

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

FINANCIAL STATEMENTS

31.12.2009

GENERAL INFORMATION	2
ACTIVITIES REPORT	3
REPORT OF THE INDEPENDENT AUDITOR TO THE SHAREHOLDERS OF FLAG JSC	10
INCOME STATEMENT	12
BALANCE-SHEET	13
CASHFLOW STATEMENT	14
CHANGES IN EQUITY STATEMENT	15
NOTES	
1. CORPORATE INFORMATION	16
2. BASIS FOR PREPARATION AND ESSENTIAL ACCOUNTING POLICIES	17
3. INCOME FROM INTEREST	28
4. FINANCIAL EXPENSES	28
5. EXPENSES ON LABOUR	29
6. OTHER OPERATIONAL EXPENSES	29
7. EXPENSES ON TAXES	30
8. CASH	30
9. ACCOUNTS RECEIVABLE AND PREPAID COSTS	31
10. EQUIPMENT AND LONG-TERM ASSETS	31
11. EXTENDED LOANS	32
12. LIABILITIES UNDER EBRD LOAN	32
13. LIABILITIES TO STAFF AND SOCIAL INSURANCE	33
14. TAX LIABILITIES	33
15. OTHER LIABILITIES	33
16. OWNERS' EQUITY	34
17. RELATED PERSONS AND TRANSACTIONS WITH RELATED PERSONS	34
18. CONTINGENT LIABILITIES AND COMMITMENTS	35
19. MANAGEMENT OF THE FINANCIAL RISK	36
20. EVENTS AFTER THE BALANCE-SHEET DATE	39
21. APPROVAL OF THE FINANCIAL STATEMENTS	39

GENERAL INFORMATION

Board of Directors:

Ekaterina Spasova Gecheva - Zaharieva
Ivelina Vesselinova Vassileva
Emil Rumenov Savov
James Hislop
Lilyana Pavlova Nikolova
Vessela Danailova Daneva
Preslav Plamenov Borisov

Executive Director:

Emil Rumenov Savov

Accountants:

Fiscalia EOOD

Management address:

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

Legal experts:

Dessislava Ivanova-Atanassova

Servicing banks:

IniCredit Bulbank
Reiffaisenbank
Bank DSK
United Bulgarian Bank
Eurobank EFG Bulgaria
Union Bank

Auditor:

BDO Bulgaria Ltd.

ACTIVITY REPORT

For the year ending on 31 December 2009

The management presents its annual report and annual financial statements as at 31 December 2009, drawn up in compliance with the International Financial Reporting Standards, adopted by the European Union.

OVERVIEW OF THE ACTIVITY

A. Business Programme

The Fund has started accepting loan applications of the municipalities on 15 January 2009 and 96 loan applications have been submitted by the end of December, amounting to a total of BGN 120.7 million, to support projects in the amount of BGN 390 million.

- Equity

The share capital of the company was increased by BGN 30 million in 2009, paid in two installments BGN 15 million each, thus bringing the total share capital to BGN 60 million. This, together with the borrowed long-term credit resource, allows FLAG to lend BGN 200 million to the local governments, with equity/borrowed resource ratio of 30/70.

- Management

The fund is managed by the Board of Directors, consisting of seven members. The Board of Directors organizes and manages the operational activity of the Fund in performing all its functions. The Board has held 25 meetings in 2009, most of which devoted to making decisions on approval of loans and annexes thereto.

The following changes took place in the membership of the BD upon decisions made by the sole proprietor in the reporting period:

- ✓ James Hislop replaced Henry Russel as a representative of the European Bank for Reconstruction and Development (EBRD) on 17 June 2009.
- ✓ Penka Yordanova and Krassimira Georgieva replaced Dimcho Mihalevsky and Iskra Mihailova as representatives of the Ministry of Regional Development and Public Works (MRDPW) on 23 July 2009.
- ✓ The Board of Directors elected Krassimira Georgieva to the post Chairperson of the Board on 28 July 2009.
- ✓ Ekaterina Zaharieva and Lilyana Pavlova replaced Penka Yordanova and Krassimira Georgieva as representatives of MRDPW; Vessela Daneva replaced Lyubomir Datsov as representative of the Ministry of Finance; Ivelina Vassileva replaced Atanas Kostadinov as representative of the Ministry of Environment and Water (MEW) and Preslav Borissov replaced Dimitar Peichev as representative of the Ministry of Agriculture and Food on 8 September.
- ✓ On 18 September 2009 the Board elected Ekaterina Zaharieva as chairperson and Ivelina Vassileva – Deputy Chairperson of the Board.

By the end of 2009 the members of the Board of Directors were the following: Ekaterina Zaharieva (MRDPW) – Chairperson, Ivelina Vassileva (MEW) – Deputy Chairperson; Vessela Daneva – MoF – member; Preslav Borissov (MAF) – member; James Hislop (EBRD) – member and Emil Savov (National Association of Municipalities in the Republic of Bulgaria) – member and Executive Director.

- Administrative Activities

- Human Resources

The key personnel of the Fund consisting of experts with appropriate qualification were already available by the beginning of 2009 so that the Fund could commence its lending activities. The status and changes in the number of staff are presented in the table below.

Position	Beginning of 2009	Hired	Dismissed	Reappointed	At the end of 2009
Experts at Projects and Monitoring Directorate	2				2
Experts at Finance and Risk Management Directorate				+1	1
Experts at Lending Directorate	2	2		-1	3
Director of Projects and Monitoring Directorate	1				1
Director of Finance and Risk Management Directorate	1				1
Director of Lending Directorate				+1	1
Internal auditor	1	1	1		1
Office manager	1	1		-1	1
Total	8	4	1	-	11

Several training events were organized for the staff during the year, focusing on municipal budgets, assessment of municipal credit bearing capacity, calculating the net operational surplus and public procurement.

- External auditor for 2009

At a meeting held on 14 October 2009 the Board of Directors approved the results of the public procurement procedure conducted for the appointment of an external auditor for 2009, pursuant to art. 2, paragraph 1, item 2 of the Ordinance on Awarding Small Public Procurement, by approving BDO Bulgaria as contractor. This decision was later approved by the proprietor of the company.

- **Loan Agreement with EBRD**

In February 2008 the Fund initiated steps for concluding a second loan agreement with EBRD for the purpose of securing additional resources at the expense of increasing its equity. The Board of Directors adopted a Letter of Mandate on the 23 April on the second loan and the Minister of Regional Development and Public Works gave his consent on concluding an agreement and after the Government made a decision to authorize the Minister of RDPW to sign a support letter, loan agreement 2 was signed on 3 July.

By virtue of the Agreement FLAG is entitled to receiving EURO 35 million for a period of 12 years with a grace period of two years. The funds from the loan shall be used to lend to municipalities which show a definite level of creditworthiness, which is insufficient however for the purposes of borrowing on the market.

- **Main results of the lending activity in 2009**

The year 2009 saw the approval of 70 loans extended to 57 municipalities in the amount of BGN 72 776 thousand, intended to support the implementation of projects in the amount of BGN 242 million, whereby the average percent of the loan in the overall budget of the supported project is 30%. The typical loan extended to the municipalities is for bridge financing in the amount of BGN 1.1 million with maturity of 11 months. This characteristics is due to the following reasons:

- ✓ Type of projects for which the municipalities sought credit resource (mainly roads and educational infrastructure under OPRD);
- ✓ Stage of the projects for which loans were requested from FLAG – as a rule for the second half of the project period;
- ✓ Character of the grant assistance –100% of projects costs were to be reimbursed, which fact determined the short-term nature of the requested loans.

The tables below show the extended loans by types of loans, by operational programmes and by sources for repayment of principals.

By type of loans	Number of loans	Total amount in BGN	Amount in BGN			Maturity in months		
			Minimum	Maximum	Average	Min.	Max.	Average
Investment	58	70,351,378	250,000	4,401,319	1,212,955	4	85	11
Preparation	1	150,791				11	11	11
Preparation with TA	11	2,273,508	32,962	350,228	206,683	8	16	11
Total	70	72,775,677						

By OPs

Regional Development	53	58,851,378	250,000	4,401,319	1,110,403	4	85	10
Environment	16	13,773,508	32,962	3,500,000	860,844	8	19	13
Total	69	72,624,886						

By repayment source

Operational programmes	68	71,846,286	32,962	4,401,319	1,056,563	4	23	10
Own funds	2	929,391	150,791	778,600	464,696	11	85	48
Total	70	72,775,677						

The funds disbursed in 2009 under loan contracts amount to BGN 65.7 million and the repayment under the loan contracts amounted to BGN 17.3 million.

62 annexes to 31 loan contracts (mainly the part concerning the repayment schedules) were considered in 2009.

10 Loan requests are being considered now in the total amount of BGN 9 million.

The municipalities of Glavinitsa, Kirkovo, Krumovgrad, Madan, Valchedrum and Mezdra (road infrastructure), Kaolinovo, Sozopol, Lovech (road infrastructure), Venets and Gabrovoby by the end of 2009 have fully repaid their loans to the Fund amounting to a total of BGN 13.7 million.

The municipality of Strambolovo was the only one in arrears of 37 days for the principal of BGN 210 thousand as at 31 December 2009. In implementing article 57 of the Municipal Debt Act FLAG notified the National Audit Office and the Municipal council about the status of the loan.

16 of the filed loan applications were not approved for the reasons summarized in the table below.

Status	Total number	Incl. OPRD	Incl. OPE	Incl. for project preparation	Total amount
Declined by the BD	3	2	1	0	5,488,703
Put off for later by the BD	2	0	2	0	5,905,215
Withdrawn by the municipality	1	0	0	1	900,000
FLAG waiting for clarifications on a case	3	0	3	0	3,527,540
Submitted at a too early stage	3	2	1	0	3,600,000

Waiting for documents to be presented	3	0	0	3	1,415,558
The project is not within the scope of financing by FLAG	1				445,000
Total	16	4	7	4	21,282,016

- **Information and publicity**

With a view to assisting the access of municipalities to FLAG financing, the Fund has developed a separate section of the Consultative Paper on the 2010 Municipal Budgets, which is traditionally developed by the National Association of Municipalities. This section of the paper contains specific recommendations and examples of good practices in using debt financing from the Fund.

B. Financial Condition

1. Report and Structure of Income and Expenses

Statement of Income and Expenses

№	Name	Amount in	
		BGN thous.	Amount in BGN
	EXPENSE ITEMS	1 600	1 600 261.96
1	Remun. BD, Ex.Director,social insurance	111	111 433.00
2	Consult. services-Consortium (SCG and CE 2000)	54	53,760.00
3	Process representation under the agreement with EBRD	3	3,103.69
4	Legal services	11	10,750.00
5	Media, announcements, brochures	4	3,876.00
6	Rental - office	105	105,062.92
7	Accounting services	18	18,000.00
8	Auditor services	8	7,790.10
9	Notary fees, courier services, cleaning, subscriptions, insurance, translations	15	14,990.23
10	Communications – telephones and cards	5	5,101.37
11	Maintenance of IT network	7	6,800.00
12	Furnishing	4	3,621.88
13	Assets – 2 computers and a telephone exchange	4	3,863.75
14	Stationery	10	10,193.34
15	Other materials	2	2,087.00
16	Fuel and automobile materials	2	2,221.33
17	Depreciation	19	18 804.85
18	Salaries and social insurance contributions	205	205 341.18
19	Business trips	1	900.10
20	Training	3	3 287.63
21	EBRD costs – non-financial	108	108 093.83

22	Bank fees, including:	246	245 522.89
	- <i>Commitment fee EBRD</i>	156	155 572.36
	- <i>Front-end commission EBRD</i>	55	54 514.63
	- <i>Loan administration fee EBRD</i>	24	24 461.75
	- <i>Commission as per contract UniCredit</i>	4	3 907.52
	- <i>Bank fees for transfers, monthly fees, etc.</i>	7	7 066.63
23	Expenses on interest charged on EBRD loan	553	553 352.64
24	Expenses on interest deducted on EBRD loan	102	102 304.23

INCOME ITEMS		4 813	4 813 286.04
1	Income from interest on loans	1 200	1 200 068.29
2	Income from default interest on loans	15	15 034.56
3	Income from fees on loans	28	28 482.22
4	Income from interest on deposits – due	766	765 729.38
5	Income from interest - deposits	2 804	2 803 971.59

DEPOSITS		64 145	64 145 377.63
1	Raiffeisenbank	46 246	46 245 826.00
2	UniCredit	17 899	17 899 551.63

Structure of Expenses

Groups of expenses	Amount	Share of total expenses
Operational costs	147,719.92	9.23%
Hired services	97,100.10	6.07%
Acquisition of LTTA and depreciation	26,290.48	1.64%
Remuneration – staff, BD	316,774.18	19.80%
UniCredit management fee, other fees	10,974.15	0.69%
On EBRD loans – interest	655,656.87	40.97%
On EBRD loans – fees	234 548.74	14.66%
On EBRD loans – other expenses	111,197.52	6.95%
	1 600 261.96	

The expenses on fees and other expenses to EBRD, as well as the payment of BGN 53.8 thousand under a consultancy contract of 2008, being hired services are one-off expenses. If they are deducted, the operational expenses of the Company will be in the amount of BGN 599 thousand.

2. Yield

1. From extended loans – at average interest rate of 5.94% the yield, including interest rate and commitment fee, stands at BGN 1,244 thousand.
2. From management of temporarily unemployed funds – FLAG has concluded contracts with banks for open-end deposits, the annual yield of which ranges from 7.90 to 10.50%. The overall yield from them is BGN 3.57 million, distributed among the different sources in the following way:

Source	Paid in 2009	Due as at 31.12.2009
UniCredit Bulbank	775	711 776

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

Raiffeisenbank	2 290 712	53 953
DSK	10 754	
Union bank	318 812	
Eurobank EFG	179 729	
Total:	2 803 972	765 729

3. Cash Available

As at the end of 2009 the Fund had BGN 65,145 thous. on deposit accounts and BGN 50 thous. on its payments account.

COMPREHENSIVE INCOME STATEMENT
For the year ending 31 December 2009

	Notes	2009 BGN'000	2008 BGN'000
FINANCIAL INCOME AND EXPENSES			
Interest income	3	4,785	1,067
Other operational income, net		28	2
Financial costs on interest and fees	4	(979)	0
NET FINANCIAL INCOME		3,834	1,069
OTHER INCOME/ EXPENSES			
Labour cost	5	(319)	(92)
Depreciation costs	10	(19)	(2)
Other operational costs	6	(361)	(306)
PROFIT FROM OPERATIONS		3,135	669
Expenses on profit tax	7	313	67
NET PROFIT FOR THE YEAR		2,822	602
OTHER COMPREHENSIVE INCOME		0	0
TOTAL COMPREHENSIVE INCOME, NET OF TAXES		2,822	602

Executive Director:

Prepared by
(Fiscalia EOOD)

Audited by:
(BDO Bulgaria Ltd.)

Stoyanka Apostolova, Manager
CPA, Registered auditor



BALANCE SHEET
As of 31 December 2009

	Notes	31 December 2009 BGN'000	31 December 2008 BGN'000
ASSETS			
Receivables on subscribed shares		0	0
Cash and cash equivalents	8	66,489	30,620
Receivables and prepaid expenses	9	5	52
Equipment and other long-term assets	10	42	57
Deferred tax assets		1	2
Extended loans	11	48,508	0
TOTAL ASSETS		115,045	30,731
LIABILITIES			
Liabilities under EBRD loan	12	51,574	0
Liabilities to staff and social insurance liabilities	13	57	38
Tax liabilities	14	258	72
Other liabilities	15	3	19
TOTAL LIABILITIES		51,892	129
EQUITY			
Authorized capital	16	60,000	30,000
Statutory reserves	16	60	0
Retained earnings	16	3,093	602
TOTAL EQUITY		63,153	30,602
TOTAL LIABILITIES AND EQUITY		115,045	30,371

Executive Director:

Prepared by:
(Fiscala EOOD)

Audited:
(BDO Bulgaria Ltd.)

Stoyanka Apostolova, Manager
CPA, Registered auditor



