

**BANK PIVDENNYI**

**Financial Statements and Auditors' Report**

**31 December 2003**

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## AUDITORS' REPORT

To the Shareholders and Board of Directors of Bank Pivdennyi:

- 1 We have audited the accompanying balance sheet of Bank Pivdennyi (the "Bank") as at 31 December 2003, and the related statements of income, of cash flows and of changes in shareholders' equity for the year then ended. These financial statements set out on pages 1 to 30 are the responsibility of the Bank's Management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2003 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*PricewaterhouseCoopers*

Kyiv, Ukraine  
30 April 2004



Auditor L. Pakhucha

Audit certificate category B # 000222 issued by the Auditors' Chamber of Ukraine

**Bank Pivdennyi**  
**Balance Sheet as at 31 December 2003**  
*(in thousands of Ukrainian hryvnias)*

	Note	2003	2002
<b>Assets</b>			
Cash and cash equivalents and mandatory reserve balances	5	121,254	79,829
Due from other banks	6	25,606	33,813
Loans and advances to customers	7	947,081	724,364
Investment securities available-for-sale	8	27,649	3,256
Other assets	9	2,907	4,361
Deferred tax asset	20	1,197	506
Premises and equipment	10	41,534	34,048
<b>Total assets</b>		<b>1,167,228</b>	<b>880,177</b>
<b>Liabilities</b>			
Due to the Central Bank	11	16,400	24,200
Due to other banks	12	98,021	70,930
Customer accounts	13	897,520	694,633
Deposit certificates		17,024	45
Subordinated debt	14	11,345	11,574
Other liabilities	15	8,100	10,052
<b>Total liabilities</b>		<b>1,048,410</b>	<b>811,434</b>
<b>Shareholders' equity</b>			
Share capital	16	108,898	66,706
Retained earnings		9,920	2,037
<b>Total shareholders' equity</b>		<b>118,818</b>	<b>68,743</b>
<b>Total liabilities and shareholders' equity</b>		<b>1,167,228</b>	<b>880,177</b>

Approved for issue by the Board of Directors and signed on its behalf on 30 April 2004.



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Vadim V. Morohkovskiy  
Chairman of the Board



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Ludmila V. Kovalenok  
Chief Accountant

**Bank Pivdennyi**  
**Statement of Income for the Year Ended 31 December 2003**  
*(in thousands of Ukrainian hryvnias)*

	Note	2003	2002 (restated)
Interest income	17	164,489	125,476
Interest expense	17	(94,127)	(62,804)
<b>Net interest income</b>		<b>70,362</b>	<b>62,672</b>
Provision for loan impairment	6,7	(28,350)	(36,053)
<b>Net interest income after provision for loan impairment</b>		<b>42,012</b>	<b>26,619</b>
(Losses less gains)/gains less losses arising from investment securities available-for-sale		(924)	920
Gains less losses arising from trading in foreign currencies		4,570	4,158
Foreign exchange translation gains less losses/(losses less gains)		31	(2)
Fee and commission income	18	37,420	33,317
Fee and commission expense	18	(2,521)	(2,982)
Losses on origination of assets at rates below market	7	(1,544)	-
Gains on origination of liabilities at rates below market	13	3,120	-
Recovery of provision /(provision) for losses on credit related commitments	22	3,542	(5,208)
Other operating income		256	273
<b>Operating income</b>		<b>85,962</b>	<b>57,095</b>
Operating expenses	19	(52,351)	(41,256)
<b>Profit before taxation</b>		<b>33,611</b>	<b>15,839</b>
Income tax expense	20	(10,828)	(5,890)
<b>Net profit</b>		<b>22,783</b>	<b>9,949</b>

**Bank Pivdennyi**  
**Statement of Cash Flows for the Year Ended 31 December 2003**  
*(in thousands of Ukrainian hryvnias)*

	Note	2003	2002
<b>Cash flows from operating activities</b>			
Interest received		165,597	122,160
Interest paid		(91,231)	(60,613)
Income received from trading in foreign currencies		4,570	4,158
Fees and commissions received		37,420	33,317
Fees and commissions paid		(2,521)	(2,982)
Other operating income received		256	273
Operating expenses paid		(45,183)	(35,995)
Income tax paid		(9,092)	(5,692)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>		<b>59,816</b>	<b>54,626</b>
<b>Changes in operating assets and liabilities</b>			
Net increase in mandatory reserve balances		(7,511)	(4,017)
Net decrease/(increase) in due from other banks		8,655	(8,511)
Net increase in loans and advances to customers		(256,814)	(377,102)
Net decrease in other assets		1,333	2,904
Net increase/(decrease) in due to other banks		26,666	(34,640)
Net increase in customer accounts		204,051	327,858
Net increase/(decrease) in deposit certificates		16,237	(1,559)
Net increase/(decrease) in other liabilities		2,476	(1,234)
<b>Net cash from/(used in) operating activities</b>		<b>54,909</b>	<b>(41,675)</b>
<b>Cash flows from investing activities</b>			
Acquisition of investment securities available-for-sale	8	(56,037)	(134,518)
Proceeds from disposal of investment securities available-for-sale		30,720	155,338
Acquisition of premises, leasehold improvements and equipment	10	(13,733)	(15,672)
Proceeds from disposal of equipment		76	210
<b>Net cash (used in)/from investing activities</b>		<b>(38,974)</b>	<b>5,358</b>
<b>Cash flows from financing activities</b>			
Issue of ordinary shares		32,192	15,000
(Decrease)/increase in borrowings from the Central Bank		(7,800)	10,486
Distributed profit		(7,000)	(5,000)
Disposal of treasury shares		-	70
<b>Net cash from financing activities</b>		<b>17,392</b>	<b>20,556</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>		<b>587</b>	<b>104</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>33,914</b>	<b>(15,657)</b>
Cash and cash equivalents as at the beginning of the year		26,476	42,133
<b>Cash and cash equivalents as at the end of the year</b>		<b>60,390</b>	<b>26,476</b>

**Bank Pivdennyi****Statement of Changes in Shareholders' Equity for the Year Ended 31 December 2003***(in thousands of Ukrainian hryvnias)*

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	Note	Share capital	Retained earnings	Total shareholders' equity
<hr/>				
<b>Balance as at 1 January 2002</b>		<b>42,736</b>	<b>4,488</b>	<b>47,224</b>
Issue of ordinary shares		15,000	-	15,000
Disposal of treasury shares		70	-	70
Dividends capitalised		8,900	(8,900)	-
Distributed profit, net of tax effect (restated)	3	-	(3,500)	(3,500)
Net profit for the year (restated)	3	-	9,949	9,949
<hr/>				
<b>Balance as at 31 December 2002</b>		<b>66,706</b>	<b>2,037</b>	<b>68,743</b>
Issue of ordinary shares		32,192	-	32,192
Dividends capitalised		10,000	(10,000)	-
Distributed profit, net of tax effect	16	-	(4,900)	(4,900)
Net profit for the year		-	22,783	22,783
<hr/>				
<b>Balance as at 31 December 2003</b>		<b>108,898</b>	<b>9,920</b>	<b>118,818</b>

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## **1 Principal Activities**

Bank Pivdennyi (the “Bank”) was founded in 1993 as a closed-type joint stock entity. The Bank is registered in Ukraine to carry out banking and foreign exchange activities and operates under a banking license issued by the National Bank of Ukraine (NBU). The Bank’s principal business activity is commercial and retail banking operations within Ukraine. As at 31 December 2003 major shareholders of the Bank are six Ukrainian companies and seven individuals which collectively own over 60% and over 31% of the outstanding shares, respectively (31 December 2002: six Ukrainian companies and three individuals owned over 83% and 14% of the outstanding shares, respectively).

The Bank has 11 branches located in Ukraine (2002: 11 branches). The Bank’s principal place of business is in Odessa.

The Bank’s registered office is located at the following address:

2, Sabansky Lane,  
65014, Odessa,  
Ukraine.

The number of the Bank’s employees as at 31 December 2003 was 917 (2002: 837).

## **2 Operating Environment of the Bank**

Ukraine continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible outside of Ukraine, restrictive currency controls, and relatively high inflation. The tax, currency and customs legislation within Ukraine is subject to varying interpretations, and changes, which can occur frequently.

Additionally, the banking sector in Ukraine is particularly impacted by adverse currency fluctuations, political instability and economic conditions. Furthermore, the need for further developments in the anti-money laundering legislation, bankruptcy laws, in formalised procedures for the registration and enforcement of collateral, and other legal and fiscal impediments contribute to the difficulties experienced by banks currently operating in Ukraine.

Whilst there have been improvements in the economic trends, the future economic direction of Ukraine is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government, together with tax, legal, regulatory, and political developments.

In addition, economic conditions continue to limit the volume of activity in the financial markets. Market quotations may not be reflective of the values for financial instruments, which would be determined in an efficient, active market.

## **3 Basis of Preparation**

**Basis of Preparation.** These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board, including International Accounting Standards (“IAS”) issued by the International Accounting Standards Committee and Interpretations issued by the Standing Interpretations Committee. The Bank maintains its accounting records in accordance with Ukrainian banking and accounting regulations. These financial statements have been prepared from those accounting records and adjusted as necessary in order to comply with IFRS.

These financial statements have been measured in the national currency of Ukraine, hryvnia (“UAH”).

The preparation of these financial statements requires the use of estimates and assumptions that effect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Although these estimates are based on Management’s best knowledge of current events and actions, actual results ultimately may differ from those estimates.

### **3 Basis of Presentation (Continued)**

Where necessary, corresponding figures have been adjusted to conform with changes in the presentation of the current year. Accrued interest income previously disclosed separately and accrued interest expense previously disclosed along with other liabilities are presented within the related balance sheet items in these financial statements.

**Correction of error.** During 2003 the Bank discovered that the tax effect of the distributed profit for 2002 was incorrectly reflected in the statement of income for the respective period. As a result the tax charge for 2002 was understated by UAH 1,500 thousand and profit for 2002 was overstated by UAH 1,500 thousand. There was no impact on the previously reported shareholders' equity as at 31 December 2002. The financial statements as at and for the year ended 31 December 2002 have been restated in 2003 to correct this error in accordance with IAS 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies".

### **4 Significant Accounting Policies**

**Cash and cash equivalents.** Cash and cash equivalents are items which can be converted into cash at short notice and which are subject to an insignificant risk of changes in value. All short term interbank placements, beyond overnight placements, are included in due from other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents.

**Mandatory reserve balances.** Mandatory reserve balances represent mandatory reserve assets which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the cash flow statement.

**Sale and repurchase agreements.** Sale and repurchase agreements ("repos") are treated as secured financing transactions. Securities purchased under agreements to resell ("reverse repo") are recorded as loans and advances to customers. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method.

**Originated loans and advances and provisions for loan impairment.** Loans originated by the Bank by providing money directly to the borrower or to a sub-participation agent at draw down, other than those that are originated with the intent of being sold immediately or in the short-term which are recorded as trading assets, are categorised as originated loans.

Originated loans and advances are recorded when cash is advanced to borrowers. Initially, originated loans and advances are recorded at cost, which is the fair value of the consideration given, and subsequently are carried at amortised cost less provision for loan impairment. Amortised cost is based on the fair value of cash consideration given to originate those loans determinable by reference to market prices at origination date.

Loans originated at interest rates different from market rates are remeasured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar loans. The difference between the fair value and the nominal value at origination is credited or charged to the statement of income as gains on origination of assets at rates above market or losses on origination of assets at rates below market. Subsequently, the carrying amount of such loans is adjusted for amortisation of the gains/losses on origination and the related income is recorded as interest income within the statement of income using the effective yield method.

A credit risk provision for loan impairment is established if there is objective evidence that the Bank will not be able to collect the amounts due according to original contractual terms. The amount of the provision is the difference between the carrying amount and estimated recoverable amount, calculated as the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the instrument's original effective interest rate.

The provision for loan impairment also covers losses where there is objective evidence that probable losses are present in components of the loan portfolio at the balance sheet date. These have been estimated based upon historical patterns of losses in each component, the credit ratings assigned to the borrowers and reflect the current economic environment in which the borrowers operate.

When a loan is uncollectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to the provision for loan impairment in the statement of income.

#### **4 Significant Accounting Policies (Continued)**

If the amount of the provision for loan impairment subsequently decreases due to an event occurring after the write-down, the release of the provision is credited to the provision for loan impairment in the statement of income.

The Bank does not enter into transactions for purchases of loans with third parties.

**Other credit related commitments.** In the normal course of business, the Bank enters into other credit related commitments including commitments to extend credit, letters of credit and guarantees. Specific provisions are recorded against other credit related commitments when losses are considered probable.

**Promissory notes purchased.** Promissory notes purchased are included in investment securities available-for-sale or in loans and advances to customers, depending on their substance and are recorded and subsequently remeasured and accounted in accordance with the accounting policies for these categories of assets.

**Investment securities available-for-sale.** This classification includes investment securities which Management intends to hold for an indefinite period of time, that may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Management determines the appropriate classification of its investment securities at the time of purchase.

Investment securities available-for-sale are initially recorded at cost (which includes transaction costs) and subsequently remeasured to fair value based on quoted bid prices. Certain investment securities available-for-sale for which there is no available external independent quotation have been fair valued by Management on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies. Realised and unrealised gains and losses arising from changes in the fair value of investment securities available-for-sale are included in the statement of income in the period in which they arise. Interest earned on investment securities available-for-sale is reflected in the statement of income as interest income on investment securities available-for-sale. Dividends received are included in dividend income within the statement of income.

All purchases and sales of investment securities available-for-sale that require delivery within the time frame established by regulation or market convention (“regular way” purchases and sales) are recognised at settlement date, which is the date when the ownership right for securities is transferred to/by the Bank.

**Premises and equipment.** Premises and equipment acquired after 31 December 2000 are stated at cost less accumulated depreciation and provision for impairment, where required. Premises and equipment acquired prior to 31 December 2000 are stated at cost, restated to the equivalent of purchasing power of the Ukrainian hryvnia at 31 December 2000 less accumulated depreciation and provision for impairment, where required.

At each reporting date the Bank assesses whether there is any indication of impairment of premises, leasehold improvements and equipment. If any such indication exists, the Bank estimates the recoverable amount, which is determined as the higher of an asset’s net selling price or its value in use. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount and the difference is charged to the statement of income. An impairment loss recognised for an asset in prior years is reversed if there has been a change in the estimates used to determine the assets recoverable amount.

Gains and losses on disposal of premises and equipment are determined by reference to their carrying amount and are taken into account in determining profit. Repairs and maintenance are charged to the statement of income when the expenditure is incurred.

**Depreciation.** Depreciation is applied on a straight-line basis over the estimated useful lives of the assets as follows:

Premises	20 years
Furniture and equipment	5 years
Motor vehicles	5 years
Computers	4 years

**Operating leases.** Where the Bank is the lessee, the total lease payments, including those on expected termination, are charged by the lessee to the statement of income on a straight-line basis over the period of the lease.

**Borrowings.** Borrowings are recorded initially at “cost”, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Subsequently, borrowings are stated at amortised cost and any difference between net proceeds and the redemption value is recorded in the statement of income over the period of the borrowings using the effective yield method.

#### **4 Significant Accounting Policies (Continued)**

Borrowings originated at interest rates different from market rates are remeasured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar borrowings. The difference between the fair value and the nominal value at origination is credited or charged to the statement of income as gains on origination of liabilities at rates below market or losses on origination of liabilities at rates above market. Subsequently, the carrying amount of such borrowings is adjusted for amortisation of the gains/losses on origination and the related expense is recorded as interest expense within the statement of income using the effective yield method.

**Debt securities in issue.** Debt securities in issue represent certificates of deposit issued by the Bank. Debt securities in issue are recorded initially at cost, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. Subsequently, debt securities in issue are stated at amortised cost and any difference between net proceeds and the redemption value is recorded in the statement of income over the period of the security issue using the effective yield method.

If the Bank purchases its own debt securities in issue, they are removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains arising from retirement of debt.

**Accrued interest income and accrued interest expense.** Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount, are included in the carrying values of related balance sheet items.

**Distributed profit.** Distributed profit is recorded in equity in the period in which cash was transferred to shareholders.

**Dividends.** Dividends are recorded in equity in the period in which they are declared. Dividends declared after the balance sheet date are disclosed in the subsequent events note. The statutory accounting reports of the Bank are the basis for profit distribution and other appropriations. Ukrainian legislation defines the basis for distribution as the retained earnings.

**Income taxes.** Taxation has been provided for in the financial statements in accordance with Ukrainian legislation currently in force. The income tax charge in the statement of income for the year comprises current tax and changes in deferred tax. Current tax is calculated on the basis of the expected taxable profit for the year, using the tax rates enacted at the balance sheet date. Taxes, other than on income, are recorded within operating expenses.

Deferred income tax is provided, using the balance sheet asset and liability method, for all temporary differences arising between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are recorded to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

**Income and expense recognition.** Interest income and expense are recorded in the statement of income for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. Interest income includes coupons earned on fixed income securities and accrued discount and premium on promissory notes and other discounted instruments. When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recorded based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

Fees, commissions and other income and expense items are generally recorded on an accrual basis when the service has been provided. Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, are recorded on completion of the underlying transaction.

**Foreign currency translation.** Transactions denominated in foreign currency are recorded at the exchange rate ruling on the transaction date. Exchange differences resulting from the settlement of transactions denominated in foreign currency are included in the statement of income using the exchange rate ruling on that date.

#### **4 Significant Accounting Policies (Continued)**

Monetary assets and liabilities denominated in foreign currency are translated into Ukrainian hryvnias at the official exchange rate of the NBU at the balance sheet date. Foreign currency gains less losses arising from the translation of assets and liabilities are reflected in the statement of income as foreign exchange translation gains less losses.

As at 31 December 2003 the principal rates of exchange used for translating foreign currency balances were:

	<b>31 December 2003, UAH</b>	<b>31 December 2002, UAH</b>
1 USD	5.331500	5.332400
1 EUR	6.662242	5.532898

Exchange restrictions and controls exist relating to converting Ukrainian hryvnia into other currencies. At present, Ukrainian hryvnia is not a convertible currency outside Ukraine.

**Fiduciary activities.** Assets and liabilities held by the Bank in its own name, but for the account of third parties, are not reported on the balance sheet. Commissions received from such business are shown in fee and commission income within the statement of income.

**Offsetting.** Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

**Accounting for the effects of hyperinflation.** Prior to 2001 Ukraine experienced relatively high levels of inflation.

In accordance with IAS 29, when an economy ceases to be hyperinflationary and an enterprise is not required to prepare and present financial statements in accordance with IAS 29, it should treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements. Those non-monetary items that arise in the periods of hyperinflation need to be restated in terms of the purchasing power of Ukrainian hryvnia at the end of the reporting period.

This restatement was prepared by indexing the historical balances by changes in the general price index up to 31 December 2000.

Monetary assets and liabilities are not restated because they are already expressed in terms of the monetary unit current at the year end. Non-monetary assets and liabilities (items which are not expressed in terms of the monetary unit current at the year end) are restated by applying the relevant conversion factor. The effect of inflation on the Bank's net monetary position in 2000 and prior years is included in retained earnings as a monetary gain or loss.

Premises and equipment purchased prior to 31 December 2000 have been indexed by the change in the general price index from the date of purchase. Where indexation is applied, an assessment has been made of the potential impairment and diminution in the carrying value of these assets and, where applicable, such assets have been reduced to their recoverable amounts.

The components of equity, except retained earnings, were restated by applying a general price index from the dates the components were contributed to 31 December 2000. Retained earnings are restated as a consequence of restating of other amounts in the balance sheet.

**Provisions.** Provisions are recorded when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

**Staff costs and related contributions.** The Bank contributions to the Ukrainian state pension and social insurance funds in respect of its employees are expensed as incurred and included into staff costs.

**5 Cash and Cash Equivalents and Mandatory Reserve Balances**

	<b>2003</b>	<b>2002</b>
Cash on hand	55,130	28,388
Balance with the NBU	55,592	47,982
Correspondent accounts and overnight placements with other banks	10,532	3,459
<b>Total cash and cash equivalents and mandatory reserve balances</b>	<b>121,254</b>	<b>79,829</b>

In 2003 the mandatory reserve balance is calculated on the basis of a simple average over a monthly period (2002: monthly period) and should be maintained at the level of 0 to 12 per cent (2002: 0 to 12 percent) of certain obligations of the Bank. As such, the balance can vary from day-to-day. As at 31 December 2003 the Bank's mandatory reserve balance was UAH 60,864 thousand (2002: UAH 53,353 thousand). The Bank may satisfy its mandatory reserve requirement with a combination of its balance on account with the NBU and up to 40% of UAH cash on hand and 20% of foreign currency cash on hand.

As the respective liquid assets are not available to finance the Bank's day-to-day operations, for the purposes of the cash flow statement, the mandatory reserve balance is excluded from cash and cash equivalents. As at 31 December 2003 the Bank's cash and cash equivalents for the purposes of cash flow statement equalled UAH 60,390 thousand (2002: UAH 26,476 thousand).

The geographical and currency analyses of cash and cash equivalents and mandatory reserve balances are disclosed in Note 21.

**6 Due from Other Banks**

	<b>2003</b>	<b>2002</b>
Current term placements with other banks	8,178	13,611
Guarantee deposits with other banks	17,659	20,766
Less: Provision for impairment of due from other banks	(231)	(564)
<b>Total due from other banks</b>	<b>25,606</b>	<b>33,813</b>

Guarantee deposits represent balances placed with other banks as cover for letters of credit and for international payments. These are effectively restricted deposits, which are required to be maintained to complete the related trade financing activity.

Movements in the provision for impairment of due from other banks are as follows:

	<b>2003</b>	<b>2002</b>
<b>Provision for impairment of due from other banks as at 1 January</b>	<b>564</b>	<b>295</b>
(Recovery of)/provision for impairment of due from other banks during the year	(333)	269
<b>Provision for impairment of due from other banks as at 31 December</b>	<b>231</b>	<b>564</b>

As at 31 December 2003 the estimated fair value of due from other banks was UAH 25,606 thousand (2002: UAH 33,813 thousand). Refer to Note 23.

Geographical, currency, maturity and interest rate analyses of due from other banks are disclosed in Note 21.

**7 Loans and Advances to Customers**

	<b>2003</b>	<b>2002</b>
Current loans	1,022,507	737,239
Rescheduled loans	21,234	20,257
Reverse sale and repurchase agreements	3,175	33,815
Overdue loans	2,112	7,048
Less: Provision for loan impairment	(101,947)	(73,995)
<b>Total loans and advances to customers</b>	<b>947,081</b>	<b>724,364</b>

Included in the balance of loans and advances to customers is an amount of UAH 39,800 thousand (2002: UAH 40,583 thousand) relating to loans pledged by the Bank in respect of loans received from the Central Bank (Note 11).

During 2003 a loss on origination of loans at rates below market in the amount of UAH 1,544 thousand (2002: nil) has been recorded in the statement of income.

## 7 Loans and Advances to Customers (Continued)

Movements in the provision for loan impairment are as follows:

	<b>2003</b>	<b>2002</b>
<b>Provision for loan impairment as at 1 January</b>	<b>73,995</b>	<b>47,116</b>
Provision for loan impairment during the year	28,683	35,784
Loans and advances to customers written off during the year as uncollectable	(731)	(8,905)
<b>Provision for loan impairment as at 31 December</b>	<b>101,947</b>	<b>73,995</b>

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

	<b>2003</b>		<b>2002</b>	
	<b>Amount</b>	<b>%</b>	<b>Amount</b>	<b>%</b>
Trade and commerce	649,553	62	491,842	62
Manufacturing	137,946	13	101,070	13
Agriculture and food industry	110,876	11	84,817	10
Transport and communication	38,522	4	58,066	7
Individuals	31,761	3	13,521	2
Other	80,370	7	49,043	6
<b>Total loans and advances to customers (aggregate amount)</b>	<b>1,049,028</b>	<b>100</b>	<b>798,359</b>	<b>100</b>

At 31 December 2003 the Bank has 14 borrowers with aggregated loan amounts above UAH 10,000 thousand each (2002: 16 borrowers with aggregated loan amounts above UAH 10,000 thousand each). The aggregate amount of these loans is UAH 365,754 thousand or 35 % of the gross loan portfolio (2002: UAH 225,065 thousand or 28% of the loan portfolio).

As at 31 December 2003 the estimated fair value of loans and advances to customers was UAH 939,190 thousand (2002: UAH 724,227 thousand). Refer to Note 23. Whilst the carrying amount of loans and advances to customers exceeds their fair value by UAH 7,891 thousand, Management believes that the carrying amount would be recovered. In assessing the recoverability of the carrying amount, Management has taken account of the fact that the difference mainly relates to cash covered loans which are provided at lower rates, as they are collateralised by customer deposits provided at similarly lower rates.

Geographical, currency, maturity and interest rate analyses of loans and advances to customers are disclosed in Note 21. The information on related party balances is disclosed in Note 24.

## 8 Investment Securities Available-for-Sale

	<b>2003</b>	<b>2002</b>
Corporate bonds	18,765	3,035
Corporate shares	5,087	101
Promissory notes	3,797	120
<b>Total investment securities available-for-sale</b>	<b>27,649</b>	<b>3,256</b>

Corporate bonds represent bonds of Ukrainian entities, traded on the Ukrainian over-the-counter market (PFTS). Fair value of those corporate bonds was determined based on quoted bid prices.

## 8 Investment Securities Available-for-Sale (Continued)

Corporate shares are shares of Ukrainian enterprises. The majority of corporate shares are traded on the Ukrainian over-the-counter market (PFTS). Fair value of quoted corporate shares was determined based on quoted bid prices.

Corporate shares for which there is no available external independent quotation have been fair valued by Management on the basis of results of recent sales of these shares between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of investees.

Included in investment securities available-for-sale are corporate bonds and promissory notes of one Ukrainian entity totalling UAH 18,598 thousand and UAH 1,000 thousand respectively (2002: nil).

The movements in investment securities available-for-sale are as follows:

	2003	2002
<b>Carrying amount as at 1 January</b>	<b>3,256</b>	<b>23,156</b>
Movement in fair value reserve for investment securities available-for-sale	(1,093)	920
Acquisition of investment securities available-for-sale	56,037	134,518
Disposal of investment securities available-for-sale	(30,551)	(155,338)
<b>Carrying amount as at 31 December</b>	<b>27,649</b>	<b>3,256</b>

Geographical, currency, maturity and interest rate analyses of investment securities available-for-sale are disclosed in Note 21. The information on related party debt investment securities available-for-sale is disclosed in Note 24.

## 9 Other Assets

	2003	2002
Trade debtors and prepayments	1,196	3,098
Prepayment for operating lease	1,379	-
Taxes receivable	56	-
Receivables on financial services rendered	9	598
Other	267	665
<b>Total other assets</b>	<b>2,907</b>	<b>4,361</b>

Geographical, currency and maturity analyses of other assets are disclosed in Note 21. The information on related party balances is disclosed in Note 24.

## 10 Premises and Equipment

	Note	Premises	Furniture and equipment	Computers	Motor vehicles	Other	Total
<b>Net book amount as at 31 December 2002</b>		<b>22,130</b>	<b>3,504</b>	<b>4,548</b>	<b>2,356</b>	<b>1,510</b>	<b>34,048</b>
<b>Book amount at cost</b>							
Opening balance		24,894	6,687	9,848	3,266	3,629	48,324
Additions		8,715	925	2,254	1,398	441	13,733
Disposals		-	(48)	(210)	(197)	(443)	(898)
<b>Closing balance</b>		<b>33,609</b>	<b>7,564</b>	<b>11,892</b>	<b>4,467</b>	<b>3,627</b>	<b>61,159</b>
<b>Accumulated depreciation</b>							
Opening balance		2,764	3,183	5,300	910	2,119	14,276
Depreciation charge	19	1,246	1,270	1,970	769	962	6,217
Disposals		-	(48)	(204)	(192)	(424)	(868)
<b>Closing balance</b>		<b>4,010</b>	<b>4,405</b>	<b>7,066</b>	<b>1,487</b>	<b>2,657</b>	<b>19,625</b>
<b>Net book amount as at 31 December 2003</b>		<b>29,599</b>	<b>3,159</b>	<b>4,826</b>	<b>2,980</b>	<b>970</b>	<b>41,534</b>

## 11 Due to the Central Bank

The Bank has pledged loans to customers for the amount of UAH 39,800 thousand (2002: UAH 40,583 thousand) as security for loans received from the Central Bank (Note 7).

As at 31 December 2003 the estimated fair value of due to the Central Bank was UAH 16,400 thousand (2002: UAH 24,200 thousand). Refer to Note 23.

Currency, maturity and interest rate analyses of due to the Central Bank are disclosed in Note 21.

## 12 Due to Other Banks

	2003	2002
Correspondent accounts and overnight placements of other banks	21,429	2,529
Term placements of other banks	76,592	68,401
<b>Total due to other banks</b>	<b>98,021</b>	<b>70,930</b>

## 12 Due to Other Banks (Continued)

Included in the total amount of due to other banks is a balance from a bank, located in Latvia, of UAH 47,234 thousand (2002:nil) (Note 24).

As at 31 December 2003 the estimated fair value of due to other banks was UAH 98,021 thousand (2002: UAH 70,930 thousand). Refer to Note 23.

Geographical, currency, maturity and interest rate analyses of due to other banks are disclosed in Note 21.

## 13 Customer Accounts

	2003	2002
<b>Corporate customers</b>		
- Current/settlement accounts	237,395	264,009
- Term deposits	278,482	164,658
<b>Individuals</b>		
- Current/demand accounts	63,481	37,730
- Term deposits	318,162	228,236
<b>Total customer accounts</b>	<b>897,520</b>	<b>694,633</b>

During 2003 a gain on origination of term deposits at rates below market in the amount of UAH 3,120 thousand (2002: nil) has been recorded in the statement of income.

Economic sector concentrations within customer accounts are as follows:

	2003		2002	
	Amount	%	Amount	%
Individuals	381,643	43	265,966	38
Trade and commerce	242,038	27	168,505	24
Manufacturing	110,725	12	37,529	6
Finance and insurance	101,430	11	79,303	12
Transport and communication	47,027	5	71,598	10
Other	14,657	2	71,732	10
<b>Total customer accounts</b>	<b>897,520</b>	<b>100</b>	<b>694,633</b>	<b>100</b>

As at 31 December 2003 the Bank has 8 customers with balances above UAH 10,000 thousand each. The aggregate balance of these customers is UAH 183,580 thousand or 20 % of total customer accounts (2002: 6 customers with an aggregated balance on current and deposit accounts above UAH 10,000 thousand totalling UAH 163,684 thousand or 24% of customer accounts).

As at 31 December 2003 included in customer accounts are deposits of UAH 1,354 thousand (2002: UAH 779 thousand) held as collateral for irrevocable commitments under issued guarantees and import letters of credit.

As at 31 December 2003 the estimated fair value of customer accounts was UAH 896,196 thousand (UAH 691,436 thousand). Refer to Note 23.

Geographical, currency, maturity and interest rate analyses of customer accounts are disclosed in Note 21. The information on related party balances is disclosed in Note 24.

## 14 Subordinated Debt

Subordinated debt is a debt that in case of the Bank's default would be secondary to the Bank's primary debt obligations. In accordance with the Law of Ukraine on Banks and Banking Activities, subordinated debt cannot be withdrawn from the bank for at least five years from the date of receipt. The subordinated debt was issued on 28 April 2000 with a nominal value of USD 2,100 thousand (UAH 11,196 thousand) and contractual maturity of 28 April 2005, bearing 13% per annum. On 28 February 2003 the Bank changed the interest rate of subordinated debt to LIBOR+4% per annum. As at 31 December 2003 the carrying value of the subordinated debt was UAH 11,345 thousand (2002: UAH 11,574 thousand).

On 30 January 2004 the subordinated debt was repaid by the Bank, following the receipt of permission from the Central Bank (Note 25).

Geographical, currency, maturity and interest rate analyses of the subordinated debt are disclosed in Note 21.

As at 31 December 2003 the estimated fair value of subordinated debt was UAH 11,154 thousand (2002: UAH 10,543 thousand). Refer to Note 23.

## 15 Other Liabilities

	Note	2003	2002
Provision for losses on credit related commitments	22	2,148	5,690
Compensated interest from the State budget		2,107	-
Trade creditors		1,289	1,493
Taxation payable		1,300	2,182
Other		1,256	687
<b>Total other liabilities</b>		<b>8,100</b>	<b>10,052</b>

Compensated interest from the State budget represents interest paid in advance by the State budget under the program of support of agricultural sector in Ukraine.

Geographical, currency and maturity analyses of other liabilities are disclosed in Note 21.

## 16 Share Capital

Authorised, issued and fully paid share capital of the Bank comprises:

	2003			2002		
	Number of shares	Nominal amount	Inflation adjusted amount	Number of shares	Nominal amount	Inflation adjusted amount
Ordinary shares	100,002,200	100,002	108,898	57,810,000	57,810	66,706
<b>Total share capital</b>	<b>100,002,200</b>	<b>100,002</b>	<b>108,898</b>	<b>57,810,000</b>	<b>57,810</b>	<b>66,706</b>

All ordinary shares have a nominal value of UAH 1 per share, rank equally and carry one vote.

During the year ended 31 December 2003 the Bank has made distributions to certain shareholders in the amount of UAH 4,900 thousand net of tax effect of UAH 2,100 thousand (year ended 31 December 2002: UAH 3,500 thousand net of tax effect of UAH 1,500 thousand).

**17 Interest Income and Expense**

	<b>2003</b>	<b>2002</b>
<b>Interest income</b>		
Loans and advances to legal entities	158,673	119,751
Loans and advances to individuals	3,306	1,651
Due from other banks	1,842	601
Investment securities available-for-sale	655	3,440
Other	13	33
<b>Total interest income</b>	<b>164,489</b>	<b>125,476</b>
<b>Interest expense</b>		
Deposits of individuals	38,608	33,715
Deposits of legal entities	34,538	20,002
Placements of other banks	11,078	4,031
Current and settlement accounts	5,309	1,499
Due to the Central Bank	2,381	1,694
Deposit certificates	1,234	-
Subordinated debt	677	1,641
Other	302	222
<b>Total interest expense</b>	<b>94,127</b>	<b>62,804</b>
<b>Net interest income</b>	<b>70,362</b>	<b>62,672</b>

Information on interest income and expenses from transactions with related parties is disclosed in Note 24.

**18 Fee and Commission Income and Expense**

	<b>2003</b>	<b>2002</b>
<b>Fee and commission income</b>		
Commission on cash and settlement services	23,915	18,373
Commission on purchase and sale of foreign currency	8,868	10,757
Commission from credit services	3,729	2,313
Commission on transactions with banks	527	734
Commission on transactions with securities	156	747
Other	225	393
<b>Total fee and commission income</b>	<b>37,420</b>	<b>33,317</b>
<b>Fee and commission expense</b>		
Commission on transactions with banks	1,861	1,947
Commission on currency purchases	-	543
Other	660	492
<b>Total fee and commission expense</b>	<b>2,521</b>	<b>2,982</b>
<b>Net fee and commission income</b>	<b>34,899</b>	<b>30,335</b>

Information on fee and commission income and expenses from transactions with related parties is disclosed in Note 24.

## 19 Operating Expenses

	Note	2003	2002
Staff costs		19,884	13,131
Occupancy		7,386	4,524
Depreciation of premises and equipment	10	6,217	5,536
Taxes other than on income		4,201	3,008
Mail and telecommunication		4,164	3,355
Insurance of credit risks		2,559	4,195
Administrative expenses		2,373	1,793
Security		1,602	1,548
Advertising and marketing		1,095	777
Professional services		658	1,052
Insurance of property and equipment		102	1,172
Other		2,110	1,165
<b>Total operating expenses</b>		<b>52,351</b>	<b>41,256</b>

Information on operating expenses from transactions with related parties is disclosed in Note 24.

## 20 Income Taxes

Income tax expense comprises the following:

	2003	2002 (restated)
Current tax charge	9,419	6,155
Deferred taxation movement due to origination and reversal of temporary differences	(930)	(1,765)
Tax effect of distribution recognised directly in equity	2,100	1,500
Effect of reduction in tax rate	239	-
<b>Income tax expense for the year</b>	<b>10,828</b>	<b>5,890</b>

In 2003 and 2002 the Bank transferred funds to certain shareholders which are treated as distributed profit in these financial statements. The tax effect on the distributions is recognised directly in equity as required by IAS 12 "Income Taxes".

The income tax rate applicable to the Bank's income is 30% (2002: 30%).

## 20 Income Taxes (Continued)

A reconciliation between the expected and the actual taxation charge is provided below.

	2003	2002 (restated)
<b>IFRS profit before tax</b>	<b>33,611</b>	<b>15,839</b>
Theoretical tax charge at the applicable statutory rate	10,083	4,752
Tax effect of items which are not deductible or assessable for taxation purposes:		
- Income recognised for tax purposes only	-	25
- Non-deductible interest and commission expense	488	647
- Non-deductible payroll expense	131	59
- Non-deductible charity expense	119	81
- Non-deductible fixed assets maintenance	11	113
- Other non-temporary differences	(243)	213
- Effect of change in tax rate	239	-
<b>Income tax expense for the year</b>	<b>10,828</b>	<b>5,890</b>

Differences between IFRS and Ukrainian statutory taxation regulations give rise to certain temporary differences between the carrying amount of certain assets and liabilities for financial reporting purposes and for profits tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 25% (2002: 30%). According to the Law of Ukraine on Amendments to Corporate Profit Tax Law, the corporate tax rate decreased to 25% from 1 January 2004.

	2001	Movement	2002	Movement	2003
<b>Tax effect of deductible temporary differences</b>					
Loan impairment provision	614	2,301	2,915	(573)	2,342
Accrued expenses	100	65	165	17	182
<b>Gross deferred tax asset</b>	<b>714</b>	<b>2,366</b>	<b>3,080</b>	<b>(556)</b>	<b>2,524</b>
<b>Tax effect of taxable temporary differences</b>					
Investment securities available-for-sale	(542)	(1,204)	(1,746)	35	(1,711)
Premises and equipment	(277)	121	(156)	473	317
Prepaid expenses	(970)	469	(501)	501	-
Gains/(losses) on origination of assets/ liabilities at rates above/below market	-	-	-	(153)	(153)
Accrued income	(184)	13	(171)	391	220
<b>Gross deferred tax liability</b>	<b>(1,973)</b>	<b>(601)</b>	<b>(2,574)</b>	<b>1,247</b>	<b>(1,327)</b>
<b>Total net deferred tax asset/(liability)</b>	<b>(1,259)</b>	<b>1,765</b>	<b>506</b>	<b>691</b>	<b>1,197</b>

## **21 Financial Risk Management**

The risk management function within the Bank is carried out in respect of financial risks (credit, market, geographical, currency, liquidity and interest rate), operational risks and legal risks. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimise operational and legal risks.

**Credit risk.** The Bank takes on exposure to credit risk which is the risk that counterparty will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, borrower and industry sector are approved regularly by the Board of the Bank.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed, in part, by obtaining collateral and corporate and personal guarantees.

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

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss as a result of another party to a financial instrument failing to perform in accordance with the terms of the contract. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

**Market risk.** The Bank takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products all of which are exposed to general and specific market movements. The Board of the Bank sets limits on the amount of risk that may be accepted. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

## 21 Financial Risk Management (Continued)

**Geographical risk.** The geographical concentration of the Bank's assets and liabilities as at 31 December 2003 is set out below:

	Ukraine	OECD	Non-OECD	Total
<b>Assets</b>				
Cash and cash equivalents and mandatory reserve balances	112,340	8,400	514	121,254
Due from other banks	23,776	1,830	-	25,606
Loans and advances to customers	947,081	-	-	947,081
Investment securities available-for-sale	27,649	-	-	27,649
Other assets	2,907	-	-	2,907
Deferred tax asset	1,197	-	-	1,197
Premises and equipment	41,534	-	-	41,534
<b>Total assets</b>	<b>1,156,484</b>	<b>10,230</b>	<b>514</b>	<b>1,167,228</b>
<b>Liabilities</b>				
Due to the Central Bank	16,400	-	-	16,400
Due to other banks	42,427	-	55,594	98,021
Customer accounts	862,681	22,377	12,462	897,520
Deposit certificates	14,892	-	2,132	17,024
Subordinated debt	-	11,345	-	11,345
Other liabilities	8,100	-	-	8,100
<b>Total liabilities</b>	<b>944,500</b>	<b>33,722</b>	<b>70,188</b>	<b>1,048,410</b>
<b>Net balance sheet position</b>	<b>211,984</b>	<b>(23,492)</b>	<b>(69,674)</b>	<b>118,818</b>
<b>Credit related commitments (Note 22)</b>	<b>72,429</b>	<b>35,620</b>	<b>-</b>	<b>108,049</b>

Balances with non-OECD countries mainly include balances due to banks located in Latvia.

The geographical concentration of the Bank's assets and liabilities as at 31 December 2002 is set out below:

	Ukraine	OECD	Non-OECD	Total
<b>Net balance sheet position</b>	<b>119,508</b>	<b>(38,829)</b>	<b>(11,936)</b>	<b>68,743</b>
<b>Credit related commitments (Note 22)</b>	<b>88,639</b>	<b>-</b>	<b>3,904</b>	<b>92,543</b>

## 21 Financial Risk Management (Continued)

**Currency risk.** The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board of the Bank sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Bank's exposure to foreign currency exchange rate risk as at 31 December 2003. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by currency. As at 31 December 2003, the Bank has the following positions in currencies:

	UAH	USD	Euro	Other currencies	Total
<b>Assets</b>					
Cash and cash equivalents and mandatory reserve balances	91,930	24,199	4,213	912	121,254
Due from other banks	8,187	16,731	688	-	25,606
Loans and advances to customers	515,624	424,679	6,778	-	947,081
Investment securities available-for-sale	27,649	-	-	-	27,649
Other assets	2,659	242	6	-	2,907
Deferred tax asset	1,197	-	-	-	1,197
Premises and equipment	41,534	-	-	-	41,534
<b>Total assets</b>	<b>688,780</b>	<b>465,851</b>	<b>11,685</b>	<b>912</b>	<b>1,167,228</b>
<b>Liabilities</b>					
Due to the Central Bank	16,400	-	-	-	16,400
Due to other banks	3,002	95,019	-	-	98,021
Customer accounts	542,727	342,343	11,732	718	897,520
Deposit certificates	14,875	2,149	-	-	17,024
Subordinated debt	-	11,345	-	-	11,345
Other liabilities	6,215	1,732	129	24	8,100
<b>Total liabilities</b>	<b>583,219</b>	<b>452,588</b>	<b>11,861</b>	<b>742</b>	<b>1,048,410</b>
<b>Net balance sheet position</b>	<b>105,561</b>	<b>13,263</b>	<b>(176)</b>	<b>170</b>	<b>118,818</b>
<b>Credit related commitments (Note 22)</b>	<b>67,181</b>	<b>35,395</b>	<b>5,473</b>	<b>-</b>	<b>108,049</b>

At 31 December 2002, the Bank had the following positions in currency

	UAH	USD	Euro	Other currencies	Total
<b>Net balance sheet position</b>	<b>53,892</b>	<b>14,169</b>	<b>(165)</b>	<b>847</b>	<b>68,743</b>
<b>Credit related commitments (Note 22)</b>	<b>60,561</b>	<b>27,589</b>	<b>3,606</b>	<b>787</b>	<b>92,543</b>

The Bank has extended loans and advances denominated in foreign currencies. Depending on the revenue stream of the borrower, the appreciation of the currencies against the Ukrainian hryvnia may adversely affect the borrowers' repayment ability and therefore increases the likelihood of future loan losses.

## 21 Financial Risk Management (Continued)

**Liquidity risk.** Liquidity risk is defined as the risk when the maturity of assets and liabilities does not match. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs and guarantees. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The liquidity risk is managed by the Asset/Liability Committee of the Bank.

The table below shows assets and liabilities as at 31 December 2003 by their remaining contractual maturity, unless there is evidence that any of these assets are impaired and will be settled after their contractual maturity dates, in which case the expected date of settlement is used. Some of the assets, however, may be of a longer term nature; for example, loans are frequently renewed and accordingly short term loans can have a longer term duration.

The liquidity position of the Bank as at 31 December 2003 is set out below:

	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>More than 1 year</b>	<b>No stated maturity</b>	<b>Total</b>
<b>Assets</b>						
Cash and cash equivalents and mandatory reserve balances	121,254	-	-	-	-	121,254
Due from other banks	23,776	1,830	-	-	-	25,606
Loans and advances to customers	114,016	114,572	358,360	360,133	-	947,081
Investment securities available-for-sale	1,647	2,196	679	18,040	5,087	27,649
Other assets	882	2,025	-	-	-	2,907
Deferred tax asset	-	-	-	-	1,197	1,197
Premises and equipment	-	-	-	-	41,534	41,534
<b>Total assets</b>	<b>261,575</b>	<b>120,623</b>	<b>359,039</b>	<b>378,173</b>	<b>47,818</b>	<b>1,167,228</b>
<b>Liabilities</b>						
Due to the Central Bank	-	-	16,400	-	-	16,400
Due to other banks	89,350	533	8,138	-	-	98,021
Customer accounts	309,975	14,471	99,145	473,929	-	897,520
Deposit certificates	-	4,716	10,160	2,148	-	17,024
Subordinated debt	11,345	-	-	-	-	11,345
Other liabilities	5,315	2,785	-	-	-	8,100
<b>Total liabilities</b>	<b>415,985</b>	<b>22,505</b>	<b>133,843</b>	<b>476,077</b>	<b>-</b>	<b>1,048,410</b>
<b>Net liquidity gap</b>	<b>(154,410)</b>	<b>98,118</b>	<b>225,196</b>	<b>(97,904)</b>	<b>47,818</b>	<b>118,818</b>
<b>Cumulative liquidity gap as at 31 December 2003</b>	<b>(154,410)</b>	<b>(56,292)</b>	<b>168,904</b>	<b>71,000</b>	<b>118,818</b>	<b>-</b>
<b>Cumulative liquidity gap as at 31 December 2002</b>	<b>(283,315)</b>	<b>(247,044)</b>	<b>(178,890)</b>	<b>31,607</b>	<b>68,743</b>	<b>-</b>

## **21 Financial Risk Management (Continued)**

Subordinated debt was classified into the category “demand and less than 1 months”, as it was repaid by the Bank on 30 January 2004 after receipt of permission from the Central Bank for early repayment (Note 14).

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the Management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

The Bank has a significant cumulative maturity mismatch of the assets and liabilities up to 3 months. This liquidity mismatch arises due to the fact that a significant source of finance for the Bank as at 31 December 2003 was customer accounts being on demand and maturing in up to 3 months. Management believes that in spite of a substantial portion of customer accounts being on demand and maturing in up to 3 months, diversification of these customer accounts and the past experience of the Bank indicates that these deposits provide a long-term and stable source of finance for the Bank.

**Interest rate risk.** The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

The Bank is exposed to interest rate risk, principally as a result of lending at fixed interest rates, in amounts and for periods, which differ from those of term borrowings at fixed interest rates. In practice, interest rates are generally fixed on a short-term basis. Also, interest rates that are contractually fixed on both assets and liabilities are usually renegotiated to reflect current market conditions.

The Board of the Bank sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored regularly. In the absence of any available hedging instruments, the Bank normally seeks to match its interest rate positions.

## 21 Financial Risk Management (Continued)

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	<b>Demand and less than 1 month</b>	<b>From 1 to 3 months</b>	<b>From 3 to 12 months</b>	<b>More than 1 year</b>	<b>Non-interest bearing</b>	<b>Total</b>
<b>Assets</b>						
Cash and cash equivalents and mandatory reserve balances	10,532	-	-	-	110,722	121,254
Due from other banks	23,776	1,830	-	-	-	25,606
Loans and advances to customers	114,016	114,572	358,360	360,133	-	947,081
Investment securities available-for-sale	1,647	2,196	679	18,040	5,087	27,649
Other assets	-	-	-	-	2,907	2,907
Deferred tax asset	-	-	-	-	1,197	1,197
Premises and equipment	-	-	-	-	41,534	41,534
<b>Total assets</b>	<b>149,971</b>	<b>118,598</b>	<b>359,039</b>	<b>378,173</b>	<b>161,447</b>	<b>1,167,228</b>
<b>Liabilities</b>						
Due to the Central Bank	-	-	16,400	-	-	16,400
Due to other banks	89,350	533	8,138	-	-	98,021
Customer accounts	270,866	14,471	99,145	473,929	39,109	897,520
Deposit certificates	-	4,716	10,160	2,148	-	17,024
Subordinated debt	11,345	-	-	-	-	11,345
Other liabilities	-	-	-	-	8,100	8,100
<b>Total liabilities</b>	<b>371,561</b>	<b>19,720</b>	<b>133,843</b>	<b>476,077</b>	<b>47,209</b>	<b>1,048,410</b>
<b>Net sensitivity gap</b>	<b>(221,590)</b>	<b>98,878</b>	<b>225,196</b>	<b>(97,904)</b>	<b>114,238</b>	<b>118,818</b>
<b>Cumulative sensitivity gap as at 31 December 2003</b>	<b>(221,590)</b>	<b>(122,712)</b>	<b>102,484</b>	<b>4,580</b>	<b>118,818</b>	<b>-</b>
<b>Cumulative sensitivity gap as at 31 December 2002</b>	<b>(370,780)</b>	<b>97,425</b>	<b>(42,841)</b>	<b>(42,180)</b>	<b>68,743</b>	<b>-</b>

## 21 Financial Risk Management (Continued)

The table below summarises the effective interest rates by major currencies for major monetary financial instruments. The analysis has been prepared based on period-end effective rates used for amortisation of the respective assets/liabilities as adjusted for remeasurement of the effect of non market interest rates at origination.

	2003			2002		
	USD	UAH	Euro	USD	UAH	Euro
<b>Assets</b>						
Term placements with other banks	2	15	-	4	-	2
Loans and advances to legal entities	16	17	18	14	20	15
Loans and advances to individuals	13	16	-	15	18	-
Corporate bonds	-	15	-	-	20	-
<b>Liabilities</b>						
Due to the Central Bank	-	10	-	-	9	-
Term placements of other banks	7	10	-	1	8	-
Term deposits of legal entities	8	11	6	8	15	-
Term deposits of individuals	10	18	9	10	24	10
Deposit certificates	11	15	-	-	-	-
Subordinated debt	Libor+4%	-	-	13	-	-

The sign “-“ in the table above means that the Bank does not have the respective assets or liabilities in corresponding currency.

## 22 Contingencies, Commitments and Derivative Financial Instruments

**Legal proceedings.** From time to time and in the normal course of business, claims against the Bank are received. On the basis of own estimates and internal professional advice the Management is of the opinion that no material losses will be incurred and accordingly no provision has been made in these financial statements.

At 31 December 2003 the Bank was not engaged in any material litigation proceedings.

**Tax legislation.** Ukrainian tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant local and central authorities. Tax authorities may be taking a more assertive position in their interpretation of the legislation and assessments. As a result, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2003 management believes that its interpretation of the relevant legislation is appropriate and the Bank's tax positions will be sustained.

**Capital commitments.** As at 31 December 2003 the Bank has no material capital commitments (2002: none).

## 22 Contingencies, Commitments and Derivative Financial Instruments (Continued)

**Operating lease commitments.** Where the Bank is the lessee, the future minimum lease payments under non cancellable operating leases are as follows:

	2003	2002
Not later than 1 year	4,403	3,192
Later than 1 year and not later than 5 years	8,836	7,137
Later than 5 years	1,365	1,747
<b>Total operating lease commitments</b>	<b>14,604</b>	<b>12,076</b>

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

Outstanding credit related commitments are as follows:

	Note	2003	2002
Irrevocable commitments to extend credit		72,429	9,504
Import letters of credit (uncovered)		1,018	2,393
Guarantees issued		36,750	86,336
Less: Provision for losses on credit related commitments	15	(2,148)	(5,690)
<b>Total credit related commitments</b>		<b>108,049</b>	<b>92,543</b>

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

The total outstanding contractual amount of commitments to extend credit, letters of credit and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded.

Movements in the provision for losses on credit related commitments are as follows:

	2003	2002
<b>Provision for losses on credit related commitments as at 1 January</b>	<b>5,690</b>	<b>482</b>
(Recovery of provision)/provision for losses on credit related commitments during the year	(3,542)	5,208
<b>Provision for losses on credit related commitments as at 31 December</b>	<b>2,148</b>	<b>5,690</b>

As at 31 December 2003, included in the provision for losses on credit related commitments is provision for losses on guarantees and letters of credit of UAH 1,502 thousand (2002: of UAH 5,191 thousand) and provision for losses arising in connection with the irrevocable commitments to extend credit in the amount of UAH 646 thousand (2002: of UAH 499 thousand).

## 22 Contingencies, Commitments and Derivative Financial Instruments (Continued)

**Derivative financial instruments.** As at 31 December 2003 there were no forward or option contracts outstanding (2002: none).

**Fiduciary assets.** These assets are not included in the Bank's balance sheet as they are not assets of the Bank. Nominal values disclosed below are normally different from the fair values of respective securities. The fiduciary assets fall into the following categories:

	2003 Nominal value	2002 Nominal value
Shares in companies held in custody	258,795	115,503

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**Assets pledged.** As at 31 December 2003 the Bank has the following assets pledged as collateral:

As disclosed in Note 5, as at 31 December 2003 the Bank's mandatory reserve balance was UAH 60,864 thousand (2002: UAH 53,353 thousand). The Bank may satisfy its mandatory reserve requirement with a combination of its balance on account with the NBU and up to 40% of UAH cash on hand and 20% of foreign currency cash on hand.

As disclosed in Note 6, balances due from other banks totalling UAH 17,659 thousand as at 31 December 2003 have been pledged as cover for letters of credit and for international payments (2002: UAH 20,766 thousand).

As disclosed in Note 7, loans to customers totalling UAH 39,800 thousand as at 31 December 2003 were pledged under a loan received from the Central Bank (2002: UAH 40,583 thousand).

## 23 Fair Value of Financial Instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price.

The estimated fair values of financial instruments have been determined by the Bank using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. As described in more detail in Note 2, Ukraine continues to display some characteristics of an emerging market and economic conditions continue to limit the volume of activity in the financial markets. While Management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realised in the current circumstances.

**Financial instruments carried at fair value.** Cash and cash equivalents and investment securities available-for-sale are carried on the balance sheet at their fair value. As set out in Note 8, external independent market quotations were not available for certain investment securities available-for-sale. The fair value of these assets was determined by Management on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies.

**Loans originated carried at amortised cost less provision for impairment.** The fair value of floating rate instruments is their carrying amount. The estimated fair value of fixed interest rate instruments is based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Refer to Notes 6 and 7 for the estimated fair values of due from other banks and loans and advances to customers, respectively.

**Liabilities carried at amortised cost.** The fair value of instruments with a quoted market price is based on quoted market prices. The estimated fair value of instruments with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest rate instruments without a quoted market price is based on expected cash flows discounted at current interest rates for new instruments with similar credit risk and remaining maturity. Refer to Notes 11, 12, 13 and 14 for the estimated fair values of due to the Central Bank, due to other banks, customer accounts and subordinated debt, respectively.

## 24 Related Party Transactions

For the purposes of these financial statements, parties are considered to be related as defined by IAS 24 “Related Party Disclosures”.

Banking transactions are entered into in the normal course of business with significant shareholders, directors and companies with which the Bank has significant shareholders in common and other related parties. These transactions include settlements, loans, deposit taking, guarantees, trade finance, transactions with securities, foreign currency transactions and other operations. These transactions are priced at market as well as at preferential rates.

The related party transactions include insurance payments to a company related by common ownership of the major shareholder. The payments relate predominantly to insurance of credit risks. The premiums are calculated based on a percentage of the loan principal being insured and range from 3 to 10% of the loan principal.

The outstanding balances at the year end and income and expense items as well as other transactions for the year with related parties are as follows:

	<b>2003</b>	
<b>Loans and advances to customers</b>		
Loans and advances as at the year end (contractual interest rate: 2003: UAH – 14%, USD –13%; 2002: UAH –17%, USD –14%)	74,292	8,862
Reverse sale and repurchase agreements as at the year end	3,175	3,374
Provision for impairment of loans and advances to customers as at the year end	(6,109)	(234)
Interest income for the year (based on contractual rates)	10,851	683
Losses on origination of loans and advances to customers at rates below market for the year	1,544	-
<b>Customer accounts</b>		
Current/settlement accounts as at the year end	13,228	55,545
Term deposits outstanding as at the year end (contractual interest rate: 2003: UAH- 21%, USD – 9%; 2002: UAH- 30%, USD – 6%;	33,101	57,441
Interest expense for the year (based on contractual rates)	4,797	1,611
Investment securities available-for-sale as at the year end	1,095	-
Result from securities trading	(144)	(29)
Guarantees issued by the Bank as at the year end	2,949	-
Fee and commission income for the year	177	11
Operating lease payments	1,488	227
Insurance of credit risks	2,559	4,195
Insurance of property and equipment	102	1,172

All of the activities disclosed above are entered with the majority shareholder group.

Subsequent to the year end related parties of the Bank purchased significant interest in a Latvian bank, which had balances outstanding with the Bank as at 31 December 2003 of UAH 47,234 thousand (Note 12).

## **25 Subsequent Events**

On 30 January 2004 the subordinated debt was repaid by the Bank (Note 14).

According to a decision of a shareholders' meeting as at 16 February 2004, the Bank announced a new share issue with a nominal value of UAH 10,000 thousand. This share issue was fully paid up and registered by 18 March 2004.

According to a decision of a shareholders' meeting as at 8 April 2004, the Bank announced capitalization of dividends of UAH 14,000 thousand. As at the date of this report capitalization of dividends was not registered by the Central Bank.

**Bank Pivdennyi**  
**Capital Adequacy Ratio – 31 December 2003 (unaudited)**  
*(in thousands of Ukrainian hryvnias)*

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**Capital Adequacy Ratio (CAR)**

The Management of the Bank calculated the CAR of the Bank in accordance with the 1988 Basle Accord principles and 1996 Amendment to the Capital Accord to Incorporate Market Risks based on the audited financial statements of the Bank as at 31 December 2003, as follows:

	<b>31 December 2003</b>
<hr/>	
<b><i>Tier 1 Capital</i></b>	
Share capital	108,898
Retained earnings	9,920
<hr/>	
<b>Total Tier 1 Capital</b>	<b>118,818</b>
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<b><i>Tier 2 Capital</i></b>	
Subordinated debt	-
<hr/>	
<b>Total Tier 2 Capital</b>	<b>-</b>
<hr/>	
<b>Total capital</b>	<b>118,818</b>
<hr/>	
<b>Risk weighted assets (calculated in accordance with the 1988 Basle Accord principles and 1996 Amendment to the Capital Accord to Incorporate Market Risks)</b>	<b>1,028,688</b>
<b>Capital adequacy ratio at 31 December 2003</b>	<b>11.6%</b>

The above information is presented for the purpose of additional analysis and is not a required part of the financial statements.

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