ProCredit Bank

Part of the
ProCredit Group

Consolidated Financial Statements 2014

PROCREDIT BANK (BULGARIA) EAD
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2014

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Independent auditor's report

To the Shareholder of ProCredit Bank (Bulgaria) EAD

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of ProCredit Bank (Bulgaria) EAD and its subsidiaries (the 'Group') which comprise the consolidated statement of financial position as of 31 December 2014 and the consolidated income statement, consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated 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 whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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 accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2014, and its financial performance and its 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

Management is also responsible for preparing of the consolidated Annual Report in accordance with the Accounting Act.

Management has prepared consolidated Annual Report as of 31 December 2014 which was presented with the consolidated financial statements as of 31 December 2014 issued in Bulgarian language and authorised by the Management on 30 March 2015.

Rositsa Boteva
Registered Auditor

Stefan Weiblen
PricewaterhouseCoopers Audit OOD

31 March 2015
Sofia, Bulgaria

Consolidated Income Statement

(all amounts expressed in thousands of BGN)	Notes	Year ended 31 December	
		2014	**2013**
Interest income	6	91,701	103,709
Interest expenses	6	(23,313)	(31,315)
Net interest income		68,388	72,394
Net impairment loss	7	(2,772)	(4,993)
Net interest income after allowances		65,616	67,401
Fee and commission income	8	20,615	21,085
Fee and commission expenses	8	(1,349)	(1,897)
Net fee and commission income		19,266	19,188
Trading result	9	4,341	4,268
Net income/(expense) from financial assets at fair value through profit and loss	10	-	(432)
Other operating (expense)/ income, net	11	(2,436)	(294)
Operating income		86,787	90,131
Personnel expenses	12	(25,171)	(27,252)
Administrative expenses	13	(35,144)	(38,858)
Operating expenses		(60,315)	(66,110)
Profit before income tax		26,472	24,021
Income tax expense	14	(2,940)	(2,342)
Profit for the year		23,532	21,679
Profit attributable to:			
Equity holders of the group		23,532	21,679
Non-controlling interest		-	-
Profit for the period		23,532	21,679

These consolidated financial statements on pages 1 to 45 were approved by the Management Board and signed on its behalf by:

Emiliya Tzareva
Executive Director and
Member of the Management Board
30 March 2015

Rumyana Todorova
Executive Director and
Member of the Management Board

Initialled for identification purposes in reference to the auditor's report

Stefan Weiblen
PricewaterhouseCoopers Audit OOD
Date: 31 March 2015

Rositsa Boteva
Registered Auditor
Date: 31 March 2015

София
Рег. №035

The following notes set out on pages 6 to 45 form an integral part of these financial statements.

Consolidated Statement of Comprehensive Income

(all amounts expressed in thousands of BGN)	Notes	Year ended 31 December	
		2014	**2013**
Profit for the year		23,532	21,679
Other comprehensive income			
Items that will never be reclassified to profit or loss			
Remeasurements of post-employment benefits, net of tax		32	45
Items that are or may be reclassified to profit or loss			
Change in revaluation reserve from available-for-sale financial assets		(741)	(247)
Other comprehensive income for the year, net of tax		(709)	(202)
Total comprehensive income for the year		22,823	21,477
Total comprehensive income attributable to:			
Equity holders of the group		22,823	21,477
Non-controlling interest		-	-
Total comprehensive income for the year		22,823	21,477

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30 March 2015

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Stefan Weiblen
PricewaterhouseCoopers Audit OOD
Date: 31 March 2015

Rositsa Boteva
Registered Auditor
Date: 31 March 2015

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Consolidated Statement of Financial Position

(all amounts expressed in thousands of BGN)	Notes	As of 31 December	
		2014	**2013**
ASSETS			
Cash and cash equivalents	15	201,246	155,490
Loans and advances to banks	16	138,119	89,224
Available-for-sale financial assets	17	29,450	29,230
Loans and advances to customers	18	988,764	1,019,497
Equipment and intangible assets	19	48,709	48,916
Deferred income tax assets	20	9	0
Other assets	21	29,641	29,973
Total assets		1,435,938	1,372,330
LIABILITIES			
Liabilities to banks	22	87,287	69,529
Liabilities to customers	23	960,010	896,451
Liabilities to institutions	24	200,687	169,910
Subordinated debt	25	8,138	8,128
Hybrid capital	26	-	50,467
Current income tax liabilities		259	72
Deferred income tax liabilities	20	-	312
Other liabilities	27	3,895	6,174
Total liabilities		1,260,276	1,201,043
SHAREHOLDERS' EQUITY			
Share capital and share premium	28	139,130	129,351
Retained earnings and other reserves	29	36,532	41,936
Total shareholders' equity		175,662	171,287
Total shareholders' equity and liabilities		1,435,938	1,372,330

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30 March 2015

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ProCredit Bank (Bulgaria) EAD • Sofia •

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Stefan Weiblen
PricewaterhouseCoopers Audit OOD
Date: 31 March 2015

Rositsa Boteva
Registered Auditor
Date: 31 March 2015

София
Рег. №085

The following notes set out on pages 6 to 45 form an integral part of these financial statements.

Consolidated Statement of Changes in Equity

(all amounts expressed in thousands of BGN)	Share capital	Share premium	Legal and other reserves	Retained earnings	Revaluation reserve	Total
Balance as of 1 January 2013	**113,142**	**3,496**	**10,482**	**29,519**	**16**	**156,655**
Comprehensive income for the period						
Profit for the year	-	-	-	21,679	-	21,679
Revaluation of AFS securities	-	-	-	-	(247)	(247)
Remeasurement of post-employment benefits, net (note 27)	-	-	45	-	-	45
Total comprehensive income for the period	**-**	**-**	**45**	**21,679**	**(247)**	**21,477**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Distributed dividends	-	-	-	(19,558)	-	(19,558)
Transfer from legal reserves	-	-	5	(5)	-	-
Capital increase, voting shares	12,713	-	-	-	-	12,713
Total contributions by and distributions to owners	**12,713**	**-**	**5**	**(19,563)**	**-**	**(6,845)**
Balance as of 31 December 2013	**125,855**	**3,496**	**10,532**	**31,635**	**(231)**	**171,287**
Comprehensive income for the period						
Profit for the year	-	-	-	23,532	-	23,532
Revaluation of AFS securities	-	-	-	-	(741)	(741)
Remeasurement of post-employment benefits, net (note 27)	-	-	32	-	-	32
Total comprehensive income for the period	**-**	**-**	**32**	**23,532**	**(741)**	**22,823**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Distributed dividends	-	-	-	(28,227)	-	(28,227)
Capital increase, voting shares	9,779	-	-	-	-	9,779
Total contributions by and distributions to owners	**9,779**	**-**	**-**	**(28,227)**	**-**	**(18,448)**
Balance as of 31 December 2014	**135,634**	**3,496**	**10,564**	**26,940**	**(972)**	**175,662**

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Date: 31 March 2015

София
Рег. №085

The following notes set out on pages 6 to 45 form an integral part of these financial statements.

Consolidated Cash Flow Statement

(all amounts expressed in thousands of BGN)	Notes	Year ended 31 December	
		2014	2013
Cash flows from operating activities			
Profit for the period		23,532	21,679
Adjustments for:			
Net impairment loss on loans and advances	7, 18	2,772	4,993
Net loss from financial assets at fair value through PL	10	-	432
Depreciation	13	5,527	5,558
Unrealised gains from currency revaluation	9	(19)	(42)
Net interest income	6	(68,388)	(72,394)
Income tax expense	14	2,940	2,342
Change in operating assets and liabilities			
Change in required reserve with the central bank		230	159
Change in financial assets at fair value through profit or loss		-	21,473
Change in loans and advances to customers		24,983	(12,991)
Change in other assets		(667)	(1,056)
Change in liabilities to banks		17,928	27,591
Change in liabilities to customers		66,351	(10,051)
Change in other liabilities		(2,280)	1,117
Interest received		95,406	106,000
Interest paid		(28,328)	(32,156)
Income tax paid		(2,784)	(3,514)
Net cash flows from operating activities		**137,203**	**59,140**
Cash flow from investing activities			
Acquisition of AFS securities		-	(28,659)
Proceeds from sale of investment securities		-	73
Acquisition of equipment and intangible assets		(5,320)	(3,768)
Net cash flows from investing activities		**(5,320)**	**(32,354)**
Cash flows from financing activities			
Proceeds from other borrowed funds		63,828	48,644
Repayments of other borrowed funds		(82,383)	(52,202)
Proceeds from issuance of share capital		9,779	12,713
Dividends paid		(28,227)	(19,558)
Net cash flows from financing activities		**(37,003)**	**(10,403)**
Net increase in cash and cash equivalents		**94,880**	**16,383**
Cash and cash equivalents at the beginning of year		**167,167**	**150,784**
Cash and cash equivalents at the end of year	**15**	**262,047**	**167,167**

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30 March 2015

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Executive Director and
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PROCREDIT BANK (BULGARIA) EAD SOFIA

Initialled for identification purposes in reference to the auditor's report

Stefan Weiblen
PricewaterhouseCoopers Audit OOD
Date: 31 March 2015

София
Рег. №085

Rositsa Boteva
Registered Auditor
Date: 31 March 2015

The following notes set out on pages 6 to 45 form an integral part of these financial statements.

1 Reporting entity

ProCredit Bank (Bulgaria) EAD (“ProCredit Bank“ or “the bank”) was established on 6 June 2001 as a result of the foundation meeting held by the shareholders, namely the European Bank for Reconstruction and Development (“EBRD”), the International Finance Corporation (“IFC”), ProCredit Holding AG & Co. KGaA (“ProCredit Holding”), Deutsche Investitions-und Entwicklungsgesellschaft GmbH (“DEG”) and Commerzbank AG. The bank was registered as a Bulgarian joint stock company on 28 September 2001 with the Sofia City Court. In 2004 a new shareholder has joined the bank - Internationale Projekt Consult GmbH. In November 2005 ProCredit Holding acquired an additional 38.84% of the capital of ProCredit Bank (Bulgaria) EAD, increasing its share to 59.13 % of the registered capital of the bank. ProCredit Holding acquired the shares from IFC and DEG. The two financial institutions remain shareholders (DEG through Kreditanstalt für Wiederaufbau (“KfW”)) and continue to be strongly involved in ProCredit Holding. In December 2007 ProCredit Holding acquired an additional 1.45% of the capital of ProCredit Bank (Bulgaria) EAD, increasing its share to 60.58% of the registered capital of the bank. ProCredit Holding acquired the shares from Internationale Projekt Consult GmbH which remains a shareholder and continues to be strongly involved in ProCredit Holding. In April 2008 ProCredit Holding acquired an additional 19.71% of the capital of ProCredit Bank (Bulgaria) EAD by purchasing the shares of EBRD and thus increasing its share to 80.29% of the registered capital of the bank. Following the bank’s capital increase in 2011 at the amount of BGN 3,621 thousand, ProCredit Holding increased its share to 80.90% of the bank’s registered capital with the remaining 19.10% held by Commerzbank. In 2012 ProCredit Holding acquired the remaining 19.10% of the capital held by Commerzbank and became the sole owner of the bank’s capital.

The bank has one wholly owned subsidiary – ProCredit Properties EAD (referred to collectively as “the group”). Together with the bank, ProCredit Properties EAD co-owns the head office building of the group of ProCredit Bank (Bulgaria) EAD. The bank is also part of the international group of financial institutions owned by ProCredit Holding. ProCredit Holding is the ultimate parent and ultimate controlling party of the ProCredit group of banks (“the ProCredit group”).

The group is managed through a Supervisory Board consisting of five members and a Management Board consisting of four members as of December 2014 which are elected for a period of three years.

ProCredit Bank is a development oriented full service bank which aims to be a house bank for businesses and private clients. Business clients, serviced by the bank, are companies, agricultural producers and self-employed persons. They are categorised as Very Small, Small and Medium in accordance to their business potential. Private clients are regular income receivers (salary, pension or other), students and business owners. The bank strives to have comprehensive knowledge for its customers and to implement an individual approach and strategy for servicing each client, being based on the client’s profile. Strategically, the bank focuses on production companies, agricultural producers, green and energy efficiency financing. Automation and increasing the usage of services delivered by high-technological channels is another focus of ProCredit Bank as efficiency is improved and more possibilities for active communication with the clients are available. The business model of ProCredit Bank proved its resilience and sustainability through the years of the economic downturn with the profitability levels in terms of return on equity being amongst the highest in the Bulgarian banking system in 2013 and 2014.

2 Basis of preparation

a Compliance with International Financial Reporting Standards

The consolidated financial statements of the group are prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"). These financial statements were prepared on a consolidated basis according to the Accountancy Act. The consolidated financial statements were approved by the Management Board on 30 March 2015. The financial statements were prepared on the historical cost basis except for the derivative financial instruments, financial assets and liabilities at fair value through profit or loss and available-for-sale financial assets that are measured at fair value. The preparation of financial statements is in conformity with IFRS, which requires the use of certain critical accounting estimates and assumptions that affect the reported amounts of assets and liabilities as well as disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. It also requires management to exercise its judgement in the process of applying the group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas in which assumptions and estimates are significant to the financial statements are disclosed in note 2d. The financial statements are presented in Bulgarian leva (BGN), which is the group's functional currency.

b Measurement basis

These consolidated financial statements were prepared under the amortised cost convention, unless IFRS require recognition at fair value. Financial instruments measured at fair value for accounting purposes on an ongoing basis include all instruments at fair value through profit or loss and financial instruments classified as available-for-sale. Details on the applied measurement techniques for the balance sheet positions are part of the accounting policies listed below.

c Consolidation

The consolidated financial statements comprise the financial statements of ProCredit Bank (Bulgaria) EAD and its subsidiaries as of 31 December 2014. Subsidiaries are all companies which are controlled by the group, i.e. for which the group can determine the financial and operating policies. All subsidiaries are fully consolidated. New subsidiaries are fully consolidated from the end of the month during which control is transferred to the group. The group had two wholly owned subsidiaries as of end 2013 – ProLease (Bulgaria) EAD ("ProLease") and ProCredit Properties EAD. ProLease was merged into the bank in December 2014 and consequently the group had one subsidiary as of end 2014 – ProCredit Properties EAD Intercompany transactions, balances and unrealised gains and losses on transactions between the bank and its subsidiary companies are eliminated. Where necessary, the accounting policies of the subsidiary have been changed to ensure consistency with the policy adopted by the group. The purchase method of accounting is used to account for the acquisition of subsidiaries by the group. The goodwill represents the excess of the cost of the acquisition over the group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess is negative (negative goodwill), it is recognised immediately in profit or loss.

d Use of assumptions and estimates

The group makes estimates and assumptions that affect the reported amounts of assets and liabilities in conformity with IFRS. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

2 Basis of preparation (continued)

d Use of assumptions and estimates (continued)

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

e New standards, amendments and interpretations adopted by the group

The following standards have been adopted by the group for the first time for the financial year beginning on or after 1 January 2014:

Amendment to IAS 32, 'Financial instruments: Presentation' on offsetting financial assets and financial liabilities. This amendment clarifies that the right of set-off must not be contingent on a future event. It must also be legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amendment also considers settlement mechanisms. The amendment did not have a significant effect on the group's financial statements.

Amendments to IAS 36, 'Impairment of assets,' on the recoverable amount disclosures for non-financial assets. This amendment removed certain disclosures of the recoverable amount of CGUs which had been included in IAS 36 by the issue of IFRS 13. The amendment did not have a significant effect on the group's financial statements.

Amendment to IAS 39, 'Financial instruments: Recognition and measurement' on the novation of derivatives and the continuation of hedge accounting. This amendment considers legislative changes to 'over-the-counter' derivatives and the establishment of central counterparties. Under IAS 39 novation of derivatives to central counterparties would result in discontinuance of hedge accounting. The amendment provides relief from discontinuing hedge accounting when novation of a hedging instrument meets specified criteria. The group has applied the amendment and there has been no significant impact on the group's financial statements as a result.

IFRS 10 'Consolidated financial statements' is based on existing principles by identifying the concept of control as the determining factor in whether an entity should be included in the consolidated financial statements of the parent company. The standard provides additional guidance on the determination of control where this is difficult to assess. The standard did not have a significant effect on the group's financial statements.

IFRS 11 "Joint actions" focuses on the rights and obligations of the parties under the joint activity, rather than its legal form. There are two types of joint activities: joint operations and joint ventures. Joint operations arise when investors have rights to the assets and obligations for the liabilities of the joint action. Participants in the joint operation take their share of the assets, liabilities, income and expenses. Joint ventures arise when investors have rights to the net assets of the cooperative activities; joint ventures are accounted for using the equity method. Proportional consolidation of joint ventures is no longer allowed. The standard did not have a significant effect on the group's financial statements.

2 Basis of preparation (continued)

e New standards, amendments and interpretations adopted by the group (continued)

IFRS 12 "Disclosure of interests in other entities " includes the disclosure requirements for all forms of interests in other entities, including joint activities, associates, structured entities and other off-balance sheet investments. The standard did not have a significant effect on the group's financial statements.

IFRIC 21, 'Levies,' sets out the accounting for an obligation to pay a levy if that liability is within the scope of IAS 37 'Provisions.' The interpretation addresses what the obligating event is that gives rise to pay a levy and when a liability should be recognised. Interpretation was approved for use is the EU on 13 June 2014.

Other standards, amendments and interpretations which are effective for the financial year beginning on 1 January 2014 are not material to the group.

f New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2014, and have not been applied in preparing these separate financial statement. None of these is expected to have a significant effect on the separate financial statements of the group, except the following set out below:

IFRS 9, 'Financial instruments,' addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI not recycling. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39. The standard is effective for accounting periods beginning on or after 1 January 2018. It has not yet been endorsed for use in the EU and earlier application is not permitted in the EU. The group is yet to assess IFRS 9's full impact.

IFRS 15, 'Revenue from contracts with customers' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2017 but it has not yet been endorsed for use in the EU and earlier application is not permitted in the EU. The group is assessing the impact of IFRS 15.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the group.

3 Summary of significant accounting policies

a Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the entity operates (“the functional currency”). The financial statements are presented in Bulgarian leva, which is the group’s functional and presentation currency. All amounts stated within the financial statements are presented in thousands of Bulgarian leva unless otherwise specified.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing on the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement (trading result).

Monetary items denominated in foreign currency are translated with the closing rate as of the reporting date. In the case of changes in the fair value of monetary assets denominated in foreign currency classified as available-for-sale, a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, while other changes in the carrying amount are recognised in equity.

Non-monetary items measured at historical cost denominated in foreign currency are translated with the exchange rate as of the date of initial recognition.

As of 31 December 2014, monetary assets and liabilities denominated in foreign currency were translated into Bulgarian leva at the official central bank exchange rate: BGN 1.95583 for EUR 1 and BGN 1.60841 for USD 1 (2013: BGN 1.95583 for EUR 1 and BGN 1.41902 for USD 1). In 1997 a currency board was introduced in Bulgaria by law. The local currency is pegged to the EUR at a rate of BGN 1.95583 for EUR 1.

b Offsetting financial instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and to settle the liability simultaneously.

c Interest income and expenses

Interest income and expenses for all interest-bearing financial instruments, except for those classified as at fair value through profit or loss, are recognised within “Interest income” and “Interest expense” in the income statement using the effective interest rate method. Interest income and expense are recognised in the income statement in the period in which they arise.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

3 Summary of significant accounting policies (continued)

c Interest income and expenses (continued)

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. For loans where there is objective evidence that an impairment loss has been incurred, the accrual of interest income is terminated not later than 90 days after the last payment. Payments received with respect to written-off loans are not recognised in "Net interest income".

d Fee and commission income and expenses

Fees and commissions consist mainly of fees for Bulgarian leva and foreign currency transactions, and are generally recognised on an accrual basis. Fee and commission expenses concern fees incurred by the group in dealings with other banks and are recognised on the date of the transaction. Asset management fees related to the servicing of loans, originated by the group and transferred to other companies are recognised over the period to which they relate.

e Net trading income

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

f Net income from other financial instruments at fair value

Net income from other financial instruments at fair value relates to financial assets and liabilities designated at fair value through profit or loss, and include all realised and unrealised fair value changes, interest, dividends and foreign exchange differences of financial assets and liabilities designated at fair value.

g Financial assets

The group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. The group holds no held-to-maturity instruments. Management determines the classification of financial assets at initial recognition.

(i) Financial assets at fair value through profit or loss
This category has two sub-categories: financial assets held for trading ("trading assets"), i.e. the derivatives held, and financial assets designated at fair value through profit or loss at inception. The group does not apply hedge accounting.

Financial assets are designated at fair value through profit or loss when they are part of a separate portfolio that is managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy. The monthly reporting on these portfolios and the included assets to key management personnel is also done on a fair value basis. The fair values reported are usually observable market prices; as a guideline, the group prefers to invest in securities for which market prices in active markets can be observed.

3 Summary of significant accounting policies (continued)

g Financial assets (continued)

Financial assets at fair value through profit or loss are initially recognised at fair value, and transaction costs are expensed in the income statement. Subsequently, they are carried at fair value. Gains and losses arising from changes in their fair value are immediately recognised in the income statement of the period. Together with interest earned on financial instruments designated as at fair value through profit and loss they are shown as "Net income from financial assets at fair value through profit or loss".

Purchases and sales of financial assets at fair value through profit or loss are recognised on the trade date – the date on which the group commits to purchase or sell the asset. Financial assets at fair value through profit or loss are derecognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred substantially all risks and rewards of ownership.

(ii) Available-for-sale financial assets

Available-for-sale assets are those intended to be held for an indefinite amount of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

At initial recognition, available-for-sale financial assets are recorded at fair value including transaction costs. Subsequently the group assesses if there is objective evidence for impairment of the financial assets. Gains and losses arising from changes in fair value of available-for-sale financial assets are recognised directly in equity in other comprehensive income in the position "Revaluation reserve from available-for-sale financial asset", until the financial asset is derecognised or impaired (for details on impairment, see note 3k). At the time of derecognition, the cumulative gain or loss previously recognised in equity in "Other comprehensive income" is recognised in profit or loss as "Gains and losses from available-for-sale financial assets". Interest calculated using the effective interest rate method and foreign currency gains and losses on monetary assets classified as available-for-sale are recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the entity's right to receive the payment is established.

Purchases and sales of available-for-sale financial assets are recorded on the trade date. The available-for-sale financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred substantially all risks and rewards of ownership.

(iii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the group provides money, goods or services directly to a debtor with no intention of trading the receivable.

Loans and receivables are initially recognised at fair value including transaction costs; subsequently they are measured at amortised cost using the effective interest method. At each balance sheet date and whenever there is evidence of potential impairment, the group assesses the value of its loans and receivables. Their carrying amount may be reduced as a consequence through the use of an allowance account (see note 3k for the accounting policy for impairment of loans, and notes 4b and 18 for details on impairment of loans). If the amount of the impairment loss decreases, the impairment allowance is reduced accordingly, and the amount of the reduction is recognised in the income statement. The maximum reduction of the impairment is equal to the amortised cost of the asset before impairment.

3 Summary of significant accounting policies (continued)

g Financial assets (continued)

Loans are recognised when the principal is advanced to the borrowers. Loans and receivables are derecognised when the rights to receive cash flows from the financial assets have expired or where the group has transferred substantially all risks and rewards of ownership.

Fair value measurement principles

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the group has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

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

If an asset or a liability measured at fair value has a bid price and an ask price, then the Group measures assets and long positions at a bid price and liabilities and short positions at an ask price.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid. The group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

The bank applies the IFRS fair value hierarchy which categorises the inputs used in valuation techniques to measure fair value into three levels.

Level 1 Inputs
Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm’s length basis.

3 Summary of significant accounting policies (continued)

g Financial assets (continued)

Level 2 Inputs
Other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation techniques applied refer to the current fair value of similar instruments and discounted cash flow analysis using observable market parameters.

Level 3 Inputs
Unobservable inputs for the asset or liability. If observable market rates are not available, internal rates are used as an input for a discounted cash flow model. Internal rates are determined taking into consideration the cost of capital depending on currencies and maturities plus a risk margin. Internal rates are regularly compared to those applied for third party transactions and are in compliance with an orderly transaction between market participants at the measurement date under current market conditions.

h Sale and repurchase agreements

Securities sold subject to repurchase agreements (“repos”) are reclassified as pledged assets when the transferee has the right by contract or custom to sell or re-pledge the collateral; the counterparty liability is included in liabilities to other banks or liabilities to customers, as appropriate. Securities purchased under agreements to resell (“reverse repos”) are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method. Securities lent to counterparties are also retained in the financial statements.

i Cash and cash equivalents

For the purposes of the balance sheet, cash and cash equivalents comprise cash and balances with the Bulgarian National Bank (“BNB”). Generally, all cash and cash equivalent items are recognised at their nominal value.

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months’ maturity from the date of acquisition including: cash, balances with the BNB excluding the minimum required reserve, and amounts due from other banks.

j Loans and receivables

The amounts reported under “Loans and advances to customers” consist mainly of loans and advances issued. In addition to overnight and term deposits, the amounts reported under “Loans and advances to banks” include current account balances.

All loans and receivables to banks as well as loans and receivables to customers fall under the category “Loans and receivables” and are carried at amortised cost, using the effective interest method. Amortised premiums and discounts are accounted for over the respective terms in the income statement under “Net interest income”. Impairment of loans is recognised on separate allowance accounts (see note 3k).

For the purposes of the cash flow statement, claims to banks with a remaining maturity of less than three months from the date of acquisition are recognised under “Cash and cash equivalents” (see note 15).

3 Summary of significant accounting policies (continued)

k Allowance for losses on loans and advances

(i) Impairment of loans and advances

The group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that impairment of a loan or a portfolio of loans has occurred which influences the future cash flow of the financial asset(s), the respective losses are immediately recognised. Depending on the size of the exposure, such losses are either calculated on an individual client basis or are collectively assessed for a portfolio of loans. The carrying amount of the exposure is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. The group does not recognise losses from expected future loss events.

Individually assessed loans and advances

Exposures are considered individually significant if they exceed EUR 30,000. For such exposures, it is assessed whether objective evidence of impairment exists, i.e. any factors which might influence a customer’s ability to fulfil contractual payment obligations towards the group:

- Delinquencies in contractual payments of interest or principal
- Breach of covenants or conditions
- Initiation of bankruptcy proceedings
- Any specific information on the customer’s business (e.g. reflected by cash flow difficulties experienced by the client) ;
- Changes in the customer’s market environment;
- The general economic situation.

Additionally, the aggregate exposure to the client and the market value of collateral held are taken into account when deciding on the allowance for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of its estimated future cash flows discounted at the financial asset’s original effective interest rate (specific impairment). If a credit exposure has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

Collectively assessed loans and advances

There are two cases in which exposures are collectively assessed for impairment:

- individually insignificant exposures that show objective evidence of impairment;
- a group of loans that does not show signs of impairment, in order to cover all losses which have already been incurred but not detected on an individual loan basis.

For the purposes of the evaluation of impairment of individually insignificant exposures, they are grouped on the basis of similar credit risk characteristics, i.e. according to the number of days in arrears. Arrears of 30 or more days are considered to be a sign of impairment. This characteristic is relevant for the estimation of future cash flows for the so defined groups of such assets, based on historical loss experiences with loans that showed similar characteristics.

3 Summary of significant accounting policies (continued)

k Allowance for losses on loans and advances (continued)

a) The collective assessment of impairment for individually insignificant exposures (lump-sum impairment) and for unimpaired exposures (portfolio-based impairment) belonging to a group of financial assets is based on a quantitative analysis of historical default rates for loan portfolios with similar risk characteristics.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the group to reduce any differences between loss estimates and actual loss experience.

If the group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether individually significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment (impairment for collectively assessed exposures).

(ii) Reversal of impairment
If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

b)

(iii) Writing off loans and advances
When an exposure is uncollectible, it is written off against the related allowance for impairment. Such exposures are written off after all the necessary legal procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the allowance for impairment in the income statement.

(iv) Restructured credit exposures
Restructured credit exposures which would otherwise be past due or impaired and which are considered to be individually significant are provisioned on an individual basis. The amount of the loss is measured as the difference between the restructured loan's carrying amount and the present value of its estimated future cash flows discounted at the loan's original effective interest rate (specific impairment). Restructured loans which would otherwise be past due or impaired and which are individually insignificant are collectively assessed for impairment.

(v) Repossessed property
Non-financial assets acquired in exchange for loans as part of an orderly realisation are reported in "Other assets". The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan at the date of exchange. No depreciation is charged for assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recognised in the income statement in "Other operating income". Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative write-down, is also recognised in "Other operating income", together with any realised gains or losses on disposal.

3 Summary of significant accounting policies (continued)

l Derivative financial instruments

Derivatives are initially recognised at the fair value of the consideration given (when acquiring financial assets) or received (when undertaking financial liabilities). Subsequently, derivatives are remeasured at fair value. If possible, fair values are obtained from quoted markets or from recent market transactions. Otherwise, they are appraised via discounted cash flow models or options pricing models, as appropriate. Derivatives with a positive fair value at the balance sheet date are carried as financial assets and reported under “Financial assets at fair value through profit or loss”. Derivatives with a negative fair value are carried as financial liabilities and are reported under “Other liabilities”.

m Equipment and intangible assets

All equipment and intangible assets are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Component parts of an asset are recognised separately if they have different useful lives or provide benefits to the enterprise in a different pattern.

Subsequent costs are included in the asset’s carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Methods of depreciation, useful life and carrying values of equipment and intangible assets are reviewed and adjusted if appropriate at each balance sheet date. Land is not depreciated. The useful lives of equipment and intangible assets are as follows:

Equipment	
Buildings	40 years
Furniture	10 years
Leasehold improvements	10 years
Computers	5 years
Motor vehicles	5 years
Other fixed assets	7 years
Intangible assets	
Licences	7 years
Software	5 years

Both assets that are subject to amortisation and land are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset’s carrying amount is written down immediately to its recoverable amount if the asset’s carrying amount exceeds its estimated recoverable amount. The recoverable amount is the higher of the asset’s fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount. These are included in the income statement.

3 Summary of significant accounting policies (continued)

n Income taxes

Taxation has been provided for in the consolidated financial statements in accordance with Bulgarian legislation currently in force. Current tax is calculated on the basis of the taxable profit for the year, using the tax rates enacted at the reporting date. Taxes other than on income are recorded under "Other administrative expenses".

Deferred income tax is provided using the balance sheet liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used in the determination of deferred income tax.

Income tax payable on profits, based on the applicable tax law in Bulgaria is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred income tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax assets, and they relate to income taxes levied by the same tax authority on the same taxable entities.

o Liabilities to banks, customers and institutions

Liabilities to banks, customers and institutions are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest rate method. All financial liabilities are derecognised when they are extinguished – that is, when the obligation is discharged, cancelled or expires.

p Subordinated debt and hybrid capital

Subordinated debt and hybrid capital consists mainly of liabilities to shareholders which in the event of insolvency or liquidation are not repaid until all non-subordinated creditors have been satisfied. While the subordinated debt has a fixed repayment term, there is no obligation to early repayment of the equity hybrid instruments (hybrid capital). Following initial recognition at acquisition cost, the subordinated debt and hybrid capital are recognised at amortised cost. Premiums and discounts are accounted for over the respective terms in the income statement under "Net interest income". Subordinated debt and equity hybrid instruments are presented as liabilities in the statement of financial position, but are part of the group's capital base for capital adequacy purposes (see notes 25 and 26).

q Provisions

Provisions are recognised if:

i. there is a present legal or constructive obligation resulting from past events;
ii. it is more likely than not that an outflow of resources will be required to settle the obligation;
iii. and the amount can be reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow of resources will be required in a settlement is determined by considering the class of obligations as a whole.

3 Summary of significant accounting policies (continued)

q Provisions (continued)

Provisions for which the timing of the outflow of resources is known are measured at the present value of the expenditures, if the outflow is not expected to occur before one year's time. The increase in the present value of the obligation due to the passage of time is recognised as an interest expense.

Contingent liabilities are possible obligations that arise from past events. As their occurrence, or non-occurrence, depends on uncertain future events not wholly within the control of the group, they are not recognised in the financial statements but are disclosed off-balance sheet unless the probability of settlement is remote.

Employee entitlements to annual leave are recognised when they are accrued to employees. A provision is made for the estimated annual leave as a result of services rendered by employees up to reporting date.

r Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the group's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the reporting date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of the Management.

Any increase in the liability relating to guarantees is taken to the income statement under "Other administrative expenses".

s Employee benefits

(i) Defined contribution plans
A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. The Government of Bulgaria is responsible for providing pensions in Bulgaria under a defined contribution pension plan. The group's contributions to the defined contribution pension plan are recognised as an employee benefit expense in profit or loss in the periods during which services are rendered by employees.

(ii) Defined benefit plans
A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The group's net obligation with respect to defined benefit plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value.

3 Summary of significant accounting policies (continued)

s Employee benefits (continued)

The group has an obligation to pay certain amounts to each employee who retires with the group in accordance with Art. 222, § 3 of the Labour Code ("LC"). According to the regulations in the LC, when a labour contract of a Group employee, who has acquired a pension right, is ended, the group is obliged to pay the employee compensation equivalent to two gross monthly salaries. In the event that the employee's length of service in the group is equal to or exceeds 10 years, as of the date of retirement, then the compensation shall amount to six gross monthly salary payments. As of reporting date, the Management of the group estimates the approximate amount of the potential expenditures for every employee based on a calculation performed by a qualified actuary using the projected unit credit method. The group recognises all actuarial gains and losses arising from defined benefit plans in personnel expenses for the period/other comprehensive income.

(iii) Termination benefits

Termination benefits are recognised as an expense when the group is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the group has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting period, then they are discounted to their present value.

t Business combinations under common control

Business combinations for entities under common control are accounted for using predecessor accounting method. Under this method, the bank incorporates the assets and liabilities of the acquired entity using the acquired entity's carrying amounts from the consolidated financial statements of the highest entity that has common control for which consolidated financial statements are prepared. These amounts include any goodwill recognised in these consolidated financial statements related to the acquired entity. The acquired entity's results are included in the bank's financial statements prospectively from the date on which the business combination occurred. The corresponding amounts for the prior year are not restated. Intercompany balances and unrealized gains and losses on transactions with the acquired entity are eliminated. Any difference between the consideration given and the carrying values of the acquired entity are included in equity in retained earnings.

4 Risk management

a Strategy in using financial instruments

By nature the group's activities are principally related to the use of financial instruments. The group accepts deposits from customers and seeks to earn above average interest margins by investing these funds in high-quality assets. The group also seeks to raise its interest margins by obtaining above average margins, net of provisions, through lending to commercial borrowers with a range of credit standing. Such exposures involve not just on-balance sheet loans and advances as the group also enters into guarantees and other commitments.

The Management Board places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions.

b Credit risk

The group takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. The group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers or geographical and industry segments. Such risks are monitored on a revolving basis and are subject to at least one review per year. Limits on the level of credit risk according to product and economic sector are approved by the Management Board. The exposure to any one borrower, including banks, is further restricted by sub-limits covering on- and off-balance sheet exposures and daily delivery risk limits in relation to trading items. Actual exposures against limits are monitored daily. Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and changing these lending limits where appropriate. Exposure to credit risk is additionally managed by obtaining collateral and corporate and personal guarantees.

Credit risk management is an integral part of the group's lending process. The group's Management Board has, in consultation with the credit risk departments, assigned specific disbursement limits to credit analysts and branch managers based on their level of experience and expertise. Loan exposures are subject to periodic monitoring to determine if there is objective evidence of impairment. If such evidence exists, the group takes the most appropriate measures for both the customer and the group to ensure settlement.

In its lending activities the group's focus is on the very small, small and medium-sized enterprises. The group requires staff members who are involved in the lending process to master specific skills. The group has developed a special training system which is implemented on a regular basis and allows staff who works in the business units, especially credit analysts, to become an integral part of the overall credit management system.

For the purpose of determining the amount of allowances to be set aside for impairment of loans and advances to customers, exposures are considered individually significant if the outstanding amount exceeds a certain threshold. All exposures with an outstanding amount exceeding EUR 30,000 are individually assessed for impairment. For such exposures, it is assessed whether objective evidence of impairment exists, i.e. any factors which might influence the customer's ability to fulfil contractual payment obligations towards the group. Additionally the amount of the allowance for impairment is calculated as the difference between the asset's carrying amount and the present value of its estimated future cash flows discounted at the financial asset's original effective interest rate (specific impairment), reflecting also the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

4 Risk management (continued)

b Credit risk (continued)

Credit risk from customer credit exposures is defined as the risk of losses due to a potential non-fulfilment of the contractual payment obligations associated with a customer credit exposure. The management of credit default risk from customer credit exposures is based on a thorough implementation of the group’s lending principles:

- Intensive analysis of the debt capacity of the group’s clients
- Careful documentation of the credit risk assessments, assuring that the analysis performed can be understood by knowledgeable third parties
- Rigorous avoidance of over indebting our clients
- Building a personal and long-term relationship with the client and maintaining regular contact
- Strict monitoring of loan repayment
- Practising tight arrears management
- Exercising strict collateral collection in the event of default
- Investing in well-trained and highly motivated staff
- Implementing carefully designed and well-documented processes

Rigorous application of the “four-eyes" principle”.

For the purposes of the evaluation of impairment of individually insignificant exposures, they are grouped on the basis of similar credit risk characteristics, i.e. according to the number of days in arrears. Arrears of 30 or more days are considered to be a sign of impairment. This characteristic is relevant for the estimation of future cash flows for the so defined groups of such assets, based on historical loss experience with loans that showed similar characteristics.

The group monitors the quality of the loan portfolio on an ongoing basis. One measure for loan portfolio quality is the portfolio at risk (PAR). The group defines PAR as all loan exposures outstanding with one or more payment of interest or principal past due by more than 30 days. The group chose this measure because the vast majority of all loans have fixed instalments entailing monthly payments of principal and interest. Exceptions are seasonal agricultural loans and investment loans, which can have grace periods. The group does not deduct any collateral and does not apply any other exposure-reducing measures when determining PAR. The value of PAR for the loan portfolio managed by the group as of 31 December 2014 was 3.7%.

Restructured credit exposures are treated according to their current status. Restructurings of credit exposures are generally necessitated by economic or payment problems encountered by the client. If a credit exposure is restructured, amendments are made to the parameters of the exposure. Otherwise, these credit exposures for which the terms have been renegotiated would be past due or impaired.

4 Risk management (continued)

b Credit risk (continued)

Exposure to credit risk

Credit risk exposures can be aggregated into the following groups:

(1) Collectively assessed impaired exposures (below EUR 30,000) – for which objective evidence exists that the quality of the exposures has deteriorated. Loan loss provisions for these exposures are determined based on the number of days in arrears;

(2) Individually assessed impaired exposures (above EUR 30,000) – for which objective evidence exists that the quality of the exposures has deteriorated. Loan loss provisions for these exposures are determined after performing an individual review of future cash flow expectations from the exposure, discounted at the effective interest rate of the exposure in order to calculate a net present value of the expected future cash flows;

(3) Loans and advances which are not impaired – these exposures also include loans with renegotiated terms, which are loans that have been restructured due to deterioration in the borrower's financial position and where the group has made concessions that it would not otherwise consider. Once the exposure is restructured it could be returned to standard credit exposure (non-restructured) provided that the following conditions are fulfilled:

   a. the client paid interest and principal during the last 6 consecutive instalment payments, but not earlier than 6 months
   b. no single payment was more than 30 days in arrears, and
   c. the credit exposure does not show any signs of impairment.

The allowance for collectively assessed exposures is based on a quantitative analysis of historical default rates for loan portfolios with similar risk characteristics. The obtained rates are applied to the collectively assessed exposures.

Loans and advances to customers	**Business clients 2014**	**Private clients 2014**	**Business clients 2013**	**Private clients 2013**
Collectively assessed impaired exposures (below EUR 30,000)				
31-90 days in arrears	2,312	74	3,000	90
91-180 days in arrears	984	53	1,440	46
over 180 days in arrears	1,473	1	1,742	49
Provision for impairment	(3,026)	(70)	(4,880)	(132)
Carrying amount	1,743	58	1,302	53
Individually assessed impaired exposure (above EUR 30,000)				
up to 30 days in arrears	42,276	144	57,451	148
31-90 days in arrears	3,408	-	2,126	-
91-180 days in arrears	4,783	191	1,759	-
over 180 days in arrears	28,330	67	31,953	76
Provision for impairment	(18,902)	(103)	(17,971)	(37)
Carrying amount	59,895	299	75,318	187
Collectively assessed exposures which are not impaired below EUR 30,000				
Gross amount	123,947	20,354	183,348	19,417
Provision for collectively assessed exposures	(2,429)	(279)	(3,775)	(260)
Carrying amount	121,518	20,075	179,573	19,157
Including with renegotiated terms	7,470	135	11,361	114
Collectively assessed exposures which are not impaired above EUR 30,000				
Gross amount	777,641	19,065	733,216	20,566
Provision for collectively assessed exposures	(11,256)	(274)	(9,625)	(250)
Carrying amount	766,385	18,791	723,591	20,316
Including with renegotiated terms	3,286	-	4,808	-
Total carrying amount of loans and advances to customers	949,541	39,223	979,784	39,713

4 Risk management (continued)

b Credit risk (continued)

Business loans include loans for business purposes (working capital or investments) disbursed to SMEs and entrepreneurs. SMEs are clients defined as Very Small, Small and Medium according to the applied internal classification and national legislation. Business loans include agricultural loans as well as business overdrafts and revolving loans. Loans to Private Clients include consumer and housing loans as well as consumer overdrafts and credit card receivables as well as loans to business owners.

Collateral held

The group applies various instruments available to reduce the risk on individual transactions related to loans and advances to customers, including security in the form of physical assets and guarantees. The most frequently provided forms of collateral are mortgage of real estate property and movables such as vehicles, goods and machines. Collateral generally is not held over other financial assets except over loans and advances to banks when securities are held as part of reverse repurchase and securities borrowing activity. The distribution of the loans and advances to customers by type of collateral is presented in the table below:

	2014	**2013**
Mortgage	669,075	692,414
Cash collateral	23,600	27,297
Bank guarantee	2,591	3,451
Other types of collateral	293,498	296,335
Total	988,764	1,019,497

For impaired loans, the group usually obtains appraisals of collateral as the current value of the collateral is an input to the impairment measurement. As of end 2014 the net carrying amount of individually significant impaired exposures amounts to BGN 60,194 thousand and the value of the identifiable collateral held against those loans and advances amounts to BGN 72,680 thousand.

The group disburses loans to small and medium enterprises under the auspices of JEREMIE program (Joint European Resources for Micro to Medium Enterprises), which is a joint initiative launched by the European Commission and the European Investment Bank ("EIB") Group to improve access to finance for Micro, Small and Medium-sized Enterprises in the EU within the Structural Funds framework for the period 2007 – 2013. The loans are disbursed under more beneficial conditions in comparison to the standard bank's terms and are partially guaranteed by the European Investment Fund ("EIF"). The total portfolio outstanding under JEREMIE program was BGN 137,691 thousand as of end 2014 (2013: 87,936 thousand).

Credit related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees, which represent irrevocable assurance that the group will make the payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans and guarantees. With respect to credit risk on commitments to extend credit, the group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total commitments since commitments to extend credit are contingent upon customers maintaining specific credit standards. The group monitors the term to maturity of credit commitments because longer-term commitments generally carry a greater degree of credit risk than shorter-term commitments.

4 Risk management (continued)

b Credit risk (continued)

Geographical concentration of assets, liabilities and off balance sheet items

The loan customers of the group are residents of Bulgaria. Placements and current accounts are with both local and non-local banks (note 16). The group is exposed to many sectors of the Bulgarian economy. However, credit risk is well distributed across a diverse range of individual and commercial customers**.**

Debt securities and Loans and advances to banks

The table below presents an analysis of debt securities and banks placements by rating agency designation, based on the credit assessments of nominated External Credit Assessment Institutions:

As of December 2014

Rating	**Debt securities, available for sale**	**Loans and advances to banks**	**Total**
AA- to AA+	-	31,941	31,941
A- to A+	-	45,995	45,995
BBB- to BBB+	28,503	-	28,503
Unrated	-	60,183	60,183
Total	28,503	138,119	166,622

As of December 2013

Rating	**Debt securities, available for sale**	**Loans and advances to banks**	**Total**
AA- to AA+	-	6,426	6,426
A- to A+	-	9,877	9,877
BBB- to BBB+	28,332	7,823	36,155
Unrated	-	65,098	65,098
Total	28,332	89,224	117,556

c Market risk

The group takes on exposure to market risks. Market risks arise from open positions in interest rate and currency products, all of which are exposed to general and specific market movements. The group estimates the market risk of positions held and the maximum losses expected based upon a number of assumptions for various changes in market conditions. The Management Board sets limits on the value of risk that may be accepted. The group does not hold portfolios for trading purposes. The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for economic value impact and modified duration gap. More information about interest rate risk management is presented in point “Cash flow and fair value interest rate risk”. The amount of the equity instruments held by the group is insignificant for the purposes of market risk management.

4 Risk management (continued)

d Currency risk

The group takes on exposures to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Management Board sets limits on the level of exposure by currency, which are monitored daily. As a general principle, all currency positions should be closed at end-of-day; long or short positions for speculative purposes are not permitted. The group manages its currency risk through the use of currency deals. The largest total net open currency position as a percentage of the group's equity on a daily basis was 0.5% in 2014. The Management Board therefore considers that the possible adverse effects from currency risk exposure are not substantial for the group. The table below summarizes the group's exposure to foreign currency exchange rate risk.

As of 31 December 2014	**BGN**	**EUR**	**USD**	**Other**	**Total**
Assets					
Cash and cash equivalents	82,133	113,853	3,895	1,365	201,246
Loans and advances to banks	-	119,204	14,708	4,207	138,119
Available-for-sale financial assets	7,889	13,021	8,540	-	29,450
Loans and advances to customers	473,087	514,013	1,663	1	988,764
Equipment and intangible assets	48,709	-	-	-	48,709
Deferred income tax assets	9	-	-	-	9
Other assets	28,359	1,277	5	-	29,641
Total assets	640,186	761,368	28,811	5,573	1,435,938
Liabilities					
Liabilities to banks	53,835	31,855	1,583	14	87,287
Liabilities to customers	610,863	315,993	27,933	5,221	960,010
Liabilities to institutions	9,494	191,193	-	-	200,687
Subordinated debt	-	8,138	-	-	8,138
Current tax liabilities	259	-	-	-	259
Other liabilities	3,022	872	1	-	3,895
Total liabilities	677,473	548,051	29,517	5,235	1,260,276
Net balance sheet position	(37,287)	213,317	(706)	338	175,662
Credit commitments (note 30)	148,229	44,472	1,350	-	194,051
Open spot and derivative transactions	15,647	(15,701)	(246)	300	-

As of 31 December 2013	**BGN**	**EUR**	**USD**	**Other**	**Total**
Total assets	643,141	695,793	29,444	3,952	1,372,330
Total liabilities	647,457	520,790	28,970	3,826	1,201,043
Net balance sheet position	(4,316)	175,003	474	126	171,287
Credit commitments (note 30)	131,510	39,411	2,881	-	173,802
Open spot and derivative transactions	(2,934)	2,464	391	78	(1)

4 Risk management (continued)

e Cash flow and fair value interest rate risk

The group takes on exposures to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Management Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily. The Management Board is satisfied that the group's position is such that exposure to movements in interest rates is minimised.

Interest sensitivity of assets, liabilities and off balance sheet items – repricing analysis
The table below summarises the group's exposure to interest rate risks. Included in the table are the group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

As of 31 December 2014	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Assets							
Cash and cash equivalents	-	-	-	-	-	201,246	201,246
Loans and advances to banks	60,175	-	-	-	-	77,944	138,119
Available-for-sale financial assets	8,439	-	129	19,935	-	947	29,450
Loans to customers	122,152	258,661	473,197	82,540	27,753	24,461	988,764
Equipment and intangible assets	-	-	-	-	-	48,709	48,709
Deferred income tax assets	-	-	-	-	-	9	9
Other assets	-	-	-	-	-	29,641	29,641
Total assets	190,766	258,661	473,326	102,475	27,753	382,957	1,435,938
Liabilities							
Liabilities to banks	36,958	777	30,066	14,578	-	4,908	87,287
Liabilities to customers	161,011	77,745	283,169	16,539	602	420,944	960,010
Liabilities to institutions	182	165,903	27,089	7,513	-	-	200,687
Subordinated debt	342	0	7,796	-	-	-	8,138
Current tax liabilities	-	-	-	-	-	259	259
Other liabilities	-	-	-	-	-	3,895	3,895
Total liabilities	198,493	244,425	348,120	38,630	602	430,006	1,260,276
Interest sensitivity gap	(7,727)	14,236	125,206	63,845	27,151	(47,049)	175,662

As of 31 December 2013	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Non-interest bearing**	**Total**
Total assets	182,930	254,570	526,007	110,300	23,257	275,266	1,372,330
Total liabilities	181,602	244,087	352,519	48,106	10,361	364,368	1,201,043
Interest sensitivity gap	1,328	10,483	173,488	62,194	12,896	(89,102)	171,287

4 Risk management (continued)

e Cash flow and fair value interest rate risk

Regarding interest rate risk, the group is mainly exposed to changes the six-month Euribor rate. Based on historical movements and volatilities for the last year in this market variable, the group believes that change of 0.24% from the current level in the six-month Euribor rate is reasonably possible. If this movements were to occur, the impact on the profit and loss after tax for the reporting period would be as follows:

	Change	
Six-month Euribor rate	(0.24%)	0.24%
Impact on the profit and loss after tax	(784)	784

The impact is calculated based on the GAP analysis of assets and liabilities with floating interest rates. Separate analyses were prepared for assets and liabilities linked to the six-month Euribor rate.

f Liquidity risk

The group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawdowns, and guarantees. The group does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with reasonable certainty. The Management Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The group is trying to maintain a balance between maturity terms of attracted funds and flexibility in the usage of funds of various maturity structures. The maintenance and management of liquidity of the group is accomplished with a view to minimise liquidity risk, by current monitoring and regular control over the assets and liabilities. The Assets and Liabilities Management Committee (ALCO), established by the group, is the main body, along with other relevant departments, which is operationally responsible for financial risk management (including liquidity risk management). The ALCO comprises Management Board members and it is convened at least once per month. The minimising of liquidity risk is reflected in the establishment of an optimal and acceptable ratio between the risk level and the desired yield from operations. Liquidity is also monitored and managed by static and dynamic indices. They represent ratios and percentages which are internally or externally set. Key measure used by the group for managing liquidity risk is the ratio of liquid assets to deposits from customers. For this purpose liquid assets are considered as including cash and cash equivalents, investments in government or supranational securities and loans and advances to banks with remaining maturity up to seven days. The average value of the ratio in 2014 was 32.9% and it stood at 38.6% as of end 2014.

The group monitors and manages its liquidity led by the “going concern” principle and the principle of prudence. The “going concern” principle regarding liquidity means that the group does not plan to liquidate itself or to restrict the scope of its activities in the future. The principle of prudence regarding liquidity entails considering cash inflows on the latest possible date and considering cash outflows on the earliest possible date. The group manages its liquidity by providing compliance with the structure of the liabilities with the appropriate structure of the assets in a way that the expected cash outflows at each point in time are covered by cash inflows. The group aims to maintain a positive cumulative net cash flow at all times.

4 Risk management (continued)

f Liquidity risk (continued)

The table below presents the assets and liabilities of the group according to the time remaining to the contractual maturity date at balance sheet date. The securities classified as available-for-sale are presented according to their maturity. They comprise highly liquid government bonds which are quoted daily and are traded on the capital market.

Maturities of assets and liabilities

As of 31 December 2014	**Up to 1 month**	**1 – 3 months**	**3 – 12 months**	**1 – 5 years**	**Over 5 years**	**Total**
Assets						
Cash and cash equivalents	201,246	-	-	-	-	201,246
Loans and advances to banks	138,119	-	-	-	-	138,119
Available-for-sale financial assets	8,439	-	129	19,935	947	29,450
Loans and advances to customers	29,975	61,067	248,684	468,084	180,954	988,764
Equipment and intangible assets	-	-	-	-	48,709	48,709
Deferred income tax assets	-	-	9	-	-	9
Other assets	4,931	-	-	-	24,710	29,641
Total assets	382,710	61,067	248,822	488,019	255,320	1,435,938
Liabilities						
Liabilities to banks	41,890	850	14,467	22,273	7,807	87,287
Liabilities to customers	581,680	77,789	283,376	16,575	590	960,010
Liabilities to institutions	182	10,892	26,554	86,781	76,278	200,687
Subordinated debt	342	-	-	7,796	-	8,138
Current tax liabilities	-	259	-	-	-	259
Other liabilities	2,864	-	-	-	1,031	3,895
Total liabilities	626,958	89,790	324,397	133,425	85,706	1,260,276
Net liquidity gap	(244,248)	(28,723)	(75,575)	354,594	169,614	175,662
As of 31 December 2013						
Total assets	286,759	69,784	323,482	447,341	244,964	1,372,330
Total liabilities	536,466	80,462	334,020	187,146	62,949	1,201,043
Net liquidity gap	(249,707)	(10,678)	(10,538)	260,195	182,015	171,287

Liabilities to customers with maturity up to 1 month include all sight deposits amounting to BGN 417,476 thousand (2013: BGN 354,833 thousand). The group’s management expects that these funds will not be withdrawn at the same time or within the period in which they are reflected. Additionally, an analysis of depositors’ behaviour revealed that 86% of term deposits at maturity date were not withdrawn but automatically renegotiated under the same terms and conditions.

The table below categorises the group’s financial liabilities according to the remaining period to the contractual maturity date as of the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows.

4 Risk management (continued)

f Liquidity risk (continued)

Maturity analysis for financial liabilities

As of 31 December 2014	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total	Total carrying amount
Cash and cash equivalents	201,246	-	-	-	-	**201,246**	201,246
Loans and advances to banks	138,119	-	-	-	-	**138,119**	138,119
Financial assets available for sale	8,436	196	434	20,612	-	**29,678**	29,450
Loans and advances to customers	29,093	69,409	281,852	547,260	204,826	**1,132,440**	988,764
Total financial assets	**376,894**	**69,605**	**282,286**	**567,872**	**204,826**	**1,501,483**	**1,357,579**
Liabilities to banks	41,922	965	15,409	24,624	8,464	**91,384**	87,287
Liabilities to customers	582,140	78,518	286,880	18,939	633	**967,110**	960,010
Other borrowed funds	570	11,181	28,654	168,757	-	**209,162**	208,825
Total financial liabilities	**624,632**	**90,664**	**330,943**	**212,320**	**9,097**	**1,267,656**	1,256,122

As of 31 December 2013	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total	Total carrying amount
Cash and cash equivalents	155,490	-	-	-	-	**155,490**	155,490
Loans and advances to banks	89,224	-	-	-	-	**89,224**	89,224
Financial assets available for sale	314	-	724	29,160	-	**30,198**	29,230
Loans and advances to customers	37,004	77,993	356,689	510,465	219,221	**1,201,372**	1,019,497
Total financial assets	**282,032**	**77,993**	**357,413**	**539,625**	**219,221**	**1,476,284**	**1,293,441**
Liabilities to banks	10,274	908	35,183	7,356	-	**53,721**	69,529
Liabilities to customers	522,069	72,871	280,765	37,109	6,543	**919,357**	896,451
Other borrowed funds	2,223	12,609	25,414	141,932	125,659	**307,837**	228,505
Total financial liabilities	**534,566**	**86,388**	**341,362**	**186,397**	**132,202**	**1,280,915**	1,194,485

g Operational risk management

The group is exposed to operational risk. Operational risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk. Operational risk may arise from inadequate information systems, technological errors, breaches in internal controls, frauds, unforeseen circumstances or other problems of an operational nature, which could result in unexpected losses. The group has established an Operational Risk Assessment Committee as the body with primary responsibility for managing operational risk. Its primary activities are to monitor the overall operational risk and the risk to which the group is exposed on the basis of regularly received operational risk reports and to prepare plans of action for extreme situations and cases of uninterrupted operations. To further reduce the impact of possible operational risk events and ensure the continuity of business operations, the group has developed disaster recovery plans pertaining to the core banking application database, international payments and Internet banking.

4 Risk management (continued)

h Capital management

The group's objectives when managing capital are to safeguard the group's ability to continue as a going concern in order to provide returns for the shareholders, protect its customers and maintain an optimal capital structure so as to reduce the cost of capital. The group calculates the total capital adequacy (the "Basel ratio") as a ratio between total own funds for solvency purposes and the total of the risk-weighted assets for credit, market and operational risks. Tier I capital adequacy is the ratio between the Tier I capital and the risk-weighted assets and should be higher than 6%. The total capital adequacy ratio should be higher than 12%.

The group's regulatory capital is divided into two tiers:

- Tier 1 capital, which includes ordinary share capital, share premiums, legal and other reserves formed from the net profit;
- Tier 2 capital, which includes received equity (hybrid) instruments which are subordinated debt with no maturity.

Tier 2 capital cannot exceed the amount of Tier 1 capital.

The group does not have a trading book so its core operations are categorised as banking book. Risk-weighted assets and capital requirements are determined according to the specific requirements of the BNB. The group's policy is to maintain a strong capital base so as to maintain creditor and market confidence and to sustain future development of the business. The group aims to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The group's regulatory capital position as of 31 December 2014 was as follows:

	2014	**2013**
Regulatory capital		
Tier 1 capital after regulatory deductions	146,027	136,057
Tier 2 capital after regulatory deductions	1,277	51,736
Total regulatory capital	147,304	187,793
Risk Weighted Assets		
Risk Weighted Assets for Credit Risk	666,029	670,732
Risk Weighted Assets for Operational Risk	144,766	179,866
Total Risk Weighted Assets	810,795	850,598
Capital ratios		
Total regulatory capital ratio	18.2%	22.1%
Tier 1 regulatory capital ratio	18.0%	16.0%

5 Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values the financial assets and liabilities in the group's statement of financial position, distributed in the respective hierarchical levels in accordance to the methods used for determining of the fair value of the instruments.

As of 31 December 2014				**Fair value hierarchy**		
Financial assets	**Cate-gory***	**Carrying value**	**Total fair value**	**Level 1**	**Level 2**	**Level 3**
Financial assets not measured at fair value						
Cash and cash equivalents	AFV	201,246	201,246	-	201,246	-
Loans and advances to banks	LaR	138,119	138,119	-	138,119	-
Loans and advances to customers	LaR	988,764	1,007,286	-	-	1,007,286
		1,328,129	**1,346,651**		**339,365**	**1,007,286**
Financial assets measured at fair value						
AFS financial assets	AFS	29,450	29,450	29,450	-	-
		29,450	29,450	29,450	-	-

Financial liabilities	**Catego ry***	**Carrying value**	**Total fair value**	**Level 1**	**Level 2**	**Level 3**
Financial liabilities not measured at fair value						
Liabilities to banks	AC	87,287	87,758	-	-	87,758
Liabilities to customers	AC	960,010	962,848	-	-	962,848
Liabilities to institutions	AC	200,687	200,814	-	-	200,814
Subordinated debt	AC	8,138	10,962	-	-	10,962
Total		**1,256,122**	**1,262,382**	**-**	**-**	**1,262,382**

* categories: AFV - At Fair value; LaR - Loans and Receivables, AFS - Available-for-sale; AC - Amortised cost

No fair value disclosures are provided for equity investment securities of BGN 766 thousand (2013: BGN 766 thousand) that are measured at cost because their fair value cannot be reliably measured. The investments are neither redeemable nor transferable and there is no market for them. The bank does not intend to dispose of these investments.

(i) Cash and cash equivalents

The item "cash and cash equivalents" includes cash at hand and balances at central banks including mandatory reserve disclosed under note 15. The fair value of these assets matches their carrying amount.

(ii) Loans and advances to banks

Loans and advances to banks include inter-bank placements. The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

(iii) Available-for-sale financial assets

The bank's portfolio of government securities is carried at fair value using the Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments. For part of the bank's portfolios of equity securities there are not available observable market prices. These instruments are carried at cost.

(iv) Loans and advances to customers

Loans and advances are net of provision for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted to determine fair value, using the interest rates currently offered by the bank. Difference in fair values and carrying amounts represents the changes in the current market interest rates. Fair value incorporates expected future losses, while amortized cost and related impairment include only incurred losses at the statement of financial position date.

5 Fair values of financial assets and liabilities (continued)

(v) Deposits and borrowings

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

If observable market rates are not available to determine the fair value of financial liabilities measured at amortised cost, ProCredit Group Treasury rates are used as an input for a discounted cash flow model. These are presented as level 3 input factors. ProCredit Group Treasury rates are determined taking into consideration the cost of capital depending on currencies and maturities plus a risk margin that depends on an internal risk rating for each institution within the ProCredit group (incl. ProCredit Bank (Bulgaria) EAD). Internal rates are regularly compared to those applied for third party transactions and are therefore in compliance with an orderly transaction between market participants at the measurement date under current market conditions.

Fair values of repossessed and investment properties (note 21) are established on the basis of internal calculations. The group considers the following valuation techniques:

- Cost technique. It considers the current replacement costs of replicating the property, including the cost of transportation, installation and start-up.
- Discounted cash flows model. It considers the present value of the net cash flows expected to be generated from the facility, taking into account the planned EBITDA growth rate and budgeted capital expenditure growth rate; the expected net cash flows are discounted using a risk-adjusted discount rate.
- Markets analogues methods. It considers direct comparison with the offered prices of similar properties.

6 Net interest income

	2014	2013
Interest income		
Loans and advances to customers	90,306	102,287
Available-for-sale financial assets	1,308	649
Financial assets at fair value	-	599
Loans and advances to banks	87	174
Total interest income	91,701	103,709
Interest expense		
Liabilities to customers	14,835	19,135
Liabilities to banks and institutions	6,473	7,465
Hybrid capital	1,185	3,894
Subordinated debt	820	821
Total interest expense	23,313	31,315

Included in “Interest income from loans and advances to customers” for 2014 is BGN 1,863 thousand of accrued interest on impaired loans (2013: BGN 2,421 thousand).

7 Net impairment loss on financial assets

	2014	2013
Impairment loss on loans and advances to customers	2,772	4,993
Total for impairment loss	2,772	4,993

8 Net fee and commission income

	2014	2013
Fee and commission income		
Money transfers	5,704	6,806
Card business	4,864	3,839
Opening and maintenance of accounts	4,216	3,998
Cash operations	2,123	1,964
Documentary business	746	859
Servicing fee	-	1,270
Others	2,962	2,349
Total fee and commission income	20,615	21,085
Fee and commission expense		
Fees related to cards	946	855
Correspondent accounts	400	317
Others	3	725
Total fee and commission expense	1,349	1,897

9 Trading result

	2014	2013
Gains less losses from foreign currency transactions	4,322	4,226
Gains less losses from foreign currency revaluation	19	42
Total trading result	4,341	4,268

10 Net income/(loss) from financial assets at fair value through profit and loss	2014	2013
Gains less losses from fair value changes	-	(432)
Total net income/(loss) from financial assets at fair value at fair value through profit and loss	-	(432)

11 Other operating (expense)/ income, net	2014	2013
Other operating income		
Income from sale of own property	386	46
Income from sale of repossessed property	188	646
Dividends from AFS securities	75	73
Other operating income	1,119	893
Total other operating income	1,768	1,658
Other operating expenses		
Impairment of repossessed property	3,027	1,443
Other expenses related to repossessed property	285	198
Other operating expenses	892	311
Total other operating expenses	4,204	1,952

"Dividends from available-for-sale financial assets" includes the dividend received by entities in which the bank has non-controlling interest.

12 Personnel expenses	2014	2013
Wages and salaries	21,730	23,450
Pension costs	1,180	1,308
Other social security costs	1,993	2,198
Other employee costs	268	296
Total staff costs	25,171	27,252

13 Administrative expenses	2014	2013
Operating lease rentals	6,785	8,216
Depreciation	5,527	5,558
Expenses for Deposit Insurance Fund	4,283	4,168
Communication and transport costs	3,250	3,407
Other professional services	3,182	2,284
Marketing, advertising and representation	2,450	2,361
Training	2,023	2,060
Consultancy, legal and audit services	1,851	3,508
Maintenance and utilities	1,715	2,185
Security services	1,200	1,064
Non-profit tax	724	550
IT expenses	572	564
Other administrative expenses	1,582	2,933
Total administrative expenses	35,144	38,858

14 Income tax expense

	2014	2013
Current income tax	3,118	2,445
Deferred income tax (Note 20)	(178)	(103)
Total income tax expense	2,940	2,342

Further information about deferred income tax is presented in note 20. The tax on the operating profit differs from the theoretical amount that would arise using the basic tax rate as follows:

Profit before income tax	26,472	24,021
Theoretical tax at a tax rate of 10 % (2013: 10 %)	2,647	2,402
Tax effect from non-taxable income	(7)	(12)
Tax effect of expenses not deductible for tax purposes	300	44
Effect related to tax losses from previous years	-	(92)
Total income tax expense	2,940	2,342

The effective tax rate for 2014 is: 11.1% (2013: 9.7%).

The tax authorities may at any time inspect the books and records within five years subsequent to the reported tax year, and may impose additional tax assessments and penalties. The group's management is not aware of any circumstances, which may give rise to a potential liability in this respect.

15 Cash and cash equivalents

	2014	2013
Cash in hand	57,634	40,653
Balances with the central bank (incl. mandatory reserve)	143,612	114,837
Total cash and cash equivalents	201,246	155,490

At 31 December 2014 the mandatory reserve with the central bank represented 10% of amounts mobilised from residents and 5% from amounts mobilised from non-residents, except for the deposits of local banks and amounts received as equity hybrid instruments and subordinated debt. The Bulgarian National Bank did not change the methodology for calculating the mandatory reserves in 2014. Included within the table below are amounts considered as cash and cash equivalents for the purposes of the Cash Flow Statement:

	2014	2013
Cash in hand	57,634	40,653
Balances with the central bank (net of mandatory reserve)	66,294	37,290
Due from other banks	138,119	89,224
Cash and cash equivalents for the Cash Flow Statement	262,047	167,167

16 Loans and advances to banks

	2014	2013
Placements with local banks	-	17,985
Placements with non-local banks	-	-
Current accounts with non-local banks	138,119	71,239
Total loans and advances to banks	138,119	89,224

17 Available-for-sale financial assets

	2014	2013
Bulgarian Government bonds	28,503	28,332
Equity securities	947	898
Total available-for-sale financial assets	29,450	29,230

Included within Government bonds is related accrued interest receivable of BGN 515 thousand (2013: BGN 479 thousand). The equity securities comprise shares in local and foreign financial intermediary institutions.

18 Loans and advances to customers

	2014	2013
Total gross loans and advances	1,025,103	1,056,426
Less provision for impairment	(36,339)	(36,929)
Total net loans and advances	988,764	1,019,497

Included within loans and advances to customers is related accrued interest receivable of BGN 6,975 thousand (2013: BGN 9,169 thousand).

18 Loans and advances to customers (continued)

Movement in provisions was as follows:

Balance at 1 January 2013	43,370
Increase in provisions for loan impairment	9,739
Loans written off	(16,180)
Balance at 31 December 2013	36,929
Increase in provisions for loan impairment	9,149
Loans written off	(9,739)
Balance at 31 December 2014	36,339

Allowance for loan impairment was formed as follows:	**2014**	**2013**
Increase in provisions for loan impairment	9,149	9,739
Less recoveries on loans previously written off	(6,377)	(4,746)
Recognised in the income statement	2,772	4,993

Economic sector risk concentrations within the customer loan portfolio were as follows:

	2014	**%**	**2013**	**%**
Trade	284,385	28%	314,061	30%
Agriculture	256,165	25%	263,612	25%
Industry and other production	170,212	17%	152,506	14%
Services	99,897	10%	101,407	10%
Construction	54,879	5%	60,225	6%
Accommodation and restaurants	55,202	5%	58,790	5%
Transport	54,738	5%	57,368	5%
Households	49,625	5%	48,457	5%
Total gross loans and advances	1,025,103	100%	1,056,426	100%

Loans to households include housing improvement loans in the amount of BGN 40,244 thousand (2013: BGN 37,406 thousand).

The analysis of the ten largest loan exposures to customers compared to the gross loan portfolio is as follows:

	2014	**2013**
The ten largest loan exposures to customers	37,890	33,325
Percentage of gross loans	4%	3%

19 Equipment and intangible assets

	Land and buildings	Furniture and fixtures	IT and other equipment	Leasehold improve-ments	Intangible assets	Total
Cost						
Balance at 1 Jan 2013	32,798	1,911	31,809	9,030	7,816	83,364
Acquisitions	912	623	2,109	874	1,098	5,616
Disposals	(58)	(461)	(1,884)	(2,258)	(153)	(4,814)
Balance at 31 Dec 2013	33,652	2,073	32,034	7,646	8,761	84,166
Depreciation						
Balance at 1 Jan 2013	2,130	980	21,633	3,983	3,932	32,658
Depreciation for the period	808	167	2881	638	1,043	5,537
Accumulated depreciation of disposal	-	(342)	(1,536)	(1,067)	-	(2,945)
Balance at 31 Dec 2013	2,938	805	22,978	3,554	4,975	35,250
Carrying amounts						
Balance at 1 Jan 2013	30,668	931	10,176	5,047	3,884	50,706
Balance at 31 Dec 2013	30,714	1268	9,056	4,092	3,786	48,916
Cost						
Balance at 1 Jan 2014	33,652	2,073	32,034	7,646	8,761	84,166
Acquisitions	311	282	4,867	677	1,194	7,331
Disposals	(457)	(166)	(4,856)	(1,023)	(540)	(7,042)
Balance at 31 Dec 2014	33,506	2,189	32,045	7,300	9,415	84,455
Depreciation						
Balance at 1 Jan 2014	2,938	805	22,978	3,554	4,975	35,250
Depreciation for the period	802	185	2,814	625	1,098	5,524
Accumulated depreciation of disposal	(112)	(131)	(4,227)	(558)	-	(5,028)
Balance at 31 Dec 2014	3,628	859	21,565	3,621	6,073	35,746
Carrying amounts						
Balance at 1 Jan 2014	30,714	1,268	9,056	4,092	3,786	48,916
Balance at 31 Dec 2014	29,878	1,330	10,480	3,679	3,342	48,709

20 Deferred income tax assets

The deferred income tax charge in the income statement and related deferred income tax assets include the following temporary differences:

	2014	2013
Deferred income tax assets		
Repossessed properties	338	172
Unused staff holiday time from previous years	56	57
Other temporary differences	243	228
Total deferred income tax assets	637	457
Deferred income tax liabilities		
Property, plant and equipment	582	688
Other temporary differences	46	81
Total deferred income tax liabilities	628	769

Changes in deferred income taxes	**2014**	**2013**
Balance at 1 January	(311)	(522)
Deferred income tax assets related to unused staff's holidays from previous years	(1)	(3)
Deferred income tax assets related to repossessed property	166	116
Deferred income tax liabilities related to PPE	106	(94)
Other temporary differences	49	192
Balance at 1 December	9	(311)
Total change in deferred income tax for the year	320	211
Change in deferred income tax positions reported directly in the equity	(142)	(108)
Total change in deferred income taxes (note 14)	(178)	(103)

21 Other assets

	2014	2013
Repossessed properties	23,662	25,239
Accounts receivable	3,983	2,734
Prepayments and deferred expenses	1,047	1,488
Investment properties	-	323
Tax receivables	949	189
Total other assets	29,641	29,973

Repossessed properties shown in the above table include real estates, agricultural and regulated land, etc. They are carried at the lower of the previous carrying amount of the written-off loan and the expected selling price less cost to sell. Reconciliation of the carrying amount of repossessed property is presented in the following table:

21 Other assets (continued)

Repossessed property	**2014**	**2013**
Balance as of 1 January	25,239	16,909
Acquisitions	8,204	14,215
Disposals (sales)	(6,754)	(4,548)
Change in fair value	(3,027)	(1,337)
Balance as of 31 December	23,662	25,239

22 Liabilities to banks

	2014	**2013**
Current accounts	4,907	4,891
Term deposits	36,800	-
Loans	45,580	64,638
Total liabilities to banks	87,287	69,529

Liabilities to ProCredit Bank (Germany) in the amount of BGN 38,683 thousand (2013: BGN 34,637 thousand) and liabilities to other sister banks from ProCredit group in the amount of BGN 4,770 thousand (2013: BGN 4,291 thousand) are reported under the current position. Liabilities to banks include accrued interest of BGN 266 thousand as of 31 December 2014 (2013: BGN 447 thousand).

23 Liabilities to customers

	2014	**2013**
Private Individuals		
-Sight deposits	82,234	72,701
-Term deposits	269,590	249,411
-Saving deposits	79,860	67,070
Total Private Individuals	431,684	389,182
Business Clients		
-Sight deposits	340,351	290,308
-Term deposits	144,707	175,731
-Saving deposits	36,106	32,813
Total Business Clients	521,164	498,852
Payments in transit	7,162	8,417
Total liabilities to customers	960,010	896,451

Included within due to customers is related accrued interest payable of BGN 7,137 thousand as of 31 December 2014 (2013: BGN 9,977 thousand).

24 Liabilities to institutions

Institution	Final year of maturity	2014	2013
European Investment Fund (EIF)	2025	76,277	29,368
Kreditanstalt für Wiederaufbau (KfW)	2018	43,614	54,583
European Investment Bank (EIB)	2019	35,274	39,195
European Bank for Reconstruction and Development (EBRD)	2019	24,988	17,307
European Fund for Southeast Europe (EFSE)	2016	11,040	18,386
State Fund Agriculture	2018	9,494	11,071
Total liabilities to institutions		200,687	169,910

The loan agreement with the European Investment Fund is under the JEREMIE program aimed towards co-financing of small and medium enterprises. The total agreed loan amount is EUR 144,000 thousand (BGN equivalent: 281,640 thousand).

The group has not had any defaults of principal, interest or other breaches with respect to its liabilities to institutions during the years ended 31 December 2014 and 2013.

25 Subordinated debt

The bank has subordinated debt from the ACTIAN N.V. (formerly: SNS Institutional Microfinance Fund). Part of the principal amount (BGN 1,276 thousand) of the subordinated debt is included in Tier 2 equity for capital adequacy purposes in accordance with articles 490 and 491 of Regulation 575/2013 of the European Parliament and the Council. The terms and conditions of the subordinated debt are as follows:

Institution	Type of the liability	Year of effective maturity	2014	2013
ACTIAN N.V.	Loan with fixed maturity with annual interest payment	2015	8,138	8,128
Total subordinated debt			8,138	8,128

The group has not had any defaults of principal, interest or other breaches with respect to its subordinated debt during the years ended 31 December 2014 and 2013.

26 Hybrid capital

The bank had hybrid capital solely from ProCredit Holding as of end 2013. The principal amount (BGN 48,896 thousand) of the hybrid capital was included in Tier 2 equity for capital adequacy purposes. In 2014 the hybrid capital was fully repaid. BGN 9,779 thousands were reinvested by ProCredit Holding into subscribed capital (common Tier 1 equity).

Institution	Type of the liability	2014	2013
ProCredit Holding	Undated equity (hybrid) instruments with annual interest payment	-	50,467
Total hybrid capital		-	50,467

The group has not had any defaults of principal, interest or other breaches with respect to its hybrid capital during the years ended 31 December 2014 and 2013.

27 Other liabilities	**2014**	**2013**
Creditors	1,194	1,344
Non-income taxes payable	1,178	921
Deferred income	1,031	1,486
Unused paid leave accrual	240	250
Provisions for off-balance items	135	-
Company pension provision	108	128
Other due payments	9	2,045
Total other liabilities	3,895	6,174

Obligations for defined benefit retirement compensations

The estimated amount of the obligation as at each reporting date and the expenses for retirement compensations recognized are based on an actuarial report (see below information on actuarial assumptions).

The defined benefit plan (obligation for compensation upon retirement) is an unfunded plan.

Movement in the present value of the defined benefit obligations

	2014	**2013**
Defined benefit obligations at 1 January	128	166
Benefits paid by the plan	-	(11)
Current service costs	10	18
Interest cost	6	5
Actuarial (gains) losses from changes in financial and demographic assumptions	(36)	(50)
Defined benefit obligations at 31 December	108	128

Actuarial assumptions

The following are the principal actuarial assumptions at the reporting date (expressed as weighted averages).

	2014	**2013**
Discount rate at 31 December	3%	3%
Future salary increases	5%	5%
Interest rate increase/decrease	5%	5%

28 Share capital and share premium	**2014**		**2013**	
Shareholder	**Share capital and share premium**	**%**	**Share capital and share premium**	**%**
ProCredit Holding	139,130	100%	129,351	100%
Total share capital and share premium	139,130	100%	129,351	100%

As of end 2014 the capital of the bank consists of registered capital and share premium. The registered capital of was divided into 135,634 thousand shares (2013: 125,855 thousand shares) with a nominal value of BGN 1 each. All shares confer equal voting power and are fully paid. The bank issued 9,779 thousand new shares in 2014 with a nominal value of BGN 1 each in order to further strengthen its Tier 1 equity position. The sole owner of the bank's capital is ProCredit Holding. The share premium was BGN 3,496 thousand (2013: BGN 3,496 thousand).

29 Retained earnings and reserves

	2014	2013
Legal reserves	3,953	3,953
Other reserves	6,611	6,579
Revaluation deficit on AFS securities	(972)	(231)
Retained earnings	26,940	31,635
Total retained earnings and reserves	36,532	41,936

Nature and purpose of the reserves

Legal and other reserves – these have been distributed from the net profit of the bank in compliance with the Commercial Law, article 246. The position “Other reserves” also comprises the amount accumulated as a result by remeasurement of post-employment benefits. The funds in these reserves could be only used for covering of current loss and loss from previous years or payments towards employees under defined benefit plan obligation.

Revaluation deficit – comprise accumulated revaluation by fair value of available-for-sale financial assets.

Retained earnings – comprise the accumulated profit of the bank from previous years. The bank paid dividends BGN 28,227 thousand in 2014 from its retained earnings from 2013 and 2012.

30 Contingent liabilities and commitments

Off-balance sheet commitments

The following table indicates the contractual amounts of the group’s off-balance sheet financial instruments that commit it to extend credit to customers:

	2014	2013
Commitments to extend credit	165,461	143,690
Letters of credit and letters of guarantee	28,590	30,112
Total contingencies and commitments	194,051	173,802

Operating lease commitments

The group leases a number of branch premises under operating leases. The leases typically run for a period of up to ten years. The leases are cancellable with prior notification up to six months. As a lessee under operating leases, the group has committed to make the following minimum rental payments:

	2014	2013
Up to 1 year	1,571	1,184

Assets pledged	**Asset**		**Related liability**	
	2014	**2013**	**2014**	**2013**
Loans and advances to customers	6,931	25,744	6,931	30,183

Pledged assets represent loans and advances to customers pledged according to the terms of loan agreements signed between ProCredit Bank and Bulgarian Development Bank EAD under programs for financing of agricultural producers and small and medium enterprises in Bulgaria.

31 Related party transactions

ProCredit Holding is the sole shareholder of ProCredit Bank and holds 100% of the bank's share capital. ProCredit Holding is the ultimate parent and ultimate controlling party of the bank. ProCredit Bank has stand-by line agreement with ProCredit Holding, directed towards liquidity management, which is not utilized as of end 2014. The bank has received loans from ProCredit Bank (Germany) (fully owned subsidiary of ProCredit Holding) under loan agreements. Other sister banks keep current accounts placements as the bank provides the functioning of a payment system within the ProCredit group (ProPay) (note 22).

The related party transactions were carried out on commercial terms and at market rates. The volumes of related party transactions outstanding at year end, and associated expenses and income for the year are as follows:

Transactions with shareholders	**2014**	**2013**
Other income earned	87	56
Liabilities at the beginning of the period	50,467	64,746
Net change during the period	(50,467)	(14,279)
Liabilities at the end of the period	-	50,467
Interest expense incurred	1,540	4,390
Other expenses incurred	2,040	2,420

Transactions with other ProCredit group entities	**2014**	**2013**
Loans and advances at the beginning of the period	58,257	14,403
Net change during the period	1,927	43,854
Loans and advances at the end of the period	60,184	58,257
Interest income earned	150	127
Other income earned	55	-
Liabilities at the beginning of the period	38,927	14,963
Net change during the period	4,526	23,964
Liabilities at the end of the period	43,453	38,927
Interest expense incurred	1,023	596
Other expenses incurred	891	881

In 2014, the total compensation of key management personnel was BGN 542 thousand (2013: BGN 616 thousand).

32 Group entities

As of 31 December 2014 the bank owns the total share capital of ProCredit Properties EAD, which is the co-owner of the head office building of the group. The registered capital of ProCredit Properties EAD is divided into 10 shares with a nominal value of BGN 5,000 each. All shares confer equal voting power and are fully paid.

33 Capital commitments

There were no capital commitments undertaken by the group as of 31 December 2014.

34 Subsequent events

There were no events after the reporting date that required additional disclosures or adjustments to the group's financial statements.

ProCredit Bank

Part of the ProCredit Group

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