Halkbank AD Skopje

Financial Statements
for the year ended
31 December 2012

Contents

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Independent auditors' report to the shareholders of Halkbank AD Skopje

We have audited the accompanying financial statements of Halkbank AD Skopje ("the Bank"), which comprise the statement of financial position as at 31 December 2012, the statement of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2012, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Macedonia DOO

KPMG Macedonia DOO
23 May 2013
Skopje

Statement of financial position

As at 31 December

In thousands of denars	*Note*	2012	2011
Assets			
Cash and cash equivalents	*15*	7,047,269	2,174,409
Trading assets	*16*	64,797	174,422
Loans and advances to banks	*17*	18,947	396,947
Loans and advances to customers	*18*	9,231,275	5,781,590
Investment securities	*19*	860,293	167,526
Property and equipment	*20*	647,835	504,872
Intangible assets	*21*	34,162	37,889
Other assets	*22*	240,188	212,995
Total assets		18,144,766	9,450,650
Liabilities			
Deposits from banks	*23*	1,999,003	10,238
Deposits from customers	*24*	10,858,588	5,478,398
Other borrowed funds	*25*	1,555,057	1,429,259
Provisions	*26*	1,761	2,270
Other liabilities	*27*	101,884	92,705
Total liabilities		14,516,293	7,012,870
Equity	*28*		
Share capital		2,893,694	1,884,150
Share premium		325,854	325,854
Other reserves		133,588	80,214
Retained earnings		275,337	147,562
Total equity		3,628,473	2,437,780
Total liabilities and equity		18,144,766	9,450,650

The notes on pages 7 – 74 are an integral part of these financial statements.

These financial statements set out on pages 1 to 74 were approved by the Supervisory Board on 21 May 2013 and were signed on its behalf by:

Mr. Necdet Palacki	Mr. Tomce Tasevski	Mr. Erturk Sumer
Chief Executive Manager	*Executive Manager*	*Executive Manager*

Statement of comprehensive income

For the year ended 31 December

In thousands of denars	***Note***	**2012**	**2011**
Interest income	*8*	793,594	557,367
Interest expense	*8*	(307,788)	(243,526)
Net interest income		485,806	313,841
Fee and commission income	*9*	134,323	119,314
Fee and commission expense	*9*	(62,855)	(49,240)
Net fee and commission income		71,468	70,074
Net trading income	*10*	10,204	7,012
Net foreign exchange gain		20,101	17,018
Other operating income	*11*	11,411	42,093
		41,716	66,123
Operating income		598,990	450,038
Net impairment loss on financial assets	*15,18,19,22*	(19,719)	23,733
Personnel expenses	*12*	(192,661)	(174,401)
Depreciation and amortisation	*20,21*	(75,337)	(71,069)
Other expenses	*13*	(247,620)	(208,567)
		(535,337)	(430,304)
Profit before income tax		63,653	19,734
Income tax expense		-	-
Profit /(Loss) for the period		63,653	19,734
Other comprehensive income, net of income tax			
Fair value reserve (available-for-sale financial assets)		(819)	(3,323)
Other comprehensive income for the period, net of income tax		(819)	(3,323)
Total comprehensive income for the period		62,834	16,411
Basic and diluted (loss)/earnings per share (MKD)	*14*	298	197

The notes on pages 7 – 74 are an integral part of these financial statements

Statement of changes in equity

For the year ended 31 December

In thousands of denars	**Share capital**	**Share premium**	**Statutory reserve**	**Fair value reserve**	**Retained earnings**	**Total**
Balance at 1 January 2011	418,700	325,854	112,195	9,118	90,052	955,919
Total comprehensive income for the year						
Profit or loss	-	-	-	-	19,734	19,734
Other comprehensive income, net of income tax						
Fair value reserve (available-for-sale financial assets)						
Net change in fair value	-	-	-	(3,323)	-	(3,323)
Total comprehensive income for the year	-	-	-	(3,323)	19,734	16,411
Transactions with equity holders, recognized directly in equity						
Appropriation to retained earnings	-	-	(37,776)	-	37,776	-
Shares issued	1,465,450	-	-	-	-	1,465,450
Total contributions by and distributions to equity holders	1,465,450	-	(37,776)	-	37,776	1,465,450
Balance at 31 December 2011	1,884,150	325,854	74,419	5,795	147,562	2,437,780

Statement of changes in equity (continued)

In thousands of denars	**Share capital**	**Share premium**	**Statutory reserve**	**Fair value reserve**	**Retained earnings**	**Total**
Balance at 1 January 2012	1,884,150	325,854	74,419	5,795	147,562	2,437,780
Total comprehensive income for the year						
Profit or loss	-	-	-	-	63,653	63,653
Other comprehensive income, net of income tax						
Fair value reserve (available-for-sale financial assets)	-	-	-	(819)	-	(819)
Total comprehensive income for the period	-	-	-	(819)	63,653	62,834
Transactions with equity holders, recognized directly in equity						
Appropriation to retained earnings	-	-	(11,478)		11,478	-
Shares issued	1,009,544	-	-	-	-	1,009,544
Transactions as result of the merger with Ziraat Bank AD Skopje						
Taken over reserves and retained earnings from Ziraat Bank	-	-	65,671	-	59,199	124,870
Taken over loss from Ziraat Bank	-	-	-	-	(6,338)	(6,338)
Other	-	-	-	-	(217)	(217)
Total contributions by and distributions to equity holders	1,009,544	-	54,193	-	64,122	1,127,859
Balance at 31 December 2012	2,893,694	325,854	128,612	4,976	275,337	3,628,473

The notes on pages 7 - 74 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December

In thousands of denars	*Note*	2012	2011
Cash flows from operating activities			
Profit for the period		63,653	19,734
Adjustments for:			
Depreciation and amortization	*20,21*	75,337	71,069
Capital gain on sale of property and equipment	*11*	(57)	(12,774)
Capital gain on sale of assets acquired through foreclosure procedure	*11*	-	(1,270)
Capital loss on sale of property and equipment		-	19
Impairment provision for off balance sheet items	*13*	227	458
Impairment provision for court-cases	*11*	-	(15,329)
Net interest income	*8*	(485,806)	(313,841)
Net trading income	*10*	(10,204)	(7,012)
Net impairment loss on financial assets	*15,18, 19,22*	19,719	(23,733)
Impairment losses on assets acquired through foreclosure procedures	*13*	1,831	1,668
Dividend income	*11*	(3,815)	(2,957)
		(339,115)	(283,968)
Change in financial assets held for trading		110,193	-
Change in loans and advances to banks		378,000	361,090
Change in loans and advances to customers		(2,871,433)	(1,262,012)
Change in other assets		(31,030)	(26,718)
Change in deposits from banks		1,988,771	(624,143)
Change in deposits from customers		3,932,064	977,859
Change in other liabilities and impairment provision related to off balance sheet items		3,725	10,518
		3,171,175	(847,374)
Interest received		794,442	560,754
Interest paid		(251,730)	(231,978)
Net cash from operating activities		3,713,887	(518,598)

Statement of cash flows (continued)

For the year ended 31 December

In thousands of denars	*Note*	2012	2011
Cash flows from investing activities			
Acquisition of property and equipment		(121,898)	(29,876)
Proceeds from the sale of property and equipment		496	37,928
Acquisition of intangible assets	*21*	(11,299)	(3,166)
Acquisition of investment securities		(555,377)	597,865
Dividends received		3,815	2,957
Net cash used in investing activities		(684,263)	605,708
Cash flows from financing activities			
Proceeds from other borrowed funds		1,864,182	896,745
Repayment of other borrowed funds		(1,735,839)	(1,261,496)
Shares issued		-	1,465,450
Net cash from/(used in) financing activities		128,343	1,100,699
Effects from impairment on cash and cash equivalents		194	-
Net increase in cash and cash equivalents		3,158,161	1,187,809
Cash and cash equivalents taken from Ziraat Bank AD Skopje as at 30 September 2012		1,714,699	-
Cash and cash equivalents at 1 January		2,174,409	986,600
Cash and cash equivalents at 31 December	*15*	7,047,269	2,174,409

The notes on pages 7 – 74 are an integral part of these financial statements.

Notes to the financial statements

1. Reporting entity

Halkbank AD Skopje ("the Bank" or "Halkbank") is a joint stock company incorporated and domiciled in the Republic of Macedonia.

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

Ul. "Mito Hadzivasilev - Jasmin"bb
1000 Skopje
Republic of Macedonia

In 2011 the Bank changed its name from Export and Credit Banka AD Skopje to Halkbank AD Skopje, as a result of a change in the shareholders structure of the Bank.

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

The shares of the Bank are traded on the free market on the Macedonian Stock exchange with trade symbol IKB and ISIN CODE (MKIKBA101015).

Merger with Ziraat Bank AD Skopje

On 24 February 2012 the Shareholder's Assembly reached a decision for initiation of a procedure for merging the Bank with Ziraat Banka AD Skopje and authorized the Supervisory Board and the Managing Board of Halkbank to reach and approve all the necessary decisions and other documents in the process of merger.

In accordance with Chapter IV, article 1 line 17.4 of the "*Decision for issuing licenses to banks*" accompanying the request for issuing a licence for merger, the Bank submitted to the National Bank of the Republic of Macedonia ("NBRM") a Merger Agreement concluded between the Supervisory Boards of both banks.

The primary objective of the merger was continuance of the banking activities in the Republic of Macedonia through a larger bank, instead of two smaller banks as separate legal entities, both in ownership of the Republic of Turkey.

In accordance with the approval received from NBRM No. 7422 dated 10 September 2012, as well as the decision for inscription of change from the Central Register of the Republic of Macedonia dated 1 October 2012, Ziraat Bank AD Skopje was deleted from the trade register, and Halkbank become the legal successor of Ziraat Bank AD Skopje.

In the absence of a specific guidance in IFRS that specifically applies to the above legal transformation transaction (status changes under common control) the management has applied the requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and used its judgment in developing and applying its own accounting policy to account for the above transaction. In choosing the appropriate accounting policy the management has considered that the ultimate ownership structure of the merging entities has not changed. Therefore the risks and benefits of the ultimate owner have not changed as a result of the legal transformation.

Notes to the financial statements

1. Reporting entity (continued)

Based on that the legal transformation transaction is considered as business combination under common control and therefore, the book value accounting method was applied to account for it. As a result:

- The assets and liabilities of the merged subsidiaries were recorded at the carrying values; No additional adjustments were necessary to be made to harmonize the accounting policies;
- The income statement reflects the results of the both entities starting from the date when the legal transaction i.e. 1 October 2012;
- Considering the legal transformation as a non-cash transaction, the following assets, liabilities, equity and reserves have not been presented in the Statement of cash flows for the year ended as at 31 December 2012:

Balance Sheet of Ziraat Bank AD Skopje at at 30 September 2012 *In thousand of denars*

Cash and cash equivalents	1,714,699
Loans and advances to customers	584,971
Investments securities	138,372
Income tax receivables	99
Other receivables	2,354
Intangible assets	7,326
Property and equipment	74,489
Total assets	**2,522,310**
Deposits from customers	1,389,517
Provisions	294
Other liabilities	4,422
Total liabilities	**1,394,233**
Share capital	1,009,544
Other reserves	65,672
Retained earnings	52,861
Total equity and reserves	**1,128,077**
Total liabilities, equity and reserves	**2,522,310**

Representative office in the Republic of Serbia

On 14 December 2012 the Bank opened a representative office in Belgrade, Republic of Serbia.

The representative office does not have a status of a separate legal entity. Its main activities include representing Halkbank AD Skopje, market research, initiating business cooperation with companies in the Republic of Serbia, promotional and informational activities etc. The costs of operation are covered by Halkbank AD Skopje and are included in these financial statements.

Notes to the financial statements

2. Basis of preparation

(a) Statement of compliance

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

(b) Basis of measurement

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

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

(c) Functional and presentation currency

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

(d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognized in the financial statements are described in note 5.

Notes to the financial statements

2. Basis of preparation (continued)

3. Significant accounting policies

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

(a) Foreign currency transactions

Transactions in foreign currencies are translated into Macedonian denars at the exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated into Macedonian denars at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in Macedonian denars at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into Macedonian denars at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for the differences arising on the retranslation of available-for-sale equity instruments, which are recognised directly in equity. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

The foreign currencies the Bank deals with are predominantly Euro (EUR) and United States Dollars (USD). The exchange rates used for translation at 31 December 2012 and 2011 were as follows:

	2012 MKD	**2011 MKD**
1 EUR	61.50	61.50
1 USD	46.65	47.53

Notes to the financial statements

3. Significant accounting policies (continued)

(b) Interest

Interest income and expense are recognised in the profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses.

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

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

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

Interest income and expense on all trading assets and liabilities are considered to be incidental to the Bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

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

(c) Fees and commission

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

Other fees and commission income, including financial services provided by the Bank in respect of foreign currency settlements, guarantees, letters of credit, domestic and foreign payment operations and other services, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognised on a straight-line basis over the commitment period.

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

(d) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes, interest, dividends and foreign exchange differences.

Notes to the financial statements

3. Significant accounting policies (continued)

(e) Dividends

Dividend income is recognised when the right to receive income is established.

(f) Lease payments made

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

(g) Income tax expense

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

- Tax on any dividend distribution – i.e. the tax base is the dividend paid;
- Tax on non deductable items – i.e. the tax base is the non deductable items specified in the tax rulebook less any allowable tax credits. The tax on non deductable items is paid each month in monthly advance installments based on the previous fiscal year computation of such non deductable differences. At year end a final tax computation is prepared with a final tax settlement (see note 23).

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

(i) Tax on dividend distribution:

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

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

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

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

(ii) Tax on non deductable items:

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

Notes to the financial statements

3. Significant accounting policies (continued)

(g) Income tax expense (continued)

Recognition of tax provisions:

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

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

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

(h) Financial assets and liabilities

(i) Recognition and initial measurement

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

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

(ii) Classification

See accounting policies 3(i), (j), (k) and (l).

(iii) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset.

Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability in the statement of financial position. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and consideration received (including any new asset obtained less any new liability assumed) is recognised in profit or loss.

Notes to the financial statements

3. Significant accounting policies (continued)

(h) Financial assets and liabilities

(iii) Derecognition (continued)

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

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

(iv) Offsetting

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

Income and expenses are presented on a net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

(v) Amortised cost measurement

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

(vi) Fair value measurement

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

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

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

Notes to the financial statements

3. Significant accounting policies (continued)

(h) Financial assets and liabilities (continued)

(vi) Fair value measurement (continued)

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

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

(vii) Identification and measurement of impairment

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

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

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

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

Notes to the financial statements

3. Significant accounting policies (continued)

(h) Financial assets and liabilities (continued)

(vii) Identification and measurement of impairment (continued)

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

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

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

(i) Cash and cash equivalents

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

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

Notes to the financial statements

3. Significant accounting policies (continued)

(j) Trading assets and liabilities

Trading assets and liabilities are those assets and liabilities that the Bank acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking.

Trading assets and liabilities are initially recognised and subsequently measured at fair value in the statement of financial position, with transaction costs recognised in profit or loss. All changes in fair value are recognised as part of net trading income in profit or loss. Trading assets and liabilities are not reclassified subsequent to their initial recognition, except that nonderivative trading assets, other than those designated at fair value through profit or loss upon initial recognition, may be reclassified out of the fair value through profit or loss (i.e., trading) category if they are no longer held for the purpose of being sold or repurchased in the near term and the following conditions are met:

- If the financial asset would have met the definition of loans and receivables (if the financial asset had not been required to be classified as held for trading at initial recognition), then it may be reclassified if the Bank has the intention and ability to hold the financial asset for the foreseeable future or until maturity.
- If the financial asset would not have met the definition of loans and receivables, then it may be reclassified out of the trading category only in ‘rare circumstances’.

(k) Loans and advances

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

Loans and advances to banks are classified as loans and receivables.

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

Notes to the financial statements

3. Significant accounting policies (continued)

(l) Investment securities

Subsequent to initial recognition investment securities are accounted for depending on their classification as either held to maturity, fair value through profit or loss, or available-for-sale.

(i) Held-to-maturity

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

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

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

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

(ii) Available-for-sale

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

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

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

Notes to the financial statements

3. Significant accounting policies (continued)

(l) Investment securities (continued)

(ii) Available-for-sale (continued)

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

(m) Property and equipment

(i) Recognition and measurement

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

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, the costs of dismantling and removing the items and restoring the site on which they are located, and capitalised borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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

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

(ii) Subsequent costs

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

(iii) Depreciation

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

Notes to the financial statements

3. Significant accounting policies (continued)

(m) Property and equipment (continued)

(iii) Depreciation (continued)

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

	%
Buildings	2.5
Furniture and equipment	10 - 25

Depreciation methods, useful lives and residual value are reviewed at each financial reporting date and adjusted if appropriate.

(n) Intangible assets

(i) Recognition and measurement

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

(ii) Subsequent expenditure

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

(iii) Amortisation

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

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

	%
Software	25
Licences	25

Amortization methods, estimated useful lives and residual values are reviewed at each financial reporting date and adjusted if appropriate.

Notes to the financial statements

3. Significant accounting policies (continued)

(o) Leased assets – lessee

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

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

(p) Impairment of non-financial assets

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

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

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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

(q) Deposits and borrowed funds

Deposits and borrowed funds are the Bank's sources of debt funding.

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

Notes to the financial statements

3. Significant accounting policies (continued)

(q) Deposits and borrowed funds (continued)

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

(r) Provisions

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

A provision for onerous contracts is recognised when the expected benefits to be derived by the Bank from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Bank recognises any impairment loss on the assets associated with that contract.

(s) Employee benefits

(i) Defined contribution plans

The Bank contributes to its employees' post retirement plans as prescribed by the national legislation and will have no legal or constructive obligation to pay further amounts. Contributions, based on salaries, are made to the national organisations responsible for the payment of pensions.

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

(ii) Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

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

Notes to the financial statements

3. Significant accounting policies (continued)

(s) Employee benefits (continued)

(iii) Other long-term employee benefits

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

(t) Share capital and reserves

(i) Ordinary shares

Ordinary shares are classified as equity.

(ii) Share issue costs

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

(iii) Repurchase of share capital

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

(iv) Dividends

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

(u) Earnings per share

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

Notes to the financial statements

3. Significant accounting policies (continued)

(v) Segment reporting

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

(w) New standards and interpretations not yet adopted

The following new Standards and Interpretations are not yet effective for the year ended 31 December 2012, and have not been applied in preparing these financial statements:

- Amendments to IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities (Effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods; to be applied retrospectively)

The Amendments contain new disclosure requirements for financial assets and liabilities that are:

- offset in the statement of financial position; or
- subject to master netting arrangements or similar agreements.

The Bank does not expect the Amendments to have any impact on the financial statements since it does not apply offsetting to any of its financial assets and financial liabilities and it has not entered into master netting arrangements.

- *IFRS 9 Financial Instruments* (2009) (Effective for annual periods beginning on or after 1 January 2015; to be applied prospectively. Earlier application is permitted.)

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

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

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

A financial asset is measured at amortized cost if the following two conditions are met:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and,
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

Notes to the financial statements

3. Significant accounting policies (continued)

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

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

The Bank is currently in the process of evaluating the potential effect of this Standard.

- Additions to *IFRS 9 Financial Instruments* (2010) (Effective for annual periods beginning on or after 1 January 2015; to be applied prospectively. Early application is permitted.)

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

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

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

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

The Bank is currently in the process of evaluating the potential effect of this Standard.

- Amendments to *IFRS 9* and *IFRS 7*: *Mandatory effective date and transitional disclosures*

These Amendments change the disclosure and restatement requirements relating to the initial application of IFRS 9 Financial Instruments (2009) and IFRS 9 (2010).

The amended IFRS 7 require to disclose more details about the effect of the initial application of IFRS 9 when an entity does not restate comparative information in accordance with the amended requirements of IFRS 9.

If an entity adopts IFRS 9 on or after 1 January 2013, then it will no longer be required to restate comparative information for periods prior to the date of initial application.

Notes to the financial statements

3. Significant accounting policies (continued)

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

If an entity early adopts IFRS 9 in 2012, then it has a choice either to restate comparative information or to provide the enhanced disclosures as required by the amended IFRS 7.

If an entity early adopts IFRS 9 prior to 2012, then neither restatement of comparative information nor provision of the enhanced disclosures under the amended IFRS 7 are required.

The Bank is currently in the process of evaluating the potential effect of this Standard.

- *IFRS 10 Consolidated Financial Statements* and *IAS 27* (2011) *Separate Financial Statements* (Effective for annual periods beginning on or after 1 January 2013; to be applied retrospectively when there is a change in the control conclusion, subject to transitional provisions that provide some relief from full retrospective application. Earlier application is permitted if IFRS 11, IFRS 12, IAS 27 (2011) and IAS 28 (2011) are also applied early.)

IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are SPEs in the scope of SIC-12. IFRS 10 introduces new requirements to assess control that are different from the existing requirements in IAS 27 (2008). Under the new single control model, an investor controls an investee when:

(1) it is exposed or has rights to variable returns from its involvements with the investee;

(2) it has the ability to affect those returns through its power over that investee; and

(3) there is a link between power and returns.

The new Standard also includes the disclosure requirements and the requirements relating to the preparation of consolidated financial statements. These requirements are carried forward from IAS 27 (2008).

The impact of the initial application of the amendment will depend on the specific facts and circumstances of the investees of the Group held at the date of initial application. Therefore, the Bank is not able to prepare an analysis of the impact this will have on the financial statements until the date of initial application.

- *IFRS 11 Joint Arrangements* (Effective for annual periods beginning on or after 1 January 2013; to be applied retrospectively, subject to transitional provisions that provide some relief from full retrospective application. Earlier application is permitted if IFRS 10, IFRS 12, IAS 27 (2011) and IAS 28 (2011) are also applied early).

IFRS 11, Joint Arrangements, supersedes and replaces IAS 31, Interest in Joint Ventures. IFRS 11 does not introduce substantive changes to the overall definition of an arrangement subject to joint control, although the definition of control, and therefore indirectly of joint control, has changed due to IFRS 10.

Under the new Standard, joint arrangements are divided into two types, each having its own accounting model defined as follows:

Notes to the financial statements

3. Significant accounting policies (continued)

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

- a joint operation is one whereby the jointly controlling parties, known as the joint operators, have rights to the assets, and obligations for the liabilities, relating to the arrangement.
- A joint venture is one whereby the jointly controlling parties, known as joint venturers, have rights to the net assets of the arrangement.

IFRS 11 effectively carves out, from IAS 31 jointly controlled entities, those cases in which, although there is a separate vehicle for the joint arrangement, separation is ineffective in certain ways. These arrangements are treated similarly to jointly controlled assets/operations under IAS 31, and are now called joint operations. The remainder of IAS 31 jointly controlled entities, now called joint ventures, are stripped of the free choice of equity accounting or proportionate consolidation; they must now always use the equity method in its consolidated financial statements.

The Bank does not expect IFRS 11 to have material impact on the financial statements since it is not a party to any joint arrangements.

- *IFRS 12 Disclosure of Interests in Other Entities* (Effective for annual periods beginning on or after 1 January 2013; to be applied retrospectively, subject to transitional provisions that provide some relief from full retrospective application. Earlier application is permitted.

Providing some of the disclosures required by IFRS 12 before the effective date does not compel the entity to comply with all the requirements of IFRS 12 or to apply IFRS 10, IFRS 11, IFRS 12, IAS 27 (2011) and IAS 28 (2011) early.)

IFRS 12 requires additional disclosures relating to significant judgements and assumptions made in determining the nature of interests in an entity or arrangement, interests in subsidiaries, joint arrangements and associates and unconsolidated structured entities.

The Bank is currently in the process of evaluating the potential effect of this Standard.

- *Amendments to IFRS 10, IFRS 12 and IAS 27 – Investment Entities*

(Effective for annual periods beginning on or after 1 January 2014; early adoption is permitted; to be applied retrospectively subject to transitional provisions)

The Amendments provide an exception to the consolidation requirements in IFRS 10 and requires qualifying investment entities to measure their investments in controlled entities – as well as investments in associates and joint ventures – at fair value through profit or loss, rather than consolidating them.
The consolidation exemption is mandatory (i.e. not optional), with the only exception being that subsidiaries that are considered as an extension of the investment entity’s investing activities, must still be consolidated.

Notes to the financial statements

3. Significant accounting policies (continued)

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

An entity qualifies as an investment entity if it meets all of the essential elements of the definition of an investment entity. According to these essential elements an investment entity

1) obtains funds from investors to provide those investors with investment management services;
2) commits to its investors that its business purpose is to invest for returns solely from appreciation and/or investment income; and
3) measures and evaluates the performance of substantially all of its investments on a fair value basis.

The amendments also set out disclosure requirements for investment entities.

The Bank does not expect the new standard to have any impact on the financial statements.

- *IFRS 13 Fair Value Measurement* (Effective prospectively for annual periods beginning on or after 1 January 2013. Earlier application is permitted).

IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRSs. The standard does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards.

The standard contains an extensive disclosure framework that provides additional disclosures to existing requirements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that are significant unobservable inputs, the effect of the measurements on profit or loss or other comprehensive income.

The Bank is currently in the process of evaluating the potential effect of this Standard.

- *Amendments to IAS 1 Presentation of Financial Statements*: Presentation of Items of Other Comprehensive Income (Effective for annual periods beginning on or after 1 July 2012; to be applied retrospectively. Earlier application is permitted.)

The amendments:

- require that an entity presents separately the items of other comprehensive income that may be reclassified to profit or loss in the future from those that would never be reclassified to profit or loss. If items of other comprehensive income are presented before related tax effects, then the aggregated tax amount should be allocated between these sections.
- change the title of the Statement of Comprehensive Income to Statement of Profit or Loss and Other Comprehensive Income, however, other titles are also allowed to be used.

Notes to the financial statements

3. Significant accounting policies (continued)

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

The Bank is currently in the process of evaluating the potential effect of these amendments.

- *IAS 19 (2011) Employee Benefits* (Effective for annual periods beginning on or after 1 January 2013; to be applied retrospectively. Transitional provisions apply. Earlier application is permitted.)

The amendment requires actuarial gains and losses to be recognised immediately in other comprehensive income. The amendment removes the corridor method previously applicable to recognising actuarial gains and losses, and eliminates the ability for entities to recognise all changes in the defined benefit obligation and in plan assets in profit or loss, which currently is allowed under the requirements of IAS 19. The amendment also requires the expected return on plan assets recognised in profit or loss to be calculated based on rate used to discount the defined benefit obligation.

The amendments are not relevant to the Bank's financial statements, since the Bank does not have any defined benefit plans.

- *IAS 27 (2011) Separate Financial Statements* (Effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted if IFRS 10, IFRS 11, IFRS 12 and IAS 28 (2011) are also applied early.)

IAS 27 (2011) carries forward the existing accounting and disclosure requirements of IAS 27 (2008) for separate financial statements, with some minor clarifications. As well, the existing requirements of IAS 28 (2008) and IAS 31 for separate financial statements have been incorporated into IAS 27 (2011). The Standard no longer addresses the principle of control and requirements relating to the preparation of consolidated financial statements, which have been incorporated into IFRS 10, Consolidated Financial Statements.

The Bank is currently in the process of evaluating the potential effect of these amendments.

- *IAS 28 (2011) Investments in Associates and Joint Ventures* (Amendments effective for annual periods beginning on or after 1 January 2013; to be applied retrospectively. Earlier application is permitted if IFRS 10, IFRS 11, IFRS 12 and IAS 27 (2011) are also applied early.)

There are limited amendments made to IAS 28 (2008):

- Associates and joint ventures held for sale. IFRS 5, Non-current Assets Held for Sale and Discontinued Operations applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale. For any retained portion of the investment that has not been classified as held for sale, the equity method is applied until disposal of the portion held for sale. After disposal, any retained interest is accounted for using the equity method if the retained interest continues to be an associate or a joint venture.

Notes to the financial statements

3. Significant accounting policies (continued)

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

- Changes in interests held in associates and joint ventures. Previously, IAS 28 (2008) and IAS 31 specified that the cessation of significant influence or joint control triggered remeasurement of any retained stake in all cases, even if significant influence was succeeded by joint control. IAS 28 (2011) now requires that in such scenarios the retained interest in the investment is not remeasured.

The Bank is currently in the process of evaluating the potential effect of these amendments.

- *Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities* (Effective for annual periods beginning on or after 1 January 2014; to be applied retrospectively. Earlier application is permitted, however the additional disclosures required by Amendments to IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities must also be made.)

The Amendments do not introduce new rules for offsetting financial assets and liabilities; rather they clarify the offsetting criteria to address inconsistencies in their application.

The Amendments clarify that an entity currently has a legally enforceable right to set-off if that right is:

- not contingent on a future event; and
- enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties.

The Bank does not expect the Amendments to have any impact on the financial statements since it does not apply offsetting to any of its financial assets and financial liabilities and it has not entered into master netting arrangements.

- *IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine* (Effective for annual periods beginning on or after 1 January 2013. It applies prospectively to production stripping costs incurred on or after the beginning of the earliest period presented. Earlier application is permitted.)

The Interpretation sets out requirements relating to the recognition of production stripping costs, initial and subsequent measurement of stripping activity assets.

To the extent that benefits from production stripping are realised in the form of inventory produced, the related production stripping costs are accounted for in accordance with IAS 2 Inventories.

Production stripping costs that improve access to ore to be mined in the future are recognised as a non-current asset if, and only if, all of the following criteria are met:

- it is probable that future economic benefits will flow to the entity;
- the entity can identify the component of the ore body for which access has been improved; and

Notes to the financial statements

3. Significant accounting policies (continued)

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

- the costs relating to the stripping activity associated with that component can be measured reliably.

The stripping activity asset shall be accounted for as an addition to, or as an enhancement of, an existing asset.

The stripping activity asset shall initially be recognised at cost while after initial recognition, it shall be carried at either its cost or its revalued amount, less depreciation or amortisation and impairment losses, in the same way as the existing asset of which it is a part.

The Interpretation also requires that when the costs of the stripping activity asset and of the inventory produced are not separately identifiable, the entity allocates production stripping costs between the two based on a 'relevant' production measure.

The Bank does not expect the Interpretation to have any impact on the financial statements since it does not have any stripping activities.

Notes to the financial statements

4. Financial risk management

(a) Introduction and overview

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

- credit risk
- liquidity risk
- market risks

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

Risk management framework

The Supervisory Board ("the Board") has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Credit Committee and Risk Management Committee, which are responsible for developing and monitoring Bank's risk management policies in their specified areas.

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

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

(b) Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

For risk management purposes, credit risk arising on trading assets is managed independently; and information thereon is disclosed below. The market risk in respect of changes in value in trading assets arising from changes in market credit spreads applied to investment and included in trading assets is managed as a component of market risk, further details are provided in note 4(d) below.

Management of credit risk

The Supervisory Board has delegated responsibility for the management of credit risk to its Credit Committee that approves all credit exposures less 10% of the Bank's own funds. All credit exposures greater than 10% of the Bank's own funds must be approved by the Risk Management Committee. Separate Bank's Credit departments (Corporate Loans Division and Retail Division) are responsible for oversight of the Bank's credit risk, including:

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

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

Regular audits of Credit divisions' processes are undertaken by Internal Audit.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Exposure to credit risk

		Loans and advances to customers		Loans and advances to banks		Investment securities	
In thousands of denars	***Note***	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**
Carrying amount	*18,17,19*	9,231,275	5,781,590	18,947	396,947	860,293	167,526
Individually impaired							
Grade A		-	-	-	-	3,248	-
Grade B		62,865	40,764	-	-	-	-
Grade C		44,049	18,495	-	-	-	-
Grade D		28,035	11,433	-	-	-	-
Grade E		298,986	221,015	-	-	-	-
Gross amount		433,935	291,707	-	-	3,248	-
Allowance for impairment		(276,427)	(181,141)	-	-	(162)	-
Carrying amount		157,508	110,566	-	-	3,086	-
Past due but not impaired:							
Past due comprises:							
up to 30 days		108,330	28,713	-	-	-	-
30-60 days		258,032	326,457	-	-	-	-
60-90 days		73,462	168,804	-	-	-	-
90-180 days		14,946	42,722	-	-	-	-
180 days+		27,952	28,749	-	-	-	-
Carrying amount		482,722	595,445	-	-	-	-
Neither past due nor impaired:							
Grade A		8,591,045	5,075,579	18,947	396,947	857,207	167,526
Carrying amount		8,591,045	5,075,579	18,947	396,947	857,207	167,526
Total carrying amount		9,231,275	5,781,590	18,947	396,947	860,293	167,526

Impaired loans and securities

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

Past due but not impaired loans

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

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Allowances for impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Write-off policy

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

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

	Loans and advances to customers	
In thousands of denars	**Gross**	**Net**
31 December 2012		
Individually impaired		
Grade A	-	-
Grade B	62,865	55,286
Grade C	44,049	31,623
Grade D	28,035	12,560
Grade E	298,986	58,039
Total	433,935	157,508
31 December 2011		
Individually impaired		
Grade A	-	-
Grade B	40,764	35,833
Grade C	18,495	12,028
Grade D	11,433	4,439
Grade E	221,015	58,266
Total	291,707	110,566

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

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

An estimate of the fair value of collateral and other security enhancements held against loans and advances to customers is shown below:

	Loans and advances to customers	
In thousands of denars	**2012**	**2011**
Cash collateral	204,611	89,661
Apartments	4,301,615	3,329,561
Business premises	6,944,692	3,949,782
Moveable lien	1,818,023	1,211,530
Other	2,078,050	457,457
	15,346,991	9,037,991

Details of financial and non-financial assets obtained by the Bank during the year by taking possession of collateral held as security against loans and advances as well as calls made on credit enhancements and held at the year end are shown below:

In thousands of denars	**2012**	**2011**
Land	18,622	24,922
Apartments	1,356	3,998
Business premises	-	2,953
Other	1,891	7,143
	21,869	39,016

The Bank's policy is to pursue timely realization of the collateral in an orderly manner.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

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

In thousands of denars	***Note***	**Loans and advances to banks** 2012	2011	**Loans and advances to customers** 2012	2011	**Investment securities** 2012	2011
Carrying amount	*18,17,19*	18,947	396,947	9,231,275	5,781,590	860,293	167,526
Concentration by sector							
Corporate		-	-	4,654,861	2,773,191	34,343	33,730
Public sector		-	-	92,753	-	825,950	133,796
Bank		18,947	396,947	-	-	-	-
Retail		-	-	4,483,661	3,008,399	-	-
		18,947	396,947	9,231,275	5,781,590	860,293	167,526
Concentration by location							
EU countries		18,947	396,947	-	-	4,471	4,555
Other European countries		-	-	267,405	-	-	-
USA		-	-	-	-	-	-
Republic of Macedonia		-	-	8,963,870	5,781,590	855,822	162,971
		18,947	396,947	9,231,275	5,781,590	860,293	167,526

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

Trading assets

The Bank‘s trading assets are comprised of debt securities – government bonds of the Republic of Macedonia of MKD 64,797 thousand at 31 December 2012 (2011: government bonds of MKD 174,422 thousand).

An analysis of the credit quality of the maximum credit exposure is as follows:

In thousands of denars	**2012**	**2011**
Government bonds	64,797	174,422
Fair value and carrying amount	64,797	174,422

The Bank considers that the trading portfolio is with high quality as all investments included in trading assets are issued by the government and are low risk securities.

The Bank does not require collateral for investment in securities.

Notes to the financial statements

4. Financial risk management (continued)

(b) Credit risk (continued)

Settlement risk

The Bank's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed.

For certain types of transactions the Bank mitigates this risk through broker clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations.

Cash and cash equivalents

The Bank held cash and cash equivalents of MKD 7,047,269 thousand at 31 December 2012 (2011: MKD 2,174,409 thousand) which represents its maximum credit exposure on these assets. The cash and cash equivalents are held with the central bank, domestic banks and foreign financial institution counterparties which are rated BBB - to AA, based on rating agency Standard&Poor's ratings.

(c) Liquidity risk

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

Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Assets, Liability and Payment Division receive information from other departments regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Assets, Liability and Payment Division then maintain a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities, loans and advances to banks and other inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank.

The daily liquidity position and market conditions are regularly monitored. All liquidity policies and procedures are subject to review and approval by ALCO. Daily reports cover the liquidity position of the Bank. Liquidity reports are submitted monthly to the NBRM.

Notes to the financial statements

4. Financial risk management (continued)

(c) Liquidity risk (continued)

Exposure to liquidity risk

The Bank has access to a diverse funding base. Funds are raised using a broad range of instruments including deposits, borrowed funds and share capital. This enhances funding flexibility, limits dependence on any one source of funds and generally lowers the cost of funds. The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required meeting business goals and targets set in terms of the overall Bank strategy.

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

Residual contractual maturities of financial liabilities

In thousands of denars	***Note***	**Carrying amount**	**Gross nominal inflow / (outflow)**	**Less than 1 month**	**1-3 months**	**3 months to 1 year**	**1-5 years**	**More than 5 years**
31 December 2012								
Non-derivative liabilities								
Deposits from banks	*23*	1,999,003	(1,999,003)	(1,998,382)	-	(621)	-	-
Deposits from customers	*24*	10,858,588	(10,858,588)	(4,789,967)	(1,136,663)	(3,192,177)	(1,734,750)	(5,031)
Other borrowed funds	*25*	1,555,057	(1,555,057)	(310,017)	(17,107)	(48,170)	(845,142)	(334,621)
Other liabilities	27	101,884	(101,884)	(79,920)	-	(17,764)	(4,200)	-
Unrecognised loan commitments		584,138	(584,138)	(584,138)	-	-	-	-
		15,098,670	(15,098,670)	(7,762,424)	(1,153,770)	(3,258,732)	(2,584,092)	(339,652)
31 December 2011								
Non-derivative liabilities								
Deposits from banks	*23*	10,238	(10,238)	(9,612)	-	(626)	-	-
Deposits from customers	*24*	5,478,398	(5,478,398)	(2,993,168)	(825,976)	(1,181,516)	(475,197)	(2,541)
Other borrowed funds	*25*	1,429,258	(1,429,258)	(286,036)	(28,478)	(147,990)	(601,283)	(365,471)
Other liabilities	27	92,958	(92,958)	(78,053)	(14,905)	-	-	-
Unrecognised loan commitments		240,354	(240,354)	(240,354)	-	-	-	-
		7,251,206	(7,251,206)	(3,607,223)	(869,359)	(1,330,132)	(1,076,480)	(368, 012)

The previous table shows the undiscounted cash flows on the Bank's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The Bank's expected cash flows on these instruments vary significantly from this analysis. For example, demand deposits from customers are expected to maintain a stable or increasing balance and unrecognised loan commitments are not all expected to be drawn down immediately.

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

Notes to the financial statements

4. Financial risk management (continued)

(c) Liquidity risk (continued)

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

(d) Market risks

Market risk is the risk that changes in market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Management of market risks

Excess of the liquidity the Bank is placing in high yielding instruments that according to the Central bank regulation are considered as placements with no risk. The Bank separates its exposure to market risk between trading and non-trading portfolios. Trading portfolios are held by the Treasury Front Office. Treasury Front Office daily follows the price movement of the quoted instruments and for adverse market movement, Board of Directors of the Bank, is instantaneously informed. In this process the Parent's support in terms of providing information on international market movements and developments is also utilized.

Assets and liabilities committee (ALCO) which holds a meeting every week is platform where market risks are analyzed and decisions are made at the operational level. ALCO performs analyses and makes decisions with regard to balance sheet structure, liquidity risk, currency risk and also is analyzing the risk of the Bank's treasury unit.

Exposure to market risks – trading portfolios

The Bank focuses on the real and potential sensitiveness of the separate positions in the portfolio as well as the total portfolio. The Bank uses internal calculation methods and stress-testing on the potential market risk exposure. Trading limits are used for daily risk management and every limits are monitored by the Risk Management Department and reported to the Board of directors of the Bank.

The principal tool used to control and measure market risk exposure within the Bank's trading portfolios is performing sensitivity analyses. By performing sensitivity analyses the Bank is making estimation of the loss that might arise on the portfolio from an adverse market movement. Sensitivity analyses that are performed are based mainly on historical simulation. The rules that are applied for performing the sensitivity analyses are:

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

- Price volatility (in absolute terms over previous number of days)
- Previous trading range (price high/low over previous number of days)
- Maximum/minimum price changes (over previous number of days)
- Price volatility correlation to P&L, internal and regulatory ratios and indicators

In order for the Bank to estimate the effect of potential volatility in the price of the securities in the trading portfolio, using the portfolio data as of 31 December 2012, hypothetical stress-test scenario analyses were performed, based on assumptions for shock changes in their price.

Under first scenario there is 10% instantaneous change in the price and results are respectively shown in the following table:

Sensitivity of prices of securities in trading portfolio

	Profit / loss for the period *(Effect in thousands of denars)*	**Capital ratio** (*effect in %)*
2012		
Net trading income (10% increase in the market price)	6,187	0.05
Net trading income (10% decrease in the market price)	(6,187)	(0.05)

Under second, more conservative scenario there is 20% instantaneous change in the price and results are respectively shown in the following table:

Sensitivity of prices of securities in trading portfolio

	Profit / loss for the period *(Effect in thousands of denars)*	**Capital ratio** (*effect in %)*
2012		
Net trading income (20% increase in the market price)	12,374	0.10
Net trading income (20% decrease in the market price)	(12,374)	(0.10)

In both scenarios the Capital ratio is above the prescribed limit of 8%.

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to interest rate risk – non-trading portfolios

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or repricing at different times or/and 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, 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. However the actual effect will depend on various factors, including stability of the economy, environment and level of the inflation.

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

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

In thousands of denars	*Note*	Carrying amount	Less than 1 month	1- 3 months	3-12 months	1-5 years	More than 5 years
31 December 2012							
Cash and cash equivalents	*15*	6,819,620	6,252,750	566,870	-	-	-
Loans and advances to banks	*17*	-	-	-	-	-	-
Loans and advances to customers	*18*	9,323,546	448,691	983,469	7,550,826	335,117	5,443
Investment securities	*19*	825,269	280,004	179,038	366,227	-	-
		16,968,435	6,981,445	1,729,377	7,917,053	335,117	5,443
Deposits from banks and other financial institutions	*23*	1,983,370	1,982,760	-	610	-	-
Deposits from customers	*24*	10,188,401	4,398,711	1,056,441	3,595,271	1,137,978	-
Other borrowed funds	*25*	1,549,570	329,108	228,192	706,057	281,037	5,176
		13,721,341	6,710,579	1,284,633	4,301,938	1,419,015	5,176
		3,247,094	270,866	444,744	3,615,115	(1,083,898)	267
31 December 2011							
Cash and cash equivalents	*15*	2,174,409	2,174,409	-	-	-	-
Loans and advances to banks	*17*	396,947	396,947	-	-	-	-
Loans and advances to customers	*18*	5,781,590	326,488	1,318,607	434,065	2,973,075	729,355
Investment securities	*19*	167,526	44,516	-	-	123,010	-
		8,520,472	2,942,360	1,318,607	434,065	3,096,085	729,355
Deposits from banks and other financial institutions	*23*	(10,238)	(9,628)	-	(610)	-	-
Deposits from customers	*24*	(5,478,398)	(3,035,703)	(824,316)	(1,143,757)	(472,107)	(2,515)
Other borrowed funds	*25*	(1,429,258)	(135,550)	(338,415)	(588,651)	(359,056)	(7,586)
		(6,917,894)	(3,180,881)	(1,162,731)	(1,733,018)	(831,163)	(10,101)
		1,602,578	(238,521)	155,876	(1,298,953)	2,264,922	719,254

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

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

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

Effect in thousands of denars	**Profit / loss for the period**
2012	
Interest income (1% increase)	55,671
Interest income (1% decrease)	(55,671)
Interest expense (1% increase)	36,705
Interest expense (1% decrease)	(36,705)
2011	
Interest income (1% increase)	64,046
Interest income (1% decrease)	(64,046)
Interest expense (1% increase)	27,449
Interest expense (1% decrease)	(27,449)

Exposure to currency risk – non-trading portfolios

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

Notes to the financial statements

4. Financial risk management (continued)

(d) Market risks (continued)

The Bank's exposure to foreign currency risk for non-trading portfolio is as follows:

In thousands of denars	2012					2011				
	MKD	**EUR**	**USD**	**Other**	**Total**	**MKD**	**EUR**	**USD**	**Other**	**Total**
Monetary assets										
Cash and cash equivalents	6,250,445	670,647	62,060	64,117	7,047,269	1,704,525	324,458	73,429	71,997	2,174,409
Loans and advances to banks	-	-	18,947	-	18,947	-	377,835	119,112	-	396,947
Loans and advances to customers	3,955,940	5,134,652	140,656	27	9,231,275	2,792,004	2,988,746	840	-	5,781,590
Investment securities	259,067	596,799	4,427	-	860,293	29,221	133,796	4,509		167,526
Other assets	195,549	43,126	1,513	-	240,188	171,937	38,035	3,023	-	212,995
	10,661,001	6,445,224	227,603	64,144	17,397,972	4,697,687	3,862,870	200,913	71,997	8,733,467
Monetary liabilities										
Deposits from banks	624	1,997,857	497	25	1,999,003	657	8,345	1,211	25	10,238
Deposits from customers	6,763,315	3,789,544	224,481	81,248	10,858,588	3,401,762	1,914,935	90,797	70,904	5,478,398
Other borrowed funds	323,677	1,231,380	0	0	1,555,057	23,571	1,405,688	-	-	1,429,259
Other liabilities	84,310	16,723	179	672	101,884	76,238	16,326	48	347	92,959
	7,171,926	7,035,504	225,157	81,945	14,514,532	3,502,228	3,345,294	92,056	71,276	7,010,854
Net FX position	3,489,075	(590,280)	2,446	(17,801)	2,883,440	1,195,459	517,576	108,857	721	1,722,613

Notes to the financial statements

4. Financial risk management (continued)

(e) Operational risk

Operational risk is risk of loss due to inappropriate or weak internal processes, inappropriate persons and inappropriate or weak systems in the Bank as well as external events.

The Bank defined its framework for managing with the operational risk by adopting the Policy and Procedure on operational risk management. Policy and Procedure for Operational Risk Management was adopted by the Supervisory Board of the Bank. In the Policy the basic aims are defined such as operational risk management (system and processes for managing operational risk, organisational structure, reporting system, internal control and etc), as well as measuring and monitoring the operational risk. Implementation of the operational risk management framework is meant to be delivered by performing RCSA (Risk and control self assessment) which is continuous process, and by using the operational loss event database.

Within the strategy for Risk Management, the Bank has defined the acceptable level of exposure to operational risk. The Bank plans to use the basic indicator for operational risk in calculating the capital necessary for covering operational risk.

For the purposes of calculation of capital adequacy, the Bank uses the basic indicator approach for the determining the capital required for coverage of operational risk.

(e) Capital management

Regulatory capital

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

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

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

- Core capital, which includes ordinary and non cumulative preference shares, share premium, bank reserves allocated from net profit that serve for covering losses arising from risks the Bank faces in its operations, retained earnings not encumbered by any future obligations, stated in the balance sheet and confirmed by a Decision of the Bank's Shareholders’ Assembly or accumulated loss from previous year, profit for the year if confirmed by the certified auditor, after deductions for loss for the year, licenses, patents, goodwill and other trademarks, treasury shares and the difference between the amount of the required allowance for impairment in accordance with the risk classification and allocated allowance for impairment and allowance for impairment calculated according the Decision for credit risk management.

Notes to the financial statements

4. Financial risk management (continued)

(e) Capital management (continued)

- Supplementary capital, which includes cumulative preference shares, share premium less the amount of purchased treasury cumulative preference shares, hybrid capital instruments and subordinated liabilities issued by the Bank.
- The total of core capital and supplementary capital is reduced by the Bank's capital investments in banks and financial institutions exceeding 10% of the capital of such institutions, subordinated instruments and other investments in other banks or other financial institutions where the Bank holds more than 10% of the capital and other deductions.

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

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

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

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

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

In 2012 NBRM introduced new Decision on the methodology for determining capital adequacy, prescribing the manner of calculation of capital required by banks for coverage of credit, operational, market and currency risks, as well as the manner of calculation of own funds. The calculation of the capital required for coverage of operational risk is based on the standardized approach in accordance with Basel II. The new decision is in force starting 1 July 2012.

As at 31 December 2012 the capital adequacy ratio of the Bank is 26.34% (31 December 2011: 29.85%) and is above the prescribed minimum of 8%.

Notes to the financial statements

5. Key sources of estimation uncertainty

Capital allocation

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

Allowances for impairment losses on loans and advances

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

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

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

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

Notes to the financial statements

5. Key sources of estimation uncertainty (continued)

Allowance for impairment of available for sale equity investments

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

Determining fair values

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

Critical accounting judgments in applying the Bank's accounting policies

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

Valuation of financial instruments

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

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

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

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

Notes to the financial statements

5. Key sources of estimation uncertainty (continued)

Critical accounting judgments in applying the Bank's accounting policies (continued)

Valuation of financial instruments (continued)

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

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

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

In thousands of denars	**Note**	**Level 1**	**Level 2**	**Level 3**	**Total**
31 December 2012					
Trading assets	*16*	64,797	-	-	64,797
Investment securities	*19*	130,833	695,117	34,343	860,293
		195,630	695,117	34,343	925,090
31 December 2011					
Trading assets	*16*	174,422	-	-	174,422
Investment securities	*19*	133,796	-	33,730	167,526
		308,218	-	33,730	341,948

Financial asset and liability classification

The Bank may designate financial assets and liabilities on inception into different accounting categories in certain circumstances:

- In classifying financial assets as "trading", the Bank has determined that it meets the definition of financial assets held for trading.
- In designating financial assets or liabilities at fair value through profit or loss, the Bank has determined that it has met one of the criteria for this designation.
- In classifying financial assets as held-to-maturity, the Bank has determined that it has both the positive intention and ability to hold the assets until their maturity date.

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

Notes to the financial statements

5. Key sources of estimation uncertainty (continued)

Critical accounting judgments in applying the Bank's accounting policies (continued)

Valuation of financial instruments (continued)

The following table shows a reconciliation from the beginning balances to the ending balances for fair value measurements in level 3 of the fair value hierarchy:

In thousands of denars	**Investments securities**	**Total**
Balance at 1 January 2011	30,994	30,994
Total gains or losses		
In profit or loss	-	-
In other comprehensive income	-	-
Purchases	5,616	5,616
Settlements	(2,880)	(2,880)
Balance at 31 December 2011	33,730	33,730
Total gains/(losses) recognised in profit or loss for financial assets and liabilities outstanding as at 31 December 2011	-	-
Balance at 1 January 2012	33,730	33,730
Total gains or losses		
In profit or loss	613	613
In other comprehensive income		
Purchases	3,167	3,167
Settlements	(2,392)	(2,392)
Balance at 31 December 2012	34,343	34,343
Total gains/(losses) recognised in profit or loss for financial assets and liabilities outstanding as at 31 December 2012	613	613

Notes to the financial statements

6. Operating segments

The Bank has 4 reportable segments, as described below, which are the Bank's strategic business units. The strategic business units offer different products and services, and are managed separately based on the Bank's management and internal reporting structure. For each of the strategic business units, the Managing Board reviews internal management reports. The following summary describes the operations in each of the Bank's reportable segments:

- Corporate Banking - Includes loans, deposits and other transactions and balances with corporate customers
- Retail Banking - Includes loans, deposits and other transactions and balances with retail customers
- Investment Banking - Includes the Bank's trading and investment finance activities
- Treasury - Undertakes the Bank's funding and centralized risk management activities through investing in liquid assets such as short-term placements and government debt securities.

Information regarding the results of each reportable segment is included below. Performance is measured based on segment profit before income tax. Segment profit is used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries.

Notes to the financial statements

6. Operating segments (continued)

Information about operating segments

2012

In thousands of denars	**Investment Banking**	**Corporate Banking**	**Retail Banking**	**Central Treasury**	**Unallocated**	**Total**
External revenue						
Net interest income	62,103	196,944	240,922	(14,163)	-	485,806
Net fee and commission income/(expense)	-	28,078	57,550	(14,160)	-	71,468
Net trading income	10,204	-	-	-	-	10,204
Other operating income	-	8,483	3,628	3,748	15,653	31,512
Total segment revenue	72,307	233,505	302,100	(24,575)	15,653	598,990
Other material non-cash items:						
Impairment losses on financial assets	-	(10,348)	(9,371)	-	-	(19,719)
Depreciation and amortization	-	-	-	-	(75,337)	(75,337)
Personnel expenses and other expenses	-	(201,338)	(238,943)	-	-	(440,281)
Reportable segment profit before income tax	72,307	21,819	53,786	(24,575)	(59,684)	63,653
Reportable segment assets	5,953,293	5,644,062	4,442,842	1,918,895	185,674	18,144,766
Reportable segment liabilities	-	5,612,557	5,822,120	3,075,832	5,784	14,516,293

Notes to the financial statements

6. Operating segments (continued)

Information about operating segments (continued)

2011

In thousands of denars	**Investment Banking**	**Corporate Banking**	**Retail Banking**	**Central Treasury**	**Unallocated**	**Total**
External revenue						
Net interest income	40,120	127,230	155,641	(9,150)	-	313,841
Net fee and commission income/(expense)	-	27,439	52,517	(9,882)	-	70,074
Net trading income	7,012	-	-	-	-	7,012
Other operating income	2,916	35,408	3,769	-	17,018	59,111
Total segment revenue	50,048	190,077	211,927	(19,032)	17,018	450,038
Other material non-cash items:						
Impairment losses on financial assets	-	11,278	12,455	-	-	23,733
Depreciation and amortization	-	-	-	-	(71,069)	(71,069)
Personnel expenses and other expenses	-	(164,403)	(218,565)	-	0	(382,968)
Reportable segment profit before income tax	50,048	36,952	5,817	(19,032)	(54,051)	19,734
Reportable segment assets	1,486,643	3,658,765	2,981,460	1,323,782	-	9,450,650
Reportable segment liabilities	-	2,760,539	3,031,300	1,221,031	-	7,012,870

Notes to the financial statements

6. Operating segments (continued)

Information about operating segments (continued)

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

In thousands of denars	**2012**	**2011**
Revenues		
Total revenue for reportable segments	583,337	433,020
Unallocated amounts	15,653	17,018
Revenue	598,990	450,038
Profit or loss		
Total profit or loss for reportable segments	123,337	73,785
Unallocated amounts	(59,684)	(54,051)
Profit before income tax	63,653	19,734
Assets		
Total assets for reportable segments	17,959,092	9,450,650
Other unallocated amounts	185,674	-
Total assets	18,144,766	9,450,650
Liabilities		
Total liabilities for reportable segments	14,510,509	7,012,870
Other unallocated amounts	5,784	-
Total liabilities	14,516,293	7,012,870

Notes to the financial statements

6. Operating segments (continued)

Information about operating segments (continued)

Geographical areas

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

Geographical information

In thousands of denars	**Republic of Macedonia**	**Europe**	**Other**	**Total**
2012				
External revenues	629,269	13,953	(44,232)	598,990
Non-current assets*	681,997	-	-	681,997
2011				
External revenues	450,714	6,256	(6,932)	450,038
Non-current assets*	542,761	-	-	542,761

* Includes property and equipment and intangibles assets

Notes to the financial statements

7. Financial assets and liabilities

Accounting classifications and fair values

The table below sets out the carrying amount and fair values of the Bank's financial assets and financial liabilities:

In thousands of denars	*Note*	Trading	Held-to-maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
31 December 2012								
Cash and cash equivalents	*15*	-	-	-	-	7,047,269	7,047,269	7,047,269
Trading assets	*16*	64,797	-	-	-	-	64,797	64,797
Loans and advances to banks	*17*	-	-	18,947	-	-	18,947	18,947
Loans and advances to customers	*18*	-	-	9,231,275	-	-	9,231,275	9,231,275
Investment securities								
Measured at fair value	*19*	-	-	-	860,293	-	860,293	860,293
Other assets	*22*	-	-	240,188	-	-	240,188	240,188
		64,797	-	9,490,410	860,293	7,047,269	17,462,769	17,462,769
Deposits from banks	*23*	-	-	-	-	1,999,003	1,999,003	1,999,003
Deposits from customers	*24*	-	-	-	-	10,858,588	10,858,588	10,858,588
Other borrowed funds	*25*	-	-	-	-	1,555,057	1,555,057	1,555,057
Other liabilities	*27*	-	-	-	-	101,884	101,884	101,884
		-	-	-	-	14,514,532	14,514,532	14,514,532
31 December 2011								
Cash and cash equivalents	*15*	-	-	-	-	2,174,409	2,174,409	2,174,409
Trading assets	*16*	174,422	-	-	-	-	174,422	174,422
Loans and advances to banks	*17*	-	-	396,947	-	-	396,947	396,947
Loans and advances to customers:	*18*	-	-	5,781,590	-	-	5,781,590	5,781,590
Investment securities:		-						
Measured at fair value	*19*	-	-	-	167,526	-	167,526	167,526
Other assets	*22*	-	-	212,995	-	-	212,995	212,995
		174,422	-	6,391,532	167,526	2,174,409	8,907,889	8,907,889
Deposits from banks	*23*	-	-	-	-	10,238	10,238	10,238
Deposits from customers	*24*	-	-	-	-	5,478,398	5,478,398	5,478,398
Other borrowed funds	*25*	-	-	-	-	1,429,259	1,429,259	1,429,259
Other liabilities	*27*	-	-	-	-	92,705	92,705	92,705
		-	-	-	-	7,010,600	7,010,600	7,010,600

Notes to the financial statements

7. Financial assets and liabilities (continued)

Investment securities – unquoted equity securities at cost

The above table includes MKD 34,506 thousand (2011: MKD 33,730 thousand) of equity investment securities in both the carrying amount and fair value columns that are measured at cost and for which disclosure of fair value is not provided because their fair value cannot be reliably measured. According to the Bank's management fair value do not differ significantly from the carrying amount and it is not cost effective to carry out independent valuation.

8. Net interest income

In thousands of denars	**2012**	**2011**
Interest income		
Cash and cash equivalents	82,563	36,657
Loans and advances to banks	168	5,330
Loans and advances to customers	680,791	501,585
Investment securities	30,072	13,795
Total interest income	793,594	557,367
Interest expense		
Deposits from banks	5,510	17,124
Deposits from customers	256,633	159,201
Other borrowed funds	45,645	67,201
Total interest expense	307,788	243,526
Net interest income	485,806	313,841

Notes to the financial statements

9. Net fee and commission income

In thousands of denars	2012	2011
Fee and commission income		
Credit related fees	16,337	9,162
Payment operations in the country	30,415	33,262
Payment operations abroad	41,255	37,778
Letters of credit and guarantees	10,391	3,102
Other	35,925	36,010
Total fee and commission income	134,323	119,314
Fee and commission expense		
Credit related fees	-	166
Payment operations within the country	16,175	11,144
Payment operations abroad	8,217	7,305
Letters of credit and guarantees	79	188
Other	38,384	30,437
Total fee and commission expense	62,855	49,240
Net fee and commission income	71,468	70,074

10. Net trading income

In thousands of denars	2012	2011
Interest income	9,636	11,484
Net change in fair value of held-for-trading assets	568	(4,472)
	10,204	7,012

11. Other operating income

In thousands of denars	2012	2011
Capital gain on sale of property and equipment	57	12,774
Capital gain on sale of assets acquired through foreclosure procedure	-	1,270
Dividends on available-for-sale equity securities	3,815	2,957
Collection of previously written off receivables	157	5,239
Release of impairment provision for court cases	-	15,329
Income from sale of gold coins	2,697	-
Income from collected claims insurance	382	-
Sale of bills of exchange	402	-
Other	3,901	4,524
	11,411	42,093

Notes to the financial statements

12. Personnel expenses

In thousands of denars	**2012**	**2011**
Wages and salaries	138,450	119,243
Compulsory contributions	48,392	40,934
Other staff costs	5,819	14,224
	192,661	174,401

13. Other expenses

In thousands of denars	**2012**	**2011**
Materials and services	127,091	93,953
Marketing and advertisement costs	26,797	32,344
Insurance premiums of deposits	29,754	20,465
Telecommunications	17,202	16,720
Rents	14,911	17,140
Security expenses	15,615	13,295
Impairment provision for off balance sheet items	227	459
Insurance of property and employees	3,622	5,641
Impairment losses on assets acquired through foreclosure procedure	1,831	1,668
Tax on non-deductable expenses	1,612	1,988
Penalties, court and administrative expenses	27	124
Other	8,931	4,770
	247,620	208,567

Notes to the financial statements

14. Earnings per share

Basic and diluted earnings per share

The calculation of basic and diluted earnings per share at 31 December 2012 was based on the profit attributable to ordinary shareholders of MKD 63,653 thousand (2011: MKD19,734 thousand) and a weighted average number of ordinary shares outstanding of 213,861 (2011: 100,087), calculated as follows:

Profit attributable to ordinary shareholders

In thousands of denars	**2012**	**2011**
Net profit /(loss) for the period	63,653	19,734
Net profit /(loss) attributable to ordinary shareholders	63,653	19,734

Weighted average number of ordinary shares

Number of shares	**2012**	**2011**
Issued ordinary shares at 1 January	188,415	41,870
Effect of own shares issued in August	-	58,217
Effect of own shares issued in October as a result of merger with Ziraat Bank	25,446	-
Weighted average number of ordinary shares at 31 December	213,861	100,087

Notes to the financial statements

15. Cash and cash equivalents

In thousands of denars	**2012**	**2011**
Cash on hand	222,212	129,025
Balances with the National Bank of Republic of Macedonia	1,615,048	719,454
Current accounts with foreign banks	147,169	147,953
Current accounts with local banks	295	19
Government bills	766,518	-
Treasury bills	4,296,027	1,177,958
	7,047,269	2,174,409

At 31 December 2012 cash and cash equivalents included MKD 893,955 thousand (2011: MKD 421,126 thousand) as obligatory reserve requirement in MKD and MKD 603,863 thousand (2010: MKD 284,240 thousand) as obligatory reserve in foreign currency requirement. Funds from obligatory reserve in foreign currency are not available for the Bank's daily business.

Part of treasury bills in the amount of MKD 300,000 thousand (2011: nil) are pledged as a collateral upon a repo agreement with NBRM (see note 25 Other borrowed funds).

In thousands of denars	**2012**	**2011**
Specific allowances for impairment		
Balance at 1 January	-	-
Balance as at 30 September from Ziraat Bank AD Skopje	194	-
Impairment loss for the year recognised in the income statement		
Recoveries	(194)	-
Balance at 31 December	-	-

16. Trading assets

In thousands of denars	**2012**	**2011**
Government bonds	64,797	174,422
	64,797	174,422

Notes to the financial statements

17. Loans and advances to banks

In thousands of denars	2012	2011
Loans and advances to foreign banks	-	377,641
Restricted loans and advances to foreign banks	18,947	19,306
	18,947	396,947

The restricted deposits include deposit placed in Deutsche Bank AG in the amount of MKD 8,030 thousand (2011: MKD 8,182 thousand) as collateral for transactions performed with MASTER payment cards and deposit placed in Raiffeisen Zentralbank Oesterreich AG in the amount of MKD 10,917 thousand (2011: MKD 11,124 thousand) as collateral for transactions performed with VISA payment cards. These funds are not available for the Bank's daily business.

18. Loans and advances to customers

In thousands of denars	2012	2011
Loans and advances to customers at amortised cost	9,231,275	5,781,590
	9,231,275	5,781,590

At 31 December 2012 MKD 6,747,768 thousand (2011: MKD 3,702,430 thousand) of loans and advances to customers are expected to be recovered more than 12 months after the reporting date.

Loans and advances to customers at amortised cost

In thousands of denars	2012	2011
Retail customers:		
Mortgage lending	353,496	315,536
Consumer loans	3,545,806	2,238,765
Credit cards	346,090	269,673
Other	407,658	305,136
Corporate customers	4,854,652	2,833,621
Less allowances for impairment	(276,427)	(181,141)
Total loans and advances to customers	9,231,275	5,781,590

Notes to the financial statements

18. Loans and advances to customers (continued)

In thousands of denars	**2012**	**2011**
Specific allowances for impairment		
Balance at 1 January	181,141	170,306
Balance as at 30 September from Ziraat Bank AD Skopje	43,568	-
Impairment loss for the year recognised in the income statement		
Charge for the year	15,507	5,422
Calculated penalty interest	36,211	5,413
Balance at 31 December	276,427	181,141

19. Investment securities

In thousands of denars	**2012**	**2011**
Available-for-sale investment securities	860,293	167,526
	860,293	167,526

Available-for-sale investment securities

In thousands of denars	**2012**	**2011**
Government Bonds	130,833	133,796
Government Bills	695,117	-
Unquoted equity securities at cost	34,506	33,730
Allowance for impairment	(163)	-
	860,293	167,526

In thousands of denars	**2012**	**2011**
Specific allowances for impairment		
Balance at 1 January	-	-
Balance as at 30 September from Ziraat Bank AD Skopje	-	-
Impairment loss for the year recognised in the income statement		
Charge for the year	163	-
Balance at 31 December	163	-

Notes to the financial statements

20. Property and equipment

In thousands of denars	**Buildings**	**Furniture and equipment**	**Assets under construction**	**Leasehold improvements**	**Total**
Cost					
Balance at 1 January 2011	501,165	273,697	-	-	774,862
Acquisitions	612	5,809	19,095	5,765	31,281
Disposals	(30,588)	(7,912)	-	-	(38,500)
Balance at 31 December 2011	471,189	271,594	19,095	5,765	767,643
Balance at 1 January 2012	471,189	271,594	19,095	5,765	767,643
Balance as at 30 September 2012 from Ziraat Banka	82,368	58,411	-	9,137	149,916
Acquisitions	20,703	87,679	-	22,395	130,777
Disposals	-	(9,576)	-	-	(9,576)
Other transfers	-	-	(8,879)	-	(8,879)
Balance at 31 December 2012	574,260	408,108	10,216	37,297	1,029,881
Depreciation					
Balance at 1 January 2011	48,356	177,495	-	-	225,851
Depreciation for the period	12,081	36,761	-		48,842
Disposals	(6,346)	(6,983)	-	-	(13,329)
Other transfers	-	227	-	1,180	1,407
Balance at 31 December 2011	54,091	207,500	-	1,180	262,771
Balance at 1 January 2012	54,091	207,500	-	1,180	262,771
Balance as at 30 September 2012 from Ziraat Banka	17,876	51,315	-	6,236	75,427
Depreciation for the period	12,301	37,369	-	3,315	52,985
Disposals	-	(9,137)	-	-	(9,137)
Balance at 31 December 2012	84,268	287,047	-	10,731	382,046
Carrying amounts					
Balance at 1 January 2011	452,809	96,202	-	-	549,011
Balance at 31 December 2011	417,098	64,094	19,095	4,585	504,872
Balance at 31 December 2012	489,992	121,061	10,216	26,566	647,835

There were no capitalised borrowing costs related to the acquisition of property and equipment during the year (2011: nil).

As at 31 December 2012 the Bank does not hold property deeds for part of the buildings with carrying amount MKD 1,133 thousand (2011: MKD 1,171 thousand). The Bank is in process of obtaining the necessary documents.

As at 31 December 2012 the Bank does not have any property pledged as collateral (2011: none).

Notes to the financial statements

20. Property and equipment (continued)

Operating leases

The Bank leases business premises under operating leases. The leases are cancellable and typically run for a period of up to 5 years.

21. Intangible assets

In thousands of denars	**Software**	**Rights and licences**	**Assets under development**	**Total**
Cost				
Balance at 1 January 2011	76,891	42,429	-	119,320
Acquisitions	1,955	1,211	-	3,166
Balance at 31 December 2011	78,846	43,640	-	122,486
Balance at 1 January 2012	78,846	43,640	-	122,486
Balance as at 30 September 2012 from Ziraat Banka	8,422	6,202	-	14,624
Acquisitions	4,566	1,352	5,381	11,299
Disposal	(2,494)	(2,388)	-	(4,882)
Balance at 31 December 2012	89,340	48,806	5,381	143,527
Amortisation				
Balance at 1 January 2011	30,828	31,542	-	62,370
Amortisation for the period	15,959	6,268	-	22,227
Balance at 31 December 2011	46,787	37,810	-	84,597
Balance at 1 January 2012	46,787	37,810	-	84,597
Balance as at 30 September 2012 from Ziraat Banka	4,928	2,370	-	7,298
Amortisation for the period	16,911	4,843	598	22,352
Disposal	(2,494)	(2,388)	-	(4,882)
Balance at 31 December 2012	66,132	42,635	598	109,365
Carrying amounts				
Balance at 1 January 2011	46,063	10,887	-	56,950
Balance at 31 December 2011	32,059	5,830	-	37,889
Balance at 31 December 2012	23,208	6,171	4,783	34,162

Notes to the financial statements

22. Other assets

In thousands of denars	**2012**	**2011**
Asset acquired through foreclosure procedure	149,905	129,881
Prepayments	10,979	12,075
Trade receivables	1,420	1,376
Inventories	12,868	3,166
Numizmatic collections	-	3,201
Fee and commission receivables	3,903	3,316
Receivables upon performed transactions - Western Union	1,494	3,048
Receivables upon performed transactions – Master Card	26,999	37,905
Receivables upon performed transactions – Visa	16,971	12,965
Receivables upon court taxes	13,167	8,553
Other	13,283	3,695
Less: allowances for impairment	(10,801)	(6,186)
	240,188	212,995

In thousands of denars	**2012**	**2011**
Specific allowances for impairment		
Balance at 1 January	6,186	5,913
Balance as at 30 September from Ziraat Banka AD Skopje	372	-
Impairment loss for the year:		
Charge for the year	4,243	273
Balance at 31 December	10,801	6,186

23. Deposits from banks

In thousands of denars	**2012**	**2011**
Domestic banks		
Current deposits	16,243	6,796
Foreign banks		
Term deposits	1,982,760	3,442
	1,999,003	10,238

Time deposits from foreign banks represent a short term deposit from Halkbank Turkey with interest rate of 0.2% p.a.

Notes to the financial statements

24. Deposits from customers

In thousands of denars	2012	2011
Retail customers:		
Term deposits	4,025,307	2,181,908
Current deposits	1,637,528	747,804
Restricted deposits	169,669	93,189
Corporate customers:		
Term deposits	2,154,155	727,795
Current deposits	1,552,066	1,635,925
Restricted deposits	1,226,065	74,403
Public sector		
Current deposits	93,798	17,374
	10,858,588	5,478,398

At 31 December 2012 MKD 1,739,781 thousand (2011: MKD 477,738 thousand) of deposits from customers are expected to be settled more than 12 months after the reporting date.

25. Other borrowed funds

In thousands of denars	2012	2011
Bank loans from other financial institutions	1,555,057	1,429,259
	1,555,057	1,429,259

At 31 December 2012 MKD 1,179,763 thousand (2011: MKD 886,366 thousand) of other borrowed funds are expected to be settled more than 12 months after the reporting date.

Notes to the financial statements

25. Other borrowed funds (continued)

Terms and conditions of outstanding loans were as follows:

In thousands of denars	Currency	Nominal interest rate	Year of maturity	2012 Face value	2012 Carrying amount	2011 Face value	2011 Carrying amount
Unsecured loans	EUR	1%	2010 – 2017	215,375	215,375	363,416	363,416
Unsecured loans	EUR	3.5%	According contracts signed with end users	8	8	396	396
Unsecured loans	EUR	2,5%	30.12.2012	1,706	1,706	1,733	1,733
Unsecured loans	EUR	No interest	According contracts signed with end users	2,093	2,093	2,093	2,093
Unsecured loans	EUR	3,5460% - 4,846%	2011 – 2016	217,605	217,605	280,622	280,622
Unsecured loans	EUR	6 monthly EURIBOR plus 1%	2009 - 2012	-	-	28,828	28,828
Unsecured loans	EUR	3,7390% - 4,2370%	2009 - 2012	-	-	19,219	19,219
Unsecured loans	EUR	5,85%	2008 – 2016	151,928	151,928	189,963	189,963
Unsecured loans	EUR	1%	2011 – 2019	33,144	33,144	32,277	32,277
Unsecured loans	EUR	3,017% - 5,159%	2013 – 2018	305,833	305,833	305,565	305,565
Unsecured loans	EUR	2,416%-4.024%	2012 – 2015	280,307	280,307	183,421	183,421
Unsecured loans	EUR	No interest	According contracts signed with end users	1,880	1,880	1,480	1,480
Unsecured loans	MKD	2%	According contracts signed with end users	20,246	20,246	20,246	20,246
Unsecured loans	EUR	3%	2012 - 2018	24,839	24,839	-	-
Secured loan	MKD	3.73%	04.01.2013	300,093	300,093	-	-
Total				1,555,057	1,555,057	1,429,259	1,429,259

The secured loan represents a repo agreement with NBRM for which the bank has pledged treasury bills (see note 15).

Notes to the financial statements

26. Provisions

In thousands of denars	Off balance sheet items	Litigation and claims	Total
Balance at 1 January 2012	1,061	1,209	2,270
Balance as at 30 September from Ziraat Bank AD Skopje	294		294
Provisions made during the year	227	-	227
Used during the year	-	(1,030)	(1,030)
Balance at 31 December 2012	1,582	179	1,761

27. Other liabilities

In thousands of denars	2012	2011
Suppliers payable	13,904	25,415
Accrued expenses	18,699	16,331
Other taxes and contributions	24	519
Liabilities for employee benefits	4,021	-
Liabilities upon performed transactions – Master Card	33,935	28,431
Liabilities upon performed transactions – Visa	2,006	3,491
Other	29,295	18,722
	101,884	92,909

28. Capital and reserves

Share capital

In number of shares	Ordinary shares 2012	2011
On issue at 1 January	188,415	41,870
Issued during the year	100,954	146,545
On issue at 31 December	289,369	188,415

At 31 December 2012 the authorised share capital comprised 289,369 (2011: 188,415) ordinary shares. Ordinary shares have a par value of MKD 10,000 (2011: MKD 10,000). All issued shares are fully paid.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share (2011: one vote per share) at shareholders' meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

Notes to the financial statements

28. Capital and reserves (continued)

Share capital (continued)

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

	% of voting share capital	
	2012	**2011**
Halk Bankasi A.S. Ankara	98.78%	98.12%
Agency for managing repossessed property	1.08%	1.66%

Statutory reserve

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

According to the amendments on the Trading Companies Law, which come into effect from 1 January 2013, the amount necessary to be allocated to statutory reserve is reduced from 15% to 5%, while the level of reserves does not reach 1/10 of the share capital.

Fair value reserve

The fair value reserve includes the cumulative net change in the fair value of available-for-sale investments, excluding impairment losses, until the investment is derecognised.

Dividends

After 31 December 2012 no dividends were proposed by the Supervisory Board of the Bank.

Notes to the financial statements

29. Contingencies

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

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

In thousands of denars	*Note*	2012	2011
Guarantees			
in MKD		455,887	161,645
in foreign currency		190,522	38,447
Letters of credit in foreign currency		48,311	37,661
Loan commitments		584,138	240,354
Provisions	*26*	(1,582)	(1,061)
		1,277,276	477,046

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

30. Related parties transactions

On 7 April 2011 Halk Bank Turkey purchased majority of the shares of Export and Credit Bank AD, Skopje (Halkbank AD, Skopje) of 91.56% and became the parent company of the Bank. Shares were acquired from Demir Halk Bank, Netherlands (DHB Bank) which owned 66.56% of shares of Export and Credit Banka AD, Skopje (Halkbank AD, Skopje) and 25% of shares from the European Bank for Research and Development (EBRD). After the changes in 2012 and the merger of Ziraat Bank AD Skopje, Halkbank Turkey owns 98.78% of the voting share capital.

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

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

Notes to the financial statements

30. Related parties transactions (continued)

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

(i) Cash and cash equivalents

In thousands of denars	Transactions with the Parent Bank 2012	2011
Placements as at 1 January	949	7,934
Placements during the year	97,141,940	7,538,681
Withdrawals during the year	(97,141,696)	(7,545,666)
Cash and cash equivalents outstanding at 31 December	1,193	949
Specific allowance for impairment	-	-
Interest income earned	-	-

(ii) Loans and advances to related parties

In thousands of denars	Key management personnel of the Bank and other related parties 2012	2011
Loans outstanding at 1 January	6,110	7,426
Loans issued during the year	2,845	3,741
Loan repayments during the year	(572)	(5,057)
Loans outstanding at 31 December	8,383	6,110
Specific allowance for impairment	85	1
Interest income earned	871	401

(iii) Deposits from related parties

	Parent and with it related parties		Other related parties		Key management personnel of the Bank and with them related parties	
In thousands of denars	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**
Deposits at 1 January	3,441	615,050	7,470	12,744	6,414	5,979
Deposits received during the year	95,902,071	8,309,080	0	24,481	128,027	110,404
Deposits repaid during the year	(93,913,403)	(8,920,689)	(7,470)	(29,755)	(121,846)	(109,969)
Deposits at 31 December	1,992,109	3,441	0	7,470	12,595	6,414
Interest expense on deposits	5,257	17,112	0	50	144	290

Notes to the financial statements

30. Related parties transactions (continued)

(iv) *Borrowings from related parties*

In thousands of denars	Parent and with it related parties 2012	2011	Other related parties 2012	2011
Borrowings at 1 January	-	180,825	-	-
Borrowings repaid during the year	-	180,825	-	-
Borrowings at 31 December	-	-	-	-
Interest expense - borrowings	-	6,609	-	-

(v) *Other transactions with related parties*

In thousands of denars	Other related parties 2012	2011	Parent 2012	2011	Key management personnel of the Bank and with them related parties 2012	2011
Cash and cash equivalents	519	22,859	-	-	-	-
Commitments and contingences	-	272	21,525	-	2,113	918
Provision for off balance	-	2	-	-	22	9
Interest income	141	4	-	1,594	730	397
Interest expense	-	19	5,257	6,609	144	215
Fee and commission expense	-	-	98	68	42	12
Fee and commission income	13	8	87	881	102	87

(vi) *Key management personnel compensation*

In thousands of denars	2012	2011
Short-term employee benefits	26,523	27,379
Termination benefits	-	3,485
	26,523	30,864

31. Subsequent events

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