

**BULGARIAN DEVELOPMENT BANK AD**

**ANNUAL MANAGEMENT REPORT  
INDEPENDENT AUDITOR'S REPORT  
ANNUAL FINANCIAL STATEMENTS**

**DECEMBER 31, 2011**



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## INDEPENDENT AUDITORS' REPORT

To the shareholders  
Bulgarian Development Bank AD

### Report on the Separate Financial Statements

We have audited the accompanying separate financial statements of Bulgarian Development Bank AD ("the Bank"), which comprise the separate statement of financial position as at 31 December 2011, the separate statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### *Management's Responsibility for the Separate Financial Statements*

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

#### *Auditor's Responsibility*

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

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

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

*Opinion*

In our opinion, the separate financial statements give a true and fair view of the unconsolidated financial position of the Bank as at 31 December 2011, and of its unconsolidated financial performance and its unconsolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

**Report on Other Legal and Regulatory Requirements**

*Annual report of the activities of the Bank prepared in accordance with the requirements of article 33 of the Accountancy Act*

As required under the Accountancy Act, we report that the historical financial information disclosed in the separate annual report of the activities of the Bank, prepared by Management as required under article 33 of the Accountancy Act, is consistent, in all material aspects, with the unconsolidated financial information disclosed in the audited separate financial statements of the Bank as of and for the year ended 31 December 2011. Management is responsible for the preparation of the separate annual report of the activities of the Bank which was approved by the Management Board of the Bank on 29 March 2012.

Krassimir Hadjidinev  
*Director*

KPMG Bulgaria OOD  
Sofia, 19 September 2012

Margarita Goleva  
*Registered auditor*




BULGARIAN DEVELOPMENT BANK AD

STATEMENT OF FINANCIAL POSITION  
AS AT 31 DECEMBER 2011

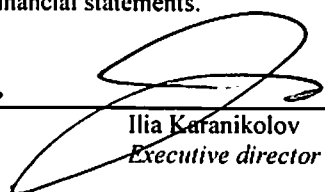
*In thousand of BGN*

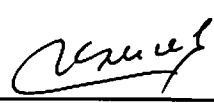
	Note	As at 31.12.2011	As at 31.12.2010
<b>Assets</b>			
Cash and balances with the Central Bank	16	70,335	33,694
Loans and advances to banks	17	858,948	636,669
Loans and advances to customers	18	477,871	367,590
Receivables from the State Budget	19	335,395	266,190
Available-for-sale securities	20	16,560	17,922
Financial assets held for trading	21	2,995	-
Investments in subsidiaries	22	84,562	32,062
Property, plant and equipment, intangible assets	23	14,523	14,190
Deferred tax assets	14	1,284	57
Current tax assets		636	-
Other assets	25	4,038	2,121
Assets classified as held for sale	24	3,244	3,291
<b>Total assets</b>		<b>1,870,391</b>	<b>1,373,786</b>
<b>Liabilities</b>			
Deposits from banks	26	120,432	91,538
Deposits from customers	27	466,826	64,284
Borrowings from international institutions	28	327,963	331,357
Other borrowings	29	195,378	145,301
Debt securities issued	30	78,499	78,499
Financial liabilities held for trading	31	3,081	-
Current tax liabilities		-	479
Other liabilities	32	12,609	2,844
<b>Total liabilities</b>		<b>1,204,788</b>	<b>714,302</b>
<b>Equity</b>			
Share capital	33	601,774	601,774
Retained earnings	34	6,218	25,883
Revaluation reserves	34	(403)	(304)
Reserves	34	58,014	32,131
<b>Total equity</b>		<b>665,603</b>	<b>659,484</b>
<b>Total equity and liabilities</b>		<b>1,870,391</b>	<b>1,373,786</b>

The accompanying notes are an integral part of these financial statements.


  
Asen Yagodin  
Executive director


  
Vladimir Gulev  
Executive director

  
Ilija Karanikolov  
Executive director

  
Ivan Lichev  
Chief accountant

In accordance with an independent auditor's report:

  
Krasimir Hadjidinev  
Director  
KPMG Bulgaria OOD

  
Margarita Goleva  
Registered auditor



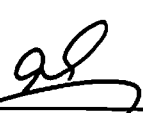
BULGARIAN DEVELOPMENT BANK AD


STATEMENT OF COMPREHENSIVE INCOME  
FOR THE YEAR ENDED 31 DECEMBER 2011


*In thousand of BGN*


	Note	Year ended 31.12.2011	Year ended 31.12.2010
Interest income	6	82,188	62,048
Interest expense	6	(20,751)	(11,181)
<b>Net interest income</b>	6	<b>61,437</b>	<b>50,867</b>
Fee and commission income	7	1,878	1,822
Fee and commission expense	7	(76)	(147)
<b>Net fee and commission income</b>	7	<b>1,802</b>	<b>1,675</b>
Net gains from foreign exchange deals	8	340	251
Net gains (losses) from available-for-sale securities	9	(176)	31
Net gains from financial instrument held for trading	10	979	-
Other operating gains (losses)	11	(335)	3,878
<b>Total operating income</b>		<b>64,047</b>	<b>56,702</b>
General and administrative expenses	13	(8,636)	(6,344)
Depreciation and amortization	23	(213)	(178)
Impairment loss on financial assets	12	(48,276)	(21,910)
<b>Profit before income tax</b>		<b>6,922</b>	<b>28,270</b>
Income tax expense	14	(704)	(2,387)
<b>Profit for the year</b>		<b>6,218</b>	<b>25,883</b>
Other comprehensive income			
Net change in fair value of available-for-sale financial assets	15	(99)	(111)
Other comprehensive income for the year, net of tax		(99)	(111)
<b>Total comprehensive income for the year</b>		<b>6,119</b>	<b>25,772</b>

The accompanying notes are an integral part of these financial statements.


  
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Chief accountant

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Krasimir Hadjidinev  
Director  
KPMG Bulgaria OOD



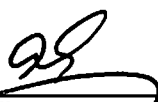
  
Margarita Goleva  
Registered auditor


BULGARIAN DEVELOPMENT BANK AD

INDIVIDUAL STATEMENT OF CHANGES IN EQUITY  
AS AT 31 DECEMBER 2011

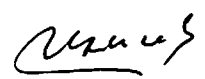
<i>In thousand of BGN</i>	Share capital	Statutory reserves	Additional reserves	AFS Revaluation reserve	Retained earnings	Total
<b>Balance as at 01 January 2010</b>	589,574	10,395	6,190	(193)	15,546	621,512
Increase in share capital	12,200	-	-	-	-	12,200
Transfer to statutory reserves	-	15,546	-	-	(15,546)	-
Profit for the year	-	-	-	-	25,883	25,883
Net change in fair value of AFS financial assets	-	-	-	(111)	-	(111)
Total comprehensive income for the year	-	-	-	(111)	25,883	25,772
<b>Balance as at 31 December 2010</b>	<b>601,774</b>	<b>25,941</b>	<b>6,190</b>	<b>(304)</b>	<b>25,883</b>	<b>659,484</b>
	Share capital	Statutory reserves	Additional reserves	AFS Revaluation reserve	Retained earnings	Total
<b>Balance as at 01 January 2011</b>	601,774	25,941	6,190	(304)	25,883	659,484
Increase in share capital	-	-	-	-	-	-
Transfer to statutory reserves	-	25,883	-	-	(25,883)	-
Profit for the year	-	-	-	-	6,218	6,218
Net change in fair value of AFS financial assets	-	-	-	(99)	-	(99)
Total comprehensive income for the year	-	-	-	(99)	6,218	6,119
<b>Balance as at 31 December 2011</b>	<b>601,774</b>	<b>51,824</b>	<b>6,190</b>	<b>(403)</b>	<b>6,218</b>	<b>665,603</b>

The accompanying notes are an integral part of these financial statements.


  
Asen Yagodin  
Executive director

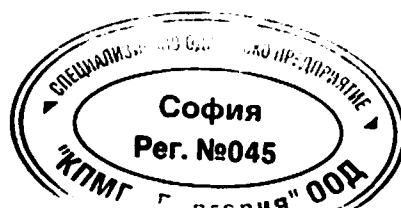
  
Vladimir Ghulev  
Executive director


  
Ilija Karanikolov  
Executive director

  
Ivan Lichev  
Chief accountant

In accordance with an independent auditor's report:

  
Krasimir Hadjidinev  
Director  
KPMG Bulgaria OOD



  
Margarita Goleva  
Registered auditor

BULGARIAN DEVELOPMENT BANK AD

STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31 DECEMBER 2011

*In thousand of BGN*


	Note	Year ended 31.12.2011	Year ended 31.12.2010
<b>Cash flows from operating activities</b>			
Profit for the year		6,218	25,883
Impairment loss on loans and advances to customers and bank portfolio guarantees		46,144	21,910
Impairment loss on available-for-sale securities		153	-
Impairment loss on assets classified as held for sale		2,132	-
Net (gain)/loss arising on revaluation of financial instruments classified as held for trading		1,600	-
Depreciation and amortization		213	178
Loss from written-off tangible assets		3	27
Income tax expense		704	2,387
<b>Cash flow from operating activity before changes in operating assets and liabilities</b>		<b>57,167</b>	<b>50,385</b>
Decrease in balances with the Central Bank		17	15
Decrease in loans and advances to banks		24,247	4,236
(Increase) in loans and advances to customers		(137,367)	(114,589)
(Increase) in receivables from the State Budget		(77,839)	(258,819)
(Increase)/ decrease in available-for-sale securities		1,110	(3,843)
Decrease in financial assets held for trading		66	-
(Increase) in assets classified as held for sale		(176)	(153)
Decrease in other assets		(458)	(216)
Increase in deposits from banks		28,764	62,733
Increase/(decrease) in deposits from customers		401,821	(4,906)
Increase in other borrowings		51,000	120,000
(Decrease) in financial liabilities held for trading		(1,580)	-
Increase/(decrease) in interest and fees payables		1,038	(5,442)
Decrease in other liabilities		(4,593)	-
Income tax paid		(3,046)	(1,885)
<b>Net cash used in operating activities</b>		<b>340,171</b>	<b>(152,484)</b>
<b>Cash flows from investing activities</b>			
Payments for property, plant and equipment, and intangible assets		(554)	(243)
Proceeds from disposal of property, plant and equipment, and intangible assets		5	-
Acquisition of shares in subsidiary		(52,500)	(4,562)
<b>Net cash used in investing activities</b>		<b>(53,049)</b>	<b>(4,805)</b>
<b>Cash flows from financing activities</b>			
Proceeds from debt securities issues		-	78,233
Proceeds from long-term borrowed funds		67,401	197,746
Repayments on long-term borrowed funds		(71,905)	(21,796)
<b>Net cash generated by financing activities</b>		<b>(4,504)</b>	<b>254,183</b>

BULGARIAN DEVELOPMENT BANK AD


STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31 DECEMBER 2011


Net increase in cash and cash equivalents		282,618	96,894
Cash and cash equivalents at the beginning of the year	36	<u>197,565</u>	<u>100,671</u>
Cash and cash equivalents at the end of the year	36	<u>480,183</u>	<u>197,565</u>

The accompanying notes are an integral part of these financial statements.


  
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Ivan Lichev  
Chief accountant

In accordance with an independent auditor's report:

  
Krasimir Hadjidinev  
Director  
KPMG Bulgaria OOD



  
Margarita Goleva  
Registered auditor



## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 1. REPORTING ENTITY AND OPERATING POLICIES

Bulgarian Development Bank AD (BDB/the Bank) was initially established on 11 March 1999 as a joint-stock company in Bulgaria under the name Encouragement Bank AD.

The Bulgarian Development Bank Act was adopted on 23 April 2008 (SG 43/29.04.2008) and the structure and the scope of Bank's activities including those for its envisaged subsidiaries were provided for therein. By virtue of that law all rights and obligations were applied to Encouragement Bank AD. Following a requirement of the law, a General Meeting of the Shareholders was held (26 June 2008) at which the name of the Bank was changed to Bulgarian Development Bank and its Articles of Incorporation were amended in line with the new legal requirements thereto.

The registered address of the bank is 10, Stefan Karadzha, Sofia.

The Bank holds a general banking licence, issued by the Central Bank of Bulgaria (BNB) on 25 February 1999 with latest update of 16 November 2009 (due to the new Credit Institutions Act) and is allowed to conduct all banking transactions permitted by the Bulgarian legislation. Nevertheless, its Articles of Incorporation prohibit the following types of operations: accepting deposits from individuals (except for deposits from the employees), transactions with precious metals, issuance and management of bank cards and provision of safe-deposit boxes. The Bank is also a licensed financial intermediary and a broker.

The Bank was established with a special purpose – to support the implementation of the economic policies of the State by financing the business development of small and medium-sized enterprises (SME) including by maintaining their investment and export abilities and initiatives. With the adoption of the Bulgarian Development Bank Act in 2008 this objective was further incorporated in the principles and scope of the Bank's activities as set by law.

These include:

- (a) pre-export and export financing of SME;
- (b) SME financing by investing in equity from its subsidiary the Capital Investment Fund (still not incorporated);
- (c) financing SME operations and projects either through local intermediary banks or directly;
- (d) guarantees issuance to SME to serve to local and foreign banks either directly or through its subsidiary the National Guarantee Fund (already established - 2008);
- (e) refinancing banks that grant loans to SME;
- (f) financing SME investments abroad;
- (g) EU financial resources management and support of activities under state, municipal and international projects directed towards the development of the economy of the country, including with regard to the utilisation of funds/subsidies for such projects; and
- (h) other activities relevant to this scope and state objectives.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 1. REPORTING ENTITY AND OPERATING POLICIES (CONTINUED)

In 2011 Bulgarian Development Bank AD has granted BGN 335 million to the Ministry of Agriculture and Food of Republic of Bulgaria the funds of which will be utilized under the Rural Development Programme of the European Union. It is expected the new guarantee fund to provide loans for over BGN 1.2 billion. The guarantee fund will be governed by National Guarantee Fund EAD, a subsidiary of Bulgarian Development Bank AD.

In the first half of 2011 the main activity of the parent company (The Bank) was related mainly to the implementation of Decision 197 dated 08 April 2010 of the Council of ministers on the "Adoption of a mechanism for settlement of State budget liabilities". The parent company (The Bank) hereby acquires the receivables arising out of contracts, concluded after applying the Law on Public procurement procedure, related to capital expenses and deliveries, where the receivables are liquid and payable as of 31.03.2010. The receivables were acquired in compliance with the specific provisions of the applicable laws and regulations through session under the Law on liabilities and contracts. All receivables have been collected in July 2011.

In 2011, the commercial banking activity continued as well, including provision of loans to private companies (with priority on long-term and investment loans), special-purpose financing of banks (on-lending), transactions with treasury bonds, deposit and REPO transactions on interbank market, attraction of long-term credit lines and loans from international financial institutions, issuance of bank guarantees – directly to customers (companies) and in favor of lending banks (under the transferred to BDB project of the MLSP "Microcredit guarantee fund"), as well as other financial services in Bulgaria.

At 31 December 2011, the parent company (The Bank) has 111 employees (31.12.2010 r.: 100).

The Bulgarian Development Bank Act (2008) envisages the establishment of two Bank subsidiaries - the Capital Investment Fund and the National Guarantee Fund.

The Capital Investment Fund is at project level and has not been established as at 31 December 2011.

The National Guarantee Fund (the NGF) was established on 12 August 2008 as a sole owner joint-stock company with 100% ownership of BDB. The registered office of the Fund is 10, Dyakon Ignatiy Str., Sofia. The registered share capital is 800 000 registered nominal shares with par value of BGN 100 each (31.12.2010: 800 000 registered nominal shares with par value of BGN 100 each), the paid-in capital of which amounts to BGN 80,000,000 (31.12.2010: BGN 27,500,000). The scope of NGF's principal activities is defined by the Bulgarian Development Bank Act. It includes:

- (a) issue of guarantees to supplement the collaterals for SME loans,
- (b) provide other guarantee products to serve as security for participation in tenders, for good performance,
- (c) guarantees for advance payments and for payment of loans to exporters, and
- (d) other similar services.

The guarantees shall cover up to 50% of the respective liability to which they refer.

The National Guarantee Fund is managed by a Board of Directors (BD) with a mandate ending 12 August 2016. The members of the BD are: Svetlin Statkov, Dimitar Mitev and Andey Genev.

At 31 December 2011, the NGF has 12 employees (31.12.2010: 12)

A micro-financing institution JOBS EAD (MFI) was registered on 14.01.2011 as sole proprietorship joint stock company, 100% owned by BDB. The registered address of the MFI is 10, Stefan Karadzha str., Sofia. As of 31.12.2011 the registered shareholder's equity comprises 45 618 nominal shares with par value of BGN 100 each, and the paid-in capital as of 31.12.2011 amounts to BGN 4,561,800 (Note 22).

## **BULGARIAN DEVELOPMENT BANK AD**

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### **1. REPORTING ENTITY AND OPERATING POLICIES (CONTINUED)**

MFI' scope of activities include, as follows:

a) micro-financing /with a maximum equivalent per product per customer – EUR 25,000 /including, but not limited to:

- provision of microloans;
- purchase from third parties and leasing of industrial equipment, automobiles and other vehicles, as well as other assets (financial leasing);
- sale and purchase of such items;
- consultancy;

JOBS MFI is managed by a Board of directors (BoD) with a mandate ending 23 December 2013. Members of the Board are: Martin Genchev, Ilia Karanikolov and Deiana Kostadinova.

The registration of the company is dated 14.01.2011. As of 31.12.2011 the entity has 9 employees.

As of 31.12.2011 Bulgarian Development Bank Group does not have branches.

The financial statements have been adopted by the Bank's Managing board of the Bank on 29 March 2012.

## **BULGARIAN DEVELOPMENT BANK AD**

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### **2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS**

#### **Statement of compliance**

These individual financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union.

These financial statements have been prepared on individual basis. The Bank prepares consolidated financial statements as per the Accounting law. The present individual financial statements shall be read together with the consolidated financial statements.

#### **Basis of preparation**

These individual financial statements have been prepared on historical cost basis except for:

- Derivative instruments, measured at fair value at the reporting date;
- Trade instruments and other instruments, designated at fair value through profit and loss, as long as the fair value can be appropriately measured;
- Instruments available-for-sale, designated at fair value through profit and loss, as long as the fair value can be appropriately measured;
- Present value of pension liability.

#### **Functional and presentation currency**

These individual financial statements are presented in Bulgarian leva (BGN) rounded to the nearest thousand, which is the Bank's functional currency.

#### **Use of estimates and judgments**

The preparation of these individual financial statements requires management to exercise its judgment in the process of applying the Group's accounting policies and the reported value of assets, liabilities, income and expense. Actual results may differ from these estimates and judgments.

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. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 5.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### **Financial instruments**

The Bank classifies its financial assets in the following categories: 'loans and receivables', 'assets available-for-sale', 'assets held-for-trading' and 'assets held-to-maturity'. The classification depends on the nature and purpose of the financial assets at the time of their acquisition. The management determines the classification of the financial assets of the Bank at the time of their initial recognition in the statement of financial position.

The Bank recognizes its financial assets in the statement of financial position on the trade date, being the date on which it commits (undertakes an ultimate engagement) to purchase the respective financial assets. All financial assets are initially measured at their fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

The Bank derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or 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 and the Bank continues to recognize secured liability (a loan) for the consideration received.

#### *Loans and advances*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. This group of financial assets includes: cash at current accounts and deposits with the Central Bank; deposits in other banks; loans granted to other banks; loans and advances to customers; and other receivables. They are carried at amortised cost in the statement of financial position amortised using the effective interest method, less any allowance for impairment. Interest income on loans and receivables is recognised on effective interest basis.

Loans and advances that have initially originated in the Bank are recognised in the statement of financial position when cash is actually advanced to borrowers or another financial or non-financial asset is provided to borrowers and are initially measured at fair value – at the provided funds value or/and other assets, incl. direct cost of the transaction.

#### *Held-to-maturity financial assets*

Held-to-maturity financial assets are such non-derivative financial assets that represent debt securities with fixed or determinable payments and fixed maturities on acquisition, of which the Bank has the positive intention and ability to hold to maturity, although the latter are traded on the market. These assets are initially measured at acquisition cost and subsequently – at amortised cost using the effective interest method, less allowance for impairment, if any.

#### *Available-for-sale financial assets*

Available-for-sale financial assets are those non-derivative assets that are either designated as available-for-sale or are not classified as another category of financial assets.

The Bank classifies as available-for-sale financial assets debt securities and investments in other entity shares intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or material changes in their yields or prices.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Financial instruments (continued)

##### *Available-for-sale financial assets, continued*

Securities are initially recognised at cost, being the fair value of the consideration given including acquisition costs associated with the investment. B They are subsequently measured at fair value. When the financial instruments represent equity investments in closed-end entities for which it is difficult to find appropriate data for making sufficiently reasonable and appropriate long-term assumptions for fair value calculation of their shares through other alternative valuation techniques, are subsequently measured at acquisition cost.

Unrealised gains and losses arising from changes in the fair value of securities classified as available-for-sale are recognised initially as "other component of comprehensive income" in the statement of comprehensive income for the year and respectively in a separate component 'Revaluation reserve' of the equity through the statement for changes in equity - until the financial asset is sold, collected or otherwise disposed of or until it is impaired, at which time the accumulated gains or losses, included as other component on the statement of comprehensive income and respectively on equity, are recognised in the statement of comprehensive income, but within the current profit or loss for the year.

During the period of holding debt instruments, classified as 'available-for-sale' the Bank recognises interest income by applying the effective interest method.

Dividends on shares, classified as 'available-for-sale' financial assets, are recognised and carried to the statement of comprehensive income as 'Other income' when the Bank's entitlement to these dividends is established.

##### *Financial asset held for trading*

Financial assets and all derivatives (except those designated as hedging instruments) are classified as held for trading, when acquired, or with intent to profit from short-term fluctuations in price or dealer's margin or profit-making sales in the short term. These financial instruments are initially recognized and subsequently remeasured at fair value. Subsequent evaluations are made on the basis of market quotations. All realized gains from operations and gains or losses from revaluation are included in profit or loss for the year.

A derivative is a financial instrument:

- Whose value changes in response to the change in an underlying variable such as an interest rate, commodity or security price, or index;
- That requires no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors;
- That is settled at a future date.

When entering a specific derivative transaction the Bank defines a position to be hedged and have met all the requirements of accounting standards, the corresponding derivative is recognized as such hedging. Derivatives that do not meet the criteria for hedge accounting are classified as held for trading.

Initially, the derivative financial instruments are measured at cost (including transaction costs) and subsequently, they are measured at fair value. Derivatives are accounted for as assets when their fair value is positive and as liabilities when it is negative.

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Financial instruments (continued)**

*Financial asset held for trading, continued*

The Bank uses derivative financial instruments to meet the financial needs of its clients, acting as an agent, and for its own transactions. These include transactions in buying and selling currency, securities, forward contracts and currency swaps in the open market. Changes in the fair value of the derivative financial instruments classified as held for trading are included in the profit or loss for the year.

As of December 31, 2011 and 2010 no transactions with derivative financial instruments that require hedge accounting under the specific requirements of IAS 39/IFRS 9 and therefore are classified as derivative financial instruments held for trading as changes in fair value are recognized in the profit or loss for the year.

**Purchase and resale agreements (reverse REPO deals)**

Securities purchased under agreements to resell are not recognised on the statement of financial position but are recorded and presented as 'due from banks' or 'loans and advances to customers' secured with securities, as appropriate. The difference between purchase and resale prices is treated as interest and accrued over the period of the life of the agreement using the effective interest rate method.

**Impairment of financial assets**

All financial assets classified as 'loans and receivables', 'held-to-maturity financial assets' and 'available for sale financial assets' are subject to review for impairment. The Bank assesses at each reporting date whether there is any objective evidence for permanent and clearly shown impairment of a financial asset or a group of financial assets.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Impairment of financial assets (continued)

##### *Loans and advances to banks and other customers*

At the end of each reporting period the Bank assesses whether there is any objective evidence that certain individual loans and receivables or a group of loans and receivables of similar characteristics have indications for impaired. A loan or a group of loans is impaired when there is an objective evidence of impairment as a result of one or more events (a 'loss event') that have occurred after the initial recognition of the asset(s) and that the loss event(s) has an impact on the estimated future cash flows of the asset(s) and this impact can be reliably estimated. The criteria used by the Bank to determine that there is objective evidence of an impairment loss include: delinquency in contractual payments of principal and interest; cash flow difficulties experienced by the borrower; problems with the implementation of the project financed with the loan, breach of key covenants and ratios (indicators) included in the loan agreement; deterioration of the borrower's financial, commercial and competitive condition; deterioration in the state and quality of collaterals; initiation of liquidation and/or bankruptcy proceedings and other similar indicators.

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

The Bank first assesses whether objective evidence of impairment exists at individual level regarding specific loan exposures that are individually significant. Subsequently, the loans for which no impairment is identified at individual level (whether individually significant or not) are included in groups with similar characteristics and are collectively assessed for impairment – on a portfolio basis. A particular loan is classified in the relevant risk group and is assessed as non-performing depending on the above criteria, mainly the occurrence of delay in contractual payments of principal and/or interest and on the basis of analysis of the financial position of the borrower and the sources for settlement of its debts to the Bank. The amount of the specific allowances for loan impairment is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collaterals, discounted on the basis of the agreed-upon effective interest rate. If there are indications of probable losses in the loan portfolio that have occurred, but have not been reported, they are included in the allowances for loan impairment for coverage of the general credit risk on a portfolio basis. They are determined based on historical experience, statistical data and techniques and the judgment of the management on the grounds of its experience and knowledge. The amounts of impairment are calculated on the basis of internal rules and techniques developed by the Bank in accordance with the requirements of IAS 39.

It is an accepted policy of the Bank that all impaired loans and amounts receivable are reviewed and analyzed on a monthly basis. Any subsequent changes in the amounts and timing of the expected future cash flows compared to the prior estimates would result in a change in the allowances for loan impairment losses and be charged or credited to loan impairment and uncollectability losses in the statement of comprehensive income (profit or loss for the year). An allowance for impairment and uncollectability is reversed only when the quality of the loan or the amount receivable has improved so that reasonable assurance exists as to the timely collection of principal and interest in accordance with the original contractual terms of the loan agreement. Subsequent recoveries or decreases in the allowances due to an event occurring after the write-down are reflected as reintegration of losses from loan impairment and uncollectability in the statement of comprehensive income.

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



### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Impairment of financial assets (continued)

##### *Financial assets held-to-maturity*

Financial assets held-to-maturity are assessed individually for objective evidence of impairment. If such evidence exists, the amount of impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows. The impairment loss is carried to an allowance account and the value of the financial asset is presented net in the statement of financial position. The impairment loss amount is currently recognised in the statement of comprehensive income.

##### *Financial assets available-for-sale*

Financial assets available-for-sale are impaired if there is objective evidence that show a significant and prolonged decline in the fair value of the respective asset or group of assets or with regard to financial assets measured at acquisition cost – when there is evidence that the carrying amount is higher than the expected recoverable amount. Additionally, alternative valuation methods are applied – discounted cash flows methods, analogous transaction price methods, analyses of trends in the accounting values of net assets, in order to establish and assess the trends in price changes, as well as to isolate the effects of the general downturn and stagnation of stock markets from those that are directly related to the individual particular features of the entity – security issuer. The recoverable amount of a debt instrument is determined on the basis of the present value of expected future cash flows, discounted at the current market interest rate for a similar financial asset. If any such clear and specific evidence for impairment exists, the cumulative revaluation loss, representing the difference between the acquisition cost and the current fair value (recoverable amount), is transferred from other components of comprehensive income, respectively equity, towards the profit or loss for the year in the statement of comprehensive income.

The Bank classifies its financial liabilities, debt and equity instruments either as financial liabilities or as equity in accordance with the substance of the contractual arrangements with the respective counterparty regarding these instruments. The Bank's financial liabilities are classified at the time of their origination. All financial liabilities, held by the Bank, are classified as "other financial liabilities" and are carried at amortised cost.

The financial liabilities include: amounts due to banks under deposits; amounts due to customers under deposits; Borrowings from international financial institutions under loan and other agreements; issued debenture loans and other current liabilities. They are initially recognised in the statement of financial position at fair value net of the directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method. Interest expense is carried to the statement of comprehensive income on current basis.

The financial liabilities are written off when the obligation under the liability is discharged or cancelled, or the counterpart loses its entitlement.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Investment in subsidiaries**

Long-term investments representing shares in subsidiaries are stated in the statement of financial position at cost, which is the fair value of the consideration which was paid, including direct acquisition costs of the investment. These investments are not traded on stock exchanges.

The investments in subsidiaries are reviewed for impairment. If there are indicators that impairment has occurred, the impairment loss is recognized in the profit and loss.

For acquisition or disposal of investments in subsidiaries "the date of conclusion" of the transaction apply. Investments are derecognised when the rights are transferred and thus the control over the economic benefits of investment is lost.. Income from their sale are presented separately in "Other income / (loss) from operations" of the statement of comprehensive income (profit or loss for the year).

#### **Property, plant and equipment**

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

##### *Initial measurement*

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

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

##### *Subsequent measurement*

The approach chosen by the Bank for subsequent measurement of property, plant and equipment, is the cost model under IAS 16, - acquisition cost less any accumulated depreciation and any accumulated impairment losses.

##### *Depreciation methods*

The Bank applies the straight-line depreciation method for property, plant and equipment. The useful life per group of assets has been determined considering: the physical wear, the characteristic features of the equipment, the intentions for future use and the expected obsolescence, and is as follows:

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

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Property, plant and equipment (continued)**

The useful life of the individual group of assets is determined by the management considering: their physical wear, the characteristic features of the equipment, the intentions for future use and the expected obsolescence. The useful life, set for any equipment, is reviewed at each year-end and it is adjusted prospectively in case that any material deviations from future expectations concerning the terms of use are determined.

#### *Subsequent costs*

Repair and maintenance costs are recognised as current expenses at the moment they are incurred. Subsequent costs incurred in relation to property, plant and equipment having the nature of replacement of certain significant parts or improvements and restructuring, are capitalized in the carrying amount of the respective asset whereas its residual useful life is reviewed at the date of capitalization. At the same time, the non-depreciated part of the replaced components is derecognised from the carrying amount of the assets and is recognised in the current expenses for the period of the restructuring.

#### *Impairment of assets*

The carrying amounts of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that they might significantly differ from their recoverable amount. If such indications exist that the estimated recoverable amount of an asset is lower than its carrying amount, the latter is adjusted to the recoverable amount of the asset. The recoverable amount of the tangible fixed assets is the higher of the fair value less costs to sell or the value in use. For the definition of the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market conditions and assessments of the time value of money and the risks, specific to the particular asset. Impairment losses are recognised in the statement of comprehensive income.

#### *Gains and losses from sale*

Property, plant and equipment are derecognised from the statement of financial position when they are permanently disposed of and no future economic benefits are expected therefore or when they are sold. The gains or losses arising from the sale of separate assets from the group of "property, plant and equipment" are determined by comparing the gains from the sale and the carrying amount of the asset at the date of sale.

#### **Intangible assets**

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

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

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

Intangible assets are written-off from the statement of financial position when they are permanently disposed of and no future economic benefits are expected from their use or when they are sold. The gains or losses arising from the sale of separate assets from the group of the "intangible assets" are determined by comparing the proceeds from sale and the carrying amount of the asset at the date of sale.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Interest income and expenses

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

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

Interest expense is recognised on accrual basis and includes the interest accrued on the deposits of customers and banks, as well as on loans received and other borrowed funds, fees and commissions under loans received, which represent an integral part of the effective interest expense.

#### Fees and commissions

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

Trust management fees are recognised on accrual basis throughout the period of providing the service.

Fee and commission expenses related to servicing nostro accounts with other banks or to the provision of another bank service are recognised at the time of provision of the underlying service and attaining the result from it.

#### Transactions in foreign currency

Foreign currency transactions are transformed into BGN by applying the daily exchange rate as quoted by the Bulgarian National Bank (BNB) as of the day of the transaction. The receivables and liabilities in foreign currency are revalued on a daily basis. At the end of the year they are revalued in BGN according to closing official rate of BNB, which for the main currencies as of the dates of the financial position are the following:

<u>Foreign currency</u>	<u>31 December 2011</u>	<u>31 December 2010</u>
US dollars	1.51158	1.47276
Euro	1.95583	1.95583

Since 1999 the Bulgarian Lev is pegged to the Euro, the official currency of the European Union, at ratio of EUR 1: BGN 1.95583.

The net gains or losses from changes in the exchange rates incurred from revaluation of receivables, liabilities and from transactions with foreign currencies are included in the statement of comprehensive income, for the period in which they have occurred.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Provisions and contingent liabilities**

Provisions are recognised when the Bank has a current constructive or legal obligation as a result of a past event and it is probable that an outflow of resources will be required to repay/settle this obligation. The provisions are measured based on the best estimate, made by the management at the end of reporting period, concerning the expenses that will be incurred for the settlement of the particular obligation. The estimate is discounted if the obligation is long-term. For the measurement of the portfolio provisions statistical methods are applied, based on historical experience and gathered data regarding behavior and events under the guarantee commitments.

Contingent liabilities are obligations arising from past events, the existence of which can be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not entirely within the control of the Bank, or it is not probable that an outflow of resources will be required to settle the obligation. They are not recognised in the statement of financial position but are subject to special disclosure.

#### **Pensions and other payables to personnel under the social security and labour legislation**

According to the Bulgarian legislation, the Bank is obliged to pay contributions to social security health insurance funds. The employment relations of the employees with the Bank, in its capacity of an employer, are based on the provisions of the Labour Code.

#### ***Short-term income***

Short-term income of the employees of the Bank in the form of remunerations, bonuses and social payments and benefits are recognised as an expense in the statement of comprehensive income in the period when the service thereon has been rendered or the requirements for their receipt have been met and as a current liability at their undiscounted amount. The Bank's payables for social security and health insurance are recognised as a current expense and liability at their undiscounted amount together with the respective benefits they relate to and within the period of their accrual.

At the end of each reporting period the Bank assesses and reports the amount of expected costs on the accumulating paid leaves, which amount is expected to be paid as a result of the unused entitlement. The assessment includes the estimated expenses on the employee's remunerations and the statutory social security and health insurance contributions due by the employer thereon.

#### ***Long-term retirement income***

In accordance with the requirements of the Labour Code, the employer is obliged to pay to its personnel upon retirement an indemnity, which depending on the length of service with an entity varies between two and six gross monthly salaries as at the termination date of the employment. In their nature these are defined benefit schemes. The calculation of the amount of these liabilities requires the participation of qualified actuaries in order to determine their present value at the date of the financial statements, at which they are included in the statement of financial position, adjusted with the amount of the unrecognised actuarial gains and losses, and respectively, the change in their value including the recognised actuarial gains and losses is included in the statement of comprehensive income (profit or loss for the year).

Past service costs are recognised immediately in the statement of comprehensive income.

At the date of issue of each set of annual financial statements, the Bank assigns certified actuaries who provide their report with calculations regarding the long-term retirement benefit obligations. For this purpose, they apply the Projected Unit Credit Method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows, which are expected to be paid within the maturity of this obligation, and using the interest rates of long-term government bonds, denominated in Bulgarian leva.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **Pensions and other payables to personnel under the social security and labour legislation (continued)**

##### *Long-term retirement income, continued*

Actuarial gains and losses arise from changes in the actuarial assumptions and experience adjustments. Those exceeding the 10% corridor against the present value of the defined benefit obligations at the end of the prior year, are recognised immediately in the statement of comprehensive income (within the profit or loss for the year). The changes in the amount of the liabilities to personnel for indemnities upon retirement, including the interest from unwinding of the present value and the recognised actuarial gains or losses, are recognised as expenses on personnel in the statement of comprehensive income.

##### *Termination benefits*

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

- for non-observed preliminary notice: one gross monthly salary;
- due to closing down of the enterprise or part of it, staff cuts, reduction of the volume of work and work stoppage for more than 15 days, etc.: one gross monthly salary;
- upon termination of the employment contract due to illness: two gross monthly salaries;
- for unused annual paid leave: for the respective years of the time recognised as service period.

The Bank recognizes employee income obligations in the event of employment termination before the normal retirement date when it is demonstrably committed, based on announced plan, to terminating the employment contract with the respective individuals without possibility of withdrawal or in case of formal issuance of documents for voluntary redundancy. Termination benefits due more than 12 months are discounted and presented in the statement of financial position at their present value.

##### **Taxation**

Current income taxes are determined in accordance with the requirements of the Bulgarian tax legislation. Current tax comprises tax payable calculated on the basis of the expected taxable income for the year, using the tax rates enacted by the date of preparation of the statement of financial position.

The tax effect, related to transactions and other events, reported in the statement of comprehensive income are recognised as well in the statement of comprehensive income and the tax effect related to transactions and other events, reported directly in the equity, is also recognised directly in the equity.

The liabilities under deferred taxes are reported for all temporary differences, subject to taxation, except in the events when they arise from the initial recognition of assets and liabilities for a transaction, which at the time of being concluded is not reflected in the accounting or the tax income (tax loss).

The deferred tax receivables are recognised for all temporary differences, subject to deduction, to the extent that it is probable that there might be an available taxable profit, against which the relevant deductions under the deferred tax receivables can be made. This is not applicable for the cases when they arise from the initial recognition of assets and liabilities for a transaction, which at the time of being concluded is not reflected in the accounting or the tax income (tax loss).

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Taxation (continued)

The deferred taxes are recognised as income or expenses and are included in the net profit for the period, except in cases, when these taxes arise from transactions or events, reported for the same or another period directly in the equity. Deferred taxes are charged or deducted directly from the equity, when these taxes refer to positions, which are charged or deducted during the same or a different period directly in the equity.

#### Cash and cash equivalents

For the purposes of the cash flow statement cash equivalents comprise cash on hand, cash at current accounts with other banks, demand deposits and placements with other banks – payable at sight and/or with original maturity up to 3 months, including repo deals with original maturity up to 3 months, as well as unrestricted (not blocked) balances with the Central Bank (BNB).

They are presented in the statement of financial position at amortised cost.

#### Assets classified as held for sale

Assets are classified as held for sale, if their carrying amount will be recovered through a sale and not through a continuing use in the operations of the Bank. Usually, these assets have been initially accepted by the Bank as collaterals and subsequently acquired thereby as a result of a “debt against property” exchange by borrowers that do not perform their obligations as per the agreed terms of loans.

Assets classified in this group are available for immediate sale in their present condition. The management is engaged actively and performs events to realize a sale within at least one year after the date on which the asset has been classified in this group.

Assets classified as held for sale are presented in the statement of financial position separately and are measured at the lower of their carrying amount and their fair value less the direct expected costs for sell.

The assets within this classification group are not depreciated.

#### Share capital and reserves

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

The share capital represents the non-distributable capital of the Bank and is presented at the nominal value of the issued shares.

The Bank is obliged to set aside a Reserve Fund in accordance with the requirements of the Bulgarian Development Bank Act. The following may be sources for the fund:

- at least a half of the profit, which should be allocated to the fund until its amount reaches 50% of the share capital or any larger amount as may be decided by the General Meeting of Shareholders;
- any premium received in excess of the nominal value of shares upon their issue (share premium reserve);
- other sources as provided for by a decision of the General Meeting of Shareholders.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Share capital and reserves (continued)

The fund amounts can only be used to cover annual loss or losses from previous years. When the amount of the Fund reaches the minimum value specified in the Statutes, the excess may be used for increasing the share capital.

The **Revaluation Reserve** is set aside from the difference between the carrying amount of the available-for-sale financial assets and their fair value at the revaluation date. This reserve is transferred into the statement of comprehensive income (into current profit and loss for the year) when the financial assets are derecognised (sold) from the statement of financial position or in case of stable and lasting impairments.

#### International Financial Reporting Standards (IFRS) and interpretations adopted from European Commission not yet effective as of the date of the Statement.

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2011, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank.

Standards, amendments to standards and interpretations that are not effective and have not been applied earlier – endorsed by the EC.

- Amendments to IFRS 7 Disclosures – Transfers of Financial Assets (issued October 2010) – effective from the first financial year that starts after 1 July 2011.
- Improvements to IFRSs 2010 (issued May 2010), various effective dates, generally 1 January 2011.

#### IASB/IFRIC documents not yet endorsed by EC:

Management believes that it is appropriate to disclose that the following new or revised standards, new interpretations and amendments to current standards, which are already issued by the International Accounting Standards Board (IASB), are not yet endorsed for adoption by the European Commission, and therefore are not taken into account in preparing these financial statements. The actual effective dates for them will depend on the endorsement decision by the EC.

- IFRS 9 Financial Instruments (issued November 2009 and Additions to IFRS 9 issued October 2010) has an effective date 1 January 2015 and could change the classification and measurement of financial instruments.
- In May 2011 the IASB issued IFRS 10 Consolidated Financial Statements, IFRS 11 Joint arrangements, IFRS 12 Disclosures of Interests in Other Entities and IFRS 13 Fair Value Measurement, which all have an effective date of 1 January 2013. The IASB also issued IAS 27 Separate Financial Statements (2011) which supersedes IAS 27 (2008) and IAS 28 Investments in Associates and Joint Ventures (2011) which supersedes IAS 28 (2008). All of these standards have an effective date of 1 January 2013.
- Amendments to IAS 12 Deferred Tax: Recovery of Underlying Assets (issued December 2010) has an effective date 1 January 2012.
- Amendments to IFRS 1 Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (issued December 2010) has an effective date 1 July 2012.
- In June 2011 the IASB issued Presentation of Items of Other Comprehensive Income (Amendments to IAS 1) with an effective date of 1 July 2012.



### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### **International Financial Reporting Standards (IFRS) and interpretations adopted from European Commission not yet effective as of the date of the Statement (continued)**

- In June 2011 the IASB issued an amended IAS 19 Employee Benefits with an effective date of 1 January 2013.
- In December 2011 the IASB issued amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities with an effective date of 1 January 2013.
- In December 2011 the IASB issued amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities with an effective date of 1 January 2014.
- IFRIC Interpretation 20: Stripping Costs in the Production Phase of a Surface Mine with an effective date of 1 January 2013.

### 4. FINANCIAL RISK MANAGEMENT

In the ordinary course of business, the Bank is exposed to a variety of financial risks. These risks are identified, measured and monitored through various control mechanisms in order to be managed and to prevent undue risk concentration. The process of risk management is essential for the Bank's financial position, profitability and existence. The main risks, to which the Group is exposed, are credit risk, market risk and liquidity risk, as well as operating risk.

#### **Risk management structure**

The main units, which are directly responsible for risk management, are as follows:

*Supervisory Board* – performs overall supervision of risk management;

*Management Board* – responsible for the overall risk management approach and for approving risk management strategies, principles and specific methods, techniques and procedures;

*Assets and Liabilities(Liquidity) Committee*- responsible for the strategy management of the assets and liabilities as well as for the management of the related market risks (including liquidity risk);

*Credit Committee and Credit Council* – analyses credit transactions from the perspective of credit risk management in general for the credit portfolio, as well as at the level of credit deals and borrowers;

*Executive Directors and members of MB* – exercise current operating control of the maintenance and observance of the set limits for the particular types of risk and the application of the developed procedures.

#### **Measurement and management of major risks**

The management of the Bank has approved a set of internal rules and methods for measurement of the different risks which are based on statistical models and good international banking practice, as well as on the historical experience of the Bank itself.

Controlling and managing risks is primarily performed based on limits established by the Group. These limits reflect on the strategy and market position of the Bank, as well as on the level of risk that can be taken. Reports on the specific types of risks are periodically prepared for the purposes of subsequent analysis and possible adjustment of already set limits.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 4. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### 4.1. Credit risk

Credit risk is the risk that the customers/counterparties will fail to discharge their contractual obligations in full and on time to the Bank.

The credit risk is the main risk for the Bank and its management is fundamental in the it's activity. Credit risk management is performed in accordance with the law for BDB AD and with the operative laws and regulations of Republic of Bulgaria related to credit activity as long as with the international regulations and bank best practices.

At portfolio level, the Bank have established units for current monitoring and control of the quality of the credit portfolio – Working group for overdue credits, Working group for current control of the credit portfolio, Provisions Committee.

The management of specific credit risk is performed by the Credit Committee of the Bank and is supervised by both the Management Board and the Supervisory Board. The credit risk management function ensures that appropriate policies are established and its compliance with the related credit monitoring procedures and controls for current supervision of the credits. Exposure to credit portfolio risk is managed through regular analysis of the ability of the borrowers to meet interest and capital repayment obligations and by establishing lending limits as appropriate. Exposure to credit risk is also reduced in part by obtaining different types of collateral.

Based on a Guarantee letter from year 2003 and the subsequent annexes signed with the European Investment Fund (EIF), the Bank participates in the EU SME Guarantee Facility under conditions determined by the long-term EU Program on SMEs. EIF is committed to provide a direct guarantee covering 50% of the remaining loss on the principal and interest of each loan, included in the sub-portfolio of the Group, formed on the basis of the conditions of the agreement, but not exceeding EUR 2,520 thousand. The Bank has applied reduced requirements in accepting collaterals for the EIF-guaranteed portfolio of loans.

The volume of the loans with EIF guarantee amounts to BGN 13,304 thousand as of 31.12.2011 (31.12.2010: BGN 16,924 thousand). This amount includes the drawn but not paid portion of loans and the engagements undertaken by the Bank under un-drawn loans. The payment engagements of EIF at this date amount to BGN 4,929 thousand (31.12.2010: BGN 4,929 thousand), whereas the losses covered by EIF amount to BGN 3,285 thousand (31.12.2010: BGN 4,115 thousand).

Letters of guarantee and letters of credit represent another source of the credit risk. The main purpose of the instruments in form of letters of guarantee and letters of credit is to ensure funds for the customer in case of need. Letters of guarantee and letters of credit, representing irrevocable commitment of the Bank to make a payment in case the customer is not able to meet his/her obligations to a third party. This instruments bear the same credit risk as the loans. Documentary and trade letters of credit, representing written commitment of the Bank on behalf of a customer, authorize a third person to draw funds up to a certain amount under certain conditions. Usually, they are secured with cash deposits, and so they are less risky than direct financing.

The un-drawn portion of authorized loan agreements in form of loans, letters of guarantee or letters of credit represents commitments of the Bank. In relation to the credit risk the Bank is potentially exposed to loss to the amount of the total un-drawn commitments. However, the likely amount of loss is less than the total un-drawn fuds since most commitments to extend credits are contingent upon customers maintaining specific credit standards. The Bank monitors on a current basis the utilization periods of the loans because longer-term commitments generally have a greater degree of credit risk than the short-term commitments.

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

*Maximum exposure of the credit risk*

The exposure to the credit risk attributable to financial assets recognised in the statement of financial position is as follows:

<i>In thousand of BGN</i>	2011	2010
<i>Financial asset</i>		
Cash and balances with the Central Bank	70,335	33,694
Receivables from Banks	858,948	636,669
Loans and advances to customers	477,871	367,590
Receivables from the State Budget	335,395	266,190
Available-for-sale securities	16,560	17,922
Held-for-sale Financial assets	2,995	-
	<u>1,762,104</u>	<u>1,322,065</u>

The exposure to credit risk attributable to off-balancesheet contingent commitments not recognised in the statement of financial position is as follows:

<i>In thousand of BGN</i>	2011	2010
Bank guarantees and letters of credit	65,825	83,773
Un-drawn authorized loans	40,490	69,370
	<u>106,315</u>	<u>153,143</u>
<b>Maximum exposure to credit risk</b>	<u><b>1,868,419</b></u>	<u><b>1,475,208</b></u>

*Credit risk - concentration*

The Management of the Bank currently monitors the credit risk of concentration of financial assets both by industry sector and by individual counterparty. Limits for maximum exposures are established and periodically analyzed and measured. Due to its major objectives, the Bank has risk exposure of concentration of loans to small- and medium sized enterprises and of long-term investment loans – with maturity of 3 to 10 years (Note 18 and 19).

Each variance from the set limits for concentration is approved by the Management Board of the Bank.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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### 4. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### 4.1. Credit risk (continued)

The financial assets of the Bank (loans and receivables, financial lease), classified by industry sectors, are presented in the table below:

*In thousand of BGN*

<i>Sectors</i>	<b>2011</b>	<b>%</b>	<b>2010</b>	<b>%</b>
Financial services	883,298	50.81	636,669	48.74
Receivables from the State Budget	335,395	19.29	266,190	20.38
Manufacturing	160,390	9.23	125,537	9.61
Transport	106,424	6.12	84,591	6.48
Construction	78,238	4.50	74,880	5.73
Trade	47,174	2.71	19,234	1.47
Collection and disposal of garbage	40,783	2.35	6,062	0.47
Tourist services	29,818	1.72	34,140	2.61
Agriculture	19,029	1.09	22,500	1.72
Operations with real estate	3,511	0.20	2,490	0.19
Other industry sectors	34,360	1.98	33,848	2.60
	<u>1,738,420</u>		<u>1,306,141</u>	

#### *Quality of the loans and receivables*

The Bank has implemented internal regulations for risk assessment of every counterparty.

The risk assessment is made according to a methodology based on current financial information, forecasts, investments projects execution and targeted use of funds, manner of exposure servicing and information on the state of accepted collaterals. Loans and receivables are classified in four (2010: four groups) risk groups depending on the result of the assessment. The adopted classification groups are as follows: "standard", "watch", "non-performing" and "loss". The classification of risk exposures is within the competence of the Credit Committee and is made on monthly basis. In addition, current financial information is required from customers quarterly and is subject to analysis under an internal methodology of Risk and Regulations Department. The investment projects execution and, respectively, loan withdrawal and utilization are currently monitored. The provided collaterals, which are subject to approval by the Credit Committee, are reviewed and revaluated periodically, but not less than once per year. All decisions of the Credit Committee are controlled and approved by the Management Board of the Bank.

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

**4. FINANCIAL RISK MANAGEMENT (CONTINUED)**

**4.1. Credit risk (continued)**

The structure of the financial assets of the Bank by risk classification groups is as follows:

*In thousand of BGN*

<b>At 31 December 2011</b>	<b>Standard</b>	<b>Watch</b>	<b>Non-performing</b>	<b>Loss</b>	<b>Total</b>
Loans and advances to banks	858,948	-	-	-	858,948
Receivables from the State Budget	335,395	-	-	-	335,395
Loans for commercial property and construction	351,391	37,477	3,687	21,831	414,386
Trade loans	82,339	14,905	906	26,558	124,708
Agricultural loans	-	-	-	2,000	2,000
Consumer loans	756	-	-	-	756
Residential mortgage loans to individuals	1,240	-	-	-	1,240
Other loans and receivables	987	-	-	-	987
<b>Total financial assets</b>	<b>1,631,056</b>	<b>52,382</b>	<b>4,593</b>	<b>50,389</b>	<b>1,738,420</b>

*In thousand of BGN*

<b>At 31 December 2010</b>	<b>Standard</b>	<b>Watch</b>	<b>Non-performing</b>	<b>Loss</b>	<b>Total</b>
Loans and advances to banks	636,669	-	-	-	636,669
Receivables from the State Budget	266,190	-	-	-	266,190
Loans for commercial property and construction	276,655	10,194	5,945	19,145	311,939
Trade loans	77,244	2,570	2,146	5,200	87,160
Agricultural loans	-	-	-	2,004	2,004
Consumer loans	747	-	-	-	747
Residential mortgage loans to individuals	846	-	-	-	846
Other loans and receivables	586	-	-	-	586
<b>Total financial assets</b>	<b>1,258,937</b>	<b>12,764</b>	<b>8,091</b>	<b>26,349</b>	<b>1,306,141</b>

All loans granted to non-financial institutions and individuals are secured. The accepted collaterals are mainly mortgages of land and industrial property, hotels, trade and residential buildings. Additional collaterals are also accepted in the form of pledge on machinery, equipment and inventories, securities, cash deposits, corporate shares, promissory notes, avals and guarantees from third parties. The common practice of the Bank is to require from loan applicants a collateral at least 100% of the contracted loan amount.

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The table below presents the types of collaterals held by the Bank at 31 December 2011 and 2010 at update fair value, determined with the assistance of an internal certified appraiser:

<i>In thousand of BGN</i>	2011	2010
<i>Collateral type</i>	Fair value	Fair value
Mortgages	323,328	289,413
Pledge of a ship	130,997	98,302
Pledges of machinery, equipment, installations and inventories	41,160	38,483
Blocked deposits	1,425	2,330
<b>Total collaterals</b>	<b>496,910</b>	<b>428,528</b>

The table below presents data on the portfolio amount of the bank's financial assets by type of instrument at amortized costs and the impairments made:

<i>In thousand of BGN</i>	Loans and amounts due from non-financial institutions		Receivables from the State Budget		Loans and amounts due from financial institutions		Loans and amounts due from individuals	
	2011	2010	2011	2010	2011	2010	2011	2010
<b>Impaired on individual basis</b>								
-----watch	52,382	12,765	-	-	-	-	-	-
-----non-performing	4,593	8,091	-	-	-	-	-	-
-----loss	49,325	23,969	-	-	-	-	-	-
Gross value	106,300	44,825	-	-	-	-	-	-
Impairment	(58,874)	(29,450)	-	-	-	-	-	-
<b>Book value</b>	<b>47,426</b>	<b>15,375</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Impaired on portfolio basis</b>								
-----performing	403,012	344,146	-	-	-	-	-	-
Gross value	403,012	344,146	-	-	-	-	-	-
Impairment	(7,332)	(6,242)	-	-	-	-	-	-
<b>Book value</b>	<b>395,680</b>	<b>337,904</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Past due but not impaired</b>								
-----up to 30 days	5,429	-	-	-	-	-	-	2
-----from 90 to 360 days	49	-	-	-	-	-	-	-
-----more than 360 days	185	2,379	-	-	-	-	-	-
<b>Book value</b>	<b>5,663</b>	<b>2,379</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2</b>
<b>Neither past due nor impaired</b>								
-----performing	26,276	10,339	335,395	266,190	858,948	636,669	1,996	1,591
-----loss	830	-	-	-	-	-	-	-
<b>Book value</b>	<b>27,106</b>	<b>10,339</b>	<b>335,395</b>	<b>266,190</b>	<b>858,948</b>	<b>636,669</b>	<b>1,996</b>	<b>1,591</b>
<b>Book value</b>	<b>475,875</b>	<b>365,997</b>	<b>335,395</b>	<b>266,190</b>	<b>858,948</b>	<b>636,669</b>	<b>1,996</b>	<b>1,593</b>

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.1. Credit risk (continued)

The Bank may re-negotiate the initial conditions under the signed contacts in case of a request by the contacting parties. Usually these conditions are the terms for disbursement of the loans, loan amounts, interest rates and/or repayment schedules with regard to the amounts of the repaid instalments. This is often observed in the case of changes of the projects' original parameters, objectives and scope, including the time schedule for their completion.

The re-negotiated loans and receivables, presented at amortised cost, are as follows:

<i>In thousand of BGN</i>	2011	2010
Loans for commercial property and construction	161,857	120,656
Trade loans	66,272	40,186
Residential mortgage loans to individuals	1,010	-
Consumer loans	648	-
Other loans and receivables	636	644
	<u>230,423</u>	<u>161,486</u>

The Bank's exposure to national debt as at 31.12.2011 and 31.12.2010 is presented in the table below:

<i>In thousand of BGN</i>							Total
<i>As at 31 December 2011</i>	Up to 1 month	1-3 months	3-12 months	1-5 years	Above 5 years	Unstated maturity	
<i>Government bonds</i>							
Bulgaria	-	-	12	-	989	-	1,001
<b>Total</b>	<u>-</u>	<u>-</u>	<u>12</u>	<u>-</u>	<u>989</u>	<u>-</u>	<u>1,001</u>

<i>In thousand of BGN</i>							Total
<i>As at 31 December 2010</i>	Up to 1 month	1-3 months	3-12 months	1-5 years	Above 5 years	Unstated maturity	
<i>Government bonds</i>							
Bulgaria	-	-	12	-	959	-	971
<b>Total</b>	<u>-</u>	<u>-</u>	<u>12</u>	<u>-</u>	<u>959</u>	<u>-</u>	<u>971</u>

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

### 4. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### 4.2. Market risk

Market risk is the risk of adverse movements of the interest rates, the exchange rates between currencies and the market price of securities and other financial instruments. These movements affect the Bank's profitability and financial position.

##### *Interest risk*

Interest risk is the probability for potential change of the net interest income or the net interest margin and the market value of the equity due to the changes in the total market interest levels.

The interest risk is related to the overall activity of the Bank. Tables with the financial assets and liabilities grouped in time intervals depending on their sensitivity to changes in the interest rates, are prepared on regular basis. Where period inconsistencies exist, changes in the interest curve are made to measure the potential risk for the interest income of the Bank. Besides the interest rate sensitivity analyses made, for the interest risk management main sources related to the change in the net interest spread of the Bank are also identified. This helps decision making on the interest rates policies of the Bank, in particular the development of specific products and providing sources of financing with the respective characteristics.

In order to determine the interest rates on loans and amounts due from non-financial institutions, the Bank has implemented internal base levels, which are related to the used financial resources for funding these loans – equity, special-purpose long-term credit facilities and other which are periodically reviewed.

Assets and Liabilities Committee currently monitors the interest risk to which the Bank is exposed and develops measures for its coverage and maintenance within the bank's permitted levels and limits.

The table below summarizes the interest exposure and risk of the Bank. It includes information on Bank's assets and liabilities at their book value in accordance with interest-related clauses, set in the contracts, their maturity structure and sensitivity to the behavior of the interest rates.



BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

<i>In thousand of BGN</i>	<i>With floating interest %</i>	<i>With fixed interest %</i>	<i>Interest-free</i>	<i>Total</i>
<b>31 december 2011</b>				
<b>Financial assets</b>				
Cash and balances with the Central Bank	-	-	70,335	70,335
Loans and advances to banks	31,272	827,676	-	858,948
Loans and advances to customers	352,934	124,937	-	477,871
Receivables from the State Budget	-	335,395	-	335,395
Available-for-sale securities	5,076	9,461	2,023	16,560
Financial assets held-for-sale	2,995	-	-	2,995
<b>Total Financial Assets</b>	<b>392,277</b>	<b>1,297,469</b>	<b>72,358</b>	<b>1,762,104</b>
<b>Financial liabilities</b>				
Deposits from banks	54,608	65,824	-	120,432
Deposits from customers, other than banks	393,958	72,868	-	466,826
Borrowings from international institutions	327,963	-	-	327,963
Other borrowings	10,954	184,424	-	195,378
Debt securities issued	-	78,499	-	78,499
Financial liabilities held-for-sale	-	2,082	999	3,081
Other liabilities	-	-	250	250
<b>Total financial liabilities</b>	<b>787,483</b>	<b>403,697</b>	<b>1,249</b>	<b>1,192,429</b>
<b>Total interest exposure</b>	<b>(395,206)</b>	<b>893,772</b>	<b>71,109</b>	<b>569,675</b>
<b>31 december 2010</b>				
<b>Financial assets</b>				
Cash and balances with the Central Bank	-	-	33,694	33,694
Loans and advances to banks	42,928	593,741	-	636,669
Loans and advances to customers	286,591	80,999	-	367,590
Receivables from the State Budget	-	266,190	-	266,190
Available-for-sale securities	6,840	8,972	2,110	17,922
<b>Total financial assets</b>	<b>336,359</b>	<b>949,902</b>	<b>35,804</b>	<b>1,322,065</b>
<b>Financial liabilities</b>				
Deposits from banks	127	91,411	-	91,538
Deposits from customers, other than banks	30,099	34,185	-	64,284
Borrowings from international institutions	331,357	-	-	331,357
Other borrowings	10,776	134,525	-	145,301
Debt securities issued	-	78,499	-	78,499
Other liabilities	-	-	515	515
<b>Total financial liabilities</b>	<b>372,359</b>	<b>338,620</b>	<b>515</b>	<b>711,494</b>
<b>Total interest exposure</b>	<b>(36,000)</b>	<b>611,282</b>	<b>35,289</b>	<b>610,571</b>

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

Analysis of interest rate sensitivity and risk

The table below includes the financial instruments of the Bank at book value, categorized by the earlier of interest rate change in the contract or maturity dates.

<i>In thousand of BGN</i>	<i>Up to 1 month.</i>	<i>1-3 months</i>	<i>3-6 months</i>	<i>6-12 months</i>	<i>1-5 years</i>	<i>over 5 years</i>	<i>Non-interest bearing</i>	<i>Total</i>
<b>31 december 2011</b>								
<b>Financial assets</b>								
Cash and balances with the Central Bank	-	-	-	-	-	-	70,335	70,335
Loans and advances to banks	409,897	433	1,938	995	87,900	357,785	-	858,948
Loans and advances to customers	352,934	124,937	-	-	-	-	-	477,871
Receivables from the State Budget	-	335,395	-	-	-	-	-	335,395
Available-for-sale securities	-	75	7,690	1,103	4,680	989	2,023	16,560
Financial assets held-for-sale	-	2,995	-	-	-	-	-	2,995
<b>Total financial assets</b>	<b>762,831</b>	<b>463,835</b>	<b>9,628</b>	<b>2,098</b>	<b>92,580</b>	<b>358,774</b>	<b>72,358</b>	<b>1,762,104</b>
<b>Financial liabilities</b>								
Deposits from banks	81,305	39,127	-	-	-	-	-	120,432
Deposits from customers, other than banks	395,261	10,655	2,153	120	58,637	-	-	466,826
Borrowings from international institutions	48,147	191,000	79,146	9,670	-	-	-	327,963
Other borrowings	-	10,954	171,206	-	5,839	7,379	-	195,378
Debt securities issued	-	-	-	-	78,499	-	-	78,499
Financial liabilities held-for-sale	-	2,082	999	-	-	-	-	3,081
Other liabilities	-	-	-	-	-	-	250	250
<b>Total financial liabilities</b>	<b>524,713</b>	<b>253,818</b>	<b>253,504</b>	<b>9,790</b>	<b>142,975</b>	<b>7,379</b>	<b>250</b>	<b>1,192,429</b>
<b>Total interest rate exposure of sensitivity</b>	<b>238,118</b>	<b>210,017</b>	<b>(243,876)</b>	<b>(7,692)</b>	<b>(50,395)</b>	<b>351,395</b>	<b>72,108</b>	<b>569,675</b>

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

<i>In thousand of BGN</i>	<i>Up to 1 month.</i>	<i>1-3 months</i>	<i>3-6 months</i>	<i>6-12 months</i>	<i>1-5 years</i>	<i>over 5 years</i>	<i>Non-interest bearing</i>	<i>Total</i>
<b>31 december 2010</b>								
<b>Financial assets</b>								
Cash and balances with the Central Bank	-	-	-	-	-	-	33,694	33,694
Loans and advances to banks	42,927	125,572	9,042	-	104,128	355,000	-	636,669
Loans and advances to customers	286,591	80,999	-	-	-	-	-	367,590
Receivables from the State Budget	-	-	-	266,190	-	-	-	266,190
Available-for-sale securities	-	9,186	4,672	-	984	970	2,110	17,922
<b>Total financial assets</b>	<b>329,518</b>	<b>215,757</b>	<b>13,714</b>	<b>266,190</b>	<b>105,112</b>	<b>355,970</b>	<b>35,804</b>	<b>1,322,065</b>
<b>Financial liabilities</b>								
Deposits from banks	64,140	3,922	-	23,476	-	-	-	91,538
Deposits from customers, other than banks	35,611	7,121	9,252	2,321	9,979	-	-	64,284
Borrowings from international institutions	50,389	155,572	114,542	10,854	-	-	-	331,357
Other borrowings	-	10,776	-	121,274	6,472	6,779	-	145,301
Debt securities issued	-	-	-	-	78,499	-	-	78,499
Other liabilities	-	-	-	-	-	-	515	515
<b>Total financial liabilities</b>	<b>150,140</b>	<b>177,391</b>	<b>123,794</b>	<b>157,925</b>	<b>94,950</b>	<b>6,779</b>	<b>515</b>	<b>711,494</b>
<b>Total interest rate exposure of sensitivity</b>	<b>179,378</b>	<b>38,366</b>	<b>(110,080)</b>	<b>108,265</b>	<b>10,162</b>	<b>349,191</b>	<b>35,289</b>	<b>610,571</b>

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

*Sensitivity of the interest assets and liabilities with floating interest rate*

The table below represents the sensitivity of the Bank on possible changes in the interest rate based on the structure of assets and liabilities as of 31 December with floating interest rate and with the assumption that the influence of the other variables is ignored. The effect is measured and presented as an impact on the financial results after tax. The actual effect of changes in the market interest rates could be different, as a significant portion of the loans and receivables from customers are accumulated at a floating interest rate, based on the determined by the Bank's variable portion, which is influenced by numerous factors.

<i>In thousand of BGN</i> Currency	2011		2010	
	<i>Increase in percentage points</i>	<i>Sensitivity of the financial result</i>	<i>Increase in percentage points</i>	<i>Sensitivity of the financial result</i>
BGN	0.50%	(1,255)	0.50%	249
EUR	0.50%	(274)	0.50%	(474)
BGN	-0.50%	1,255	-0.50%	(249)
EUR	-0.50%	274	-0.50%	474

*Currency risk*

The currency risk is a risk with a negative impact of fluctuations in the prevailing currency exchange rates on the financial position and cash flows of the Bank as a result of open currency positions. In the currency risk management the Bank follows the principle of maintaining a minimal open currency positions according to set limits. The currency positions are not formed with speculative purposes but after transactions in foreign currencies related to the normal operating activities. Policy of the Bank is that the main part of the assets and liabilities, and respectively the bank operations, are denominated in EUR or BGN. The Bank does not carry out significant transactions and does not hold significant open positions in currencies other than EUR and BGN. As the Bulgarian lev is pegged to the euro, there is no significant open currency risk for the Bank.

The following table summarizes the Bank's exposure to currency risk. The table includes the financial instruments and the contingent liabilities and commitments of the bank at book value, categorized by type of currency.

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

*In thousand of BGN*

<i>As at 31 December 2011</i>	In USD	In EUR	In other foreign currency	In BGN	Total
<b>Financial assets</b>					
Cash and balances with the Central Bank	9	623	-	69,703	70,335
Loans and advances to banks	10,880	396,796	108	451,164	858,948
Loans and advances to customers	25,858	321,269	17,387	113,357	477,871
Receivables from the State Budget	-	-	-	335,395	335,395
Available-for-sale securities	-	11,887	-	4,673	16,560
Financial assets held-for-sale	-	2,995	-	-	2,995
<b>Total financial assets</b>	<b>36,747</b>	<b>733,570</b>	<b>17,495</b>	<b>974,292</b>	<b>1,762,104</b>
<b>Financial liabilities</b>					
Deposits from banks	15,274	76,598	-	28,560	120,432
Deposits from customers, other than banks	4,016	88,653	1	374,156	466,826
Borrowings from international institutions	-	310,263	17,700	-	327,963
Other borrowings	-	18,333	-	177,045	195,378
Debt securities issued	-	78,499	-	-	78,499
Financial liabilities held-for-sale	999	2,082	-	-	3,081
Other liabilities	-	213	-	37	250
<b>Total financial liabilities</b>	<b>20,289</b>	<b>574,641</b>	<b>17,701</b>	<b>579,798</b>	<b>1,192,429</b>
<b>Net balance sheet currency position</b>	<b>16,458</b>	<b>158,929</b>	<b>(206)</b>	<b>394,494</b>	<b>569,675</b>
<b>Contingent liabilities and commitments</b>	<b>1,133</b>	<b>54,520</b>	<b>-</b>	<b>50,662</b>	<b>106,315</b>

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.2. Market risk (continued)

*In thousand of BGN*

<i>As at 31 December 2010</i>	In USD	In EUR	In other foreign currency	In BGN	Total
<b>Financial assets</b>					
Cash and balances with the Central Bank	8	10,870	-	22,816	33,694
Loans and advances to banks	538	152,256	18	483,857	636,669
Loans and advances to customers	-	269,369	18,576	79,645	367,590
Receivables from the State Budget	-	-	-	266,190	266,190
Available-for-sale securities	-	9,700	-	8,222	17,922
<b>Total financial assets</b>	<b>546</b>	<b>442,195</b>	<b>18,594</b>	<b>860,730</b>	<b>1,322,065</b>
<b>Financial liabilities</b>					
Deposits from banks	-	27,422	-	64,116	91,538
Deposits from customers, other than banks	530	37,874	-	25,880	64,284
Borrowings from international institutions	-	312,461	18,896	-	331,357
Other borrowings	-	17,555	-	127,746	145,301
Debt securities issued	-	78,499	-	-	78,499
Other liabilities	-	460	-	55	515
<b>Total financial liabilities</b>	<b>530</b>	<b>474,271</b>	<b>18,896</b>	<b>217,797</b>	<b>711,494</b>
<b>Net balance sheet currency position</b>	<b>16</b>	<b>(32,076)</b>	<b>(302)</b>	<b>642,933</b>	<b>610,571</b>
<b>Contingent liabilities and commitments</b>	<b>-</b>	<b>92,653</b>	<b>-</b>	<b>66,001</b>	<b>158,654</b>

*Price risk of shares quoted on the Stock Exchange*

The Bank is exposed to price risk in respect to the shares it holds, classified as investments available-for-sale. The management of the Bank monitors and analyzes all changes in the securities market, as well as uses the advisory services of authoritative investment intermediaries in the country. In addition, at this stage, due to the economic and financial crisis, the management of the the Bank has decided to greatly reduce the operations on the stock markets, the hold of the purchased shares in the longer horizon for ongoing monitoring of the reported from the respective issuer financial and business indicators, as well as the development of its activities under the circumstances of a crisis.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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### 4. FINANCIAL RISK MANAGEMENT (CONTINUED)

#### 4.3. *Liquidity risk*

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

The business of the bank requires a stable flow of funds both to replace existing deposits and received loans as they mature and to satisfy demands of customers for additional borrowing. Undrawn borrowing facility commitments and the level of all outstanding contingent obligations are taken into consideration in managing the liquidity risk in the Bank.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the liquidity management of the bank. It is unusual for banks ever to be completely matched. An unmatched position potentially enhances profitability, but also increases the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates. To manage this risk, the Bank maintains at all times highly liquid assets depending on the currency of its liabilities. The overall liquidity control and monitoring are performed by the Assets and Liabilities (Liquidity) Committee and is based on maturity tables with scenarios for measuring the net cash flows by periods and normatively enacted by Bulgarian National Bank ratios. Additionally variety of correlations are monitored to indicate the liquid position by periods. Liquidity risk is also measured through application of additional tree scenarios for the cash flows from the operations and monitoring of the liquidity buffers of the Bank and the additional sources of financing in case of market and idiosyncrasy shocks.

The table below presents the amounts in percentage of the ratio of liquid assets to liabilities of the Bank:

	2011	2010
	%	%
As at 31 December	14.32%	14.86%
Average for the period	26.56%	17.44%
Highest for the period	37.90%	30.89%
Lowest for the period	14.32%	10.11%

BULGARIAN DEVELOPMENT BANK AD

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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

The table below provides an analysis of the financial assets and liabilities of the Bank grouped by remaining maturity:

<i>In thousand of BGN</i>							
<i>As at 31 December 2011</i>	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Maturity not defined	Total
<b>Financial assets</b>							
Cash and balances with the Central Bank	70,335	-	-	-	-	-	70,335
Loans and advances to banks	409,897	1,770	2,933	87,000	357,348	-	858,948
Loans and advances to customers	14,198	15,830	75,428	249,347	123,068	-	477,871
Receivables from the State Budget	-	335,395	-	-	-	-	335,395
Available-for-sale securities	-	75	8,793	4,680	989	2,023	16,560
Financial assets held-for-sale	-	2,995	-	-	-	-	2,995
<b>Total financial assets</b>	<b>494,430</b>	<b>356,065</b>	<b>87,154</b>	<b>341,027</b>	<b>481,405</b>	<b>2,023</b>	<b>1,762,104</b>
<b>Financial liabilities</b>							
Deposits from banks	65,854	10	15,451	39,117	-	-	120,432
Deposits from customers, other than banks	395,261	10,655	2,273	58,637	-	-	466,826
Borrowings from international institutions	1,424	9,094	33,148	183,240	101,057	-	327,963
Other borrowings	225	171,462	5,367	7,379	10,945	-	195,378
Debt securities issued	-	266	-	78,233	-	-	78,499
Financial liabilities held-for-sale	-	2,082	999	-	-	-	3,081
Other liabilities	107	106	37	-	-	-	250
<b>Total financial liabilities</b>	<b>462,871</b>	<b>193,675</b>	<b>57,275</b>	<b>366,606</b>	<b>112,002</b>	<b>-</b>	<b>1,192,429</b>
<b>Difference in maturity thresholds of assets and liabilities</b>	<b>31,559</b>	<b>162,390</b>	<b>29,879</b>	<b>(25,579)</b>	<b>369,403</b>	<b>2,023</b>	<b>569,675</b>
<b>Contingent liabilities and commitments</b>	<b>2,762</b>	<b>16,730</b>	<b>40,892</b>	<b>45,925</b>	<b>6</b>	<b>4,694</b>	<b>111,009</b>



BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

*In thousand of BGN*

<i>As at 31 December 2010</i>	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Maturity not defined	Total
<b>Financial assets</b>							
Cash and balances with the Central Bank	33,694	-	-	-	-	-	33,694
Loans and advances to banks	158,236	16,766	3,539	103,128	355,000	-	636,669
Loans and advances to customers	12,762	15,821	85,462	171,233	82,312	-	367,590
Receivables from the State Budget	-	-	266,190	-	-	-	266,190
Available-for-sale securities	-	4,332	1,470	9,051	959	2,110	17,922
<b>Total financial assets</b>	<u>204,692</u>	<u>36,919</u>	<u>356,661</u>	<u>283,412</u>	<u>438,271</u>	<u>2,110</u>	<u>1,322,065</u>
<b>Financial liabilities</b>							
Deposits from banks	64,140	3,922	23,476	-	-	-	91,538
Deposits from customers, other than banks	35,611	7,121	11,573	9,979	-	-	64,284
Borrowings from international institutions	1,374	5,561	65,178	144,554	114,690	-	331,357
Other borrowings	57	60	122,424	11,933	10,827	-	145,301
Debt securities issued	-	266	-	78,233	-	-	78,499
Other liabilities	55	404	56	-	-	-	515
<b>Total financial liabilities</b>	<u>101,237</u>	<u>17,334</u>	<u>222,707</u>	<u>244,699</u>	<u>125,517</u>	<u>-</u>	<u>711,494</u>
<b>Difference in maturity thresholds of assets and liabilities</b>	<u>103,455</u>	<u>19,585</u>	<u>133,954</u>	<u>38,713</u>	<u>312,754</u>	<u>2,110</u>	<u>610,571</u>
<b>Contingent liabilities and commitments</b>	<u>31,091</u>	<u>2,362</u>	<u>45,574</u>	<u>74,933</u>	<u>-</u>	<u>4,694</u>	<u>158,654</u>

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.3. Liquidity risk (continued)

The liquidity requirements to support calls under guarantees and letters of credit are considerably lower than the amount of the commitment because the Bank does not generally expect the third party to draw funds under these agreements.

The table below presents the gross undiscounted cash flows related to the Bank's liabilities as of 31 December:

<i>In thousand of BGN</i>	Carrying amount	Gross nominal outflow	Less than 1 month	1 to 3 months	3 to 12 months	1 to 5 years	over 5 years
<b>As at 31 December 2011</b>							
<b>Financial liabilities</b>							
Deposits from banks	120,432	125,028	65,880	10	15,847	43,291	-
Deposits from customers, other than banks	466,826	471,140	395,261	10,741	2,293	62,845	-
Borrowings from international institutions	327,963	364,352	1,152	8,256	33,471	199,487	121,986
Other borrowings	195,378	248,399	223	171,464	17,016	47,713	11,983
Debt securities issues	78,499	96,417	-	980	2,875	92,562	-
Financial liabilities held-for-sale	3,081	4,975	-	-	999	3,976	-
Other liabilities	250	250	107	106	37	-	-
	<u>1,192,429</u>	<u>1,310,561</u>	<u>462,623</u>	<u>191,557</u>	<u>72,538</u>	<u>449,874</u>	<u>133,969</u>
Provisions on bank guarantees	10,942	10,942	600	1,200	4,200	4,942	-
Undrawn credit commitments	<u>40,490</u>	<u>40,490</u>	<u>777</u>	<u>14,521</u>	<u>24,408</u>	<u>784</u>	<u>-</u>
<b>As at 31 December 2010</b>							
<b>Financial liabilities</b>							
Deposits from banks	91,538	92,131	64,144	3,936	24,051	-	-
Deposits from customers, other than banks	64,284	65,065	35,616	7,197	11,744	10,508	-
Borrowings from international institutions	331,357	364,786	1,375	5,611	66,683	155,460	135,657
Other borrowings	145,301	150,072	79	133	126,055	12,778	11,027
Debt securities issues	78,499	95,974	-	980	2,875	92,119	-
Other liabilities	515	515	55	404	56	-	-
	<u>711,494</u>	<u>768,543</u>	<u>101,269</u>	<u>18,261</u>	<u>231,464</u>	<u>270,865</u>	<u>146,684</u>
Provisions on bank guarantees	676	676	100	300	276	-	-
Undrawn credit commitments	<u>69,370</u>	<u>69,370</u>	<u>31,091</u>	<u>4,862</u>	<u>33,417</u>	<u>-</u>	<u>-</u>

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.4. *Capital management*

The main objectives of the Bank's capital management is to maintain its level at amounts sufficient for activities development and achieving the general objectives set at its foundation – support of the economic policy of the country and the development of small- and medium-sized businesses.

In its activities the Bank should observe the regulatory requirements for capital adequacy (Notes № 33, 34), as well as continue operating as a going concern.

The table below shows the main equity components following the regulatory requirements and ratios achieved by the Bank:

<i>In thousand of BGN</i>	2011	2010
<b><i>Tier 1 capital</i></b>		
Ordinary shares	601,774	601,774
Total reserves	51,824	25,941
Other general-purpose reserves	<u>6,190</u>	<u>6,190</u>
<b>Total Tier 1 capital</b>	<u>659,788</u>	<u>633,905</u>
<b><i>Tier 2 capital</i></b>	<u>-</u>	<u>-</u>
<b>Total capital</b>	<u>659,788</u>	<u>633,905</u>
<b>Investments</b>	(84,736)	(32,103)
Incl. Intangible assets	<u>(174)</u>	<u>(41)</u>
<b>Other deductions</b>		
Specific provisions for credit risk using standardized approach	<u>5,613</u>	<u>2,888</u>
Evaluation differences, included in Tier 1 capital	<u>403</u>	<u>304</u>
<b><i>Tier 1 capital base</i></b>	<i>569,036</i>	<i>598,610</i>
<b><i>Tier 2 capital base</i></b>	<i>569,036</i>	<i>598,610</i>
<b>Credit risk</b>		
<b><i>Risk-weighted assets</i></b>	<u>963,289</u>	<u>910,636</u>
Incl. Risk-weighted assets for credit risk	881,282	790,782
Incl. Off-balance sheet equivalents of risk-weighted assets for credit risk	78,937	119,854
Incl. Derivatives	<u>3,070</u>	<u>-</u>
<b>Risk component</b>	<u>963,289</u>	<u>910,636</u>

BULGARIAN DEVELOPMENT BANK AD

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4. FINANCIAL RISK MANAGEMENT (CONTINUED)

4.4. Capital management (continued)

Total capital requirements for operating risk	5,559	3,168
Reconciliation of the risk component for operating risk (operating risk *12.5)	69,488	39,600
<b>Total risk component</b>	<b>1,032,777</b>	<b>950,236</b>
Tier 1 capital adequacy	55.10%	63.00%
Total capital adequacy	55.10%	63.00%
<b>Regulatory required levels</b>		
Tier 1 capital adequacy	10.00%	10.00%
Total capital adequacy	12.00%	12.00%

5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS

Accounting estimates

The presentation of the financial statements in accordance with the International Financial Reporting Standards requires the management to make the best estimates, accruals and reasonable assumptions, which affect the reported amounts of assets and liabilities, revenues and expenses and disclosure of contingent claims and liabilities as of the reporting date. These estimates, accruals and assumptions are based on the information available as of the date of the financial statements, and by reason of that the future actual results could be different from them. The items, that require a higher degree of discretion or complexity or where the assumptions and accounting estimates are essential for the financial statements, are disclosed below.

*Key estimates and assumptions with high uncertainty*

*a) Impairment losses on loans and advances*

At the date of each financial statements the Bank reviews its loan portfolios in order to detect the availability and calculates the losses from such impairment. When determining whether to include the impairment loss in the statements for the comprehensive income, the bank's management considers whether there are and what are the visible indicators and data, which indicate that there is a measurable reduction in the expected cash flows of the loan portfolio as a whole, or respectively – a decrease associated with a particular loan/component from this portfolio. Such indicators and data are those that indicate the existence of an adverse change in the payment options by the borrowers from a particular group or by a particular borrower, or the presence of national, economic or other conditions that are associated with a particular risk for a given group/type of loans.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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### 5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

#### *Key estimates and assumptions with high uncertainty (continued)*

##### *a) Impairment losses on loans and advances (continued)*

When analyzing the risks of impairment losses and uncollectability, the loans are grouped into four risk classification groups: "standard", "watch", "non-performing" and "loss". The main indicators for determining the risk groups are financial condition of the debtor and project implementation, funded by the loan, problems with servicing, including interest in arrears and maturing principal, sources of repayment and granted collateral, as a type and opportunity for realization. Additionally, for loans, guaranteed by the EIF, the impairment loss is recognized after deduction of the part, borne by the Fund (Note № 4.1).

In determining the future cash flows pattern, the management of the Bank uses estimates, judgments and assumptions based on its historical loss experience for assets with similar credit risk characteristics, as well as an objective evidence for impairment of the portfolio from non-crystallized loss in a particular component thereof. Analogous approach is used also for assessments at individual loan level taking into account the quality of collaterals as well. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly so as to minimize the discrepancies between loss estimates and actual loss experienced (Notes № 12, 18).

##### *b) Measurement of available-for-sale financial instruments non-quoted on the active stock market*

The Bank classifies its investments as share participation in other non-public companies/entities (below 20% of their capital) as available-for-sale financial assets that have been acquired for the purpose of establishing and development of business relations of importance for the bank. The management has judged and accepted that they should be measured at cost because sufficiently reliable sources and methods to determine their fair value are not available at present and due to the specific closed manner of their trading until the time when new circumstances occur that allow the formation of reasonable assumptions and reliable valuation.

Analysis and assessment is performed at each end of reporting period as to whether indicators for impairment of the Bank's investments are present. The significant and continuous decrease in the equity, including below the level of the registered share capital of the company/entity, subject to the investment, is regarded as a main indicator. In such cases impairment is determined with the assistance of a certified appraiser but at least at the level of the difference between the acquisition cost (cost) and the assessment of participation under the equity method including with additional adjustments of net assets, if necessary. In the cases of partial sales of similar shares in the reporting period, those from the same issuer but remaining in the Bank's statement of financial position are revalued at the price of the sale (Notes № 9, 20).

## 5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

### *Key estimates and assumptions with high uncertainty (continued)*

#### *c) Impairment of available-for-sale financial instruments quoted on stock market*

As at 31.12.2011 the company had made a detailed comparative analysis of the changes in the stock market prices of public companies shares held by the bank on the national fund market.

For investments in companies, whose shares are listed for the Bulgarian Stock Exchange of dealing the management has carried out investigation and analysis and is in position to assess further on fair value, determined directly on realized transactions in the stock market in the last month of the financial year (Level 1). Additionally, the applied prices are analyzed for trends in the behavior in stock exchange prices of the respective securities at the least three months of the year and respectively against for the date of issuing of the financial statements. (Notes № 9, 15, 20). The management has used compulsory and alternative valuation methods for further confirmation of the applicable assessment as fair value for both reporting years.

For all investment securities available for sale, held by the bank more than one year relation to the date of acquisition, has performed a special analysis of monitored graphics of the stock exchange prices and fair values, defined by alternative methods of valuation for a period of 18 months to 31 December, in order to define if there are conditions of permanent and material impairment.

#### *d) Provisions for issued bank guarantees*

At the end of each reporting period the Bank reviews its contingent liabilities for the purpose of establishing whether any events have occur, that would confirm with a high probability outflow of resources might take place for the settlement of an obligation. If such events occur, the Bank provides its liability up to the amount of its future costs (loses) related to the outflows from economic benefits (payments). These costs (loses) are determined on the basis of the present value of the future net cash flows, representing the difference between the payment obligation and the possible inflows from subsequent resources to third parties (Notes № 12, 35).

With regard to portfolio guarantees related to the implementation of the Micro-credits Guarantee Fund Project of the Ministry of Labour and Social Policy (as per the BDB Act), in 2011 a retrospective analysis was made of the actual losses from loans granted (for which guarantees had been issued) for a seven-year period by partner-bank. percent of losses was determined for the whole period under assessment by partner-bank and in general for the whole portfolio of such type of loans, using appropriate statistical instruments. As a result of the analysis the management has determined the average percent of loss for the whole portfolio to be 32.50% (2010: 1.64 %) as minimum level for calculation of provisions for losses by partner-bank and when the average rate for a particular bank is higher than that minimum level, the respective percent for that is applied. The obtained average percent of the provision against the whole guarantee portfolio under this project is 32.50 % (2010: 1,71 %).

#### *e) Actuarial calculations*

For assessing the present value of the long-term liabilities to employees upon retirement are used actuarial methods and calculations based on assumptions for mortality rate, staff turnover rate, future level of salaries and discount factor considered by the management as reasonable and relevant to the Bank (Note № 32).

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### 5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

#### **Fair value of financial assets and liabilities**

The fair value is defined as the value compared to which an asset could be changed or a liability could be settled between informed and willing parties in a fair transaction. The Bank publishes information for the fair value of those financial assets and liabilities for which there is available market information and whose fair value is materially different from the one reported in the statement of financial position.

The fair values of financial assets and liabilities dealing on active markets and for which there is available market information are based on declared market prices or prices closing. The use of real market prices and information reduce the need for information of management assessment and assumptions, as well as the uncertainty related to determination of the fair values. The availability of real market prices and information varies depending on products and markets and changes in according to the specific events and the general financial market conditions. For some of the other financial instruments the Bank determines the fair values by using of assessment method based on net present value. The net present value calculation is provided by market yield curves and credit spreads, where necessary for the respective instrument. The purpose of evaluation techniques is to determine fair value, which would be precised by direct market participants. For investments in subsidiaries and associated companies and equity investments for which no observable market prices are, the Bank accepts, that the fair value is the price of acquisition. The Bank has established control environment under assessment of fair values.

The fair value of financial instruments not traded in active markets that are the subject of a transaction between the parties are determined using valuation techniques (such instruments as derivatives not traded on the market).

These valuation techniques adhere to the use of market data when available and as less as possible the use of specific assessments of the company.

If there is significant increase in requirements for fair value of the reference financial instrument, it is included in Level 2.

#### **Fair Value Hierarchy**

The Bank determines the following hierarchy for disclosing the fair value of financial instruments using valuation techniques:

- Level 1: quoted (not adjusted) prices on active markets for identical assets or liabilities;;
- Level 2: other techniques for which the all incoming information, which has a material effect on the reported fair value is subject to monitoring, either directly or indirectly;
- Level 3: techniques that use an incoming information, which has a material effect on the reflected fair value not based on the observed market data. In addition, this level include investments valued at cost, for which no reliable market value exists.

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**5. USE OF ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)**

The following charts summarize information on the assets and liabilities at fair value for 2011 and 2010:

<i>In thousand of BGN</i>	Carrying amount	Level 1 – quoted market price	Level 2 – Evaluation technique - monitored market levels	Level 3 – Evaluation technique – not monitored market levels
<b>2011</b>				
Available-for-sale securities	16,560	14,657	138	1,765
Financial assets held for trading	2,995	-	2,995	-
<b>Total assets</b>	<b>19,555</b>	<b>14,657</b>	<b>3,133</b>	<b>1,765</b>
Financial liabilities held for trading	3,081	-	3,081	-
<b>Total liabilities</b>	<b>3,081</b>	<b>-</b>	<b>3,081</b>	<b>-</b>
<i>In thousand of BGN</i>	Carrying amount	Level 1 – quoted market price	Level 2 – Evaluation technique - monitored market levels	Level 3 – Evaluation technique – not monitored market levels
<b>2010</b>				
Available-for-sale securities	17,922	16,019	138	1,765
<b>Total assets</b>	<b>17,922</b>	<b>16,109</b>	<b>138</b>	<b>1,765</b>



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**6. NET INTEREST INCOME**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
<b>Interest income</b>		
Loans and advances to customers	43,470	28,517
Loans and advances to banks	22,822	22,887
Receivables from the State Budget	11,530	7,261
Deposits in banks	3,393	2,591
Available-for-sale securities	973	792
	<u>82,188</u>	<u>62,048</u>
<b>Interest expense</b>		
Borrowing from international institutions	9,624	5,162
Other borrowings	3,956	1,646
Debt securities issued	3,903	1,285
Deposits from customers, other than banks	1,862	1,486
Deposits from banks	1,406	1,602
	<u>20,751</u>	<u>11,181</u>
<b>Net interest income</b>	<u>61,437</u>	<u>50,867</u>

**7. NET FEE AND COMMISSION INCOME**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
<b>Fee and commission income</b>		
Gurantees and letters of credit	1,140	970
Customers' accounts, bank transfers, cash operations of customers	371	506
Servicing of debenture loans	292	269
Trust management of borrowings	75	77
	<u>1,878</u>	<u>1,822</u>
<b>Fee and commission expense</b>		
Agency commissions	52	96
Current accounts due from other banks	15	18
Bank transfers and cash operations with other banks	9	33
	<u>76</u>	<u>147</u>
<b>Net fee and commission income</b>	<u>1,802</u>	<u>1,675</u>

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**8. NET GAINS FROM FOREIGN EXCHANGE DEALS**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Net gain from dealing in foreign currencies	326	186
Net gain from foreign currency translation of assets and liabilities	<u>        </u>	<u>65</u>
	<u><b>340</b></u>	<u><b>251</b></u>

**9. NET GAINS (LOSSES) FROM AVAILABLE-FOR-SALE SECURITIES**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Net gain on transactions with available-for-sale securities, incl. revaluation reserve	(23)	59
Allowance for impairment on available-for-sale securities	<u>(153)</u>	<u>(28)</u>
	<u><b>(176)</b></u>	<u><b>31</b></u>

**10. NET GAINS FROM FINANCIAL INSTRUMENTS HELD FOR TRADING**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Net interest income from hedge instrument	61	-
Net gains from revaluation of hedge instrument	<u>918</u>	<u>-</u>
	<u><b>979</b></u>	<u><b>-</b></u>

**11. OTHER OPERATING GAINS (LOSSES)**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Rentals, net	24	4
Legal fees and expenses, net	(188)	(456)
Net gain/(losses) from assets classified as held for sale	(172)	(90)
Dividends received	21	4
Withholding tax	(119)	(163)
Gains from grants	-	4,566
Other income/ (expenses), net	<u>99</u>	<u>13</u>
	<u><b>(335)</b></u>	<u><b>3,878</b></u>

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**12. IMPAIRMENT LOSS ON FINANCIAL ASSETS**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Individual allowance for impairment loss, net	30,060	13,177
Collective allowances for impairment loss on portfolio basis, net	1,090	1,544
Letters of guarantee provisions, net	14,994	7,189
Impairment loss on assets classified as held for sale	2,132	-
	<u>48,276</u>	<u>21,910</u>

**13. GENERAL AND ADMINISTRATIVE EXPENSES**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Personnel costs and social security contributions	3,920	3,089
Remuneration of Managing Board and Supervisory Board members	1,790	1,032
Communications and IT services	390	412
Office and office equipment maintenance	492	430
Government taxes and charges	255	53
Audit, legal and consulting services	328	233
Advertising and entertainment expenses	215	176
Contribution to the Statutory Fund for Guaranteeing Deposits	266	235
Hired services	127	140
Business trips	69	85
Rentals	784	459
	<u>8,636</u>	<u>6,344</u>

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
<i>Personnel costs and social security contributions include:</i>		
Salaries	3,313	2,619
Social security contributions	452	364
Social benefits	120	76
Accruals for indemnities upon retirement	35	30
	<u>3,920</u>	<u>3,089</u>

The average number of the personnel for 2011 is 111 (2010: 100)

The remunerations and personnel costs include redundancy payments to the members of the Board of Directors and Supervisory Board, and also of terminated labour contracts. (2010 – no such).

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14. INCOME TAX EXPENSE

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Current tax expense	1,931	2,334
Deferred tax expense/(income) as a result of temporary differences	<u>(1,227)</u>	<u>53</u>
<b>Total income tax expense</b>	<b><u>704</u></b>	<b><u>2,387</u></b>

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Profit before income tax	6,922	28,270
Income tax, calculated on standard tax rate (10% for 2011, 10% for 2010)	692	2,827
Tax effect from permanent differences	12	(440)
<b>Total income tax expense</b>	<b><u>704</u></b>	<b><u>2,387</u></b>
<b>Effective tax rate</b>	<b><u>10.17%</u></b>	<b><u>8.44%</u></b>

Outstanding amounts of deferred income taxes on income related to the following items from the statement for the financial position :

<i>In thousand of BGN</i>	Deferred tax assets		Deferred tax liabilities		Net tax assets/liabilities	
	2011	2010	2011	2010	2011	2010
Property and equipment	(4)	(3)	-	-	(4)	(3)
Assets classified as held for sale	(213)	-	-	-	(213)	-
Provisions for guarantees	(1,094)	(68)	-	-	(1,094)	(68)
Other liabilities	(22)	(25)			(22)	(25)
Available-for-sale securities	-		49	39	49	39
<b>Net deferred tax (assets)/liabilities</b>	<b><u>(1,333)</u></b>	<b><u>(96)</u></b>	<b><u>49</u></b>	<b><u>39</u></b>	<b><u>(1,284)</u></b>	<b><u>(57)</u></b>

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**14. INCOME TAX EXPENSE (CONTINUED)**

The changes in the temporary differences during the year are recognised in the statement for comprehensive income and in the statement of equity as follows:

<i>In thousand of BGN</i>	<b>2011</b>	<b>Changes in profit and loss</b>	<b>2010</b>
Property and equipment	(4)	(1)	(3)
Assets classified as held for sale	(213)	(213)	-
Provisions for guarantees	(1,094)	(1,026)	(68)
Other liabilities	(22)	3	(25)
Available-for-sale securities	49	10	39
	<u>(1,284)</u>	<u>(1,227)</u>	<u>(57)</u>

On recognising deferred tax assets, the probability of a reversal of the individual differences and the abilities of the bank to generate sufficient taxable profit in the future, have been taken into account.

**15. NET CHANGE IN FAIR VALUE OF AVAILABLE-FOR-SALE FINANCIAL ASSETS**

*Other comprehensive income include:*

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Change in fair value of available-for-sale securities		
Profit/(loss) for the year	(38)	(111)
Less: Correction from reclassification of profit/(loss), included in current year profit and loss	<u>(61)</u>	<u>-</u>
<b>Other comprehensive income for the year, net of tax</b>	<u><u>(99)</u></u>	<u><u>(111)</u></u>

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**16. CASH AND BALANCES WITH THE CENTRAL BANK**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Cash on hand	124	674
<i>Balances with the Central Bank:</i>		
Current accounts	70,162	22,979
Minimum required reserve	-	9,975
Security fund	49	66
	<u>70,211</u>	<u>33,020</u>
<b>Total cash and balances with The Central bank</b>	<b><u>70,335</u></b>	<b><u>33,694</u></b>

Deposits with the Central Bank are not interest-bearing.

**17. LOANS AND ADVANCES TO BANKS**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
<b>Current accounts and deposits</b>		
Current accounts with local banks	166	39,559
Current accounts with foreign banks	1,821	820
Term deposits with local banks	306,749	134,614
Term deposits with foreign banks	101,161	-
Loans granted to local banks	445,685	458,548
Loans granted to foreign banks	3,366	3,128
	<u>858,948</u>	<u>636,669</u>

As at 31.12.2011 there are loans granted to local banks with nominal value of EUR 14,750 thousand and BGN equivalent 28,848 thousand. (31.12.2010: EUR 1,299 ths. and BGN equivalent – 2,541 ths.), with original maturity of nine years and repayment in bullet at the end of the loans period. These are special-purpose loans and are granted to banks for direct crediting of customers with the objective of SME development under funding from the Ministry of Finance with KfW funds. Loans are charged with interest equal to BIR plus 3.25% margin, payable every 3 or 6 months. Loans are secured up to 50% of their nominal amount through a pledge of government securities.

As at 31.12.2011 the Bank has receivables from foreign banks in foreign currency with amortized amount of EUR 1,721 thousand and BGN equivalent 3,366 thousand under agreement signed for serving export deals (2010: BGN 3,128 thousand or EUR 1,599 thousand).

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**17. LOANS AND ADVANCES TO BANKS (CONTINUED)**

As at 31.12.2011 there are loans granted to banks in BGN with nominal value of BGN 415,500 thousand. (31.12.2010: BGN 455,000 ths.) under two programs. The loans are with a special purpose under the first program (BGN 375,000 thousand of nominal value) and are granted to banks with the objective of direct lending of clients for the purpose of SME development, with original maturity from 5 to 10 years and repayment in bullet at the end of loan period or according to repayment schedule with 5 years grace period. Under the second program (BGN 80,000 thousand – nominal value) the loans are with special purpose and are granted to banks with the objective of direct lending to agricultural producers with original maturity of 5 years and repayment in bullet to maturity or according to repayment schedule with 3 or 4 years grace period. Loans are charged with fixed interest rate equal to 5% payable every 6 months. Loans are secured up to 100% of their nominal amount through a pledge of government securities or through a pledge on receivables.

As at 31.12.2011 the Bank has term deposits receivables denominated in BGN or EUR from ten local banks and four foreign banks, representing 47.49 % of the carrying value of the deposits due from banks (31.12.2010: fourteen local banks – with 21.14 %). The term deposits are with original maturity up to three months (31.12.2010: up to four months).

As at 31.12.2011 the Bank has three repo deals receivable denominated in BGN with amortized amount of BGN 17,606 ths., with maturity up to 30.01.2012 and contracted interest rate from 1% to 4 % (31.12.2010: BGN 3,010 ths.)

**18. LOANS AND ADVANCES TO CUSTOMERS**

<i>In thousand of BGN</i>	2011	2010
Loans and advances to customers	544,077	403,282
Less allowance for loan impairment loss	<u>(66,206)</u>	<u>(35,692)</u>
	<u>477,871</u>	<u>367,590</u>

<i>In thousand of BGN</i>	2011	2010
<b>A. Analysis by customer type</b>		
Corporate and sole traders	531,985	391,347
Municipalities	10,096	10,342
Individuals	<u>1,996</u>	<u>1,593</u>
	<u>544,077</u>	<u>403,282</u>

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18. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

<i>In thousand of BGN</i>	2011	2010
<b>B. Analysis of loans by industry sector</b>		
Manufacturing	160,390	125,537
Transport	106,424	84,591
Construction	78,238	74,880
Trade	47,174	19,234
Collection and disposal of wastes	40,783	6,062
Tourist services	29,818	34,140
Financial services	24,350	-
Agriculture	19,029	22,500
Real estate operations	3,511	2,490
Other industry sectors	34,360	33,848
	<u>544,077</u>	<u>403,282</u>

The the Bank provides funds mainly for activities of small and medium-sized enterprises as well as investment projects with 5 to 10 years return on investment.

C. Movement in the allowances for loan impairment and uncollectability

<i>In thousand of BGN</i>	2011			2010		
	Individually impaired	Collectively impaired	Total	Individually impaired	Collectively impaired	Total
As at January 01	29,450	6,242	35,692	16,796	4,698	21,494
Net increase/(decrease) for the year	30,060	1,090	31,150	13,177	1,544	14,721
Written-off against impairment	(636)	-	(636)	(523)	-	(523)
As at December 31	<u>58,874</u>	<u>7,332</u>	<u>66,206</u>	<u>29,450</u>	<u>6,242</u>	<u>35,692</u>

The management of the Bank maintain consistent conservative credit risk management. The inherited from previous reporting periods credit portfolio of the bank was fully reviewed during 2011. As a result the margin of coverage by impairment of the exposure to non-financing institutions was raised from 8,9% as at 31.12.2010 to 12,2% as at 31.12.2011.



## BULGARIAN DEVELOPMENT BANK AD

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### 19. RECEIVABLES FROM THE STATE BUDGET

<i>In thousand of BGN</i>	2011	2010
Loans and advances	<u>335,395</u>	<u>266,190</u>
	<u>335,395</u>	<u>266,190</u>

In December 2011 Bulgarian Development Bank AD has granted BGN 335 million to the Ministry of Agriculture and Food of Republic of Bulgaria the funds of which will be utilized under the Rural Development Programme of the European Union.

The loan provided by BDB is the first step of the project for establishing a Guarantee Fund in the amount of BGN 335 million, financed jointly by the EU and the Bulgarian Government. The guarantee fund will be governed by National Guarantee Fund EAD, a subsidiary of Bulgarian Development Bank AD. As part of its full capacity the guarantee fund will be able to take guarantees bank loans to over BGN 1.2 billion allocated to beneficiaries in rural areas of the country. In the Statement of financial position as at 31.12.2011 the receivables are presented under the amortised cost model and are amounting BGN 335,395 thousand.

In the mean time, the Ministry of Finance submits a deposit amounting BGN 171,000 thousand for the period up to 30.03.2012, but not before the date of full repayment of the loan extended by the Bulgarian Development Bank signed on 20.12.2011. (Note 29).

Upon implementation of Decision 197 of the Council of Ministers for the "Adoption of a mechanism for settlement of liabilities in the national budget" dated 8 April 2010 and the Agreement between BDB AD and the Council of Ministers dated 13 April 2010, the bank should have acquired receivables arising from contracts after a procedure, as provided by the Public Procurement Act, relating to capital expenses and supplies, due and payable as of 31.03.2010 and subject to the specific requirements of current legislation, through cession under the Law on Obligations and Contracts. As at 31.12.2010 the Bank has purchased receivables with nominal value of BGN 276,574 thousand. In the statement of financial position, the receivables are stated their at amortised cost amounting BGN 266,190 ths.

The Council of Ministers, in turn has repaid to the bank on 20.07.2011 the payment obligations under the receivables, purchased by the bank. For the implementation of the purchase of receivables program, the bank has committed to provide its own resources to a maximum amount of up to BGN 100,000 thousand, and if necessary, the Ministry of Finance should provide additional resources by depositing funds of up to BGN 400,000 thousand in the bank. As at 31.12.2010 the Ministry of Finance has provided such a resource amounting to BGN 120,000 thousand. (Note 29).

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**20. AVAILABLE-FOR-SALE SECURITIES**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Corporate bonds	13,536	14,841
Government bonds	1,001	971
Non-public companies' shares	1,903	1,903
Public companies' shares	120	207
	<u>16,560</u>	<u>17,922</u>

**Movement in available-for-sale securities**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
<b>As at January 01</b>	17,922	14,190
Additions (purchases)	4,784	5,989
Disposals (sale and/or redemption)	(6,047)	(2,146)
Net decrease from revaluation of available-for-sale securities to fair value	<u>(99)</u>	<u>(111)</u>
<b>As at December 31</b>	<u>16,560</u>	<u>17,922</u>

Shares denominated in EUR, held by the Group, represent shares of the capital of the European Investment Fund (EIF). The portion of the nominal value of the acquired shares of EIF, which has not been paid, is due after a decision to be taken on the General meeting of the EIF shareholders (Note № 35).

The shares in non-public companies, denominated in BGN, represent shares in a company licensed as payment system operator under the Bulgarian law – BORICA - Bankservice AD. Only banks can be shareholders in this company and they acquire its shares following a specific procedure whereas the value per share is determined using a formula stated in the company's statute. The shares are presented at cost (acquisition price) due to their specific closed way of trading (except where sufficiently reliable information is available on a particular company so that the actual fair value could be determined).

The shares in public companies in BGN have been acquired mainly for the purpose of investments in companies in which the Bank is interested. They are presented at average stock exchange prices at the end of the financial year.

The reserve formed of the available-for-sale financial assets as of 31.12.2011 is at the amount of BGN 403 ths. – negative value (31.12.2010: BGN 304 ths. – negative value) (Note № 34).

In 2011 impairment allowance of available-for-sale securities is transferred and reported on the statement of comprehensive income (as part of the current profit or loss for the year) amounting to BGN 153 ths. (Note № 9) (2010 r.: BGN 28 ths.)

## BULGARIAN DEVELOPMENT BANK AD

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### 21. FINANCIAL ASSETS HELD FOR TRADING

As at 31.12.2011, the financial assets held for trading include derivative financial instruments – interest rate swaps. They represent marketable instruments with positive fair value amounting BGN 2,995 ths as of 31.12.2011. These instruments are traded for its own account, including the netting of transactions in foreign currency, interest rate and credit risk, and to cover transactions with customers of the Bank.

### 22. INVESTMENTS IN SUBSIDIARIES

The Bank is sole owner of National Guarantee Fund EAD, a company established according to the Trade register on 22 August 2008. As at 31 December 2011 the registered share capital is 800,000 registered nominal shares with par value of BGN 100 each (31.12.2010: 800,000 registered nominal shares with par value of BGN 100 each). As at 31 December 2011 the paid-in capital amounts to BGN 80,000 thousands (31.12.2010: BGN 27,500 thousands).

As at 31 December 2011 the value of the investment in the subsidiary amounts to BGN 80,000 thousands (31.12.2010: BGN 27,500 thousands) valued on a historical cost of acquisition basis.

A micro-financing institution JOBS EAD (MFI) was registered on 14 January 2011 as sole proprietorship joint stock company, 100% owned by Bulgarian Development Bank AD. The registered shareholder's equity of the company comprises of 45,618 nominal shares with par value of BGN 100 each. As at 31 December 2011 the value of the investment in the subsidiary amounts to BGN 4,562 thousands valued on a historical cost of acquisition basis.

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**23. PROPERTY, PLANT AND EQUIPMENT, INTANGIBLE ASSETS**

<i>In thousand of BGN</i>	Land and buildings	Bank equipment and computers	Furniture and fixtures	Motor vehicles	Licenses and software	Total
<b>Book value</b>						
As at 01 January 2010	1,926	809	282	426	328	3,771
Additions	12,241	145	50	-	7	12,443
Disposals	(24)	(339)	(61)	-	(22)	(446)
As at 31 December 2010	14,143	615	271	426	313	15,768
Additions	31	287	34	14	183	549
Disposals	-	(45)	-	(52)	(67)	(164)
As at 31 December 2011	14,174	857	305	388	429	16,153
<b>Accumulated depreciation</b>						
As at 01 January 2010	323	671	184	366	275	1,819
Charge for the year	38	70	29	22	19	178
Written off	-	(336)	(61)	-	(22)	(419)
As at 31 December 2010	361	405	152	388	272	1,578
Charge for the year	38	72	30	23	50	213
Written off	-	(42)	-	(52)	(67)	(161)
As at 31 December 2011	399	435	182	359	255	1,630
<b>Carrying amount</b>						
As at 31 December 2011	13,775	422	123	29	174	14,523
As at 31 December 2010	13,782	210	119	38	41	14,190

As at 31.12.2011 the book value of fully depreciated property, plant and equipment, which are still in use by the Bank amounts to BGN 648 ths. (31.12.2010: BGN 616 ths.).

The Bank provides rental space from the owned building under two rental agreements (operating lease). The term of the rent agreements is not determined as they have a clause for one-month preliminary notification in case of termination by any of the parties, without subsequent penalties. The amount of the annual rental income for the year ended 31.12.2011 is BGN 46 ths. (for 2010: BGN 39 ths.).

The license represents the right for identification and participation in the system for international settlement - SWIFT.

As at 31.12.2011 г. отчетната the book value of fully amortized intangible assets, which are still in use by the Bank amounts to BGN 189 ths. (31.12.2010: BGN 254 ths.).

## BULGARIAN DEVELOPMENT BANK AD

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### 24. ASSETS CLASSIFIED AS HELD FOR SALE

The available assets classified held for sale as at 31.12.2011 with book value of BGN 3,244 ths., include property (land and buildings) at the amount of BGN 2,404 ths. (31.12.2010: BGN 3,261 ths.) and machinery and equipment at the amount of BGN 840 ths. (31.12.2010: BGN 30 ths.), acquired by the Bank in 2011 against a settlement of the liabilities under problematic loans of its borrowers.

The assets are not used and are not intended to be used in the activities of the Bank. The management actively searches buyers for them with the aim to sell them by the end of 2012.

### 25. OTHER ASSETS

<i>In thousand of BGN</i>	2011	2010
Prepayments and advances	82	56
Other receivables	48	61
VAT refundable	9	201
Other assets	3,899	1,803
	<u>4,038</u>	<u>2,121</u>

Other assets includes assets classified as held for sale, but not realized within the stipulated 12-month period and were reclassified in other assets.

### 26. DEPOSITS FROM BANKS

<i>In thousand of BGN</i>	2011	2010
Deposits from local banks	100,787	87,616
Deposits from foreign banks	19,645	3,922
	<u>120,432</u>	<u>91,538</u>

The average interest rates on term deposits in BGN are from 0.3% to 1.45% (for 2010: from 0.17% to 0.90%), and for term deposits in EUR are from 0.20% to 4.10% (for 2010: from 1.85% to 4.20%).

In 2010 Bulgarian Development Bank AD signed a short-term loan contract with Citi Bank N.A – Bulgaria branch. As at 31.12.2011 the loan is fully repaid.

On 31.08.2011 Bulgarian Development Bank AD signed a second short-term loan contract amounting EUR 7,900 ths. The loan is for financing international and local traders. As at 31.12.2011 the loan is utilized in full. As at 31.12.2011 the outstanding principal is 7,900 ths. with BGN equivalent of 15,451 ths.

On 16.09.2011 Bulgarian Development Bank AD signed a long-term contract with Citi Bank amounting EUR 20,000 ths. The funds from this loan are intended for direct and indirect funding of SME. As at 31.12.2011 the loan is utilized in full.

As at 31.12.2011 the outstanding principal is EUR 20,000 ths. with BGN equivalent of 39,117 ths. The interest rate is fixed using a standart interest rate swap.

**BULGARIAN DEVELOPMENT BANK AD**

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**27. DEPOSITS FROM CUSTOMERS**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Individuals	771	740
Companies and sole traders	131,033	63,544
Budget companies	335,022	-
	<u>466,826</u>	<u>64,284</u>

The amounts due to individuals represent deposits of employees of the bank.

The amounts due to budget companies represent deposit of National Guarantee Fund EAD (subsidiary of BDB) related to the project of the establishment of guarantee fund supporting the village regions in the country.

**28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Long-term framework loan agreement with the Council of Europe Development Bank	78,410	58,801
Long-term loans from the European Investment Bank	52,199	54,090
Long-term loans from KfW	49,219	49,062
Long-term loans from the Nordic investment bank	38,397	31,437
Long-term loans from BSTDB	30,796	15,697
Long-term loan from DEXIA Kommunalkredit	19,543	19,512
Short-term loan Sumitomo Mitsui – Banking Corporation Europe	18,321	5,616
Long-term loans from JBIC Japan Bank for International Cooperation	17,700	28,804
Long-term loan from DEPFA Investment Bank	17,472	21,348
Long-term loan from China Development Bank	5,906	7,869
Short-term loan from Hypo Noe Gruppe Bank	-	39,121
	<u>327,963</u>	<u>331,357</u>

Interest rates on borrowed funds from international institutions at 31.12.2011 ranged from 1.676% to 5.255% (31.12.2010: from 1.276% to 6.7737%).

***Council of Europe Development Bank***

On 2 January 2003 between the Council of Europe Development Bank (CEB), the Republic of Bulgaria represented by the Minister of Finance and Encouragement Bank AD (being at present Bulgarian Development Bank AD) are signed two Framework Loan Agreements for EUR 10,000 thousand and EUR 5,000 thousand for the financing of micro-, small and medium-sized enterprises in Bulgaria. The loan agreement at the amount of EUR 10,000 thousand is secured with state guarantee from the Republic of Bulgaria. As of 31.12.2011 the 2003 Loans are fully utilized.

As of 31.12.2011 the outstanding principal under the facility amounts to EUR 15,000 thousand equivalent to BGN 29,337 thousand (31.12.2010: EUR 15,000 thousand equivalent to BGN 29,337 thousand). The interest rate is floating, based on 3-month EURIBOR + margin.

On 18 November 2009 a third Loan agreement is signed between Bulgarian Development Bank AD and the Council of Europe Development Bank (CEB) in the amount of EUR 15,000 thousand. The loan is unsecured. As of 31.12.2011 the Loan is fully utilized.

As of 31.12.2011 the outstanding principal under the facility amounts to EUR 15,000 thousand equivalent to BGN 29,337 thousand (31.12.2010: EUR 15,000 thousand equivalent to BGN 29,337 thousand). The interest rate is floating, based on 3-month EURIBOR + margin.

## BULGARIAN DEVELOPMENT BANK AD

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### 28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

#### *Council of Europe Development Bank (continued)*

On 25 March 2011 a fourth Loan Agreement is signed between the Bulgarian Development Bank and the Council of Europe Development Bank for the amount of EUR 20,000 thousand. The loan is unsecured. As of 31.12.2012 the utilized amount under the LA is EUR 10,000 thousand, equivalent to BGN 19,558 thousand. The interest rate under the loan is floating, based on 3-month EURIBOR + margin.

#### *European Investment Bank*

On the 4/6 October 2000 BDB signed a financial contract (Global Loan Bulgaria – Encouragement Bank) with the European Investment Bank in the amount of EUR 10,000 thousand for the financing of small and medium sized enterprises. The loan is based on signed Agreement between European Investment Bank and Republic of Bulgaria on 14.07.1997. The loan is secured with state guarantee from the Republic of Bulgaria and is fully utilized.

As of 31.12.2011 the outstanding principal under the facility amounts to EUR 1,684 thousand, equivalent to BGN 3,294 thousand (31.12.2010: EUR 2,651 thousand, equivalent to BGN 5,186 thousand). The interest rate under the loan is based on the EIB Reference Interest Rate and is determined quarterly.

On the 30 December 2009 a second finance contract is signed between EIB and BDB in the amount of EUR 25,000 thousand for financing of SMEs and priority projects in the fields of infrastructure, energy, environmental protection, industry, health and education. The loan is unsecured and has been fully utilized.

As of 31.12.2011 the outstanding principal under the loan amounts to EUR 25,000 thousand equivalent to BGN 48,896 thousand. (as of 31.12.2011 no funds are utilized under the loan). The interest rate is floating, based on 3-month EURIBOR plus margin.

#### *Kreditanstalt für Wiederaufbau*

On the 27 July 2010 Bulgarian Development Bank AD signed a direct loan agreement for EUR 25,000 thousand with the German development bank Kreditanstalt für Wiederaufbau. The financial resource is intended for direct lending to small and medium sized enterprises and/or for providing credit lines to commercial banks for special-purpose financing for the business. The loan is unsecured and as of 31.12.2012 is fully utilized.

As of 31.12.2011 the outstanding principal under the loan amounts to EUR 25,000 thousand equivalent to BGN 48,896 thousand. The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

#### *Nordic Investment Bank*

On 16 November 2004 a Loan Agreement was signed with the Nordic Investment Bank for a credit facility amounting to EUR 10,000 thousand for the financing of projects of small- and medium-sized enterprises, which are of mutual interest for Bulgaria and the Nordic Investment Bank member states. The Loan is secured with a Letter of intent. As of 31.12.2011 the loan is fully utilized.

As of 31.12.2011 the outstanding principal under the loan amounts to EUR 6,235 thousand equivalent to BGN 12,195 thousand (31.12.2010: EUR 7,412 thousand, equivalent to BGN 14,496 thousand). The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

On 15.12.2010 a second credit line has been signed between the Nordic Investment Bank and Bulgarian Development Bank AD in the amount of EUR 20,000 thousand. The funds are intended for the financing of investment projects with participation of the Nordic Investment Bank member states and ecological projects, as the financing may be provided directly from BDB or through bank-partners. The loan is unsecured.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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### 28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

#### *Nordic Investment Bank (continued)*

As of 31.12.2011 two tranches are utilized under the Loan, amounting to EUR 13,461 thousand, equivalent to BGN 26,327 thousand. The term of the Loan is 10 years with 2 years grace period. The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

#### *Black Sea Trade and Development Bank (BSTDB)*

On the 9 October 2009 Bulgarian Development Bank and Black Sea Trade and Development Bank signed a Loan Agreement in the amount of EUR 8,000 thousand. The resources are intended for the financing of Bulgarian small and medium-sized enterprises. The loan is unsecured. As of 31.12.2011 the loan is fully utilized.

As of 31.12.2011 the outstanding loan amount is EUR 6,000 thousand, equivalent to BGN 11,735 thousand (31.12.2010: EUR 8,000 thousand, equivalent to BGN 15,656 thousand). The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

On 9 September 2011 a second Loan Agreement is signed between Bulgarian Development Bank and Black Sea Trade And Development Bank in the amount of EUR 31,000 thousand. The loan is intended for the financing of investment projects, working capital, export and pre-export financing of SMEs. The loan is unsecured.

As of 31.12.2011 the first tranche has been utilized, amounting to EUR 10,000 thousand, equivalent to BGN 19,558 thousand. The interest rate is floating, on the basis of 3-month EURIBOR plus margin.

#### *DEXIA Kommunalkredit Bank*

On 23 May 2007 the Bank has signed a Loan agreement with DEXIA Kommunalkredit Bank for EUR 10,000 thousand. The loan is intended for the financing of investment projects of small and medium sized enterprises in Bulgaria. As of 31.12.2011 the loan is fully utilized. The loan is secured with a Letter of intent, signed by the Minister of Finance.

As of 31.12.2011 the outstanding principal under the facility amounts to EUR 10,000 thousand, equivalent to BGN 19 558 thousand (31.12.2010: EUR 10,000 thousand, equivalent to BGN 19 558 thousand). The interest rate is floating, on the basis of 3-month EURIBOR plus margin.

#### *Sumitomo Mitsui – Banking Corporation Europe*

On 13 May 2010 Bulgarian Development Bank AD and Sumitomo Mitsui – Banking Corporation Europe signed a bilateral. According to the facility Sumitomo Mitsui – Banking Corporation Europe may provide short-term financing to BDB AD for commercial transactions for period of up to 1 year and limit of up to USD 5,000 thousand. On 19 May 2011 an amendment to the commercial financial facility was signed, providing an additional limit in the amount of EUR 9,450 thousand.

As of 31.12.2011 the outstanding principal under the facility amounts to EUR 9,138 thousand, equivalent to BGN 17,872 thousand. The interest rate is on the basis of 12-month EURIBOR plus a margin.



## BULGARIAN DEVELOPMENT BANK AD

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### 28. BORROWINGS FROM INTERNATIONAL INSTITUTIONS (CONTINUED)

#### *Japan Bank for International Cooperation (JBIC)*

On 19 July 2006 a Loan Agreement was signed between Bulgarian Development Bank AD and the Japanese Bank for International Cooperation in the amount of EUR 10,000 thousand. The purpose of the loan is financing of the import of Japanese investment goods and part of the local expenses of Bulgarian companies. The Loan is secured with a Letter of intent.

As of 31.12.2011 the Loan is fully repaid (31.12.2010: the total outstanding principal was EUR 4,945 thousand, equivalent to BGN 9,672 thousand.)

On 17 December 2009 a second Loan agreement is signed between Bulgarian Development Bank AD and Japan Bank for International Cooperation for the amount of EUR 20,000 thousand. The loan can be utilized both in EUR or in JPY. For a loan in EUR the applicable interest rate will be formed as fixed (CIRR plus risk margin) for 60% of the amount and floating (6-month EURIBOR + margin) for the rest 40% of the amount. For a loan in JPY the applicable interest rate is fixed (CIRR plus risk margin). The loan is unsecured. As of 31.12.2011 the utilized amount under the Loan is JPY 1,122,594 thousand, equivalent to BGN 19,812 thousand.

As of 31.12.2011 the outstanding principal amount of the loan is JPY 912,105 thousand, equivalent to BGN 17,804 thousand.

#### *DEPFA Investment Bank*

On 18 May 2007 an Agreement is signed with DEPFA Investment Bank for EUR 15,000 thousand for general corporate purposes. The Loan is unsecured. As of 31.12.2011 the Loan is fully utilized.

As of 31.12.2011 the outstanding principal under the loan agreement amounts to EUR 9,000 thousand equivalent to BGN 17,602 thousand. (31.12.2010: EUR 11,000 thousand, equivalent to BGN 21,514 thousand). The interest rate is floating, on the basis of 6-month EURIBOR plus margin.

#### *China Development Bank (CDB)*

On the 15 October 2009, Bulgarian Development Bank and China Development Bank signed a credit agreement in the amount EUR 5,000 thousand. The funds under the loan are intended for direct lending to small and medium sized enterprises. The loan is unsecured. As of 31.12.2011 the credit line is fully utilized.

As of 31.12.2011 the outstanding principal under the loan amounts to EUR 3,000 thousand, equivalent to BGN 5,867 thousand (31.12.2010: the outstanding principal under the loan amounts to EUR 4,000 thousand, equivalent to BGN 7,823 thousand). The interest rate is floating on the basis of 6-month EURIBOR plus margin.

#### *Hypo Noe Gruppe Bank*

On 3 November 2010 Bulgarian Development Bank AD signed a short-term loan with Hypo Noe Gruppe Bank in the amount of EUR 20,000 thousand. The purpose of the loan is financing of transactions under Decision №197 of 08.04.2012 of the Council of Ministers of the Republic of Bulgaria for adoption of a mechanism for settlement of liabilities of primary, secondary and lower grade budget spending institutions, payable from the republican budget, incurred and accrued before 31.12.2009 under contracts, signed by them. The loan is unsecured.

As of 31.12.2011 the loan is fully repaid (31.12.2010: the outstanding principal under the loan amounted to EUR 20,000 thousand, equivalent to 39,117 thousand.)

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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### 29. OTHER BORROWINGS

<i>In thousand of BGN</i>	2011	2010
Borrowed financing from the Ministry of Finance with funds from KfW	10,954	10,776
KfW funds provided by the Ministry of Finance for trust management	7,379	6,779
Attracted special purpose deposit from the Ministry of Finance	171,206	121,274
Long-term refunding agreement with the State Fund Agriculture	5,839	6,472
	<u>195,378</u>	<u>145,301</u>

#### ***Borrowed financing from the Ministry of Finance with funds from KfW***

On 18 April 2007 the Bank concluded a loan agreement with the government of the Republic of Bulgaria, represented by the Minister of Finance. This agreement is based on the Treaty between Bulgaria and Germany for financial collaboration from year 2001 and an agreement between the Republic of Bulgaria and KfW. By virtue of this agreement, the amount of EUR 4,929 thousand is granted to the Bank designated as Project Provider for the purpose of financing micro, small and medium-sized enterprises. The term of the agreement is 10 years as from the date of fund receipt while the latter along with the due interest is repaid bullet at the end of the period. The loan interest is capitalized quarterly and is based on 3-month EURIBOR plus margin.

As at 31.12.2011 the amount of the loan is EUR 5,600 thousand, equivalent to BGN 10,954 thousand (31.12.2010: EUR 5,509 thousand, equivalent to BGN 10,776 thousand).

As at 31.12.2011 the the Bank has no provided any funds to partner - banks. (31.12.2010: EUR 1,299 thousand).

#### ***KfW funds provided by the Ministry of Finance for trust management***

The Bank concluded an agreement with the Ministry of Finance (MF) for management of funds granted by Kreditanstalt fur Wiederaufbau (KfW) pursuant to an agreement between the Governments of Bulgaria and Germany. These funds are provided for the purpose of financing small and medium-sized enterprises. The Ministry retains the risk for the advanced provided to the partner – banks.

The main responsibilities of the Parent company (the Bank) in respect of the funds management include the following: selection of the banks – intermediaries, and transferring the funds to those approved; gathering of information and performance of periodic reviews regarding the funds utilization. Also monitoring of the timely payments of the interest and principal due and their repayment to the special account of the Ministry of Finance.

As at 31 December 2011 the balance of the loan with the Bank amounts to EUR 3,773 thousand, equivalent to BGN 7,379 thousand (31 December 2010: EUR 3,466 thousand equivalent to BGN 6,779 thousand).

The Bank receives a management fee of 1% per annum. The calculation of the management fee is based on the total of funds advanced to the partner-banks plus the balance on the current account of the Fund with the Bank. The balance bears quarterly interest of 2% per annum.

As at 31 December 2011 no funds are transferred to partner – banks (31 December 2010: BGN 803 thousand).

**29. OTHER BORROWINGS (CONTINUED)**

*Attracted special purpose deposit from the Ministry of Finance*

On 20 December 2011 the Bank concluded a deposit agreement with the Ministry of Finance for the provision of deposit in the amount of BGN 171,000 thousand up to 30.03.2012, but not before the date of full repayment of the loan granted by the Bank under the state loan from 20.12.2011 year. (Note 19). As at 31 December 2011 the nominal amount of the deposit is BGN 171,000 thousand.

In 2010 the funds of Ministry of Finance provided pursuant Decision 197 of 8 April 2010 and an Agreement between the Council of Ministers and the Bank of 13 April 2010 for implementation of mechanism for settling obligations pursuant to State budget. In order to fulfill the provisions of the set mechanism, Ministry of Finance provides an additional financial support by depositing funds in the bank up to the amount of BGN 400,000 thousand. As at 31 December 2010 the Ministry of Finance has provided such resources with a nominal amount of BGN 120,000 thousand.

*Long-term refinancing agreement with the State Fund Agriculture*

Under a Contract, signed in 2002, with the State Fund Agriculture for re-financing *special-purpose loans provided to farmers*, the Fund has refinanced the Bank with its own funds for granting such loans in relation to investment projects and disclosed investment programs. The interest due by the Bank on the Borrowings is 2% p.a. Since 18.05.2011 the Bank provided loans to farmers at 7% annual pursuant in accordance with Annex 1 (before 18.05.2011 loans granted by the Bank to the farmers are at 9% annual interest rate).

As at 31 December 2011 the amounts received for refinancing from the Fund is BGN 5,712 thousand (31 December 2010: BGN 6,462 thousand).

On 21.07.2011 the Bank signed a new Refinancing agreement with funds of the State Agricultural Fund for providing loans to applicants with approved projects under measures of the Rural Development Program (RDP) for the period 2007 – 2013. The interest due by the Bank to State Agricultural Fund is 2% p.a. The Bank provides loans to approved projects under measures of RDP at 7% p.a.

As at 31 December 2011 the amounts received for refinancing from the Fund is BGN 117 thousand.

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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**30. DEBT SECURITIES ISSUED**

In May 2010 the Bank has issued second ordinary, corporate, interest bearing, non-cash, registers, freely transferable, non-convertible, unsecured bonds ISIN code BG 2100005201 with a total nominal value EUR 20,000 thousands and par value of bond - EUR 1,000 each. The term of bond loan is 60 months, to 15 May 2015. The agreed interest is paid quarterly by applying interest rate of 5% p.a. The principal is payable single installment on maturity.

In December 2010 the bank issued third registers, non-cash, freely transferable, ordinary, non-convertible, unsecured, interest bearing bonds with a total nominal value EUR 20,000 thousands and par value of bond – EUR 1,000 each. The term of bond loan is 60 months, to 30 December 2015. The contracted interest is paid quarterly by applying interest rate of 4,8 % p.a. The principal is payable single installment on maturity.

Debt securities issued are presented in the statement of financial position at amortized cost.

**31. FINANCIAL LIABILITIES HELD FOR TRADING**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
Interest rate swaps	2,082	-
Currency swaps	999	-
	<u>3,081</u>	<u>-</u>

**32. OTHER LIABILITIES**

	<b>2011</b>	<b>2010</b>
Provisions on bank guarantees	10,942	676
Charges on debenture loans	1,173	1,371
Accruals for expenses	250	111
Payables to personnel and for social security	244	282
Payables to EIF	-	404
	<u>12,609</u>	<u>2,844</u>

*Provisions on bank guarantees* represent the amount expected to be actually paid to third parties by the Bank under issued thereby guarantees. It is comprised of two components: a) individual provisions – when at 31 December (the balance date) there are already sufficiently clear evidence as to the individual guarantees that they will be enforced and the beneficiaries there under will have undeniable right and may submit request for payment – BGN 2 300 ths. (31.12.2010: BGN 0 ths.), as well as (b) portfolio provisions – determined as at 31 December (the reporting date) based on the assessment of the risk of loss for each guaranteed credit portfolio of a partner-bank under the Micro-credits Guarantee Fund Project of the Ministry of Labor and Social Policy – BGN 8,642 ths. (31.12.2010: BGN 676 ths.).

*Payables to personnel* include: accruals on compensated leaves and social security contributions thereon as well as the present value of the Bank's liability due on retirement benefit obligations as at 31 December 2011 (the statement-of-financial-position date).

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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32. OTHER LIABILITIES (CONTINUED)

In accordance with the Labor Code each employee is entitled to indemnity on retirement at the amount of two gross monthly salaries, and if he or she has worked for more than 10 years for the Bank – six gross monthly salaries at the time of retirement. The Bank has estimated the amount of these liabilities by using mathematical models and the services of a certified actuary. On the basis of the calculations made, the amount of BGN 142 ths. is included in the balance at 31 December 2011 (31.12. 2010: BGN 115 ths.).

<i>In thousand of BGN</i>	2011	2010
Present value of the liability at 1 January	106	114
Unrecognised actuarial gain/ loss at 1 January	9	(1)
<b>Liability recognised in the balance sheet at 1 January</b>	<b>115</b>	<b>113</b>
Expenses for the period	35	30
Amounts paid in the period	(8)	(28)
<b>Liability recognised in the balance sheet at 31 December</b>	<b>142</b>	<b>115</b>
Unrecognised actuarial gain/(loss) at 31 December	25	9
Present value of the liability at 31 December	117	106

The change in Bank's liability to personnel for indemnities on retirement for the reporting year is presented in the statement of comprehensive income and includes:

<i>In thousand of BGN</i>	Amounts on retirement for old age and service	Amounts on retirements due to illness	Total
Interest expense	6	1	7
Current service costs	24	-	24
Net actuarial (gain) loss recognised for the period	-	4	4
<b>Expense recognised in the statement of comprehensive income (as current profit or loss for the period)</b>	<b>30</b>	<b>5</b>	<b>35</b>

The following actuarial assumptions are used in calculating the present value of the liabilities as at 31 December 2011:

- mortality rate – in accordance with the table, on basis of statistics issued by the National Statistical Institute for the total mortality rate of the population in Bulgaria for the period 2008 – 2010;
- staff turnover rate – from 0% to 10% depending of the five age groups formed;
- effective annual interest rate for discounting – 5.7% (2010 – 6.5%);
- The assumptions for the future level of working salaries in the Bank is based on the plan for development of the company and verified by the Bank with confirmation letter: for 2012 – 5 % compared to level in 2011 and for 2013 and subsequent years – 5 % compared to the previous year level.

BULGARIAN DEVELOPMENT BANK AD

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**33. SHARE CAPITAL**

<i>In thousand of BGN</i>	<b>2011</b>	<b>2010</b>
<b>Share capital</b>		
Ordinary shares issued for cash fully paid	587,964	587,964
Ordinary – in-kind contribution (parcel building of the bank)	12,200	12,200
Issued ordinary shares – in-kind contribution (building of the bank)	<u>1,610</u>	<u>1,610</u>
	<u><u>601,774</u></u>	<u><u>601,774</u></u>
<b>Share capital movement</b>		
<b>As at January 01</b>	601,774	589,574
Newly issued shares	<u>-</u>	<u>12,200</u>
<b>As at December 31</b>	<u><u>601,774</u></u>	<u><u>601,774</u></u>

The capital of the Bank is composed by 6,017,735 ordinary registered voting shares with par value of BGN 100 each.

The increase of capital in 2010 was made through non-monetary contribution, representing the value of ownership of real estate – private state property with an area of 893.42 square meters, located in the city of Sofia, 1 Dyakon Ignatij street. The non-monetary contribution was made by the State on basis and to implementation of Decision 340 of the Council of Ministers in 2010, as against this contribution the State acquires 122 000 new registered shares with par value of BGN 100 each.

The new Bulgarian Development Bank Act provides that not less than 51% of the shares - should be owned by the State whereas shares of the State amounting to not less than 51% of the registered share capital, are non-transferable. Also, a specific limit is established with regard to the remaining shareholders, other than the Bulgarian State, through the Ministry of Finance. They may be: the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund as well as other banks for development in EU member states.

The Bank's shares may not be pledged and the rights thereon may not be subject to transfer deals.

## BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
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### 34. RESERVES

Specific requirements, other than under the general regulation of the Commercial Act regarding the Reserve Fund of the Bank have been introduced with the new Bulgarian Development Bank Act from 2008. Under the law the Bank should allocate to the fund not less than ½ the annual profit after taxes until 50% of the share capital as per the Articles of Association are reached.

The Bank can use the money from the Reserve Fund to cover its current or prior period losses, but cannot use it for distribution of dividends without permission by Bulgarian National Bank.

In addition, under the Credit Institutions Act, the banks may not distribute dividends before reaching the minimum reserves (mainly Reserve Fund) required by law or by the Articles of Association, or in case the distribution of dividends results in violating the regulatory capital adequacy ratios. The requirement under the Bulgarian Development Bank Act is analogous.

As at 31.12.2011 the Statutory reserve of the Bank amount to BGN 51,824 ths. (31.12.2010: BGN 25,941 ths.).

As at 31.12.2011 the additional reserves of the Bank amount to BGN 6,190 thousand. (31.12.2010: BGN 6,190 ths.) and are formed as result of distribution of profits of the bank from previous periods, according to decisions of the General Meeting of shareholders.

In 2011 and 2010 there are no dividends paid.

In accordance with the Bulgarian Development Bank Act, each shareholder of the Bank may refuse the dividend due thereto and then the dividend amount is transferred to supplementary reserves.

The Bank has set aside a special component of equity 'AFS Revaluation Reserve', to which are accumulated all retained earnings and accumulated losses from revaluation to fair value of securities held and for sale, existing in the statement of financial position. These profits and losses are transferred to current profit and loss on sale/maturity of the respective securities and/or in a case of lasting impairment. The revaluation reserve is presented net of deferred taxes. As at 31 December 2011 it is negative value amounting to BGN 403 ths. (31.12.2010: BGN 304 thousand – negative value).

### 35. CONTINGENT LIABILITIES AND COMMITMENTS

<i>In thousand of BGN</i>	2011	2010
<b>Contingent liabilities</b>		
Bank guarantees and letters of credit	76,767	85,266
Recognised in the statement of financial position (provided)	<u>(10,942)</u>	<u>(676)</u>
	65,825	84,590
<b>Irrevocable commitments</b>		
Undrawn authorized loans	40,490	69,370
Non-paid portion of NGF shares	-	52,500
Uncalled nominal portion of held EIF shares	4,694	4,694
	<u>45,184</u>	<u>126,564</u>
	<u>111,009</u>	<u>211,154</u>

## BULGARIAN DEVELOPMENT BANK AD

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### 35. CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

By virtue of the Bulgarian Development Bank Act, the transfers of the activities under the Micro-credits Guarantee Fund Project from the Ministry of Labor and Social Policy (MLSP) to the National Guarantee Fund EAD – subsidiary of the Parent Company (the bank) were started in the last quarter of 2008. Based on this law and on Council of Ministers Decision No. 309/3 May 2007, re-negotiations was carried out within one year (until May 2009) with each of the partner-banks under the Micro-credits Guarantee Fund Project of MLSP for replacing the security of MLSP deposits with bank guarantees of the Bulgarian Development Bank AD. The capital of the Bulgarian Development Bank AD and respectively, of the National Guarantee Fund, shall be increased with the amount of the released government funds under the project.

Agreements with eight partner-banks were concluded as at 31 December 2011 and the Bank guarantees at the amount of BGN 26,590 ths. were issued. (31.12.2010: eight partner-banks and issued guarantess at the amount of BGN 39,594 ths.).

#### *Nature of instruments and credit risk*

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

The guarantees of the Bank issued under the Micro-credits Guarantee Fund Project are not secured. In case of activation of a guarantee of the Bank component, the payment is not assessed as ultimate loss because the partner-bank is obliged to undertake all necessary measures for realizing the received collaterals of the non-performing loan and to reimburse the respective amount to the Bank.

The non-paid portion of the nominal value of European Investment Fund shares, held by the Bank shall become due for payment after a special decision for this purpose taken by fund's General Meeting of Shareholders. By the issue date of this financial statement no such a decision has been taken.



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**36. CASH AND CASH EQUIVALENTS**

	2011	2010
Cash on hand (Note 16)	124	674
Current account with the Central Bank (Note 16)	70,162	22,979
Minimum required reserve with the Central Bank	-	9,975
Amounts due from other banks, with up to 90 days maturity	<u>409,897</u>	<u>163,937</u>
	<u>480,183</u>	<u>197,565</u>

**37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE**

<i>Company/person</i>	<i>Type of control</i>
Ministry of Finance	Majority shareholder of the capital of the BDB AD representing the State
National Guarantee Fund EAD	Subsidiary
Microfinancing Institution JOBS EAD	Subsidiary
Holding Bulgarian State Railways EAD	Company under joint control with the State
National Electricity Company EAD	Company under joint control with the State
BULGARGAS EAD	Company under joint control with the State
Bulgarian Institute for Standardization	Company under joint control with the State
State-owned Enterprise "Communicative Construction and Rehabilitation"	Company under joint control with the State
South Stream Bulgaria AD	Company under joint control with the State
State-owned Enterprise "Transport Construction and Rehabilitation"	Company under joint control with the State
"I C J B" AD	Company under joint control with the State
Ministry of Agriculture and Food	Company under joint control with the State
State Fund Agriculture	Company under joint control with the State
Ministry of Environment and Water	Company under joint control with the State
Bulgarian State Railways EAD	Company under joint control with the State

BULGARIAN DEVELOPMENT BANK AD

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**37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (CONTINUED)**

*Balances with related parties and companies under joint control with the State (in thousand of BGN):*

<b>Assets</b>			
<i>Company/person</i>	<i>Type of balance</i>	<b>2011</b>	<b>2010</b>
Ministry of Agriculture and Food	Receivables from the State budget	335,395	-
Microfinancing Institution JOBS EAD	Loans and advances to customers	24,000	-
Ministry of Finance	Available-for-sale securities	1,001	971
Ministry of Finance	Receivables from the State budget	-	265,894
Ministry of Environment and Water	Receivables from the State budget	-	296
<b>Liabilities</b>			
<i>Company/person</i>	<i>Type of balance</i>	<b>2011</b>	<b>2010</b>
National Guarantee Fund EAD	Deposits from customers	345,762	6,872
Ministry of Finance	Other borrowings	189,539	138,829
South Stream Bulgaria AD	Deposits from customers	5,851	50
State Fund Agriculture	Other borrowings	5,839	6,472
Microfinancing Institution JOBS EAD	Deposits from customers	534	4,562
"ICJB" AD	Deposits from customers	389	3,912
Bulgarian Institute for Standardization	Deposits from customers	37	48
BULGARGAS EAD	Deposits from customers	13	19
National Electricity Company EAD	Deposits from customers	2	183
State-owned Enterprise "Transport Construction and Rehabilitation"	Deposits from customers	2	4
State-owned Enterprise "Communicative Construction and Rehabilitation"	Deposits from customers	-	4
Holding Bulgarian State Railways EAD	Deposits from customers	-	1,363

*Transactions with related parties and companies under joint control with the State (in thousand of BGN):*

<i>Company/person</i>	<i>Type of transaction</i>	<b>2011</b>	<b>2010</b>
Ministry of Finance	Fee and commission income	75	77
	Interest income	11,016	7,225
	Interest expense	(3,811)	(1,461)
National Guarantee Fund EAD	Fee and commission income	1	1
	Fee and commission expense	(52)	(96)
	Interest income	(6)	(9)
Microfinancing Institution JOBS EAD	Interest expense	42	33
	Fee and commission income	1	-
	Interest income	309	-
Holding Bulgarian State Railways EAD	Interest expense	(1)	-
	Rentals	16	-
	Fee and commission income	70	70
Ministry of Agriculture and Food	Interest expense	-	(1)
	Interest income	395	-
State Fund Agriculture	Interest expense	(124)	(133)
Ministry of Environment and Water	Interest income	173	50

BULGARIAN DEVELOPMENT BANK AD

NOTES TO THE INDIVIDUAL FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2011

**37. TRANSACTIONS WITH RELATED PARTIES AND COMPANIES UNDER JOINT CONTROL WITH THE STATE (CONTINUED)**

*Contingent liabilities and commitments with related parties (in thousand of BGN):*

<i>Company/person</i>	<i>Type of transaction</i>	<b>2011</b>	<b>2010</b>
Microfinancing Institution JOBS EAD	Bank guarantees issued	2	-
Microfinancing Institution JOBS EAD	Undrawn authorized loans	6,000	-
National Guarantee Fund EAD	Non-paid portion of shares	-	52,500

*Relations with key management personnel (in thousand of BGN):*

<b>Balances with key management personnel</b>	<b>2011</b>	<b>2010</b>
Deposits from customers	124	141
Remunerations payable	29	52
Loans and advances to customers	-	(20)
	<u>153</u>	<u>173</u>

<b>Transactions with key management personnel</b>	<b>2011</b>	<b>2010</b>
Remunerations and social security contributions	1,790	1,032
Interest expense	1	5
Interest income	-	1

**38. EVENTS AFTER THE REPORTING PERIOD**

No adjusting and/or non-adjusting events have occurred after the reporting period that require additional disclosures in the financial statements.

**BULGARIAN DEVELOPMENT BANK AD**

**ACTIVITY REPORT  
2011**

### **Information on the Bank**

Bulgarian Development Bank AD (BDB AD) was established on March 11, 1999 as a joint stock company under the Bulgarian Law with the name of Encouragement Bank AD.

On April 23, 2008 was adopted the Law on the Bulgarian Development Bank. It regulates the bank's structure and scope of activities, including those of the subsidiaries provided for establishment.

The mission of Bulgarian Development Bank is to be a contemporary banking institution, which utilizes its unique position on the Bulgarian banking market for implementation of the state's economic policy. Main focus for the Bank are local SME's, project finance for export orientated companies, as well as investment banking for public projects with national importance. Moreover, the Law on the Bulgarian Development Bank grants the institutions in the Group a status within the meaning of Art. 44, paragraph b, item ii of Council Regulation (EC) No. 1083/2006 (granting of subsidies under the EU Operational programs, European Regional Development Fund and the Cohesion Fund through equity participation funds, guarantees and loans and sustainable urban development funds).

As of 31.12.2011 the paid-in share capital amounts to BGN 601 774 thousand (31.12.2010 – BGN 601 774 thousand), consisting of 6,017,735 ordinary registered shares with nominal value of BGN 100 each. The Bank has complied with the requirements of BNB for minimum share capital for banking activity, as well as the capital requirements of the Law on BDB. The ownership of the capital is as follows: 99,9999% is owned by the Republic of Bulgaria represented by the Ministry of Finance; 0,0001% is owned by DSK Bank.

In compliance with its Statute, the scope of activity of the Bank is:

- ✓ Public attraction of deposits and other repayable funds and extension of loans and other financing for its own account and at its own risk;
- ✓ Payment services within the meaning of the Law on Payment Services and Payment System, without issuance of bank payment card and e-money;
- ✓ Activities as depositary and custodian institutions;
- ✓ Financial leasing;
- ✓ Guarantee agreements;
- ✓ Trading for its own account or on behalf of customers with money market instruments, foreign currency and precious metals; financial futures, options, instruments related to exchange rates and interest rates, as well as other derivative instruments;
- ✓ Trading for its own account or on behalf of customers with transferable securities, participation in origination of securities, as well as other services and activities under Art.5, para.2 and 3 of the Law on the markets of financial instruments;
- ✓ Money brokerage;
- ✓ Advising companies on their capital structure, industrial strategy and related matters, as well as advising on the restructuring of companies, mergers and acquisitions;
- ✓ Purchase of receivables related to delivery of goods and provision of services /factoring/;
- ✓ Acquisition and management of equity stakes;
- ✓ Collection, provision of information and references on the creditworthiness of customers;
- ✓ Other similar activities, specified by a regulation of the Bulgarian national bank;

The seat of Bulgarian Development Bank AD, is: 10 Stefan Karadhza Str., Sredets District, Sofia 1000.

As of December 31, 2011 the headcount of the Bank includes 111 employees.

## **Characteristics of the environment**

### **Macroeconomic environment and bank system**

The recovery of the Bulgarian economy continued in 2011. The GDP for the year reached an amount of BGN 75.3 billion and registered a real growth of 1.7%. The main contribution to the growth of the newly created income was the foreign demand. Current account for 2011 was positive, amounting to EUR 743.7 million (1.9% of GDP). According to preliminary data from the Balance of payments, Foreign Direct Investment amounted to EUR 1 064.5 million and reinvested profit in the banking sector is estimated at EUR 82.5 million.

As a result of the ongoing processes of economic restructuring, the employment in the Bulgarian economy in 2011 continued to decline and unemployment rate increased. According to preliminary data the annual unemployment rate increased to 11.2%. The price dynamics in the country slowed down and cumulative year inflation decreased to 2.0% (2010: 4.4%). The average annual inflation was 3.4%.

### **Review of activities**

2011 was the beginning of a modernization and upgrade of BDB. In the meantime, the Bank continued to rapidly grow its business.

New strategy with horizons to 2014 and 2016 was developed in compliance with the Law on BDB. A new horizontal management structure in accordance with the best practices of modern banking was adopted. It includes a small number of management levels with clearly specified functional duties and responsibilities of the units. The staff engaged in non-business activities was reduced, while at the same time highly qualified professionals were attracted.

A comprehensive review of internal regulations was undertaken and the process of modernization was initiated. The main regulations of the bank were updated - market risk, assets and liabilities management. Substantially was improved the organization of the bank's core business – the lending, where new lending regulations with clearly defined responsibilities of participants in the process and systems for monitoring and controlling of the lending were introduced.

The loan portfolio of BDB was thoroughly reviewed. Following the analysis, all necessary measures were taken to prevent deterioration of the portfolio. The management of the Bank adheres to a consistent conservative risk assessment policy, in line with the economic environment and the specific characteristics of the loan portfolio of the bank. In 2011 impairment coverage of exposures to non-financial institutions was raised from 8.9% to 12.2%.

As of 31.12.2011 the financial result of the Bulgarian Development Bank before tax amounted to BGN 6,992 thousand (2010: BGN 28,720 including a donation of BGN 4,556 thousand). The lower financial result for 2011 is mainly due to higher impairment of inherited from previous years loan portfolio. Net costs for impairment of loans are at a total amount of BGN 31,150 thousand. The increase in impairments is associated with the conservative approach to credit risk assessment and the need for additional impairment coverage of individual credit exposures formed before the first half of 2011. Also increased is the coverage of loans classified in categories other than "Regular".

In addition, BDB Group adopted an assessment, based on actual historical experience, of expected future payments under guarantee commitments under the Micro Credit Guarantee Fund program (MCGF), transferred in 2009 from Ministry of Labour and Social Policy in BDB

and administrated by NGF. Under the issued bank guarantees in this portfolio were allocated net provisions in the amount of BGN 14,994 thousand. These provisions are formed by two positions – provisions for covering future payments in 2011 and allocation of provisions for future payments under guarantees in this portfolio. Valuations on the assets held for sale were also updated.

As a result of the expanded operations, the realized operating income of the Bank for 2011 reached BGN 64,047 thousand (2010 - BGN 56,702 thousand including a donation of BGN 4,566 thousand). The general and administrative expenses in 2011 amount to BGN 8,636 thousand (2010 – BGN 6,344 thousand), which gives the BDB the lowest expenses to income ratio for the Bulgarian banking system in 2011, amounting to 13.8%.

The volumes of assets, liabilities and income of the Bank in 2011 had been significantly impacted by the following financial transactions:

- In December 2011 BDB signed an agreement to provide a loan to the Ministry of Agriculture and Foods (MAF), amounting to BGN 335,022 thousand as part of an initiative related to the Rural Areas Development Program (RDP) of the EU. The loan provided by BDB is the first step of a project for establishing a Guarantee Fund under the RDP, jointly funded by the EU and the Bulgarian government. The funds under this initiative are provided by MAF to National Guarantee Fund and in turn as at 31.12.2011 NGF placed them as a deposit in BDB.
- In July 2011 was completed the implementation of Decree 197 of the Council of Ministers (CM) from 08 April 2010 on "Adoption of a mechanism for settlement of State budget liabilities" and the Agreement between BDB and CM from 13 April 2010. The government repaid the Bank all liabilities under acquired receivables. The value of receivables the Bank purchased under this initiative at the end of 2010 was BGN 266,190 thousand. Estimated net effect of these operations is an increase in net interest income of the Bank of about BGN 5 million for each of the two years of the agreement.

As of 31.12.2011 the assets of Bulgarian Development Bank reached BGN 1,870 million, an increase of 36.15% compared to the end of 2010. At the end of 2010 the amount of total assets was higher due to the temporary effect of the discount credits under Decree 197 of 2010 and at the end of 2011 – due to the funds under the initiative of the RDP. Excluding these temporary effects, the increase of assets is from BGN 1,214 million at the end of 2010 to BGN 1,364 million at the end of 2011.

In 2011, the Bank continues to actively develop its activities, supporting the Bulgarian business in a difficult economic environment. The loan portfolio increased by 35% to BGN 544,077 thousand, as BDB continued to maintain a diversified sectoral structure of its loan portfolio. Significantly decreased the share of construction (minus 4.2%) and tourist services (minus 3%). Increased was the share of the sectors waste collection (+ 6%) and trade (+ 3.9%).

The volume of indirect lending through commercial banks (on-lending) as of 31.12.2011 amounted to BGN 445,685 thousand (BGN 458,548 thousand at the end of 2010). In addition to the two existing programs for support of SMEs and agricultural producers, a new program under which four commercial banks received funds borrowed from KfW was launched.

The securities portfolio of BDB declined by 7.60% to BGN 16,560 thousand and its share in the assets declined from 1.62% to 1.08%. The main part of this portfolio consists of corporate securities. Investments in securities are not among the priority activities for BDB.

As of 31.12.2011 the amount of utilized funds from international financial institutions is BGN 327,963 thousand (2010: BGN 331,357 thousand). Negotiated were over EUR 120 million in new credit lines at attractive for the local market terms, which will be used to finance (directly and through other local banks) SMEs under preferential conditions. The cooperation with key

international partners was continued. A new loan agreement for SMEs was signed for EUR 20 million with the Council of Europe Development Bank. Funds were utilized under the 2010 loan from Nordic Investment Bank, used to finance projects for renewable energy and environment. The existing cooperation with Citibank – Sofia was successfully extended. The Loan agreement signed in 2010 was successfully finalized and replaced by two newly negotiated and fully utilized new credit lines with a total amount of EUR 28 million. A third agreement was signed with another strategic partner of BDB - Black Sea Trade and Development Bank, in the amount of EUR 31 million. The first utilization under this line was also drawn during the year. The resources under these loans are aimed at supporting the SME sector in Bulgaria by financing new projects to final borrowers - SMEs. Also important for BDB is the development of partnership with Sumitomo Mitsui Banking Corporation Europe, which increased the limit for refinancing of letters of credit by EUR 9.5 million. The approved increase is fully utilized.

Outside of its traditional sources of funding, in 2011 BDB initiated negotiations for additional financial facilities. Negotiations started with the Hungarian Exim Bank and Turk Exim Bank for an extension of export financing and financing of projects of mutual interest. As a respected partner, BDB maintains an intensive dialogue with KfW Exim Bank, Germany, Spanish Development Bank (ICO), Spain, Bank of North Rhine-Westphalia (NRW), Germany.

### ***Risk management***

In the ordinary course of business, the Bank is exposed to a variety of financial risks. These risks are identified, measured and monitored through various control mechanisms in order to be managed and to prevent undue risk concentration. The process of risk management is essential for the Bank's profitability and existence. The main risks, to which the Bank is exposed, are credit risk, market risk and operating risk.

### **Credit risk**

Credit risk is the main risk to which the bank is exposed, hence its management is essential for the business. Credit risk management is carried out in accordance with the Law on BDB and the laws and regulations of the Republic of Bulgaria regulating lending activity, as well as in accordance with established international standards and good banking practices.

The Bank uses a model to generate an internal rating for assessing and managing credit risk exposures. These ratings indicate the credit quality of the borrower for each loan transaction. Within BDB are created and function bodies for current monitoring and controlling of the quality of loan portfolio, namely a Work group on overdue loans, Work group for current control on the loan portfolio, Provisions committee and Work group on the loans at court.

For the management of the credit risk in the BDB, a system of interbank limits for economic sectors is observed, as well as other credit and concentration limits, and the results of compliance monitoring are reported to competent authorities. The system of limits is revised and updated periodically.

### **Market risks**

When managing the foreign currency risk, the BDB follows the principle of maintaining a minimal open currency positions within the specified limits. Foreign exchange positions are not formed for speculative purposes, but due to foreign currency transactions arising in the ordinary course of banking business. The Bank does not implement significant transactions and does not hold significant open positions in currencies other than Euro and Bulgarian



Leva. Until the exchange rate of the Lev is fixed to the euro, the euro is not considered a currency bearing currency risk for the cash flows and the financial position of the Bank.

As a part of the management of interest rate risk, regular reports on financial assets and liabilities are prepared, divided in time intervals depending on their sensitivity to changes in interest rates. In case of discrepancies in periods, an assessment of expected changes in interest curve is applied and potential risk for the interest income of the Bank is measured.

Risks in operations on money and capital markets are managed by a system of limits reflecting the risk profile of investments and certain parameters of the portfolio, such as counterparty, financial instrument, maturity, etc. The system of limits is reviewed periodically, and implementation of the limits is subject to daily monitoring. The securities portfolio formed by BDB is below the specified regulatory threshold requiring an allocation of capital for price risk and price risk is negligible compared to the size of business.

Liquidity of BDB is managed by closely monitored ratios indicating liquidity position by periods. Liquidity risk is measured by applying additional scenarios for cash flows from operations. Measured and monitored are also the liquidity buffers of the Bank and the additional sources of funding in case of market and idiosyncratic shocks.

### ***Operational risk***

Operational risk management is implemented through close observation and recording of all operational events. Events, characterized by greater frequency, are the basis of scenario analysis on operational risk. With the relatively small headcount in the BDB, the operational risk is easily measurable and controllable. In the course of business a register of operational events is created, serving as a basis for analysis and improvement of work processes and minimizes factors that potentially could lead to operational events and losses for the Bank.

### ***Banking regulators under the Bulgarian law***

In accordance with the requirements of laws and regulations governing the banking in the country, Bulgarian Development Bank should comply with restrictions related to certain ratios. As of 31.12.2011 the Bank has complied with all regulatory requirements of BNB and the Bulgarian legislation.

The capital adequacy on an individual basis as of 31.12.2011 is 55.10% (31.12.2010: 63.00%) which manifold exceeds the minimum required capital adequacy ratio of 12%. The decrease registered in 2011 is associated with the more intensive use of the bank's capital in its business and the capital contributions to subsidiaries of BDB.

### ***Credit rating and international activities***

On December 14, 2011 the rating agency Fitch Ratings affirmed the long term rating "BBB-" (BBB minus) of BDB AD as an issuer of long-term foreign currency debt, with stable outlook. The short-term rating of the bank is affirmed at "F3" and the individual – at "D". The investment community considers this rating as an investment rating. The ratings confirmed by the agency reflect the high level of capitalization of the bank as well as the support by the shareholder – the Bulgarian state, represented by the Ministry of Finance.

BDB continues to successfully develop fruitful partnerships with major European and International financial institutions. These relations enable the Bank to be preferred business partner, to utilize the best banking practises and to participate in their development and implementation.

BDB is a shareholder in the European Investment Fund, holding 0,10% of its equity and participates regularly in the Committee of the minority shareholders of the financial institution, where the guidelines for development of the activities and policy of EIF were discuss. The

Bank is an active member of the European Association of Public Banks (EAPB) since 2005. In 2011 BDB continued to take an active participation in the workshops and seminars organized by EAPB, related to the development of the European banking and financial legislation. In addition, the permanent representative of BDB participates in the Competitiveness and Development Committee. Simultaneously, the membership in EAPB facilitates the exchange of experience and best practices between BDB and more European public banks.

The Bank is a member of the Network of European Financial institutions (NEFI), participated by 15 European countries. The objectives of NEFI are to improve the exchange of information, know-how and experience in SME financing among banks, as well as to engage in constructive dialogue with the EU institutions regarding issues with SME in the European Union.

BDB retains its status as an observer and participates in the Club of Institutions of the European Union Specializing in Long-Term Credit, jointly with the EIB, EBRD, Caisse des depots et consignations (CDC), Cassa depositi i prestiti (CDP) and others.

BDB is also a member in organizations that help identification of opportunities for development of export and pre-export financing of the Bank: the French-Bulgarian Chamber of Commerce, German-Bulgarian Industrial Chamber of Commerce, Bulgarian – Nordic Chamber of Commerce, Bulgarian – Japanese Economic Council at BCCI.

### ***Management of the Bank***

Bulgarian Development Bank has a two-tier management structure consisting of Supervisory Board and Management Board.

In the beginning of 2011 Supervisory Board members of BDB are Roumen Andonov Porodzanov (Chairman of SB), Garabed Ardashes Minassian (member of SB) and Francis Adam Wakefield Carpenter (member of SB). The Management Board members of the Bank are: Dimitar Kirilov Dimitrov (Chairman and Executive Director), Sasho Petrov Tchakalski (Deputy Chairman and Executive Director) and Angel Kirilov Guekov (member of MB and Executive Director). The Bank has two procurators – Krasimirka Velinova – Saeva and Todor Vanev. The Bank is managed and represented jointly by any two of the three Executive Directors, or by procurator jointly with one of the three Executives Directors.

Changes in the management took place on 15 April 2011 when the Supervisory Board of BDB at its session released from their duties as members of the MB Dimitar Kirilov Dimitrov, Sasho Petrov Tchakalski and Angel Kirilov Guekov. The SB has elected the following members of the Management Board: Assen Vasilev Yagodin (Chairman of the Management Board and CEO); Vladimir Vladimirov Gyulev (Vice-Chairman of the Board and Executive Director); Iliya Zapryanov Karanikolov (Member of the Board and Executive Director); Andrey Ivanov Genev (Member of the Board) and Hristo Vanguelov Karamfilov (Member of the Board). The changes in the MB are registered in the Commercial Register on 05.05.2011 and the procurations of Krasimirka Velinova – Saeva and Todor Vanev are terminated on 30.05.2011. After the changes the Bank is represented jointly by any two of the three Executive Directors.

The General Meeting of the Shareholders approved changes in the Supervisory Board. Since 15.06.2011 the Board consists of the following members: Rumen Andonov Porodhanov, Diana Toneva Dragneva-Ivanova and Dorothea Ivanova Pandova. The following members were released: Garabed Ardashes Minassian and Francis Adam Wakefield Carpenter. In the period from 15.06.2011 to 6.12.2011 Chairman of SB was Roumen Porodhanov, and since 6.12.2011 – Dorothea Ivanova Pandova.

The remuneration paid to the persons, managing the Bank in 2011 amounted to BGN 1,790 thousand<sup>1</sup>.

There are no contracts within the meaning of Art. 240 "b" of the Commercial Law concluded between the members of SB and MB or related persons on one side and the Bank on the other side, which diverge from their usual activities or significantly deviate from markets conditions.

The participation within the meaning of Art.247, paragraph 2, item 4 of the Commercial Law of members of the SB and MB in commercial companies as general partners, holding more than 25 percent of the capital of another company, as well as participation in the management of other companies or cooperations as procurators, managers or Board members is as follows:

- Members of the SB and MB of BDB do not participate in the capital of other companies.
- Members of the SB do not participate in the management of other companies.
- Members of the MB have the following participation in the management of other companies:
  - Assen Vasilev Yagodin participates in the management of BULGARIAN STOCK EXCHANGE - SOFIA, UIC - 030412611 as Chairman of the Board of Directors
  - Vladimir Vladimirov Gyulev does not participate in the management of other companies.
  - Iliya Zapryanov Karanikolov participates in the management of MFI JOBS EAD., UIC 201390740 as Chairman of the Board of Directors
  - Andrey Ivanov Genev participates in the management of NGF EAD, UIC 200321435 as Chairman of the Board of Directors
  - On 01.03.2012, with a decision of the MB of BDB, Hristo Vanguelov Karamfilov was elected as member of the Board of Directors of MFI JOBS EAD, UIC 201 390 740.

***Transactions with related persons and companies under common control of the state***

Owner of BDB is the Bulgarian state, hence the Bank is a related party to the government bodies of the Republic of Bulgaria and the companies in which it exercises control. In note № 37 to the individual financial statements of BDB for 2011 are presented transactions with related parties and companies under common control of the state.

**Development of Bulgarian Development Bank AD during 2012**

In 2012 BDB develops its activities in accordance with the approved strategy for development of BDB in horizons until 2014 and until 2016.

**Development strategy and business objectives. Financial goals and objectives**

The strategy of BDB in the horizons to 2014 and to 2016 establishes a framework for modernization of the bank's activity and accelerated growth in support of the Bulgarian business. One of its substantial parts is the return of the focus to the main priority of the Bank - small and medium enterprises, export-oriented businesses and public projects. The main

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<sup>1</sup> The amount of remuneration paid includes benefits for early terminated management and labor relations.

goal is to position BDB among the leading financial institutions in the Bulgarian banking market, reaching a scale that ensures significant influence of the bank in the processes in the financial sector and allow it to become an important instrument of state policy in the economy. Thus BDB's capacity will be effectively utilized. On the basis of its solid foundation (100% state ownership, substantial for local standards capital, the highest possible rating for Bulgaria), the Bank will attract resources under favorable terms and will transfer this price advantage to the Bulgarian SMEs.

Within the horizon of its strategy, BDB should reach an adequate for its fundamentals ratio "equity – loan portfolio" of about "1 to 4", compared to "1 to 1.2" at the end of 2010.

BDB will continue to be a significant partner of the Bulgarian banks in lending to SMEs - using its competitive advantages to attract external resources at attractive price levels the Bank will continue to expand its "on-lending" portfolio - credit lines to other local banks for lending to SMEs under preferential conditions.

BDB will assume an active position in respect of utilization of the EU funds – the Bank will aim directly to actively support the process of absorption of the funds under OP and RDP. BDB will support both the beneficiaries (SMEs and agricultural producers) in implementing their investment projects, as well as, relying on its experience and where appropriate, the public administration.

BDB will assume a leading role in the implementation of projects of national importance. Given its unique status for the local market, but relatively limited resources, the bank will pursue the role of lead advisor / arranger and partial lender in the implementation of major transactions in the field of project financing.

The development of the activity for 2012 will adhere to the strategically planned increase in business volumes and profitability. The Bank will continue to follow its conservative approach to assumed risks and impairment of assets, taking into account the general level of credit risk in the banking system and the specific characteristics of the loan portfolio formed until the end of 2010. In 2012 BDB will undertake expenses and investments, necessary for the update of its information and communication systems.

Further accelerated expansion of the lending activity, both direct and indirect, is anticipated. For the financing of its assets BDB will continue to rely mainly on its equity and attracted funding from international financial institutions.

The construction work on the office building of the Bank is expected to be initiated in 2012, while main investment costs for this project will be done in 2013 and 2014.

#### ***Events after the date of the balance***

In the period between the balance date and the preparation of this report no events have occurred, which have a significant impact on the facts in the report.

#### ***Declaration of the management***

The management of the Bank declares that the attached annual financial statements fairly reflect the assets and financial status of the bank as of the end of 2011 and that calculation of the financial results for the year is done in accordance with applicable law. Appropriate accounting policies are used and applied consistently. The necessary judgments are made in accordance with the prudence principle in preparation of the annual financial accounting statement at the end of the year. The management consistently uses the applicable accounting standards and the annual financial report is prepared on a going concern basis.

The management of the Bank endeavors to maintain adequate accounting system that complies with applicable accounting standards. The annual financial statements disclose the condition of the bank with a reasonable degree of accuracy.

All measures are taken to protect the Bank's assets, to prevent fraud and violations of laws in the country and regulations of BNB on the banking activity.

This Activity report was approved on 29 March 2012 by the Management board of the Bank and signed by:

EXECUTIVE DIRECTORS:

Assen Yagodin

Vladimir Gyulev

Iliya Karanikolov