

**Central Bank of the Republic of Kosovo**

**Financial statements**

**as at and for the year ended 31 December 2008**

**(with independent auditor's report thereon)**

# Central Bank of the Republic of Kosovo

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## Independent Auditors' Report

To the Governing Board of  
the Central Bank of the Republic of Kosovo

Pristina, 2 June 2009

We have audited the accompanying financial statements of the Central Bank of the Republic of Kosovo ("the Bank"), which comprise the balance sheet as at 31 December 2008, 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 Bank as at 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance 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 Law No. 03/L-074 on the Central Bank of the Republic of Kosovo, the Capital and General Reserve Account of the Bank 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 Bank at the end of each financial year. As at 31 December 2008 and 2007 this requirement was not satisfied.

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# Central Bank of the Republic of Kosovo

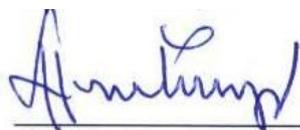
## Balance sheet

As at 31 December

<i>In thousands of EUR</i>	<b>Note</b>	<b>2008</b>	<b>2007</b>
<b>Assets</b>			
Cash on hand	7	39,674	63,817
Current accounts with non-resident banks	8	10,403	1,946
Treasury bills	9	541,019	229,277
Deposit accounts with non-resident banks	10	519,276	762,579
Property and equipment	11	2,087	2,108
Intangible assets	12	86	122
Other assets	13	406	295
<b>Total assets</b>		<b><u>1,112,951</u></b>	<b><u>1,060,144</u></b>
<b>Liabilities</b>			
Due to domestic banks	14	137,158	113,554
Due to local governmental institutions	15	908,212	856,730
Due to public and commercial entities	16	24,400	48,381
Other domestic liabilities	17	1,978	7,743
<b>Total liabilities</b>		<b><u>1,071,748</u></b>	<b><u>1,026,408</u></b>
<b>Capital and reserves</b>			
Statutory fund	18	30,000	20,000
Reserve fund	19	11,203	13,736
<b>Total capital and reserves</b>		<b><u>41,203</u></b>	<b><u>33,736</u></b>
<b>Total liabilities, capital and reserves</b>		<b><u>1,112,951</u></b>	<b><u>1,060,144</u></b>

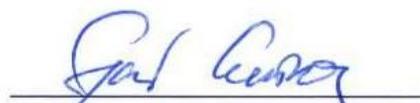
The notes on pages 5 to 37 are an integral part of these financial statements.

These financial statements set out on pages 1 to 37 were approved by the management of CBK on 5 May 2008 and signed on its behalf by:



Hashim Rexhepi

Governor



Gani Gerguri

Deputy Governor

# Central Bank of the Republic of Kosovo

## Income statement

For the year ended 31 December

<i>In thousands of EUR</i>	Note	2008	2007
Interest income		42,841	34,275
Interest expense		(34,063)	(24,371)
Net interest income	20	<u>8,778</u>	<u>9,904</u>
Fee and commission income		884	743
Fee and commission expense		(215)	(226)
Net fee and commission income	21	<u>669</u>	<u>517</u>
Grant revenue	22	85	453
Other operating income	23	1,087	954
<b>Operating income</b>		<b>10,619</b>	<b>11,828</b>
Personnel expenses	24	(1,771)	(1,412)
Depreciation and amortization	11,12	(458)	(447)
General and administrative expenses	25	(923)	(823)
<b>Operating expenses</b>		<b>(3,152)</b>	<b>(2,682)</b>
<b>Profit for the period</b>		<b><u>7,467</u></b>	<b><u>9,146</u></b>

The notes on pages 5 to 37 are an integral part of these financial statements.

# Central Bank of the Republic of Kosovo

## Statement of changes in equity for the year ended 31 December

*In thousands of EUR*

	Note	Statutory fund	Reserve fund	Retained Earnings	Total
<b>Balance at 1 January 2007</b>		<b>10,000</b>	<b>14,590</b>	-	<b>24,590</b>
Profit for the period		-	-	9,146	9,146
Total recognized income and expense		-	-	9,146	9,146
Transfer to statutory fund	18	10,000	(10,000)	-	-
<b>Balance at 31 December 2007</b>		<b>20,000</b>	<b>4,590</b>	<b>9,146</b>	<b>33,736</b>
<b>Balance at 1 January 2008</b>		<b>20,000</b>	<b>4,590</b>	<b>9,146</b>	<b>33,736</b>
Profit for the period		-	-	7,467	7,467
Total recognized income and expense		-	-	7,467	7,467
Transfer to statutory fund	18	10,000	(854)	(9,146)	-
<b>Balance at 31 December 2008</b>		<b>30,000</b>	<b>3,736</b>	<b>7,467</b>	<b>41,203</b>

The notes on pages 5 to 37 are an integral part of these financial statements.

# Central Bank of the Republic of Kosovo

## Statement of cash flows

For the year ended 31 December

<i>In thousands of EUR</i>	Note	2008	2007
<b>Cash flows from operating activities</b>			
<b>Profit for the period</b>		7,467	9,146
<i>Adjustments for:</i>			
Depreciation	11	378	353
Amortization	12	80	94
Grant revenue	17	(85)	(252)
Gain on sale of equipment		(5)	(4)
Interest income	20	(42,841)	(34,275)
Interest expense	20	34,063	24,371
		(943)	(567)
Change in treasury bills		(145,749)	(117,269)
Change in deposit accounts with non resident banks		197,908	(182,467)
Change in other assets		(111)	(118)
Change in due to domestic banks		23,604	19,077
Change in due to local governmental institutions		51,482	380,909
Change in due to public and commercial entities		(23,835)	3,305
Change in other domestic liabilities		(5,717)	5,337
		<b>96,639</b>	<b>108,207</b>
Interest received		47,329	29,912
Interest paid		(34,209)	(24,371)
<b>Net cash from operating activities</b>		<b>109,759</b>	<b>113,748</b>
<b>Cash flows from investing activities</b>			
Proceeds from sale of equipment		5	4
Purchase of equipment	11	(357)	(1,199)
Purchase of intangible assets	12	(44)	(72)
<b>Net cash used in investing activities</b>		<b>(396)</b>	<b>(1,267)</b>
<b>Cash flows from financing activities</b>			
Proceeds from grants	17	36	-
<b>Net cash from financing activities</b>		<b>36</b>	<b>-</b>
<b>Net increase in cash and cash equivalents</b>		<b>109,399</b>	<b>112,481</b>
Cash and cash equivalents at 1 January		621,479	508,998
<b>Cash and cash equivalents at 31 December</b>	26	<b>730,878</b>	<b>621,479</b>

The notes on pages 5 to 37 are an integral part of these financial statements.

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 1. Reporting entity

The Central Bank of the Republic of Kosovo (hereinafter "CBK"), the successor to the Central Banking Authority of Kosovo, is an independent juridical entity with full capacity as a legal person under the law applicable in the Republic of Kosovo. CBK is a distinct public entity with the authority to license, supervise and regulate financial institutions in the Republic of Kosovo. The initial predecessor entity of the CBK – the Banking and Payments Authority of Kosovo was established in accordance with the provisions of the United Nations Interim Administration Mission in Kosovo (hereinafter "UNMIK") Regulation no. 1999/20 issued on 15 November 1999, as amended on 1 October 2001 (UNMIK Regulation 2001/24). On 24 August 2006, a new regulation (UNMIK Regulation no. 2006/47) entered into force transforming the Banking and Payments Authority of Kosovo into the Central Banking Authority of Kosovo. On 5 June 2008, Law no. 03/L-074 on the Central Bank of the Republic of Kosovo was adopted by the Assembly of the Republic of Kosovo. As per this law, the principal objectives of CBK are to:

- foster the soundness, solvency and efficient functioning of a stable market-based financial system, encouraging market emergence of safe financial instruments; and
- without prejudice to this, support the general economic policies in Kosovo with a view to contributing to an efficient allocation of resources in accordance with the principle of an open market economy.

CBK has, amongst others, the powers:

- to recommend broad policy guidelines to the assembly and the government in areas under its responsibility;
- to formulate and implement measures for, and oversee and regulate, payments and settlement systems for transactions in domestic and foreign currency in Kosovo;
- to own and operate one or more payments systems;
- to act as banker to the Ministry of Finance and Economy and to provide financial advice at its request;
- to act as fiscal agent of the Ministry of Finance and Economy;
- to hold foreign currency deposits of banks, the Ministry of Finance and Economy, and other public entities;
- to ensure an adequate supply of bank notes and coins for the settlement of cash transactions;
- to maintain a depository for safe keeping of currency and securities;
- to license, supervise and regulate financial institutions;
- to conduct regular economic and monetary analysis of the Kosovo economy, make public the results, and submit proposals and measures to the assembly and government on the basis of such analysis;
- to supervise and regulate dealers in foreign exchange, broker-dealers, and mutual funds;
- to approve external auditors of the financial institutions; and
- to set accounting standards for the financial institutions in Kosovo in line with international financial reporting standards.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 1. Reporting entity (continued)

CBK operates from its premises located in Pristina. The address of the registered office of CBK is as follows:

33 Garibaldi Street

Pristina, Kosovo.

### ***Governing Board***

The Governing Board formulates policies for the operations of CBK and supervises their implementation. The management of CBK is required to report, not less than ten times each year, to the Governing board on the conduct of its operations and policies, on the soundness of the financial system, and on the state of the money, capital and foreign exchange markets, including all events and conditions that have or are expected to have a significant effect on the administration or operations of CBK or on the conduct of its policies or on the financial system or on the before-mentioned markets and on any other matter that affects or would potentially affect the policies of CBK.

The Governing Board determines policies for the operations of CBK and supervises their implementation. Under the Law No. 03/L-074, the Governing Board is composed of five members. The governing board has the following powers:

- to approve the policies for the execution of the powers of CBK and to supervise their implementation by the management and staff;
- to adopt all rules, orders and guidelines issued by CBK;
- to approve all reports and recommendations that CBK makes to the Assembly and Government;
- to designate, by resolution, at least two non-executive directors to constitute an Audit Committee;
- to approve the organization of CBK;
- to appoint the two Deputy Governors upon proposal by the Governor for a term of up to five years;
- to approve the appointment of the Inspector General of CBK for a term of up to five years;
- to approve the budget of CBK;
- to approve the accounting policies of CBK and to approve the periodic reports and financial statements of CBK;
- to decide on the incurrence of debt in material amounts by CBK and the terms and conditions of such debt;
- to approve the categories of assets that shall be suitable for investment of the financial resources of CBK;
- to approve or deny applications for financial institution licenses or registrations and to revoke financial institution licenses or registrations;
- to adopt internal structures, policies and procedures for licensing, registering, supervising and regulating financial institutions, including delegating powers to CBK staff to take corrective actions; and
- to ratify, before their implementation, all enforcement measures prepared by CBK staff, with the exception of those which are specifically under the competence of the Governor by law

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 1. Reporting entity (continued)

#### *Governing Board (continued)*

As at 31 December 2008, the Governing Board of CBK comprised the following members:

Gazmend Luboteni – Chairman

Hashim Rexhepi – Governor

Lulzim Ismajli – Director of Treasury of Ministry of Finance and Economy

Sejdi Rexhepi – Member

### 2. Basis of preparation

#### a) Statement of compliance

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

#### b) Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following:

- derivative financial instruments are measured at fair value
- financial instruments at fair value through profit or loss are measured at fair value
- available-for-sale financial assets are measured at fair value
- investment property is measured at fair value
- liabilities for cash-settled share-based payment arrangements are measured at fair value
- recognised financial assets and financial liabilities designated as hedged items in qualifying fair value hedge relationships are adjusted for changes in fair value attributable to the risk being hedged.

#### c) Functional and presentation currency

These financial statements are presented in Euro (“EUR”), which is CBK’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. 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.

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

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, unless otherwise stated)

### 3. Significant accounting policies

#### 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 the 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.

CBK deals predominantly in EUR, while the foreign currencies CBK deals with are predominantly United States Dollars (USD). The exchange rates used for translation at 31 December 2008 and 2007 were as follows:

	<b>2008</b>	<b>2007</b>
	<b>EUR</b>	<b>EUR</b>
1 USD	0.718	0.679

#### 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.

#### 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 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.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 3. Significant accounting policies (continued)

#### d) Employee benefits

##### *i. Defined contribution plans*

CBK 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. CBK's contributions are charged to the income statement as incurred.

Additionally CBK recognizes fixed contributions payable into external pension funds. The supplementary contribution rate is 10% of gross salary. These amounts are recognized as expenses when they are due. CBK 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

CBK is exempt from income tax according to Law No. 03/L-074 issued on 5 June 2008 which requires CBK 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 (see note 4 f).

#### f) Financial assets and liabilities

##### *i. Recognition*

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

##### *ii. Derecognition*

CBK 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 CBK is recognized as a separate asset or liability.

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

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 3. Significant accounting policies (continued)

#### f) Financial assets and liabilities (continued)

##### *iii. Offsetting*

Financial assets and liabilities are set off and the net amount is presented in the balance sheet when, and only when, CBK 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. CBK 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 CBK 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.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, restructuring of a placement or advance by CBK on terms that CBK 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 CBK, or economic conditions that correlate with defaults in CBK.

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.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 3. Significant accounting policies (continued)

#### 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 CBK 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.

##### *i. Held-to-maturity*

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that CBK 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 CBK 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 CBK 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.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, unless otherwise stated)

### 3. Significant accounting policies (continued)

#### i) Property and equipment (continued)

##### 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:

	2008	2007
• Leasehold improvement	20 years	20 years
• Equipment	5 years	5 years
• Computers	3 years	3 years
• Vehicles	5 years	5 years

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

#### j) Intangible assets

Software acquired by CBK 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 (2007: 3 years).

#### k) Impairment of non-financial assets

The carrying amounts of CBK'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.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, unless otherwise stated)

### 3. Significant accounting policies (continued)

#### l) Deposits and other financial liabilities

Deposits are CBK'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 CBK chooses to carry the liabilities at fair value through profit or loss.

#### m) Grant revenue

Government grants are recognised initially as deferred income when there is reasonable assurance that they will be received and that CBK will comply with the conditions associated with the grant. Grants that compensate CBK 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 CBK 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 individuals engaged at CBK are international experts appointed by international organisations who provide financial support to CBK. 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 the international organisations directly to the appointee, the extent of the payments are not known nor are they included in these financial statements.

#### o) Provisions

A provision is recognised if, as a result of a past event, CBK 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 CBK 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, CBK recognises any impairment loss on the assets associated with that contract.

#### p) 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 2008, 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 Standard, failure to meet non-vesting conditions will generally result in treatment as a cancellation. Revised IFRS 2 is not relevant to CBK's operations as CBK does not have any share-based compensation plans.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, unless otherwise stated)

### 3. Significant accounting policies (continued)

#### p) New standards and interpretations not yet adopted

- 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 recognized and measured at fair value as of the acquisition date, including contingent consideration.
  - Subsequent change in contingent consideration will be recognized in profit or loss.
  - Transaction costs, other than share and debt issuance costs, will be expensed as incurred.
  - 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, on a transaction-by-transaction basis.

CBK does not expect this revised Standard to be relevant to its operations.

- 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. CBK has not yet completed its analysis of the impact of this revised Standard.
- 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). CBK 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 CBK's operations as the CBK does not have any qualifying assets for which borrowing costs would be capitalised.
- Amendments to IAS 27 *Consolidated and Separate Financial Statements* (effective for annual periods beginning on or after 1 January 2009). The amendments remove the definition of "cost method" currently set out in IAS 27, and instead require all dividends from a subsidiary, jointly controlled entity or associate to be recognised as income in the separate financial statements of the investor when the right to receive the dividend is established. In addition, the amendments provide guidance when the receipt of dividend income is deemed to be an indicator of impairment. IAS 27 is not relevant to CBK's operations as CBK does not have interests in subsidiaries that will be affected by the revisions to this Standard.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, unless otherwise stated)

### 3. Significant accounting policies (continued)

#### p) 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. IAS 27 is not relevant to CBK's operations as CBK does not have interests in subsidiaries that will be affected by the revisions to this Standard.
- Amendments to IAS 32 Financial Instruments: Presentation, and IAS 1, Presentation of Financial Statements (effective for annual periods beginning on or after 1 January 2009). The amendments introduce an exemption to the principle otherwise applied in IAS 32 for the classification of instruments as equity; the amendments allow certain puttable instruments issued by an entity that would normally be classified as liabilities to be classified as equity if, and only if, they meet certain conditions. The subject of these revisions is not relevant to CBK's operations as CBK does not issue puttable instrument.
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement (effective for annual periods beginning on or after 1 July 2009). The amended Standard clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. In designating a hedging relationship the risks or portions must be separately identifiable and reliably measurable; however inflation cannot be designated, except in limited circumstances. The amendments to IAS 39 are not relevant to CBK's operations as CBK does not apply hedge accounting.
- 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. IFRIC 13 is not relevant to CBK's operations as CBK does not have customer loyalty programmes.
- IFRIC 15 *Agreements for the Construction of Real Estate* (effective for annual periods beginning on or after 1 January 2009). IFRIC 15 clarifies that revenue arising from agreements for the construction of real estate is recognised by reference to the stage of completion of the contract activity in the following cases:
  - the agreement meets the definition of a construction contract in accordance with IAS 11.3;
  - the agreement is only for the rendering of services in accordance with IAS 18 (e.g., the entity is not required to supply construction materials); and
  - the agreement is for the sale of goods but the revenue recognition criteria of IAS 18.14 are met continuously as construction progresses.

In all other cases, revenue is recognised when all of the revenue recognition criteria of IAS 18.14 are satisfied (e.g., upon completion of construction or upon delivery). IFRIC 15 is not relevant to the CBK's operations as the CBK does not provide real estate construction services or develop real estate for sale.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 3. Significant accounting policies (continued)

#### p) New standards and interpretations not yet adopted (continued)

- IFRIC 16 Hedges of a Net Investment in a Foreign Operation (effective for annual periods beginning on or after 1 October 2008). The Interpretation explains the type of exposure that may be hedged, where in entity the hedged item may be held, whether the method of consolidation affects hedge effectiveness, the form the hedged instrument may take and which amounts are reclassified from equity to profit or loss on disposal of the foreign operation. CBK does not expect the Interpretation to have any impact on the financial statements.
- IFRIC 17 Distributions of Non-cash Assets to Owners (effective prospectively for annual periods beginning on or after 15 July 2009). The Interpretation applies to non-reciprocal distributions of non-cash assets to owners acting in their capacity as owners. In accordance with the Interpretation a liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity and shall be measured at the fair value of the assets to be distributed. The carrying amount of the dividend payable shall be remeasured at each reporting date, with any changes in the carrying amount recognised in equity as adjustments to the amount of the distribution. When the dividend payable is settled the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable shall be recognised in profit or loss. As the Interpretation is applicable only from the date of application, it will not impact the financial statements for periods prior to the date of adoption of the interpretation. Further, since CBK does not distribute dividends, CBK does not expect the Interpretation to have any impact on the financial statements.
- IAS 40 Investment Property (effective for annual periods beginning on or after 1 January 2009). IAS 40 is amended to include property under construction or development for future use as investment property in its definition of “investment property”. This results in such property being within the scope of IAS 40; previously it was within the scope of IAS 16. IAS 40 is not relevant to current CBK’s operations as they have no investment property.

The International Accounting Standards Board made certain amendments to existing standards as part of its first annual improvements project. The effective dates for these amendments vary by standard and most will be applicable to the Bank’s 2009 financial statements. The Bank does not expect these amendments to have any significant impact on the financial statements.

#### q) Comparatives

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

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 4. Financial risk management

#### a) Introduction and overview

CBK 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 CBK's exposure to each of the above risks, CBK's objectives, policies and processes for measuring and managing risk, and CBK'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 CBK's risk management framework. CBK management reports regularly to the Governing Board on risk management practice. The Executive Committee and Investment Committee have obligations for developing and monitoring CBK risk management policies. These policies are implemented by the respective organisational units.

CBK's risk management policies are established to identify and analyze the risks faced by CBK, 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. CBK, 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.

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

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 4. Financial risk management (continued)

#### b) Credit risk

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

#### *Management of credit risk*

##### *i. Investments and exposure to other banks*

CBK limits its exposure to credit risk by investing only in securities issued by the governments of 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.

##### *ii. Exposure to credit risk*

The maximum exposure to credit risk as at 31 December 2008 and 31 December 2007 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 CBK's exposures are past due or impaired. There are no changes in the credit risk management policies from previous years. CBK does not hold any collateral or other credit enhancements against its exposure to credit risk.

#### c) Liquidity risk

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

#### *Management of liquidity risk*

CBK'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 CBK's reputation.

Policies to monitor and address liquidity risk are set by the Governing Board. CBK manages its liquidity risk by investing in short term deposits with non resident banks and holding adequate quantity of cash in its vaults. Liquidity management policies are set to ensure that even under adverse conditions, CBK 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 CBK management. Daily reports covering the liquidity position of CBK are regularly submitted to the Investment Committee members by the Asset Management Department.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, 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	Less than 1 month	1-3 months	3 Months to 1 year
<b>31 December 2008</b>					
<i>Non-derivative liabilities</i>					
Due to domestic banks	14	137,158	137,158	-	-
Due to local governmental institutions	15	908,212	640,642	109,715	157,855
Due to public and commercial entities	16	24,400	22,554	1,846	-
Other domestic liabilities	17	1,978	1,978	-	-
		<b>1,071,748</b>	<b>802,332</b>	<b>111,561</b>	<b>157,855</b>

##### **31 December 2007**

##### *Non-derivative liabilities*

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	37,825	-	10,556
Other domestic liabilities	17	7,743	7,743	-	-
		<b>1,026,408</b>	<b>1,015,852</b>	<b>-</b>	<b>10,556</b>

The previous table shows the discounted cash flows of CBK'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 of the financial liability or commitment.

##### ***Volatility in global and Kosovo's financial markets***

The ongoing global financial and economic crisis has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and volatility in stock markets. Further adverse developments resulting from the crisis might result in negative implications on the financial and liquidity position of the CBK.

#### **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 CBK'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.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 4. Financial risk management (continued)

#### d) Market risks (continued)

##### *Management of market risks*

CBK'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, there is exposure to basis risk, which is the difference in repricing characteristics of the various floating rate indices.

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

CBK 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 instruments because of a change in market interest rates. Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands. The Investment Committee is the monitoring body for compliance with these limits. A summary of CBK's interest rate gap position on non-trading portfolios is as follows:

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, 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
<b>31 December 2008</b>					
Cash on hand	7	39,674	39,674	-	-
Current accounts with non-resident banks	8	10,403	10,403	-	-
Treasury bills	9	541,019	175,559	335,881	29,579
Deposit accounts with non-resident banks	10	519,276	505,242	1,829	12,205
<b>Total</b>		<b>1,110,372</b>	<b>730,878</b>	<b>337,710</b>	<b>41,784</b>
Due to domestic banks	14	(137,158)	(137,158)	-	-
Due to local governmental institutions	15	(908,212)	(750,357)	(157,855)	-
Due to public and commercial entities	16	(24,400)	(24,400)	-	-
Other domestic liabilities	17	(1,978)	(1,978)	-	-
<b>Total</b>		<b>(1,071,748)</b>	<b>(913,893)</b>	<b>(157,855)</b>	<b>-</b>
<b>Gap</b>		<b>38,624</b>	<b>(183,015)</b>	<b>179,855</b>	<b>41,784</b>
<b>31 December 2007</b>					
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
<b>Total</b>		<b>1,057,619</b>	<b>621,479</b>	<b>276,878</b>	<b>159,262</b>
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	(7,743)	(7,743)	-	-
<b>Total</b>		<b>(1,026,408)</b>	<b>(1,021,252)</b>	<b>-</b>	<b>(5,156)</b>
<b>Gap</b>		<b>31,211</b>	<b>(399,773)</b>	<b>276,878</b>	<b>154,106</b>

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, unless otherwise stated)

### 4. Financial risk management (continued)

#### d) Market risks (continued)

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

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a regular basis include a 100 basis point (bp) parallel fall or rise in all yield curves. An analysis of the Bank'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:

2008	up to 1 Year scenarios		over 1 Year scenarios	
	100 bp Increase	100 bp decrease	100 bp increase	100 bp decrease
Estimated Profit (loss) effect	95	(95)	-	-

2007	up to 1 Year scenarios		over 1 Year scenarios	
	100 bp Increase	100 bp decrease	100 bp increase	100 bp Decrease
Estimated Profit (loss) effect	268	(268)	-	-

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

CBK is exposed to currency risk through transactions in foreign currencies. CBK 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. CBK's exposure to foreign currency risk is as follows:

	EUR	USD	Total
<b>31 December 2008</b>			
<b>Assets</b>			
Cash on hand	39,674	-	39,674
Current accounts with non-resident banks	10,403	-	10,403
Treasury bills	541,019	-	541,019
Deposit accounts with non-resident banks	519,276	-	519,276
Other assets	406	-	406
<b>Total</b>	<b>1,110,778</b>	<b>-</b>	<b>1,110,778</b>
<b>Liabilities</b>			
Due to domestic banks	137,158	-	137,158
Due to local governmental institutions	908,212	-	908,212
Due to public and commercial entities	24,400	-	24,400
Other domestic liabilities	1,978	-	1,978
<b>Total</b>	<b>1,071,748</b>	<b>-</b>	<b>1,071,748</b>
<b>Net foreign currency position</b>	<b>39,030</b>	<b>-</b>	<b>39,030</b>

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, 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
<b>31 December 2007</b>			
<b>Assets</b>			
Cash on hand	63,805	12	63,817
Current accounts with non-resident banks	1,946	-	1,946
Treasury bills	229,277	-	229,277
Deposit accounts with non-resident banks	762,579	-	762,579
Other assets	295		295
<b>Total</b>	<b>1,057,902</b>	<b>12</b>	<b>1,057,914</b>
<b>Liabilities</b>			
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
<b>Total</b>	<b>1,026,408</b>	<b>-</b>	<b>1,026,408</b>
<b>Net foreign currency position</b>	<b>31,494</b>	<b>12</b>	<b>31,506</b>

#### (e) Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with CBK'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 CBK's operations and are faced by all organization units.

CBK's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to CBK'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 CBK 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 actions;
- development of contingency plans;
- training and professional development;
- ethical and conduct standards; and
- risk mitigation, including insurance where this is effective.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### 4. Financial risk management (continued)

#### e) Operational risks (continued)

Compliance with CBK 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 CBK management.

#### f) Capital management

##### *Regulatory capital*

Law no. 03/L-074 on the Central Bank of the Republic of Kosovo, approved on 5 June 2008 by the Assembly of the Republic of Kosovo, sets the capital requirements of CBK. According to this law, the authorised capital of CBK is EUR 30 million. According to legal provisions, the capital and the general reserve accounts shall be at least equivalent to five percent of the aggregate amount of the credit balances of all accounts maintained on the books of CBK by account holders shown on the balance sheet of CBK for the end of each financial year. The capital may be increased by such amounts as may be determined by the CBK Governing Board and approved by the Government. CBK capital is not subject to encumbrance.

No reduction of capital can be effected except by promulgation of legislation adopted by the Assembly. Whenever:

- on a monthly pro forma balance sheet of CBK the value of its assets falls below the sum of its liabilities and its unimpaired authorised capital,
- the net profit of CBK for any financial year is insufficient to increase the capital and general reserve accounts of CBK to a level equivalent to five percent of the aggregate amount of the credit balances of all accounts maintained on the books of CBK by account holders shown on the balance sheet of CBK 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 CBK in such amount or amounts as shall be necessary to remedy this deficit.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

(in thousands of EUR, unless otherwise stated)

### 4. Financial risk management (continued)

#### f) Capital management (continued)

##### Regulatory capital (continued)

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

	Note	2008	2007
<b>Capital and general reserve</b>			
Statutory fund	18	30,000	20,000
Reserve fund	19	3,736	4,590
Retained earnings	19	7,467	9,146
<b>Total</b>		<b>41,203</b>	<b>33,736</b>

##### Accounts maintained in the books of CBK as at 31 December

Due to domestic banks	14	137,158	113,554
Due to local governmental institutions	15	908,212	856,730
Due to public and commercial entities	16	24,400	48,381
Other domestic liabilities	17	1,695	1,612
<b>Total</b>		<b>1,071,465</b>	<b>1,020,277</b>

##### Capital/Accounts maintained in the books of CBK as at 31 December

	<b>3.85%</b>	<b>3.31%</b>
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##### Ratio required as per law

	<b>5%</b>	<b>5%</b>
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Other domestic liabilities disclosed in the previous table do not include the balances which related to 'Deferred grant revenue', 'Sundry creditors and accruals' and 'Transit accounts'.

As per Law no. 03/L-074, the net income or the net loss of CBK is calculated in accordance with International Financial Reporting Standards (IFRS).

Net income is allocated in each year to a general reserve account until the capital and general reserve accounts are equal to five percent of the aggregate amount of the credit balances of all accounts maintained on the books of the CBK by account holders shown on the balance sheet of the CBK for the end of each financial year.

Any balance of net realized income is required to be transferred to the Ministry of Finance and Economy as revenue for the budget. If there is a net realized loss, it is required to be charged to the general reserve account or to capital, in that order.

# Central Bank of the Republic of Kosovo

## Note to the financial statements

*(in thousands of EUR, unless otherwise stated)*

### **5. Use of estimates and judgments**

Management discusses with the Governing Board the development, selection and disclosure of CBK'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 management.

##### **Critical accounting judgments in applying the CBK's accounting policies**

Critical accounting judgements made in applying CBK's accounting policies include:

##### **Financial asset and liability classification**

CBK'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, CBK 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).

# Central Banking Authority of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 6. Financial assets and liabilities

#### Accounting classifications and fair values

The table below sets out CBK's classification of each class of financial assets and liabilities, and their fair values.

<i>In thousands of EUR</i>	Note	Loans and receivables	Held-to-maturity	Other amortized cost	Total carrying amount	Fair value
<b>31 December 2008</b>						
Cash on hand	7	39,674	-	-	39,674	39,674
Current accounts with non-resident banks	8	10,403	-	-	10,403	10,403
Treasury bills	9	-	541,019	-	541,019	541,759
Deposit accounts with non-resident banks	10	519,276	-	-	519,276	519,276
		<b>569,353</b>	<b>541,019</b>	<b>-</b>	<b>1,110,372</b>	<b>1,111,112</b>
Due to domestic banks	14	-	-	137,158	137,158	137,158
Due to local governmental institutions	15	-	-	908,212	908,212	908,212
Due to public and commercial entities	16	-	-	24,400	24,400	24,400
Other domestic liabilities	17	-	-	1,978	1,978	1,978
		<b>-</b>	<b>-</b>	<b>1,071,748</b>	<b>1,071,748</b>	<b>1,071,748</b>
<b>31 December 2007</b>						
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	762,579	-	-	762,579	762,579
		<b>828,342</b>	<b>229,277</b>	<b>-</b>	<b>1,057,619</b>	<b>1,057,657</b>
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	-	-	7,743	7,743	7,743
		<b>-</b>	<b>-</b>	<b>1,026,408</b>	<b>1,026,408</b>	<b>1,026,408</b>

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 7. Cash on hand

Cash on hand is denominated as follows:

	2008	2007
EUR	39,674	63,805
USD	-	12
<b>Total</b>	<b>39,674</b>	<b>63,817</b>

### 8. Current accounts with non-resident banks

These accounts were held at the following banks:

	2008	2007
Deutsche Bundesbank	9,436	1,343
Raiffeisen Zentralbank	161	255
Svenska Handelsbanken	130	197
Dresdner Bank	-	112
Commerzbank	676	39
<b>Total</b>	<b>10,403</b>	<b>1,946</b>

### 9. Treasury bills

Treasury bills are debt securities issued by governments of European Union countries. They have maturities up to twelve months and they are to be held until maturity. All bills are denominated in EUR and have effective interest rates ranging from 1.83% to 4.37% (2007: 3.83% to 4.18%).

Treasury bills are issued by governments of European Union countries as follows:

	2008	2007
Germany	69,537	54,572
France	84,929	39,627
Finland	-	35,786
The Netherland	54,904	-
Italy	67,128	24,738
Portugal	43,836	19,890
Belgium	220,685	54,664
<b>Total</b>	<b>541,019</b>	<b>229,277</b>

The Bank invests in treasury bills with a minimum credit rating of AA (Standard & Poor's rating).

Treasury bills at 31 December 2008 include an amount of EUR 267,893 thousand that represents treasury bills purchased by the Bank for the Ministry of Finance and Economy (the "Ministry"). Based on a Memorandum of Understanding with the Ministry, the Bank will act as an Investment Manager of the funds of the Ministry. The parties are in the process of seeking clarification on the agreement, including accounting implications such as whether the investments are assets or liabilities of the Bank, if they should be recognized in the balance sheet and whether the Bank is exposed to any credit risk relating to such investments.

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 10. Deposit accounts with non-resident banks

Deposit accounts with non-resident banks are composed of:

	2008	2007
<b>Time deposits</b>		
Raiffeisen Zentralbank	29,700	103,800
Svenska Handelsbanken	166,200	90,800
HBOS Treasury Service	-	70,268
ING Bank	21,735	107,330
Dresdner Bank	-	92,600
Deutsche Bundesbank	50,300	101,800
KBC	41,571	66,488
Rabobank	96,579	32,754
Danske Bank	46,813	20,016
Commerzbank	65,700	71,200
	<b>518,598</b>	<b>757,056</b>
<b>Interest accrued on time deposits</b>		
Raiffeisen Zentralbank	153	426
Svenska Handelsbanken	92	971
HBOS Treasury Service	-	825
ING Bank	2	901
Dresdner Bank	-	701
Deutsche Bundesbank	95	477
KBC	5	540
Rabobank	319	214
Danske Bank	6	337
Commerzbank	6	131
	<b>678</b>	<b>5,523</b>
<b>Total</b>	<b>519,276</b>	<b>762,579</b>

Deposits placed with non-resident banks are denominated in EUR and earn interest at effective interest rates ranging from 1.41% to 5.00% (2007: 3.00% to 4.80%) and have original maturities from 1 to 355 days (2007: from 1 to 368 days).

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 11. Property and equipment

Property and equipment is composed as follows:

	Leasehold improvement	Equipment	Computers	Vehicles	Assets in course of construction	Total
<b>Cost</b>						
<b>At 1 January 2007</b>		<b>469</b>	<b>351</b>	<b>87</b>	<b>1,041</b>	<b>1,948</b>
Acquisitions	-	68	94	32	1,005	1,199
Transfers	1,279	767	-	-	(2,046)	-
Disposals	-	(33)	-	-	-	(33)
<b>At 31 December 2007</b>	<b>1,279</b>	<b>1,271</b>	<b>445</b>	<b>119</b>	<b>-</b>	<b>3,114</b>
At 1 January 2008	1,279	1,271	445	119	-	3,114
Acquisitions	-	188	169	-	-	357
Disposals	-	-	(1)	(12)	-	(13)
<b>At 31 December 2008</b>	<b>1,279</b>	<b>1,459</b>	<b>613</b>	<b>107</b>	<b>-</b>	<b>3,458</b>
<b>Depreciation</b>						
<b>At 1 January 2007</b>	-	<b>405</b>	<b>229</b>	<b>52</b>	-	<b>686</b>
Charge for the period	64	200	74	15	-	353
Disposals	-	(33)	-	-	-	(33)
<b>At 31 December 2007</b>	<b>64</b>	<b>572</b>	<b>303</b>	<b>67</b>	<b>-</b>	<b>1,006</b>
At 1 January 2008	64	572	303	67	-	1,006
Charge for the period	64	203	94	17	-	378
Disposals	-	-	(1)	(12)	-	(13)
<b>At 31 December 2008</b>	<b>128</b>	<b>775</b>	<b>396</b>	<b>72</b>	<b>-</b>	<b>1,371</b>
<b>Carrying amounts</b>						
<b>At 1 January 2007</b>	-	<b>64</b>	<b>122</b>	<b>35</b>	<b>1,041</b>	<b>1,262</b>
<b>At 31 December 2007</b>	<b>1,215</b>	<b>699</b>	<b>142</b>	<b>52</b>	<b>-</b>	<b>2,108</b>
<b>At 31 December 2008</b>	<b>1,151</b>	<b>684</b>	<b>217</b>	<b>35</b>	<b>-</b>	<b>2,087</b>

Assets in course of construction relate to security improvements of CBK's office building. According to article three of Law no. 03/L-074, CBK, for its official business purposes, utilizes and administers the property and facilities, including moveable and immovable property, located at Garibaldi Street 33, Pristina, Kosovo.

There are no assets pledged as collateral as at 31 December 2008 (2007: none).

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 12. Intangible assets

Intangible assets are composed as follows:

	Software under development	Software	Total
<b>Cost</b>	-		
Balance at 1 January 2007	-	945	945
Acquisitions	-	72	72
<b>Balance at 31 December 2007</b>	-	<b>1,017</b>	<b>1,017</b>
Balance at 1 January 2008	-	1,017	1,017
Acquisitions	25	19	44
<b>Balance at 31 December 2008</b>	<b>25</b>	<b>1,036</b>	<b>1,061</b>
<b>Amortization</b>			
Balance at 1 January 2007	-	801	801
Amortization for the period	-	94	94
<b>Balance at 31 December 2007</b>	-	<b>895</b>	<b>895</b>
Balance at 1 January 2008	-	895	895
Amortization for the period	-	81	80
<b>Balance at 31 December 2008</b>	-	<b>976</b>	<b>975</b>
<b>Carrying amounts</b>			
<b>Balance at 1 January 2007</b>	-	<b>144</b>	<b>144</b>
<b>Balance at 31 December 2007</b>	-	<b>122</b>	<b>122</b>
<b>Balance at 31 December 2008</b>	<b>25</b>	<b>60</b>	<b>86</b>

### 13. Other assets

Other assets are composed as follows:

	2008	2007
Accrued fee income	357	264
Accounts receivable and prepayments	49	31
<b>Total</b>	<b>406</b>	<b>295</b>

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

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 14. Due to domestic banks

Under CBK supervision Banking Rule XVII, commercial banks operating in Kosovo are required to maintain a liquidity reserve amounting to 10% of their qualifying customer deposits. At least half of these reserve balances must be kept in accounts at CBK.

CBK shall pay interest on the balances held at CBK up to the amount of the 10% minimum required reserve ratio. The annual interest rate as at 31 December 2008 was 1.25% (31 December 2007: 3%).

	2008	2007
ProCredit Bank	25,117	21,889
Raiffeisen Bank	23,875	19,219
NLB Prishtina	7,699	6,865
Commercial Bank	1,132	-
Economic Bank	2,191	1,927
Bank for Business	2,025	1,460
Banka Kombetare Tregtare	352	124
Turkish Economic Bank	1,381	-
<b>Total required liquidity reserves</b>	<b>63,772</b>	<b>51,484</b>
ProCredit Bank	34,242	12,551
Raiffeisen Bank	12,438	18,854
NLB Prishtina	7,023	15,243
Economic Bank	1,520	1,701
Bank for Business	10,164	5,869
Credit Bank of Pristina	226	72
Banka Kombetare Tregtare	4,852	5,731
Commercial Bank	1,179	2,029
Turkish Economic Bank	1,742	20
<b>Total current accounts</b>	<b>73,386</b>	<b>62,070</b>
<b>Total</b>	<b>137,158</b>	<b>113,554</b>

### 15. Due to local governmental institutions

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

	2008	2007
Privatization Agency of Kosovo	403,610	405,895
Ministry of Finance and Economy	498,425	447,469
Other governmental institutions	6,177	3,342
UNMIK	-	24
<b>Total</b>	<b>908,212</b>	<b>856,730</b>

The effective interest rate for current accounts as at 31 December 2008 is 1.25% (31 December 2007: 3%).

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 16. Due to public and commercial entities

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

	2008	2007
<b>Current accounts</b>		
Insurance companies	15,394	14,866
Public utility corporations	1,535	20,986
Pension funds	67	1,916
Other	2	2
	<b>16,998</b>	<b>37,770</b>
<b>Time deposits</b>		
Insurance companies	7,402	5,204
Public utility corporations	-	5,407
Pension funds	-	-
	<b>7,402</b>	<b>10,611</b>
<b>Total</b>	<b>24,400</b>	<b>48,381</b>

The effective interest rate for current accounts as at 31 December 2008 is 1.25% (31 December 2007: 3%) and for time deposits is between 3.95% and 4.45% (31 December 2007: 1.6% and 4.05%).

### 17. Other domestic liabilities

	2008	2007
Liabilities to the Kosovo Government	1,162	1,094
Deferred grant revenue	-	49
Liabilities to the former National Bank of Kosovo	495	480
Sundry creditors and accruals	283	178
Transit account	-	5,904
Other domestic liabilities	38	38
<b>Total</b>	<b>1,978</b>	<b>7,743</b>

The balance due to the Kosovo Government represents rent and supervisory penalties which were collected by the Bank. At the date of the approval of these financial statements the beneficiary of such revenue was not yet determined.

Liabilities to the former National Bank of Kosovo arise from the following. Upon inception, CBK inherited certain amounts in cash, in various currencies, from the former National Bank of Kosovo. Also included in this balance is the related interest accumulated since 5 January 2004. The cash was initially converted into DEM 872 thousand on 22 December 2000 and subsequently transferred and deposited in CBK's account at Commerzbank AG Frankfurt. The balance of the account as at 1 January 2002 was converted to EUR 446 thousand and the resulting balance as at 31 December 2008 and 31 December 2007 includes this balance and interest earned as at those dates.

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 17. Other domestic liabilities (continued)

The transit account amounting to EUR 5,904 thousand in 2007 relates to an outgoing transfer for Kosovo Energy Corporation (KEK). 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/EU	World Bank/Other	Total
Deferred grant revenue at 1 January 2007	149	152	301
Grants received during the year	-	-	-
Grant revenue for the year	(149)	(103)	(252)
<b>Deferred grant revenue at 31 December 2007</b>	<b>-</b>	<b>49</b>	<b>49</b>
Deferred grant revenue at 1 January 2008	-	49	49
Grants received during the year	36	-	36
Grant revenue for the year	(36)	(49)	(85)
<b>Deferred grant revenue at 31 December 2008</b>	<b>-</b>	<b>-</b>	<b>-</b>

### 18. Statutory fund

Based on provisions of the UNMIK Regulation no. 2006/47, the initial statutory fund of CBK, 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.

Further to UNMIK Regulation no. 2006/47, on 15 June 2007 EUR 10,000 was transferred from the reserve fund to the statutory fund upon the approval of the Governing Board. Further to Law no 03/L-074, on 29 July 2008 the Governing Board approved the transfer of another EUR 10,000 thousand from the reserve fund.

CBK reports directly to the Assembly of Kosovo. CBK capital is not subject to encumbrance.

### 19. Reserve fund

The reserve fund was created in accordance with UNMIK Regulation no. 1999/20. Subsequently, it was also addressed by replacing UNMIK regulations.

At present, the level of the reserve fund is regulated by Law no. 03/L-074. Net profit of each financial year, in accordance with this law and with the authorization of the Governing Board, is transferred to the reserve fund or to the Ministry of Finance and Economy account.

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 20. Net interest income

Net interest income is composed as follows:

	2008	2007
<b>Interest income</b>		
From fixed term placements	33,290	25,447
From treasury bills	9,467	8,639
From current account placements (balances)	84	189
	<b>42,841</b>	<b>34,275</b>
<b>Interest expense</b>		
On current account deposits of non-bank entities	22,011	20,477
On eligible current account deposits of banks	3,066	1,624
On fixed term deposits	8,986	2,270
	<b>34,063</b>	<b>24,371</b>
<b>Net interest income</b>	<b>8,778</b>	<b>9,904</b>

### 21. Net fee and commission income

Net fee and commission income is composed as follows:

	2008	2007
<b>Fee income</b>		
From cash deposits	124	124
From foreign incoming transfers	96	197
From foreign outgoing transfers	356	283
From inter-bank clearing system	145	122
From credit registry system	67	-
Other fees	96	17
	<b>884</b>	<b>743</b>
<b>Fee expenses</b>		
For cash transportation	182	197
For correspondent bank transactions	33	29
	<b>215</b>	<b>226</b>
<b>Net fee and commission income</b>	<b>669</b>	<b>517</b>

### 22. Grant revenue

Grant revenue is composed as follows:

	2008	2007
World Bank	49	275
EU	36	178
<b>Total</b>	<b>85</b>	<b>453</b>

### 23. Other operating income

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

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 24. Personnel expenses

Personnel expenses are composed as follows:

	2008	2007
Wages and salaries	1,219	999
Social security and health insurance cost	326	259
Staff training	132	87
Governing Board remuneration	58	37
Other	36	30
<b>Total</b>	<b>1,771</b>	<b>1,412</b>

The number of employees at CBK as at 31 December 2008 is 158 (31 December 2007: 141).

### 25. General and administrative expenses

General and administrative expenses are composed as follows:

	2008	2007
Insurance expenses	234	191
Repairs and maintenance	69	67
Software maintenance	108	93
Communication expense (telephone, telex and internet)	79	62
Utilities	70	80
Audit and consulting expense	23	20
Security and cash transportation expenses (guard services)	44	46
Travel and transportation	68	75
Vehicle operating expenses	25	20
Stores and stationery	22	18
Food and restaurant expenses	12	10
Computer and other consumables expense	58	38
Publication and literature expenses	51	29
Other	60	74
<b>Total</b>	<b>923</b>	<b>823</b>

### 26. Cash and cash equivalents

Cash and cash equivalents are composed as follows:

	Note	2008	2007
Cash on hand	7	39,674	63,817
Current accounts with non-resident banks	8	10,403	1,946
Treasury bills with maturity up to three months		175,559	9,924
Deposit accounts with non-resident banks with maturity up to three months		505,242	545,792
<b>Total</b>		<b>730,878</b>	<b>621,479</b>

# Central Bank of the Republic of Kosovo

## Notes to the financial statements

(In thousands of EUR, unless otherwise stated)

### 27. Commitments and contingencies

#### Legal

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

#### Credit related commitments

As at 31 December 2008, CBK had commitments to place deposits in total amount of EUR nil (31 December 2007 EUR 28,191 thousand).

#### Other commitments

Other commitments are composed as follows:

#### 2008

	Not later than 1 year
Purchase of vehicles	144
Purchase of computer applications	50
Repair - Installation of the voicing system	42
<b>Total</b>	<b>236</b>

#### 2007

	Not later than 1 year
Premises security upgrade (works and consulting)	92
Purchase of equipment	48
<b>Total</b>	<b>140</b>

### 28. Related party transactions

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

	2008	2007
Governing Board remuneration	58	37
Management remuneration	100	65
<b>Total</b>	<b>158</b>	<b>102</b>

### 29. Subsequent events

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