Banka Kombetare Tregtare Sh.a. - Kosovo Branch

Financial statements

for the year ended 31 December 2012

(with independent auditors' report thereon)

Contents

KPMG Albania Sh.p.k., Kosovo Branch
14, Sulejman Vokshi Street
Pristina, Kosovo

Telephone +381(38)246771
Telefax +381(38)246772
E-mail al-kosovo@kpmg.com
Internet www.kpmg.al

Independent Auditors' Report

To the shareholder and management of
Banka Kombetare Tregtare Sh.a. – Kosovo Branch

Prishtina, 25 February 2013

We have audited the accompanying financial statements of Banka Kombetare Tregtare Sh.a. – Kosovo Branch ("the Bank"), which comprise the statement of financial position as at 31 December 2012, the statements 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 present fairly, in all material respects 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 Albania Shpk Kosovo Branch

KPMG Albania Sh.p.k, Kosovo Branch
14, Sulejman Vokshi Street
Pristina, Kosovo

Statement of financial position

(in EUR)

	Notes	31 December 2012	31 December 2011
Assets			
Cash and balances with Central Bank	6	41,839,531	12,577,219
Balances with banks	6	560,892	96,887
Investment securities	7	847,868	8,415,498
Due from Head Office	20	32,905,410	-
Loans to customers	8	109,572,537	111,429,252
Property and equipment	9	5,133,216	4,599,440
Other assets	10	1,147,125	605,826
Total assets		**192,006,579**	**137,724,122**
Liabilities and shareholder's equity			
Liabilities			
Customer deposits	11	175,850,759	99,577,963
Due to banks	12	2,200,206	5,876,666
Due to Head Office	20	-	23,254,213
Deferred tax liabilities	22	480,265	-
Accruals and other liabilities	13	150,425	93,916
Total liabilities		**178,681,655**	**128,802,758**
Shareholder's equity			
Share capital	14	12,000,000	8,000,000
Accumulated profit/ (loss)		921,364	(544,954)
Profit for the year		403,560	1,466,318
Total shareholder's equity		**13,324,924**	**8,921,364**
Total liabilities and shareholder's equity		**192,006,579**	**137,724,122**

The statement of financial position is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 34.

The financial statements were authorised for release by the Board of Directors on 25 January 2013 and signed on its behalf by:

Suat Albayrak
Managing Director

Fatos Krasniqi
Head of Financial Control

Statement of comprehensive income

(in EUR)

	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Interest			
Interest income	15	12,977,954	10,578,662
Interest expense	16	(5,128,815)	(3,331,103)
Net interest margin		**7,849,139**	**7,247,559**
Non-interest income, net			
Fees and commissions, net	17	1,398,972	836,343
Foreign exchange revaluation gain, net		14	14
Loss from FX trading activities, net		(47,720)	(3,400)
Other income, net		(3,314)	100
Total non-interest income, net		**1,347,952**	**833,057**
Operating expenses			
Personnel expenses	18	(2,828,892)	(2,128,833)
Administrative expenses	19	(3,529,830)	(2,672,108)
Depreciation	9	(1,131,864)	(730,279)
Total operating expenses		**(7,490,586)**	**(5,531,220)**
Loan impairment expense	8	**(822,680)**	**(1,083,078)**
Profit before income tax		**883,825**	**1,466,318**
Income Tax	22	(480,265)	-
Profit for the year		**403,560**	**1,466,318**
Other comprehensive income, net of income tax		**-**	**-**
Total comprehensive income for the year		**403,560**	**1,466,318**

The statement of comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 34.

Statement of changes in equity
(in EUR)

	Share capital	Retained earnings/ (Accumulated loss)	Total
Balance at 1 January 2011	**8,000,000**	**(544,954)**	**7,455,046**
Transactions with owners recorded directly in equity			
Contributions by and distributions to owners			
Increase in share capital	-	**-**	**-**
Total contributions by and distributions to owners	-	-	**-**
Total comprehensive income for the year			
Profit for the year	**-**	1,466,318	**1,466,318**
Other comprehensive income, net of income tax	-	-	**-**
Total comprehensive income for the year	-	1,466,318	**1,466,318**
Balance at 31 December 2011	**8,000,000**	**921,364**	**8,921,364**
Transactions with owners recorded directly in equity			
Contributions by and distributions to owners			
Increase in share capital	4,000,000	-	**4,000,000**
Total contributions by and distributions to owners	-	-	**-**
Total comprehensive income for the year			
Profit for the year	**-**	403,560	**403,560**
Other comprehensive income, net of income tax	-	-	**-**
Total comprehensive income for the year	**-**	**403,560**	**403,560**
Balance at 31 December 2012	**12,000,000**	**1,324,924**	**13,324,924**

The statement of changes in equity is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 34.

Statement of cash flows

(in EUR)

	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Cash flows from operating activities:			
Profit before income tax		**883,825**	**1,466,318**
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Interest expense	16	5,128,815	3,331,103
Interest income	15	(12,977,954)	(10,578,662)
Depreciation	9	1,131,864	730,279
Impairment of loans	8	822,680	1,083,078
Cash flows from operating profit before changes in operating assets and liabilities		**(5,010,770)**	**(3,967,884)**
(Increase)/decrease in operating assets:			
Restricted balances with Central Bank		(13,656,000)	(6,161,000)
Loans to customers		1,003,946	(44,330,730)
Due from Head Office		(32,905,410)	-
Other assets		(541,299)	(352,650)
		(46,098,763)	**(50,844,380)**
Increase/(decrease) in operating liabilities:			
Due to customers		74,940,317	55,787,804
Due to Head Office		(23,254,213)	(13,929,506)
Accruals and other liabilities		56,509	13,190
		51,742,613	**41,871,488**
Interest paid		(3,801,857)	(2,812,042)
Interest received		13,315,770	10,385,726
Net cash flows from / (used in) operating activities		**10,146,993**	**(5,367,092)**
Cash flows used in investing activities			
Redemptions of investment securities		7,259,904	-
Purchases of property and equipment		(1,665,640)	(2,915,034)
Net cash from/ (used in) investing activities		**5,594,264**	**(2,915,034)**
Cash flows from financing activities			
(Repayments of)/ Proceeds) from due to banks		(3,670,940)	2,871,005
Capital Injection		4,000,000	-
Net cash generated from financing activities		**329,060**	**2,871,005**
Net increase/(decrease) in cash and cash equivalents		**16,070,317**	**(5,411,121)**
Cash and cash equivalents at the beginning of the period	6	**3,326,106**	**8,737,227**
Cash and cash equivalents at the end of the period	6	**19,396,423**	**3,326,106**

The statement of cash flows is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 5 to 34.

1. General

Banka Kombetare Tregtare Sh.a.- Dega ne Kosove ("BKT Kosovo Branch" or the "Bank") is a foreign branch 100% owned by Banka Kombetare Tregtare Sh.a ("BKT"). The Bank offers a wide range of universal services to state and privately owned enterprises and to individuals in the Republic of Kosovo. The main source of funding for the Bank are deposits, which are accepted in various forms including current accounts, demand and term deposits, in both EUR and foreign currency. BKT offers a variety of corporate and consumer loans, EMV-compliant debit and credit cards, ATMs, qualified international banking services and various treasury products.

BKT - Kosovo Branch was registered on 30 August 2007 with the Central Bank of Republic of Kosovo ('CBK') to operate as a bank in the Republic of Kosovo and is subject to CBK regulations. Upon the Board of Directors Decision taken on 28 September 2012, the Bank increased its paid-up capital by EUR 4,000,000 to EUR 12,000,000.

The Head Office of BKT is located in Tirana and the administrative office of BKT - Kosovo Branch is located in Prishtina. The network in Kosovo includes 24 units. Five units are located in Prishtina, and the other units are located in Prizren, Peja, Gjilan, Ferizaj, Mitrovica, Gjakova, Vushtrri, Fushe Kosova, Podujeva, Drenas, Rahovec, Viti and Lipjan, Hani i Elezit, Dheu i Bardhe, Prishtina Airport and Skenderaj. In 2012, the Bank opened one additional unit in Skenderaj.

The number of employees at the end of 2012 was 285 (2011: 254).

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 available-for-sale financial assets, which are measured at fair value, and investment property, which is measured at fair value.

(c) Functional and presentation currency

These financial statements are presented in EUR, which is also the Bank's functional currency.

(d) Use of estimates and judgements

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

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 judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in notes 4 and 5.

3. Significant accounting policies

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

(a) Foreign currency transactions

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

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historic cost, are translated at the foreign exchange rate ruling at the date of the transaction.

(b) Interest

Interest income and expense are recognised in 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 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.

(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 are recognised as the related services are performed. Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

(d) 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. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

(e) Financial assets and liabilities

(i) Recognition

The Bank initially recognises loans, deposits, debt securities issued and subordinated liabilities 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.

3. Significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

(ii) Classification

See accounting policies 3(f) and (g).

(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 rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognised as a separate asset or liability.

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

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the statement of financial position. Transfers of assets with retention of all or substantially all risks and rewards include, for example, securities lending and repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if it does not retain control over the asset. The rights and obligations retained in the transfer are recognised separately as assets and liabilities as appropriate. In transfers in which control over the asset is retained, 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.

In certain transactions the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised in its entirety if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract, depending on whether the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

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

(iv) Offsetting

Financial assets and liabilities are set off and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

(v) Amortised cost measurement

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

(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.

3. Significant accounting policies (continued)

(e) Financial assets and liabilities (continued)

(vi) Fair value measurement (continued)

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

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

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. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss depending on the individual facts and circumstances of the transaction but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

(vii) Identification and measurement of impairment

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

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Bank, or economic conditions that correlate with defaults in the Bank. 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 at both a specific asset and collective level. All individually significant loans are assessed for specific impairment. All individually significant loans found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans that are not individually significant are collectively assessed for impairment by grouping together loans with similar risk characteristics.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans. 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.

3. Significant accounting policies (continued)

(f) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central banks 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.

(g) Loans

Loans 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. When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date ("reverse repo"), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the Bank's financial statements.

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

(h) Investment securities

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

(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. Any sale or reclassification of a more than insignificant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available-for-sale, and prevent the Bank from classifying investment securities as held-to-maturity for the current and the following two financial years.

(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. Available-for-sale investments are carried at fair value.

Interest income is recognised in profit or loss using the effective interest method. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss. Other fair value changes are recognised directly in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in other comprehensive income are recognised in profit or loss.

(i) 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.

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.

3. Significant accounting policies (continued)

(i) Property and equipment (continued)

(ii) Subsequent costs

The cost of replacing a 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. Land is not depreciated.

The estimated useful lives for the current and comparative periods are as follows:

• Buildings	20 years
• Motor vehicles and machinery	5 years
• Office furniture	5 years
• Computers and electronic equipment	5 years

Depreciation methods, useful lives and residual values are reassessed at the reporting date.

Leasehold improvements are depreciated over the shorter of the lease term and their useful lives.

(j) Impairment of non-financial assets

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

An impairment loss is recognised if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in profit or loss.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(k) Deposits and borrowings

Deposits and borrowings are part of the Bank's sources of debt funding.

When the Bank sells a financial asset and simultaneously enters into an agreement to repurchase the asset (or a similar asset) at a fixed price on a future date ("repo" or "stock lending"), the arrangement is accounted for as a deposit, and the underlying asset continues to be recognised in the Bank's financial statements.

Deposits and borrowings are initially measured at fair value plus directly attributable transaction costs, and subsequently measured at their amortised cost using the effective interest method.

3. Significant accounting policies (continued)

(l) 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 restructuring is recognised when the Bank has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating costs are not provided for. 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.

(m) Employee benefits

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss when they are due. The Bank makes compulsory social security contributions that provide pension benefits for employees upon retirement. The local authorities are responsible for providing the legally set minimum threshold for pensions in Kosovo under a defined contribution pension plan.

(ii) Short-term benefits

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

(n) Income tax expense

Income tax expense comprises current and deferred tax. Income tax expense is recognized in the profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income.
Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

In determining the amount of current and deferred tax the Bank takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The Bank believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax law and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Bank to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

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

3. Significant accounting policies (continued)

(o) Investment property

Investment property is property that has been acquired through the enforcement of security over financial receivables and is held either to earn rental income or for capital appreciation or for both, but not for use in the production or supply of goods or services or for administrative purposes. Investment property is measured at fair value with reference to the market prices, and with any change therein recognised in profit or loss. When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

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

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2012, and have not been applied in preparing these financial statements. None of these will have an effect on the financial statements of the Bank, with the exception of:

- FRS 9 *Financial Instruments* (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 assets is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and,
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

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

It is expected that the new Standard, when initially applied, will have a significant impact on the financial statements, since the classification and the measurement of the Bank's financial assets are expected to change. The Bank will prepare an analysis of the impact this will have on the financial statements, and is planning to complete this analysis before the date of initial application. The Bank has not yet decided on the date that it will initially apply the new 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*. 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.

It is expected that the amended standards, when initially applied, will have a significant impact on the financial statements, since the classification and the measurement of the Bank's financial assets are expected to change and its effect will be required to be disclosed in the Bank's financial statements.

4. Use of estimates and judgements

Management discusses with the Audit Committee the development, selection and disclosure of the Bank's critical accounting policies and estimates, and the application of these policies and estimates.

These disclosures supplement the commentary on financial risk management (see note 5).

Allowances for credit losses

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

The Bank reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in profit or 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 an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

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(e)(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. See also "Valuation of financial instruments" below.

Critical accounting judgements in applying the Bank's accounting policies

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

Valuation of financial instruments

The Bank's accounting policy on fair value measurements is discussed under note 3(e)(vi).

The Bank measures fair values using the following hierarchy of methods:

- Level 1: Quoted market price in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could 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.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, polynomial option pricing models and other valuation models.

4. Use of estimates and judgements (continued)

Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgment and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Bank uses proprietary valuation models, which usually are developed from recognised valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Valuation models that employ significant unobservable inputs require a higher degree of management judgment and estimation in the determination of fair value. Management judgment and estimation are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

Fair values

Loans to customers

Loans are net of allowances for impairment. The Bank’s loan portfolio has an estimated fair value approximately equal to its book value due to their underlying interest rates, which approximate market rates. The majority of the loan portfolio is subject to re-pricing within a year.

Investment securities

Fair value of investment securities is based on market prices or broker/dealer price quotations. Where this information is not available, fair value has been estimated using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity.

As at 31 December 2011, the fair value of the bond portfolio was EUR 7,715,726 which is lower than the carrying amount by EUR 699,772 (note 7). In 2012, the Bank transferred the bond to the Head Office at a value equal to the carrying amount at disposal date.

The treasury bills have an estimated fair value approximately equal to their carrying amount, because of their short-term nature and underlying yield rates, which approximate market rates. The fair value of these instruments is based on the Level 2 method described above.

Deposits and borrowings

The time deposits have an estimated fair value approximately equal to their carrying amount, because of their short-term nature and underlying interest rates, which approximate market rates.

5. Financial risk management

(a) Introduction and overview

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

- credit risk
- liquidity risk
- market risks
- operational 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.

A financial instrument is any contract that gives rise to the right to receive cash or another financial asset from another party (financial asset) or the obligation to deliver cash or another financial asset to another party (financial liability). Financial instruments result in certain risks to the Bank. The most significant risks facing the Bank are credit risk, liquidity risk and market risk. Market risk includes foreign currency risk, interest rate risk and other price risk.

Risk management framework

BKT Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Bank Asset and Liability Committee (ALCO) in Head Office, Risk Management Group and Credit Committees, which are responsible for developing and monitoring Bank risk management policies in their specified areas. All these bodies report regularly to the Board of Directors on their activities.

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

The Audit Committee in Head Office 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 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.

Current developments

The Bank operates in the condition of a dynamically developing global financial environment. The management of the Bank performs daily monitoring over all positions of assets and liabilities, income and expenses, as well as the development of the international financial markets, applying the best banking practices. The management based on this analyses profitability, liquidity and the cost of funds and implements adequate measures in respect to credit, market (primarily interest rate) and liquidity risk, thus limiting the possible negative effects from the global financial and economic crisis. In this way the Bank responds to the challenges of the market environment, maintaining a stable capital and liquidity position.

The start up phase of the Bank, which is the main reason for the accumulated losses, was supported by the Head Office.

5. Financial risk management (continued)

(b) Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's Loans to customers and other banks and investment securities. For risk management reporting purposes, the Bank considers all elements of credit risk exposure (such as individual obligor default risk, country and sector risk). BKT Kosovo has formed a Branch Credit Committee to oversee the approval of requests for credits up to the limit of 250,000 EUR. Amounts up to EUR 1,000,000 are approved by the Credit Committee in Head Office. Credit requests with amounts over EUR 1,000,000 are approved only upon decision of the Board of Directors. There is a continuous focus on the quality of credits extended both at the time of approval and throughout their lives.

Each business unit is required to comply with Bank credit policies and procedures. Regular audits of business units and Credit Risk Management processes are undertaken by Internal Audit.

Maximum credit exposure

Maximum exposures to credit risk before collateral and other credit enhancements as at 31 December 2012 and 2011 are as follows:

	31 December 2012	31 December 2011
Loans to customers (net)	109,572,537	111,429,252
Balances with banks	560,892	96,887
Investment securities - held to maturity	847,868	8,415,498
Financial guarantees	30,698,570	29,444,021
Maximum exposures to credit risk	**141,679,867**	**149,385,658**

Impaired loans and securities

Impaired loans and securities are loans and securities for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan / securities agreement(s). These loans are graded A to D in the Bank's internal credit risk grading system and the Risk Committee of BKT is engaged with the grading of the customers and their scoring according to the appropriate categories. It decides the changes of grading and takes the necessary actions according to the monitoring procedures.

The risk committee grades each loan according to these factors:

- Ability to Pay
- Financial Condition
- Management Ability
- Collateral and Guarantors
- Loan Structure
- Industry and Economics

Past due but not impaired loans

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

Loans with renegotiated terms

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

Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring.

5. 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.

Write-off policy

The Bank writes off a loan / security balance (and any related allowances for impairment losses) with the decision of the Board of Directors, in accordance with the regulations of Central Bank of Kosovo. The write-off decision is taken 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.

	Loans to customers		
31 December 2012	**Retail**	**Corporate**	**Total**
Neither past due nor impaired	34,050,706	56,136,275	**90,186,981**
Past due and individually tested but not impaired	6,764,224	12,217,210	**18,981,434**
Individually impaired	2,381,801	775,691	**3,157,492**
Total	**43,196,731**	**69,129,176**	**112,325,907**
Allowance for impairment	(1,966,344)	(787,026)	**(2,753,370)**
Total Loans, net of impairment	**41,230,387**	**68,342,150**	**109,572,537**

	Loans to customers		
31 December 2011	**Retail**	**Corporate**	**Total**
Neither past due nor impaired	35,311,978	64,617,360	99,929,338
Past due and individually tested but not impaired	4,492,352	6,694,084	11,186,436
Individually impaired	1,330,208	913,960	2,244,168
Total	**41,134,538**	**72,225,404**	**113,359,942**
Allowance for impairment	**(1,038,995)**	**(891,695)**	**(1,930,690)**
Total Loans, net of impairment	**40,095,543**	**71,333,709**	**111,429,252**

Set out below is an analysis about the credit quality of corporate loans to customers:

Rating	**31 December 2012**	**31 December 2011**
A – Good	1,415,300	539,220
B – Acceptable	58,653,452	69,150,298
C - Close monitoring	1,589,193	1,112,413
D – Unacceptable	7,338,526	1,342,444
Sub Total	**68,996,471**	**72,144,375**
Accrued Interest	450,165	488,406
Deferred fee income	(317,460)	(407,377)
Total	**69,129,176**	**72,225,404**

5. Financial risk management (continued)

(b) Credit Risk (continued)

Set out below is the ageing analysis of all loans to customers:

Category (Ageing)	31 December 2012	31 December 2011
Standard (0 - 30 days past due)	97,399,665	106,502,338
Special Mention (31 - 60 days past due)	2,041,083	1,904,964
Substandard (61 - 90 days past due)	2,487,090	1,821,099
Doubtful (91 - 180 days past due)	2,885,571	1,248,578
Loss (over 181 days past due)	7,512,498	1,882,963
Total Loans	**112,325,907**	**113,359,942**
Less: Provision for loan losses	(2,753,370)	(1,930,690)
Total Loans, Net	**109,572,537**	**111,429,252**

Set out below is an analysis of collateral obtained during the years:

	Loans to customers		
31 December 2012	**Retail**	**Corporate**	**Total**
Residential, commercial or industrial property	156,039,774	234,137,446	390,177,220
Financial assets	3,565,636	19,303,463	22,869,099
Other	21,240,637	11,206,076	32,446,713
Total	**180,846,047**	**264,646,985**	**445,493,032**

	Loans to customers		
31 December 2011	**Retail**	**Corporate**	**Total**
Residential, commercial or industrial property	177,330,334	217,819,508	395,149,842
Financial assets	1,876,354	24,619,378	26,495,732
Other	18,244,315	11,288,783	29,533,098
Total	**197,451,003**	**253,727,669**	**451,178,672**

(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.

The purpose of Liquidity Risk Management (LRM) 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. Bank’s LRM policy includes how the Bank identifies, measures, monitors and control that risk. Liquidity Risk Management is handled in collaboration and close supervision of BKT Treasury Group in Head Office.

5. Financial risk management (continued)

(c) Liquidity risk (continued)

As at 31 December 2012, the Bank's assets, liabilities and shareholder's equity have remaining maturities as follows:

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-specific	Total
Assets							
Cash and balances with Central Bank	41,839,531	-	-	-	-	-	41,839,531
Balances with banks	560,892	-	-	-	-	-	560,892
Investment securities	-	847,868	-	-	-	-	847,868
Due from Head Office	-	-	-	-	-	32,905,410	32,905,410
Loans to customers	8,099,604	7,146,383	29,526,092	53,971,653	10,828,805	-	109,572,537
Property and equipment	-	-	-	-	-	5,133,216	5,133,216
Other assets	1,147,125	-	-	-	-	-	1,147,125
Total assets	**51,647,152**	**7,994,251**	**29,526,092**	**53,971,653**	**10,828,805**	**38,038,626**	**192,006,579**
Liabilities							
Customer deposits	103,494,299	12,942,854	52,934,043	6,479,563	-	-	175,850,759
Due to banks	2,200,206	-	-	-	-	-	2,200,206
Deferred tax liabilities	-	-	-	-	-	480,265	480,265
Accruals and other liabilities	150,425	-	-	-	-	-	150,425
Shareholder's equity	-	-	-	-	-	13,324,924	13,324,924
Total liabilities and equity	**105,844,930**	**12,942,854**	**52,934,043**	**6,479,563**	**-**	**13,805,189**	**192,006,579**
Net Position	**(54,197,778)**	**(4,948,603)**	**(23,407,951)**	**47,492,090**	**10,828,805**	**24,233,437**	**-**
Cumulative net position	**(54,197,778)**	**(59,146,381)**	**(82,554,332)**	**(35,062,242)**	**(24,233,437)**	**-**	

The Head Office manages the liquidity risk of the Bank on an ongoing basis.

5. Financial risk management (continued)

(c) Liquidity risk (continued)

As at 31 December 2011, the Bank's assets, liabilities and shareholder's equity have remaining maturities as follows:

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-specific	Total
Assets							
Cash and balances with Central Bank	12,577,219	-	-	-	-	-	12,577,219
Balances with banks	96,887	-	-	-	-	-	96,887
Investment securities	312,057	8,697	39,725	8,055,019	-	-	8,415,498
Loans to customers	8,560,735	5,395,811	29,544,411	55,560,381	12,367,914	-	111,429,252
Property and equipment	-	-	-	-	-	4,599,440	4,599,440
Other assets	605,826	-	-	-	-	-	605,826
Total assets	**22,152,724**	**5,404,508**	**29,584,136**	**63,615,400**	**12,367,914**	**4,599,440**	**137,724,122**
Liabilities							
Customer deposits	53,731,210	6,640,742	36,585,631	2,590,372	30,008	-	99,577,963
Due to banks	5,876,666	-	-	-	-	-	5,876,666
Due to Head Office	-	-	-	-	-	23,254,213	23,254,213
Accruals and other liabilities	93,916	-	-	-	-	-	93,916
Shareholder's equity	-	-	-	-	-	8,921,364	8,921,364
Total liabilities and equity	**59,701,792**	**6,640,742**	**36,585,631**	**2,590,372**	**30,008**	**32,175,577**	**137,724,122**
Net Position	**(37,549,068)**	**(1,236,234)**	**(7,001,495)**	**61,025,028**	**12,337,906**	**(27,576,137)**	**-**
Cumulative net position	**(37,549,068)**	**(38,785,302)**	**(45,786,797)**	**15,238,231**	**27,576,137**	**-**	

5. Financial risk management (continued)

(d) Market risk

1) Foreign currency risk

Foreign currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. The Bank manages this risk by establishing and monitoring limits on open positions and also ensuring that these positions remain in compliance with the Central Bank of Republic of Kosovo guidelines and Bank's internal operational covenants. The Bank has in place procedures for the independent checking of open foreign currency positions. The Head Office manages the foreign currency positions and balances the currency spread of the Bank on an ongoing basis.

The following tables present the equivalent amount of assets, liabilities and shareholder's equity by currency as at 31 December 2012 and 2011:

2012	**EUR**	**ALL**	**USD**	**GBP**	**CHF**	**Other**	**Total**
Assets							
Cash and balances with Central Bank	39,712,434	10,762	212,857	131,301	1,761,514	10,663	41,839,531
Balances with banks	556,759	-	1,814	543	1,776	-	560,892
Investment securities	847,868	-	-	-	-	-	847,868
Due to Head Office	31,189,894	(14,951)	2,716,585	143,978	(1,119,433)	(10,663)	32,905,410
Loans to customers	109,572,534	-	3	-	-	-	109,572,537
Property and equipment	5,133,204	12	-	-	-	-	5,133,216
Other assets	1,140,994	6,131	-	-	-	-	1,147,125
Total assets	**188,153,687**	**1,954**	**2,931,259**	**275,822**	**643,857**	**-**	**192,006,579**
Liabilities							
Customer deposits	172,434,474	1,928	2,494,713	275,815	643,829		175,850,759
Due to banks	2,200,206	-	-	-	-	-	2,200,206
Deferred tax liabilities	480,265						480,265
Accruals and other liabilities	149,235	16	1,137	8	29		150,425
Shareholder's equity	13,324,924	-	-	-	-	-	13,324,924
Total liability and equity	**188,589,104**	**1,944**	**2,495,850**	**275,823**	**643,858**	**-**	**192,006,579**
Net position	**(435,417)**	**10**	**435,409**	**(1)**	**(1)**	**-**	**-**
Cumulative net position	**(435,417)**	**(435,407)**	**2**	**1**	**-**	**-**	

5. Financial risk management (continued)

(d) Market risk (continued)

1) Foreign currency risk (continued)

2011	**EUR**	**ALL**	**USD**	**GBP**	**CHF**	**Other**	**Total**
Assets							
Cash and balances with Central Bank	12,064,426	3,395	250,575	10,310	243,214	5,299	12,577,219
Balances with banks	92,732	-	1,857	539	1,759	-	96,887
Investment securities	8,415,498	-	-	-	-	-	8,415,498
Loans to customers	111,429,252	-	-	-	-	-	111,429,252
Property and equipment	4,599,440	-	-	-	-	-	4,599,440
Other assets	599,666	6,160	-	-	-	-	605,826
Total assets	**137,201,014**	**9,555**	**252,432**	**10,849**	**244,973**	**5,299**	**137,724,122**
Liabilities							
Customer deposits	97,429,961	46	1,498,311	196,178	453,451	16	99,577,963
Due to banks	5,876,666	-	-	-	-	-	5,876,666
Due to Head Office	24,885,395	9,508	(1,251,923)	(185,337)	(208,713)	5,283	23,254,213
Accruals and other liabilities	87,859	1	5,875	7	174		93,916
Shareholder’s equity	8,921,364	-	-	-	-	-	8,921,364
Total liability and equity	**137,201,245**	**9,555**	**252,263**	**10,848**	**244,912**	**5,299**	**137,724,122**
Net position	**(231)**	**-**	**169**	**1**	**61**	**-**	**-**
Cumulative net position	**(231)**	**(231)**	**(62)**	**(61)**	**-**	**-**	

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk

Interest rate risk is the risk that the value of financial instruments will fluctuate due to changes in market interest rates. The Treasury Department in Head Office manages the interest rate risk through monitoring the market conditions and taking necessary re-pricing or reallocation decisions with the approval of the Asset and Liability Committee in Head Office. The sensitivity analysis has been determined based on the exposure to interest rates for both financial assets and financial liabilities assuming that their amounts outstanding at the reporting date were outstanding for the whole year.

The average effective yields of significant categories of financial assets and liabilities of the Bank as at 31 December 2012 are as follows:

	USD	*Euro*
Assets		
Cash and balances with Central Bank	-	-
Loans to customers	-	10.30%
Investment securities available for sale	-	1.60%
Liabilities		
Customer deposits and due to banks	1.75%	4.84%

The average effective yields of significant categories of financial assets and liabilities of the Bank as at 31 December 2011 are as follows:

	USD	*Euro*
Assets		
Cash and balances with Central Bank	-	0.10%
Loans to customers	-	10.31%
Investment securities held-to-maturity	-	4%
Liabilities		
Customer deposits and due to banks	2.16%	4.47%

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 statement of financial position) is as follows:

2012	**up to 1 Year scenarios**		**over 1 Year scenarios**	
	100 bp Increase	100 bp Decrease	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	(298,988)	298,988	375,741	(375,741)

2011	**up to 1 Year scenarios**		**over 1 Year scenarios**	
	100 bp Increase	100 bp Decrease	100 bp Increase	100 bp Decrease
Estimated Profit (loss) effect	157,701	(157,701)	(119,601)	119,601

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk

The interest re-pricing dates of significant categories of financial assets and liabilities of the Bank as at 31 December 2012 and 2011 are as follows:

2012	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Non-specific**	**Total**
Assets							
Cash and balances with Central Bank	41,839,531	-	-	-	-	-	41,839,531
Balances with banks	560,892	-	-	-	-	-	560,892
Investment securities	-	847,868	-	-	-	-	847,868
Due from Head Office	-	-	-	-	-	32,905,410	32,905,410
Loans to customers	36,824,478	8,912,728	52,687,058	10,870,641	277,632	-	109,572,537
Total	**79,224,901**	**9,760,596**	**52,687,058**	**10,870,641**	**277,632**	**32,905,410**	**185,726,238**
Liabilities							
Customer Deposits and due to banks	105,694,505	12,942,854	52,934,043	6,479,564	-	-	178,050,965
Total	**105,694,505**	**12,942,854**	**52,934,043**	**6,479,564**	**-**	**-**	**178,050,965**

2011	**Up to 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**Over 5 years**	**Non-specific**	**Total**
Assets							
Cash and balances with Central Bank	12,577,219	-	-	-	-	-	12,577,219
Balances with banks	96,887	-	-	-	-	-	96,887
Investment securities	312,057	8,697	39,725	8,055,019	-	-	8,415,498
Loans to customers	39,498,029	9,142,475	56,929,249	5,263,942	595,557	-	111,429,252
Total	**52,484,192**	**9,151,172**	**56,968,974**	**13,318,961**	**595,557**	**-**	**132,518,856**
Liabilities							
Customer Deposits and due to banks	59,607,869	6,640,742	36,585,631	2,590,378	30,009	-	105,454,629
Due to Head Office	-	-	-	-	-	23,254,213	23,254,213
Total	**59,607,869**	**6,640,742**	**36,585,631**	**2,590,378**	**30,009**	**23,254,213**	**128,708,842**

5. Financial risk management (continued)

(e) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Bank's operations. The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity. The implementation of controls to address operational risk is supported by the development of overall standards for the management of operational risk and carried out with collaboration with Head Office.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The implementation of controls to address operational risk is supported by the development of overall standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions
- requirements for the reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- documentation of controls and procedures
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standards
- risk mitigation, including insurance where this is effective.

Compliance with internal standards is supported by a programme of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Bank.

(f) Capital management

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

Regulatory capital

The Bank monitors the adequacy of its capital using, among other measures, the rules and ratios established by the Central Bank of Kosovo ("CBK"). The Bank operates in compliance with CBK Rule "On Capital Equivalency Deposit for Branches of Foreign Banks", effective from 3 December 2012.

5. Financial risk management (continued)

(f) Capital management (continued)

Capital Adequacy

The scope of CBK Rule "On bank capital adequacy", effective from 3 December 2012 excludes branches of foreign banks.

BKT monitors the adequacy of its capital using, among other measures, the rules and ratios established by the Albanian regulator, the Bank of Albania. The regulation "On capital adequacy" is issued pursuant to Law No. 8269 date 23.12.1997 "On the Bank of Albania" and Law No. 9662 date 18.12.2006 "On Banks in the Republic of Albania".

The Capital Adequacy Ratio is the proportion of the regulatory capital to risk weighted assets and 'off balance-sheet' items, expressed as a percentage. The minimum Capital Adequacy Ratio required by the Bank of Albania is 12%.

The Modified Capital Adequacy Ratio is the proportion of the base capital to risk-weighted assets and 'off balance-sheet' items, expressed as a percentage. The minimum modified capital adequacy is 6%.

Compliance

Both BKT and the Bank, as an individually regulated operation have complied with all internally and externally imposed capital requirements.

6. Cash and balances with Central Bank and other banks

Cash and balances with Central Bank as at 31 December 2012 and 2011, are detailed as follows:

	31 December 2012	31 December 2011
Cash on hand	6,352,523	3,475,159
Balances with CBK	35,487,008	9,102,060
	41,839,531	**12,577,219**

Balances with CBK include the minimum required statutory reserve of 10% of customer deposits in Kosovo and the minimum cash deposit pledged as capital equivalency deposit.

Cash and cash equivalents as at 31 December 2012 and 2011 are presented as follows:

	31 December 2012	31 December 2011
Cash and balances with Central Bank	41,839,531	12,577,219
Statutory reserves	(16,004,000)	(9,348,000)
Minimum capital equivalency deposit (see note 7)	(7,000,000)	-
Balances with banks	560,892	96,887
	19,396,423	**3,326,106**

Balances with banks at 31 December 2012, include placements of EUR 500,011 (2011: nil). Placements are held with non-resident banks from Organisation for Economic Cooperation and Development ("OECD") countries and have contractual maturities up to 1 year. Current accounts represent balances with correspondent banks in Kosovo and in OECD countries.

7. Investment securities

	31 December 2012	31 December 2011
Treasury bills available-for-sale	847,868	-
Irish Bond held-to-maturity	-	8,415,498
	847,868	**8,415,498**

Treasury bills available-for-sale

Treasury bills available-for-sale as at 31 December 2012 represent Euro denominated Kosovo Treasury Bills as follows:

	Nominal Value	Purchase Price	Amortized discount	Net Value
Government of Kosovo	850,000	845,067	2,801	847,868
	850,000	**845,067**	**2,801**	**847,868**

Investment securities held-to-maturity

Investment securities held-to-maturity as at 31 December 2011 represent a Euro denominated Irish Government Bond as follows:

	Nominal Value	Unamortized Premium	Accrued interest	Net Value	Moody's Rating
Irish Government Bond	8,000,000	107,772	307,726	8,415,498	Ba1
	8,000,000	**107,772**	**307,726**	**8,415,498**	

As at 31 December 2011 the Irish Bond was pledged as a capital equivalency deposit required for a branch of a foreign bank. In 2012, the bond was released and the capital equivalency deposit was deposited in accounts held with CBK (see note 6).

8. Loans to customers

Loans to customers consisted of the following:

	31 December 2012	31 December 2011
Loans to customers	111,558,553	112,562,499
Accrued interest	767,354	797,443
Less allowances for impairment on loans	(2,753,370)	(1,930,690)
	109,572,537	**111,429,252**

Movements in the allowance for impairment on loans:

	2012	2011
At 1 January	1,930,690	847,612
Net impairment charge for the year	822,680	1,083,078
At the end of the year	**2,753,370**	**1,930,690**

The breakdown of the loan portfolio is as follows:

	2012	2011
Retail (individuals)	38%	36%
Private Enterprises	62%	64%

All the loans are in EUR and bear interest rates ranging from 1.5% to 22.0 %. The Bank has granted a few loans with interest rates at the minimum limit shown above, which are lower than the rates that are generally offered by the Bank, and are covered by cash collaterals.

8. Loans to customers (continued)

The classification of loans granted to private enterprises by industry is as follows:

	31 December 2012		31 December 2011	
	EUR	**%**	**EUR**	**%**
Wholesale Trade	25,225,702	37%	21,613,330	30%
Construction	10,169,254	15%	12,701,325	18%
Retail Trade	12,588,284	18%	12,751,282	18%
Hotels and Restaurants	2,012,620	3%	1,568,867	2%
Other Community, Social and Personal Activities	2,147,771	3%	2,645,064	4%
Agriculture, Hunting and Forestry	515,155	1%	628,948	1%
Manufacturing of Food, Beverages, Tobacco	3,845,266	6%	9,578,882	13%
Personal Needs	21,378	-	991,461	1%
Manufacturing of Rubber and Plastic Products	1,760,680	3%	425,846	1%
Manufacturing of Wood and Wood Products	167,930	1%	159,254	-
Financial Intermediation	2,023,712	3%	728,181	1%
Manufacturing of Basic Metals and Metal Products	983,846	1%	1,359,664	2%
Transport, Storage and Communication	763,750	1%	907,322	1%
Manufacturing of Textile and Textile Products	722,268	1%	689,476	1%
Education	3,481,378	5%	2,878,022	4%
Health and Social Work	1,265,938	2%	999,686	1%
Manufacturing of Pulp and Paper Products	178,967	-	42,567	-
Manufacturing of Transport Equipment	23,505	-	28,720	-
Private Households	19,796	-	17,001	-
Real Estate & Renting Activity	191,585	-	331,291	-
Manufacturing of Furniture	233,365	-	287,520	-
	68,342,150	**100%**	**71,333,709**	**100%**

The classification of retail loans by type is as follows:

	31 December 2012		31 December 2011	
	EUR	**%**	**EUR**	**%**
Home Purchase	23,353,446	57%	24,399,189	61%
Home Improvement	4,601,529	11%	4,646,072	12%
Home Construction	486,914	1%	592,603	1%
Call Loan	7,864,813	19%	6,658,866	17%
Shop Purchase	875,150	2%	1,176,901	3%
Overdraft and Credit Cards	2,125,283	5%	1,377,998	3%
Car Purchase	346,655	1%	273,624	1%
Cash Loan	1,448,997	4%	801,666	2%
Education	127,600	-	168,624	-
	41,230,387	**100%**	**40,095,543**	**100%**

9. Property and equipment

Property and equipment as at 31 December 2012 and 2011 are composed as follows:

	Buildings and leasehold improvements	**Motor vehicles and machinery**	**Computers and electronic**	**Office Furniture**	**Total**
Cost					
At 1 January 2011	**1,202,634**	**784,328**	**1,274,030**	**188,933**	**3,449,925**
Additions	1,260,790	274,359	1,265,682	114,203	2,915,034
At 31 December 2011	**2,463,424**	**1,058,687**	**2,539,712**	**303,136**	**6,364,959**
At 1 January 2012	**2,463,424**	**1,058,687**	**2,539,712**	**303,136**	**6,364,959**
Additions	381,145	183,668	962,647	147,962	1,675,422
Disposals	(2,375)	(27,800)	-	-	(30,175)
At 31 December 2012	**2,842,194**	**1,214,555**	**3,502,359**	**451,098**	**8,010,206**
Accumulated depreciation					
At 1 January 2011	**(264,103)**	**(291,478)**	**(393,000)**	**(86,659)**	**(1,035,240)**
Charge for the year	(158,369)	(180,017)	(348,590)	(43,303)	(730,279)
At 31 December 2011	**(422,472)**	**(471,495)**	**(741,590)**	**(129,962)**	**(1,765,519)**
At 1 January 2012	**(422,472)**	**(471,495)**	**(741,590)**	**(129,962)**	**(1,765,519)**
Charge for the year	(273,235)	(223,896)	(564,340)	(70,393)	(1,131,864)
Disposals	240	20,153	-		20,393
At 31 December 2012	**(695,467)**	**(675,238)**	**(1,305,930)**	**(200,355)**	**(2,876,990)**
Net book value					
At 1 January 2011	**938,531**	**492,850**	**881,030**	**102,274**	**2,414,685**
At 31 December 2011	**2,040,952**	**587,192**	**1,798,122**	**173,174**	**4,599,440**
At 31 December 2012	**2,146,727**	**539,317**	**2,196,429**	**250,743**	**5,133,216**

10. Other assets

Other assets as at 31 December 2012 and 2011 are as follows:

	31 December 2012	**31 December 2011**
Cards transactions settlement	559,630	313,582
Prepaid expenses	219,707	284,178
Advances to suppliers	175,586	716
Collaterals repossessed by the Bank	139,115	-
Other debtors	53,087	7,350
	1,147,125	**605,826**

Collaterals repossessed by the Bank represent the repossessed collaterals of some unrecoverable loans, the ownership of which was taken on behalf of the Bank. The Bank has established an Asset Sale Committee, responsible for the disposal of these assets. The fair value of these assets at the reporting date is determined with reference to the current market prices.

11. Customer deposits

Customer deposits as of 31 December 2012 and 2011 are composed as follows:

	31 December 2012	31 December 2011
Current accounts:		
Individuals	35,380,406	22,227,988
Private enterprises	46,392,197	18,376,265
State owned entities	511,099	273,875
	82,283,702	**40,878,128**
Term Deposits:		
Individuals	49,765,411	23,811,133
Private enterprises	23,822,827	21,118,638
State owned entities	19,978,819	13,770,064
	93,567,057	**58,699,835**
	175,850,759	**99,577,963**

Current accounts and deposits can be further analysed as follows:

	31 December 2012			31 December 2011		
	Local currency	Foreign currency	Total	Local currency	Foreign currency	Total
Current accounts	80,588,560	1,695,142	82,283,702	39,775,836	1,102,292	40,878,128
Term Deposits	**91,845,914**	**1,721,143**	**93,567,057**	**57,654,125**	**1,045,710**	**58,699,835**
One month	5,409,838	146,391	5,556,229	7,235,259	25,312	7,260,571
Three months	19,139,067	495,386	19,634,453	7,971,514	149,262	8,120,776
Six months	2,160,040	277,488	2,437,528	9,044,198	137,522	9,181,720
Twelve months	58,238,489	731,881	58,970,370	30,293,804	685,418	30,979,222
Two years and over	6,898,480	69,997	6,968,477	3,109,350	48,196	3,157,546
Total deposits	**172,434,474**	**3,416,285**	**175,850,759**	**97,429,961**	**2,148,002**	**99,577,963**

The five largest depositors of the Bank at 31 December 2012 comprise approximately 30% (2011: 26%) of total deposits.

12. Due to banks

	31 December 2012	31 December 2011
Current accounts	68,051	71,005
Borrowings from resident banks	2,132,015	5,800,000
Accrued interest	140	5,661
	2,200,206	**5,876,666**

13. Accruals and other liabilities

	31 December 2012	31 December 2011
Accrued expenses	15,626	15
Accounts payable	126,538	85,645
Guarantee deposits received	8,261	8,256
	150,425	**93,916**

“Guarantee deposits received” represents guarantees received from suppliers based on contracts with them.

14. Share capital

At 31 December 2012 the authorised share capital was EUR 12,000,000 (2011: EUR 8,000,000).

15. Interest income

Interest income is composed as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Balances with Central Bank	8,597	22,488
Due from Head Office	337,425	-
Investment securities	271,709	268,933
Loans to customers	12,360,223	10,287,241
	12,977,954	**10,578,662**

16. Interest expense

	Year ended 31 December 2012	Year ended 31 December 2011
Due to banks	118,901	56,749
Due to Head Office	149,664	1,078,149
Customer deposits	4,860,250	2,196,205
	5,128,815	**3,331,103**

17. Fees and commissions, net

Fee and commission income and expense are comprised of the following items:

	Year ended 31 December 2012	Year ended 31 December 2011
Fee and commission income		
Lending activity	58,126	73,633
Payment services to clients	1,299,182	774,390
Customer accounts' maintenance	28,919	25,094
Cash transactions with clients	62,269	32,773
	1,448,496	**905,890**
Fee and commission expense		
Inter bank transactions	(49,524)	(69,547)
	(49,524)	**(69,547)**
	1,398,972	**836,343**

18. Personnel expenses

Personnel expenses are composed as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Salaries	2,558,305	1,972,626
Life insurance for staff	40,914	24,410
Social insurance	112,625	87,989
Training	65,051	17,139
Other	51,997	26,669
	2,828,892	**2,128,833**

19. Administrative expenses

Administrative expenses are composed as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Marketing expenses	1,013,735	771,430
Telephone, electricity and IT expenses	559,918	288,935
Security and insurance expenses	300,125	280,890
Repairs and maintenance	281,728	190,802
Lease payments	813,239	762,017
Credit/debit card miscellaneous expenses	143,241	80,449
Office stationery and supplies	85,808	71,305
Other external services	209,557	80,373
Representation expenses	45,616	49,146
Taxes other than tax on profits	44,963	71,627
Sundry expenses	31,900	25,134
	3,529,830	**2,672,108**

20. Related party transactions

The Bank has a related party relationship with BKT, and with its directors and executive officers. The sole shareholder of BKT is Calik Finansal Hizmetler, which is owned by Calik Holding at 100% at 31 December 2011. Aktif Yatirim Bankasi is controlled by Calik Holding.

Balances and transactions with related parties

	31 December 2012	31 December 2011
Balances with banks		
Aktif Yatirim Bankasi	47,309	86,575
Due from /(to) Head Office	32,905,410	(23,254,213)
	32,952,719	**(23,167,638)**

The balances due from/ (to) Head Office include transfers of funds on behalf of the Bank or its customers, management of foreign currency positions performed by the BKT Kosovo, and other inter-company balances. Inter-company transactions during the year include the transfer of an Irish Bond to the Head Office (see note 7).

Balances due to Head Office in 2012, relate mainly to the increase in deposits during the year. The excess of liquidity, resulting from such increase as at 31 December 2012, was deposited with the Head Office. These funds bear an interest rate of 2.83% p.a. (31 December 2011: 3% p.a.).

	Year ended 31 December 2012	Year ended 31 December 2011
Administrative expenses		
Head Office	452	39,034
Interest expenses		
Head Office	149,664	1,078,149
Personnel expenses		
Administrators	283,283	212,611
	433,399	**1,329,794**
Interest income		
Head Office	337,425	-
	337,425	**-**

21. Contingencies and commitments

Guarantees and letters of credit	**31 December 2012**	**31 December 2011**
Guarantees in favour of customers	9,455,947	8,340,021
Letters of credit issued to customers	21,242,623	21,104,000

Guarantees issued in favour of customers are guaranteed by mortgages or fully cash collateralised.

Other	**31 December 2012**	**31 December 2011**
Undrawn credit commitments	18,564,565	16,317,034
Collaterals for loan portfolio	445,493,032	451,178,672

Legal

In the normal course of business the Bank is presented with legal claims and litigation; the Bank's management is of the opinion that no material losses will be incurred in relation to legal claims outstanding as at 31 December 2012.

Lease commitments

Lease commitments for the years ended 31 December 2012 and 2011 are composed as follows:

	31 December 2012	**31 December 2011**
Not later than 1 year	692,304	725,582
Later than 1 year and not later than 5 years	2,453,278	2,687,217
Later than 5 years	785,446	1,109,328
Total	**3,931,028**	**4,522,127**

The Bank has entered into lease commitments with duration up to ten years. The Bank may cancel these leases upon giving three months notice. Therefore, at 31 December 2012, the maximum non-cancellable commitment payable not later than one year is EUR 173,076 (2011: EUR 181,396).

22. Income tax

Income tax is comprised as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Current income tax	-	-
Deferred tax expense	480,265	-
	480,265	**-**

The tax on the Bank's results before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the Banks as follows:

	Year ended 31 December 2012	Year ended 31 December 2011
Profit before tax	**883,825**	**1,466,318**
Tax calculated at tax rate 10%	88,383	146,632
Expenses not deductible for tax purposes	6,427	40,020
Tax losses carried forward	385,455	-
Utilization of previously unrecognised tax losses	-	(45,700)
Other temporary differences not recognised	-	(140,952)
Tax charge	**480,265**	**-**
Effective tax rate	**54%**	**-**

Deferred tax is calculated based on the enacted tax rate of 10%. The carry forward period for any tax losses in accordance with the laws in Kosovo is seven years. The Bank did not recognize the net deferred tax assets relating to temporary differences, due to the fact that it is not certain that the deferred tax asset will be utilized. The tax losses are detailed as follows:

Year	2007	2008	2009	2010	2011	2012	Accumulated tax loss
Tax losses	(65,789)	(820,496)	(801,580)	-	-	(3,854,547)	(5,542,412)
Utilisation	-	-	-	548,463	456,997	-	1,005,460
Net	**(65,789)**	**(820,496)**	**(801,580)**	**548,463**	**456,997**	**(3,854,547)**	**(4,536,952)**

The movement on the deferred income tax account is as follows:

	31 December 2012	31 December 2011
Liability at 1 January	-	-
Expense	480,265	-
Liability at the end of the year	**480,265**	**-**

Deferred income tax (liabilities)/assets are attributable to the following items:

	31 December 2012	31 December 2011
Allowance for loan impairment	(586,996)	-
Decelerated depreciation	(11,873)	-
Deferred interest expenses	118,604	-
	(480,265)	**-**

23. Subsequent events

There are no subsequent events that would require either adjustments or additional disclosures in the financial statements.