CENTRAL BANK OF MONTENEGRO

Financial Statements and Auditor's Report
31 December 2003

Contents

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES

To the Parliament of the Republic of Montenegro

1. We have prepared the financial statements as at and for the year ended 31 December 2003, which present fairly, in all material respects, the financial position of the Central Bank of Montenegro (the "CBM") as at 31 December 2003, and the results of its operations and its cash flows for the year then ended. The Management is responsible for ensuring that the CBM keeps accounting records that comply with laws and regulations effective in the Republic of Montenegro and can be suitably amended to disclose the financial position of the CBM and the results of its operations and cash flows in accordance with the Law on the Central Bank of Montenegro ("the Law") and International Financial Reporting Standards that include International Accounting Standards and Interpretations issued by the International Accounting Standards Board. The Management also has a general responsibility for taking such steps as are reasonably available to them to safeguard the assets of the CBM and prevent and detect fraud and other irregularities.

2. The Management considers that, in preparing the financial statements set out on pages 2 to 27, the CBM has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgment and estimates.

3. The financial statements are hereby approved on behalf of the Management.

Ljubiša Krgović President of the Council of the Central Bank of Montenegro	Zdenka Rakočević Finance and accounting director of the Central Bank of Montenegro

10 May 2004

Podgorica

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AUDITOR'S REPORT

To the Management of the Central Bank of Montenegro

1. We have audited the accompanying balance sheet of the Central Bank of Montenegro ("the CBM") as at 31 December 2003, and the related statements of income, of cash flows and of changes in equity for the year then ended. These financial statements, set out on pages 2 to 27, are the responsibility of the CBM's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. 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 and judgments made by the Management, as well as evaluating the overall financial statement presentation and whether the accounting policies are appropriate to the CBM's circumstances, consistently applied and adequately disclosed. We believe that our audit provides a reasonable basis for our opinion.

3. In our opinion the accompanying financial statements present fairly, in all material respects, the financial position of the CBM as at 31 December 2003 and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

4. Without qualifying our opinion, we draw attention to Note 23, which describes in more detail the uncertainty in respect of the completeness of assets, liabilities and other obligations in these financial statements arising on establishment of the CBM. The CBM's rights and obligations in respect of inherited assets, liabilities and other obligations are subject to negotiations with the National Bank of Serbia, which commenced in mid-2003. The Council is currently unable to make a reliable estimation of the total amount of assets, liabilities and other obligations which should be assumed by the CBM in addition to those reflected in these financial statements.

Belgrade, Serbia and Montengro
10 May 2004

(in thousands of EUR unless otherwise stated)

Balance Sheet

	Note	2003	2002
Assets			
Cash and cash equivalents	5	12,424	16,710
Placements with foreign banks	6	38,015	38,774
Loans and advances to the Government prior to commencement of operations of the CBM	7	7,546	13,547
Loans and advances to domestic banks granted by the predecessor central bank	8	1,353	2,479
Other assets	9	3,624	1,702
Premises and equipment	10	16,691	15,835
Total assets		**79,653**	**89,047**
Liabilities			
Accounts of commercial banks	11	31,829	51,608
Accounts of the Government and other entities	12	9,010	3,282
Accrued interest expense and other liabilities	13	1,051	895
Liabilities in respect of primary emission of the predecessor central bank	14	5,308	5,308
Total liabilities		**47,198**	**61,093**
Equity			
Founding capital	15	2,556	-
Retained earnings and other reserves		21,582	19,619
Fair value reserve for investments available-for-sale		-	11
Revaluation reserve for premises	10	8,317	8,324
Total equity		**32,455**	**27,954**
Total liabilities and equity		**79,653**	**89,047**

Signed and approved on behalf of the Council on 10 May 2004.

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Ljubiša Krgović	Zdenka Rakočević
President of the Council	Finance and accounting director
of the Central Bank of Montenegro	of the Central Bank of Montenegro

(in thousands of EUR unless otherwise stated)

Statement of Income

	Note	2003	2002
Interest income	16	2,209	2,788
Interest expense	16	(90)	(88)
Net interest income		**2,119**	**2,700**
Release/(Charge) of provision for loan impairment	17	70	(1,564)
Net interest income after provision for loan impairment		**2,189**	**1,136**
Foreign exchange translation losses, net of gains		(632)	(601)
Fee and commission income	18	12,896	14,695
Fee and commission expense	18	(189)	(226)
Other operating income	19	414	174
Operating income		**14,678**	**15,178**
Staff costs	20	(5,588)	(6,470)
Other operating expenses	21	(6,127)	(7,667)
Net operating income		**2,963**	**1,041**

(in thousands of EUR unless otherwise stated)

Statement of Cash Flows

	Note	2003	2002
Cash flows from operating activities			
Interest received		2,122	878
Interest paid		(99)	(73)
Fees and commissions received		12,444	14,440
Fees and commissions paid		(87)	(226)
Other operating income received		646	174
Staff costs paid		(6,919)	(6,453)
Operating expenses paid		(3,571)	(5,664)
Cash flows from operating activities before changes in operating assets and liabilities		**4,536**	**3,076**
Changes in operating assets and liabilities			
Net increase in term deposits with foreign banks		(760)	(8,501)
Net decrease in loans and advances to the Government prior to commencement of operations of the CBM		422	34
Net decrease in loans and advances to domestic banks granted by the predecessor central bank		388	568
Net increase in other assets		(535)	(210)
Net decrease in accounts of commercial banks		(10,983)	(6,075)
Net increase/(decrease) in accounts of the Government and other entities		5,286	(3,128)
Net increase/(decrease) in other liabilities		441	(130)
Net cash used in operating activities		**(1,205)**	**(14,366)**
Cash flows from investing activities			
Purchase of premises and equipment	10	(1,759)	(1,396)
Net cash used in investing activities		**(1,759)**	**(1,396)**
Cash flows from financing activities			
Distribution of net income to the Government	15	(1,000)	(307)
Net cash used in financing activities		**(1,000)**	**(307)**
Effect of exchange rate changes on cash and cash equivalents		**(322)**	**(430)**
Net decrease in cash and cash equivalents		**(4,286)**	**(16,499)**
Cash and cash equivalents at the beginning of the year	5	16,710	33,209
Cash and cash equivalents at the end of the year	5	**12,424**	**16,710**

(in thousands of EUR unless otherwise stated)

Statement of Changes in Equity

	Note	Founding capital	Retained earnings and other reserves	Fair value reserve for investments available-for-sale	Revaluation reserve for premises	Total equity
Balance at 31 December 2001		**-**	**18,885**	**2**	**7,780**	**26,667**
Net fair value gains arising on investments available-for-sale		-	-	9	-	9
Revaluation of premises and equipment	10	-	-	-	544	544
Net operating income for the year		-	1,041	-	-	1,041
Distribution of net income to the Government		-	(307)	-	-	(307)
Balance at 31 December 2002		**-**	**19,619**	**11**	**8,324**	**27,954**
Disposals of investments and fixed assets		-	-	(11)	(18)	(29)
Revaluation of premises and equipment		-	-	-	11	11
Net operating income for the year		-	2,963	-	-	2,963
Distribution of net income to the Government	15	-	(1,000)	-	-	(1,000)
Unpaid founding capital	9	2,556	-	-	-	2,556
Balance at 31 December 2003		**2,556**	**21,582**	-	**8,317**	**32,455**

1 Principal Activities

The Central Bank of Montenegro ("the CBM") was established in November 2000 after the adoption of the Law on the Central Bank of Montenegro ("the Law") by the Parliament of the Republic of Montenegro. In accordance with the Law, on the day the Law came into force, the CBM assumed ownership of the property of the predecessor central bank, the National Bank of Montenegro ("the NBM"), including the Payment Operations Department ("ZOP") in Podgorica. The NBM operated since 1999 and was formed on the basis of the Podgorica branch of the National Bank of Yugoslavia (NBY). All former employees of the NBM and Payment Operations Department ("ZOP") became employees of the CBM. In accordance with the Transitional and Closing Provisions of the Law, the CBM commenced operations in March 2001 with the appointment of members of the Council, the Management body of the CBM.

The CBM is an independent institution and reporting to the Assembly of Montenegro.

The CBM is 100% owned by the Republic of Montenegro. The equity of the CBM was derived from the difference between total identifiable assets and total identifiable liabilities inherited by the CBM from the NBM. As described in Note 23, the amount of assets and liabilities inherited from the predecessor central bank is subject to negotiations with the National Bank of Serbia. As described in Note 2, the major principles of restructuring relations between Serbia and Montenegro have been outlined in the Constitutional Charter of the State Union of Serbia and Montenegro adopted on 4 February 2003 ("the Constitutional Charter"). In accordance with Article 59 of the Constitutional Charter, the property of the Federal Republic of Yugoslavia necessary for the operation of the institutions of Serbia and Montenegro becomes the property of Serbia and Montenegro. The property of the Federal Republic of Yugoslavia in the territory of the member states becomes the property of the member states based on the territorial principle.

The CBM operates in accordance with the Law and the By-Laws of the CBM. In accordance with the Law, the CBM is responsible for the monetary policy of the Republic of Montenegro, establishing and maintaining a sound banking system, efficient payment operations in the Republic and managing foreign exchange reserves of the Republic, except for the part that is handled by licensed banks.

Since the introduction of the Euro on 1 January 2002, the monetary policy of the CBM is based on Euro ("EUR") as the monetary unit, as the means of payment and as the reserve currency.

In carrying out the functions specified above, the CBM has the following authorities as set out in the Law:

- To issue and revoke operating licences to banks and financial institutions; to regulate and control their activities and liquidate banks and financial institutions in the Republic;
- To grant loans from its own resources to banks licensed to operate in the Republic under the conditions determined by the Law;
- To regulate and supervise payment operations, settlement and interbank clearing in the Republic;
- To carry out and supervise domestic and foreign payment operations;
- To carry out the activities of banker, advisor and fiscal agent of bodies and organisations of the Republic;
- To buy and sell currencies and precious metals for its own account or for the account of the Republic;
- To buy and sell securities, at the secondary market, issued by the Republic, a European Union member-state, or other state designated in a regulation of the CBM;
- To perform regular macroeconomic analysis, including monetary, fiscal, financial and balance of payments' analysis of the economy of the Republic, and give recommendations to the Government in the field of economic policy;
- To prepare and participate in the preparation of laws and other regulations for monetary, foreign exchange and banking system, in accordance with the international standards, including determination of reserves for different types of deposits;
- To provide banking services on behalf of foreign governments, foreign central banks, as well as on behalf of international organisations and other international institutions in which the Central Bank or the Republic participate;
- To accept deposits from banks, state bodies and organisations;
- To open and maintain accounts for the needs of state bodies and organisations, domestic and foreign banks, international financial institutions and donor organisations;
- To prescribe the manner of performing activities of dealers and banks in foreign exchange transactions, determine limits on foreign exchange positions of dealers and banks and supervise them;
- To own and operate one or more payment systems;

1 Principal Activities (continued)

- To ensure an adequate supply of banknotes and coins for the settlement of financial transactions;
- To manage the foreign currency reserves of the Republic, except for the part that is managed by authorised banks;
- To open accounts in other countries;
- To perform other activities specified by the Law.

In respect of monetary policy tools, the activities of the CBM are limited by the Law, which prohibits the CBM from:

- Issuing its own currency;
- Extending credits to the Government of the Republic of Montenegro or other legal entities and individuals, except under specific conditions prescribed by the Law;
- Guaranteeing obligations of the Republic.

The CBM's registered office is located at the following address: Nemanjina obala 7, 81000 Podgorica. The number of the CBM employees as at 31 December 2003 is 474 persons (2002: 739 persons).

The Council of the Bank has approved the "Reform Activity Plan". During 2003, as part of the improvements, a revised organisational structure was introduced, which streamlines operational and reporting procedures within the Bank. Procedures and manuals will be updated in 2004. The Payment Operation Department was migrated to be run by commercial banks in January 2004. New IT equipment will be purchased in 2004 for this system. The branch premises made vacant by this transfer have been leased out to commercial banks. Further improvements will be made during 2004 and beyond to the governance and committed structures, including establishment of an Audit Committee. Enhancements will be also made to the Bank's risks management procedures to improve monitoring and control of risk.

The Management will introduce revised procedures for the recruitment, retention and professional training of the Bank's staff. This will include revised job descriptions, staff appraisals and a reward system based on performance.

The Management is also developing contingency plans and possible changes to prudential reporting and banking supervision in connection with the introduction of IFRS.

2 Operating Environment of the CBM

The Republic of Montenegro is an emerging economy. The political structure, regulatory and legal framework are currently under development, as further described in the following paragraphs. The volume of activity in the financial market is insignificant. As such, external independent market quotations were not available for certain financial instruments. The Management has therefore used the best available information to reflect their estimate of fair values.

On 14 March 2002 officials of the former Federal Republic of Yugoslavia, the Republic of Serbia and the Republic of Montenegro signed the "Accord on Principles" in relations of Serbia and Montenegro in the common state (known as "the Belgrade Agreement"), which provided for the development of the Constitutional Charter, the highest legal act of the State Union of Serbia and Montenegro. In the activities plan developed based on the Belgrade Agreement, the representatives of the Government of Serbia and the Government of Montenegro agreed to the existence of two separate monetary systems, two central banks and two currencies as legal payment instruments.

The Constitutional Charter of the State Union of Serbia and Montenegro ("the Union") adopted by the National Assembly of the Republic of Serbia, the Assembly of the Republic of Montenegro and the Federal Assembly of the former Federal Republic of Yugoslavia on 4 February 2003 outlined the major principles for the restructuring of relations between Serbia and Montenegro. The state union is based on the equality of the two member states, the state of Serbia and the state of Montenegro. However, the formalisation of the relationship in particular areas, such as the split of assets, liabilities and other obligations of the former Federal Republic of Yugoslavia assumed by each member state of the Union, is subject to further negotiations between the member states.

2 Operating Environment of the CBM (continued)

In accordance with the "Law on the Implementation of the Constitutional Charter of the State Union of Serbia and Montenegro", the member states and the State Union have established in April 2003 a commission comprising representatives of the Government of the Republic of Serbia, the Government of the Republic of Montenegro, the Council of Ministers of the State Union of Serbia and Montenegro and central banks of the member states to develop proposals in respect of the property of the State Union essential for functioning of its institutions and the Army of Serbia and Montenegro, as well as the scope, structure and manner of distribution of the remaining assets. The Commission is in the process of finalising its recommendations.

Also in April 2003 the Council of Ministers of the State Union adopted the decision of representation of the State Union in the International Monetary Fund ("the IMF") and the World Bank. Under this decision, the National Bank of Serbia shall be the fiscal agent and depository of the State Union in the IMF and the depository of the State Union in the World Bank, and the Central Bank of Montenegro shall be fiscal agent of the State Union in the World Bank.

3 Basis of Presentation

The financial statements of the CBM are prepared in accordance with International Financial Reporting Standards ("IFRS"), including International Accounting Standards ("IAS") and Interpretations issued by the International Accounting Standards Board.

During 2003 the Management of CBM has introduced a number of improvements to the accounting function as part of organisational changes. A new chart of accounts and other improvements in financial reporting and controls will be made during 2004.

The financial statements have been measured in the monetary unit of the Republic of Montenegro, Euro ("EUR").

The preparation of the financial statements requires the use of estimates and assumptions that effect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Although these estimates are based on Management's best knowledge of current events and actions, future results ultimately may differ from those estimates.

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

Certain reclassifications between assets and liabilities, profit and loss categories have been made in 2003 for presentational purposes. In particular, contractual advance payments to contractors previously showed as other assets in 2002 financial statements in the amount of EUR 1,106 thousand are now included in assets under construction; provision for impairment of other assets previously presented as other expenses in 2002 financial statements in the amount of EUR 255 thousand are now included in Release/(Charge) of provision for loan impairment.

4 Significant Accounting Policies

Cash and cash equivalents. Cash and cash equivalents are items which can be converted into cash at short notice and which are subject to an insignificant risk of changes in value. All short term interbank placements, beyond overnight deposits and placements on call, are included in term placements with other banks. Amounts, which relate to funds that are of a restricted nature, are excluded from cash and cash equivalents.

Loans and advances and provisions for loan impairment. Loans originated by the CBM by providing money directly to the borrower are categorised as originated loans. This category as at 31 December 2003 consists of loans prior to commencement of operations of the CBM. As disclosed in Note 1, the activities of the CBM are limited by the Law in respect of monetary policy tools, which prohibits the CBM from extending credits to the Government of the Republic of Montenegro or other legal entities and individuals, except under specific conditions prescribed by the Law.

4 Significant Accounting Policies (continued)

Originated loans and advances are recognised when cash is advanced to borrowers. Initially, originated loans and advances are recorded at cost, which is the fair value of the consideration given, and subsequently are carried at amortised cost less provision for loan impairment. Amortised cost is based on the fair value of cash consideration given to originate those loans determinable by reference to market prices at origination date.

Loans originated at interest rates different from market rates are re-measured at origination to their fair value, being future interest payments and principal repayment(s) discounted at market interest rates for similar loans. The difference between the fair value and the nominal value at origination is credited or charged to the statement of income as gains on origination of assets at rates above market or losses on origination of assets at rates below market. Subsequently, the carrying amount of such loans is adjusted for amortisation of the gains/losses on origination and the related income is recorded as interest income within the statement of income using the effective yield method.

A credit risk provision for loan impairment is established if there is objective evidence that the CBM will not be able to collect the amounts due according to original contractual terms. The amount of the provision is the difference between the carrying amount and estimated recoverable amount, calculated as the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the instrument’s original effective interest rate.

The provision for loan impairment also covers losses where there is objective evidence that probable losses are present in components of the loan portfolio at the balance sheet date. These have been estimated based upon historical patterns of losses in each component, the credit ratings assigned to the borrowers and reflect the current economic environment in which the borrowers operate.

When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to the provision for loan impairment in the statement of income.

If the amount of the provision for loan impairment subsequently decreases due to an event occurring after the write-down, the release of the provision is credited to the provision for loan impairment in the statement of income.

The CBM does not enter into transactions for purchases of loans with third parties.

Investments available-for-sale. This classification includes investments which the Management intends to hold for an indefinite period of time. The Management determines the appropriate classification of its investments at the time of purchase.

Investments available-for-sale are initially recognised at cost (which includes transaction costs) and subsequently re-measured to fair value based on market prices. Investments available-for-sale for which there is no available external independent quotation have been fair valued by the Management on the basis of results of recent sales of equity interests in the investees between unrelated third parties, consideration of other relevant information such as discounted cash flows and financial data of the investees and application of other valuation methodologies. Unrealised gains and losses arising from changes in the fair value of investments available-for-sale are recognised in the statement of changes in equity. When the investments available-for-sale are disposed of, the related accumulated fair value adjustments are included in the statement of income as gains less losses arising from investments available-for-sale. Impairment and reversal of impairment of investments available-for-sale is recorded through the statement of income.

Because of the inherent settlement risk of the securities market, security purchases and sales under ‘regular way’ contracts are recorded on the date that ownership is transferred. ‘Regular way’ contracts are contracts that require delivery of the securities within the time frame generally established by regulation or convention in the market place concerned.

4 Significant Accounting Policies (continued)

Premises and equipment. Premises and equipment at the CBM are stated at cost or revalued amounts, as described below, less accumulated depreciation and provision for impairment, where required. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount and the difference is charged to the statement of income. The estimated recoverable amount is the higher of an asset's net selling price and its value in use.
Premises and equipment of the CBM are subject to revaluation on a regular basis. The frequency of revaluation depends upon the movements in the fair values of the premises and equipment being revalued. The revaluation reserve included in equity is transferred directly to retained earnings when the surplus is realised, i.e. either on the retirement or disposal of the asset.

Advance payments made to contractors are included as assets under construction, which are subject to certification by an internal technical commission of the CBM during construction. Asset under construction are carried at cost less provision for impairment. Upon completion, assets are transferred to premises and equipment at their carrying amount. Asset under construction is not depreciated until the asset is available for use.

Gains and losses on disposal of premises and equipment are determined by reference to their carrying amount and are taken into account in determining the result for the period. 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 as follows:

Premises	50-75 years
Computers	3 years
Furniture and equipment	5-10 years
Motor vehicles	7 years

Land is not depreciated.

Operating leases. Assets leased out under operating leases are included in property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment. Rental income (net of any incentives given to lessees) is recognised on a straight-line basis over the lease term.

Computer software development costs. Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with identifiable and unique software products controlled by the CBM and will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include staff costs of the software development team and an appropriate portion of relevant overheads.

Expenditure which enhances or extends the performance of computer software programmes beyond their original specifications is recognised as a capital improvement and added to the original cost of the software. Computer software development costs recognised as assets are amortised using the straight-line method over their useful lives, not exceeding a period of 7 years.

Income and expense recognition. Interest income and expense are recognised in the statement of income for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price. When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

Fees and commissions for payment system services are recorded on a cash basis when the fees are collected from payment system participants. Other fees, commissions and other income and expense items are generally recorded on an accrual basis when the service has been provided.

(in thousands of EUR unless otherwise stated)

4 Significant Accounting Policies (continued)

Foreign currency translation. Transactions denominated in currencies other than EUR are recorded at the exchange rate ruling on 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 currencies other than EUR are translated into EUR at the mid-market exchange rates 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 in the current period as foreign exchange translation gains less losses. Translation differences on non-monetary items such as equities available-for-sale are recorded as part of the fair value gain or loss. As at 31 December 2003 the principal rates of exchange used for translating balances in currencies other than EUR, were:

	31 December 2003	31 December 2002
1 USD	0.7996	0.9588
1 YUD	0.0146	0.0163
1 CHF	0,6413	0.6878
1 GBP	1,4203	1.5373

Founding capital and reserves As at the date of issuing these financial statements, the founding capital had not yet been allocated by the Government of Montenegro into the CBM's equity (see Note 9). The retained earnings and other reserves of the CBM were derived from the difference between total identifiable assets and total identifiable liabilities inherited by the CBM from the NBM, the predecessor central bank and prior year net operating income.

Distribution of net income to the Government. The CBM is required by the Law to distribute the rest of net income to the Government of Montenegro. Net income shall be allocated each year to the account of general reserves, until amounts of founding capital and general reserves get even with at least five percent of the total amount of credit balances of all accounts, that are presented as liabilities in the balance sheet at the end of the financial year. The rest of net income represents the income of the budget of the Republic and it shall be transferred to the account of the Ministry of Finance that has been established with the Central Bank. The distribution of net income to the Government is recorded in equity in the period in which it is declared by the Council of the CBM. The statutory accounting reports of the CBM are the basis for net income distribution and other appropriations.

Taxation. In accordance with the Law, the CBM is exempt from income tax. Taxes, other than on income, are recorded within operating expenses. Tax to be paid is disclosed under other liabilities (Note 13) as taxes payable.

Fiduciary assets. Assets and liabilities held by the CBM in its own name, but for the account of third parties, are not reported on the balance sheet. Commissions received from such business are shown in fee and commission income within the statement of income.

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.

Provisions. Provisions are recorded when the CBM has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Pension costs. The CBM contributes to the state pension scheme, obligatory medical insurance and employment funds in respect of its employees. The CBM's pension scheme contributions amount to 12% of employees' gross salaries and are expensed as incurred. Pension scheme and other contributions are included in staff costs in the statement of income.

(in thousands of EUR unless otherwise stated)

5 Cash and Cash Equivalents

	2003	2002
Cash in EUR:		
- cash held in the CBM vault	3,804	2,450
- cash in vaults and cashiers' offices of Payment Operations Department	6,905	13,386
Cash in transit	1,061	-
Foreign currency cash	211	631
Demand deposits with foreign banks	443	243
Total cash and cash equivalents	**12,424**	**16,710**

The geographical and currency analyses of cash and cash equivalents are presented in Note 22.

6 Placements with Foreign Banks

The placements are with foreign banks, with AA credit rating assigned by an international rating agency.

As at 31 December, 2003 the estimated fair value of term placements with foreign banks was EUR 38,015 thousand (2002: EUR 38,774 thousand).

Geographical, currency, maturity and interest rate analyses of term placements with foreign banks are disclosed in Note 22.

7 Loans and Advances to the Government Prior to Commencement of Operations of the CBM

	2003	2002
Loans to the Government granted by Payment Operations Department	7,268	13,268
Loans to the Government granted from primary emission by the NBM	2,532	2,955
Other advances to the Government	329	329
Less: Provision for loan impairment	(2,583)	(3,005)
Total loans and advances to the Government prior to commencement of operations of the CBM	**7,546**	**13,547**

Loan to the Government granted by the prior State Payment Operations Organisation (ZOP), amounting EUR 13,268 thousand, has been secured by a pledge deposit placed by the Government with the CBM (Note 12). The Loan was repaid in September 2003 in the amount of EUR 6,000 thousand.

As a result, no provision has been raised against this loan as at 31 December 2003.

Loans to the Government granted from primary emission prior to the establishment of the CBM were inherited by the CBM from the predecessor central bank. The loans were granted by the NBM in Yugoslav dinars (YUD). During 2000 these loans were re-arranged as loans repayable in DEM and accrued interest was capitalised. The corresponding liability in respect of primary emission is disclosed in Note 14. With the introduction of EUR in 2002 these loans became repayable in EUR.

(in thousands of EUR unless otherwise stated)

7 Loans and Advances to the Government Prior to Commencement of Operations of the CBM (continued)

Movements in the provision for loan impairment are as follows:

	2003
Provision for loan impairment as at 1 January	**3,005**
Recovery for provision for loan impairment during the year	(422)
Provision for loan impairment at 31 December	**2,583**

On adoption of IAS 39 on 1 January 2002 interest-free loans granted to the Government have been re-measured to their fair value, being expected future principal repayments discounted at the interest rate for similar loans to the Government.

As at 31 December 2003 the estimated fair value of loans and advances to the Government prior to commencement of operations of the CBM was EUR 7,546 thousand (2002: EUR 13,547 thousand).

Currency, maturity and interest rate analyses of loans and advances to the Government prior to commencement of operations of the CBM are disclosed in Note 22.

8 Loans and Advances to Domestic Banks Granted by the Predecessor Central Bank

	Note	**2003**	**2002**
Current short-term loans		-	881
Rescheduled loans granted from primary emission by the NBM:			
- long-term loans granted under State programs		680	777
- other long-term loans		673	897
Less: Provision for loan impairment		-	(76)
Total loans and advances to domestic banks granted by the predecessor central bank		**1,353**	**2,479**

Loans to banks were granted from primary emission prior to the establishment of the CBM. These loans were granted in YUD to finance specific programs including agriculture, tourism and electricity. During 2000 these loans were re-arranged as loans repayable in DEM and accrued interest was capitalised. The corresponding liability in respect of primary emission is disclosed in Note 14. With the introduction of EUR in 2002 these loans became repayable in EUR.

Loans granted to banks from the primary emission are regularly repaid during 2003. As at 31 December 2003 estimated fair value of loans to domestic banks prior to commencement of operations of the CBM is EUR 1,353 thousand (2002: EUR 2,479 thousand).

(in thousands of EUR unless otherwise stated)

8 Loans and Advances to Domestic Banks Granted by the Predecessor Central Bank (continued)

Movements in the provision for loan impairment are as follows:

	2003
Provision for loan impairment at 1 January	**76**
Recovery of provision for loan impairment during the year	(76)
Provision for loan impairment at 31 December	-

On adoption of IAS 39 on 1 January 2002 long-term loans granted to banks by the predecessor central bank under State programs at rates below market have been re-measured to their fair value, being future interest payments and principal repayments discounted at interest rates for similar loans. The difference between the fair value and the nominal value was charged to the opening balance of retained earnings as loss on origination of assets at rates below market. Subsequently, the carrying amount of these loans was adjusted for amortisation of the loss on origination and the related income was recorded as interest income within the statement of income using the effective yield method. Recovery of provision for loan impairment during the year was due to loan repayments.

The recovery of previously written off loans to commercial banks has been recorded in the amount of EUR 67 thousand.

Currency, maturity and interest rate analyses of loans and advances to domestic banks granted by the predecessor central bank are disclosed in Note 22.

9 Other Assets

	2003	2002
Accrued interest income:		
Loans to the Government prior to commencement of operations of the CBM	459	364
Loans to domestic banks granted by the predecessor central bank	19	28
Term placements with foreign banks	4	6
Less: Provision for impairment	(459)	(361)
	23	37
Due from the Government:		
In respect of foundation capital	2,556	-
Fees receivable from Ministry of Finance	652	255
Less: Provision for impairment	(652)	(255)
	2,556	-
Non-operating assets	348	777
Stock of numismatic coins and office supplies	356	374
Other debtors and prepayments	241	352
Investments available for sale	100	162
Total other assets	**3,624**	**1,702**

(in thousands of EUR unless otherwise stated)

9 Other Assets (continued)

According to the accepted accounting polices, the CBM has calculated interest on loans to the Government (EUR 13,260 thousand) for the period from 1 January to the date of making pledge deposit by Government (see Note 12) using EURIBOR valid at date of agreement. The CBM has accrued interest (EUR 62 thousand) using an average interest rate of 2,25% p.a. The full amount of calculated interest is provisioned.

Non-operating assets represent the balance of loans provided to employees of the CBM for purchase of apartments, receivables from the CBM employees in respect of apartments provided to them by the CBM and apartments under construction.

Fee receivables from Ministry of Finance are related to fiscal agent services undertaken by the CBM on behalf of the Ministry of Finance for Treasury Bills issuance.

Movements in the provision for impairment of accrued interest income are as follows:

	Note	2003
Provision for impairment of accrued interest income at 1 January		**361**
Charge for provision for impairment of accrued interest income during the year	17	181
Collection of previously provisioned accrued interest income	17	(83)
Provision for impairment of accrued interest income at 31 December		**459**

Movements in the provision for impairment fee receivables from Ministry of Finance are as follows:

	Note	2003
Provision for impairment of other assets at 1 January		**255**
Charge for provision for impairment of other assets during the year	17	397
Provision for impairment of other assets at 31 December		**652**

Geographical, currency and maturity analyses of accrued interest income are disclosed in Note 22.

(in thousands of EUR unless otherwise stated)

10 Premises and Equipment

	Land	Premises	Office and computer equipment	Assets under construction	Other	Total
Net book amount at 31 December 2002	**326**	**11,425**	**1,491**	**1,390**	**97**	**14,729**
Adjustment of opening balances	-	-	-	1,106	-	1,106
Net book amount at 31 December 2002	**326**	**11,425**	**1,491**	**2,496**	**97**	**15,835**
Book amount at cost or valuation						
Opening balance	326	16,392	5,261	2,496	206	24,681
Additions	-	-	11	1,855	26	1,892
Transfers	-	23	556	(579)	-	-
Disposals	-	(54)	(180)	-	-	(234)
Closing balance 31 December 2003	**326**	**16,361**	**5,648**	**3,772**	**232**	**26,339**
Accumulated depreciation						
Opening balance	-	4,967	3,770	-	109	8,846
Depreciation charge (Note 21)	-	215	712	-	8	935
Disposals	-	(14)	(119)	-	-	(133)
Closing balance 31 December 2003	**-**	**5,168**	**4,363**	**-**	**117**	**9,648**
Net book amount at 31 December 2003	**326**	**11,193**	**1,285**	**3,772**	**115**	**16,691**

Assets under construction relate mainly to construction and refurbishment of the CBM's Head office and certain branch premises of Domestic Payment. Advance payments made to suppliers in respect of reconstruction of the Bank's premises amounting to EUR 1,129 thousand (2002: EUR 1,106 thousand) are also included in assets under construction. Construction is subject of regular technical certification by an internal commission of the CBM. Upon final completion, assets are transferred to premises.

Premises and equipment have been revalued to market value. The revaluation was performed in July 2001 on the basis of appraisals performed by independent valuers. The appraisal of Payment Operations Department premises and equipment was performed by a professional appraisal company "Bc Excel". The appraisal of premises of the CBM was performed by Civil Engineering Faculty from Podgorica, which is authorised to perform valuations in the Republic of Montenegro. The basis used for the appraisals was market value, where it was identifiable, and depreciated replacement cost for those assets that were in use for a significant period of time.

In accordance with Payment System Transformation, the CBM leased equipment in amount of EUR 67 thousand and business premises in amount of EUR 3,178 thousand to commercial banks.

(in thousands of EUR unless otherwise stated)

11 Accounts of Commercial Banks

	2003	2002
Mandatory reserves of commercial banks	19,122	31,569
Gyro accounts of commercial banks	12,707	18,712
Sub-accounts of commercial banks subsidiaries	-	1,327
Total accounts of commercial banks	**31,829**	**51,608**

Commercial banks and their branches operating in the Republic of Montenegro are required to calculate mandatory reserves on specified customer accounts and deposit the respective funds with the CBM. In 2003 the mandatory reserve was calculated by applying a specified percentage (23%) to the average deposit amount during the previous two-week period.

The CBM pays interest of 1% per annum on the funds deposited in commercial banks' mandatory reserve accounts.

As at 31 December 2003 the estimated fair value of accounts of commercial banks was EUR 31,829 thousand (2002: EUR 51,608 thousand). Refer to Note 24.

Geographical, currency, maturity and interest rate analyses of accounts of commercial banks are disclosed in Note 22.

12 Accounts of the Government and Other Entities

	2003	2002
Accounts of the Government	7,690	2,403
Accounts of legal entities	-	478
Other accounts	1,320	401
Total accounts of the Government and other entities	**9,010**	**3,282**

The Government and public organisations and other entities hold their gyro accounts with the Payment Operations Department for the purpose of participation in payment operations. All accounts of the Government and other entities are non-interest bearing.

Included in Accounts of the Government is an amount of EUR 7,268 thousand, held as a pledge deposit for the remaining portion of loans to the Government granted by Payment Operation Department. Refer to Note 7.

As at 31 December 2003 the estimated fair value of accounts of the Government and other entities was EUR 9,010 thousand (2002: EUR 3,282 thousand). Refer to the Note 24.

Geographical, currency and maturity analyses of accounts of the Government and other entities are disclosed in Note 22.

(in thousands of EUR unless otherwise stated)

13 Accrued Interest Expense and Other Liabilities

	Note	2003	2002
Provision for restructuring costs	21	751	621
Accrued expenses		74	125
Taxes payable		18	111
Accrued interest expense		6	15
Other		202	23
Total accrued interest expense and other liabilities		**1,051**	**895**

Provision for the restructuring costs represents the Management's estimate of the amounts to be paid as a result of the transfer of the Payment Operation Department activities to commercial banks with effect from January 2004 (see Note 26).

Geographical, currency and maturity analyses of accrued interest expense and other liabilities are disclosed in Note 22.

14 Liabilities in Respect of Primary Emission of the Predecessor Central Bank

Yugoslav dinars (YUD) issued by the former National Bank of Yugoslavia (NBY) were the monetary unit of Montenegro as part of the former Federal Republic of Yugoslavia, up until November 1999.

As disclosed in Note 23, the CBM's rights and obligations in respect of inherited assets and liabilities are subject to negotiations with the National Bank of Serbia (NBS).

Prior to the adoption of IAS, liabilities in respect of primary emission of the predecessor central bank were stated in the amounts and currencies that corresponded to the assets inherited by the CBM.

15 Founding Capital, Retained Earnings and Other Reserves

Equity of the CBM on establishment represents the difference between the total carrying value of identifiable assets and identifiable liabilities inherited by the CBM from the NBM. As described in Note 23, the amount of assets, liabilities and other potential obligations inherited from the predecessor central bank is subject to negotiations with the NBS.

In accordance with the Law, the founding capital of the CBM should equal DEM 5 million (EUR 2,556 thousand). As at the date of issuing these financial statements, this amount had not yet been allocated by the Government of Montenegro into the CBM's capital (see Note 9). The level of founding capital and general reserve of the CBM should not be lower than 5% of the aggregate amount of all liabilities recorded in the balance sheet at the end of a financial year. The capital may be increased by amounts determined by the CBM and approved by the Government. The net income of the CBM for the year is distributed under the decision of the Council of the CBM to general reserves and Government of Montenegro. Part of the net income defined by the Council of the CBM represents income of the budget of the Republic and is transferred to the Ministry of finance. A net loss for a period shall be covered from the general reserve or charged to capital, if general reserve is not sufficient. Any capital deficit of the CBM shall be covered by the Government.

During 2003, in accordance with the decision of the Council, the CBM distributed to the Government a portion of net operating income for the year ended 31 December 2002 in the amount of EUR 1,000 thousand.

(in thousands of EUR unless otherwise stated)

16 Interest Income and Expense

	2003	2002
Term deposits at foreign banks	1,034	679
Loans and advances to the Government originated prior to commencement of operations of the CBM		
- amortisation of discount on origination	-	1,516
- interest income earned under contractual terms	62	339
Loans and advances to domestic banks granted by the predecessor central bank		
- interest income earned under contractual terms commercial banks	432	182
- amortisation of discount on origination	-	72
Interest earned on usage of obligatory reserves	681	-
Total interest income	**2,209**	**2,788**
Interest expense		
Mandatory reserves of commercial banks	(90)	(88)
Total interest expense	**(90)**	**(88)**
Net interest income	**2,119**	**2,700**

17 Release of Provision for Loan Impairment

	Note	2003	2002
Provision charge for bad and doubtful accrued interest and fee receivables	9	(578)	(1,797)
Release of provision for loan impairment	7,8	581	233
Recovery of previously written off loans	8	67	-
Total release of provision for loan impairment		**70**	**(1,564)**

(in thousands of EUR unless otherwise stated)

18 Fee and Commission Income and Expense

	2003	2002
Fee and commission income		
Commission for services of payment system	11,295	12,962
Fees for registration of documentary operations	989	990
Commission for issue of licenses and permissions	115	123
Other fee and commission income	497	620
Total fee and commission income	**12,896**	**14,695**
Fee and commission expense		
Fees for services provided by other banks	46	212
Other fee and commission expense	143	14
Total fee and commission expense	**189**	**226**
Net fee and commission income	**12,707**	**14,469**

Commission for services of payment system represents commission earned by Payment Operations Department in respect of services provided by the CBM to the gyro account holders.

19 Other operating income

	Note	2003	2002
Property rental income	10	203	-
Other income		211	174
Total other income		**414**	**174**

20 Staff Costs

	2003	2002
Salaries and wages	2,925	4,876
Contributions in respect of payments to employees	1,701	1,151
Other employee benefits	962	443
Total staff costs	**5,588**	**6,470**

(in thousands of EUR unless otherwise stated)

21 Other Operating Expenses

	Note	2003	2002
Administrative expenses		1,562	1,390
Movement in provision for restructuring costs	13	1,062	621
Depreciation of premises and equipment	10	935	1,329
Loans to employees written off	9	929	868
Other expenses related to premises and equipment		453	421
Other		415	636
Communication, mail and transportation		328	936
Humanitarian aid and cultural activities		259	441
Taxes other than on income		101	347
Insurance		83	67
Cost of converting DEM into EUR		-	611
Total other operating expenses		**6,127**	**7,667**

22 Financial Risk Management

The risk management function within the CBM is carried out in respect of financial risks (credit, market, geographical, currency, liquidity and interest rate), operational risks and legal risks. The primary objectives of the financial risk management function are to establish risk limits, and then ensure that exposure to risks stays within these limits. The operational and legal risk management functions are intended to ensure proper functioning of internal policies and procedures to minimize operational and legal risks. As part of the Council's plan to improve the internal operation environment of the Bank, the Management is undertaking a comprehensive review of internal controls and procedures, including a re-assessment of the risk management process.

Credit risk. The CBM is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. As the loans and advances outstanding as at 31 December 2003 were granted prior to commencement of operations of the CBM, the CBM is unable to manage credit risk in respect of these loans.

Exposure to credit risk in respect of placements with foreign banks is managed through regular analysis of the ability of counterparties to meet interest and principal repayment obligations.

The CBM's maximum exposure to credit risk is primary 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.

Market risk. The CBM takes on exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements.

Geographical risk. At 31 December 2003 and 31 December 2002, all loans and advances are placed in Montenegro and gyro accounts represent funds placed by resident organisations. Balances due from banks outside the Republic of Montenegro are reflected in the respective notes to the financial statements. Demand deposits, placements with foreign banks and accrued interest totalling EUR 38,015 thousand (2002: EUR 38,895 thousand) are due from German and British banks.

(in thousands of EUR unless otherwise stated)

22 Financial Risk Management (continued)

Currency risk. The CBM takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The table below summarises the CBM's exposure to foreign currency exchange rate risk at 31 December 2003. Included in the table are the CBM's assets and liabilities at carrying amounts, categorised by currency. At 31 December 2003, the CBM has the following positions in currencies:

	EUR	USD	GBP	YUD	CHF	Other currencies	Total
Assets							
Cash and cash equivalents	12,210	164	-	-	35	15	12,424
Term placements with foreign banks	35,516	1,856	72	-	571	-	38,015
Loans and advances to the Government prior to commencement of operations of the CBM	7,546	-	-	-	-	-	7,546
Loans and advances to domestic banks granted by the predecessor central bank	1,353	-	-	-	-	-	1,353
Other assets	3,624	-	-	-	-	-	3,624
Premises and equipment	16,691	-	-	-	-	-	16,691
Total assets	**74,384**	**2,020**	**72**	**-**	**606**	**15**	**79,653**
Liabilities							
Accounts of commercial banks	31,829	-	-	-	-	-	31,829
Accounts of the Government and other entities	9,010	-	-	-	-	-	9,010
Accrued interest expense and other liabilities	1,051	-	-	-	-	-	1,051
Liabilities in respect of primary emission of the predecessor central bank	-	-	-	5,308	-	-	5,308
Total liabilities	**41,890**	**-**	**-**	**5,308**	**-**	**-**	**47,198**
Net balance sheet position	**35,060**	**2,020**	**72**	**(5,308)**	**606**	**15**	**32,455**

At 31 December 2002 the CBM had the following positions in currency:

	EUR	USD	YUD	Other currencies	Total
Net balance sheet position	**28,601**	**3,909**	**(5,293)**	**78**	**27,954**

(in thousands of EUR unless otherwise stated)

22 Financial Risk Management (continued)

Liquidity risk. Liquidity risk is defined as the risk when the maturity of assets and liabilities does not match. The table below shows assets and liabilities as at 31 December 2003 by their remaining contractual maturity.

The liquidity position of the CBM as at 31 December 2003 is set out below.

.	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	More than 1 year	Non stated maturity	Total
Assets						
Cash and cash equivalents	12,424	-	-	-	-	12,424
Term placements with foreign banks	38,015	-	-	-	-	38,015
Loans and advances to the Government prior to commencement of operations of the CBM	-	-	59	7,487	-	7,546
Loans and advances to domestic banks granted by the predecessor central bank	-	-	-	1,353	-	1,353
Other assets	-	-	-	-	3,624	3,624
Premises and equipment	-	-	-	-	16,691	16,691
Total assets	**50,439**	**-**	**59**	**8,840**	**20,315**	**79,653**
Liabilities						
Accounts of commercial banks	31,829	-	-	-	-	31,829
Accounts of the Government and other entities	9,010	-	-	-	-	9,010
Accrued interest expense and other liabilities	300	-	751	-	-	1,051
Liabilities in respect of primary emission of the predecessor central bank	-	-	-	-	5,308	5,308
Total liabilities	**41,139**	**-**	**751**	**-**	**5,308**	**47,198**
Net liquidity gap	**9,300**	**-**	**(692)**	**8,840**	**15,007**	**32,455**
Cumulative liquidity gap at 31 December 2003	**9,300**	**9,300**	**8,608**	**17,448**	**32,455**	**-**
Cumulative liquidity gap at 31 December 2002	**7,305**	**7,353**	**8,443**	**9,963**	**27,954**	**-**

Overdue assets are fully provided against, and thus, have no impact on the above table.

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

(in thousands of EUR unless otherwise stated)

22 Financial Risk Management (continued)

Interest rate risk. The CBM takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise.

The CBM is exposed to interest rate risk, principally as a result of its historic lending at fixed interest rates. As the loans and advances outstanding as at 31 December 2003 prior to commencement of operations of the CBM, the CBM is unable to manage interest rate risk in respect of these loans. All other activities are undertaken on short term interest rates, and the CBM's exposure to interest rate risk is limited as the CBM does not have term borrowings.

The table below summarises the CBM's exposure to interest rate risks. Included in the table are the CBM's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	More than 1 year	Non-interest bearing	Total
Assets						
Cash and cash equivalents	-	-	-	-	12,424	12,424
Term placements with foreign banks	38,015	-	-	-	-	38,015
Loans and advances to the Government prior to commencement of operations of the CBM	-	-	-	220	7,326	7,546
Loans and advances to domestic banks granted by the predecessor central bank	-	-	-	1,353	-	1,353
Other assets	-	-	-	-	3,624	3,624
Premises and equipment	-	-	-	-	16,691	16,691
Total assets	**38,015**	**-**	**-**	**1,573**	**40,065**	**79,653**
Liabilities						
Accounts of commercial banks	11,243	-	-	-	20,586	31,829
Accounts of the Government and other entities	-	-	-	-	9,010	9,010
Accrued interest expense and other liabilities	-	-	-	-	1,051	1,051
Liabilities in respect of primary emission of the predecessor central bank	-	-	-	-	5,308	5,308
Total liabilities	**11,243**	**-**	**-**	**-**	**35,955**	**47,198**
Net gap	**26,772**	**-**	**-**	**1,573**	**4,110**	**32,455**
Cumulative gap at 31 December 2003	**26,772**	**-**	**-**	**28,345**	**32,455**	**-**

As at 31 December 2003 the CBM's interest rate sensitivity analysis based on the repricing of the CBM's assets did not differ significantly from the maturity analysis. As at 31 December 2003 all liabilities of the CBM were non-interest bearing.

(in thousands of EUR unless otherwise stated)

22 Financial Risk Management (continued)

The table below summarises the effective interest rates by major currencies for major monetary financial instruments. For assets which are contractually non-interest bearing, or bear interest below market rate, the effective interest rate disclosed below reflects the amortisation of discount calculated at origination. The analysis has been prepared using period-end effective interest rates.

	2003			2002		
	EUR	**USD**	**CHF**	**DEM**	**EUR**	**USD**
Assets						
Term deposits with foreign banks	2.25%	1.12%	0.12%	2.81%	1.25%	0.50%
Loans to the Government prior to commencement of operations of the CBM	12.00%	-	-	12.00%	-	-
Loans and advances to domestic banks granted by the predecessor central bank	12.00%	-	-	12.00%	-	-
Short-term loans and advances to domestic banks	3.50%	-	-	3.50%	-	-
Liabilities						
Mandatory reserves of commercial banks	1.00%	-	-	1.00%	-	-

23 Contingencies and Commitments

Settlements with the National Bank of Serbia. On the establishment of the CBM in November 2000, assets, liabilities and obligations of the CBM were inherited from the National Bank of Montenegro, which operated since 1999 and was formed on the basis of the Podgorica branch of the NBY and Payment Operations Department (ZOP). The CBM's rights and obligations in respect of inherited assets and liabilities are subject to negotiations with the National Bank of Serbia, which commenced in mid-2003. The Management is currently unable to make a reliable estimation of the total amount of assets and liabilities which should be assumed by the CBM in addition to those reflected in these financial statements.

The Commission comprising representatives of the Government of the Republic of Serbia, the Government of the Republic of Montenegro, the Council of Ministers of the State Union of Serbia and Montenegro and the central banks of the member states had several meetings regarding establishing and distribution of foreign exchange reserves, succession assets, debts and loans, assets and liabilities of National Bank of Yugoslavia, setting up dates and criteria's of dividing assets. A preliminary report has been subject of discussion but due to a number of issues, no final agreement has been reached. The Management of the CBM has the opinion that the CBM can not take over debt to London and Paris Club creditors as well as other liabilities which were established by Republic of Montenegro. The Central Bank Law prohibits that the CBM can be guarantors for the Republic of Montenegro.

Payment Operations System. Commercial banks are carriers of the payment system and providers of the following services for their clients: set up and maintain on accounts for individuals and legal entities, practice cash and non-cash payment operations, report on account balances, supply clients with cash and collect fees for their services. Commercial banks are obliged to inform the CBM about their domestic payment fee rates. The CBM is setting up and maintaining Treasury and State organisations accounts, commercial banks and other CBM client's accounts in accordance with the Law on Central Bank of Montenegro.

The CBM also distributes and supplies commercial banks with cash and provides central processings of all payment orders and reports to clients on transactions and balances of their accounts. The CBM collects fees for payment services provided to its clients in accordance with the Decision on fees for payment operations in the country.

23 Contingencies and Commitments (continued)

In May 2001 the Council of the CBM adopted the "Reform Activity Plan" for transformation of the domestic payment operations. The reform of the payment system is aimed towards improving the efficiency of the system by moving payment services from the CBM to commercial banks, and by implementing new IT hardware and software.

During October 2003 the CBM issued an international public tender for procurement of IT solutions for a new inter-bank payment system in the Republic of Montenegro. The bids should include the implementation of new hardware- and software solutions. The Bank received several proposals until the end of November 2003 and started the selection process. The implementation is expected to take place during 2004.

Legal proceedings. From time to time and in the normal course of business, claims against the CBM are received. On the basis of own estimates and internal professional advice the Management is of the opinion that no material losses will be incurred and accordingly no provision has been made in these financial statements.

Capital commitments. As at 31 December 2003 the CBM has capital commitments in respect of refurbishment of premises totalling EUR 170 thousand (2002: EUR 760 thousand). The CBM's Management believes that future net revenues and funding will be sufficient to cover this and any similar commitments.

Credit related commitments. As at 31 December 2003, the CBM does not have any material credit related commitments (2002: none).

Assets pledged. The CBM does not have any assets pledged as at 31 December 2003.

24 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 CBM using available market information, where it exists, and appropriate valuation methodologies. However, judgement is necessarily required to interpret market data to determine the estimated fair value. As described in more detail in Note 2, the Republic of Montenegro is an emerging economy. Political structure, regulatory and legal framework are currently under development. The volume of activity in financial markets is insignificant. While the 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.

Financial instruments carried at fair value. Cash and cash equivalents and investments available-for-sale are carried on the balance sheet at their fair value. As set out in Note 4, external independent market quotations were not available for certain available-for-sale investments. The fair value of these assets were determined by the Management on the basis of results of recent sales of equity interests in the investees between unrelated third parties and consideration of other relevant information such as financial data of the investees.

Term placements with foreign banks. The fair value of floating rate placements is their carrying amount. The estimated fair value of fixed interest bearing placements is based on discounted cash flows using prevailing money market interest rates for instruments with similar credit risk and remaining maturity. Refer to Note 6 for the estimated fair value of term placements with foreign banks as at 31 December 2003.

Loans and advances to the Government and domestic banks. Loans and advances to the Government and domestic banks are stated net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value. Refer to Notes 7 and 8 for the estimated fair value of loans and advances as at 31 December 2003.

Borrowings. The estimated fair value of liabilities with no stated maturity is the amount repayable on demand.

The Management believes that it is difficult to estimate the fair value of liabilities arising in respect of primary emission of the predecessor central bank as the status of these obligations is still uncertain.

25 Related Party Transactions

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. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

As at 31 December 2003, the current account of the Government of Montenegro opened with the CBM showed a balance of EUR 9,010 thousand (2002: EUR 3,282 thousand) refer to Note 12; the amount outstanding of Loans and Advances to the Government Prior to Commencement of Operations of the CBM was EUR 7,546 thousand (2002: EUR 13,547 thousand) refer to Note 7.

26 Subsequent Events

The CBM completely migrated payment system function to commercial banks on 5 January 2004. The transfer of the payment function will lead to a decrease in fee income for CBM. As part of its wider initiative to increase operational efficiency and improve risk management, CBM has started during 2003 to consider appropriate methods for reducing operating expenses connected with this function.