# SAVINGS BANK OF THE RUSSIAN FEDERATION

## Financial Statements and Auditors' Report

## 31 December 1999

## Contents

PRICEWATERHOUSE

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**AUDITORS' REPORT**

**To the Shareholders and Supervisory Council of the Savings Bank of the Russian Federation:**

We have audited the accompanying balance sheet of the Savings Bank of the Russian Federation ("the Bank") as at 31 December 1999, and the related statements of income, of cash flows and of changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Bank's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the 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 the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 4, the accompanying financial statements do not comply with the requirements of International Accounting Standard 29 "Financial Reporting in Hyperinflationary Economies". An estimate of the effect of IAS 29 on the balance sheet, the statement of income and the statement of cash flows is presented in Note 30.

In our opinion, except for the effect on the financial statements of the matter referred to in paragraph 3 above, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 1999 and the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards.

Without further qualifying our opinion, we draw your attention to Note 2 to the financial statements. The operations of the Bank, and those of similar financial institutions having operations in the Russian Federation, have been affected, and may continue to be affected for the foreseeable future by the continuing regulatory, political and economic uncertainties existing for enterprises operating in the Russian Federation.

Moscow, Russia
31 May 2000

***Savings Bank of the Russian Federation***
***Balance Sheet as at 31 December 1999***
*(expressed in thousands of Russian Roubles - Note 3)*

| | Note | 1999 | 1998 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 5 | 21 281 813 | 19 280 745 |
| Mandatory cash balances with the CBRF | | 22 319 097 | 8 657 838 |
| Dealing securities | 6 | 8 212 037 | 580 947 |
| Loans and advances to banks | 7 | 16 612 631 | 6 562 224 |
| Loans and advances to customers | 8 | 119 885 961 | 32 360 614 |
| Investment securities | 9 | 128 499 852 | 113 665 021 |
| Other investments | 10 | 136 257 | 164 237 |
| Other assets | 11 | 13 289 923 | 11 465 008 |
| Premises and equipment | 12 | 37 426 297 | 24 089 338 |
| **Total assets** | | **367 663 868** | **216 825 972** |
| **Liabilities** | | | |
| Deposits from banks | 13 | 7 117 422 | 1 219 556 |
| Deposits from individuals | 14 | 228 049 244 | 149 991 349 |
| Customer accounts | 14 | 73 487 772 | 39 570 959 |
| Bills of exchange | | 25 654 985 | 6 282 320 |
| Other borrowed funds | 15 | 540 000 | 1 631 350 |
| Deferred tax liability | 21 | 7 161 181 | 3 055 171 |
| Other liabilities | 16 | 7 802 612 | 12 938 967 |
| **Total liabilities** | | **349 813 216** | **214 689 672** |
| **Shareholders' equity** | | | |
| Share capital | 17 | 750 100 | 750 100 |
| Share premium | 18 | 828 599 | 828 599 |
| Revaluation reserve for premises and equipment | 12 | 14 043 010 | 6 537 787 |
| Retained earnings/(Accumulated deficit) and other reserves | | 2 236 029 | (5 945 327) |
| Treasury shares | 17 | (7 086) | (34 859) |
| **Total shareholders' equity** | | **17 850 652** | **2 136 300** |
| **Total liabilities and shareholders' equity** | | **367 663 868** | **216 825 972** |

Signed on behalf of the Board of Directors on 31 May 2000.

President

Chief Accountant

*(expressed in thousands of Russian Roubles - Note 3)*

| | Note | 1999 | 1998 |
|---|---|---|---|
| Interest income on loans | | 28 755 782 | 11 140 112 |
| Interest income on investment securities | | 31 448 540 | 22 127 026 |
| Interest expense | | (47 132 983) | (24 190 936) |
| **Net interest income** | | **13 071 339** | **9 076 202** |
| Provision for losses on loans and advances | 7, 8 | (9 112 845) | (12 831 235) |
| **Net interest income/(negative interest margin) after provision for losses on loans and advances** | | **3 958 494** | **(3 755 033)** |
| Gains less losses arising from securities | | 2 912 623 | 252 570 |
| Gains less losses arising from dealing in foreign currency | | 4 103 940 | (2 434 371) |
| Foreign exchange translation gains less losses | | 22 456 850 | 35 846 469 |
| Fee and commission income | | 4 432 369 | 2 479 907 |
| Fee and commission expense | | (234 764) | (360 993) |
| Other operating income | 19 | 2 356 725 | 1 318 753 |
| **Operating income** | | **39 986 237** | **33 347 302** |
| Staff costs | | (14 571 345) | (9 583 465) |
| General, administrative and other operating expenses | 20 | (12 443 113) | (9 159 672) |
| Recovery / (provision) for losses on derivative foreign exchange contracts | 27 | 219 709 | (6 198 384) |
| Provision for diminution in value of investment securities and other investments | 9, 10 | (80 221) | (722 224) |
| **Profit before provisions on federal government securities and taxation** | | **13 111 267** | **7 683 557** |
| Provision for federal government securities | 3, 9 | - | (20 000 000) |
| **Profit/(loss) before taxation** | | **13 111 267** | **(12 316 443)** |
| Taxation | 20 | (4 895 165) | (2 516 266) |
| **Net profit/(loss)** | | **8 216 102** | **(14 832 709)** |
| **Earnings/(loss) per share**, basic and diluted (expressed in RR per share) | 22 | **585.68** | **(1 121.91)** |

*(expressed in thousands of Russian Roubles - Note 3)*

| | Note | 1999 | 1998 |
|---|---|---|---|
| **Cash Flows From Operating Activities** | | | |
| Interest received on loans | | 27 718 290 | 11 048 593 |
| Interest received on investment securities | | 25 487 518 | 11 341 030 |
| Interest paid | | (46 971 605) | (22 274 899) |
| Realised gains less losses from dealing in securities | | 3 395 016 | 257 637 |
| Realised gains less losses from dealing in foreign currency | | (41 905) | (3 630 719) |
| Commissions received | | 4 432 369 | 2 479 907 |
| Commissions paid | | (234 764) | (360 993) |
| Other operating income received | | 2 353 510 | 1 314 726 |
| Staff costs paid | | (14 571 345) | (9 583 465) |
| General administrative and other operating expenses paid | | (10 079 631) | (7 250 563) |
| Income tax paid | | (2 615 671) | (4 376 016) |
| **Operating losses before changes in operating assets and liabilities** | | **(11 128 218)** | **(21 034 762)** |
| **(Increase)/Decrease in Operating Activities** | | | |
| Net (increase)/decrease in mandatory cash balances with the CBRF | | (13 661 259) | 2 764 995 |
| Net decrease in securities | | 5 935 045 | 21 607 867 |
| Net increase in loans and advances to banks | | (8 666 573) | (4 946 365) |
| Net increase in loans and advances to customers | | (89 246 500) | (5 489 533) |
| Net decrease/(increase) in other assets | | 600 388 | (1 704 560) |
| Net increase/(decrease) in deposits from banks | | 5 591 360 | (7 464 829) |
| Net increase/(decrease) in deposits from individuals | | 68 347 663 | (581 239) |
| Net increase in customer accounts | | 30 673 202 | 19 002 465 |
| Net increase in bills of exchange | | 18 949 611 | 4 386 506 |
| Net (decrease)/increase in other liabilities | | (3 322 430) | 3 519 133 |
| **Net cash from operating activities** | | **4 072 289** | **10 059 678** |
| **Cash Flows From Investing Activities** | | | |
| Purchase of premises and equipment | | (4 002 888) | (3 442 008) |
| Disposal of premises and equipment | | 404 958 | 524 032 |
| Disposal of other investments | | 179 838 | 241 298 |
| Dividends received from other investments | | 3 215 | 4 027 |
| **Net cash used in investing activities** | | **(3 414 877)** | **(2 672 651)** |
| **Cash Flows From Financing Activities** | | | |
| Issue of ordinary shares | | - | 700 000 |
| Sale of treasury shares | | 27 773 | 50 831 |
| Other funds borrowed | | - | 792 018 |
| Repayment of other borrowed funds | | (1 399 410) | (3 403 412) |
| Dividends paid | | (341 618) | (146 644) |
| **Net cash used in financing activities** | | **(1 713 255)** | **(2 007 207)** |
| **Effect of exchange rate changes on cash and cash equivalents** | | **3 056 911** | **5 937 936** |
| **Net increase in cash and cash equivalents** | | **2 001 068** | **11 317 756** |
| Cash and cash equivalents at beginning of the year | | 19 280 745 | 7 962 989 |
| **Cash and cash equivalents at the end of the year** | 5 | **21 281 813** | **19 280 745** |

**Note:** The effect of revaluation of foreign currency balances on the Bank's assets and liabilities was eliminated from the above statement of cash flows.

*(expressed in thousands of Russian Roubles - Note 3)*

| | **Share capital** | **Treasury shares** | **Share premium** | **Revaluation reserve for premises and equipment** | **Retained earnings / (Accumulated deficit) and other reserves** | **Total share-holders' equity** |
|---|---|---|---|---|---|---|
| **Balance at 1 January 1998** | **700 100** | **(37 362)** | **178 599** | **2 603 026** | **8 743 640** | **12 188 003** |
| Share issue (Note 17) | | | | | | |
| - Nominal value | 50 000 | - | - | - | - | 50 000 |
| - Share premium | - | - | 650 000 | - | - | 650 000 |
| Purchase and sale of treasury shares, net | - | 2 503 | - | - | - | 2 503 |
| Revaluation of premises, net (Note 12) | - | - | - | 7 133 674 | - | 7 133 674 |
| Recognition of deferred tax liability in respect of revaluation of premises (Note 21) | - | - | - | (3 055 171) | - | (3 055 171) |
| Reclassification of depreciation charged in the statement of operations in respect of revaluation reserve | - | - | - | (143 742) | 143 742 | - |
| Net loss for the year | - | - | - | - | (14 832 709) | (14 832 709) |
| **Balance at 31 December 1998** | **750 100** | **(34 859)** | **828 599** | **6 537 787** | **(5 945 327)** | **2 136 300** |
| Purchase and sale of treasury shares, net | - | 27 773 | - | - | - | 27 773 |
| Revaluation of premises, net (Note 12) | - | - | - | 12 069 263 | - | 12 069 263 |
| Recognition of deferred tax liability in respect of revaluation of premises (Note 21) | - | - | - | (4 244 881) | - | (4 244 881) |
| Reclassification of realized deferred tax benefit (Note 21) | - | - | - | 138 871 | (138 871) | - |
| Reclassification of depreciation charged in the statement of income in respect of revaluation reserve | - | - | - | (458 030) | 458 030 | - |
| Net profit for the year | - | - | - | - | 8 216 102 | 8 216 102 |
| Dividends declared (Note 23) | | | | | | |
| - Ordinary shares | - | - | - | - | (315 045) | (315 045) |
| - Preference shares | - | - | - | - | (38 860) | (38 860) |
| **Balance at 31 December 1999** | **750 100** | **(7 086)** | **828 599** | **14 043 010** | **2 236 029** | **17 850 652** |

## 1 Principal Activities

Savings Bank of the Russian Federation (the "Bank") is a joint stock commercial bank formed in 1841 and has operated in various forms since then. The Bank's principal shareholder, the Central Bank of the Russian Federation, owns 57.66% of the issued shares at 31 December 1999. The Bank is registered in the Russian Federation to carry out banking activities and has operated under a full banking license issued by the Central Bank of the Russian Federation ("CBRF") since 1991. The Bank's principal business activity is retail and commercial banking operations within the Russian Federation. Deposits of individuals placed with the Bank are guaranteed by the State.

The Supervisory Council of the Bank is headed by the Chairman of the CBRF and co-chaired by the authorised representative of the president of Russia for the relations with international financial organisations and the Deputy Chairman of the CBRF. The Supervisory Council also includes representatives from the Agency for Restructuring of Credit Organisations and from the Bank's shareholders.

The Bank has 25 041 branches within the Russian Federation. The main office of the Bank is located at 117817, Moscow, Vavilova St. 19. The average number of the Bank's employees during 1999 was 199 491.

## 2 Effect of Economic Conditions in the Russian Federation on the Financial Statements of the Bank

The Russian Federation continues to experience economic difficulties following the financial crisis of August 1998. Consequently, the country's currency continues to devalue, there is continued volatility in the debt and equity market, hyperinflation persists, confidence in the banking sector has yet to be fully restored and there continues to be a general lack of liquidity in the economy. In addition, laws and regulations affecting businesses operating within the Russian Federation, as well as throughout the CIS, continue to change rapidly. The Russian Federation's return to economic stability is dependent to a large extent on the effectiveness of the measures taken by the government, decisions of international lending organisations, and other factors, including regulatory and political developments, which are beyond the Bank's control. The Bank's assets and operations could be at risk if there is any further significant adverse changes in the political and business environment. Management is unable to predict what effect the outcome of any future event might have on the financial position of the Bank. No adjustments related to these particular risks have been included in the accompanying financial statements.

Specific components of the Bank that have been affected include, but are not limited to, the securities portfolio, loans and advances and forward foreign exchange contracts. In the Bank's 1998 and 1999 financial statements, the Bank has:

- Recorded a provision in respect of the Bank's investment in the federal debt securities portfolio relating to the decline in their value which Management regards as other than temporary, and has recorded write-downs to reduce the carrying value of the remaining securities portfolio to estimated market values;

- Recorded charges, based on Management's best estimates of the current circumstances, in the statement of income to adjust the provision for loan losses to a level which Management believes is sufficient to cover losses inherent in the loan portfolio; and

- Incurred significant contractual losses on forward foreign exchange contracts where the Bank had agreed to sell other currencies in exchange for Russian Roubles. For contracts where the Bank had agreed to sell Russian Roubles in exchange for other currencies, the Bank has significant contractual gains, though there is a credit risk attached to the collectability of these gains and accordingly such gains have been provided for to the extent they are regarded as uncollectable.

In addition, economic conditions have caused a significant decline in the volume of activity in the financial markets. Market quotations may not be reflective of the values for securities which would be determined in an efficient, active market involving willing buyers and willing sellers.

## 3 Basis of Presentation

***Basis of Presentation.*** The Bank maintains its accounting records in accordance with Russian banking regulations. These financial statements have been prepared from those accounting records and adjusted as necessary in order to comply, in all material respects, with International Accounting Standards ("IAS") issued by the International Accounting Standards Committee, except that the financial statements have not been adjusted for hyperinflation as required by IAS 29 “Financial Reporting in Hyperinflationary Economies”, and that certain equipment have been revalued in the first quarter of 1998 as of 1 January 1997 according to guidelines prescribed by the Government of the Russian Federation as set out in Note 4. These guidelines would not necessarily state the value of the assets at their fair value at the date of the revaluation as required by IAS 16 “Property, Plant and Equipment”.

The financial statements are presented in the national currency of the Russian Federation, the Russian Rouble ("RR").

Where necessary, corresponding figures have been adjusted to conform with changes in the presentation of the current year.

## 4 Significant Accounting Policies

***Consolidated financial statements.*** Consolidated financial statements have not been prepared since the financial position of the Bank as at 31 December 1999 and its results for the year then ended would not be materially altered by consolidation of subsidiaries and associated companies. Investments in non-consolidated subsidiaries and associated companies have been included within other investments (Note 10) in these financial statements, and have been recorded at cost less a provision for diminution in value.

***Cash and cash equivalents.*** Cash and cash equivalents are items which can be converted into cash within a day. All short term interbank placements, beyond overnight deposits and correspondent accounts denominated in precious metals, are included in loans and advances to banks.

***Mandatory balances with the CBRF.*** Mandatory balances with the Central Bank of the Russian Federation ("CBRF") represent mandatory reserve deposits which are not available to finance the Bank's day to day operations and hence are not considered as part of cash and cash equivalents for the purposes of the cash flow statement.

***Precious metals.*** Precious metals are represented primarily by correspondent accounts denominated in gold and other precious metals, and are recorded at current CBRF purchase prices which are quoted at a discount to London metal exchange prices.

***Loans and provisions for bad and doubtful debts.*** Loans are stated at the principal amounts outstanding net of provisions for losses on loans.

Provisions for losses on loans are based on the evaluation by Management of the collectability of loans and advances. Specific provisions are raised against debts whose recovery has been identified as doubtful. A general provision is raised against the latent bad and doubtful loans which are inherent in the loan portfolio but which at the date of preparing the financial statements have not been specifically identified. Recoveries of amounts previously provided for are treated as income by reducing the provision for losses on loans for the year. The net aggregate provisions raised during the year are recognised in the statement of income.

Estimates of losses require the exercise of judgement and the use of assumptions. The principal factors considered in determining the loan loss provision are the growth, composition and quality of the loan portfolio, the ability of the individual borrowers to repay the loans, the past performance history of the individual loans, the level of past due loans, current economic conditions, the value and adequacy of collateral and sector and regional concentration.

Loans and advances that cannot be recovered are written off and charged against the provision for losses on loans. Such loans are written off after all the necessary legal procedures have been completed and the amount of the loss has been determined.

***Other credit related commitments.*** In the normal course of business, the Bank enters into other credit related commitments including loan commitments, letters of credit and guarantees. The accounting policy and provisioning methodology is similar to that for loans noted above.

## 4 Significant Accounting Policies (Continued)

***Securities.*** The Bank generally allocates its securities between dealing and investment portfolios based on Management's intention to hold such securities either for the short or long term. Transfers of securities between the two portfolios are made at fair market value. The Bank's accounting policies for dealing and investment securities are as follows:

- **Dealing securities**. Dealing securities, which are held for trading purposes, are stated at market value. All interest income and gains/losses realised and unrealised from trading in dealing securities are reported in gains less losses arising from dealing securities.

- **Investment securities.** Investment securities are those which Management intends and is able to hold until maturity, and are stated at cost as adjusted for the amortization of discounts on purchase over the period to maturity. The amortised discount and coupons earned on investment securities are reflected in the statement of income as interest income on investment securities. A provision for diminution in the value of investments is made where the value of an investment security has declined, and Management believes that the decline is not temporary in nature.

Because of inherent settlement risk within the securities market, security purchases and sales are recorded on the date that ownership is transferred.

***Other investments.*** Other investments include the Bank's investments in subsidiaries and associated companies, which have not been accounted for on a consolidation basis or on an equity accounting basis, and trade investments held for the long-term purposes. These investments are carried at cost less any provision for permanent diminution in value, created in cases where the value of an investment has declined, and Management believes that such decline is not temporary in nature. Income derived from these investments is accounted for on a cash basis.

***Sale and repurchase agreements.*** Sale and repurchase agreements ("repo") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are included in dealing securities. The corresponding liability is presented under deposits from banks. Securities purchased under agreements to resell ("reverse repo") are recorded as loans and advances to banks or customers as appropriate. The differences between the sale and repurchase prices are treated as interest and accrued evenly over the life of the repo or reverse-repo agreement.

***Premises and Equipment.*** Premises and equipment are stated at cost or revalued amounts, as described below, less accumulated depreciation.

Premises of the Bank have been revalued to market value as of 31 December 1999. The revaluation was performed on the basis of an independent appraisal performed by an international real estate appraisal company. The basis used for the appraisal was the sales comparison method. Accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the Bank's premises, and the net amount is restated to the revalued amount of the asset.

Equipment was last revalued per Russian statutory rules during 1998 as of 1 January 1997. The revaluation was performed based on government indices. The indices applied are provided by the State Statistics Committee of the Russian Federation and are designed to restate the carrying value of such asset to a level, which more closely reflects market value. The indices vary according to asset type and acquisition date.

Construction in progress is carried at cost less provision for any permanent loss of value. Upon completion, assets are transferred to premises and equipment at cost. Construction in progress is not depreciated until the asset is available for use.

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and maintenance are charged to the statement of income when the expenditure is incurred.

***Depreciation.*** Depreciation is applied on a straight-line basis over the estimated useful lives of the assets using the following rates:

Premises 2.5% per annum (remaining average useful life of 22 years); and

**4 Significant Accounting Policies (Continued)**

Equipment 10-25% per annum.

***Bills of exchange***. Bills of exchange issued by the Bank to its customers, more commonly known as "veksels", carry a fixed date of repayment. These may be issued against cash deposits or as a payment instrument, which the customer can discount in the over-the-counter secondary market. Bills of exchange issued by the Bank are recorded at nominal value with the corresponding discount recorded to other assets and amortised to the statement of income using the effective interest rate method.

The Bank also purchases bills of exchange from its customers or in the market. These bills are carried at cost and the discount against the nominal value is accrued over the period to maturity. Provision is made, based on Management's assessment, for bills of exchange that are considered uncollectable. Bills of exchange are included in loans to customers or to banks, depending on their issuers.

***Treasury shares.*** Shares of the Bank owned by the Bank, and held at the balance sheet date, are designated as treasury shares. The cost of such shares is shown as a reduction in shareholders' equity.

***Dividends.*** Dividends payable are not accounted for until they have been ratified at the Bank's Annual Shareholders' Meeting. Dividends are accounted for in accordance with IAS 10 (revised) "Events After the Balance Sheet Date".

***Income taxes.*** Taxation has been provided for in the financial statements in accordance with Russian legislation currently in force. Taxation on the profit or loss for the year comprises current tax and changes in deferred tax. Current tax is calculated on the basis of the expected taxable profit for the year, using the tax rates enacted at the balance sheet date. Taxes, other than on income, are recorded within general, administrative and other operating expenses.

Deferred income tax is provided, using the balance sheet liability method, for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

The deferred tax liability arising on the revaluation of premises is charged through the statement of income based on the estimated useful life of the underlying premises. A corresponding transfer is also recorded in the statement of equity to reflect the realization of this portion of the net revaluation reserve.

***Income and expense.*** Interest income and expense are recognised in the statement of income on an accrual basis. Interest income is suspended when overdue by more than 30 days and is excluded from interest income in the statement of income until received. Interest income on investment securities includes coupons earned on fixed income investment securities and accrued discounts on federal government securities. Commissions and other income are credited to income when the related transactions are completed. Non-interest expenses are recognised as incurred.

***Foreign currency translation.*** Transactions denominated in foreign currency are recorded at the exchange rate ruling at the transaction date. Exchange differences resulting from the settlement of transactions denominated in foreign currency are included in the statement of income using the exchange rate ruling on that date.

Monetary assets and liabilities denominated in foreign currency are translated into Russian Roubles at the official exchange rate of the CBRF at the balance sheet date. Foreign currency gains and losses arising from the translation of assets and liabilities are reflected in the statement of income as foreign exchange translation gains less losses. As at 31 December 1999 the principal rate of exchange used for translating foreign currency balances was USD 1 = RR 27.00 (1998: USD 1 = RR 20.65). Exchange restrictions and controls exist relating to converting Russian Roubles into other currencies. At present, the Russian Rouble is not a convertible currency outside of the Russian Federation.

## 4 Significant Accounting Policies (Continued)

***Derivative financial instruments.*** Derivative financial instruments include forward and spot transactions, and option contracts in foreign exchange markets. The Bank's normal policy is to measure these instruments using contractual rates, with resultant gains or losses being reported within gains less losses arising from dealing in foreign currency within the statement of income. The current economic circumstances have necessitated the Bank to adopt specific accounting methods. The following describes the accounting methods followed by the Bank:

Index Forwards

- The Bank has either paid the amount due under index contracts, and realised a loss/gain, or negotiated a settlement for a lesser amount and has recognised a loss/gain based on the agreed terms, or has not settled with the counterparty. Where no settlements or agreements have been reached the loss/gain on the index contracts has been recognised applying the rate of exchange ruling at the date of the contract maturity, for domestic counterparties, and the year end exchange rate, for foreign counterparties. This difference in the application of exchange rates is due to the fact that settlements with domestic counterparties in the normal course of business have been performed in Roubles, and with foreign counterparties – in foreign currency.

  Gains and losses recognised on the index contracts have been offset within each counterparty since existing legal practice provides that there is a legally enforceable right to offset these amounts, and management intends to settle all the contracts with the same counterparty on a net basis.

Deliverable Forwards

- The Bank has either paid the amount due under deliverable contracts and recognised a loss/gain, or negotiated a settlement for a lesser amount and has recognised a loss/gain based on the agreed terms, or has not settled with the counterparty. Where no settlements or agreements have been reached the loss/gain on the deliverable contracts has been recognised based on the year end exchange rate. Gains and losses on the deliverable contracts have not been offset within counterparty.

Options

- Where conditions of an option agreement include the actual delivery of currency, the Bank has recognised a loss/gain in the same way as for the deliverable forward contracts, otherwise the Bank has used index forwards approach.

Management has made significant provisions against the receivables related to recognised gains where collectability is doubtful.

***Offsetting.*** Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

***Accounting for the effects of hyperinflation.*** The Russian Federation continues to experience relatively high levels of inflation. In accordance with IAS 29, "Financial Reporting in Hyperinflationary Economies", these financial statements should be adjusted to reflect the effects of the change in purchasing power of the Russian Rouble based on general price indices in the country. These adjustments have not been made and the amounts in these financial statements are stated at historical cost, except for premises and equipment. The approximate effect of hyperinflation adjustments that would be required under IAS 29 is disclosed in Note 30.

***Pension costs.*** The Bank contributes to the Russian Federation state pension schemes, social insurance and employment funds in respect of its employees. The Bank's pension scheme contributions amount to 28% of employees' gross salaries, and are expensed as incurred. The contributions are included into staff costs.

***Year 2000 costs.*** External and internal costs specifically associated with modifying internal-use software for the year 2000 are charged to the statement of income as incurred.

*(expressed in thousands of Russian Roubles - Note 3)*

***Operating leases.*** Payments made under operating leases are charged against income in equal instalments over the period of the lease.

## 5 Cash and Cash Equivalents

| | 1999 | 1998 |
|---|---|---|
| Cash on hand | 10 289 040 | 6 184 429 |
| Cash balances with the CBRF (other than mandatory reserve deposits) | 5 654 889 | 5 023 230 |
| Correspondent accounts and placements with other banks | | |
| - Russian Federation | 205 706 | 132 963 |
| - Other countries | 2 856 219 | 7 263 571 |
| Precious metals | 2 275 959 | 676 552 |
| **Total cash and cash equivalents** | **21 281 813** | **19 280 745** |

## 6 Dealing Securities

| | 1999 | 1998 |
|---|---|---|
| **Federal government securities** | | |
| **RR denominated** | | |
| Federal loan bonds (OFZ) | 4 235 020 | - |
| **USD denominated** | | |
| Russian Federation Eurobonds | 1 159 364 | - |
| VneshEconomBank 3% coupon bonds (VEB) | 1 299 738 | - |
| **Total federal government securities** | **6 694 122** | **-** |
| **Other RR denominated securities** | | |
| Local government bonds | 724 454 | - |
| Corporate shares | 681 013 | 281 655 |
| Other RR denominated securities | 112 448 | 299 292 |
| **Total dealing securities** | **8 212 037** | **580 947** |

Federal government securities held for dealing purposes are reflected at year end market value. For a detailed description of federal government securities in the Bank's portfolio refer to Note 9.

Local government bonds are bonds issued by municipal and regional governments. Included in the Bank's dealing portfolio are municipal bonds of the city of St Petersburg which are reflected at year end market value.

Corporate shares are shares of Russian companies. They are reflected at year-end market value, which has been estimated by the Management using (1) last traded prices; (2) maximum bid prices; and (3) minimum ask prices obtained from the Russian Trade System (RTS) and over-the-counter market. However, the market for most of these shares has been illiquid, and therefore the prices used may not reflect the value of these shares that could be obtained in a transaction between a willing buyer and a willing seller. The purchase price of the shares was RR 1 593 722 thousand resulting in a write-down of RR 912 709 thousand (1998: RR 460 507 thousand). This write-down has been reflected within gains less losses arising from securities in the statement of income.

*(expressed in thousands of Russian Roubles - Note 3)*

Other RR denominated securities consist mostly of other types of bonds issued by the Ministry of Finance of the Russian Federation and are stated at year end market value which has been estimated by Management and has resulted in a write-down of RR 8 012 thousand (1998: RR 8 662 thousand). This write-down has been reflected within gains less losses arising from securities in the statement of income.

## 7 Loans and Advances to Banks

| | 1999 | 1998 |
|---|---|---|
| Current loans | 17 191 193 | 6 704 259 |
| Overdue loans | 442 240 | 716 342 |
| Less: Provision for losses on loans | (1 020 802) | (858 377) |
| **Total loans and advances to banks** | **16 612 631** | **6 562 224** |

Movements in provision for losses on loans are as follows:

| | 1999 | 1998 |
|---|---|---|
| **Provision for losses on loans at 1 January** | **858 377** | **424 000** |
| Charge against profits for losses on loans in the year | 341 576 | 930 892 |
| Loans written off during the year as uncollectable | (179 151) | (496 515) |
| **Provision for losses on loans at 31 December** | **1 020 802** | **858 377** |

The average interest rate on loans and advances to banks during 1999 was 21.4% on loans placed in Russian Roubles and 5% on loans in foreign currency.

A further breakdown of loans and advances to banks is set out as follows:

| | 1999 | 1998 |
|---|---|---|
| Russian Federation, except for loans to the CBRF | 5 743 282 | 2 590 554 |
| CBRF | - | 3 200 000 |
| Other countries | 11 890 151 | 1 630 047 |
| **Total loans and advances to banks** | **17 633 433** | **7 420 601** |

The majority of loans and advances to foreign banks are placed with Western European banking institutions.

Included in loans and advances to banks as at 31 December 1998 are loans of RR 722 750 thousand issued under "reverse repo" agreements against the receipt of securities and therefore these loans are fully collateralised (1999: Nil).

Currency analysis of loans and advances to banks is disclosed in Note 24. The maturity structure of the loan portfolio is detailed in Note 26.

*(expressed in thousands of Russian Roubles - Note 3)*

## 8 Loans and Advances to Customers

| | 1999 | 1998 |
|---|---|---|
| Current loans | 140 419 753 | 40 321 600 |
| Overdue loans | 6 524 784 | 10 840 823 |
| Less: Provision for losses on loans | (27 058 576) | (18 801 809) |
| **Total loans and advances to customers** | **119 885 961** | **32 360 614** |

Movements in provision for losses on loans are as follows:

| | 1999 | 1998 |
|---|---|---|
| **Provision for losses on loans at 1 January** | **18 801 809** | **8 449 640** |
| Charge against profit for losses on loans in the year | 8 771 269 | 11 900 343 |
| Loans written off during the year as uncollectable | (514 502) | (1 548 174) |
| **Provision for losses on loans at 31 December** | **27 058 576** | **18 801 809** |

Economic sector risk concentrations within the customer loan portfolio are as follows:

| | 1999 | | 1998 | |
|---|---|---|---|---|
| | **Amount** | **%** | **Amount** | **%** |
| Government and municipal bodies | 31 295 297 | 21.3 | 7 565 982 | 14.8 |
| Oil, gas and chemical | 27 335 437 | 18.6 | 3 123 269 | 6.1 |
| Construction | 15 750 274 | 10.7 | 11 515 979 | 22.5 |
| Trade | 15 672 996 | 10.7 | 6 241 496 | 12.2 |
| Food and agriculture | 10 565 288 | 7.2 | 2 669 548 | 5.2 |
| Machine-building | 7 477 132 | 5.1 | 4 780 431 | 9.3 |
| Telecommunications | 6 087 524 | 4.1 | 693 353 | 1.4 |
| Individuals | 5 663 223 | 3.9 | 4 013 296 | 7.8 |
| Metallurgy | 4 205 337 | 2.9 | 987 376 | 2.0 |
| Energy | 3 571 734 | 2.4 | 1 156 288 | 2.3 |
| Timber industry | 2 951 514 | 2.0 | 1 763 340 | 3.4 |
| Transport, aviation and space | 2 611 900 | 1.8 | 1 083 732 | 2.1 |
| Other | 13 756 881 | 9.3 | 5 568 333 | 10.9 |
| **Total loans and advances to customers (aggregate amount)** | **146 944 537** | **100.0** | **51 162 423** | **100.0** |

The Bank has 12 borrowers with aggregated loan amounts above RR 1 800 000 thousand. The aggregate amount of these loans is RR 62 328 599 thousand or 42% of the loan portfolio. The aggregate amount of loan loss provision related to these borrowers amounted to RR 6 519 512 thousand. Loans to the two largest borrowers, represented by a government body and a large industrial company, amounted to RR 29 800 000 thousand or 20.3% of the gross loan portfolio.

The average interest rate on loans and advances to customers during 1999 was 40.2% on loans placed in Russian Roubles and 12.9% on loans in foreign currency.

*(expressed in thousands of Russian Roubles - Note 3)*

Geographical and currency analysis of loans and advances to customers is disclosed in Note 24. The maturity structure of the loan portfolio is detailed in Note 26. The Bank has several loans to related parties. The relevant information on related party loans is disclosed in Note 29.

## 9 Investment Securities

| | 1999 | 1998 |
|---|---|---|
| **Federal government securities** | | |
| **RR denominated** | | |
| Federal short term zero coupon bonds (GKO) | - | 31 031 323 |
| Federal loan bonds (OFZ) | 32 891 531 | 10 631 155 |
| Federal savings bonds (OGSZ) | 4 366 369 | 10 101 591 |
| **USD denominated** | | |
| Russian Federation Eurobonds | 72 449 818 | 52 515 825 |
| VneshEconomBank 3% coupon bonds (VEB) | 37 073 975 | 27 706 046 |
| **Total federal government securities before provision** | **146 781 693** | **131 985 940** |
| Less: Provision for diminution in value of federal government securities | (20 000 000) | (20 000 000) |
| **Total federal government securities** | **126 781 693** | **111 985 940** |
| **Other RR denominated securities** | | |
| Local government bonds | 1 226 421 | 1 679 081 |
| **Other USD denominated securities** | | |
| Ukraine government bonds | 491 738 | - |
| **Total securities** | **128 499 852** | **113 665 021** |

GKO and OFZ bonds are federal government securities issued and guaranteed by the Ministry of Finance of the Russian Federation. GKO bonds are purchased at a discount to nominal value. OFZ bonds have a medium to long term maturity period and are otherwise identical to GKOs but with a coupon rate of 5-30% in 1999, depending on the type of bond issue.

At 31 December 1998, the Bank's holdings comprised RR 39 916 498 thousand (nominal value RR 53 090 098 thousand) in defaulted GKO and OFZ obligations of the Russian government and RR 1 745 980 thousand (nominal value RR 2 202 429 thousand) in non-defaulted obligations. The Bank elected to participate in the Russian government's debt restructuring program. The estimated fair value of the OFZ bond portfolio at 31 December 1999 is RR 18 985 113 using quoted market prices as a basis. In the beginning of year 2000 the market quotes for Russian state debt securities increased, and at 31 May 2000 the market value of the Bank's OFZ portfolio totalled RR 29 850 084 thousand.

OGSZ are savings bonds sold by the Ministry of Finance to banks for resale to the general public. During 1999, the coupon rate varied for different tranches of OGSZ in the range of 46.66%-65.26%. OGSZ have maturity dates from 21 January 2000 to 15 January 2001. The market value of the Bank's OGSZ portfolio at 31 December 1999 is RR 4 506 640 thousand (RR 4 191 966 thousand at 31 May 2000).

Eurobonds are securities issued by the Ministry of Finance of the Russian Federation, which are freely tradable internationally. The major part of the Bank's portfolio of Eurobonds consists of two tranches with maturity dates in July 2005 and July 2018. The annual coupon rates on these bonds are 8.75% and 11%, respectively, and interest is payable semi-annually. These Eurobonds were obtained by the Bank from the Ministry of Finance in July 1998 in exchange for part of the Bank's GKO portfolio in an open auction following a securities restructuring offer from the

*(expressed in thousands of Russian Roubles - Note 3)*

Ministry of Finance. The market value of the Bank's Eurobond portfolio at 31 December 1999 is RR 57 181 693 thousand (RR 66 532 458 thousand at 31 May 2000).

## 9 Investment Securities (Continued)

VEB bonds are bearer securities, which carry the guarantee of the Ministry of Finance of the Russian Federation. The securities are commonly referred to as "MinFin bonds" and are freely tradable internationally. The bonds are purchased at a discount to nominal value and carry an annual coupon interest of 3%. The bonds have maturity dates ranging from 1999 to 2011. The market value of the Bank's VEB bond portfolio at 31 December 1999 is RR 18 600 144 thousand (RR 21 649 610 thousand as 31 May 2000). Certain tranches of the VEB bond portfolio in respect of the former USSR state debt are currently being restructured.

In 1998 the Bank recorded a provision of RR 20 000 000 thousand in respect of the carrying value, including amortised discount, of federal government securities based on its assessment that the decline in value of these securities is other than temporary. The provision was created taking into consideration factors such as the subsequent improvement in market value of government securities, the Bank's ability to hold these securities to their maturity, down-grading of Russian Government credit risk rating by international rating agencies and other macroeconomic factors. In estimating the amount of provision, Management considered the above factors, including subsequent improvement in market value of these securities up until the opinion date of these financial statements, which is May 31, 2000. Accordingly, a provision in the same amount is also recorded in the Bank's 1999 financial statements , which are issued concurrently with the 1998 financial statements. The Bank has treated this provision on federal government securities as an exceptional item with respect to the Bank's overall performance and has classified this provision as a separate line within the statement of income.

Local government bonds are bonds issued by municipal and regional governments. Most of these bonds are not freely tradable in the Russian markets and are stated at cost less provision of RR 430 175 thousand for diminution in value of these bonds (1998: RR 688 002 thousand).

Ukrainian Ministry of Finance bonds, ratified by the Ukrainian government on 16 December 1995, were issued as a settlement of Ukraine's debt to RAO Gazprom for the supply of natural gas. The bonds are USD denominated, have maturities from 2000 to 2006 and carry a coupon of 8.5% per annum being paid on a quarterly basis. In May 2000, the Bank participated in the restructuring program for these bonds under which it has received cash settlement and new bonds. The new bonds carry a coupon of 11% per annum and are redeemable in installments with final repayment due on 15 March 2007. These bonds are reflected at cost less provision for diminution in value of RR 489 906 thousand.

The provision for diminution in value of local government bonds and Ukraine government bonds is reflected within provision for diminution in value of securities and other investments in the statement of income.

A summary of the movements in the provision for diminution in value of securities is as follows:

| | 1999 | 1998 |
|---|---|---|
| **Provision for diminution in value of securities as at 1 January** | **688 002** | **104 859** |
| Charge against profit for the provision for diminution in value of securities | 232 079 | 583 143 |
| **Provision for diminution in value of securities as at 31 December** | **920 081** | **688 002** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 10 Other Investments

| | 1999 | 1998 |
|---|---|---|
| Trade investments | 311 059 | 445 292 |
| Investments in non-consolidated subsidiary companies | 35 261 | 92 670 |
| Investments in associated companies | 60 697 | 48 893 |
| Less: Provision for diminution in value of other investments | (270 760) | (422 618) |
| **Total other investments** | **136 257** | **164 237** |

Included in trade investments is RR 87 807 thousand (1998: RR 146 264 thousand) related to the joint activity agreements of the Bank primarily for real estate construction purposes.

A summary of the movements in the provision for diminution in value of other investments is as follows:

| | 1999 | 1998 |
|---|---|---|
| **Provision for diminution in value of other investments as at 1 January** | **422 618** | **283 537** |
| (Recovery) / provision of amounts previously provided against | (151 858) | 139 081 |
| **Provision for diminution in value of other investments as at 31 December** | **270 760** | **422 618** |

For the year ended 31 December 1999, the majority of the subsidiary and associated companies have not prepared financial statements in accordance with IAS. These investments are carried at cost less provision for diminution in value, and have not been consolidated with the results of the Bank nor accounted for under the equity method, as the effect of consolidation or equity accounting would not materially alter the financial position of the Bank at 31 December 1999 or the results of its operations or cash flows for the year then ended.

The principal non-consolidated subsidiary companies are:

| Name | Nature of business | Country of registration | Percentage of equity controlled | Cost of investment | Loans granted to company | Deposits taken from company |
|---|---|---|---|---|---|---|
| ZAO “Meta-Dom” | Real estate | Russia | 100.00% | 9 633 | 662 829 | - |
| OOO “Auction” | Real estate | Russia | 100.00% | 8 000 | 43 019 | 37 000 |
| ZAO “RG Leasing” | Leasing | Russia | 55.00% | 5 484 | 133 060 | 87 900 |
| ZAO Trade House “Rosprod” | Trading | Russia | 51.00% | 3 060 | 1 879 674 | 263 738 |
| OOO “Group Tema” | Housing construction | Russia | 80.00% | 40 | 2 043 873 | 16 500 |
| **Total** | | | | **26 217** | **4 762 455** | **405 138** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 10 Other Investments (Continued)

The principal associated companies are:

| Name | Nature of business | Country of registration | Percentage of equity controlled | Cost of investment | Loans granted to company | Deposits taken from company |
|---|---|---|---|---|---|---|
| ZAO “Media-finance” | Mass media | Russia | 25.00% | 30 000 | - | - |
| OAO “NIIES” | Research institute | Russia | 37.40% | 16 152 | - | - |
| **Total** | | | | **46 152** | **-** | **-** |

## 11 Other Assets

| | 1999 | 1998 |
|---|---|---|
| Accrued interest income | 8 377 390 | 5 878 434 |
| Prepaid taxes | 1 722 416 | 2 450 975 |
| Trade debtors and prepayments | 1 678 662 | 2 247 586 |
| Deferred charges | 734 035 | 196 076 |
| Amounts receivable under derivative financial instruments (Note 27) | 613 962 | 687 615 |
| Settlements on conversion operations | 145 433 | - |
| Other | 18 025 | 4 322 |
| **Total other assets** | **13 289 923** | **11 465 008** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 12 Premises and Equipment

| | Premises | Office and computer equipment | Construction In progress | Total |
|---|---|---|---|---|
| **Net book amount at 31 December 1998** | **19 249 648** | **2 630 157** | **2 209 533** | **24 089 338** |
| **Cost or valuation** | | | | |
| Opening balance | 19 249 648 | 5 830 912 | 2 209 533 | 27 290 093 |
| Additions | - | 2 609 666 | 1 393 222 | 4 002 888 |
| Revaluation (net) | - | (36 620) | - | (36 620) |
| Transfers | 2 098 443 | - | (2 098 443) | - |
| Disposals | (133 063) | (199 711) | (119 451) | (452 225) |
| **Closing balance** | **21 215 028** | **8 204 247** | **1 384 861** | **30 804 136** |
| **Accumulated depreciation** | | | | |
| Opening balance | - | (3 200 755) | - | (3 200 755) |
| Depreciation charge | (919 652) | (1 410 582) | - | (2 330 234) |
| Revaluation (net) | - | 267 | - | 267 |
| Disposals | 5 116 | 42 151 | - | 47 267 |
| **Closing balance** | **(914 536)** | **(4 568 919)** | **-** | **(5 483 455)** |
| **Net book amount at 31 December 1999** | **20 300 492** | **3 635 328** | **1 384 861** | **25 320 681** |
| Revaluation of premises as at 31 December 1999 | 12 105 616 | - | - | 12 105 616 |
| **Closing balance** | **32 406 108** | **3 635 328** | **1 384 861** | **37 426 297** |

Construction in progress consists mainly of construction and refurbishment of branch premises, and equipment. Upon completion, assets are transferred, as appropriate, to premises and equipment at cost. The transfers from construction in progress to premises and equipment amounted to RR 2 098 443 thousand during 1999.

The Bank's premises have been independently valued at 31 December 1999. The valuation was carried out by an independent firm of valuers, Arthur Andersen. The basis used for the appraisal was the sales comparison approach.

Included in the above net book value of premises is RR 20 803 890 thousand representing the cumulative revaluation surplus relating to the premises of the Bank. A deferred tax liability of RR 7 161 181 thousand (net of a utilization charge of RR 138 871 thousand) was calculated with respect to this fair value adjustment and has been recorded directly to equity in accordance with the applicable accounting standards. Refer to Note 21.

As of 31 December 1999 the cost of equipment has been increased by the cumulative effect of the application of indices provided by the State Statistics Committee which has given rise to a revaluation surplus of RR 400 301 thousand (1998: RR 511 481 thousand). The revaluation indices provided by the State Statistics Committee have been applied for the period through 1 January 1997. However, no independent valuation of the equipment has been carried out, and therefore Management is unable to ascertain if the application of the indices has been appropriate. Management estimates that the maximum potential increase in carrying value of the equipment arising from the application of indices amounts to RR 400 301 thousand.

*(expressed in thousands of Russian Roubles - Note 3)*

## 13 Deposits from Banks

| | 1999 | 1998 |
|---|---|---|
| **Amounts on "Vostro" accounts of other banks** | | |
| - Russian Federation | 1 977 268 | 823 713 |
| - Other countries | 480 178 | 148 388 |
| **Short term deposits from other banks** | | |
| - Russian Federation | 4 626 508 | 73 702 |
| - Other countries | 33 468 | 173 753 |
| **Total deposits from banks** | **7 117 422** | **1 219 556** |

The average interest rate on deposits from banks during 1999 was 10.4% for term deposits in Russian Roubles and 4.6% in foreign currency. Geographical and currency analysis of deposits from banks is disclosed in Note 24 and maturity analysis is provided in Note 26.

## 14 Deposits from Individuals and Customer Accounts

| | 1999 | 1998 |
|---|---|---|
| **State and public organisations** | | |
| - Current/settlement accounts | 19 784 229 | 9 769 186 |
| - Term deposits | 1 317 158 | 815 889 |
| **Other legal entities** | | |
| - Current/settlement accounts | 47 198 401 | 26 108 493 |
| - Term deposits | 5 187 984 | 2 877 391 |
| **Total customer accounts** | **73 487 772** | **39 570 959** |
| **Individuals** | | |
| - Current/demand accounts | 62 157 628 | 55 952 390 |
| - Term deposits | 165 891 616 | 94 038 959 |
| **Total deposits from individuals** | **228 049 244** | **149 991 349** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 14 Deposits from Individuals and Customer Accounts (Continued)

The average interest rate on customer accounts during 1999 was: for term deposits in Russian Roubles – 25.7%; in foreign currency – 5.3%; for current and settlement accounts in Russian Roubles – 2.3%; in foreign currency – 1.4%.

Geographical and currency analysis of deposits from individuals and customer accounts is disclosed in Note 24 and maturity analysis is provided in Note 26. The relevant information on related parties is disclosed in Note 29.

Economic sector concentrations within deposits from individuals and customer accounts are as follows:

| | 1999 | | 1998 | |
|---|---|---|---|---|
| | Amount | % | Amount | % |
| Individuals | 228 049 244 | 75.6 | 149 991 349 | 79.1 |
| Trade | 14 308 217 | 4.7 | 11 032 854 | 5.8 |
| State organisations | 14 224 446 | 4.7 | 7 537 707 | 4.0 |
| Municipal bodies | 6 876 941 | 2.3 | 2 444 216 | 1.3 |
| Oil and gas | 5 516 052 | 1.9 | 1 504 164 | 0.8 |
| Construction | 4 656 296 | 1.6 | 2 590 381 | 1.4 |
| Food and agriculture | 3 656 425 | 1.2 | 2 903 127 | 1.5 |
| Equipment manufacturing | 2 544 355 | 0.9 | 1 017 194 | 0.5 |
| Transport, aviation and space | 2 480 025 | 0.8 | 1 233 473 | 0.7 |
| Metallurgy | 1 004 851 | 0.3 | 861 362 | 0.5 |
| Energy | 982 948 | 0.3 | 1 008 853 | 0.5 |
| Other | 17 237 216 | 5.7 | 7 437 628 | 3.9 |
| **Total deposits from individuals and customer accounts** | **301 537 016** | **100.0** | **189 562 308** | **100.0** |

Included in customer accounts are deposits of RR 1 045 331 thousand (1998: RR 743 707 thousand) held as collateral for irrevocable commitments under import letters of credit. Refer to Note 27.

## 15 Other Borrowed Funds

| | 1999 | 1998 |
|---|---|---|
| Russian Federation | - | 41 300 |
| Other countries | 540 000 | 1 590 050 |
| **Total other borrowed funds** | **540 000** | **1 631 350** |

The Bank has borrowings of USD 20 000 thousand, equivalent of RR 540 000 thousand (1998: USD 77 000 thousand, equivalent of RR 1 590 050 thousand) in the form of loans from international banking institutions. The remaining contractual maturities of the borrowings vary from 22 to 29 months and the annual interest rate is LIBOR+1.95%.

*(expressed in thousands of Russian Roubles - Note 3)*

## 16 Other Liabilities

| | 1999 | 1998 |
|---|---|---|
| Accrued interest expense | 3 958 785 | 3 797 407 |
| Trade creditors | 1 271 500 | 2 147 980 |
| Obligations under derivative financial instruments (Note 27) | 1 250 444 | 5 689 651 |
| Taxation payable | 1 082 106 | 1 128 698 |
| Provision for potential losses on credit related commitments (Note 27) | 104 400 | 71 152 |
| Other accruals and deferred income | 44 349 | 27 692 |
| Dividends payable (Note 23) | 14 171 | 1 884 |
| Other | 76 857 | 74 503 |
| **Total other liabilities** | **7 802 612** | **12 938 967** |

## 17 Share Capital

Statutory capital authorised, issued and fully paid comprises:

| | 1999 | | 1998 | |
|---|---|---|---|---|
| | Number of shares | Amount | Number of shares | Amount |
| Ordinary shares | 14 002 000 | 700 100 | 14 002 000 | 700 100 |
| Preference shares | 50 000 000 | 50 000 | 50 000 000 | 50 000 |
| **Total share capital** | **64 002 000** | **750 100** | **64 002 000** | **750 100** |

All ordinary shares have a nominal value of RR 50 per share, rank equally and carry one vote.

The preference shares have a nominal value of RR 1 and carry no voting rights but rank ahead of the ordinary shares in the event of liquidation of the Bank. Preference shares are not mandatorily redeemable. They carry a minimum annual dividend of 15 percent.

As at 31 December 1999, 7 832 ordinary shares (1998: 73 568 shares) and 85 448 preference shares (1998: 268 392 shares) at a total cost of RR 7 086 thousand (1998: RR 34 859 thousand) were owned by the Bank and accordingly are reflected as treasury shares in the balance sheet.

In 1998, the Bank registered the 9$^{th}$ share issue, which was fully subscribed and paid for by the CBRF. The volume of the issue was 1 000 000 ordinary shares, with the total nominal value of RR 50 000 thousand and a premium of RR 650 000 thousand paid.

## 18 Share Premium

Share premium represents the excess of contributions over the nominal value of the shares issued.

In respect of shares subscribed in foreign currency before 1 July 1997, the share premium is the difference between the nominal value of the shares and the Russian Rouble value of foreign currency contributions to the share capital translated at the official exchange rate of the CBRF ruling on the date of the contributions.

*(expressed in thousands of Russian Roubles - Note 3)*

## 19 Other Operating Income

| | 1999 | 1998 |
|---|---|---|
| Late charges on loans and other penalties | 1 099 687 | 802 068 |
| Recoveries of amounts previously charged-off | 353 225 | 65 108 |
| Income on operations with precious metals | 351 402 | 185 366 |
| Leasing and other income on premises and equipment | 174 459 | 76 653 |
| Other | 377 952 | 189 558 |
| **Total other operating income** | **2 356 725** | **1 318 753** |

## 20 General, Administrative and Other Operating Expenses

| | 1999 | 1998 |
|---|---|---|
| Depreciation and other expenses on premises and equipment | 5 542 311 | 3 682 197 |
| Taxes other than on income | 4 154 913 | 3 094 926 |
| Administrative expenses | 1 353 157 | 1 146 195 |
| Advertising and marketing | 230 677 | 142 503 |
| Court expenses and related charges | 176 905 | 84 030 |
| Provision for credit related commitments (Note 27) | 33 248 | 1 268 |
| Realised loss on settlement operations | - | 401 962 |
| Other | 951 902 | 606 591 |
| **Total general, administrative and other operating expenses** | **12 443 113** | **9 159 672** |

## 21 Income Taxes

Income tax expense is comprised of the following:

| | 1999 | 1998 |
|---|---|---|
| Current tax charge | 5 034 036 | 2 516 266 |
| Movement in deferred taxation | 4 106 010 | 3 055 171 |
| Amount recorded directly to equity | (4 244 881) | (3 055 171) |
| **Total taxation for the year** | **4 895 165** | **2 516 266** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 21 Income Taxes (Continued)

The income tax rate changed during 1999 and the rate applicable to the majority of the Bank's income is 38 percent (1998: 43 percent). The tax rate went from 43 percent to 38 percent as of 1 April 1999. A reconciliation between the expected and the actual taxation charge is stated below.

| | 1999 | 1998 |
|---|---|---|
| **IAS profit/(loss) before taxation** | 13 111 267 | (12 316 443) |
| Theoretical tax charge at the applicable statutory rate | 4 982 281 | (5 296 070) |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| - Provision for diminution in value of securities and other investments | 84 022 | 8 835 542 |
| - Accrual of loss on derivative financial instruments | (2 008 881) | 2 546 895 |
| - Non deductible expenses | 8 277 682 | 8 747 701 |
| - Income exempt from taxation | (4 527 130) | (24 961 090) |
| - Losses of branches, not offset against Bank’s profit | 4 052 050 | 9 602 194 |
| - Income on government securities taxed at different rates | (8 418 539) | (1 689 464) |
| - Other IAS adjustments that have non-temporary nature | 434 923 | (1 152 122) |
| Effect of the change in tax rate | 796 695 | - |
| Non-recognised deferred tax asset movement | 1 222 062 | 5 882 680 |
| **Income tax expense for the year** | **4 895 165** | **2 516 266** |

Differences between IAS and Russian statutory taxation regulations give rise to certain temporary differences between the carrying value of certain assets and liabilities for financial reporting purposes and for profits tax purposes. The tax effect of the movement on these temporary differences is recorded at the rate of 38%, except for income on state securities that is taxed at 15%.

| | 1998 | Movement | 1999 |
|---|---|---|---|
| **Tax effect of deductible temporary differences** | | | |
| Provision for losses on loans to customers | 4 823 081 | 909 249 | 5 732 330 |
| Accruals | 1 632 885 | (128 547) | 1 504 338 |
| Premises and equipment | 354 613 | 271 771 | 626 384 |
| State securities | 2 398 355 | 441 677 | 2 840 032 |
| Other assets and other liabilities | 30 595 | 210 200 | 240 795 |
| **Gross deferred tax asset** | **9 239 529** | **1 704 350** | **10 943 879** |
| **Tax effect of taxable temporary differences** | | | |
| Accruals | (153 488) | (376 400) | (529 888) |
| Revaluation of premises | (3 055 171) | (4 106 010) | (7 161 181) |
| Provision for losses on loans to banks | - | (105 888) | (105 888) |
| **Gross deferred tax liability** | **(3 208 659)** | **(4 588 298)** | **(7 796 957)** |
| **Net tax effect of temporary differences** | **6 030 870** | **(2 883 948)** | **3 146 922** |
| Less non-recognised net deferred tax asset | (9 086 041) | (1 222 062) | (10 308 103) |
| **Total net deferred tax liability** | **(3 055 171)** | **(4 106 010)** | **(7 161 181)** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 21 Income Taxes (Continued)

The estimated amount of the change in the deferred tax liability resulting from the reduction in the tax rate is RR 355 252 thousand.

As at 31 December 1999, a net deferred tax asset in the amount of RR 10 308 103 thousand (1998: RR 9 086 041 thousand) has not been recorded for the net deductible temporary differences as it is not probable that sufficient taxable profit will be available to allow the benefit of that deferred tax asset to be utilised. A deferred tax liability of RR 7 161 181 thousand (1998: RR 3 055 171 thousand) has been recorded in the balance sheet in respect of the fair valuation of the Bank's premises. Refer to Note 12. This deferred tax liability is of a long-term nature since it is derived from the fair value adjustment of premises, and accordingly it is being realized over the estimated average useful life of these premises. The movement in this deferred tax liability amounting to RR 138 871 thousand (1998: nil) was credited to the statement of income and a corresponding figure has been transferred from revaluation reserve to retained earnings recognizing the realization of a portion of the revaluation reserve.

## 22 Earnings/(Loss) per Share

Basic earnings/(loss) per share are calculated by dividing the net loss or profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Bank and held as treasury shares.

The Bank has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal basic earnings per share.

| | **1999** | **1998** |
|---|---|---|
| Net profit/(loss) attributable to shareholders | 8 216 102 | (14 832 709) |
| Less: preference dividends (Note 23) | (38 860) | - |
| Net profit/(loss) attributable to ordinary shareholders | 8 177 242 | (14 832 709) |
| Weighted average number of ordinary shares in issue (thousands) | 13 962 | 13 221 |
| **Basic and diluted earnings/(loss) per share (expressed in RR per share)** | **585.68** | **(1 121.91)** |

## 23 Dividends

| | **1999** | **1998** |
|---|---|---|
| **Ordinary and preference dividends** | | |
| Declared and paid during the year | 339 734 | - |
| Declared and not paid at year end | 14 171 | - |
| **Total dividends** | **353 905** | **-** |

*(expressed in thousands of Russian Roubles - Note 3)*

| | 1999 | 1998 |
|---|---|---|
| **Ordinary dividends** | | |
| Dividends per share (expressed in RR per share) | 22.50 | - |
| **Preference dividends** | | |
| Dividends per share (expressed in RR per share) | 0.78 | - |

All dividends are declared and payable in Russian Roubles.

## 24 Geographical Analysis and Currency Risk

***Geographical analysis.*** Loans and advances to customers are placed in Russia. Deposits by customers are taken primarily from companies in Russia and citizens of Russia. Loans and advances to banks placed with banks outside the Russian Federation and deposits from banks and other borrowings attracted from banks outside the Russian Federation are reflected in the notes to the respective components.

***Currency analysis.*** Currency risk is the risk that the value of financial instruments will fluctuate due to changes in foreign exchange rates. At year end, the Bank had balances in Russian Roubles and other currencies. Other currencies represent mainly amounts in US dollars.

At 31 December 1999, the Bank had the following positions in foreign currencies:

| | RR | Other currencies | Provisions | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 11 548 108 | 9 733 705 | - | 21 281 813 |
| Mandatory cash balances with the CBRF | 22 319 097 | - | - | 22 319 097 |
| Dealing securities | 5 752 935 | 2 459 102 | | 8 212 037 |
| Loans and advances to banks | 5 881 878 | 11 751 555 | (1 020 802) | 16 612 631 |
| Loans and advances to customers | 110 322 533 | 36 622 004 | (27 058 576) | 119 885 961 |
| Investment securities | 38 792 248 | 110 627 685 | (20 920 081) | 128 499 852 |
| Other investments | 134 865 | 1 392 | - | 136 257 |
| Other assets | 7 106 728 | 6 183 195 | - | 13 289 923 |
| Premises and equipment | 37 426 297 | - | - | 37 426 297 |
| **Total assets** | **239 284 689** | **177 378 638** | **(48 999 459)** | **367 663 868** |
| **Liabilities** | | | | |
| Deposits from banks | (5 055 494) | (2 061 928) | - | (7 117 422) |
| Deposits from individuals | (179 728 340) | (48 320 904) | - | (228 049 244) |
| Customer accounts | (57 787 692) | (15 700 080) | - | (73 487 772) |
| Bills of exchange | (22 777 626) | (2 877 359) | - | (25 654 985) |
| Other borrowed funds | - | (540 000) | - | (540 000) |
| Deferred tax liability | (7 161 181) | - | - | (7 161 181) |
| Other liabilities | (6 735 354) | (1 067 258) | - | (7 802 612) |

*(expressed in thousands of Russian Roubles - Note 3)*

| | | | | |
|---|---|---|---|---|
| **Total liabilities** | **(279 245 687)** | **(70 567 529)** | **-** | **(349 813 216)** |
| **Net balance sheet position** | **(39 960 998)** | **106 811 109** | **(48 999 459)** | **17 850 652** |
| **Off balance sheet net notional position** | **(62 100)** | **62 100** | **-** | **-** |
| **Credit commitments** | **17 394 885** | **12 988 100** | **-** | **30 382 985** |

The off balance sheet position includes notional positions on foreign exchange deliverable forward and spot contracts. The gains or losses accrued on these contracts and on the index contracts with domestic counterparties have been reflected on the balance sheet as a receivable or payable in Russian Roubles. The losses accrued on the index contracts with foreign counterparties have been reflected on the balance sheet as a payable in foreign currency.

## 24 Geographical Analysis and Currency Risk (Continued)

The provision for losses on loans and advances to banks, loans and advances to customers and securities have been presented in a separate column, as Management is unable to allocate the general element of the provision between respective currencies. All other provisions have been matched with the respective currencies.

The Bank has extended loans and advances denominated in foreign currencies. Although these loans are generally funded by the same currencies, depending on the revenue stream of the borrower, the appreciation of the currencies against the Russian Rouble may adversely affect the borrowers' repayment ability and therefore potentially increases the likelihood of future loan losses.

## 25 Fair Value of Financial Instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price.

The estimated fair values of financial instruments have been determined by the Bank using available market information and appropriate valuation methodologies, where they exist. However, judgement is necessarily required to interpret market data to determine the estimated fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Bank could realise in a current market exchange. As described in more detail in Note 2, the Russian Federation is in a period of economic difficulty, which has caused a significant decline in the volume of activity in the financial markets. While Management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realised in the current circumstances.

Management does not believe that it is practicable to estimate the fair value of loans, term deposits, bills of exchange and other borrowed funds. These instruments are not currently traded in the Russian financial markets and an objective estimate of fair value is not available. The instability of the interest rate and exchange rate environment significantly affects the fair value of financial instruments. The current uncertain economic conditions have caused significant increases in the rates of interest and a significant decrease in the value of the Russian Rouble when compared to fully convertible currencies. Some financial institutions have been unwilling to lend to or invest in Russian companies, thus limiting information which might otherwise be available to Management to assist in estimating fair values. Because of these factors, Management does not believe that an objective basis for the fair value of loans, term deposits and other borrowed funds can be obtained with sufficient reliability to provide meaningful information to users.

Management does not believe that it is practicable to estimate the fair value of forward foreign exchange contracts. Currently these instruments are not actively traded in the Russian financial markets and an objective estimate of fair value is not available.

The following methods and assumptions were used to estimate the fair value of the Bank's other financial instruments.

Financial assets

For monetary assets, excluding federal government securities held for investment purposes, customer loans and amounts due from other banks, fair value approximates the carrying value; balances denominated in foreign currencies have been translated at appropriate year-end exchange rates. Investment in non-consolidated subsidiaries and associates and other trade investments are accounted for at cost less provision as Management believes this carrying value approximates fair value of their share of equity. Federal government securities held for investment purposes are stated at cost less provision as the Bank is holding this portfolio of securities to maturity. The respective fair values of these securities are disclosed in Note 9.

Financial liabilities

For monetary liabilities, excluding term deposits and other borrowed funds, fair value approximates the carrying value; balances denominated in foreign currencies have been translated at appropriate year-end exchange rates.

## 26 Interest Rate, Liquidity and Credit Risk

***Interest rate risk.*** The Bank is exposed to interest rate price risk, principally as a result of lending and advances to customers and other banks, at fixed interest rates, in amounts and for periods which differ from those of term deposits and other borrowed funds at fixed interest rates.

The majority of the loans and advances to banks and customers are of fixed rates. Approximately all of the Bank's term deposits, excluding placements from other banks and other borrowed funds, are at fixed rates for periods ranging between 1 month and 1 year.

In practice, interest rates that are contractually fixed on both assets and liabilities are often renegotiated to reflect current market conditions. Management does not believe it is practicable, therefore, to present reliable quantitative information on interest rate risk.

Average interest rates applicable to the major components of the balance sheet have been disclosed within the notes relating to these components.

***Liquidity risk.*** Liquidity risk is defined as risk when maturity of assets and liabilities does not match. The liquidity risk is managed by Committee on Interest Rates and Limits of the Bank. The table below shows assets and liabilities at 31 December 1999 by remaining contractual maturity. Some of the assets have a longer term nature; for example, loans are frequently renewed and accordingly short-term loans can have a longer term duration.

The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the Management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of an uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

*(expressed in thousands of Russian Roubles - Note 3)*

## 26 Interest Rate, Liquidity and Credit Risk (Continued)

The liquidity position of the Bank as at 31 December 1999 is set out below.

| | Demand and less than 1 month | From 1 to 6 months | From 6 to 12 months | More than 1 year | No stated maturity/ provisions/ overdue | Total |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 21 281 813 | - | - | - | - | 21 281 813 |
| Mandatory cash balances with the CBRF | - | - | - | - | 22 319 097 | 22 319 097 |
| Dealing securities | 53 933 | 2 033 796 | 3 119 772 | 2 323 523 | 681 013 | 8 212 037 |
| Loans and advances to banks | 11 487 467 | 5 702 009 | - | 1 717 | 442 240 | 17 633 433 |
| Provision for bad and doubtful debts | - | - | - | - | (1 020 802) | (1 020 802) |
| Loans and advances to customers | 27 418 392 | 49 176 055 | 34 589 654 | 29 209 531 | 6 550 905 | 146 944 537 |
| Provision for bad and doubtful debts | - | - | - | - | (27 058 576) | (27 058 576) |
| Investment securities | 917 115 | 2 717 678 | 3 304 499 | 139 840 643 | (18 280 083) | 128 499 852 |
| Other investments | - | - | - | - | 136 257 | 136 257 |
| Other assets | 8 022 718 | 3 151 929 | 627 234 | 482 059 | 1 005 983 | 13 289 923 |
| Premises and equipment | - | - | - | - | 37 426 297 | 37 426 297 |
| **Total assets** | **69 181 438** | **62 781 467** | **41 641 159** | **171 857 473** | **22 202 331** | **367 663 868** |
| **Liabilities** | | | | | | |
| Deposits from banks | (7 109 755) | (7 199) | - | (468) | - | (7 117 422) |
| Deposits from individuals | (107 234 662) | (112 197 601) | (5 040 418) | (3 576 563) | - | (228 049 244) |
| Customer accounts | (65 252 665) | (5 699 511) | (1 955 088) | (580 508) | - | (73 487 772) |
| Bills of exchange | (20 341 839) | (4 701 469) | (563 202) | (48 475) | - | (25 654 985) |
| Other borrowed funds | - | - | - | (540 000) | - | (540 000) |
| Deferred tax liability | - | - | - | - | (7 161 181) | (7 161 181) |
| Other liabilities | (7 335 445) | (153 799) | (23 317) | (30 144) | (259 907) | (7 802 612) |
| **Total liabilities** | **(207 274 366)** | **(122 759 579)** | **(7 582 025)** | **(4 776 158)** | **(7 421 088)** | **(349 813 216)** |
| **Net liquidity gap** | **(138 092 928)** | **(59 978 112)** | **34 059 134** | **167 081 315** | **14 781 243** | **17 850 652** |
| **Cumulative liquidity gap** | **(138 092 928)** | **(198 071 040)** | **(164 011 906)** | **3 069 409** | **17 850 652** | **-** |

Management believes that in spite of a substantial portion of deposits from individuals being on demand, diversification of these deposits by number and type of depositors as well as their deposits being guaranteed by the Russian Government, and the past experience of the Bank would indicate that these deposits form a long-term and stable source of funding for the Bank.

***Credit risk.*** The Bank's maximum exposure to credit risk, excluding the value of collateral is generally reflected in the carrying amounts of financial assets on the balance sheet. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant.

Credit risk for off-balance sheet financial instruments is defined as the possibility of sustaining a loss because any other party to a financial instrument fails to perform in accordance with the terms of the contract. The Bank uses the same credit policies in making conditional obligations as it does for on-balance sheet financial instruments through established credit approvals, risk control limits and monitoring procedures.

*(expressed in thousands of Russian Roubles - Note 3)*

## 27 Contingencies, Commitments and Derivative Financial Instruments

***Legal Proceedings.*** From time to time and in the normal course of business, claims against the Bank are received from customers. At 31 December 1999 the Bank was not engaged in any material litigation proceedings. Therefore, no provision has been made as the Management believes that it is unlikely that any significant loss will eventuate.

***Tax legislation.*** Due to the presence in Russian commercial legislation, and tax legislation in particular, of provisions allowing more than one interpretation, and also due to the practice developed in a generally unstable environment by the tax authorities of making arbitrary judgement of business activities, Management's judgement of the Bank's business activities may not coincide with the interpretation of the same activities by tax authorities. If a particular treatment was to be challenged by the tax authorities, the Bank may be assessed additional taxes, penalties and interest, which can be significant. Tax years remain open to review by the tax authorities for three years.

***Capital commitments.*** As at 31 December 1999 the Bank had capital commitments in respect of construction and computer systems totalling RR 641 792 thousand (1998: RR 1 494 946 thousand). The Bank's Management believes that future revenues and funding will be sufficient to cover this and any similar commitments.

***Operating lease commitments.*** In the course of its business the Bank enters into a number of lease agreements. The majority of these lease agreements are cancellable. The table below presents future minimum lease payments under non-cancellable binding operating leases where the Bank is a lessee:

| | **1999** | **1998** |
|---|---|---|
| Not later than 1 year | 20 678 | 22 671 |
| Later than 1 year and not later than 5 years | 3 910 | 21 312 |
| Later than 5 years | - | - |
| **Total operating lease commitments** | **24 588** | **43 983** |

***Credit related commitments.*** The credit related commitments comprise loan commitments, letters of credit and guarantees. The contractual amount of these commitments represents the value of risk should the contract be fully drawn upon, the client defaults, and the value of any existing collateral becomes worthless. In general, the majority of the Bank's import letters of credit are collateralised with cash deposits or collateral pledged to the Bank and accordingly the Bank normally assumes minimal risk. Outstanding credit related commitments are as follows:

| | **1999** | **1998** |
|---|---|---|
| Undrawn credit lines | 24 988 258 | 9 616 986 |
| Export letters of credit | 2 503 455 | 527 256 |
| Import letters of credit (Note 14) | 2 192 914 | 881 728 |
| Guarantees issued | 698 358 | 1 021 611 |

The amount of undrawn credit lines issued by the Bank as at 31 December 1999 was RR 24 988 258 thousand. The Bank however has the right to renegotiate the terms of credit line agreements. At 31 December 1999, the probability of losses arising in connection with these commitments is considered remote and accordingly no provision has been established.

Management evaluated the likelihood of possible losses arising from credit related commitments and concluded that a provision of RR 104 400 thousand was necessary as at 31 December 1999 (1998: RR 71 152 thousand). This provision is disclosed under other liabilities in Note 16 and current year movement in provision is recorded in general, administrative and other operating expenses in Note 20.

***Derivatives.*** As at 31 December 1999 the Bank had outstanding contracts with Russian and foreign banks whereby it had agreed to buy or sell Russian Roubles in exchange for another currency at an exchange rate agreed to at the date of the contract. A majority of these contracts were entered into prior to 17 August 1998 and these contracts matured during 1998 but have not yet been settled. The Bank was able to settle outstanding contracts with several counterparties during 1999 and any resultant gains or losses have been recorded.

*(expressed in thousands of Russian Roubles - Note 3)*

## 27 Contingencies, Commitments and Derivative Financial Instruments (Continued)

Foreign exchange off-balance sheet financial instruments are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. The nominal amounts for off-balance sheet financial instruments are not reflected in the consolidated balance sheet.

The following two tables provide an analysis of the principal or agreed amounts of contracts outstanding at the year end and the loss or gain arising on these positions. These tables reflect gross position after the netting of any counterparty position by type of investment.

The table below includes contracts with a maturity date subsequent to 31 December 1999. These deals were entered into in December 1999 and are short term in nature.

| | Domestic | | | Foreign | | |
|---|---|---|---|---|---|---|
| | **Principal or agreed amount** | **Loss** | **Gain** | **Principal or agreed amount** | **Loss** | **Gain** |
| *Deals entered into in 1999:* | | | | | | |
| **Deliverable forwards** | | | | | | |
| - sale of foreign currency | - | - | - | (164 284) | (904) | - |
| - purchase of foreign currency | 8 100 | - | - | - | - | - |
| **Spot** | | | | | | |
| - purchase of foreign currency | 54 000 | (20) | - | - | - | - |
| **Total** | **62 100** | **(20)** | **-** | **(164 284)** | **(904)** | **-** |

For the contracts summarised above, the Bank has accrued a loss of RR 924 thousand which is included within gains less losses from dealing in foreign currency.

The following table includes contracts for which the date of maturity is past due and no settlement had been completed as of 31 December 1999.

| | Domestic | | | Foreign | | |
|---|---|---|---|---|---|---|
| | **Principal or agreed amount** | **Loss** | **Gain** | **Principal or agreed amount** | **Loss** | **Gain** |
| *Deals entered into in 1998:* | | | | | | |
| **Deliverable forwards** | | | | | | |
| - sale of foreign currency | (540 000) | (416 470) | - | - | - | - |
| - purchase of foreign currency | 540 000 | - | 416 470 | - | - | - |
| **Index forwards** | | | | | | |
| - sale of foreign currency | (8 127 000) | (1 249 218) | - | (144 783) | (101 517) | - |
| - purchase of foreign currency | 20 660 400 | - | 4 218 097 | - | - | - |
| **Options** | | | | | | |
| - sale of foreign currency | (4 995 000) | (350 000) | - | - | - | - |
| - purchase of foreign currency | 13 081 500 | - | 2 825 755 | - | - | - |
| **Total** | **20 619 900** | **(2 015 688)** | **7 460 322** | **(144 783)** | **(101 517)** | **-** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 27 Contingencies, Commitments and Derivative Financial Instruments (Continued)

A summary of amounts due to the Bank, and the Bank's obligations as at 31 December 1999 with respect to contracts entered into during 1998 and 1999 is set out below.

| | Loss | Gain |
|---|---|---|
| Domestic counterparty losses and gains on contracts entered into in 1998 | (2 015 688) | 7 460 322 |
| Losses offset by counterparty gains | 867 685 | - |
| Gains offset by counterparty losses | - | (867 685) |
| Domestic counterparty losses and gains after netting by counterparty position | (1 148 003) | 6 592 637 |
| Foreign counterparty losses | (101 517) | - |
| **Subtotal before provision for uncollectable gains** | **(1 249 520)** | **6 592 637** |
| Less: provision for uncollectable gains | - | (5 978 675) |
| Accrual for losses on contracts entered into in 1999 | (924) | - |
| **Obligations due and amounts receivable on forward and option contracts as at 31 December 1999** | **(1 250 444)** | **613 962** |

Movements in provisions for uncollectable gains are as follows:

| | 1999 | 1998 |
|---|---|---|
| **Provision for uncollectable gains at 1 January** | **6 198 384** | **-** |
| (Recovery)/charge against profit for uncollectable gains during the year | (219 709) | 6 198 384 |
| **Provision as at 31 December 1999** | **5 978 675** | **6 198 384** |

During 1999 the Bank settled certain deals entered into in 1998 with foreign counterparties in the amount of RR 2 796 450 thousand on sale of foreign currency and RR 535 850 thousand on purchase of foreign currency and also domestic counterparties in the amount of RR 3 586 443 thousand for sale of foreign currency and RR 2 362 540 thousand for purchase of foreign currency. The financial result of these settlements has been reflected within gains less losses arising from dealing in foreign currency in the statement of operations for 1998.

Subsequent to 31 December 1999, the Bank settled outstanding contracts with three domestic counterparties in the total amount of RR 151 709 thousand. The total contractual obligations of these counterparties to the Bank were RR 889 593 thousand, and the total contractual obligations of the Bank to these counterparties were RR 822 076 thousand. The financial result of these settlements has been reflected within gains less losses arising from dealing in foreign currency in the statement of income for 1999.

*(expressed in thousands of Russian Roubles - Note 3)*

## 27 Contingencies, Commitments and Derivative Financial Instruments (Continued)

***Fiduciary assets.*** These assets are not included in the Bank's balance sheet as they are not assets of the Bank. The fiduciary assets fall into the following categories:

| **Fiduciary assets** | **1999 Nominal value** | **1998 Nominal value** |
|---|---|---|
| Client GKO and OFZ securities held on an account with the National Depository Centre | 17 267 909 | 4 528 560 |
| Client VEB bonds held in custody | 753 941 | 2 207 877 |
| Shares in companies held in custody | 593 408 | 31 400 |
| Client OGSZ securities held in custody | 472 915 | 874 808 |
| Client local government bonds held in custody | 173 395 | 781 276 |
| Other | 39 874 | - |

***Assets pledged.*** As at 31 December 1999, the Bank had VEB bonds in the amount of RR 588 836 thousand (1998: nil) pledged as collateral against short-term loans in the total amount of RR 550 000 from a Russian bank.

## 28 Reconciliation of Russian Accounting Rules to International Accounting Standards

The following is a reconciliation of the Bank's profit before taxation and reserves under Russian Accounting Rules to profit before taxation and reserves under International Accounting Standards. The profit before taxation is before allocation of profits for the year to the reserve accounts. Reserves according to Russian Accounting Rules include the total of the reserve accounts, the revaluation account and the profit undistributed during the year. In accordance with Russian Law on Banks and Banking Activity, the Bank must distribute all profits as dividends or transfer them to reserve (fund accounts) on the basis of financial statements prepared in accordance with Russian Accounting Rules.

| | **1999** | | **1998** | |
|---|---|---|---|---|
| | **Profit before taxation** | **Retained earnings and other reserves** | **(Loss) / profit before taxation** | **Accumulated deficit and other reserves** |
| **Russian Accounting Rules** | **13 939 517** | **32 891 994** | **15 391 683** | **25 735 610** |
| Reversal of prior year items | (1 401 545) | 3 366 932 | 2 202 604 | 47 596 |
| Accrual of revenue and expenses | 8 711 037 | 8 711 037 | 4 895 419 | 4 895 419 |
| Reclassification of expenses charged directly to reserves | (1 358 492) | - | (813 785) | (21 719) |
| Provision for losses on loans | (3 623 206) | (14 910 824) | (6 672 563) | (11 287 618) |
| Provision for diminution in value of investments and write-downs of investments | (221 111) | (20 931 899) | (20 547 771) | (20 710 788) |
| Provision and net losses on forward foreign exchange contracts | 5 286 530 | (636 482) | (5 923 012) | (5 923 012) |
| Share premium classification | - | (828 599) | - | (828 599) |
| Expenses recorded in the balance sheet | 88 776 | (313 186) | (401 962) | (401 962) |
| Revaluation reserve for premises and equipment | - | (2 481 407) | - | (2 518 107) |
| Additional depreciation of premises and equipment and of revaluation reserve for premises and equipment | (1 189 146) | (1 514 662) | (448 815) | (783 546) |
| Reversal of the accrual for excess profit tax in 1998 | (5 849 638) | - | - | 5 849 638 |
| Other | (1 271 455) | (1 116 875) | 1 759 | 1 761 |
| **International Accounting Standards** | **13 111 267** | **2 236 029** | **(12 316 443)** | **(5 945 327)** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 29 Related Party Transactions

For the purposes of these financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

Banking transactions are entered into in the normal course of business with significant shareholders, directors, subsidiaries and companies with which the Bank has significant shareholders in common.

During 1999, a number of banking transactions were entered into with related parties in the normal course of business. These included settlements, loans, deposit taking, trade finance and foreign currency transactions. These transactions were priced predominantly at preferential rates. The outstanding balances at the year end and interest expense and income for the year with related parties are as follows:

| | 1999 | 1998 |
|---|---|---|
| **Loans** | | |
| Loans outstanding as at year end | 7 758 674 | 6 531 057 |
| Interest income | 717 158 | 236 930 |
| **Deposits** | | |
| Outstanding balance as at year end | 512 274 | 161 481 |
| Interest expense | 1 351 922 | 801 345 |
| **Guarantees issued by the Bank** | 2 723 | 328 426 |

### *Transactions with State Organisations*

State organisations represent a significant element of the Bank's customer base. These organisations perform settlements through accounts opened with the Bank, and are granted significant loans by the Bank as described in Notes 8 and 14. Additionally, the Russian Federation guarantees the funds of all individual depositors at the Bank.

As detailed in Note 9, the Bank has a significant portfolio of state securities of Russian Federation. The Bank is considered a major market maker in respect of the government debt securities. Thus, the Bank's ability to liquidate its portfolio of state securities is influenced by the Bank's position in the securities market, by the condition of this market and to a certain extent by government policy.

## 30 Hyperinflationary Accounting

The economy of the Russian Federation has experienced significant inflation in recent years. Set out below is a summary of the estimated effects of inflation on the historical cost financial statements. Accounting for hyperinflation is intended to reflect the effect of changes in the general purchasing power of the Russian Rouble on the financial capital employed through restating the financial statements from their historical amounts to amounts expressed in the equivalent purchasing power of the Russian Rouble at the current balance sheet date. The application of this principle results in an adjustment to the statement of income for the loss of purchasing power of the Russian Rouble.

The restated estimated financial information provided below has been prepared by indexing the balances reported in the historical balance sheet and statement of income by changes in the general price index up to the balance sheet date, and by indexing the corresponding figures prepared under this methodology by the change in the general price index between the balance sheet dates, using 1988 as the base year. The official inflation rates for Russia over the past three years were 36.5% for 1999, 84.4% for 1998 and 11.0% for 1997.

The Bank's financial records have been maintained with the principal objective of preparing historical cost financial information. This information has been used together with the following assumptions to present the following restated balance sheet and statement of income summary information.

*(expressed in thousands of Russian Roubles - Note 3)*

## 30 Hyperinflationary Accounting (Continued)

All amounts within this particular footnote, including corresponding figures, are stated in terms of the measuring unit (i.e. Russian Rouble) current at 31 December 1999. Monetary assets and liabilities are not restated because they are already expressed in terms of the monetary unit current at 31 December 1999. Non-monetary assets and liabilities (items which are not expressed in terms of the monetary unit current at 31 December 1999) and shareholders' equity, including ordinary share capital, are restated by applying the relevant conversion factor. The effect of inflation on the Bank's net monetary position would be reflected in the statement of income as a monetary gain or loss.

Statement of income items have been indexed by the change in the general price index based on following assumptions:

- In general, inflation occurred evenly over the year and thus quarterly inflation averages have been used; and

- Income and expenditures have accrued evenly over the year except for the diminution in value of investments and securities, provision for loan losses and provision for off-balance sheet instruments, all of which have been treated, for the purpose of this calculation, as occurring at the year end.

Premises and equipment have been indexed by the change in the general price index from the approximate date of purchase or from the date on which an external appraisal was performed. Where large acquisitions or disposals in the year were known, indexation has been applied from that date. In all other cases, an average indexation has been applied to acquisitions and disposals. An assessment has been made of the potential impairment in the carrying value of premises and equipment, and where applicable such assets have been reduced to their recoverable amounts.

Other non-monetary assets (principally investments in non-consolidated subsidiaries and associates) have been indexed from the date that they were originally recorded. The effect of the application of IAS 29 in restating non-monetary assets and liabilities has not been considered when calculating the deferred tax liability as the Management of the Bank do not believe that any calculation thereon would materially alter the presentation of the estimated effect of inflation on the historical cost financial statements.

### Restated Summary Statement of Income

| | **1999** | **1998** |
|---|---:|---:|
| Operating income | 43 922 844 | 72 578 958 |
| Operating costs | (29 811 371) | (45 326 571) |
| Provision for federal government securities | - | (27 317 000) |
| Impairment loss | (9 116 623) | (17 556 795) |
| Monetary gain | 6 956 549 | 8 301 095 |
| **Profit/ (loss) before taxation** | **11 951 399** | **(9 320 313)** |
| Taxation | (5 710 198) | (3 436 842) |
| **Net profit / (loss) for the year, restated for hyperinflation** | **6 241 201** | **(12 757 155)** |

*(expressed in thousands of Russian Roubles - Note 3)*

## 30 Hyperinflationary Accounting (Continued)

### Restated Summarised Balance sheet

| | **1999** | **1998** |
|---|---|---|
| Monetary assets | 330 101 314 | 263 025 012 |
| Premises and equipment | 37 426 297 | 32 902 423 |
| Other non-monetary assets | 136 257 | 224 323 |
| **Total assets** | **367 663 868** | **296 151 758** |
| Monetary liabilities | 342 652 035 | 289 060 987 |
| Non-monetary liabilities | 7 161 181 | 4 408 295 |
| **Total liabilities** | **349 813 216** | **293 469 282** |
| **Restated shareholders' equity** | **17 850 652** | **2 682 476** |

### Effect on cash flows

A simplified approach has been applied to estimate the impact on the cash flows of the Bank as follows:

| | **1999** | **1998** |
|---|---|---|
| Cash and cash equivalents at the beginning of the year restated | 26 334 606 | 20 063 478 |
| Cash and cash equivalents at the end of the year | 21 281 813 | 26 334 606 |
| **Net (decrease)/increase in cash and cash equivalents, restated for hyperinflation** | **(5 052 793)** | **6 271 128** |

### Effect on net monetary position

Monetary gains and losses are calculated in accordance with IAS 29 following the methodology and assumptions described above. The restated statement of income for the year ended 31 December 1999 reflects the effect of a change in the Bank's net monetary liability position and impairment of non-monetary assets during the year as a decrease of profit in the amount of RR 1 974 901 thousand.

This decrease in profit arises because of the impairment of the Bank's non-monetary assets in a year during which the consumer price index has risen by 36.5%.