**PJSC West Finance and Credit Bank**

# Financial Statements
# 31 December 2010

*These financial statements contain 50 pages*

# Contents

| *(in thousands of UAH)* | *Note* | **31 December 2010** | **31 December 2009** |
|---|---|---|---|
| **Assets** | | | |
| Cash | | **2,816** | 3,532 |
| Balances with the National Bank of Ukraine | *5* | **12,157** | 13,617 |
| Due from banks | *6* | **145,300** | 94,207 |
| Loans and advances | *7* | **51,858** | 151,820 |
| Property, equipment and intangible assets | *8* | **1,524** | 2,205 |
| Investment property | *9* | **3,704** | - |
| Assets held-for-sale | *11* | **-** | 5,018 |
| Other assets | *10* | **6,419** | 1,489 |
| **Total assets** | | **223,778** | 271,888 |
| **Liabilities** | | | |
| Due to banks | *12* | **23,762** | - |
| Current accounts | *13* | **62,902** | 22,950 |
| Deposits | *14* | **16,573** | 129,952 |
| Income tax payable | | **634** | 2 |
| Deferred tax liability | *27* | **1,947** | 2,521 |
| Other liabilities | *15* | **932** | 613 |
| Subordinated debt | *16* | **33,092** | 31,930 |
| **Total liabilities** | | **139,842** | 187,968 |
| **Equity** | | | |
| Share capital | *17* | **72,175** | 72,175 |
| Additional paid-in capital | | **7,328** | 7,328 |
| Retained earnings | | **4,433** | 4,417 |
| **Total equity** | | **83,936** | 83,920 |
| **Total liabilities and equity** | | **223,778** | 271,888 |
| **Commitments and contingent liabilities** | *18* | | |

The statement of financial position is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 7 to 50.

| *(in thousands of UAH)* | *Note* | **2010** | 2009 |
|---|---|---|---|
| Interest income | *19* | **23,245** | 28,592 |
| Interest expense | *19* | **(9,816)** | (14,319) |
| **Net interest income** | *19* | **13,429** | 14,273 |
| Fee and commission income | *20* | **4,865** | 2,695 |
| Fee and commission expense | *20* | **(973)** | (1,543) |
| **Net fee and commission income** | *20* | **3,892** | 1,152 |
| Financial aid received | *21* | **-** | 11,984 |
| Gains less losses arising from foreign currency exchange | *22* | **1,591** | 3,934 |
| Other income | *23* | **951** | 128 |
| **Operating income** | | **19,863** | 31,471 |
| Salaries and employee benefits | *24* | **(10,946)** | (11,107) |
| General administrative expenses | *25* | **(9,551)** | (10,809) |
| Depreciation and amortisation | *8* | **(887)** | (1,352) |
| Reversal of/(provision for) impairment | *26* | **1,720** | (6,102) |
| **Operating expenses** | | **(19,664)** | (29,370) |
| **Profit before tax** | | **199** | 2,101 |
| Income tax expense | *27* | **(183)** | (602) |
| **Net profit and total comprehensive income** | | **16** | 1,499 |

The statement of comprehensive income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 7 to 50.

| | *Note* | **2010** | 2009 |
|---|---|---|---|
| *(in thousands of UAH)* | | | |
| ***Operating activities*** | | | |
| Interest received | | **22,161** | 29,196 |
| Interest paid | | **(9,158)** | (13,997) |
| Fees and commissions received | | **4,865** | 2,695 |
| Fees and commissions paid | | **(965)** | (1,543) |
| Net receipts from dealing in foreign currencies | | **1,981** | 3,959 |
| Other income and financial aid received | | **920** | 12,112 |
| Operating expenses paid | | **(20,341)** | (21,916) |
| | | **(537)** | 10,506 |
| ***Changes in operating assets and liabilities*** | | | |
| Change in due from banks with original maturity more than three months and mandatory reserve with the NBU | | **1,350** | (1,332) |
| Change in deposit certificates of the National Bank of Ukraine | | **-** | 23,000 |
| Change in loans and advances | | **96,747** | (43,979) |
| Change in other assets | | **738** | 1,272 |
| Change in due to banks | | **23,189** | - |
| Change in current accounts | | **40,378** | 9,612 |
| Change in deposits | | **(112,925)** | 74,848 |
| Change in other liabilities | | **139** | 85 |
| **Net cash from operating activities before tax** | | **49,079** | 74,012 |
| Income tax paid | | **(125)** | (423) |
| **Cash flows from operating activities** | | **48,954** | 73,589 |
| ***Investing activities*** | | | |
| Proceeds from sale of assets held-for-sale | | **1,167** | 1,042 |
| Acquisition of property, equipment and intangible assets | *8* | **(278)** | (391) |
| Proceeds from disposals of property, equipment and intangible assets | | **103** | 471 |
| **Cash flows from investing activities** | | **992** | 1,122 |

The statement of cash flows is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 7 to 50.

| *(in thousands of UAH)* | *Note* | **2010** | 2009 |
|---|---|---|---|
| Cash and cash equivalents as at 1 January | | **108,577** | 33,834 |
| Effect of exchange rates fluctuations on cash and cash equivalents | | **(30)** | 32 |
| Net increase in cash and cash equivalents | | **49,946** | 74,711 |
| **Cash and cash equivalents as at 31 December** | | **158,493** | 108,577 |

Cash and cash equivalents as at 31 December as shown in the cash flow statement is composed of the following items:

| *(in thousands of UAH)* | *Note* | **2010** | 2009 |
|---|---|---|---|
| Cash | | **2,816** | 3,532 |
| Balances with the National Bank of Ukraine which are available for withdrawal | *5* | **10,965** | 11,317 |
| Balances due from banks with original maturity less than three months | *6* | **144,712** | 93,728 |
| **Total cash and cash equivalents** | | **158,493** | 108,577 |

The statement of cash flows is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 7 to 50.

| *(in thousands of UAH)* | **Share capital** | **Additional paid-in capital** | **Retained earnings** | **Total** |
|---|---|---|---|---|
| **Balances as at 31 December 2008** | **72,175** | **7,328** | **2,918** | **82,421** |
| Net profit and total comprehensive income | **-** | **-** | **1,499** | **1,499** |
| **Balances as at 31 December 2009** | **72,175** | **7,328** | **4,417** | **83,920** |
| Net profit and total comprehensive income | **-** | **-** | **16** | **16** |
| **Balances as at 31 December 2010** | **72,175** | **7,328** | **4,433** | **83,936** |

The statement of changes in equity is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 7 to 50.

# 1 Background

## (a) Organization and operations

Public Joint Stock Company "West Finance and Credit Bank" (the Bank) was created as a closed joint stock company according to Ukrainian legislation and registered by the National Bank of Ukraine (the NBU) on 4 October 2006. In January 2009, the Bank was reorganised into open joint-stock company. In January 2011, the Bank was re-registered in the form of a public joint stock company in line with changes of the Ukrainian legislation entered into force in 2009 which prescribes that joint stock companies should be either public or private.

The Bank provides banking services to individuals and companies operating in different industries, including machinery, trade and others. These services include taking deposits and granting loans, investing in securities, transferring payments in Ukraine and abroad, exchanging of currencies and other services.

The office is located at 17 Kovpaka St., Kyiv, Ukraine. As at 31 December 2010 and 2009, the Bank has 1 outlet located in Kyiv. The Bank has 59 employees as at 31 December 2010 (31 December 2009: 62).

## (b) Ukrainian business environment

Ukraine is experiencing political and economic change that has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in Ukraine involve risks that typically do not exist in other markets. In addition, the contraction in the capital and credit markets and its impact on the economy of Ukraine have further increased the level of economic uncertainty in the environment. These financial statements reflect management's current assessment of the impact of the Ukrainian business environment on the operations and the financial position of the Bank. The future business environment may differ from management's assessment.

Management is unable to reliably estimate the effects on the Bank's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and liquidity position of the Bank's business in the current circumstances.

# 2 Basis of preparation

## (a) Statement of compliance

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

## (b) Basis of measurement

The financial statements are prepared on the historical cost basis except for derivative financial instruments stated at fair value.

## (c) Functional and presentation currency

The national currency of Ukraine is the Ukrainian hryvnia (UAH). Consequently, the functional and presentation currency for the purposes of these financial statements is the Ukrainian hryvnia.

## (d) Critical accounting estimates and judgments in applying accounting policies

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and the reported amounts of assets, liabilities, income and expense. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from these estimates.

In particular, information about significant areas of estimation uncertainty and judgements in applying accounting policies is as follows:

### *(i) Critical judgements*

The Bank's accounting policies allow offsetting of assets and liabilities (i.e. loans due from and deposits due to the same banks) only when there is legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. Although settlement of loans and deposits is typically done on the same day, loans due from and deposits due to the same banks are settled by receiving and paying separate amounts, thus exposing the Bank to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. These risk exposures may be significant even though relatively brief. Management believes that these transactions are in substance foreign currency exchange swaps and accounts for these transactions in accordance with the Bank's accounting policy in respect of derivatives (note 3(b)). Accordingly, the net fair value of foreign currency exchange swaps is recognised as an asset when the fair value is positive and as a liability when the fair value is negative. The gross amount of amounts receivable/payable on settlement (having the legal form of loans due from and deposits due to the same banks) are offset and not recognised on the balance sheet. Refer to note 28 for the information about maximum exposure to credit risk arising from these derivative instruments (i.e. gross amount of receivable upon settlement of loans due from banks). Refer to note 30 for the information about exposure to liquidity risk (i.e. gross amount of payable upon settlement of deposits due to banks).

*(ii) Significant estimation uncertainty*

Impairment of loans and advances. Management estimates impairment by assessing the likelihood of repayment of loans and advances based on analysis of individual accounts for all loans. Factors taken into consideration when assessing individual loans include collection history, current financial condition of the borrower, timeliness of repayments and collateral, if any. To determine the amount of impairment, management estimates the amounts and timing of future payments of principal and interest and proceeds from the disposal of collateral, if any. These cash flows are then discounted using the loan's original interest rate. Actual principal and interest payments depend on the borrowers' ability to generate cash flows from operations or obtain alternative financing, and could differ from management's estimates.

Factors taken in consideration when estimating impairment of loans assessed collectively include historical loss experience, portfolio delinquency rates and overall economic conditions.

Note 7 contains a description of the sensitivity of the carrying amount of loans and advances to changes in estimates. Should actual repayments be less than management estimates, the Bank would be required to record additional impairment expense.

# 3 Significant accounting policies

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

## (a) Foreign currency translation

Transactions in foreign currencies are translated to the respective hryvnias at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to hryvnias at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in hryvnias at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to hryvnias at the exchange rate at the date that the fair value is determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

The principal UAH exchange rates used in the preparation of these financial statements are as follows:

| **Currency** | **31 December 2010** | 31 December 2009 |
|---|---|---|
| US dollar | **7.96** | 7.99 |
| EUR | **10.57** | 11.45 |

As at the date of these financial statements, 18 May 2011, the NBU exchange rate is UAH 7.98 to USD 1.00 and UAH 11.31 to EUR 1.00.

## (b) Financial instruments

### *Classification*

*Financial instruments at fair value through profit or loss* are financial assets or liabilities that are:

- acquired or incurred principally for the purpose of selling or repurchasing in the near term

- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking

- derivative financial instruments (except for derivative financial instruments that are designated and effective hedging instruments) or,

- upon initial recognition, designated as at fair value through profit or loss.

Management may designate financial assets and liabilities at fair value through profit or loss where either:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis

- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise or,

- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

All trading derivatives in a net receivable position (positive fair value), as well as options purchased, are reported as assets. All trading derivatives in a net payable position (negative fair value), as well as options written, are reported as liabilities.

Management determines the appropriate classification of financial instruments in this category at the time of the initial recognition. Derivative financial instruments and financial instruments designated as at fair value through profit or loss upon initial recognition are not reclassified out of at fair value through profit or loss category. Financial assets that would have met the definition of loan and receivables may be reclassified out of the fair value through profit or loss or available-for-sale category if the entity has an intention and ability to hold it for the foreseeble future or until maturity. Other financial instruments may be reclassified out of at fair value through profit or loss category only in rare circumstances. Rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term.

*Loans and receivables* are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that Management:

- intends to sell immediately or in the near term

- upon initial recognition designates as at fair value through profit or loss

- upon initial recognition designates as available-for-sale or,

- may not recover substantially all of its initial investment, other than because of credit deterioration.

*Held-to-maturity investments* are non-derivative financial assets with fixed or determinable payments and fixed maturity that Management has the positive intention and ability to hold to maturity, other than those that:

- Management upon initial recognition designates as at fair value through profit or loss

- Management designates as available-for-sale or,

- meet the definition of loans and receivables.

*Available-for-sale financial assets* are those non-derivative financial assets that are designated as available-for-sale or are not classified as loans and receivables, held-to-maturity investments or financial instruments at fair value through profit or loss.

### *Recognition*

Financial assets and liabilities are recognized in the statement of financial position when the Bank becomes a party to the contractual provisions of the instrument. All regular way purchases of financial assets are accounted for at the settlement date.

### *Measurement*

A financial asset or liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, financial assets, including derivatives that are assets, are measured at their fair values, without any deduction for transaction costs that may be incurred on sale or other disposal, except for:

- loans and receivables which are measured at amortized cost using the effective interest method

- held-to-maturity investments that are measured at amortized cost using the effective interest method

- investments in equity instruments that do not have a quoted market price in an active market and whose fair value can not be reliably measured which are measured at cost.

All financial liabilities, other than those designated at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortized cost.

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortized based on the effective interest rate of the instrument.

Financial assets or liabilities originated at interest rates different from market rates are re-measured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar instruments. The difference between the fair value and the nominal value at origination is credited or charged to profit or loss as gains or losses on origination of financial instruments at rates different from market rates. Subsequently, the carrying amount of such assets or liabilities is adjusted for amortization of the gains/losses on origination and the related income/expense is recorded in interest income/expense within profit or loss using the effective interest method.

### *Fair value measurement principles*

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

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

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

The 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 on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

### *Gains and losses on subsequent measurement*

A gain or loss arising from a change in the fair value of a financial asset or liability is recognized as follows:

- a gain or loss on a financial instrument classified as at fair value through profit or loss is recognized in profit or loss

- a gain or loss on an available-for-sale financial asset is recognized as other comprehensive income in equity (except for impairment losses and foreign exchange gains and losses on debt financial instruments available-for-sale) until the asset is derecognized, at which time the cumulative gain or loss previously recognised in equity is recognized in profit or loss. Interest in relation to an available-for-sale financial asset is recognized in profit or loss using the effective interest method.

For financial assets and liabilities carried at amortized cost, a gain or loss is recognized in profit or loss when the financial asset or liability is derecognized or impaired, and through the amortization process.

### *Derecognition*

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability in the statement of financial position. The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

The Bank writes off assets deemed to be uncollectible.

### *Derivative financial instruments*

Derivative financial instruments include swaps, forwards, futures, spot transactions and options in interest rates, foreign exchanges, precious metals and stock markets, and any combinations of these instruments.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognised immediately in profit or loss.

Derivatives may be embedded in another contractual arrangement (a host contract). An embedded derivative is separated from the host contract and is accounted for as a derivative if, and only if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and the combined instrument is not measured at fair value with changes in fair value recognised in profit or loss. Derivatives embedded in financial assets or financial liabilities at fair value through profit or loss are not separated.

Although the Bank trades in derivative instruments for risk hedging purposes, these instruments do not qualify for hedge accounting.

### *Interest bearing borrowings*

Interest bearing borrowings are recognised initially at cost, net of any transaction costs incurred. Subsequent to initial recognition, interest bearing borrowings are stated at amortised cost and any difference between cost and redemption value is recognised in the statement of comprehensive income over the period of the borrowings.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is immediately recognised in the statement of comprehensive income.

## (c) Impairment

### *(i) Calculation of recoverable amount*

*Financial assets carried at amortized cost*

Financial assets carried at amortized cost consist principally of loans and other receivables (loans and receivables). Management reviews its loans and receivables to assess impairment on a regular basis. A loan or receivable is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the loan or receivable and that event (or events) has had an impact on the estimated future cash flows of the loan that can be reliably estimated.

Management first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If Management determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of a loan or advance on terms that Management would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the group, or economic conditions that correlate with defaults in the group.

If there is objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable’s original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data relating to similar borrowers. In such cases, Management uses its experience and judgement to estimate the amount of any impairment loss.

The 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.

All impairment losses in respect of loans and receivables are recognized in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. The Bank writes off a loan balance (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

*Available-for-sale financial assets*

Impairment losses on available-for-sale financial assets are recognised by transferring the cumulative loss that is recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

For an investment in an equity security available-for-sale, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

*Non financial assets*

Other non financial assets, other than deferred taxes, are assessed at each reporting date for any indications of impairment. The recoverable amount of goodwill is estimated at each reporting date. The recoverable amount of non financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised when the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

All impairment losses in respect of non financial assets are recognized in profit or loss and reversed only if there has been a change in the estimates used to determine the recoverable amount. Any impairment loss reversed is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. An impairment loss in respect of goodwill is not reversed.

*(ii) Reversal of impairment*

An impairment loss in respect of a held-to-maturity asset or a loan or a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. An impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be related objectively to an event occurring after the impairment loss was recognised in profit or loss, then the impairment loss is reversed, with the amount of the reversal recognised in the statement of comprehensive income.

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

## (d) Credit related commitments

In the normal course of business, the Bank enters into credit related commitments, comprising undrawn loan commitments, letters of credit and guarantees, and provides other forms of credit insurance.

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

A financial guarantee liability is recognised initially at fair value net of associated transaction costs, and is measured subsequently at the higher of the amount initially recognised less cumulative amortisation or the amount of provision for losses under the guarantee. Provisions for losses under financial guarantees and other credit related commitments are recognised when losses are considered probable and can be measured reliably.

Financial guarantee liabilities and provisions for other credit related commitment are included in other liabilities.

## (e) Property, equipment and intangible assets

Property, equipment and intangible assets are carried at cost less accumulated depreciation and amortization and impairment losses. Depreciation and amortization is computed by the straight-line method over the estimated useful lives of the assets. Depreciation and amortization commences from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. The estimated useful lives are as follows:

| | |
|---|---|
| Furniture and equipment | 5 years |
| Motor vehicles | 5 years |
| Intangible assets | 3 years |

Expenditures for leasehold improvements are recognised as assets and charged to the statement of comprehensive income on a straight-line basis over the shorter of their economic life or the period of the applicable lease.

## (f) Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in normal course of business, or for the use in production or supply of goods or services or for administrative purposes. Investment property is measured at cost less accumulated depreciation and impairment losses.

### (g) Assets held-for-sale

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

### (h) Leases

Payments for operating leases, where the Bank does not assume substantially all the risks and rewards of ownership, are classified as expenses when incurred.

### (i) Income and expense recognition

Interest income and expense are recognized in profit or loss on an accrual basis, taking into account the effective yield/rate of the asset/liability or an applicable floating rate. Interest income and expense include the amortization of any discount or premium or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Commission income and expense are recognized on an accrual basis.

Fees received in connection with loan originations are netted against the direct costs incurred to grant the loan, and are amortized over the life of the loan as an adjustment to interest income using the effective interest method.

### (j) Segment reporting

An operating segment is a component of a Bank that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same Bank); whose operating results are regularly reviewed by the chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

The Bank represents one reportable segment that has central management and follows common lending policy and marketing strategy.

### (k) Taxation

Income tax on the profit or loss comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in other comprehensive income in equity, in which case it is recognised in other comprehensive income in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the end of the reporting period.

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

### (l) Employee benefits

The Bank pays into social insurance funds an amount based on each employee's wage, in accordance with Ukrainian legislation. These amounts are expensed when the related compensation expense is incurred.

### (m) Cash and cash equivalents

Cash and cash equivalents include cash, balances with the National Bank of Ukraine and current accounts due from banks with the original maturities of less than three months. As at 31 December 2010 and 2009, the mandatory reserve with the NBU is not considered to be cash equivalent due to restrictions on its withdrawability.

### (n) Additional paid-in capital

Additional paid-in capital includes contribution to the equity other than increase of share capital. The result from transactions with the Parent Company acting in capacity as shareholder of the Bank is recorded directly in equity.

### (o) Offsetting

Financial assets and liabilities are offset and the net amount 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 realize the asset and settle the liability simultaneously.

### (p) Adoption of new accounting standards

Various Improvements to IFRSs have been dealt with on a standard-by-standard basis.

### (q) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective as at 31 December 2010, and are not applied in preparing these financial statements. Of these pronouncements, potentially the following will have an impact on the financial position and performance. Management plans to adopt these pronouncements when they become effective.

- Revised IAS 24 *Related Party Disclosures* (2009) (effective for annual periods beginning on or after 1 January 2011) introduces an exemption from the basic disclosure requirements in relation to related party disclosures and outstanding balances, including commitments, for government-related entities. Additionally, the standard has been revised to simplify some of the presentation guidance that was previously non-reciprocal. The revised standard is to be applied retrospectively.

- IFRS 9 *Financial Instruments* will be effective for annual periods beginning on or after 1 January 2013. The new standard is to be issued in several phases and is intended to replace International Financial Reporting Standard IAS 39 *Financial Instruments: Recognition and Measurement* once the project is completed by the end of 2010. The first phase of IFRS 9 was issued in November 2009 and relates to the recognition and measurement of financial assets.

- *Improvements to IFRSs 2010* resulting from the International Accounting Standards Board's third annual improvements project are to be dealt with on a standard-by-standard basis. The effective date of each amendment is included in the IFRSs affected.

Management is currently studying what effect these new standards and amendments may have on the financial position and result of operations.

## 5 Balances with the National Bank of Ukraine

Balances with the National Bank of Ukraine as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Balances available for withdrawal | **10,965** | 11,317 |
| Restricted balances | **1,192** | 2,300 |
| **Total** | **12,157** | 13,617 |

The Bank is required by the NBU to maintain an obligatory reserve balance calculated as an average of certain customer funds over a period of one month.

As at 31 December 2010 mandatory reserve with the NBU amounting to UAH 1,192 thousand is restricted for withdrawal (2009: UAH 2,300 thousands).

On 1 December 2008 the NBU adopted Resolution 406 which imposed a new requirement regarding mandatory reserve that should be kept on the correspondent accounts of the NBU. This Resolution became effective on 1 January 2009. The reserve is calculated based on the amount of loans in foreign currency granted during 2010 to the borrowers which do not have income in foreign currency. The NBU restricts withdrawal of amounts equivalent to certain foreign currency denominated loans as well as amounts equivalent to 40% of the obligatory reserves calculated based on the NBU methodology.

## 6 Due from banks

Balances due from banks as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Current accounts: | | |
| Domestic | **77,730** | 80,933 |
| OECD countries | **66,982** | 12,795 |
| | **144,712** | 93,728 |
| Loans and advances: | | |
| Domestic | **588** | 479 |
| **Total** | **145,300** | 94,207 |

The following table represents an analysis of due from banks by rating agency designation based on Standard and Poor's ratings (S&P) or their equivalent as at 31 December:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Current accounts: | | |
| BBB- to A+ | **66,982** | - |
| B- to B+ | **921** | 93,712 |
| CCC to C | **76,809** | - |
| Unrated | **-** | 16 |
| | **144,712** | 93,728 |
| Loans and advances: | | |
| B- to B+ | **588** | 479 |
| **Total** | **145,300** | 94,207 |

As at 31 December 2010, balances due from banks amounting to UAH 139,413 thousand, or 95.9% of the gross exposure of due from banks, are placed with two banks (2009: UAH 89,113 thousand, or 94.6%).

As at 31 December 2010 and 2009, balances due from banks are not impaired or past due.

## 7 Loans and advances

Loans and advances as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Commercial | **55,780** | 154,993 |
| Retail | **7,438** | 11,308 |
| **Total loans, gross** | **63,218** | 166,301 |
| Provision for impairment (note 26) | **(11,360)** | (14,481) |
| **Total** | **51,858** | 151,820 |

Loans and advances include loan principal and accrued interest as at 31 December 2010 and 2009.

Changes in collection estimates can affect the impairment losses recognised. For example, to the extent that the net present value of the estimated cash flows differs by plus/minus one percent, the loan impairment as at 31 December 2010 would be UAH 519 thousand lower/higher (2009: UAH 1,518 thousand).

As at 31 December 2010, loans and advances to the ten largest borrowers (or groups of borrowers) totals UAH 47,872 thousand, and represent 75.7% of the total gross loans and advances (31 December 2009: UAH 137,164 thousand or 82.5%).

Loan impairment as at 31 December 2010 is as follows:

| *(in thousands of UAH)* | **Gross loans** | **Impairment** | **Net loans** | **Impairment to gross loans** |
|---|---|---|---|---|
| **Commercial loans** | | | | |
| Impaired loans | **15,859** | **(10,831)** | **5,028** | **68.3%** |
| Loans without specifically identified impairment | **39,921** | **(140)** | **39,781** | **0.4%** |
| **Total commercial loans** | **55,780** | **(10,971)** | **44,809** | **19.7%** |
| **Retail loans** | | | | |
| Loans without specifically identified impairment | **7,438** | **(389)** | **7,049** | **5.2%** |
| **Total retail loans** | **7,438** | **(389)** | **7,049** | **5.2%** |
| **Total** | **63,218** | **(11,360)** | **51,858** | **18.0%** |

Loan impairment as at 31 December 2009 is as follows:

| *(in thousands of UAH)* | Gross loans | Impairment | Net loans | Impairment to gross loans |
|---|---|---|---|---|
| Commercial loans | | | | |
| Impaired loans | 16,119 | (10,610) | 5,509 | 65.8% |
| Loans without specifically identified impairment | 138,874 | (1,587) | 137,287 | 1.1% |
| Total commercial loans | 154,993 | (12,197) | 142,796 | 7.9% |
| Retail loans | | | | |
| Impaired loans | 2,361 | (210) | 2,151 | 8.9% |
| Loans without specifically identified impairment | 8,947 | (2,074) | 6,873 | 23.2% |
| Total retail loans | 11,308 | (2,284) | 9,024 | 20.2% |
| Total | 166,301 | (14,481) | 151,820 | 8.7% |

As at 31 December 2010 and 2009, there were no loans and advances, terms of which were renegotiated, that would otherwise be past due or impaired.

As at 31 December 2010 and 2009, there were no loans that are past due but not impaired.

As at 31 December 2010, accrued interest income on impaired loans and advances amounted to UAH 1,095 thousand (2009: nil).

The following table provides an analysis of the gross loan portfolio by types of collateral:

| | **31 December 2010** | | | 31 December 2009 | | |
|---|---|---|---|---|---|---|
| **Type of collateral** | **Commercial loans** | **Retail Loans** | **Total** | Commercial loans | Retail Loans | Total |
| *(in thousands of UAH)* | | | | | | |
| *Impaired loans* | | | | | | |
| Pledged assets | **6,435** | **-** | **6,435** | 8,086 | 2,361 | 10,447 |
| Unsecured | **9,424** | **-** | **9,424** | 8,033 | - | 8,033 |
| *Total impaired loans* | **15,859** | **-** | **15,859** | | | |
| *Loans without specifically identified impairment:* | | | | | | |
| Pledged assets | **34,245** | **6,672** | **40,917** | 54,784 | 7,008 | 61,792 |
| Deposits with the Bank | **4,933** | **-** | **4,933** | 83,202 | - | 83,202 |
| Unsecured | **743** | **766** | **1,509** | 888 | 1,939 | 2,827 |
| *Total loans without specifically identified impairment* | **39,921** | **7,438** | **47,359** | 138,874 | 8,947 | 147,821 |
| *Total loans:* | | | | | | |
| Pledged assets | **40,680** | **6,672** | **47,352** | 62,870 | 9,369 | 72,239 |
| Deposits with the Bank | **4,933** | **-** | **4,933** | 83,202 | - | 83,202 |
| Unsecured | **10,167** | **766** | **10,933** | 8,921 | 1,939 | 10,860 |
| **Total** | **55,780** | **7,438** | **63,218** | 154,993 | 11,308 | 166,301 |

These tables summarize the amount of loans secured by collateral, rather than the fair value of the collateral itself.

Pledged assets primarily include real estate, production facilities and automobiles.

During 2008, the Bank foreclosed collateral, which secured the loan, with a fair value of UAH 7,314 thousand. The foreclosed collateral is curtain fabric was initially classified as assets held for sale (note 11). During 2010 the Bank was unable to sell the foreclosed curtain fabric. As at 31 December 2010 the foreclosed curtain fabric does not meet the definition of assets held for sale and was reclassified to other assets.

During 2010, the Bank foreclosed collateral, which secured the loans, represented by commercial property and land plot with a cost of UAH 3,704 thousand. The commercial property and land plot will be retained for capital appreciation, and accordingly, are recognised as investment property (note 9).

As at 31 December 2010, the fair value of collateral pledged for impaired loans is approximately UAH 2,839 thousand (2009: UAH 8,803 thousand).

The Bank's lending activities are conducted in Ukraine. The ability of the borrowers to repay their debt is dependent on a number of factors including the overall financial health of the individual borrowers and the continued development of the Ukrainian economy.

Gross corporate loans and advances by economic sector as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Production | **18,141** | 14,711 |
| Trade | **13,567** | 43,669 |
| Real estate | **13,078** | - |
| Agriculture | **6,384** | 8,220 |
| Construction | **2,808** | 84,011 |
| Financial Services | **906** | 3,421 |
| Transportation | **896** | 961 |
| **Total** | **55,780** | 154,993 |

# 8 Property, equipment and intangible assets

A summary of activity in property, equipment and intangible assets for the year ended 31 December 2010 is as follows:

| *(in thousands of UAH)* | **Leasehold impro-vements** | **Furniture and equipment** | **Motor Vehicles** | **Intangible assets** | **Total** |
|---|---|---|---|---|---|
| Cost: | | | | | |
| **As at 1 January 2010** | **80** | **2,277** | **750** | **923** | **4,030** |
| Additions | **-** | **235** | **-** | **43** | **278** |
| Disposals | **-** | **-** | **(78)** | **(5)** | **(83)** |
| **As at 31 December 2010** | **80** | **2,512** | **672** | **961** | **4,225** |
| Accumulated depreciation and amortisation: | | | | | |
| **As at 1 January 2010** | **58** | **846** | **267** | **654** | **1,825** |
| Depreciation and amortisation | **22** | **465** | **190** | **210** | **887** |
| Disposals | | | **(10)** | **(1)** | **(11)** |
| **As at 31 December 2010** | **80** | **1,311** | **447** | **863** | **2,701** |
| **Net book value as at 31 December 2010** | **-** | **1,201** | **225** | **98** | **1,524** |

A summary of activity in property, equipment and intangible assets for the year ended 31 December 2009 is as follows:

| *(in thousands of UAH)* | Leasehold impro-vements | Furniture and equipment | Motor Vehicles | Intangible assets | Total |
|---|---|---|---|---|---|
| Cost: | | | | | |
| As at 1 January 2009 | 322 | 2,227 | 1,251 | 802 | 4,602 |
| Additions | - | 270 | - | 121 | 391 |
| Disposals | (242) | (220) | (501) | - | (963) |
| As at 31 December 2009 | 80 | 2,277 | 750 | 923 | 4,030 |
| Accumulated depreciation and amortisation: | | | | | |
| As at 1 January 2008 | 99 | 442 | 116 | 308 | 965 |
| Depreciation and amortisation | 183 | 609 | 214 | 346 | 1,352 |
| Disposals | (224) | (205) | (63) | - | (492) |
| As at 31 December 2009 | 58 | 846 | 267 | 654 | 1,825 |
| Net book value as at 31 December 2009 | 22 | 1,431 | 483 | 269 | 2,205 |

# 9 Investment property

A summary of activity in investment property for the year ended 31 December is as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| **As at 1 January** | **-** | - |
| Additions | **3,704** | - |
| Impairment | **-** | - |
| **As at 31 December** | **3,704** | - |

During the year ended 31 December 2010, the Bank foreclosed non-residential real estate and land with a cost of UAH 3,704 thousand. The Bank intends to keep the property for capital appreciation.

Non-residential real estate has an estimated useful life of 25 years and is depreciated using a straight-line method over the estimated useful life of the asset.

## 10 Other assets

Other assets as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Foreclosed curtain fabric | **4,460** | - |
| Derivative financial instruments (note 28) | **851** | 4 |
| Prepaid taxes, other than income tax | **772** | 570 |
| Prepayments | **232** | 682 |
| Materials and supplies | **70** | 84 |
| Other | **34** | 149 |
| **Total** | **6,419** | 1,489 |

## 11 Assets held-for-sale

During 2008, the Bank foreclosed on collateral with a fair value of UAH 7,314 thousand. The Bank does not use the foreclosed collateral in the normal course of its business. The foreclosed collateral is curtain fabric was initially classified as assets held for sale (note 11). During 2010 the Bank was unable to sell the foreclosed curtain fabric. As at 31 December 2010 the foreclosed curtain fabric does not meet the definition of assets held for sale and was reclassified to other assets. Upon reclassification the curtain fabric was measured at its recoverable amount.

## 12 Due to banks

Balances due to banks as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Domestic | **23,762** | - |
| **Total** | **23,762** | - |

As at 31 December 2010, balances due to banks amounting to UAH 23,762 thousand, or 100.0% of the gross exposure of due to banks, are placed with two banks (2009: nil).

## 13 Current accounts

Current accounts as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Commercial | **54,757** | 18,197 |
| Retail | **8,145** | 4,753 |
| **Total** | **62,902** | 22,950 |

As at 31 December 2010, current accounts of the five largest customers (or group of customers) total UAH 46,984 thousand, or 74.7% of the total current accounts (2009: UAH 10,836 thousand, or 47.2%).

## 14 Deposits

Deposits as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Commercial | **2,550** | 110,954 |
| Retail | **14,023** | 18,998 |
| **Total** | **16,573** | 129,952 |

As at 31 December 2010, deposits of the five largest customers (or group of customers) total UAH 12,678 thousand, or 76.5% of total deposits (2009: UAH 116,389 thousand, or 89.6%).

## 15 Other liabilities

Other liabilities as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Provision for unused vacations | **644** | 488 |
| Taxes payable, other than income tax | **236** | - |
| Accounts payable for services | **-** | 79 |
| Other | **52** | 46 |
| **Total** | **932** | 613 |

# 16 Subordinated debt

In 2008 the Bank received from the shareholder (by way of an entity under common control), JSC "ALTINBAŞ HOLDİNG ANONİM ŞIRKETİ", a subordinated loan denominated in US dollars amounting to USD 5,000 thousand with a nominal fixed interest rate of 5.5%. The principal amount of this loan was initially repayable in August 2013. During 2009 the maturity of the loan was extended until August 2015.

This loan was recognised initially at fair value. The fair value of this loan was determined by management as the present value of the future payments for the loans discounted using a market rate of interest for similar loans of 12.0%. On initial recognition, the difference of UAH 5,901 thousand between the fair value of the loan of UAH 18,099 thousand and total proceeds received of UAH 24,000 thousand is recognized as additional paid-in capital in the statement of changes in equity. After initial recognition, the difference between the fair value and the nominal value is amortised in the statement of comprehensive income over the term of the loan using the effective interest method. As at 31 December 2010, the effective interest rate is 10.6% (2009: 10.6%).

Subordinated debt includes principal and accrued interest as at 31 December 2010 and 2009.

# 17 Share capital

The share capital as at 31 December 2010 and 2009 is as follows:

| *(in thousands of UAH) (except for number of shares)* | **Number of shares** | **Amount** |
|---|---|---|
| Ordinary shares authorised, issued and fully paid | **72,175,000** | **72,175** |

The nominal value of an ordinary share is UAH 1 per share as at 31 December 2010 and 2009. All ordinary shares have equal voting, dividend and capital repayment rights. No dividends were declared or paid in 2010 and 2009.

In accordance with Ukrainian legislation, the distributable reserves are limited to the balance of accumulated reserves as recorded in the statutory financial statements prepared in accordance with National Accounting Standards.

# 18 Commitments and contingent liabilities

## (a) Commitments to extend credit

As at 31 December 2010, the Bank granted irrevocable commitments to extend credit amounting to UAH 22,674 thousand (2009: UAH 1,279 thousand).

## (b) Operating lease commitments

The Bank leases operational space in its normal course of business. Future non-cancellable lease payments as at 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Within one year | **185** | 385 |
| | **185** | 385 |

## (c) Insurance

The insurance industry in Ukraine is in a developing stage and many forms of insurance protection common in other countries are not yet generally available. The Bank does not have full coverage for its premises and equipment, business interruption, or third party liability in respect of damage arising from accidents on Bank property or relating to operations. Until the Bank obtains adequate insurance coverage, there is a risk that the loss or destruction of certain assets could have a material adverse effect on the operations and financial position.

## (d) Tax contingency

The Ukrainian tax system can be characterised by numerous taxes and frequently changing legislation. Tax regulations are often unclear, open to wide interpretation, and in some instances are conflicting. Instances of inconsistent opinions between local, regional and national tax authorities and between the National Bank of Ukraine and the Ministry of Finance are not unusual. Tax declarations are subject to review and investigation by a number of authorities that are enabled by law to impose significant penalties and interest charges. These facts create tax risks in Ukraine substantially more significant than typically found in countries with more developed tax systems.

In December 2010, a new Tax Code was adopted in Ukraine. The new Tax Code assumes significant changes in tax accounting for VAT and corporate income tax, including changes in applicable rates and accounting policies for recognition of taxable income and expenses. In particular, under the new Tax Code, the corporate income tax rate will be decreased in steps from 25% in 2010 to 16% in 2014.

Management believes it has complied with all existing tax legislation. However, there can be no assurance that the tax authorities will not have a different interpretation of the Bank's compliance with existing legislation and assess fines and penalties. No provision for potential tax assessments has been made in these financial statements.

## (e) Litigation

The Bank is involved in various legal proceedings in the ordinary course of business. Management does not believe the result of any such actions will have a material effect on financial position or results of operations.

## 19 Net interest income

Net interest income for the year ended 31 December is as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| **Interest income** | | |
| Loans and advances | **15,063** | 23,481 |
| Due from banks | **7,867** | 3,164 |
| Deposit certificates of the National Bank of Ukraine | **315** | 1,947 |
| **Total interest income** | **23,245** | **28,592** |
| **Interest expense** | | |
| Deposits | **5,620** | 9,675 |
| Subordinated debt | **3,333** | 3,307 |
| Current accounts | **580** | 1,257 |
| Due to banks | **283** | 80 |
| **Total interest expense** | **9,816** | 14,319 |
| **Net interest income** | **13,429** | 14,273 |

Interest income on impaired loans and advances during the year ended 31 December 2010 amounts to UAH 2,301 thousand (2009: UAH 1,536 thousand)

## 20 Net fee and commission income

Net fee and commission income for the year ended 31 December is as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| **Fee and commission income:** | | |
| Payments and cash withdrawals | **2,753** | 1,759 |
| Currency exchange | **1,990** | 915 |
| Other | **122** | 21 |
| **Total fee and commission income** | **4,865** | 2,695 |
| **Fee and commission expense:** | | |
| Payments and cash withdrawals | **(751)** | (1,518) |
| Other | **(222)** | (25) |
| **Total fee and commission expense** | **(973)** | (1,543) |
| **Net fee and commission income** | **3,892** | 1,152 |

## 21 Financial aid received

During 2009, the Bank received USD 1,500 thousand of non-refundable financial aid from Douglas Trading SA, which is not a related party.

## 22 Gains less losses arising from foreign currency exchange

Gains less losses arising from dealing in foreign currencies relate to the valuation of currency positions and the spreads earned on foreign currency exchange activities.

## 23 Other income

Other income for the year ended 31 December is as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Net result from operations with foreign currency derivatives | **851** | 4 |
| Penalties and fines | **44** | 115 |
| Other | **56** | 9 |
| **Total** | **951** | 128 |

## 24 Salaries and employee benefits

Salaries and employee benefits for the year ended 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Salaries and other benefits | **8,401** | 8,786 |
| Social security and other salary related charges | **2,545** | 2,321 |
| **Total** | **10,946** | 11,107 |

# 25 General administrative expenses

General administrative expenses for the year ended 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Rent | **1,520** | 4,825 |
| Communication | **1,816** | 1,767 |
| Professional services | **2,138** | 1,649 |
| Repairs and maintenance of property, equipment and intangible assets | **597** | 1,060 |
| Business trips | **140** | 212 |
| Security | **154** | 164 |
| Materials and low-value items | **860** | 527 |
| Other | **2,326** | 605 |
| **Total** | **9,551** | 10,809 |

# 26 Provision for impairment

The following is a schedule of movements in provision for impairment for the year ended 31 December:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Balance as at 1 January | **15,735** | 9,633 |
| Provision for impairment (recoveries of provision for impairment) for: | | |
| Commercial loans and advances | **(1,232)** | 2,890 |
| Retail loans and advances | **(1,538)** | 1,965 |
| Due from banks | **-** | - |
| Assets held-for-sale | **(1,254)** | 1,254 |
| Other assets | **2,304** | (7) |
| | **(1,720)** | 6,102 |
| Commercial loans and advances write-off | **(351)** | - |
| Other assets write-off | **(339)** | |
| **Balance as at 31 December** | **13,325** | 15,735 |

The allowances for impairment recognised in the balance sheet as at 31 December is as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Loans and advances (note 7) | **11,360** | 14,481 |
| Assets held-for-sale (note 11) | **-** | 1,254 |
| Other assets (note 10) | **1,965** | - |
| **Balance as at 31 December** | **13,325** | 15,735 |

## 27 Income tax expense

The statutory income tax rate is 25% for 2010 and 2009.

The components of income tax expense for the year ended 31 December are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| Current tax expense | **757** | 399 |
| Deferred tax (benefit) expense | **(574)** | 203 |
| **Total tax expense** | **183** | 602 |

The difference between the total expected income tax expense computed by applying the statutory income tax rate to profit before tax and the reported income tax expense is as follows:

| | **Years ended 31 December** | | | |
|---|---|---|---|---|
| *(in thousands of UAH)* | **2010** | **2010** | 2009 | 2009 |
| Profit before tax | **199** | **100.0%** | 2,101 | 100.0% |
| Computed expected income tax expense at statutory rate | **50** | **25.5%** | 525 | 25.0% |
| Non-deductible expenses | **504** | **253.1%** | 77 | 3.7% |
| Effect of change in income tax rate | **(371)** | **(186.4%)** | - | - |
| **Income tax expense for the year** | **183** | **92.0%** | 602 | 28.7% |

## (a) Movements in recognised temporary differences during the year

Deferred tax assets and liabilities as at 31 December 2010 are attributable to the items detailed as follows:

| *(in thousands of UAH)* | **1 January 2010 Asset (liability)** | **Recognised in statement of comprehensive income Benefit (charge)** | **31 December 2010 Asset (liability)** |
|---|---|---|---|
| Property, equipment and intangible assets | **(63)** | **62** | **(1)** |
| Loans and advances | **(791)** | **(157)** | **(948)** |
| Other assets | **270** | **1** | **271** |
| Subordinated debt | **(2,046)** | **737** | **(1,309)** |
| Other liabilities | **109** | **(69)** | **40** |
| **Total** | **(2,521)** | **574** | **(1,947)** |

Deferred tax assets and liabilities as at 31 December 2009 are attributable to the items detailed as follows:

| *(in thousands of UAH)* | 1 January 2009 Asset (liability) | Recognised in statement of comprehensive income Benefit (charge) | 31 December 2009 Asset (liability) |
|---|---|---|---|
| Property, equipment and intangible assets | (161) | 98 | (63) |
| Loans and advances | 181 | (972) | (791) |
| Amounts due from other banks | (5) | 5 | - |
| Other assets | (129) | 399 | 270 |
| Subordinated debt | (2,254) | 208 | (2,046) |
| Other liabilities | 50 | 59 | 109 |
| **Total** | (2,318) | (203) | (2,521) |

## 28 Derivative financial instruments

The Bank has loans due from and deposits due to the same banks that are denominated in different currencies for the same period with the similar amounts. Cash flows under these instruments are similar to cash flows under foreign exchange swaps. Refer to note 2 for a description of critical accounting judgement made by the management in application of the Bank's accounting policies for these instruments.

The table below sets out gross amounts of receivable and payable upon settlement of loan due from and deposit due to bank. Because these contracts are short-term (within one month), the net amount of receivable or payable upon settlement also approximates the positive (net receivable) or negative (net payable) fair value of the foreign currency exchange contracts.

| *(in thousands of UAH)* | **2010** **Contracts with positive fair value** | 2009 Contracts with positive fair value |
|---|---|---|
| **Gross amount upon settlement:** | | |
| UAH receivable | **69,996** | 24,758 |
| USD receivable | **29,057** | - |
| EUR receivable | **21,166** | - |
| UAH payable | **(8,046)** | - |
| USD payable | **(90,195)** | (24,754) |
| EUR payable | **(21,127)** | - |
| **Net fair value assets (net amount receivable) (note 10)** | **851** | 4 |
| **Maximum exposure to credit risk (gross amount receivable)** | **120,219** | 24,758 |

## 29 Analysis by segment

The Bank represents one reportable segment that has central management and follows common lending policy and marketing strategy.

There are no customers from which revenues exceed 10% of total external revenue.

Substantially all of assets are located in Ukraine.

## 30 Financial risk management

Management of risk is fundamental to the business of banking and is an essential element of operations. The major risks faced by the Bank are those related to credit exposures, market risk (which includes risk of movements in foreign exchange rates and in interest rates) and liquidity risk.

## (a) Risk management framework

The risk management policies aim to identify, analyze and manage the risks faced by the Bank, to set appropriate risk limits and controls and to continuously monitor risk levels and adherence to limits.

The risks are managed in an integrated manner and are evaluated in terms of the policy of the Bank, which is reviewed and approved by the Board on an annual basis. Risk limits are established for credit, market and liquidity risks and the level of exposure is then maintained within these limits.

## (b) Credit risk

Credit risk is the risk of a financial loss to the Bank if a customer or counterparty fails to meet its contractual obligations, and arises principally from loans and advances and investment securities. The maximum credit risk exposure is generally net carrying amounts of instruments as at end of the reporting period. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual customer and counterparty default risk, country and industry risk).

Management uses the same procedures and methodologies, as defined in the policy for approving credit related commitments (undrawn loan commitments, letter of credit and guarantees) as it does for balance sheet credit obligations (loans). The maximum exposure to off balance sheet credit risk is reflected in note 18.

Management monitors concentration of credit risk. For the analysis of concentration of credit risk in respect of loans and advances refer to note 7.

The Bank has to comply with varying NBU regulations that limit exposure to companies, groups of companies and related parties. To manage credit risk, the Bank deals with counterparties of good credit standing.

The Bank manages its credit risk by establishing limits in relation to single borrowers and groups of borrowers, which are recommended by the Credit Department and approved by the Credit Committee as part of the loan portfolio risk management system, and by complying with exposure limits established by the NBU. The Bank also mitigates its credit risk by obtaining collateral and using other security arrangements.

*Corporate Lending*

In making its lending decisions, the Bank evaluates potential borrowers on the basis of their financial condition as reflected in their financial statements, their credit history with the Bank and other financial institutions and the amount of risk involved in lending to a particular borrower, using a rating scale. A lack of credit history with the Bank or lack of credit history in general is not an absolute bar to granting a loan, provided the Bank receives sufficient information to assess the borrower’s business and financial condition. However, when the Bank lends to a borrower with no credit history, it sets conditions such as a requirement to transfer a certain part of the customer’s banking operations to the Bank for a certain period and charging a higher interest rate, or requiring additional collateral or guarantees from such borrower.

In evaluating the risks associated with a particular borrower, the Bank takes into account the borrower’s business and factors such as the quality of its management, its main business activities, its geographic location, suppliers, customers, other indebtedness, financial stability, turnover, likely return on the loan, the liquidity of the proposed collateral and whether it is sufficient in view of the credit risk.

*Retail Lending*

Retail loans are subject to a standardised approval procedure.

The approval is primarily based on financial condition and solvency of the borrower. The timing and frequency of assessment of the financial state of the borrower depends on the servicing of the debt and term of the loan, however, it should be made not less than once a year.

The determination of the financial condition of the borrower includes general data, financial indicators, purpose of the loan and personal qualities.

Loans are subject to maximum limits depending on the applicant's income, stability of future earnings, liquidity and quality of collateral. The Credit Committee reviews a credit application and makes the relevant decision as to whether to grant the loan.

The Bank continuously monitors the performance of individual credit exposures and regularly reassesses the creditworthiness of its customers. The review is based on an analysis of overdue payments and other information obtained by the Bank. In light of this information the borrower's internal credit rating may be revised.

The basic means of problem loan recovery include foreclosure on the pledged property and recovery of funds from the debtor or guarantor.

The Bank's maximum exposure to on balance sheet credit risk is generally reflected in the carrying amounts of financial assets on the statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

The maximum exposure to credit risk at the reporting date is as follows:

| *(in thousands of UAH)* | **31 December 2010** | 31 December 2009 |
|---|---|---|
| Balances with the National Bank of Ukraine | **12,157** | 13,617 |
| Due from banks | **145,300** | 94,207 |
| Loans and advances | **51,858** | 151,820 |
| **Total balance sheet exposure** | **209,315** | 259,644 |
| Irrevocable commitments | **22,674** | 1,279 |
| Gross amount receivable on derivatives | **120,219** | 24,758 |
| **Total exposure** | **352,208** | 285,681 |

For the analysis of concentration of credit risk in respect of loans and advances to customers refer to note 7.

## (c) Market risk

Market risk is the risk that changes in the market prices, such as interest rate, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's/issuer's credit standing) will affect income or the value of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

### (d) Foreign currency risk

Currency risk is the risk that movements in foreign exchange rates will affect income or the value of its portfolios of financial instruments.

The Bank has assets and liabilities denominated in several foreign currencies. Foreign currency risk arises when the actual or forecasted assets in a foreign currency are either greater or less than the liabilities in that currency. Management establishes limits and constantly monitors foreign currency positions in accordance with the regulations of the NBU and internally developed methodology. The policy with regard to open currency position is restricted to certain thresholds under Ukrainian law and is strictly regulated by the NBU on a daily basis.

Foreign currency positions as at 31 December 2010 are as follows:

| *(in thousands of UAH)* | **USD** | **EUR** |
|---|---|---|
| **Assets** | | |
| Cash | **695** | **124** |
| Due from banks | **103,792** | **4,108** |
| Loans and advances | **26,740** | **-** |
| **Total assets** | **131,227** | **4,232** |
| **Liabilities** | | |
| Current accounts | **(8,541)** | **(3,917)** |
| Deposits | **(9,258)** | **(321)** |
| Due to banks | **(7,962)** | **-** |
| Subordinated debt | **(33,092)** | **-** |
| **Total liabilities** | **(58,853)** | **(4,238)** |
| **Net long on balance sheet position** | **72,374** | **(6)** |
| **(Short)/long off balance sheet position** | **(61,138)** | **39** |
| **Net long on and off balance sheet position** | **11,236** | **33** |

Foreign currency positions as at 31 December 2009 are as follows:

| *(in thousands of UAH)* | USD | EUR |
|---|---|---|
| **Assets** | | |
| Cash | 1,868 | 557 |
| Due from banks | 74,810 | 2,087 |
| Loans and advances | 92,861 | - |
| **Total assets** | 169,539 | 2,644 |
| **Liabilities** | | |
| Current accounts | (5,180) | (1,652) |
| Deposits | (86,362) | (329) |
| Subordinated debt | (31,930) | - |
| **Total liabilities** | (123,472) | (1,981) |
| **Net long on balance sheet position** | 46,067 | 663 |
| **Short off balance sheet position** | (24,754) | - |
| **Net long on and off balance sheet position** | 21,313 | 663 |

As at 31 December 2010 and 2009, 10 percent weakening of the Ukrainian hryvnia against the following currencies would have increased (decreased) net profit for the year ended 31 December and total equity as at 31 December by the amount shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| USD | **843** | 1,598 |
| EUR | **2** | 50 |

As at 31 December 2010 and 2009 a 10 percent strengthening of the Ukrainian hryvnia against the above currencies would have had an equal but opposite effect on the net profit and total equity to the amount shown above, on the basis that all other variables remain constant.

## (e) Interest Rate Risk

Interest rate risk is the risk that movements in interest rates will affect income or the value of financial instruments.

Interest rate risk is measured by the extent to which changes in market interest rates impact on margins and net interest income. To the extent the term structure of interest bearing assets differs from that of liabilities, net interest income will increase or decrease as a result of movements in interest rates. To manage interest rate risk, management continually assesses market interest rates for different types of interest bearing assets and liabilities.

Interest margins on assets and liabilities having different maturities may increase as a result of changes in market interest rates. In practice, management resets interest rates on both assets and liabilities based on current market conditions and mutual agreement, which is documented in an addendum to the original agreement.

The ALCO and the Credit Committee are responsible for interest rate risk management. ALCO establishes the principal policies and approaches to interest rate risk management, including maximum credit loan and minimum borrowing rates in respect of products, customer groups and tenors. The Credit Committee are responsible for ensuring compliance with guidelines set by ALCO. At the same time the Corporate Business Centre and Retail Business Centre, with the approval of the Risk Management Department, recommend altering certain interest rates to ALCO subject to changes in market conditions or for internal reasons. Interest rate risk management is conducted using the ‘‘GAP’’ analysis method, whereby the difference or gap between rate sensitive assets and rate sensitive liabilities is determined and analysed. The Tariff Committee is responsible for ensuring compliance with guidelines set by ALCO.

As at 31 December the average effective interest rates of major interest bearing assets and liabilities are as follows:

| | **2010** | | | **2009** | | |
|---|---|---|---|---|---|---|
| | **UAH** | **USD** | **EUR** | **UAH** | **USD** | **EUR** |
| Due from banks | **2.5%** | **1.8%** | **-** | 7.7% | 3.3% | - |
| Loans and advances | **17.4%** | **10.3%** | **-** | 23.4% | 11.6% | - |
| Due to banks | **15.0%** | **5.0%** | **-** | - | - | - |
| Current accounts | **1.4%** | **1.0%** | **0.1%** | 2.5% | 1.5% | 1.0% |
| Deposits | **13.4%** | **7.9%** | **3.6%** | 19.5% | 9.2% | 3.6% |
| Subordinated debt | **-** | **10.6%** | **-** | - | 10.6% | - |

For the majority of corporate loans the Bank has the right to change the interest rate when the market interest rate changes. Due to the fact that the majority of other financial instruments have fixed rates, the remaining contractual maturity dates also approximate the contractual interest and repricing dates for those instruments.

As at 31 December 2010, if interest rates at that date had been 100 basis points higher with all other variables held constant, post-tax profit for the year would have been UAH 519 thousand higher (2009: UAH 1,518 thousand), arising mainly as a result of higher interest income on loans where the Bank has the right, and has exercised the right, to change the interest rate when the market interest rate changes. If interest rates had been 100 basis points lower, with all other variables held constant, post-tax profit for the year would not have changed significantly because the majority of the borrowers generally do not have the ability to lower interest rates when market interest rates decrease and the majority of other financial instruments have fixed rates.

## (f) Liquidity Risk

Liquidity risk arises in the general funding of activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

Management’s approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank’s reputation.

The Bank seeks to actively support a diversified and stable funding base comprising debt securities in issue, long-term and short-term loans from other banks, core corporate and retail customer deposits, accompanied by diversified portfolios of highly liquid assets, in order to be able to respond quickly and smoothly to unforeseen liquidity requirements.

To maintain its short-term liquidity, the Bank takes short-term deposits, enters into repurchase transactions and buys and sells foreign currency, securities and precious metals. To maintain its long-term liquidity, the Bank takes medium and long-term deposits, sells assets such as securities, regulates its interest rate policy and strives to reduce expenses.

The contractual remaining maturities of assets and liabilities, excluding interest payments, as at 31 December 2010 are as follows:

| **Description** | **Maturity periods** | | | | | | **Total** |
|---|---|---|---|---|---|---|---|
| | Within one month | From one to three months | From three months to one year | From one to five years | More than five years | No maturity | |
| *(in thousands of UAH)* | | | | | | | |
| Cash | **2,816** | **-** | **-** | **-** | **-** | **-** | **2,816** |
| Balances with the National Bank of Ukraine | **12,157** | **-** | **-** | **-** | **-** | **-** | **12,157** |
| Due from banks | **144,712** | **-** | **-** | **588** | **-** | **-** | **145,300** |
| Loans and advances | **5,088** | **2,646** | **21,591** | **22,533** | **-** | **-** | **51,858** |
| Property, equipment and intangible assets | **-** | **-** | **-** | **-** | **-** | **1,524** | **1,524** |
| Investment property | **-** | **-** | **-** | **-** | **-** | **3,704** | **3,704** |
| Other assets | **1,417** | **-** | **-** | **4,932** | **-** | **70** | **6,419** |
| **Total assets** | **166,190** | **2,646** | **21,591** | **28,053** | **-** | **5,298** | **223,778** |
| **Liabilities** | | | | | | | |
| Due to banks | **23,762** | **-** | **-** | **-** | **-** | **-** | **23,762** |
| Current accounts | **62,902** | **-** | **-** | **-** | **-** | **-** | **62,902** |
| Deposits | **1,030** | **448** | **8,611** | **6,484** | **-** | **-** | **16,573** |
| Income tax payable | **634** | **-** | **-** | **-** | **-** | **-** | **634** |
| Deferred tax liability | **-** | **-** | **1,947** | **-** | **-** | **-** | **1,947** |
| Other liabilities | **288** | **-** | **644** | **-** | **-** | **-** | **932** |
| Subordinated debt | **189** | **-** | **-** | **32,903** | **-** | **-** | **33,092** |
| **Total liabilities** | **88,805** | **448** | **11,202** | **39,387** | **-** | **-** | **139,842** |
| Liquidity surplus (gap) for the period | **77,385** | **2,198** | **10,389** | **(11,334)** | **-** | **5,298** | **83,936** |
| **Cumulative liquidity surplus** | **77,385** | **79,583** | **89,972** | **78,638** | **-** | **83,936** | |

The contractual remaining maturities of assets and liabilities, excluding interest payments, as at 31 December 2009 are as follows:

| Description | Maturity periods | | | | | | Total |
|---|---|---|---|---|---|---|---|
| | Within one month | From one to three months | From three months to one year | From one to five years | More than five years | No maturity | |
| *(in thousands of UAH)* | | | | | | | |
| Cash | 3,532 | - | - | - | - | - | 3,532 |
| Balances with the National Bank of Ukraine | 13,617 | - | - | - | - | - | 13,617 |
| Due from banks | 93,728 | - | - | 479 | - | - | 94,207 |
| Loans and advances | 3,126 | 24,908 | 98,681 | 25,105 | - | - | 151,820 |
| Property, equipment and intangible assets | - | - | - | - | - | 2,205 | 2,205 |
| Assets held-for-sale | - | - | 5,018 | - | - | - | 5,018 |
| Other assets | 603 | 570 | 316 | - | - | - | 1,489 |
| Total assets | 114,606 | 25,478 | 104,015 | 25,584 | - | 2,205 | 271,888 |
| Liabilities | | | | | | | |
| Current accounts | 22,950 | - | - | - | - | - | 22,950 |
| Deposits | 32,572 | 33,673 | 30,770 | 30,987 | 1,950 | | 129,952 |
| Income tax payable | - | 2 | - | - | - | - | 2 |
| Deferred tax liability | 28 | 72 | 312 | 2,046 | 63 | - | 2,521 |
| Other liabilities | 352 | 85 | - | - | 176 | - | 613 |
| Subordinated debt | 189 | - | - | - | 31,741 | - | 31,930 |
| Total liabilities | 56,091 | 33,832 | 31,082 | 33,033 | 33,930 | - | 187,968 |
| Liquidity surplus (gap) for the period | 58,515 | (8,354) | 72,933 | (7,449) | (33,930) | 2,205 | 83,920 |
| Cumulative liquidity surplus | 58,515 | 50,161 | 123,094 | 115,645 | 81,715 | 83,920 | |

As at 31 December 2010, under Ukrainian law individual depositors can withdraw their funds prior to the stated maturity date upon two-day notification. Management believes that a majority of individual deposits will not be withdrawn prior to the stated maturity date.

The contractual maturity analysis of undiscounted cash flows (including interest payments) for financial liabilities and credit related commitments as at 31 December 2010 is as follows:

| **Description** | **Maturity periods** | | | | | **Total** |
|---|---|---|---|---|---|---|
| *(in thousands of UAH)* | Within one month | From one to three months | From three months to one year | From one to five years | More than five years | |
| Current accounts | **62,902** | **-** | **-** | **-** | **-** | **62,902** |
| Deposits | **1,036** | **453** | **9,038** | **8,473** | **-** | **19,000** |
| Subordinated debt | **189** | **455** | **1,820** | **42,192** | | **44,656** |
| Notional amount of derivative liabilities | **119,368** | **-** | **-** | **-** | **-** | **119,368** |
| Credit related commitments | **329** | **-** | **52** | **22,293** | **-** | **22,674** |
| **Total** | **183,824** | **908** | **10,910** | **72,958** | **-** | **268,600** |

The contractual maturity analysis of undiscounted cash flows (including interest payments) for financial liabilities and credit related commitments as at 31 December 2009 is as follows:

| **Description** | **Maturity periods** | | | | | **Total** |
|---|---|---|---|---|---|---|
| *(in thousands of UAH)* | Within one month | From one to three months | From three months to one year | From one to five years | More than five years | |
| Current accounts | 22,950 | - | - | - | - | 22,950 |
| Deposits | 32,871 | 34,599 | 34,155 | 41,213 | 3,023 | 145,861 |
| Subordinated debt | 189 | 439 | 1,756 | 8,781 | 32,808 | 43,973 |
| Notional amount of derivative liabilities | 24,754 | - | - | - | - | 24,754 |
| Credit related commitments | - | - | - | 1,279 | - | 1,279 |
| **Total** | 80,764 | 35,038 | 35,911 | 51,273 | 35,831 | 238,817 |

### (g) Capital management

*Regulatory capital*

The NBU sets and monitors capital requirements for the Bank as a whole. The Bank and individual banking operations are directly supervised by their local regulators.

Under the current capital requirements set by the NBU banks have to maintain a ratio of capital to risk weighted assets (statutory capital ratio) above the prescribed minimum level. If it does not maintain or sufficiently increase its capital base in line with the increase in its risk weighted assets, it may be non-compliant with the NBU capital adequacy regulations, which could lead to the imposition of sanctions by the NBU. This could have a material adverse effect on results of operations and financial condition. As at 31 December 2010, the minimum level required by the NBU is 10.0% (2009: 10.0%).

The following table shows the composition of the capital position calculated in accordance with the requirements of the Basle Accord, as at 31 December:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | **72,175** | 72,175 |
| Retained earnings and additional paid-in capital | **11,761** | 11,745 |
| **Total Tier 1 capital** | **83,936** | 83,920 |
| **Allowable subordinated debt** | **26,474** | 25,544 |
| **Total capital** | **110,410** | 109,464 |
| **Total risk-weighted assets** | **124,383** | 199,015 |
| **Capital ratios** | | |
| Total Tier I expressed as a percentage of total risk-weighted assets | **67.5%** | 42.2% |
| Total capital expressed as a percentage of risk-weighted assets | **88.8%** | 55.0% |

## 31 Balances with related parties

The Bank grants loans and advances to customers, attracts deposits and performs other transactions with related parties in the ordinary course of business. Parties are considered to be related if one party has the ability to control the other party or exercises significant influence over the party when making financial and operational decisions. Related parties comprise the shareholders of the Bank, companies which are under common control with the Bank, key management personnel and their close family members, companies that are controlled or significantly influenced by shareholders, by key management personnel or by their close family members.

As at 31 December 2010 and 2009, the ultimate controlling party of the Bank is JSC “ALTINBAŞ HOLDING ANONIM ŞIRKETI”, which is ultimately controlled by members of Altinbaş family.

Balances and transactions with the related parties as at 31 December and for the year then ended are as follows:

| *(in thousands of UAH)* | **2010** | 2009 |
|---|---|---|
| **Shareholders and other entities under common control** | | |
| ***Statement of financial position:*** | | |
| Current accounts | **-** | - |
| Deposits | **-** | - |
| Subordinated debt | **33,092** | 31,930 |
| ***Statement of comprehensive income:*** | | |
| Interest expense and similar charges | **3,333** | 3,307 |
| **Key management personnel** | | |
| ***Statement of financial position:*** | | |
| Current accounts | **1,802** | 260 |
| Deposits | **1,642** | 1,139 |
| ***Statement of comprehensive income:*** | | |
| Interest expense and similar charges | **28** | 84 |
| Salary expenses | **1,469** | 2,074 |

The foreign currency positions and interest rates of transactions with related parties as at 31 December 2010 are as follows:

| | **UAH** | **Interest rate** | **USD** | **Interest rate** | **EUR** | **Interest rate** |
|---|---|---|---|---|---|---|
| **Balances with shareholders and other entities under common control** | | | | | | |
| Subordinated debt | **-** | **-** | **33,092** | **10.6%** | **-** | **-** |
| **Balances with key management personnel** | | | | | | |
| Current accounts | **27** | **0.3%** | **1,666** | **0.3%** | **109** | **0.3%** |
| Deposits | **-** | **-** | **1,642** | **6.9%** | **-** | **-** |

The foreign currency positions and interest rates of transactions with related parties as at 31 December 2009 are as follows:

| | UAH | Interest rate | USD | Interest rate | EUR | Interest rate |
|---|---|---|---|---|---|---|
| **Balances with shareholders and other entities under common control** | | | | | | |
| Subordinated debt | - | - | 31,930 | 10.6% | - | - |
| **Balances with key management personnel** | | | | | | |
| Current accounts | 35 | 4.1% | 223 | 3.6% | 2 | 1.0% |
| Deposits | 207 | 22.0% | 932 | 9.8% | - | - |

The contractual remaining maturities of balances with related parties as at 31 December 2010 are as follows:

| *(in thousands of UAH)* | **Within one month** | **From one to three months** | **From three months to one year** | **From one to five years** | **More than five years** | **Total** |
|---|---|---|---|---|---|---|
| **Balances with shareholders and other entities under common control** | | | | | | |
| Subordinated debt | **189** | **-** | **-** | **32,903** | **-** | **33,092** |
| **Balances with key management personnel** | | | | | | |
| Current accounts | **1,802** | **-** | **-** | **-** | **-** | **1,802** |
| Deposits | **-** | **-** | **1,642** | **-** | **-** | **1,642** |

The contractual remaining maturities of balances with related parties as at 31 December 2009 are as follows:

| *(in thousands of UAH)* | Within one month | From one to three months | From three months to one year | From one to five years | More than five years | Total |
|---|---|---|---|---|---|---|
| **Balances with shareholders and other entities under common control** | | | | | | |
| Subordinated debt | 189 | - | - | - | 31,741 | 31,930 |
| **Balances with key management personnel** | | | | | | |
| Current accounts | 260 | - | - | - | - | 260 |
| Deposits | 131 | 882 | 126 | - | - | 1,139 |

Key management personnel are those individuals that have the authority and responsibility for planning, directing and controlling the activities of the Bank directly or indirectly, and includes members of the Board of Management.

# 32 Estimation of fair value

## (a) Financial instruments not measured at fair value

The estimated fair values of financial assets and liabilities are determined using discounted cash flow and other appropriate valuation methodologies and may not be indicative of the fair value of those instruments at the date these financial statements are distributed. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular financial instrument. Fair value estimates are based on judgments regarding future expected cash flows, current economic conditions, risk characteristics of various financial instruments and other factors.

Fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities not considered financial instruments. In addition, tax ramifications related to the realization of the unrealized gains and losses can have an effect on fair value estimates and have not been considered.

The fair values of all financial assets and liabilities are estimated to approximate their carrying values due to their short-term nature and market interest rates at period end.

## (b) Fair value hierarchy

The Bank measures fair values for financial instruments recorded on the statement of financial position using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs, either directly (i.e, as prices) or indirectly (i.e, derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible.

The estimates of fair value are intended to approximate the amount for which a financial instrument can be exchanged between knowledgeable, willing parties in an arm's length transaction. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realisable in an immediate sale of the assets or settlement of liabilities.

Assets and liabilities measured at fair value by hierarchy levels are as follows:

| *(in thousands of UAH)* | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| **31 December 2010** | | | | |
| Derivative financial instruments | | **851** | | |

| *(in thousands of UAH)* | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| 31 December 2009 | | | | |
| Derivative financial instruments | | 4 | | |

As at 31 December 2010 and 2009, the Bank does not have any financial instruments for which fair value is based on valuation techniques involving the use of non-market observable inputs.

# 33 Events after the reporting period

## (a) Increase of share capital

Subsequent to 31 December 2010, shareholders decided to increase the share capital of the Bank by UAH 15,870 thousand by issuing additional 15,870 thousand shares with a par value of UAH 1. As at the date of these financial statements, the share capital amounting to UAH 15,870 thousand was not paid in.

## (b) Increase of subordinated debt

Subsequent to 31 December 2010, the Bank obtained a long-term subordinated loan from the Parent Company amounting to USD 500 thousand. The subordinated loan matures in July 2016 and bears interest rate of 6.11% per annum.

18 May 2011

| | |
|---|---|
| Mr. Adnan Anacali | Mr. Igor Kuzmenko |
| Head of the Board | Chief Accountant |

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# Independent Auditors' Report

To the Board of Directors
Public Joint-Stock Company West Finance and Credit Bank

We have audited the accompanying financial statements of Public Joint-Stock Company West Finance and Credit Bank ("the Bank"), which comprise the statement of financial position as at 31 December 2010, and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Financial Statements*

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

*Auditors' Responsibility*

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

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

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

*Basis for Qualified Opinion*

In note 21, management asserted that financial aid received in 2009 amounting to UAH 11,984 thousand is not a transaction with a related party. We were unable to satisfy ourselves that financial aid received amounting to UAH 11,984 thousand is not a transaction with a related party and that this transaction is not a transaction with the Bank's owners acting in their capacity as Bank's owners. Accordingly, we were unable to determine whether disclosures of related party transactions as shown in the note 31 of the accompanying financial statements are accurate and complete and whether any adjustments might have been found necessary to financial aid received, taxation, net profit and retained earnings as at and for the year ended 31 December 2009. Our opinion on the financial statements as at and for the year ended 31 December 2009 dated 10 June 2010 was modified accordingly. Our opinion on the current year's financial statements is also modified because of the possible effects of this matter on the comparability of the current year's figures and the corresponding figures.

*Qualified opinion*

In our opinion, except for the possible effects on the corresponding figures and related disclosures as at and for the year ended 31 December 2009 and the possible effects on the comparability of the current year's figures of the matter described in the Basis for Qualified Opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

JSC KPMG Audit

JSC KPMG Audit
18 May 2011