CENTRAL BANK OF MONTENEGRO

FINANCIAL STATEMENTS AND AUDITOR'S REPORT
31 DECEMBER 2005

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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 2005, which present fairly, in all material respects, the financial position of the Central Bank of Montenegro (the "CBM") as at 31 December 2005, 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 the Law on the Central Bank of Montenegro ("the Law") and 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 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 33, 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.

CENTRALNA BANKA CRNE GORE
PODGORICA

Ljubiša Krgović	Zdenka Rakočević
President of the Council	Finance and Accounting Director
of the Central Bank of Montenegro	of the Central Bank of Montenegro

Podgorica, 18 May 2006

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers d.o.o.
Makedonska 30
11000 Belgrade
Serbia and Montenegro
Telephone +381 (11) 3302 100
Facsimile +381 (11) 3302 101

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 2005, and the related statements of income, cash flows and changes in equity for the year then ended. These financial statements, set out on pages 2 to 33, 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 2005 and of 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. 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.

PricewaterhouseCoopers d.o.o.

PricewaterhouseCoopers d.o.o. Beograd

Belgrade, 18 May 2006

(in thousands of EUR unless otherwise stated)

Balance Sheet

	Note	2005	2004
Assets			
Cash and cash equivalents	5	44,109	7,225
Placements with foreign banks	6	128,810	52,829
Loans and advances to the Government prior to commencement of operations of the CBM	7	10,762	7,561
Loans and advances to domestic banks granted by the predecessor central bank	8	573	950
Other assets	9	4,592	3,357
Premises and equipment	10	17,284	17,597
Total assets		**206,130**	**89,519**
Liabilities			
Accounts of banks and financial institutions	11	102,479	40,927
Accounts of Government and other entities	12	53,249	8,742
Accrued interest expense and other liabilities	13	10,707	673
Liabilities in respect of primary issue of the predecessor central bank	14	5,308	5,308
Total liabilities		**171,743**	**55,650**
Shareholders' equity			
Founding capital	15	2,556	2,556
Retained earnings and other reserves		23,514	22,996
Revaluation reserve for premises	10	8,317	8,317
Total shareholders' equity		**34,387**	**33,869**
Total liabilities and shareholders' equity		**206,130**	**89,519**

Signed and approved on behalf of the Council on 18 May 2006.

CENTRALNA BANKA CRNE GORE PODGORICA

Ljubiša Krgović
President of the Council
of the Central Bank of Montenegro

Zdenka Rakočević
Finance and Accounting Director
of the Central Bank of Montenegro

(in thousands of EUR unless otherwise stated)

Income Statement

	Note	2005	2004
Interest income	16	3,020	1,438
Interest expense	16	(1,178)	(85)
Net interest income		**1,842**	**1,353**
(Charge) /Release of provision for impairment	17	4,234	(1,232)
Net interest income after provision for loan impairment		**6,076**	**121**
Foreign exchange translation losses, net of gains		335	(156)
Fee and commission income	18	6,017	10,877
Fee and commission expense	18	(236)	(171)
Other operating income	19	932	816
Operating income		**13,124**	**11,487**
Staff costs	20	(3,927)	(4,135)
Other operating expenses	21	(3,302)	(2,975)
Net operating income		**5,895**	**4,377**

(in thousands of EUR unless otherwise stated)

Statement of Changes in Equity

	Note	Founding capital	Retained earnings and other reserves	Revaluation reserve for premises	Total equity
Balance as at 31 December 2003		**2,556**	**21,582**	**8,317**	**32,455**
Net operating income for the year		-	4,377	-	4,377
Distribution of net income to the Government	15	-	(2,963)	-	(2,963)
Balance as at 31 December 2004		**2,556**	**22,996**	**8,317**	**33,869**
Net operating income for the year		-	5,895	-	5,895
Distribution of net income to the Government	15	-	(4,377)	-	(4,377)
Distribution of reserves for settling receivables for founding capital	15	-	(1,000)	-	(1,000)
Balance as at 31 December 2005		**2,556**	**23,514**	**8,317**	**34,387**

(in thousands of EUR unless otherwise stated)

Cash Flow Statement

	Note	2005	2004
Cash flows from operating activities			
Interest received		2,500	993
Interest paid		(1,152)	(85)
Fees and commissions received		5,327	10,032
Fees and commissions paid		(153)	(171)
Other operating income received		816	716
Employee costs paid		(3,621)	(3,855)
Operating expenses paid		(3,002)	(2,081)
Cash flows from operating activities before changes in current assets and liabilities		**715**	**5,549**
Changes in current assets and liabilities			
Net increase in term deposits with foreign banks		(75,981)	(14,814)
Net decrease in loans and advances to domestic banks granted by the predecessor central bank		377	403
Net decrease /(increase) in other assets		787	(348)
Net increase in accounts of banks and financial institutions		61,552	9,098
Net increase / (decrease) in accounts of the Government and other entities		44,507	(266)
Net increase / (decrease) in other liabilities		10,002	(380)
Net cash used in operating activities		**41,959**	**(758)**
Cash flows from investing activities			
Purchase of property and equipment	10	(1,033)	(1,878)
Net cash used in investing activities		**(1,033)**	**(1,878)**
Cash flows from financing activities			
Distribution of net income to the Government	15	(4,377)	(2,407)
Net cash used in financing activities		**(4,377)**	**(2,407)**
Effect of exchange rate changes on cash and cash equivalents		**335**	**(156)**
Net decrease in cash and cash equivalents		**36,884**	**(5,199)**
Cash and cash equivalents at the beginning of the year	5	7,225	12,424
Cash and cash equivalents at the end of the year	5	**44,109**	**7,225**

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 founding equity of the CBM is EUR 2,556 thousand; however the reserves of CBM were derived from the difference between total identifiable assets and total identifiable liabilities inherited by the CBM from the NBM. 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 the Note 23. 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"), as described in Note 2. 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 and pursuant to the Law, the CBM has the authorities to:

- To issue and revoke operating licences to banks and financial institutions and regulate and control their activities;
- To conduct bankruptcy and liquidation proceedings over 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;

1. Principal Activities (continued)

- 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;
- 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, the activities of the CBM are limited by the Law which prohibits the CBM to:

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

The CBM's registered Head Office is located at the following address: 7 Bulevar Sv. Petra Cetinjskog, 81000 Podgorica.

The number of the CBM employees as at 31 December 2005 was 295 (2004: 323).

The Central Bank is owner and operator of the inter-bank payment operations system, which started its operations on 6 January 2005. The Central Bank opened accounts for its clients, while commercial banks invested in their own systems for intra-bank payment operations. The process of introduction of the new payment operations system in Montenegro has been completed successfully, in accordance with prescribed procedures and without disturbances.

1. Principal Activities (continued)

The premises of the payment operations department, which were no longer used for the activities of the Central Bank, were partly leased to commercial banks and partly used for new regional centres for distribution of cash funds to commercial banks. During 2005 the Central Bank established an Audit Committee and improved and modernised operating and reporting procedures within the Bank. The risk management procedure was also improved with the aim to ensure enhanced risk monitoring and risk control.

The Management introduced changes in employment procedures, as well as in procedures of retaining employees in the Bank and trainings. An Act was passed on Job Classification and Description, Employee Promotion and an Incentive Payment System.

The Management is also developing contingency plans and plans for possible changes for the purpose of a more prudent reporting and banking supervision in relation to 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 however steadily growing. 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.

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.

(In thousands of EUR unless otherwise stated)

2. Operating Environment of the CBM (continued)

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.

On 20 December 2004, Standard and Poor's, one of the world's major provider of credit rating services awarded the Republic of Montenegro the "BB" long term and the "B" short term credit rating. The Republic of Serbia, comprising the State Union of Serbia and Montenegro together with the Republic of Montenegro, was awarded the same credit rating. In December 2005 Standard and Poor's revised its outlook on the Republic of Montenegro to positive from stable.

3. Basis of Preparation

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 2005, the Management of CBM introduced a number of improvements to the accounting function as part of organisational changes. Also, other improvements in financial reporting and controls were made during 2005.

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 affect 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.

Adoption of new and revised standards

In 2005 the Bank adopted the following IFRSs, which are relevant to its operations. The 2004 accounts have been amended as required, in accordance with the relevant requirements.

-	IAS 1 (revised 2003)	Presentation of Financial Statements
-	IAS 8 (revised 2003)	Accounting Policies, Changes in Accounting Estimates and Errors
-	IAS 10 (revised 2003)	Events after the Balance Sheet date
-	IAS 16 (revised 2003)	Property, Plant and Equipment
-	IAS 17 (revised 2003)	Leases
-	IAS 21 (revised 2003)	The effects of Changes in Foreign Exchange rate
-	IAS 24 (revised 2003)	Related Party Disclosures
-	IAS 32 (revised 2003)	Financial Instruments: Disclosure and Presentation
-	IAS 39 (revised 2003)	Financial Instruments: Recognition and measurement
-	IAS 36 (revised 2004)	Impairment of Assets
-	IAS 38 (revised 2004)	Intangible assets

3. Basis of Preparation (continued)

The adoption of the revised IAS 1, 8, 10, 16, 17, 21, 24, 32 and 39 (all revised 2003) and IAS 36 and 38 (all revised 2004) resulted in certain additional disclosures, but did not result in material changes to the Bank's accounting policies and accounting treatment of transactions.

Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Bank's accounting periods beginning on or after 1 January 2006 or later periods but which the bank has not early adopted.

IFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007).

IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in IAS 32, Financial Instruments: Disclosure and presentation. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of any entity's capital and how it manages capital. The Bank will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

IFRS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts (effective from 1 January 2006).

This amendment requires issued financial guarantees, other than those previously asserted by the entity to be insurance contracts, to be initially recognized at their fair value, and subsequently measured at the higher of (a) the unamortized balance of the related fees received and deferred, and (b) the expenditure required to settle the commitment at the balance sheet date.

The following, interpretations and amendments to published standards that are not yet effective are not expected to have any significant impact on the Bank:

- IFRIC 4, Determining whether an Arrangement contains a Lease (effective from 1 January 2006).
- IAS 39 (Amendment) – The Fair Value Option (effective from 1 January 2006).
- IAS 39 (Amendment) – Financial Guarantee Contracts (effective from 1 January 2006).
- IFRS 7 Financial Instruments: Disclosures and a complementary Amendment to IAS 1 Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007).
- IAS 19 (Amendment) - Employee Benefits (effective from 1 January 2006);
- IAS 21 (Amendment) - Net Investment in a Foreign Operation (effective from 1 January 2006);
- IFRS 6, Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006);
- IFRS 1 (Amendment) - First-time Adoption of International Financial Reporting Standards and IFRS 6 (Amendment) - Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006);

3. Basis of Preparation (continued)

- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006);
- IFRIC 6, Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment (effective for periods beginning on or after 1 December 2005, that is from 1 January 2006).
- IFRIC 7, Applying the Restatement Approach under IAS 29 (effective for periods beginning on or after 1 March 2006, that is from 1 January 2007).
- IFRIC 8, Scope of IFRS 2 (effective for periods beginning on or after 1 May 2006, that is from 1 January 2007).
- IFRIC 9, IFRIC 9 Reassessment of Embedded Derivatives (effective for 1 June 2006)

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

4. Significant Accounting Policies

4.1 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.

4.2 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 consists of loans granted 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.

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.

An impairment loss on loans 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 impairment loss is the difference between the carrying amount and the present value of estimated future cash flows, discounted at the instrument's original effective interest rate.

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.

4. Significant Accounting Policies (continued)

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal shall be recognised in profit or loss.

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

4.3 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. 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 gains or losses previously recognized in equity shall be recognized in the statement of income. 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.

4.4 Premises and equipment

Premises and equipment at the CBM are stated at cost or revalued amounts, as described below, less accumulated subsequent depreciation and subsequent impairment losses, 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 changes in 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.

4. Significant Accounting Policies (continued)

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.

4.5 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.

4.6 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.

4.7 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.

4.8 Income and expense recognition

Interest income and expense are recognised in the statement of income for all interest instruments measured at amortized costs using the effective yield method based on the actual purchase price (i.e. fair value on origination). 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.

(In thousands of EUR unless otherwise stated)

4. Significant Accounting Policies (continued)

Fees and commissions for payment system services, as well as other fees, commissions, other income and expense items are generally recorded on an accrual basis when the service has been provided.

4.9 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 2005 the principal rates of exchange used for translating balances in currencies other than EUR, were:

	31 December 2005	31 December 2004
1 USD	0.8477	0.7329
1 CHF	0.6430	0.6477
1 GBP	1.4592	1.4108

4.10 Founding capital and reserves

As at the date of issuing these financial statements, the share capital paid by the Government of Montenegro amounted to EUR 1,556, based on the protocol of the manner of payment of the share capital (Note 15). 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.

4.11 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 reach 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.

4.12 Taxation

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

(In thousands of EUR unless otherwise stated)

4. Significant Accounting Policies (continued)

4.13 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 as the risks and rewards related to these amounts rests with the third parties. Commissions received from such business are shown in fee and commission income within the statement of income.

4.14 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.

4.15 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.

4.16 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 9.60% of employees' gross salaries. Pension scheme and other contributions are expensed as incurred and are included in staff costs in the statement of income.

5. Cash and Cash Equivalents

	2005	**2004**
Cash in EUR:		
- cash held in the CBM vault	14,216	3,772
- cash in vaults and cashiers' offices of Payment Operations	-	2,643
Foreign currency cash	149	133
Demand deposits with foreign banks	29,744	677
Total cash and cash equivalents	**44,109**	**7,225**

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

(In thousands of EUR unless otherwise stated)

6. Placements with Foreign Banks

The term placements are with foreign banks, with AA credit rating assigned by an International Rating Agency. The high amount of term placements is a result of an increase in government deposits (Note 12) and deposits of commercial banks (Note 11).

As at 31 December 2005 the estimated fair value of term placements with foreign banks was EUR 128,810 thousand (2004: EUR 52,829 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

	2005	2004
Loan to the Government granted by Payment Operations Department	7,442	7,436
Loans to the Government granted from primary emission by the NBM	3,692	3,294
Other advances to the Government	-	329
Less: Provision for loan impairment	(372)	(3,498)
Total loans and advances to the Government prior to commencement of operations of the CBM	**10,762**	**7,561**

The loan to the Government granted by the prior state Payment Operations Department (ZOP), in the original amount of EUR 13,268 thousand was partially repaid in September 2003 in the amount of EUR 6,000 thousand. For the outstanding amount of EUR 7,268 thousand, the Government placed and pledged a cash deposit as collateral for the loan (Note 12). Although the loan was due in 31 December 2002, in the opinion of the management of the CBM the amount is fully collectible.

According to the accepted accounting polices, the CBM calculated interest on this loan using EURIBOR valid at the date of agreement. In 2005 the CBM calculated interest in the amount of EUR 174 thousand (2004: EUR 168 thousand) using an average interest rate of 2.27% p.a. (2004: 2.27% p.a.).

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.

Loans to the Government granted from primary emission by the NBM bear interest of 12% p.a. The related accrued interest income amounts EUR 1,160 thousand (2004: EUR 762 thousand).

(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 impairment of loans and accrued interest income are as follows:

	Note	2005	2004
Provision as at 1 January		**3,498**	**3,042**
Release of provision for impairment of loans	17	(1,882)	-
Release of provision for impairment of accrued interest income	17	(915)	-
Write off - advances given to the Government	17	(329)	-
Provision for impairment of accrued interest income during the year	17	-	456
Provision as at 31 December		**372**	**3,498**

The provision for impairment of loans and accrued interest income has been released in accordance with the decision of the Bank's Management, as a result of the collection of receivables for loans to the Government granted from primary emission and accrued interest income and placing a deposit with the CBM by the Ministry of Finance as cash collateral in the amount of EUR 405 thousand for the remaining debt after the balance sheet date, refer to Note 26.

The provision for impairment in the amount of EUR 372 thousand (2004: EUR 372 thousand) is related to the impairment of loans granted to the Pension Fund of the Republic of Montenegro (Fund PIO).

As at 31 December 2005 the estimated fair value of loans and advances to the Government prior to commencement of operations of the CBM was EUR 10,762 thousand (2004: EUR 7,561 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	2005	2004
Rescheduled loans granted from primary emission by the			
- long-term loans granted under State programs		349	502
- other long-term loans		224	448
Total loans and advances to domestic banks granted		**573**	**950**

(In thousands of EUR unless otherwise stated)

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

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 issue were regularly repaid during 2005. As at 31 December 2005 the estimated fair value of loans to domestic banks prior to commencement of operations of the CBM was EUR 573 thousand (2004: EUR 950 thousand).

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.

Loans to commercial banks were repaid in the amount of EUR 377 thousand and reduced outstanding receivables from banks.

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

	Note	2005	2004
Due from the Government:			
In respect of foundation capital	15	1,000	2,000
Fees receivable from the Ministry of Finance		2,331	1,437
Less: Provision for impairment		-	(1,437)
		3,331	2,000
Non-operating assets		450	418
Stock of numismatic coins and office supplies		288	329
Other debtors and prepayments		434	510
Investments available for sale		89	100
Total other assets		**4,592**	**3,357**

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 the Ministry of Finance are related to fiscal agent services undertaken by the CBM on behalf of the Ministry of Finance for Treasury Bills issuance and fees for the participation in domestic payments system.

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

(In thousands of EUR unless otherwise stated)

9. Other Assets (continued)

	Note	2005	2004
Provision as at 1 January		**1,437**	**652**
Provision for impairment of accrued fee income during the year	17	-	785
Collection of previously provisioned accrued fee income during the year	17	(20)	-
Release of provision for accrued fee income	17	(1,417)	-
Provision as at 31 December		**-**	**1,437**

The provision for impairment of accrued fee income has been released in accordance with the decision of the Bank's Management, as a result of the collection of fee receivables due from the Government after the balance sheet date, refer to Note 26.

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

(In thousands of EUR unless otherwise stated)

10. Property, plant, equipment and intangible assets

	Land	Premises	Office and computer equipment	Assets under construction	Intangible assets	Total
Acquisition cost						
Balance as at 1 January 2004	**326**	**16,361**	**5,852**	**3,775**	**80**	**26,394**
Additions	-	-	24	1,878	26	1,928
Transfer from assets in construction	-	58	548	(606)	-	-
Disposals	-	(171)	(390)	(124)	(36)	(721)
Balance as at 31 December 2004	**326**	**16,248**	**6,034**	**4,923**	**70**	**27,601**
Accumulated depreciation and amortization						
Balance as at 1 January 2004	-	**5,168**	**4,498**	**-**	**37**	**9,703**
Depreciation and amortization (Note 21)	-	214	519	-	7	740
Disposals	-	(89)	(350)	-	-	(439)
Balance as at 31 December 2004	**-**	**5,293**	**4,667**	**-**	**44**	**10,004**
Acquisition cost						
Balance as at 1 January 2005	326	16,248	6,034	4,923	70	27,601
Additions	-	-	3	1,033	-	1,036
Transfer from assets in construction	-	47	921	(1,795)	827	-
Disposals	-	(1)	(1,969)	(142)	-	(2,112)
Balance as at 31 December 2005	**326**	**16,294**	**4,989**	**4,019**	**897**	**26,525**
Accumulated depreciation and amortization						
Balance as at 1 January 2005	-	5,293	4,667	-	44	10,004
Depreciation and amortization (Note 21)	-	213	594	-	157	964
Disposals	-	-	(1,727)	-	-	(1,727)
Balance as at 31 December 2005	**-**	**5,506**	**3,534**	**-**	**201**	**9,241**
Net book value as at 31 December 2005	**326**	**10,778**	**1,455**	**4,019**	**696**	**17,284**
Net book value as at 31 December 2004	**326**	**10,955**	**1,367**	**4,923**	**26**	**17,597**

Assets under construction relate mainly to construction and refurbishment of the CBM’s Head office and certain former branch premises of ZOP. Advance payments made to suppliers in respect of refurbishment of the Bank’s premises amounting to EUR 719 thousand (2004: EUR 611 thousand). A building in construction is subject to regular technical certification by an internal commission of the CBM. Upon final completion, the value will be transferred to premises.

(In thousands of EUR unless otherwise stated)

10. Property, plant, equipment and intangible assets (continued)

Premises and equipment have been revalued to market value. 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. The management has the opinion that market values of the buildings have not materially changed in 2005.

In accordance with transformation of the Payment Operations Department, the CBM leased to commercial banks and other legal entities business premises in the amount of EUR 3,042 thousand (2004: 2,870 thousand).

11. Accounts of Banks and Financial Institutions

	2005	2004
Mandatory reserves of commercial banks	53,934	25,454
Gyro accounts of commercial banks	47,342	15,473
Liability to FDA	1,203	-
Total accounts of banks and financial institutions	**102,479**	**40,927**

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 2005 the mandatory reserve was calculated by applying a specified percentage (23%) to the average deposit amount during the previous one-week period.

The CBM pays interest of 1% per annum on 25% of the funds deposited in commercial banks' mandatory reserve accounts.

Liability to the state financial institution Fund for insurance of deposits ("the FDA") relates to the term deposit in the amount of EUR 1,203 thousand.

As at 31 December 2005 the estimated fair value of the commercial banks' accounts was EUR 102,479 thousand (2004: EUR 40,927 thousand), refer to Note 24.

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

(In thousands of EUR unless otherwise stated)

12. Accounts of the Government and other entities

	2005	2004
Accounts of the Government	52,067	7,520
Other accounts	1,182	1,222
Total accounts of the Government and other entities	**53,249**	**8,742**

The Government, public organisations and other entities hold their gyro accounts with the Central Bank for the purpose of participation in payment operations. All accounts of the Government and other entities are non-interest bearing, except deposits received from privatization.

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 (Note 7), as well as the funds received from privatization in the amount of EUR 40,633 thousand.

As at 31 December 2005 the estimated fair value of accounts of the Government and other entities was EUR 53,249 thousand (2004: EUR 8,742 thousand). Refer to the Note 24.

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

13. Accrued Interest Expense and Other Liabilities

	Note	2005	2004
Liability to HAAB		10,000	-
Accrued expenses		217	153
Taxes payable		127	130
Provision for redundancy costs		74	181
Accrued interest expense		25	7
Other		264	202
Total accrued interest expense and other liabilities		**10,707**	**673**

Liability in the amount of EUR 10,000 thousand relates to the deposit for founding capital of Hypo Alpe Adria Bank International ("the HAAB"). This amount was transferred on the current account of the HAAB with the Central Bank as at 3 March 2006, after the Contract on opening and maintaining account for domestic payments operations has been signed.

Provision for redundancy costs is related to the transfer of domestic payments function from the Central Bank to commercial banks, which was finalized in January 2006.

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

14. Liabilities in Respect of Primary issue 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).

The CBM has chosen to recognize these liabilities in historic values of Euro equivalents.

15. Founding Capital, Retained Earnings and Other Reserves

Equity and reserves 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). In 2004 an amount of EUR 556 thousand was paid as a transfer from the net income, resulting in outstanding liability to pay the founding capital of EUR 2,000 thousand as at 31 December 2004. As at the date when the financial statements were published, an amount of EUR 1,000 thousand was paid in partial settlement of this liability, consisting of a transfer from general reserves. The settlement was based on the signed protocol on the manner of payment of shareholders' equity, pursuant to Article 52 of the Law on the Central Bank of Montenegro (see Note 9). The remaining debt will be settled by 30 June 2006. 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 the general reserve is not sufficient. Any capital deficit of the CBM shall be covered by the Government.

During 2005, in accordance with the Council decision, the CBM distributed to the Government a portion of net operating income for the year ended 31 December 2004 in the amount of EUR 4,377 thousand (2003: EUR 2,963 thousand).

(In thousands of EUR unless otherwise stated)

16. Interest Income and Expense

	2005	2004
Term deposits at foreign banks	2,500	903
Loans and advances to the Government prior to commencement of operations of the CBM		
- interest income earned under contractual terms	175	168
Loans and advances to domestic banks granted by the predecessor central bank		
- interest income earned under contractual terms	345	367
Total interest income	**3,020**	**1,438**
Interest expense		
Mandatory reserves of commercial banks	(115)	(73)
Other interest expense	(1,063)	(12)
Total interest expense	**(1,178)**	**(85)**
Net interest income	**1,842**	**1,353**

17. Release / (Charge) of Provision for Loan Impairment

	Note	2005	2004
Provision charge for bad and doubtful accrued interest	7	-	(456)
Provision charge for bad and doubtful fee receivables	9	-	(785)
Release of provision for loans to the Government	7	1,882	-
Release of provision for accrued interest income	7	915	-
Release of provision for fee receivables collected during the year	9	20	-
Release of provision for fee receivables	9	1,417	
Collection of loans previously written off		-	9
Total release / (charge) of provision for impairment		**4,234**	**(1,232)**

(In thousands of EUR unless otherwise stated)

18. Fee and Commission Income and Expense

	2005	2004
Fee and commission income		
Commission for payment operation services	4,821	9,346
Fee for services as fiscal agent	399	845
Fees for registration of documents	503	479
Commission for issue of licenses and permits	68	48
Other fee and commission income	226	159
Total fee and commission income	**6,017**	**10,877**
Fee and commission expense		
Fees for services provided by other banks	(7)	(52)
Other fee and commission expense	(229)	(119)
Total fee and commission expense	**(236)**	**(171)**
Net fee and commission income	**5,781**	**10,706**

Commission for services of payment system represents commission earned by Payment Operations Department in respect of services provided by the CBM to the commercial banks and government institutions. The decrease in commission earnings in 2005 is the result of introduction of the new payment operations system in Montenegro. Consequently, a portion of fee income has been transferred to commercial banks (Note 1).

Other fee and commission expenses are mostly related to financing of the Fund for insurance of deposits (“the FDA”), in process of establishment, in the amount of EUR 188 thousand, based on the decision of the CBM dating 25 December 2004.

19. Other Operating Income

	Note	2005	2004
Property rental income	10	426	432
Other income		506	384
Total other income		**932**	**816**

(In thousands of EUR unless otherwise stated)

20. Staff Costs

	2005	2004
Salaries and wages	2,472	2,371
Contributions in respect of payments to employees	467	535
Other employee benefits	988	1,229
Total employee costs	**3,927**	**4,135**

21. Other Operating Expenses

	Note	2005	2004
Administrative expenses		1,493	1,148
Depreciation and amortisation of premises and equipment	10	964	740
Communication, mail and transportation		324	265
Other expenses related to premises and equipment		221	429
Humanitarian aid and cultural activities		189	210
Insurance		84	75
Taxes other than on income		27	72
Other		-	36
Total other operating expenses		**3,302**	**2,975**

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 risks), operational risks and legal risks. The primary objective of the financial risk management function is to establish risk limits, as well as to ensure that risk exposure 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.

(a) *Credit risk*

The Bank manages the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower or groups of borrowers and to geographical segments. Such risks are monitored on a revolving basis and are subject to an annual or more frequent review.

The loans and advances as at 31 December 2005 were granted prior to commencement of operations of the CBM.

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

(In thousands of EUR unless otherwise stated)

22. Financial Risk Management (continued)

(b) *Geographical risk*

As at 31 December 2005 and 31 December 2004, all loans and advances were 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 financial statements. Demand deposits, placements with foreign banks and accrued interest totalling EUR 128,810 thousand (2004: EUR 52,829 thousand) are due primarily from German, British and American banks.

(c) *Currency risk*

The CBM takes on exposure resulting from fluctuations in prevailing foreign currency exchange rates on its financial position and cash flows. The structure of foreign currency reserves reflects the main functions of the central bank and foreign currency reserves, i.e. support for the ability of CBM to perform intervention, insurance against a Balance of Payments crisis i.e. maintaining liquidity in International payment transactions and reflects the basic principle of management of assets, being diversification. The table below summarises the CBM's exposure to foreign risk. Included in the table are the CBM's foreign currency – denominated assets and liabilities at carrying amounts, categorised by currency.

	EUR	USD	GBP	CSD	CHF	Other curren-cies	Total
Assets							
Cash and cash equivalents	43,548	462	-	-	89	10	44,109
Term placements with foreign banks	126,691	2,119	-	-	-	-	128,810
Loans and advances to the Government prior to commencement of operations of the CBM	10,762	-	-	-	-	-	10,762
Loans and advances to domestic banks granted by the predecessor central bank	573	-	-	-	-	-	573
Other assets	4,592	-	-	-	-	-	4,592
Premises and equipment	17,284	-	-	-	-	-	17,284
Total assets	**203,450**	**2,581**	**-**	**-**	**89**	**10**	**206,130**
Liabilities							
Accounts of banks and financial institutions	102,479	-	-	-	-	-	102,479
Accounts of the Government and other entities	53,249	-	-	-	-	-	53,249
Accrued interest expense and other liabilities	10,707	-	-	-	-	-	10,707
Liabilities in respect of primary issue of the predecessor central bank	-	-	-	5,308	-	-	5,308
Total liabilities	**166,435**	**-**	**-**	**5,308**	**-**	**-**	**171,743**
Net balance sheet position 2005	**37,015**	**2,581**	**-**	**(5,308)**	**89**	**10**	**34,387**
Net balance sheet position 2004	**36,318**	**2,077**	**97**	**(5,308)**	**612**	**73**	**33,869**

(In thousands of EUR unless otherwise stated)

22. Financial Risk Management (continued)

(d) *Liquidity risk*

The Bank monitors and manages the structure and duration of its foreign currency reserves in compliance with the principles prescribed by the CBM regulations. The table below shows assets and liabilities of the Bank into relevant maturity bands based on the remaining period as at the balance sheet date to the contractual maturity date.

	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	44,109	-	-	-	-	44,109
Term placements with foreign banks	128,796	-	-	-	14	128,810
Loans and advances to the Government prior to commencement of operations of the CBM	-	-	10,747	-	15	10,762
Loans and advances to domestic banks granted by the predecessor central bank	-	-	-	573	-	573
Other assets	-	-	-	-	4,592	4,592
Property and equipment	-	-	-	-	17,284	17,284
Total assets	**172,905**	**-**	**10,747**	**573**	**21,905**	**206,130**
Liabilities						
Accounts of banks and financial institutions	102,479	-	-	-	-	102,479
Accounts of the Government and other entities	53,249	-	-	-	-	53,249
Accrued interest expense and other liabilities	707	10,000	-	-	-	10,707
Liabilities in respect of primary issue of the predecessor central bank	-	-	-	-	5,308	5,308
Total liabilities	**156,435**	**10,000**	**-**	**-**	**5,308**	**171,743**
Net liquidity gap	**16,470**	**(10,000)**	**10,747**	**573**	**16,597**	**34,387**
Cumulative liquidity gap at 31 December 2005	**16,470**	**6,470**	**17,217**	**17,790**	**34,387**	**-**
Cumulative liquidity gap at 31 December 2004	**9,882**	**9,882**	**9,763**	**18,201**	**33,869**	-

(e) *Interest rate risk*

The CBM takes on exposure resulting from 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. Rules for investing foreign currency reserves are targeted to limit the significant risk of a change in interest rates.

(In thousands of EUR unless otherwise stated)

22. Financial Risk Management (continued)

The CBM is exposed to interest rate risk, principally as a result of its historic lending at fixed interest rates. All other activities are undertaken on short term interest rates. The CBM is managing its interest rate risk utilising short-term variable interest rates. The current policy of the CBM is not to use derivative financial instruments.

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.

	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	-	-	-	-	44,109	44,109
Term placements with foreign banks	128,796	-	-	-	14	128,810
Loans and advances to the Government prior to commencement of operations of the CBM	-	-	10,747	-	15	10,762
Loans and advances to domestic banks granted by the predecessor central bank	-	-	-	573	-	573
Other assets	-	-	-	-	4,592	4,592
Property and equipment	-	-	-	-	17,284	17,284
Total assets	**128,796**	**-**	**10,747**	**573**	**66,014**	**206,130**
Liabilities						
Accounts of banks and financial institutions	55,137	-	-	-	47,342	102,479
Accounts of the Government and other entities	40,633	-	-	-	12,616	53,249
Accrued interest expense and other liabilities	-	-	-	-	10,707	10,707
Liabilities in respect of primary issue of the predecessor central bank	-	-	-	-	5,308	5,308
Total liabilities	**95,770**	-	-	-	**75,973**	**171,743**
Net risk	**33,026**	**-**	**10,747**	**573**	**(9,959)**	**34,387**
Cumulative risk as at 31 December 2005	**33,026**	**33,026**	**43,773**	**44,346**	**34,387**	**-**
Cumulative risk as at 31 December 2004	**37,344**	**37,344**	**44,670**	**45,840**	**33,869**	**-**

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 rates, 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.

(In thousands of EUR unless otherwise stated)

22. Financial Risk Management (continued)

	2005			2004		
	EUR	**USD**	**CHF**	**EUR**	**USD**	**CHF**
Assets						
Term deposits with foreign banks	2.25%	4.00%	0.55%	2.00%	1.50%	0.30%
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						
Obligatory reserves of commercial banks	1.00%	-	-	1.00%	-	-

23. Contingencies and Commitments

(a) *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. 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 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 the CBM to be guarantor for the Republic of Montenegro.

23. Contingencies and Commitments (continued)

(b) *Payment Operations System*

Commercial banks are carriers of the payment system and providers of the following services for their clients: setting up and maintaining of accounts for individuals and legal entities, performance of cash and non-cash payment operations, reporting account balances, supplying clients with cash and collecting fees for their services. The CBM sets up and maintains 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. The CBM collects fees for payment services provided to its clients in accordance with the Decision on fees for payment operations in the country.

(c) *Bank bankruptcy and liquidation*.

According to the Law on Bank Bankruptcy and Liquidation, the bankruptcy proceedings and liquidation proceedings over a bank shall be commenced and conducted by the Central Bank. However, commitments related to the bankruptcy and liquidation proceedings cannot be charged to the CBM.

(d) *Legal proceedings*

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

(e) *Credit related commitments*

As at 31 December 2005, the CBM did not have any material credit related commitments (2004: none).

(f) *Assets pledged*

The CBM did not have any assets pledged as at 31 December 2005.

24. Fair Value of Financial Instruments

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between the 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.

24. Fair Value of Financial Instruments (continued)

(a) *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.

(b) *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 time placements with foreign banks as at 31 December 2005.

(c) *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 2005.

(d) *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 2005, the current account of the Government of Montenegro opened with the CBM showed a balance of EUR 53,249 thousand (2004: EUR 8,742 thousand), refer to Note 12; the amount outstanding of Loans and Advances to the Government prior to commencement of operations of the CBM, EUR 11,134 thousand (2004: EUR 11,059 thousand), refer to Note 7; fees receivable from the Ministry of Finance in the amount of EUR 2,331 thousand (2004: EUR 1,437 thousand) and receivables for the foundation capital in the amount of EUR 1,000 thousand (2004: EUR 2,000), refer to Note 9.

The impairment provision in respect of loans given to the Government amounts to EUR 372 thousand as at 31 December 2005 (2004: EUR 3,498 thousand), refer to Note 7. The Bank has not formed impairment provision for fee receivables as at 31 December 2005 (2004: EUR 1,437 thousand), refer to Note 9.

26. Post balance sheet events

As at 10 May 2006, a Protocol on the repayment of the debt of the Government no. 10 - 310/4 has been signed by the CBM and the Ministry of Finance. According to the protocol signed, the Ministry of Finance has paid the amount of EUR 5,208 thousand as at 12 May 2006 and thus repaid the outstanding loans in the amount of EUR 1,626 thousand, accrued interest on loans granted in the amount of EUR 1,251 thousand and fee receivables for acting as fiscal agent, performing international payment operations and providing other services in the amount of EUR 2,331 thousand.

In accordance with the abovementioned protocol, the CBM and the Ministry of Finance have agreed that the loan granted to the Government by the predecessor of the CBM in the amount of EUR 7,268 thousand (Note 7) will be repaid during 2006 from the deposit placed with the CBM as cash collateral (Note 12).

As at 18 May 2006 the Ministry of Finance has reached an agreement with the CBM and placed a deposit with the CBM in the amount of EUR 405 thousand as cash collateral for the remaining debt related to the loans granted from primary emission by the NBM.