

**FUND FOR LOCAL AUTHORITIES AND
GOVERNMENTS IN BULGARIA – FLAG JSC**

ANNUAL ACTIVITIES REPORT AND FINANCIAL
STATEMENTS

31 December , 2011

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Board of Directors:

Dobromir Prodanov Simidchiev - Chairperson
Ivelina Vesselinova Vassileva – Deputy Chairperson
Emil Rumenov Savov – member
Daniel Bryan Berg – member
Nadya Yordanova Dankinova - member
Denitsa Plamenova Nikolova - member
Yulia Petkova Tsoleva –Ilieva - member

Registered address

17-19 Sv. Sv. Kiril i Metodi St.
Sofia 1202

Management address

27 Solunska St.
Sofia 1000

Legal advisor

Dessislava Ivanova-Atanassova

Servicing banks

UniCredit Bulbank
Raiffeisen bank
Bank DSK
MKB - Unionbank

Auditor

Earns & Young Audit Ltd.
Polygraphia office center
47A Tzarigradsko shosse boulevard
4th floor
Sofia 1124

ANNUAL REPORT

On the Activity of Fund for Local Authorities and Governments in Bulgaria – FLAG JSC/FLAG/ for FY 2011

This Report was prepared in compliance with the requirements of article 23 of the Regulation on the Way the State shall exercise its Rights in Commercial Entities with State Interest in Owner's Equity and in compliance with the Commerce Act.

1. Business Programme

1.1. Equity and Loan Resource

The share capital of the company stands at BGN 60 million, paid in three installments in 2008 and 2009. The borrowed long-term resource is in the amount of EUR 35 million, granted under Loan Agreement № 37525 of 22.12. 2008 concluded with the European Bank for Reconstruction and Development. FLAG has been in command of a credit resource in the amount of BGN 128.8 million in FY 2011.

1.2. Management

The Fund is managed by a Board of Directors (BoD), consisting of seven members. The BoD organizes and manages the current activities of the Fund in delivering all its functions. The BoD held 13 meetings in 2011.

The following changes in the composition of the BoD were made during the period under review, upon decision of the sole proprietor of the Fund:

- ✓ On 27 June , 2011 with Protocol № T3 - 36/27.06.2011 the Minister of Regional Development and Public Works, as a representative of the state as a sole proprietor, made structural changes in the BoD, replacing the second representative of the Ministry of Finance by a representative of the Minister of EU Funds Management.
- ✓ On 14 July , 2011 with Protocol № T3 - 40/14.07.2011 the Minister of Regional Development and Public Works, as a representative of the state as a sole proprietor , made changes in the membership of the Board of Directors. Vessela Danailova Danova was relieved of her duties as a member of BoD and replaced by Nadya Yordanova Dankinova as a representative of the National Association of Municipalities in the Republic of Bulgaria/NAMRB/. Emil Rumenov Savov, member of the BoD and representative of NAMRB, was designated as a representative of the Minister of EU Funds Management.
- ✓ On 15 September, 2011 with Protocol № T3 - 56/15.09.2011 the Minister of Regional Development and Public Works, as a representative of the state as a sole proprietor, made changes in the membership of the BoD, appointing Denitsa Plamenova Nikolova as a member of the BoD, to replace Lilyana Pavlova Nikolova.

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At the end of 2011, the Board of Directors consists of the following members: Dobromir Simidchiev (representative of MRDPW) – Chairperson, Ivelina Vassileva (representative of MEW) – Deputy Chairperson, Denitsa Nikolova (representative of MRDPW) – member, Emil Savov (representative of Minister of EU Funds Management – member, Yulia Tsoleva (representative of MoF) – member, Daniel Berg (representative of EBRD) – member, and Nadya Dankinova (representative of National Association of Municipalities in RB) – member and Executive Director.

Under Bulgarian law the management should prepare financial statements for every financial year, giving a true and fair view of the financial condition of the company as at the year-end, its financial performance and cash flows.

The management acknowledges that it has been consistently applying adequate accounting policies in preparing the annual financial statements as at 31 December, 2011 and has come up with reasonable and prudent judgments, assumptions and estimates.

The management also acknowledges that it has applied the existing accounting standards and has observed the going concern principle when drawing up the financial statements.

The management is responsible for the proper management of the accounting ledgers, for the expedient asset management and adoption of necessary measures in order to avoid and reveal any possible fraud or other irregularities.

1.3. Human Resources

The Fund's key staff has the appropriate qualifications in order to perform the lending activities in 2011. The structure and number of staff are presented in the table below.

Position	Number of staff approved for 2011	Number of staff as at 31.12.2011
Director, Projects and Monitoring Directorate	1	1
Director, Lending Directorate	1	1
Director, Finance and Risk Management Directorate	1	-
Experts, Projects and Monitoring Directorate	2	2
Experts, Lending Directorate	3	3
Experts, Finance and Risk Management Directorate	1	1
Internal auditor	1	1
Office manager	1	1
Expert, General Administration Directorate	2	-
Total	13	10

The accounting and legal servicing, as well as the maintenance of the computer network have been contracted out to external suppliers.

1.4. External Auditor for 2011

At a meeting on 18 October , 2011 the Board of Directors approved the results of a public procurement procedure for selection of an external auditor for 2011 pursuant to article 2, par. 1 p. 2 of the Regulation on Awarding Small Public Procurement and approved Earns & Young Audit Ltd. as contractor. With Protocol T3 - 68/02.11.2011 this decision was later endorsed by the Minister of Regional Development and Public Works, as a representative of the state as a sole proprietor.

1.5. Loan Agreements with EBRD

The loan resources under Loan Agreement № 37525 of 22.12 2008 concluded with the European Bank for Reconstruction and Development, amounting to EUR 35 million have been fully absorbed and are at the disposal of the Fund. Because of sufficient unemployed funds for execution of the operations, it was not necessary to have any funds disbursed under the second loan agreement, signed on 3 July , 2009 and it was terminated on 13 October , 2011.

1.6. Managing Bank

At its meeting held on 20 May , 2011, taking into account that the term of the existing contract with the Managing Bank would expire on 22.12. 2011, the Board of Directors made a decision to conduct a selection procedure for a lending institution, which should perform the functions and activities of a managing bank for FLAG JSC and should assist its lending activities to municipalities and municipal commercial entities.

After a successful public procurement procedure, on 18 October , 2011 the BoD made a decision , approved by the sole proprietor, to award the contract to UniCredit Bulbank SC . The contract was signed on 21.11. 2011.

1.7. Main Results of the Lending Activity in 2011

In 2011 the Fund has received 132 loan requests for a total of BGN 123.9 million for implementation of projects the value of which amounts to BGN 349.7 million. The BoD has considered 115 loan requests, 106 of which were approved, 2 were rejected and 7 postponed.

106 loans were extended to 70 municipalities in 2011, amounting to BGN 95.4 million, supporting the implementation of projects in the amount of BGN 309.6 million. The average share of the loan within the budget of the respective supported project was 30.8%. The typical loan extended to a municipality was one for bridge financing in the amount of BGN 900 thousand, with maturity of 15 months. FLAG included in its scope of work new programmes, namely the 5 Cross-border Cooperation Operational Programmes.

The table below presents loans extended in 2010 and 2011 by type and principal repayment source.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
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Types of loans	Number of loans in 2010	Amount of loans extended in 2010 (BGN)	Number of loans in 2011	Amount of loans extended in 2011 (BGN)
Long-term	13	17,043,122	44	44,695,556
incl. bridge financing	9	14,687,438	37	40,636,431.28
incl. with own funds	4	2,355,684	7	4,059,124.72
Short-term	43	45,742,136	62	50,747,926.62
incl. bridge financing	43	45,742,136	62	50,747,926.62
incl. with own funds	0	0	0	0
Total	56	62,785,258	106	95,443,482.62

The three tables that follow present the typology of the lending activity in 2011 by type of projects, by OPs and by source for repayment of principals.

By type of loans	Number of loans	Total value in BGN	Value in BGN			Maturity in months		
			Min.	Max.	Average	Min.	Max.	Average
Investment	96	91,677,609.41	57,088.80	6,433,749.50	954,975.10	3	88	15
Preparation with TA	10	3,765,873.21	98,766	1,490,305	376,587.32	6	60	15

By Operational Programmes	Number of loans	Total value in BGN	Value in BGN			Maturity in months		
			Min.	Max.	Average	Min.	Max.	Average
Regional development	35	55,463,531.38	140,800	4,427,752.17	1,584,672.33	6	82	15
Environment	13	10,687,457.25	98,766	6,433,749.50	822,112.10	6	60	15
EEA Financial Mechanism	3	1,051,155.02	184,000	590,000	350,385.01	7	9	8
RDP	47	18,719,738.42	57,088.80	1,339,126.60	398,292.31	7	88	15
CBC	6	8,919,656.55	836,357.97	2,566,448.48	1,486,609.43	3	21	15
OPAC	1	330,000	330,000	330,000	330,000	24	24	24
Preparation of project proposal	1	271,944	271,944	271,944	271,944	48	48	48

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By repayment source	Number of loans	Total value in BGN	Value in BGN			Maturity in months		
			Min.	Max.	Average	Min.	Max.	Average
Operational programmes	99	91,384,357.90	57,088.80	6,433,749.50	923,074.32	3	24	12
Own funds	7	4,059,124.72	85,303.60	2,467,948.39	579,874.96	48	88	61

The funds absorbed in 2011 under signed loan contracts amount to BGN 61,552 thous. (BGN 64,116 thous. in 2010), and the repaid loans stand at BGN 42 750 thous. (against BGN 64,994 thous. in 2010).

The year 2011 saw the signing of 160 annexes to 92 loan contracts, referring mainly to the repayment schedule.

24 of the loan applications, submitted in 2011 for a total amount of BGN 17.8 million, are in a process of consideration as at 31.12. 2011.

52 of the loans amounting to BGN 4.3 million were repaid in full in 2011.

As at 31.12. 2011 the active loans were 97, with total principals standing at BGN 66.4 million.

As at the end of 2011 the municipalities of Brezovo, Elin Pelin, Yakoruda, Dolna Banya and Madan were in arrears of 6 days. No municipality had arrears of over 30 days.

One of the submitted 116 loan applications was not approved by the Board of Directors, 2 were rejected by UniCredit Bulbank and the consideration of another 7 was postponed. An approved loan application was withdrawn by the municipality. A summary description of the rejected applications is presented below.

Status	Total number	Incl. OPRD	Incl. OPE	Incl. RDP	Total amount
Rejected by BoD	1			1	2,200,978.23
Rejected by UniCredit Bulbank	2	1		1	2,137,635.26
Postponed by BoD	7	1		6	4,198,261.96
Withdrawn by the municipality	1			1	130,465.00
Total	11	2		9	8,667,340.45

1.8. Changes in the Lending Policy

With its decision dated 18 February , 2011, the BoD has approved lending to finance municipal investment projects under the Cross-border Cooperation programmes. It also approved lending for financing municipal projects for GIS and preparation of integrated development plans. It also approved the proposal to remove the limitations regarding the time line for repayment of loans for preparation of project proposals and eventually structuring such loans as long-term ones. The changes are consistent with the policy of covering all operational programmes that finance investment projects.

1.9. Information and Publicity

It is a tradition for representatives of the Fund to participate in major events of the municipalities, organized by the National Association of municipalities in RB where the opportunities offered by the Fund are presented and the municipalities are given specific consultations.

The information on the Internet site of FLAG is regularly updated and maintained. An information material was also published in 2011, reflecting the lending activities of the Fund from the time of its establishment until November, 2011.

2. Financial Condition

2.1. Report and Structure of Income and Expenses

2.1.1. Statement of Income and Expenses

EXPENSE ITEMS, BGN thous.		4,282
1	Remun. BoD, Exec. Director and social security contributions	71
2	Rental office and utilities (electricity, heating, water-supply)	49
3	Accounting services	24
4	Auditor services	26
5	Consultant services	45
6	Hired services (legal, IT maintenance)	21
5	Other hired services (notary fees, courier services, insurance, translation)	22
6	Communication services	9
7	Other expenses (cleaning, janitorial, car-wash, subscriptions, hospitality)	10
8	Stationery	8
9	Fuel and automotive materials	3

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10	Other materials	4
11	Depreciation	14
12	Salaries and social security contributions	262
13	Business trips	1
15	Bank charges	1,033
16	Expenses on interest charged on EBRD loan	1,169
17	Expenses on interest charged on EBRD loan, paid in 2011	1,446
18	Expenses on impairment	65
INCOME ITEMS, BGN thous.		7,794
1	Income from interest on loans	2,644
2	Income from default interest on loans	64
3	Income from fees on loans	70
4	Income from interest on deposits, charged but not received in 2011	1,077
5	Income from interest on deposits, charged and received in 2011	3,939
DEPOSITS, BGN thous.		6,7596
1	Raiffeisenbank	36,649
2	UniCredit Bulbank	3,647
3	UniCredit Bulbank – res. account EBRD	4,300
4	Bank DSK	13,000
3	MKBUnionbank	10,000

2.1.2. Structure of Expenses

Groups of expenses	Amount, BGN thous.	Share of total expenses
Operational costs	106	2.48%
Hired services	116	2.73%
Acquisition of LTTA and depreciation	14	0.32%
Remuneration – staff, BoD	333	7.77%
UniCredit Bulbank Management fee, other fees	6	0.14%
On EBRD loans - interest	2,615	61.04%
On EBRD loans – fees	1,027	23.99%
Impairment/provisions	65	1.53%
	4,282	

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2.1.3. Income

The total income of the Fund for the period stands at BGN 7,794 thous., broken down by type in the table below:

Income	2011	Share
Interest and fees on loans and other income (BGN thous.)	2,778	35.6%
Yield from deposits (BGN thous.)	5,016	64.4%
Total	7,794	

- 2.1.3.1. From extended loans** – at average interest rate of 5.605% the yield, including interest and commitment fee, is in the amount of BGN 2,572 thous. The surcharge for FLAG throughout the whole year was 1.715 %. The real interest burden for the municipalities, given the compensation received pursuant to CoM Decree 155/2011, is 1.89%.
- 2.1.3.2. From management of temporarily unemployed funds** – As of 31.12. 2011 FLAG has concluded four contracts with banks for open-end deposits and one fixed-term deposit. The overall yield from the management of temporarily unemployed funds stands at BGN 5,016 thous., distributed among the different sources as follows:

Source	Paid in 2011 (BGN thous.)	Due as at 31.12.2011 (BGN thous.)	Total (BGN thous.)
Raiffeisenbank JSC	3,044	165	3,209
UniCredit Bulbank SC	505	167	672
UniCredit Bulbank SC Reserve account		15	15
Bank DSK JSC		603	603
MKBUnionbank SC	3	127	130
SG Expressbank SC	316		316
Piraeus bank	71		71
Total:	3,939	1,077	5,016

2.2 Results for the Current Period

The profit of the Fund before taxes amounts to BGN 3,512 thous., and the net profit – BGN 3,161 thous.

2.3 Dividends and Distribution of Profit

The Company forms a “Reserve” fund in the amount of 10% of the net profit (2010)– BGN 481 thous., after which a dividend is distributed to the state in the amount of 80%, i.e. BGN 3,460 thous.

2.4 Investment

As at 31 December , 2011 FLAG JSC has no equity participation in other companies.

3. Most likely Development of the Company in 2012

The Business Plan was prepared on the basis of the following:

- ✓ The loan contracts concluded in 2011, the servicing of which will continue in 2012;
- ✓ Expected parameters of loan applications which are being processed now;
- ✓ Indicative lists and repayment schedules of OPRD and OPE, information about RDP and CBC programmes, meetings with representatives of the Managing Authorities of OPE and of OPRD, discussions with municipalities;
- ✓ A set of assumptions, based on FLAG’s experience from 2009 - 2011.

3.1 Overall Estimate of Demanded Loan Resource

The summarized estimate of the expected new loan resources is presented in the table below in BGN million:

Programmes/type of loans	Bridge financing	Municipal co-financing	Total
OPRD	40.1	3.5	43.6
OPE	14.5	8.4	22.9
RDP	16.2	2.6	18.8
CBC	16.1	1.1	17.5
Total:	86.9	15.6	102.5

3.2 Financial Proceeds and Result

The total amount of expected financial proceeds from the activity is projected to come to BGN 6.6 million, where 72% will be revenues from loans extended to municipalities.

3.3 Information as per Article 187d and Article 247 of the Commerce Act

No own shares have been acquired or transferred in 2011.

3.4 Branches of the Enterprise

The Company has no branches

Prepared by: Nadya Dankinova – Executive Director

March, 2012

Report of the Independent Auditor

To the Sole Proprietor

Of Fund for Local Authorities and Governments in Bulgaria – FLAG JSC

Report on the Financial Statements

We have performed an audit of the accompanying financial statements of Fund for Local Authorities and Governments in Bulgaria – FLAG JSC, which comprise the report on the financial condition as at 31 December, 2011, the Consolidated Income Statement, Statement of Changes in Owner's Equity and Cash Flow Statement for the year ending on this date, as well as the summary of significant accounting policies and other explanatory notes.

Management Responsibility for the Financial Statements

Management is responsible for the preparation and presentation of these financial statements, which give a true and fair view, in accordance with the International Financial Reporting Standards, the way they are accepted and applied in the European Union as well as for putting in place such an internal control system as the management deems necessary for the preparation of financial statements that are free from material misstatement, whether due to error or fraud.

Auditor's responsibility

Our responsibility is confined to expressing an auditor opinion on these financial statements, based on the audit we have conducted. This audit was performed in compliance with the International Auditing Standards. These standards require that we comply with the ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

The audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the system of internal control relevant to the entity's preparation and true 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 system. The audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates, made by the management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit provides a sufficient and appropriate basis for our audit opinion.

Opinion

In our opinion the financial statements give a true and fair view of the financial position of Fund for Local Authorities and Governments in Bulgaria - FLAG JSC as of 31 December 2011, as well as of its financial performance and its cash flows for the year then ended in conformity with the International Financial Reporting Standards, as they are accepted and applied in the European Union.

Report on other Legal and Regulatory Requirements

In accordance with article 38, para 4 of the Accountancy Act we have familiarized ourselves with the content of the accompanying Activities Report for 2011. In our opinion the Activities Report presented by the management is consistent with the financial statements for the year ending on 31 December, 2011.

Joanis Mistakidis

Manager

„Ernst and Young Audit Ltd.

Nikolai Garnev, FCCA, CPA

Registered auditor

16 March, 2012

Sofia, Bulgaria

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
COMPREHENSIVE INCOME STATEMENT**

For the year ending on 31 December, 2011

	<u>Notes</u>	<u>2011</u>	<u>2010</u>
		<i>BGN thous.</i>	<i>BGN thous.</i>
Interest income	5.1	7,724	8,935
Costs on interest and fees	5.2	(3,648)	(2,863)
Other income from activity, net		70	26
Total operational income		4,146	6,098
Costs on impairment of extended loans	11	(65)	(143)
Labour costs	5.3	(333)	(326)
Depreciation costs	9	(14)	(18)
Other operational costs	5.4	(222)	(273)
Profit before tax		3,512	5,338
Costs on income taxes	6	(351)	(533)
Profit for the year		3,161	4,805
Other comprehensive income for the year, net of taxes		-	-
Total comprehensive income for the year, net of taxes		3,161	4,805

Nadya Yordanova Dankinova
Executive Director



Kalinka Ruskova Todorova
Chief Accountant



The Financial Statements were approved for issuing by virtue of decision of the Board of Directors dated 15 March, 2012

The explanatory notes from p.7 to p. 33 constitute an inseparable part of the Financial Statements.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
STATEMENT OF FINANCIAL POSITION**

For the year ending on 31 December, 2011

	<u>Notes</u>	<u>2011</u>	<u>2010</u>
		<i>BGN thous.</i>	<i>BGN thous.</i>
ASSETS			
Cash and cash equivalents	7	68,690	87,089
Receivables of overpaid income tax	6,14	110	
Receivables and prepaid expenses	8	4	7
Extended loans	11	66,304	47,545
Assets from deferred taxes	10	1	1
Plant and Equipment	9	13	25
Software	9	8	
Prepaid initial costs for fees under EBRD loan	12,		660
TOTAL ASSETS		<u>135,130</u>	<u>135,327</u>
LIABILITIES AND EQUITY			
Liabilities			
Liabilities to staff and social insurance liabilities	13	28	49
Tax liabilities	14		209
Other liabilities	15	125	9
Liabilities under EBRD loan	12	69,349	69,133
Total liabilities		<u>69,502</u>	<u>69,400</u>
Equity			
Authorized capital	16.1	60,000	60,000
Statutory reserves	16.2	823	342
Retained earnings		4,805	5,585
Total equity		<u>65,628</u>	<u>65,927</u>
TOTAL LIABILITIES AND EQUITY		<u>135,130</u>	<u>135,327</u>

Nadya Yordanova Dankinova
Executive Director



Kalinka Ruskova Todorova
Chief Accountant



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**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
STATEMENT OF CHANGES IN EQUITY**

For the year ending on 31 December, 2011

	Authorized capital (Note 15.1) <i>BGN thous.</i>	Retained earnings <i>BGN thous.</i>	Statutory reserves (Note 15.2) <i>BGN thous.</i>	Total <i>BGN thous.</i>
Balance as of 1 January 2010	60,000	3,093	60	63,153
Profit for the year	-	4,805	-	4,805
Other comprehensive income	-	-	-	-
Total comprehensive income	-	4,805	-	4,805
Distribution of dividends (Note 17)	-	(2,031)	-	(2,031)
Transfer of reserves	-	(282)	282	-
As at 31 December 2010	60,000	5,585	342	65,927
Balance as of 1 January 2011	60,000	5,585	342	65,927
Profit for the year	-	3,161	-	3,161
Other comprehensive income	-	-	-	-
Total comprehensive income	-	3,161	-	3,161
Distribution of dividends (Note 17)	-	(3,460)	-	(3,460)
Transfer of reserves	-	(481)	481	-
As at 31 December 2011	60,000	4,805	823	65,628

Nadya Yordanova Dankinova
Executive Director



Kalinka Ruskova Todorova
Chief Accountant



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The explanatory notes from p.7 to p. 33 constitute an inseparable part of the Financial Statements.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

	Notes	2011	2010
		<i>BGN thous.</i>	<i>BGN thous.</i>
Cash flow from operational activity			
Interest received on bank deposits		5,016	5,869
Loans extended to municipalities		(61,552)	(64,116)
Loans repaid by municipalities		42,750	64,944
Interest received on extended loans		2,691	3,082
Payments to suppliers		(214)	(266)
Payments to staff and for social insurance		(340)	(317)
Other proceeds / (payments), net		152	(28)
Paid income tax	14	<u>(670)</u>	<u>(577)</u>
Net cash flow from/(used in) operational activities		<u>(12,167)</u>	<u>8,591</u>
Cash flow from investment activities			
Purchase of equipment and other long-term assets		<u>(10)</u>	<u>(1)</u>
Net cash flow used in investment activity		<u>(10)</u>	<u>(1)</u>
Cash flow from financial activity			
EBRD loan			16,344
Paid dividends	17	(3,460)	(2,031)
Contributions to authorized capital		-	-
Paid interest on EBRD loans		(2421)	(1 868)
Fees and commissions paid by the EBRD loan		<u>(341)</u>	<u>(435)</u>
Net cash flow from financial activity		<u>(6,222)</u>	<u>12,010</u>
Net increase of cash and cash equivalents		<u>(18,399)</u>	<u>20,600</u>
Cash and cash equivalents, beginning of period	7	<u>87,089</u>	<u>66,489</u>
Cash and cash equivalents, end of period	7	<u><u>68,690</u></u>	<u><u>87,089</u></u>

Nadya Yordanova Dankinova
Executive Director



Kalinka Ruskova Todorova
Chief Accountant



The Financial Statements were approved for issuing by virtue of decision of the Board of Directors dated 15 March, 2012

The explanatory notes from p.7 to p. 33 constitute an inseparable part of the Financial Statements.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

1. Corporate Information

The financial statements of FLAG JCS (the Company) for the year ending 31 December 2011 was prepared on 10 March 2012 and was approved with decision of the Board of Directors dated 15 March 2012.

FLAG EAD is a joint-stock company incorporated by virtue of Decision No 1 / 04.07.2007 under company file 10151/2007 of Sofia City Court, having its seat in Sofia, Bulgaria. The financial year of the Company ends on 31 December.

The core activity of the Company includes financing against consideration of municipal infrastructure and other projects and co-financing the development and implementation of projects of the European Union.

As at 31 December 2011 the shareholders of the Company include:
the Republic of Bulgaria represented by the Minister of Regional Development and Public Works - 100.00 %

2.1 Basis of Preparation

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

Disclosures in the financial statements are in Bulgarian leva and all amounts have been rounded to the nearest thousand (BGN'000), unless otherwise stated.

Statement of compliance

The financial statements of FLAG JSC have been prepared in accordance with the International Financial Reporting Standards, which have been endorsed by the European Union (IFRS applicable in EU).

2.2 Summary of Significant Accounting Policies

a) Foreign currency translation

The financial statements are presented in Bulgarian levs, which is also the functional and disclosure currency of the Company. Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated on a monthly basis by applying the exchange rate, published by the Bulgarian National Bank for the last working day of the respective month. All exchange differences are recognized in the statement of comprehensive income. Non-monetary items that are measured in terms of historical cost of acquisition in a foreign currency, are translated using the exchange rate as of the date of initial transaction (acquisition).

b) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured, regardless of the timing of the payment. Revenue is measured at the fair value of the consideration received or due, based on the contractual terms of payment, excluding discounts, rebates, and other sales taxes or duty. The Company analyses its selling agreements according to specific criteria to determine whether it acts as principal or as an agent. It has concluded that it acts as principal in all such arrangements. The following specific recognition criteria must be also met before revenue is recognised:

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

2.2 Summary of Significant Accounting Policies (continued)

b) Revenue recognition (continued)

Interest income

Interest income is recognised using the effective interest rate, i.e. the interest rate that discounts exactly the estimated future cash flows over the estimated useful life of the financial instrument, or a shorter period where appropriate, to the carrying amount of the financial asset. Interest income is included in the financial income in the statement of comprehensive income.

Rendering of services

Revenue from services rendered is recognised in the period during which the service is performed.

c) Taxes

Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the tax authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date. The management analyses the various items in the tax return when the applicable tax provisions are subject to interpretation, and recognises provisions where appropriate.

Current taxes are recognised directly in equity (not in the statement of comprehensive income) if the tax relates to items which have been recognised directly in equity.

Deferred income tax

Deferred income tax is recognized using the liability method on all temporary differences at the reporting date arising between the tax bases of assets and liabilities and their carrying amounts.

A deferred tax liability is recognised for all taxable temporary differences:

- except, where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.
- for temporary taxable differences related to investments in subsidiaries, associates and joint venture interests, except where the Company is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference would not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, unused tax credits and unused tax losses carried forward, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and carried forward unused tax credits and unused tax losses may be used:

- except, where the deferred income tax asset arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction affects neither the accounting profit nor taxable profit or loss; and
- for deductible temporary differences related to investments in subsidiaries, associates and joint venture interests, a deferred tax asset is recognised only to the extent it is probable that the temporary difference will reverse within the foreseeable future and taxable profit will be available to utilise the temporary difference.

The carrying amount of deferred income tax assets is reviewed by the Company at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent it has become probable that future taxable profit will be gained, which would allow recovery of the deferred tax asset.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

2.2 Summary of Significant Accounting Policies (continued)

e) Taxes (continued)

Deferred income tax (continued)

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date.

Deferred taxes, related to items recognised outside the profit or loss, are recognised outside the profit or loss. Deferred taxes are recognised depending on the related transaction either in the other comprehensive income statement or directly in equity.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income tax assets and liabilities relate to the same taxable entity and the same tax authority.

d) Financial instruments - initial recognition and subsequent measurement

• Financial assets

Initial recognition

Financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are classified as either financial assets at fair value through profit or loss, or loans and receivables, or held to maturity investments, or available for sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company designates the classification of its financial liabilities upon initial recognition.

When financial assets are recognised initially, they are measured at fair value, plus, in the case of financial assets not disclosed at fair value in the profit or loss, costs directly attributable to the acquisition of the financial asset.

Purchases or sales of financial assets that require the transfer of the asset over a period of time, established normally by regulation or existing practice on the respective market (regular way purchases), are recognised on the date of the transaction, i.e. the date when the Company has committed to buy or sell the asset.

The financial assets of the Company include cash and cash equivalents, loans granted and trade and other receivables.

Subsequent measurement

The subsequent measurement of the financial assets depends on their classification as follows:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. After initial measurement, loans and receivables are subsequently carried at amortised cost using the effective interest method (EIRM) less any allowance for impairment. Amortised cost is calculated taking into account any discounts or premiums on acquisition and fees or expenses inherent to the EIR. EIR amortisation is included in the financial income in the income statement. Impairment losses are taken to the comprehensive income statement as finance costs.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

2.2 Summary of Significant Accounting Policies (continued)

d) Financial instruments - initial recognition and subsequent measurement (continued)

• **Financial assets (continued)**

Derecognition

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the contractual rights to receive the cash flows from the financial asset are transferred or the Company has assumed the obligation to pay in full the cash flows received, without significant delay to a third party under a transfer agreement; where (a) the Company has transferred significantly all risks and rewards from the title over the financial asset; or (b) the Company has neither transferred nor retained significantly all risks and rewards from the title over the financial asset, but has not retained control over the asset.

Where the Company has transferred its rights to receive cash flows from a financial asset or has concluded a transfer agreement and has neither transferred nor retained substantially all the risks and rewards of the financial asset but has retained the control of the asset, the asset is recognised to the extent of the Company's continuing involvement in the asset. In this case the Company recognises the related liability as well. The transferred asset and the related liability are recognised on a basis, which reflects the rights and obligations retained by the Company.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

Impairment of financial assets

Financial assets carried at amortised cost

For financial assets carried at amortised cost the Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If it is assessed that no objective evidence for impairment exists for an individually measured financial asset, regardless of whether it is significant or not, the Company includes the asset in a group of financial assets with similar features of credit risk and reviews them for impairment collectively. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised, are not included in a collective assessment of impairment.

If objective evidence exists for impairment loss, the amount is the difference between the asset's carrying amount and the present value of the expected future cash flows (excluding any future loan losses that have not yet been incurred). The present value of the expected future cash flows is discounted using the original effective interest rate of the financial asset. If a loan has a floating interest rate the discount rate for impairment loss represents the current effective interest rate.

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy/announce over-indebtedness or undertake other financial reorganisation or where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with debtors' defaults.

For the year ending on 31 December, 2011

2.2 Summary of Significant Accounting Policies (continued)

d) Financial instruments - initial recognition and subsequent measurement (continued)

- **Financial assets (continued)**

Financial assets carried at amortised cost

Due to the specific nature of its operations the Company sets aside impairment provisions as follows:

Specific impairment

The purpose of the specific impairment is to adjust the value of specific loans granted, for which objective evidence of impairment exists, to their recoverable amount and to set aside provisions reflecting the risk of non-repayment of the respective loans.

Impairment on portfolio basis

Impairment is charged in consideration of the common risk nature of the portfolio and takes into account the overall structure of the loan portfolio, the amount of receivables overdue as at the reporting date and the management's expectations as to the recoverable amount of loans granted.

The carrying amount of the asset is written down using an allowance account and the impairment loss is recognised in the statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount, based on the original interest rate of the asset, which is used to discount the future cash flows for the purpose of measurement of the impairment loss.

Loans granted, and the related allowances are written off when no realistic opportunity exists to collect them in the future and all collateral has been realised or has been transferred to the Company. If in a subsequent year the expected impairment loss increases or decreases due to an event occurring after the recognition of the impairment, the impairment loss recognised before is increased or decreased through an adjustment in the allowance account. If the future write-down is recovered at a later stage, the recovery is recognised in the current period result.

- **Financial liabilities**

Initial recognition and measurement

Financial liabilities within the scope of IAS 39 are classified as financial liabilities at fair value through profit or loss or as loans and borrowings, or as derivatives, which are effective hedging instruments, as appropriate. The company designates the classification of its financial liabilities upon initial recognition.

Financial liabilities are initially recognised at fair value, plus in the case of loans and borrowings, the transaction costs directly related to the acquisition of the financial liability.

The Company's financial liabilities include interest-bearing loans and trade and other payables.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

2.2 Summary of Significant Accounting Policies (continued)

d) Financial instruments - initial recognition and subsequent measurement (continued)

- **Financial liabilities (continued)**

Subsequent measurement

The subsequent measurement of the financial liabilities depends on their classification as follows:

Loans and borrowings

After initial recognition, loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Gains and losses on loans and borrowings are recognised in the current period result when the liabilities are derecognised as well as through the amortisation process.

Amortised cost is calculated taking into account any discounts or premiums on acquisition and fees or expenses inherent to the EIR. The amortisation of EIR is included in the interest expense in the statement of comprehensive income.

Derecognition

A financial liability is derecognised when the obligation under the contract is discharged, or cancelled, or expired.

When an existing financial liability is exchanged for another liability from the same creditor at significantly different terms or the terms of the existing liability are significantly modified, this exchange or modification is treated as derecognition of the original liability and recognition of a new one, and the difference in the respective carrying amounts is recognised in the profit or loss for the period.

e) Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is taken to the statement of financial position, if and only if there is a legally enforceable right to offset the recognised amounts and the Company intends to settle the asset and liability on net basis, or to simultaneously realise the assets and settle the liabilities.

f) Fair value of financial instruments

At each reporting date the fair value of financial instruments which are traded actively at the markets is determined based on quoted market prices or quotes from dealers ("buy" prices on long positions and "sell" prices on short positions) without deducting any transaction costs.

The fair value of financial instruments without an active market is determined using appropriate valuation techniques. These techniques include use of recent market arm's length transactions; references to the current fair value of similar instruments that are significantly the same; analysis of the discounted cash flows, and other valuation models.

Analysis of the fair values of financial instruments and details of their measurement are presented in Note 21.

g) Share capital

Share capital is presented at the nominal amount of the shares issued and paid-in. The Company is obliged to set aside a **Reserves Fund** in accordance with the Commercial Act. Sources for the fund may include:

- portion of the profit set by the sole owner of the capital, but no less than 1/10 until the funds in the Reserves Fund reach 1/10 of the capital;
- funds, received in excess of par value of shares at issue thereof;
- other sources in accordance with decision of the General Assembly.

The Reserves Fund may only be used to cover current and prior year losses. When the Reserves Fund reaches the minimum amount set out in the statutes, any excess may be used for share capital increases.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

2.2 Summary of Significant Accounting Policies (continued)

h) Plant and equipment

Plant and equipment are carried at acquisition cost less the accumulated depreciation and the accumulated impairment losses, if any. Acquisition cost includes costs related to replacement of parts of the plant and equipment, and borrowing costs on long-term construction contracts, if they meet the criteria for recognition of an asset. When costs are incurred for major inspection of plant and / or equipment these are capitalised in the carrying amount of the respective asset as replacement cost, provided they meet the asset recognition criteria. All other repair and maintenance costs are taken to statement of comprehensive income in the period incurred.

Depreciation is calculated on a straight line basis over the estimated useful life of the assets as follows:

Computers	2 years
Property, plant and equipment	5 years
Transport vehicles	4 years
Fixtures and fittings	5 years

An item of plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds, if any, and the carrying amount of the asset) is included in the statement of comprehensive income in the year the asset is derecognised.

i) Software

Software is carried on acquisition cost less accumulated depreciation and accumulated impairment loss, if any.

Depreciation is calculated on a straight line basis over the estimated useful life of the assets as follows:

Software	2 year
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A review of residual value, of the useful life and applied depreciation methods of tangible and intangible assets is conducted at the end of each financial year and if expectations differ from previous estimates, the latter are modified in future periods.

j) Cash and Cash Equivalents

Cash and short-term deposits in the statement of financial position include cash at banks, and on hand and short-term deposits with original maturity of twelve months or less, available to the Company on demand without incurring significant financial losses.

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

k) Provisions

General

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all expenses of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of comprehensive income net of any recoveries. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

2.3 Changes in accounting policies and disclosures

New and amended standards and interpretations

The accounting policies adopted are consistent with those of the previous reporting period except the following new and amended IFRS and Interpretations (IFRIC) to the International Financial Reporting Standards effective as at 1 January 2011:

- IAS 24 Related Party Disclosures (Amendment) Act in force at 1 January 2011
- IAS 32 Financial Instruments: Presentation (Amendment) Act in force at 1 February 2010
- IFRIC 14 Prepayment of minimum funding requirement (Amendment) existing at January 1, 2011
- IFRIC 19 Repayment of financial liabilities, with equity instruments, existing at July 1, 2010
- Improvements to IFRSs (May 2010)

When the adoption of IFRS is considered to have an effect on the financial statements or results of operations of the Company, this effect is described below:

IAS 24 Related Party Disclosures (Amendment)

The International Accounting Standards Board (IASB) published amendments to IAS 24, which clarifies the definition of related party. The new definitions emphasize symmetrical perspective on relationships with related parties and explain the circumstances under which a person as a member of key management personnel affects relationships with affiliates of the company. In addition, the amendment provides an exemption from the general disclosure requirements for related party transactions with government or state bodies and enterprises which are controlled, jointly controlled or who have significant influence by the same government or public authority, as the reporting enterprise. The adoption of the amendment had no impact on the financial condition or results of operations of the Company.

IAS 32 Financial Instruments: Presentation (Amendment)

IASB published an amendment by which changes the definition of financial liability in IAS 32 to allow enterprises to classify emission rights and certain options or warrants as equity instruments. The amendment is applicable if the rights are granted pro rata to all existing owners of the same class of non-derivative equity instruments of the entity to acquire a fixed number of own equity instruments of the entity for a fixed amount in any currency. The amendment applies retroactively. The amendment does not affect the financial condition or results of operations of the Company as it has no such instruments.

IFRIC 14 Prepayment of minimum funding requirement (Amendment)

The amendment removes an unintended consequence when an entity is subject to minimum funding requirements and makes early payment of contributions to cover these requirements. The amendment allows the prepayment of costs for future service by the entity to be recognized as a pension asset. The amendment applies retroactively. The Company is not subject to minimum funding requirements in Bulgaria and therefore the change in the Interpretation does not affect the financial condition or results of its operations.

IFRIC 19 Repayment of financial liabilities using equity instruments

The Interpretation clarifies that equity instruments issued to the lender for repayment of a financial liability shall be eligible for consideration paid. Issued equity instruments are measured at fair value. If this can not be done reliably, instruments are measured at fair value of the liability repaid. Emerging gain or loss is recognized immediately in the current financial results. The amendment does not affect the financial position or results of operations of the Company.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

2.3 Changes in accounting policies and disclosures (continued)

Improvements to IFRSs

In May 2010 the IASB published its third set of changes in standards, mainly to remove some inconsistencies and clarifying wording. For each standard there are separate transitional provisions. Amendments resulting from Improvements to IFRSs for the following standards and interpretations had no impact on accounting policies, financial condition or results of operations of the Company:

IFRS 1 First-time

IFRS 3 Business Combinations

IFRS 7 Financial Instruments - Disclosures

IAS 1 Presentation of Financial Statements

IAS 27 Consolidated and Separate Financial Statements

IAS 34 Interim Financial Reporting

IFRIC 13 Customer Loyalty Programmes

3. Significant accounting judgments, estimates and assumptions

The preparation of the financial statements requires the management to apply accounting judgements, estimates and assumptions, which have effect on the amount of reported assets and liabilities, and the disclosure of the contingent liabilities at the date of the financial statements, as well as on the income and expenses reported for the period. Uncertainties related to these assumptions and estimates may lead to actual results requiring material adjustments in the carrying amounts of the respective assets or liabilities in subsequent reporting periods.

Estimates and assumptions

The key assumptions concerning future and other key sources of uncertainty in the estimations at the date of the statement of financial position, that have a significant risk of causing material adjustments to the carrying amounts of assets and liabilities within the next reporting period are discussed below:

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

3. Significant Accounting Judgments, Estimates and Assumptions
(continued)

Estimates and assumptions (continued)

Impairment of financial receivables

The Company is using an adjustment account to report the provision on the impairment of doubtful and bad receivables from customers. The management assesses the appropriateness of this impairment based on ageing analysis of the receivables, historical experience as to the write-off rates of bad debts, as well analysis of the solvency of the respective municipality, changes in the contractual payment terms, etc. If the financial position and performance of municipalities deteriorate (in excess of the expected) the amount of the receivables to be written off in the next reporting periods may be higher than the one estimated at the date of the statement of financial position. At 31 December 2011, the best estimate of the management for the necessary provision for impairment of receivables is BGN 208 thousand (2010: BGN 143 thous., 2009: nil). Further information is presented in Note 11.

4. Published standards not in force

Published standards, that are not in force or not applied prior to the date of the financial statements of the Company, are listed below. The list includes standards and interpretations which the Company reasonably expected to affect over disclosures, financial condition and results of operations, when applied in the future. The Company intends to apply these standards when they enter into force.

IAS 1 Presentation of Financial Statements (Amendment) - Presentation of items in other comprehensive income

The amendment is effective for annual periods beginning on or after July 1, 2012. Amendments to IAS 1 changes the grouping of items presented in the statement of comprehensive income. Items that can be reclassified (or "recycled") in profit or loss at some point in the future (e.g. withdrawal or settlement) should be presented separately from items that will never be reclassified. The amendment affects only the presentation and does not affect the financial position or results of operations of the Company. This amendment has not been adopted yet by the EU.

IAS 12 Income Taxes (Amendment) - Recovery of underlying assets

The amendment is effective for annual periods beginning on or after January 1, 2012. The amendment clarifies the definition of deferred tax on investment property measured at fair value. It introduces a rebuttable presumption that the deferred tax on investment property measured at fair value under fair value model in IAS 40 should be determined on the basis that their carrying amount will be recovered through sale. In addition, the amendment introduces a requirement that the estimated deferred taxes on non-depreciable assets that, are valued by application of the revaluation model in IAS 16, should always be determined on the basis of the asset sale. The Company does not expect any effect on the financial condition or results of operations. This amendment has not been adopted yet by the EU.

IAS 19 Employee Benefits (Amendments)

The amendment is effective for annual periods beginning on or after 1 January 2013. The IASB published a number of amendments to IAS 19. They range from fundamental changes, such as removing the corridor approach and the concept of expected return on plan assets to simple clarifications and changes in the wording of the texts. Earlier application is permitted. The Company is currently assessing the effects of climate on the financial condition or results of operations. These changes have not been adopted yet by the EU.

IAS 27 Separate Financial Statements (Revised)

The standard is effective for annual periods beginning on or after January 1, 2013. As a consequence of the introduction of new IFRS 10 and IFRS 12 what remains in IAS 27 is limited to accounting for subsidiaries, jointly controlled entities and associates enterprises in the financial statements. Earlier application is permitted. The Company is currently assessing the effects of this standard on the financial condition or results of operations. The standard has not been adopted yet by the EU.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

4. Published standards not in force (continued)

IAS 28 Investments in associates and joint ventures (Revised)

The standard is effective for annual periods beginning on or after January 1, 2013. As a consequence of the introduction of new IFRS 11 and IFRS 12, IAS 28 was renamed IAS 28 *Investments in associates and joint ventures*. The standard describes the application of equity method to investments in joint ventures in addition to associated companies. Earlier application is permitted. The Company is currently assessing the effects of this standard on the financial condition or results of operations. The standard has not been adopted yet by the EU.

IAS 32 Financial Instruments (Amendment): Presentation - Net presentation of financial assets and financial liabilities

The amendment is effective for annual periods beginning on or after January 1, 2014. This amendment clarifies the meaning of "now it is a legally enforced right to offset" and also clarifies the application of the criteria of IAS 32 on net performance in settlement systems. Amendments to IAS 32 are applied retrospectively. Earlier application is permitted. However, once the company decides to implement at an earlier date, it shall disclose that fact and also make the disclosures required by the amendments to IFRS 7 *Net presentation of financial assets and financial liabilities*. The Company is currently assessing the effects of climate on the financial condition or results of operations. This amendment has not been adopted yet by the EU.

IFRS 7 Financial Instruments: Disclosures (Amendment) - Improved disclosure requirements for exits

The amendment is effective for annual periods beginning on or after July 1, 2011. The amendment requires additional disclosures about financial assets that are transferred but not written off, in order to enable users of financial statements to understand the relationship with the assets, which have not been written off and the associated liabilities. In addition, the amendment requires disclosure of continued participation in the write off assets in order to enable the user to assess their nature and risks associated with continuing involvement in those derecognised assets. This amendment affects only disclosures. The amendment has no effect on the financial condition or results of operations of the Company.

IFRS 7 Financial Instruments: Disclosures (Amendment) - Net presentation of financial assets and financial liabilities

This amendment becomes effective for annual periods beginning on or after January 1, 2013. This amendment introduces requirements for general disclosures. These disclosures will provide users of financial statements useful information to enable them to assess the impact or potential impact of netting agreements on the financial position of the Company. Amendments to IFRS 7 apply retrospectively. The Company is currently assessing the effects of climate on the financial condition or results of operations. This amendment has not been adopted yet by the EU.

IFRS 9 Financial Instruments: Classification and Measurement

The standard is effective for annual periods beginning on or after January 1, 2015. IFRS 9, as published, reflects the first phase of the work of the IASB to replace IAS 39 and is applicable to classification and measurement of financial assets as defined in IAS 39. Phase I of IFRS 9 will have a material effect on (i) the classification and measurement of financial assets and (ii) a change in accounting for those businesses that have defined the measurement of financial liabilities using the fair value option. At subsequent stages, the IASB will address hedge accounting and impairment of financial assets. Completion of this project is expected in the first half of 2012, the Company is currently assessing the effects of this standard on the financial condition or results of operations. The standard has not been adopted yet by the EU.

IFRS 10 Consolidated Financial Statements

The standard is effective for annual periods beginning on or after 1 January 2013. IFRS 10 replaces a section of IAS 27 *Consolidated and Separate Financial Statements*, which addresses accounting in the consolidated financial

4. Published standards not in force (continued)

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG EAD
NOTES TO THE FINANCIAL STATEMENTS

For the year ending on 31 December, 2011

statements. It includes the issues raised in SIC-12 *Consolidation - Special Purpose Entities*. FRS 10 defines a single control model that is applicable to all entities, including those with special functions. Compared with the requirements that existed in IAS 27, the changes made by IFRS 10 require the management to exercise significant discretion in determining which companies are controlled and therefore which ones are required to be consolidated by the parent company. The Company is currently assessing the effects of this standard on the financial condition or results of operations. The standard has not been adopted yet by the EU.

IFRS 11 Joint Agreements

The standard is effective for annual periods beginning on or after January 1, 2013. FRS 11 supersedes IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities - Non-cash contributions by the participants*. FRS 11 removes the option of accounting for jointly controlled entities (RCP) using proportionate consolidation. Instead, RCP, which meets the definition of a joint venture, should be accounted for by the application of equity method. The Company is currently assessing the effects of this standard on the financial condition or results of operations. The standard has not been adopted yet by the EU.

FRS 12 Disclosure of interests in other enterprises

The standard is effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all the disclosures that were previously included in IAS 27 and which were related to the consolidated financial statements and all disclosures that were previously included IAS 31 *Interests in joint ventures* and IAS 28 *Investments in Associates*. These disclosures relate to the company's participation in subsidiaries, joint agreements, associates and structured entities. A number of new disclosures is required. The Company is currently assessing the effects of this standard on disclosures in the financial statements. The standard has not been adopted yet by the EU

FRS 13 Valuation at fair value

The standard is effective for annual periods beginning on or after 1 January 2013. IFRS 13 is a source of guidance for all estimates under IFRS. FRS 13 does not change the requirements when an entity is required to use fair value, but rather provides guidance on how to assess it in accordance with IFRS, as required or allowed. The standard should be applied prospectively and earlier application is permitted. The Company is currently assessing the effects of this standard on the financial condition or results of operations. The standard has not been adopted yet by the EU.

IFRIC 20 Cost of overburden in the exploitation phase of the surface of a mine

The amendment is effective for annual periods beginning on or after January 1, 2013. This amendment applies only to the cost of overburden arising from operations for the extraction of coal reserves, carried out on the surface of a mine (operating costs of overburden). Cost of carrying out activities to overburden leads to two possible benefits: a) the production of ore as an inventory in the current period and / or b) improved access to ore, which will be extracted in a future period (asset generated by the cost of overburden). Where costs can not be specifically allocated to the works during the period and stock asset generated by the cost of overburden, IFRIC 20 requires an entity to use a basis for allocation, based on appropriate production measure. Earlier application is permitted. The Company does not expect the new KRFSMO to have an effect on the financial condition or results of operations. IFRIC 20 has not been adopted yet by the EU.

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5. Income and Expenses

5.1 Interest Income

	<u>2011</u>	2010
	<i>BGN thous.</i>	<i>BGN thous.</i>
Interest income on deposits and bank accounts	5,016	5,870
Income on loans granted and receivables	<u>2,708</u>	3,065
Total interest income	<u>7,724</u>	<u>8,935</u>

5.2 Expenses on interest and fees

	<u>2011</u>	2010
	<i>BGN thous.</i>	<i>BGN thous.</i>
Interest expenses on loans and borrowings	2,615	2,289
Expenses on currency transactions		49
Expenses on fees and commissions*	1,033	525
<i>Including cancelled loan agreement</i>	<u>660</u>	
Total interest and fee expense	<u>3,648</u>	<u>2,863</u>

*Notice: The amount of BGN 1033 thous. includes bank fees charged on Loan Agreement with EBRD concluded in 2009, which was fully cancelled in 2011. Till the canceling of the agreement the bank fees relating to it, were rescheduled for the duration of the entire period of its validity. The canceling of the agreement eliminated the grounds for rescheduling the fees and the amount of BGN 660 thous. was carried to financial expenses.

5.3 Personnel expenses

	<u>2011</u>	2010
	<i>BGN thous.</i>	<i>BGN thous.</i>
Remuneration	294	289
Social security contributions	<u>39</u>	37
Total personnel expenses	<u>333</u>	<u>326</u>

5.4 Other operating costs

	<u>2011</u>	2010
	<i>BGN thous.</i>	<i>BGN thous.</i>
Legal services – EBRD	15	75
Rent	42	71
Consulting services	46	-
Accounting and audit services	50	53
Materials	12	21
Computer support	6	5
Communications	8	8
Media		1

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Translations	8	2
Social	2	2
Insurance	2	2
Other	31	33
Total other operating costs	<u>222</u>	<u>273</u>

6. Income Tax

The main components of the income tax expenses for the years ending on 31 December, 2011 and 2010 are:

	<u>2011</u>	<u>2010</u>
	<i>BGN thous.</i>	<i>BGN thous.</i>
Current income tax expense	351	533
Deferred tax income	-	
Income tax expense	<u>351</u>	<u>533</u>

The income tax rate applicable for 2011 is 10% (2010 10%).

The reconciliation between the income tax expense and the accounting profit, multiplied by the applicable tax rate for the years ending on 31 December 2011 and 31 December 2010, is presented below:

	<u>2011</u>	<u>2010</u>
	<i>BGN thous.</i>	<i>BGN thous.</i>
Accounting profit before tax	3,512	5,338
Income tax expense at the applicable tax rate of 10% for 2011 (2010: 10%)	351	534
Non-deductible expenses		
Other		(1)
Income tax expense	<u>351</u>	<u>533</u>

7. Cash and Cash Equivalents

	<u>2011</u>	<u>2010</u>
	<i>BGN thous.</i>	<i>BGN thous.</i>
Cash on hand and at banks	16	46
Balances of interest receivable on deposits	1,078	2,007
Short-term deposits	67,596	85,036
Total cash and cash equivalents	<u>68,690</u>	<u>87,089</u>

Cash at banks accrue floating interest rates based on the daily interest rates on bank deposits. Short-term deposits have a term of one year with a possibility to change the amounts held in the deposits depending on the liquidity needs of the Company. They accrue interest at the contractual interest rates which vary between 3,62% and 7,25% per annum (2010: 5%-7.5%). Balances on interest receivable on deposits include cash and cash equivalents as the amounts accrued are available to the Company on demand. The fair value of cash and short-term deposits is equal to

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their carrying amount.

8. Receivables and Prepaid Expenses

	2011	2010
	<i>BGN thous.</i>	<i>BGN thous.</i>
Other receivables	4	7
Total receivables and prepaid expenses	4	7

Other receivables relate to guarantees granted and non-financial deferred expenses.

9. Plant and Equipment, Software

	Computers	Fixtures and fittings	Plant and equipment	Motor vehicles	Software	Total
	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>	<i>BGN'000</i>
Book value:						
On 1 January 2010.	19	7	1	36		63
Acquired	-	-	1	-	-	1
Transfers	-	-	-	-	-	-
Disposals	-	-	-	-	-	-
On 31 December 2010	19	7	2	36	-	64
Acquired	-	-	-	-	10	10
Transfers	-	-	-	-	-	-
Disposals	-	-	-	-	-	-
On 31 December 2011	19	7	2	36	10	74
Depreciation:						
On 1 January 2010	-10	-2	-	-9	-	-21
Depreciation charged for the year	-8	-1	-	-9	-	-18
Written off	-	-	-	-	-	-
On 31 December 2010	-18	-3	-	-18	-	-39
Depreciation charged for the year	-1	-1	-1	-9	-2	-14
Written off	-	-	-	-	-	-
On 31 December 2010	-19	-4	-1	-27	-2	-53
Carrying amount:						
On 1 January 2010	9	5	1	27	0	42
On 31 December 2010	1	4	2	18	0	25
On 31 December 2011	0	3	1	9	8	21

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10. Deferred Tax Assets

As at 31 December 2011 and 31 December 2010 deferred taxes are related to the following:

	Statement of financial position		Statement of comprehensive income	
	2011	2010	2011	2010
	BGN'000	BGN'000	BGN'000	BGN'000
<i>Deferred tax assets</i>				
Unused leave of the personnel	1	1	-	
Deferred tax income			-	
Deferred tax assets, net	1	1		

11. Loans Granted

	2011	2010
	BGN thous.	BGN thous.
Loans granted	66,434	47,632
Impairment of receivables on loans granted	(208)	(143)
Receivables on interest	76	56
Receivables on fees	2	-
Total loans granted	66,304	47,545

Loans granted represent loans extended to municipalities. Most of the loans granted – BGN 60,811 thousand are used as bridge financing under European programmes. The remaining amount of BGN 5,623 thousand is intended for lending for municipalities' own activities.

Loans granted are secured mainly with specific pledges over the future receivables of the municipalities under the grant agreements and the future own revenue of the municipalities.

The movements in the impairment loss provisions of loans granted in 2011 and 2010 are as follows:

	<i>Impairment of receivables on loans granted</i>
Position at 1 January 2010	-
Accrued during the year	(143)
Reversed during the year	-
Net movements in impairment	-
Receivables written off against provisions	-
Position at 31 December 2010	(143)
Accrued during the year	(65)
Reversed during the year	-
Net movements in impairment	(65)
Receivables written off against the accumulated impairment	-
Position at 31 December 2011	(208)

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12. Payables on EBRD Loan

	Effective interest rate %	Maturity	2011 <i>BGN thous.</i>	2010 <i>BGN thous.</i>
Long-term				
Payables on EBRD loan	4.08%	August 2023	68,454	68,454
Deferred fees under contracts with EBRD			(274)	(296)
Accrued interest due			1,169	975
Total payables on EBRD loan			69,349	69,133

The payables of the Company to the European Bank for Reconstruction and Development (EBRD) due to utilisation of funds under the loan agreement with a limit of EUR 35,000 thousand (BGN 68,454 thousand), which amount has two components:

1. Loan "a" – at the amount of EUR 18,000 thousand (BGN 35,205 thousand)
2. Loan "b" – at the amount of EUR 17,000 thousand (BGN 33,249 thousand)

The term of the loans is 15 years with a 3-year grace period. The contractual interest rate is based on six-month EURIBOR plus a floating margin of 2.25% to 2.75%, defined on the bases of existence and amount of bad debt in the Company's loan portfolio. Additional fees are envisaged: (a) annual commitment fee; (b) one-off Front - End Fee; (c) annual administration fee.

As at 31 December 2011 the Company has utilised the full amount of the loan - EUR 35,000 thousand (BGN 68,454 thousand) - of the resource granted and is not in violation of any covenants of the agreement with EBRD on capital and financial adequacy.

Unutilised loans

As at 31 December 2011 the Company has terminated the agreement for a second loan from EBRD at the total amount of BGN 68,454 thousand in respect of which all contractual terms and conditions have been met. The prepaid fee related to the initial costs to set up the credit line is presented in the statement of financial position for 2010 and is carried in the statement of comprehensive income under the straight-line method over the term of the loan. As at 31 December 2011 the prepaid fee is finally carried as financial expense (2010: BGN 660 thousand).

13. Payables to Personnel and Social Security Contributions

Payables to personnel and social security at 31 December 2011 in connection with accrued bonuses (bonuses) and are distributed as follows:

	2011 <i>BGN thous.</i>	2010 <i>BGN thous.</i>
Payables to personnel	25	40
Payables on social security contributions	3	9
Total payables to personnel and social security contributions	28	49

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For the year ending on 31 December, 2011

14. Tax Payables

There are no tax payables as at 31 December, 2011 since the income tax was overpaid during the year:

	<u>2011</u>	<u>2010</u>
	<i>BGN thous.</i>	<i>BGN thous.</i>
Income tax		209
Total taxes payable		209

The movements in taxes payable in 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
	<i>BGN thous.</i>	<i>BGN thous.</i>
Taxes payable as at 31 January	(209)	(253)
Tax paid during the year	670	577
Tax accrued for the year	<u>(351)</u>	<u>(533)</u>
Taxes payable at 31 December	110	(209)

Note: The overpaid profit tax is to be deducted from payments to be made in 2012. It is presented in Note 8

15. Other Payables

	<u>2011</u>	<u>2010</u>
	<i>BGN thous.</i>	<i>BGN thous.</i>
Other payables	125	9
<i>Incl. contingent fee for consideration of loan request</i>	108	
<i>Performance guarantee</i>	16	
Total other payables	125	9

16. Share Capital and Reserves

16.1 Share capital

	<u>2011</u>	<u>2010</u>
	<i>BGN thous.</i>	<i>BGN thous.</i>
60,000 ordinary shares at a par value of BGN 1,000 each	60,000	60,000
Total share capital	60,000	60,000

As at 31 December, 2011 and 31 December, 2010 the issued registered capital is fully paid-in.

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16.2 Statutory reserves

Statutory reserves are formed by FLAG JCS as a distribution of the profit as provided for under art. 246 of the Commercial Act. They are set aside until the amount reaches one tenth or more of the capital. Sources to form the statutory reserves include at least one tenth of the net profit, share premiums and funds set out in the statutes or in accordance with a decision of the general assembly of the shareholders.

The statutory reserves may only be used to cover current and prior reporting period losses. As at 31 December 2011 statutory reserves amount to BGN 823 thousand (2010: BGN 342 thousand).

17. Dividend Distribution

In accordance with art. 25 of Decree 334/29.12.2010 of the Council of Ministers dividends are distributed to the sole shareholder at the amount of BGN 3,460 thousand (2010: BGN 2,031 thousand). Dividends per share amount to BGN 57.67 (2010: BGN 33.85).

18. Commitments and Contingencies

Lawsuits

As at 31 December, 2011 and 31 December, 2010 there are no lawsuits filed against the Company.

Guarantees

As at 31 December, 2011 and 31 December, 2010 the Company has not extended any guarantees.

19. Related Party Disclosures

Composition of related parties

Shareholder – sole owner

The Republic of Bulgaria through the Ministry of Regional Development and Public Works is the sole owner of the shares of FLAG JSC

Other related parties

All state-owned companies and companies with state interest are related parties to the Company.

Salaries of management staff

In 2011 the cost of executive remuneration is BGN 67 thousand (2010 -. BGN 65 thous.)

Related party transactions

In 2007, 2008, 2009, 2010 and 2011 there have been no closed and / or implemented related party transactions, excluding the distributed dividend, presented in Note 17.

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20. Financial Risk Management Objectives and Policy

The main financial liabilities of the Company include interest bearing loans and borrowings, and trade payables. The main objective of these financial instruments is to secure financing for the Company's operations. The Company holds financial assets, such as loans granted, cash and short-term deposits which arise directly from its operations.

In 2011 and 2010 the Company did not hold and trade with derivative financial instruments.

The main risks arising from the Company's financial instruments include interest rate risk, liquidity risk, foreign currency risk, and credit risk. The policy adopted by the Company's management to manage these risks is summarised below.

Interest rate risk

The Company is exposed to the risk of changes in the market interest rates, mainly in respect of its floating rate long-term financial liabilities. The Company's policy is to manage interest expense through the extension of floating interest rate loans.

The table below presents a sensitivity analysis to the possible changes in the interest rates and their effect on the profit before tax (through the effect on floating interest rate liabilities and floating interest rate loans granted), assuming that all other variables remain constant.

	Increase/ decrease in interest rates	Effect on profit before tax
		<i>BGN'000</i>
2011		
In EUR	+0.5%	(342)
In BGN	+0.5%	332
In EUR	-1%	684
In BGN	-1%	(664)
2010		
In EUR	+0.5%	(342)
In BGN	+0.5%	238
In EUR	-1%	684
In BGN	-1%	(476)

Liquidity risk

The effective management of the Company's liquidity requires ensuring sufficient working capital, mainly through maintaining unemployed funds on deposit accounts.

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20. Financial Risk Management Objectives and Policy (continued)

Liquidity risk (continued)

As at 31 December, 2011 the maturity structure of the Company's financial assets and financial and other liabilities, based on agreed undiscounted payments, is presented in the tables below:

Liabilities

As at 31 December, 2011

	Demand	< 3 months	3-12 months	1-5 years	> 5 years	Total
	BGN'000	BGN'000	BBGN'000	BBGN'000	BBGN'000	BBGN'000
Interest bearing loans and borrowings	-	4,245	4,245	33,962	42,453	84,905
Trade and other payables	-	153				153
	-	4,398	4,245	33,962	42,453	85,058

As at 31 December, 2010

	Demand	< 3 months	3-12 months	1-5 years	> 5 years	Total
	BGN'000	BGN'000	BBGN'000	BBGN'000	BBGN'000	BBGN'000
Interest bearing loans and borrowings	-	1,360	1,360	39,571	45,881	88,172
Trade and other payables	-	267	-	-	-	267
	-	1,627	1,360	39,571	45,881	88,439

The maturity structure of assets and liabilities as at 31 December, 2011 is drawn up based on the expectations of the management regarding the recovery / settlement of amounts:

Assets	<i>Up to 1 year</i>	<i>Over 1 year</i>	Total
Cash and cash equivalents	68,690	-	68,690
Receivables for overpaid income tax	110	-	110
Receivables and prepaid expenses	4	-	4
Loans granted	53,034	13,270	66,304
Deferred tax assets	-	1	1
Plant, equipment and software	-	21	21
Total assets	121,838	13,292	135,130

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20. Financial Risk Management Objectives and Policy (Continued)

Liquidity risk (continued)

Liabilities	<i>Up to 1 year</i>	<i>Over 1 year</i>	Total
Payables to personnel and social security contributions	28	-	28
Taxes payable		-	
Other payables	125	-	125
Payables on EBRD loan	6,846	62,503	69,349
Total liabilities	6,999	62,503	69,502

The maturity structure of assets and liabilities as at 31 December, 2011 is drawn up based on the expectations of the management regarding the recovery / settlement of amounts:

Assets	<i>Up to 1 year</i>	<i>Over 1 year</i>	Total
Cash and cash equivalents	87,089	-	87,089
Receivables and prepaid expenses	7	-	7
Loans granted	39,571	7,974	47,545
Deferred tax assets	-	1	1
Plant and equipment	-	25	25
Prepaid initial costs on fees on EBRD loan	55	605	660
Total assets	126,722	8,605	135,327

Liabilities	<i>Up to 1 year</i>	<i>Over 1 year</i>	Total
Payables to personnel and social security contributions	49	-	49
Taxes payable	209	-	209
Other payables	9	-	9
Payables on EBRD loan	927	68,206	69,133
Total liabilities	1,194	68,206	69,400

Foreign currency risk

The Company has no purchases, sales and does not grant loans in foreign currencies and the loans received are denominated in EUR. Since the exchange rate BGN / EUR is fixed to 1.95583, the currency risk resulting from the Company's exposures in EUR is not significant.

Credit risk

Credit risk is the risk that the clients / counterparties will be unable to pay in full the amounts due to the Company within the envisaged / agreed deadlines. At the end of 2011 the remaining liability of municipalities to the Company amounts to BGN 66,434 thousand.

Credit risk management in 2011 is carried out by the "Lending" Directorate and is monitored simultaneously by the Executive Director and the Board of Directors. The credit risk management function is to ensure the implementation of appropriate investment policy in respect of the funds available and accordingly – the compliance of this policy with the related procedures and controls for current monitoring of the respective loan, deposit or receivable.

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20. Financial Risk Management Objectives and Policy (continued)

Credit risk (continued)

The risk credit exposure is managed through on-going analysis of the ability of the counterparties / servicing banks to comply with their contractual obligations to pay interest and principal, and through setting appropriate credit limits. Cash deposits are placed with prime banks having good reputation on the Bulgarian market. Furthermore, subject to on-going monitoring is the existence of concentration of receivables with certain counterparty, and if such is found – the respective counterparty is subject to special supervision. The impairment accrued on loans granted as at 31 December 2011 is portfolio based, and not in respect of specific exposures.

The maximum exposure of the Company to credit risk as at 31 December, 2011 and 31 December, 2010 is as follows:

	2011		2010	
	<i>Gross</i>	<i>Net</i>	<i>Gross</i>	<i>Net</i>
Exposure				
Cash and cash equivalents	68,690	68,690	87,088	87,088
Loans granted	66,512	66,304	47,688	47,545
Receivables and prepaid expenses	4	4	7	7
Total balance sheet items	135,206	134,998	134,783	134,640

The Company allocates its financial assets into several classification groups to assess their credit risk. The table below shows the classification of the gross financial assets in the statement of financial position depending on their default as at 31 December 2011:

	<i>Neither overdue, nor impaired</i>	<i>Overdue, but not impaired</i>	<i>Impaired on individual basis</i>	<i>Total</i>
Cash and cash equivalents	68,690	-	-	68,690
Loans granted	63,578	2,934	-	66,512
Receivables and prepaid expenses	4	-	-	4
	132,272	2,934	-	135,206

Receivables overdue, but not impaired have been overdue for up to 40 days.

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20. Financial Risk Management Objectives and Policy (continued)

Credit risk (continued)

The classification of the gross financial assets in the balance sheet depending on their arrears as at 31 December 2010 is as follows:

	<i>Neither overdue, nor impaired</i>	<i>Overdue, but not impaired</i>	<i>Impaired</i>	<i>Total</i>
Cash and cash equivalents	87,089	-	-	87,089
Loans granted	46,386	1,302	-	47,688
Receivables and prepaid expenses	7	-	-	7
	<u>133,482</u>	<u>1,302</u>	<u>-</u>	<u>134,784</u>

Receivables overdue, but not impaired have been overdue for up to 40 days.

Capital management

The primary objective of the Company's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value.

The Company manages its capital structure and makes adjustments to it, in light of changes in economic conditions. The Company is subject of Decrees of the Council of Ministers for dividend distribution to the Ministry of Regional Development and Public Works. In 2011 and 2010 there have been no changes in the objectives, policies or processes regarding the Company's capital management.

The Company monitors its equity through the reporting period's financial result as follows:

	2011	2010
	<i>BGN'000</i>	<i>BGN'000</i>
Net profit in BGN thousand.	<u>3,161</u>	<u>4,805</u>

The Company should comply with externally imposed capital requirements in accordance with the concluded bank loan agreement. They refer to compliance with certain financial ratios, amongst which is the debt to equity ratio, which should not exceed 7:3. The Company has been in compliance with the externally imposed capital requirements as at 31 December 2011 and 31 December 2010.

	2011	2010
	<i>BGN'000</i>	<i>BGN'000</i>
Interest bearing loans and borrowings	68,454	68,454
Authorized capital	60,000	60,000
Statutory reserves	823	342
Retained earnings	4,805	5,585
Equity	<u>65,628</u>	<u>65,927</u>

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21. Financial Instruments

Fair values

The fair value is the amount at which a financial instrument may be exchanged or settled in an arm's length transaction between willing and knowledgeable parties as best proof of its market value in an active market.

The estimated fair value of the financial instruments is determined by the Company on the basis of available market information, if any, by using proper valuation models. The fair value of financial instruments, which are traded actively at organised financial markets, is determined based on the "bid price" quotes at the end of the last working day of the reporting period. The fair value of financial instruments, for which no active market exists, is determined using valuation models. These models include the use of recent market transactions between knowledgeable, willing and honest parties; use of the current fair value of another instrument having similar features; analysis of the discounted cash flows or other valuation techniques.

The management of FLAG JSC believes that fair values of the financial instruments which include cash and short-term deposits, trade and other receivables, interest bearing loans and borrowings, trade and other payables, do not differ from their carrying amounts as they are of a short-term nature and the applicable interest rates move in unison with the market conditions. The Company has analysed the fair values of fixed interest rate deposits and believes that they approximate their carrying amounts.

22. Events after the Reporting Date

Except as disclosed above, no events have occurred after 31 December 2011 that may require additional adjustments and / or disclosures in the Company's financial statements for the year ending on 31 December, 2011.