

"MERIDIAN BANK" AD, NOVI SAD

**REPORT ON AUDITED OF FINANCIAL STATEMENTS  
FOR THE YEAR 2004**

Novi Sad,  
January 2005

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## Meridian Bank Ad Novi Sad Independent Auditors Report

1. We have audited accompanying balance sheet of Meridian Bank AD Novi Sad (hereinafter: the Bank) as at 31st December 2004 and related Income Statement, Cash Flows and Changes in Shareholder Equity for the year then ended.

The Financial Statements are responsibility of the Bank's management. Our responsibility is to express an opinion on the Financial Statements based on our audit.

2. We have conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatements. An audit includes examining, on the test basis, evidence supporting amounts and disclosures in the Financial Statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating overall financial statements. We believe our audit provides a reasonable basis for our opinion.
3. As explained in Note 1.2., in year 2004 the Bank's accounting policy was in accordance with the Accounting Regulations in Republic of Serbia and Law on Banks and Other Financial Organizations as well as with other applicable sub laws.

Report on Audit is presented in accordance with Decision of Central Bank of Serbia on Minimal Requirements for Contents of Report on Audit of Financial Statements for Banks and Other Financial Organizations.

4. In our opinion the Financial Statements give a true and fair view of the financial position of the Bank a at 31st December 2004, and the results of its operations, Cash Flows and Changes in Equity for the year then ended, in accordance with the requirements of Serbian legislation (described in Notes 1.2. and 2.).

Novi Sad, 31<sup>st</sup> of January 2005.

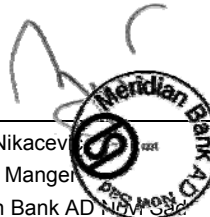


*Branch Manager*  
  
.....  
**Imre Šuhajda**  
*Ovlašćeni revizor*

# Meridian Bank Ad Novi Sad Financial Statements

## Income statement for the year ended 31<sup>st</sup> December 2004

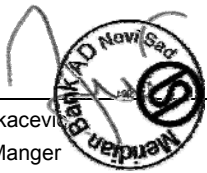
	Notes	CSD '000	
		2004	2003
<b>OPERATING INCOME AND EXPENSES</b>			
Interest and similar income	2.1., 3.1.a)	325,941	154,387
Interest and similar expense	2.1., 3.1.b)	(29,057)	(9,236)
<b>NET INTEREST INCOME</b>		<b>296,884</b>	<b>145,151</b>
<b>Fee and commission income</b>			
Fee and commission income	2.2., 3.2.a)	411,499	279,205
Fee and commission expenses	2.2., 3.2.b)	(48,437)	(47,041)
<b>NET FEE AND COMMISSION INCOME</b>		<b>363,062</b>	<b>232,164</b>
<b>NET INTEREST, FEE AND COMMISSION INCOME</b>			
		<b>659,946</b>	<b>377,315</b>
<b>Other operating income</b>			
Net income from securities trading	2.3.	842	2,565
Net foreign currency exchange gain	2.4.	20,030	20,867
Net dividend income		-	1
Other operating income	3.3.	228,069	7,007
Expenses from right-offs and provisions	3.4.	(282,130)	-
Other operating expenses	3.5.	(501,984)	(291,620)
Net income from changes in value of assets and liabilities	3.6.	193,847	
<b>OPERATING PROFIT</b>		<b>318,620</b>	<b>116,135</b>
<b>Net extraordinary income</b>			
Net extraordinary income	3.3.	36	3
<b>PROFIT BEFORE INCOME TAX</b>	<b>3.8.</b>	<b>318,656</b>	<b>116,138</b>
Income tax expense		-	-
<b>PROFIT AFTER INCOME TAX</b>		<b>318,656</b>	<b>116,138</b>

  
 Zlatica Nikacev  
 General Manager  
 Meridian Bank AD Novi Sad

The Notes on pages 6 to 58 are an integral part of these financial statements  
Auditor's opinion is given on page 1.

## Balance sheet as at 31st December 2004

	Notes	CSD '000	
		2004	2003
<b>ASSETS</b>			
Cash and cash equivalents	2.6., 4.1.	894,841	485,611
Deposits with Central Bank and eligible securities	2.7., 4.2.	50,263	146,281
Accounts receivable (interest and fees)	4.3.	18,332	10,427
Loans to banks	2.9.- 2.10., 4.4.	334,122	91,238
Loans to clients	2.9-2.10., 4.5-4.7.	1,625,551	1,224,432
Held-to-maturity securities	2.8., 4.8.	428	810
Equity securities, other trading securities	2.8., 4.8.	7,674	670
Intangible assets	2.11., 4.9.	14,358	807
Property, plant and equipment	2.11., 4.9.	635,206	289,128
Other and deferred assets	4.10.	36,391	22,495
<b>TOTAL ASSETS</b>		<b>3,617,166</b>	<b>2,271,899</b>
<b>TOTAL OFF-BALANCE SHEET ASSETS</b>		<b>1,014,534</b>	<b>984,921</b>
<b>LIABILITIES</b>			
Deposits from banks	4.11.	44,153	2,445
Other deposits	4.12.	2,285,828	1,372,182
Due for interest and fees	4.13.	52	78
Other operating liabilities	4.14.	71,195	130,907
Provisions	4.15.	68,559	11,623
Deferred liabilities	4.16.	25,613	6,791
<b>TOTAL LIABILITIES</b>		<b>2,495,400</b>	<b>1,524,026</b>
<b>EQUITY</b>			
Share capital	4.17.	703,820	661,820
Reserves	4.17.	13,237	-
Retained earnings	4.17.	404,709	70,436
Revaluation reserves		-	15,617
<b>TOTAL EQUITY</b>		<b>1,121,766</b>	<b>747,873</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>3,617,166</b>	<b>2,271,899</b>
<b>OFF-BALANCE SHEET LIABILITIES</b>			
Potential liabilities for operations for third parties	4.19.	30,559	-
Guarantees, endorsement, other irrevocable contingent liabilities	4.18.a)	812,231	964,132
Other off-balance sheet liabilities	4.18.b)	171,744	20,789

  
 Zlatica Nikacevic  
 General Manger  
 Meridian Bank AD Novi Sad

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## Statement of changes in equity

All amounts in CSD '000

	Notes	Share capital	Profit	Previous year loss	Reserves from profit	Revaluation reserves	Total
<b>Balance at 1st January 2004</b>		<b>713,943</b>	<b>83,197</b>	<b>(49,267)</b>	-	-	<b>747,873</b>
Adjustments from audit		(52,123)	32,941	3,565	-	15,617	-
Loss coverage	4.17.	-	(30,085)	45,702	-	(15,617)	-
15 <sup>th</sup> shares issuance emission	5.1.	42,000	-	-	-	-	<b>42,000</b>
Profit from 2004	3.8., 4.17.	-	318,656	-	-	-	<b>318,656</b>
Other*	4.17.	-	-	-	13,237	-	<b>13,237</b>
<b>Balance at 31st December 2004</b>		<b>703,820</b>	<b>404,709</b>	-	<b>13,237</b>	-	<b>1,121,766</b>
<b>Balance at 1st January 2003</b>		<b>514,058</b>	-	<b>(45,702)</b>	-	<b>112,726</b>	<b>581,082</b>
Revaluation for 2003		49,659	-	(3,565)	-	-	<b>46,094</b>
14 <sup>th</sup> share issuance emission		37,500	-	-	-	-	<b>37,500</b>
Equity revaluation from previous years		112,726	-	-	-	(112,726)	-
Profit from 2003		-	83,197	-	-	-	<b>83,197</b>
<b>Balance at 31st December 2003</b>		<b>713,943</b>	<b>83,197</b>	<b>(49,267)</b>	-	-	<b>747,873</b>

\* Provisions for unidentified losses from on balance sheet and off-balance sheet items

The Notes on pages 6 to 58 are an integral part of these financial statements  
Auditor's opinion is given on page 1.



## Cash flow statement

	CSD '000	
	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
<b>CASH RECEIVED FROM OPERATING ACTIVITIES</b>	<b>739,312</b>	<b>425,411</b>
Interest received	321,939	148,459
Fees received	410,218	267,741
Other operating income	6,340	2,201
Extraordinary income	815	7,010
<b>CASH PAYMENTS FROM OPERATING ACTIVITIES</b>	<b>(604,456)</b>	<b>(393,358)</b>
Interest payments	(29,057)	(9,236)
Fees payments	(48,437)	(47,041)
Cash payments to employees (gross salaries and other)	(183,214)	(84,260)
Cash for other taxes and contributions	(129,218)	(74,020)
Other payments	(209,312)	(171,957)
Extraordinary payments	(5,218)	(6,844)
<b>NET CASH RECEIVED BEFORE CHANGES IN LOANS AND DEPOSITS</b>	<b>134,856</b>	<b>32,053</b>
<b>DECREASE IN LOANS AND INCREASE IN DEPOSITS</b>	<b>5,080,161</b>	<b>843,217</b>
Decrease in loans to banks and other financial institutions	98,352	-
Decrease in loans to clients	2,612,373	-
Decrease in trading and other securities	-	15,683
Increase in deposits from banks and other financial institutions	51,890	-
Increase in deposits from clients	2,317,546	827,534
<b>INCREASE IN LOANS AND DECREASE IN DEPOSITS</b>	<b>(4,666,752)</b>	<b>(532,411)</b>
Increase in loans to banks and other financial institutions	(193,870)	(66,192)
Increase in loans to clients	(2,784,251)	(466,219)
Decrease in deposits from banks and other financial organizations	(10,216)	-
Decrease in deposits from clients	(1,678,415)	-
<b>NET RECEIVED FROM OPERATING ACTIVITIES</b>	<b>413,400</b>	<b>342,859</b>
<b>CASHFLOW FROM INVESTMENT ACTIVITIES</b>		
<b>CASH RECEIVED FROM INVESTMENT ACTIVITIES</b>	<b>15</b>	<b>1,463</b>
Proceeds from sale of property and equipment and intangible assets	15	1,463
<b>CASH USED IN INVESTMENT ACTIVITIES</b>	<b>(201,462)</b>	<b>(112,876)</b>
Acquisitions of subsidiaries	(7,088)	-
Purchase of intangible assets, property, plant and equipment	(194,374)	(112,876)
<b>NET CASH USED IN INVESTMENT ACTIVITIES</b>	<b>(201,447)</b>	<b>(111,413)</b>
<b>CASHFLOW FROM FINANCING ACTIVITIES</b>		
<b>CASH RECEIVED FROM FINANCING ACTIVITIES</b>	<b>42,382</b>	<b>37,500</b>
Issue of ordinary shares	42,000	37,500
Net cash received from securities	382	-
<b>NET CASH RECEIVED FROM FINANCING ACTIVITIES</b>	<b>42,382</b>	<b>37,500</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>389,200</b>	<b>268,946</b>
<b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>	<b>485,611</b>	<b>219,207</b>
<b>INCREASE FROM EFFECTS OF EXCHANGE RATE CHANGES</b>	<b>622,224</b>	<b>105,923</b>
<b>DECREASE FROM EFFECTS OF EXCHANGE RATE CHANGES</b>	<b>(602,194)</b>	<b>(108,465)</b>
<b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>	<b>894,841</b>	<b>485,611</b>

The Notes on pages 6 to 58 are an integral part of these financial statements  
Auditor's opinion is given on page 1.

# 1. Grounds for presentation of accountant statements

## 1.1. General information and activity

Meridian Bank AD, with its seat in Novi Sad, Futoski put 42-44, operated under the name Yuco Bank AD, Novi Sad, up until September 20<sup>th</sup> 2001. The Bank name change has been registered with the Commercial Court of Law Register in Novi Sad based on Decree no. Fi. 2766/01 dated September 20<sup>th</sup> 2001.

The Bank was incorporated through the Articles of Association of a joint stock company Yuco Bank DD, Novi Sad, signed on August 15<sup>th</sup> 1991 by the founders Yuco Kataloska Prodaja LLC, wholesale and retail trading company, Novi Sad, and a foreign corporate entity RCS Trading Company Ltd, Isle of Man, Great Britain.

The Bank received its operations license by the Decision no. 0.36 of the National Bank of Yugoslavia on February 19<sup>th</sup> 1992. The incorporation of the Bank was registered with the Commercial Court of Law Register in Novi Sad based on Decree no. Fi. 827/92 of March 3<sup>rd</sup> 1992 (file no. 1-5120).

The Bank aligned its operations and acts in accordance with the Banks and Other Financial Organization Law (the Official Gazette of FRY no. 32/93) and organized itself as a shareholding company, as registered with the Economic Court of Law Register in Novi Sad, Decree no. Fi. 2947/95 of June 22<sup>nd</sup> 1995. New Articles of Association were signed on June 16<sup>th</sup> 1995 on incorporation of Yuco Bank shareholding company, Novi Sad, by 15 founders (8 local legal entities, 5 foreign legal entities and 2 individuals).

The General Meeting held on January 3<sup>rd</sup> 2001 granted approval for the takeover of Banca de Credit Cooperatist BankCoop SA., Bucharest, Affiliate Vrsac. As a result of the statutory change, the Articles of Association of Yuco Bank AD, Novi Sad were amended and the amendment approved by the National Bank of Yugoslavia Decree no. IV/143-263/1 dated February 15<sup>th</sup> 2001. The statutory change of merger by takeover of Banca de Credit Cooperatist BankCoop SA, Bucharest, Affiliate in Vrsac, was registered with the Commercial Court of Law Register in Novi Sad, Decree no. Fi. 506/01 dated January 19<sup>th</sup> 2001.

Bank's business activities are:

- Pecuniary deposits (deposit activities)
- Loans (loan activities)
- Foreign currency and exchange operations
- Issuance of securities and payment cards (issuance activities)
- Deposits of assets and securities and the management thereof (depo operations)
- Securities sale purchase (effect activities)
- Issuance of guarantees and other collaterals (guarantee activities),
- Payment operations in accordance with the federal Laws
- Mediation in securities trading
- Purchase and collection of receivables
- Other financial services and foreign payments and loan activities

The Bank has central bank authorization to conduct international payment operations and loan businesses (effected by the "Major banking license"), issued to the Bank by the National Bank of Yugoslavia Decree no. 90/2001 of August 30<sup>th</sup> 2001.

The Bank performs its business at its seat in Novi Sad, and its 59 organizational units – branch offices located in: Subotica, Nis, Belgrade, Vranje, Smederevo, Stara Pazova, Temerin, Backa Palanka, Ruma, Sombor, Loznica, Krusevac, Zrenjanin, Cacak, Jagodina, Sid, Novi Pazar, Vrsac, Kragujevac, Kraljevo, Valjevo, Zajecar, Gornji Milanovac, Lazarevac, Pozega, Svilajnac, Obrenovac, Vlasotince, Novi Becej, Trstenik, Bujanovac, Prokuplje, Sabac, Aleksinac, Smederevska Palanka, Sremska Mitrovica, Indjija, Pozarevac, Priboj, Cuprija, Prijepolje, Knjazevac, Nova Varos, Paracin, Arandjelovac, Ub and Vrbas.

At December 31<sup>st</sup> 2004, the Bank had 562 employees (compared to 404 on December 31<sup>st</sup> 2003). The Bank's tax ID is 101697525.

## 1.2. Statement of compliance

The Bank's accounting policy during 2004 complied with the Accounting Regulations of Republic of Serbia and the Regulations of the National Bank of Serbia. On December 31<sup>st</sup> 2003, the Bank reconciled its books in line with the new accounting rules for banks and other financial organizations. Based on the balance of the accounts following the reconciliation, the Bank composed financial reports in accordance with the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS).

In all materially significant issues, the financial reports of the Bank have been prepared in line with the standards and interpretations approved by the International Accounting Standards Board (IASB), entitled IFRS. According to the Law on Accounting and Audit, the keeping of books, preparation and presentation of financial reports mandatory for all legal entities must comply with the accounting principles defined within the IFRS.

The presentation of financial reports in line with the IFRS requires the Bank management to make fair value estimates and reasonable assumptions that affect the presented levels of assets and liabilities on balance sheet date, as well as total income and expenses for that financial year. These estimates and assumptions are based on the information available on balance sheet date and future Bank performance may therefore differ from these estimates.

CSD is the official currency, and the financial statements are expressed in thousands of CSD.

## 1.3. The extent of analysis performed

The audit has been performed in accordance with the generally accepted audit standards and has encompassed, amongst other things, the following procedures:

- Direct reconciliation of 67.36% and assessment of 68.64% of the credit portfolio value;
- Direct reconciliation of 49.13% and assessment of 69.69% of the liabilities value;
- Direct reconciliation of 100% of gyro-account balances

The auditor was present at the December 31<sup>st</sup> 2004 cash inventory inspection.

### **1.3.1. IFRS compliance**

The Bank management has on December 31<sup>st</sup> 2004 compiled financial statements (partially) in line with the IFRS.

### **1.3.2. Accounting policy compliance**

The accounting policies applied in the preparation of these financial reports are not different from those defined by the IFRS.

### **1.3.3. Departures from IFRS**

The most significant departures of the accounting policies employed in making certain valuations pursuant to the relevant National Bank of Serbia regulations from IFRS are present in IAS 32: "Financial Instruments: Presentation and Disclosure" and IAS 39: "Financial instruments: Recognition and Measurement". Given the absence of an active market in financial instruments in the Republic of Serbia, fair value cannot therefore be reliably determined.

### **1.3.4. Valuation of tangible assets**

Valuation of tangible assets (Property, Plant and Equipment) was not carried out in line with IAS 16: "Property, Plant and Equipment" nor with IAS 36: "Impairment of Assets". Depreciation has been evaluated by applying the prescribed amortization rates to the purchase cost / depreciated value, i.e. without the establishment of the residual value of the tangible assets.

### **1.3.5. Concept of cash and cash equivalents**

The concept of cash and cash equivalents has been more narrowly defined than by IAS 7: "Consolidated Cash Flow Statement"

### **1.3.6. Discrepancies**

We have not been in a position to quantify these discrepancies, however their possible material importance does not permit us to express an opinion about the financial statements prepared on the IFRS basis.

### **1.3.7. Balance sheet preparation**

Balance sheet prepared on December 31<sup>st</sup> 2003 represents in its essence the opening balance sheet as per IFRS 1: "First time Adoption of International Financial Reporting Standards".

### **1.3.8. Comparative data**

Comparative data for the previous financial year has been brought in line with the presented financial reports for the current period.

## 2. Accounting policies applied

### 2.1. Interest and similar income/expenses

Income and expenses from interest, including regular interest as well as penalty interest, and other income and expenses related to interest-bearing assets and/or liabilities, have been recognized on an accrual basis, taking into account the effective yield of the assets or an applicable floating rate. Income from interest includes also any income generated by risk management financial instruments, ordinarily the annuity indexation to the EURCSD exchange rate or the growth of the retail price index, and is calculated upon maturity of each annuity. The Bank has fully applied its business policy and monetary policy regulations regarding the interest rate policy.

### 2.2. Fee and commission income/expenses

Fee and commission revenues/expenses arising upon financial services provided by or to the Bank have been recognized on an accrual basis. Income from fees and commissions are recognized on provision of service, when calculated or charged, depending on the type of service provided.

### 2.3. Income from securities

Dealing securities are recorded at cost. Gains and losses from securities are recognized upon sale. General risk provision for impairment related to securities is made through a valuation correction for the corresponding amount of securities identified by the Bank as doubtful.

Held-to-maturity and available-for-sale securities are stated at the lower of cost and market value.

Equity security holdings in other legal entities are stated as per capital methodology, i.e. in proportion to the valuation of capital of those legal entities. All realized gains due to a change in securities' market valuation are recognized as income/expense. Dividends received from equity investments in other legal entities are taken to dividend income when received. General risk provision for impairment related to securities is made through a valuation correction for the corresponding amount of securities identified by the Bank as doubtful.

### 2.4. Foreign currency

Foreign currency transactions are translated to CSD at the mid exchange rate set by the inter-bank currency market applicable on the day of the respective transaction.

Assets and liabilities in foreign currencies stated on balance sheet date are translated to CSD using the mid foreign exchange rate ruling at balance sheet date.

Gross positive or negative foreign exchange differences arising on translation are recognized in the income statement as foreign currency exchange gains or losses.

Contingent foreign currency liabilities and commitments have been translated at the official foreign exchange rate ruling at the balance sheet date.

Exchange rates set on December 31<sup>st</sup> 2004 and 2003 at the inter-bank foreign currency market for major currencies and used in the translation of the balance sheet items denominated in foreign currencies to CSD were as follows:

	31st December	
	2004	2003
EUR	78.8850	68.3129
USD	57.9355	54.6372
CHF	51.0913	43.7847

### 2.5. Financial instruments

#### (i) Classification

Financial instruments comprise loans originated by the Bank and receivables, held-to-maturity securities, available-for-sale assets and payables.

Originated loans and receivables created by the Bank providing money to a debtor are loans and receivables other than those created with the intention of short-term profit taking.

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

Available-for-sale assets are financial assets that are not held to maturity or classified as securities held for trading purposes.

Payables are contracted liabilities in cash or other financial assets towards another legal entity or an exchange of financial instruments with other legal entities on terms that may be disadvantageous to the Bank.

#### (ii) Recognition

Settlement date accounting has been adapted to record transaction.

(iii) Derecognition

A financial asset is derecognized when the Bank loses control over the contractual rights that comprise that asset. This occurs when the rights are realized, expired or are surrendered. A financial liability is derecognized when it is extinguished.

(iv) Measurement

Accounting policies applied to measurement of specific financial instruments are set out in the notes that follow.

## **2.6. Cash and cash equivalents**

Cash and cash equivalents comprise cash balances on hand, cash held on the Bank's giro account and accounts with other banks, as well as other cash equivalents which are highly liquid, have a less than 3-month maturity from the date of acquisition and are, in line with the Bank's business policy, acquired for the purpose of primary reserve liquidity maintenance.

## **2.7. Balances with Central Bank and refinancable securities**

Funds maintained for the mandatory reserve prescribed by the Central Bank are not available to finance the Bank's day to day operations. The Central Bank CSD and foreign currency mandatory reserve funds are placed in accordance with the Central Bank of Serbia regulations.

## **2.8. Securities**

Held-to-maturity and available-for-sale securities are stated at the lower of cost and market value. Equity security holdings in other legal entities are stated as per capital methodology, i.e. in proportion to the valuation of capital of those legal entities. General risk provision for impairment related to securities is made through a valuation correction for the corresponding amount of securities identified by the Bank as doubtful. Available-for-sale securities include equity of other banks and corporate entities.

Available-for-sale securities are stated at the lower of cost adjusted for any provisions and their market value. Those instruments that do not have a quoted market price in an active market are stated at reimbursement value. This value is based on estimated future cash-flows, discounted at an average active interest rate on loans.

## **2.9. Loans**

Loans are stated on the balance sheet at the amount of principal outstanding net of allowances to reflect the estimated recoverable amounts related to individually reviewed and identified risks for specific loans and risks known from experience to be present in the lending portfolio. When estimating the above mentioned risks, the Bank applies the methodology determined by the National Bank of Serbia.

Since the market interest rate is not known, in order to assess outstanding value, or fair value in line with the IFRS, a pre-agreed interest rate is used to bring the net discounted present value of future cash-flows in line with the nominal principal of the loan approved, reduced for the amount of principal repaid.

CSD loans, with risk mitigation in the form of indexation to the EURCSD exchange rate, are revalued subject to specific contract for each loan.

Fair value in line with the IFRS on these receivables is calculated by applying the agreed interest rate, given that the market interest rate is not known.

The Bank approves short- and long-term loans depending on the level of available funds and the term structure of the assets.

For a loan application to be approved it is necessary to fulfill the following conditions:

- a good track record in honoring previous obligations towards the Bank, if any
- no outstanding matured liabilities towards the Bank
- provision of all required documentation for loan approval in accordance with the relevant Decisions of the National Bank of Serbia and the Bank's policy regarding the procedure for approval and collection of receivables

For the credit risk to be minimized, a comprehensive assessment of credit potential and solvency is carried out for each loan application. Credit assessment procedure requires that the loan applicant be registered with the appropriate Court of Law and as such can take part in the payment transaction system.

The credit worthiness appraisal is performed by establishing the income, operational and financial potential and stability of the borrower as well as the following indicators:

- liquidity of the first, second and third order
- solvency of the second order
- solvency of the third order and
- indebtedness.

On approval, to secure the payback of loans the Bank collects the following forms of collateral:

- bills of exchange of the principal borrower and their guarantors
- authorization for collection from the borrower's accounts, as well as the guarantors'
- cash deposit (CSD or foreign currency)
- mortgage or mortgage statement
- pledge on durables/ mobile assets
- securities deposit
- bank guarantees etc.

The quality and type of loan security instrument depend on the amount and the risk inherent in the loan.

The bank has complete and proper documentation related to the above issues.

## 2.10. Impairment of financial assets

The Bank makes a value correction-allowance for overdue matured receivables due to principal repayment installments and interest charges that have not been settled within 60 and 90 days from their due date correspondingly, in accordance with the Bank's business policy.

A general provision for loan impairment due to potential losses known from experience to be present in the lending portfolio is established in line with the requirements of the National Bank of Serbia. Loans, advances and other Bank exposure are classified into categories according to the estimated level of collectability of loans and other assets depending on the number of days overdue, customers' financial position, the quality of collateral received and other prescribed criteria. As at December 31<sup>st</sup> 2004, the amount of general loan provision was calculated by applying 2% for loans classified in category A, 5% for category B, 25% for category V, 50% for category G, and 100% for category D.

General loan provision for categories B, V, G, and D is made against the carrying amount of loans and advances that are identified as being potentially impaired in order to reduce their value to recoverable amount. General loan provision for category A placements is accounted against retained earnings and presented as a reserve within the Bank's capital.

General impairment provision for categories B, V, G, and D against guarantees issued and other off-balance sheet items is shown on the income statement and stated as provision on the balance sheet. The general impairment provision against guarantees issued and other off-balance sheet items for category A is accounted against retained earnings and presented as a reserve within the Bank's capital.

Impairments are written off upon court approval, settlement between the parties involved and in line with the General Meeting decisions and Decisions of Management Board.

## 2.11. Tangible and intangible assets

Depreciation is the systematic decrease of purchase cost by accumulated depreciation of an asset over its estimated useful life.

Accounting for depreciation commences from the start of the month following the month when the asset is brought into use.

Depreciation is provided on the straight-line basis at rates given by the estimated useful lives of the assets.

The carrying amount of an asset on which depreciation is applied is the purchase cost decreased for recoverable value and accumulated depreciation.

The recoverable value is the net value that the Bank could receive on disposal of the asset at the end of its useful life, once deducted for the anticipated cost of disposal.

The applied accounting formula of depreciation is reviewed periodically and for any significant changes in the anticipated useful life of relevant assets the accounting method is adjusted to support the new estimate. When such an adjustment to the depreciation formula is required, it is accounted for as an adjustment to the fair value, and the depreciation amounts for the current and future periods are revised.

Depreciation is provided on the straight line basis at prescribed annual rates designed to write off the cost or valuation of plant, property and equipment and intangible assets over their expected useful lives:

	Per annum
Buildings	1.3%
Computers	20.0%
Furniture and equipment	14.5% - 15.5%
Intangible assets	20%

Investments in intangible assets include investments in leased business premises.

## 2.12. Income tax

Tax base - amount taxable of a legal entity is payable on the taxable profit reported within the tax returns. Income tax rate is 10% on taxable profit. Taxable profit reported in the tax returns includes the profit shown in the statutory Statement of income, prepared in accordance with the international accounting standards and regulations on accounting as defined by the Income Tax Law.

Income tax is the amount resulting from applying the prescribed rate on earnings before income tax as stated in line with IFRS, following adjustments for permanent differences that revise the official rate to the effective income tax rate. Taxable profit is determined in the tax return by adjusting profit as stated in the income statement for eligible expense and income allowances in line with the Tax Law. Derived tax amount is deducted for tax allowances (own capital expenditure, hiring of new employees and generating profit in newly opened branches in underdeveloped geographical areas).

Final amount due in respect of income tax is determined by levying the prescribed tax rate on the tax base reported within the tax returns.

Losses from operating, financial and non-operating transactions, as given by the tax return, excluding those resulting from capital gains or losses as defined by this law, can be carried forward against profit stated in the annual tax return for future tax periods, although for no more than 10 years.

Income and losses due to fundamental errors or change in the accounting policy are not shown in financial statements in the period in which they have occurred, and are not contained in the gains or losses for the current period. Instead, subsequently

discovered errors and effects of accounting policy change are contained in the corrections to financial reports for the year in which they took place. A fundamental error is considered to be such an error which, as defined by IRS, changes the taxable income – or loss, shown in the tax return by more than 2%.

There is no income tax charge based on the resultant tax base derived from the tax return and adjustment for the tax allowance due to the hiring of new employees.

## **2.13. Fair value**

In order to establish fair value, present value of future cash-flows is derived by applying a discount rate equal to the contracted interest rate, which brings present value on par with nominal value. Provision is made for the amount of estimated risk that accounting value will not be realized. In the Republic of Serbia, sufficient market experience, stability and liquidity do not exist for the purchase and sale of loans and other financial assets and liabilities, nor is published market information readily available. Accordingly, fair value cannot be reliably determined in the absence of an active market, as requested by IFRS.

## **2.14. Employee benefits**

The Bank does not have own pension funds or employee stock options and on that basis it has no identified liabilities on December 31<sup>st</sup> 2004. The present value of other liabilities, such as pension benefits once the necessary conditions have been satisfied, is not materially significant for the opening balance sheet prepared in line with IFRS on December 31<sup>st</sup> 2003.

## **2.15. Risk management policies**

Organizational units of the Bank in charge of risk management are the Division for domestic currency operations, the Division for foreign currency operations, Collection Department, Risk Control Department and Customer Support Department,

The purpose of risk management is to ensure the fundamentals for Bank's successful operation in an environment of inherent risk parameters, with the aim of realizing its business goals. Risk management includes efficient and active management of credit risk, liquidity risk, interest rate risk, currency risk and other banking exposures.

Credit risk is the risk of financial loss occurring as a result of counterparty default regarding its contractual obligations to the Bank. To secure collection and manage credit risk the Bank took relevant collateral instruments before disbursing a loan to a client.

The purpose of interest rate risk management, as part of asset and liability management, is to achieve the optimal interest margin, and thus income for the Bank. With that objective, it is important to evaluate the income sensitivity to sudden market interest rate changes. In the interest of minimizing exposure to interest rate risk the Bank protects itself by contracting variable interest rates, matching the term structure of interest-earnings assets and interest-bearing liabilities, as well as employing other interest risk management tools (Note 10).

The Bank is exposed to currency risk through its foreign currency operations, arising from the currency fluctuations and the change in CSD value to other currencies in which the Bank has assets and liabilities. In the interest of minimizing exposure to currency risk the Bank monitors the balance between the foreign currency denominated assets and liabilities, as well as currency matching. To this effect, the Bank has been indexing the loans granted to the EURCSD exchange rate (Note 11).

The responsibility for liquidity risk management lies with the Bank management. In pursuing the liquidity risk management policy the Bank's governing principle is guided by rational diversification of placements and term structure of assets and liabilities (Note 9).

## **Income Statement and Balance Sheet Analysis**



### 3. Income statement analysis

Structure of income and expenses shown in the income statement is as follows:

	2004				2003		O.y.A. (2004/2003) Index
	Balance before audit	Auditors' corrections	Balance after audit	Percentage share	Balance after audit	Percentage share	
	CSD '000	CSD '000	CSD '000	%	CSD '000	%	
<b>I INCOME</b>							
Interest income	325,941	-	325,941	18.28	154,387	27.46	2.11
Fee and commission income	411,499	-	411,499	23.08	279,205	48.71	1.47
Gains from exchange rate fluctuations	623,070	-	623,070	34.94	105,923	22.68	4.79
Dividend income	-	-	-	-	1	-	-
Other operating income	228,947	-	228,947	12.83	9,575	1.67	23.91
Income from changes in value of assets and liabilities	193,847	-	193,847	10.87	-	-	-
<b>TOTAL INCOME</b>	<b>1,783,304</b>	<b>-</b>	<b>1,783,304</b>	<b>100.00</b>	<b>573,148</b>	<b>100.00</b>	<b>3.22</b>
<b>II EXPENSES</b>							
Interest expenses	(29,056)	-	(29,056)	1.98	(9,236)	2.02	3.15
Fee and commission expenses	(48,438)	-	(48,438)	3.31	(47,041)	10.27	1.03
Expenses from right-offs	(614)	-	(614)	0.04	-	-	-
Expenses from provisions	(281,516)	-	(281,516)	19.22	-	-	-
Losses from exchange rate fluctuations	(603,040)	-	(603,040)	41.17	(108,465)	24.04	5.48
Other operating expenses	(501,984)	-	(501,984)	34.28	(291,620)	63.67	1.72
<b>TOTAL EXPENSES</b>	<b>(1,464,648)</b>	<b>-</b>	<b>(1,464,648)</b>	<b>100.00</b>	<b>(457,010)</b>	<b>100.00</b>	<b>3.20</b>
<b>PROFIT BEFORE TAX</b>	<b>318,656</b>		<b>318,656</b>		<b>116,138</b>		<b>.274</b>

#### 3.1. Interest income and expenses

	CSD '000	
	2004	2003
<b>a) INTEREST INCOME</b>		
Interest from mandatory foreign currency savings reserve with Central Bank	4,393	2,780
Interest from loans to other banks	6,471	2,970
Interest from loans to clients	311,231	147,516
Interest from mandatory reserves with Central Bank	3,846	1,121
<b>TOTAL INTEREST INCOME</b>	<b>325,941</b>	<b>154,387</b>
<b>b) INTEREST EXPENSES</b>		
Interest paid on deposits of banks and other clients	(29,057)	(8,923)
Interest paid for use of mandatory reserves with Central Bank	-	(304)
<b>TOTAL INTEREST EXPENSES</b>	<b>(29,057)</b>	<b>(9,236)</b>

### 3.2. Fee and commission income and expenses

	CSD '000	
	2004	2003
<b>a) INCOME FROM FEES AND COMMISSIONS</b>		
Service fees and commissions	316,451	213,397
Fees for contingent liabilities and commitments	30,949	22,042
Commissions from FX services	64,099	43,766
<b>TOTAL INCOME FROM FEES AND COMMISSIONS</b>	<b>411,499</b>	<b>279,205</b>
<b>b) FEE AND COMMISSION EXPENSES</b>		
Fees for domestic payment services	(19,136)	(24,580)
Fees for international payment services	(4,457)	(7,138)
Other fees and commissions	(24,844)	(15,323)
<b>TOTAL FEE AND COMMISSION EXPENSES</b>	<b>(48,437)</b>	<b>(47,041)</b>

The Bank has charged a fee for all provided services, set according to the prevailing market conditions and term-structure of business, with the aim of providing a realistic price to cover costs incurred and achieve appropriate income.

### 3.3. Other operating income

	CSD '000		
	Notes	2004	2003
Lease income		219	129
Recovered right-offs		692	58
Income from previous years		480	299
Other operating income		226,678	6,521
Income from securities		842	2,565
Extraordinary income		36	3
<b>TOTAL OTHER OPERATING INCOME</b>		<b>228,069</b>	<b>7,007</b>

Other business income in the amount of CSD 226,678 thousand consist of value added income amounting to CSD 206,740 thousand (evaluation of investment in the application software of the integrated IT system), income from recovery of loan impairment write-offs amounting to CSD 17,963 thousand, income from decrease in liabilities CSD 1,437 thousand, other income CSD 523 thousand and proceeds from sale of property, plant and equipment and intangible assets of CSD 15 thousand.

### 3.4. Expenses from right-offs and provisions

	CSD '000	
	2004	2003
<b>a) RIGHT-OFFS</b>		
Loans to clients	614	-
<b>TOTAL RIGHT-OFFS</b>	<b>614</b>	<b>-</b>
<b>b) PROVISIONS FOR POTENTIAL LOSSES</b>	<b>210,495</b>	<b>-</b>
For granted loans	71,021	-
For off-balance sheet items	281,516	-
<b>TOTAL PROVISIONS FOR POTENTIAL LOSSES</b>	<b>282,130</b>	<b>-</b>

### 3.5. Other operating expenses

	CSD '000	
	2004	2003
Net wages and salaries	(104,873)	(67,801)
Taxes and contributions	(72,544)	(45,332)
Other personnel expenses	(1,822)	(50)
Donations and sponsorships	(678)	(907)
Leases	(31,050)	(15,678)
Insurance premiums	(6,716)	(3,815)
Representational expenses – promotional material, client entertainment and related	(3,461)	(3,342)
Marketing and advertising	(79,967)	(48,481)
Stationary	(39,833)	(24,717)
Other tax expenses	(5,606)	(36)
Depreciation	(45,957)	(22,671)
Other intangible expenses	(23,823)	(10,339)
Services (telecom, utilities, etc.)	(46,753)	(32,268)
Disposal of property, plant and equipment, right-offs	(30,224)	-
Other expenses	(8,677)	(25,067)
<b>TOTAL OTHER OPERATING EXPENSES</b>	<b>(501,984)</b>	<b>(300,504)</b>

### 3.6. Income from changes in value of assets and liabilities

Income from changes in value of assets and liabilities amounts to CSD 193,847 thousand and arise from contracted foreign currency clauses that index CSD denominated loans to the EURCSD exchange rate.

### 3.7. Gains and losses from exchange rate fluctuations

	CSD '000	
	2004	2003
a) Gains from exchange rate fluctuations	632,070	105,923
b) Losses from exchange rate fluctuations	603,040	108,465

### 3.8. Profit before and after tax

Gross profit on December 31<sup>st</sup> 2004 amounts to CSD 318,656 thousand, and is equal to the net profit. Income tax payable is adjusted for tax allowance due to hiring of new employees.

## 4. Balance sheet analysis

The structure of the reclassified balance sheet of the Bank is as follows:

	2004				2003		Grow./(Fall) (2004/2003)  Index
	Balance before audit	Auditors' corrections	Balance after audit	Percentage share	Balance after audit	Percentage share	
	CSD '000	CSD '000	CSD '000	%	CSD '000	%	
<b>ASSETS</b>							
Cash and cash equivalents	894,841	-	894,841	24.74	485,611	21.37	1.84
Deposits with Central Bank and eligible securities	50,263	-	50,263	1.39	146,281	6.44	(2.91)
Accounts receivable (interest and fees)	18,332	-	18,332	0.50	10,427	0.46	1.76
Loans to banks	334,122	-	334,122	9.24	91,238	4.02	3.66
Loans to clients	1,625,551	-	1,625,551	44.94	1,224,432	53.89	1.33
Held-to-maturity securities	428	-	428	0.01	810	0.04	(1.89)
Investments in associated undertakings, other trading securities	7,674	-	7,674	0.21	670	0.03	11.45
Intangible assets	14,358	-	14,358	0.40	807	0.03	17.79
Property, plant and equipment	635,206	-	635,206	17.56	289,128	12.73	2.20
Other and deferred assets	36,391	-	36,391	1.01	22,495	0.99	1.62
<b>TOTAL ASSETS</b>	<b>3,617,166</b>	<b>-</b>	<b>3,617,166</b>	<b>100.00</b>	<b>2,271,899</b>	<b>100.00</b>	<b>1.59</b>
<b>LIABILITIES</b>							
Deposits from banks	44,153	-	44,153	1.22	2,445	0.11	18.06
Other deposits	2,285,828	-	2,285,828	63.19	1,372,182	60.40	1.67
Due for interest and fees	52	-	52	-	78	-	(1.52)
Other operating liabilities	71,195	-	71,195	1.97	130,908	5.76	(1.84)
Provisions	68,559	-	68,559	1.82	11,623	0.51	5.90
Deferred liabilities	25,631	-	25,631	0.71	6,791	0.30	3.77
<b>TOTAL LIABILITIES</b>	<b>2,495,400</b>	<b>-</b>	<b>2,495,400</b>	<b>68.98</b>	<b>1,524,026</b>	<b>67.08</b>	<b>1.64</b>
<b>EQUITY</b>							
Share capital	703,820	-	703,820	19.46	661,820	29.13	1.06
Reserves	13,237	-	13,237	0.37	-	-	-
Retained earnings	404,709	-	404,709	11.19	70,436	3.10	5.75
Revaluation reserves	-	-	-	-	15,617	0.69	-
<b>TOTAL EQUITY</b>	<b>1,121,766</b>	<b>-</b>	<b>1,121,766</b>	<b>31.02</b>	<b>747,873</b>	<b>32.92</b>	<b>1.50</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>3,617,166</b>	<b>-</b>	<b>3,617,166</b>	<b>100.00</b>	<b>2,271,899</b>	<b>100.00</b>	<b>1.59</b>

#### 4.1. Cash and cash equivalents

	CSD '000	
	2004	2003
Cash on hand:		
In CSD	58,622	24,479
In foreign currency	173,399	73,992
Current account	246,694	219,002
Foreign currency accounts with domestic banks	792	686
Foreign currency accounts with banks abroad	415,334	167,452
<b>TOTAL</b>	<b>894,841</b>	<b>485,611</b>

#### 4.2. Deposits with Central Bank and eligible securities

	CSD '000	
	2004	2003
Mandatory reserves		
In CSD*	-	117,773
In foreign currency	50,236	28,508
<b>TOTAL</b>	<b>50,236</b>	<b>146,281</b>

\*Mandatory reserve calculated on CSD-denominated notional is kept on Banks' gyro accounts.

The mandatory reserve deposited with the NBS is the minimum reserve on CSD-denominated funds that is allocated in accordance with the Decision on Obligatory Reserves of Banks with the NBS. This obligatory reserve deposit may be used for liquidity purposes. The Bank was compliant with the aforementioned regulation on December 31<sup>st</sup> 2004. The average interest rate on the designated funds during 2004 was approximately 2.97% per annum.

The mandatory foreign currency deposit with the NBS represents the minimum reserve on foreign currency funds that is allocated in accordance with the Decision on Obligatory Reserves of Banks with the NBS and is determined based on the average amount of the foreign currency reserve during the calendar month. The Bank was compliant with the aforementioned regulation on December 31<sup>st</sup> 2004.

During 2004 the Bank received income from interest on mandatory reserve funds in the amount of CSD 5,359 thousand.

During 2004 the Bank did not use its mandatory reserve, nor incur any interest expense on that basis.

#### 4.3. Accounts receivable (interest and fees)

	Notes	CSD '000	
		2004	2003
Accounts receivable, interest and fees from banks			
In CSD		13,368	13,240
In foreign currency		93	118
Accounts receivable, interest and fees from other clients		17,329	9,401
<b>Total</b>		<b>30,790</b>	<b>22,759</b>
Deductions			
Specific corrections of value		(12,458)	(11,808)
General corrections of value		-	(524)
<b>TOTAL</b>		<b>18,332</b>	<b>10,427</b>

### 4.3.1. Changes in accounts receivable (interest and fees) during the course of the year

	CSD '000		
	Interest	Fees	Total
Balance as per 1st January 2004	6,326	4,101	10,427
Accrued during the course of the year	325,941	(411,499)	737,440
Collected during the course of the year	(320,988)	(408,547)	(729,535)
Balance as per 31st December 2004	11,279	7,053	18,332

### 4.4. Loans to banks

	CSD '000	
	2004	2003
Short-term loans in CSD	175,512	357
Loans in foreign currency	158,610	90,881
<b>TOTAL</b>	<b>334,122</b>	<b>91,238</b>

Other CSD-denominated bank placements in the amount of CSD 175,512 thousand relate to deposits with the NBS (CSD 173,000 thousand) and Atlas bank AD (CSD 2,512 thousand).

Other foreign currency denominated placements with banks in the total amount of CSD 158,610 thousand relate to the deposited foreign currency citizens' savings with the NBS (CSD 154,415 thousand), other financial foreign currency placements with the NBS (CSD 3,701 thousand), and a foreign currency transaction account with Atlas bank AD (CSD 494 thousand).

### 4.5. Loans to clients

	CSD '000	
	2004	2003
Short-term loans:		
In CSD	1,043,082	726,015
In foreign currency	231,755	219,548
Long-term loans		
In CSD	306,733	306,516
Forthcoming maturing of long-term loans	278,718	10,783
<b>Total</b>	<b>1,860,288</b>	<b>1,262,862</b>
Deductions: Corrections of value	(234,737)	(38,430)
<b>TOTAL</b>	<b>1,625,551</b>	<b>1,224,432</b>

Loans up to one year in CSD were granted with a term from 30 days up to one year, with monthly interest rates ranging from 0.5% to 1.5%.

Long-term loans were granted with a maturity between 1 and 5 years, with monthly interest rates between 0.5% and 1.5%.

Other foreign currency denominated financial placements to customers on December 31<sup>st</sup> 2004 amount to CSD 219,460 thousand and refer to claims towards international trading company VTF Kamaz, Naberezni Celni, the Russian Federation, originating from previous years. This claim was taken over from company Yuco Hemija AD, Novi Sad. The foreign currency claim amounts to USD 3,788,000 (original loan amount of USD 2,418,000, plus loan revaluation at the amount of USD 1,370,000) the CSD equivalent of which on December 31<sup>st</sup> 2004 amounts to CSD 206,966 thousand. The Bank's claim is based on the effective and enforceable Decision of the Foreign Trade Arbitrary with the Yugoslav Chamber of Commerce in Belgrade (no. T-2/93 of June 22<sup>nd</sup> 1994), as well as on the Decision pronounced by the Superior Court of the Republic Tatarstan of the Russian Federation (no. 3p-17 of June 16<sup>th</sup> 1995) that recognized the aforementioned arbitrary Decision and ordered the enforcement of the Decision in the Russian Federation territory from the whole property of the Kamaz company.

Meridian Bank AD was on June 3<sup>rd</sup> 2003 notified by an authorized representative of Serbia and Montenegro in the Committee for Former SFRY's Financial Property and Debts that the claim towards VTF Kamaz, Russian Federation, has since March 26<sup>th</sup> 2003 been included within the regulated commercial debts of former USSR according to Decree no. 931 and the Memorandum on settlement of mutual financial claims regarding traded goods between former USSR and former SFRY.

According to Decree no. 931 the settlement of former USSR commercial debts was envisaged by issuance of government securities with imbursement running up to 2030 with a discount rate of 37.5% (amortization schedule up to 2030).

By way of collateral against regular collection, Yuco Hemija AD, as a guarantor of the signed over claim, has pledged a first-degree mortgage on the entire manufacturing complex in Backi Jarak, Cara Lazara bb, in benefit of Meridian Bank AD. The mortgage pledge runs up until the final settlement between Meridian Bank AD and VTF Kamaz in the full amount of the transferred claim. The first-degree mortgage has been valued at CSD 750,000 thousand, i.e. three times the claim value.

Yuco Hemija AD has given a Statement-Order whereby it irrevocably states that the full foreign currency inflow originating from the settlement with VTF Kamaz according to the Decision no.T-2/93 of the Foreign Trade Arbitrary with the Yugoslav Chamber of Economy in the amount of USD 24,905,391.80, with a court-ruled annual interest rate of 6% starting from March 29<sup>th</sup> 1994, will be directed via its accounts to Meridian Bank AD.

There were no changes on the basis of this claim in 2004.

The claim against VTF Kamaz is, in line with the Decision on Criteria for Classification of Balance Sheet and Off-balance Sheet Assets of Banks and Other Financial Organizations according to the Level of Collectability and the Level of Special Provisions of Banks and Other Financial Organizations, classified as category D.

	CSD '000	
	2004	2003
Short-term loans in CSD		
To companies	910,389	811,682
To individuals	31,013	103,738
Matured receivables	359,473	42,030
Forthcoming maturing receivables	278,718	10,783
Long-term loans in CSD		
To companies	173,390	155,697
To individuals	107,305	138,932
<b>Total</b>	<b>1,860,288</b>	<b>1,262,862</b>
Deductions:		
Specific corrections of value	(14,396)	(11,468)
General corrections of value	(220,341)	(26,962)
<b>TOTAL</b>	<b>1,625,551</b>	<b>1,224,432</b>

#### 4.5.1. Changes in corrections of value during the course of the year

	CSD '000					Total 2004	Total 2003
	Loans to clients	Interest and fees	Other assets	Securities			
<b>Specific corrections of value</b>							
Balance as at 1st January 2004	56,062	12,334	-	-	68,396	23,261	
Net increase (decrease) during the year	(41,666)	124	232	-	(41,310)	18,173	
Balance as at 31st December 2004	14,396	12,458	232	-	27,086	41,434	
<b>General corrections of value</b>							
Balance as at 1st January 2004	26,962	-	-	-	26,962	26,962	
Net increase (decrease) during the year	193,379	-	-	-	193,379	-	
Balance as at 31st December 2004	220,341	-	-	-	220,341	26,962	
<b>TOTAL</b>	<b>234,737</b>	<b>12,458</b>	<b>232</b>	<b>-</b>	<b>247,427</b>	<b>68,396</b>	

#### 4.6. Level of reconciliation in short-term and long-term loans

	CSD '000			
	Balance in Bank's books	Reconciled	Non reconciled	Partially reconciled
Long-term loans	559,413	391,413	168,000	-
Short-term loans	1,066,138	926,863	139,275	-
<b>Total as at 31st December 2004</b>	<b>1,625,551</b>	<b>1,318,276</b>	<b>307,275</b>	<b>-</b>

Non reconciled long-term and short-term loans in the amount of CSD 307,275 thousand consist of loans to retail clients in the amount of CSD 138,318 thousand, thus the remaining non reconciled loans amount to CSD 168,957 thousand, or 10.39%.

#### 4.7. Changes in granted loans during the course of the year

	CSD '000					
	Short-term in CSD	Short-term in FC	Due receivables	Long-term in CSD	Forthcoming receivables	Total loans
Balance as at 1st January 2004	687,585	219,548	-	306,516	10,783	1,224,432
<b>Increase</b>						
Granted loans	3,118,179	-	-	1,183,579	-	4,301,758
Forthcoming maturities	-	-	-	-	317,015	317,015
Increase in matured receivables	-	-	529,735	-	-	529,735
Changes in value (FX clause)	111,330	-	11,006	82,516	-	204,852
<b>Decrease</b>						
Collected matured loans	(3,172,684)	-	(39,355)	(964,947)	(10,783)	(4,187,769)
Transfer to matured receivables	-	(219,548)	-	(310,187)	-	(529,735)
Changes in value	(37,745)	-	(141,913)	(16,782)	(38,297)	(234,737)
<b>TOTAL LOANS AS AT 31st December 2004</b>	<b>706,665</b>	<b>-</b>	<b>359,473</b>	<b>280,695</b>	<b>278,718</b>	<b>1,625,551</b>

The detailed breakdown of interest rates is given in Chapter 10 – Risk of interest rate fluctuations.

The concentration of total placements to clients by the Bank is significant in the following industries:

	CSD '000	
	2004	2003
Processing	803,408	820,641
Construction	161,350	64,682
Tourism and hospitality	30,192	5,000
Agriculture and food processing	63,142	53,120
Transport	69,341	20,693
Finance, mining and energy	532,283	21,417
Trade	786,616	410,377
Government and municipal	76,875	1,553
Other industries	1,778,551	1,859,337
<b>TOTAL</b>	<b>4,301,758</b>	<b>3,256,820</b>



## 4.8. Securities

	Notes	CSD '000	
		2004	2003
Held-to-maturity securities			
Commercial papers and corporate bonds		428	810
Equity securities, other trading securities			
Equity securities		7,757	670
Corrections of value of equity securities		(83)	-
<b>TOTAL</b>		<b>8,102</b>	<b>1,480</b>

## 4.9. Property, plant and equipment and intangible assets

Changes in property, plant and equipment and intangible assets during the course of year 2004 were as follows:

	CSD '000					
	Business premises	Computers	Other equipment	Advances	Total	Intangible assets
<b>Purchase cost</b>						
Balance as at 1st January 2004	157,034	46,046	132,817	20	355,917	1,439
New purchase	47,630	57,131	299,937	14,848	419,546	16,015
Sale and disposal	-	-	(35,087)	-	(35,087)	(467)
<b>Balance as at 31st December 2004</b>	<b>204,664</b>	<b>103,177</b>	<b>397,667</b>	<b>14,868</b>	<b>720,376</b>	<b>16,987</b>
<b>Corrections of value</b>						
Balance as at 1st January 2004	7,972	17,292	21,525	-	46,789	632
Depreciation (Note 2.11.)	2,308	14,676	26,977	-	43,961	1,997
Sale and disposal	-	-	(5,580)	-	(5,580)	-
<b>Balance as at 31st December 2004</b>	<b>10,280</b>	<b>31,968</b>	<b>42,922</b>	<b>-</b>	<b>85,170</b>	<b>2,629</b>
<b>Net changes in value 31/12/2004</b>	<b>194,384</b>	<b>71,209</b>	<b>354,745</b>	<b>14,868</b>	<b>635,206</b>	<b>14,358</b>
<b>Net changes in value 31/12/2003</b>	<b>149,062</b>	<b>28,754</b>	<b>111,292</b>	<b>20</b>	<b>289,128</b>	<b>807</b>

## 4.10. Other and deferred assets

	CSD '000	
	2004	2003
Receivables from sale	-	34
Receivables from employees	73	498
Receivables from overpaid taxes	55	57
Advances	17,952	10,380
Other operating receivables	12,296	11,490
Deferred assets	6,015	36
<b>TOTAL</b>	<b>36,391</b>	<b>22,495</b>

Other assets refer to claims on grounds of theft and treasury funds shortage (CSD 6,167 thousand), claims for contributions made for pregnancy leave (CSD 904 thousand), claims against overpaid payment orders abroad (CSD 320 thousand), claims against taxes paid (CSD 1,391 thousand), claims against employees due to embezzlement of retail clients' funds and non-payment to the designated payee (CSD 2,191 thousand) and other claims (CSD 1,323 thousand).

Deferred assets in the amount of CSD 6,015 thousand relate to deferred realized income (CSD 5,693 thousand), other CSD expenses (CSD 221 thousand) carried forward, other foreign currency expenses (CSD 8 thousand) carried forward, and other deferred assets (CSD 93 thousand).

#### 4.11. Liabilities towards banks

	CSD '000	
	2004	2003
On demand deposits		
In CSD	-	322
In foreign currency	129	2,111
Short-term deposits in foreign currency	39,443	-
Long-term deposits in CSD	-	12
Other financial liabilities		
In CSD	3,475	-
In foreign currency	1,106	-
<b>TOTAL</b>	<b>44,153</b>	<b>2,445</b>

Short term deposits in foreign currency in the amount of 39,443 thousand CSD are in fact purpose (guarantee) deposit of Vojvodjanska Banka for the loan in the amount of 500,000 EUR granted by the Bank.

#### 4.12. Liabilities towards clients

	CSD '000	
	2004	2003
On demand deposits		
In CSD	1,039,537	871,996
In foreign currency	466,290	251,282
Short-term deposits		
In CSD	186,380	9,551
In foreign currency	370,886	165,089
Long-term deposits		
In CSD	51,757	16,424
In foreign currency	170,978	57,840
<b>TOTAL</b>	<b>2,285,828</b>	<b>1,372,182</b>

On demand CSD deposits represent to a large extent the balance of current accounts of corporate, state institution and other legal entities and individuals. On CSD on demand deposits of legal entities the Bank paid an interest rate equal to 30% of the NBS discount rate on an annual basis. On CSD on sight deposits of individual clients the Bank paid 2.5% on a monthly basis.

On foreign currency on demand deposits of legal entities the Bank paid an annual interest rate equal to 30% of the NBS discount rate.

CSD-denominated savings accounts earned 3% annual interest rate. Foreign currency savings accounts earned 2% annual interest rate.

Short-term deposits of retail clients in CSD and foreign currency earned annual interest rates ranging between 5%-8%, and 2%-4.5% respectively.

Short-term deposits of corporate clients in CSD earned annual interest rate ranging between 30%-100% of the NBS discount rate, depending on the term of the deposit.

Long-term deposits of retail clients in CSD and foreign currency earned 8% and 5% interest rate respectively.

Liabilities towards clients have the following structure:

	CSD '000	
	2004	2003
Companies (legal entities)	1,076,876	577,865
Individuals	817,496	486,236
Foreign entities	244,881	224,360
Other clients	146,575	83,721
<b>TOTAL</b>	<b>2,285,828</b>	<b>1,372,182</b>

#### 4.13. Due for interest and fees

	CSD '000	
	2004	2003
To banks	16	19
To other clients	36	59
<b>TOTAL</b>	<b>52</b>	<b>78</b>

#### 4.14. Other operating liabilities

	CSD '000	
	2004	2003
Liabilities for salaries, taxes and contributions	18,659	13,236
Liabilities to suppliers	47,949	28,165
Other liabilities	4,587	89,506
<b>TOTAL</b>	<b>71,195</b>	<b>130,907</b>

Other liabilities totaling CSD 4,587 thousand refer to: liabilities towards clients for CSD receipts against purchases of foreign currency and unallocated foreign currency income (CSD 1,791 thousand), payment cards settlements (CSD 1,245 thousand), purpose CSD deposits for loans in foreign currency (CSD 611 thousand), advances received (CSD 752 thousand), and other liabilities (CSD 188 thousand).

#### 4.15. Provisions

Provisions amounting to CSD 68,559 thousand represent provisions against potential impairment of off-balance assets classified in categories B, V, G, and D (Chapter 6). (In 2003, CSD 11,623 thousand.)

#### 4.16. Deferred liabilities

	CSD '000	
	2004	2003
Deferred liabilities for interest		
In CSD	1	1
Other deferred liabilities in CSD	25,612	6,790
<b>TOTAL</b>	<b>25,613</b>	<b>6,791</b>

Other deferred liabilities as at December 31<sup>st</sup> 2004 amount to CSD 25,612 thousand. They refer to: commission for cheque discounting (CSD 24,405 thousand), advances for endorsements issued (CSD 1,114 thousand) and other deferred liabilities (CSD 94 thousand).

## 4.17. Equity

	CSD '000	
	2004	2003
Share capital		
Ordinary shares	673,922	616,973
Priority shares	29,898	44,847
Revaluation reserves	-	15,617
Loss from previous years	-	(45,702)
Provisions from earnings for potential loan losses	13,237	-
Retained earnings from previous years	86,053	-
Retained earnings from current year	318,656	116,138
<b>TOTAL</b>	<b>1,121,766</b>	<b>747,873</b>

a) The Bank's equity capital is composed of initial shareholders investment and subsequent issuance of new shares, as well as revaluations. The bank has ordinary and priority shares. According to the book value, the priority share participation in the Bank's equity capital represents 4.25%.

In 2004, the Bank did not express earnings per share.

b) Losses from previous years as at December 31<sup>st</sup> 2003 amounted to CSD 45,702 thousand, that were covered, in line with the Decision of General Meeting dated September 29<sup>th</sup> 2004, from Bank's revaluation reserves in the amount of CSD 15,617 thousand and from profit CSD 30,085 thousand.

c) Retained earnings from previous years the Bank stated in the amount of CSD 86,053 thousand (after covering for losses). Retained earnings for the current year amount to CSD 318,656 thousand.

## 4.18. Contingent liabilities and commitments

a) Contingent liabilities and commitments

	CSD '000	
	2004	2003
Payment guarantees in CSD	271,626	522,265
Performance guarantees in CSD	-	250
Uncovered letters of credit	-	29,178
Endorsements and bills of exchange	426,342	359,641
Irrevocable potential liabilities	114,260	52,798
<b>TOTAL</b>	<b>812,231</b>	<b>964,132</b>

b) Other off-balance sheet liabilities

	CSD '000	
	2004	2003
Pledges taken	288	20,769
Cheques of legal entities	13,763	-
Cheques in depo	17	20
Cheques for collection	1,738	-
Equity revaluation	106,635	-
Pledges given	49,306	-
<b>TOTAL</b>	<b>171,747</b>	<b>20,789</b>

**4.19. Contingent liabilities relating to third party operations**

	CSD '000	
	2004	2003
Short-term loans granted in the name and on behalf of third parties	29,783	-
Long-term loans granted in the name and on behalf of third parties	776	-
Short-term liabilities in the name and on behalf of third parties	(29,783)	-
Long-term liabilities in the name and on behalf of third parties	(776)	-
<b>TOTAL</b>	-	-

## **Analysis of Bank's Business Solvency**

## 5. Equity

### 5.1. Share capital – structure

Meridian Bank AD, Novi Sad, up to and including December 31<sup>st</sup> 2003 issued 14 emissions of shares:

Share capital consists of 1,501 shares – specifically:

- 511 shares with nominal value CSD 100 thousand
- 450 shares with nominal value CSD 150 thousand
- 260 shares with nominal value CSD 350 thousand
- 280 shares with nominal value CSD 150 thousand

The book value of share capital is increased for the revaluation amount.

Breakdown of shares issued by emission series, year of issuance, type and number of shares:

Share issuance	Year of issuance	Type of shares	Number of shares	Nominal value CSD '000
1 <sup>st</sup> (incorporation)	1992	Ordinary	-	-
2 <sup>nd</sup> , 3 <sup>rd</sup> , and 4 <sup>th</sup>	1992	Ordinary	-	-
5 <sup>th</sup> , 6 <sup>th</sup> , 7 <sup>th</sup> , 8 <sup>th</sup> , 9 <sup>th</sup>	1993	Ordinary	-	-
10 <sup>th</sup>	1994	Ordinary	-	-
11 <sup>th</sup>	1995	Priority	-	-
12 <sup>th</sup>	1997	Priority	511	100
Shares from takeover of BankCoop SA, Vrsac	2001	Ordinary	260	350
13 <sup>th</sup>	2002	Priority	200	150
14 <sup>th</sup>	2003	Ordinary	250	150
15 <sup>th</sup>	2004	Ordinary	280	150
<b>TOTAL</b>			<b>1,501</b>	

The Bank in 2004 issued the 15<sup>th</sup> emission of shares based on the Decision on Approval of Security Issuance by the Securities Exchange Commission no. 4/0-17-778/4-04 dated July 15<sup>th</sup> 2004. Shares were issued in the total amount of CSD 42,000 thousand, namely 280 ordinary shares of individual nominal value of CSD 150 thousand.

The change in equity capital is detailed in the Report on changes in equity capital.

As on 31st December 2004 major shareholders of the Bank are:

	Ordinary shares	Priority shares	Total [(1)+(2)]	Ordinary shares (%)	Priority shares (%)	Total [(4)+(5)]%
	(1)	(2)	(3)	(4)	(5)	(6)
DIMONT AD LIMITED	87,918	-	87,918	12.49	-	12.49
ARIOUS LTD	87,647	-	87,647	12.45	-	12.45
T&D LTD	87,569	-	87,569	12.44	-	12.44
FLAGARY INVESTMENT INC	87,422	-	87,422	12.42	-	12.42
MAGNOLIA FINANCE INC	87,276	-	87,276	12.40	-	12.40
RCS TRADING COMPANY	84,774	-	84,774	12.04	-	12.04
YUCO HEMIJA AD, Novi Sad	63,987	-	63,987	9.09	-	9.09
Other shareholders	87,329	29,898	117,228	12.41	4.25	16.66
<b>TOTAL</b>	<b>673,922</b>	<b>29,898</b>	<b>703,820</b>	<b>95.75</b>	<b>4.25</b>	<b>100.00</b>

### 5.2. Share capital – compliance

The Bank's share capital amounts to CSD 1,121,766 thousand, and once deducted for intangible asset investments of CSD 14,358 thousand, amounts to CSD 1,107,408 thousand.

Total value at risk amounts to CSD 2,542,192 thousand.

The bank is obliged to keep the ratio of capital to net value at risk (capital adequacy ratio) above 8% - as at December 31<sup>st</sup> 2004 it is equal to 43.56%.

During the year the Bank had a share emission in the amount of CSD 42,000 thousand.

The monetary portion of the Bank's capital on December 31<sup>st</sup> 2004 amounts to 14,036,362.08 EUR (minimum regulatory requirement on December 31<sup>st</sup> 2004 was EUR 10,000,000). As at December 31<sup>st</sup> 2004 the Bank complies with the monetary portion of capital requirement.

## 6. Quality of assets

### 6.1. Classification of assets

The classification of balance sheet assets and off-balance sheet items in the interest of establishing asset quality has been carried out in accordance with the Decision on Criteria for Classification of Balance Sheet and Off-balance Sheet Assets according to the Level of Collectability and the Level of Special Provisions of Banks and Other Financial Organizations.

Review of asset classification as well as loan provision amounts for identified and unidentified losses is presented in the Report on Classification of Balance Sheet and Off-balance Sheet Assets of Banks and Other Financial Organizations according to the Level of Collectability as at December 31<sup>st</sup> 2004.

Under provisions for identified losses, a percentage of assets classified in categories B, V, G, and D is apportioned - more specifically, a sum of 5% made against the carrying amount of loans and advances classified in category B, 25% against assets in category V, 50% against assets classified in category G, and 100% against assets classified in category D.

Provisions for unidentified losses are charged as expense and are stated as indirect loan impairment against the balance sheet assets (under general loan provisions) and as provisions for losses against the off-balance assets (account 801).

Provisions for unidentified losses refer to general loan loss provisions for category A at 2% (in line with the NBS Instruction).

The general loan loss provision for category A is accounted against retained earnings and presented as a reserve within the Bank's capital (account 814).

After audit corrections, the total established special provisions against potential losses, amounting to CSD 302,137 thousand, refer to:

	Categories					Total	
	A	B	V	G	D	CSD '000	%
Off-balance sheet assets	3,603	9,138	55,147	632	3,642	72,162	23.88
Balance sheet assets	9,634	28,007	24,412	13,166	154,756	229,975	76.12
<b>Total value at risk</b>	<b>13,237</b>	<b>37,145</b>	<b>79,559</b>	<b>13,798</b>	<b>158,398</b>	<b>302,137</b>	<b>100.00</b>
<b>%</b>	<b>4.38</b>	<b>12.29</b>	<b>26.33</b>	<b>4.57</b>	<b>52.43</b>		

Provisions for unidentified losses (category A) amount to CSD 13,237 thousand, provisions for identified losses for off-balance sheet assets amount to CSD 68,559 thousand, and provisions for identified losses for on-balance sheet assets amount to CSD 220,341 thousand.

### 6.2. Largest borrowers

As at December 31<sup>st</sup> 2004, the Bank has one large loan user (over 10% of Bank's equity capital):

Borrower	Total exposure	% of equity
FCG DOO, Beograd	120,958	10.79
<b>TOTAL</b>	<b>120,958</b>	<b>10.79</b>

As at December 31<sup>st</sup> 2004, the Bank has four loan users – related parties, i.e. entities which are shareholders of the Bank. Total exposure to these loan users – related parties is:

Borrower	Total exposure	% of equity
YUCO HEMIJA AD, Novi Sad	5,437	0.49
MERIDIAN INVEST AD, Beograd	6,946	0.62
INTERSPED AD, Subotica	5,257	0.47
WELLAS AD, Subotica	980	0.09
<b>TOTAL</b>	<b>18,620</b>	<b>1.67</b>



The Bank's largest debtors are:

Borrower	Total exposure	% of equity
1. KAMAZ FOREIGN TRADE	219,460	8.05
2. FCG, Beograd	127,323	4.69
3. BIG BUL PTP, Bacinci	67,100	2.47
4. MAG PROMET, Jagodina	64,346	2.37
5. MERCATA DOO, Beograd	45,000	1.66
6. ZONED GRADJEVINAR, Novi Sad	43,655	1.61
7. RIBOPRODUKT DOO, Pozega	42,000	1.55
8. BIG CHOCKEN DOO, Bacinci	40,000	1.47
9. CODEX INTERNATIONAL DOO, Novi Sad	39,000	1.44
10. RAGIONE DOO, Subotica	37,934	1.40
11. DIGITRON IST DOO, Beograd	34,865	1.29
12. UNIVERZITET U NOVOM PAZARU	31,554	1.16
13. RAJIC AD, Backi Jarak	26,304	0.97
14. JKP TOPLANA, Zajecar	25,689	0.95
15. ENTRIX DOO, Beograd	23,754	0.88
16. KONEKS DOO, Nova Pazova	21,318	0.79
17. VOCE TRADE, Loznica	21,000	0.77
18. PREZIDENT DOO, Novi Sad	20,327	0.76
19. IKSEL DOO, Beograd	18,951	0.70
20. PREMIER DOO, Indjija	18,222	0.67
21. COOL PLUS, Beograd	18,067	0.67
22. RM ALKON STAHL, Beograd	17,678	0.65
23. KOMPAS TURISM & TRAVEL DOO, Novi Sad	17,118	0.63
24. BOJADIX ZECEVIC DOO, Kraljevo	16,732	0.62
25. DRVO MIX DOO, Kraljevo	16,605	0.61
26. CONTINETAL PROMET DOO, Smederevo	16,106	0.59
27. EUROPANEL TEAM DOO, Smederevo	15,463	0.57
28. ATP VOJVODINA, Novi Sad	15,230	0.56
29. AUTONENA, Beograd	15,000	0.55
30. SPADA DOO, Zrenjanin	13,362	0.49
31. Other borrowers	1,583,108	58.37
<b>TOTAL</b>	<b>2,712,271</b>	<b>100.00</b>

## 7. Performance indicators

### 7.1. Major indicators

Performance ratios achieved as per Decision on Detailed Conditions of the Application of Articles 26 and 27 of the Law on Banks and Other Financial Organizations are:

	Achieved	Prescribed
Monetary portion of equity (EUR)	14,036,382	10,000,000
Capital adequacy	43.56%	min 8%
Investments in fixed assets	58.05%	max 60%
Large and largest allowed loans indicator	12.60%	max 400%

Liquidity ratio calculated at a monthly level, as an average of all working days in a month, and as per working day in a month, was always significantly above the required level during the year.

The foreign exchange risk ratio was in 2004 in compliance with the regulation.

Bank's participation in the equity capital of any single legal entity was not above 15% of the Bank's share capital.

The Bank has one large loan to a single borrower in an amount exceeding 10% of Bank's equity capital.

The Bank did not disburse the largest loan to a single borrower – related party, of above 5% of the Bank's equity capital.

The bank has satisfied performance indicators as per Decision on Detailed Conditions of the Application of Articles 26 and 27 of the Law on Banks and Other Financial Organizations.

## 8. Profitability

### 8.1. Major ratios

Realized interest income and expenses and their structure for the year ended December 31<sup>st</sup> 2004 are shown in Note 3 (Income Statement Analysis).

Interest income amounts to CSD 325,941 thousand. Interest income from placements to clients makes up 79.46%. Following is interest income from individual clients (17.37%), interest income from other banks (1.99%) and interest income from NBS on mandatory reserve designated funds (1.18%).

The most significant participation in total interest expenses derives from interest expenses on deposits held by banks (99.93%), with interest expenses on retail clients' deposits of 0.07%.

The Bank's profitability can be observed from the following indicators taken from the balance sheet and income statement data as at December 31<sup>st</sup> 2004, calculated in line with the NBS Decision on the Minimum Content of Reports on Audited Financial Statements for Banks and Other Financial Organizations and shown with comparative indicators for the previous financial year:

Ratio	%	
	2004	2003
Return on assets	9	5
Return on equity	28	7
Interest income over assets	9	0.4
Interest expenses over liabilities	0.8	0.4
Provisions over assets	8	-
Other income over assets	6	13
Other expenses over liabilities	14	16
Net interest income over interest bearing assets	15	11
Operating expenses over total expenses	32	84
Operating expenses over net interest income	157	202
Operating expenses over net interest and fee income	71	8
Operating expenses over other financial expenses	171	103
Operating expenses over net non interest income/expenses	137	112
Operating expenses over assets	13	13

Interest-bearing assets amount to CSD 1,967,775 thousand, or 54.40% of the total assets, while non-interest bearing assets amount to CSD 1,649,391 thousand, or 45.60% of the total assets.

## 9. Liquidity

### 9.1. Liquidity ratios

Bank's solvency and liquidity, as well as its capability to timely settle its matured liabilities, depends foremost on the balance sheet structure of the Bank, i.e. the harmonization of incoming and outgoing cash-flows. Term structure of assets and liabilities points to a significant mismatch of inflows and outflows of funds in periods of 8-15 days, 16-39 days, 31-90 days, 181-365 days and over 365 days.

The primary cause of the mismatch is the larger value of capital, long-term reservations, long-term liabilities and long-term financial placements compared to the value of plant, property and equipment and other long-term assets.

One of the priority goals of Meridian Bank in its daily operations is to maintain current solvency and liquidity in accordance with the Business Policy and legal regulations.

Bank's Statute regulates the matter of liquidity. Article 63 of the Statute regulates that the Bank, in order to maintain its solvency and liquidity, may use: liquidity loans from the NBS and other banks and financial organizations, foreign currency reserves kept above the minimum requirement depending on the economic interest as well as other resources of funds, in accordance with regulations.

The General Manager of the Bank and others employed in the Bank in whose competence is liquidity maintenance, are the ones immediately responsible for the Bank's solvency and liquidity within their authorization, which is closely regulated by the Act on Internal Organization.

The management of the Bank daily observes liquidity through reports on daily inflow and outflow of funds from all organizational units of the Bank. Those reports are collected and form a unique review in which all-available funds and amounts are listed, as well as Bank's liabilities. The Bank also has at hand information on necessary funds required by companies, Bank's clients, as reported daily in line with their needs. Surplus of funds the Bank grants as loans to most favorable seekers of available short-term funds and uses them in other profitable fashion.

The Bank maintains its foreign currency liquidity pursuant to the regulations relevant for foreign currency operations.

The liquidity of the Bank can be observed from the following comparative indicators, calculated in line with the NBS Decision on the Minimum Content of Reports on Audited Financial Statements for Banks and Other Financial Organizations:

	%	
Ratio	2004	2003
Total loans over total deposits	84	96
Liquid assets over deposits up to three months	510	6,005
Liquid assets over total assets	25	21
Liquid assets and total short-term liabilities	40	34
Off-balance sheet liabilities over total deposits	44	72

The Bank has no stand-by arrangements or guarantees at disposal for management of any eventual temporary liquidity shortages.

Throughout 2004 the Bank maintained a sufficient degree of solvency and liquidity for its clients to be able to manage their funds uninterruptedly and participate in payment operations.

According to reports on liquidity indicators of banks and other financial organizations, the Bank's monthly liquidity indicator ranged between 1.71-2.30, i.e. it was significantly above that required (requirement at 1.00), while the daily indicator was at 2.29 (requirement at 1.0).

## 10. Interest rate risk

### 10.1. Interest rate policy

The Bank in 2004 lead a policy of positive real and variable interest rates. The interest rate level was shaped depending on: cost of funding, ratio of supply and demand in financial markets, changes in the retail price index, changes in the interest rate levels of the competitor banks, structure of the funding sources and placements, in line with the measures of monetary policy and banks' Code of Business Ethics.

Interest rate policy falls to jurisdiction of the Bank's General Meeting, with a primary function of securing the Bank's profitability and dividend generation. Basic philosophy of the Bank's interest rate policy is to secure, thorough application of suitable measures and solutions, not just congruency with legal regulations, but also to maintain competitive advantage and successful operation while acknowledging the needs and interest of its clients.

The Bank's fee policy for banking services for 2004 accounts for fixed or floating interest rates.

In determining the level of interest rates, the Bank's management took into account its competitive position in the money market and considered the following elements:

- the NBS discount rate
- interest rate in the money market
- EURCSD exchange rate fluctuations
- interest rates charged by other banks and financial organizations
- structure of the sources of funding and the impact of interest rate changes on business performance

In line with its business policy, Meridian Bank AD charged a weighted interest rate through monthly annuities to its loan users.

The interest is calculated and charged on a monthly basis when due, and for long-term loans monthly, according to the amortization schedule, or quarterly.

The Bank applies the conform methodology for interest calculation, in arrears, unless otherwise agreed, except for loans linked to discount of cheques and bills of exchange, and the loan-provision business with individuals, where the interest calculation is also made in advance.

The number of days for which interest is charged is counted from the first day of loan utilization up to, but excluding, the day of loan repayment.

In forming the passive interest rate level the Bank observes interest rate trends in the local financial market.

With fixed-term deposits of corporate and retail clients, the interest rate applied is stipulated by the Contract signed with the depositor.

For all matured, overdue liabilities, the Bank calculates and charges interest at the rate stipulated by the Law on Penalty Interest Rate.

In instances where the contracted interest rate is higher than the penalty interest rate, the contracted interest rate is applied.

### 10.2. Active interest rates

In the period from January 1<sup>st</sup> to December 31<sup>st</sup> 2004, the Bank applied the following active interest rates on a monthly basis:

Type of placement	Interest rate
Short-term loans to corporate clients	0.50-1.50 %
Long-term loans to corporate clients	0.50-1.50 %
Short-term loans to entrepreneurs	0.50-1.50 %
Consumer loans	0.50-1.00 %
Overdraft facility on current account	0.10-1.13 %
Cheque discounting	1.10 %

On all matured, overdue liabilities, the bank calculates and charges penalty interest at 0.13% per day.

### 10.3. Passive interest rates

On CSD on demand deposits of legal entities the Bank paid an interest rate equal to 30% of the NBS discount rate on an annual basis.

Short-term deposits of corporate clients in CSD earned annual interest rate ranging between 30%-100% of the NBS discount rate, depending on term of deposit.

On CSD deposits of retail clients, during 2004 the Bank applied the following annual interest rate:

Type of deposit	Interest rate
On demand deposits	3.0 %
Current account	2.5 %
Fixed term deposits	

Up to 1 month	5.0 %
Up to 2 months	5.0 %
Up to 3 months	6.0 %
Up to 6 months	7.0 %
Up to 1 year	8.0 %
Over 1 year	8.0 %

On foreign currency deposits of retail clients, the Bank applied the following monthly interest rates during 2004:

Currency	Term deposits				
	On demand	Over 1 month	Over 3 months	Over 6 months	Over 1 year
EUR	2.00 %	3.00 %	4.00 %	4.50 %	5.00 %
USD	1.00 %	2.00 %	3.00 %	3.50 %	4.00 %
CHF	0.50 %	0.70 %	1.00 %	1.50 %	2.00 %

Based on the inspected Bank's documentation, such as contracts on granted loans, calculation of interest, and all on the basis of a random sample of borrowers, we reached the conclusion that the Bank complied with its interest rate policy during 2004.

## 11. Foreign currency risk

### 11.1. Foreign currency sub balance sheet

	2004		2003	
	CSD '000	%	CSD	%
<b>ASSETS</b>				
Cash and cash equivalents	589,525	56.96	242,130	37.57
Deposits with Central Bank and eligible securities	50,263	4.86	28,508	4.42
Accounts receivable (interest and fees)	93	0.01	118	0.02
Loans to banks	158,610	15.32	90,881	14.10
Loans to clients	226,766	21.91	219,548	43.89
Other and deferred assets	9,780	0.94	-	-
<b>TOTAL ASSETS</b>	<b>1,035,037</b>	<b>100.00</b>	<b>581,185</b>	<b>100.00</b>
<b>LIABILITIES</b>				
Deposits from banks	40,678	3.07	2,111	0.44
Other deposits	1,008,154	76.09	474,211	98.51
Other operating liabilities	2,330	0.18	1,595	0.33
Deferred liabilities	-	-	3,473	0.72
Equity	273,740	20.66	-	-
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>1,324,902</b>	<b>100.00</b>	<b>481,390-</b>	<b>100.00</b>

The Bank is responsible to maintain the ratio between assets and liabilities in such a way that the total Bank's foreign currency denominated value at risk (the sum of long-term and short-term open net foreign currency positions across all currencies and precious metals) at the end of each working day does not exceed 30% of the Bank's capital.

The Bank's realized net currency position is stated separately for receivables and payables in USD and EUR, and grossed up for all other currencies.

Foreign currency receivables which are stated in foreign currency are adjusted for corrections of those receivables.

The CSD equivalent of foreign currency receivables and payables is established according to the official mid exchange rate against the CSD on the date of Bank's foreign exchange position reporting.

Deposits for Bank's share capital purchases can be excluded from the calculation of the Bank's currency position.

From the DEVMES form (monthly report on the Bank's foreign exchange risk indicator), it can be concluded that the Bank had no breaches of foreign exchange risk, and that the indicator of foreign exchange risk during the last quarter of 2004 amounted to 22.91% (December 2004 17.92%).

## 12. Contingent liabilities and commitments exposure

### 12.1. Off-balance sheet liabilities

The Bank keeps its off-balance sheet liabilities categorized according to the type of contingent liability or commitment and per client. When approving off-balance sheet placements, the Bank verifies solvency of the applicant, measures their credit capability in the same manner applied when granting loans. The structure of off-balance sheet positions is stated in Note 4.18 and 4.19..

The changes in contingent liabilities and commitments were as follows:

	CSD '000				
	Balance as at 01/01/2004	Increase in liabilities	Decrease in liabilities	Liabilities exercised	Balance as at 31/12/2004
Operations in the name and on behalf of	-	34,276	(3,717)	-	30,559
Payment guarantees	522,265	1,222,277	(1,470,677)	(2,239)	271,626
Performance guarantees	250	-	(250)	-	-
Endorsements and bills of exchange	359,641	248,894	(182,193)	-	426,342
Irrevocable contingent commitments	29,178	76,229	(89,187)	-	16,220
Other	52,798	159,533	(114,288)	-	98,043
Other off-balance sheet liabilities	20,789	187,882	(36,927)	-	171,744
<b>TOTAL</b>	<b>984,921</b>	<b>1,929,091</b>	<b>(1,897,239)</b>	<b>(2,239)</b>	<b>1,014,534</b>

During the course of 2004 the Bank had to pay against the following contingent liabilities, for the following clients:

Payment guarantees	CSD '000
MARTA BOR	2,239
<b>TOTAL</b>	<b>2,239</b>

The Bank does not extend any further guarantees to those clients for which it had to make a payment against a contingent liability or commitment.



## 13. HR and organizational competence and facilities

### 13.1. Employees

At December 31<sup>st</sup> 2004, the Bank had 562 employees.

The educational structure of the Bank on December 31<sup>st</sup> 2004 was as follows:

	Total	%
University education	208	37.00
Collage education	79	14.00
High school education	275	49.00
<b>TOTAL</b>	<b>562</b>	<b>100.00</b>

### 13.2. Management Board, General Meeting, Supervisory Board

Members of the Management Board are:

- Tomislav Djordjevic (MSc), Chairman
- Aleksandar Vlahovic (PhD), member
- Slobodan Nikitovic (PhD), member

The General Meeting chairman is Radivoje Nikacevic, representative of Yuco Hemija AD, and the General Meeting deputy chairman is Mr. Daniel Rouse, representative of EUREXA, Boulogne, France.

Members of the Supervisory Board are:

- Mirjana Srijemac, Chairperson
- Zivojin Janjic, member
- Snezana Bajic, member.

### 13.3. Organizational structure

The Bank's Head Office has the following departments:

- Corporate clients department
- Foreign currency department
- Retail banking department
- Accounting and finance department
- IT department
- Administrative department
- Quality assurance department
- Payment operations department
- PR and marketing department
- HR department
- Collection department.

### 13.4. Organizational units

Organizational unit	Address
1. Head Office NOVI SAD	Novi Sad, Futoski put 42-44
2. Branch office No. 2 SUBOTICA	Subotica, Marksov put 15
3. Branch office No. 3 NIŠ	Nis, Pobedina 10
4. Branch office No. 4 BEOGRAD	Beograd, Vojislava Ilica 40 Beograd, Bircaninova 33 Beograd, Kolarceva 7 Beograd, Bulevar AVNOJ-a 64 Beograd, Jurija Gagarina 81 Beograd, Branislava Nusica 2g Beograd, 22. Oktobra 15

	Beograd, Lole Ribara 156
5. Branch office No. 6 VRANJE	Vranje, Lenjinova 14
6. Branch office No. 7 SMEDEREVO	Smederevo, Kralja Petra I 12
7. Branch office No. 9 STARA PAZOVA	Stara Pazova, Svetosavska 1
8. Branch office No. 10 TEMERIN	Temerin, Novosadska 326
9. Branch office No. 11 BAČKA PALANKA	Bačka Palanka, Kralja Petra I 5
10. Branch office No. 12 RUMA	Ruma, Orlovićeva 4
11. Branch office No. 13 SOMBOR	Sombor, Venac Radomira Putnika 26
12. Branch office No. 14 LOZNICA	Loznica, SPC "Kadinjaca" bb
13. Branch office No. 15 NOVI SAD	Novi Sad, Maksima Gorkog 4/e Novi Sad, Bulevar Oslobođenja 54
14. Branch office No. 16 KRUŠEVAC	Krusevac, Jug Bogdana bb
15. Branch office No. 17 ZRENJANIN	Zrenjanin, Trg Republike 8/3
16. Branch office No. 18 ČAČAK	Cacak, Gradsko setaliste 14
17. Branch office No. 19 JAGODINA	Jagodina, Maksima Gorkog 13
18. Branch office No. 20 ŠID	Sid, Svetog Save 8
19. Branch office No. 21 NOVI PAZAR	Novi Pazar, Ulica AVNOJ-a bb
20. Branch office No. 22 VRŠAC	Vrsac, Sterijina 26
21. Branch office No. 23 KRAGUJEVAC	Kragujevac, Mikusa Gajevica 6
22. Branch office No. 24 KRALJEVO	Kraljevo, Vojvode Putnika 24
23. Branch office No. 25 VALJEVO	Valjevo, Karadjordjeva 99
24. Branch office No. 26 ZAJEČAR	Zajecar, Mose Pijade 11
25. Branch office No. 27 GORNJI MILANOVAC	Gornji Milanovac, Vojvode Milana 1
26. Branch office No. 28 LAZAREVAC	Lazarevac, Nikole Vujacica 4
27. Branch office No. 29 POŽEGA	Pozega, Heroja Lekovica 23
28. Branch office No. 30 UŽICE	Uzice, Mihajla Pupina 1
29. Branch office No. 31 LESKOVAC	Leskovac, Trg Revolucije 13
30. Branch office No. 32 BOR	Bor, Nikole Pasica 8
31. Branch office No. 33 PANCEVO	Pancevo, Oslobođenja 39
32. Branch office No. 34 BOGATIC	Bogatic, Mike Mitrovica 2
33. Branch office No. 36 IVANJICA	Ivanjica, Venijamina 2
34. Branch office No. 37 GUCA	Guca, Republike 82
35. Branch office No. 38 KIKINDA	Kikinda, Brace Tatic 2
36. Branch office No. 39 ARILJE	Arilje, Trzni centar 1/7
37. Branch office No. 40 APATIN	Apatin, Srpskih Vladara 1
38. Branch office No. 41 SVILAJNAC	Svilajnac, Svetog Save bb
39. Branch office No. 42 OBRENOVAC	Obrenovac, Vlade Aksentijevica 6
40. Branch office No. 43 VLASOTINCE	Vlasotince, Nemanjina 75
41. Branch office No. 44 NOVI BECEJ	Novi Becej, M. Tita 11
42. Branch office No. 45 TRSTENIK	Trstenik, V. Karadzica 18
43. Branch office No. 46 BUJANOVAC	Bujanovac, Karadjordja Petrovica 215
44. Branch office No. 47 PROKUPLJE	Prokuplje, Jug Bogdanova 85
45. Branch office No. 48 SABAC	Sabac, Cvetni trg 1
46. Branch office No. 49 ALEKSINAC	Aleksinac, Knjaza Milosa 153
47. Branch office No. 50 SMEDREVSKA PALANKA	Smedrevska Palanka, I srpskog ustanka 107
48. Branch office No. 51 SREMSKA MITROVICA	Sremska Mitrovica, Kralja Petra I 30
49. Branch office No. 52 INDIJIA	Indjija, Jug Bogdanova 2
50. Branch office No. 53 POZAREVAC	Pozarevac, Veljka Dugosevica 42

51. Branch office No. 54 PRIBOJ	Priboj, Veljka Vlahovica 1
52. Branch office No. 55 CUPRIJA	Cuprija, Kneza Milosa 44
53. Branch office No. 56 PRIJEPOLJE	Prijepolje, Izeta Cavica 4 (Vakuf)
54. Branch office No. 57 KNJAZEVAC	Knjazevac, Knjaza Milosa 41
55. Branch office No. 58 NOVA VAROS	Nova Varos, Karadjordjeva 40
56. Branch office No. 59 PARACIN	Paracin, TC kocka
57. Branch office No. 60 ARANDJELOVAC	Arandjelovac, Knjaza Milosa 261
58. Branch office No. 61 UB	Ub, Kralja Petra I oslobodioca 27
59. Branch office No. 62 VRBAS	Vrbas, Blok Save Kovacevica 1

### **13.5. Business premises**

As at December 31st 2004, the Bank possesses in own property 3,139.76 m<sup>2</sup> of business premises. Beside these, Bank makes use of 5,521.87 m<sup>2</sup> of leased business premises.

Size of business premises used satisfies the prescribed standards regarding the number of Meridian Bank employees as well as types and volumes of business conducted by the Bank.

The Bank's Head Office in Novi Sad occupies 1,200 m<sup>2</sup>.

## **14. Level of automatic of data processing**

### **14.1. IT infrastructure**

The IT system is of particular importance in tracking and planning of the Bank's activities and operations. The year off 2004 has been marked with several significant changes at the Bank. These changes were: migration of e-banking system in-house, start of ATM operations as well as the introduction of a list of new products and services. These changes dictated the channeling of a large part of the Bank's effort towards the introduction and implementation of new IT solutions. E-banking system initiated in autumn 2002 as an outsourced facility was, after successful testing and trial period, transferred in-house.

Timely preparations were the key factor in successful completion of the above mentioned as well as other tasks during 2004.

### **14.2. Organization of IT department**

IT department has 25 employees, most of whom are university-educated. The employees possess the skills and expertise to conduct all necessary operations that such an IT system requires.

### **14.3. Hardware resources**

The backbone of the Bank's IT hardware infrastructure is IBM cluster server made out of two IBM x445 servers linked to FAST 900 SAN storage system with a capacity of 3.5 TB disk storage, and Blade Center with 10 IBM Blade Servers. The core system is accompanied by 17 IBM servers (3x345, 7x326 and 7x306) and a dozen of other servers. For disaster recovery the Bank uses Fujitsu – Siemens cluster server that is capable of fully coping with the Bank's workload in case of any major default of primary system.

Broader hardware recourses include around 400 workstations, 70 pass-book printers and above 160 general purpose printers.

### **14.4. Communications**

The Bank's network system comprises of internal networks (LAN) implemented in head office and branch offices and network of communication links that connect all branches with the head office (WAN). The whole network is relying on Cisco routers and switches. The backbone of the LAN network are two redundant Cisco 4500 Layer 3 switches accompanied by Cisco Catalyst 3550 switches connected by an optical link. Two Cisco access servers provide access to the Bank's e-bank service center. Cisco 3725 and 3640 routers are used as central routers while the branches use Cisco 2620 and 1721 routers.

Physical links are recourses leased from Telekom Srbija. These links are based on digital nx64k, Frame Relay and other physical links. All branch offices are permanently on-line with Base ISDN being used as a back up link.

Link to the Internet is established through two independent ISPs (YuNet and Telekom), each providing a speed of connection of no less than 256 kbps.

Beside abovementioned infrastructure for data transfer, the Bank has installed 54 IP Siemens telephony centers that provide faster communication between branches as well as higher quality of service for the clients calling the Bank. The remaining 36 Siemens centers that the Bank acquired are to be installed by mid 2005. Telephony infrastructure consists of 3 Primary ISDN, 30 Base ISDN and 25 SMIN ports (042) as well as a large number of analogue telephone lines.

### **14.5. Software recourses**

The Bank's applications are based on software developed by PEXIM DOO. All applications are acquired together with their source codes so that additional improvements in-house are possible.

The integral software solution that covers all of the Bank's needs is based on MS Windows 2000 OS with the database managed on MS SQL Server 2000.

The Bank is part of the SWIFT network through which all international payments operations are conducted.

Other external connections include links to: the Central Bank, Association of Serbian Banks, Reuters, Central Registry of Securities, etc.

### **14.6. System security and data integrity**

The complete IT infrastructure is protected from interruptions in power supply and electric shocks through Uninterrupted Power Supply devices (UPS) MGE with a total power of 30 KW relaying on a power generator with capacity of 60 KW. Additional UPS devices also operate inside the system.

The daily data recovery strategy includes archiving of all data in 15 minute intervals i.e. with a regular 15-minute data automatic recall phase. Complete data back-up is also conducted daily. All archived data is kept both on data tapes and CDs.

System security is maintained through user name/password protection implemented at the level of workstation, data access is managed through each application additionally which provides facility for implementation of different authorization levels for different positions. In instances when external access is necessary (e-bank), security is provided through usage of PKI infrastructure.