

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

CONSOLIDATED ANNUAL DIRECTOR'S REPORT
AND CONSOLIDATED FINANCIAL STATEMENTS

31 DECEMBER 2015

FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC

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FUND FOR LOCAL AUTHORITIES AND GOVERNMENTS IN BULGARIA – FLAG JSC

General information

Board of directors

Dobromir Prodanov Simidchiev - Chairperson
Asya Petrova Stankova - member
Emil Rumenov Savov - member
Susan Mary Goranson - member
Nadya Yordanova Dankinova – member and Executive director
Maria Blagoeva Lazarova– member
Yulia Petkova Tsoleva–Ilieva – member

Registered address

Sofia, 17-19 St. Saint Cyril and Methodius Street

Business address

1 Sixth September Street, Fourth Floor, Sofia

Legal advisors

Law Firm „Lozanova and Atanasov”
Antoniya Svetlinova Mladenova

Servicing banks

Unicredit Bulbank
Ci Bank
DSK Bank
Municipal Bank

Auditor

Baker Tilly Klitou and Partners Limited
1612 Sofia
104 Akademik Ivan Geshov, Seventh Floor

CONSOLIDATED REPORT
on the principal activities of
Fund for Local Authorities and Governments in Bulgaria – FLAG JSC in 2015

This Report has been drawn up in compliance with the requirements laid down in Article 23 of the Regulation laying down the rules for exercising the rights of the government in state-owned commercial undertakings and the Commercial Act.

1. Business Program

1.1. Equity and loan resources

Share capital of the Group is BGN 90,000 thousand, and it is paid on four instalments in 2008, 2009 and 2014.

The contracted long-term credit resource from the European Bank for Reconstruction and Development (EBRD) amounts to EUR 70,000 thousand as negotiated in two Loan contracts dated 22 December 2008 and 31 October 2013. The total amount of principal payable to EBRD as of 31.12.2015 amounts to EUR 49.5 million /BGN 96.8 million/.

During 2014 FLAG increased its utilisable loan resources with additional BGN 40 million, which the Group received under the form of revolving credit facility, included as an additional function during public procurement tender for choice of Managing bank. As of 31.12.2015 the outstanding principal related to this loan is BGN 20 million.

During 2015 FLAG increased borrowed resources with 3 new revolving loan contracts as follows:

- BGN 40 million from DSK bank
- EUR 20 million from Ci Bank
- BGN 14 million from Municipal bank

As of 31.12.2015 total outstanding balance related to loans stated above is as follows:

- BGN 38,4 million payable to DSK bank
- EUR 19.9 million payable to Ci Bank
- BGN 13.1 million payable to Municipal bank

According to an operational agreement between European Investment Bank, Fund for Sustainable Urban Development of Sofia EAD and Fund for Local Authorities and Governments in Bulgaria – FLAG EAD, signed on 30.05.2012, a contingent loan in the amount of BGN 24,600 thousand was granted for financing urban development projects under the JESSICA initiative. As at 31.12.2015 the unutilized amount of BGN 2,653 thousand, intended for sub-loans, has been deposited into the special account.

1.2. Management

The affairs of the Fund are managed by a Board of Directors (BoD), which is composed of seven members and is responsible for all ongoing activities of the Fund. In 2015 seventeen board meetings were held.

During the reporting period the following changes in the composition of the BoD were made pursuant to a decision of the sole shareholder:

➤ On 07 January 2015 with Protokol № T3-104/16.12.2015 the Minister of Regional Development, in his capacity of representative of Government as a sole shareholder, approved changes to the composition of the BoD. Minister of Regional Development released Radoslav Rusev Rusev as a member of BoD and elected on his place Denitza Plamenova Nikolova.

➤ On 25 September 2015 with Protokol № T3-108/16.09. 2015 the Minister of Regional Development, in his capacity of representative of Government as a sole shareholder, approved changes to the composition of the BoD. Minister of Regional Development released Denitza Plamenova Nikolova and Yana Nikolova Georgieva as members of BoD and elected on their places Asya Petrova Stankova and Maria Blagoeva Lazarova.

As of 31 December 2015, Board of Directors has the following members: Dobromir Simidchiev – Chairperson, Asya Stankova – member, Maria Lazarova – member, Emil Savov - member, Yulia Tsoleva – member, Susan Mary Goranson – member and Nadya Yordanova Dankinova – member and executive director.

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

Management confirms that adequate accounting policies have been consistently applied in preparing the annual consolidated financial statements as of 31 December 2015, and reasonable and prudent judgments, assumptions and estimates have been made.

Management also acknowledges that it has applied the existing accounting standards and the consolidated financial statements have been prepared under the going concern principle.

Management is responsible for the proper keeping of accounting records, for the appropriate asset management and for the undertaking of all necessary measures for avoidance and detection of fraud and other irregularities.

1.3. Human Resources

The Group's staff has the appropriate qualifications for performing the lending activities in 2015. The organizational structure includes 4 Directorates, as follows: "Projects and monitoring", "Finance and Risk management", "Lending" and „General administration“. As of 31.12.2015 the approved number of personnel is 21 employees. As of 31.12.2015 there are 4 vacant places for employees, and one employee is on maternity leave.

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

1.4. External auditor for 2015

On BoD meeting dated 26 August 2014 BoD approved the results from public tender for external auditor for 2014 and 2015 and approved „Baker Tilly Klitou and Partners“ OOD. Subsequently this choice has been confirmed with Protokol T3-67/04.09.2014 from the Minister of Regional Development, in his capacity of representative of Government as a sole shareholder.

1.5. Loan agreements with EBRD and EIB

During 2015 credit resources under loan agreements dated 22.12.2008 and 30.10.2013 with European Bank for Reconstruction and Development amounting to EUR 70,000 thousand /BGN 136,908 thousand/ are fully utilized and loans are repaid regularly. In 2015, the Group continued to repay the loans and two instalments were paid on 03.02.2015 and on 03.08.2015 amounting to EUR 8,853 thousand /BGN 17,315 thousand/.

As of 31.12.2015 total loan payable related to borrowed capital from EBRD amounts to EUR 49,477 thousand /BGN 96,768 thousand/.

As at 31.12.2015 the Operational Agreement, concluded between the European Investment Bank, the Fund for Sustainable Urban Development of Sofia EAD and the Fund for Local Authorities and Governments - FLAG EAD on 30 May 2012, for provision of contingent loan, is still in force. The entire loan amount has been made available to the borrower while the unutilized amount intended for sub-loans to final recipients in the special account amounts to BGN 2,653 thousand.

Amendment agreement №1 to the Operational Agreement was signed in 2014 under which the sanctions for breaching the first period for disbursement of funds to final recipients – 31.12.2013 are waived under condition. The Amendment was signed due to the inability for disbursement of the funds under the JESSICA initiative in the predetermined period. This was due to circumstances beyond the Fund's control. In particular, there was a six month delay in the signing of an Operational Agreement; another six months were needed for establishing the method for assessment of the state aid available for projects and the method for certification, through independent expert assessment, and selection of eligible experts to undertake the assessment. The volatile political situation and the frequent change of the governments, which deteriorated investors' confidence, as well as the innovative nature of the JESSICA financial instrument and the lack of experience in its application in Bulgaria, also played a role in delaying the investment process.

Under this additional agreement an "administration amount" of BGN 923 thousand was paid in exchange for future repayments by final recipients. The contingent loan was effectively reduced by this amount.

Amendment Agreement №2 was signed on 18.12.2014. Under this agreement the period for disbursing funds under project funding agreements is extended to 31.12.2015 and the "administration amount" of BGN 923 thousand is specified as being deducted from the loan amount. The amount of the contingent loan is changed to BGN 23,685 thousand.

Amendment agreement №3 was signed on 10.07.2015 in relation to the changes in the criteria for selection of new partner bank of FSUDS. Under Amendment agreement №4 dated 11.12.2015, the final disbursement date for the funds provided under the Contingent loan was extended to 30.06.2016. The provision for reimbursement of the administrative amount withheld in line with Amendment agreement №1 is discarded. The amount of the contingent loan remains BGN 23,685,093.

On 07.12.2015 FSUDS was informed that the Funding Agreement between Republic of Bulgaria and EIB will expire on 31.12.2015 and in line with decision of the Managing Authority of JHF Bulgaria and the Investment Board, it will not be extended. On the basis of article 14.04B of the Operational Agreement, EIB assigns all of its rights, obligations and interests by way of novation to the OPRD Managing Authority, which will take on its functions for a transition period until it is further transferred to the Fund Manager of Financial Instruments. A Transfer and Substitution Agreement was signed on 14.12.2015 between EIB, MRDPW, FSUDS and FLAG, where the transfer process and EIB's continuing obligations during the interim period are agreed.

1.6. Managing bank

During 2015 Unicredit Bulbank continued to carry out the functions of managing the bank and providing revolving credit facility in the amount of BGN 40,000 thousand. Cost of funds is determined by one month Sofibor and allowance of 2.50%.

As of 31.12.2015 the amount payable under revolving loan from Unicredit Bulbank is BGN 20,000 thousand.

A procedure for selection of Partner-bank of FSUDS was undertaken in 2015 due to the expiry of the contract with Raiffeisenbank Bulgaria EAD on 20.06.2015. With decision 47 from 28.04.2015 a public tender procedure with subject: "Selection of Partner-bank for FSUDS EAD" was initiated. Two offers were submitted within the statutory term – from UniCredit Bulbank and CiBank EAD. Taking into account the method for assessment of the candidates and the requirements of the Public procurement law, the Committee selected CiBank EAD. A decision with the selection process results was published on 09.06.2015.

Amendment agreement №3, which provides for candidates that do not have the rating required under the Operational agreement to be admitted to the procedure, and Annex 1 to the Accounts receivable pledge agreement with EIB were signed on 10.07.2015. Contract for assigning the functions of a Partner-bank, Agreement for special terms and conditions on bank accounts, and Pledge agreement on government securities were signed on 27.07.2015 between FSUDS and CiBank EAD.

