

Central Banking Authority of Kosovo

Financial statements

as at and for the year ended 31 December 2007

(with independent auditor's report thereon)

Central Banking Authority of Kosovo

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Independent Auditors' Report

To the Governing Board of the Central Banking Authority of Kosovo:

We have audited the accompanying financial statements of the Central Banking Authority of Kosovo ("the CBAK"), which comprise the balance sheet as at 31 December 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 our 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, we consider 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 principles 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 opinion.



Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the CBAK as at 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 4 (f) to the financial statements which states that according to the UNMIK Regulation No 2006/47 the capital and the General reserve accounts of the CBAK shall be at least equivalent to five percent of the aggregate amount of the credit balances of all accounts maintained on the books of the CBAK by account holders shown on the balance sheet for the end of each financial year. As at 31 December 2007 and 2006 this requirement was not satisfied.

KPMG Albania Sh.p.k. - Kosovo Branch

KPMG Albania

21 April 2008
Pristina, Kosovo

Central Banking Authority of Kosovo

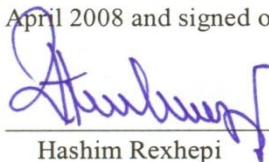
Balance sheet

As at 31 December

<i>In thousands of euro</i>	Note	2007	2006
Assets			
Cash on hand	7	63,817	11,136
Current accounts with non resident banks	8	1,946	22,480
Treasury bills	9	229,277	203,398
Deposit accounts with non resident banks	10	762,579	404,025
Property and equipment	11	2,108	1,262
Intangible assets	12	122	144
Other assets	13	295	177
Total assets		1,060,144	642,622
Liabilities			
Due to domestic banks	14	113,554	94,477
Due to local governmental institutions	15	856,730	475,821
Due to public and commercial entities	16	48,381	45,076
Other domestic liabilities	17	7,743	2,658
Total liabilities		1,026,408	618,032
Capital and reserve			
Statutory fund	18	20,000	10,000
Reserve fund	19	13,736	14,590
Total capital and reserve		33,736	24,590
Total liabilities, capital and reserves		1,060,144	642,622

The notes on pages 5 to 41 are an integral part of these financial statements.

These financial statements set out on pages 1 to 41 were approved by the Management of the CBAK on 21 April 2008 and signed on its behalf by:


Hashim Rexhepi

Managing Director




Gani Gerguri

Deputy Managing Director

Central Banking Authority of Kosovo

Income statement

For the year ended 31 December

<i>In thousands of euro</i>	Note	2007	2006
Interest income		34,275	15,187
Interest expense		(24,371)	(8,731)
Net interest income	20	<u>9,904</u>	<u>6,456</u>
Fee and commission income		743	744
Fee and commission expense		(226)	(250)
Net fee and commission income	21	<u>517</u>	<u>494</u>
Grant revenue	22	453	317
Other operating income	23	956	792
Operating income		<u>11,830</u>	<u>8,059</u>
Personnel expenses	24	(1,412)	(1,254)
Depreciation and amortisation	11,12	(449)	(282)
General and administrative expenses	25	(823)	(870)
Operating expenses		<u>(2,684)</u>	<u>(2,406)</u>
Profit for the period		<u>9,146</u>	<u>5,653</u>

The notes on pages 5 to 41 are an integral part of these financial statements.

Central Banking Authority of Kosovo

Statement of changes in equity for the year ended 31 December

<i>In thousands of euro</i>	Statutory fund	Reserve fund	Retained Earnings	Total
Balance at 1 January 2006	10,000	9,722	-	19,722
Profit for the period	-	-	5,653	5,653
Total recognized income and expense	-	-	5,653	5,653
Payments to the Ministry of Finance and Economy	-	(785)	-	(785)
Transfer to reserve fund	-	5,653	(5,653)	-
Balance at 31 December 2006	10,000	14,590	-	24,590
Balance at 1 January 2007	10,000	14,590	-	24,590
Profit for the period	-	-	9,146	9,146
Total recognized income and expense	-	-	9,146	9,146
Transfer to statutory fund	10,000	(10,000)	-	-
Balance at 31 December 2007	20,000	4,590	9,146	33,736

The notes on pages 5 to 41 are an integral part of these financial statements.

Central Banking Authority of Kosovo

Statement of cash flows

For the year ended 31 December

<i>In thousands of euro</i>	Note	2007	2006
Cash flows from operating activities			
Profit for the period		9,146	5,653
<i>Adjustments for:</i>			
Depreciation	11	353	137
Amortization	12	94	145
Grant revenue for the year	22	(252)	(124)
Gain on sale of equipment		(4)	(9)
Interest income	20	(34,275)	(15,187)
Interest expense	20	24,371	8,731
		(567)	(654)
Change in treasury bills		(117,269)	(57,178)
Change in deposit accounts with non resident banks		(182,467)	(24,254)
Change in other assets		(118)	200
Change in due to domestic banks		19,077	11,959
Change in due to local governmental institutions		380,909	245,930
Change in due to public and commercial entities		3,305	(19,050)
Change in other domestic liabilities		5,337	(5)
		<u>108,207</u>	<u>156,948</u>
Interest received		29,912	13,875
Interest paid		(24,371)	(8,731)
Net cash from operating activities		113,748	162,092
Cash flows from investing activities			
Proceeds from sale of equipments		4	9
Purchase of equipment	11	(1,199)	(1,070)
Purchase of intangible assets	12	(72)	(124)
Net cash used in investing activities		(1,267)	(1,185)
Cash flows from financing activities			
Payments to Ministry of Finance and Economy	19	-	(785)
Proceeds from grants	17	-	42
Net cash from financing activities		-	(743)
Net (decrease)/increase in cash and cash equivalents		112,481	160,164
Cash and cash equivalents at 1 January		508,998	348,834
Cash and cash equivalents at 31 December	26	621,479	508,998

The notes on pages 5 to 41 are an integral part of these financial statements

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

1. Reporting entity

The Central Banking Authority of Kosovo (the “CBAK”), a successor to the Banking and Payments Authority of Kosovo (BPK) is a distinct public entity with the authority to license, supervise and regulate financial institutions in the territory of Kosovo. The CBAK was established in accordance with the provisions of the United Nations Interim Administration Mission in Kosovo (“UNMIK”) Regulation no. 1999/20 issued on November 15, 1999 (as amended on October 1, 2001, by regulation 2001/24) “On the Banking and Payments Authority of Kosovo”. Furthermore, on August 24, 2006 Special Representative of the Secretary General has signed a new Regulation on Central Banking Authority of Kosovo and transformed the Banking and Payments Authority of Kosovo into Central Banking Authority of Kosovo (Regulation 2006/47). Under this Regulation the CBAK’s principal objectives are to:

- Foster the soundness, solvency and efficient functioning of a stable market based financial system, encouraging market emergence of safe financial instruments; and
- Support the general economic policies in Kosovo with a view to contributing to an efficient allocation of resources in accordance with the principles of an open market economy.

The CBAK has, among others, the following specific powers to:

- Recommend broad policy guidelines to the Special Representative of the Secretary-General of the United Nations and Provisional Institutions of Self Government in areas under its responsibility,
- Formulate and implement measures for, and oversee and regulate, payments and settlement systems for transactions in domestic and foreign currency in Kosovo;
- Own and operate one or more payments systems;
- Act as banker and fiscal agent to the Ministry of Finance and Economy and, to provide financial advice at its request;
- Hold foreign currency deposits of banks, Ministry of Finance and Economy and other public entities;
- Ensure an adequate supply of bank notes and coins for the settlement of cash transactions;
- License, supervise and regulate financial institutions; and
- Conduct regular economic and monetary analysis of the Kosovo economy, make public the results, and submit proposals and measures to the United Nations Interim Administration Mission in Kosovo and the Provisional Institutions of Self Government on the basis of such analysis.

The CBAK operates from the premises located in Pristina.

The address of the registered office of the CBAK is as follows:

33, Garibaldi Street,
Pristina,
Kosovo.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

1. Reporting entity (continued)

Governing Board

The Governing Board determines policies for the operations of the CBAK and supervises their implementation. Under UNMIK regulations, the Board is composed of five members appointed the Special Representative of the Secretary General.

As at 31 December 2007 the Governing Board of CBAK comprised of the following members:

- Mr Gazmend Luboteni, Chairperson of Governing Board, Non-executive Director
- Mr Michel Svetchine, Managing Director of CBAK
- Ms Chiara Bronchi, Non-executive Director
- Mr Lulzim Ismajli, Non-executive Director
- Mr. Isa Mustafa, Non-executive Director

2. Basis of preparation

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs).

During the period CBAK adopted IFRS 7 *Financial Instruments: Disclosures* and IAS 1 *Presentation of Financial Statements - Capital Disclosures*, which increased the level of disclosure in respect of financial instruments and capital, but had no impact on the reported profits or financial position of the CBAK. In accordance with the transitional requirements of the standards, the CBAK has provided full comparative information.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis.

(c) Functional and presentation currency

These financial statements are presented in euro ("EUR"), which is the CBAK's functional currency. Except as indicated, financial information presented in euro has been rounded to the nearest thousand.

(d) Use of estimates and judgments

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

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

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

2. Basis of preparation (continued)

(d) Use of estimates and judgments (continued)

In particular, information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amount recognized in the financial statements are described in note 5.

3. Significant accounting policies

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

(a) Foreign currency transactions

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

The CBAK deals predominantly in EUR, while the foreign currencies the CBAK deals with are predominantly United States Dollars (USD). The exchange rates used for translation at 31 December 2007 and 2006 were as follows:

	2007	2006
	EUR	EUR
1 USD	0.679	0.759

(b) Interest

Interest income and expense are recognised in the income statement using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

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

Interest income and expense presented in the income statement include:

- interest on financial assets and liabilities at amortised cost on an effective interest rate basis.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

(c) Fees and commission

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

Other fees and commission income, including of transaction fees for operating accounts, fund transfers and licensing fees are recognized as the related services are performed.

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

(d) Employee benefits

(i) *Defined contribution plans*

The CBAK makes compulsory social security contributions that provide pension benefits for employees upon retirement. The local authorities are responsible for providing the legally set minimum threshold for pensions in Kosovo under a defined contribution pension plan. The CBAK's contributions to the benefit pension plan are charged to the income statement as incurred.

Additionally the CBAK recognizes fixed contribution payable into external pension funds. The supplementary contribution rate is 10% of gross salary. This amount is recognized as expenses when they are due. CBAK has no legal or constructive obligation to pay further contributions.

(ii) *Short-term benefits*

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

(e) Taxation and profit allocation

The CBAK is exempt from income tax according to the UNMIK Regulation 1999/20 issued on 15 November 1999 (as amended on 1 October 2001) "On the Banking and Payments Authority of Kosovo" replaced with the new UNMIK Regulation 2006/47 issued on 24 August 2006 "On Central Banking Authority of Kosovo" and is required by law to pay any balance of its net income directly to the Ministry of Finance and Economy after allocation to replenish the levels of reserve funds.

(f) Financial assets and liabilities

(i) *Recognition*

The CBAK initially recognizes deposits on the date that they are originated. All other financial assets and liabilities are initially recognized on the trade date at which the CBAK becomes a party to the contractual provisions of the instrument.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

(f) Financial assets and liabilities (continued)

(ii) Derecognition

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

The CBAK derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

(iii) Offsetting

Financial assets and liabilities are set off and the net amount is presented in the balance sheet when, and only when, the CBAK has a legal right to set off the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions.

(iv) Amortized cost measurement

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

(v) Fair value measurement

The determination of fair values of financial assets and financial liabilities is determined by using valuation techniques. Valuation techniques include net present value techniques, the discounted cash flow method, comparison to similar instruments for which market observable prices exist, and valuation models. The CBAK uses widely recognised valuation models for determining the fair value of common and simpler financial instruments. For these financial instruments, inputs into models are market observable.

(vi) Identification and measurement of impairment

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

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

(f) Financial assets and liabilities (continued)

(vi) Identification and measurement of impairment (continued)

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

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on the impaired asset continues to be recognised through the unwinding of the discount.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss is reversed through profit or loss.

(vii) Designation at fair value through profit or loss

The CBAK has designated financial assets and liabilities at fair value through profit or loss when 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.

CBAK has no financial assets designated at fair value through profit or loss as at 31 December 2007 and 31 December 2006.

(g) Cash and cash equivalents

Cash and cash equivalents include cash balance on hand, demand deposits with banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the CBAK in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the balance sheet.

(h) Investment securities

Investment securities are initially measured at fair value plus incremental direct transaction costs and subsequently accounted for as held-to-maturity.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

(h) Investment securities (continued)

(i) *Held-to-maturity*

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

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

(i) Property and equipment

(i) *Recognition and measurement*

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

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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

(ii) *Subsequent costs*

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

(iii) *Depreciation*

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

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

	2007	2006
• Vehicles	5 years	5 years
• Office and other equipment	5 years	5 years
• Computer equipment	3 years	3 years
• Leasehold improvement	20 years	-

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

(i) Property and equipment (continued)

(iii) Depreciation (continued)

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

(j) Intangible assets

Software acquired by the CBAK is stated at cost less accumulated amortisation and accumulated impairment losses.

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

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use. The estimate useful life of software is three years (2005: 3 years).

(k) Impairment of non-financial assets

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

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

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(l) Deposits and other financial liabilities

Deposits are the CBAK's sources of funding. They are initially measured at fair value plus transaction costs, and subsequently measured at their amortized cost using the effective interest method, except where the CBAK chooses to carry the liabilities at fair value through profit or loss.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

(m) Grant revenue

Government grants are recognised initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions associated with the grant. Grants that compensate the CBAK for expenses incurred are recognised in profit or loss on a systematic basis in the same periods in which the expenses are recognised. Grants that compensate the CBAK for the cost of an asset are recognised in profit or loss on a systematic basis over the useful life of the asset.

(n) Donor financed salaries

Certain members of the management of the CBAK are international experts appointed by international organisations who provide financial support to the CBAK. In addition these international organisations also appoint short term experts and consultants as the need arises. The financial support of these international organisations includes but it is not limited to the payment of the salaries to these management and consultant appointments. As this assistance is paid by international directly to the appointee the extent of the payments are not known nor are they included in these financial statements.

(o) Fiduciary activities

In certain specific instances the CBAK acts as fiscal agent and paying agent of the Ministry of Finance and Economy. Assets and income arising from these activities are excluded from these financial assets where the CBAK acts in fiduciary capacity such as nominee or agent.

(p) Provisions

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

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

(q) Reserve fund

In accordance with UNMIK Regulation No 2006/47 (which superseded UNMIK Regulation 2001/24) each year the CBAK shall allocate net income to the general reserve fund until the capital and the general reserve fund amount to 5% of the aggregate, amount of the credit balance of all accounts maintained on the books of the CBAK by account holders shown on the balance sheet of the CBAK for the year ended of each financial year.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

(r) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2007, and have not been applied in preparing these financial statements:

- Revised IFRS 2 *Share-based Payment* (effective from 1 January 2009). The revised Standard will clarify the definition of *vesting* conditions and *non-vesting* conditions. Based on the revised Standards failure to meet non-vesting conditions will generally result in treatment as a cancellation. Revised IFRS 2 is not relevant to the CBAK's operations as the CBAK does not have any share-based compensation plans.
- Revised IFRS 3 *Business Combinations* (effective for annual periods beginning on or after 1 July 2009). The scope of the revised Standard has been amended and the definition of a business has been expanded. The revised Standard also includes a number of other potentially significant changes including:
 - All items of consideration transferred by the acquirer are recognised and measured at fair value as of the acquisition date, including contingent consideration.
 - Transaction costs are not included in the acquisition accounting.
 - The acquirer can elect to measure any non-controlling interest at fair value at the acquisition date (full goodwill), or at its proportionate interest in the fair value of the identifiable assets and liabilities of the acquiree.
 - Acquisitions of additional non-controlling equity interests after the business combination must be accounted for as equity transactions.Revised IFRS 3 is not relevant to the CBAK's operations as the CBAK does not have any interests in subsidiaries that will be affected by the revisions to the Standard.
- IFRS 8 *Operating Segments* (effective from 1 January 2009). The Standard requires segment disclosure based on the components of the entity that management monitors in making decisions about operating matters. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The standard is not relevant to the CBAK's operations.
- Revised IAS 1 *Presentation of Financial Statements* (effective from 1 January 2009). The revised Standard requires information in financial statements to be aggregated on the basis of shared characteristics and introduces a statement of comprehensive income. Items of income and expense and components of other comprehensive income may be presented either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). The CBAK is currently evaluating whether to present a single statement of comprehensive income, or two separate statements.
- Revised IAS 23 *Borrowing Costs* (effective from 1 January 2009). The revised Standard will require the capitalization of borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. Revised IAS 23 is not relevant to the CBAK's operations as the CBAK does not have any qualifying assets for which borrowing costs would be capitalised.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

3. Significant accounting policies (continued)

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

- Revised IAS 27 *Consolidated and Separate Financial Statements* (effective for annual periods beginning on or after 1 July 2009). In the revised Standard the term minority interest has been replaced by non-controlling interest, and is defined as "the equity in a subsidiary not attributable, directly or indirectly, to a parent". The revised Standard also amends the accounting for non-controlling interest, the loss of control of a subsidiary, and the allocation of profit or loss and other comprehensive income between the controlling and non-controlling interest. The standard is not relevant to the CBAK's operations.
- IFRIC 11 IFRS 2 - *Group and Treasury Share Transactions* (effective for annual periods beginning on or after 1 March 2007). The Interpretation requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity-instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments needed are obtained. It also provides guidance on whether share-based payment arrangements, in which suppliers of goods or services of an entity are provided with equity instruments of the entity's parent should be accounted for as cash-settled or equity-settled in the entity's financial statements. The Interpretation is not relevant to the CBAK's operations.
- IFRIC 12 *Service Concession Arrangements* (effective from 1 January 2008). The Interpretation provides guidance to private sector entities on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. The Interpretation is not relevant to the CBAK's operations.
- IFRIC 13 *Customer Loyalty Programmes* (effective for annual periods beginning on or after 1 July 2008). The Interpretation explains how entities that grant loyalty award credits to customers who buy other goods or services should account for their obligations to provide free or discounted goods or services ('awards') to customers who redeem those award credits. Such entities are required to allocate some of the proceeds of the initial sale to the award credits and recognise these proceeds as revenue only when they have fulfilled their obligations. The CBAK does not expect the Interpretation to have any impact on the unconsolidated financial statements.
- IFRIC 14 IAS 19 - *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their interactions* (effective for annual periods beginning on or after 1 January 2008). The interpretation addresses when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available, how a minimum funding requirements (MFR) might affect the availability of reductions in future contributions and when a MFR might give rise to a liability. No additional liability need be recognised by the employer under IFRIC 14 unless the contributions that are payable under the minimum funding requirement cannot be returned to the company. The Interpretation is not relevant to the CBAK's operations.

(s) Comparatives

The comparative information is presented consistently applying the CBAK's accounting policies. When necessary, comparative figures are reclassified for the purposes of comparability.

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management

(a) Introduction and overview

The CBAK has exposure to the following risks from its use of financial instruments:

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

This note presents information about the CBAK's exposure to each of the above risks, CBAK's objectives, policies and processes for measuring and managing risk, and the CBAK's management of capital. Further quantitative disclosures are included throughout these financial statements.

Risk management framework

The Governing Board has overall responsibility for the establishment and oversight of the CBAK's risk management framework. The CBAK management reports regularly to the Governing Board on risk management practice. Executive Committee, and Investment Committee, which are management committees, have obligations for developing and monitoring CBAK risk management policies. These policies are implemented by the respective organizational units.

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

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

(b) Credit risk

Credit risk is the risk of financial loss to the CBAK if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the CBAK's investments in securities and deposits in other banks.

Management of credit risk

Investments and exposure to other banks

The CBAK limits its exposure to credit risk by investing only in securities issued by the governments of the EU countries and having deposits with foreign banks whose short term liabilities are rated in one of the two highest categories by internationally recognized credit rating agencies. Given the high credit ratings, management does not expect any counterparty to fail to meet its obligations.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(b) Credit risk (continued)

Exposure to credit risk

The maximum exposure to credit risk as at 31 December 2007 and 31 December 2006 is presented by the carrying amount of its cash on hand, current accounts with non resident banks, treasury bills and deposit accounts with non resident banks. For details on the exposures see Notes 7, 8, 9 and 10.

None of the CBAK's exposures are past due or impaired. There are no changes in the credit risk management policies from previous years. Considering the nature of CBAK's exposure to credit risk, the CBAK does not hold any collateral or other credit enhancements against its exposure to credit risk.

(c) Liquidity risk

Liquidity risk is the risk that the CBAK will encounter difficulty in meeting obligations from its financial liabilities.

Management of liquidity risk

The CBAK'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 CBAK's reputation.

Policies to monitor and address the liquidity risk are set by the Governing Board. The CBAK manages its liquidity risk by investing in short term deposits with non resident banks. Liquidity management policies are set to ensure that even under adverse conditions the CBAK is in a position to meet its obligations.

The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by CBAK management. Daily reports cover the liquidity position of CBAK are regularly submitted to the Investment Committee members by the Asset Management Department.

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(c) Liquidity risk (continued)

Exposure to liquidity risk

Residual contractual maturities of financial liabilities

	Note	Carrying amount	Gross nominal inflow / (outflow)	Less than 1 month	1-3 months	3 Months to 1 year
31 December 2007						
<i>Non-derivative liabilities</i>						
Due to domestic banks	14	113,554	(113,554)	113,554	-	-
Due to local governmental institutions	15	856,730	(856,730)	856,730	-	-
Due to public and commercial entities	16	48,381	(48,381)	37,825	-	10,556
Other domestic liabilities	17	7,516	(7,516)	7,516	-	-
		1,026,181	(1,026,181)	1,015,625	-	10,556
31 December 2006						
<i>Non-derivative liabilities</i>						
Due to domestic banks	14	94,477	(94,477)	94,477	-	-
Due to governmental institutions	15	475,821	(475,821)	475,821	-	-
Due to public and commercial entities	16	45,076	(45,076)	37,108	5,950	2,018
Other liabilities	17	2,140	(2,140)	2,140	-	-
		617,514	(617,514)	609,546	5,950	2,018

The previous table shows the undiscounted cash flows on the CBAK's financial liabilities on the basis of their earliest possible contractual maturity. The Gross nominal inflow / (outflow) disclosed in the previous table is the contractual, undiscounted cash flow on the financial liability or commitment.

(d) Market risks

Market risk is the risk that changes in 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 the CBAK's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Management of market risks

The CBAK's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. In the case of floating rate assets and liabilities, the CBAK is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as the savings rate, LIBOR and different types of interest.

Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the CBAK's business strategies.

The CBAK exposure to market risk is related only to non-trading portfolios.

Exposure to interest rate risk - non-trading portfolios

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instrument because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands. The Asset Management Committee is the monitoring body for compliance with these limits. A summary of the Bank's interest rate gap position on non-trading portfolios is as follows:

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to interest rate risk – non-trading portfolios (continued)

	Note	Carrying amount	Less than 3 months	3-6 months	6-12 months	1-5 years
31 December 2007						
Cash on hand	7	63,817	63,817	-	-	-
Current accounts with non resident banks	8	1,946	1,946	-	-	-
Treasury bills	9	229,277	9,924	199,591	19,762	-
Deposit accounts with non resident banks	10	762,579	545,792	77,287	139,500	-
		1,057,619	621,479	276,878	159,262	-
Due to domestic banks	14	(113,554)	(113,554)	-	-	-
Due to local governmental institutions	15	(856,730)	(856,730)	-	-	-
Due to public and commercial entities	16	(48,381)	(43,225)	-	(5,156)	-
Other domestic liabilities	17	(7,516)	(7,516)	-	-	-
		(1,026,181)	(1,021,025)	-	(5,156)	-
		31,438	(399,546)	276,878	154,106	-
31 December 2006						
Cash on hand	7	11,136	11,136	-	-	-
Current accounts with non resident banks	8	22,480	22,480	-	-	-
Treasury bills	9	203,398	101,616	101,782	-	-
Deposit accounts with non resident banks	10	404,025	373,766	5,062	25,197	-
		641,039	508,998	106,844	25,197	-
Due to domestic banks	14	(94,477)	(94,477)	-	-	-
Due to local governmental institutions	15	(475,821)	(475,821)	-	-	-
Due to public and commercial entities	16	(45,076)	(37,108)	(5,400)	(2,568)	-
Other domestic liabilities	17	(2,140)	(2,140)	-	-	-
		(617,514)	(609,546)	(5,400)	(2,568)	-
		23,525	(100,548)	101,444	22,629	-

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the CBAK's financial assets and liabilities to various standard and non-standard interest rate scenarios. An analysis of the CBAK's sensitivity to an increase or decrease in market interest rates and forecasted movements in balance sheet position is as follows:

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to interest rate risk – non-trading portfolios (continued)

2008	Scenario A		Scenario B		Scenario C	
	Total	Average	Total	Average	Total	Average
Liabilities		964,043		849,624		849,624
Current accounts		875,754		761,335		761,335
Time deposit		88,289		88,289		88,289
Capital and reserves		34,094		34,094		34,094
Capital		20,000		20,000		20,000
Reserves		14,094		14,094		14,094
Total		998,137		883,718		883,718
Cash on hand		(76,963)		(76,963)		(76,963)
Funds available for investment		921,174		806,755		806,755
Net interest income						
Gross interest income	34,007		29,373		11,287	
Gross interest expenses	(23,490)		(20,744)		(5,274)	
Total	10,517		8,629		6,013	
Net interest marginal rate	8,348		7,204		5,396	
Operating income and expenses	(1,144)		(1,144)		(1,144)	
Income from operating activities	1,879		1,879		1,879	
Expenses from operating activities	(3,023)		(3,023)		(3,023)	
Net position profit and loss	9,372		7,484		4,869	
Net position profit and loss (marginal rate)	7,204		6,060		4,252	

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to interest rate risk – non-trading portfolios (continued)

2009	Scenario A		Scenario B		Scenario C	
	Total	Average	Total	Average	Total	Average
Liabilities		729,057		446,490		446,490
Current accounts		609,952		349,940		349,940
Time deposit		119,105		96,550		96,550
Capital and reserves		35,002		21,366		21,366
Capital		20,000		20,000		20,000
Reserves		15,002		1,366		1,366
Total		764,059		467,856		467,856
Cash on hand		(76,963)		(35,719)		(35,719)
Funds available for investment		687,096		432,137		432,137
Net interest income						
Gross interest income	27,901		15,544		6,740	
Gross interest expenses	(17,974)		(11,102)		(2,872)	
Total	9,928		6,442		3,868	
Net interest marginal rate	6,841		4,291		3,211	
Operating income and expenses	(1,260)		(1,260)		(1,260)	
Income from operating activities	1,850		1,850		1,850	
Expenses from operating activities	(3,110)		(3,110)		(3,110)	
Net position profit and loss	8,697		5,211		2,637	
Net position profit and loss (marginal rate)	5,581		3,031		1,951	

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to interest rate risk – non-trading portfolios (continued)

2010	Scenario A		Scenario B		Scenario C	
	Total	Average	Total	Average	Total	Average
Liabilities		598,830		279,453		279,453
Current accounts		464,430		228,363		228,363
Time deposit		134,400		51,090		51,090
Capital and reserves		34,094		20,000		20,000
Capital		20,000		20,000		20,000
Reserves		14,094				
Total		634,924		299,453		299,453
Cash on hand		(76,963)		(24,341)		(24,341)
Funds available for investment		555,961		275,112		275,112
Net interest income						
Gross interest income	22,007		10,794		4,141	
Gross interest expenses	(14,910)		(6,911)		(1,779)	
Total	7,098		3,882		2,362	
Net interest marginal rate	5,386		2,631		1,966	
Operating income and expenses	(1,190)		(1,190)		(1,190)	
Income from operating activities	1,930		1,930		1,930	
Expenses from operating activities	(3,120)		(3,120)		(3,120)	
Net position profit and loss	5,919		2,704		1,183	
Net position profit and loss (marginal rate)	4,196		1,441		766	

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to interest rate risk – non-trading portfolios (continued)

The forecasts are based on historical trends and information regarding some events that could happen during 2008 - 2010. According to the CBAK management investment policy the marginal rate is around 1% (+/-) for current account deposit and 0.5% for time deposit. In the below scenarios there are presented two net position of interest expenses, the first follows the trend of time deposits and current accounts and the second net position of interest is based on marginal interest rate calculation.

Scenario A is based in more optimist trends of CBAK deposits with slight reduction during period of 2008 - 2010, as a result of this net position is much higher then expectation on scenario B and C. It is to mention that scenario A does not take under consideration at all interest rate changes. This scenario is more close to previous year figures, with a slightly reduction of government and KTA deposits.

Scenario B takes under consideration a very high reduction of government and KTA deposits (having in mind that the new Kosova Government is planning to use as much as possible the budget funds and disbursement of KTA funds to borrowers and employees).

Scenario C considers also facts mentioned to the scenario B and decrease on interest rate. The interest rate increase does not have any negative impact on the results of the operations of the Bank. The calculation of net income for scenario C is still positive, so CBAK even when the interest rate falls on level 1.5% on market it has ability to cover the Bank's expenses (interest expenses and operating expenses).

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Overall non-trading interest rate risk positions are managed by Asset Management Committee, which uses investment securities and advances to banks, to manage the overall position arising from the CBAK's non-trading activities.

An analysis of the CBAK's sensitivity to an increase or decrease in market interest rates (assuming no asymmetrical movement in yield curves and a constant balance sheet position) is as follows:

<i>Effect in thousands of euro</i>	(Loss) / profit for the period
2007	
Interest income (1% increase)	11,552
Interest income (1% decrease)	(11,552)
Interest expense (1% increase)	(8,959)
Interest expense (1% decrease)	8,959
2006	
Interest income (1% increase)	5,498
Interest income (1% decrease)	(5,498)
Interest expense (1% increase)	(4,813)
Interest expense (1% decrease)	4,813

Exposure to other market risks/currency risk – non-trading portfolios

The CBAK is exposed to currency risk through transactions in foreign currencies. The CBAK ensures that the net exposure is kept to an acceptable level by buying or selling foreign currency at spot when necessary to address short-term imbalances. The CBAK's exposure to foreign currency risk is as follows:

Central Banking Authority of Kosovo

Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(d) Market risks (continued)

Exposure to other market risks/currency risk – non-trading portfolios (continued)

	EUR	USD	Total
31 December 2007			
Assets			
Cash on hand	63,805	12	63,817
Current accounts with non resident banks	1,946	-	1,946
Treasury bills	229,277	-	229,278
Deposit accounts with non resident banks	762,579	-	762,578
Other assets	295	-	295
Total	1,057,902	12	1,057,914
Liabilities			
Due to domestic banks	113,554	-	113,554
Due to local governmental institutions	856,730	-	856,730
Due to public and commercial entities	48,381	-	48,381
Other domestic liabilities	7,743	-	7,743
Total	1,026,408	-	1,026,408
Net foreign currency position	31,492	12	31,504
31 December 2006			
Assets			
Cash on hand	11,123	13	11,136
Current accounts with non resident banks	22,480	-	22,480
Treasury bills	203,398	-	203,398
Deposit accounts with non resident banks	404,025	-	404,025
Other assets	177	-	177
Total	641,203	13	641,216
Liabilities			
Due to domestic banks	94,477	-	94,477
Due to local governmental institutions	475,821	-	475,821
Due to public and commercial entities	45,076	-	45,076
Other domestic liabilities	2,658	-	2,658
Total	618,032	-	618,032
Net foreign currency position	23,171	13	23,184

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(e) Operational risks

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

The CBAK's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the CBAK's reputation with overall cost effectiveness.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to managerial staff within each organization unit. This responsibility is supported by the development of overall CBAK standards for the management of operational risk in the following areas:

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

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

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(f) Capital management

Regulatory capital

UNMIK Regulation No 2006/47 approved on 24 August 2006 from the Special Representative of the Secretary General, sets capital requirements for the CBAK.

According to this regulation, the authorized capital of CBAK shall be EUR 20,000 thousand. In implementing current capital requirements the CBAK should maintain a prescribed ratio of total capital and reserves to total aggregated amount of the credit balances of all accounts maintained on the books of the CBAK by account holders shown on the balance sheet for the end of each year at least equivalent to 5%. The capital may be increased for such amounts as may be determined by the CBAK Governing Board and approved by the Special Representative of the Secretary-General. Whenever the net profit of CBAK for any financial year is insufficient to increase the capital and the General Reserve accounts of the CBAK to a level equivalent to 5% of the aggregate amount of the credit balance of all accounts maintained on the books of the CBAK by account holders shown on the balance sheet of the CBAK for the end of that financial year, the Ministry of Finance and Economy shall, within one month after publication of that balance sheet, make a capital contribution to CBAK in such amount or amounts as shall be necessary to remedy this deficit.

The net income shall be allocated in each year to the General Reserve account until the capital and General Reserve account are equal to 5% of the aggregated amount of the credit balance of all accounts maintained on the books of the CBAK by account holders shown on the balance sheet of the CBAK for the end of each financial year. Any balance in excess to such amount should be transferred to the Ministry of Finance and Economy as revenue for the budget.

The Bank's regulatory capital position at 31 December is as follows:

	Note	2007	2006
Capital and General Reserve			
Statutory Fund	18	20,000	10,000
Reserve Fund	19	4,590	14,590
Retained earnings	19	9,146	-
Total		<u>33,736</u>	<u>24,590</u>
Accounts maintained in the books of CBAK as at 31 December			
Due to domestic banks	14	113,554	94,477
Due to local governmental institutions	15	856,730	475,821
Due to public and commercial entities	16	48,381	45,076
Other domestic liabilities	17	1,612	2,139
Total		<u>1,020,277</u>	<u>617,513</u>
Capital/ Accounts maintained in the books of CBAK as at 31 December		3.305%	3.982%
Ratio required as per Regulation no 2006/47		5%	5%

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

4. Financial risk management (continued)

(f) Capital management (continued)

That 2006 and 2007 actual end-of-year ratios of CBAK total capital and reserves to total credit balances of all accounts maintained by account holders with the CBAK fall short of 5%, the Ministry of Economy and Finance was let to know. Following the audit for the financial year 2007, the CBAK will officially advise the Ministry of Economy and Finance of this shortfall. The CBAK does not consider it critical for properly carrying out its operations under UNMIK Regulation 2006/47, especially taking into account that balances of the Ministry of Finance and Economy and the Kosovo Trust Agency accounts, which constitute most of the total credit balances of all accounts maintained by account holders with the CBAK, have been foreseen to decline considerably in a very near future, thus enabling an increase in the above ratio.

5. Use of estimates and judgments

Management discussed with the Governing Board the development, selection and disclosure of the CBAK's critical accounting policies and estimates, and the application of these policies and estimates. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

These disclosures supplement the commentary on financial risk management (see note 4).

Key sources of estimation uncertainty

Allowances for impairment losses on loans and advances

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

The specific counterparty component of the total allowances for impairment applies to claims evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about counterparty's financial situation. In case any asset is impaired, it is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Management.

Critical accounting judgments in applying the CBAK's accounting policies

Critical accounting judgements made in applying the CBAK's accounting policies include:

Financial asset and liability classification

The CBAK's accounting policies provide scope for assets and liabilities to be designated on inception into different accounting categories in certain circumstances:

- In classifying financial assets as held-to-maturity, the CBAK has determined that it has both the positive intention and ability to hold the assets until their maturity date as required by accounting policy 3(h)(i).

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Notes to the financial statements

(In thousands of euro, unless otherwise stated)

6. Financial assets and liabilities

Accounting classifications and fair values

The table below sets out the CBAK's classification of each class of financial assets and liabilities, and their fair values (excluding accrued interest).

<i>In thousands of EUR</i>	Note	Loans and receivables	Held-to-maturity	Other amortised cost	Total carrying amount	Fair value
31 December 2007						
Cash on hand	7	63,817	-	-	63,817	63,817
Current accounts with non resident banks	8	1,946	-	-	1,946	1,946
Treasury bills	9	-	229,277	-	229,277	229,315
Deposit accounts with non resident banks	10	757,056	-	-	757,056	757,056
		<u>822,819</u>	<u>229,277</u>	<u>-</u>	<u>1,052,096</u>	<u>1,052,134</u>
Due to domestic banks	14	-	-	113,554	113,554	113,554
Due to local governmental institutions	15	-	-	856,730	856,730	856,730
Due to public and commercial entities	16	-	-	48,381	48,381	48,381
Other domestic liabilities	17	-	-	7,696	7,696	7,696
		<u>-</u>	<u>-</u>	<u>1,026,361</u>	<u>1,026,361</u>	<u>1,026,361</u>
31 December 2006						
Cash on hand	7	11,136	-	-	11,136	11,136
Current accounts with non resident banks	8	22,480	-	-	22,480	22,480
Treasury bills	9	-	203,398	-	203,398	203,398
Deposit accounts with non resident banks	10	402,563	-	-	402,563	402,563
		<u>436,179</u>	<u>203,398</u>	<u>-</u>	<u>639,577</u>	<u>639,577</u>
Due to domestic banks	14	-	-	94,477	94,477	94,477
Due to local governmental institutions	15	-	-	475,821	475,821	475,821
Due to public and commercial entities	16	-	-	45,076	45,076	45,076
Other domestic liabilities	17	-	-	2,357	2,357	2,357
		<u>-</u>	<u>-</u>	<u>617,731</u>	<u>617,731</u>	<u>617,731</u>

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

7. Cash on hand

Cash on hand is denominated as follows:

	2007	2006
EUR	63,805	11,123
USD	12	13
Total	63,817	11,136

The exchange rate used is 1 EUR = 1.4721 USD (31 December 2006: 1 EUR = 1.3173 USD)

8. Current accounts with non resident banks

These accounts were held at the following banks:

	2007	2006
Deutsche Bundesbank	1,343	21,967
Raiffeisen Zentralbank Osterreich AG	255	237
Svenska Handelsbanken	197	211
Dresdner Bank	112	48
Commerzbank AG	39	17
Total	1,946	22,480

9. Treasury bills

Treasury bills are discounted debt securities issued by governments of countries part of the European Union with maturities from three to six months. All bills are denominated in EUR and are to be held to maturity with effective interest rates ranging from 3.83% to 4.18% (2006: from 3.07% to 3.59%). They all have highest grade credit rating graded by the three credit rating agencies – Standard & Poor's, Fitch Ratings, or Moody's.

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Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

10. Deposit accounts with non resident banks

Deposit accounts with non resident banks are composed of:

	2007	2006
Time deposits		
Raiffeisen Zentralbank Osterreich AG	103,800	69,818
Svenska Handelsbanken	90,800	53,400
HBOS Treasury Service Plc	70,268	50,368
ING Bank	107,330	49,646
Dresdner Bank	92,600	46,300
Deutsche Bundesbank	101,800	45,000
KBC	66,488	44,612
Rabobank	32,754	21,680
Danske Bank	20,016	14,639
Commerzbank AG	71,200	7,100
	757,056	402,563
Interest accrued on time deposits		
Raiffeisen Zentralbank Osterreich AG	426	75
Svenska Handelsbanken	971	279
HBOS Treasury Service Plc	825	243
ING Bank	901	278
Dresdner Bank	701	190
Deutsche Bundesbank	477	72
KBC	540	165
Rabobank	214	146
Danske Bank	337	6
Commerzbank AG	131	8
	5,523	1,462
Total	762,579	404,025

Deposits placed with non resident banks are denominated in EUR and earn interest at effective interest rates ranging from 3.00% to 4.80% (2006: 3.16% to 3.79%) and have original maturities from 1 to 368 days (2006: from 7 to 367 days).

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

11. Property and equipment

	Lease hold improvement	Equipment	Computers	Vehicles	Assets in course of construction	Total
Cost						
Balance at 1 January 2006	-	469	288	99	61	917
Acquisitions	-	-	63	27	980	1,070
Disposals	-	-	-	(39)	-	(39)
Balance at 31 December 2006	-	469	351	87	1,041	1,948
Balance at 1 January 2007	-	469	351	87	1,041	1,948
Acquisitions	-	68	94	32	1,005	1,199
Transfers	1,279	767	-	-	(2,046)	-
Disposals	-	(33)	-	-	-	(33)
Balance at 31 December 2007	1,279	1,271	445	119	-	3,114
Depreciation						
Balance at 1 January 2006	-	337	179	72	-	588
Depreciation for the period	-	68	50	19	-	137
Disposals	-	-	-	(39)	-	(39)
Balance at 31 December 2006	-	405	229	52	-	686
Balance at 1 January 2007	-	405	229	52	-	686
Depreciation for the period	64	200	74	15	-	353
Disposals	-	(33)	-	-	-	(33)
Balance at 31 December 2007	64	572	303	67	-	1,006
Carrying amounts						
Balance at 1 January 2006	-	132	109	27	61	329
Balance at 31 December 2006	-	64	122	35	1,041	1,262
Balance at 31 December 2007	1,215	699	142	52	-	2,108

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

11. Property and equipment (continued)

Assets in course of construction relate to security improvements on the premises where the CBAK is exercising its activity. According to section three of UNMIK Regulation no 2006/47 on the Central Banking Authority of Kosovo the CBAK may for its official business purpose utilize and administer on behalf of the United Nations Interim Administration Mission in Kosovo ("UNMIK") the property and facilities, including moveable and immovable property, located at Garibaldi Street 33, Pristina, Kosovo and previously used by the Public Accounting Service of Kosovo. There are no assets pledged as collateral as at 31 December 2007 (2006: none).

12. Intangible assets

	<u>Software</u>
Cost	
Balance at 1 January 2006	821
Acquisitions	22
Disposals	-
Transfers	102
Balance at 31 December 2006	<u>945</u>
Balance at 1 January 2007	945
Acquisitions	72
Disposals	-
Transfers	-
Balance at 31 December 2007	<u>1,017</u>
Amortization	
Balance at 1 January 2006	656
Amortisation for the period	145
Disposal	-
Balance at 31 December 2006	<u>801</u>
Balance at 1 January 2007	801
Amortisation for the period	94
Disposal	-
Balance at 31 December 2007	<u>895</u>
Carrying amounts	
Balance at 1 January 2006	<u>165</u>
Balance at 31 December 2006	<u>144</u>
Balance at 31 December 2007	<u>122</u>

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

13. Other assets

	2007	2006
Accrued fee income	264	159
Accounts receivable and prepayments	31	18
Total	295	177

Accrued fee income represents estimated license renewal fee for the fourth quarter from local financial institutions.

14. Due to domestic banks

Under the CBAK supervision regulation Rule XVII commercial banks operating in Kosovo are required to maintain liquidity reserve amounting to 10% of their respective total customer deposits. At least half of these reserve balances must be kept in accounts at the CBAK.

The CBAK shall pay interest on the balances held at the CBAK up to the amount of the 10% minimum required reserve ratio. The interest rate as at 31 December 2007 was 3% (31 December 2006: 2.25%).

	2007	2006
ProCredit Bank Kosovo	21,889	19,039
Raiffeisen Bank Kosovo	19,219	15,232
Kasabank	4,880	5,105
New Bank of Kosovo	1,985	2,270
Economic Bank of Pristina	1,927	2,030
Bank for Business	1,460	1,650
National Commercial Bank of Albania	124	
Credit Bank of Pristina	-	-
Total required liquidity reserves	51,484	45,326
ProCredit Bank Kosovo	12,551	5,354
Raiffeisen Bank Kosovo	18,854	11,225
Kasabank	11,037	12,133
New Bank of Kosovo	4,206	4,840
Economic Bank of Pristina	1,701	4,008
Bank for Business	5,869	6,487
Credit Bank of Pristina	72	99
National Commercial Bank of Albania	5,731	5,005
Komercialna Banka	2,029	
Turk Economic Bank	20	-
Total current accounts	62,070	49,151
Total	113,554	94,477

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

15. Due to local governmental institutions

Due to local governmental institutions include current accounts from the following:

	2007	2006
Kosovo Trust Agency	405,895	275,022
Ministry of Finance and Economy	447,469	200,049
Other governmental institutions	3,342	578
UNMIK	24	172
Total	856,730	475,821

The effective interest rate for current accounts as at 31 December 2007 is 3% (31 December 2006: 2.25%).

16. Due to public and commercial entities

Due to public and commercial entities include current accounts and time deposits from the following:

	2007	2006
<i>Current accounts</i>		
Insurance companies	14,866	18,525
Public utility corporations	20,986	10,369
Pension funds	1,916	8,167
Other	2	18
	37,770	37,079
<i>Time deposits</i>		
Insurance companies	5,204	2,025
Pension funds	-	5,972
Public Utilities	5,407	-
	10,611	7,997
Total	48,381	45,076

The effective interest rate for current accounts as at 31 December 2007 is 3% (31 December 2006: 2.25%) and for time deposits are between 1.6% and 4.05% as at 31 December 2007 (31 December 2006: 2.35% to 3.39%).

17. Other domestic liabilities

	2007	2006
Liabilities to the Kosovo Government	1,094	1,636
Deferred grant revenue	49	301
Liabilities to the Former National Bank of Kosovo	480	467
Sundry creditors and accruals	178	218
Suspense account	5,904	-
Other domestic liabilities	38	36
Total	7,743	2,658

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

17. Other domestic liabilities (continued)

The balance of due to the Kosovo Government as at 31 December 2007 refers to EUR 1,094 thousand (2006: EUR 1,038 thousand) of rent collected for public buildings until establishment of ownership and EUR 1 thousand (2006: EUR 598 thousand) of supervisory penalties collected from financial institutions. On 18 May 2007 the amount of EUR 598 thousand collected since 24 April 2002 and related interest remunerated on this account was paid back to Government.

Liabilities to the Former National Bank of Kosovo arise from the following. Upon inception, the CBAK inherited certain amounts in cash, in various currencies, from the former National Bank of Kosovo. Also in this balance are included the related interest accumulated during the years since 5 January 2004. The cash was initially converted into DEM 872 thousand on 22 December 2000 and subsequently physically transferred and deposited in the CBAK's account at the Commerzbank AG Frankfurt. Balance of the account as at 1 January 2002 was converted in EUR 446 thousand and the resulting balance as at 31 December 2007 and 31 December 2006 includes this balance and interest remunerated as of those dates.

Suspense account amounting EUR 5,904 thousand (2006: EUR 0 thousand) relates to an outgoing transfer for KEK (Kosovo Electric Supplier). The amount was settled on 2 January 2008.

The movement in deferred grant revenue was as follows:

	Central Fiscal Authority/Ministry of Economy and Finance	World Bank/Other	Total
Deferred grant revenue at 31 December 2005	222	161	383
Deferred grant revenue at 1 January 2006	222	161	383
Grants received during the year	-	42	42
Grant revenue for the year	(73)	(51)	(124)
Deferred grant revenue at 31 December 2006	149	152	301
Deferred grant revenue at 1 January 2007	149	152	301
Grants received during the year	-	-	-
Grant revenue for the year	(149)	(103)	(252)
Deferred grant revenue at 31 December 2007	-	49	49

18. Statutory fund

The initial statutory fund of the CBAK, totaling DEM 5,000 thousand (EUR 2,556 thousand) was contributed by the Central Fiscal Authority on 31 March 2000. As at 8 June 2004 based on the decision of DSRSG (Deputy of Special Representative of the Secretary General) Pillar IV the statutory fund was increased from EUR 2,556 thousand to EUR 10,000 thousand.

On 15 June 2007 the amount of EUR 10,000 was transferred from reserve fund to statutory fund upon the approval from the board of directors. The CBAK is reporting directly to the Special Representative of the Secretary General of the United Nations Organisation. The CBAK capital is not subject to encumbrance.

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

19. Reserve fund

The reserve fund was created during the period up to 31 December 2006, in accordance with Regulation 2001/24 (amending Regulation 1999/20), amended by Regulation 2006/47 dated 24 August 2006 and the decision of the CBAK's Governing Board. All net profit for the year in 2005 was transferred to the reserve fund. For the year 2007 the decision is not yet taken but since the reserve is under the limits determined in the regulation the whole profit of the year is expected to be transferred to the reserve fund.

In 2006 the CBAK paid to the Ministry of Finance and Economy the amount of EUR 785 thousand (2005: EUR 382 thousand), representing the excess of its reserve fund over limits prescribed by the UNMIK Regulation 1999/20 issued on 15 November 1999 (as amended by Regulation 2001/24 in 1 October 2001) "On the Banking and Payment Authority of Kosovo". In 2007 no payments have been paid to the Ministry of Finance and Economy (2006: EUR 785 thousand)

20. Net interest income

Net interest income is composed as follows:

	2007	2006
Interest income		
From fixed term placements	25,447	9,493
From treasury bills	8,639	5,099
From current account placements (balances)	189	595
	34,275	15,187
Interest expense		
From current account deposits of non-bank entities	20,477	8,116
From eligible current account deposits of banks	1,624	492
From fixed term deposits	2,270	123
	24,371	8,731
Net interest income	9,904	6,456

21. Net fee and commission income

Net fee and commission income is composed as follows:

	2007	2006
Fee income		
From cash deposits	124	116
From foreign incoming transfers	197	196
From foreign outgoing transfers	283	291
From inter-bank clearing system	122	127
Other fees	17	14
	743	744
Fee expenses		
For cash export/import	197	204
For correspondent bank transactions	29	42
Other fees	-	4
	226	250
Net fee and commission income	517	494

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

22. Grant revenue

Grant revenue is composed as follows:

	2007	2006
MEF-World bank	275	142
EU	178	175
Total	453	317

23. Other operating income

Other operating income includes mainly fees charged to financial institutions in Kosovo as part of issuing or renewing of licenses as well as other statutory fees related to their activities.

24. Personnel expenses

	2007	2006
Wages and salaries	999	904
Social security and health insurance cost	259	224
Staff training	87	86
Governing Board remuneration	37	22
Other	30	18
Total	1,412	1,254

The number of employees of the CBAK as at 31 December 2007 was 141 (31 December 2006: 143).

25. General and administrative expenses

	2007	2006
Insurance expenses	191	240
Repairs and maintenance	67	89
Software maintenance	93	88
Communication expense (telephone, telex and internet)	62	85
Utilities	80	76
Audit and consulting expense	20	58
Security and cash transportation expenses (guard services)	46	53
Travel and transportation	75	42
Vehicle operating expenses	20	15
Stores and stationery	18	12
Food and restaurant expenses	10	11
Computer and other consumables expense	38	10
Publication and Literature Expenses	29	-
Other	74	91
Total	823	870

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

26. Cash and cash equivalents

Cash and cash equivalents comprise the following:

	Note	2007	2006
Cash on hand	6	63,817	11,136
Current accounts with non resident banks	7	1,946	22,480
Treasury bills with maturity up to three months	8	9,924	101,616
Deposit accounts with non resident banks with maturity up to three months	9	545,792	373,766
Total		621,479	508,998

27. Commitments and contingencies

Legal

The CBAK is involved in routine legal proceedings in the ordinary course of business. It is the management's opinion that the final outcome of these lawsuits will not have a material effect on the CBAK's results.

Credit related commitments

As at 31 December 2007, the CBAK had commitments to place deposits in total amount of EUR 28,191 thousand (31 December 2006 EUR 30,916 thousand).

Other commitments

Other commitments are composed as follows:

2007

	Not later than 1 year	Later than 1 year and not later than 5 years
Premises security upgrade (works and consulting)	92	-
Software maintenance	48	-
Total	140	-

2006

	Not later than 1 year	Later than 1 year and not later than 5 years
Premises security upgrade (works and consulting)	941	29
Purchase of equipment	51	-
Total	992	29

Central Banking Authority of Kosovo

Notes to the financial statements

(Amounts in EUR '000, unless otherwise stated)

28. Related party transactions

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

Related parties include the Management and the Governing Board. Their compensations are presented below:

	2007	2006
Governing Board remuneration	29	14
Management remuneration	65	50
Total	94	64

Management remuneration does not include the remuneration to the Managing Director of the CBAK, which is paid by the International Monetary Fund.

29. Subsequent events

There are no events after the balance sheet date that would require either adjustments or additional disclosures in the financial statements.