

Izola Bank Limited

Annual report

2007

Izola Bank Limited

2007

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Izola Bank Limited

Directors' Report

For the Year Ended 31 December 2007

The directors present their report, together with the financial statements of Izola Bank Limited (the "bank"), for the year ended 31 December 2007.

Board of directors

Mr. Carl Van Marcke (Chairman)
Mrs. Magdalena De Roeck (Deputy Chairperson)
Countess Alexis d'Oultremont
Mr. Peter Van Marcke
Mr. Frederick E. Amato-Gauci
Mr. Louis de Spirlet
Mr. John Melillo
Mr. Joseph Caruana

Company secretary

Mr. Karl Vella

Principal activities

Izola Bank Limited is registered in Malta as a limited liability company under the Companies Act, 1995. The bank is licensed by the Malta Financial Services Authority to carry out the business of banking in terms of the Banking Act, 1994. The bank is principally engaged in providing corporate banking services to non-resident customers.

Financial performance

The bank achieved a profit before taxation amounting to EUR1,293,752, realising a pre-tax return on shareholders' funds of 12%. These results were achieved by continuing to deliver quality products and service to our corporate client base.

Net interest income increased by 2% to EUR1,369,715 when compared to the adjusted net interest income for 2006 at EUR1,344,041, registering a net interest margin of 41%.

Non-interest income grew by 22% when compared to the previous year's figure.

At end of 2007 total assets stood at EUR56,426,948 representing an increase of 5% when compared to 2006.

Total customer deposits at EUR44,510,872 increased by 2% over the previous year.

Events after the balance sheet date

No significant events have occurred after the balance sheet date that requires mentioning in this report.

Izola Bank Limited

Directors' Report

For the Year Ended 31 December 2007

Future developments

2008 will see the launch of additional credit products specifically tailor-made for its corporate customer base. The bank's e-banking services will also be heavily promoted.

Dividends

No dividends are recommended.

Reserves

After adding the current year's profit to retained profits brought forward, the directors propose that the balance of retained profits amounting to EUR5,718,808 be carried forward.

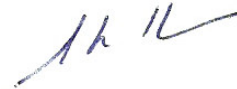
Auditors

The auditors, KPMG, have signified their willingness to continue in office and a resolution to re-appoint them and to authorise the directors to set their remuneration will be proposed at the next Annual General Meeting.

Approved by the Board of Directors on 2 April 2008 and signed on its behalf by:



Mr. Carl Van Marcke
Chairman



Mrs. Magdalena De Roeck
Deputy Chairperson

Registered Office

53-58 East Street
Valletta
Malta

Izola Bank Limited

Directors' Responsibility for the Financial Statements

The Companies Act, 1995 (the "Act") requires the Directors of Izola Bank Limited (the "bank") to prepare financial statements for each financial period which give a true and fair view of the financial position of the bank as at the end of the financial period and of the profit or loss of the bank for that period in accordance with the requirements of International Financial Reporting Standards.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy, at any time, the financial position of the bank and to enable them to ensure that the financial statements have been properly prepared in accordance with the provisions of the Act.

The Directors are also responsible for safeguarding the assets of the bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

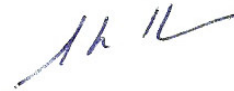
The Directors, through oversight of management, are responsible to ensure that the bank establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Management is responsible, with oversight from the Directors, to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the bank's business. This responsibility includes establishing and maintaining controls pertaining to the bank's objective of preparing financial statements as required by the Act and managing risks that may give rise to material misstatements in those financial statements. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud.

Signed on behalf of the Board of Directors by:



Mr. Carl Van Marcke
Chairman



Mrs. Magdalena De Roeck
Deputy Chairperson

Izola Bank Limited

Balance Sheet

As at 31 December 2007

		2007	2006
	Note	EUR	EUR
ASSETS			
Cash		466	1,409
Balances with Central Bank of Malta		1,117,828	-
Investments	12	25,568,878	24,876,652
Loans and advances to banks	13	9,168,258	7,184,794
Factored receivables	14	2,916,099	2,773,556
Other loans and advances to customers	15	14,255,000	15,696,545
Property and equipment	16	2,106,232	1,846,601
Prepayments and accrued income	17	1,294,187	1,215,632
Total assets		56,426,948	53,595,189
LIABILITIES			
Amounts owed to customers	18	44,510,872	43,693,758
Deferred tax liabilities	19	372,811	235,896
Current tax payable		201,847	186,668
Accruals and deferred income	20	967,703	452,910
Total liabilities		46,053,233	44,569,232
EQUITY			
Called up share capital		4,000,000	4,000,000
Property revaluation reserve		654,907	420,773
Retained earnings		5,718,808	4,605,184
Total equity	21	10,373,715	9,025,957
Total equity and liabilities		56,426,948	53,595,189
Memorandum items			
Commitments	22	3,502,027	3,573,422

The official central parity rate of exchange issued by the Central Bank of Malta between the Euro and the Maltese Lira at 31 December 2007 stood at 0.4293, irrevocably fixed at this rate on 10 July 2007.

The notes on pages 9 to 50 are an integral part of these financial statements.

The financial statements on pages 4 to 50 were approved by the Board of Directors on 2 April 2008 and signed on its behalf by:

Mr. Carl Van Marcke
Chairman

Mrs. Magdalena De Roeck
Deputy Chairperson

Izola Bank Limited

Statement of Changes in Equity

For the Year Ended 31 December 2007

	Total	Share capital	Revaluation reserve	Retained earnings
	EUR	EUR	EUR	EUR
Balance at 1 January 2006	7,454,083	4,000,000	425,353	3,028,730
Transfer of depreciation on revaluation surplus net of deferred tax	-	-	(4,580)	4,580
Profit for the year	1,571,874	-	-	1,571,874
Balance at 31 December 2006	9,025,957	4,000,000	420,773	4,605,184
	=====	=====	=====	=====
Balance at 1 January 2007	9,025,957	4,000,000	420,773	4,605,184
Revaluation of immovable property	368,793	-	368,793	-
Deferred tax on revaluation surplus	(129,078)	-	(129,078)	-
Transfer of depreciation on revaluation surplus net of deferred tax	3,005	-	(5,581)	8,586
Profit for the year	1,105,038	-	-	1,105,038
Balance at 31 December 2007	10,373,715	4,000,000	654,907	5,718,808
	=====	=====	=====	=====

The notes on pages 9 to 50 are an integral part of these financial statements.

Izola Bank Limited

Income Statement

For the Year Ended 31 December 2007

		2007	2006
	Note	EUR	EUR
Interest receivable and similar income			
- on loans and advances	5	1,771,686	1,353,068
- on debt securities		1,596,135	1,920,114
Interest expense	6	(1,998,106)	(1,418,666)
Net interest income		1,369,715	1,854,516
Fees and commissions income		811,706	677,757
Fees and commissions expense		(36,442)	(41,601)
Net fees and commissions income	7	775,264	636,156
Net trading gains	8	15,241	7,519
Other operating income		4,193	4,193
Operating income		2,164,413	2,502,384
Administrative expenses		(575,995)	(540,607)
Depreciation		(210,817)	(185,255)
Impairment allowance	14.2	(83,849)	(6,854)
Profit before income tax	9	1,293,752	1,769,668
Income tax expense	10	(188,714)	(197,794)
Profit for the year		1,105,038	1,571,874
Earnings per share	11	6.91	9.82

The notes on pages 9 to 50 are an integral part of these financial statements.

Izola Bank Limited

Cash Flow Statement

For the Year Ended 31 December 2007

		2007	2006
	Note	EUR	EUR
Cash flows from operating activities			
Interest and commission receipts		2,593,722	2,015,409
Interest and commission payments		(1,525,355)	(1,442,292)
Payments to employees and suppliers		(531,868)	(618,188)
		-----	-----
Operating profit / (loss) before changes in operating assets/liabilities		536,499	(45,071)
Decrease / (increase) in operating assets:			
- loans and advances to customers		1,441,543	(3,700,867)
- factored receivables		(218,776)	(679,175)
Increase in operating liabilities:			
- amounts owed to customers		817,110	7,848,501
		-----	-----
Net cash from operating activities before income tax	23	2,576,376	3,423,388
Income tax paid		(162,695)	(162,698)
		-----	-----
Net cash from operating activities		2,413,681	3,260,690
		-----	-----
Cash flows from investing activities			
Payments to acquire property and equipment		(101,655)	(318,004)
Payments to acquire investments		(1,635,000)	(3,360,000)
Proceeds from maturity of investments		1,636,097	3,346,564
Interest received from investments		787,226	694,364
		-----	-----
Net cash from investing activities		686,668	362,924
		-----	-----
Net increase in cash and cash equivalents		3,100,349	3,623,614
Cash and cash equivalents at beginning of year		7,186,203	3,562,589
		-----	-----
Cash and cash equivalents at end of year	24	10,286,552	7,186,203
		=====	=====

The notes on pages 9 to 50 are an integral part of these financial statements.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

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Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

1 Reporting entity

Izola Bank Limited (the “bank”) is a limited liability company domiciled and incorporated in Malta.

2 Basis of preparation

2.1 Statement of compliance

The financial statements have been prepared and presented in accordance with the provisions of the Banking Act, 1994 and the Companies Act, 1995 enacted in Malta (the “Act”), which requires adherence to International Financial Reporting Standards (IFRSs).

The Act specifies that in the event that any one of its provisions is in conflict or not compatible with IFRSs or its application is incompatible with the obligation for the financial statements to give a true and fair view, that provision shall be departed from in order to give a true and fair view.

2.2 Basis of measurement

The financial statements have been prepared on the historical cost basis except that available-for-sale financial assets are stated at fair value.

The methods used to measure fair values are discussed in note 4.

2.3 Functional and presentation currency

These financial statements are presented in Euro, which is the bank’s functional currency.

2.4 Use of estimates and judgements

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 27.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

3.1 Financial instruments

3.1.1 *Non-derivative financial instruments*

Non-derivative financial instruments comprise investments in equity and debt securities, cash and cash equivalents and loans and receivables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Cash and cash equivalents comprise cash balances and deposits with contractual maturity of less than three months. Subsequent to initial recognition cash equivalents are measured at amortised cost.

3.1.1.1 *Held-to-maturity investments*

If the bank has the positive intention and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method, less any impairment losses.

3.1.1.2 *Available-for-sale financial assets*

The bank's investments in equity securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses (see accounting policy 3.4), and foreign exchange gains and losses on available-for-sale monetary items (see accounting policy 3.11), are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss.

3.1.1.3 *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These include loans and advances to banks and customers that are recognised on the day the cash is advanced to the borrowers. These are initially recognised at fair value plus transaction costs that are directly attributable to the acquisition of the financial assets. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less impairment losses (see accounting policy 3.4).

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies (continued)

3.1 Financial instruments (continued)

3.1.2 Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, have been realised or are transferred and control is not retained by the bank or substantially all the risks and rewards of ownership have been transferred by the bank.

A financial liability is derecognised when it is extinguished, that is when the obligation is discharged, cancelled or expires.

Assets designated by the bank as available-for-sale assets that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as at the date the bank commits to sell the assets.

Held-to-maturity instruments and loans and receivables are derecognised on the day these are transferred by the bank.

3.2 Offsetting financial instruments

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

3.3 Property and equipment

3.3.1 Recognition and measurement

Items of property and equipment are measured at cost or revaluation less accumulated depreciation (see accounting policy 3.3.2) and accumulated impairment losses (see accounting policy 3.4).

Freehold property is revalued to fair value on the basis of its existing use every five years or earlier, whenever its fair value differs materially from its carrying amount. Revaluations are performed by a professionally qualified architect. Any surpluses arising on such revaluation are credited to a revaluation reserve. Any deficiencies resulting from decreases in value are deducted from this reserve to the extent that it is sufficient to absorb them, with any excess charged to profit or loss thereafter.

Where parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies (continued)

3.3 Property and equipment (continued)

3.3.1 Subsequent costs

The cost of replacing part of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied with the part will flow to the bank and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

3.3.2 Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

The estimated useful lives for the current and comparative periods are as follows:

Premises and improvements	100	years
Other assets	5	years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

3.4 Impairment

The carrying amounts of the bank's assets, other than deferred tax assets (see accounting policy 3.12), are reviewed at each balance sheet date to determine whether there is objective evidence of impairment.

A financial asset or group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss has an impact on the estimated future cash flows of the financial assets or group of financial assets that can be reliably measured. If there is objective evidence, the asset's recoverable amount is estimated.

In the case of other assets, an impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss unless the asset is carried at revalued amount, in which case the impairment is treated as a revaluation decrease, to the extent of the credit balance on the revaluation reserve.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies (continued)

3.4 Impairment (continued)

3.4.1 *Assets carried at amortised cost*

The recoverable amount of the bank's investments in held-to-maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

Loans and advances are presented net of specific and collective impairment allowances for uncollectibility. The bank assesses at each balance sheet date whether there is any objective evidence that a loan is impaired. Specific impairment allowances are determined by an evaluation of the exposures on a case-by-case basis and are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts.

Collective impairment allowances are maintained to reduce the carrying amount of portfolios of financial assets with similar risk characteristics to their estimated recoverable amounts at the balance sheet date. The expected cash flows for portfolios of financial assets with similar risk characteristics are estimated based on, amongst others, observable data and considering the credit rating of the underlying customers and late payments of interest or penalties.

Increases and decreases in the specific and collective impairment allowances are recognised in profit or loss. When a loan is known to be uncollectible, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off.

3.4.2 *Financial assets measured at fair value*

The recoverable amount of an equity instrument is its fair value.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in the income statement even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies (continued)

3.4 Impairment (continued)

3.4.3 Other assets

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

3.4.4 Reversals of impairment

An impairment loss in respect of a held-to-maturity asset or receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar risk characteristics.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to profit or loss.

An impairment can be reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

3.5 Provisions

A provision is recognised if, as a result of a past event, the bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies (continued)

3.6 Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

The calculation of the effective interest rate includes all transaction costs, and discounts or premiums that are an integral part of the effective interest rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Interest income and expense presented in the income statement include interest on financial assets and liabilities at amortised cost on an effective interest rate basis.

3.7 Fees and commissions

Fees and commissions income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, loan commitment fees are recognised on a straight-line basis over the commitment period.

Other fees and commissions expense relate mainly to transaction service fees, which are expensed as the services are received.

3.8 Trading gains/losses

Trading gains/losses comprises all realised and unrealised foreign exchange differences.

3.9 Operating lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

3.10 Employee benefits

The bank contributes towards the State pension defined contribution plan in accordance with local legislation and to which it has no commitment beyond the payment of fixed contributions. Obligations for contributions to the defined contribution plan are recognised as an expense in profit or loss as they fall due.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies (continued)

3.11 Foreign currency transactions

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Euro at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in profit or loss. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Euro at foreign exchange rates ruling at the dates the fair values were determined.

3.12 Income tax

Income tax expense comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on a different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each balance sheet date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

3.13 Earnings per share

The bank presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the bank by the weighted average number of ordinary shares outstanding during the period.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

3 Significant accounting policies (continued)

3.14 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2007 and have not been applied in preparing these financial statements:

- IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires all owner changes in equity to be presented in a statement of changes in equity and all non-owner changes in equity to be presented either in one statement of comprehensive income or in two statements (a separate income statement and statement of comprehensive income). It requires the presentation of a statement of financial position as at the beginning of the earliest comparative period in a complete set of financial statements when an entity applies an accounting policy retrospectively or makes a retrospective restatement, or when an entity reclassifies items in the financial statements. Revised IAS1, which becomes mandatory for the bank's 2009 financial statements, also requires the disclosure of reclassification adjustments and income tax relating to each component of other comprehensive income and the presentation of dividends recognised as distributions to owners and related amounts per share in the statement of changes in equity or in the notes.

4 Financial risk management

4.1 Organisation

The Board of Directors has overall responsibility for the establishment and oversight of the bank's risk management framework. The Board has established the Board Committee, the Audit Committee and the Credit Committee, which are responsible for the monitoring of risk in their specified areas. Executive and non-executive directors sit on these Committees and the Committees report regularly to the Board of Directors on their activities.

Risk management policies have been established to identify and analyse the risks faced by the bank, to set out appropriate risk limits and controls, and to monitor risks and adherence to limits.

The risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The bank has developed appropriate risk management training for the needs of the relevant staff members.

4.2 Risk exposure

The bank is exposed to a number of risks, which it manages at different organisational levels.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.2 Risk exposure (continued)

The main categories of risk are:

- *Credit risk*: Risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. It arises from the lending, treasury and other activities undertaken by the bank.
- *Market risk*: Risk of losses arising from unfavourable changes in the level and volatility of interest rates, foreign exchange rates or investment prices.
- *Liquidity risk*: Liquidity risk is divided into two-categories:
 - *Market (product) liquidity risk*: risk of losses arising from difficulty in accessing a product or market at the required time, price and volume.
 - *Funding liquidity risk*: risk of losses arising from a timing mismatch between investing, placements and fund arising activities resulting in obligations missing the settlement date or satisfied at higher than normal rates.
- *Operational risk*: Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the bank's operations and are faced by all business entities.

4.3 Capital base

The bank is a licenced financial services provider and must therefore comply with the capital requirements under the relevant capital requirements laws and regulations. The bank has adopted the Standardised Approach to calculate its capital requirements.

4.3.1 Capital management

The bank must have sufficient capital to comply with regulatory capital requirements. The purpose of the bank's capital management is to ensure an efficient use of capital in relation to risk appetite as well as business development.

The bank's regulatory capital is analysed into two tiers:

- Tier 1 capital, which includes ordinary share capital, retained earnings, property revaluation reserve, and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes.
- Tier 2 capital, which includes collective impairment allowances.

Banking operations are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The bank has complied with all capital requirements directives and rules throughout the year.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.3 Capital base (continued)

4.3.1 Capital management (continued)

There have been no material changes in the bank's management of capital during the year.

4.3.1.1 Calculation of minimum capital requirement and risk-weighted assets

The minimum capital requirements are calculated for the credit, market and operational risk. The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets. The total capital ratio must be no lower than 8%.

Total risk-weighted assets are determined by multiplying the capital requirements for market risk and operational risk by 12.5 (i.e. the reciprocal of the minimum capital ratio of 8%) and adding the resulting figures to the sum of risk-weighted assets for credit risk.

Below is the bank's capital requirements and capital adequacy ratio computation.

	2007	2006
	EUR	EUR
Tier 1 capital		
Ordinary share capital	4,000,000	4,000,000
Retained earnings	5,718,808	4,605,184
Property revaluation reserve	654,907	420,773
	10,373,715	9,025,957
Tier 2 capital		
Collective allowance for impairment	29,850	28,022
	29,850	28,022
Total regulatory capital	10,403,565	9,053,979

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.3 Capital Base (continued)

4.3.1 Capital management (continued)

4.3.1.1 Calculation of minimum capital requirement and risk-weighted assets (continued)

Capital Adequacy ratio as at 31 December	Balance sheet value 2007 EUR	Exposure value 2007 EUR	Balance sheet value 2006 EUR	Exposure value 2006 EUR
On balance sheet assets				
Cash	466	-	1,409	-
Balances with Central Bank of Malta	1,117,828	-	-	-
Investments	25,568,878	-	24,876,652	-
Loans and advances to Banks	9,168,258	1,833,651	7,184,794	1,436,959
Factored receivables	2,916,099	2,916,099	2,773,556	2,773,556
Other loans and advances to customers	14,255,000	-	15,696,545	-
Property and equipment	2,106,236	2,106,236	1,846,601	1,846,601
Prepayments and accrued income	1,294,183	1,294,183	1,215,632	1,215,632
	-----	-----	-----	-----
	---		--	
	56,426,948	8,150,169	53,595,189	7,272,748
	=====	-----	=====	-----
Off-balance sheet assets				
Commitments	3,502,027	-	3,573,422	-
	=====	-----	=====	-----
Credit risk capital requirement		652,013		581,819
Foreign exchange risk capital requirement		3,354		3,657
Operational risk capital requirement		292,480		236,701
		-----		-----
Total capital requirement		9,098,016		8,094,925
		=====		=====
Own funds				
Original own funds	10,373,715		9,025,957	
Additional own funds	29,850		28,022	
	-----		-----	
	---		--	
Total own funds	10,403,565		9,053,979	
	=====		=====	
Capital adequacy ratio		87%		89%
		===		===

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.4 Credit risk

Credit risk is the risk of financial loss to the bank if a customer or counterparty to the financial instrument fails to meet its contractual obligations, and arises principally from the bank's loans and advances to customers and other investment securities. For risk management reporting purposes, the bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

The bank follows standards, policies and procedures established by the bank's credit committee for the control and monitoring of all risks. The Board of Directors has delegated the responsibility for the management of credit risk to the Board Committee and Credit Committee. The bank's management is responsible for the oversight of the bank's credit risk. The bank's credit risk policies and procedures are reviewed regularly through internal audit.

It is the bank's policy to obtain prime collateral to cover its exposure in case of default. At balance sheet date all loans to customers were cash secured.

4.4.1 Maximum exposure to credit risk

The bank's maximum credit risk exposure to on and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements can be classified in the following categories:

- Financial assets recognised on balance sheet comprising balance with Central Bank of Malta, financial investments, factored receivables, loans and advances and acceptances and endorsements. The maximum exposure of these financial assets to credit risk, equals their carrying amount.
- Commitments for factored receivables that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities.

4.4.2 Industry concentration

The following industry concentrations relating to loans and advances to customers are considered significant:

	2007		2006	
	EUR	%	EUR	%
Manufacturing	9,300,000	65	13,776,545	88
Wholesale and retail trade	4,000,000	28	25,000	-
Real estate, renting and business activities	955,000	7	1,895,000	12
	-----	----	-----	----
	14,255,000	100	15,696,545	100
	=====	===	=====	==

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.4 Credit risk (continued)

4.4.3 Analysis of collateral

The bank holds collateral against loans and advances to customers and investment securities in the form of pledges over deposits held with the bank. Except for pledges over deposits held with the bank, estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. Factored receivables are unsecured and collateral generally is not held over loans and advances to banks.

The fair value of collateral held as security is as follows:

Type of collateral	Carrying amounts of neither past due nor impaired			
	Loans and advances to customers		Investment securities	
	2007	2006	2007	2006
	EUR	EUR	EUR	EUR
Deposits held with the bank	14,225,000	15,696,545	25,561,572	24,872,999
	=====	=====	=====	=====

4.4.4 Impaired loans, securities and factored receivables

These comprise loans, securities and factored receivables for which the bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan/securities/factored receivables agreements.

	2007	2006
	EUR	EUR
Factored receivables - gross	3,027,970	2,801,578
	-----	-----
	--	
Collectively determined Allowance for impairment	2,945,950 29,851	2,801,578 28,022
Specifically impaired Allowance for impairment	82,020 82,020	- -

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.4 Credit risk (continued)

4.4.5 Neither past due nor impaired loans and securities

	2007	2006
	EUR	EUR
Loans and advances to customers	14,255,000	15,696,545
Loans and advances to banks	9,168,258	7,184,794
Investment securities	25,568,878	24,876,652
	-----	-----
	48,992,136	47,757,991
	=====	=====

4.4.6 Past due but not impaired

Receivables where contractual interest or principal payments are past due but the bank believes that impairment is not appropriate on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the bank.

The Bank did not have any past due not impaired receivables.

4.4.7 Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring.

The Bank does not have loans with renegotiation terms.

4.4.8 Allowances for impairment

The bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its factored receivables portfolio. The main components of this allowance are a specific loss component that relates to individually impaired receivables, and a collective loss allowance established for groups of factored receivables in respect of losses that have been incurred but have not been identified and subjected to individual assessment for impairment.

	2007	2006
	EUR	EUR
<i>Factored receivables</i>		
Specific allowance for impairment	82,020	-
Collective allowance for impairment	29,851	28,022
	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.4 Credit risk (continued)

4.4.9 Write-off policy

The bank writes off a loan, security and/or factored receivable balance (and any related allowance for impairment losses) when management determines that the loan, security and/or factored receivable is uncollectible. This determination is reached after considering information such as occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

4.4.10 Concentration risk

The bank monitors concentration of credit risk by sector and by geographic location. An analysis of concentrations of credit risk is shown on page 25.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.4 Credit risk (continued)

4.4.10 Concentration risk (continued)

	Loans and advances to customers		Factored receivables		Loans and advances to banks		Investment securities	
	2007	2006	2007	2006	2007	2006	2007	2006
	EUR	EUR	EUR	EUR	EUR	EUR	EUR	EUR
Carrying amount	14,255,000 =====	15,696,545 =====	2,916,099 =====	2,773,556 =====	9,168,258 =====	7,184,794 =====	25,568,878 =====	24,876,652 =====
Concentration by sector								
Corporate	14,255,000	15,696,545	2,916,099	2,773,556	-	-	25,565,225	24,872,999
Banks	-	-	-	-	9,168,258	7,184,794	-	-
Equity	-	-	-	-	-	-	3,653	3,653
	14,255,000 =====	15,696,545 =====	2,916,099 =====	2,773,556 =====	9,168,258 =====	7,184,794 =====	25,568,878 =====	24,876,652 =====
Concentration by location								
Europe	14,255,000 =====	15,696,545 =====	2,916,099 =====	2,773,556 =====	9,168,258 =====	7,184,794 =====	25,568,878 =====	24,876,652 =====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.4 Credit risk (continued)

4.4.10 Concentration risk (continued)

Concentration by location for loans and advances to customers and banks and investment securities is measured based on the location of the borrower or issuer of the security.

4.5 Market risk

Market risk comprises the risk of losses in value caused by unexpected changes in market prices (interest, share prices, exchange rates, prices of goods) before the affected positions can be closed out or hedged.

Market risk for the bank consists of three elements:

- Interest rate risk, which is the risk of losses because of changes in interest rates.
- Exchange rate risk, which is the risk of losses on the bank's positions in foreign currency because of changes in exchange rates.
- Investment price risk, which is the risk of losses because of changes in investments prices.

4.5.1 Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or re-price at different times or at different amounts. The bank accepts deposits from customers at both fixed and floating rates and for varying maturity periods. This risk is managed through the matching of the interest resetting dates on assets and liabilities. However, the bank seeks to maximise the spread over the cost of capital by investing funds in a portfolio of securities and loans and receivables with a longer tenure than the liabilities (therefore carrying a negative maturity gap position) through the efficient management of shorter term liabilities over the medium to longer term. The table on page 27 summarises re-pricing mismatches at balance sheet date together with the effective interest rates where applicable.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

2007	Effective Interest Rate	Less than three months	Between three months and one year	Between one year and five years	More than five years	Others
	EUR %	EUR	EUR	EUR	EUR	EUR
Assets						
Cash	466	-	466	-	-	-
Balances with Central Bank of Malta	1,117,828	4.0	1,117,828	-	-	-
Investments:						
- Debt securities held-to-maturity	25,565,225	6.3	1,635,000	12,716,574	11,213,651	-
- Equities available-for-sale	3,653	-	-	-	-	3,653
Loans and advances to banks	9,168,258	4.2	9,168,258	-	-	-
Loans and advances to customers	14,255,000	4.8	11,255,000	-	3,000,000	-
Factored receivables	2,916,099		2,916,099	-	-	-
Other assets	3,400,419		-	-	-	3,400,419
Total assets	56,426,948		26,092,651	12,716,574	14,213,651	-
Liabilities						
Amounts owed to customers	44,510,872	3.4	14,697,852	-	29,813,020	-
Current tax payable	201,847		-	-	-	201,847
Other liabilities	1,340,514		-	-	-	1,340,514
	46,053,233		14,697,852	-	29,813,020	-
Equity						
Issued capital	4,000,000		-	-	-	4,000,000
Property revaluation reserve	654,907		-	-	-	654,907
Retained earnings	5,718,808		-	-	-	5,718,808
	10,373,715		-	-	-	10,373,715
Total liabilities and equity	56,426,948		14,697,852	-	29,813,020	-
Gap			11,394,799	12,716,574	(15,599,369)	-
Cumulative Gap			11,394,799	24,111,373	8,512,004	8,512,004

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

2006	Effective Interest Rate		Less than three months	Between three months and one year	Between one year and five years	More than five years	Others
	EUR	%	EUR	EUR	EUR	EUR	EUR
Assets							
Cash	1,409	-	1,409	-	-	-	-
Investments:							
- Debt securities held-to-maturity	24,872,999	6.5	1,636,097	12,716,574	10,520,328	-	-
- Equities available-for-sale	3,653	-	-	-	-	-	3,653
Loans and advances to banks	7,184,794	4.2	7,184,794	-	-	-	-
Loans and advances to customers	15,696,545	3.7	12,350,000	-	3,346,545	-	-
Factored receivables	2,773,556	5.4	2,115,337	658,219	-	-	-
Other assets	3,062,233	-	-	-	-	-	3,062,233
	-----		-----	-----	-----	-----	-----
Total assets	53,595,189		23,287,637	13,374,793	13,866,873	-	3,065,886
	=====		=====	=====	=====	=====	=====
Liabilities							
Amounts owed to customers	43,693,758	2.5	32,183,103	-	497,787	11,012,868	-
Current tax payable	186,668	-	-	-	-	-	186,668
Other liabilities	668,806	-	-	-	-	-	668,806
	-----		-----	-----	-----	-----	-----
	44,569,232		32,183,103	-	497,787	11,012,868	875,474
	-----		-----	-----	-----	-----	-----
Equity							
Issued capital	4,000,000	-	-	-	-	-	4,000,000
Property revaluation reserve	420,773	-	-	-	-	-	420,773
Retained earnings	4,605,184	-	-	-	-	-	4,605,184
	-----		-----	-----	-----	-----	-----
	9,025,957		-	-	-	-	9,025,957
	-----		-----	-----	-----	-----	-----
Total liabilities and equity	53,595,189		32,183,103	-	497,787	11,012,868	9,901,431
	=====		=====	=====	=====	=====	=====
Gap			(8,895,466)	13,374,793	13,369,086	(11,012,868)	(6,835,545)
			-----	-----	-----	-----	-----
Cumulative Gap			(8,895,466)	4,479,327	17,848,413	6,835,545	-
			=====	=====	=====	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

4.5.1.1 Interest rate profile

At the reporting date the interest rate profile of the bank's interest bearing financial instruments was:

	2007	2006
	EUR	EUR
Fixed rate instruments		
Investments – Debt securities held-to-maturity	11,213,651	10,520,328
Loans and advances to banks	9,094,045	7,106,779
Loans and advances to customers	11,255,000	12,696,545
Amounts owed to customers	(30,204,020)	(13,639,655)
	-----	-----
	1,358,676	16,683,997
	=====	=====
Variable rate instruments		
Balances with Central Bank of Malta	1,117,828	-
Investments – Debt securities held-to-maturity	14,351,574	14,352,671
Loans and advances to banks	74,213	78,015
Loans and advances to customers	3,000,000	3,000,000
Amounts owed to customers	(14,306,852)	(30,054,103)
	-----	-----
	4,236,763	(12,623,417)
	=====	=====

4.5.1.2 Fair value sensitivity analysis for fixed rate instruments

The Bank does not account for any fixed rate financial assets and liabilities at fair value through profit or loss. Therefore, a change in interest rates at the reporting date would not affect profit or loss.

4.5.1.3 Cash flow sensitivity analysis for variable rate instruments

The sensitivity of the interest rate gaps to various interest rate scenarios is also monitored by management. Standard scenarios that are considered on a monthly basis include a 100 basis point (bp) parallel rise or fall in all the yield curves. An analysis of the bank's sensitivity to an increase or decrease in market interest rates is as presented on page 30. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

4.5.1.3 Cash flow sensitivity analysis for variable rate instruments (continued)

	Impact on profit or loss and equity	
	2007	2006
	EUR	EUR
+100 basis points	45,189	47,751
-100 basis points	(45,189)	(47,751)

4.5.3 Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to the changes in foreign exchange rates. The bank holds and deals in foreign currency with the aim to service client foreign exchange buying and selling activity. The bank does not speculate on its foreign exchange holdings. The bank's foreign exchange exposure is mainly limited to the United States Dollar and Swiss Francs originating from the bank's corporate banking business. The bank manages this risk by ensuring that its foreign currency denominated liabilities is matched with corresponding assets in the same currency.

Exposure to foreign currencies is maintained at minimum levels and within the prescribed limits set by the bank's Board of Directors. Under the scenario that all foreign currencies fluctuate up or down by 20% against the Euro, the fair values of financial assets and liabilities would fluctuate, up or down by EUR10,366 respectively.

The following table provides an analysis of the financial assets and liabilities of the bank into relevant currency groupings.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.3 Currency risk (continued)

	2007			2006		
	Euro	Other Currencies	Total	Euro	Other Currencies	Total
	EUR	EUR	EUR	EUR	EUR	EUR
Financial Assets						
Cash	-	466	466	943	466	1,409
Investments:						
- Debt securities held-to-maturity	25,565,225	-	25,565,225	24,872,999	-	24,872,999
- Equities available-for-sale	3,653	-	3,653	3,653	-	3,653
Loans and advances to banks	9,144,999	1,141,087	10,286,086	6,023,549	1,161,245	7,184,794
Loans and advances to customers	14,255,000	-	14,255,000	15,696,545	-	15,696,545
Factored receivables - gross	3,027,970	-	3,027,970	2,801,578	-	2,801,578
	-----	-----	-----	-----	-----	-----
	51,996,847	1,141,553	53,138,400	49,399,267	1,161,711	50,560,98
	=====	=====	=====	=====	=====	=====
Financial Liabilities						
Amounts owed to customers	43,417,253	1,093,619	44,510,872	42,573,037	1,120,721	43,693,758
	-----	-----	-----	-----	-----	-----
	43,417,253	1,093,619	44,510,872	42,573,037	1,120,721	43,693,758
	=====	=====	=====	=====	=====	=====

At the balance sheet date, the bank was not exposed to any off balance sheet currency risk.

4.5.4 Investment price risk

The exposure of the bank to this risk is not significant. Frequent management reviews are carried out to ensure high quality of the portfolio.

Fair value and price verification control

The majority of the financial assets and liabilities of the bank are carried out at cost or amortised cost and not fair value.

Investments – Debt securities held-to-maturity

This category of assets is carried at amortised cost. The instruments are unquoted and no quoted market price for similar instruments is available. There is no other appropriate or workable method of reasonably estimating the fair value of these unquoted investments for disclosure purposes.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.4 Investment price risk (continued)

Investments – Equity instruments available-for-sale

The bank has an interest in an unquoted equity investment as disclosed in note 12.3. The investment is measured at fair value. Fair value has been determined by reference to the amount recoverable which is represented by the notional amount of the investment.

Loans and advances to banks and customers and factored receivables

This category of assets is reported net of impairment allowances to reflect the estimated recoverable amounts. Loans and advances to banks and factored receivables are all repriceable within 3 months. On the other hand, 79% of loans and advances to customers are repriceable within 3 months while 21% are repriceable within two years. The fact that the majority of this category of financial assets has a short term contractual repricing coupled with the fact that interest rates reflect current market rates, the carrying amounts of these financial assets approximates their fair values.

Amounts owed to customers

This category of liabilities is carried at amortised cost and amounts to EUR44,510,872 (2006: EUR43,693,758). 33% of the bank's amounts owed to customers have a contractual repricing term of three months or less. The carrying value of these amounts approximates their fair values. In respect of other longer-term fixed-maturity deposits, these being repriceable upon their contractual maturity date, it is not practicable to determine fair value with sufficient reliability. Fair value is therefore taken to be the amount payable at balance sheet date.

4.6 Liquidity risk

Liquidity risk is the risk that the bank's obligations to repay liabilities or fund new loans exceeds the bank's ability to raise funds from either the liquidation of assets or the acceptance of new deposits. Liquidity risk arises because a bank does not exactly match the maturity of assets with the maturity of liabilities but must always be able to meet its liabilities as they fall due. Liquidity risk may also be affected by the depth of the market in which a bank has its assets and liabilities.

The bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the bank's reputation.

The bank's liquidity risk management focuses on structuring both the asset and liability portfolio so as to maintain diversity of funding sources and a spread of asset and liability maturities. It is bank's policy to reduce exposure to liquidity risk by matching, as much as possible, assets and liabilities in different maturity periods. A significant proportion of deposits are pledged, which contributes to the reduction of liquidity risk.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.6 Liquidity risk (continued)

Liquidity policies and procedures are reviewed regularly through Internal Audit reporting. All liquidity policies are subject to the review and approval of the Board of Directors.

The following table provides an analysis of the financial assets and liabilities of the bank into relevant maturity groupings based on the remaining periods to repayment.

At 31 December 2007	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years	Total
	EUR	EUR	EUR	EUR	EUR	EUR
Financial assets						
Investments:						
Debt securities held-to-maturity	-	-	-	15,828,651	9,736,574	25,565,225
Loans and advances to banks	9,739,525	546,560	-	-	-	10,286,086
Loans and advances to customers	11,255,000	-	-	3,000,000	-	14,255,000
Factored receivables – gross	1,031,749	1,855,887	140,335	-	-	3,027,970
	-----	-----	-----	-----	-----	-----
	--	-	-	--	---	--
	22,026,274	2,402,447	140,335	18,828,651	9,736,574	53,134,281
	=====	=====	=====	=====	=====	=====
Financial liabilities						
Amounts owed to customers	14,697,852	-	-	29,813,020	-	44,510,872
	=====	===	===	=====	===	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.6 Liquidity risk (continued)

At 31 December 2006	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years	Total
	EUR	EUR	EUR	EUR	EUR	EUR
Financial assets						
Investments:						
Debt securities held-to-maturity	-	1,636,097	-	15,135,328	8,101,574	24,872,999
Loans and advances to banks	6,790,418	394,376	-	-	-	7,184,794
Loans and advances to customers	12,350,000	-	-	3,346,545	-	15,696,545
Factored receivables – gross	1,124,331	1,012,375	664,872	-	-	2,801,578
	-----	-----	-----	-----	-----	-----
	---	-	-	--	--	--
	20,264,749	3,042,848	664,872	18,481,873	8,101,574	50,555,916
	=====	=====	=====	=====	=====	=====
Financial liabilities						
Amounts owed to customers	31,908,103	275,000	497,787	11,012,868	-	43,693,758
	=====	=====	=====	=====	=====	=====

4.6.1 Exposure to liquidity risk

The key measure used by the bank for managing liquidity risk is the ratio of net liquid assets to customer deposits. For this purpose net liquid assets are considered as including cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month. This calculation is used to measure the bank's compliance with the liquidity limit established by the Malta Financial Services Authority. Details of the bank's ratio of net liquid assets to deposits at the reporting date and during the reported period are as follows:

	2007	2006
As at 31 December	184%	185%
Average for the year	207%	126%
Maximum for the year	325%	153%
Minimum for the year	118%	76%

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.6 Liquidity risk (continued)

4.6.2 Residual contractual maturities of financial liabilities

The table below shows a maturity analysis for financial liabilities by remaining contractual maturities of cash flows.

	Carrying amount	Gross nominal inflow / (outflow)	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years
	EUR	EUR	EUR	EUR	EUR	EUR	EUR
At 31 December 2007							
Amounts owed to customers	44,510,872	(47,612,999)	(14,732,028)	-	-	(32,880,971)	-
	=====	=====	=====	===	=====	=====	===
At 31 December 2006							
Amounts owed to customers	43,693,758	(46,156,406)	(31,974,156)	(282,269)	(513,729)	(13,386,252)	-
	=====	=====	=====	=====	=====	=====	===

4.7 Operational risks

4.7.1 Management of operational risk

The bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the bank's reputation with overall cost effectiveness. To manage this risk in an appropriate manner the following policies have been adopted:

- To adopt policies, processes and procedures to control and/or mitigate material operational risks.
- To identify and assess the operational risk inherent in all material products, activities, processes and systems. Before new products, activities, processes and systems are introduced or undertaken, the operational risk inherent in them is subject to adequate assessment.
- To monitor all potential operational risks and material exposures to losses.
- To monitor whether there is motive, means and opportunity, within the overall control environment to commit fraudulent acts.
- To adopt contingency and business continuity plans to ensure ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management. Periodic internal audit reports are submitted to the bank's Audit Committee.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

4 Financial risk management (continued)

4.7 Operational risks (continued)

4.7.1 Management of operational risk (continued)

A financial measurement of this risk is arrived at by the bank for the purpose of allocating risk capital using the Basic Indicator Approach under the Capital Requirements Directive rules. The capital requirement for operational risk under this method was calculated at EUR292,480 as at 31 December 2007 (2006: EUR 236,701).

5 Interest receivable and similar income

	2007	2006
	EUR	EUR
On loans and advances to banks	354,742	142,546
On loans and advances to customers	1,416,944	1,210,522
	-----	-----
	1,771,686	1,353,068
	=====	=====

6 Interest expense

	2007	2006
	EUR	EUR
On amounts owed to banks	3,331	146
On amounts owed to customers	1,994,775	1,418,520
	-----	-----
	1,998,106	1,418,666
	=====	=====

7 Net fees and commissions income

	2007	2006
	EUR	EUR
Straight-through-processing fees	607,728	547,775
Commissions from factoring services	203,978	129,982
	-----	-----
Fees and commissions income	811,706	677,757
	-----	-----
Commissions payable	151	483
SWIFT and bank charges	36,291	41,118
	-----	-----
Fees and commissions expense	36,442	41,601
	-----	-----
	775,264	636,156
	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

8 Net trading gains

Net trading gains comprise exchange rate differences.

9 Profit before income tax

9.1 Profit before income tax is stated after charging auditors' remuneration amounting to EUR20,615 (2006: EUR19,241).

9.2 Staff costs incurred by the bank during the year are analysed as follows:

	2007	2006
	EUR	EUR
Directors' fees	23,671	22,750
Staff costs:		
- wages, salaries and allowances	151,735	147,378
- defined contribution social security costs	8,196	8,820
	183,602	178,948
	=====	=====

9.3 The weekly average number of persons employed by the bank during the year was as follows:

	2007	2006
	No.	No.
Managerial	2	2
Supervisory and clerical	4	4
	---	---
	6	6
	==	==

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

10 Income tax expense

10.1 Recognised in the income statement

		2007	2006
	Note	EUR	EUR
Current income tax expense			
Current tax charge		177,874	195,811
Deferred tax expense			
Origination and reversal of temporary differences	19.2	10,840	1,983
		-----	-----
		188,714	197,794
		=====	=====

10.2 The income tax expense for the year and the result of the accounting profit multiplied by the tax rate applicable in Malta, the bank's country of incorporation, are reconciled as follows:

	2007	2006
	EUR	EUR
Profit before income tax	1,293,752	1,769,668
	-----	-----
Income tax at the applicable tax rate of 35%	(452,813)	(619,384)
Income tax effect of:		
Flat rate foreign tax credit	279,484	423,989
Different tax rates	(9,143)	925
Depreciation charges not deductible by way of capital allowances	(4,978)	(2,093)
Non-taxable income	137	137
Non-deductible expenses	(1,401)	(1,368)
	-----	-----
Income tax expense	(188,714)	(197,794)
	=====	=====

11 Earnings per share

Earnings per share is calculated on the profit after tax of the bank for the year ended 31 December 2007 amounting to EUR1,105,038 (2006: EUR1,571,874) divided by 160,000 (2006: 160,000), being the weighted average number of ordinary shares in issue and ranking for dividend during the year.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

12 Investments

12.1	Investments comprise:	2007	2006
		EUR	EUR
	Debt securities held-to-maturity	25,565,225	24,872,999
	Equity instruments available-for-sale	3,653	3,653
		-----	-----
		25,568,878	24,876,652
		=====	=====

12.2 Debt securities held-to-maturity comprise unquoted non-convertible nominative bonds amounting to EUR25,565,225 (2006: EUR24,872,999) issued by related parties and acquired on issuance by the bank. The debt securities are cash secured by amounts owed to customers held by the bank.

12.3 Equity instruments available-for-sale comprise:

		2007	2006
		EUR	EUR
	Unquoted equity holding		
	- Society for Worldwide Interbank Financial Telecommunications sc		
	2 ordinary shares fully paid up	3,653	3,653
		=====	=====

12.4 The movement in investments may be summarised as follows:

	Held-to-maturity	Available-for-sale	Total
	EUR	EUR	EUR
At 1 January 2007	24,872,999	3,653	24,876,652
Acquisitions	1,635,000	-	1,635,000
Redemptions	(1,636,097)	-	(1,636,097)
Capitalisation of interest	693,323	-	693,323
	-----	-----	-----
At 31 December 2007	25,565,225	3,653	25,568,878
	=====	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

12 Investments (continued)

12.4 The movement in investments may be summarised as follows:

	Held-to- maturity	Available- for-sale	Total
	EUR	EUR	EUR
At 1 January 2006	24,209,112	5,575	24,214,687
Acquisitions	3,360,000	-	3,360,000
Redemptions	(3,346,564)	-	(3,346,564)
Capitalisation of interest	650,451	-	650,451
Adjustment to acquisition	-	(1,922)	(1,922)
	-----	-----	-----
At 31 December 2006	24,872,999	3,653	24,876,652
	=====	=====	=====

13 Loans and advances to banks

	2007	2006
	EUR	EUR
Repayable on call and at short notice	74,213	78,015
Term loans and advances	9,094,045	7,106,779
	-----	-----
	9,168,258	7,184,794
	=====	=====

14 Factored receivables

	2007	2006
	EUR	EUR
Receivables factored without recourse	3,027,970	2,801,578
Allowance for uncollectibility	(111,871)	(28,022)
	-----	-----
	2,916,099	2,773,556
	=====	=====
Allowances for uncollectibility		
Specific allowances	82,020	-
Collective allowances	29,851	28,022
	-----	-----
	111,871	28,022
	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

14 Factored receivables (continued)

14.2

	Specific allowances	Collective allowances	Total
	EUR	EUR	EUR
At 1 January 2007	-	28,022	28,022
Additions	82,020	1,829	83,849
At 31 December 2007	82,020	29,851	111,871

14.3 The aggregate amount of impaired factored receivables amounted to EUR82,020 (2006: Nil). No further specific allowances for uncollectibility were required in terms of Banking Directive 09.

14.4 An allowance for uncollectibility is provided against receivables factored without recourse, other than exposures to European governmental agencies.

15 Other loans and advances to customers

15.1

	2007	2006
	EUR	EUR
Term loans and advances	14,255,000	15,696,545

15.2 Loans and advances to customers represent amounts due by related parties.

15.3 All loans are cash secured by amounts owed to customers held by the bank and no specific or collective allowances for uncollectibility are necessary.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

16 Property and equipment

16.1		Revalued amount		Cost		
		Total	Premises and improvements	Computer hardware and software	Other equipment	Motor vehicles
	EUR	EUR	EUR	EUR	EUR	
Cost/revaluation						
	At 1 January 2006	2,492,486	1,242,214	966,195	284,077	-
	Acquisitions	318,004	-	295,592	16,589	5,823
	At 31 December 2006	2,810,490	1,242,214	1,261,787	300,666	5,823
	At 1 January 2007	2,810,490	1,242,214	1,261,787	300,666	5,823
	Acquisitions	101,655	-	81,359	20,296	-
	Revaluation	368,793	368,793	-	-	-
	At 31 December 2007	3,280,938	1,611,007	1,341,146	320,962	5,823
Depreciation						
	At 1 January 2006	778,634	77,861	452,501	248,272	-
	Charge for the year	185,255	13,039	157,762	13,941	513
	At 31 December 2006	963,889	90,900	610,263	262,213	513
	At 1 January 2007	963,889	90,900	610,263	262,213	513
	Depreciation the year	210,817	14,222	179,806	15,626	1,163
	At 31 December 2007	1,174,706	105,122	790,069	277,839	1,676
Carrying amount						
	At 1 January 2006	1,713,852	1,164,353	513,694	35,805	-
	At 31 December 2006	1,846,601	1,151,314	651,522	38,455	5,310
	At 1 January 2007	1,846,601	1,151,314	651,522	38,455	5,310
	At 31 December 2007	2,106,232	1,505,885	553,077	43,123	4,147

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

16 Property and equipment (continued)

16.2 Revaluation of premises

The bank's premises and improvements were revalued by an independent professionally qualified valuer on an existing use basis during August 2007.

The carrying amount of premises and improvements that would have been included in the financial statements had these assets been carried at cost less depreciation is EUR497,047 (2006: EUR502,811).

16.3 Capital commitments

At balance sheet date there were no capital commitments.

17 Prepayments and accrued income

17.1	2007	2006
	EUR	EUR
Accrued income	1,144,662	1,019,970
Prepayments and other receivables	149,525	195,662
	-----	-----
	1,294,187	1,215,632
	=====	=====

17.2 Accrued income on bonds issued by foreign related parties amounted to EUR1,142,694 (2006: EUR1,015,716).

18 Amounts owed to customers

18.1	2007	2006
	EUR	EUR
Repayable on demand	14,306,852	30,054,103
Term deposits	30,204,020	13,639,655
	-----	-----
	44,510,872	43,693,758
	=====	=====

18.2 Amounts owed to customers include an amount of EUR34,915,956 (2006: EUR36,418,631) owing by the bank to related parties.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

19 Deferred tax liabilities

19.1 Deferred income taxes are calculated on all temporary differences under the liability method using rates substantively enacted at balance sheet date. The deferred income tax balance composition is analysed below:

Deferred tax assets and (liabilities) are attributable to the following:

	Assets	Liabilities	Net	Assets	Liabilities	Net
	2007	2007	2007	2006	2006	2006
	EUR	EUR	EUR	EUR	EUR	EUR
Excess of capital allowances over depreciation	-	(26,038)	(26,038)	-	(10,796)	(10,796)
Collective impairment allowances	1,567	-	1,567	1,471	-	1,471
Specific impairment allowances	4,306	-	4,306	-	-	-
Revaluation of property	-	(352,644)	(352,644)	-	(226,571)	(226,571)
	-----	-----	-----	-----	-----	-----
		--	--		--	--
	5,873	(378,682)	(372,809)	1,471	(237,367)	(235,896)
	=====	=====	=====	=====	=====	=====

19.2 Movement in temporary differences relating to:

	At 1 January 2007EUR	Recognised in income	Recognised in equity	At 31 December 2007 EUR
		EUR	EUR	
Excess of capital allowances over depreciation	(10,796)	(15,242)	-	(26,038)
Collective impairment allowances	1,471	96	-	1,567
Specific impairment allowances	-	4,306	-	4,306
Revaluation of property	(226,571)	-	(126,073)	(352,644)
	-----	-----	-----	-----
	(235,896)	(10,840)	(126,073)	(372,809)
	=====	=====	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

19 Deferred tax liabilities (continued)

	At 1 January 2006	Recognised in income	At 31 December 2006
	EUR	EUR	EUR
Excess of capital allowances over depreciation	(5,984)	(4,812)	(10,796)
Impairment allowances	1,111	360	1,471
Revaluation of property	(229,040)	2,469	(226,571)
	-----	-----	-----
	(233,913)	(1,983)	(235,896)
	=====	=====	=====

20 Accruals and deferred income

20.1	2007	2006
	EUR	EUR
Accrued interest payable	808,208	299,015
Deferred factoring commissions	29,057	21,441
Other accrued expenses	130,438	132,454
	-----	-----
	967,703	452,910
	=====	=====

20.2 Accruals and deferred income includes amounts due to related parties amounting to EUR704,611 (2005: EUR218,172).

21 Share capital and reserves

21.1 Share capital

	Ordinary shares	
	2007	2006
	No.	No.
On issue at 1 January:		
Issued for cash	54,762	54,762
Issued in lieu of dividend payment	105,238	105,238
	-----	-----
On issue at 31 December – fully paid	160,000	160,000
	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

21 Share capital and reserves (continued)

21.1 Share capital (continued)

At 31 December 2007, the authorised and issued share capital comprised 160,000 ordinary shares (2006: 160,000) of EUR25 each.

All shares in issue are fully paid up.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings of the bank.

21.2 Property revaluation reserve

The property revaluation reserve represents the surplus arising on the revaluation of the bank's premises and improvements, net of related deferred tax effects, and net of that part of the surplus realised through use and depreciation of the revalued property. This reserve is not distributable except on realisation of the assets through sale.

22 Commitments

	2007	2006
	EUR	EUR
Unutilised factoring commitments	3,502,027 =====	3,573,422 =====

The bank may unconditionally cancel factoring commitments at its discretion, other than amounts being currently utilised by customers.

Factoring commitments are granted to customers at prevailing market rates at transfer date.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

23 Cash generated from operations

	2007	2006
	EUR	EUR
Profit for the year:	1,105,038	1,571,874
Adjustments for:		
Depreciation	210,817	185,255
Income tax expense	188,714	197,794
Impairment allowance	83,849	6,854
Interest receivable on debt securities	(1,596,135)	(1,920,114)
	(7,717)	41,663
Working capital changes:		
Debtors	1,213,663	(4,407,170)
Creditors	1,370,430	7,788,895
	2,576,376	3,423,388
	=====	=====

24 Cash and cash equivalents

	2007	2006
	EUR	EUR
Cash	466	1,409
Balances with Central Bank of Malta	1,117,828	-
Loans and advances to banks with contractual maturity of three months or less	9,168,258	7,184,794
	10,286,552	7,186,203
	=====	=====

25 Operating leases

The future minimum lease payments for the bank under non-cancellable operating lease rentals payable to a third party are as follows:

	2007	2006
	EUR	EUR
Less than one year	11,808	5,871
Between one and five years	37,932	19,081
	49,740	24,952
	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

25 Operating leases (continued)

The bank leases two motor vehicles under operating leases. During the year ended 31 December 2007 EUR6,564 was recognised as an expense in the income statement in respect of operating leases (2006: EUR6,401).

In case of termination of the lease contract, the bank is entitled to pay liquidation damages equivalent to 50% of the rental charges due from the date of termination for the period of all unexpired leases including all rental charges due to the termination of the contract.

26 Related parties

26.1 Identity of related parties

Related parties are related by virtue of having common directors. Transactions with related parties are carried out entirely on an arm's length basis.

26.2 Related party transactions

Interest, fees and other income/charges in respect of related parties in the income statement comprise:

	2007	2006
	EUR	EUR
Interest receivable and similar income	3,012,496	3,130,600
Fees and commissions receivable	789,731	659,955
Other operating income	4,193	4,193
	=====	=====
Interest expense	1,623,800	1,142,024
	=====	=====

26.3 Related party balances

The balance sheet includes outstanding transactions and balances in respect of related parties as follows:

	2007	2006
	EUR	EUR
Assets		
Loans and advances to customers	14,255,000	15,696,545
Investments	25,565,225	24,872,999
Prepayments and accrued income	1,142,694	1,015,716
	=====	=====

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

26 Related parties (continued)

26.3 Related party balances (continued)

	2007	2006
	EUR	EUR
Liabilities		
Amounts owed to customers	34,915,956	36,418,631
Accruals and deferred income	704,611	218,172
	=====	=====

26.4 Compensation to key management personnel

	2007	2006
	EUR	EUR
Compensation to key management personnel	97,433	88,166
	=====	=====

26.5 The financial results and assets and liabilities of the bank are included in the consolidated financial statements of VMKG, the registered office of which is Bruulstraat 77, 1130 Brussels, Belgium.

27 Accounting estimates and judgements

27.1 The directors considered the development, selection and disclosure of the bank's critical accounting policies and estimates and the application of these policies and estimates. Estimates and judgements are continually evaluated and are based on historical and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

27.2 Critical accounting judgements in applying the bank's accounting policies

Certain critical accounting judgements in applying the bank's accounting policies are described below.

27.2.1 Classification of held-to-maturity investments

The bank follows the guidance in IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. The classification requires significant judgement. In making this judgment, the bank evaluates its intention and ability to hold such investments to maturity. If the bank fails to keep these investments to maturity other than for specific circumstances, for example, selling an insignificant amount close to maturity, it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value instead of at amortised cost.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

27 Accounting estimates and judgements (continued)

27.2 Critical accounting judgements in applying the bank's accounting policies (continued)

27.2.2 Impairment losses on loans and advances and factored receivables

The bank reviews its loan portfolio to assess impairment on an ongoing basis as relevant generic data is observed concerning risks associated with loans and factored receivables with similar risk characteristics. As a result, the bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and factored receivables, before the decrease is actually identified with an individual loan or factored receivable in that portfolio. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

27.2.3 Revaluation of premises

The bank's premises are measured at revaluation amount less accumulated depreciation. The revaluation amount is determined on the basis of open market values provided periodically, but at least every five years, by independent valuers. The open market valuation provided by independent valuers in August 2007 of the property disclosed in note 16 is EUR1,747,030. The directors applied a downward adjustment of EUR232,937 to limit the revaluation to what they believe is the lower range of the fair open market value.

28 Comparative information

Certain comparative amounts have been reclassified to conform with the current year's presentation.

Izola Bank Limited

Notes to the Financial Statements

For the Year Ended 31 December 2007

Independent Auditors' Report

To the shareholder's of

Izola Bank Limited

Report on the Financial Statements

We have audited the financial statements of Izola Bank Limited (the "Bank") as set out on pages 4 to 50 ("the financial statements"), which comprise the balance sheet as at 31 December 2007 and the statement of changes in equity, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Financial Statements

As described on page 3, the directors are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report, including the opinion, has been prepared for and only for the bank's members as a body in accordance with Article 179 of the Companies Act 1995 and Article 31 of the Banking Act, 1994 enacted in Malta and may not be appropriate for any other purpose.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the bank as at 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Independent Auditors' Report (continued)

To the Shareholder's of

Izola Bank Limited

Report on Other Legal and Regulatory Requirements

The Banking Act, 1994 requires us to report:

- whether we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
- whether in our opinion, proper books of account have been kept by the bank so far as appears from our examination thereof;
- whether the financial statements are in agreement with the books; and
- whether these give the information required by any law in force in the manner so required and give a true and fair view.

We also report to you our opinion as to whether the financial statements are properly prepared in accordance with the Companies Act, 1995 ('the Act'). In addition, we report to you if, in our opinion:

- the information given in the Directors' Report is not consistent with the financial statements; or
- the bank has not kept proper accounting records; or
- the bank's financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations for our audit, or if the information specified by Article 31(O) of the Third Schedule to the Act regarding directors' emoluments is not disclosed, in which case we are required to include a statement in our report giving the required particulars.

We read the Directors' Report and consider the implications for our report if we become aware of any material misstatements of fact within it.

Opinion

We have obtained all the information and explanations, which to the best of our knowledge and belief were necessary for the purposes of our audit. In our opinion, proper books of account have been kept by the Bank so far as appears from our examination thereof. The financial statements are in agreement with the books.

Also, in our opinion, the financial statements have been properly prepared in accordance with the provisions of the Companies Act, 1995 and the Banking Act, 1994 enacted in Malta.



Joseph C Schembri (Partner) for and on behalf of

KPMG
Registered Auditors

2 April 2008