements

6. Income tax expense

Recognised in the income statement

In thousands of denars	Note	2005	2004
Current tax expense			
Current year		49,280	42,441
		49,280	42,441
Deferred tax income			
Origination and reversal of temporary differences	19	368	187
Total income tax expense in the income statement		49,648	42,628

Reconciliation of effective tax rate

In thousands of denars	2005	2005	2004	2004
Profit before tax		406,786		742,818
Profit tax	15.0%	61,018	15.0%	111,423
Non-deductible expenses	4.7%	19,254	4.1%	30,301
Tax exempt revenue	(0.2%)	(706)	(0.3%)	(2,027)
Tax incentives not recognised in the income statements	(7.4%)	(29,918)	(13.1%)	(97,069)
	12.1%	49,648	5.7%	42,628

7. Cash and cash equivalents

In thousands of denars	2005	2004
Cash on hand	837,770	571,327
Balances with NBRM	2,911,973	1,936,178
Current accounts with foreign banks	624,898	722,886
Current accounts with local banks	4,454	5,909
Treasury bills	228,565	-
Restricted deposits	19,383	43,072
Other short term highly liquid investments	29,304	23,034
Less allowance for impairment	(80,772)	(39,295)
	4,575,575	3,263,111

At 31 December 2005 cash and cash equivalents included MKD 1,140,923 thousand (2004: MKD 817,630 thousand) as obligatory reserve requirement in MKD and MKD 1,850,229 thousand (2004: 1,184,089 thousand) as obligatory reserve in foreign currency requirement. These funds are not available for the Bank's daily business.

Interest equal to 2% per annum is accrued on the MKD obligatory reserve (2004: 2% per annum), while no interest is accrued (2004: 1% per annum) on the obligatory reserve in foreign currency.

Notes to the financial statements

7. Cash and cash equivalents continued

Treasury bills are with maturity of 28 days and interest rate of 8.4% to 8.58% per annum and are traded on the secondary market. In 2004 treasury bills were classified as investments held-to-maturity, because the secondary market for treasury bills was still not established in the Republic of Macedonia (refer note 12).

As at 31 December 2005 part of current accounts with foreign banks of MKD 79,934 thousand (2004: MKD 76,105 thousand) represent current accounts held with AY Bank Limited, London which is under liquidation. In 2005 the Bank has fully provided for the outstanding receivable from AY Bank Limited, London (2004: allowance for impairment of MKD 38,053 thousand). During 2005 the Bank has not received any payment from AY Bank Limited, London (2004: the Bank has received an amount of MKD 44,980 thousand). The Bank has no payables to AY Bank Limited.

As at 31 December 2005 part of current accounts with foreign banks of MKD 42,489 thousand (2004: MKD 36,004 thousand) represent a deposit held with HSBC Bank PLC (formerly Midlan Bank PLC), as a collateral for transactions performed with MASTER payment cards. These funds are not available for the Bank's daily business.

Restricted accounts represent deposits for opened letters of credit with maturity of 90 days or less, on behalf of the Bank's customers.

The interest rates shown represent rates at the end of the reporting period.

8. Financial assets at fair value through profit and loss

In thousands of denars	**2005**	**2004**
Financial assets at fair value through profit and loss		
Debt and other fixed-income instruments		
Government bonds	3,896	4,544
	3,896	4,544
Listed	3,896	4,544
Equity investments and other non-fixed-income instruments		
Equity investments	3,361	5,453
	3,361	5,453
Listed	2,226	4,318
Unlisted	1,135	1,135
Total financial assets at fair value through profit and loss	7,257	9,997

Notes to the financial statements

8. Financial assets at fair value through profit and loss continued

Income from debt and other fixed-income instruments is recognised in interest income. Income from equity investments and other non-fixed income instruments is recognised in dividend income.

9. Placements with, and loans to, banks

In thousands of denars	**2005**	**2004**
Short term placements with domestic banks	56,895	-
Short term placements with foreign banks	15,908,519	14,364,651
Long term placements with foreign banks	-	191,813
Placements with, and loans to, banks	15,965,414	14,556,464

Analysis by interest rates

In thousands of denars	**2005**	**2004**
Short term placements with domestic banks		
EUR deposits with fixed interest rate of 5.38% (2004: null) per annum	56,895	-
	56,895	-
Short term placements with foreign banks		
EUR deposits with fixed interest rates 1.82% - 4.45% (2004: 1.5% - 2.17%) per annum	12,656,626	11,768,439
USD deposits with fixed interest rates 4.05% - 4.30% (2004: 2.05% - 2.30%) per annum	2,563,645	2,072,659
AUD deposit with fixed interest rates 4.40% - 5.00% (2004: 4.50% - 5.05%) per annum	154,758	120,600
GBP deposit with fixed interest rates 3.50% - 4.00% (2004: 4.20% - 4.70%) per annum	188,363	142,203
CHF deposit with fixed interest rate 0.30% - 0.75% (2004: 0.55%) per annum	307,640	223,082
CAD deposit with fixed interest rate 2.22% (2004: 2.40%) per annum	37,487	28,826
SEK deposit with fixed interest rate 1.9 % per annum	-	8,842
	15,908,519	14,364,651
Long term placements with foreign banks		
EUR deposits with fixed interest rates 2.90% - 4.45% per annum	-	191,813
	-	191,813
Placements with, and loans to, banks	15,965,414	14,556,464

Notes to the financial statements

9. Placements with, and loans to, banks continued

Analysis by interest rates continued

As at 31 December 2005 part of the short term placements with foreign banks of MKD 122,585 thousand (2004: MKD 128,981 thousand) represents deposits held as a collateral for issued letters of guarantees and confirmation of letters of credit, bearing fixed interest rate of 1.82% to 2.37% (2004: 1.52% to 2.12%) per annum.

Part of short term placements in foreign banks in EUR (2004: long term placements with foreign banks) in amount of MKD 191,399 thousand (2004: MKD 191,813 thousand) represent deposits held with Westdeutsche Landesbank on 3 months to 1 year period (2004: from 3 to 5 years), bearing fixed interest of 2.90% to 4.45% per annum (2004: 2.9 to 4.45% per annum). These deposits are kept as collateral for the credit line from International Financial Corporation.

The interest rates shown represent rates at the end of the reporting period.

10. Loans and advances to customers

Analysis by customers

In thousands of denars	**Total 2005**	**Short Term 2005**	**Long Term 2005**	**Total 2004**	**Short Term 2004**	**Long Term 2004**
Corporate	11,860,380	7,852,922	4,007,458	10,799,825	7,313,404	3,486,421
Government and local authorities	523,255	523,255	-	619,476	619,476	-
Retail	3,158,131	763,777	2,394,354	2,668,740	729,603	1,939,137
	15,541,766	9,139,954	6,401,812	14,088,041	8,662,483	5,425,558
Current maturity	-	1,774,306	(1,774,306)	-	1,699,275	(1,699,275)
Less allowance for impairment	(2,612,081)	(1,834,343)	(777,738)	(2,234,804)	(1,643,699)	(591,105)
Net loans and advances to customers	12,929,685	9,079,917	3,849,768	11,853,237	8,718,059	3,135,178

Short-term corporate loans are with variable interest rate ranging from 3.5% to 14.5% (2004: from 3.5% to 15%) per annum, while long-term corporate loans are with variable interest rate from 2% to 14.5% (2004: from 3% to 15%) per annum.

Included in long-term corporate loans are loans financed through Agency of the Republic of Macedonia for assets management in the amount of MKD 138,149 thousand (2004: MKD 150,418 thousand) that have 2.5% commission per annum.

Included in the total amount of long-term corporate loans are loans financed from different credit lines, placed with certain interest margin for the Bank. Interest rates range from 6% to 14.7% (2004: from 4% to 11%) per annum.

Notes to the financial statements

10. Loans and advances to customers continued

Analysis by customers continued

Part of short-term receivables from government and local authorities in the amount of MKD 482,640 thousand (2004: MKD 400,260 thousand) represent purchased receivables with fixed interest rate of 3.2% to 4.7% (2004: 4.7%) per annum. As at 31 December 2004 part of short-term receivables from government and local authorities of MKD 199,216 thousand represent government bills purchased at original issuance with fixed interest rate of 8.7% to 9.4% per annum and with maturity up to March 2005. The remaining part of short-term loans to government institutions and local authorities has variable interest rate of 12% (2004: of 12%) per annum.

Short-term retail loans are with variable interest rate ranging from 3.5% to 14.5% (2004: from 3.5% to 15%), while long-term retail loans are with variable interest ranging from 3.5% to 14.5% (2004: from 3.5% to 15%) per annum.

The above interest rates represent rates at the end of the reporting period.

Concentration of credit risk by industry

The commercial lending is concentrated to companies located in the Republic of Macedonia.

In thousands of denars	**2005**	**2004**
Industry	5,183,922	3,720,059
Commerce and finance	3,341,403	2,622,802
Retail customers	3,158,131	2,668,740
Agriculture	691,640	1,425,639
Business and other services	22,466	3,577
Government institutions and local authorities	523,255	619,476
Construction	1,247,275	1,707,218
Transport	916,525	696,703
Catering and tourism	159,798	136,982
Other	297,351	486,845
	15,541,766	14,088,041
Less allowance for impairment	(2,612,081)	(2,234,804)
Net loans and advances to other customers	12,929,685	11,853,237

11. Interest receivable and other assets

In thousands of denars	**2005**	**2004**
Interest receivable	17,292	29,593
Accrued interest	66,206	47,555
Fee and commission receivable	9,796	9,251
Receivable for sold asset acquired through foreclosure procedure	506,250	-
Other assets	122,506	92,340
	722,050	178,739

Notes to the financial statements

11. Interest receivable and other assets

In December 2005 the Bank has sold business premises acquired through foreclosure procedure to a client at the amount of MKD 675,000 thousand. MKD 168,750 thousand, representing 25% of the agreed sale price were paid in cash in December 2005 and the remaining part of the receivable of MKD 506,250 thousand or 75% of the agreed sale price has been fully paid on 23 February 2006. The ownership over the property has been transferred to the buyer on the full payment of the sales price, on 23 February 2006.

12. Investments

In thousands of denars	**2005**	**2004**
Debt and other fixed-income instruments held-to-maturity		
Government bonds	315,552	366,855
Treasury bills	-	399,416
	315,552	766,271
Listed	315,552	366,855
Unlisted	-	399,416
Debt and other non-fixed-income instruments held-to-maturity		
Government bonds	15,933	19,120
	15,933	19,120
Unlisted	15,933	19,120
Equity investments and other non-fixed-income instruments available-for-sale		
Equity investments	67,728	67,096
	67,728	67,096
Unlisted	67,728	67,096
Total investments	399,213	852,487
Less allowance for impairment	(9,492)	(5,196)
Net investments	389,721	847,291

Government Bonds comprise of MKD 315,552 thousand (2004: MKD 366,855 thousand), received in exchange for the settlement of certain non-performing loans, bearing interest at a rate of 2% per annum. The principal is repayable in 20 equal semi-annual installments commencing from April 2002 up to October 2011.

Notes to the financial statements

12. Investments continued

Government bonds in the amount of MKD 15,933 thousand (2004: MKD 19,120 thousand) represent 15 year bonds bearing interest at a rate that is equal to the prime rate of the NBRM, which at 31 December 2005 was set at 6.5% (2004: 6.5%) per annum. The principal is repayable in 15 equal annual installments commencing from April 1996 to April 2010.

As at 31 December 2004 treasury bills issued by NBRM are with maturity of 7 and 14 days and with fixed interest of 7% per annum. In 2004 treasury bills have been classified as held-to-maturity since there was no active market to be readily convertible in cash. During 2005 a secondary market for trading treasury bills between the banks was established in the Republic of Macedonia. As at 31 December 2005 treasury bills are classified as cash and cash equivalents (refer note 7).

Equity investments before allowance are carried at cost. There is no active market for these investments and there are no recent transactions, which would provide evidence for their current market value.

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

Income from equity investments is recognised in dividend income.

13. Allowance for impairment

In thousands of denars	**Note**	**2005**	**2004**
Balance on 1 January		2,331,338	2,256,955
Impairment losses recognized:			
Additional allowances	4	697,071	84,230
Amounts released	4	-	(17,806)
Other		-	7,959
Write off		(283,475)	-
Balance on 31 December		2,744,934	2,331,338

The allowance is apportioned as follows:

In thousands of denars	**Note**	**2005**	**2004**
As a reduction of cash and cash equivalents	7	80,772	39,295
As a reduction of loans and advances to customers	10	2,612,081	2,234,804
As a reduction of investments	12	9,492	5,196
As a reduction of other assets		42,589	52,043
		2,744,934	2,331,338

Notes to the financial statements

14. Investment property

In thousands of denars	Note	2005	2004
Balance at 1 January		102,575	118,865
Transfer from property and equipment	18	1,511	842
Transfer to property and equipment	18	(9,675)	-
Decrease		(37,562)	-
Decrease in fair value	5	(1,542)	(17,132)
Balance at 31 December		55,307	102,575

Investment property comprises a number of commercial properties that are leased to third parties. Each of these leases contains an initial cancelable period from 15 to 60 days. The carrying amount of investment property is the fair value of the property as determined by an authorised valuator. Fair values were determined having regard to recent market transactions for similar properties and similar location as the Bank's investment property.

15. Assets acquired through foreclosure procedures

Assets received in exchange for non-performing loans include apartments, equipment and business premises which are not used by the Bank for its core operations. These assets are revalued annually by an authorised valuer. The Bank plans to dispose of the assets acquired through foreclosure procedures within three years of forced acquisition.

During 2005 the Bank has sold business premises acquired through foreclosure procedure in amount of MKD 675,000 thousand under the conditions explained in note 11. As at 31 December 2005 the amount of MKD 506,250 thousand represents outstanding receivable and therefore as a non-cash transaction it is not presented in the cash flow statement for the year ended 31 December 2005.

Part of the assets acquired through foreclosure procedure in amount of MKD 468,464 thousand were acquired through foreclosure procedure during 2005 as collection of previously written off receivables and therefore as a non-cash transaction, this is not presented in the cash flow statement for the year ended 31 December 2005.

16. Investment in associate

During 2005 the Bank has obtained a license to establish a pension insurance fund, KB Prvo penzisko drustvo AD Skopje ("the Company") together with Prva pokojninska druzba dd Ljubljana, Slovenia. The Bank owns 49% of the Company or 735,000 EUR. Total shareholders equity of the Company is 1,500,000 EUR.

The Bank has following investments in associates:

		Ownership	
	Country	2005	2004
KB Prvo Penzisko Drustvo AD Skopje	R. Macedonia	49%	-

Notes to the financial statements

16. Investment in associate continued

The Bank's share of post-acquisition total losses in the above associate for the year ended 31 December 2005 was MKD 11,880 thousand (2004: nil).

Summary financial information on associate – 100 percentages:

In thousands of denars	**Assets**	**Liabilities**	**Equity**	**Revenues**	**(Loss)**
2005					
KB Prvo Penzisko Drustvo AD Skopje	106,249	38,385	67,864	-	(24,245)
At 31 December 2005	106,249	38,385	67,864	-	(24,245)

17. Intangible assets

Movements of intangible assets during 2005 are as follows:

In thousands of denars	**Software**	**Assets under development**	**Total**
Cost or valuation			
At 1 January 2005	65,183	-	65,183
Additions		25,300	25,300
Transfer from assets under development	25,300	(25,300)	-
At 31 December 2005	90,483	-	90,483
Depreciation			
At 1 January 2005	33,805	-	33,805
Charge for the year	12,519	-	12,519
At 31 December 2005	46,324	-	46,324
Carrying amount			
At 1 January 2005	31,378	-	31,378
At 31 December 2005	44,159	-	44,159

Notes to the financial statements

17. Intangible assets

Movements of intangible assets during 2004 are as follows:

In thousands of denars	**Software**	**Assets under development**	**Total**
Cost or valuation			
At 1 January 2004	59,466	-	59,466
Additions	-	7,181	7,181
Transfer from assets under development	7,181	(7,181)	-
Disposals	(1,807)	-	(1,807)
Transfer from KB Broker	343	-	343
At 31 December 2004	65,183	-	65,183
Depreciation			
At 1 January 2004	22,885	-	22,885
Charge for the year	12,206	-	12,206
Disposals	(1,453)	-	(1,453)
Transfer from KB Broker	167	-	167
At 31 December 2004	33,805	-	33,805
Carrying amount			
At 1 January 2004	36,581	-	36,581
At 31 December 2004	31,378	-	31,378

Notes to the financial statements

18. Property and equipment

Movements in property and equipment during 2005 are as follows:

In thousands of denars	**Buildings**	**Furniture & equipment**	**Assets under construction**	**Total**
Cost or valuation				
At 1 January 2005	1,221,485	686,119	234,427	2,142,031
Additions	-	-	84,980	84,980
Transfer from assets under construction	179,528	107,782	(287,310)	-
Transfer to investment property	(1,511)	-	-	(1,511)
Transfer from investment property	9,675	-	-	9,675
Disposals	(7,920)	(64,502)	-	(72,422)
At 31 December 2005	1,401,257	729,399	32,097	2,162,753
Depreciation				
At 1 January 2005	249,824	413,882	-	663,706
Charge for the year	34,816	118,149	-	152,965
Disposals	(1,317)	(63,959)	-	(65,276)
At 31 December 2005	283,323	468,072	-	751,395
Carrying amount				
At 1 January 2005	971,661	272,237	234,427	1,478,325
At 31 December 2005	1,117,934	261,327	32,097	1,411,358

Notes to the financial statements

18. Property and equipment continued

Movements in property and equipment during 2004 are as follows:

In thousands of denars	Buildings	Furniture & equipment	Assets under construction	Total
Cost or valuation				
At 1 January 2004	1,008,610	577,189	320,384	1,906,183
Additions	-	-	282,939	282,939
Transfer from assets under construction	242,842	126,054	(368,896)	-
Transfer to investment property	(842)	-	-	(842)
Disposals	(29,125)	(24,491)	-	(53,616)
Transfer from KB Broker	-	7,367	-	7,367
At 31 December 2004	1,221,485	686,119	234,427	2,142,031
Depreciation				
At 1 January 2004	228,083	321,102	-	549,185
Charge for the year	30,750	114,129	-	144,879
Disposals	(9,009)	(24,801)	-	(33,810)
Transfer from KB Broker	-	3,452	-	3,452
At 31 December 2004	249,824	413,882	-	663,706
Carrying amount				
At 1 January 2004	780,527	256,087	320,384	1,356,998
At 31 December 2004	971,661	272,237	234,427	1,478,325

All buildings are occupied by the Bank for its own activities.

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

19. 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	(1,092)	(1,441)	-	-	(1,092)	(1,441)
Intangible assets	(12)	(31)	-	-	(12)	(31)
Tax (assets)/liabilities	(1,104)	(1,472)	-	-	(1,104)	(1,472)
Set off of tax	-	-	-	-	-	-
Net tax (assets)/liabilities	(1,104)	(1,472)	-	-	(1,104)	(1,472)

Notes to the financial statements

19. 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	(1,441)	349	-	(1,092)
Intangible assets	(31)	19	-	(12)
	(1,472)	368	-	(1,104)

20. Deposits from banks and other financial institutions

In thousands of denars	**2005**	**2004**
Demand deposits		
Domestic banks and other financial institutions	214,261	95,254
Foreign banks	38,152	37,611
Insurance companies	73,151	89,291
	325,564	222,156
Time deposits		
Domestic banks and other financial institutions	178,428	32,610
Insurance companies	15,776	-
	194,204	32,610
Total deposits	519,768	254,766

Part of the demand deposits of MKD 256,617 thousand (2004: MKD 155,162 thousand) are with a variable interest rates from 0.5% to 1% (2004: from 0.5% to 1%) per annum, and the remaining part is non-interest bearing.

Part of time deposits from domestic banks and other financial institutions in amount of MKD 64,237 thousand (2004: none) are with fixed interest rate of 1.5% per annum, and the remaining part is with variable interest rates ranging from 5.8% to 10% (2004: 1% to 1.5%) per annum.

As at 31 December 2005 time deposits from insurance companies are with variable interest rate ranging from 6.5% to 7.5% per annum.

The above interest rates represent rates at the end of the reporting period.

Interest is recognized in interest expense.

Notes to the financial statements

21. Amounts owed to other depositors

In thousands of denars	Short Term 2005	Long Term 2005	Short Term 2004	Long Term 2004
Demand deposits				
Citizens	10,276,943	-	9,390,530	-
Domestic companies	6,071,578	-	6,156,759	-
Foreign companies	498,031	-	505,837	-
	16,846,552	-	16,053,126	-
Time deposits				
Citizens	10,800,254	37,683	8,344,755	290,402
Domestic companies	2,079,557	84	1,817,473	84
Government institutions and local authorities	303,792	1	317,913	1
	13,183,603	37,768	10,480,141	290,487
Restricted deposits				
Citizens	83,013	224,661	244,240	187,642
Domestic companies	191,590	-	257,366	5,109
	274,603	224,661	501,606	192,751
Total	30,304,758	262,429	27,034,873	483,238

The Bank accrues variable interest on demand deposits from citizens of 0.1% to 1.7% (2004: 0.1% to 1.7%) per annum. The Bank accrues variable interest on demand deposits from companies of 0.5% to 1% (2004: from 0.5% to 1%) per annum.

The Bank accrues variable interest on time deposits from citizens of 0.15% to 7.5% (2004: 0.15% to 7.5%) per annum.

As at 31 December 2005 the Bank accrues variable interest on time deposits of companies of 0.25% to 8.5% per annum. As at 31 December 2004 part of the time deposits of companies in amount of MKD 82,216 thousand is with fixed interest rate of 1% to 5.5% per annum. On the remaining part, the Bank calculates interest rate from 0.5% to 9.1% per annum, variable depending on the currency and maturity period.

As at 31 December 2005 part of time deposits from government institutions and local authorities are with variable interest rate of 1% to 7.5% per annum depending on the maturity period. As at 31 December 2004 part of government institutions and local authorities in the amount of MKD 97,275 thousand is with fixed interest rates of 1% to 5.5% per annum. On the remaining time deposits from government institutions and local authorities the Bank accrues variable interest at a rate of 1% to 7% per annum.

Notes to the financial statements

21. Amounts owed to other depositors continued

Restricted deposits represent deposits made by companies for payments to be made abroad by the Bank on their behalf, for facilitating opening of letters of credit, for purchase of foreign currencies and as collateral for loans and guarantees extended by the Bank to certain customers, as well as advances received from citizens upon consumer and retail loans.

Part of restricted deposits of domestic companies in the amount of MKD 11,652 thousands (2004: MKD 36,351 thousands) are with variable interest rate of 0.25% (2004: 0.25%) per annum

Part of deposits to other depositors in amount of MKD 1,914,340 thousands (2004: MKD 1,749,601 thousands) are non-interest bearing.

The above interest rates represent rates at the end of the reporting period.

Interest is recognized in interest expense.

22. Other borrowed funds

In thousands of denars	**Short Term 2005**	**Long Term 2005**	**Short Term 2004**	**Long Term 2004**
Domestic borrowings				
Macedonian Bank for Development Promotion	121,377	226,987	118,678	92,956
Agency for Managing Accounts	-	138,109	-	149,179
National Bank of the Republic of Macedonia	-	20,127	-	24,704
Ministry of Finance	-	16,864	-	6,282
Foreign borrowings				
Macedonian Bank for Development Promotion	-	399,578	-	353,773
International Bank for Reconstruction and Development	-	2,830	-	21,876
ICDF Taiwan	-	7,795	-	7,571
International Financial Corporation	-	65,741	-	131,766
Council of Europe Social Development Fund	-	152,688	-	153,018
European Investment Bank	-	225,437	-	239,072
Current maturity	355,996	(355,996)	223,351	(223,351)
	477,373	900,160	342,029	956,846

Notes to the financial statements

22. Other borrowed funds continued

Short-term loans from the Macedonian Bank for Development Promotion (MBDP) are for promotion of export activities with fixed interest rate of 5% to 6% (2004: 6%) per annum.

Part of long term loans from MBDP in the amount of MKD 41,014 thousand (2004: 51,616 thousand) represents long term borrowing from NEPA Foundation, which during 2003 was terminated, and the credit lines were taken over by MBDP. Borrowings from the NEPA Foundation are for crediting small and medium enterprises. The interest rate is 2% below the prime rate of NBRM, but not below 5% per annum, out of which 1.5% is paid to MBDP, and the remaining part of 3.5% is capitalized. Long term loans from MBDP in the amount of MKD 139,289 thousand (2004: MKD 41,340 thousand) is for promotion of small and medium enterprises with fixed interest rate from 5% to 5.5% (2004: 5% to 8%) per annum. The remaining part represents long term borrowing from MBDP in amount of MKD 46,684 thousand (2004: none) is non-interest bearing.

The other part of long-term loans is from different credit lines extended through the MBDP with different interest rates and maturity.

The amount of MKD 123,013 thousand (2004: MKD 162,957 thousand) is from Kreditansatlt fur Wiederaufbau (KfW) credit line distributed through MBDP with variable interest rates of 7% and 8% (2004: 7% and 8%) per annum.

The amount of MKD 253,574 thousand (2004: MKD 158,617 thousand) is from an Italian Government credit line distributed through MBDP with fixed interest rate of 4% and 5% (2004: 4% and 5%) per annum and the rest of MKD 22,991 thousand (2004: MKD 32,199 thousand) is from German Macedonian Fund with fixed interest rate of 5.5% (2004: 5.5%) per annum.

Part of the long term loans from the Agency for Assets Management of MKD 22,139 thousand (2004: MKD 33,209 thousand) is payable in 10 equal semi-annual installments commencing from June 2003 and the remaining part in the amount of MKD 115,970 thousand (2004: MKD 115,970 thousand) is due and is payable in January 2020. Fees of 1.5% per annum are paid. These loans were approved from the primary issue of the NBRM and were converted from short-term to long-term in accordance with the Law for transformation of short-term loans from the primary issue into long-term loans "Official Gazette of RM No. 29/93 and 65/95" and has been approved from the Bank to the following borrowers: Tutunski Kombinat AD – Prilep and Zito Prilep AD – Prilep. These are liabilities of the final beneficiaries. In cases of their default, the liability is transferred to the Bank.

Part of the long term loans from the NBRM of MKD 9,157 thousand (2004: MKD 13,734 thousand) is payable in 10 equal semi-annual installments commencing from June 2003 and the remaining part in the amount of MKD 10,970 thousand (2004: MKD 10,970 thousand) is due and is payable in January 2020. Fees of 1.5% per annum are paid. These loans were approved from the primary issue of the NBRM and were converted from short-term to long-term in accordance with the Law for transformation of short-term loans from the primary issue into long-term loans "Official Gazette of RM No. 29/93 and 65/95" and has been approved from the Bank to the following borrowers: Zito Luks AD – Skopje, Zito Skopje AD – Skopje, ZPZ Napredok – Skopje, Pelagonija – Bitola, Dzumajlija AD – s. Lozovo, Sveti Nikole, Blagoj Gjorev AD Veles. These are liabilities of the final beneficiaries. In cases of their default, the liability is transferred to the Bank.

Notes to the financial statements

22. Other borrowed funds continued

Long-term loan from the International Bank for Reconstruction and Development for financing industrial and agricultural production is paid until April 2007 and has interest rate from six month LIBOR for EUR plus 1% to six month LIBOR for EUR plus 3.75% (2004: from six month LIBOR for EUR plus 1% to six month LIBOR for EUR plus 3.75%) per annum.

Long-term loan from the International Corporation Development Fund (ICDF) is paid in 20 equal semi annual installments until 2014 and the interest rate equal to six month LIBOR for USD minus 0.5% (2004: six month LIBOR for USD minus 0.5%) per annum.

Borrowing from International Finance Corporation is paid in 7 equal semi annual installments until 2006 and the interest rate equal to six month LIBOR for EUR plus 3% (2004: six month LIBOR for EUR plus 3%) per annum.

Borrowing from the Council of Europe Social Development Fund has two trenches. First in the amount of MKD 74,491 thousand (2004: MKD 74,652 thousand) is payable in 10 annual installments starting from September 2006 until 2015, and has interest rate of three month EURIBOR plus 1.4% (2004: three month EURIBOR plus 1.4%) per annum. The second trench of MKD 78,197 thousand (2004: MKD 78,366 thousand) is payable in 10 annual installments starting from May 2008 until 2017 with interest rate of 3 month EURIBOR plus 1.44% (2003: 3 month EURIBOR plus 1.44%) per annum.

Seven trenches from the long-term loan from the European Investment Group (EIB) are payable in semi annual installments until 2012 with variable interest rate (EURIBOR) set by the EIB plus 0.25% (2004: variable interest rate (EURIBOR) set by the EIB plus 0.25%).

The above interest rates represent rates at the end of the reporting period.

23. Accruals

In thousands of denars	**2005**	**2004**
Accrued interest due and payable	9,229	8,218
Accrued interest	94,099	59,066
	103,328	67,284

24. Impairment provisions related to off balance sheet items

In thousands of denars	**Note**	**2005**	**2004**
Balance at 1 January		112,234	64,096
Provisions made during the year	5	94,493	48,138
Balance at 31 December	31	206,727	112,234

Notes to the financial statements

25. Other liabilities

In thousands of denars	**2005**	**2004**
Suppliers payable	18,025	10,673
Dividends payable	14,695	10,754
Fee and commission	5,687	3,397
Taxes and contributions	-	8,854
Liabilities for compensation benefits	35,000	-
Liabilities to Ministry of Finance from state owned apartments sold	12,440	21,682
Other	42,126	64,437
	127,973	119,797

26. Capital and reserves

Share capital and share premium

	Ordinary shares		**Non-redeemable shares Preference shares**	
In number of shares	**2005**	**2004**	**2005**	**2004**
Issued and fully paid at 1 January	365,283	365,283	187,652	187,652
Conversion of preference shares	54,325	-	(55,957)	-
Share split 5 for 1	1,462,764	-	-	-
Issued and fully paid at 31 December	1,882,372	365,283	131,695	187,652

Ordinary shares have a par value of MKD 1,000 (2004: MKD 5,000) and preference shares have a par value of MKD 1,000 (2004: MKD 1,000). 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 meetings of the Bank. Preference shares give right to priority in the dividend payment, but do not carry the right to vote. All shares rank equally with regard to the Bank's residual assets. In respect of the Bank's shares that are held by the Bank, all rights are suspended until those shares are reissued.

Considering the fact that the nominal value of preference shares was lower than the nominal value of ordinary shares, in accordance with the article 277, paragraph 3 of the Trade Companies Law, the Shareholders Assembly of the Bank on its 18th meeting held on 23 March 2005 took a decision for amendment of the Statute of the Bank, among others to decrease the nominal value of ordinary shares to MKD 1,000 by dividing the nominal value of ordinary shares. The conversion of the ordinary shares was 5 new shares for one current share. This did not affect the total value of the share capital.

Notes to the financial statements

26. Capital and reserves continued

According to the Decision by the Bank's Shareholders' Assembly dated 24 March 2004, holders of preference shares may convert their shares in ordinary shares of the Bank. The option is exercisable up to 31 December 2006. During 2005, 55,957 preference shares were converted into 54,325 ordinary shares (2,040 preference shares for 408 ordinary shares before the share split 5 for 1, and 53,917 preference shares for 53,917 ordinary shares after the share split 5 for 1).

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

	% of voting share capital
European Bank for Reconstruction and Development	6.35

Revaluation reserve

The revaluation reserve relates to intangible assets and property and equipment and comprises the cumulative increased carrying value based on the increase of the producers price index on the date of the revaluation.

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 reaching the minimum required level statutory reserve could only be used for loss recovery. When the minimum level is reached 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. The Bank has already reached the minimum required level.

Reserve for own shares

The reserve for the Bank's own shares comprises the cost of the Bank's shares held by the Bank. At 31 December 2005 the Bank holds 10,000 (2004: nil) of the Bank's shares.

Dividends

After the balance sheet date the following dividends were proposed by the Directors. The dividends have not been provided for.

In thousands of denars	**2005**	**2004**
MKD 153 (2004: MKD 96) per qualifying ordinary share	288,498	175,532
MKD 65 (2004: MKD 95) per preference share	8,621	17,819
	297,119	193,351

Notes to the financial statements

26. Capital and reserves continued

The proposed dividends per qualifying ordinary share for the year ended 31 December 2004 in the amount of MKD 96 per qualifying ordinary share represents restated dividends per qualifying ordinary share from the one published in the Bank's financial statements for the year ended 31 December 2004 (published for the year 2004: MKD 480 per qualifying ordinary share) due to the share split (5 for 1) and the subsequent increment of the number of ordinary shares of the Bank.

27. Earnings per share

Basic earnings per share

The calculation of basic earnings per share at 31 December 2005 was based on the net profit attributable to ordinary shareholders of MKD 348,517 thousand (2004: MKD 682,371 thousand) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2005 of 1,839,089 (2004: 1,826,415), calculated as follows:

Net profit attributable to ordinary shareholders

In thousands of denars	**2005**	**2004**
Net profit for the year	357,138	700,190
Dividends on non-redeemable preference shares	(8,621)	(17,819)
Net profit attributable to ordinary shareholders	348,517	682,371

Weighted average number of ordinary shares

In number of shares	**2005**	**2004**
Issued ordinary shares at 1 January	1,826,415	365,283
Effect of decrease the nominal value of ordinary shares	-	1,461,132
Issued ordinary shares at 1 January, corrected	1,826,415	1,826,415
Effect of conversion of preference shares in January	1,719	-
Effect of conversion of preference shares in February	138	-
Effect of own shares acquired in April	(6,713)	-
Effect of conversion of preference shares in April	3,015	-
Effect of conversion of preference shares in May	5,569	-
Effect of own shares sold in June	2,500	-
Effect of conversion of preference shares in June	2,651	-
Effect of own shares acquired in July	(4,167)	-
Effect of conversion of preference shares in July	1,128	-
Effect of own shares sold in August	1,690	-
Effect of conversion of preference shares in August	819	-
Effect of conversion of preference shares in September	1,484	-
Effect of conversion of preference shares in October	1,773	-
Effect of conversion of preference shares in November	872	-
Effect of conversion of preference shares in December	196	-
Weighted average number of ordinary shares at 31 December	1,839,089	1,826,415

Notes to the financial statements

27. Earnings per share continued

Diluted earnings per share

The calculation of diluted earnings per share at 31 December 2005 was based on the net profit attributable to ordinary shareholders of MKD 348,517 thousand (2004: MKD 682,371 thousand) and a weighted average number of ordinary shares outstanding during the year ended 31 December 2005 of 1,970,782 (2004: 1,967,154), calculated as follows:

Net profit attributable to ordinary shareholders (diluted)

In thousands of denars	**2005**	**2004**
Net profit attributable to ordinary shareholders	348,517	682,371
Net profit attributable to ordinary shareholders	348,517	682,371

Weighted average number of ordinary shares (diluted)

In number of shares	**2005**	**2004**
Issued ordinary shares at 1 January	1,839,089	365,283
Effect of decrease the nominal value of ordinary shares	-	1,461,132
	1,839,089	1,826,415
Effect of issued potential ordinary shares	131,695	140,739
Weighted average number of ordinary shares (diluted) at 31 December	1,970,784	1,967,154

28. 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 and other non-fixed-income instruments available for sale) at fair value with changes in fair value recognised 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. 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.

Notes to the financial statements

29. Fair value

The Bank has financial assets, which include cash and cash equivalents, placements with, and loans to, banks, loans and advances to customers, and investments. The Bank has financial liabilities which include deposits from banks and customer and borrowed funds.

Estimation of fair values

The following summarizes the major methods and assumptions used in estimating the fair values of major items of financial instrument.

Cash and cash equivalents: The carrying amount of cash and cash equivalent approximates their fair value.

Placements with, and loans to, banks: Placements with, and loans to, banks in the amount of is with maturity up to one year, thus its carrying amount approximates its fair value.

Loans and advances to customers: The fair value of variable yield loans and short-term loans that regularly reprise, with no significant change in credit risk, generally approximate their carrying amount. Out of the total amount of loans and advances to customers in the amount of MKD 12,929,685 thousand (2004: MKD 11,853,237 thousand) , the amount of MKD 8,846,135 thousand or 68% (2004: MKD 9,126,539 thousand or 77%) represent floating rate instruments, while fixed interest rate instruments of MKD 632,001 thousand or 4.9% (2004: 721,173 thousand or 6.1%) mature up to 1 year. A small portion of loans and advances to customers of MKD 288,733 thousand or 2.2% (2004: MKD 226,156 thousand or 1.9%) are with fixed interest rate and maturity over one year, hence the fair value of total loans and advances to customers approximates the carrying amount at the balance sheet date.

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

Government bonds held-to-maturity in the amount of MKD 315,552 thousand (2004: MKD 366,855 thousand) represent fixed-income bonds, received in exchange for the settlement of certain non-performing loans, bearing interest at a rate of 2% per annum. These bonds are stated at their notional amount. These bonds are traded on the official market and as at 31 December 2005 the current market ask price equaled 85% (31 December 2004: 76%).

As at 31 December 2004 significant portion of the Bank's investment comprise treasury bills purchased at original issuance with maturity from 7 to 14 days, thus their carrying amount approximates their fair value.

Notes to the financial statements

29. Fair value continued

Estimation of fair values continued

Bank and customer deposits: For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the balance sheet date. The fair value of time deposits with variable interest rates approximates their carrying values at the balance sheet date. The estimated fair value of deposits with fixed interest rate is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. As these deposits represent only a small fraction of total deposits, the fair value of total deposits approximates the carrying values at the balance sheet date.

Other borrowed funds: The fair value of borrowings up to one year and borrowings with floating interest rate represents the carrying amount at the balance sheet date. The fair value of long-term borrowings with fixed interest rate is based on quoted market prices, if available. For long-term borrowing without quoted prices the fair value should be 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.

30. Trust activities

The Bank manages assets on behalf of third parties which are mainly in the form of loans to various clients. The Bank receives fee income for providing these services. Trust assets are not assets of the Bank and are not recognised in the balance sheet. The Bank is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

At 31 December 2005 the total assets held by the Bank on behalf of customers were MKD 283,894 thousand (2004: MKD 186,096 thousand).

31. Commitments and 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 three years. Expirations are not concentrated in any period.

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

In thousands of denars	**Note**	**2005**	**2004**
Guarantees			
in MKD		1,978,804	1,642,874
in foreign currency		1,382,189	1,439,411
Letters of credit			
in foreign currency		641,428	841,129
Credit card commitments		361,587	-
Undrawn overdraft facilities		589,210	-
Provisions	24	(206,727)	(112,234)
		4,746,491	3,811,180

Notes to the financial statements

31. Commitments and 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.

32. 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 requires 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 commitments to extend credit and guarantees issued (refer note 31).

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. As at 31 December 2004 the Bank's credit exposure to GD Granit AD Skopje, one of the leading construction companies in the Republic of Macedonia, is MKD 1,063,520 thousand representing 34.3% of the guarantee capital of the Bank. This exposure was over the limit allowed with the local law requirements and with the prescribed limits within the Bank's Credit Policy. Upon this, the Bank has received a waiver from the National Bank to comply with the prescribed limits up to 30 June 2005. As at 31 December 2005 the Bank's credit exposure to GD Granit AD Skopje is MKD 678,201 thousand representing 19.15% of the guarantee capital of the Bank. The aggregated credit exposure of the Bank to GD Granit AD Skopje and its related party JV Granit ATM is MKD 728,693 thousand representing 20.57% of the guarantee capital of the Bank.

Notes to the financial statements

32. Risk management disclosures continued

(i) Credit risk continued

The major concentrations of credit risk arise by location and type of customer in relation to the Bank's loans and advances, commitments to extend credit and guarantees issued.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

The Bank's policy is to require suitable collateral to be provided by the customers prior to the disbursement of approved loans. Guarantees and letters of credit are also subject to rigorous credit assessments before being provided.

Collateral for loans, guarantees, and letters of credit is usually obtained in the form of cash, Bank's and first class companies' guarantees, inventory, or other property.

(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 deposits, borrowings and share capital.

This enhances funding flexibility, limits dependence on any one source of funds and generally lowers the cost of funds. The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities.

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

32. 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	4,575,575	-	-	-	-	4,575,575
Financial assets at fair value through profit and loss	7,257	-	-	-	-	7,257
Placements with, and loans to, banks	15,503,794	270,221	191,399	-	-	15,965,414
Loans and advances to customers	3,746,602	1,209,934	4,123,381	2,660,317	1,189,451	12,929,685
Income tax receivable	-	-	60,859	-	-	60,859
Interest receivable and other assets	209,413	479,099	8,172	1,651	23,715	722,050
Investments	-	26,296	26,296	210,369	126,760	389,721
Investment in associate	-	-	-	-	33,258	33,258
	24,042,641	1,985,550	4,410,107	2,872,337	1,373,184	34,683,819
Liabilities						
Deposits from banks and other financial institutions	460,003	14,765	45,000	-	-	519,768
Amounts owed to other depositors	22,609,867	3,724,485	3,970,406	262,429	-	30,567,187
Other borrowed funds	55,993	171,112	250,268	584,541	315,619	1,377,533
Accruals	103,328	-	-	-	-	103,328
Other liabilities	92,679	35,084	210	-	-	127,973
	23,321,870	3,945,446	4,265,884	846,970	315,619	32,695,789
Net liquidity gap	720,771	(1,959,896)	144,223	2,025,367	1,057,565	1,988,030

Notes to the financial statements

32. 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	3,225,059	-	-	38,052	-	3,263,111
Financial assets at fair value through profit and loss	9,997	-	-	-	-	9,997
Placements with, and loans to, banks	14,362,582	2,069	-	191,813	-	14,556,464
Loans and advances to customers	2,701,550	1,396,960	4,619,549	2,542,533	592,645	11,853,237
Interest receivable and other assets	135,405	15,679	24,088	3,567	-	178,739
Investments	399,415	-	55,595	222,378	169,903	847,291
	20,834,008	1,414,708	4,699,232	2,998,343	762,548	30,708,839
Liabilities						
Deposits from banks and other financial institutions	254,766	-	-	-	-	254,766
Amounts owed to other depositors	21,556,691	3,196,253	2,281,929	483,238	-	27,518,111
Other borrowed funds	27,920	26,990	287,119	602,680	354,166	1,298,875
Accruals	14,388	8,965	43,931	-	-	67,284
Income tax payable	31,140	-	-	-	-	31,140
Other liabilities	119,797	-	-	-	-	119,797
	22,004,702	3,232,208	2,612,979	1,085,918	354,166	29,289,973
Net liquidity gap	(1,170,694)	(1,817,500)	2,086,253	1,912,425	408,382	1,418,866

Notes to the financial statements

32. Risk management disclosures continued

(iii) Market risk

Equity price risk

Equity price risk is the possibility that equity prices will fluctuate affecting the fair value of equity investments. The primary exposure to equity prices arises from equity investments that are not traded.

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) 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 reprising characteristics of the various floating rate indices, such as the savings rate, and three or six months EURIBOR/ 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.

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

32. 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	4,575,575	1,625,253	228,565	-	-	-	-	2,721,757
Financial assets at fair value through profit and loss	8	7,257	-	3,896	-	-	-	-	3,361
Placements with, and loans to, banks	9	15,965,414	-	15,503,794	270,221	191,399	-	-	-
Loans and advances to customers	10	12,929,685	8,846,135	93,710	111,521	426,770	270,288	18,445	3,162,816
Investments	12	389,721	15,933	-	26,296	26,296	210,368	52,592	58,236
Investment in associate	16	33,258	-	-	-	-	-	-	33,258
Liabilities									
Deposits from banks and other financial institutions	20	(519,768)	(386,584)	(64,237)	-	-	-	-	(68,947)
Amounts owed to other depositors	21	(30,567,187)	(28,652,847)	-	-	-	-	-	(1,914,340)
Other borrowed funds	22	(1,377,533)	(618,518)	(36,506)	(18,737)	(168,638)	(316,866)	(13,348)	(204,920)
Asset liability gap		1,436,422	(19,170,628)	15,729,222	389,301	475,827	163,790	57,689	3,791,221

Notes to the financial statements

32. 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: 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	3,263,111	2,624,790	-	-	-	-	-	638,321
Financial assets at fair value through profit and loss	8	9,997	-	4,544	-	-	-	-	5,453
Placements with, and loans to, banks	9	14,556,464	-	14,362,582	2,069	-	191,813	-	-
Loans and advances to customers	10	11,853,237	9,126,539	109,000	227,744	384,429	221,887	4,269	1,779,369
Investments	12	847,291	19,120	399,416	-	52,409	209,632	104,814	61,900
Liabilities									
Deposits from banks and other financial institutions	20	(254,766)	(187,507)	-	-	-	-	-	(67,259)
Amounts owed to other depositors	21	(27,518,111)	(25,589,019)	(12,491)	(46,298)	(120,702)	-	-	(1,749,601)
Other borrowed funds	22	(1,298,875)	(767,876)	(18,559)	-	(176,510)	(160,101)	(1,945)	(173,884)
Asset liability gap		1,458,348	(14,773,953)	14,844,492	183,515	139,626	463,231	107,138	494,299

Notes to the financial statements

32. Risk management disclosures continued

Currency risk continued

	2005						2004					
	MKD	**EUR**	**USD**	**CHF**	**Other**	**Total**	**MKD**	**EUR**	**USD**	**CHF**	**Other**	**Total**
Monetary assets												
Cash and cash equivalents	1,600,324	2,358,331	308,019	200,618	108,283	4,575,575	993,795	1,724,012	261,722	165,031	118,551	3,263,111
Financial assets at fair value through profit and loss	3,361	3,896	-	-	-	7,257	9,997	-	-	-	-	9,997
Placements with, and loans to, banks	-	12,713,521	2,563,645	307,640	380,608	15,965,414	-	11,960,251	2,072,659	223,082	300,472	14,556,464
Loans and advances to customers	11,063,247	1,807,875	58,563	-	-	12,929,685	10,649,379	1,150,794	53,064	-	-	11,853,237
Interest receivable and other assets	630,399	84,461	6,899	80	211	722,050	124,318	48,725	5,530	48	118	178,739
Income tax receivable	60,859	-	-	-	-	60,859	-	-	-	-	-	-
Investments	74,168	315,553	-	-	-	389,721	475,893	371,398	-	-	-	847,291
Investments in KB Prvo Penzisko	33,258	-	-	-	-	33,258	-	-	-	-	-	-
	13,465,616	17,283,637	2,937,126	508,338	489,102	34,683,819	12,253,382	15,255,180	2,392,975	388,161	419,141	30,708,839
Monetary liabilities												
Deposits from banks and other financial institutions	370,765	107,346	25,212	9,058	7,387	519,768	157,069	66,335	24,574	3,378	3,410	254,766
Amounts owed to other depositors	11,973,185	15,141,118	2,796,049	295,802	361,033	30,567,187	11,390,134	13,144,382	2,339,748	337,222	306,625	27,518,111
Other borrowed funds	523,464	846,274	7,795	-	-	1,377,533	391,799	899,505	7,571	-	-	1,298,875
Income tax payable	-	-	-	-	-	-	31,140	-	-	-	-	31,140
Accruals	96,032	7,091	205	-	-	103,328	60,190	6,890	201	3	-	67,284
Other liabilities	111,093	13,281	2,880	-	719	127,973	78,077	23,947	15,214	30	2,529	119,797
	13,074,539	16,115,110	2,832,141	304,860	369,139	32,695,789	12,108,409	14,141,059	2,387,308	340,633	312,564	29,289,973
Net position	391,077	1,168,527	104,985	203,478	119,963	1,988,030	144,973	1,114,121	5,667	47,528	106,577	1,418,866

Notes to the financial statements

33. Related party transactions

According to the Bank's Articles of Association, the supreme body is the assembly of the Bank, constituted of all the holders of the Bank's registered shares. The overall control of the Bank is with the non-executive Board of Directors ("the Managing Board") who are appointed by shareholders. The Managing Board comprises representatives of the Bank's major customers, however customers who are net debtors are excluded.

The Bank makes loans, extends guarantees attracts and takes deposits and loans from enterprises and banks to which it is related. The directors consider that these transactions are on a normal commercial basis, at arm’s length, and in the normal course of business.

At the year end the transactions with related parties were as follows:

- credit exposure to the individuals related to the Bank of MKD 26,368 thousand (2004: MKD 20,261 thousand);
- credit exposure to enterprises related to the Bank of MKD 466,019 thousand (2004: 424,245 thousand);
- other receivables from enterprises to which the Bank is related of MKD 23,715 thousand (2004: none);
- deposits from enterprises to which the Bank is related of MKD 484,910 thousand (MKD 535,456 thousand);
- interest income from enterprises to which the Bank is related of MKD 27,532 thousand (MKD 8,869 thousand);
- interest expense to enterprises to which the Bank is related of MKD 14,256 thousand (MKD 691 thousand);
- fee and commission income from enterprises to which the Bank is related of MKD 8,237 thousand (MKD 8,512 thousand);
- there are no fee and commission expense to enterprises to which the Bank is related (2004: 127 thousand).

Transactions with key management personnel

Directors of the Bank control 0.80 percent (2004: 0.97 percent) of the voting shares of the Bank.

Notes to the financial statements

33. Related party transactions continued

Transactions with key management personnel continued

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

In thousands of denars	**2005**	**2004**
Directors	91,478	75,735
Non-executive officers	4,937	4,226
	96,415	79,961

Associates

During the year ended 31 December 2005 the associate placed time deposits in the Bank in amount of MKD 44,800 thousand (2004: none).

During the year ended 31 December 2005 the Bank paid MKD 3,803 thousand as interest expense. No dividends were received from associates in 2005.

34. Subsequent events

According to the Decision for conversion of preference into ordinary shares, as at 15 February 2006 the number of ordinary shares equals to 1,923,323 and the number of preference shares equals to 90,744. The nominal value of the total share capital is MKD 2,014,067.

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.

Notes to the financial statements

35. Accounting estimates and judgments

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 asset acquired through foreclosure procedure

In December 2005 the Bank has acquired business premises through foreclosure procedure in amount of MKD 468,464 thousand, as collection of previously written off receivables. Said business premises are in excellent condition and located in prime business area of the city of Skopje.

Management of the Bank are confident that the business premises will be sold in a reasonable time frame, with no loss. On the contrary, adjustments will be made in future periods if future market activity indicates that such adjustments are appropriate.

Critical accounting judgments in applying the Bank's accounting policies

Certain critical accounting judgments in applying the Bank's accounting policies are described below:

Held-to-maturity investments

The Bank holds debt securities issued by the Republic of Macedonia, received in exchange for the settlement of certain non-performing loans, bearing interest at a rate of 2% per annum. The principal is repayable in 20 equal semi-annual installments commencing from April 2002 up to October 2011. As at 31 December 2005 the outstanding balance of these receivables amounts MKD 315,552 thousand (2004: MKD 366,855 thousand). In addition, the Bank holds 15 year government bonds issued by the Republic of Macedonia, bearing interest at a rate equal to the prime rate of the NBRM. The principal is repayable in 15 equal annual installments commencing from April 1996 up to April 2010. As at 31 December 2005 the outstanding balance of these receivables amounts MKD 15,933 thousand (2004: MKD 19,120 thousand). The Bank has the intent and ability to hold to maturity these securities. Therefore, they have been classified as held-to-maturity assets.