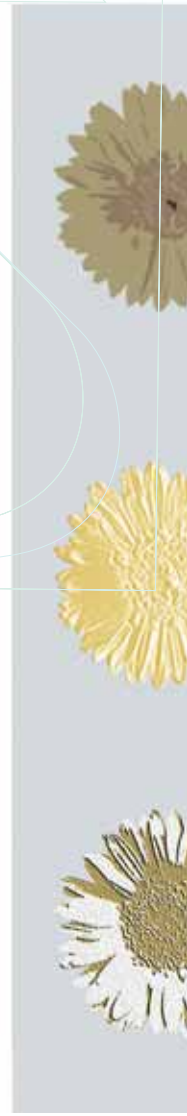




ENCOURAGEMENT BANK AD



2005 Annual Report



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KEY FIGURES	2005	2004
	BGN'000	BGN'000
Net Profit	2,778	1,917
Shareholder's Equity	36,840	33,934
Total Assets	94,172	94,486
Credit Lines from IFIs (including under trust management)		
Outstanding	53,527	54,910
Approved	74,854	98,085
Guarantee lines (EIF), in EUR thousand	21,000	21,000
Loans to SMEs		
Outstanding	69,066	64,394
Approved	141,542	115,674
INCOME		
Net Interest Income	7,851	6,785
Net Fees and Commissions Income	239	341
Operating Income before Provisions	4,754	4,797
Interests – subscription to the capital of the European Investment Fund – in EUR thousand	3,000	3,000
RATIOS		
Return on Assets	2.95%	2.03%
Return on Equity	7.54%	5.65%
Capital/Assets Ratio	39.1%	35.9%
Total Capital Adequacy Ratio	41.54%	40.69%
Employees	78	78
Exchange Rate BGN/EUR (pegged under existing currency board arrangements)	1.96	1.96

ENCOURAGEMENT BANK – GENERAL INFORMATION

Encouragement Bank AD (EB) was incorporated in 1999 as a fully state-owned institution with the special purpose of providing in priority medium- and long-term financing to the Bulgarian small and medium-sized enterprises (SMEs) and of promoting Bulgarian export. Encouragement Bank (EB) is unique on the local bank market being the only Bulgarian bank statutory and legally bound to SME lending (Chapter IV, Art.16 of the Law on Small and Medium-Sized Enterprises) with primary focus on long-term (up to 10-years) SME financing.

EB functions as a joint-stock company, entirely owned by the Ministry of Finance of the Republic of Bulgaria.

Mission

The establishment of Encouragement Bank AD, as an institution contributing to economic growth, is one of the measures undertaken by the Bulgarian Government to promote and support the start-up and development of SMEs. Limited access to debt financing for SMEs is the most serious barrier to entrepreneurship. The mission of Encouragement Bank is therefore to provide a range of financial products and services responding to the credit needs of enterprises, which the private banking system does not cover or covers only in part. As a state-owned institution, Encouragement Bank AD operates at market terms alongside with other commercial banks in Bulgaria and meets the financing needs of the Bulgarian SME sector.

Business Development Objectives

Encouragement Bank was organized and is operated as Bulgaria's specialized vehicle for SME financing. The prime objective of the Bank is to promote business and to create a favorable environment through the provision of financial services which are competitively priced and delivered in a responsive manner.

The specific business development objectives of the Bank are as follows:

- To provide accessible medium and long-term investment loans to SMEs.
- To provide the necessary pre- and co-financing under the EU Pre-Accession Programs (PHARE and SAPARD)
- To promote the Bulgarian Export by developing the Bank's trade financing activity and by offering customized export financing products;





Funding

In order to provide the necessary financial support for the accomplishment of its business development objectives EB employs its own capital and the funds raised from international and local financial and non-financial institutions. The credit, guarantee and other tailored SME facilities secure the Bank's lending capacity and diversify its lending products.

International Partners

In addition to the valuable financial support made available to the Bank under the loan and guarantee agreements, the co-operation with our partners stands for a strategic partnership and synergy where useful information and experiences are exchanged thereby positively contributing to the implementation of sound banking practices and the success of economic reforms while joining the European Union. Our consolidated efforts in this direction facilitate the pursuit of Community objectives in the field of small- and medium-sized enterprises, which Encouragement Bank AD aims to implement.

In the field of SME support and access to finance EB cooperates with the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank and the Bulgarian State Agricultural Fund under loan/guarantee agreements signed with all of them. EB is also a trustee of the Bulgarian Government for the management of the KfW SME on-lending program. The Bank has signed Cooperation Agreements with institutions of similar business objectives such as the Spanish Instituto de Credito Oficial and the German North – Rhine Westphalia Bank (NRW).

Shareholding ties have been established with the European Investment Fund where a minority stake for strategic partnership purposes has been acquired.

EB is a member in the European Association of Public Banks and the Club of Institutions of the EU Specializing in Long-Term Credit.



Lending Activity

The establishment of EB evidenced the determination of the Bulgarian Government to ensure an effective and friendly environment for SMEs growth and reinforcement. In this sense, Encouragement Bank functions as the promotional bank for Bulgaria making up for the limited access to long-term financing for the SME sector.

As an institution providing financial support and stimulating the emergence and development of Bulgarian SMEs, EB has concentrated its resources in the following areas:

- Providing long-term (up to 10 years) financial support to effective economic initiatives and business projects of SMEs. As of 2005, EB's loan portfolio (outstanding) accounts for EUR 35,312 thousand (7.25% increase versus 2004) and is 100% formed by loans to SMEs. The share of long-term loans (above 3 years) is 63%.
- Promoting the country's export capacities.

Since establishment EB has been fulfilling its statutory objectives by providing both direct and second floor loans. Over 86% of the financings granted by the Bank have maturity above 1 year and cover the investment needs of the Bulgarian SME sector – a critical aspect of their development while preparing to join the common European market. Encouragement Bank is also directly involved in EU integration initiatives through its support for and contribution to the faster and efficient utilization of the EU Pre-accession Programs allocated to Bulgaria. EB's value added is evidenced also by the more than 5,600 jobs created and preserved.

Since 1999 onwards EB has valuably contributed to the development of the local SME sector by sustainably increasing its investment support to the Bulgarian enterprises. In line with the Bank's statutory priority of providing affordable resources to companies with growth potential, for the period 1999 – 31st December 2004 341 SME loans totalling EUR 73 mio have been approved.





Direct Lending

Loans funded with EB's own resources and/or the refinancing provided under the loan agreements with IFIs are provided under 8 programs for investment financing of SMEs and 1 program for specialized pre-export financing programs.

Second-floor loans

In its on-lending activity Encouragement Bank operates as an agent of the Ministry of Finance, working in partnership with Bulgarian commercial banks, through which it channels its attractively priced long-term resources raised from KfW.



*Dear Ladies and Gentlemen,
Dear colleagues and partners,*

One of the most intensive and dynamic years of the Bulgarian banking sector passed by and I am glad to share that this was a particularly successful period for Encouragement Bank AD.

In 2005, the Bank continued to consolidate its specific identity before the small and medium sized enterprises. The dynamic development of the Bulgarian lending market imposed new challenges before our willingness to expand the Bank's exposure towards the small and medium-sized enterprises in the country.

The Bank remained one of the main tools of state intervention for SME promotion, view the fact that long-term investment financing, being however a factor of vitality for the sector's development, is still hardly accessible for all entrepreneurs. The mission of the Bank is to overcome this market gap of the banking system.

In 2005, the Bank strictly followed the lending growth restrictions, imposed on the entire banking system, while implementing the adopted targets for development of its activity.

Since its establishment in 1999, our financial institution has provided loans for more than BGN 143 mio to Bulgarian SMEs. These financings resulted in the implementation of 290 investment projects, mainly for construction of units and purchase of long-term fixed and intangible assets. Through the extended loans, the Bank assisted the creation and preservation of more than 5,600 jobs.

During the seven years since its creation, the Bank marked a serious lending growth, thereby reinforcing its position as a factor on the SME long-term investment financing market. As of the end of 2005, the Bank's lending portfolio amounts to BGN 77 mio (interest rates of 10.48% and 9.98% for EUR and BGN-denominated loans respectively). The projections for average lending growth show figures of 24% on an annual basis and 6% quarterly.

The financial standing of the Bank as of the end of 2005, presented in more details in the Annual Report, confirms that Encouragement Bank AD will continue to play an essential role in supporting SME' s development and growth.





In February 2005, the Bank launched a new lending program "Northern Business Initiative" to finance loans under the EUR 10 mio credit line with the Nordic Investment Bank. This agreement is the first project, implemented pursuant to the signed Memorandum of understanding between the Ministry of Finance of the Republic of Bulgaria and Nordic Investment Bank.

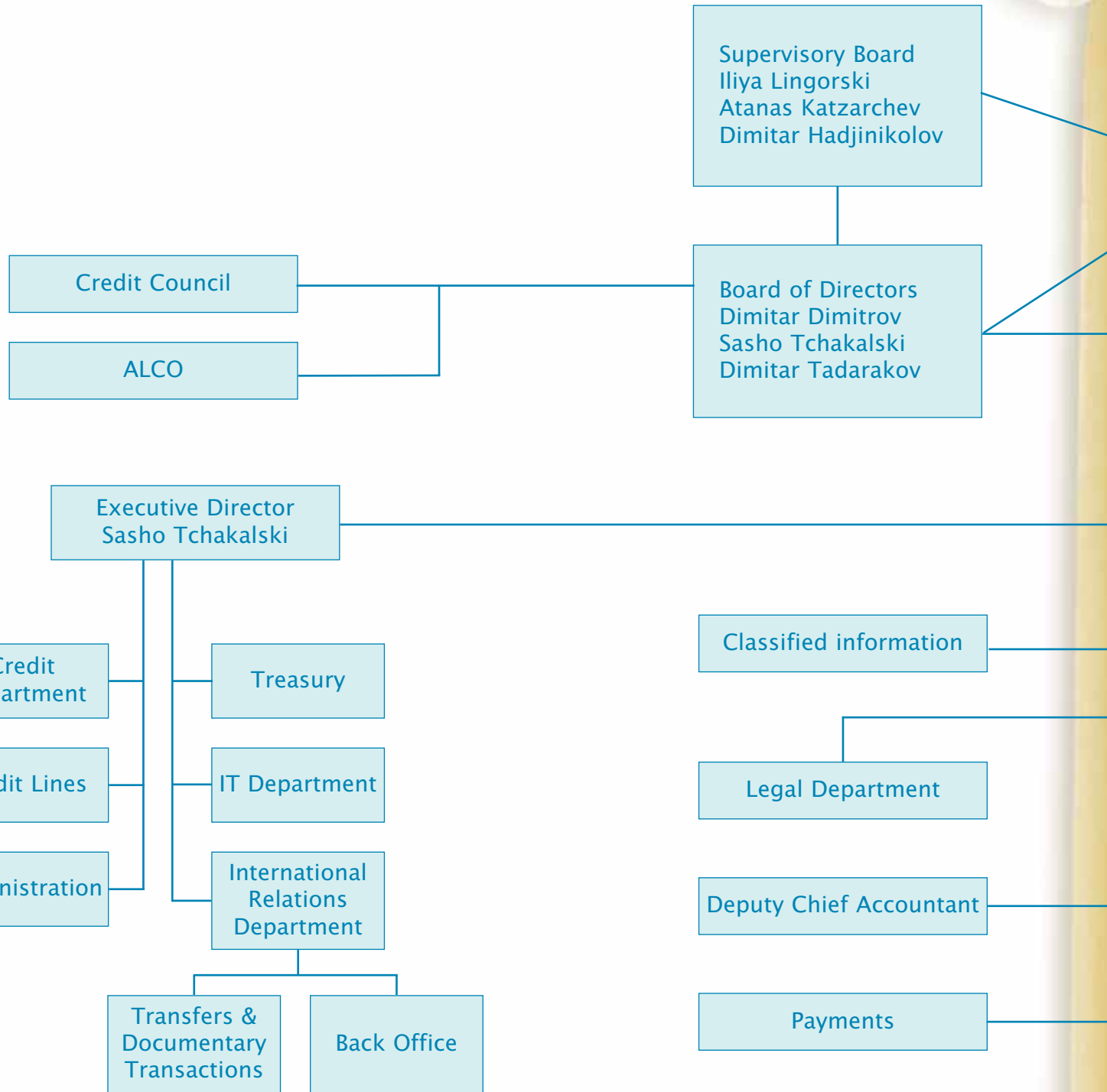
In 2005, the Bank continued to develop its customer policy and concentrated its efforts both on increasing its popularity among the target groups on national and regional level, as well as on selectively approaching potential customers.

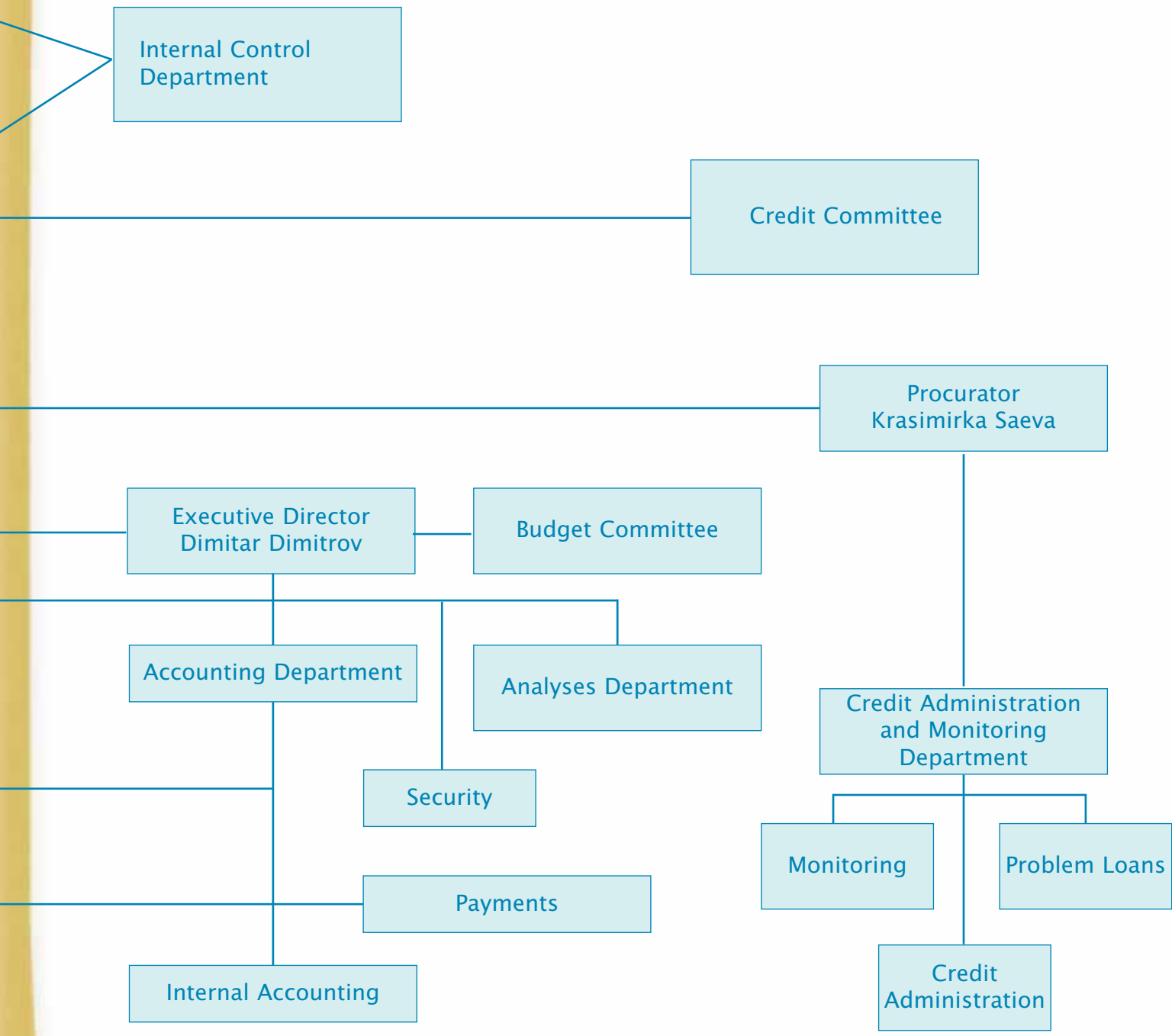
In conclusion, I would like to emphasize the contribution of the employees and partners of Encouragement Bank AD for the positive 2005 results, as well as to thank them all for their efficient, continuous and active work for the prosperity of our institution.



Dimitar Dimitrov

Chairman of the Board of Directors







SUPERVISORY BOARD

Iliya Lingorski
Chairman

Atanas Katzarchev
Deputy Chairman

Dimitar Hadjinikolov
Member

BOARD OF DIRECTORS

Dimitar Dimitrov
Executive Director
Chairman

Sasho Tchakalski
Executive Director
Vice Chairman

Dimitar Tadarakov
Member



MAIN MACROECONOMIC AND FINANCIAL INDICATORS	Notes	2004	2005
REAL SECTOR			
National accounts			
GDP, current prices	thous. BGN	38,275,339	41,948,109
Final consumption	thous. BGN	33,222,394	37,163,929
Gross fixed capital formation	thous. BGN	7,969,398	9,971,137
Exports of goods and services	thous. BGN	22,191,700	25,505,927
Imports of goods and services	thous. BGN	26,114,500	32,449,355
GDP real growth rate, y/y	(%)	5.7	5.5
Final consumption	(%)	5.1	6.8
Gross fixed capital formation	(%)	13.5	19.0
Exports of goods and services	(%)	13.0	7.2
Imports of goods and services	(%)	14.1	14.6
GDP, current prices	thous. BGN	38,275,339	41,948,109
Agriculture and forestry	thous. BGN	3,589,696	3,341,383
Industry	thous. BGN	9,908,944	10,968,566
Services	(%)	19,670,538	21,712,769
GDP real growth rate, y/y	(%)	5.7	5.5
Agriculture and forestry	(%)	3.0	-8.6
Industry	(%)	5.8	7.3
Services	(%)	5.7	6.6
Production indice			
Industrial sales real growth rate, 2000=100 *	(%)	44.9	53.9
Industrial production real growth rate, 2000=100 *	(%)	42.8	52.3
Inflation			
Inflation, end of period	(%)	4.0	6.5
Inflation, annual average	(%)	6.2	5.0
Labour market			
Employed, annual average**		3,226,343	3,276,111
Public sector		737,428	702,422
Private sector		2,488,915	2,573,689
Average monthly wage, BGN***	BGN	292.4	319.5
Public sector	BGN	366.7	397.8
Private sector	BGN	254.1	282.6
Registered unemployed (end of period)		450,566	397,340
Unemployment rate (till 2002 end of period; since 2003 average for the period)	(%)	11.8	9.9



MAIN MACROECONOMIC AND FINANCIAL INDICATORS	Notes	2004	2005
FISCAL SECTOR			
Consolidated budget revenues (accumulated)	mln. BGN	15,854.6	17,982.6
Consolidated budget revenues (accumulated)	mln. BGN	15,199.0	16,997.0
Cash balance (accumulated)	mln. BGN	655.6	985.6
Internal government debt (annual average)	mln. BGN	2,511.8	2,782.4
External government debt (annual average)	mln. BGN	14,005.9	11,232.0
FINANCIAL SECTOR			
Broad money (M3)	thous. BGN	20,394,366	25,259,580
Annual growth rate	(%)	23.1	23.9
Claims on non-government sector	thous. BGN	14,109,843	18,662,582
Annual growth rate	(%)	48.7	32.3
Base interest rate (period average)	(%)	2.6	
Exchange rate BGN/USD (period average)		1.6	1.6
Interest spread (between short term credits and time deposits in levs)	(%)	6.0	4.9
EXTERNAL SECTOR			
Current account	mln. EUR	-1,131.3	-2,530.6
Exports	mln. EUR	7,984.9	9,454.1
Imports	mln. EUR	-10,938.4	-13,823.2
Financial account	mln. EUR	2,910.9	2,874.6
Foreign direct investments	mln. EUR	2,727.5	1,789.0
Overall balance	mln. EUR	1,399.6	569.3

* Percentage changes are derived from the indices, which are arithmetic average of the monthly NSI indices based on 2000=100.

** Data for 2005 is preliminary

Source: Agency for economic analysis and forecasting



BANKING SECTOR REVIEW

2005

EQUITY ANALYSIS

Capital

Total shareholder' s equity	thous. BGN	3,446,356
Subscribed capital	thous. BGN	1,212,322
Total reserves	thous. BGN	1,433,367
Current year profit	thous. BGN	584,235
Capital Adequacy		
Capital base	thous. BGN	2,957,728
Risk component	thous. BGN	19,502,131
Primary capital adequacy	(%)	12.52%
Degree of coverage of the assets	(%)	10.93%
Total capital adequacy	(%)	15.17%

ASSET ANALYSIS

Asset Structure/Total Assets

Asset Structure/Total Assets	thous. BGN	32,850,884
Cash and balances with the Bulgarian National Bank	thous. BGN	3,239,425
Cash/ Assets	(%)	9.86%
Due from financial institutions	thous. BGN	5,841,939
Due from financial institutions/ Total Assets	(%)	17.78%
Held-for-sale portfolio	thous. BGN	2,036,494
Investment portfolio	thous. BGN	2,696,231
Investment in securities/ Total Assets	(%)	14.41%
Loans to non-financial institutions	thous. BGN	18,379,092
Loans/ Total Assets	(%)	53.99%
Allowances for loan impairment (non-financial institutions)	thous. BGN	641,827
Allowances for loan impairment/ Loans	(%)	3.49%
Assets for resale	thous. BGN	17,538
Assets for resale/ Total assets	(%)	0.05%
Long-term fixed assets	thous. BGN	776,287
Long-term fixed assets/ Capital	(%)	22.52%
Long-term fixed assets/ Total Assets	(%)	2.36%
Interest bearing assets	thous. BGN	28,311,929
Interest bearing assets / Total Assets	(%)	86.16%
Currency Component		
Foreign currency denominated assets/ Total assets	(%)	53.72%
Foreign currency denominated liabilities/ Total liabilities	(%)	50.81%



BANKING SECTOR REVIEW

2005

Quality of the Loan Portfolio

Standard exposures	(%)	94.16%
Watch exposures	(%)	3.06%
Substandard exposures	(%)	1.07%
Non-performing exposures	(%)	1.70%

PROFITABILITY

Return on assets (Net Profit/ Total Assets)	(%)	1.97%
Return on interest bearing assets	(%)	2.28%
Return on equity (Net Profit/ Subscriber capital)	(%)	51.38%
Cost of interest bearing liabilities = Interest expenses/Interest bearing liabilities	(%)	2.24%
Cost of interest bearing assets = Interest income/ Interest bearing assets	(%)	7.64%
Interest margin = Cost of interest bearing assets – Cost of interest bearing liabilities	(%)	5.39%
Net interest margin = (Interest income – Interest expenses)/ Interest bearing assets	(%)	5.30%
Interest expenses/ Interest income	(%)	30.60%
Interest income from loans advanced to customers/ Loans advanced to customers	(%)	9.51%
Interest income from securities/ Securities	(%)	4.62%
Interest from dealings in foreign currencies and revaluation/ Interest bearing assets	(%)	-0.09%
Non-interest expenses/ Interest bearing assets	(%)	4.25%
Efficiency = Non-interest expenses/ Profit		1.87

LIQUIDITY

Liquid assets	thous. BGN	10,936,020
Attracted funds (deposits)	thous. BGN	29,386,046
Primary liquidity	(%)	12.75%
Liquid assets ratio	(%)	31.30%

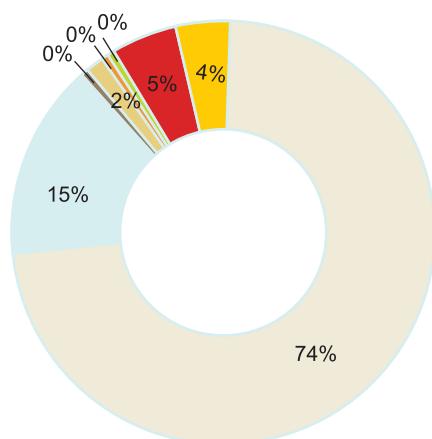


BALANCE SHEET

At the end of 2005 Encouragement Bank's total assets reached BGN 94,172 thousand – down 0.3% on an annual basis, after growth of 30% in 2004. The decrease is mostly due to the lower than expected increase of loan portfolio generated by the Bank, after Bulgarian National Bank implemented restrictions in the field of lending. The aim of the regulator was to limit the increase of lending in Bulgarian banking sector. The restrictions were accepted in March 2005, so they lessen the annual growth of Encouragement Bank. However main banking aggregates were healthy and shown good financial and operational performance of the Bank.

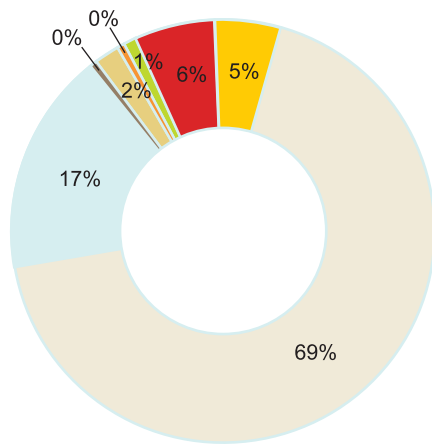
At the end of 2005 the share of interest-bearing assets was over 90% of total assets. Encouragement Bank maintained a comfortable liquid reserve of BGN 18,952 thousand in liquid assets (20.1% of total assets).

The structure of Encouragement Bank's assets remained relatively unchanged with main share attributable to loans to SMEs (over 70%). Another interest-bearing component in the Bank's assets accounting for 19% is investments in securities and placements in banks. Compared to previous years (22% in 2004) the share of securities in 2005 is lower releasing cash to finance new loans and drawdowns under current year commitments. Almost 5 % of the cash is held on current accounts and mandatory reserves with the Central Bank and only 6% in other assets (of which 2% in property and equipment).



Assets structure as of 31.12.2005

- Cash and balances with the Central Bank
- Loans and advances to customers
- Securities held-to-maturity
- Intangible assets
- Due from other banks
- Securities available-for-sale
- Property and equipment
- Other assets



Assets structure as of 31.12.2005

- Cash and balances with the Central Bank
- Due from other banks
- Loans and advances to customers
- Securities available-for-sale
- Securities held-to-maturity
- Property and equipment
- Intangible assets
- Other assets

As in the previous years the main component in Encouragement Bank's assets is the loans to SMEs representing over 73% of total assets. In 2005 new loans and net drawdowns accumulated BGN 69,066 thousand of loans outstanding. The growth versus 2004 on a gross (before provisions) basis is 7.2% in new operations with SMEs.

Around 51% of the loans extended by the bank are EUR-denominated and the remaining 49% are BGN-denominated. In comparison in 2004 the proportion was – 62% EUR-denominated and 38% BGN-denominated loans. The currency risk is mitigated with the currency-board arrangements effective in Bulgaria where the local currency is pegged to the EUR. The currency structure of Encouragement Bank's liabilities is similarly dominated by EUR denominated-component: 54% against 46% for the local currency one.

As in previous years the Bank financed its lending operations mainly through funds raised from international financial institutions and from its own capital. Borrowed funds from international institutions dropped to BGN 47 255 thousand against 49 543 thousand in 2004 due to the cancellation of the Black Sea Trade and Development Bank line and also to regular repayments under other IFI's agreements. Other borrowed funds rise to BGN 6 272 thousand from BGN 5 367 thousand.

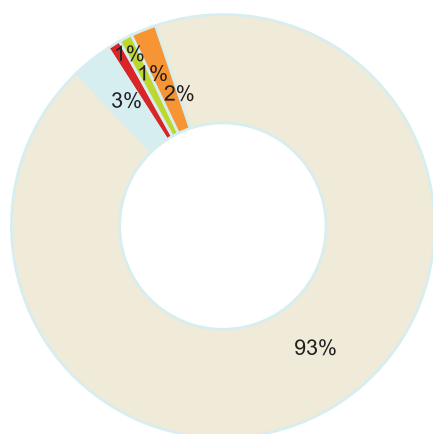
Following the last subscription to the capital by the main shareholder of the Bank – the Ministry of Finance which took place back in 2003, the authorized capital remained unchanged at BGN 29,574 thousand. Reserves increased by 2% from BGN 4 360 thousand in 2004 to BGN 7 266 thousand in 2005.



INCOME STATEMENT

SUMMARY INCOME STATEMENT IN BGN ' 000	2005	2004
Net interest and other similar income	7 851	6 785
Net fees and commissions income	239	341
Gains from dealing in foreign currencies	77	110
Gains from securities	45	814
Other operating income	150	49
Total revenues	8 362	8 099
Operating expenses	- 3 608	- 3 302
Income before provisions	4 754	4 797

In 2005 Encouragement Bank reported a net profit of BGN 2,778 thousand securing comfortable profitability ratios ROA and ROE of 2.95 and 7.54 respectively, against 2.03% and 5.65% in 2004. The Bank was ranked second (by ROA) among the Bulgarian Banking System as of the end of 2005. The positive results in the generated income are a product of stability in revenues and profitability combined with the ability of Encouragement Bank's management to control financial and operating costs. An additional growth-contributing factor is the implementation of a proper business policy and a sound credit and market risk management. The significant share of income from ongoing operations and the low portion of gains from extraordinary (one - off) transactions further substantiate this conclusion.



Revenue structure

- Net interest and other similar income
- Gains from foreign currencies
- Other operating income
- Net fees and commission income
- Gains from securities



Consistent with the main focus of the Bank's operations – lending – and the high share of interest-bearing assets in total assets, net interest income continued to grow and to be a major component in total revenues with more than 90% share in total revenues (BGN 7,851 thousand). Consequently, gains from dealing in securities, dropped sharply from 814 thousand in 2004 to only 45 in 2005, because of overall downtrend in the bonds market.

The interest income structure matches the total revenue structure with main share attributable to interest income from loans (82%) up 25% to BGN 8,567 thousand in 2005 (from BGN 6854 thousand in 2004). As a result of the decrease in the securities portfolio, interest income on securities available for sale shrank in absolute and relative terms to BGN 528 thousand from BGN 825 thousand in 2004.

Interest expense is dominated by the interest payable on other borrowed funds (loans from financial and non-financial institutions) with 97% of total interest expense. At the end of 2005 the average (weighted) interest rate on the bank's long-term borrowings accounted to 2.67% p.a. (2004: 3.04% p.a.).

Net fees and commissions income dropped to BGN 239 thousand from BGN 341 thousand in 2004 with largest share attributable to fees and commissions on customers' accounts, bank transfers and cash operations. Transaction fees for subprojects under the EU/EIB SME Finance Facility and the trust management fees of borrowed funds are other main components in the structure of this indicator.

Operating (general administrative) expenses increased in absolute terms to BGN 3,608 thousand mainly from higher personnel and management costs. In relative terms however the Bank maintained these costs at around 40% of total revenues in the last three accounting years.

Profit before tax in 2005 increased sharply with 37% on a year to year basis and reached BGN 3 272 thousand against BGN 2,397 thousand in 2004. As a result of the increase in net interest and other similar income to BGN 8 567 thousand from BGN 6 854 thousand in 2004.



CAPITAL ADEQUACY

In 2005 Encouragement Bank continued to be well capitalized above the regulatory minimum requirements. Although the capital base of the bank went up 6%, while bank's risk component rose 3% on a year to year basis. Capital adequacy remained high at over 42% providing for a large reserve for further expansion of Encouragement Bank's lending activity. Encouragement Bank AD calculates its total capital adequacy ratio as a percentage of its own funds to the risk weighted assets (Regulation No.8 of the Bulgarian National Bank). The own funds include share capital and reserves. The total risk weighted assets include balance sheet and off balance sheet exposures as reported in the statutory financial statements. The minimum capital adequacy ratio required by law is 12%.

Ratios	Legal requirements	Encouragement Bank AD	
		2005	2004
Total capital adequacy	Min.12%	42.33%	40.69%
Primary capital adequacy	Min.6%	40.64%	39.46%
Asset coverage ratio	Min.6%	35.89%	33.76%

INTERNATIONAL ACTIVITIES

In 2005, Encouragement bank AD continued to successfully manage and operate the attracted from international financial institutions credit lines and other facilities.

In 2005, the capitalized amount of the KfW SME Lending Program, placed under trust management with EB as Fund manager on behalf and on the account of the Ministry of Finance (direct borrower under the KfW loan), reached EUR 3,873,878. As of the end of the year, after repayment of the amounts due by Allianz Bulgaria AD under concluded loan agreements (amounting to EUR 1 480 000), the only partner bank remained Eurobank (Piraeus Eurobank AD at present) with total granted funds of EUR 2,000,000.

The credit lines from the European Investment Bank and the Council of Europe Development Bank are fully utilized under long-term investment projects of SMEs. The total outstanding amount under these credit facilities accounts for BGN 45,202,835 as of the end of 2005.

Due to the concentration of the Bank's main activity in the sector of long-term investment financing, where the available in the banking system resources are most limited and hardly accessible, by the end of 2005 the loan agreement with the Black Sea Trade and Development Bank was cancelled.



By the end of the year, Encouragement Bank AD disbursed EUR 1 mio under the signed in November 2004 loan agreement with the Nordic Investment Bank. Under this tranche, two projects of mutual interest for Bulgaria and the Nordic countries were financed, totaling more than EUR 4.5 mio.

As first approved financial intermediary between all accession and acceding countries under the Multiannual program of the European Union for enterprises and entrepreneurship, Encouragement Bank AD was granted a guarantee line of EUR 21 mio by the European Investment Fund. The guarantees issued under the facility are direct and cover for a period of 10 years 50% of the newly formed medium and long-term loan portfolio of the Bank. In 2005, loans totaling more than EUR 9 mio were approved and covered with an EIF guarantee, thereby reaching a total volume of guaranteed loans of more than EUR 21 mio (approved amount).

In compliance with its mission and statutory priorities to implement the best SME financing practices, the Bank signed a cooperation agreement with NRW (institution of similar business objectives) – North Rhine Westphalia Bank. The agreement's scope includes exchange of information under financial projects, exchange of know-how and best practices in the field of SME financing products and personnel training. NRW is the state-owned development institution of North Rhine Westphalia and is awarded with AAA long-term rating.

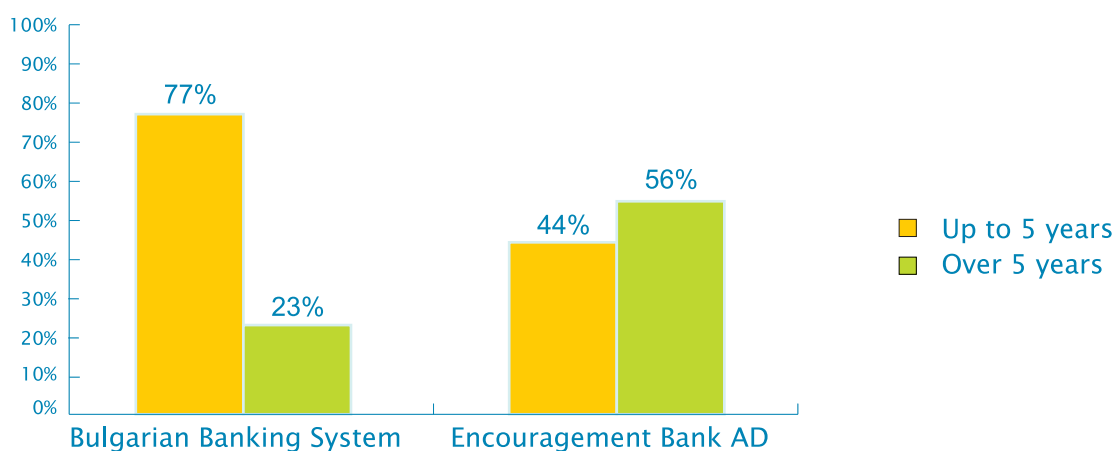
With the aim to consolidate its corporate identity on EU markets, in May 2005 Encouragement bank AD became a member of the prestigious European Association of Public Banks. This organization's members include a number of EU banks. The association represents the interests of about 100 financial institutions with 15% market share all over Europe and assets of more than EUR 3 billion. The members of EAPB are banks with state participation in the capital, development banks and other EU financial institutions. The mission of the association is to present the specific interests of state-owned and development banks at European level. Encouragement Bank is also a shareholder in the European Investment Fund and an observer member of the organization "Institutions of the European Union Specializing in Long-term Credit".



LENDING

The development of the SME lending in the last few years follows the growing trends of the credit expansion on the Bulgarian banking market. Despite the fact that Bulgarian SMEs are starting to be considered by the main banks as a market niche with great potential, long-term SME lending is still inadequate. The reason for this gap on the market is, on one hand, the mismatch between the maturity structure of banks' funding base (supply side) and the maturity of loans requested by SMEs (demand side). A major part of the deposits of individuals and corporate customers are at sight or have a maturity of not more than one year. Long-term credit lines from abroad are still limited to a medium-term horizon.

Established and operated as Bulgaria's special vehicle for SMEs, providing long-term investment financing and promoting the local export, during 2005 Encouragement Bank AD further expanded its lending activity thereby responding to the sustainably high demand for long-term SME loans. Despite the growth in the long-term lending only 22% of BGN and foreign currency denominated credits to non-financial institutions in Bulgaria have a tenor of more than 5 years. This figure should be regarded as including mostly loans to individuals, mortgage loans and loans to large corporate customers (non SMEs). This obstructs the technological upgrade and improvement of the competitiveness of Bulgarian SMEs. The structure of EB's receivables from SMEs is reversed which evidences the importance of its intervention, filling an existing market gap.



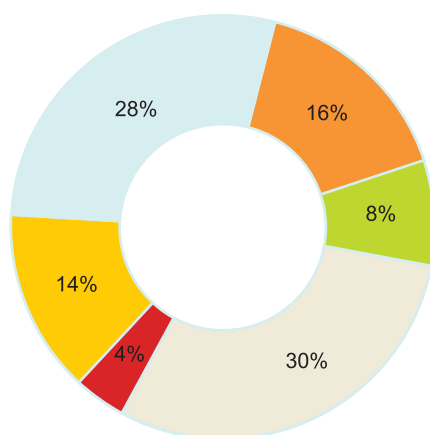


Direct Lending

In 2005 the main priorities in Encouragement Bank's lending activity were the following:

- To provide accessible medium and long-term investment loans to SMEs;
- To provide the necessary pre- and co-financing under the EU Pre-Accession Programs (SAPARD);
- To promote the Bulgarian export by developing the Bank's trade financing activity and by offering customized export financing products (loans);
- To provide Working capital financing which is important component some small and medium size businesses require to remain competitive, up-to-date and confident in their marketplace.

In order to meet its targets while responding to the existing market demand Encouragement Bank offered 5 investment and one working capital programs, each one focusing on a different aspect of SMEs' financing needs. The scope of financing covers from capital good purchases through intangibles to working capital needs for investment and export purposes. The amount of financing, extended by Encouragement Bank, usually ranges from EUR 15 thousand to EUR 1 mio.



Loan Portfolio Breakdown by Lending Program

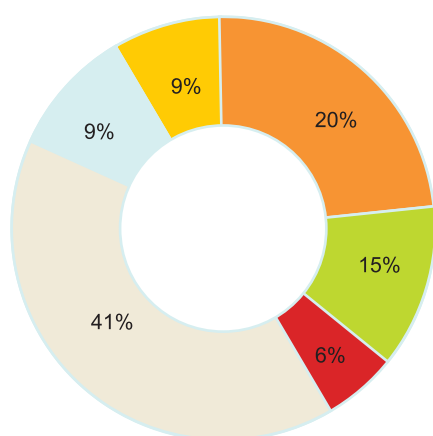
- Long-term Investment Financing
- SME Investment Financing
- Nordic Investment Bank
- SAPARD Investment Financing
- Export Financing
- Working Capital Financing



During 2005 71 loan applications were received of which 57 were approved totaling BGN 37,225 thousand.

Encouragement Bank's loan portfolio as of 31st December 2005 went up 9% on a year to year basis and reached BGN 75 744 thousand (before provisions) versus BGN 69 723 thousand as of the end of 2004. Provisions totaled BGN 6 224 thousand providing for a coverage ratio of 8.22% versus 3.49% on an average for the banking sector which is due to the specific activity of Encouragement Bank – the long-term lending associated with higher than the average risks.

The breakdown of the Bank's loan portfolio as of 31st December 2005 by economic sectors is as follows:



Loan Portfolio Breakdown by Sector

- Agriculture and Forestry
- Trade
- Processing Industry
- Hotels and restaurants
- Construction
- Other



Despite the fact that Encouragement Bank does not maintain a branch network and is domiciled only in Sofia, the Bank has a balanced coverage of the country corresponding closely to the distribution of companies with a growth and job creation potential throughout Bulgaria. As of 31st December 2005 31% of loans approved have been extended to Sofia and Sofia region companies, 28% – to companies located in the Northern part of Bulgaria and 41% – in the South.

In 2005 a major marketing objective was to promote the name of the Bank, and to strengthen its important place in the field of SMEs' financing, through presentations and on-site campaigns, PR publications and media advertisements. The development of the credit market in Bulgaria set new challenges for the Bank on the way to increase its market share.

As a whole in 2005 the biggest clients' interest was in the field of medium and long-term investment loans, also working capital financing. In 2006 Encouragement Bank will continue to promote its SMEs financing products, and development of new ones.

On-lending

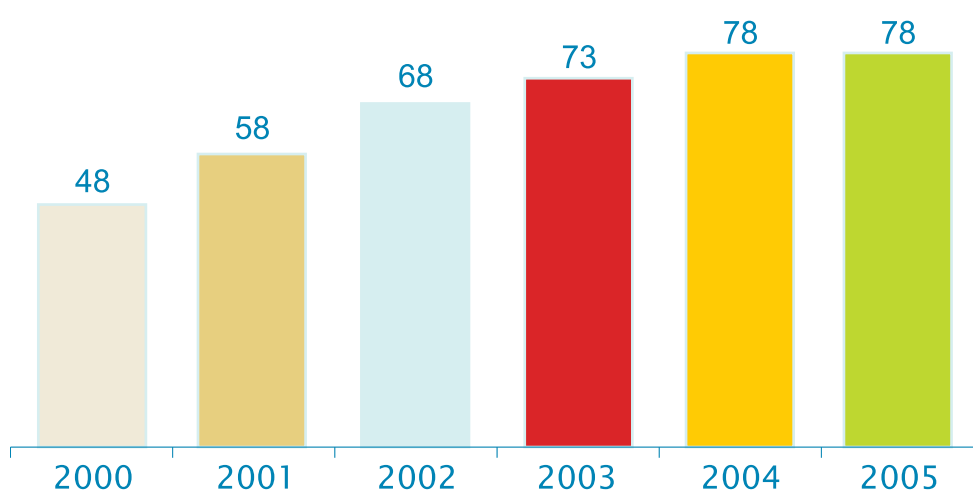
In its on-lending activity Encouragement Bank operates as an agent of the Ministry of Finance, working in partnership with Bulgarian Commercial Banks, through which it channels its attractively priced long-term resources raised from KfW. The loan portfolios of the partner bank included in the SME lending program comprised at the end of 2005 78 loans with total outstanding amount of BGN 717 thousand and with tenor of up to three years.



HUMAN RESOURCES

In line with the growing volume of operations since its establishment the number of staff employed by Encouragement Bank has been raising 10% p.a. on an average.

Staff Trend



As at 31 December 2005 the number of permanently employed personnel accounted to 78, unchanged on annual basis.

Recognizing the fact that the building up of a well-trained and devoted staff is one of the keys to success, Encouragement Bank has been applying consistent efforts to further develop the skills and professional qualification of its employees. In 2005 the Bank started developing internal quarterly assessment forms for direct evaluation of the performance of its employees which make the remuneration system more flexible and result-oriented. To stimulate its staff and make the working environment a rewarding activity Encouragement Bank sponsored a number of external training courses.



OPERATING OUTLOOK

True to the underlying principles of its establishment and the business development objectives set forth in its incorporation documents, in 2006 Encouragement Bank will remain faithful to its mission of supporting the investment initiatives of Bulgarian SMEs with a particular focus on their fast and efficient integration into the European Union and of promoting Bulgarian Export. With this respect, respecting however the new lending restrictions, introduced by the Bulgarian National Bank, concerning the credit activity of all commercial banks in the country, the management of Encouragement Bank envisages to:

- Maintain the principal lending target of the Bank on the SMEs by providing long-term investment credits, as well as export credits, which will result in moderate growth of the loan portfolio in 2006;
- Increase the volume of financial resources raised from other International Financial Institutions;
- Continue to be innovative by introducing new lending products for its customers, flexibly adapting to their financial needs and by further improving its home banking products;
- Strive to build up the professional background of the Bank's staff through various training courses while stimulating their performance with appropriate remuneration packages.



MAZARS & GUÉRARD



AUDITORS' REPORT

**TO
THE SHAREHOLDERS
OF ENCOURAGEMENT BANK AD**

We have audited the accompanying balance sheet of Encouragement Bank AD (the Bank) as at 31 December 2005, and the related statements of income, cash flows and changes in equity for the year then ended. These financial statements are the responsibility of the Bank's management. 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 plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2005, and of the results of its operations, its cash flows and changes in equity for the year then ended in accordance with International Financial Reporting Standards.

MAZARS & GUERARD

Max Dongar

Le Vinci - 4, Allee de L'Arche
92075 La Defense Cedex, France

29 March 2006

AFA OOD
Registered Specialised Audit Firm

Renny Georgieva Iordanova

Valia Iordanova Iordanova

38, Oborishte Street
1504 - Sofia, Bulgaria



SUPERVISORY BOARD:

Chairman:	Iliya Lingorski
Member:	Atanas Katzarchev
Member:	Dimitar Hadjinikolov

MANAGEMENT BOARD:

Chairman:	Dimitar Dimitrov
Deputy Chairman:	Sasho Tchakalski
Member:	Dimitar Tadarakov

AUDITORS:
AFA OOD
38, Oborishte Str.
Sofia 1504, Bulgaria
MAZARS & GUERARD
Le Vinci – 4, Allee de L'Arche
92075 La Defencse Cedex, France

Head Office:
1, Dyakon Ignatiy Str.
Sofia 1000
Bulgaria



INCOME STATEMENT	Notes	2005 BGN'000	2004 BGN'000
Interest and other similar income		9,264	7,947
Interest and other similar expenses	3	(1,413)	(1,162)
Net interest and other similar income		7,851	6,785
Fee and commission income	4	259	363
Fee and commission expenses	4	(20)	(22)
Net fee and commission income		239	341
Gains less losses from dealing in foreign currencies	5	77	110
Gains less losses from securities available-for-sale	6	45	814
Other operating income	7	150	49
Total operating income		8,362	8,099
Loan impairment and uncollectability losses	8	(1,482)	(2,400)
General administrative expenses	9	(3,608)	(3,302)
Profit before taxes		3,272	2,397
Income tax expense	10	(494)	(480)
Net profit for the year		2,778	1,917

The accompanying notes on pages 37 to 80 form an integral part of these financial statements.



BALANCE SHEET	Notes	31 Dec 2005 BGN'000	31 Dec 2004 BGN'000
Assets			
Cash and balances with the Central Bank	11	4,597	5,893
Due from other banks	12	4,095	4,721
Loans and advances to customers	13	69,066	64,394
Securities available-for-sale	14	13,697	16,238
Securities held-to-maturity	15	197	197
Property and equipment	16	2,323	2,351
Intangible assets	17	103	184
Other assets	18	94	508
Total assets		94,172	94,486
Liabilities			
Due to other banks	19	273	1,347
Due to customers	20	2,960	3,850
Borrowed funds from international institutions	21	47,255	49,543
Other borrowed funds	22	6,272	5,367
Other liabilities	23	376	311
Deferred tax liabilities	24	196	134
Total liabilities		57,332	60,552
Shareholders' equity			
Share capital	25	29,574	29,574
Reserves	26	7,266	4,360
Total shareholders' equity		36,840	33,934
Total shareholders' equity and liabilities		94,172	94,486

The accompanying notes on pages 37 to 80 form an integral part of these financial statements.

The financial statements have been approved for issue by the Management Board of Encouragement Bank AD and signed on its behalf on 29 March 2006 by:

Dimitar Dimitrov
Executive Director

Sasho Tchakalski
Executive Director

Ivan Lichev
Chief Accountant (preparer)



CASH FLOW STATEMENT	Notes	2005 BGN'000	2004 BGN'000
Cash flows from operating activities			
Profit before taxes		3,272	2,397
Loan impairment and uncollectability losses		1,482	2,400
Depreciation/amortisation		322	313
Impairment of other assets		-	68
Net book value of assets written-off		65	21
Cash flows from operating activities before changes in working capital		5,141	5,199
Changes in operating assets and liabilities:			
Decrease/(increase) in mandatory reserve deposit at the Central Bank		186	(4,543)
Decrease/(increase) in amounts due from other banks		2,000	(2,000)
Increase in loans and advances to customers		(6,049)	(26,514)
Decrease in securities available-for-sale		2,934	8,200
Decrease in interest receivables		14	162
Decrease in other assets		123	14
(Decrease)/increase in amounts due to other banks		(1,074)	1,261
(Decrease)/increase in amounts due to customers		(890)	2,273
Increase in other borrowed funds	22	3,164	231
Increase in interest payables		-	68
(Decrease)/increase in other liabilities		(55)	97
<i>Net cash from operating activities before income taxes</i>		5,494	(15,552)
Income taxes paid		(134)	(1,012)
Net cash from/(used in) operating activities		5,360	(16,564)



	Notes	31 Dec 2005 BGN'000	31 Dec 2004 BGN'000
Cash flows from investing activities			
Purchase of equipment and computer software	15,16	(278)	(419)
Purchase of held-to-maturity securities		-	(196)
Net cash used in investing activities		(278)	(615)
Cash flows from financing activities			
Dividends paid		(260)	(1,182)
Proceeds from long-term borrowed funds	21,22	1,956	24,663
Payments on long-term borrowed funds	21,22	(6,440)	(6,499)
Net cash (used in)/from financing activities		(4,744)	16,982
Net increase/(decrease) in cash and cash equivalents			
		338	(197)
Cash and cash equivalents at the beginning of the year			
	28	3,842	4,039
Cash and cash equivalents at the end of the year			
	28	4,180	3,842

The accompanying notes on pages 37 to 80 form an integral part of these financial statements.



STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY	Notes	Share capital BGN'000	Statutory reserve BGN'000	Other reserves BGN'000	Revaluation reserve BGN'000	Retained earnings BGN'000	Total BGN'000
Balance at 31 December 2003	25,26	29,574	702	302	1,072	1,657	33,307
Allocation of profit for year 2003 for:							
*Reserves		-	365	1,182	-	(2,729)	(1,182)
*Dividends		-	-	-	-	(1,182)	(1,182)
Transfer to "profit or losses for the year" upon sale of available-for-sale investments		-	-	-	(845)	-	(845)
Net unrealised valuation gains from available-for-sale investments taken to equity		-	-	-	647	-	647
Effect of deferred taxes on items directly taken to equity		-	-	-	90	-	90
Net profit for the year		-	-	-	-	1,917	1,917
Balance at 31 December 2004	25,26	29,574	1,067	1,484	964	845	33,934
Allocation of profit for year 2004 for:							
* Reserves		-	325	260	-	(845)	(260)
* Dividends		-	-	-	-	(260)	(260)
Transfer to "profit or losses for the year" upon sale of available-for-sale investments		-	-	-	(47)	-	(47)



STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY	Notes	Share capital BGN'000	Statutory reserve BGN'000	Other reserves BGN'000	Revaluation reserve BGN'000	Retained earnings BGN'000	Total BGN'000
Net unrealised valuation gains from available-for-sale investments taken to equity		-	-	-	503	-	503
Effect of deferred taxes on items directly taken to equity		-	-	-	(68)	-	(68)
Net profit for the year		-	-	-	-	2,778	2,778
Balance at 31 December 2005	25,26	29,574	1,392	1,744	1,352	2,778	36,840

The accompanying notes on pages 37 to 80 form an integral part of these financial statements.



1. CORPORATE BACKGROUND

1.1. Incorporation

Encouragement Bank AD was incorporated in Bulgaria on 11 March 1999 as a joint-stock company. The registered office of the Bank is at 1, Dyakon Ignatiy Street, Sofia.

1.2. Ownership and management

The issued share capital of the Bank is held by the Republic of Bulgaria, represented by the Ministry of Finance – 99.997% and Bank DSK AD – 0.003%.

The Bank has been represented as at 31 December 2005 by Dimitar Dimitrov – Executive Director and Chairman of the Management Board, Sasho Tchakalski – Executive Director and Deputy Chairman of the Management Board and Krasimirka Velinova – Saeva – Procurator.

After three challenging years, Georgi Momtchilov, Executive Director and member of the Management Board, moved from Encouragement Bank to another financial institution (decision of the Supervisory Board dated 9 May 2005).

1.3. Activities

The Bank holds a general banking licence, issued by the Central Bank of Bulgaria (BNB) and is allowed to perform all banking operations permitted by Bulgarian law. Nevertheless, the Articles of Association of the Bank prohibit the following types of operations: accepting deposits from individuals (with an exception of deposits from the employees), transactions with precious metals, issuance and management of bank cards, and provision of bank safes. The Bank is also a licensed financial intermediary and a broker.

The Bank was incorporated with the special purpose of supporting the implementation of the economic policies of the State by financing business projects of small – and medium-sized enterprises (SME), including supporting their export abilities.

The principal activities in 2005 was related to providing of commercial banking services, including granting loans to private companies, dealing in government securities, performing REPO deals on the interbank market, and other financial services in Bulgaria.

At 31 December 2005 the Bank employed 78 employees (2004: 78).



1.4. Structure of the bank

The bank has no branches and offices opened as at 31 December 2005.

1.5. Main indicators of the economic environment

The main economic indicators of the economic environment that affected the Bank's activities throughout the period 2002 – 2005, are presented in the table below:

Indicator	2002	2003	2004	2005
GDP in million BGN	32,324	34,410	38,008	30,047*
Actual growth of GDP	4.48%	4.3%	5.6%	4.6%*
GDP per capita in BGN	4,052	4,398	4,884	2,445**
Year-end inflation	3.8%	5.6%	4%	6.5%
Average exchange rate of USD for the year	2.07697	1.73262	1.57511	1.57415
Exchange rate of the USD at the year-end	1.88496	1.54856	1.43589	1.65790
Basic interest rate at the year-end	3.31%	2.83%	2.37%	2.05%
Unemployment rate at the year-end	16.27%	13.5%	12.16%	10.73%



2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1. Basis for preparation of the financial statements

The financial statements of Encouragement Bank AD have been prepared in accordance with all International Financial Reporting Standards (IFRS), which comprise: Financial Reporting Standards and the International Financial Reporting Interpretations Committee (IFRIC) interpretations, approved by the International Accounting Standards Board (IASB), as well as the International Accounting Standards (IAS) and the Standing Interpretations Committee (SIC) interpretations, approved by the International Accounting Standards Committee (IASC), which are in force on 1 January 2005 and have been accepted by the Commission of the European Union.

For the current financial year the Bank has adopted all new and/or revised standards and interpretations, issued by IASB and respectively, by IFRIC, which are relevant to its activities. The adoption of the new or revised standards does not result in changes in the Bank's accounting policies except for the extension of the disclosures.

The Bank's management anticipates that the standards and interpretations that have been issued but still not in force as at the date of approval of these financial statements would not have a significant impact on its financial statements in the future.

The Bank maintains its accounting books in Bulgarian lev (BGN), which is accepted as its presentation currency. The data in the financial statements and the notes thereto are presented in thousands of Bulgarian levs (BGN'000).

The presentation of the financial statements in accordance with IFRS requires the management to make best estimates, accruals and reasonable assumptions that affect the reported values of assets and liabilities and of the disclosure of contingent receivables and payables as at the date of the financial statements, and the amounts of income and expenses for the reporting period. These estimates, accruals and assumptions are based on the information, which is available at the date of the financial statements, and therefore, future actual results might differ from these amounts.



2.2. Comparatives

The Bank presents in its financial statements comparative information for one prior period.

For the purposes of achieving a more reliable presentation of the reporting items and transactions, where necessary, changes are made in their classification and presentation in the individual components of the financial statements and then prior year comparatives are also reclassified to ensure the required comparability with the current period.

2.3. Accounting convention

These financial statements have been prepared under the historical cost convention, with modifications for the measurement of available-for-sale securities, which are stated at their fair value, and for loans granted and securities held-to-maturity, which are stated at amortised cost.

2.4. Functional and presentation currency

The functional and presentation currency is the Bulgarian Lev. Transactions denominated in foreign currencies are reported in BGN equivalent based on the official exchange rate quoted by the Central Bank (BNB) on the transaction date.

Starting from 1 July 1997 the Bulgarian Lev was fixed by law to the German Mark at the ratio of BGN 1 : DEM 1. With the introduction of the euro as an official currency of the European Union, starting from 1 January 1999, the fixed ratio between both currencies is EUR 1 : BGN 1.95583. The ratio BGN / USD is 1.6549 : 1 as at 31 December 2005 (2004: 1.43589 : 1).

All assets and liabilities denominated in foreign currencies are presented in BGN equivalent based to Bulgarian Lev at the rates of exchange prevailing at the balance sheet date.

All gains and losses resulting from foreign currency translation are reported on a net basis in the income statement.



2.5. Interest income and expenses

Interest income and expenses are recognised in the income statement on accrual basis for all interest-bearing instruments using the effective yield method based on the actual purchase price or the applicable floating rate. Interest income and expenses include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Interest income includes coupons earned on available-for-sale government bonds, interest on deposits with other banks, interest on loans and advances to customers, and fees and commissions on loans and advances to customers, which are an integral part of the effective yield of the financial instrument.

Interest expense is recognized on accrual basis and includes the interest accrued on the deposits of customers and banks as well as on the other borrowed funds.

2.6. Fee and commission income and expenses

Fees and commissions on bank guarantees and performance bonds are recognised on a systematic basis over the period of the exposure to match the cost of providing the service.

The trust management fees are recognized on accrual basis throughout the period of providing the service.

Transaction-related fees earned on the execution of a significant acts under agreements with the European Investment Bank related to SME facility sub-projects, are recognized on completion of the underlying transaction.

Expenses on fees and commissions related to servicing nostro accounts with other banks are recognized on providing the underlying service.

2.7. Loans and advances

Loans initially originated in the Bank by providing funds directly to the borrower are carried at amortised cost. All loans and advances are recognized when cash is advanced to borrowers.



2.8. Allowances for loan impairment and uncollectability

Allowances for loan impairment and uncollectability are accrued in a special allowance account if there is objective evidence that the Bank will not be able to collect all amounts due.

The amount of the specific allowances for loan impairment and uncollectability is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collaterals, discounted on the basis of the agreed-upon interest rate.

If there are indications of probable losses in the loan portfolio that have not been specifically identified and crystallized, allowances for coverage of the general credit risk are also provided for on a portfolio basis.

Allowances are also made for other components of the loan portfolio at the balance sheet date, estimated based on historical patterns of losses in each component, current economic conditions in which the borrowers operate and other relevant factors affecting the loan portfolio.

A loan is classified as non-performing depending on the period of delayed payment of principal and/or interest as well as on the basis of the analysis of the financial position of the borrower and the sources for settlement its debts to the bank.

All impaired loans are reviewed and analyzed monthly. Any subsequent changes in the amounts and timing of the expected future cash flows compared to the prior estimates would result in a change in the allowances for loan impairment losses and be charged or credited to loan impairment and uncollectability losses in the income statement.

An allowance for impairment and uncollectability is reversed only when the quality of the loan has improved so that reasonable assurance exists as to the collection of principal and interest in accordance with the original contractual terms of the loan agreement.

Subsequent recoveries or decreases in the allowances due to an event occurring after the write-down are credited to the loan impairment losses and uncollectability in the income statement.

When a loan is uncollectable, it is written-off against the related allowance for impairment losses. Such loans are written-off after all necessary legal procedures have been completed and the amount of the final loss has been determined.



2.9. Securities held-to-maturity

The Bank classifies its security portfolio into the category 'held-to-maturity' when the securities represent financial assets with fixed or determinable payments and fixed maturity, for which the Bank has the positive intent and ability to hold until maturity.

Securities held-to-maturity are initially recognised at cost, being the fair value of the consideration given including acquisition charges associated with the investment. They are subsequently re-measured at amortised cost using the effective interest method and are subject to review for impairment. Held-to-maturity financial assets are impaired if the carrying amount is greater than the estimated recoverable amount. The recoverable amount of a debt instrument is the present value of expected future cash flows, discounted at the current market interest rate for a similar asset.

Interest earned whilst possessing held-to-maturity securities is reported as interest income in the income statement.

All purchases and sales of held-to-maturity securities are recognised on the date of trading, which is the date when the Bank undertakes the commitment to purchase or sell the asset.

2.10. Securities available-for-sale

The Bank classifies its portfolio of government securities and the investments in shares of other entities into the category 'available-for-sale'.

Securities available-for-sale are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. The Bank's management determines the appropriate classification of its investments at the time of the purchase.

Securities are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment. They are subsequently re-measured at fair value based on quoted bid prices or amounts derived from cash flow models, except for the investments in other companies' shares, for which fair value cannot be determined. The latter are presented at cost.

Unrealised gains and losses arising from changes in the fair value of securities classified as available-for-sale are recognised directly in a separate component of equity through the statement for changes in equity until the financial asset is sold, collected or otherwise disposed of or until it is impaired, at which time the accumulated gains or losses recognised in prior periods in the equity, are recognised in the income statement for the reporting period.



Available-for-sale financial assets are impaired if the carrying amount is greater than the estimated recoverable amount. The amount of the recognised impairment loss is equal to the difference between the acquisition cost, net of principal repayments and current fair value (for equity instruments) or recoverable amount (for debt instruments). The recoverable amount of a debt instrument is the present value of expected future cash flows, discounted at the current market interest rate for a similar financial asset.

Interest earned whilst holding debt securities available-for-sale is reported as interest income.

Dividend income earned whilst holding capital securities available-for-sale is reported as other income.

All purchases and sales of securities available-for-sale are recognised at the date of trading, which is the date when the Bank undertakes the commitment to purchase or sells the asset.

2.11. Sale and repurchase agreements (REPO deals)

Securities sold under sale and repurchase agreements are retained in the financial statements as financial assets whereas the corresponding liability is included in deposits due to other banks when the Bank has not lost its control on these securities. The difference between sale and repurchase price is treated as interest and is accrued evenly over the period of the REPO agreements.

2.12. Property and equipment

Property and equipment (tangible fixed assets) are presented in the financial statements at historical cost of acquisition (cost) less the accumulated depreciation and any impairment losses in value.

Initial measurement

Upon their initial acquisition, property and equipment are valued at cost, which comprises the purchase price, including customs charges and any directly attributable costs of bringing the asset to working condition for its intended use. The directly attributable costs include the cost of site preparation, initial delivery and handling costs, installation costs, professional fees related to the project, non-refundable taxes, etc.

The Bank has set a value threshold of BGN 150, below which any asset acquired, regardless of its nature as a fixed asset, is treated as current expense at the acquisition date.



Subsequent measurement

The chosen by the Bank approach for subsequent measurement of property and equipment, is the cost model under IAS 16, i.e. costs less any accumulated depreciation and any accumulated impairment losses in value.

Depreciation methods

The Bank applies the straight-line depreciation method for property and equipment. Depreciation starts when an asset is available for use. The useful life of the assets has been defined in terms of their physical wearing out, the characteristic features of the equipment, the future intentions for use and the expected obsolescence and is determined per group as follows:

- Buildings – 50 years;
- Bank equipment and computers – 5 years;
 - Motor vehicles – 5 years;
 - Furniture and fixtures – 6.7 years.

The useful life, set for any tangible fixed asset, is reviewed at each year-end and it is adjusted prospectively in case that any material deviations from future expectations concerning the terms of use are determined.

Subsequent costs

Costs of repairs and maintenance are recognised as current as incurred. Subsequent costs, relating to items of property and equipment having the nature of replacement of significant parts or improvements and restructuring with new parts, are recognized in the carrying amount of the respective asset and its residual useful life is reviewed as at the date of capitalisation. At the same time, the non-depreciated portion of the components that are replaced is derecognized from the carrying amount of the assets and is reported as current expense in the period of restructuring.

Impairment of assets

The carrying amounts of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying amount might significantly differ from their recoverable amount. If any such indications exist that the estimated recoverable amount is lower than their carrying amount, then the latter is written-down to the recoverable amount of the assets. The recoverable



amount of property and equipment is the greater of: fair value less costs to sell and the value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market conditions and assessments of the time value of money as well as and the risks specific to the particular asset. Impairment losses are recognized in the income statement.

2.13. Intangible assets

Intangible assets are stated in the financial statements at cost (acquisition price) less accumulated amortization and any impairment losses in value. They include software and license for their use.

The Bank applies the straight-line amortization method for the intangible assets with determined useful life of 5 years.

The carrying amount of the intangible assets is subject to review for impairment when events or changes in the circumstances indicate that the carrying amount might exceed their recoverable amount. Impairment losses are included in the income statement.

2.14. Provisions and contingent liabilities

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources will be required to settle (repay) the obligation. The measurement of provisions is based on the best estimate, made by the management at the balance sheet date, concerning the expenses that will be incurred for the settlement of the particular obligation. The estimate is discounted if the obligation is long-term.

Contingent liabilities are obligations arising from past events and whose existence can be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Bank, or it is not probable that an outflow of resources will be required to settle the obligation. They are not recognized in the balance sheet but are disclosed. (Note 27).



2.15. Pension and other payables to personnel under the social security and labour legislation

The employment and social security relations with the employees of the Bank are based on the provisions of the Labor Code and on the provisions of the effective social security legislation.

The employer's major obligation is to meet its statutory obligation to the State Social Security concerning pension benefits, health insurance and against unemployment.

The social security contributions are defined under the Law on the Budget of the State Social Security for the respective year. The contributions are allocated between the employer and the employee at a ratio, which is changed annually, and is provided for in the Social Security Code. The total contribution rate for the statutory state social security, unemployment and health insurance schemes in 2005 is 43.1% while the employer:employee ratio is 70:30 for the individuals working under the terms of third category of employment to which the employees of the Bank belong.

In 2006, the contribution amount has been changed to 36,6% and the employer:employee ratio – to 65:35. As of 1 January 2005, the employers are obliged to pay insurance contribution of 0.5% to the Employees' Receivables Guarantee Fund.

There is no established and functioning private voluntary social security scheme with the Bank.

The social security and pension schemes (plans) applied by the Bank in its capacity of an employer are based on the Bulgarian legislation and are defined contributions plans.

In accordance with the provisions of the Labor Code, the employer is obliged, upon termination of the employment contracts, to pay indemnities as follows:

- for non-observed preliminary notice: at the amount of one gross monthly salary;
- due to closing down of the enterprise or part of it, staff cuts, reduction of the volume of work and work stoppage for more than 15 days, etc.: not more than one gross monthly salary;
- upon termination of the employment contract due to illness: at the amount of gross remuneration of the employee for two months if the employee has at least five years of length of service and has not received indemnity on the same grounds during the last 5 years;



- upon retirement: 2 to 6 gross monthly salaries depending on the length of service with the Bank;
- for unused paid annual leave: for the respective years of the time recognized as service period.

Except for payment of the above indemnities, no further liabilities to employees arise for the employer.

Short-term employee benefits in the form of remunerations, bonuses and social payments and benefits (payable within 12 months after the end of the period when the employees have rendered the service or has met the expected deadlines and requirements) are recognized as expense in the income statement in the period when the service thereon has been rendered or the requirements for their receipt have been met and as current liability (less any amounts already paid and deductions due) at their undiscounted amount. The Bank's obligations for social security and health insurance are recognized as a current expense and liability at their undiscounted amount together with the respective benefits they relate to and within the period of the respective income to which they are related.

At the date of each financial statements, the Bank measures the expected amount of accumulating compensated absences, which amount is expected to be paid as a result of the unused entitlement. The measurement includes the estimated expenses on the remunerations and the statutory social security contributions due thereon by the employer.

In accordance with the requirements of the Labour Code, the employer is obliged to pay to its personnel upon retirement an indemnity, which depending on the length of service with the Bank may vary between 2 and 6 gross monthly salaries as at the employment termination date. In their nature these are defined benefit plans.

The calculation of the amount of these obligations requires participation of qualified actuaries for establishing their present value as at the date of the financial statements, which shall be included in the balance sheet while the change in value shall be included respectively in the income statement.

At each balance sheet date, the management assigns actuaries who issue reports with their calculation of the long-term retirement benefit obligations to personnel.



2.16. Income taxes

Current income taxes

Current income taxes are determined in accordance with the requirements of the Bulgarian tax legislation – the Corporate Income Taxation Act (CITA). The nominal income tax rate for 2005 is 15% (2004: 19.5%).

Deferred income taxes

Deferred income taxes are determined using the liability method on all temporary differences existing at the balance sheet date between the carrying amounts of the assets and liabilities and their tax bases.

Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax assets are recognised for all deductible temporary differences and tax loss carry-forwards, to the extent that it is probable that they will reverse and a sufficient taxable profit will be available or taxable temporary differences might occur, against which these deductible temporary differences can be utilized, except those, which arise from the recognition of an asset or liability that at the date of the transaction does not affect the accounting and tax profit/(loss).

The carrying amount of all deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that they will reverse and sufficient taxable profit will be generated or occurring in the same period taxable temporary differences to allow the deferred tax asset to be compensated.

Deferred taxes related to items directly credited or charged to equity or other balance sheet item, are also reported directly in the respective equity component or that balance sheet item.

Deferred tax assets and liabilities are measured at the tax rates that are expected to be applied in the period when the asset will be realised or the liability will be settled (paid), based on the tax laws that are enacted or substantively enacted. As at 31 December 2005 the tax rate used is 15%, effective for year 2006 (31 December 2004: 15%, effective for year 2005).

2.17. Grants

The funds received gratuitously as grants related to the purchase depreciable assets (computer hardware), are deferred and recognized as income in a period and at a proportion identical to depreciation expense of these assets.



2.18. Cash and cash equivalents

Cash equivalents, for the purposes of cash flow statement, comprise cash on hand, cash in current accounts with other banks, demand deposits and placements with other banks – payable at sight or within 3 months, as well as unrestricted (not blocked) balances with the Central Bank of Bulgaria (BNB).

2.19. Share capital and reserves

Being a joint-stock company, the Bank is obliged to register in the Commercial Register a certain amount of share capital, which should serve as a security for the receivables of the Bank's creditors. The shareholders are liable for the obligations of the Bank only up to the amount of the share of the capital held by them and may claim returning of this share only in liquidation or bankruptcy proceedings.

Share capital represents the non-distributable capital of the Bank.

Following the requirements of the Commercial Act and the Banks Law, the Bank is obliged to set aside a statutory Reserve Fund from allocation of profit (Note 26).


2.20. Critical accounting judgements on applying the Bank's accounting policies and key estimates and assumptions of high uncertainty

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on its historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

a) Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment losses at least on a monthly basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. An evidence for this may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group or of an accurate borrower, or national, economic or





other conditions that correlate with defaults on assets in the group/type of loans. In the analysis of the risk from impairment losses and uncollectability, the loans are classified per risk groups with criteria, financial position, problematic performance, including interest and matured principal in arrears and provided collateral in terms of type and possibility for realisation. Regarding the loans, approved for guarantees from the EIF, impairment loss is recognised after deducting the portion assumed by the Fund (Note 30). Management uses estimates based on its historical loss experience for assets with credit risk characteristics as well as of objective evidence for impairment of the portfolio. Analogous approach is used also for assessments at individual loan level. 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 (Note 13).

b) Valuation of equity instruments

Investments of the Bank representing shares in the equity of other non-public companies (below 5%) that have been acquired with the objective of establishing and development of business relations being of significance to the Bank, are classified as financial assets 'available-for-sale'. They have been presented at cost, which is accepted to be approximately their fair value. (Note 14).

c) Actuarial valuations

Actuarial calculations have been used when determining the long-term retirement benefit obligations on the basis of assumptions for mortality rate, staff turnover rate, future salaries level and discount factor (Note 23).



3. NET INTEREST AND OTHER SIMILAR INCOME	2005 BGN'000	2004 BGN'000
Interest income and other similar income		
Loans and advances to customers	8,567	6,854
Securities available-for-sale and held-to-maturity	528	825
Placements with other banks	169	268
	9,264	7,947
Interest expenses and other similar expenses		
Borrowed funds from international institutions	1,256	1,017
Other borrowed funds	117	134
Customer deposits	35	9
Deposits of other banks	5	2
	1,413	1,162
Net interest and other similar income	7,851	6,785

4. NET FEE AND COMMISSION INCOME AND EXPENSE	2005 BGN'000	2004 BGN'000
Fee and commission income		
Customers' accounts, bank transfers, cash operations	160	167
Trust management of borrowed funds	75	72
Guarantees and letters of credit	24	15
Transaction fees for subprojects under the EU/EIB SME Finance facility	–	109
	259	363
Fee and commission expenses		
Bank transfers and cash operations with other banks	12	13
Current accounts due to other banks	8	9
	20	22
Net fee and commission income	239	341



5. GAINS LESS LOSSES FROM DEALING IN FOREIGN CURRENCIES	2005 BGN'000	2004 BGN'000
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Net gain from dealing in foreign currencies	79	109
Net foreign currency translation (loss)/gain	(2)	1
	77	110

6. GAINS LESS LOSSES FROM SECURITIES AVAILABLE-FOR-SALE	2005 BGN'000	2004 BGN'000
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Net gain on security transactions, including ZUNK bonds scheduled principal repayments	45	814
	45	814

7. OTHER OPERATING INCOME	2005 BGN'000	2004 BGN'000
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Legal expenses recovered	61	-
Rentals	38	44
Dividends	32	4
Other incomes	19	1
	150	49

8. LOAN IMPAIRMENT AND UNCOLLECTABILITY LOSSES	2005 BGN'000	2004 BGN'000
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Specific allowances for loan impairment	1,429	1,930
General allowances for loan impairment on portfolio basis	53	470
	1,482	2,400



9. GENERAL ADMINISTRATIVE EXPENSE	2005 BGN'000	2004 BGN'000
Personnel costs	1,695	1,482
Remuneration of the members of the Management Board and the Supervisory Board	341	274
Office and office equipment maintenance	386	321
Depreciation and amortisation	322	313
Taxes and governmental charges	275	252
Communications and IT services	251	214
Hired services	130	167
Advertising and representative expenses	111	201
Business trips expenses	52	52
Rental expenses	23	18
Contribution to the Statutory Fund for Guaranteeing Deposits	22	8
	3,608	3,302
Personnel costs comprise:		
Salaries	1,146	999
Social security contributions	306	263
Social benefits	235	210
Employee benefits upon retirement	8	10
	1,695	1,482

Personnel costs include Executive Directors' remuneration amounting to BGN 88 thousand (2004: BGN 155 thousand).

Taxes include: unrecoverable input VAT, one-off taxes, local taxes and fees, governmental and legal charges.



10. INCOME TAX EXPENSE	2005 BGN'000	2004 BGN'000
Current income tax expense	501	489
Deferred income tax expense related to:		
- temporary differences	(7)	(20)
- tax rate decrease – none (2004: by 4.5%)	–	11
Income tax expense	494	480
Reconciliation of income tax expense		
Accounting profit for the year	3,272	2,397
Tax calculated at the standard rate of 15% (2004: 19.5%)	491	467
Tax effects from:		
- expenses not deductible for tax purposes	3	2
- tax rate decrease – none (2004: by 4.5%)	–	11
Income tax expense	494	480

11. CASH AND BALANCES WITH THE CENTRAL BANK	2005 BGN'000	2004 BGN'000
Cash on hand	81	70
Balances with the Central Bank:		
Current account in BGN	4	1,124
Mandatory reserve deposit	4,511	4,696
Security fund	1	3
	4,516	5,823
Total cash and balances with the Central Bank	4,597	5,893

The deposits with the Central bank are not interest-bearing.



12. DUE FROM OTHER BANKS	2005 BGN'000	2004 BGN'000
Current accounts		
Local banks		
BGN	357	65
Foreign currency	152	389
Foreign banks		
Foreign currency	201	111
	710	565
Term deposits repayable within one month		
Local banks		
Foreign currency	3,385	2,083
	3,385	2,083
Term deposits repayable within 3 to 6 months		
Local banks		
BGN	-	2,073
	-	2,073
	4,095	4,721

Effective interest rates on amounts due from other banks	2005		2004	
The average interest rates applied to the current accounts are:				
	from	to	from	to
USD	0.20%	3.75%	0.30%	3.00%
EUR	0.20%	2.00%	0.30%	2.00%
BGN	0.75%	1.00%	0.75%	1.00%

The average interest rates applied to the term deposits are:				
BGN	1.85%	3.50%	0.30%	5.30%
EUR	1.90%	2.38%	1.55%	2.55%



13. LOANS AND ADVANCES TO CUSTOMERS	2005 BGN'000	2004 BGN'000
Loans	75,745	69,723
Allowances for loan impairment and uncollectability	(6,679)	(5,329)
	69,066	64,394
A. Analysis of loans by type of customers		
Companies and sole traders		
BGN	37,108	26,149
Foreign currency	38,386	43,458
	75,494	69,607
Individuals		
BGN	251	116
	75,745	69,723
B. Analysis of loans by sector of economy		
Manufacturing	28,530	34,360
Tourist services	15,588	17,935
Trade	15,565	8,981
Agriculture	8,180	4,965
Construction	4,168	1,967
Other industrial sectors	3,714	1,515
	75,745	69,723

The Bank provides funding mainly to small and medium-size businesses.



13. LOANS AND ADVANCES TO CUSTOMERS	2005 BGN'000	2004 BGN'000
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C. Maturity of loans

Up to 1 month	461	54
From 1 month to 3 months	2,156	1,134
From 3 months to 1 year	7,982	6,144
From 1 year to 3 years	17,297	8,284
From 3 years to 5 years	14,422	18,248
Over 5 years	33,427	35,859
	75,745	69,723

The loans denominated in BGN bear interest at floating rates. The interest rate is calculated at the official Central Bank base interest plus a set margin. At 31 December 2005 the effective margins vary from 5% to 12% p.a. (2004: from 6% to 12% p.a.).

The loans denominated in foreign currency (EUR) bear interest, which is calculated using the base interest rate determined by the Bank on the grounds of the cost of funds and a margin set individually for each customer. The Bank has the right to reconsider the base interest rate in accordance with change in the cost of funds. At 31 December 2005 the effective rates vary from 6.55% to 16% p.a. (2004: from 6.78% to 16%).

D. Movement in the allowances for loan impairment and uncollectability

	Specific allowances BGN'000	General allowances BGN'000	Total BGN'000
Balance at 31 December 2003	1,915	1,018	2,933
Allowance for loan impairment for the year	1,926	470	2,396
Balance at 31 December 2004	3,841	1,488	5,329
Allowance for loan impairment for the year	1,429	53	1,482
Write-offs	(132)	-	(132)
Balance at 31 December 2005	5,138	1,541	6,679



14. SECURITIES AVAILABLE-FOR-SALE	2005 BGN'000	2004 BGN'000
Government bonds in BGN	4,334	6,959
Government bonds in EUR (ZUNK bonds)	7,545	7,473
Unquoted equity shares	1,818	1,806
	13,697	16,238
Movement in securities available-for-sale		
At 1 January	16,238	24,854
Additions (purchases)	12	20
Disposals (sale and/or redemption)	(2,941)	(9,010)
Net valuation gain on remeasurement of securities available-for-sale at fair value	388	374
At 31 December	13,697	16,238

Fair value of government bonds

	Par value BGN'000	Fair value BGN'000	Accrued interest as at 31 Dec BGN'000	Interest rate	Maturity
2005					
Medium-term government bonds in BGN	1,500	1,562	46	6.50 % - 7 %	2006 - 2007
Long-term government bonds in BGN	2,320	2,649	77	7 % - 7.50 %	2009 - 2013
Government bonds in EUR (ZUNK bonds)	7,557	7,463	82	6-month EURIBOR	2019
	11,377	11,674	205		
2004					
Medium-term government bonds in BGN	4,000	4,129	107	5.75 % - 7 %	2005 - 2007
Long-term government bonds in BGN	2,320	2,646	77	7 % - 7.50 %	2009 - 2013
Government bonds in EUR (ZUNK bonds)	8,097	7,388	85	6-month EURIBOR	2019
	14,417	14,163	269		

As at 31 December 2005, securities with a carrying amount of BGN 5,858 thousand are blocked as a collateral for borrowed funds from the State Budget in the special account of the Ministry of Finance (2004: BGN 2,594 thousand).



14. SECURITIES AVAILABLE-FOR-SALE	Shares BGN'000	Par value BGN'000	Percentage in share capital BGN'000	Capital paid	Fair value
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Fair value of unquoted equity shares

Shares denominated in EUR	3	5,867	0.15%	1,173	1,765
Shares denominated in BGN	1,926	19	0.25%	19	41
Shares denominated in BGN	3	3	0.12%	3	12

The Bank owns shares in EUR in the European Investment Fund (EIF). They are presented at cost (acquisition price), which is accepted to be approximately their fair value at 31 December 2005 also due to the specific way of trading with them.

The not paid-in portion of the nominal value of the acquired shares of EIF is due after decision of the General Meeting of Shareholders.

The shares denominated in BGN are shares of Bankservice AD and Borika AD. Three shares of Borika AD were purchased in 2005 at the amount of BGN 12 thousand – this is a Bank Institution for Bank Cards Payments. Bankservice AD is the Bulgarian company, which develops and maintains the National Intra-bank Settlement System BISERA; the System for Electronic Budget Settlements SEBRA and the System for Prompt Cash Transfers EXPRESS M.



15. SECURITIES HELD- TO-MATURITY	Number of bonds	Par value EUR	Amortized cost BGN'000	Fair value BGN'000
Bonds denominated in EUR	100	1,000	197	200

In 2004 the Bank purchased 100 non-cash, interest-bearing, unsecured bonds from the first issue of Doverie United Holding AD, denominated in EUR. The amount of the debenture loan is EUR 1,360 thousand. The par value of the bonds is EUR 1,000. The loan maturity is after 60 months. Principal is paid in three equal portions on: 30 November 2007, 30 November 2008 and 30 November 2009. The bonds are with fixed interest rate of 6.75% p.a. The six-month interest coupons are payable in May and November. The bonds are presented at amortized cost.

16. PROPERTY AND – EQUIPMENT	Buildings	Bank equipment and computers	Furniture and fittings	Motor vehicles	Total
	BGN'000	BGN'000	BGN'000	BGN'000	BGN'000

Book value (cost)

At 1 January 2005	1,869	679	182	290	3,020
Additions	–	120	16	80	216
Disposals	–	–	–	–	–
At 31 December 2005	1,869	799	198	370	3,236

Accumulated depreciation

At 1 January 2005	133	401	75	60	669
Charge for the year	38	112	27	67	244
Disposals	–	–	–	–	–
At 31 December 2005	171	513	102	127	913

Net book value

At 31 December 2005	1,698	286	96	243	2,323
At 1 January 2005	1,736	278	107	230	2,351



17. INTANGIBLE ASSETS	License BGN'000	Software BGN'000	Total BGN'000
Book value (cost)			
At 1 January 2005	38	379	417
Additions		62	62
Disposals	–	(196)	(196)
At 31 December 2005	38	245	283
Accumulated depreciation			
At 1 January 2005	14	219	233
Charge for the year	8	69	77
Disposals	–	(130)	(130)
At 31 December 2005	22	158	180
Net book value			
At 31 December 2005	16	87	103
At 1 January 2005	24	160	184

The license represents the right for entrance and participation in the SWIFT system.

18. OTHER ASSETS	2005 BGN'000	2004 BGN'000
Prepayments and advances	76	156
Income tax receivable	–	246
Other assets	18	106
	94	508

At 31 December 2005 other assets include mainly: receivable on ZUNK installment payment for 2005 amounting to BGN 7 thousand (2004: BGN 47 thousand), assets acquired in 2004 against debt at the amount of BGN 8 thousand (2004: BGN 54 thousand) and guarantee deposits amounting to BGN 2 thousand (2004: BGN 5 thousand).

As at 31 December 2004 an income tax receivable has been reported at the amount of BGN 246 thousand which has arisen as a result of the change in the accounting policy (in 2004) related to the presentation of the remeasurement of the financial assets available-for-sale.



19. DUE TO OTHER BANKS	2005 BGN'000	2004 BGN'000
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Deposits from local banks

BGN	273	1,347
	273	1,347

Maturity of deposits:

Term deposits – within 1 month	–	1,000
Blocked deposits	273	347
	273	1,347

The average interest rates applied are:

	2005		2004	
	from	to	from	to
BGN	1.60%	2.35%	0.50%	3.70%
EUR	–	–	2.09%	2.09%
USD	–	–	1.57%	1.57%

20. DUE TO CUSTOMERS	2005 BGN'000	2004 BGN'000
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A. Analysis by type of customer

BGN	191	148
Foreign currency	55	132
	246	280

Companies and sole traders

BGN	2,396	2,847
Foreign currency	318	723
	2,714	3,570
	2,960	3,850

The amounts due to individuals represent deposits of the Bank's employees.



20. DUE TO CUSTOMERS

	2005 BGN'000	2004 BGN'000
B. Maturity of deposits		
Demand deposits		
BGN	2,163	1,945
Foreign currency	300	791
	2,463	2,736
Term deposits		
Up to 1 month:		
BGN	398	26
Foreign currency	72	61
	470	87
From 1 month to 1 year:		
BGN	26	1,024
Foreign currency	1	3
	27	1,027
	2,960	3,850

C. Interest rates

The interest rates applied to the customers' accounts in 2005 are:

	USD	EUR	BGN	GBP
Current accounts:	0.20%	0.10%	0.20%	0.00%
Term deposits:				
up to 1 month	2.10%	1.75%	1.75%	1.50%
up to 3 months	2.15%	1.85%	2.00%	1.70%
up to 6 months	2.20%	1.90%	2.10%	2.00%
up to 1 year	2.25%	1.95%	2.50%	2.50%

The interest rates applied to the customers' accounts in 2004 are:

	USD	EUR	BGN	GBP
Current accounts:	0.20%	0.10%	0.20%	0.00%
Term deposits:				
up to 1 month	1.80%	2.00%	2.00%	1.50%
up to 3 months	2.00%	2.10%	2.20%	1.70%
up to 6 months	2.10%	2.15%	2.50%	2.00%
up to 1 year	2.30%	2.20%	3.00%	2.50%



21. BORROWED FUNDS FROM INTERNATIONAL INSTITUTIONS	2005 BGN'000	2004 BGN'000
Long-term Global Loan from the European Investment Bank	15,885	18,020
Long-term Framework Loan Agreements with the Council of Europe Development Bank	29,458	29,457
Long-term loan from the Nordic Investment Bank Loan Agreement for a Revolving Pre-export Facility with the Black Sea Trade and Development Bank	1,912 –	– 2,066
	47,255	49,543

European Investment Bank

The Bank has signed a financial agreement (Global Loan Bulgaria – Encouragement Bank AD) with the European Investment Bank for EUR 10,000 thousand to be used for funding of small and medium-sized businesses. This contract is based on a framework agreement signed on 14 July 1997 between the European Investment Bank and the Republic of Bulgaria. The loan has been entirely utilised in tranches. As at 31 December 2005 the outstanding balance is EUR 8,112 thousand (2004: EUR 9,204 thousand). Interest is payable quarterly. The interest rate is determined at the beginning of each interest period on a quarterly EURIBOR basis. The effective interest rate as at 31 December 2005 is 2.56% (2004: 2.27%). The loan will be repaid in 22 semi-annual installments starting on 15 December 2003 until 15 June 2014. It is guaranteed by the Republic of Bulgaria.

Council of Europe Development Bank (CEB)

Framework Loan Agreements for EUR 10,000 thousand and EUR 5,000 thousand were signed on 2 January 2003 between the Council of Europe Development Bank (CEB), the Republic of Bulgaria represented by the Minister of Finance and Encouragement Bank AD. The loans have been drawn in tranches and as at 31 December 2005 the whole amount of EUR 15,000 thousand has been entirely utilised. Interest is payable on a quarterly basis. The interest rate is determined at the beginning of each interest period on the basis of quarterly EURIBOR plus 0.29% – 0.34%. At 31 December 2004 the effective interest rates are 2.477% – 2.781% (2004: 2.434% – 2.497%). The maturity of the loans is 10 years from the date of utilisation of the respective tranche. The principal amount is due bullet, at maturity. The loan agreement for the amount of EUR 10,000 thousand is guaranteed by the Republic of Bulgaria.



Nordic Investment Bank

On 16 November 2004 the Bank signed a Loan Agreement with the Nordic Investment Bank for a loan amounting to EUR 10,000 thousand. The repayment term for the loan is 10 years for each of the tranches utilised and a grace period of up to 2 years. The loan can be utilised in maximum 5 tranches each of them being for not less than EUR 1,000 thousand and not more than EUR 5,000 thousand. The deadline for utilising the loan is 15 December 2007. The purpose of the loan is the financing up to 50% of the expenses on investment projects of small and medium sized enterprises in Bulgaria for projects of mutual interest for Bulgaria and the NIB member countries. The Government of the Republic of Bulgaria has issued a Letter of Comfort accepted as a collateral for the credit line. As at 31 December 2005, the Bank has utilised one tranche of EUR 1,000 thousand with a repayment schedule from July 2007 till July 2015 at 17 equal installments. The interest rate is determined at the beginning of each interest period on the basis of six-month EURIBOR. The effective interest rate as at 31 December 2005 is 3.176%.

Black Sea Trade and Development Bank

A Loan Agreement was concluded on 4 May 2004 between the Bank and the Black Sea Trade and Development Bank for a revolving pre-export credit line at the amount of EUR 5,000 thousand. The credit line is intended for funding the export transactions of Bulgarian companies in the Black Sea region and beyond it. The repayment term for each of the tranches is up to 360 days. The loan is unsecured but Encouragement Bank is obliged to observe specific financial covenants and ratios. The maturities of the individual tranches fall within the period from 7 January 2005 to 15 September 2005. As at 31 December 2005, the credit line has been terminated and all tranches have been repaid.

22. OTHER BORROWED FUNDS

	2005 BGN'000	2004 BGN'000
Long-term refunding agreement with the State Fund Agriculture	2,607	4,866
KfW funds provided by MF for trust managements	3,665	501
	6,272	5,367



KfW funds provided by the Ministry of Finance for trust management

The Bank has concluded an agreement with the Ministry of Finance (MF) for management of funds granted to the Ministry by Kreditanstalt für Wiederaufbau pursuant to an agreement between the Governments of Bulgaria and Germany. These funds are advanced to other partner-banks intermediaries, for the purpose of financing small and medium-sized businesses. The Ministry retains the risk for the advances provided to the partner-banks.

The main responsibilities of the Bank in respect of the funds management include the following: selection of the banks – intermediaries, jointly with the Ministry of Finance, and transferring the funds to those approved; gathering of information and performance of periodic reviews regarding the funds utilization, establishing of a pledge on government securities on the part of the borrowers, monitoring of the timely payments of the interest and principal due and their repayment to the special account of the Ministry of Finance. At 31 December 2005 the total funds transferred to partner-banks amount to BGN 3,912 thousand (2004: BGN 6,806 thousand). They are secured with a pledge on government securities amounting to 50% of the funds provided. At 31 December 2005 the government securities pledged in favour of the Bank are at the amount of BGN 2,066 thousand (2004: BGN 3,057 thousand).

The Bank receives a management fee of 1% per annum. The calculation of the management fee is based on the total of funds advanced to the partner-banks plus the balance on the current account of the Fund with the Bank. The liability of BGN 3,665 thousand represents the balance of funds not yet transferred to partner-banks. The balance bears quarterly interest of 2% per annum.

Long-term refunding agreement with the State Fund Agriculture

Under a Contract, signed in 2002, with the State Fund Agriculture for re-financing special-purpose loans provided to farmers, the Fund has refinanced the Bank with its own funds for granting such loans in relation to investment projects and disclosed investment programs. The interest due by the Bank on the borrowed funds is 2% p.a. The loans granted by the Bank to the farmers are at 9% annual interest rate. The re-financing amount received from the Fund is BGN 72 thousand as at 31 December 2005 (2004 : BGN 130 thousand). In 2003, the Bank signed a contract and annexes thereto with State Fund Agriculture for re-financing loans granted by the Bank for the execution of approved projects under SAPARD program, for which agreements have been concluded for grant-based aid under the terms and conditions of the Special pre-accession program of EC for the development of agriculture and the rural areas in Bulgaria. The interest on the borrowed funds due by the Bank is 2% p.a. The Bank grants loans to farmers under the SAPARD program at 9% annual interest rate. The re-financing amount obtained from the Fund as at 31 December 2005 is BGN 2,531 thousand (2004: 4,736 thousand).



23. OTHER LIABILITIES

	2005 BGN'000	2004 BGN'000
Payables to personnel and for social security	180	128
Taxes payable	131	15
Accruals	57	06
Unamortised grant for the purchase of computer equipment	3	6
Other creditors	5	56
	376	311

The payables to personnel include the present value of the Bank's liability due on retirement benefit obligations as at 31 December 2005. Under the Labor Code each employee is entitled to indemnity at the amount of two gross monthly salaries upon retirement while if the service period with the Bank exceeds 10 years, the indemnity shall amount to six gross monthly salaries.

An actuarial valuation was carried out by the Bank using the services of a certified actuary in order to determine the amount of these liabilities. On the basis of the actuarial report, a liability was included in the balance sheet as at 31 December 2005 at the amount of BGN 56 thousand (2004: BGN 48 thousand).

Present value of the liability at 1 January	51	40
Unrecognized actuarial loss at 1 January	(3)	-
Liability recognized in the balance sheet at 1 January	48	40
Expenses for the period	8	8
Liability recognized in the balance sheet at 31 December	56	48
Unrecognized actuarial loss at 31 December	(5)	(3)
Present value of the liability at 31 December	61	51

The following actuarial assumptions were used on determination of the value as at 31 December 2005:

- mortality rate - in accordance with the table issued by the National Statistics Institute for the total mortality rate of the population in Bulgaria for the period 1998 - 2001;
- staff turnover rate - from 0% to 10% for the four age groups formed with the Bank;
- discount factor - a rate based on the effective annual interest rate $i = 7\%$ has been used which corresponds to an annual discount rate $d = 6.54\%$. It is grounded on the market yield on the long-term government bonds (with 10 years maturity). Their effective yield is within 5% effective annual rate (as per the BNB bulletin). Considering that the average term to pensioning is longer than 10 years the discount rate has been established through extrapolation;
- the assumption for the future level of the salaries is based on the information provided by the Bank's management and amounts to 10% annual growth for 2006 against 2005 and 5% for each subsequent year compared to the prior reporting period has been envisaged.



24. DEFERRED TAX LIABILITIES	2005 BGN'000		2004 BGN'000	
	Temporary difference	Tax	Temporary difference	Tax
Deferred tax assets				
Property and equipment	91	14	36	5
Payables to personnel	195	29	203	31
Total deferred tax assets	286	43	239	36
Deferred tax liabilities				
Unrealised gains from remeasurement of available-for-sale securities	1,590	239	1,134	170
Total deferred tax liabilities	1,590	239	1,134	170
Net deferred tax liabilities	1,304	196	895	134

25. SHARE CAPITAL	2005 BGN'000		2004 BGN'000	
Share capital				
295,735 ordinary personal voting shares of BGN 100 nominal value each				
Issue of ordinary shares for cash fully paid		27,964		27,964
Issue of ordinary shares – contribution-in-kind (Bank's building)		1,610		1,610
		29,574		29,574

The Bank did not issue new shares in 2005.



26. RESERVES

In accordance with the Bank Law, the Bank is obliged to allocate at least one fifth of its profit after taxes and before distribution of dividends, for establishing the statutory Reserve Fund until the moment when the Reserve reaches the amount of 1.25 percent of the total balance sheet assets and off-balance sheet commitments.

The Bank can use the Reserve Fund to cover current or prior period losses.

In 2005, on allocating the profit for 2004, the Bank fulfilled the requirement regarding the formation of the Reserve Fund.

Following decision of the General Meeting of Shareholders of 3 May 2005, the Bank has set aside additional reserves with the remaining part of the 2004 profit after the transfer of the amounts to the statutory Reserve Fund and allocation of dividends.

27. CONTINGENT LIABILITIES AND COMMITMENTS	Contract amount 2005 BGN'000	Contract amount 2004 BGN'000
Contingent liabilities		
Bank guarantees and letters of credit	1,085	2,104
Irrevocable commitments		
Undrawn loans	7,937	10,128
Uncalled nominal portion of EIF shares (Note 14)	4,694	4,694
	12,631	14,822
	13,716	16,926

Nature of instruments and credit risk

These commitments and contingent liabilities bear an off-balance sheet credit risk because only fees are recognised in the financial statements until the commitments are fulfilled or expire. The amounts reflected in the above table for guarantees represent the maximum accounting loss that would be recognised at the balance sheet date if counterparties failed completely to perform as contracted. Many of the contingent liabilities and commitments will expire without being advanced fully or partially. Therefore, the amounts do not represent expected future cash flows. The collateral coverage ratio for guarantees is over 100% and represents deposits blocked at the Bank, mortgages of real estate and insurance policies issued in favour of the Bank.



28. CASH AND CASH EQUIVALENTS

	2005 BGN'000	2004 BGN'000
Cash and cash equivalents include:		
Cash in hand	81	70
Current account with the Central Bank	4	1,124
Amounts due from other banks, with less than 90 days maturity	4,095	2,648
	4,180	3,842

29. BANK REGULATORS IN ACCORDANCE WITH THE BULGARIAN LEGISLATION

According to the requirements of the banking legislation effective in Bulgaria and the instructions of the Bulgarian National Bank (BNB) in its capacity of a Central Bank, Encouragement Bank AD shall observe certain restrictions related to the following ratios:

Total capital adequacy ratio

The Bank calculates its total capital adequacy ratio as a percentage of its net capital base to the total risk weighted assets. The capital base includes the registered share capital, the Reserve Fund and the other reserves up to a particular amount. The total risk weighted assets include the balance sheet and off-balance sheet exposures (items) as reported, weighted in accordance with their risk. The reported capital adequacy ratio level at 31 December 2005 is 41.54% (2004: 40.69%). The minimum capital adequacy ratio required by law is 12 %.

Minimum share capital

As at 31 December 2005, the Bank's share capital is BGN 29,574 thousand (2004: BGN 29,574 thousand) and it has met the Central Bank (BNB) requirements for a minimum capital of BGN 10,000 thousand.

Other regulatory ratios

Capital base to open foreign currency positions – the maximal ratio is up to 30% for all foreign currency positions and respectively, up to 15% for each foreign currency position with the exception of those in EUR;

Capital base to large risk exposures – the total amount of all large loans cannot exceed 8 times the Bank's capital base. The exposure to a borrower or related parties cannot exceed 25% of the Bank's capital base;

Liquid assets to net cash flows – the Central Bank (BNB) monitors the amount and composition of the Banks' liquid assets and when necessary, determines minimal liquidity ratio for each bank, which shall be reached within a defined term as a percentage of the liquid assets to the funds attracted;



Capital base to the amount of property, equipment and shares in non-financial institutions – the investments cannot exceed the Bank's capital base while only those in property and equipment can amount up to 50% of the capital base.

As at 31 December 2005 the Bank has complied with all regulatory requirements of the Central Bank and Bulgarian legislation.

30. RISK MANAGEMENT

In the ordinary course of business, the Bank is exposed to a variety of risks the most important of which are credit risk, market risk and liquidity risk. These risks are identified, measured and monitored through various control mechanisms in order to price facilities and bank products on a risk adjusted basis and to prevent undue risk concentrations.

Credit risk

Credit risk is the risk that customers will fail to repay to the Bank the amounts due in full and within the set term.

The management of specific credit risk is performed by the Credit Committee of the Bank and is supervised by both the Management and the Supervisory Boards. The credit risk management function ensures that appropriate policies are established and ensures its compliance with the related credit monitoring procedures and controls. Exposure to credit portfolio risk is managed through regular analysis of the ability of borrowers to meet interest and capital repayment obligations and by establishing lending limits as appropriate. Exposure to credit risk is also reduced in part by obtaining different types of collateral. In addition, on 24 June 2003 the Bank signed a guarantee letter with the European Investment Fund (EIF) for participation in the EU SME Guarantee Facility under conditions determined by the long-term EU program on SMEs. EIF on its part is committed to provide a guarantee covering 50% of the loss on the principal and interest of each loan, included in the sub-portfolio of the Bank, formed on the basis of the conditions of the agreement, but not exceeding EUR 840 thousand. The maximal amount of the loans granted, which will be covered by the EIF guarantee, is EUR 14,000 thousand.

With an Annex to the guarantee letter with the EIF dated 2 July 2004, the guarantee facility provided to the Bank under the EC Multiannual Programme for Enterprise and Entrepreneurship of the European Commission was increased from EUR 7,000 thousand to EUR 21,000 thousand. The utilisation term for the guarantee facility was extended until 30 June 2007 by means of an Annex of 31 December 2005. The guarantee provided is partial and covers 50% of the newly approved investment credits of the Bank with a term exceeding 36 months as formed within the availability period of the facility (i.e. by 30 June 2007). EIF's payment commitment amounts to 12% of the guarantees issued – up to EUR 2,520 thousand. Against the guarantees issued the Bank has undertaken to decrease its collateral requirements for loans included in the portfolio and guaranteed by the EIF.



The Bank is exposed to risk due to the concentration in small and medium sized businesses and in long-term loans with maturity of mainly 3 to 10 years.

The primary purpose of the instruments in the form of guarantees and letters of credit is to ensure that funds are available to a customer as required. Guarantees and letters of credit, which represent irrevocable commitments that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to extend credit represent undrawn portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit the Bank is potentially exposed to loss in an amount equal to the total undrawn commitments. However, the likely amount of loss is less than the total unused commitment since most commitments to extend credits are contingent upon customers maintaining specific credit standards. The Bank monitors on a current basis the utilization periods of credit commitments because longer-term commitments generally have a greater degree of credit risk than the shorter-term commitments.

Market risk

Market risk is the risk of adverse movements in the level of interest rates, in the rate of exchange between currencies and the market price of securities and other financial instruments. Accordingly, these movements may affect the Bank's profitability.

The Bank is always exposed to the effects of fluctuations in the prevailing levels of market interest rates which impacts its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

Interest rates on assets and liabilities denominated in BGN are based on the movements of the basic interest rate as determined by the the Central Bank (BNB) and the fluctuations are to a certain extent relatively predictable. The Bank monitors constantly interest rate movements in foreign currencies, the mismatch in interest rate levels and in the maturity structure of its assets and liabilities. It also monitors the price changes and the yields of the traded government securities. Market risk is actively monitored by the Analysis Department to ensure compliance with market risk limits. The Bank's market risk exposure is monitored on a current basis by its Assets and Liabilities Committee.

The table below summarises the Bank's exposure to interest rate risks. Information on the Bank's assets and liabilities at their carrying amounts and as categorised by maturity dates and their sensitivity to the interest rate floatations has been provided in the table below.



30. RISK MANAGEMENT

The table below summarises the Bank's exposure to interest rate risks. Information on the Bank's assets and liabilities at their carrying amounts and as categorised by maturity dates and their sensitivity to the interest rate floatations has been provided in the table below.

Interest rate risk analysis	Fixed interest rate instruments						
	Floating interest rate instruments	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2005							
Assets							
Interest bearing assets							
Due from other banks	710	3,385	-	-	-	-	4,095
Loans and advances to customers	50,944	-	18,122	-	-	-	69,066
Securities available-for-sale	7,545	-	-	-	3,703	631	11,879
Securities held-to-maturity	-	-	-	-	197	-	197
	59,199	3,385	18,122	-	3,900	631	85,237
Non-interest bearing assets							8,935
Total assets	59,199	3,385	18,122	-	3,900	631	94,172
Liabilities							
Interest bearing liabilities							
Due to other banks	-	273	-	-	-	-	273
Due to customers	-	2,589	11	12	3	-	2,615
Borrowed funds from international institutions		1,912	45,343				47,255
Other borrowed funds	-	-	-	-	2,607	3,665	6,272
	-	4,774	45,354	12	2,610	3,665	56,415
Non-interest bearing liabilities							917
Total liabilities	-	4,774	45,354	12	2,610	3,665	57,332
Interest sensitivity gap	59,199	(1,389)	(27,232)	(12)	1,290	(3,034)	



	Floating interest rate instruments	Fixed interest rate instruments					Total
		Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	
As at 31 December 2004							
Assets							
Interest bearing	34,687	-	39,828	2,073	6,539	617	81,671
Non-interest bearing							10,742
	34,687	-	39,828	2,073	6,539	617	92,413
Liabilities							
Interest bearing	-	5,837	47,520	27	4,866	501	58,751
Non-interest bearing							1,801
	-	5,837	47,520	27	4,866	501	60,552
Interest sensitivity gap	34,687	(5,837)	(7,692)	2,046	1,673	116	

Currency risk

The currency risk is the risk of adverse impact of fluctuations in the prevailing foreign currency exchange rates on the Bank's financial position and cash flows. The net position in any currency is monitored on a continuous basis by the Assets and Liabilities (Liquidity) Committee. The major part of the Bank's assets and liabilities are denominated in EUR and since the BGN is fixed to the EUR there is no significant exchange rate risk related thereto. The table below summarizes the Bank's exposure to foreign currency exchange rate risk. Included in the table are the Bank's assets and liabilities at carrying amount, categorized by currency.



Foreign currency position analysis

At 31 December 2005	In USD	In EUR	In other foreign currency	In BGN	Total
	BGN '000	BGN '000	BGN '000	BGN '000	BGN '000
Assets					
Cash and balances with the Central Bank	12	14	-	4,571	4,597
Due from other banks	59	3,570	109	357	4,095
Loans and advances to customers	-	34,921	-	34,145	69,066
Securities available-for-sale	-	9,310	-	4,387	13,697
Securities held-to-maturity	-	197	-	-	197
Property and equipment	-	-	-	2,323	2,323
Intangible assets	-	-	-	103	103
Other assets	-	-	-	94	94
Total assets	71	48,012	109	45,980	94,172
Liabilities					
Due to other banks	-	-	-	273	273
Due to customers	63	288	22	2,587	2,960
Funds borrowed from international institutions	-	47,255	-	-	7,255
Other borrowed funds	-	3,665	-	2,607	6,272
Other liabilities	1	26	-	349	376
Deferred tax liabilities	-	-	-	196	196
Total liabilities	64	51,234	22	6,012	57,332
Net balance sheet position	7	(3,222)	87	39,968	36,840
Contingent liabilities and commitments	-	7,150	-	6,566	13,716
As at 31 December 2004					
Total assets	129	51,725	15	42,094	93,963
Total liabilities	122	50,835	14	9,581	60,552
Net balance sheet position	7	890	1	32,513	33,411
Contingent liabilities and commitments	15	10,582	-	6,329	16,926



30. RISK MANAGEMENT

Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its current and potential payment obligations as and when they fall due without unacceptable losses.

The Bank's business requires a stable flow of funds both to replace existing deposits as they mature and to satisfy demands of customers for additional borrowing. Undrawn borrowing facility commitments and the level of outstanding contingent obligations are taken into consideration in monitoring the Bank's liquidity position.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched. An unmatched position potentially enhances profitability, but also increases the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates. To manage this risk, the Bank maintains at all times highly liquid assets in different currencies. The overall liquidity control and monitoring are performed by the Asset and Liability (Liquidity) Committee.

The table below analyses assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at balance sheet date to the remaining maturity.



Maturity analysis

	Floating interest rate instruments	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
As at 31 December 2005							
Assets							
Cash and balances with the Central Bank	4,597	-	-	-	-	-	4,597
Due from other banks	4,095	-	-	-	-	-	4,095
Loans and advances to customers	1,010	2,687	18,636	34,302	12,431	-	69,066
Securities available-for-sale	746	-	512	5,441	5,180	1,818	13,697
Securities held-to-maturity	-	-	1	196	-	-	197
Property and equipment	-	-	-	-	-	2,323	2,323
Intangible assets	-	-	-	-	-	103	103
Other assets	8	14	69	3	-	-	94
Total assets	10,456	2,701	19,218	39,942	17,611	4,244	94,172
Liabilities							
Due to other banks	273	-	-	-	-	-	273
Due to customers	2,867	31	62	-	-	-	2,960
Borrowed funds from international institutions	1	39	2,237	9,331	35,647	-	47,255
Other borrowed funds	76	185	4,055	1,225	731	-	6,272
Other liabilities	39	-	215	122	-	-	376
Deferred tax liabilities	-	-	-	196	-	-	196
Total liabilities	3,256	255	6,569	10,874	36,378	-	57,332
Net liquidity gap	7,200	2,446	12,649	29,068	(18,767)	4,244	36,840
Contingent liabilities and commitments	2,336	2,220	2,208	2,257	1	4,694	13,716
As at 31 December 2004							
Total assets	9,397	6,763	10,913	28,709	34,363	4,341	94,486
Total liabilities	4,912	473	5,025	12,408	37,734	-	60,552
Net liquidity gap	4,485	6,290	5,888	16,301	(3,371)	4,341	33,934
Contingent liabilities and commitments	1,093	1,276	9,038	825	-	4,694	16,926



31. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value is generally the amount for which an asset could be exchanged or a liability settled in an arm's length transaction. The policy of the Bank is to disclose in its financial statements the fair value of the financial assets and liabilities for which quoted market prices are available.

The concept of fair value assumes realisation of financial instruments through sale. However, in the majority of cases, particularly in respect of loans and deposits, the Bank expects to realise assets through their collection (repayment) in full over time.

Many assets and liabilities are either short-term in nature or are carried at their market value (placements, deposits from banks, investments in securities) to the balance sheet and therefore, their fair value is equal to their carrying amount.

Sufficiently developed market, with stability and liquidity for specific purchases and sales of some financial assets and liabilities is still not in place in the country and published market price quotations for these assets are not readily available.

The management of the Bank is of the opinion that the amounts of the financial assets and liabilities reported in the balance sheet are as reliable, adequate and valid for the purposes of financial reporting as possible under the circumstances.

32. RELATED PARTY TRANSACTIONS

	Notes	2005 BGN'000	2004 BGN'000
Related party balances in the balance sheet:			
Key management personnel deposits	20	125	59
Funds under trust management received from the Ministry of Finance	22	3,665	501
Related party transactions:			
Fee and commission income	4	75	72
Interest expense on funds under trust management	3	(14)	(9)
Interest expense on key management personnel deposits	3	3	2
Key management personnel compensations:			
Short-term remunerations and other related benefits	9	429	429



33. POST BALANCE SHEET EVENTS

General Meeting of the Shareholders

General Meeting of the Shareholders was held on 1 February 2006 where a decision was taken for deleting the names of Dimitar Hadjinikovlov and Iliya Lingorski from the list of the members of the Supervisory Board and for entry of the names of Nina Radeva and Kiril Ananiev therein. The approved changes have been entered in the Bank's file with a Decision No. 21 of 23 February 2006 of Sofia City Court.

