

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA –
FLAG JSC
ANNUAL DIRECTORS' REPORT AND
INDIVIDUAL FINANCIAL STATEMENTS
31 DECEMBER 2012**

*(THESE INDIVIDUAL FINANCIAL STATEMENTS IN ENGLISH ARE TRANSLATION FROM THE
ORIGINAL IN BULGARIAN)*

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
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Independent Auditor's Report to the sole shareholder of FLAG JSC	

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
GENERAL INFORMATION
31 DECEMBER 2012

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 Tsołova –Ilieva - member

Registered address

Sofia, 17-19 St. St. Cyril and Methodius Str.

Business address

Sofia 27 Solunska Str.

Legal advisor

Dessislava Ivanova-Atanassova

Servicing banks

UniCredit Bulbank
Raiffeisenbank
DSK Bank
Unionbank

Auditor

PricewaterhouseCoopers Audit OOD
1000 Sofa, Bulgaria
9-11 Maria Louisa Blvd.

ANNUAL REPORT

on the principal activities of
Fund for Local Authorities and Governments in Bulgaria – FLAG JSC

This Report was prepared in compliance with the requirements of article 23 of the Regulation of the Order for Exercising of the Rights of the State in the Commercial Companies with State Participation in the Capital and in compliance with the Commercial Act.

1. Business Program

1.1 Equity and Loan Resource

The share capital of the company amounts to BGN 60 million and was paid in three installments in 2008 and 2009. The contracted long-term credit resource amounts to EUR 35,000 thousand as negotiated in the Loan contract N37525/22 December 2008 with the European Bank for Reconstruction and Development. As at the end of 2012 the financial resource of the Fund amounts to BGN 122,750 thousand.

1.2 Management

The Fund is managed by a Board of Directors (BoD) consisting of seven members. The BoD organizes and manages the ongoing activities of the Fund. In 2012 the BoD held fifteen meetings.

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

- On 27 January 2012, according to minutes №Т3 8/27.01.2012, the Minister of Regional Development, representative of the State as sole owner, approved changes in the composition of the BoD as Ekaterina Spasova Gecheva – Zaharieva was replaced as Board member by Dobromir Prodanov Simidchiev.
- On 24 February 2012, according to minutes 70, Dobromir Simidchiev was elected as Chairman to the BoD.
- As at the end of 2012, the Board of Directors consists of the following members: Dobromir Simidchiev (representative of MRDPW) – Chairman, Ivelina Vasileva (Representative of MEW) – Deputy Chairperson, Denitsa Nikolova (Representative of MRDPW) – member, Emil Savov (representative of the 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 the Municipalities in the Republic of Bulgaria) – member and Executive Director.

According to the Bulgarian legislation, the Management is required to prepare annual financial statements that provide a true and fair view on the financial positions of the Company as at the year end, its financial results and cash flows.

Management confirms that adequate accounting policies have been consistently applied in preparing the annual individual financial statements as of 31 December 2012, and reasonable and prudent judgments, assumptions and estimates have been made.

Management also acknowledges that it applies the existing accounting standards and the individual financial statements are prepared under the going concern principle. Management is responsible for the proper keeping of accounting records, for the appropriate asset management and for the undertaking of all necessary measures for avoidance and detection of fraud and other irregularities.

1. Business Program (continued)

1.3 Human Resources

The Fund's staff has the appropriate qualifications for performing the lending activities in 2012. The structure and number of staff are presented in the table below.

Position	Approved number for 2012	Actual number as at 31 December 2012
Director, Projects and Monitoring Directorate	1	1
Director, Lending Directorate	1	1
Director, Finance and Risk Management Directorate	1	1
Experts, Projects and Monitoring Directorate	3	2
Experts, Lending Directorate	4	3
Experts, Finance and Risk Management Directorate	1	1
Internal auditor	1	1
Office manager	1	1
Total:	13	11

The accounting and legal services, as well as the maintenance of the computer network, are outsourced.

1.4 External Auditor for 2012

At a meeting on 25 September 2012 the Board of Directors approved the results of a public tender for selection of an external auditor for 2012 and approved PricewaterhouseCoopers Audit OOD as external auditor. Subsequently, this was approved by the Minister of Regional Development, representative of the sole proprietor with protocol 107/15 October 2012.

1.5 Loan Agreement with EBRD

In 2012 the credit resource under the Loan Agreement № 37525/ 22 December 2008 with the European Bank for Reconstruction and Development amounting to EUR 35 million is fully utilised. In 2012 FLAG starts repaying the loan as two installments were paid on 3 February 2012 and 3 August 2012 amounting to BGN 5,704 thousand.

1.6 Managing Bank

In 2012 "UniCredit Bulbank" AD remains as a Managing Bank of the Fund. It was selected with an open public procurement procedure and the contract was signed on 21 November 2011 for a three-year period.

1.7 Main Results of the Lending Activity in 2012

In 2012, 168 loan applications were received at a total value of BGN 148,500 thousand which refer to projects amounting to 313,300 thousand.

In 2012, 153 loans of 87 municipalities were approved amounting to BGN 136,560 thousand, supporting the implementation of projects which are worth BGN 299,100 thousand. The average percent of a loan granted in the total amount of the project is 45.7%. A "typical" loan granted to municipalities is for construction of bridges amounting to BGN 849 thousand for twelve-month period.

The table below presents loans made in 2011 and 2012 by type of loans and source of principal repayment.

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
DIRECTORS' REPORT (CONTINUED)
31 DECEMBER 2012**

1. Business Program (continued)

1.7 Main Results of the Lending Activity in 2012 (continued)

Type of loans	Number of loans in 2011	Value of the loans granted in 2011	Number of loans in 2012	Value of the loans granted in 2012
Long-term	44	44,695	55	42,398
<i>Bridge</i>	37	40,636	25	29,779
<i>own contribution</i>	7	4,059	30	12,619
Short-term	62	50,748	98	94,162
<i>Bridge</i>	62	50,748	96	92,804
<i>contribution</i>	-	-	2	1,358
Total:	106	95,443	153	136,560

The following two tables present the structure of the lending operations for 2012 by type of projects, by operational programmes and by source of principal repayment.

By Operational Programme	Number of loans	Total amount in BGN /'000/	Amount in BGN /'000/			Maturity in months		
			Min.	Max.	Average	Min.	Max.	Average
Regional Development	92	93,781	33	4,997	987	8	84	22
Environmental	11	10,899	74	3,107	991	8	86	34
Rural Development	22	12,723	94	1,966	578	9	81	20
CBC	28	19,157	75	3,874	684	5	18	11

By source of repayment	Number of loans	Total amount in BGN /'000/	Amount in BGN /'000/			Maturity in months		
			Min.	Max.	Average	Min.	Max.	Average
Operational programmes	122	123,562	33	4,997	1,013	5	21	12
Own contribution	31	12,998	65	1,966	382	12	86	50

In 2012 the funds utilised under the concluded loan agreements amounted to BGN 132,153 thousand (2011: BGN 61,552 thousand), while the repayments amounted to BGN 85,395 thousand (2011: BGN 42,750 thousand).

In 2012 142 annexes related to 101 loan agreements were concluded, mainly for rescheduling the repayments. From the total signed annexes (142), 10 are for change in the source of repayment of the loan. The remaining annexes are for rescheduling the period of absorption and repayment of the loan or change in the budget accounts.

As at 31 December 2012 15 loan applications amounting to BGN 9 mln. are still under consideration. In 2012 72 loans amounting to BGN 66,000 thousand were fully repaid.

1. Business Program (continued)

1.7 Main Results of the Lending Activity in 2012 (continued)

As at 31 December 2012 there were 156 active loans with principal amounting to BGN 113,191 thousand.

As at the end of 2012, the payments of the municipalities of Velingrad and Mirkovo were with 7 days overdue. Municipality Markovo's delay is due to the transfer of funds from State Fund Agriculture (SFA) made in the last working day of the year. There are no loans which are overdue more than 30 days.

1.8 Changes in the Lending and Pricing Policy of FLAG

- The Board of Directors approved on 25 September 2012 changes in the Rules of Financing and Crediting and based on that the Fund can grant loans for engineering and social infrastructure provided that this infrastructure contributes to the overall implementation of the infrastructure project approved by the EU Operational Programme but is not included in the budget of the project.
- The Board of Directors approved on 20 January 2012 a change in the pricing policy regarding new rules for payment to the Managing Bank: remuneration of the Managing Bank is defined as a monthly fee of BGN 100. The fee is paid monthly since the first month of fund absorption until final repayment of the loan. It is paid together with the due interest. To all agreements which have been active as at 20 January 2012 are signed annexes for changing the margin to 1.85%.

1.9. Information and Publicity

It is a tradition representatives of the Fund to participate in major events of the municipalities, organized by the National Association of Municipalities in Republic of Bulgaria, on which the Fund represents itself and conducts consultations with municipalities.

During the year, representatives of the Fund participated in a series of seminars organized by the Bulgarian Construction Chamber on "Problems in the absorption of EU funds and ways of resolving them". The information on the website of FLAG is updated regularly. Representatives of the Fund participated in the meeting of the Monitoring Committees of OP "Regional Development" and OP "Environment", and in the monthly meetings of the Managing Authorities with municipalities.

2. Financial Condition

2.1 Statement and Structure of Income and Expenses

2.1.1. Statement of Income and Expenses

EXPENSES, BGN /'000/		3,823
1	Remuneration	331
2	Social securities	43
3	Accounting and audit services	50
4	Legal and consulting services	12
5	Other hired services (hardware and software maintenance, translation, insurance)	16
6	Rent	49
5	Communication services	7
6	Materials	15
7	Other costs (cleaning, maintenance, car wash, subscription)	33
8	Depreciation charge	17
9	Bank fees	384
10	Interest expense on EBRD loan	2,645
11	Loss provisioning	221

INCOME ITEMS, BGN /'000/		7,068
1	Interest income	4,320
2	Defaults interest income	33
3	Fee income	204
4	Interest on deposits, charged but not received in 2012	220
5	Interest on deposits, charged and received in 2012	2,291

DEPOSITS, BGN /'000/		14,702
1	Raiffeisenbank	5,000
2	Unicredit Bulbank	5,402
3	Unicredit Bulbank – reserve bank account EBRD	4,300

2.1.2 Structure of Expenses

Group of expenses	Amount in BGN thousand	Share in total expenses
Operational costs	76	1.99
Hired services	106	2.77
Acquisition of assets and depreciation	17	0.44
Remuneration of staff, BoD	374	9.78
Unicredit Management fee, other fees	342	8.95
EBRD loans – interest	2,645	69.19
EBRD loans – other expenses	42	1.10
Impairment/provisions	221	5.78
	3,823	100

2. Financial Condition (continued)

2.1 Statement and Structure of Income and Expenses (continued)

2.1.2 Structure of Expenses (continued)

The amount of interest expenses on loans for 2012 includes interest amounting to BGN 245 thousand of which BGN 71 thousand refer to 2010 and BGN 174 thousand refer to 2011. These costs are charged by EBRD in 2013

2.1.3 Income

The total revenue of the Fund for 2012 amounts to BGN 7,068 thousand, as presented below by type:

Income in '000 BGN	2012	Share
Interest and fees on loans and other income	4,557	64.47%
Interest on deposits	2,511	35.53%
Total	7,068	100%

Granted loans - At an average interest rate of 4.694 %, return, including interest rate and commitment fee, amounts to BGN 4,557 thousand.

Management of temporarily free resources - As at 31 December 2012 FLAG has 3 agreements with banks for open deposits. The total income from on deposits amounts to BGN 2,511 thousand and is allocated as follows:

Source	Paid in 2012 BGN /'000/	Accrued as at 31 December 2012 BGN /'000/	Total BGN /'000/
Raiffeisenbank	1,886	9	1,895
Unicredit Bulbank	13	199	212
Unicredit Bulbank – reserve account	177	12	189
DSK Bank	47	-	47
MKB Unionbank	168	-	168
Total:	2,291	220	2,511

2.2 Results for the current period

The Fund's profit before taxes amounts to BGN 3,245 thousand and net profit amounts to BGN 2,921 thousand. The real profit before tax for 2012 is BGN 3,490 thousand and net profit BGN 3,166 thousand after being adjusted with costs which refer to 2010 and 2011 amounting to BGN 245 thousand.

2.3 Dividends and distribution of profit

In 2012 the Board of Directors approved the establishment of "Reserve Fund" in the amount of 10% of net profit for 2011 (BGN 316 thousand). The remaining retained earnings are then distributed as dividend to the state in the amount of 80% (BGN 2,276 thousand), which was paid during the year.

Under Ordinance of the Government № 367 of 29 December 2011, the retaining earnings for 2008, 2009 and 2010 amounting to BGN 1,644 thousand are distributed as dividend to the state and paid in 2012 as well.

2. Financial Condition (continued)

2.4 Investment

As at 31 December 2012 "FLAG" JSC is the sole shareholder in the "Fund for Sustainable Urban Development of Sofia" JSC, registered in the Registry Agency on 23 April 2012. As at 31 December 2012 the Company has no operating activities.

3. Most likely development of the Company in 2013

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

- The loan contracts concluded in 2012 and previous years and which will be active in 2013;
- Expected parameters of loan applications which are under consideration as at 31 December 2012;
- Indicatives lists and repayment schedules of OPRD and OPE, information about RDP and EEA, meeting with representatives of the Managing Authorities of OPE and OPRD, discussions with municipalities;
- A set of assumptions, based on FLAG's accumulated experience for the period 2009-2012.

3.1 Overall assessment of the demand for loan resources

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

Programmes/type of loans	Bridge financing BGN /'000/	Municipal co-financing BGN /'000/	Total BGN /'000/
OPRD	124,900	11,300	136,200
OPE	46,500	18,900	65,400
RDP	6,900	-	6,900
CBC	27,900	-	27,900
Total:	206,200	30,200	236,400

The Fund is starting negotiations with EBRD for a new loan in the total amount of approximately EUR 40 million.

3.2 Financial Proceeds and Results

The total amount of cash inflows is projected to be up to BGN 5.7 million as 92% is income from loans granted to municipalities.

3.3 Information as per article 187 and article 247 of the Commercial Act

In 2012 there are no shares acquired or transferred.

3.4 Branches of the Enterprise

In 2012, the Company has established a subsidiary - "Fund for Sustainable Urban Development of Sofia" JSC, 100% owned by the "Fund for Local Authorities and Governments - FLAG" JSC with a capital of BGN 500 thousand.

Prepared by: Nadya Dankinova – Executive Director
27 March 2013



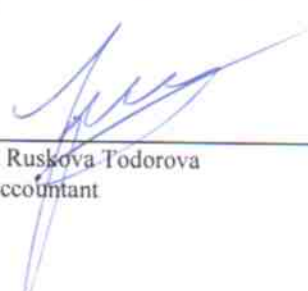
These individual financial statements in English are translation from the original in Bulgarian

**FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDING 31 DECEMBER 2012**

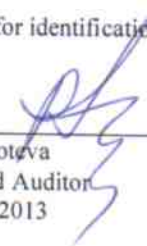
	Notes	2012 <i>BGN'000</i>	2011 <i>BGN'000</i>
Interest income	3.1	6,864	7,724
Interest expenses and charges	3.2	(3,029)	(3,648)
Other operating income, net		204	70
Net operating income		4,039	4,146
Loan loss provisioning	9	(221)	(65)
Payroll expenses	3.3	(374)	(333)
Depreciation and amortisation expenses	7	(17)	(14)
Other operating expenses	3.4	(182)	(222)
Profit before tax		3,245	3,512
Income tax expense	4	(325)	(351)
Profit for the year		2,920	3,161
Other comprehensive income for the year, net of taxes		-	-
Total comprehensive income for the year, net of taxes		2,920	3,161

These individual financial statements were authorized for issue by the Board of Directors on 27 March 2013. The notes on pages 13 to 36 are an integral part of these financial statements.


Nadya Yordanova Dankinova
Executive Director


Kalinka Ruskova Todorova
Chief Accountant

Initialed for identification purposes in reference to the auditor's report:

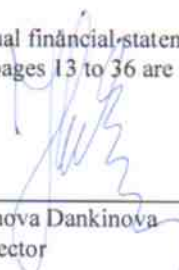

Rositsa Boteva
Registered Auditor
27 March 2013

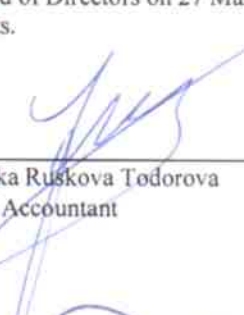

Petko Dimitrov
PricewaterhouseCoopers Audit OOD

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2012


	Notes	31 December	
		2012	2011
		BGN'000	BGN'00
ASSETS			
Cash and cash equivalents	5	14,953	68,690
Receivables on overpaid corporate tax	12	80	110
Receivables and prepayments	6	9	4
Loans granted	9	112,871	66,304
Deferred tax assets		-	1
Property, plant and equipment	7	21	13
Software	7	4	8
Investment in subsidiary	8	500	-
TOTAL ASSETS		128,438	135,130
LIABILITIES AND EQUITY			
Liabilities			
Payroll and social securities payables	11	31	28
Other liabilities	13	104	125
Loan payable to EBRD	10	63,675	69,349
Total liabilities		63,810	69,502
Equity			
Share capital	14.1	60,000	60,000
Statutory reserves	14.2	1,139	823
Retained earnings		3,489	4,805
Total equity		64,628	65,628
TOTAL LIABILITIES AND EQUITY		128,438	135,130

These individual financial statements were authorized for issue by the Board of Directors on 27 March 2013. The notes on pages 13 to 36 are an integral part of these financial statements.


 Nadya Yordanova Dankinova
 Executive Director


 Kalinka Ruskova Todorova
 Chief Accountant

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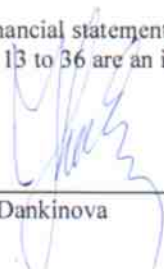

 Rositsa Boteva
 Registered Auditor
 27 March 2013

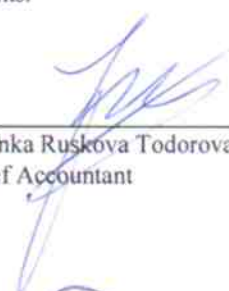

 Petko Dimitrov
 PricewaterhouseCoopers Audit OOD

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL STATEMENT OF CHANGES IN EQUITY
AS AT 31 DECEMBER 2012


	Share capital (Note 14.1)	Retained earnings	Statutory reserves (Note 14.2)	Total
	<i>BGN'000</i>	<i>BGN'00</i>	<i>BGN'000</i>	<i>BGN'00</i>
As at 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 15)	-	(3,460)	-	(3,460)
Transfer of reserves	-	(481)	481	-
As at 31 December 2011	60,000	4,805	823	65,628
As at 1 January 2012	60,000	4,805	823	65,628
Profit for the year	-	2,920	-	2,920
Other comprehensive income	-	-	-	-
Total comprehensive income	-	2,920	-	2,920
Distribution of dividends (Note 15)	-	(3,920)	-	(3,920)
Transfer of reserves	-	(316)	316	-
As at 31 December 2012	60,000	3,489	1,139	64,628

These individual financial statements were authorized for issue by the Board of Directors on 27 March 2013.
 The notes on pages 13 to 36 are an integral part of these financial statements.


 Nadya Yordanova Dankinova
 Executive Director


 Kalinka Ruskova Todorova
 Chief Accountant

Initialled for identification purposes in reference to the auditor's report:


 Rositsa Boteva
 Registered Auditor



 Petko Dimitrov
 PricewaterhouseCoopers Audit OOD


27 March 2013

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
INDIVIDUAL CASH FLOW STATEMENT
FOR THE YEAR ENDING 31 DECEMBER 2012


	Notes	2012 <i>BGN'000</i>	2011 <i>BGN'000</i>
CASH FLOWS FROM OPERATING ACTIVITY			
Proceeds from interest on bank deposits		2,510	5,016
Loans granted to municipalities		(132,153)	(61,552)
Loans repaid by municipalities		85,395	42,750
Interest received on granted loans		4,323	2,691
Payments to suppliers		(495)	(214)
Payments to personnel and for social security		(390)	(340)
Other proceeds, net		173	152
Income tax paid	12	(295)	(670)
Net cash flows used in operating activity		(40,932)	(12,167)
CASH FLOWS FROM INVESTING ACTIVITY			
Purchase of equipment and other fixed assets		(21)	(10)
Acquisition of subsidiary, net of cash acquired	8	(500)	-
Net cash flows used in investing activity		(521)	(10)
CASH FLOWS FROM FINANCING ACTIVITY			
Repayment of EBRD loan		(5,705)	-
Dividends paid	15	(3,920)	(3,460)
Interest paid on EBRD loan		(2,639)	(2,421)
Fees and commissions paid on EBRD loan		(20)	(341)
Net cash flows from financing activity		(12,284)	(6,222)
Net decrease in cash and cash equivalents		(53,737)	(18,399)
Cash and cash equivalents at the beginning of the period	5	68,690	87,089
Cash and cash equivalents at the end of the period	5	14,953	68,690

These individual financial statements were authorized for issue by the Board of Directors on 27 March 2013. The notes on pages 13 to 36 are an integral part of these financial statements.


 Nadya Yordanova Dankinova
 Executive Director


 Kalinka Ruskova Todorova
 Chief Accountant

Initialed for identification purposes in reference to the auditor's report:


 Rositsa Boteva
 Registered Auditor
 27 March 2013


 Petko Dimitrov
 PricewaterhouseCoopers Audit OOD

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDING 31 DECEMBER 2012

1. Corporate information

The individual financial statements of FLAG JCS (the Company) for the year ending 31 December 2012 were prepared on 4 March 2013 and authorized for issue by a decision of the Board of Directors dated 27 March 2013.

FLAG JSC is a joint-stock company incorporated by virtue of Decision No 1 dated 4 July 2007 under company file 10151/2007 of the Sofia City Court, having its seat in the city of Sofia, Sofia Region, Bulgaria. The financial year of the Company ends on 31 December.

As at the date of approval of these individual financial statements, the Company has not yet prepared IFRS consolidated financial statements of the Company and its subsidiary (the „Group”) in accordance with the requirement of IAS 27.42. The Company has applied the interpretation, included in the agenda of the European Union, Internal Market and Services sector, of the Meeting of the Accounting Regulatory Committee (paper ARC/08/2007) concerning the relation between the IAS regulations and the Fourth and the Seventh Directives on commercial laws. The Commission’s Service Department is of the opinion that if the Company chooses or is obliged to present its annual financial statements in accordance with the IFRS adopted for use in the EU, they could be prepared and certified separately from the consolidated ones.

The investment in the subsidiary (the entity where the Group is able, directly or indirectly, to exercise control on its operations) would have been consolidated had the consolidated financial statements been prepared.

As disclosed in Note 8, the subsidiary was registered in 2012 and as at the balance sheet date there were not any other economic events, but the capital paid in, that must be reported and that could have a significant impact on these individual financial statements.

These individual financial statements have been prepared in accordance with the requirements of the law effective in Bulgaria.

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

As at 31 December 2012 the shareholders of the Company include:
Republic of Bulgaria represented by the Minister of Regional Development and Public Works - 100.00 %

2.1 Basis of preparation of the financial statements

The individual financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union (EU). They have been prepared under the historical cost convention.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note o).

(a) New and amended standards adopted by the Company

There are no new standards and amendments to standards accepted by the Company for application for the financial year, beginning 1 January 2012.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDING 31 DECEMBER 2012

2.1 Basis of preparation of the financial statements (continued)

(b) New and amended standards, and improvements to IFRS mandatory for the first time for the financial year beginning on or after 1 January 2012 but not currently relevant to the Company (although they may affect the accounting for future transactions and events)

Disclosures—Transfers of Financial Assets – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The Company does not expect the amendments to have any material effect on its financial statements.

(c) New standards and interpretations that are mandatory for the annual periods beginning on or after 1 January 2013 or later, and which the Company has not early adopted

IFRS 13, Fair value measurement, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Company is currently assessing the impact of the standard on its financial statements.

Amendments to IAS 1, Presentation of Financial Statements (issued June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Company expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances.

Amended IAS 19, Employee Benefits (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. The Company is currently assessing the impact of the amended standard on its financial statements.

Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Company is currently assessing the impact of the amended standard on its financial statements.

Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDING 31 DECEMBER 2012

2.1 Basis of preparation of the financial statements (continued)

(c) New standards and interpretations that are mandatory for the annual periods beginning on or after 1 January 2013 or later, and which the Company has not early adopted (continued)

Other changes in standards and interpretations, which are not expected to have any impact on these financial statements:

IFRS 1 “First time adoption of IFRS – amendment regarding severe hyperinflation and elimination of references to fixed dates for some exceptions and exemptions (issued in December 2010 and effective for annual periods beginning on or after 1 January 2013).

IAS 12 “Income tax” (issued in December 2010 and effective for annual periods beginning on or after 1 January 2013) – the amendment introduced a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale.

IFRS 10, Consolidated Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013, EU effective date is for annual periods beginning on or after 1 January 2014), replaces all of the guidance on control and consolidation in IAS 27 “Consolidated and separate financial statements” and SIC-12 “Consolidation - special purpose entities”. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Company does not expect the new standard to have any material effect on its financial statements.

IFRS 11, Joint Arrangements, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013, EU effective date is for annual periods beginning on or after 1 January 2014).

IFRS 12, Disclosure of Interest in Other Entities, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013, EU effective date is for annual periods beginning on or after 1 January 2014).

IAS 27, Consolidated and Separate Financial Statements, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013, EU effective date is for annual periods beginning on or after 1 January 2014).

IAS 28, Investments in Associates and Joint Ventures, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013, EU effective date is for annual periods beginning on or after 1 January 2014) - accounting for investments in joint ventures using the equity method.

IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine, (issued in October 2011 and effective for annual periods beginning on or after 1 January 2013).

Amendments to IFRS 1 First-time adoption of International Financial Reporting Standards - Government loans (effective for annual periods beginning on or after 1 January 2013). The amendments, dealing with loans received from governments at a below market rate of interest, give first-time adopters of IFRSs relief from full retrospective application of IFRSs when accounting for these loans on transition. This will give first-time adopters the same relief as existing preparers.

(d) New or revised standards and interpretations not yet adopted by the European Union

IFRS 9, Financial Instruments: Classification and Measurement. IFRS 9, issued in November 2009, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDING 31 DECEMBER 2012

2.1 Basis of preparation of the financial statements (continued)

(d) New or revised standards and interpretations not yet adopted by the European Union(continued)

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

Improvements to International Financial Reporting Standards (issued in May 2012 and effective for annual periods beginning 1 January 2013). The improvements consist of changes to five standards. IFRS 1 was amended to (i) clarify that an entity that resumes preparing its IFRS financial statements may either repeatedly apply IFRS 1 or apply all IFRSs retrospectively as if it had never stopped applying them, and (ii) to add an exemption from applying IAS 23, Borrowing costs, retrospectively by first-time adopters. IAS 1 was amended to clarify that explanatory notes are not required to support the third balance sheet presented at the beginning of the preceding period when it is provided because it was materially impacted by a retrospective restatement, changes in accounting policies or reclassifications for presentation purposes, while explanatory notes will be required when an entity voluntarily decides to provide additional comparative statements. IAS 16 was amended to clarify that servicing equipment that is used for more than one period is classified as property, plant and equipment rather than inventory. IAS 32 was amended to clarify that certain tax consequences of distributions to owners should be accounted for in the income statement as was always required by IAS 12. IAS 34 was amended to bring its requirements in line with IFRS 8. IAS 34 will require disclosure of a measure of total assets and liabilities for an operating segment only if such information is regularly provided to chief operating decision maker and there has been a material change in those measures since the last annual financial statements.

Transition Guidance Amendments to IFRS 10, IFRS 11 and IFRS 12 (issued on 28 June 2012 and effective for annual periods beginning 1 January 2013). The amendments clarify the transition guidance in IFRS 10 Consolidated Financial Statements. Entities adopting IFRS 10 should assess control at the first day of the annual period in which IFRS 10 is adopted, and if the consolidation conclusion under IFRS 10 differs from IAS 27 and SIC 12, the immediately preceding comparative period (that is, year 2012 for a calendar year-end entity that adopts IFRS 10 in 2013) is restated, unless impracticable. The amendments also provide additional transition relief in IFRS 10, IFRS 11, Joint Arrangements, and IFRS 12, Disclosure of Interests in Other Entities, by limiting the requirement to provide adjusted comparative information only for the immediately preceding comparative period. Further, the amendments will remove the requirement to present comparative information for disclosures related to unconsolidated structured entities for periods before IFRS 12 is first applied.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDING 31 DECEMBER 2012

2.1 Basis of preparation of the financial statements (continued)

(d) New or revised standards and interpretations not yet adopted by the European Union(continued)

Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014). The amendment introduced a definition of an investment entity as an entity that (i) obtains funds from investors for the purpose of providing them with investment management services, (ii) commits to its investors that its business purpose is to invest funds solely for capital appreciation or investment income and (iii) measures and evaluates its investments on a fair value basis. An investment entity will be required to account for its subsidiaries at fair value through profit or loss, and to consolidate only those subsidiaries that provide services that are related to the entity's investment activities. IFRS 12 was amended to introduce new disclosures, including any significant judgements made in determining whether an entity is an investment entity and information about financial or other support to an unconsolidated subsidiary, whether intended or already provided to the subsidiary.

The individual financial statements have been prepared on a historical cost basis.

The individual financial statements are presented in Bulgarian leva (BGN) and all values are rounded off to each whole thousands of Bulgarian leva (BGN'000) unless otherwise stated.

Statement of compliance

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

2.2 Summary of significant accounting policies

a) Foreign currency translation

The financial statements are presented in Bulgarian Levas (BGN), which is the Company's functional and presentation currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into the functional currency at the end of each month by applying the closing exchange rate published by the Bulgarian National Bank for the last working day of the respective month. All foreign currency differences are recognised in the statement of comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated into the functional currency using the exchange rate as at the date of the initial transaction (acquisition).

b) Revenue recognition

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

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. The calculation includes all fees and consideration paid or received to/from the parties to the contract that are an integral part of the effective interest rate, transaction costs and any other premiums or discounts.

Interest income is included in finance income in the statement of comprehensive income.

Rendering of services

For sales of services, revenue is recognised in the accounting period in which services are rendered.

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 taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantially enacted by the reporting date. Management analyses the individual items of the tax return for which the applicable tax provisions are subject to interpretation and recognises provisions where appropriate.

Current income tax is recognised directly in the equity (and not in the statement of comprehensive income) where the tax relates to items that have been recognised directly in the equity.

Deferred income tax

Deferred income tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- when the deferred tax liability arises from the initial recognition of goodwill or 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
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

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

- when the deferred tax asset relating to the deductible temporary difference 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
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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 income tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

2.2 Summary of significant accounting policies (continued)

c) Taxes (continued)

Deferred income tax(continued)

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in 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 at the reporting date.

Deferred tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity.

Deferred income tax assets and deferred income tax liabilities are offset by the Company only if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation 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 derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company determines the classification of its financial assets at initial recognition.

Financial assets are recognised initially at fair value, plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

Purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the market place (regular purchases) are recognised on the trade (transaction) date, which is the date that the Company commits to purchase or sell the asset.

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

Subsequent measurement

The subsequent measurement of 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 in an active market. After initial measurement loans and receivables are subsequently carried at amortised cost using the effective interest method (EIR), less any allowance for impairment. Amortised cost is calculated taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the statement of comprehensive income. The losses arising from impairment are recognised as other expenses in the statement of comprehensive income.

Derecognition

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

- the contractual rights to receive cash flows from the asset have expired;
- the Company has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Company has transferred substantially all the risks and rewards of the asset, or (b) the Company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

2.2 Summary of significant accounting policies (continued)

• Financial assets (continued)

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

Derecognition (continued)

Where the Company has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset or transferred control of the asset, the asset is recognised to the extent of the Company's continuing involvement in the asset. In that case the Company also recognises as associated liability. The transferred asset and the related liability are recognised on a basis that reflects the rights and obligations that the Company has retained.

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 the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. 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 there is objective evidence that an impairment loss has incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate (EIR).

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 or other financial reorganisation, and 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 defaults.

Financial assets at amortised cost

Due to its specific activity, the Company accrues allowance for impairment 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 a 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 reduced through the use of an allowance account and the amount of the loss is recognised in the statement of comprehensive income. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

2.2 Summary of significant accounting policies (continued)

- **Financial assets (continued)**

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

Impairment of financial assets (continued)

Impairment on a portfolio basis (continued)

Loans granted and the related allowances are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Company. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is recognised in the statement of comprehensive income.

- **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, loans and borrowings, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company determines the classification of its financial liabilities at initial recognition.

Financial liabilities are recognised initially at fair value and in the case of loans and borrowings, plus directly attributable transaction costs.

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

Subsequent measurement

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

Loans and borrowings

After initial recognition, interest-bearing loans are subsequently measured by the Company at amortised cost using the EIR method. Gains and losses relating to loans and borrowings are recognised in the statement of comprehensive income for the period when the liabilities are derecognised as well as through the amortisation process.

Amortised cost is calculated by taking into account any discounts or premiums on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in interest expenses in the statement of comprehensive income.

Derecognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the statement of comprehensive income.

e) Offsetting of financial instruments

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

2.2 Summary of significant accounting policies (continued)

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 transactions between 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.

An analysis of fair values of financial instruments and further details as to how they are measured are provided in Note 19.

g) Share capital

The share capital is presented at the par value of shares issued and paid. 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 a decision of the General Meeting.

The Reserves Fund may be used only to cover current and prior year losses. When the Reserves Fund reaches the minimum amount set out in the Articles of Association, the excess may be used to increase the share capital.

h) Plant and equipment

Items of plant and equipment are stated at cost, net of accumulated depreciation and any accumulated impairment losses. Such cost includes the cost of replacing parts of the plant and equipment and borrowing costs for long-term construction projects if the recognition criteria are met. When a major inspection of an item of plant and/or equipment is performed, its cost is recognised in the carrying amount of the respective assets as a replacement if the recognition criteria are satisfied. All other repair and maintenance costs are recognised in the statement of comprehensive income for the period in which they have been incurred.

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

Hardware	2 years
Plant and equipment	5 years
Motor 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 and the carrying amount of the asset) is included in the statement of comprehensive income for the year in which the asset is derecognised.

2.2 Summary of significant accounting policies (continued)

i) Software

Software is measured on initial recognition at cost, less any accumulated amortisation and accumulated impairment losses.

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

Software	2 years
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The assets residual values, useful lives and methods of depreciation/amortisation are reviewed at each financial year end, and adjusted prospectively, if appropriate.

j) Impairment of fixed tangible assets (FTAs)

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

k) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

l) Investments in subsidiaries and consolidation

Subsidiaries are all entities (including special purpose entities) over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The Company also assesses existence of control where it does not have more than 50% of the voting power but is able to govern the financial and operating policies by virtue of de-facto control.

Investments in subsidiaries are stated at cost, less any impairment, in the separate financial statements.

m) Cash and cash equivalents

Cash and short-term deposits in the statement of financial position comprise cash in bank accounts, cash on hand, and short-term deposits with an original maturity of twelve months or less that are available to the Company on demand without incurring significant financial losses.

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

2.2 Summary of significant accounting policies (continued)

n) Provisions

General

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, 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 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 reimbursement. 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.

o) Significant accounting judgments, estimates and assumptions

The preparation of the financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amount of the asset or liability affected in the future.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Impairment of financial receivables

The Company uses an allowance account to report the provision for impairment of doubtful and bad debts. Management assesses the adequacy of this impairment based on an ageing analysis of the receivables, historical experience as to the write-off rates of bad debts, as well as solvency analysis of the respective municipality, changes in the contractual payment terms, etc. If the financial position and financial performance of municipalities deteriorate (more than 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 2012, the best estimate of management for the necessary impairment of receivables amounted to BGN 429 thousand (2011: BGN 208 thousand). Further details are given in Note 9.

Corporate income tax

A significant judgement is required to determine the overall tax provision. There are many transactions and calculations, for which the final tax cannot be determined precisely in the normal course of activity. The Company recognises liabilities for estimated tax payables in the event of future tax audits based on the management's judgement as to whether additional taxes will be assessed or not. When the tax finally set as due as a result of such events differs from the one initially reported, the corresponding differences will be reported in the short-term corporate income tax payables and will have an effect on the deferred taxes for the period in which this clarification has been made.

Estimated useful lives of property, plant and equipment

Management uses significant accounting estimates and judgements for the purpose of determining the useful lives of its property, plant and equipment, which are based on a study and judgements of the technical staff that assesses the useful lives of tangible and intangible assets.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDING 31 DECEMBER 2012

(all amounts are in thousand BGN unless otherwise stated)

3. Income and expenses

3.1 Interest income

	<u>2012</u>	<u>2011</u>
Interest income on deposits and bank accounts	2,511	5,016
Income on loans granted and receivables	4,353	2,708
Total interest income	<u>6,864</u>	<u>7,724</u>

3.2 Interest expenses and charges

	<u>2012</u>	<u>2011</u>
Interest expenses on loans and borrowings	2,645	2,615
Expenses on fees and commissions	384	1,033
<i>*Including cancelled loan agreement</i>	-	660
Total interest expenses and charges	<u>3,029</u>	<u>3,648</u>

Interest expenses on loans amounting to BGN 245 thousand relate to 2010 - BGN 71 thousand and to 2011 - BGN 174 thousand, respectively. Pursuant to the loan agreement, FLAG JSC has met the conditions to be granted a reduced interest rate, but it was not allowed to use this reduction before February 2013. Interest amounts were calculated by using supplementary interest rate sheets.

3.3 Payroll expenses

	<u>2012</u>	<u>2011</u>
Salaries and wages	331	294
Social securities	43	39
Total costs of personnel	<u>374</u>	<u>333</u>

3.4 Other operating expenses

	<u>2012</u>	<u>2011</u>
Accounting and audit services	50	50
Rent	49	42
Materials	15	12
Legal services – EBRD	10	15
Translation and interpretation services	8	8
Communication services	7	8
Hardware maintenance	6	6
Consulting services	2	46
Social expenses	2	2
Insurances	2	2
Other expenses	31	31
Total other operating expenses	<u>182</u>	<u>222</u>

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
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(all amounts are in thousand BGN unless otherwise stated)

4. Income tax

The main components of income tax expense for the years ended 31 December 2012 and 2011 include:

	<u>2012</u>	<u>2011</u>
Current income tax expense	324	351
Deferred income tax expense	1	-
Income tax expense	<u>325</u>	<u>351</u>

In 2012 the applicable statutory tax rate is 10% (2011: 10%).

Reconciliation between income tax benefit and the accounting profit multiplied by the statutory tax rate for the years ended 31 December 2012 and 31 December 2011 is presented as follows:

	<u>2012</u>	<u>2011</u>
Accounting profit before taxes	3,245	3,512
Income tax benefit at statutory tax rate of 10% for 2012 (2011: 10%)	325	351
Tax effect of expenses not deductible for tax purposes	-	-
Other	-	-
Income tax expense	<u>325</u>	<u>351</u>

At 31 December 2012 the Company reported an overpaid corporate income tax amounting to BGN 80 thousand (2011: BGN 110 thousand).

5. Cash and cash equivalents

	<u>31 December 2012</u>	<u>31 December 2011</u>
Cash on hand and in current accounts	31	16
Short-term bank deposits	14,922	68,674
Total cash and cash equivalents	<u>14,953</u>	<u>68,690</u>

Cash in bank accounts bears floating interest rates based on the daily interest rates on bank deposits. The term of short-term deposits is one year, but the amounts therein can be changed depending on the liquid needs of the Company. They bear the agreed interest rates, which vary from 3.75 to 5.75 % p.a. (2011: 3.62-7.25 %). The balances of interest receivables on deposits are included in cash and cash equivalents since the amounts accrued are available to the Company on demand. The fair value of cash and short-term deposits equals their carrying amount.

6. Receivables and prepayments

	<u>31 December 2012</u>	<u>31 December 2011</u>
Other receivables	9	4
Total receivables and prepayments	<u>9</u>	<u>4</u>

Other receivables comprise guarantees provided and non-financial prepayments.

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(all amounts are in thousand BGN unless otherwise stated)

7. Plant and equipment, software

	<u>Hardware</u>	<u>Fixtures and fitting</u>	<u>Plant and equipment</u>	<u>Vehicles</u>	<u>Software</u>	<u>Total</u>
Book value:						
As at 1 January 2011	19	7	2	36	-	64
Additions	-	-	-	-	10	10
As at 31 December 2011	19	7	2	36	10	74
Additions	19	-	1	-	1	21
As at 31 December 2012	38	7	3	36	11	95
Depreciation:						
As at 1 January 2011	(18)	(3)	-	(18)	-	(39)
Depreciation charge	(1)	(1)	(1)	(9)	(2)	(14)
As at 31 December 2011	(19)	(4)	(1)	(27)	(2)	(53)
Depreciation charge	(1)	(2)	-	(9)	(5)	(17)
As at 31 December 2012	(20)	(6)	(1)	(36)	(7)	(70)
Net book value:						
As at 1 January 2011	1	4	2	18	-	25
As at 31 December 2011	-	3	1	9	8	21
As at 31 December 2012	18	1	2	-	4	25

8. Investments in subsidiary

By a decision dated 3 April 2012 of the sole owner of FLAG JSC, the MRDPW, and after a meeting of the Board of Directors of the Fund, a new company was incorporated - Fund for Sustainable Urban Development of Sofia, with capital of BGN 500 thousand. The company was registered on 23 April 2012 with the Registry Agency and the capital was paid in full by FLAG JSC. The purpose of the newly established subsidiary is to implement financing under the European programme Jessica in accordance with a trilateral agreement among EIB, FLAG JSC and FSUDS EAD. As at the end of 2012 there were no other events relating to the implementation of the agreement. This investment is not consolidated in these financial statements.

9. Loans granted

	<u>31 December 2012</u>	<u>31 December 2011</u>
Loans granted	113,300	66,512
Loan loss provisioning	(429)	(208)
Total loans granted	112,871	66,304

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEAR ENDING 31 DECEMBER 2012

(all amounts are in thousand BGN unless otherwise stated)

9. Loans granted (continued)

Loans granted represent loans extended to municipalities. Most of the loans granted – BGN 93,749 thousand are used as bridge financing under European programmes. The remaining amount of BGN 19,442 thousand is intended for lending of municipalities' own activities.

In 2011 bridge financing loans amounted to BGN 60,811 thousand and those for lending of own activities amounted to BGN 5,623 thousand.

Receivables on loans granted have been impaired in accordance with the portfolio-based impairment policy adopted by FLAG JSC. As at 31 December 2012, the impairment of bridge financing loans amounted to BGN 234 thousand (2011: BGN 152 thousand) and the impairment of loans repaid by own funds at 31 December 2012 amounted to BGN 195 thousand (2011: BGN 56 thousand).

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 2012 and 2011 are as follows:

	<i>Impairment of receivables on loans granted</i>
As at 1 January 2011, incl.	(143)
- for bridge financing	(111)
- for own financing	(32)
Charged for the year – incl.	(65)
- for bridge financing	(41)
- for own financing	(24)
Reversed during the year	-
Net change in impairment	-
Receivables written off against provisions	-
As at 31 December 2011 r. incl.	(208)
- for bridge financing	(152)
- for own financing	(56)
Charged for the year – incl.	(221)
- for bridge financing	(83)
- for own financing	(138)
Reversed during the year	-
Net change in impairment	-
Receivables written off against accumulated impairment	-
As at 31 December 2012 r. incl.	(429)
- for bridge financing	(235)
- for own financing	(194)

Provisions accrued are not specific provisions, by specific loans, but portfolio loans in accordance with the adopted policy for impairment in the event of credit losses.

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10. Loan payable to EBRD

	Effective interest rate %	Maturity	31 December 2012	31 December 2011
Long-term				
Payables on EBRD loan	3.164%	August 2023	62,750	68,454
Deferred fees under contracts with EBRD			(251)	(274)
Accrued interest due			1,176	1,169
Total payables on the EBRD Loan			63,675	69,349

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

1. Loan "a" – amounting to EUR 18,000 thousand (BGN 35,205 thousand)
2. Loan "b" – amounting to EUR 17,000 thousand (BGN 33,249 thousand)

The term of the loans is 15 years with a 3-year grace period. For the period following the grace period, two equal instalments a year are to be made, from February 2012 to August 2023. The contractual interest rate is based on the six-month EURIBOR plus a floating margin of 2.25% to 2.75%, defined based on the existence and amount of bad debts within 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 2012 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.

The year of 2012 is the first year in which the repayment of the loan commenced. Two instalments were repaid amounting to BGN 5,704 thousand in total.

11. Payroll and social securities payables

Payables to personnel and for social security at 31 December 2012 relate to the accrued additional remuneration (bonuses) and are allocated as follows:

	31 December 2012	31 December 2011
Payables to personnel	25	25
Payables for social security	6	3
Total payables to personnel and for social security	31	28

12. Receivables on overpaid corporate income tax

Tax liabilities were not due at 31 December 2012 as the corporate income tax was overpaid during the year.

The movements in tax liabilities for 2012 and 2011 are as follows:

	31 December 2012	31 December 2011
Tax receivable / (liability) as at 31 January	110	(209)
Tax paid throughout the year	295	670
Tax accrued for the year (Note 4)	(325)	(351)
Tax receivable as at 31 December	80	110

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12. Receivables on overpaid corporate income tax (continued)

According to the latest amendments of the Corporate Income Tax Act (CITA), the overpaid corporate income tax is not subject to deduction but to refund in accordance with the Tax and Social Security Procedure Code. It is stated in Note 4.

13. Other liabilities

	31 December 2012	31 December 2011
Other liabilities	104	125
<i>incl. contingent fee to consider a loan</i>	79	108
<i>Performance guarantee</i>	16	16
<i>Payables to suppliers</i>	9	-
Total other liabilities	104	125

14. Share capital and reserves

14.1 Share capital

	31 December 2012	31 December 2011
60,000 ordinary shares at nominal value of BGN 1,000 each	60,000	60,000
Total share capital	60,000	60,000

At 31 December 2012 and 31 December 2011 the issued registered capital was fully paid-in.

14.2 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 Articles of Association or in accordance with a decision of the General Meeting of Shareholders.

The statutory reserves may only be used to cover current and prior reporting period losses. As at 31 December 2012 statutory reserves amount to BGN 1,139 thousand (2011: BGN 823 thousand).

15. Dividend distribution

In accordance with art. 28 of the Council of Ministers Decree No 334 of 29 December 2011, dividends were distributed to the sole shareholder amounting to BGN 2,276 thousand (2011: BGN 3,460 thousand). Dividends per share amount to BGN 37.93 (2011: BGN 57.67). Under the terms of the same Decree, the retained earnings for 2008, 2009 and 2010 amounting to BGN 1,644 thousand were also distributed as dividends.

16. Commitments and contingencies

Legal claims

As at 31 December 2012 and 31 December 2011 there were no legal claims brought against the Company.

Guarantees

As at 31 December 2012 and 31 December 2011 the Company has not extended guarantees.

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
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(all amounts are in thousand BGN unless otherwise stated)

16. Commitments and contingencies (continued)

Loan commitments

As at 31 December 2012 the Company has taken loan commitments amounting to BGN 5,738 thousand on 9 loan agreements signed with municipalities; no funds were utilized at the year-end. The number of contracts for the previous year was 5 totalling to BGN 3,770 thousand.

Assets pledged as collateral

As at 31 December 2012 the Company did not have assets pledged as collateral.

Commitments related to rents / operating leases

The Company has a rental contract concluded for the rent of an office for a term of four years, which comes into force on 1 March 2013.

17. Related party disclosure

Composition of the related parties

Shareholder – sole owner

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

Remuneration of management staff

In 2012, the remuneration of management staff amounted to BGN 75 thousand (2011: BGN 67 thousand).

Related party transactions

In 2007, 2008, 2009, 2010, 2011 and 2012, there have not been closed and / or implemented related party transactions, except for the dividend paid, as disclosed in Note 15.

18. Financial risk management objectives and policies

The major financial liabilities of the Company comprise interest-bearing loans and borrowings, and trade payables. The main objective of these financial instruments is to secure financing of the Company's operations. The Company has various financial assets such as trade receivables and cash, which arise directly from its operations.

In 2012 and 2011, the Company neither owned nor traded in derivative financial instruments.

The main risks arising from the Company's financial instruments are interest rate risk, liquidity risk, currency risk and credit risk. The management reviews and agrees policies for managing each of these risks which are summarised below.

Interest-rate risk

The Company's exposure to the risk of changes in market interest rate relates primarily to the Company's short-term financial liabilities with variable (floating) interest rates. The Company's policy is to manage its interest expenses through using financial instruments with fixed and floating interest rates.

Sensitivity to possible changes in interest rates (through the effect on loans and borrowings with floating interest rates) of the Company's profit before tax, with all other variable held constant is presented below. There is no effect on other equity components of the Company.

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18. Financial risk management objectives and policies (continued)

Interest-rate risk (continued)

	Increase/ Decrease in interest rates	Effect on the pre- tax profit
2012		
In EUR	+0.5%	(314)
In BGN	+0.5%	566
In EUR	-1%	627
In BGN	-1%	(1,132)
2011		
In EUR	+0.5%	(342)
In BGN	+0.5%	332
In EUR	-1%	684
In BGN	-1%	(664)

Liquidity risk

The effective management of the Company's liquidity presumes that sufficient working capital will be ensured mainly through maintaining a given amount of money on deposit. A cash flow movement plan is elaborated based on short-term budgets, and also on long-term planning.

As at 31 December the maturity structure of the Company's financial liabilities, based on the agreed undiscounted payments, is presented below:

Liabilities

At 31 December 2012

	On demand	< 3 months	3-12 months	1-5 year	> 5 years	Total
Interest-bearing loans and borrowings	-	3,873	3,873	30,980	46,470	85,196
Trade and other payables	-	104	-	-	-	104
	-	3,977	3,873	30,980	46,470	85,300

At 31 December 2011

	On demand	< 3 months	3-12 months	1-5 year	> 5 years	Total
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

These individual financial statements in English are translation from the original in Bulgarian

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC
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18. Financial risk management objectives and policies (continued)

Liquidity risk (continued)

The maturity structure of the Company's assets and liabilities at 31 December 2012 has been developed based on the expectations of management regarding the recoverability/settlement of amounts:

Assets	<i>Within 1 year</i>	<i>Over 1 year</i>	<i>Total amount</i>
Cash and cash equivalents	14,953	-	14,953
Receivables on overpaid corporate income tax	81	-	81
Receivables and prepayments	9	-	9
Loans granted	63,262	49,609	112,871
Plant, equipment and software	-	25	25
Investment in subsidiary	-	500	500
Total assets	78,305	50,134	128,439
Liabilities	<i>Within 1 year</i>	<i>Over 1 year</i>	<i>Total amount</i>
Payables to personnel and for social security	31	-	31
Other liabilities	104	-	104
Payables on the EBRD loan	6,858	56,817	63,675
Total liabilities	6,993	56,817	63,810

The maturity structure of the Company's assets and liabilities as at 31 December 2011 has been developed based on the expectations of management regarding the recoverability/settlement of amounts:

Assets	<i>Within 1 year</i>	<i>Over 1 year</i>	<i>Total amount</i>
Cash and cash equivalents	68,690	-	68,690
Receivables on overpaid corporate income tax	110	-	110
Receivables and prepayments	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
Liabilities	<i>Within 1 year</i>	<i>Over 1 year</i>	<i>Total amount</i>
Payables to personnel and for social security	28	-	28
Other liabilities	125	-	125
Payables on the EBRD loan	6,846	62,503	69,349
Total liabilities	6,999	62,503	69,502

Currency risk

The Company has no purchases, sales and does not grant loans denominated in foreign currencies and the loans received are denominated in EUR. Since the exchange rate of BGN / EUR is fixed at the rate of 1.95583, the currency risk arising out of the Company's exposures in EUR is immaterial.

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18. Financial risk management objectives and policies (continued)

Credit risk

Credit risk is the risk that the clients / counterparties will not be able to pay in full the amounts due to the Company within the envisaged / agreed deadlines. As at the end of 2012 the remaining liability of municipalities to the Company amounted to BGN 66,434 thousand.

Credit risk management in 2012 was carried out by the "Lending" Directorate and was monitored simultaneously by the Executive Director and the Board of Directors. The credit risk management function is to ensure the implementation of an appropriate investment policy in respect of the funds available and respectively, the compliance of this policy with the related procedures and controls for current monitoring of the respective loan, deposit or a receivable.

The risk credit exposure is managed through a current analysis of the ability of the counterparties / servicing banks to comply with their contractual obligations to pay interest and principal, as also through setting appropriate credit limits. Cash deposits are placed with prime banks having good reputation at the Bulgarian market. In compliance with the adopted internal rules for contracting cash deposits, invitations to submit an offer are sent only to banks that have the right to operate in the territory of the Republic of Bulgaria and have an assigned and not withdrawn (valid at the time of offer submission) credit rating not lower than a) BB+ assigned by the rating agencies Standard and Poor's or Fitch, or b) Ba1 assigned by Moody's.

Furthermore, subject to current monitoring is also the existence of concentration of receivables from a particular counterparty, and if such is found – the respective counterparty is subject to special current supervision. The impairment accrued on loans granted as at 31 December 2012 is portfolio based, and not in respect of specific exposures.

The maximum exposure of the Company to credit risk as at 31 December 2012 and 31 December 2011 is as follows:

	<u>2012</u>		<u>2011</u>	
	<i>Gross maximum exposure</i>	<i>Net maximum exposure</i>	<i>Gross maximum exposure</i>	<i>Net maximum exposure</i>
Exposure				
Cash and cash equivalents	14,953	14,953	68,690	68,690
Loans granted	113,300	112,871	66,512	66,304
Receivables and prepayments	9	9	4	4
Total balance sheet items	128,262	127,833	135,206	134,998

The Company allocates its financial assets in several classification groups with the aim to assess their credit risk. The table below shows the classification of the gross amount of financial assets from the statement of financial position depending on their arrears at 31 December 2012:

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18. Financial risk management objectives and policies (continued)

Credit risk (continued)

	2012		2011	
	<i>Neither overdue nor impaired</i>	<i>Overdue but not impaired</i>	<i>Impaired, on an individual base</i>	<i>Total</i>
Cash and cash equivalents	14,953	-	-	14,953
Loans granted	113,232	68	-	113,300
Receivables and prepayments	9	-	-	9
	128,194	68	-	128,262

Receivables overdue, but not impaired have been overdue for up to 40 days. As at 31 December 2012, 14 restructured loans are with no default and are amounting to BGN 6,259 thousand, or 5.5 % of the overall loan portfolio.

The classification of the gross amount of financial assets from the balance sheet depending on their arrears as at 31 December 2011 is as follows:

	2012		2011	
	<i>Neither overdue nor impaired</i>	<i>Overdue but not impaired</i>	<i>Impaired, on an individual base</i>	<i>Total</i>
Cash and cash equivalents	68,690	-	-	68,690
Loans granted	63,578	2,934	-	66,512
Receivables and prepayments	4	-	-	4
	132,272	2,934	-	135,206

Receivables overdue, but not impaired have been overdue for up to 40 days. There are no restructured loans.

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 to support its business and maximise shareholder value.

The Company manages its capital structure and adjusts it, where necessary, depending on the changes in the economic environment. The Company is subject to the Council of Ministers Decrees for dividend distribution to the Ministry of Regional Development and Public Works. In 2012 and in 2011 there have been no changes in the objectives, policies or processes related to the Company's capital management.

The Company monitors its equity through the financial result achieved for the reporting period, as follows:

	2012	2011
Net profit in thousands of Bulgarian leva	2,921	3,161

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18. Financial risk management objectives and policies (continued)

Capital management (continued)

The Company is obliged to follow externally imposed capital requirements in accordance with the concluded bank loan contract. They include the observance of certain financial ratios, such as the debt to equity ratio. This ratio must not exceed the ratio of 7 to 3. The Company complied with these externally imposed capital requirements as at 31 December 2012 and 31 December 2011.

	31 December 2012	31 December 2011
Interest bearing loans and borrowings	62,750	68,454
Share capital	60,000	60,000
Statutory reserves	1,139	823
Retained earnings	3,489	4,805
Equity	64,628	65,628

19. Financial instruments

Fair values

Fair value is the amount at which a financial instrument may be exchanged or settled in an arm's length transaction 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, or proper valuation models. The fair value of financial instruments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the last working date of the reporting period. For financial instruments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis or other valuation models.

Management of FLAG JSC believes that the fair values of financial instruments comprising cash and short-term deposits, trade and other receivables, interest-bearing loans and borrowings, trade and other payables, do not differ significantly from their current carrying amounts, especially when they are short-term in nature or their interest rates are changing in line with the change in the current market conditions. The Company has analysed the fair values of fixed interest rate deposits and is of the opinion that they approximate their carrying amounts.

20. Events after the reporting date

Besides the disclosed above, no other events have occurred after 31 December 2012, which require additional adjustments and/or disclosures in the Company's financial statements for the year ended 31 December 2012.



Independent auditor's report

To the Shareholder of Fund for Local Authorities and Governments – FLAG EAD

Report on the Financial Statements

We have audited the accompanying financial statements of **Fund for Local Authorities and Governments – FLAG EAD** which comprise the statement of financial position as of 31 December 2012 and the statements of comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on 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 internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

PricewaterhouseCoopers Audit OOD, 9-11 Maria Louisa Blvd., 1000 Sofia, Bulgaria
T: +359 2 9355200, F: +359 2 9355266, www.pwc.com/bg
Registered with the Sofia City Court under company file number 13424/1997.

This version of our report/the accompanying documents is a translation from the original, which was prepared in Bulgarian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.



Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Fund for Local Authorities and Governments – FLAG EAD as of 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Report on Other Legal and Regulatory Requirements

Management is also responsible for preparing the Annual Report in accordance with the Accounting Act.

We are required by the Accounting Act to express an opinion whether the Annual Report is consistent with the annual financial statements of the Company.

In our opinion, the Annual Report set out on pages 2 to 8, is consistent with the accompanying financial statements of the Company as of 31 December 2012.


Rositsa Boteva
Registered Auditor

27 March 2013
Sofia, Bulgaria




Petko Dimitrov
PricewaterhouseCoopers Audit OOD