Banka Kombetare Tregtare sh.a.

Independent Auditors' Review Report
and
Consolidated Interim Financial Information as at
30 June 2010

Contents

KPMG Albania Sh.p.k
"Deshmoret e Kombit" Blvd
Twin Towers Buildings
Building 1, 13th floor
Tirana, Albania
NIPT J91619001D

Telephone +355 (4) 2274 524
+355 (4) 2274 534
Telefax +355 (4) 2235 534
E-mail al-office@kpmg.com
Internet www.kpmg.al

Independent Auditors' Report on Review of Interim Financial Statements

To the shareholder and management of
Banka Kombetare Tregtare sh.a.

Tirana, 27 July 2010

Introduction

We have reviewed the accompanying consolidated statement of financial position of Banka Kombetare Tregtare sh.a. ("the Bank") as at 30 June 2010, the consolidated statements of comprehensive income, changes in equity and cash flows for the six-month period then ended, and notes, comprising a summary of significant accounting policies and other explanatory information (the consolidated interim financial statements). Management is responsible for the preparation and fair presentation of these consolidated interim financial statements in accordance with IAS 34, 'Interim Financial Reporting'. Our responsibility is to express a conclusion on these consolidated interim financial statements based on our review.

Scope of Review

We conducted our review in accordance with the International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Basis for Qualified Conclusion

As explained in Note 3 (b), the Bank has treated its share capital issued in United States Dollars as a monetary item and recognized the revaluation difference during the six-month period ended 30 June 2010 within net profit in the consolidated statement of comprehensive income. This treatment is not in accordance with IAS 21, 'The Effects of Changes in Foreign Exchange Rates'. Share capital should be treated as a non-monetary item and carried at the exchange rate at the date of transaction. Accordingly, if share capital had been treated as a non-monetary item, the effect as of 30 June 2010 would have been to increase the retained earnings and to reduce the translation reserve by USD 8,965,458. The net profit for the six-month period ended 30 June 2010 would have been increased by USD 12,253,493. This would not effect total shareholder's equity.

Qualified Conclusion

Based on our review, with the exception of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the accompanying consolidated interim financial statements do not give a true and fair view of the financial position of the Bank as at 30 June 2010, and of its financial performance and its cash flows for the six-month period then ended in accordance with IAS 34, 'Interim Financial Reporting'.

KPMG Albania Shpk

KPMG Albania Sh.p.k.
"Deshmoret e Kombit" Blvd.
Twin Towers Buildings
Building 1, 13th floor
Tirana, Albania

Consolidated interim statement of financial position as at 30 June 2010

(amounts in USD, unless otherwise stated)

	Notes	30 June 2010	31 December 2009
Assets			
Cash and balances with Central Bank	7	127,953,062	142,263,329
Placement and balances with banks	8	93,305,742	132,642,747
Treasury bills	9	252,539,237	255,640,833
Investment securities available-for-sale	10	54,108,220	49,520,063
Investment securities held-to-maturity	11	193,904,644	194,965,671
Loans and advances to banks	12	51,077,249	45,487,888
Loans and advances to customers	13	481,997,427	494,271,286
Property and equipment	14	15,800,768	19,371,484
Intangible assets	15	1,596,611	1,518,375
Non – current assets held for sale	16	1,800,567	1,297,477
Other assets	17	2,756,328	3,062,500
Total assets		**1,276,839,855**	**1,340,041,653**
Liabilities and shareholders' equity			
Liabilities			
Customer deposits	18	1,101,255,514	1,167,146,858
Due to banks	19	60,221,105	69,175,055
Due to third parties	20	1,125,546	456,415
Deferred tax liabilities	21	937,701	736,954
Accruals and other liabilities	22	8,007,195	7,855,717
Total liabilities		**1,171,547,061**	**1,245,370,999**
Shareholders' equity			
Share capital	23	84,622,200	78,299,000
Translation reserve	23	(953,412)	(209,293)
Fair value reserve	23	748,322	56,674
Retained earnings	23	20,875,684	16,524,273
Total shareholders' equity		**105,292,794**	**94,670,654**
Total liabilities and shareholders' equity		**1,276,839,855**	**1,340,041,653**

The consolidated interim statement of financial position is to be read in conjunction with the notes to and forming part of the consolidated financial information set out on pages 6 to 55.

The consolidated interim financial statements were authorised for release by the Board of Directors on 27 July 2010 and signed on its behalf by:

Seyhan Pencapligil
CEO and Board Member

Skender Emini
Head of Financial Control

Consolidated interim statement of comprehensive income for the six-month and three-month periods ended 30 June 2010 and 2009

(amounts in USD, unless otherwise stated)

	Notes	Six-month period ended 30 June 2010	Three-month period ended 30 June 2010	Six-month period ended 30 June 2009	Three-month period ended 30 June 2009
Interest					
Interest income	24	49,575,899	24,599,954	37,612,248	19,339,974
Interest expense	25	(24,372,513)	(11,823,555)	(21,206,697)	(10,928,064)
Net interest margin		**25,203,386**	**12,776,399**	**16,405,551**	**8,411,910**
Non-interest income, net					
Fees and commissions, net	26	2,363,117	1,000,682	2,534,126	1,424,122
Foreign exchange revaluation gain/(loss), net	27	2,356,839	1,087,237	1,550,861	(714,650)
Profit from FX trading activities, net		904,650	469,808	1,005,727	528,715
Other income/(expense), net	28	19,876	(48,361)	(125,210)	(147,623)
Total non-interest income, net		**5,644,482**	**2,509,366**	**4,965,504**	**1,090,564**
Operating expenses					
Personnel	29	(6,026,604)	(2,865,857)	(5,879,903)	(3,039,079)
Administrative	30	(7,027,980)	(3,443,455)	(5,812,431)	(2,925,077)
Depreciation and amortization	14, 15	(2,042,114)	(986,311)	(1,888,367)	(980,449)
Total operating expenses		**(15,096,698)**	**(7,295,623)**	**(13,580,701)**	**(6,944,605)**
Impairment of loans	13	(1,641,994)	(899,223)	(961,831)	62,188
Profit before taxes		**14,109,176**	**7,090,919**	**6,828,523**	**2,620,057**
Income tax	31	(1,420,632)	(670,910)	(708,001)	(274,959)
Net profit for the period		**12,688,544**	**6,420,009**	**6,120,522**	**2,345,098**
Foreign currency translation differences		(744,119)	(758,533)	1,068,027	256,540
Net change in fair value reserves		691,648	(752,076)	282,520	82,877
Other comprehensive income for the period, net of income tax		**(52,471)**	**(1,510,609)**	**1,350,547**	**339,417**
Total comprehensive income for the period		**12,636,073**	**4,909,400**	**7,471,069**	**2,684,515**

The consolidated interim statement of comprehensive income is to be read in conjunction with the notes to and forming part of the consolidated financial information set out on pages 6 to 55.

Consolidated interim statement of changes in equity for the six-month period ended 30 June 2010

(amounts in USD, unless otherwise stated)

	Share capital	Translation reserve	Fair value reserve	Retained earnings	Total
Balance as at 1 January 2009	**63,400,000**	**(829,955)**	**(198,883)**	**21,483,347**	**83,854,509**
Transactions with owners recorded directly in equity					
Contributions by and distributions to owners					
Increase in share capital	14,899,000	-	-	(14,899,000)	-
Appropriation of 2008 year translation difference	-	-	-	(829,955)	(829,955)
Adjustment of retained earnings with 2009 year end exchange rate	-	-	-	(2,273,704)	(2,273,704)
Total contributions by and distributions to owners	14,899,000	-	-	(18,002,659)	(3,103,659)
Total comprehensive income for the year					
Net profit for the year	-	-	-	13,043,585	13,043,585
Other comprehensive income, net of income tax					
Net change in fair value reserves	-	-	255,557	-	255,557
Foreign currency translation differences	-	620,662	-	-	620,662
Total other comprehensive income	-	620,662	255,557	-	876,219
Total comprehensive income for the year	-	620,662	255,557	13,043,585	13,919,804
Balance as at 31 December 2009	**78,299,000**	**(209,293)**	**56,674**	**16,524,273**	**94,670,654**

Consolidated interim statement of changes in equity for the six-month period ended 30 June 2010

(amounts in USD, unless otherwise stated)

	Share capital	Translation reserve	Fair value reserve	Retained earnings	Total
Balance as at 1 January 2010	**78,299,000**	**(209,293)**	**56,674**	**16,524,273**	**94,670,654**
Transactions with owners recorded directly in equity					
Contributions by and distributions to owners					
Increase in share capital	6,323,200	-	-	(6,323,200)	-
Appropriation of 2009 year translation difference	-	-	-	(209,293)	(209,293)
Adjustment of retained earnings with June 2010 exchange rate	-	-	-	(1,804,640)	(1,804,640)
Total contributions by and distributions to owners	6,323,200	-	-	(8,337,133)	(2,013,933)
Total comprehensive income for the period					
Net profit for the period	-	-	-	12,688,544	12,688,544
Other comprehensive income, net of income tax					
Net change in fair value reserve	-	-	691,648	-	691,648
Foreign currency translation differences	-	(744,119)	-	-	(744,119)
Total other comprehensive income	-	(744,119)	691,648	-	(52,471)
Total comprehensive income for the period	-	(744,119)	691,648	12,688,544	12,636,073
Balance as at 30 June 2010	**84,622,200**	**(953,412)**	**748,322**	**20,875,684**	**105,292,794**

The consolidated interim statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial information set out on pages 6 to 55.

Consolidated interim statement of cash flows for the six-month periods ended 30 June 2010 and 2009

(amounts in USD, unless otherwise stated)

	Notes	Six-month period ended 30 June 2010	Six-month period ended 30 June 2009
Cash flows from operating activities:			
Profit before taxes		14,109,176	6,828,523
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Interest expense	25	24,372,513	21,206,697
Interest income	24	(49,575,899)	(37,612,248)
Depreciation and amortization	14, 15	2,042,114	1,888,367
Gain on sale of property and equipment		(20,836)	(3,034)
Gain on sale of treasury bills		(38,309)	(9,441)
Gain on recovery of lost loans		(5,685)	-
Write-off of property and equipment		2,891	1,169
Loss on unrecoverable lost loans		82,086	139,377
Movement in the fair value reserve		749,140	259,052
Deferred tax movement	21	325,644	391,981
Impairment of loans	13	1,641,994	961,831
Cash flows from operating profits before changes in operating assets and liabilities		(6,315,171)	(5,947,726)
(Increase)/decrease in operating assets:			
Placements and balances with banks		22,237,400	(26,161,732)
Loans and advances to banks		(12,839,493)	-
Loans and advances to customers		(60,553,172)	(22,623,860)
Other assets		(1,056,857)	(1,527,819)
		(52,212,122)	(50,313,411)
Increase/(decrease) in operating liabilities:			
Customer deposits		100,023,838	4,750,350
Due to third parties		785,064	(526,175)
Accruals and other liabilities		1,342,036	919,154
		102,150,938	5,143,329
Interest paid		(19,654,605)	(18,329,185)
Interest received		42,717,374	34,882,836
Income taxes paid		(1,223,767)	(1,266,632)
Net cash flows from/(used in) operating activities		65,462,647	(35,830,789)
Cash flows from investing activities			
Purchases of investment securities		(40,220,158)	(4,850,154)
Purchases of treasury bills		(36,539,307)	(11,589,482)
Purchases of property and equipment		(1,424,927)	(3,372,834)
Proceeds from sale of property and equipment		3,175	1,165
Proceeds from sale of treasury bills		5,813,482	4,848,270
Net cash used in investing activities		(72,367,735)	(14,963,035)
Cash flows from financing activities			
Proceeds from short term borrowings		792,528	43,776,360
Net cash from financing activities		792,528	43,776,360
Net decrease in cash and balances with Central Bank		**(6,112,560)**	**(7,017,464)**
Translation difference		(8,197,707)	(5,270,507)
Cash and Central Bank at the beginning of the year	**7**	**142,263,329**	**137,037,501**
Cash and Central Bank at the end of the six months	**7**	**127,953,062**	**124,749,530**

The consolidated interim statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial information set out on pages 6 to 55.

1. General

Banka Kombetare Tregtare Sh.a. (the "Bank" or "BKT") is a commercial bank offering a wide range of universal services. The Bank provides banking services to state and privately owned enterprises and to individuals in Albania and in Kosovo. The main sources of funding for the Bank are deposits, which are accepted in various forms including current accounts, demand and term deposits, in both Lek and foreign currency. BKT offers: a variety of corporate and consumer loans, EMV-compliant debit and credit cards, ATMs, internet banking, on-line banking facilities, qualified international banking services and various treasury products. It also invests in government securities and takes part actively in the local and international inter-bank markets.

BKT was established in its present legal form on 30 December 1992, although some of its branches date back to the 1920s. BKT is subject to Law no. 8269 "On the Bank of Albania" dated December 1997 and Law no. 9662 "On Banks on the Republic of Albania", dated 18 December 2006.

Upon the Shareholder's Decision dated 31 March 2010, the Bank increased its paid-up capital by USD 6,323,200 (equivalent of Lek 653,249,792), using part of the retained earnings from the year 2009. The capital increase was translated into USD using the exchange rate published by Bank of Albania as at 31 March 2010 (103.31 Lek per USD).

Following this increase, the shareholding structure remained the same as did the nominal value of shares at USD 12.35, while the number of shares increased by 512,000. The shareholding structure as at 30 June 2010 and 31 December 2009 was as follows:

	30 June 2010			*31 December 2009*		
	No. of shares	**Total in USD**	**%**	**No. of shares**	**Total in USD**	**%**
Calik Finansal Hizmetler A.S.	6,852,000	84,622,200	100	6,340,000	78,299,000	100

The headquarters of BKT is located in Tirana. Currently in Albania, the Bank has a network of 27 branches, 25 agencies and 3 custom agencies. Eleven of the branches are in Tirana, while the others are located in Durres, Elbasan, Korca, Gjirokastra, Vlora, Lushnja, Shkodra, Fier, Berat, Pogradec, Saranda, Lezha, Kukes, Peshkopi, Fushe Kruja and Kavaja. Similarly, most of the agencies are in Tirana (eight of them), whereas the others are located in Kamza, Vora, Bilisht, Delvina, Lac, Rreshen, Shkozet, Bushat, Koplik, Librazhd, Peqin, Rrogozhina, Durres (two agencies), Orikum, Kucove and Fier, followed by custom agencies in Kakavija, Durres Seaport and Rinas Airport. During 2010, the Bank opened two new agencies in Albania, while one custom agency was closed and two branches were merged.

BKT also holds a branch in Kosovo having a network of 12 units. Four are located in Prishtina, whereas the others are in Prizren, Peja, Ferizaj, Podujeva, Gjilan, Drenas, Rahovec and Gjakova.

The Bank had 863 employees as at 30 June 2010 (31 December 2009: 854), out of which 137 (31 December 2009: 129) employees belong to Kosovo Branch.

2. Basis of preparation

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standard 34 (IAS 34) ’Interim Financial Reporting’.

(b) Basis of measurement

The consolidated interim financial information have been prepared on the historical cost basis except for available-for-sale financial assets, which are measured at fair value and assets held for sale, which are measured at the lower of carrying amount and fair value less costs to sell.

(c) Functional and presentation currency

This consolidated interim financial information is presented in USD. Albanian Lek (“Lek”) is the Bank’s functional currency.

The Bank has chosen to present its financial information in USD, as its equity is wholly owned by international investors, who have issued the start-up capital in USD and view the performance of the investment in terms of USD.

(d) Use of estimates and judgements

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

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

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described in notes 4 and 5.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Bank entities.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities (branches) controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances.

On September 3, 2007 BKT opened its first branch outside of the territory of the Republic of Albania. The Administrative Office of this branch was opened in Prishtina, Kosovo.

3. Significant accounting policies (continued)

(a) Basis of consolidation (continued)

(ii) Transactions eliminated on consolidation

Intra-group balances, and income and expenses (except for foreign currency transaction gains or losses) arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(b) Foreign currency

(i) Foreign currency transactions

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

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historic cost, are translated at the foreign exchange rate ruling at the date of the transaction, with the exception of the share capital, which is issued and maintained in USD as per the legislation in Albania as well as per Special Law No. 8634, dated 6 July 2000, between the Bank's shareholders and the Republic of Albania on the Bank's privatisation.

Furthermore, the Operating Policy Guidelines of the Bank require that the share capital be hedged by USD assets, and it is therefore treated as a monetary item, with the revaluation difference being taken to the profit and loss account together with the revaluation difference of the corresponding USD asset, which offset each other in a natural hedge.

(ii) Foreign operations

The assets and liabilities of foreign operations are translated into Lek at spot exchange rates at the reporting date. The income and expenses of foreign operations are translated into Lek at spot exchange rates at the dates of the transactions. Foreign currency differences on the translation of foreign operations are recognised directly in other comprehensive income. Such differences have been recognised in the foreign currency translation reserve.

(iii) Translation of financial statements from functional currency to presentation currency

Translation of financial statements from functional currency to presentation currency is done as follows:

- assets and liabilities for each statement of financial position presented (including comparatives) are translated at the closing rate at the date of that statement of financial position.
- income and expenses in the profit and loss (including comparatives) are translated at exchange rates at the dates of the transactions.
- equity items other than the net profit for the period and share capital are translated at the closing rate existing at the reporting date.

3. Significant accounting policies (continued)

(b) Foreign currency (continued)

(iii) Translation of financial statements from functional currency to presentation currency (continued)

- share capital has been translated as described in paragraph 3.(b).(i) above; and
- all resulting exchange differences are recognised as a separate component of equity in the "Translation reserve" account.

(iv) Spot foreign exchange transactions

The Bank during the normal course of business enters into spot foreign exchange transactions with settlement dates 1 or 2 days after the trade date. These transactions are recorded in the financial statements on the settlement date. Foreign currency differences are recognised in profit or loss on the settlement date.

(c) Interest

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

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

(d) Fees and commission

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

Other fees and commission income are recognised as the related services are performed.

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

(e) Lease payments made

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

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

(f) Income tax expense

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

3. Significant accounting policies (continued)

(f) Income tax expense (continued)

Deferred tax is provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Additional income taxes that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised.

(g) Financial assets and liabilities

(i) Recognition

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

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

(ii) Classification

See accounting policies 3(h), (i) and (j).

(iii) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognised as a separate asset or liability. The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

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

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

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(iii) Derecognition (continued)

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if it does not retain control over the asset. The rights and obligations retained in the transfer are recognised separately as assets and liabilities as appropriate. In transfers in which control over the asset is retained, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

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

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

(iv) Offsetting

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

(v) Amortised cost measurement

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

(vi) Fair value measurement

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

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

3. Significant accounting policies (continued)

(g) Financial assets and liabilities (continued)

(vi) Fair value measurement (continued)

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss depending on the individual facts and circumstances of the transaction but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

(vii) Identification and measurement of impairment

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

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

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

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

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised directly in other comprehensive income to profit or loss. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income. If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss.

3. Significant accounting policies (continued)

(h) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(i) Loans and advances

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

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

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method, except when the Bank chooses to carry the loans and advances at fair value through profit or loss as described in accounting policy (g),(vi).

(j) Investment securities

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

(i) Held-to-maturity

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

Held-to-maturity investments are carried at amortised cost using the effective interest method. Any sale or reclassification of a more than insignificant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available-for-sale, and prevent the Bank from classifying investment securities as held-to-maturity for the current and the following two financial years.

(ii) Available-for-sale

Available-for-sale investments are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments are carried at fair value.

Interest income is recognised in profit or loss using the effective interest method. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss.

Other fair value changes are recognised directly in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in other comprehensive income are recognised in profit or loss.

3. Significant accounting policies (continued)

(k) Property and equipment

(i) Recognition and measurement

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

Cost includes expenditures that are directly attributable to the acquisition of the asset.

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

(ii) Subsequent costs

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

(iii) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Land is not depreciated.

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

• Buildings	20 years
• Motor vehicles and other equipment	5 years
• Office equipment	5 years
• Computers and electronic equipment	4 years

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

(l) Intangible assets

Intangible assets comprise software acquired by the Bank. Software acquired by the Bank is stated at cost less accumulated amortisation and accumulated impairment losses.

Expenditure on internally developed software is recognised as an asset when the Bank is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete the development. The capitalised costs of internally developed software include all costs directly attributable to developing the software, and are amortised over its useful life. Internally developed software is stated at capitalised cost less accumulated amortisation and impairment.

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

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The estimated useful life of software is four years.

3. Significant accounting policies (continued)

(m) Non- current assets held for sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets are remeasured in accordance with the Bank's accounting policies. Thereafter generally the assets are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

(n) Impairment of non-financial assets

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

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

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

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

(o) Deposits

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

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

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

(p) Provisions

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

3. Significant accounting policies (continued)

(p) Provisions (continued)

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

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

(q) Employee benefits

(i) Defined contribution plans

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

(ii) Defined benefit plans

The Bank has created a fully employer sponsored pension plan fund (see Note 22, “Reserve fund for retiring employees”) during 2002. The amount to be charged to this fund is decided upon at the beginning of the year as 5% of yearly budgeted personnel salary expenses. During the year, the amount accrued is charged to the income statement and to the fund on a monthly basis.

The benefit due to employees is calculated based on the number of years they have worked at the Bank, starting from 1 January 2002, and the most recent monthly salary. Only employees that have worked at the Bank for at least 5 years starting from 1 January 2002 are entitled to the benefit.

The amount due to employees based on the above plan will be grossed up by the interest that will accrue from the date the employees leave the Bank until their retirement. It will be paid to employees only when they reach the Albanian statutory retirement age, in monthly instalments equal to a minimum of 75% of their state monthly pension until the accumulated fund for the employee is consumed.

The Bank’s net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods and discounting that benefit to determine its present value and compare it with the net amount in the statement of financial position. The discount rate is the yield at the reporting date on AAA credit-rated long-term bonds that have maturity dates approximating the terms of the Bank’s obligations.

(iii) Short-term benefits

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

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

3. Significant accounting policies (continued)

(r) Segment reporting

An operating segment is a component of the Bank that engages in business activities from which may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Bank's other Components, whose operating results are reviewed regularly by the management to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available (see Note 6). The Bank's format for segment reporting is based on geographical segments.

(s) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2010, and have not been applied in preparing these consolidated financial statements. None of these will have an effect on the financial statements of the Bank, with the exception of:

- IFRS 9 *Financial Instruments* (effective for annual periods beginning on or after 1 January 2013, early adoption is permitted). This Standard replaces the guidance in IAS 39, *Financial Instruments: Recognition and Measurement*, about classification and measurement of financial assets. The Standard eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivable.

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

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

  A financial asset is measured at amortized cost if the following two conditions are met: the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and, its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

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

  It is expected that the new Standard, when initially applied, will have an impact on the financial statements, since it will be required to be retrospectively applied. However, the Bank is not able to prepare an analysis of the impact this will have on the financial statements until the date of initial application.

- *IFRS 7 Financial Instruments: Disclosures* (effective for annual periods beginning on or after 1 January 2011, early adoption is permitted). This standard is amended to add an explicit statement that the interaction between qualitative and quantitative disclosures better enables users to evaluate an entity's exposure to risks arising from financial instruments.

  The existing disclosure requirements of IFRS 7 are amended as follows:

  - Disclosure of the amount that best represents an entity's maximum exposure to credit risk without considering any collateral held is required only if the carrying amount of a financial asset does not reflect such exposure already.
  - The financial effect of collateral held as security and other credit enhancements in respect of a financial instrument is required to be disclosed in addition to the existing requirement to describe the existence and nature of such collateral.

3. Significant accounting policies (continued)

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

- The requirement to disclose the nature and carrying amounts of collateral obtained, including policies for using the financial and non-financial assets when they cannot be converted into cash immediately, applies only to collateral held at the end of the reporting period.

The following requirements have been removed from IFRS 7:

- The requirement to disclose the carrying amount of financial assets that are not past due or are not impaired as a result of their terms having been renegotiated.
- The requirement to provide a description of collateral held as security and other credit enhancements in respect of financial assets that are past due or impaired, including an estimate of their fair value.

Additionally, the clause stating that quantitative disclosures are not required when a risk is not material has been removed from IFRS 7.

- *IAS 1 Presentation of Financial Statements - Presentation of statement of changes in equity* (effective for annual periods beginning on or after 1 January 2011, early adoption is permitted). IAS 1 is amended to state that for each component of equity a reconciliation from opening to closing balances is required to be presented in the statement of changes in equity. That reconciliation is required to show separately changes arising from items recognised in profit or loss, in other comprehensive income, and from transactions with owners acting in their capacity as owners. Disaggregation of changes in each component of equity arising from transactions recognised in other comprehensive income also is required to be presented, but is permitted to be presented either in the statement of changes in equity or in the notes.
- *IAS 34 Interim Financial Reporting - Significant events and transactions* (effective for annual periods beginning on or after 1 January 2011, early adoption is permitted).

A number of examples have been added to the list of events or transactions that require disclosure under IAS 34, being:

- recognition of a loss from the impairment of financial assets;
- significant changes in an entity's business or economic circumstances that have an impact on the fair value of items in the statement of financial position, regardless of whether such items are accounted for at fair value;
- significant transfers of financial instruments between levels of the fair value hierarchy; and
- changes in assets' classification (e.g. from available for sale to held to maturity) as a result of changes in their purpose or use.

In addition, references to materiality are removed from the section in IAS 34 that describes other minimum disclosures.

The Bank is currently in the process of determining the impact of the revised standards on the financial statements.

4. Use of estimates and judgements

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

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

Allowances for credit losses

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

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

Held-to maturity investments

The Bank follows the IAS 39 guidance on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. This classification requires significant judgment. In making this judgment, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for specific circumstances – for example, selling an insignificant amount close to maturity – it will be required to reclassify the entire category as available for sale. The investments would therefore be measured at fair value not amortized cost.

Determining fair values

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

Critical accounting judgements in applying the Bank's accounting policies

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

Valuation of financial instruments

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

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

- Level 1: Quoted market price in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

4. Use of estimates and judgements (continued)

Valuation of financial instruments (continued)

- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs could have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques. Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

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

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

Fair values

Placements and balances with Banks

Placements and balances with banks include inter-bank placements and items in the course of collection. As all the placements and overnight deposits are short term and at floating rates their fair value is considered to be equal to their carrying amount. The fair value of these instruments is based on the Level 2 method described above.

4. Use of estimates and judgements (continued)

Treasury bills

Treasury bills are interest-bearing assets held to maturity. Since no active market exists for these investments, fair value has been estimated using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity. The fair value of these instruments is based on the Level 2 method described above.

As at 30 June 2010, the fair value of the Treasury bills held-to-maturity portfolio was USD 95,545,980 (2009: USD 88,110,129), which is higher than the carrying amount by USD 433,447 (2009: higher by USD 252,599).

Investment securities held-to-maturity

Fair value of investment securities held-to-maturity is based on market prices or broker/dealer price quotations. The fair value of these instruments is based on the Level 1 method described above. Where this information is not available, fair value has been estimated using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity (see Level 2 method described above).

As at 30 June 2010, the fair value of the bond portfolio was USD 194,737,115 (2009: USD 195,087,775), which is higher than the carrying amount by USD 832,471 (2009: higher by USD 122,104).

Loans and advances to customers

Loans and advances are net of allowances for impairment. The Bank’s loan portfolio has an estimated fair value approximately equal to its book value due to either their short-term nature or underlying interest rates, which approximate market rates. The majority of the loan portfolio is subject to re-pricing within a year. The fair value of these instruments is based on the Level 3 method described above.

Deposits and borrowings

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The time deposits have an estimated fair value approximately equal to their carrying amount, because of their short-term nature and underlying interest rates, which approximate market rates. The fair value of these instruments is based on the Level 3 method described above.

5. Financial risk management

(a) Introduction and overview

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

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

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

A financial instrument is any contract that gives rise to the right to receive cash or another financial asset from another party (financial asset) or the obligation to deliver cash or another financial asset to another party (financial liability).

Financial instruments result in certain risks to the Bank. The most significant risks facing the Bank are credit risk, liquidity risk and market risk. Market risk includes foreign currency risk, interest rate risk and other price risk.

Risk management framework

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

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

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

(b) Credit Risk

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

5. Financial risk management (continued)

(b) Credit Risk (continued)

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

Maximum credit exposure

Maximum exposures to credit risk before collateral and other credit enhancements as at 30 June 2010 and 31 December 2009 are as follows:

	30 June 2010	**31 December 2009**
Treasury bills and other eligible bills	252,539,237	255,640,833
Due from other banks	144,382,991	178,130,635
Loans and advances to customers (net)	481,997,427	494,271,286
Investment securities - available for sale	54,108,220	49,520,063
Investment securities - held to maturity	193,904,644	194,965,671
Financial guarantees	18,899,978	21,634,109
Standby letters of credit	1,968,715	4,323,930
Commitments to extend credit	20,794,196	23,744,714
Maximum exposures to credit risk	**1,168,595,408**	**1,222,231,241**

Impaired loans and securities

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

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

Past due but not impaired loans

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

Loans with renegotiated terms

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

5. Financial risk management (continued)

(b) Credit Risk (continued)

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

Allowances for impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. It relates to the specific loss component for individually significant exposures. Refer to note 4.

Write-off policy

The Bank writes off a loan / security balance (and any related allowances for impairment losses) with the decision of the Board of Directors, in accordance with the regulation of Bank of Albania "On Credit Risk Management". The write-off decision is taken after considering information such as the occurrence of significant changes in the borrower / issuer's financial position, such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

	Loans and advances to customers			
30 June 2010	**Retail**	**Corporate**	**Advances**	**Total**
Neither past due nor impaired	107,528,962	285,230,155	3,522,503	396,281,620
Past due but not impaired	2,902,950	5,354,289	117,301	8,374,540
Individually impaired	33,023,546	53,167,724	2,075,032	88,266,302
Total Loans, Gross (Note 13)	**143,455,458**	**343,752,168**	**5,714,836**	**492,922,462**
Allowance for impairment	(4,162,824)	(4,650,780)	(2,111,431)	(10,925,035)
Total Loans, Net of impairment	**139,292,634**	**339,101,388**	**3,603,405**	**481,997,427**

	Loans and advances to customers			
31 December 2009	**Retail**	**Corporate**	**Advances**	**Total**
Neither past due nor impaired	112,152,302	310,496,018	4,471,513	427,119,833
Past due but not impaired	2,507,943	772,233	301,359	3,581,535
Individually impaired	31,194,924	41,401,658	1,897,077	74,493,659
Total Loans, Gross (Note 13)	**145,855,169**	**352,669,909**	**6,669,949**	**505,195,027**
Allowance for impairment	(6,166,720)	(2,859,944)	(1,897,077)	(10,923,741)
Total Loans, Net of impairment	**139,688,449**	**349,809,965**	**4,772,872**	**494,271,286**

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

Rating	**30 June 2010**	**31 December 2009**
A – Good	20,648,011	23,489,059
B – Acceptable	260,417,974	280,148,911
C – Close Monitoring	44,906,558	29,288,840
D – Unacceptable	13,236,487	16,828,881
(Note 13)	**339,209,030**	**349,755,691**
Accrued interest	5,424,980	4,003,653
Less: unamortized deferred fee income	(881,842)	(1,089,435)
Total	**343,752,168**	**352,669,909**

5. Financial risk management (continued)

(b) Credit Risk (continued)

Set out below are the carrying amount of loans and advances to customers whose term has been renegotiated:

	Loans and advances to customers			
	Retail	**Corporate**	**Advances**	**Total Loans**
30 June 2010	558,102	12,691,567	138,184	13,387,853
31 December 2009	473,188	9,513,024	-	9,986,212

Set out below is the ageing analysis of all past due loans either impaired or not impaired individually:

	Loans and advances to customers			
30 June 2010	**Retail**	**Corporate**	**Advances**	**Total Loans**
Past due up to 30 days	9,493,749	7,920,894	762,895	18,177,538
Past due 31-60 days	3,412,138	3,062,381	76,250	6,550,769
Past due 61-90 days	3,003,357	7,897,251	184,874	11,085,482
Past due 91-180 days	4,297,771	4,707,524	138,030	9,143,325
Past due 180 days- 365 days	2,596,687	1,330,596	37,942	3,965,225
Past due 1-2 years	2,072,227	5,418,775	63,454	7,554,456
Past due over 2 years	1,087,915	4,890,180	-	5,978,095
Total	**25,963,844**	**35,227,601**	**1,263,445**	**62,454,890**

	Loans and advances to customers			
31 December 2009	**Retail**	**Corporate**	**Advances**	**Total Loans**
Past due up to 30 days	8,361,839	3,452,186	753,165	12,567,190
Past due 31-60 days	3,888,949	2,225,796	67,533	6,182,278
Past due 61-90 days	2,288,738	2,196,984	57,875	4,543,597
Past due 91-180 days	2,195,042	1,143,711	-	3,338,753
Past due 180 days- 365 days	2,964,663	7,379,090	243,264	10,587,017
Past due 1-2 years	1,926,824	7,907,945	82,114	9,916,883
Past due over 2 years	891,469	901,834	-	1,793,303
Total	**22,517,524**	**25,207,546**	**1,203,951**	**48,929,021**

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

	Loans and advances to customers			
30 June 2010	**Retail**	**Corporate**	**Advances**	**Total Loans**
Residential, commercial or industrial Property	398,045,499	645,988,351	-	1,044,033,850
Financial assets	5,649,262	85,634,882	-	91,284,144
Other	25,905,038	94,056,832	-	119,961,870
Total	**429,599,799**	**825,680,065**	**-**	**1,255,279,864**

	Loans and advances to customers			
31 December 2009	**Retail**	**Corporate**	**Advances**	**Total Loans**
Residential, commercial or industrial Property	373,660,522	665,055,918	-	1,038,716,440
Financial assets	4,206,043	121,505,830	-	125,711,873
Other	26,275,644	28,042,086	-	54,317,730
Total	**404,142,209**	**814,603,834**	**-**	**1,218,746,043**

5. Financial risk management (continued)

(b) Credit Risk (continued)

Credit quality of other financial assets is detailed as follows:

30 June 2010	Treasury Bills	Due from other banks	Available for sale portfolio	Held to maturity portfolio	Total
Good	252,539,237	144,382,991	54,108,220	193,904,644	644,935,092
Acceptable	-	-	-	-	-
Close monitoring	-	-	-	-	-
Total	**252,539,237**	**144,382,991**	**54,108,220**	**193,904,644**	**644,935,092**

31 December 2009	Treasury Bills	Due from other banks	Available for sale portfolio	Held to maturity portfolio	Total
Good	255,640,833	178,130,635	49,520,063	194,965,671	678,257,202
Acceptable	-	-	-	-	-
Close monitoring	-	-	-	-	-
Total	**255,640,833**	**178,130,635**	**49,520,063**	**194,965,671**	**678,257,202**

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The purpose of Liquidity Risk Management (LRM) is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation. Bank’s LRM policy includes how the Bank identifies, measures, monitors and control that risk.

Organization of LRM: Bank’s LRM Organization includes two different bodies in the monitoring and management of liquidity. The involvement of different bodies helps provide clear allocation of the responsibility for monitoring/reporting and management of Liquidity Risk. Day-to-day management of liquidity belongs to the Treasury Group but day-to-day monitoring of Liquidity risk and compliance to the limits belongs to the Risk Management Group. The main purpose of the Risk Management Group, which conducts daily overview of LRM reports, is to provide early warning signal of liquidity risk to the top management of Bank.

LRM Reports: Bank’s LRM policy includes sets of daily and monthly reports to be reviewed and monitored by Operational & Market Risk Department. Daily reports include Maximum Cumulative Outflow table and Cumulative Assets and Liabilities Breakdown table, which control respectively daily and monthly inflows/outflows of liquidity till 1-year maturity under “business as usual” scenario. Monthly reports include stress testing liquidity breakdown tables, which control daily and monthly inflows/outflows of liquidity under separate bank specific and market specific crisis scenarios till 3-months maturity.

The LRM approach of the Bank results in positive cumulative liquidity gaps for all time buckets up to one year as at 30 June 2010. This resulted mainly because of the following three main assumptions:

- Using statistical method and historical data (derived since 2001), the actual LRM reports include analysis into the behavioural re-investment pattern of deposits;
- Short term securities available for sale are considered liquid through the secured funding from Bank of Albania;
- Bank’s reserve requirements held with BoA are considered as non-liquid assets.

5. Financial risk management (continued)

(c) Liquidity risk (continued)

An analysis of the Bank's expected timing of cash flows by simple remaining maturity is shown in the following tables.

As at 30 June 2010, the Bank's assets, liabilities and shareholders' equity have remaining contractual maturities as follows:

	Upto1month	*1-3months*	*3-12months*	*1-5years*	*Over5year*	**Total**
Assets						
Cash and balances with Central Bank	127,953,062	-	-	-	-	127,953,062
Placement and balances with banks	73,476,285	2,564,568	17,264,889	-	-	93,305,742
Treasury bills	9,344,821	69,996,061	173,198,355	-	-	252,539,237
Investment securities available-for-sale	-	-	-	47,314,465	6,793,755	54,108,220
Investment securities held-to-maturity	5,037,879	-	16,030,068	172,836,697	-	193,904,644
Loans and advances to banks	6,124,015	15,310,253	29,642,981	-	-	51,077,249
Loans and advances to customers	22,699,475	63,067,598	201,583,363	101,730,524	92,916,467	481,997,427
Property and equipment	-	-	-	5,694,882	10,105,886	15,800,768
Intangible assets	-	-	-	1,596,611	-	1,596,611
Non current assets held for sale	-	-	1,800,567	-	-	1,800,567
Other assets	2,756,328	-	-	-	-	2,756,328
Total assets	**247,391,865**	**150,938,480**	**439,520,223**	**329,173,179**	**109,816,108**	**1,276,839,855**
Liabilities and shareholders' equity						
Customer deposits	359,771,940	312,535,908	384,676,859	42,434,904	1,835,903	1,101,255,514
Due to banks	40,392,041	19,829,064	-	-	-	60,221,105
Due to third parties	1,125,546	-	-	-	-	1,125,546
Deferred tax liabilities	-	-	-	937,701	-	937,701
Accruals and other liabilities	6,060,254	-	-	-	1,946,941	8,007,195
Shareholders' equity	-	-	-	-	105,292,794	105,292,794
Total liabilities and shareholders' equity	**407,349,781**	**332,364,972**	**384,676,859**	**43,372,605**	**109,075,638**	**1,276,839,855**
Net Position	**(159,957,916)**	**(181,426,492)**	**54,843,364**	**285,800,574**	**740,470**	**-**
Cumulative Net Position	**(159,957,916)**	**(341,384,408)**	**(286,541,044)**	**(740,470)**	**-**	**-**

LRM reports are produced for each single currency Lek, Euro and USD and for the total statement of financial position as well. Maximum cumulative outflow limits, which are managed and monitored on a daily-basis, have been assigned for each of the above currencies.

5. Financial risk management (continued)

(c) Liquidity risk (continued)

As at 31 December 2009, the Bank's assets, liabilities and shareholders' equity have remaining contractual maturities as follows:

	Up to 1 month	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 year*	**Total**
Assets						
Cash and balances with Central Bank	142,263,329	-	-	-	-	142,263,329
Placement and balances with banks	115,637,114	1,617,809	15,387,824	-		132,642,747
Treasury bills	14,635,934	52,461,906	188,542,993	-	-	255,640,833
Investment securities available-for-sale	-	-	-	31,074,694	18,445,369	49,520,063
Investment securities held-to-maturity	11,934,852	6,991,633	20,469,927	155,569,259	-	194,965,671
Loans and advances to banks	-	-	45,487,888	-	-	45,487,888
Loans and advances to customers	15,323,789	35,286,943	224,963,456	119,866,687	98,830,411	494,271,286
Property and equipment	-	-	-	7,424,050	11,947,434	19,371,484
Intangible assets	-	-	-	1,518,375	-	1,518,375
Non current assets held for sale	-	-	1,297,477	-	-	1,297,477
Other assets	3,062,500	-	-	-	-	3,062,500
Total assets	**302,857,518**	**96,358,291**	**496,149,565**	**315,453,065**	**129,223,214**	**1,340,041,653**
Liabilities and shareholders' equity						
Customer deposits	397,375,804	214,953,386	511,357,665	41,590,446	1,869,557	1,167,146,858
Due to banks	69,175,055	-	-	-	-	69,175,055
Due to third parties	456,415	-	-	-	-	456,415
Deferred tax liabilities	-	-	-	736,954	-	736,954
Accruals and other liabilities	6,102,019	-	-	-	1,753,698	7,855,717
Shareholders' equity	-	-	-	-	94,670,654	94,670,654
Total liabilities and shareholders' equity	**473,109,293**	**214,953,386**	**511,357,665**	**42,327,400**	**98,293,909**	**1,340,041,653**
Net Position	**(170,251,775)**	**(118,595,095)**	**(15,208,100)**	**273,125,665**	**30,929,305**	**-**
Cumulative Net Position	**(170,251,775)**	**(288,846,870)**	**(304,054,970)**	**(30,929,305)**	**-**	**-**

Exposure to liquidity risk

One of the key ratios used by the Bank for managing liquidity risk is the ratio of highly liquid assets to total assets, which should be at a minimum of 15%. For this purpose highly liquid assets are considered: cash balances, unrestricted balances with central bank, current account balances with banks, placements with banks matured within seven days, 80% of treasury bills portfolio with remaining maturity more than two weeks, and 80% of government securities portfolio with remaining maturity less than one year. A similar, but not identical, calculation is used to measure the Bank's compliance with the liquidity limit established by the Bank's regulator, Bank of Albania.

Details of the reported Bank ratio at the reporting dates were as follows:

	30 June 2010	***31 December 2009***
Highly Liquid Assets/Total Assets Ratio	18.60%	21.1%

5. Financial risk management (continued)

(d) Market risk

1) Foreign currency risk

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

The following tables present the equivalent amount of assets, liabilities and shareholders' equity by currency as at 30 June 2010 and 31 December 2009 in accordance with the Bank of Albania foreign currency disclosure requirements:

30 June 2010	*Lek*	*USD*	*Euro*	*Other*	*Total*
Assets					
Cash and balances with Central Bank	68,147,910	9,655,300	49,765,427	384,425	127,953,062
Placements and balances with banks	-	42,405,510	41,592,128	9,308,104	93,305,742
Treasury bills	246,924,299	-	3,641,532	1,973,406	252,539,237
Investment securities available-for-sale	1,816,758	19,772,471	27,624,470	4,894,521	54,108,220
Investment securities held-to-maturity	146,153,018	24,763,094	22,988,532	-	193,904,644
Loans and advances to banks	-	9,343,896	41,733,353	-	51,077,249
Loans and advances to customers	181,572,991	74,987,494	222,294,848	3,142,094	481,997,427
Property and equipment	12,941,925	-	2,858,843	-	15,800,768
Intangible assets	1,596,611	-	-	-	1,596,611
Non current assets held for sale	1,800,567	-	-	-	1,800,567
Other assets	1,485,678	294,632	970,015	6,003	2,756,328
Total assets	**662,439,757**	**181,222,397**	**413,469,148**	**19,708,553**	**1,276,839,855**
Spot foreign exchange contracts	611,989	7,790,072	1,471,291	3,828,021	13,701,373
Liabilities and shareholders' equity					
Customer deposits	610,683,433	77,094,312	398,466,331	15,011,438	1,101,255,514
Due to banks	58,829,094	236,674	1,150,186	5,151	60,221,105
Due to third parties	1,125,546	-	-	-	1,125,546
Deferred tax liabilities	937,701	-	-	-	937,701
Accruals and other liabilities	1,967,459	4,502,423	1,473,136	64,177	8,007,195
Shareholders' equity	20,670,594	84,622,200	-	-	105,292,794
Total liabilities and shareholders' equity	**694,213,827**	**166,455,609**	**401,089,653**	**15,080,766**	**1,276,839,855**
Spot foreign exchange contracts	76,438	4,442,181	979,540	8,203,214	13,701,373
Net position (GAP)	**(31,238,519)**	**18,114,679**	**12,871,246**	**252,594**	**-**
Cumulative net position	(31,238,519)	(13,123,840)	(252,594)	-	-
Total assets / Total liabilities	95.50%	110.60%	103.20%	101.08%	100.00%
GAP / FX denominated assets		0.10	0.031	0.0107	-
Sensitivity analysis					
Lek depreciates by 10%		1,646,789	910,218	22,963	**2,579,970**
Lek depreciates by 5%		862,604	476,781	12,028	**1,351,413**
Lek appreciates by 5%		(953,404)	(526,969)	(13,294)	**(1,493,667)**
Lek appreciates by 10%		(2,012,742)	(1,112,489)	(28,066)	**(3,153,297)**

The property and equipment in foreign currency is related to Kosovo Branch.

5. Financial risk management (continued)

(d) Market risk (continued)

1) Foreign currency risk (continued)

31 December 2009	*Lek*	*USD*	*Euro*	*Other*	*Total*
Assets					
Cash and balances with Central Bank	70,302,833	11,560,606	59,636,791	763,099	142,263,329
Placements and balances with banks	-	43,320,764	76,104,931	13,217,052	132,642,747
Treasury bills	253,631,437	-	-	2,009,396	255,640,833
Investment securities available-for-sale	2,080,287	36,051,207	8,138,045	3,250,524	49,520,063
Investment securities held-to-maturity	161,996,337	13,960,347	19,008,987	-	194,965,671
Loans and advances to banks	-	9,343,313	36,144,575	-	45,487,888
Loans and advances to customers	204,847,219	58,882,739	226,853,783	3,687,545	494,271,286
Property and equipment	15,844,953	-	3,526,531	-	19,371,484
Intangible assets	1,518,375	-	-	-	1,518,375
Non current assets held for sale	1,297,477	-	-	-	1,297,477
Other assets	1,898,099	310,713	853,314	374	3,062,500
Total assets	**713,417,017**	**173,429,689**	**430,266,957**	**22,927,990**	**1,340,041,653**
Spot foreign exchange contracts	722,263	8,170,777	791,963	2,460,544	12,145,547
Liabilities and shareholders' equity					
Customer deposits	658,300,519	81,413,243	410,282,480	17,150,616	1,167,146,858
Due to banks	63,207,050	263,157	5,704,848	-	69,175,055
Due to third parties	456,415	-	-	-	456,415
Deferred tax liabilities	736,954	-	-	-	736,954
Accruals and other liabilities	2,509,797	4,176,007	1,131,949	37,964	7,855,717
Shareholders' equity	16,371,654	78,299,000	-	-	94,670,654
Total liabilities and shareholders' equity	**741,582,389**	**164,151,407**	**417,119,277**	**17,188,580**	**1,340,041,653**
Spot foreign exchange contracts	636,965	2,457,614	863,959	8,187,009	12,145,547
Net position (GAP)	**(28,080,074)**	**14,991,445**	**13,075,684**	**12,945**	**-**
Cumulative net position	(28,080,074)	(13,088,629)	(12,945)	-	
Total assets / Total liabilities	96.22%	109.00%	103.13%	100.05%	100.00%
GAP / FX denominated assets		0.08	0.030	0.001	-
Sensitivity analysis					
Lek depreciates by 10%		1,362,859	868,105	1,177	**2,232,141**
Lek depreciates by 5%		713,878	454,722	616	**1,169,216**
Lek appreciates by 5%		(789,023)	(502,587)	(681)	**(1,292,291)**
Lek appreciates by 10%		(1,665,716)	(1,061,017)	(1,438)	**(2,728,171)**

2) Interest rate risk

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

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk (continued)

The average effective yields of significant categories of financial assets and liabilities of the Bank as at 30 June 2010 are as follows:

	Lek	*USD*	*Euro*
Assets			
Cash and balances with Central Bank	3.68%	0.10%	0.70%
Placement and balances with banks	N/A	1.63%	0.60%
Treasury bills	8.98%	N/A	5.66%
Investment securities	10.50%	7.11%	7.93%
Loans and advances to banks	N/A	3.16%	3.72%
Loans and advances to customers	13.02%	8.70%	9.05%
Liabilities			
Customer deposits	5.05%	1.55%	3.15%
Due to banks	5.34%	0.10%	0.10%

The average effective yields of significant categories of financial assets and liabilities of the Bank as at 31 December 2009 were as follows:

	Lek	*USD*	*Euro*
Assets			
Cash and balances with Central Bank	3.68%	0.10%	0.70%
Placement and balances with banks	N/A	1.64%	0.40%
Treasury bills	9.23%	N/A	N/A
Investment securities	10.46%	6.54%	8.05%
Loans and advances to banks	-	3.19%	3.45%
Loans and advances to customers	13.34%	8.81%	9.17%
Liabilities			
Customer deposits	5.33%	1.52%	3.38%
Due to banks	5.32%	0.10%	0.10%

The interest re-pricing dates of significant categories of financial assets and liabilities of the Bank as at 30 June 2010 are as follows:

	Upto1month	**1-3months**	**3-12months**	**1-5years**	**Over5year**	**Total**
Assets						
Cash and balances with Central Bank	127,953,062	-	-	-	-	127,953,062
Placement and balances with banks	73,476,285	2,564,568	17,264,889	-	-	93,305,742
Treasury bills	9,344,821	69,996,061	173,198,355	-	-	252,539,237
Investment securities available-for-sale	-	-	1,816,759	45,497,706	6,793,755	54,108,220
Investment securities held-to-maturity	5,037,879	2,805,205	124,616,125	61,445,435	-	193,904,644
Loans and advances to banks	6,124,015	15,310,253	29,642,981	-	-	51,077,249
Loans and advances to customers	72,227,386	33,757,802	313,509,318	50,525,701	11,977,220	481,997,427
Total	**294,163,448**	**124,433,889**	**660,048,427**	**157,468,842**	**18,770,975**	**1,254,885,581**
Liabilities						
Customer deposits	359,771,940	312,535,908	384,676,859	42,434,904	1,835,903	1,101,255,514
Due to banks	40,392,041	19,829,064	-	-	-	60,221,105
Total	**400,163,981**	**332,364,972**	**384,676,859**	**42,434,904**	**1,835,903**	**1,161,476,619**

5. Financial risk management (continued)

(d) Market risk (continued)

2) Interest rate risk (continued)

The interest re-pricing dates of significant categories of financial assets and liabilities of the Bank as at 31 December 2009 were as follows:

	Up to 1 month	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 year*	*Total*
Assets						
Cash and balances with Central Bank	142,263,329	-	-	-	-	142,263,329
Placement and balances with banks	115,637,114	1,617,808	15,387,825	-	-	132,642,747
Treasury bills	14,635,934	52,461,906	188,542,993	-	-	255,640,833
Investment securities available-for-sale	-	-	2,080,287	28,994,407	18,445,369	49,520,063
Investment securities held-to-maturity	11,934,852	32,510,660	110,392,333	40,127,826	-	194,965,671
Loans and advances to banks	-	-	45,487,888	-	-	45,487,888
Loans and advances to customers	355,240,709	8,212,269	78,264,522	39,573,894	12,979,892	494,271,286
Total	**639,711,938**	**94,802,643**	**440,155,848**	**108,696,127**	**31,425,261**	**1,314,791,817**
Liabilities						
Customer deposits	397,375,804	214,953,386	511,357,665	41,590,446	1,869,557	1,167,146,858
Due to banks	69,175,055	-	-	-	-	69,175,055
Total	**466,550,859**	**214,953,386**	**511,357,665**	**41,590,446**	**1,869,557**	**1,236,321,913**

Interest rate sensitivity

The sensitivity analysis below has been determined based on the exposure to interest rates at the reporting date and the stipulated change taking place at the beginning of the financial year and held constant throughout the reporting period. The following is a stipulation of effects of changes in interest rate to the net profit, assuming all the other variables are held constant:

	30 June 2010	*31 December 2009*
Interest rate increases by 2%	303,875	983,793
Interest rate increases by 1.5%	227,906	737,845
Interest rate increases by 1%	151,937	491,896
Interest rate decreases by 1%	(151,937)	(491,896)
Interest rate decreases by 1.5%	(227,906)	(737,845)
Interest rate decreases by 2%	(303,875)	(983,793)

(e) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank’s processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Bank’s operations.

5. Financial risk management (continued)

(e) Operational risks (continued)

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

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

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

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

(f) Capital management

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. There have been no material changes in the Bank's management of capital during the period.

Regulatory capital

The Bank monitors the adequacy of its capital using, among other measures, the rules and ratios established by the Albanian regulator, the Bank of Albania ("BoA"), which ultimately determines the statutory capital required to underpin its business. The regulation "On capital adequacy" is issued pursuant to Law No. 8269 date 23.12.1997 "On the Bank of Albania", and Law No. 9662 date 18.12.2006 "On Banks in the Republic of Albania".

5. Financial risk management (continued)

(f) Capital management (continued)

Capital Adequacy Ratio

The Capital Adequacy Ratio is the proportion of the regulatory capital to risk weighted assets and 'off balance-sheet' items, expressed as a percentage. The minimum Capital Adequacy Ratio required by Bank of Albania is 12%, while the Bank has maintained this ratio at 14.9% as at 30 June 2010.

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

Risk-Weighted Assets (RWAs)

Assets are weighted according to broad categories of notional risk, being assigned a risk weighting according to the amount of capital deemed to be necessary to support them. Four categories of risk weights (0%, 20%, 50%, 100%) are applied; for example cash and money market instruments with Bank of Albania have a zero risk weighting, which means that no capital is required to support the holding of these assets. Property and equipment carries a 100% risk weighting, meaning that capital equal to 12% of the carrying amount must support it.
Off-balance-sheet credit related commitments are taken into account. The amounts are then weighted for risk using the same percentages as for on-balance-sheet assets.

Compliance

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

6. Segmental reporting

As at 30 June 2010, the Bank's geographical segments are as follows:

	Albania	Kosovo	Consolidated
Assets			
Cash and balances with Central Bank	121,200,272	6,752,790	127,953,062
Placement and balances with banks	93,304,921	821	93,305,742
Treasury bills	252,539,237	-	252,539,237
Investment securities available-for-sale	54,108,220	-	54,108,220
Investment securities held-to-maturity	183,704,971	10,199,673	193,904,644
Loans and advances to banks	51,077,249	-	51,077,249
Loans and advances to customers	419,992,738	62,004,689	481,997,427
Property and equipment	12,941,911	2,858,857	15,800,768
Intangible assets	1,596,611	-	1,596,611
Non - current assets held for sale	1,800,567	-	1,800,567
Other assets	22,693,665	(19,937,337)*	2,756,328
Total assets	**1,214,960,362**	**61,879,493**	**1,276,839,855**
Liabilities and shareholders' equity			
Liabilities			
Customer deposits	1,047,277,181	53,978,333	1,101,255,514
Due to banks	60,221,105	-	60,221,105
Due to third parties	1,125,546	-	1,125,546
Deferred tax liabilities	937,701	-	937,701
Accruals and other liabilities	7,853,938	153,257	8,007,195
Total liabilities	**1,117,415,471**	**54,131,590**	**1,171,547,061**
Shareholders' equity			
Share capital			84,622,200
Translation reserve			(953,412)
Fair value reserve			748,322
Retained earnings			20,875,684
Total shareholders' equity			**105,292,794**
Total liabilities and shareholders' equity			**1,276,839,855**

***** Included within the USD 19,937,337 credit for Kosovo 'Other assets' is an amount of USD 20,037,774, which represents intra-group balances between the Head Office and Branches in Albania and Kosovo Branch as at 30 June 2010, and has been eliminated in consolidation.

6. Segmental reporting (continued)

For the six months ended 30 June 2010, the Bank's geographical segments are as follows:

	Albania	Kosovo	Consolidated
Interest			
Interest income	46,250,773	3,325,126	49,575,899
Interest expense	(22,998,585)	(1,373,928)	(24,372,513)
Net interest margin	**23,252,188**	**1,951,198**	**25,203,386**
Non-interest income, net			
Fees and commissions, net	2,060,832	302,285	2,363,117
Foreign exchange revaluation gain (loss), net	2,354,794	2,045	2,356,839
Profit from FX trading activities, net	904,650	-	904,650
Other income (expense), net	19,876	-	19,876
Total non-interest income, net	**5,340,152**	**304,330**	**5,644,482**
Operating expenses			
Personnel	(5,258,373)	(768,231)	(6,026,604)
Administrative	(6,344,201)	(683,779)	(7,027,980)
Depreciation and amortization	(1,759,035)	(283,079)	(2,042,114)
Total operating expenses	**(13,361,609)**	**(1,735,089)**	**(15,096,698)**
Impairment of loans	(621,957)	(1,020,037)	(1,641,994)
Profit/(loss) before taxes	**14,608,774**	**(499,598)**	**14,109,176**
Income tax	(1,420,632)	-	(1,420,632)
Net profit/(loss) for the period	**13,188,142**	**(499,598)**	**12,688,544**

6. Segmental reporting (continued)

As at 31 December 2009, the Bank's geographical segments are as follows:

	Albania	Kosovo	Consolidated
Assets			
Cash and balances with Central Bank	131,197,389	11,065,940	142,263,329
Placement and balances with banks	132,642,225	522	132,642,747
Treasury bills	255,640,833	-	255,640,833
Investment securities available-for-sale	49,520,063	-	49,520,063
Investment securities held-to-maturity	182,703,198	12,262,473	194,965,671
Loans and advances to banks	45,487,888	-	45,487,888
Loans and advances to customers	439,321,137	54,950,149	494,271,286
Property and equipment	15,844,936	3,526,548	19,371,484
Intangible assets	1,518,375	-	1,518,375
Non - current assets held for sale	1,297,477	-	1,297,477
Other assets	18,026,688	(14,964,188)*	3,062,500
Total assets	**1,273,200,209**	**66,841,444**	**1,340,041,653**
Liabilities and shareholders' equity			
Liabilities			
Customer deposits	1,112,560,092	54,586,766	1,167,146,858
Due to banks	64,855,252	4,319,803	69,175,055
Due to third parties	456,415	-	456,415
Deferred tax liabilities	736,954	-	736,954
Accruals and other liabilities	7,785,919	69,798	7,855,717
Total liabilities	**1,186,394,632**	**58,976,367**	**1,245,370,999**
Shareholders' equity			
Share capital			78,299,000
Translation reserve			(209,293)
Fair value reserve			56,674
Retained earnings			16,524,273
Total shareholders' equity			**94,670,654**
Total liabilities and shareholders' equity			**1,340,041,653**

***** Included within the USD 14,964,188 credit for Kosovo 'Other assets' is an amount of USD 15,033,540, which represents intra-group balances between the Head Office and Branches in Albania and Kosovo Branch as at 31 December 2009, and has been eliminated on consolidation.

6. Segmental reporting (continued)

For the six months ended 30 June 2009, the Bank's geographical segments are as follows:

	Albania	**Kosovo**	**Consolidated**
Interest			
Interest income	36,709,395	902,853	37,612,248
Interest expense	(21,003,790)	(202,907)	(21,206,697)
Net interest margin	**15,705,605**	**699,946**	**16,405,551**
Non-interest income, net			
Fees and commissions, net	2,327,568	206,558	2,534,126
Foreign exchange revaluation gain (loss), net	1,550,846	15	1,550,861
Profit from FX trading activities, net	1,005,727	-	1,005,727
Other income (expense), net	(125,342)	132	(125,210)
Total non-interest income, net	**4,758,799**	**206,705**	**4,965,504**
Operating expenses			
Personnel	(5,258,894)	(621,009)	(5,879,903)
Administrative	(5,163,303)	(649,128)	(5,812,431)
Depreciation and amortization	(1,693,466)	(194,901)	(1,888,367)
Total operating expenses	**(12,115,663)**	**(1,465,038)**	**(13,580,701)**
Impairment of loans	(938,788)	(23,043)	(961,831)
Profit/(loss) before taxes	**7,409,953**	**(581,430)**	**6,828,523**
Income tax	(708,001)	-	(708,001)
Net profit/(loss) for the period	**6,701,952**	**(581,430)**	**6,120,522**

7. Cash and balances with Central Bank

Cash and balances with Central Bank as at 30 June 2010 and 31 December 2009, are detailed as follows:

	30 June 2010	***31 December 2009***
Cash on hand	24,433,528	32,005,341
Deposits with the Central Bank of Kosovo	4,796,374	8,322,177
Bank of Albania		
Current account	1,383,550	20,597
Statutory reserve	97,294,940	101,860,647
Accrued interest	44,670	54,567
	98,723,160	101,935,811
	127,953,062	**142,263,329**

In accordance with the Bank of Albania's requirement relating to the deposit reserve, the Bank should maintain a minimum of 10% of customer deposits with the Bank of Albania as a statutory reserve account, which during the month can be decreased up to 60% of its level, provided that the monthly average is obtained.

Deposits with the Central Bank of Kosovo include the statutory reserve of 10% of customer deposits in Kosovo.

8. Placements and balances with banks

Placements and balances with banks as at 30 June 2010 and 31 December 2009 consisted as follows:

	30 June 2010	*31 December 2009*
Placements	90,101,460	125,477,813
Cash collateral held by financial institutions	1,392,305	3,472,346
Current accounts	1,496,357	3,367,088
Accrued interest	315,620	325,500
	93,305,742	**132,642,747**

Placements are held with non-resident banks from Organisation for Economic Cooperation and Development ("OECD") countries and have contractual maturities up to 1 year. Current accounts represent balances with correspondent banks in the OECD countries.

Cash collateral represents mostly collateral held by correspondent banks and financial institutions against letters of credit issued to the Bank's clients by the correspondent banks and cash deposits, which secure risks that are related to the credit cards activity of the Bank.

9. Treasury bills

Treasury bills bear interest at market rates ranging from 7.10% p.a. to 10.09% p.a. on a compound basis and are all denominated in Lek, except for two held-to-maturity foreign currency t-bills: one EUR denominated 9-monthly treasury bill of Albanian Government with a face value of equivalent to USD 3.8 million at an average yield of 5.66% and one TRY denominated 12-monthly treasury bill of Turkish Government with a face value of equivalent to USD 2 million at a yield of 7.97%.

Treasury bills portfolio is composed as follows:

	30 June 2010	*31 December 2009*
Treasury bills available-for-sale	157,426,704	167,783,303
Treasury bills held-to-maturity	95,112,533	87,857,530
	252,539,237	**255,640,833**

Treasury bills available-for-sale

Treasury bills available-for-sale by original maturity as at 30 June 2010 and 31 December 2009 are presented as follows:

	30 June 2010				*31 December 2009*			
	Purchase Value	Amortized discount	Marked to market gain (loss)	Fair value	Purchase Value	Amortized discount	Marked to market gain (loss)	Fair value
3 months	-	-	-	-	19,594	109	13	19,716
6 months	123,071	2,081	105	125,257	219,388	1,998	343	221,729
12 months	148,664,957	7,776,399	860,091	157,301,447	161,773,775	5,440,623	327,460	167,541,858
	148,788,028	**7,778,480**	**860,196**	**157,426,704**	**162,012,757**	**5,442,730**	**327,816**	**167,783,303**

The fair value of these instruments is based on the Level 2 method described in Note 4.

9. Treasury bills (continued)

Treasury bills held-to-maturity

Treasury bills held-to-maturity by original maturity as at 30 June 2010 and 31 December 2009 are presented as follows:

	30 June 2010			*31 December 2009*		
	Purchase Value	Amortized discount	Amortized cost	Purchase value	Amortized discount	Amortized cost
6 months	4,887,002	23,254	4,910,256	-	-	-
9 months	3,640,394	1,138	3,641,532	-	-	-
12 months	83,011,064	3,549,681	86,560,745	84,775,810	3,081,720	87,857,530
	91,538,460	**3,574,073**	**95,112,533**	**84,775,810**	**3,081,720**	**87,857,530**

As at 30 June 2010, the fair value of the Treasury bills held-to-maturity portfolio was USD 95,545,980, which exceeds the carrying value by USD 433,447, while as at 31 December 2009 the fair value of this portfolio was USD 88,110,129, which was higher than the carrying value by USD 252,599.

10. Investment securities available-for-sale

Investment securities available-for-sale as at 30 June 2010 comprise as follows:

Type	Nominal value	Unamortized discount	Accrued interest	Marked to market gain (loss)	Fair Value	S & P / Moody's Bond Rating
Lek Denominated Bonds	1,794,688	-	10,630	11,440	1,816,758	B1
USD Denominated Bonds	18,850,000	531,910	355,041	35,520	19,772,471	B- – A+
EUR Denominated Bonds	26,325,153	1,207,858	382,528	(291,069)	27,624,470	Baa3 – A2
GBP Denominated Bonds	4,505,653	58,733	197,377	132,758	4,894,521	Baa1
	51,475,494	**1,798,501**	**945,576**	**(111,351)**	**54,108,220**	

The foreign currency denominated bonds outstanding as at 30 June 2010 are composed of Eurobonds issued by foreign governments, corporates and international banks. The fair value of these instruments is based on the Level 1 method described in Note 4.

Investment securities available-for-sale as at 31 December 2009 comprise as follows:

Type	Nominal value	Unamortized discount	Accrued interest	Marked to market gain (loss)	Fair value	S & P / Moody's Bond Rating
Lek Denominated Bonds	2,087,465	-	12,364	(19,542)	2,080,287	B1
USD Denominated Bonds	35,500,000	207,321	545,171	(201,285)	36,051,207	B1 – Baa1
EUR Denominated Bonds	7,199,666	592,594	385,445	(39,660)	8,138,045	A2
GBP Denominated Bonds	3,228,056	3,904	36,080	(17,516)	3,250,524	Baa1
	48,015,187	**803,819**	**979,060**	**(278,003)**	**49,520,063**	

11. Investment securities held-to-maturity

Investment securities held-to-maturity as at 30 June 2010 comprise as follows:

Type	**Nominal Value**	**Unamortized Premium / (Discount)**	**Accrued interest**	**Net Value**	**S & P / Moody's Bond Rating**
Lek Denominated Bonds	142,831,258	(4,484)	3,326,244	146,153,018	B1
USD Denominated Bonds	24,594,550	(145,400)	313,944	24,763,094	B – BB
EUR Denominated Bonds	24,488,514	(1,685,917)	185,935	22,988,532	BB- – Aa1
	191,914,322	**(1,835,801)**	**3,826,123**	**193,904,644**	

As at 30 June 2010, the fair value of the bond portfolio was USD 194,737,115, which is higher than the carrying value by USD 832,471. USD and EUR denominated bonds outstanding as at 30 June 2010 are composed of Eurobonds issued by foreign governments, banks and corporates.

As at 30 June 2010, an Irish Bond denominated in EUR and amounting to USD 10.2 million is pledged in favour of the Central Bank of the Republic of Kosovo ('CBK') as a capital equivalency deposit required for a branch of a foreign bank.

Investment securities held-to-maturity as at 31 December 2009 comprise as follows:

Type	**Nominal Value**	**Unamortized Premium / (Discount)**	**Accrued interest**	**Net Value**	**S & P / Moody's Bond Rating**
Lek Denominated Bonds	158,304,096	(15,566)	3,707,808	161,996,338	B1
USD Denominated Bonds	14,100,902	(259,144)	118,588	13,960,346	B – BB-
EUR Denominated Bonds	20,159,065	(1,595,583)	445,505	19,008,987	BB- – Aa1
	192,564,063	**(1,870,293)**	**4,271,901**	**194,965,671**	

As at 31 December 2009, the fair value of the held-to-maturity bond portfolio was USD 195,087,775, which is higher than the carrying value by USD 122,104.

12. Loans and advances to banks

The Bank has participated in syndicated loans with some non-resident banks as at 30 June 2010, with contractual details as follows:

Counterparty	**Currency**	**Principal**	**Accrued interest**	**Total**	**Maturity Date**
Turk Eximbank	EUR	12,244,257	71,370	12,315,627	04-Oct-2010
Akbank	EUR	6,122,128	378	6,122,506	25-Aug-2010
Turkiye Is Bankasi	EUR	6,122,128	4,220	6,126,348	24-Sep-2010
Investec Bank	EUR	6,122,128	12,109	6,134,237	11-Oct-2010
BANIF	EUR	6,122,128	1,887	6,124,015	01-Jul-2010
Yapi ve Kredi Bankasi	EUR	3,061,065	334	3,061,399	24-Sep-2010
Asya Katilim Bankasi	EUR	1,836,639	12,582	1,849,221	07-Apr-2011
Credit Europe Bank Suisse	USD	9,335,000	8,896	9,343,896	15-Dec-2010
Total	**USD**	**50,965,473**	**111,776**	**51,077,249**	

12. Loans and advances to banks (continued)

Loan and advances to banks as at 31 December 2009 were detailed as follows:

Counterparty	Currency	Principal	Accrued interest	Total	Maturity Date
Turk Eximbank	EUR	14,399,332	88,595	14,487,927	04-Oct-2010
Akbank	EUR	7,199,666	15,787	7,215,453	25-Aug-2010
Turkiye Is Bankasi	EUR	7,199,666	5,525	7,205,191	24-Sep-2010
Alternatifbank	EUR	7,199,666	36,338	7,236,004	19-Apr-2010
Credit Europe Bank Suisse	USD	9,335,000	8,313	9,343,313	15-Dec-2010
Total	**USD**	**45,333,330**	**154,558**	**45,487,888**	

13. Loans and advances to customers

Loans and advances to customers consisted of the following:

	30 June 2010	*31 December 2009*
Loans and advances to customers, gross	488,515,666	502,412,220
Accrued interest	6,683,141	5,317,311
Less allowances for impairment on loans and advances	(10,925,035)	(10,923,741)
Less unamortized deferred fee income	(2,276,345)	(2,534,504)
	481,997,427	**494,271,286**

Movements in the allowance for impairment on loans and advances:

	2010	*2009*
At 1 January	10,923,741	8,591,888
Impairment charge for the six months/ twelve months	1,641,994	3,068,156
Translation difference	(1,640,700)	(736,303)
At the end of the period	**10,925,035**	**10,923,741**

The impairment charge for six-month period ended 30 June 2009 was USD 961,831. As at 30 June 2010, the Bank's loans in arrears for more than 90 days totalled USD 26,641,100 (31 December 2009: USD 25,635,956). All loans are secured by mortgages and personal guarantees.

As at 30 June 2010 the breakdown of the loan portfolio is as follows:

Individuals	48.7%
Private Enterprises	46.3%
Public Enterprises	3.8%
Structured Finance	1.2%

Loans to individuals and loans to private enterprises are secured by mortgages and personal guarantees.

13. Loans and advances to customers (continued)

All loans are denominated in Lek, Euro, USD and CHF and bear interest at the following rates:

Loans in Lek	2.00% to 22.00%
Loans in Euro	1.64% to 22.00%
Loans in USD	3.84% to 13.00%
Loans in CHF	4.64% to 5.84%

The Bank has granted a few loans with interest rates at the minimum limit shown above, which are lower than the rates that are generally offered by the Bank, and are covered by cash collaterals.

The classification of corporate loans by industry is as follows:

	30 June 2010		31 December 2009	
	USD	**%**	**USD**	**%**
Wholesale Trade	75,488,933	22%	63,422,051	18%
Construction	43,152,606	13%	47,324,985	13%
Manufacture of Textile and Textile Products	28,693,575	8%	29,197,853	8%
Retail Trade	28,205,017	8%	27,869,564	8%
Manufacturing of Basic Metals and Fabricated Metal Products	26,499,103	8%	29,877,785	9%
Other Community, Social and Personal Activities	19,014,481	6%	30,939,076	9%
Manufacture of Food Products, Beverages	15,692,541	4%	16,932,317	5%
Hotels and Restaurants	15,228,976	4%	18,846,807	5%
Loan to Albanian Government	13,604,015	4%	15,839,265	5%
Manufacturing of Other Non-metallic Products	12,495,814	4%	15,303,510	4%
Manufacture of Machinery and Equipment	8,821,253	3%	-	-
Health and Social Work	8,146,668	2%	7,955,535	2%
Personal Needs	7,997,500	2%	8,414,108	2%
Financial Intermediation	7,101,645	2%	7,356,718	2%
Education	6,942,315	2%	3,552,489	1%
Manufacture of Rubber and Plastic Products	6,737,367	2%	7,990,887	2%
Manufacture of Wood and Wood Products	5,389,361	2%	6,423,558	2%
Transport, Storage and Communication	2,349,315	1%	2,428,319	1%
Real Estate, Renting and Business Activity	1,813,318	1%	2,317,131	1%
Other Sectors	5,835,227	2%	7,763,733	3%
	339,209,030	**100%**	**349,755,691**	**100%**

The classification of retail loans by type is as follows:

	30 June 2010		31 December 2009	
	USD	**%**	**USD**	**%**
Home purchase	84,844,056	57%	84,701,578	55%
Home improvement	21,900,548	15%	22,998,213	15%
Home reconstruction	10,079,262	7%	11,409,058	7%
Shop purchase	9,862,245	6%	9,981,830	7%
Super Loan	7,376,741	5%	8,714,315	6%
Home advances	5,666,213	4%	6,614,599	4%
Overdraft and credit cards	4,243,446	3%	3,858,200	2%
Technical equipment	832,559	0.5%	1,022,851	1%
Car purchase	678,101	0.5%	806,146	1%
Other types	3,823,465	2%	2,549,739	2%
	149,306,636	**100%**	**152,656,529**	**100%**

14. Property and equipment

Property and equipment as at 30 June 2010 and 31 December 2009 are composed as follows:

	Land and buildings	Vehicles and other equipment	IT equipment	Office equipment	Total
Gross value					
At 1 January 2009	**17,657,817**	**4,127,015**	**10,522,714**	**1,196,284**	**33,503,830**
Additions	1,687,811	708,854	2,800,040	277,114	**5,473,819**
Disposals / transfers	(877)	(117,937)	(41,871)	(626)	**(161,311)**
Translation difference	(1,349,118)	(279,212)	(785,475)	(80,362)	**(2,494,167)**
At 31 December 2009	**17,995,633**	**4,438,720**	**12,495,408**	**1,392,410**	**36,322,171**
Additions	195,935	64,749	535,243	11,916	**807,843**
Disposals / transfers	-	(65,381)	(684,900)	(3,167)	**(753,448)**
Translation difference	(2,538,637)	(630,686)	(1,766,731)	(197,727)	**(5,133,781)**
At 30 June 2010	**15,652,931**	**3,807,402**	**10,579,020**	**1,203,432**	**31,242,785**
Accumulated depreciation					
At 1 January 2009	**(5,752,777)**	**(2,096,370)**	**(6,296,847)**	**(656,577)**	**(14,802,571)**
Charge for the year	(774,378)	(694,055)	(1,907,748)	(171,117)	**(3,547,298)**
Disposals / write offs	-	116,298	41,147	609	**158,054**
Translation difference	478,955	174,426	534,088	53,659	**1,241,128**
At 31 December 2009	**(6,048,200)**	**(2,499,701)**	**(7,629,360)**	**(773,426)**	**(16,950,687)**
Charge for the period	(373,614)	(320,436)	(962,008)	(89,508)	**(1,745,566)**
Disposals / write offs	-	64,519	683,191	2,773	**750,483**
Translation difference	874,769	374,960	1,138,796	115,228	**2,503,753**
At 30 June 2010	**(5,547,045)**	**(2,380,658)**	**(6,769,381)**	**(744,933)**	**(15,442,017)**
Net book value					
At 31 December 2009	**11,947,433**	**1,939,019**	**4,866,048**	**618,984**	**19,371,484**
At 30 June 2010	**10,105,886**	**1,426,744**	**3,809,639**	**458,499**	**15,800,768**

As at 30 June 2010 the gross value of the assets which were fully depreciated was USD 6,396,466 (31 December 2009: USD 7,307,818).

15. Intangible assets

Intangible assets as of 30 June 2010 and 31 December 2009 are composed as follows:

	Software
Gross value	
At 1 January 2009	**3,408,206**
Additions	958,070
Translation difference	(281,024)
At 31 December 2009	**4,085,252**
Additions	568,211
Translation difference	(572,976)
At 30 June 2010	**4,080,487**
Accumulated depreciation	
At 1 January 2009	**(2,205,808)**
Charge for the year	(548,285)
Translation difference	187,216
At 31 December 2009	**(2,566,877)**
Charge for the period	(296,548)
Translation difference	379,549
At 30 June 2010	**(2,483,876)**
Net book value	
At 31 December 2009	**1,518,375**
At 30 June 2010	**1,596,611**

Software represents mostly the Bank’s operating and accounting system implemented during 2001, which was upgraded during the first half of 2005, followed by the purchase of a license for additional users for the years 2007 to 2010. Furthermore, in 2009 the Bank obtained the license and software for providing internet and mobile banking services.

16. Non – current assets held for sale

This item comprises the collateral values of some unrecoverable loans totalling USD 1,800,567 (2009: USD 1,297,477), the ownership of which, was taken on behalf of the Bank. The values of these assets are reappraised on a regular basis and the Bank has in place an Asset Sale Committee, which deals with the sale process of these assets. The fair value of these assets is determined with reference to the current market prices.

17. Other assets

Other assets, net as at 30 June 2010 and 31 December 2009 are as follows:

	30 June 2010	*31 December 2009*
Cheques for collection and payments in transit	199,474	218,587
Inventory	547	636
Spot transactions revaluation gain	220,529	212,477
Other debtors, net	2,335,778	2,630,800
	2,756,328	**3,062,500**

"Cheques for collection and payments in transit" represent customers' cheques and payments drawn on other banks that are in the process of being collected.

"Inventory" represents stationary, supplies and printed-paper waiting to be deployed in use.

"Other debtors" are composed as follows:

	30 June 2010	*31 December 2009*
Other debtors	2,338,432	2,633,454
Provision	(2,654)	(2,654)
	2,335,778	**2,630,800**

"Other debtors" are composed of four main items. The first item of USD 1,407,733 (2009: USD 1,293,867) consists mostly of USD 1,242,797 (2009: USD 1,235,157) of credit disbursement and administration costs paid by the Bank, but charged and repayable by the borrowers. The other three items represent advance payments to suppliers of USD 176,923 (2009: USD 137,372), prepaid expenses of USD 625,218 (2009: USD 567,939) and income tax receivable of USD 128,558 (2009: USD 634,276).

18. Customer deposits

Customer deposits as at 30 June 2010 and 31 December 2009 are composed as follows:

	30 June 2010	*31 December 2009*
Current accounts:		
Individuals	46,909,938	58,983,855
Private enterprises	82,064,817	95,777,461
State owned entities	31,178,414	34,097,782
	160,153,169	**188,859,098**
Deposits:		
Individuals	846,442,761	883,367,078
Private enterprises	40,189,661	40,815,611
State owned entities	41,564,411	40,986,047
	928,196,833	**965,168,736**
Other customer accounts:		
Individuals	5,747,614	3,099,749
Private enterprises	6,271,212	9,129,505
State owned entities	886,686	889,770
	12,905,512	**13,119,024**
	1,101,255,514	**1,167,146,858**

18. Customer deposits (continued)

Current accounts and deposits can be further analysed as follows:

	30 June 2010			*31 December 2009*		
	Local currency	*Foreign currency*	*Total*	*Local currency*	*Foreign currency*	*Total*
Current accounts	**102,173,943**	**57,979,226**	**160,153,169**	**110,832,536**	**78,026,562**	**188,859,098**
Deposits						
On demand	98,087	9,848,426	**9,946,513**	34,411	9,065,182	**9,099,593**
One month	23,069,689	40,136,533	**63,206,222**	28,909,346	38,851,617	**67,760,963**
Three months	65,764,785	59,155,339	**124,920,124**	70,381,878	60,729,086	**131,110,964**
Six months	92,024,552	77,991,141	**170,015,693**	98,508,001	72,445,336	**170,953,337**
Twelve months	271,155,228	207,331,668	**478,486,896**	287,910,872	212,243,895	**500,154,767**
Two years and over	35,806,476	24,104,597	**59,911,073**	41,068,249	24,876,557	**65,944,806**
Accrued interest on deposits	14,866,972	6,843,340	**21,710,312**	14,772,328	5,371,978	**20,144,306**
Total deposits	**502,785,789**	**425,411,044**	**928,196,833**	**541,585,085**	**423,583,651**	**965,168,736**
Other customer accounts	**5,723,701**	**7,181,811**	**12,905,512**	**5,882,898**	**7,236,126**	**13,119,024**
Total customer deposits	**610,683,433**	**490,572,081**	**1,101,255,514**	**658,300,519**	**508,846,339**	**1,167,146,858**

Other customer accounts are composed as follows:

	30 June 2010			*31 December 2009*		
	Local currency	*Foreign currency*	*Total*	*Local currency*	*Foreign currency*	*Total*
Deposit guarantees for letters of credit	-	170,004	**170,004**	-	1,451,634	**1,451,634**
Escrow accounts	4,541,345	4,704,043	**9,245,388**	5,092,480	4,334,831	**9,427,311**
Bank drafts	-	7,589	**7,589**	-	7,780	**7,780**
Payment orders to be executed	46,928	194,618	**241,546**	44,418	187,354	**231,772**
Other	1,135,428	2,105,557	**3,240,985**	746,000	1,254,527	**2,000,527**
	5,723,701	**7,181,811**	**12,905,512**	**5,882,898**	**7,236,126**	**13,119,024**

“Deposit guarantee for letters of credit” represent the cash collateral held by the Bank against similar collateral provided by the Bank to correspondent banks for letters of credit opened on behalf of its customers.

“Escrow accounts” balance represents sums blocked until the completion of an operation or the extinction of a risk. Amounts registered in these accounts are mostly related to cash coverage received from customers due to the issuance of bid and performance bonds by the bank or due to treasury bills’ transactions with Bank of Albania intermediated by the bank.

“Other” represents deposits that are pending to be allocated into the relevant deposit category the next business day (value date).

19. Due to banks

Due to banks as at 30 June 2010 and 31 December 2009 consisted as follows:

	30 June 2010	*31 December 2009*
Treasury bills sold under Repo agreements with Central Bank	56,136,043	63,206,277
Deposits from banks	2,692,386	4,319,803
Current accounts of non resident banks	1,362,976	1,598,351
Current accounts of resident banks	29,700	50,624
	60,221,105	**69,175,055**

Deposits from banks as at 30 June 2010 represent an overnight borrowing denominated in Lek obtained from a resident bank:

Bank	**Principal**	**Accrued interest**	**Total deposit**	**Maturity date**
Alpha Bank Albania	2,692,032	354	2,692,386	01 July 2010
	2,692,032	**354**	**2,692,386**	

20. Due to third parties

The Bank acts as an agent for the tax authorities either in the collection of taxes or in performing advance payments for the budget. In return, the Bank charges a commission to the taxpayers for the service rendered. The credit balance as at 30 June 2010 of USD 1,125,546 (31 December 2009: USD 456,415) represents the net outstanding amount of payments and collections made by the Bank to and from the third parties, on behalf of tax authorities.

21. Deferred tax liabilities

Deferred income taxes are calculated on all temporary differences under the balance sheet method using a tax rate of 10%. The movement on the deferred income tax account is as follows:

	30June2010	*31December2009*
Balance at 1 January	(736,954)	(167,338)
Income statement expense	(325,644)	(588,760)
Exchange differences	124,897	19,144
Balance at the end of the period	**(937,701)**	**(736,954)**

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

	30June2010	*31December2009*
Deferred income on fees on loans	227,634	253,450
Allowance for loan impairment	(1,389,001)	(1,225,853)
Decelerated depreciation	223,666	235,449
	(937,701)	**(736,954)**

22. Accruals and other liabilities

A breakdown of accruals and other liabilities as at 30 June 2010 and 31 December 2009 is presented as follows:

	30 June 2010	*31 December 2009*
Creditors	1,844,174	1,844,891
Transit account	343,803	205,850
Reserve fund for retiring employees	1,946,941	1,753,698
Due to tax authorities	282,651	201,926
Social insurance	111,270	122,775
Accrued expenses and deferred income	2,464,281	2,415,930
Other	1,014,075	1,310,647
	8,007,195	**7,855,717**

"Creditors" represent balances from old transactions that the Albanian Government is keeping with the Bank, pending the determination of the rightful owner of these amounts. As at the date of the report, a decision is not yet taken.

"Transit account" mostly represents the undefined customer accounts that are cleared within a couple of days after the end of the period.

"Reserve fund for retiring employees" represents a specific fund created in 2002 by the Bank, which will be paid to staff on their retirement.

"Accrued expenses" includes USD 736,231 (2009: USD 477,587) of deposit insurance premium due for the second quarter of 2010 according to the Law no. 8873 "On the Insurance of Deposits" dated 29 March 2002, that provides insurance coverage to individual depositors against bank failures.

Accrued expenses for personnel amounting to USD 1,054,352 (2009: USD 984,566) represents the accrued amounts of holiday salary and of yearly performance bonus for the bank's staff and management.

"Other" consists of two items. The first item of USD 958,895 (2009: USD 1,120,153) are payments due to construction companies in relation to semi finished home loans. The other item represents cash guarantees received from the suppliers of USD 55,180 (2009: USD 81,994).

23. Shareholders' equity

Share Capital

At 30 June 2010 the authorised share capital comprised 6,852,000 ordinary shares (2009: 6,340,000). The shares have a par value of USD 12.35. All issued shares are fully paid. The holders of ordinary shares are entitled to receive dividends from time to time, if declared. All shares rank equally with regard to the Bank's residual assets.

Reserves

Translation reserve

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations as well as from the translation of consolidated financial statements from functional currency to presentation currency.

Fair value reserve

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

23. Shareholders' equity (continued)

Retained earnings

Retained earnings as at 30 June 2010 includes the cumulative non distributed earnings from the profit for 2009 and six months ending 30 June 2010. As described in Note 1, the Bank has used its statutory retained earnings amounting to Lek 653,249,792 or USD 6,323,200 to increase its share capital on 31 March 2010.

24. Interest income

Interest income is composed as follows:

	Six-month period ended 30 June 2010	***Six-month period ended 30 June 2009***
Placements and balances with banks and Central Bank	2,313,386	3,378,328
Treasury bills and investment securities	22,772,852	16,686,671
Loans and advances to customers	24,489,661	17,547,249
	49,575,899	**37,612,248**

Interest income can be further analysed as follows:

	Six-month period ended 30 June 2010	***Six-month period ended 30 June 2009***
Available-for-sale financial assets	8,600,436	4,386,401
Held-to-maturity investments	16,485,802	15,678,598
Loans and receivables	24,489,661	17,547,249
	49,575,899	**37,612,248**

Interest income on impaired loans for the six-month period ended 30 June 2010 was USD 375,886 (30 June 2009: USD 804,751).

25. Interest expense

Interest expense raised from financial liabilities measured at amortized cost is composed as follows:

	Six-month period ended 30 June 2010	***Six-month period ended 30 June 2009***
Due to banks	1,279,477	1,222,845
Customer deposits	23,093,036	19,983,852
	24,372,513	**21,206,697**

26. Fees and commissions, net

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

	Six-month period ended 30 June 2010	*Six-month period ended 30 June 2009*
Fee and commission income		
Lending activity	1,168,838	1,231,706
Payment services to clients	960,926	875,315
Customer accounts' maintenance	311,147	283,860
Inter bank transactions	275,793	44,221
Card transactions	201,067	119,668
Cash transactions with clients	153,891	126,573
Other fees and commissions	35,060	27,889
	3,106,722	*2,709,232*
Fee and commission expense		
Transactions with clients	(660,767)	-
Customer accounts' maintenance	(45,929)	(47,185)
Inter bank transactions	(28,241)	(119,209)
Payment services to clients	(8,668)	(8,712)
	(743,605)	*(175,106)*
Fees and commissions, net	**2,363,117**	**2,534,126**

27. Foreign exchange revaluation gain (loss), net

Foreign exchange revaluation gain represents the net revaluation of the Bank's foreign currency monetary assets and liabilities. In addition, as described in Note 3(b) it also includes the revaluation of the Bank's share capital. The revaluation loss on the share capital for the six-month period ended 30 June 2010 is USD 12,253,493 (six months ended 30 June 2009: USD 2,234,259 - loss).

28. Other income / (expense), net

Other income and expenses are composed as follows:

	Six-month period ended 30 June 2010	*Six-month period ended 30 June 2009*
Other income		
Gain on sale of fixed assets	20,836	3,034
Gain on recovery of lost loans	5,685	-
Sundry	92,243	36,042
	118,764	*39,076*
Other expense		
Loss on sale or write off of fixed assets	(2,891)	(1,169)
Loss on unrecoverable lost loans	(82,086)	(139,377)
Sundry	(13,911)	(23,740)
	(98,888)	*(164,286)*
Other income / (expense), net	**19,876**	**(125,210)**

29. Personnel expenses

Personnel expenses are composed as follows:

	Six-month period ended 30 June 2010	*Six-month period ended 30 June 2009*
Salaries	4,620,746	4,305,057
Performance bonus	531,255	683,367
Social insurance	443,254	506,807
Reserve fund for retiring employees	193,655	207,511
Training	148,545	142,801
Life insurance	4,313	5,044
Other	84,836	29,316
	6,026,604	**5,879,903**

30. Administrative expenses

Administrative expenses are composed as follows:

	Six-month period ended 30 June 2010	*Six-month period ended 30 June 2009*
Marketing expenses	1,377,763	1,082,536
Telephone, electricity and IT expenses	1,052,502	1,063,212
Deposit insurance expense	1,581,578	940,043
Lease payments	847,822	777,711
Repairs and maintenance	507,660	430,370
Security and insurance expenses	372,475	391,231
Credit/debit cards expenses	308,870	327,390
Transportation and business related travel	293,231	257,824
Office stationery and supplies	204,955	201,575
Other external services (including external audit fees)	180,816	207,632
Representation expenses	35,616	39,461
Taxes other than tax on profits	79,383	47,880
Sundry	185,309	45,566
	7,027,980	**5,812,431**

31. Income tax

Income tax is comprised of:

	Six-month period ended 30 June 2010	*Six-month period ended 30 June 2009*
Current income tax	1,094,988	316,020
Deferred tax expense (note 21)	325,644	391,981
	1,420,632	**708,001**

31. Income tax (continued)

The tax on profit before tax differs from the theoretical amount that would arise using the basic tax rate as follows:

	Six-month period ended 30 June 2010	*Six-month period ended 30 June 2009*
Profit before taxes	**14,109,176**	**6,828,523**
Computed tax using applicable tax rate	1,410,918	682,852
Non tax deductible expenses	67,589	49,115
Foreign exchange difference	(57,875)	(23,966)
Income tax	**1,420,632**	**708,001**
Effective tax rate	**10%**	**10%**

32. Related party transactions

In accordance with IAS 24 “Related Party Disclosures”, a related party is any party that has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions.

Identity of related parties

The Bank has related party relationships with its shareholder, directors and executive officers.

Transactions with shareholders

The Bank had only one deposit placed with and two available-for-sale corporate bonds purchased from its shareholders outstanding as at 30 June 2010, for which contractual details are as follows:

Related party	**Amount**	**Interest rate**	**Value date**	**Maturity date**	
Aktifbank	7,000,000	3.50%	29 April 2010	26 April 2011	
	Nominal value	**Coupon rate**	**Fair value**	**Maturity date**	**Fitch Bond Rating**
Calik Holding	1,350,000	8.5%	1,270,605	March 2012	B-

At 30 June 2010, the Bank had an outstanding loan of USD 5,414,573 to Huawei Technologies Albania Sh.p.k for the purpose of transferring that entity’s receivables from Eagle Mobile Sh.a. to the Bank. The Bank has the right to require the repayment of this amount from Eagle Mobile Sh.a.

The aggregate value of transactions and outstanding balances included in Customer deposits and relating to the related parties were as follows:

	30 June 2010	**Net movements**	**31 December 2009**
Alb Telecom Sh.a.	5,859,111	3,339,262	2,519,849
Eagle Mobile Sh.a.	1,737,153	(4,225,995)	5,963,148
Total	**7,596,264**	**(886,733)**	**8,482,997**

Net movements include the total deposits, withdrawals, interest and related fees between these entities and the Bank.

32. Related party transactions (continued)

Transactions with directors and executive officers

The remuneration of directors and executive officers is included in personnel expenses. It can be detailed as follows:

	Six-month period ended 30 June 2010	*Six-month period ended 30 June 2009*
Directors	56,667	20,000
Executive officers	901,243	735,388
	957,910	**755,388**

The remuneration of directors and executive officers for the year ended 31 December 2009 was USD 1,965,529.

33. Contingencies and commitments including off-balance sheets items

Guarantees

	30 June 2010	*31 December 2009*
Guarantees in favour of customers	18,899,978	21,634,109
Guarantees received from credit institutions	1,046,270	1,591,569
Letters of credit issued to customers	1,968,715	4,323,930

Guarantees and letters of credit issued in favour of customers mostly are counter guaranteed by other financial institutions or fully cash collateralised.

At present the Bank is operating as an agent for the Government in the administration and implementation of certain loans to state owned entities utilising credit lines received from international donors. These donors have received individual guarantees from the government of Albania to cover the reimbursement of their lines of credit.

Other

	30 June 2010	*31 December 2009*
Undrawn credit commitments	20,794,196	23,744,714
Outstanding cheques of non-resident banks	192,576	315,142
Spot foreign currency contract	13,701,373	12,145,547
Collaterals for loan portfolio	1,255,279,864	1,218,746,043

Legal

In the normal course of business the Bank is presented with legal claims and litigation; the Bank's management is of the opinion that no material losses will be incurred in relation to legal claims outstanding as at 30 June 2010.

Lease commitments

Such commitments for the period ended 30 June 2010 and year ended 31 December 2009 are composed as follows:

	30 June 2010	*31 December 2009*
Not later than 1 year	1,689,123	1,741,167
Later than 1 year and not later than 5 years	6,084,245	6,264,853
Later than 5 years	3,492,663	4,161,564
Total	**11,266,031**	**12,167,584**

33. Contingencies and commitments including off-balance sheets items (continued)

Lease commitments (continued)

The Bank has entered into lease commitments for all the branches and agencies opened during the years 2003-2010 with a maximum duration of ten years.

The Bank had 62 rented buildings as at 30 June 2010, in which are included the rented space dedicated to off site disaster recovery and the 12 buildings rented for units of Kosovo Branch.

The Bank may cancel these leases upon giving three months' notice.

34. Subsequent events

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