

# **NATIONAL BANK OF SERBIA**

**Financial Statements  
prepared in accordance with  
International Financial Reporting Standards  
for the year ended 31 December 2004  
with Independent Auditor's Report**

Belgrade, April 2005

FINANCIAL STATEMENTS  
PREPARED IN ACCORDANCE WITH  
INTERNATIONAL FINANCIAL REPORTING STANDARDS  
FOR THE YEAR ENDED 31 DECEMBER 2004  
WITH INDEPENDENT AUDITOR'S REPORT

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TO THE GOVERNOR AND THE COUNCIL OF  
THE NATIONAL BANK OF SERBIA

**Independent Auditor's Report**

We have audited the accompanying balance sheet of National Bank of Serbia (hereinafter: "the Bank") as at 31 December 2004 and the related statements of income, cash flow and changes in shareholders' equity for the year then ended. The financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audit. The Bank's financial statements as of, and for the year ended, 31 December 2003 were audited by other auditor.

We conducted our audit in accordance with International Standards on Auditing (ISA). Those Standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2004, and the results of its operations, changes in equity and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Without qualifying our opinion, we draw your attention to the following matters:

(a) As disclosed in Note 19 to the accompanying financial statements, as of 31 December 2004, matured and unpaid liabilities with respect to certain foreign bank borrowings amounted to CSD 4,635 million (31 December 2003 – CSD 2,459 million). Given that the Bank did not repay the matured portion of the borrowing and related interest when due, the creditor may demand early re-payment of the non-matured portion of the liabilities in the amount of CSD 1,159 million (31 December 2003 – CSD 3,005 million). Management has informed us that terms and conditions of these borrowings are currently being negotiated with the foreign creditor regarding its rescheduling and potential write-offs and the creditor has not made any repayment demands as of the date of these financial statements.

(b) As explained in Note 28 the discussion on distribution of property of the Federal Republic of Yugoslavia between the Republic of Serbia and the Republic of Montenegro are currently ongoing. The completion of these negotiations may have a material impact on the financial statements of the Bank for the year, including the possible reversal of specific provisions made for doubtful assets and on the treatment of liabilities, including interest income and interest expense. The effect on the financial statements of the Bank could not be quantified at present.

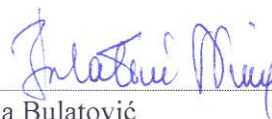
Belgrade, 26 April 2005

KPMG Hungary Kft. Budapest



John Varsanyi  
*Partner*

KPMG d.o.o. Beograd



Nina Bulatović  
*Managing Partner*

**INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2004**

In millions of CSD	Notes	<i>Audited by Other Auditors</i>	
		2004	2003
Interest income	3.1, 4	8,067	5,376
Interest expense	3.1, 5	(4,824)	(3,423)
Net interest income		3,243	1,953
Fee and commission income	3.1, 6	3,841	4,575
Fee and commission expense	3.1	(1,268)	(975)
Net fee and commission income		2,573	3,600
Net trading income	7	8,092	3,387
Dividend income	3.1	30	54
Other income	3.1	1,206	952
Total operating income		15,144	9,946
Net impairment losses and provisions	3.9, 8	(2,391)	(3,022)
Other operating expenses	9	(5,931)	(5,254)
Profit before exceptional item		6,822	1,670
Exceptional item		-	2,130
<b>Profit</b>		<b>6,822</b>	<b>3,800</b>

The notes on pages 7 to 26 form an integral part of these financial statements.  
Independent Auditor's Report – pages 1 - 2.

**BALANCE SHEET AS AT 31 DECEMBER 2004**

		Audited by Other Auditors	
In millions of CSD	Notes	2004	2003
ASSETS			
Cash and current accounts	3.4, 10	12,895	16,581
Deposits with foreign banks	3.5	103,829	92,176
Gold and other precious metals	3.6, 11	8,871	7,837
Trading securities	3.7, 12	125,334	84,175
Securities available for sale	3.8, 13	15,291	-
Securities held-to-maturity	3.8, 14	-	17,000
Loans	3.8, 15	2,549	1,586
IMF membership quota and SDR holdings	16	42,007	37,848
Property, plant, equipment and intangible assets	3.12, 17	16,986	7,947
Other assets	18	1,868	3,483
Total Assets		329,630	268,633
LIABILITIES AND EQUITY			
Liabilities			
Liabilities to other banks and financial institutions	19	116,066	87,302
Liabilities to the Government and other depositors	20	37,979	33,796
Liabilities to the International Monetary Fund	21	103,087	92,308
Securities issued		1,765	2,223
Dinars in circulation	22	45,165	42,979
Other liabilities	23	3,028	3,259
Total Liabilities		307,090	261,867
Equity			
Capital	25	3,319	3,319
Revaluation reserves		13,932	5,067
Retained earnings/(Accumulated loss)		5,289	(1,620)
Total Equity		22,540	6,766
Total Liabilities and Equity		329,630	268,633

Belgrade, 26 April 2005

Signed on behalf of the National Bank of Serbia:

  
Ivan Rangelov  
Director of Accounting and Finance

  
Radovan Jelašić  
Governor

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Independent Auditor's Report – pages 1 - 2.

**STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED 31 DECEMBER 2004**

In millions of CSD	Capital	Revaluation Reserves	Retained earnings/ (Accumulated loss)	Total
<b>For the year ended 31 December 2003</b>				
Balance, beginning of the year	3,319	4,004	(5,420)	1,903
Revaluation of property, plant, equipment and intangible assets	-	1,063	-	1,063
Profit for the year	-	-	3,800	3,800
<b>Balance, end of year</b>	<b>3,319</b>	<b>5,067</b>	<b>(1,620)</b>	<b>6,766</b>
<b>For the year ended 31 December 2004</b>				
Balance, beginning of the year	3,319	5,067	(1,620)	6,766
Revaluation of property, plant, equipment and intangible assets	-	8,952	-	8,952
Transfers	-	(87)	87	-
Profit for the year	-	-	6,822	6,822
<b>Balance, end of year</b>	<b>3,319</b>	<b>13,932</b>	<b>5,289</b>	<b>22,540</b>

The notes on pages 7 to 26 form an integral part of these financial statements.  
Independent Auditor's Report – pages 1 - 2.

**STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2004**

In millions of CSD	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Operating activities		
Interest receipts	7,907	5,764
Fee and commission receipts	3,740	4,435
Inflow from other operating activities	4,083	2,052
Cash generated from operating activities	15,730	12,251
Interest payments	(2,929)	(2,290)
Fee and commission payments	(1,250)	(925)
Outflow from operation expenses	(5,336)	(6,126)
Cash used in operating activities	(9,515)	(9,341)
Increase in deposits and inflow from surplus of expenses	23,701	55,041
Increase in loans and investments	(41,159)	(63,329)
Increase in investments and decrease in received deposits	(17,458)	(8,288)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(11,243)</b>	<b>(5,378)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Investing activities		
Purchase of intangible assets and property	(1,134)	(960)
Net cash used in investing activities	(1,134)	(960)
<b>NET DECREASE IN CASH</b>	<b>(12,377)</b>	<b>(6,338)</b>
<b>Cash at the beginning of period</b>	<b>24,338</b>	<b>27,336</b>
Positive effect of exchange rate changes	43,039	12,466
Negative effect of exchange rate changes	(33,325)	(9,126)
<b>Cash at the end of period</b>	<b>21,675</b>	<b>24,338</b>

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## **1 THE BANK'S ESTABLISHMENT AND OPERATING POLICY**

The origins of the National Bank of Serbia (hereinafter: "the Bank") date back to 1884, when the "Privilegovana banka Kraljevine Srbije" [The Chartered Bank of the Kingdom of Serbia] was founded. In 1920, the National Bank of the Kingdom of the Serbs, Croats and Slovenes was constituted, and in 1929, the Bank's name was changed to the National Bank of the Kingdom of Yugoslavia. From 1946, the Bank continued its activities as the National Bank of Yugoslavia (hereinafter: "NBY"), representing the central monetary institution of the Socialist Federal Republic of Yugoslavia (SFRY) up until the dissolution of the federal state in 1991.

The Bank continued its operations in Belgrade, as the central bank of the Federal Republic of Yugoslavia, representing two of the successor republics of the former SFRY, Serbia and Montenegro, which in April of 1992 comprised the Federal Republic of Yugoslavia (FRY), when its Constitution was officially decreed by both republics.

On 25 June 1993, the Parliament of the FRY enacted the Law on the National Bank of Yugoslavia wherein the NBY is defined as an independent and integrated issuing institution of the FRY monetary system. All intangible and tangible assets that the Bank used in its operations represented the ownership of the FRY, and the Federal Government of FRY guaranteed all of the Bank's obligations.

Pursuant to the Law on the Implementation of the Constitutional Charter of the State Union of Serbia and Montenegro, effective as of 4 February 2003, the Bank continued to operate as the central bank of the Republic of Serbia, as confirmed by the Law on the National Bank of Serbia, effective as of 19 July 2003.

The National Bank of Serbia is the central bank of the Republic of Serbia. The Bank's principal functions are defined under the terms of the Constitutional Charter of the State Union of Serbia and Montenegro ("Official Gazette of the State Union of Serbia and Montenegro ", No. 1/2003), and by the Law on the National Bank of Serbia (Official Gazette of the Republic of Serbia, No. 72/2003 and 55/2004).

The primary objective of the Bank is to achieve and maintain the price stability. In addition to this, the Bank's objective is to maintain financial stability and, without prejudice to its primary objective to support the pursuance of economic policy of the Government of the Republic of Serbia.

The basic functions of the Bank are to:

- Determine and implement monetary policy;
- Autonomously pursue the Dinar exchange rate policy and to determine the Dinar exchange rate regime with the consent of the Government;
- Hold and manage foreign currency reserves;
- Issue banknotes and coins;
- Regulate, control and promote unhindered functioning of internal and external payment operations;
- Issue and revoke operating licenses, carry out supervision of banks and other financial institutions and enact regulations in this field;
- Issue and revoke licenses, i.e. authorization for carrying out the insurance operations, performs control i.e. supervision over such operations and also carry out other duties in line with legal regulation governing the field of insurance.

The governing bodies of the Bank include: the Monetary Board, the Governor and the Council.

- The Monetary Board is composed of the Governor and Vice Governors and sets the monetary policy of the Republic of Serbia.
- The Governor represents and acts on behalf of the Bank, heads the operation of the Bank, and is responsible for implementation of decisions of the Monetary Board and the Council, organization and operation of the Bank and preparation of regulations and decisions within the scope of authority of the Bank which are not within the scope of authority of the Monetary Board and the Council. The Republic of Serbia Parliament appoints the Governor for a term of five years, with the right to re-election. The Bank has three Vice-Governors appointed by the Bank's Council for a term of five years, with the right to re-election, based upon the Governor's recommendation.
- The Council, following the recommendation of the Governor, adopts the Bank's financial plans and the annual reports. The Council has a president and four members appointed by the Republic of Serbia Parliament for a term of five years, with the right to re-election.

The Bank is a legal entity domiciled in Belgrade, Kralja Petra 12. The Bank is comprised of a Main Republic Branch Office situated in Belgrade, with 8 affiliates; and Branch Offices located in the cities of Novi Sad, with 10 affiliates; Niš, with 5 affiliates; Kragujevac, with 5 affiliates; Užice, with 4 affiliates; and Priština. In addition, the Bank has a specialised organisational unit, the Banknotes and Coins Factory located in Belgrade (hereinafter: "ZIN").

As at 31 December 2004, the Bank had 4,081 employees (31 December 2003: 5,349 employees).

## **2 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS**

These financial statements have, in all material respects, been prepared in accordance with standards and interpretations approved by the International Accounting Standards Board, which are referred to as International Financial Reporting Standards (IFRS). These standards and interpretations were previously called International Accounting Standards (IAS). In accordance with the Law on Accounting and Auditing (Official Gazette of FRY No. 71 dated 27 December 2002), all legal entities are required to prepare financial statements in accordance with IFRS.

The presentation of financial statements in accordance with IFRS requires management to make best estimates and reasonable assumptions that effect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements as well as their reported amounts of revenues and expenses arising during the reporting period. These estimates and assumptions are based on the information available as of the date of the accompanying financial statements and thus, future actual results could differ from those estimates.

The measurement and reporting currency of the Bank is the Montenegrin and Serbian Dinar ("Dinar" or "CSD"). Amounts in these financial statements are stated in millions of Dinars, unless otherwise stated.

As disclosed in Note 28 to the financial statements, the negotiations on distribution of property of Federal Republic of Yugoslavia are ongoing between the Republic of Serbia and the Republic of Montenegro, commenced upon the adoption of the Constitutional Charter of the State Union of Serbia and Montenegro, as which have not yet been finalised as of the date of these financial statements.

As at 31 December 2004, the Bank has an equity investment in the audit firm "MGI Revizija i Računovodstvo" A.D., Belgrade holding 100% of its shares. However, as at 31 December 2004, the Bank has not prepared consolidated financial statements, since the Bank's management intends to dispose this investment in the future period. In addition, as at 31 December 2004, the Bank has an equity investment in tourism and leisure firm "Rekreaturs" A.D., Belgrade, holding 3.59% of its shares.

### **3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **3.1 Income and Expense Recognition**

Interest income and interest expense, other operating income and expenses are accounted for on an accrual basis.

Fee and commission income arising on financial services is recognised when the corresponding services are rendered.

Dividend income is recognised when the right to receive a dividend is established.

#### **3.2 Foreign Exchange Translation**

Transactions denominated in foreign currencies are translated into Dinars at official exchange rates prevailing at the date of each transaction.

Assets and liabilities denominated in foreign currencies are translated into Dinars at official exchange rates prevailing at the balance sheet date.

Net foreign exchange gains or losses arising upon the translation of transactions, and the asset and liability components denominated in foreign currencies are credited or charged, as appropriate, to the income statement.

#### **3.3 Financial Instruments**

##### *Classification*

Financial instruments include: held-for-trading assets, originated loans and receivables, held-to-maturity assets, available-for-sale assets and financial liabilities.

*Held-for-trading assets* are principally acquired for security and liquidity purposes, as well as for generating a profit.

*Originated loans and receivables* are loans and receivables originated by the Bank in providing money to a debtor.

*Held-to-maturity assets* are financial assets with fixed or determinable payments and fixed maturities that the Bank has the positive intent and ability to hold to maturity.

*Available-for-sale assets* are financial assets that do not fall into any of the above categories.

A *financial liability* is any liability that is a contractual obligation to deliver cash or another financial asset to another enterprise or to exchange financial instruments with another enterprise under conditions that are potentially unfavourable.

#### *Recognition*

Financial instruments are recognised on settlement date.

#### *Derecognition*

A financial asset is derecognised when the Bank loses control over the contractual right over the asset. This occurs when the rights are realised, expired or are surrendered. A financial liability is derecognised when it is extinguished.

#### *Measurement*

The accounting policies applied in the measurement of specific financial instruments are disclosed below.

### **3.4 Cash and cash equivalents**

Cash and cash equivalents include cash, current accounts and SDR holdings.

### **3.5 Deposits with Foreign Banks**

Deposits with foreign banks represent short-term deposits placed with banks with high credit ratings. They are stated at their nominal amounts. The interest accrued on these deposits up-to the balance sheet date is reported as other assets.

### **3.6 Gold and Other Precious Metals**

Gold and other precious metals are measured at their fair value as of the balance sheet date. Fair value is determined based on the average price listed at the three main gold exchanges – London, New York and Zurich. Changes in fair value are included under net foreign exchange gains/(losses).

### **3.7 Trading Securities**

Trading securities are comprised of the government bonds of OECD member countries. These instruments are measured at their fair value as of the balance sheet date, being their published market price. Changes in fair value, as well as any gains and/or losses on the sale of these securities are included under net trading income.

Over the period of holding of trading securities, the Bank accrues interest and records income from collection of coupons. These are included under interest income.

### **3.8 Securities Held to Maturity and Originated Loans and Receivables**

Securities held to maturity and originated loans and receivables are stated at amortised cost less an allowance for impairment losses.

### **3.9 Allowances for Impairment Losses on Financial Assets**

Financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If such evidence exists, the recoverable amounts of such assets are determined and their carrying values are reduced to the recoverable amounts using allowance accounts.

### **3.10 Equity Investments**

Equity investments, as reported within other assets, are classified as financial instruments available-for-sale.

Equity investments in international financial institutions are stated at their nominal value, denominated in foreign currencies. The effects of changes in foreign exchange rates are included in net foreign exchange gains/(losses).

Equity investments in domestic entities are stated at cost less any allowance for impairment.

### **3.11 Inventories**

Inventories are recognised at the lower of current cost and net realisable value at the balance sheet date.

### **3.12 Property, Plant and Equipment and Intangible Assets**

Property, plant and equipment and intangible assets are initially stated at cost. Allowed alternative treatment of property, plant and equipment and intangible assets was applied for subsequent measurement. The valuation of the property was performed on 31 December 2004 based on market information provided by an independent appraiser. The amounts of the revaluation of property, plant and equipment, and intangible assets are recorded under the revaluation reserves under equity. Cost and accumulated depreciation of property, plant and equipment, and intangible assets are increased proportionately for the net effect of revaluation. In accordance with IAS 16, "Property, Plant and Equipment" and IAS 38 "Intangible Assets" the revaluation of property, plant, equipment and intangible assets is allowed in so far as it is carried out on their appraised fair value.

The Bank uses the same policy for valuation of its investment properties as for other property. Rental income from investment property is recognised in the income statement on an accrual basis, under other operating income.

The carrying amounts of the tangible and intangible assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are first charged directly against any corresponding revaluation reserve, and subsequently, any remaining balances are charged to the income statement.

Depreciation and amortisation are provided for on a straight-line basis to the cost or revalued cost of property, plant, equipment and intangible assets, in order to write them off over their useful lives. Depreciation and amortisation are provided for using the following annual rates:

Description	%
Buildings	2
Equipment	
Motor vehicles	20
Furniture and office equipment	14.2
Computers	25
Intangible assets	25

The depreciation of property, plant and equipment, and intangible assets commences when the applicable asset is placed into use.

### 3.13 Income Taxes

According to current legislation the Bank is exempt from paying corporate income taxes.

## 4 INTEREST INCOME

In millions of CSD	2004	2003
Deposits with foreign banks	1,367	1,322
Deposits with domestic banks	299	-
Trading securities	4,602	1,609
Securities held-to-maturity	1,314	1,645
Loans	467	798
Other	18	2
<b>Year Ended 31 December</b>	<b>8,067</b>	<b>5,376</b>

## 5 INTEREST EXPENSE

In millions of CSD	2004	2003
Deposits from banks	1,525	1,211
Deposits from the Government and other depositors	668	263
Securities issued	430	207
Loans from other banks	542	661
Liabilities to the International Monetary Fund	1,659	1,081
<b>Year Ended 31 December</b>	<b>4,824</b>	<b>3,423</b>

**6 FEE AND COMMISSION INCOME**

In millions of CSD	2004	2003
Domestic payments	1,382	2,157
Foreign exchange dealing	1,729	1,792
Other	730	626
<b>Year Ended 31 December</b>	<b>3,841</b>	<b>4,575</b>

**7 NET TRADING INCOME**

In millions of CSD	2004	2003
Net gains/(losses) on trading securities	(1,623)	46
Net foreign exchange gains/(losses)	9,715	3,341
<b>Year Ended 31 December</b>	<b>8,092</b>	<b>3,387</b>

**8 NET IMPAIRMENT LOSSES AND PROVISIONS**

**a) Increase/(Decrease) During the Year**

In millions of CSD	2004	2003
Securities available for sale	4,410	-
Securities held to maturity	(1,899)	875
Loans and deposits	39	444
Other assets	(159)	1,031
Property and equipment	-	672
<b>Year Ended 31 December</b>	<b>2,391</b>	<b>3,022</b>

**b) Changes in the Allowances for Impairment**

In millions of CSD	Securities available for sale (Note 13)	Securities held to the maturity (Note 14)	Loans and deposits	Accrued interest and other assets (Note 18)	Total
Balance, beginning of year	-	2,745	7,107	6,405	16,257
Charged during the year	4,410	-	810	49	5,269
Released during the year	-	(1,899)	(771)	(208)	(2,878)
Foreign exchange differences and other	-	100	305	84	489
<b>Balance, of the year</b>	<b>4,410</b>	<b>946</b>	<b>7,451</b>	<b>6,330</b>	<b>19,137</b>

## 9 OTHER OPERATING EXPENSES

In millions of CSD	2004	2003
Personnel costs	3,099	2,582
Depreciation and amortisation	498	451
General, administrative and other operating	2,334	2,221
<b>Year Ended 31 December</b>	<b>5,931</b>	<b>5,254</b>

## 10 CASH AND CURRENT ACCOUNTS

In millions of CSD	2004	2003
Cash on hand in foreign currency	6,252	6,363
Current accounts		
With domestic banks	5,752	6,778
With foreign banks	890	3,439
Other	1	1
<b>Year Ended 31 December</b>	<b>12,895</b>	<b>16,581</b>

## 11 GOLD AND OTHER PRECIOUS METALS

In millions of CSD	2004	2003
In standard form		
Gold	8,529	7,525
Silver	141	116
Platinum	106	94
Other	1	1
Total standard form	8,777	7,736
In other forms	94	101
<b>Year Ended 31 December</b>	<b>8,871</b>	<b>7,837</b>

## 12 TRADING SECURITIES

Trading securities in the amount of CSD 125,334 million (31 December 2003 – CSD 84,175 million) relate to bonds of Governments and central banks of OECD countries and of international financial institutions that are due in period of 1 to 3 years.



### 13 SECURITIES AVAILABLE FOR SALE

In millions of CSD	2004	2003
Bonds of Republic of Serbia in Dinars		
Nominal value	19,701	-
Allowance for impairment	(4,410)	-
<b>Year Ended 31 December</b>	<b>15,291</b>	<b>-</b>

Securities available for sale in the amount of CSD 15,291 million relate to long term bonds in Dinars of Republic of Serbia that bear interest at an interest rate of 8.5% p.a. and will become due until 2010.

### 14 SECURITIES HELD TO MATURITY

In millions of CSD	2004	2003
Banks	946	946
Government and public enterprises	-	18,799
<b>Total</b>	<b>946</b>	<b>19,745</b>
Allowances for impairment		
Banks	(946)	(946)
Government and public enterprises	-	(1,799)
<b>Total</b>	<b>(946)</b>	<b>(2,745)</b>
<b>Year Ended 31 December</b>	<b>-</b>	<b>17,000</b>

### 15 LOANS

In millions of CSD	2004	2003
Banks	7,329	5,743
Government and governmental institutions	1,861	2,950
<b>Total</b>	<b>9,190</b>	<b>8,693</b>
Allowances for impairment		
Banks	(5,822)	(5,573)
Government and governmental institutions	(819)	(1,534)
<b>Total</b>	<b>(6,641)</b>	<b>(7,107)</b>
<b>Year Ended 31 December</b>	<b>2,549</b>	<b>1,586</b>

## 16 INTERNATIONAL MONETARY FUND

In millions of CSD	2004	2003
Membership quota in the International Monetary Fund	41,972	37,827
Commitment fee for undrawn funds	32	-
SDR holdings	3	21
<b>Year Ended 31 December</b>	<b>42,007</b>	<b>37,848</b>

The quota of the State Union of Serbia and Montenegro in the International Monetary Fund ("the IMF") is secured by promissory notes issued by the Government of the FRY, and recorded as a placement denominated in SDRs. In December 2000, FRY re-activated its member status with the IMF after the period of sanctions imposed by the United Nations in 1992. As of 31 December 2004 and 2003, the membership quota amounted to SDR 467.7 million.

## 17 FIXED ASSETS AND INTANGIBLE ASSETS

In millions of CSD	Land and Buildings	Equipment and Other Assets	Constructions in Progress	Intangible Assets	Investment Property	Total
<b>Cost</b>						
Balance, beginning of year	3,078	4,361	4,309	299	582	12,629
Increases						
Additions	63	302	684	37	13	1,099
Transfers	158	38	(194)	-	17	19
Revaluation	19,366	34	-	-	-	19,400
Decreases						
Transfer to the Ministry of Finance	(586)	(35)	(3)	-	-	(624)
Disposals and shortages	(81)	(662)	(4)	(151)	(36)	(934)
<b>Balance, end of year</b>	<b>21,998</b>	<b>4,038</b>	<b>4,792</b>	<b>185</b>	<b>576</b>	<b>31,589</b>
<b>Accumulated Depreciation and Amortisation</b>						
Balance, beginning of year	1,273	3,240	-	133	36	4,682
Increases						
Charge for the year	62	382	-	54	-	498
Revaluation	10,447	-	-	-	-	10,447
Other	27	108	-	-	-	135
Decreases						
Transfer to the Ministry of Finance	(306)	(31)	-	-	-	(337)
Disposals and shortages	(46)	(634)	-	(106)	(36)	(822)
<b>Balance, end of year</b>	<b>11,457</b>	<b>3,065</b>	<b>-</b>	<b>81</b>	<b>-</b>	<b>14,603</b>
<b>Net Book Value 31 December 2004</b>	<b>10,541</b>	<b>973</b>	<b>4,792</b>	<b>104</b>	<b>576</b>	<b>16,986</b>
<b>Net Book Value 31 December 2003</b>	<b>1,805</b>	<b>1,121</b>	<b>4,309</b>	<b>166</b>	<b>546</b>	<b>7,947</b>

## 18 OTHER ASSETS

In millions of CSD	2004	2003
Accrued interests	802	863
Equity investment	534	2,005
Inventories	327	269
Memorable coins	189	228
Housing loans to employees	158	204
Advances paid	284	414
Other assets	5,904	5,905
<b>Total</b>	<b>8,198</b>	<b>9,888</b>
Allowances for impairment		
Accrued interest	(527)	(694)
Advances paid	(111)	(208)
Other assets	(5,692)	(5,503)
<b>Total</b>	<b>(6,330)</b>	<b>(6,405)</b>
<b>Year Ended 31 December</b>	<b>1,868</b>	<b>3,483</b>

Equity investments comprise the following:

In millions of CSD	2004	2003
Bank for International Settlements, Basel	328	295
European Bank for Reconstruction and Development, London	-	1,675
Other	206	35
<b>Year Ended 31 December</b>	<b>534</b>	<b>2,005</b>

## 19 LIABILITIES TO OTHER BANKS AND FINANCIAL INSTITUTIONS

In millions of CSD	2004	2003
Deposits from banks and other financial institutions		
Current accounts	29,618	8,239
Obligatory reserves	64,255	58,470
Term deposits	263	424
Borrowings	11,588	12,106
<b>Total</b>	<b>105,724</b>	<b>79,239</b>
Central deposit	5,691	3,306
Dinars in vaults of banks	4,651	4,757
<b>Year Ended 31 December</b>	<b>116,066</b>	<b>87,302</b>

*Obligatory reserves of commercial banks and other financial institutions*

In millions of CSD	2004	2003
Obligatory reserves in Dinars	-	16,212
Obligatory reserves in foreign currencies	18,496	9,642
Obligatory reserves with respect to public foreign currency savings	45,759	32,616
<b>Year Ended 31 December</b>	<b>64,255</b>	<b>58,470</b>

Obligatory reserves in Dinars and foreign currencies relate to the obligation of commercial banks and other financial institutions to maintain average deposits with the Bank that are to be equal to 21% (31 December 2003 – 18%) of their deposits and certain other liabilities. In 2004 obligatory reserve in Dinars was transferred to current accounts of commercial banks and other financial institutions that are now obliged to maintain monthly average balance of current account on a level higher than their obligatory reserve in Dinars.

Obligatory reserves with respect to public foreign currency savings relate to the obligation of the commercial banks and other financial institutions to deposit with the Bank 47% (31 December 2003 – 50%) of the total balances of the public saving accounts denominated in foreign currencies that were deposited subsequent to 30 June 2001.

*Borrowings*

In millions of CSD	2004	2003
Bank of China	5,794	5,464
Export-Import Bank of China	5,794	5,464
OECD member government	-	1,178
<b>Year Ended 31 December</b>	<b>11,588</b>	<b>12,106</b>

The borrowing from the Bank of China was originally extended in 1997, and was rolled-over annually until December 2004. The interest on the borrowing is regularly calculated and semi-annually paid at the annual rate of six month LIBOR + 1%, and has been regularly paid. The management is presently negotiating a new rescheduling of the borrowing.

The borrowing from the Export-Import Bank of China, in the amount of USD 100 million, was extended in December 1999 with a grace period until July 2002 and under semi-annual repayment terms, until January 2005. Although interest on this borrowing has been accrued, neither the interest, nor the instalments due have been paid since January 2001. The matured liabilities with respect to the loan amounted to CSD 4,635 million (31 December 2003 – CSD 2,459 million). Given that the Bank did not repay the matured portion of the borrowing and relating interest when due, the creditor may call for early re-payment of the non-matured portion of the liabilities in the amount of CSD 1,159 million (31 December 2003 – CSD 3,005 million). The creditor has not made such a request as of the date of these financial statements. The accrued interest on the borrowing, as included in these financial statements is based on the due dates specified under the borrowing agreement. Terms and conditions of the loan are currently being negotiated with the foreign creditor regarding its rescheduling and potential write-offs.

The borrowing from the OECD member government amounting to EUR 17.25 million is an interest free borrowing extended for the purpose of regulating the membership of Serbia and Montenegro in the European Bank for Reconstruction and Development, with a grace period until the end of 2005. In 2004, the shares with the European Bank for Reconstruction and Development and this liability were transferred to the Republic of Serbia.

## 20 DEPOSITS FROM THE GOVERNMENT AND OTHER DEPOSITORS

In millions of CSD	2004	2003
Demand deposits	32,880	19,463
Term deposits	5,099	14,333
<b>Year Ended 31 December</b>	<b>37,979</b>	<b>33,796</b>

## 21 LIABILITIES TO THE INTERNATIONAL MONETARY FUND

In millions of CSD	2004	2003
Promissory notes and other liabilities with respect to the membership in the IMF	41,973	37,828
Post-conflict emergency assistance	5,247	9,457
Stand-by arrangement	8,974	16,176
Extended arrangement	41,505	24,264
SDR allocation	5,085	4,583
Accrued interest	303	-
<b>Year Ended 31 December</b>	<b>103,087</b>	<b>92,308</b>

On 20 December 2000, the IMF approved a post-conflict emergency assistance facility in the amount of SDR 117 million maturing in 2004 and 2005. Out of total of SDR 117 million of liabilities, the Bank repaid a total of SDR 58.5 million in 2004.

On 11 June 2001, the IMF approved a one-year Stand-by arrangement in the total amount of SDR 200 million, which matures in 2004, 2005 and 2006. Out of total of SDR 200 million, the Bank repaid a total of SDR 100 million in 2004.

On 13 May 2003, the IMF approved a three-year extended arrangement in the amount of SDR 650 million. The arrangement is intended to financially support the country's economic programme in the period from 2002 to 2005. With fulfilment of obligations defined under Article VIII of the Articles of Agreement of the International Monetary Fund, Dinar became convertible in all current external transactions. As of 31 December 2004, the IMF extended nine instalments on this extended arrangement totalling SDR 462.5 million (31 December 2003: six instalments totalling SDR 300 million). Repayments of the facility are scheduled from November 2006 to December 2011.

The IMF charges interest on these facilities, quarterly, at the rates based on the IMF's Articles of Agreement and the General Terms of Financial Assistance.

## 22 DINARS IN CIRCULATION

Banknotes and coins in circulation in amount of CSD 45,165 million (31 December 2003 – CSD 42,979 million in 2003) represent an obligation of the Bank to the holders of banknotes and coins.

## 23 OTHER LIABILITIES

In millions of CSD	2004	2003
Accrued interest	2,148	1,705
Liabilities with respect to equity investments in the European Bank for Reconstruction and Development	-	498
Payroll and social security costs	152	117
Liabilities to suppliers and advances received	228	184
Other	500	755
<b>Year Ended 31 December</b>	<b>3,028</b>	<b>3,259</b>

Accrued interest as of 31 December 2004 includes accrued interest and penalty interest on the borrowing from the Export-Import Bank of China (Note 19) in the amount of CSD 1,869 million (31 December 2003 – CSD 1,259 million).

## 24 FAIR VALUE INFORMATION

The following table is a comparison of the carrying amounts (after impairment adjustments) and fair values of all Bank's financial assets and liabilities:

In millions of CSD	2004 Carrying amount	2004 Fair value
Financial assets		
Trading securities	125,334	125,334
Available for sale securities	15,291	15,291
Loans	1,740	1,740
Deposits with foreign banks	104,638	104,638
Other assets	967	967
Financial liabilities		
Deposits of banks and other financial institutions	99,827	99,827
Borrowings from banks	11,588	11,588
Liabilities to IMF	103,087	103,087
Deposits of Government and other depositors	37,979	37,979
Other liabilities	2,215	2,215

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the table.

*(a) Trading securities*

Held-for-trading assets relate to OECD government bonds measured at fair value based on the published price quotations.

*(b) Securities available for sale*

Available for sale securities were measured at best estimate of fair value using the effective interest rate method with additional consideration for imputed interest loss.

*(c) Loans and advances carried at cost*

Held-to-maturity assets and originated loans and receivables were measured at amortised cost using the effective interest rate method with additional consideration for imputed interest loss.

*(d) Bank and customer deposits*

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the balance sheet date. The value of long term relationships with depositors is not taken into account in estimating fair values.

*(e) Borrowings*

The fair value of borrowings related to Export-Import Bank of China was not practical to be determined since the Bank is currently in negotiations over repayment of this loan (see Note 19).

## **25 EQUITY**

The sole owner of the Bank is the Republic of Serbia

In accordance with the Law on the National Bank of Serbia, the Bank's equity is comprised of its capital and defined reserves. The capital shall amount to CSD 10 billion and is formed from its retained earnings. Defined reserves shall be formed by appropriations of not more than 30% of profits and may not exceed the Bank's capital. Any remaining profits, reduced by the amounts of any unrealised items included in income, constitute the revenue of the Republic of Serbia budget. The losses of the Bank are to be covered from its special reserves. If the special reserves are not sufficient to absorb the losses, then they are to be covered from the Republic of Serbia budget, or by securities issued by the Republic of Serbia for that specific purpose. Repayment of such securities will be made from the Bank's profits available in the future periods.

## **26 MEMORANDUM ACCOUNTS OF THE BALANCES RELATING TO THE FORMER SFRY**

Up to the year ended 31 December 2000, the Bank's financial statements included the assets and liabilities originating from the period prior to the disintegration of the former SFRY, irrespective of to which of the former constituent republics such assets and liabilities corresponded.

On 29 June 2001, the Ministers of Foreign Affairs of the Federal Republic of Yugoslavia, Bosnia and Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia and Slovenia executed the Agreement on Succession Issues (the "Succession Agreement"). The Succession Agreement defines the newly established five countries as sovereignty equal states and as the successors of the former SFRY.

Subsequent to the execution of the aforesaid agreement, the Parliament of FRY, in February 2002, enacted the Law on the Preparation of the Balance Sheet of the National Bank of Yugoslavia in the SFRY, and the Law on the Preparation of Balance Sheet of the National Bank of Yugoslavia in the FRY.

As of 1 November 2001, the Bank extracted from its balance sheet the assets and liabilities that correspond to the former SFRY.

The off-balance sheet records of assets and liabilities of the former SFRY include the following items:

- Balances on frozen accounts with foreign banks and liabilities to banks and other depositors relating to the frozen accounts,
- Amounts due from commercial banks and liabilities with respect to refinanced loans and relating interest from the Paris Club of Creditors and the London Club of Creditors,
- Other receivables from and payables to commercial banks.

During 2003, US banks released balances on accounts of former National bank of SFRY in USD, and distributed these in accordance with the Succession Agreement, frozen in 1992 upon dissolution of the SFRY and subsequent introduction of UN sanctions, in the amount of USD 90.3 million (equivalent of CSD 5,267 million). The Bank recognised on its balance sheet the aforementioned amount under cash, corresponding liabilities to depositors, and the difference between the assets and the liabilities as exceptional income in the amount of CSD 2,130 million.

The Bank has similar balances on frozen accounts maintained with European banks. The effects of the release of such account, when it happens, will be included in the Bank's financial statements of the future periods. The Bank's management believes that other items with respect to the assets and liabilities of the former SFRY would not have a material effect on the Bank's future financial statements.

## **27 RISK MANAGEMENT POLICIES**

### ***Liquidity Risk***

Liquidity risk includes both the risk of not being able to fund assets at appropriate maturities and interest rates, and the risk of not being able to liquidate an asset at a reasonable price and within an appropriate time frame.



The Bank is the lender of last resort to commercial banks in the Republic of Serbia. However, the day-to-day operations of the Bank are aimed at ensuring that adequate liquidity exists to meet all domestic obligations and commitments as they become due. The Bank has access to diverse funding sources. Funds are raised through deposits, issue of securities and borrowings. Diversification of funding sources enhances funding flexibility, limits dependence on any source of funds and generally lowers the cost of funds. The Bank maintains a balance between the continuity of its funding and the flexibility of funding sources through the use of funding sources with a range of maturities. The Bank assesses liquidity risk by identifying and monitoring changes in funding sources required to meet the goals strategically set by the Bank's management. In addition, the Bank holds a portfolio of liquid assets, such as current accounts and deposits with foreign banks, and OECD government bonds, as a part of its liquidity risk exposure management strategy.

The following table summarises an analysis of the Bank's financial assets and liabilities based on the remaining periods to repayment.

In millions of CSD	Up to one month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	No maturity	Total
<b>Assets</b>							
Cash and current accounts	12,895	-	-	-	-	-	12,895
Deposits with foreign banks	69,740	34,089	-	-	-	-	103,829
Gold and other precious metals	8,777	94	-	-	-	-	8,871
Trading securities	125,334	-	-	-	-	-	125,334
Securities available for sale	-	-	-	7,800	7,491	-	15,291
Loans	68	-	1,352	688	441	-	2,549
IMF membership quota and SDR holdings	3	-	32	-	-	41,972	42,007
Property and equipment	-	-	-	-	-	16,986	16,986
Other assets	683	-	628	-	535	22	1,868
<b>Total Assets</b>	<b>217,500</b>	<b>34,183</b>	<b>2,012</b>	<b>8,488</b>	<b>8,467</b>	<b>58,980</b>	<b>329,630</b>
<b>Liabilities</b>							
Liabilities to other banks and financial institutions	105,387	-	5,900	128	-	4,651	116,066
Liabilities to the Government and other depositors	29,884	8,095	-	-	-	-	37,979
Liabilities to the IMF	1,873	1,121	9,846	28,979	61,268	-	103,087
Securities issued	1,720	45	-	-	-	-	1,765
Currency in circulation	-	-	-	-	-	45,165	45,165
Other liabilities	2,703	-	132	18	175	-	3,028
<b>Total Liabilities</b>	<b>141,567</b>	<b>9,261</b>	<b>15,878</b>	<b>29,125</b>	<b>61,443</b>	<b>49,816</b>	<b>307,090</b>
<b>Equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>22,540</b>	<b>22,540</b>
<b>Total liabilities and equity</b>	<b>141,567</b>	<b>9,261</b>	<b>15,878</b>	<b>29,125</b>	<b>61,443</b>	<b>72,356</b>	<b>329,630</b>
<b>Net Liquidity Gap</b>	<b>75,933</b>	<b>24,922</b>	<b>(13,866)</b>	<b>(20,637)</b>	<b>(52,976)</b>	<b>(13,376)</b>	<b>-</b>

### ***Interest Rate Risk***

Interest rate risk includes the risk of interest rate fluctuations that might cause the interest-bearing assets and interest-bearing liabilities to mature or reprice at different times, or at varying amounts. The Bank manages interest rate exposure by being in a position to:

- Set interest rates, to monitor them, and subsequently, to adjust them in order to fulfil the overall goals of the adopted monetary policy (obligatory reserves in Dinars and foreign currency of the commercial banks and reserves with respect to public foreign currency savings);
- Maintain the Government's deposits and those of governmental institutions;
- Maintain funds on current accounts and short-term deposits with foreign banks maturing up to 30 days and maturing from 30 up to 90 days, and invest in the highly liquid securities of the governments of OECD member countries.

The Bank is exposed to interest rate risk related to issued securities, foreign currency borrowings and liabilities toward the International Monetary Fund.

The following table provides a summary of the average, annual interest rates on the most significant interest-bearing financial instruments stated in the balance sheet as of 31 December 2004, as per the major currencies:

	Dinars	EUR	USD	SDR
Financial assets				
Current accounts with foreign banks	-	0.0-1.3%	0.0-2.0%	-
Deposits with foreign banks	-	1.7-2.3%	1.6-2.3%	-
Trading securities	-	4.3%	3.3%	-
Securities available for sale	8.5%	-	-	-
Loans and securities held to maturity	8.5-12.0%	-	-	-
Financial liabilities				
Obligatory reserves of banks	3.0%	0.4-2.0%	0.45-2.25%	-
Time deposits	3.0%	1.9-2.0%	2.1-2.2%	-
Borrowings	-	-	2.8-8.0%	-
Securities issued	11.0-18.9%	-	-	-
Liabilities to International Monetary Fund	-	-	-	2.2%

### ***Currency Risk***

The Bank is exposed to foreign currency risk in its transactions in foreign currencies. The Bank exposures give rise to foreign currency gains and losses that are recognised in the income statement. These exposures comprise the monetary assets and monetary liabilities that are not denominated in the measurement currency of the Bank. The Bank manages the foreign currency exposure by pursuing the policy of structuring its asset/currency mix in such a manner that would be in line with expected future known foreign currency obligations. The following table provides an analysis of the Bank's foreign currency exposure as at 31 December 2004:

In millions of CSD	EUR	USD	SDR	Other Currencies	Total Foreign Currencies	Dinars	Total Balance Sheet
<b>Assets</b>							
Cash and current accounts	4,337	679	-	2,127	7,143	5,752	12,895
Deposits with foreign banks	77,117	24,322	-	2,390	103,829	-	103,829
Gold and other precious metals	-	-	-	8,871	8,871	-	8,871
Trading securities	84,191	40,888	-	255	125,334	-	125,334
Securities available for sale	-	-	-	-	-	15,291	15,291
Loans	-	-	-	-	-	2,549	2,549
IMF membership quota and SDR holdings	-	-	10,296	-	10,296	31,711	42,007
Property and equipment	-	-	-	-	-	16,986	16,986
Other assets	102	11	328	31	472	1,396	1,868
<b>Total assets</b>	<b>165,747</b>	<b>65,900</b>	<b>10,624</b>	<b>13,674</b>	<b>255,945</b>	<b>73,685</b>	<b>329,630</b>
<b>Liabilities</b>							
Liabilities to other banks and financial institutions	55,919	20,819	-	1,454	78,192	37,874	116,066
Liabilities to the Government and other depositors	8,660	978	-	509	10,147	27,832	37,979
Liabilities to the IMF	-	-	103,087	-	103,087	-	103,087
Securities issued	-	-	-	-	-	1,765	1,765
Currency in circulation	-	-	-	-	-	45,165	45,165
Other liabilities	240	1,968	-	35	2,243	785	3,028
<b>Total liabilities</b>	<b>64,819</b>	<b>23,765</b>	<b>103,087</b>	<b>1,998</b>	<b>193,669</b>	<b>113,421</b>	<b>307,090</b>
<b>Equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>22,540</b>	<b>22,540</b>
<b>Total liabilities and equity</b>	<b>64,819</b>	<b>23,765</b>	<b>103,087</b>	<b>1,998</b>	<b>193,669</b>	<b>135,961</b>	<b>329,630</b>
<b>Net balance sheet position</b>	<b>100,928</b>	<b>42,135</b>	<b>(92,463)</b>	<b>11,676</b>	<b>62,276</b>	<b>(62,276)</b>	<b>-</b>

### **Credit Risk**

The primary exposure to credit risk arises from deposits and investments in foreign securities, as well as from held-to maturity securities, and loans extended to domestic banks, the Government, governmental institutions, and public enterprises. The amount of credit exposure in this respect is represented by the carrying amounts of the financial assets stated in the balance sheet. Management believes that the allowances stated in the balance sheet are adequate to absorb the losses that may arise from the exposures.

The concentration of credit exposures arising on financial instruments occurs in instances in which counterparties have similar economic characteristics that could render their ability to meet contractual obligations, to be similarly affected by changes in economic or other circumstances.

The significant geographical concentrations of foreign assets of the Bank as of 31 December 2004 are as follows:

	European Union	United States of America	Switzerland	Other	Total
Current accounts with foreign banks	669	47	27	147	890
Deposits with foreign banks	72,596	1,993	20,976	9,074	104,639
Trading securities	84,446	40,888	-	-	125,334

The Bank has significant concentrations of its domestic assets in the placements to the Pension and Disability Fund and the Budget of the Republic of Serbia.

## **28 FORMER FRY DIVISION BALANCE DISCUSSIONS**

The republics of the former Federal Republic of Yugoslavia comprised of Serbia and Montenegro have yet to reach an agreement on the division to be applied to assets and liabilities arising from transformation of the FRY to the State Union of Serbia and Montenegro. Such discussions are on going, and the Bank's management is inherently involved in these negotiations that should determine the date and nature of the specific agreement, and the effects of the agreement on the financial statements of the Bank.

The completion of the FRY division negotiations may have an impact on the Bank's financial position, possibly involving a reversal of specific provisions made for doubtful assets, and on the treatment of liabilities, including interest income and interest expense.

## **29 LITIGATION**

As at 31 December 2004, there are a number of legal proceedings in which the Bank is defendant. The Bank's management believes that these lawsuits will not result in outflow of resources of the Bank in future and, that no provision is required in this respect.

## **30 EXCHANGE RATES**

The official exchange rates for the major currencies used in the translation of the balance sheet items denominated in foreign currencies as of 31 December 2004 and 2003 were as follows:

In CSD	31 December 2004	31 December 2003
USD	57.9355	54.6372
EUR	78.8850	68.3129
SDR	89.7415	80.8794