UNICREDIT BANK A.D., BANJA LUKA

Financial statements
for the year ended
31 December 2011

This version of our report is a translation from the original, which was prepared in Serbian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over translation.

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Director's Report

To the Supervisory Board and shareholders of UniCredit Bank a.d., Banja Luka

Dear shareholders and business partners,

It is my great pleasure to present, on behalf of the Bank's Management Board, the results achieved in the year that was very successful for the Bank, and that result is even more important if we bear in mind the macroeconomic business conditions and general financial situation in the country and in the world. We have surpassed the budgeted profit along with the growth of total income over 20%, and we have kept the operating expenses of the Bank at approximately the same level as in the previous year. According to majority of main parameters we operated better than the competition and with considerable better quality than it was the case in the previous years. It is also important to emphasize that the financial result is not the only thing on the system of value scale of our Bank and UniCredit Group we belong to, but the achievement of the good-quality financial results is a necessary assumption for further growth and development of the Bank, and better and greater contribution to the community in which it operates. Having achieved good results in 2011 we have opened a space to direct the Bank, through dedicated and prudent work, with even better support from the Group which was evident through the increase of share capital completed in this year, toward the place that belongs to it in the RS market.

We have achieved the growth of income by improving quality in granting credits to our clients and more efficient approach to assets and liabilities management of the Bank. In the part of granting credits to legal entities, the main shift was realized in several larger placements, and in the part of retail operations through we have achieved the targeted growth of loan volumes through several loan actions. With the growth of volumes and income, we have initiated and implemented a set of activities directed to cost rationalization, whereby we have enabled that some unplanned new expenses, such as increased taxes and contributions on salaries, do not lead to surpass of total planned costs at the Bank level.

In 2011, the Bank realized profit before tax in the amount of BAM 9.4 million, income tax amounted to BAM 1.2 million, and net profit BAM 8.2 million. Net interest income was realized in the amount of BAM 31.8 million which is by 23% more than in the previous year, and net non-interest income (fees and commission) was realized in the amount of BAM 12.3 million which is by 18% more than in the previous year.

Total net loans to customers at the end of last year amounted to BAM 537.1 million and are higher by 26.6% compared to the previous year, of which loans to legal entities amounted to BAM 250.5 million which is by 35% more than in the previous year, and loans to individuals amounted to BAM 286.5 million which is by 20% more than in the previous year. In terms of structure 47% of total loans relate to legal entities, and 53% to individuals.

In addition to loan activities in 2011 the Bank had more significant investments into debt securities issued by the Government of Republika Srpska in the amount of BAM 47.3 million.

Deposits and loans from the Banks at the end of 2011 amounted to BAM 194.7 million and they are higher by 169% compared to the previous year, while deposits and loans from customers amounted to BAM 397.6 million and are lesser by 6% compared to the previous year. Deposits and loans from customers comprise deposits and loans of legal entities and entrepreneurs in the amount of BAM 217.5 million and deposits from individuals in the amount of BAM 180.1 million. In terms of structure 55% of total deposits and loans relate to legal entities and 45% to deposits of individuals.

Retail

Intensive credit activity during 2011 brought about the significant increase of loan portfolio volume and increase of Bank's market share. By better management of loan portfolio positive margins were achieved, and improved maturity structure of the term deposit portfolio along with continuation of growth trend of total deposits.

Having introduced several new products (e-banking, opened savings, and alike) we have improved the offer of products and services in retail operations, and the introduction of new card products (Master Card, instalment card, etc.) is in progress.

After the reorganization of the business network, performed in 2010, the activities for the measurement and evaluation of efficiency of the branches and every employee individually have continued. On basis of obtained results and local market potential we continuously implement the optimization of the business network.

In the market in which it operates, the Bank is improving its products and services on a daily basis, focusing on clients and their needs. The established service quality system is regularly monitored and improved. The results of this year's campaign of client satisfaction research indicate a significant improvement compared to the results achieved in 2010 and the results are significantly above the market average.

Corporate banking

Positive breakthroughs were made in 2011 in cooperation with the Public sector, which are reflected through the increase of placements and improvement of the quality of business relationship.

In the domain of loan operations with the private sector, we have focused on lesser number of clients with higher creditworthiness, having achieved through several larger placements growth of loan volume considerably higher than the market growth, by which we have increased the market share.

Owing to such approach, and with continuous improving of sales staff expertise, the growth of loan volume was realized with the provisioning costs which were two times lower than the budgeted.

Financial markets

The impact of the economic crisis is still present and it is manifested through low rates in the money market, sluggish economic activity, and a decrease of inflow of foreign currency from abroad. These negative tendencies are partially mitigated by debt securities issuing, mostly government bonds and treasury bills, which had an impact on the increase of turnover volume in the local stock exchange compared to the previous year, as well as improved liquidity in the local market.

Financial markets managed to keep the basis of existing clients in 2011, and modifying the range and price of products and services in the next period we are planning to intensify activities on the acquisition of clients with significant foreign trade activity and increase of market position in all business segments.

Risk management

In the previous year the Bank accomplished a growth of loan portfolio significantly above the growth of the total banking sector in Republika Srpska. Portfolio of restructured and workout loans in spite of increased demand for rescheduling and deterioration of loan quality has not been increased, which is the result of intensified monitoring and collection of due liabilities and existing delinquent loans. The quality of portfolio of loans extended to corporate banking clients was stable, while the intensified default risk in loan liabilities was noticed with small entrepreneurs and individuals.

Decline in the standard of living and purchasing power, growth of unemployment and salary reductions have influenced on the increase of demand for rescheduling of loans of individuals. In such an environment the Bank has intensified its offer of restructuring products and thus satisfied the need of its clients and prevented further deterioration of portfolio quality.

Due to slowness of the judicial system in solving of court processed collection, and insolvency of the market of real estate, which was received as collateral, risk of collection of bad loans increased, so the Bank separated a significant amount of additional provisions for risk coverage in the portfolio of bad loans.

Process of further development of management of market risk and liquidity risk continued in the previous year also in compliance with the requirements of the local regulator and Group standards.

Operational risk losses are significantly lower compared to the previous year. Transfer of risk to insurance holders has additionally positively influenced the level of net loss.

In conformity with activities of the Group, the Bank has been establishing the system of management with internal capital requirements for the coverage of credit, market and operational risks and business risk of investment into securities and risk of own real estate. Business activities of the Bank were realized in the previous year in accordance with risk strategies and risk tolerance defined by the Bank management through risk appetite measures.

Expectations for 2012

Success in the last year expressed through a good business result in the previous year is something that additionally motivates and obligates us. We are aware there is still a lot of work ahead of us in order to make the Bank sustainable in the long term and successful financial institution and that the areas and space for improvement initiated in 2011 are only the good starting points for further prosperity which requires continuous work.

Therefore it is necessary to continue in 2012 with rational and efficient cost management, intensifying activities on structure improvement, strengthening of motivation level and improvement of expert knowledge and competences, developing management quality and improving cooperation both in the Bank and the Group and externally with the clients, institutions and the community.

Finally, I would like to express my most sincere gratitude to all of our clients and business partners, as well as our shareholders for the confidence they have demonstrated. I direct particular thanks to all of the Bank's employees for their conscientious and professional approach to their work.

I am convinced that the mutual cooperation and trust in the forthcoming period will be even better and more successful.

Director of the Bank

Ivan Vlaho

Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements

The Management is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Bank and of the results of its operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. Management has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Management is responsible for selecting suitable accounting policies to conform to applicable legal requirements and then apply them consistently; make judgements and estimates that are reasonable and prudent; and prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements, following which the Supervisory Board is required to approve the annual financial statements for submission to the General Assembly of Shareholders for adoption.

Financial statements at pages from 8 to 79 were authorised by the Management Board on 17 February 2011 for issue to the Supervisory Board, and are signed below to signify this, on behalf of the Bank, by:

For and on behalf of the Management Board

UniCredit Bank a.d. Banja Luka

Ivan Vlaho	Ljubiša Tešić
Director	*Executive Manager for Finance Management*

Indepedent Auditor's report to the owner or UniCredit Bank a.d. Banja Luka

We have audited the accompanying financial statements of UniCredit Bank a.d. Banja Luka ("the Bank"), which comprise the statement of financial position as at 31 December 2011, statements of comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Financial Statements

Management Board is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant 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.

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Indepedent Auditor's report to the owner or UniCredit Bank a.d. Banja Luka (continued)

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG B-H ***d.o.o. za reviziju***
Registered auditors
Zmaja od Bosne 7-7A/III
71000 Sarajevo
Bosnia and Herzegovina

D.O.O. ZA REVIZIJU KPMG B-H SARAJEVO

17 February 2012

For and on behalf of KPMG B-H d.o.o za reviziju:

Manal Bećirbegović
Executive Director

Senad Pekmez
FBiH authorised auditor

Licence number: 3090044102

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Statement of comprehensive income
For the year

	Note	**2011** **BAM ‘000**	**2010** **BAM ‘000**
Interest income	*6*	41,504	37,648
Interest expense	*7*	(9,685)	(12,016)
Net interest income		**31,819**	**25,632**
Fee and commission income	*8*	13,237	11,599
Fee and commission expenses	9	(981)	(1,206)
Net fee and commission income		**12,256**	**10,393**
Net gains from financial instruments at fair value through the profit and loss and foreign exchange differences from translation of monetary assets and liabilities	*10*	167	130
Other operating income		26	549
Net gains from financial assets available for sale	*11*	35	114
Total operating income		**44,303**	**36,818**
Personnel expenses	*12*	(13,186)	(11,720)
Depreciation and amortisation	*21,22*	(5,915)	(5,300)
Other expenses	*13*	(10,289)	(11,688)
Total operating expenses		**(29,390)**	**(28,708)**
Profit before impairment and provisions		**14,913**	**8,110**
Net impairment losses and provisions	*14*	(5,541)	(7,009)
Profit before tax		**9,372**	**1,101**
Income tax expense	*15*	(1,171)	(723)
Profit for the year		**8,201**	**378**
Other comprehensive income			
Net change in fair value reserves		(127)	(85)
Other comprehensive income		**(127)**	**(85)**
Total comprehensive income for the year		**8,074**	**293**
Basic and diluted earnings per share (in BAM)	*30*	79.67	4.26

Statement of financial position
As at 31 December

	Note	2011 BAM '000	2010 BAM '000
Assets			
Cash reserves	*16*	22,012	40,449
Obligatory reserve with the Central Bank	*17*	32,216	47,974
Loans and receivables from banks	*18*	38,128	30,482
Financial assets available for sale	*20a*	47,611	462
Financial assets at fair value through profit or loss	*20c*	-	-
Loans and receivables from customers	*19*	534,460	423,321
Financial assets held to maturity	*20b*	200	-
Property and equipment	*21*	19,093	22,485
Intangible assets	*22*	5,329	6,178
Accrued interest and other assets	*23*	4,574	4,777
Deferred tax assets	*28*	19	2
Total assets		**703,642**	**576,130**
Liabilities			
Deposits and loans from banks	*24*	194,687	72,429
Deposits and loans from customers	*25*	397,581	423,904
Financial liabilities at fair value through profit or loss	*20c*	-	-
Accrued interest and other liabilities	*26*	9,666	6,575
Provisions for liabilities and charges	*27*	1,795	1,820
Income tax liability		735	191
Deferred tax liability	*28*	247	355
Total liabilities		**604,711**	**505,274**
Equity			
Issued share capital	*29*	82,055	62,054
Share premium		373	373
Regulatory reserve for credit losses		5,861	3,496
Revaluation reserve		2,195	2,195
Fair value reserve		(141)	(14)
Legal reserve		387	2,374
Profit for the year		8,201	378
Total equity		**98,931**	**70,856**
Total liabilities and equity		**703,642**	**576,130**

Statement of changes in equity
For the year

	Issued share capital	Share premium	Regulatory reserve for credit losses	Revaluation reserve	Fair value reserve	Legal reserve	Profit for the year	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Balance as at 1 January 2011	**62,054**	**373**	**3,496**	**2,195**	**(14)**	**2,374**	**378**	**70,856**
Issue of share capital	20,001	-	-	-	-	-	-	20,001
Transfer to reserves	-	-	2,365	-	-	(1,987)	(378)	-
Net profit for the year	-	-	-	-	-	-	8,201	**8,201**
Other comprehensive income								
Net loss from change in fair value of financial assets available for sale	-	-	-	-	(141)	-	-	**(141)**
Deferred tax	-	-	-	-	14	-	-	**14**
Total other comprehensive income	-	-	-	-	*(127)*	-	-	***(127)***
Total comprehensive income	-	-	-	-	(127)	-	8,201	**8,074**
Balance as at 31 December 31 2011	**82,055**	**373**	**5,861**	**2,195**	**(141)**	**387**	**8,201**	**98,931**

As explained in Note 4a, the Bank has estimated the amount required to be held in a non-distributable reserve for credit losses within equity to be BAM 9,288 thousand at 31 December 2011 (2010: BAM 5,861 thousand). The shortfall of BAM 3,427 thousand (2010: BAM 2,365 thousand) is intended to be made up by a transfer from current year profit to be proposed for adoption by shareholders in general meeting.

Statement of changes in equity (continued)
For the year

	Issued share capital	Share premium	Regulatory reserve for credit losses	Revaluation reserve	Fair value reserve	Legal reserve	Profit for the year	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Balance as at 1 January 2010 *(restated)*	**62,054**	**373**	**3,496**	**2,195**	**71**	**2,335**	**39**	**70.563**
Net profit for the year	-	-	-	-	-	-	378	**378**
Other comprehensive income								
Net gain from change in fair value of financial assets available for sale	-	-	-	-	16	-	-	**16**
Transfer to profit and loss on realisation of financial assets available for sale (Note 11)	-	-	-	-	(114)	-	-	**(114)**
Foreign exchange difference on non-monetary financial assets available for sale	-	-	-	-	3	-	-	**3**
Deferred tax	-	-	-	-	10	-	-	**10**
Total other comprehensive income	-	-	-	-	*(85)*	-	-	***(85)***
Total comprehensive income	-	-	-	-	(85)	-	378	**293**
Transfer of profit into legal reserve	-	-	-	-	-	39	(39)	**-**
Balance as at 31 December 2010	**62,054**	**373**	**3,496**	**2,195**	**(14)**	**2,374**	**378**	**70,856**

Statement of cash flows
For the year

	Note	2011 BAM '000	2010 BAM '000
Cash flow from operating activities			
Profit before tax		**9,372**	**1,101**
Adjustments:			
- depreciation and amortisation	*21,22*	5,915	5,300
- impairment losses on loans to customers and other assets		5,542	7,189
- losses from provisions for liabilities and charges		-	1,178
- net foreign exchange gain	*10*	(167)	(130)
- (gains)/losses on disposal and write-off of property and equipment		(56)	84
Changes in operating assets and liabilities			
(Increase)/decrease in placements with and loans to other banks		(7,646)	7,871
Increase in loans to customers		(118,459)	(36,364)
Decrease/(Increase) in accrued interest and other assets		2,111	(1,746)
Decrease/(increase) in obligatory reserve with the Central Bank		15,758	(2,008)
Increase/(decrease) in deposits from banks		122,258	(21,351)
Decrease in deposits from customers		(26,323)	(23,292)
Increase in other liabilities		3,091	1,215
Net cash inflow/(outflow) from operating activities before tax		**11,396**	**(60,953)**
Income taxes paid		(737)	(550)
Net cash inflow/(outflow) from operating activities		**10,659**	**(61,503)**
Cash flow from investing activities			
Purchase of property, equipment and intangible assets		(1,748)	(1,053)
(Increase)/decrease in financial assets available for sale		(47,149)	228
Increase of financial assets held to maturity		(200)	-
Increase in share capital		20,001	
Net cash outflow from investment activities		**(29,096)**	**(825)**
Effect of foreign exchange rate changes on cash and cash equivalents		-	25
Net decrease in cash and cash equivalents		**(18,437)**	**(62,303)**
Cash and cash equivalents at the beginning of the year	*16*	**40,449**	**102,752**
Cash and cash equivalents at the end of the year	*16*	**22,012**	**40,449**

Notes to financial statements

1. Reporting entity

UniCredit Bank a.d. ("the Bank") is a joint stock company incorporated and domiciled in Republika Srpska for conducting payment transactions, domestic and foreign credit and deposit transactions, and, in accordance with legislation of Republika Srpska.

As at 31 December 2011, the Bank consisted of the Head Office in Banja Luka registered at Marije Bursac 7, 37 branch offices and 7 agencies and there were no changes compared to 31 December 2010.

As at 31 December 2011 the Bank had 443 employees (2010: 482 employees).

The Bank's tax identification number is 4400958880009, and the VAT number is 400958880009.

2. Basis for preparation of the financial statements

2.1. Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The financial statements were authorised for issue by the Management Board on 17 February 2011 for approval by the Supervisory Board.

This is the English translation of the official statutory financial statements issued in Serbian.

2.2. Basis of preparation

The financial statements are prepared on the principle of historical or amortised cost with the exception of financial assets available for sale and financial assets and liabilities at fair value through profit or loss which are stated at fair value and buildings which are stated at market value decreased by accumulated depreciation.

2.3. Use of estimates and judgments

The preparation of financial statements in accordance with International Financial Reporting Standards requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

Areas that require a higher level of judgment or which entail complexity and areas where estimates and judgments have a significant impact on the financial statements are discussed in Note 4.

2.4. Functional and presentation currency

The financial statements are presented in Convertible Marks ("BAM"), which is also the functional currency. Amounts are rounded to the nearest thousand (unless otherwise stated).

The Central Bank of Bosnia and Herzegovina ("Central Bank") has implemented a foreign exchange policy on a currency board principle according to which BAM is aligned to EUR at an exchange rate of EUR 1: BAM 1.955830, which prevailed through out 2011 and 2010.

3. Specific accounting policies

The accounting policies presented hereinafter have been consistently applied for all years presented.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.1. Interest income and expense

Interest income and expense are recognised in the statement of comprehensive income as they accrue for all interest-bearing instruments using the effective interest rate method, i.e. in accordance with the rate that discounts the estimated cash flows to their net present value during the term of the agreement.

The effective interest rate is the rate that precisely discounts the estimated future cash disbursement or payment through the expected duration of the financial instrument or, where appropriate, a shorter period, on the net carrying value of financial assets or financial liabilities. When calculating the effective interest rate, the Bank performs an assessment of cash flows, taking into consideration all conditions of the agreement related to the financial instrument, but not considering future loan losses. The calculation includes all fees and commissions paid and received, and which are a constituent part of the effective interest rate, transaction costs and all other premiums and discounts.

Such income and expense are presented as interest income and interest expense in the statement of comprehensive income.

3.2. Fee and commission income and expense

Fee and commission income and expense mainly comprise fees related to credit card transactions, the issue of guarantees and letters of credit, domestic and foreign payment transactions, foreign exchange trading, brokerage services, depository activities and other services and are recognised in the statement of comprehensive income upon performance of the relevant service.

3.3. Net gains from financial assets at fair value through the profit and loss and, foreign exchange differences from translation of monetary assets and liabilities and net gains from investment securities

Net gains and losses from financial assets at fair value through profit and loss, and foreign exchange differences from translation of monetary assets and liabilities include non-realized and realized gains and losses from derivative financial instruments, and gains and losses on the basis of translation of monetary assets and liabilities.

Net gains from investment securities include realized net gains from the sale of financial assets available for sale.

3.4. Foreign currency

Transactions in foreign currency are translated into BAM at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into BAM at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income, except in the case of differences arising on non-monetary available-for-sale financial assets, which are recognised in equity. Non-monetary assets and liabilities denominated in foreign currency measured at historical cost are translated into BAM using the exchange rate at the date of the transaction and are not retranslated at the reporting date.

3.5. Income tax expenses

Income tax is based on taxable profit for the year and comprises current and deferred tax.

Current tax

Current tax is the amount calculated according to the prescribed tax rate (currently 10%) on the tax base determined in the tax return, which represents the amount of the profit before tax adjusted for the effect of reconciling income and expenses, in accordance with tax legislation of Republika Srpska.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.5. Income tax expenses (continued)

Deferred taxes

Deferred tax items are calculated using the balance sheet liability method, for all temporary differences arising between the tax base of assets and liabilities and their carrying value for financial reporting purposes.

Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which realisation or settlement of the carrying value of the assets or liabilities is expected, and on the basis of the tax rate applicable at the balance sheet date.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the balance sheet date, to recover or settle the book value of these assets and liabilities.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the statement of financial position. Deferred tax assets are recognised only to the extent that it is probable that they could be utilised as tax relief. At each reporting date, the Bank reassesses unrecognised potential deferred tax assets and tests the carrying value of recognised deferred tax assets for recoverability.

3.6. Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: loans and receivables, available-for-sale financial assets, financial assets and liabilities at fair value through profit or loss, financial assets held to maturity and other financial liabilities. Management determines the classification of financial instruments on inception and re-evaluates initial classification at each reporting date.

Loans and receivables are non-derivative financial assets with fixed or determined payment that are not quoted on an active market. Loans and receivables arise when the Bank provides money to a debtor with no intention of trading with the receivable. Loans and receivables include placements with and loans to banks and loans to customers and the obligatory reserve with the Central Bank.

Available-for-sale financial assets are non-derivative financial assets classified as available for sale or which are not classified in any other category. Financial assets classified as available for sale are intended to be held for an indefinite period of time, but may be sold in response to a need for liquidity or a change in interest rates, foreign exchange rates or equity prices. Assets available for sale include debt and equity securities.

Financial assets and financial liabilities at fair value through the profit or loss have two sub-categories: financial assets held for trading (including derivatives) and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term, for the purpose of short-term profit-taking, or designated as such by management.

Financial assets held to maturity comprise debt securities that the Bank intends to hold until their maturity.

Other financial liabilities comprise all financial liabilities which are not held for trading or designated at fair value through profit or loss and include current accounts, deposits and borrowings.

Recognition

Loans and receivables and other financial liabilities are recognised when advanced to borrowers or received from lenders.

The Bank recognises financial assets available for sale, financial assets held to maturity and financial assets and liabilities at fair value through the profit or loss at the trade date.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

Measurement

(a) Loans and receivables

Loans and receivables are initially recognised at fair value. After initial recognition, loans and receivables are measured at amortised cost using the effective interest rate method, less any impairment.

(b) Available for sale financial assets

Available-for-sale financial assets are initially measured at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset. Subsequent to initial recognition all available-for-sale financial assets are measured at fair value, except for equity securities that do not have a quoted market price in an active market, or whose fair value cannot be reliably measured, which are stated at cost, including transaction costs, less possible impairment.

c) Financial assets and financial liabilities at fair value through the profit or loss

Financial assets and liabilities at fair value through profit or loss are initially recognised at fair value. All transaction costs are immediately expensed. Subsequent measurement is also at fair value.

(d) Financial assets held to maturity

Financial assets held to maturity are initially recognised at fair value. After initial recognition, financial assets held to maturity are measured at amortised cost using the effective interest rate method, less impairment.

(e) Other financial liabilities

Other financial liabilities are initially measured at fair value. Subsequent to initial recognition, other financial liabilities are measured at amortised cost using the effective interest rate method.

Recognition of gains and losses on subsequent measurement of financial instruments

Interest income on monetary assets at fair value through profit or loss is recognised as interest income at the coupon interest rate.

Gains and losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognised in the income statement.

Gains and losses arising from changes in the fair value of available-for-sale monetary assets are recognised directly in other comprehensive income. Upon sale or other derecognition of available-for-sale financial assets, all cumulative gains or losses are transferred from other comprehensive income to profit or loss.

Foreign exchange gains and losses on available-for-sale equity instruments are part of the fair value of these instruments and are recognised in equity. Impairment losses, interest income and amortisation of premium or discount using the effective interest method on available-for-sale debt securities are recognised in profit or loss. Dividend income on available for sale equity securities is recognised in the statement of comprehensive income when the right to receive payment has been established.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

Impairment of financial assets

The Bank reviews financial assets at each reporting date to determine whether there is objective evidence of impairment. The impairment of financial assets or a group of financial assets is recognised if there is objective evidence of impairment as the result of one or more events occurring after initial recognition, which has an influence on estimated future cash flows from the financial assets or the group of financial assets, which can be reliably estimated ("an event that causes the impairment").

1) Loans and receivables

The Bank regularly reviews and monitors at each reporting date whether there is objective evidence of impairment of loans and receivables as well as other financial assets.

If there is objective evidence of impairment of loans and receivables on an individual basis, the impairment loss is determined as the difference between the carrying value of the assets and the present value of the expected future cash flows discounted by the original effective interest rate of the financial assets. The carrying value of the assets is decreased by the amount of loan loss provision, and the amount of the loss is recognised in profit or loss. If loans and receivables have a variable interest rate, the discount rate represents the current effective interest rate determined by an agreement at the moment when impairment has occurred.

Financial assets for which no impairment was recognised on an individual basis, are grouped with other financial assets with similar characteristics, which are then reviewed for impairment on a group basis for any impairment that has been incurred but not yet identified ("IBNR").

If the loan cannot be collected and all legal procedures have been completed and the final amount of the loss is known, the loan is directly written off. If, in the subsequent period, the amount of impairment loss decreases and the decrease can be directly linked to an event that has occurred after the write-off, the amount written-off or the loan loss provision is then shown as income in the profit or loss. Write-off of uncollectible receivables is performed based on the decision of the Credit Committee, and in accordance with court decisions, agreements between interested parties and the Bank's assessments.

In accordance with local regulations, the Bank also calculates loan loss provisions according to Banking Agency of Republika Srpska ("BARS") regulations. Loans, placements and other financial assets of the Bank are classified into categories prescribed by the BARS according to the expected recoverability determined on the basis of the number of days overdue, an assessment of the debtor's financial position and the quality of the collateral. The assessed amount of such provisions is calculated by applying percentages prescribed by the BARS.

If the provisions calculated in accordance with BARS regulations are higher than the impairment allowances recognised under IFRS, and the existing regulatory reserve this difference is presented in the financial statements as a regulatory reserve for credit losses within equity and is covered from the profit for the period, retained earnings, legal reserve or any other reserve formed from the profit in previous periods.

Transfers to this regulatory reserve are made directly within equity from the profit for the year or from equity. In accordance with BARS instructions, such transfers are made in arrears, upon approval by the shareholders in general meeting.

2) Available for sale financial assets

At each reporting date, the Bank reviews whether there is objective evidence of impairment of individual financial assets or groups of financial assets.

In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exist for the available for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from the other comprehensive income and recognised in profit or loss.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

2) Available for sale financial assets (continued)

Impairment losses recognised in the statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the statement of comprehensive income.

3) Financial assets held to maturity

Impairment losses are recognised as the difference between the carrying value of the financial assets and the present value of expected future cash flows discounted by current market interest rates for similar financial assets. Impairment losses on these instruments, recognised in profit or loss, are not subsequently reversed through profit or loss.

Derecognition

A financial asset is derecognised (in full or in part) when the Bank loses control over the contractual rights over that financial asset which occurs when the rights are realized, expire or are surrendered.

Available-for-sale financial assets, financial assets and liabilities at fair value through profit or loss and financial assets held to maturity are derecognised on the trade date.

Loans and receivables and other financial liabilities are derecognised at the date that they are transferred by the Bank or when the liability ceases to exist.

The Bank derecognises financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognising that liability and will instantaneously recognise a new financial liability, with new terms and conditions.

Fair value measurement principles

The fair value of derivatives traded in regulated markets is estimated at the amount that the Bank would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

Specific instruments

a) Financial derivatives

Financial derivatives include foreign exchange forward and swap contracts. Financial derivatives are initially recognised and subsequently measured at their fair value. Market values are obtained by application of various assessment techniques, including discounted cash flow models. All derivatives are presented as financial assets at fair value through profit or loss when their fair value is positive and as financial liabilities at fair value through profit or loss when it is negative. Changes in the fair value of financial derivatives are recorded as gains or losses.

b) Cash and cash equivalents

Cash and cash equivalents include: cash, cheques sent for collection and cash deposited with the Central Bank (not including the amount of the obligatory reserve).

c) Placements with and loans to banks and obligatory reserve with Central Bank

Placements with and loans to banks and obligatory reserve with Central Bank are classified as loans and receivables and are carried at amortised cost less any impairment losses. Funds on the accounts with other banks are also included in placements with and loans to banks.

d) Loans to customers

Loans to customers are presented net of impairment allowances to reflect the estimated recoverable amounts.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

Specific instruments (continued)

e) Equity securities

Equity securities are classified as assets available-for-sale and are carried at fair value, unless there is no reliable measure of the fair value, in which case they are stated at acquisition cost, less any impairment.

f) Debt securities

Debt securities are classified as available for sale financial assets and financial assets held to maturity depending on the purpose for which those debt securities had been acquired.

g) Current accounts and deposits from banks and customers

Current accounts and deposits are classified as other liabilities and are initially measured at fair value less transaction costs, and subsequently stated at their amortised cost using the effective interest rate method.

h) Borrowings

Interest-bearing borrowings are classified as other liabilities and are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, these are stated at amortised cost on an effective interest rate basis.

3.7. Property and equipment

(a) *Recognition and measurement*

Property and equipment are tangible assets that are held for use in the supply of services or for other administrative purposes.

Property, including land and buildings, is measured at market value less accumulated depreciation. Periodic valuations of the Bank's property are performed for the purpose of minimizing the differences between its carrying and market value. This policy has been applied since 2000. Revaluation is based on valuations performed by an independent appraiser.

Any surplus arising from revaluation is recognised directly as revaluation reserves within equity, except when the surplus cancels out a previous revaluation deficit for the same asset recognised in the statement of comprehensive income, in which case an amount up to this amount is recognised in the statement of comprehensive income. Any deficit arising from revaluation is recognised in the statement of comprehensive income, to the extant that when the deficit cancels out a previous revaluation surplus for the same asset, in which case it is recognised directly in revaluation reserves.

Equipment is measured at cost less accumulated depreciation and impairment.

Subsequent costs

Purchase value includes the invoice value of purchased assets increased by all costs incurred until the moment of putting the new assets into use. Subsequent costs are included in the book value of the asset or recognised as a separate asset, as appropriate, only when it is probable that the Bank will have future economic benefits from this asset and the value of this asset can be reliably measured. All other repairs and maintenance are charged to the statement of comprehensive income during the period in which they are incurred.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.7. Property and equipment (continued)

(b) *Depreciation*

Depreciation is calculated for all assets, except land and assets not yet put into use, on a straight line basis in order to write off the acquisition cost through their estimated useful life.

The remaining value of assets and estimated useful life are reviewed at each reporting date.

Profit or loss on the disposal of assets is determined as the difference between the sales proceeds and net book value and is recorded within other operating income or other operating expenses.

Depreciation rates for property plant and equipment are set out below:

	2011	**2010**
Buildings	1.3% -1.5%	1.3% - 4%
Computer equipment	20%-25%	20%
Furniture and other equipment	10%-15.50%	5% - 20%
Motor vehicles	15.50%	10% - 30%
Other	5%-20%	10% - 20%
Leasehold improvements	depending on the lease period	depending on the lease period

As presented in the table above, the Bank has in 2011, compared to the 2010, changed the estimated useful life of certain groups of assets. The effect of changes on the statement of financial position and statement of comprehensive income are explained in Note 4e.

3.8. Intangible assets

Intangible assets are measured at cost less accumulated amortisation and impairment. Purchase value includes all costs directly attributable to the acquisition of the asset.

Intangible assets, with the exception of assets not yet put into use, are amortised on a straight line basis over their estimated useful economic life.

Useful life is reviewed and adjusted, if necessary, at each reporting date.

Amortisation rates for intangible assets are set out below:

	2011	**2010**
Intangible investment – software and licences	11.67%-16,67%	10% - 25%

As presented in the table above, the Bank has in 2011, compared to the 2010, changed the estimated useful life of assets. The effect of changes on the statement of financial position and statement of comprehensive income are explained in Note 4e.

3.9. Impairment of non-financial assets

The net carrying value of intangible assets not yet brought into use and intangible assets that have an indefinite useful life, are tested for impairment and their recoverable amount estimated whenever events or changes in circumstances indicate that their carrying amount may not be recoverable, or at least annually.

The net carrying value of other non-financial assets of the Bank (other than deferred tax) are tested for impairment at each balance sheet date in order to determine whether there are circumstances that indicate impairment. If the existence of such indications is established, the recoverable amount is estimated. An impairment loss is recognised in the statement of comprehensive income whenever the carrying amount of an asset exceeds its recoverable amount.

The recoverable value of non-financial assets is the higher of the asset's fair value less costs to sell 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 assets not generating mostly independent cash flows, their recoverable amount is determined together with cash generating assets, and with which those assets are linked.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.9. Impairment of non-financial assets (continued)

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, considering amortisation, if no impairment loss had been recognised.

3.10. Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, if 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, or as required by law in the case of provisions for unidentified losses on off-balance-sheet credit risk exposures.

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors. Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

3.11. Employee benefits

a) Employee's salaries

Gross salary costs and mandatory social security contributions are charged to profit or loss as incurred.

b) Jubilee awards

The Bank pays out jubilee awards to its employees, the liabilities for which are estimated using the projected monetary unit method. The projected monetary units' method takes into consideration each year of employment with the Bank, where the sum of all the particular units is the final liability which is measured individually for each unit. Liabilities are measured at present values of estimated future cash flows discounted at an econometrically modeled interest rate, which is more adequate in existing market conditions than the interest rate on state long-term debt securities. Jubilee awards are paid out in the amount of one average salary of the Bank accrued in the month preceding the payment for the completion of 20 years of employment, or two average salaries of the Bank for the completion of 30 years of employment with the Bank.

c) Severance payment

In accordance with internal regulations on salaries, the Bank pays severance payments to employees upon their entry into retirement in the amount of two average monthly salaries for the employee.

Calculation of long-term provisions for employee severance payments is performed annually by a certified actuary using the projected monetary unit method. The projected monetary units' method takes into consideration each year of employment with the Bank, where the sum of all the particular units is the final liability which is measured individually for each unit. Liabilities are measured at present values of estimated future cash flows discounted at an econometrically modeled interest rate, which is more adequate in existing market conditions than the interest rate on state long-term debt securities.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.12. Equity

Share capital

Share capital comprises ordinary shares denominated in BAM.

Statutory reserves

Statutory reserves are derived from the distribution of net profit from previous years.

According to the Companies Act, joint stock companies in Republika Srpska are obligated to allocate a minimum of 5% of their annual profit (if any) to statutory reserves, until the amount of such reserves reaches the level of 10% of the joint stock company's share capital.

Share premium

Share premium represents the excess of the paid-in amount (net of transaction costs) and nominal value of the issued shares upon initial issue of shares.

Regulatory reserve for credit losses

As explained in Note 3.6. the Regulatory reserve for credit losses represents the excess of loan loss provisions calculated in accordance with BARS regulations over impairment allowances recognised under IFRS.

The balance on the reserve at the reporting date represents the excess established at the previous reporting date. Any further requirement as a result of operations during the reporting period is transferred from profit for the year or from retained earnings after the reporting date, and is recognised in the following reporting period, when the transfer is approved by the Bank's shareholders.

Fair value reserve

The fair value reserve represents unrealized net gains and losses arising from a change in the fair value of financial assets available for sale, net of related deferred tax.

Dividends

Dividends on ordinary and preference shares are recognised as a liability in the period in which they are approved by the Bank's shareholders.

3.13. Dividend income

Dividend income is recognised in the profit or loss when the right to receive dividends has been established.

3.14. Earnings per share

The Bank presents basic and diluted earnings per share. Basic earnings per share are calculated by dividing the profit or loss for the period with the weighted average number of ordinary shares in circulation during the reporting period.

3.15. Leases

Leases in terms of which the Bank as a lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. At the balance sheet date, the Bank did not have any finance leases. All other leases are operating leases. Payments made under operating leases are recognised in the profit or loss on a straight-line basis over the term of the lease.

3.16. Off-balance-sheet commitments and contingent liabilities

In the ordinary course of business, the Bank enters into credit-related commitments which are recorded off balance sheet and primarily comprise guarantees, letters of credit, undrawn loan commitments and credit card limits. Such financial commitments are recorded in the Bank's statement of financial position if and when they become payable.

Notes to financial statements (continued)

3. Specific accounting policies (continued)

3.17. Managed funds for and on behalf of third parties

The Bank manages funds for and on behalf of third parties. These amounts do not constitute part of the Bank's assets, and, therefore, they are excluded from the statement of financial position. The Bank receives fee income for providing these services and does not bear any credit risk.

3.18. Segment reporting

A business segment represents the part of assets and business activities (products and services) which is subject to risks and benefits different from those in other business segments. A geographic segment generates products or services within a specific economic environment which are subject to risks and benefits different from those operating in other economic environments.

The Bank has identified four main segments: Retail, Corporate Banking, Investments and Central Unit.

Basic information per segment is based on the internal reporting structure for business segments.

Segment results are measured applying an internal funding price (Note 5).

3.19. Influences of debt crisis

In market of Bosnia and Herzegovina losses such as those incurred in the financial sector of developed countries have been avoided as activities in those financial instruments, which were the trigger of the crisis in developed countries, has been minimised, and capital markets are undeveloped.

However, the debt crisis in the Eurozone, which, in the most part, reflects the significant slowdown of the economic growth of those countries, has negative influences in the domestic economy which are reflected in the following:

- reduced credit resources directed through banks from BAM 5.7 billion in 2009 to BAM 4.4 billion in 2011;
- financing costs on foreign markets have increased as a result of the increase in risk premium on international financial markets although market rates such EURIBOR have decreased;
- lower remittances from citizens abroad;
- the decrease of foreign direct investment with the present more extensive caution of investors when making investment decisions;
- a decrease on domestic consumption, which, combined with the general fall of demand abroad, directly affects the production and growth of economy in BH;
- difficult access to funds because of the stricter criteria of granting loans
- growing insolvency and claims collection problems.

The above mentioned effects of the crisis will influence the economy and the level of banking operations. This means that, in the next period, banks will be focused more on self-sustainability, with balanced growth of deposit-taking and credit activities, and a more prudent approach when assuming banking risks. Domestic sovereign debt raised in local markets to finance current account deficits can, on the one hand, lead to a decrease in funds available for corporate and individual users, decrease of deposits basis, while, on the other hand, it can positively influence the liquidity of the corporate sector.

Furthermore, a prolonged debt crisis can have adverse affect on real estate market and the valuation of assets used as collateral for loans and therefore further impact on impairment allowance.

Notes to financial statements (continued)

3.19. New standards and interpretations

Several new and altered Standards and Interpretations issued by the International Accounting Standards Board and its International Financial Reporting Interpretations Committee, have been authorised for issue but are not applicable to entities reporting under IFRS for period ended 31 December 2011, and have not been applied in preparation of these financial statements. Most new and altered Standards and Interpretations are not relevant to the Bank's business and will not affect the financial statements, except for below stated.

IFRS 9 *Financial Instruments* (a complete version of which has not yet been adopted), which replaces IAS 39 *Financial Instruments: Recognition and Measurement*, is effective for annual periods beginning on or after 1 January 2015; early adoption is permitted. This Standard introduces significant changes with respect to the classification and measurement of financial assets. The Bank has not yet decided on the date of the initial application of the new Standard neither it has analysed the effects of its application.

4. Significant accounting estimates and judgements

The Bank makes estimates and assumptions about certain events, including estimates and judgements about the future. Such accounting assumptions and estimates are regularly evaluated and based on historical experience and other factors such as: expected flow of future events that can be realistically assumed in the existing circumstances, but in spite of this, necessarily represent sources of uncertainty.

The estimation of impairment losses in the Bank's loan portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are described below.

a) Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. The need for impairment of the Bank's on and off-balance sheet exposure to credit risk is assessed on a monthly basis.

Impairment losses are made mainly against the carrying value of loans to legal entities and individuals (as disclosed in Note 19) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 26).

Impairment losses are also considered for credit risk exposures to banks and for other assets not carried at fair value, where the primary risk of impairment is not credit risk.

Financial assets carried at amortised cost

The Bank assesses impairment on an individual basis for all exposures where there is objective evidence of impairment. Assets which are not significant are assessed on a group (portfolio) basis for impairment.

The Bank estimates impairment losses in cases where it estimates that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets. Evidence includes irregular repayment or other indications of financial difficulties of borrowers, unfavourable changes in economic conditions in which the borrowers operate, changes in the value or collectability of collateral instruments when these changes can be linked to the above-mentioned breach of terms.

Notes to financial statements (continued)

4. Significant accounting estimates and judgments (continued)

a) Impairment losses on loans and receivables (continued)

	Note	2011 '000 BAM	2010 '000 BAM
Summary of impairment allowances (IFRS)			
Impairment allowance for loans to customers	*19*	44,660	39,735
Provisions for liabilities and charges	*26*	527	570
		45,187	**40,305**
Impairment allowance for interests and fee receivables		4,672	4,136
Impairment allowance for other assets	*23*	844	802
Available-for-sale financial assets fair value adjustment		274	-
		50,977	**45,243**

In addition to impairment allowance calculated and recognised in accordance with IFRS, the Bank also calculates impairment in accordance with BARS regulations with any excess recognised as a regulatory reserve for credit losses within equity.

The following table summarizes impairment allowances calculated in accordance with BARS regulations:

	2011 '000 BAM	2010 '000 BAM
Summary of impairment allowances (BARS)		
Impairment allowance for loans to customers	53,245	44,636
Provisions for liabilities and charges	1,277	1,354
	54,522	**45,990**
Impairment allowance for interests and fee receivables	4,439	3,889
Impairment allowance for other assets	1,304	1,225
	60,265	**51,104**

Regulatory reserve for credit risk requirement as of 31 December:

	2011 '000 BAM	2010 '000 BAM
Impairment allowances under BARS	60,265	51,104
Impairment allowances under IFRS	50,977	45,243
Excess at period end	9,288	5,861
Excess at previous period	(5,861)	(3,496)
Movement (transfer required)	**3,427**	2,365

Any increase in excess in allowances calculated in accordance with BARS regulations over amounts recognised under IFRS is required to be transferred to the regulatory reserve from profit or retained earnings. BAM 3.427 thousand will transferred to the regulatory reserve in 2012 from current year profit for 2011 based on the decision of the General Assembly, to meet requirement.

The Bank takes into consideration the combined effect of several events when assessing impairment and uses its experience in making judgments in cases where the observable data required to estimate impairment is limited.

Notes to financial statements (continued)

4. Significant accounting estimates and judgments (continued)

a) Impairment losses on loans and receivables (continued)

At year end, the gross value of specifically impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognised were as follows:

	2011 BAM '000			2010 BAM '000		
	Corporate	**Retail**	**Total**	**Corporate**	**Retail**	**Total**
Gross exposure	53,651	16,841	**70,492**	55,245	15,621	**70,866**
Impairment rate	41.5%	82.0%	**51.2%**	35.6%	84.3%	**46.3%**

An increase in the impairment rate of 1 percentage point of the gross non-performing exposure presented above as at 31 December 2011, would lead to the recognition of an additional impairment loss of BAM 704.9 thousand (2010: BAM 708.7 thousand).

In addition to separately identified losses for NPLs on an individual and portfolio basis, as explained on previous pages, the Bank also recognises impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified (IBNR).

The amount of IBNR as at 31 December 2011 assessed on a portfolio basis amounted to BAM 9.079 thousand (2010: BAM 7,468 thousand) of the relevant on and off-balance sheet exposure. Total IBNR provision amounted to 1.7% (2010: 1.8%) of net loans to customers and 1.5% (2010 1.6%) of the total net on and off-balance-sheet credit risk exposure.

b) Taxation

The Bank provides for tax liabilities in accordance with the tax regulations of Republika Srpska and the state of Bosnia and Herzegovina. Tax returns are subject to the approval of the tax authorities which are entitled to carry out subsequent inspection of taxpayers' records.

c) Regulatory requirements

The Banking Agency of Republika Srpska is authorised to perform regulatory inspection of the Bank's operations and to request adjustments to the carrying value of assets and liabilities, in accordance with the underlying regulations.

d) Litigation and claims

The Bank performs an individual assessment of all court cases and creates provisions in accordance with the assessment. Assessment is carried out by a special commission of three members, two of whom are employed in Legal Affairs, and one in the Workout Department. Proposals on provisions after the assessment are verified by the managers of Legal Affairs and Risk Management, and the decision on creating the provisions is made by the Bank's Management Board.

As stated in Note 27, the Bank provided BAM 1,080 thousand (2010: BAM 1,205 thousand), which the management estimates as sufficient. It is not practicable for management to estimate the financial impact of changes to the assumptions based on which the management assesses the need for provisions.

e) Change in expected useful life of assets

The Bank has for a certain group of assets changed depreciation rate with respect to the change in estimate of expected useful life of those assets. If the Bank had applied depreciation rates as in 2010 year depreciation expense in 2011 for would be BAM 705 thousand lower than the cost reported in the financial statements for the year. The net book value of those assets would be higher for that amount.

Notes to financial statements (continued)

4. Significant accounting estimates and judgments (continued)

f) Comparative financial information

In order to achieve consistency with the disclosures in the current reporting period certain changes were made in comparative financial information for 2010, as explained below. The stated changes do not affect the result and the net assets of the Bank.

Statement of financial position

- Funds on current accounts with other banks in the amount of BAM 2,037 thousand were reclassified from ”cash reserves“ to ”loans and receivables from banks“. This modification has an impact on the statement of cash flow through the change of ”cash and cash equivalents“ as at 1 January 2011;

- Cheques in the foreign currency in the amount of BAM 26 thousand were reclassified from ”cash reserves“ to ”accrued interest and other assets“. This modification has an impact on the statement of cash flow through the change of ”cash and cash and equivalents“ as at 1 January 2011;

- accrued due interest receivables on the performing portfolio in the amount of BAM 1,634 thousand were reclassified from „accrued interest and other assets“ to ”loans and receivables from customers“;

- Collected loan processing fees which are recognised in accordance with IAS 18 in the amount of BAM 2,515 thousand were reclassified from “accrued interest and other liabilities” to “loans and receivables from customers”. This modification had an impact on the amount of total assets and liabilities presented as comparative financial information at the end of 2010;

- Provisions for liabilities and charges in the amount of BAM 570 thousand have been reclassified to “accrued interest and other liabilities“;

- Deferred taxes were presented in net amounts in the Financial statements for the year ended 2010. In these Financial statements the Bank presented gross amounts - the BAM 2 thousand of deferred tax assets and BAM 355 thousand of deferred tax liabilities for 2010.

Report on comprehensive profit

- Income from foreign exchange trading in the amount of BAM 2,142 thousand has been reclassified from “net gains from financial instruments at fair value through the profit and loss and foreign exchange differences from translation of monetary assets and liabilities” to “fee and commission income”;

- Net losses from impairment of interest receivables in the amount of BAM 180 thousand has been reclassified from “net impairment losses and provisions” to “interest income” decreasing the interest income for the amount of BAM 180 thousand;

- Other personnel expenses (holiday bonus, compensation for the transport, meal allowance, etc) in the amount of BAM 1,355 thousand has been reclassified from “other expenses” to “personnel expenses”;

- Expenses from change in jubilee awards and severance payments in the amount of BAM 96 thousand has been reclassified from “other expenses” to “Personnel expenses”.

Notes to financial statements (continued)

5. Financial information by segment

Segments recognised for the purposes of segment reporting comprise the following:

1. “Retail”: data on individuals and small business
2. “Corporate Banking”: large and mid companies, state and public sector
3. “Investments”: Financial Markets (“MIB”) and Assets and Liabilities Management (“ALM”) and
4. “Central Unit”: capital and reserves, investments in other legal entities and other ownership shares and other assets and liabilities not associated with other segments.

Segment reporting is based on management reports.

When measuring business results internal funding prices are applied based on specific prices, appropriate currencies and maturities with embedded additional adjustments.

The methodology for allocation of revenues and costs to segments is consistent with previous year.

Statement of comprehensive income by segments

31 December 2010	**Retail ’000 BAM**	**Corporate Banking ’000 BAM**	**Investments ’000 BAM**	**Central Unit ’000 BAM**	**Total ’000 BAM**
Net interest income	19,193	8,120	6,675	(2,169)	31,819
Net fee and commission income	8,334	4,175	(204)	(49)	12,256
Net gains and losses from financial instruments at fair value through the profit and loss and foreign exchange differences from translation of monetary assets and liabilities	(1)	(1)	169	-	167
Net profit from fixed and financial assets available for sale	-	-	-	35	35
Other operating income	-	-	(13)	39	26
Total operating income	**27,526**	**12,294**	**6,627**	**(2,144)**	**44,303**
Operating expenses	(23,563)	(5,015)	(812)	-	(29,390)
Net impairment losses and provisions	(4,579)	(962)	-	-	(5,541)
Segment result	**(616)**	**6 ,317**	**5,815**	**(2,144)**	**9,372**
Income tax	-	-	-	(1,171)	(1,171)
Net profit for the year	**(616)**	**6,317**	**5,815**	**(3,315)**	**8,201**

Notes to financial statements (continued)

5. Financial information by segment (continued)

31 December 2010	**Retail ’000 BAM**	**Corporate ’000 BAM**	**Investments ’000 BAM**	**Central Unit ’000 BAM**	**Total ’000 BAM**
Net interest income	18,093	5,548	3,714	(1,723)	25,632
Net fee and commission income	7,576	3,124	(307)	-	10,393
Net gains and losses from financial instruments at fair value through the profit and loss and foreign exchange differences from translation of monetary assets and liabilities	-	-	130	-	130
Net profit from fixed and financial assets available for sale	-	-	-	114	114
Other operating income	-	-	-	549	549
Total operating income	**25,669**	**8,672**	**3,537**	**(1,060)**	**36,818**
Operating expenses	(20,850)	(5,814)	(807)	(1,237)	(28,708)
Net impairment losses and provisions	(2,092)	(4,917)	-	-	(7,009)
Segment result	**2,727**	**(2,059)**	**2,730**	**(2,297)**	**1,101**
Income tax	-	-	-	(723)	(723)
Net profit for the year	**2,727**	**(2,059)**	**2,730**	**(3,020)**	**378**

Notes to financial statements (continued)

5. Financial information by segment (continued)

Statement of financial position by segments

31 December 2011	Retail '000 BAM	Corporate '000 BAM	Investments '000 BAM	Central Unit '000 BAM	Total '000 BAM
Assets by segments	338,424	241,527	72,438	50,855	703 244
Equity shareholdings	-	-	-	379	379
Deferred tax assets	-	-	-	19	19
Total assets	**338,424**	**241,527**	**72,438**	**51,253**	**703,642**
Liabilities by segments	205,700	185,612	200,956	111,127	703,395
Deferred tax liability	-	-	-	247	247
Total liabilities and capital	**205,700**	**185,612**	**200,956**	**111,374**	**703,642**

31 December 2010	Retail '000 BAM	Corporate '000 BAM	Investments '000 BAM	Central Unit '000 BAM	Total '000 BAM
Assets by segments	284,620	138,748	107,367	45,041	575,776
Equity shareholdings	-	-	-	352	352
Deferred tax assets	-	-	-	2	2
Total assets	**284,620**	**138,748**	**107,367**	**45,395**	**576,130**
Liabilities by segment	208,028	209,568	78,737	79,442	575,775
Deferred tax liability	-	-	-	355	355
Total liabilities and capital	**208,028**	**209,568**	**78,737**	**79,797**	**576,130**

Notes to financial statements (continued)

6. Interest income

a) Analysis by source:

	2011 '000 BAM	2010 '000 BAM
Retail	26,237	23,800
Companies and entrepreneurs	12,620	12,263
Banks and banking institutions	507	559
Public sector	2,140	1,026
	41,504	**37,648**

b) Analysis by product

	2011 '000 BAM	2010 '000 BAM
Loans to customers	40,585	37,081
Placements with and loans to banks	203	162
Obligatory reserve with the Central Bank	261	397
Debt securities	455	8
	41,504	**37,648**

7. Interest expense

a) Analysis by recipient:

	2011 '000 BAM	2010 '000 BAM
Individuals	3,185	3,816
Companies and entrepreneurs	2,346	3,686
Banks and other financial institutions	2,620	1,575
Public sector	936	1,831
Other organisations	598	1,108
	9,685	**12,016**

Notes to financial statements (continued)

7. Interest expense (continued)

b) Analysis by product :

	2011 '000 BAM	2010 '000 BAM
Current accounts and deposits - retail	3,185	3,816
Borrowings	2,409	1,915
Current accounts and deposits - corporate	1,831	3,868
Current accounts and deposits - banks	1,662	1,309
Other	598	1,108
	9,685	**12,016**

8. Fee and commission income

	2011 '000 BAM	2010 '000 BAM
Domestic payment transactions	4,333	4,077
Foreign payment transactions	1,546	1,284
Foreign pension payments	1,357	1,465
Guarantees and letters of credit	1,385	902
Debit cards	745	632
Loan fees	453	517
Foreign exchange spot trading gains and cash operations	2,894	2,273
Other	524	449
	13,237	**11,599**

9. Fee and commission expense

	2011 '000 BAM	2010 '000 BAM
Domestic payment transactions	153	148
Foreign payment transactions	61	56
Guarantees and letters of credit	26	148
Credit card	523	423
Cash operations	109	240
Loan fees	41	165
Other	68	26
	981	**1,206**

Notes to financial statements (continued)

10. Net gains from financial instruments at fair value through the profit and loss and foreign exchange differences from translation of monetary assets and liabilities

	2011 '000 BAM	2010 '000 BAM
Positive unrealised foreign exchange differences	31,593	29,077
Negative unrealised foreign exchange differences	(31,426)	(28,947)
Net gains from financial instruments at fair value	-	-
	167	**130**

11. Net gains from financial assets

	2011 '000 BAM	2010 '000 BAM
Net gains from financial assets available for sale	35	114

12. Personnel expenses

	2011 '000 BAM	2010 '000 BAM
Net salary	6,564	6,571
Contributions on salaries and compensations of salaries	3,712	3,239
Taxes on salaries and compensations of salaries	731	459
	11,007	**10,269**
Other personnel expenses	2,179	1,451
Total personnel expenses	**13,186**	**11,720**

Personnel expenses include contributions for pension and disability insurance paid in 2011 in the amount of BAM 2,013 thousand (2010: BAM 2,025 thousand).

Notes to financial statements (continued)

13. Other expenses

	2011 '000 BAM	2010 '000 BAM
Provisions for liabilities and charges	-	1,082
Materials	967	971
Production services	2,908	3,070
Other services	5,674	5,646
Other taxes and contributions	662	614
Other operating expenses	78	305
	10,289	**11,688**

14. Net impairment losses and provisions

	2011 '000 BAM	2010 '000 BAM
Loans and receivables from customers (Note 19)	5,558	6,803
Other assets (Note 23)	26	104
Off-balance sheet exposures (Note 26)	(43)	102
	5,541	**7,009**

15. Income tax

Income tax charged in the income statement comprises current and deferred tax.

a) Income tax expense recognised in the income statement

	2011 '000 BAM	2010 '000 BAM
Current income tax	1,282	704
Deferred income tax, net (Note 28)	(111)	19
Total	**1,171**	**723**

b) Reconciliation of income tax expense

	2011 '000 BAM	2010 '000 BAM
Profit before tax	9,372	1,101
Income tax at rate of 10%	937	110
Tax deduction for excluded income	(106)	(73)
Impairment losses on loans and other assets not deductible for tax purposes and other expenses	596	827
Impairment losses on loans and other assets deductible for tax purposes (20% of the adjusted tax base)	(256)	(141)
Income tax expense	**1,171**	**723**
Average effective income tax rate	**12.5%**	**65.7%**

Notes to financial statements (continued)

15. Income tax (continued)

Tax regulations stipulate that for the purpose of calculation of the tax base, a maximum of 20% of the adjusted tax base (result for the period), which represents the difference between adjusted income and expenses before impairment of loans and other assets, may be taken as a taxable deductible expense in respect of charges for the impairment of loans and other assets.

The Bank's tax liabilities are required in a tax return prepared by the Bank and are subject to subsequent inspection and consequent adjustment by tax authorities in a five year period after recognition. The Bank's Management Board is not aware of any circumstances, which may give rise to a potential material liability in this respect.

16. Cash reserves

	2011 '000 BAM	**2010 '000 BAM**
Cash in domestic currency	7,210	7,452
Funds with the Central Bank – giro account	10,024	28,910
Cash in foreign currency	4,778	4,087
	22,012	**40,449**

The amount of cash reserves also represents cash and cash equivalents for the purpose of preparing the statement of cash flows.

17. Obligatory reserve with the Central Bank

	2011 '000 BAM	**2010 '000 BAM**
Obligatory reserve with the Central Bank in domestic currency	**32,216**	**47,974**

The Central Bank of Bosnia and Herzegovina (the "Central Bank") has prescribed a method for calculating and holding obligatory reserve, as well as the amount and manner of payment of fees on the amount of obligatory reserve and on the amount of funds held on the account with the Central Bank above the obligatory reserve.

The basis for the calculation of the obligatory reserve is the average amount of deposits and borrowed funds in BAM and foreign currencies (denominated in BAM, calculated according to the exchange rate of the Central Bank valid at the time of the calculation period).
The basis for calculation of obligatory reserve excludes:

- borrowed funds from non-residents,
- deposits and loans from government and entities (residents) intended for development projects.

The Bank is obliged to hold at least 10% (2010: 14%) of deposits and borrowed funds with an agreed maturity date up to one year, and 7% of the deposits and borrowed funds with an agreed maturity date over one year, on reserve with the Central Bank.

The Central Bank calculates interest on resers as follows

- for the amount of obligatory reserves: 70% of the rate which is determined based on the weighted average interest rates earned by the Central Bank at the same period on funds invested up to one month (in 2011 this rate ranged from 0.11% to 1.22%);

- for the amount of funds above obligatory reserves requirement: 90% of the rate which is determined based weighted average interest rates earned by the Central Bank at the same period on funds invested up to one month (in 2011 this rate ranged from 0.14% to 1.22%).

Notes to financial statements (continued)

18. Loans and receivables from banks

	2011 '000 BAM	2010 '000 BAM
Maturity up to 30 days		
- foreign banks	38,126	29,289
- domestic banks	2	-
	38,128	**29,289**
Maturity over 30 days		
- domestic banks	-	1,193
	38,128	**30,482**

Loans to and receivables from banks include BAM 36,960 thousand (2010: BAM 12,069 thousand) of loans to and receivables from related parties.

19. Loans and receivables from customers

a) Analysis by product

	2011 '000 BAM	2010 '000 BAM
Corporates		
- in KM	136,739	64,188
- in foreign currency	123,667	132,814
- with foreign currency clause	13,804	9,240
Total gross	**274,210**	**206,242**
Impairment allowance	(23,668)	(20,596)
	250,542	**185,646**
Individuals		
- in KM	129,724	43,865
- in foreign currency	111	118
- with foreign currency clause	177,741	213,804
Total gross	**307,576**	**257,787**
Impairment allowance	(20,992)	(19,139)
	286,584	**238,648**
Net loans	**537,126**	**424,294**
Due interest receivables	1,600	1,542
Accrued fee income	(4,266)	(2,515)
Loans and receivables from customers	**534.460**	**423.321**

Notes to financial statements (continued)

19. Loans and receivables from customers (continued)

b) Movement in impairment allowance of loans and liabilities

	Loans to corporate '000 BAM	Loans to retail '000 BAM	Total loans '000 BAM
Balance as at 1 January 2010	**18,242**	**18,169**	**36,411**
Net loss in the profit or loss (Note 14)	5,259	1,544	**6,803**
Write off	(2,905)	(574)	**(3,479)**
Balance as at 31 December 2010	**20,596**	**19,139**	**39,735**
Net loss in the profit or loss (Note 14)	3,697	1,861	**5,558**
Write off	(625)	(8)	**(633)**
Balance as at 31 December 2011	**23,668**	**20,992**	**44,660**

c) Geographic concentration of credit risk

Credit risk is highly concentrated on the state of Bosnia and Herzegovina. Geographic concentration in gross amounts of balance sheet exposure is as follows:

	Bosnia and Herzegovina	OECD countries	Non-OECD countries	Total
31 December 2011				
Loans to individuals	307,576	-	-	307,576
Loans to legal entities	274,210	-	-	274,210
Total	**581,786**	**-**	**-**	**581,786**
31 December 2010				
Loans to individuals	257,633	154	-	257,787
Loans to legal entities	206,242	-	-	206,242
Total	**463,875**	**154**	**-**	**464,029**

Notes to financial statements (continued)

19. Loans and receivables from customers (continued)

d) Concentration of credit risk by industry

The Bank's loan portfolio as at 31 December 2011 is analysed by industry in the table below:

	2011 '000 BAM	2010 '000 BAM
Legal entities		
Mining and energy	12,913	12,092
Agriculture	19,559	14,013
Civil engineering	16,522	12,009
Industry	48,576	45,263
Trade	140,338	87,159
Services	1,594	9,076
Transport	9,757	8,524
Finance	1,450	2,730
Other	23,501	15,376
	274,210	**206,242**
Individuals	307,576	257,787
Total gross loans	**581,786**	**464,029**
Impairment allowance	(44,660)	(39,735)
Total net loans	**537,126**	**424,294**

The structure of the credit portfolio is regularly monitored by the Risk Management sector in order to recognise potential events that could have a significant impact on the credit portfolio (usual risk factors) and, if needed, mitigate the Bank's exposure to certain sectors of the economy.

20. Financial assets

20. a) Financial assets available for sale

	2011 '000 BAM	2010 '000 BAM
Equity securities, quoted		
Dunav osiguranje a.d. Banja Luka	19	19
Krajina Osiguranje d.d. Banja Luka	14	28
Debt securities, quoted		
Bonds of the City of Banja Luka	-	100
Bonds of the Municipality of Šamac	10	10
RS bonds issued by public offer	45,130	-
RS for verified old FX savings	2,092	-
	47,265	**157**

Notes to financial statements (continued)

20. Financial assets (continued)

20. a) Financial assets available for sale (continued)

	2011 '000 BAM	2010 '000 BAM
Equity securities, unquoted		
"BLB export-import" d.o.o., Banja Luka	-	84
Banjalučka berza a.d., Banja Luka	237	167
Central Registry of Securities	101	46
SWIFT	8	8
	346	**305**
Total financial assets available for sale	**47,611**	**462**

As at 31 December 2011, fair value reserves for financial assets available for sale amounted to BAM 156 thousand or BAM 141 thousand net of deferred tax (31 December 2010: in the amount of BAM 16 thousand, or BAM 14 thousand, net of deferred tax).

As of 31 December 2009, the Bank had 49% shareholdings in the total equity of the company "BLB export-import" d.o.o., Banja Luka.

Summary of financial assets available for sale in accordance with fair value levels

Summary of financial assets available for sale (other than equity securities carried at cost reduced for the possible impairment) in accordance with fair value levels is presented in the table below. The Bank uses the following hierarchy of fair value measurement that reflects the significance of inputs used in measuring fair value:

- Level 1: The fair value of financial instruments is based on their quoted market price available in an active market.
- Level 2: The fair value of financial instruments is estimated using valuation techniques based on market inputs, either direct (eg. prices) or indirectly (eg. derived from the price).
- Level 3: The fair value of financial instruments is estimated using valuation techniques that are not based on observable market inputs.

31 December 2011.	**Level 1 BAM 000**	**Level 2 BAM 000**	**Level 3 BAM 000**	**Total BAM 000**
Bonds of the Municipality of Šamac	-	-	10	**10**
RS bonds issued by public offer	-	45,130	-	**45,130**
RS for verified old FX savings	-	2,092	-	**2,092**
Total	**-**	**47,222**	**10**	**47,232**
31 December 2010.				
Bonds of the City of Banja Luka	-	-	100	**100**
Bonds of the Municipality of Šamac	-	-	10	**10**
Total	**-**	**-**	**110**	**110**

During the year or in 2010, there was no migration of financial assets available for sale between certain levels of fair value.

Notes to financial statements (continued)

20. Financial assets (continued)

20. b) Financial assets held to maturity

	2011 '000 BAM	2010 '000 BAM
Bonds of Atlantik doo Banja Luka, quoted	200	-
Total financial assets held to maturity	**200**	**-**

20. c) Financial assets and liabilities at fair value through profit or loss

	2011 **'000 BAM** Nominal value	**2011** **'000 BAM** Fair value	**2010** **'000 BAM** Nominal value	**2010** **'000 BAM** Fair value
Currency swap	26,757	-	18,580	-

Currency swap refers to BAM/EUR transaction whose fair value, given the fix rate under currency board, amounts to zero.

Notes to financial statements (continued)

21. Property and equipment

	Land and buildings BAM '000	Equipment and other assets BAM '000	Leasehold improvements BAM '000	Assets under construction BAM '000	Total BAM '000
Cost or valuation					
Balance as at 1 January 2011	**26,653**	**16,034**	**1,638**	**357**	**44,682**
Additions	-	-	-	691	691
Brought into use	-	724	7	(731)	-
Disposals and write-offs	(13)	(601)	-	-	(614)
Balance as at 31 December 2011	**26,640**	**16,157**	**1,645**	**317**	**44,759**
Depreciation					
Balance as at 1 January 2011	10,367	11,098	732	-	22,197
Depreciation	499	2,857	653	-	4,009
Disposals and write-offs	-	(539)	(1)	-	(540)
Balance as at 31 December 2011	**10,866**	**13,416**	**1,384**	**-**	**25,666**
Net carrying amount:					
Balance as at 1 January 2011	**16,286**	**4,936**	**906**	**357**	**22,485**
Balance as at 31 December 2011	**15,774**	**2,741**	**261**	**317**	**19,093**

Assets under construction as at 31 December 2011 relate to equipment not yet put into use.

Notes to financial statements (continued)

21. Property and equipment (continued)

	Land and buildings BAM '000	Equipment and other assets BAM '000	Leasehold improvements BAM '000	Assets under construction BAM '000	Total BAM '000
Cost or valuation					
Balance as at 01 January 2010	**26,604**	**15,318**	**1,931**	**1,069**	**44,922**
Additions	-	-	-	604	604
Brought into use	124	1,164	28	(1,316)	-
Disposals and write-offs	(75)	(448)	(321)	-	(844)
Balance as at 31 December 2010	**26,653**	**16,034**	**1,638**	**357**	**44,682**
Depreciation					
Balance as at 01 January 2010	9,982	9,777	790	-	20,549
Depreciation	389	1,732	188	-	2,309
Disposals and write-offs	(4)	(411)	(246)	-	(661)
Balance as at 31 December 2010	**10,367**	**11,098**	**732**	**-**	**22,197**
Net carrying amount:					
Balance as at 01 January 2010	**16,622**	**5,541**	**1,141**	**1,069**	**24,373**
Balance as at 31 December 2010	**16,286**	**4,936**	**906**	**357**	**22,485**

Assets under construction as at 31 December 2010 relate to equipment not yet put into use.

Notes to financial statements (continued)

22. Intangible assets

	Software	Other	Assets under construction	Total
	BAM '000	BAM '000	BAM '000	BAM '000
Cost				
Balance as at 01 January 2011	**12,835**	**2,948**	**202**	**15,985**
Additions		319	738	1,057
Brought into use	758	167	(925)	-
Balance as at 31 December 2011	**13,593**	**3,434**	**15**	**17,042**
Amortisation				
Balance as at 01 January 2011	**7,523**	**2,284**	**-**	**9,807**
Amortisation	876	1,030	-	1,906
Balance as at 31 December 2011	**8,399**	**3,314**	**-**	**11,713**
Net carrying amount:				
01 January 2011	**5,312**	**664**	**202**	**6,178**
31 December 2011	**5,194**	**120**	**15**	**5,329**

Assets under construction as at 31 December 2011 relate to software and other intangible assets not yet put into use.

Notes to financial statements (continued)

22. Intangible assets (continued)

	Software BAM '000	Other BAM '000	Assets under construction BAM '000	Total BAM '000
Cost				
Balance as at 01 January 2010	12,605	2,868	-	15,473
Additions	-	-	512	512
Brought into use	230	80	(310)	-
Balance as at 31 December 2010	**12,835**	**2,948**	**202**	**15,985**
Amortisation				
Balance as at 01 January 2010	4,946	1,870	-	6,816
Amortisation	2,577	414	-	2,991
Balance as at 31 December 2010	**7,523**	**2,284**	**-**	**9,807**
Net carrying amount:				
01 January 2010	**7,659**	**998**	**-**	**8,657**
31 December 2010	**5,312**	**664**	**202**	**6,178**

Assets under construction as at 31 December 2010 relate to software and other intangible assets not yet put into use.

Notes to financial statements (continued)

23. Accrued interest and other assets

	2011 BAM '000	2010 BAM '000
Accrued interest	490	195
Receivables for fees in local currency	115	139
Other receivables	4,813	5,245
Impairment allowance	(844)	(802)
Total accrued interest and other assets	**4,574**	**4,777**

Movement in impairment allowance for other assets:

	Total BAM '000
Balance as at 01 January 2010	**1,089**
Net loss in the profit or loss (Note 14)	104
Write-offs	(391)
Balance as at 31 December 2010	**802**
Net loss in the profit or loss (Note 14)	26
Write-offs and transfers	16
Balance as at 31 December 2011	**844**

Notes to financial statements (continued)

24. Deposits and loans from banks

	2011 BAM '000	2010 BAM '000
Demand deposits		
- in KM	12	171
- in foreign currency	17	14
	29	**185**
Term deposits		
- in KM	38,080	90
- in foreign currency	132,214	50,852
	170,294	**50,942**
Total deposits	**170,323**	**51,127**
Loans		
- Fund for Italian Participation in the Stabilisation, Reconstruction and Development of the Balkans - "MCI Fund"	817	912
- European Investment Bank	23,547	20,390
Total loans taken	**24,364**	**21,302**
Total deposits and loans from banks	**194,687**	**72,429**

Deposits and loans from banks include BAM 170,214 thousand due to related parties (2010: BAM 50,916 thousand).

Notes to financial statements (continued)

25. Deposits and loans from customers

	2011 BAM '000	2010 BAM '000
Corporate		
Demand deposits		
- in KM	109,031	98,073
- in foreign currency	21,288	17,351
	130,319	**115,424**
Term deposits		
- in KM	5,276	844
- currency clause	12,592	30,996
- in foreign currency	9,805	40,310
	27,673	**72,150**
Total corporate	**157,992**	**187,574**
Retail		
Demand deposits		
- in KM	78,580	60,344
- in foreign currency	28,426	34,439
	107,006	**94,783**
Term deposits		
- in KM	9,168	8,134
- currecny clause	-	602
- in foreign currency	63,962	75,602
	73,130	**84,338**
Total retail	**180,136**	**179,121**
Total deposits	**338,128**	**366,695**
Loans from customers		
- Housing Fund of Republika Srpska	29,808	28,900
- Fund for development of the Eastern part of Republika Srpska	6,445	5,464
- Fund for development and employment of Republika Srpska	23,200	22,845
Total loans from customers	**59,453**	**57,209**
Total deposits and loans from customers	**397,581**	**423,904**

Deposits and loans from customers include BAM 513 thousand due to related parties (2010: BAM 469 thousand).

Notes to financial statements (continued)

26. Accrued interest and other liabilities

	2011 BAM '000	2010 BAM '000
Accrued interest	1,837	2,876
Liabilities to employees	780	234
Liabilities to suppliers	2,278	516
Provisions for off-balance-sheet contingent liabilities	527	570
Other liabilities	4,244	2,379
	9,666	**6,575**

Provisions cost for off-balance-sheet exposures are recognised through net impairment losses and provisions in the profit or loss (Note 14).

Movement of provisions for off-balance sheet contingent liabilities:

	Total BAM '000
Balance as at 01 January 2010	**469**
Net loss in the statement of comprehensive income (note 14)	102
Write-offs	(1)
Balance as at 31 December 2010	**570**
Net profit in the statement of comprehensive income (note 14)	(43)
Balance as at 31 December 2011	**527**

Notes to financial statements (continued)

27. Provisions for liabilities and charges

	2011 BAM '000	2010 BAM '000
Severance payments	517	472
Jubilee awards	198	143
Court cases	1,080	1,205
	1,795	**1,820**

Movement of provisions for liabilities and charges

	Court cases	Jubilee awards	Severance payments	Total
	BAM '000	BAM '000	BAM '000	BAM '000
Balance as at 01 January 2010	**238**	**83**	**436**	**757**
Net loss/(gain) in the statement of Comprehensive income	1,082	60	36	1,178
Provisions used during the period and brought into use	(115)	-	-	(115)
Balance as at 31 December 2010	**1,205**	**143**	**472**	**1,820**
Net loss/(gain) in the statement of Comprehensive income	-	32	45	77
Provisions used during the period and brought into use	(125)	23	-	(102)
Balance as at 31 December 2011	**1,080**	**198**	**517**	**1,795**

Losses and gains from provisions for court cases are recognised as other expenses (Note 13), losses and gains from provisions for severance payments and jubilee awards are recognised as personnel expenses (Note 12).

28. Net deferred tax liability

Deferred taxes are calculated for temporary differences according to the balance sheet method using the effective tax rate of 10 % (2010: 10%). Movements in temporary differences and components of deferred tax liabilities, recognised in equity or in the Comprehensive income as follows:

	2011 BAM '000	2010 BAM '000
Deferred tax assets		
Fair value reserve	19	2
Deferred tax liabilities		
Fair value reserve	(3)	-
Revaluation reserve	(244)	(244)
Property and equipment	-	(111)
Net deferred tax liabilities	**(228)**	**(353)**

Notes to financial statements (continued)

28. Net deferred tax liability (continued)

Movement in deferred tax liabilities is as follows:

	Deferred tax assets	Deferred tax liabilities	Net deferred tax liabilities
	BAM '000	**BAM '000**	**BAM '000**
Balance as at 001 January 2010	**(8)**	**(336)**	**(344)**
Increase recognised in income (Note 15)	-	(19)	(19)
Changes in fair value and disposal of financial assets available for sale recognised in comprehensive income	10	-	10
Balance as at 31 December 2010	**2**	**(355)**	**(353)**
Balance as at 001 January 2011	**2**	**(355)**	**(353)**
Cancellation of deferred tax liabilities based on differences of amortisation rates in the profit or loss (Note 15)	-	111	111
Net changes in fair value of financial assets available for sale recognised in other comprehensive income	17	(3)	14
Balance as at 31 December 2011	**19**	**(247)**	**(228)**

29. Share capital

	Ordinary shares BAM '000
Balance as at 01 January 2010	62,054
Balance as at 31 December 2010	**62,054**
Increase of share capital through 8th issue of shares through the private offer	20,001
Balance as at 31 December 2011	**82,055**
Nominal value (KM)	700
Number of shares	117,221

Notes to financial statements (continued)

29. Share capital (continued)

The shareholders of the Bank as at 31 December 2011 were 104 domestic and foreign legal entities and individuals. The following shareholders hold over 1% of the shares at that date:

	% of equity holding
Bank Austria Creditanstalt AG, Vienna	**92.92%**
Share Fund of Republika Srpska	1.46%
ZIF Kristal invest fond a.d. Banja Luka	1.08%
	95.46%
Others	4.54%
	100,00%

The ultimate parent of the Bank is Unicredit S.p.A., an Italian bank with its headquarters in Milan.

As at 31 December 2011, members of Supervisory Board, Audit Committee and Management Board did not possess any shares in the Bank.

30. Earnings per share

	2011	2010
Total number of shares	117,221	88,649
Weighted average number of shares	102,935	88,649
Net profit in BAM 000	8,201	378
Basic and diluted earnings per share in BAM	79.67	4.26

Notes to financial statements (continued)

31. Commitments and contingencies

	2011 BAM '000	2010 BAM '000
Performance guarantees:		
- in BAM	14,484	14,491
- in foreign currency	967	450
Other guarantees:		
- in BAM	6,721	8,173
- in foreign currency	2,725	2,293
Contingent liabilities based on unused loans and guarantees :		
- in BAM	36,156	33,861
- in foreign currency	13,961	3,721
Letters of credit in foreign currency	372	1,785
Total	**75,386**	**64,774**

As at 31 December 2011, impairment allowances in respect of commitments and contingencies amounted to BAM 527 thousand (2010: BAM 570 thousand). The movement in impairment allowances is presented in Note 26.

Notes to financial statements (continued)

32. Transactions with related parties

The Bank is a member of the UniCredit Group. The key shareholder of the Bank is UniCredit Bank Austria AG Vienna with 92.92% (2010: 90.92%). No individual minority shareholder has a share in the Bank's share capital exceeding 5%.

The Bank considers that its immediate related parties are its immediate and ultimate parent and their subsidiaries and associated companies, members of the Supervisory Board, members of the Management Board and other senior management of the Bank (together, "key management"), close family members of key management and legal entities where key management and/or their close family members have control or significant influence.

Transactions with related parties are part of the Bank's regular operations.

Amounts of assets and liabilities with UniCredit Group members are as follows:

	2011 BAM '000	2010 BAM '000
Assets:		
Current accounts:		
- UniCredit Bank Austria AG Vienna	588	792
- UniCredit Bank Serbia A.D. Belgrade	2	27
- Zagrebačka banka d.d., Zagreb	345	194
- Hypo Vereinsbank AG – (HVB)	1,003	23
- Unicredito Italiano SpA Milan	103	59
- UniCredit Bank d.d. Mostar	2	2
	2,043	**1,097**
Short term deposits:		
- UniCredit Bank Austria AG Vienna	34,917	9,779
- UniCredit Bank d.d. Mostar	-	1,193
	34,917	**10,972**
Total assets	**36,960**	**12,069**
Liabilities:		
Short-term deposits:		
- UniCredit Bank Austria AG Vienna	132,214	50,856
- UniCredit d.d. Mostar	38,000	-
Suppliers:		
- Bank Austria Global Information – BAGIS, Vienna	-	60
Total liabilities	**170,214**	**50,916**
Net liabilities	**(133,254)**	**(38,847)**

Notes to financial statements (continued)

32. Transactions with related parties (continued)

Amounts of income and expenses with related parties are as follows:

	2011 BAM '000	2010 BAM '000
Items included in the statement of comprehensive income:		
Interest income:		
-UniCredit Bank Austria AG Vienna	167	85
-UniCredit bank d.d., Mostar	6	6
Total interest income	**173**	**91**
Fee and commission income:		
-UniCredit Bank Austria AG Vienna	69	16
-Zagrebačka banka d.d., Zagreb	-	1
Total fee and commission income	**69**	**17**
Interest expense:		
-UniCredit Bank Austria AG Vienna	1,498	1,310
-UniCredit bank d.d. Mostar	481	-
Total interest expense	**1,979**	**1,310**
Fee and commission expense:		
-UniCredit Bank Austria AG Vienna	71	128
-Unicredio Italiano SPA Milan	2	2
-Zagrebačka banka d.d., Zagreb	2	3
-UniCredit bank d.d. Mostar	41	82
Total fee and commissions expense	**116**	**215**
Software maintenance costs:		
-BTS – Banking Transaction services s.r.o., Prague	75	84
-UGIS -Wawe), Vienna	675	627
-IT, Vienna	-	57
-Bank Austria Global Information – BAGIS, Vienna	725	647
Total software maintenance costs	**1,475**	**1,415**
Net expense	**(3,328)**	**(2,832)**

Notes to financial statements (continued)

32. Transactions with related parties (continued)

Salaries and contributions paid to Supervisory and Management Board members are presented below:

	2011 BAM'000	2010 BAM '000
Supervisory Board	-	-
Management Board		
- Gross salaries	554	581
- Bonuses	-	112
- Severance payments		169
Total Management Board	**554**	**862**
Other key management		
- Gross salaries	1,094	902
- Bonuses	-	188
Total other key management	**1,094**	**1,090**
Total key management	**1,648**	**1,952**

Transactions and balances from loans and deposits, together with related interest income and expense are presented below:

	2011 BAM'000	2010 BAM '000
Supervisory Board	-	-
Management Board		
- Loans as at 31 December	-	2
- Interest income for year ended 31 December	-	-
- Deposits as at 31 December	92	73
- Interest expense for the year ended 31 December	2	1
Other key management		
- Loans as at 31 December	689	496
- Interest income for year ended 31 December	48	34
- Deposits as at 31 December	421	396
- Interest expense for the year ended 31 December	4	3

Other key management comprise 21 employees of the Bank (2010: 19).

Notes to financial statements (continued)

33. Risk management

The Bank's risk management is conducted through a system of policies, programmes, work procedures and determined limits, which are continuously upgraded in accordance with changes in legislation, changes in business activities based on market trends and development of new products, as well as through the adoption of risk management standards of UniCredit Group ("the Group"). The Group has a comprehensive risk management system based on defined risk appetite, risk strategies and operative policies and procedures and established risk limits.

The Supervisory Board and Management Board of the Bank prescribe overall risk management principles and adopt risk strategies and internal acts covering business areas. In accordance with Group requirements, the Bank has implemented a standard approach to the international Basel II standard, through an IT platform, which is aligned with the requirements of this standard.

Risk management is organised into organisational units within the competence of the Chief Risk Officer:

1. Underwriting responsible inter alia for credit fraud prevention
2. Credit Risk Monitoring
3. Special Credit Management
4. Risk Controlling with the function of collateral instrument management
5. Market Risk Management
6. Operational Risk Management

Within Special Credit Management there are three departments: Restructuring, Workout and Retail Collection Centres.

The most significant types of risk to which the Bank is exposed are credit risk, market risk and operational risk.

33.1. Credit risk

The Bank is exposed to credit risk that can be defined as the possibility that a debtor may default on the liabilities defined in its loan agreements, which results in financial loss for the Bank. The assumption of credit risk is managed in accordance with the specific rules and principles defined by the Group for areas of credit strategies, policies, models development, risk concentration, new products introduction, monitoring and reporting. Credit risk exposure is managed in accordance with the Bank's strategies and policies in force, as well as the other internal acts prescribed by the Supervisory Board and the Management Board. Credit risk strategies, define the main strategic goals, and determine the limits of credit risk assumption within the business operations with all clients segments.

General principles and rules of credit risk management have been established by the Group through a general credit policy, which the Bank applies in its business operations in accordance with the requirements of the local regulator, group standards and best practice. General rules and principles have been defined in more detail by specified special credit policies.

a) Credit Risk Measurement

The following factors are taken into account in credit risk measurement: risk of loss resulting from insolvency of the debtor, risk of loss resulting from a change in client risk rating, credit exposure including balance sheet and off-balance-sheet positions of the Bank and the material value of collateral instruments.

Credit risk is measured at the level of individual users of loans / transactions and at the level of the total portfolio.

With the support of the Group, the Bank is developing and establishing both a system of credit risk measurement on the portfolio basis applying the Basel II basic parameters of credit risk for calculation of expected loss from the loan portfolio, and the calculation of the internal capital requirements to cover potential loss because of the credit risk on the basis of calculation of loan VaR. Loan VaR as the measure of economic / internal capital is also the basic input for defining credit strategies, analysis of credit limits and risk concentration.

Notes to financial statements (continued)

33. Risk management (continued)

33.1. Credit risk (continued)

a) Credit Risk Measurement (continued)

The established system of reporting analyses the main triggers and components of credit risk and their dynamics in order to undertake corrective activities if necessary and in time. Reports contain the information about changes in the size and quality of the credit portfolio at the client segment level and for the Bank.

b) Risk control policies

The Bank manages, limits and controls credit risk concentrations, wherever such risk concentrations has been established, particularly with regard to specific clients and/or groups, and industry sectors.

The Bank sets the credit risk level, which it assumes by setting limits for the amount of risk accepted in relation to one borrower or group of borrowers, or industry segments. Such risks are monitored on a regular monthly basis through a report to the Credit Committee of the Bank on limits utilisation.

The Credit Committee, Management Board and the Supervisory Board of the Bank are regularly informed of all significant changes in the value and quality of the portfolio.

Credit risk is also managed by the regular analysis of the ability of borrowers and potential borrowers to settle liabilities for principal repayment and interest payment, and change in credit limits where necessary.

In order to minimize the risks from lending activities, the Bank has set up policies for definition, assessment and treatment of collateral serving as security for claims collection, and as the collateral for the collection of its claims, it uses acceptable collateral. Acceptable collateral is a pledge over an asset which has a known active market and stable prices, whose value is satisfactory compared to the Bank's receivables and which is sufficient to protect the Bank from possible loss of principal, interest, fees and collection costs.

Notes to financial statements (continued)

33. Risk management (continued)

33.1. Credit risk (continued)

33.1.1. Maximum exposure to credit risk for on and off-balance sheet

	2011 BAM '000	2010 BAM '000
Balance sheet assets		
Resources with Central Bank –bank account (Note 16)	10,024	28,910
Obligatory reserve with the Central Bank (Note 17)	32,216	47,974
Loans to and placements with banks (Note 18)	38,128	30,482
Loans to customers - legal entities (Note 19)	250,542	185,646
Loans to customers - individuals (Note 19)	286,584	238,648
Accrued interest (Note 19)	1,600	1,542
Financial assets available for sale (Note 20a)– debt securities	47,232	110
Financial assets held tol maturity (Note 20b)	200	-
Other assets (Note 23)	4,574	4,777
Total balance sheet items exposed to credit risk	**671,100**	**538,089**
Off-balance sheet (note 31)		
Guarantees and other sureties	25,269	27,192
Approved overdrafts, global loans and guarantees	50,117	37,582
Total off-balance-sheet exposure to credit risk	**75,386**	**64,774**
	746,486	**602,863**

The table represents the maximum exposure to credit risk of the Bank as at 31 December 2011 and 31 December 2010, without taking into consideration pledges or other loan collateral instruments. For balance sheet assets, the presented exposures are based on net carrying values. As shown in the table above, 71.9% of total maximum exposure originates from loans to customers (2010: 70.4%), and 5.1% originates from loans to other banks (2010: 5.1 %). The Management Board believes in the Bank's ability to continue controlling and maintaining the exposure to credit risk

Notes to financial statements (continued)

33. Risk management (continued)

33.1. Credit risk (continued)

The Bank takes collateral for loans and receivables in the form of mortgages on real estates, the pledges over other assets, and guarantees. Initial assessments of the value of collateral, or real estate, are performed when approving a credit request, or they are an integral part of the process of approval of clients' loan requests. Reassessments are performed in accordance with the principles and rules of the collateral management system. Collateral is not taken in the case of loans and advances from other banks and financial assets available for sale.

In view of the impact of the general financial and economic crisis, there is considerable uncertainty related to the fair market value of such collateral, along with the time needed to realise the sale of such collateral.

33.1.2. Credit risk management and policies for impairment and provisions

Impairment and impairment policies

At each reporting date, the Bank checks the existence of objective evidence of impairment of financial assets, as previously explained in note 3.6.

For the purpose of determining impairment of loans and receivables, the Bank distinguishes three approaches

- Loans assessed on an individual basis
- Loans assessed on a group basis
- Loans assessed on a portfolio basis ("IBNR")

Loans assessed on an individual basis

Individually significant loans are assessed on an individual basis are all loans for objective evidence of impairment i.e. factors that can influence the ability and readiness of each individual debtor to fulfill their obligations toward the Bank, are as follows:

- Failure to settle or delay in payment of interests or principal
- failure to meet conditions of agreements
- bankruptcy or receivership of the company
- any specific information about business difficulties (e.g. reflected in the insufficient liquidity of the client)
- significant changes in the customer's market environment
- global economic situation.

Loans assessed on a group basis

For assessing the impairment of loans which are not individually significant, loans are grouped on the basis of similar characteristics of credit risk, i.e. on the basis of days of delay in repayment, collateral structure, purpose and other similar characteristics, based on which the Bank recognises impairment allowance.

Loans assessed on a portfolio basis ("IBNR")

The Bank also recognises impairment for losses which are incurred but have not yet been reported ("IBNR"). IBNR is calculated for groups of financial assets with similar characteristics of credit risk and is considered on a portfolio basis applying parameters of credit risk (such as probability of default, loss given default, amount that the Bank requires in terms of non-fulfillment of liabilities) determined by Basel II and reconciled with IFRS requirements.

Notes to financial statements (continued)

33. Risk management (continued)

33.1. Credit risk (continued)

33.1.2. Credit risk management and policies on impairment and provisions (continued)

For the purpose of credit monitoring and the management of credit risk, the Bank divides its credit portfolio into the following groups:

- Performing loans – loans that are neither due nor impaired
- Past due but not impaired loans
- Non-performing loans for which impairment has been recognised.

The analysis of loan portfolio according to the above-stated categories is presented below.

	2011 BAM '000			2010 BAM '000		
	Loans	**Provisions**	**%**	**Loans**	**Provisions**	**%**
Performing and past due but not impaired loans not specifically impaired						
- loans to corporate	220,559	1,385	0,6%	150,997	954	0.6%
- loans to retail	290,735	7,184	2,5%	242,166	5,972	2.5%
Non-performing loans						
- loans to corporate	53,651	22,283	41,5%	55,245	19,642	35.6%
- loans to retail	16,841	13,808	82,0%	15,621	13,167	84.3%
Total loans	**581,786**	**44,660**	**7,7%**	**464,029**	**39,735**	**8.6%**

Provision coverage of non-performing portfolio amounts to 51.2% (2010: 46.3%).

Notes to financial statements (continued)

33. Risk management (continued)

33.1. Credit risk (continued)

33.1.2. Credit risk management and policies on impairment and provisions (continued)

The table below presents the analysis of gross and net (net of impairment allowance) loans to and receivables from customers:

	2011 BAM '000	2010 BAM '000
Corporate		
Loans to customers that are neither due nor impaired	218,814	148,400
Past due but not impaired loans	1,745	2,597
Non-performing loans (impaired loans)	53,651	55,245
Gross exposure	**274,210**	**206,242**
Impairment allowance:		
- Portfolio (IBNR), individual and group impairment allowance	(23,668)	(20,596)
Net exposure	**250,542**	**185,646**

	2011 BAM '000	2010 BAM '000
Retail		
Loans to customers that are neither due nor impaired	290,707	242,142
Past due but not impaired loans	28	24
Non-performing loans (impaired loans)	16,841	15,621
Gross exposure	**307,576**	**257,787**
Impairment allowance :		
- Portfolio (IBNR), individual and group impairment allowance	(20,992)	(19,139)
Net exposure	**286,584**	**238,648**
Total gross exposure	**581,786**	**464,029**
Portfolio impairment allowance (IBNR)	(8,569)	(6,926)
Individual and group impairment allowance	(36,091)	(32,809)
Net exposure	**537,126**	**424,294**

Notes to financial statements (continued)
33. Risk management (continued)

33.1. Credit risk (continued)

33.1.2. Credit risk management and policies on impairment and provisions (continued)

a*) Loans to customers that are neither due nor impaired*

The quality of the portfolio of loans to customers that are neither due nor impaired can be assessed through the internal standard monitoring system. Loans to customers are regularly monitored and systematically reviewed in order to identify any irregularities or warning signals. These loans are subject to constant monitoring with the aim of taking timely action based on improvement/deterioration of clients' risk profile

An overview of gross exposure of loans to customers that are neither due nor impaired according to the type of loan is as follows:

	Loans to individuals				Loans to legal entities			
	Customer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2011	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**
Standard monitoring	212,507	60,389	17,811	**290,707**	125,896	47,799	45,119	**218,814**
2010								
Standard monitoring	176,394	49,733	16,015	**242,142**	28,847	82,715	36,838	**148,400**

Notes to financial statements (continued)

33. Risk management (continued)

33.1. Credit risk (continued)

33.1.2. Credit risk management and policies on impairment and provisions (continued)

b) *Past due but not impaired loans*

Loans to and receivables from customers less than 90 days overdue are not considered as impaired, unless other information is available to indicate the contrary. The gross amount of loans to and receivables from customers that were past due but not impaired were as follows:

	Loans to individuals				Loans to legal entities			
	Customer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large **BAM '000**	Medium **BAM '000**	Small **BAM '000**	**Total BAM '000**
2011	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**				
Past due up to 30 days	13	-	-	13	1,000	295	30	1,325
Past due 30 – 60 days	11	-	-	11	-	150	17	167
Past due 60 – 90 days	4	-	-	4	-	100	-	100
Past due over 90 days	-	-	-	-	101	-	52	153
Total	**28**	**-**	**-**	**28**	**1,101**	**545**	**99**	**1,745**
Value of collateral	-	-	-	**-**	1,101	485	18	**1,604**
2010								
Past due up to 30 days	13	-	-	13	-	100	5	105
Past due 30 – 60 days	6	-	-	6	1,000	-	7	1,007
Past due 60 – 90 days	5	-	-	5	1,450	-	3	1,453
Past due over 90 days	-	-	-	-	-	-	32	32
Total	**24**	**-**	**-**	**24**	**2,450**	**100**	**47**	**2,597**
Value of collateral	1	-	-	**1**	1,787	100	26	**1,913**

Notes to financial statements (continued)

33. Risk management (continued)

33.1. Credit risk (continued)

33.1.2. Credit risk management and policies on impairment and provisions (continued)

c) Non-performing loans (impaired loans)

The classification of loans to customers that are impaired, together with the allocated value of associated collateral instruments, is as follows:

	Loans to individuals				Loans to legal entities			
	Customer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2011	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**
Non-performing loans	13,382	1,641	1,818	**16,841**	6,872	24,445	22,334	**53,651**
Value of collateral	1,755	1,450	-	**3,205**	6,872	22,510	13,748	**43,130**
2010								
Non-performing loans	12,283	1,678	1,660	**15,621**	9,632	23,672	21,941	**55,245**
Value of collateral	366	1,476	-	**1,842**	9,632	22,633	12,830	**45,095**

The data shown in the table above are presented in gross amounts.

As at 31 December 2011, assets acquired in settlement of non-performing loans amounted to BAM 174 thousand (2010: BAM 282 thousand), which are recorded off-balance

d) Restructured loans and receivables

During the year, the Bank restructured certain loans to clients in order to improve their final recoverability. Restructuring is mainly performed in response to deterioration or for the prevention of further deterioration of the clients' financial situation based on an analysis of the possibility of successful restructuring in order to remove difficulties in the client's operations within a defined time limit and return the client to the "performing" portfolio. In all cases of restructured loans where the net present value of expected future cash flows resulted with losses, the Bank recognised an impairment allowance.

Restructured loans that would otherwise be past due or impaired as at 31 December 2011 amounted to a total of BAM 27.176 thousand (2010: BAM 12.734 thousand).

	2011 BAM '000	**2010 BAM '000**
Loan portfolio	581,786	464,029
Restructured loans	27,176	12,734
Restructured loans recorded as % of loan portfolio	4.7%	2.7 %

Notes to financial statements (continued)

33. Risk management (continued)

33.2. Liquidity risk (continued)

The table below analyses the assets and liabilities according to relevant maturity groupings based on the remaining period from the reporting date to the contractual maturity date. The maturity of assets and liabilities and the possibility of rescheduling of interest-bearing liabilities on their maturity date, at an affordable cost, are important factors in assessing the liquidity of the Bank and its exposure to risks due to changes in interest rates and exchange rates. The remaining maturity of assets and liabilities as at 31 December 2011 and 31 December 2010 is as follows:

2011	Up to 1 month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
Assets						
Cash reserves	22,012	-	-	-	-	22,012
Obligatory reserve with the Central bank	32,216	-	-	-	-	32,216
Loans to and receivables from banks	38,128	-	-	-	-	38,128
Loans to and receivables from customers	84,236	25,117	94,551	220,098	110,458	534,460
Financial assets available for sale	45,291	-	2,092	228	-	47,611
Financial assets held to maturity	-	-	-	200	-	200
Property and equipment	-	-	-	-	19,093	19,093
Intangible assets	-	-	-	-	5,329	5,329
Accrued interest and other assets	1,593	1,577	1,404	-	-	4,574
Deferred tax assets	-	-	19	-	-	19
Total assets	**223,476**	**26,694**	**98,066**	**220,526**	**134,880**	**703,642**
Liabilities and equity						
Deposits and loans from banks	85,824	45,515	41,805	14,140	7,403	194,687
Deposits and loans from customers	138,725	30,732	54,878	116,021	57,225	397,581
Accrued interest and other liabilities	4,354	392	3,937	940	43	9,666
Provisions for liabilities and charges	-	-	716	1,079	-	1,795
Profit tax liability	-	735	-	-	-	735
Deferred tax liability	-	-	-	247	-	247
Equity	-	-	8,201	-	90,730	98,931
Total liabilities and equity	**228,903**	**77,374**	**109,537**	**132,427**	**155,401**	**703,642**
Maturity gap	**(5,427)**	**(50,680)**	**(11,471)**	**88,099**	**(20,521)**	**-**

Notes to financial statements (continued)

33. Risk management (continued)

33.2. Liquidity risk (continued)

2010	Up to 1 month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
Assets						
Cash reserves	40,449	-	-	-	-	40,449
Minimum reserve with Central bank	47,974	-	-	-	-	47,974
Loans to and receivables from banks	29,289	-	1,193	-	-	30,482
Loans to and receivables from customers	24,874	40,349	87,678	180,201	90,219	423,321
Financial assets available for sale	50	-	50	352	10	462
Buildings and equipment	-	-	-	-	22,485	22,485
Intangible assets	-	-	-	-	6,178	6,178
Accrued interest and other assets	2,946	504	1,300	10	17	4,777
Deferred tax assets	-	-	-	2	-	2
Total assets	**145,582**	**40,853**	**90,221**	**180,565**	**118,909**	**576,130**
Liabilities and equity						
Deposits and loans from banks	258	17,619	34,527	11,292	8,733	72,429
Deposits and loans from customers	156,167	37,483	100,503	103,420	26,331	423,904
Accrued interest and other liabilities	2,435	176	1,445	2,519	-	6,575
Provisions for liabilities and charges	781	142	163	734	-	1,820
Liability for profit tax		191				191
Deferred tax liability	-	-	-	355	-	355
Equity	-	-	-	-	70,856	70,856
Total liabilities and equity	**159,641**	**55,611**	**136,638**	**118,320**	**105,920**	**576,130**
Maturity gap	**(14,059)**	**(14,758)**	**(46,417)**	**62,245**	**12,989**	**-**

Notes to financial statements (continued)

33. Risk management (continued)

33.3. Market risk management

Market risks result from general and specific trends and changes of specified market variables (interest rates, prices of securities, exchange rate changes) which can affect the economic value the Bank's portfolio in the trading book and in the banking book. The Bank is exposed to market risk mainly because of positions and business activities in the banking book.

Management of the exposure to market risk has been organised through a system of internal acts and the setting of defined limits and warning signals which are supervised on a daily basis. Measurement of market risk is based on the VaR („ Value at Risk) methodology and is performed in cooperation with the Group. VaR is the appraised potential overnight loss which occurs at total and particular positions of balance sheet structure in a defined time period, based on numerous assumptions of changes of market conditions with a level of reliability of 99%. Beside VaR methodology, Market Risk Management also uses calculations of currencies and time buckets.

Factors which are of the same importance are also the stress oriented levels of warning and limits. Risk Management currently performs stress liquidity test and reports on results on a monthly basis to ALCO. Stress tests, in the future, will also be implemented for interest rate and currency risk.

Overview of total VaR items of the Bank:

BAM ‘000	**2011**	**2010**
- average for the period	48	n/a
- maximum for the period	137	n/a
- minimum for the period	14	n/a

An internal model based on the VaR for the Bank was implemented in 2011. Out of all components which affecting: interest rate risk, risk of exchange rate changes, risk of changes of prices of securities and loan spread; of the largest impact on the Bank's VaR comes from interest rate risk.

33.3.1. Currency risk

Currency risk is the risk of the possibility of occurrence of negative effects on the financial results and net assets capital because of a change in exchange rate. Bank’s exposure to foreign currency risk results from credit, deposit and trading activities and is controlled daily, according to legal and internal Group limits for particular payment currencies, and in total amount for all assets and liabilities denominated in foreign currency or linked to foreign currency.

Market Risk is responsible for daily monitoring of foreign exchange risk calculations in accordance with Group guidelines in compliance with defined rules for monitoring of movements through the conversion accounts for individual currency.

Exposure to this risk is monitored on a daily basis in accordance with legally and internally determined limits for each currency and in the total amount for assets and liabilities denominated in foreign currencies or linked to a foreign currency clause. The currency risk ratio is the proportion between the total open currency items and the Bank’s capital.

At the moment, the Bank measures the risk exposure to foreign exchange rate through the open positions in foreign currency in comparison with the determined limit. In accordance with the decision which regulates the capital adequacy, the Bank is obliged to maintain relations between assets and liabilities so that its total open foreign exchange position at the end of each working day is not higher than 30 % of its capital.

Notes to financial statements (continued)

33. Risk management (continued)

33.3. Market risk management (continued)

33.3.1. Currency risk (continued)

	2011	2010
Currency risk ratios:		
- as at 31 December	16.1%	8.5%
- maximum for the period –December	20.5%	13.4%
- minimum for the period –December	1.7%	3.5%

The Bank protects itself from loss due to possible change of local currency exchange rate by agreeing on loans and placements with foreign exchange clause. The major part of business transactions exposes the Bank to the risk of EUR exchange rate change. Due to the Currency Board policy according to which the ratio of the local currency to EUR is fixed, the exposure of the Bank to foreign exchange rate risk can be considered to be not materially significant.

The Bank protects itself from the risk in respect of exposure to open positions in the other foreign currencies except for EUR through derivative financial instruments for the purpose of managing assets and liabilities (currency swap, futures contracts). Limits are valid for all foreign currency relevant products within sector of financial markets. They also cover trading items as well as selective strategic foreign currency items of ALM. These limits are briefly described (including their calculation and procedures) in the General part of Financial Markets Rulebook.

All sensitivities which result from the positions related to payment currencies are also included in general daily VaR limit, which among other risks, also limits maximally allowed loss of open positions in foreign currencies.

Notes to financial statements (continued)

33. Risk management (continued)

33.3. Currency risk (continued)

The analysis of assets and liabilities shown in foreign currency amounts, as at 31 December 2011, is presented in the table below

	EUR BAM '000	EUR related items BAM '000	USD BAM '000	Other currencies BAM '000	Total currencies BAM '000	BAM BAM '000	Total BAM '000
31.12.2011							
Assets							
Cash reserves	3,191	-	189	1,398	4,778	17,234	22,012
Minimum reserve with Central bank	-	-	-	-	-	32,216	32,216
Loans to and receivables from banks	30,196	-	6,257	1,675	38,128	-	38,128
Loans to and receivables from customers	111,300	180,892	-	-	292,192	242,268	534,460
Financial assets available for sale	-	10	-	-	10	47,601	47,611
Financial assets held until maturity	-	-	-	-	-	200	200
Buildings and equipment	-	-	-	-	-	19,093	19,093
Intangible assets	-	-	-	-	-	5,329	5,329
Accrued interest and other assets	127	-	49	7	183	4,391	4,574
Deferred tax assets	-	-	-	-	-	19	19
Total assets	**144,814**	**180,902**	**6,495**	**3,080**	**335,291**	**368,351**	**703,642**
Liabilities and equity							
Deposits and loans from banks	156,594	80	1	-	156,675	38,012	194,687
Deposits and loans from customers	122,623	73,235	6,397	7,434	209,689	187,892	397,581
Accrued interest and other liabilities	1,779	-	112	20	1,911	7,755	9,666
Provisions for liabilities and charges	-	-	-	-	-	1,795	1,795
Profit tax liability	-	-	-	-	-	735	735
Net deferred tax liability	-	-	-	-	-	247	247
Equity	3,382	-	-	-	3,382	95,549	98,931
Total liabilities and equity	**284,378**	**73,315**	**6,510**	**7,454**	**371,657**	**331,985**	**703,642**
Net foreign currency position	**(139,564)**	**107,587**	**(15)**	**(4,374)**	**(36,366)**	**36,366**	**-**

Decrease of foreign currencies (except for EUR) in comparison with BAM for 10%, if all other variables remained the same, would result in increase of profit after tax for 2011 for BAM 439 thousand (2010: decrease for BAM 28 thousand).

Increase of 10% of the foreign currencies would result with decrease of profit after tax for 2011 in the amount of BAM 439 thousand (2010: increase for BAM 28 thousand).

Notes to financial statements (continued)

33. Risk management (continued)

33.3. Currency risk (continued)

	EUR BAM '000	EUR related items BAM '000	USD BAM '000	Other currencies BAM '000	Total currencies BAM '000	BAM '000	Total BAM '000
31.12.2010							
Assets							
Cash reserves	2,898	-	185	1,004	4,087	36,362	40,449
Minimum reserve with Central bank	-	-	-	-	-	47,974	47,974
Loans to and receivables from banks	21,009	-	4,304	3,976	29,289	1,193	30,482
Loans to and receivables from customers	122,290	212,021	-	-	334,311	89,010	423,321
Financial assets available for sale	-	110	-	-	110	352	462
Buildings and equipment	-	-	-	-	-	22,485	22,485
Intangible assets	-	-	-	-	-	6,178	6,178
Accrued interest and other assets	659	165	50	-	874	3,903	4,777
Deferred tax assets	-	-	-	-	-	2	2
Total assets	**146,856**	**212,296**	**4,539**	**4,980**	**368,671**	**207,459**	**576,130**
Liabilities and equity							
Deposits and loans from banks	72,158	90	10	-	72,258	171	72,429
Deposits and loans from customers	158,537	88,789	4,493	4,689	256,508	167,396	423,904
Accrued interest and other liabilities	2,439	273	20	26	2,758	3,817	6,575
Provisions for liabilities and charges	29	-	-	-	29	1,791	1,820
Liability for profit tax	-	-	-	-	-	191	191
Deferred tax liability	-	-	-	-	-	355	355
Equity	-	-	-	-	-	70,856	70,856
Total liabilities and equity	**233,163**	**89,152**	**4,523**	**4,715**	**331,553**	**244,577**	**576,130**
Net foreign currency position	**(86,307)**	**123,144**	**16**	**265**	**37,118**	**(37,118)**	**-**

Foreign exchange rate

The official exchange rates applied for recalculation of the balance sheet positions as at 31 December 2011 and 2010 for the following more significant currencies was:

	31 December 2011	**31 December 2010**
USD	1.511577	1.472764
CHF	1.608942	1.567800
EUR	1.955830	1.955830

Notes to financial statements (continued)

33. Risk management (continued)

33.3.2. Interest rate risk

The Bank is exposed to the risk which is the result of the interest rates fluctuations on the financial position of the Bank and cash flows. The Bank's business operations are influenced by the interest rates change, to the extent that interest bearing assets and liabilities mature or their interest rates change at different times or in different amounts.

Exposure to risk of the interest rates change is monitored by the determined reports and in accordance with Group guidelines and it is in the domain of market risks management. Methodology which is used for risk assessment of interest rates change is based on the GAP analysis of the time difference. Differences between interest-bearing funds and liabilities in different time "baskets" show that two sides of balance sheet differently react on the change of interest rates:

- in case of positive GAP difference, the Bank is exposed to risk of the loss in case that interest rates of given maturities for the relevant payment currency fall,
- in case of negative GAP difference the Bank is exposed to risk of the loss in case that interest rates of the given maturity for the relevant payment currency grow.

Number and distribution of time "baskets" is defined at the level UniCredit Group. GAP limits are determined per currencies. The Bank assesses exposure to interest rate risk on the basis of the influence of changes in interest rates by 1pp on net interest income for a period of 12 months. A simulation is performed based on simultaneous growth or decline in interest rates on items in the balance sheet of the Bank sensitive to changes in interest rates, whereas the change in net interest income due to the change in interest rates must not exceed 10% of the planned net interest income.

All effects of sensitivities of Bank's positions on the potential change of interest rates have also been included general daily VaR limit.

Sensitivity analysis

Taking into consideration discrepancies between assets and liabilities in the observed periods: up to one month, 1-3 months and 3-12 months, an assessment of the impact of interest rate change +/-1pp was performed on the net interest income of the Bank for 2011 and for 2010.

Discrepancy of assets and liabilities up to 12 months indicates that the Bank has "sensitive liabilities / assets" which means that changes of interest rate in liabilities / assets happen faster than in assets / liabilities. Specified circumstances, in case of growth / fall of interest rates in surroundings, would bring up to reduction / growth of interest income of the Bank. Decrease of interest rate by 1pp would cause the decrease of Net interest income for 2011 in the amount of about BAM 717 thousand, in per cent 2%. Simulation of influence of interest rate changes on the Net interest income in the previous year resulted by the decrease of Net interest income in the amount of BAM 1,045 thousand or 3 %.The effects are presented in the following table:

	2011	**2010**
Potential decrease in net interest income (BAM '000)	(717)	(1,045)
% of decrease in planned net interest income	(2%)	(3%)

An overview of the Bank's exposure to interest rate risk as at 31 December 2011 and 31 December 2010 is shown on the following pages.

The Bank is in the process of establishing stress testing in accordance with methodology and models developed in the Group, and will also measure exposure to interest rate risk in comparison with the economic value of equity in the future.

Notes to financial statements (continued)

33. Risk management (continued)

33.4. Interest rate risk (continued)

a) Period of interest rate changes, interest risk analysis and amounts onto which fixed interest rates are applied

The Bank is exposed to various risks which, associated with the effects of fluctuations in the levels of market interest rates have an impact on its financial position and cash flows. The following table presents the Bank's estimate of the interest rate risk as at 31 December 2011 and 2010, as well as certain sensitivity of the Bank's earnings to movements in interest rates, which is not necessarily indicative for forthcoming periods. Earnings will also be affected by the maturity structure of the Bank's assets and liabilities:

	Up to 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Non-interest bearing	Total	fixed interest rate
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
31.12.2011								
Assets								
Cash reserves	10,024	-	-	-	-	11,988	22,012	-
Minimum reserve with Central bank	32,216	-	-	-	-	-	32,216	-
Loans to and receivables from banks	37,281	-	-	-	-	847	38,128	38,128
Loans to and receivables from customers	404,658	7,770	107,919	6,065	8,048	-	534,460	12,318
Financial assets available for sale	-	-	-	2,086	45,146	379	47,611	47,232
Financial assets held until maturity	-	-	-	200	-	-	200	200
Buildings and equipment	-	-	-	-	-	19,093	19,093	-
Intangible assets	-	-	-	-	-	5,329	5,329	-
Accrued interest and other assets	-	-	-	-	-	4,574	4,574	-
Deferred tax assets	-	-	-	-	-	19	19	-
Total assets	**484,179**	**7,770**	**107,919**	**8,351**	**53,194**	**42,229**	**703,642**	**97,878**
Liabilities and equity								
Deposits and loans from banks	95,583	57,818	40,448	-	-	838	194,687	112, 736
Deposits and loans from customers	275,863	193	52,809	45,476	5,189	18,051	397,581	61,676
Accrued interest and other liabilities	-	-	-	-	-	9,666	9,666	-
Provisions for liabilities and charges	-	-	-	-	-	1,795	1,795	-
Liability for profit tax						735	735	
Deferred tax liability	-	-	-	-	-	247	247	-
Equity	-	-	-	-	-	98,931	98,931	-
Total liabilities and equity	**371,446**	**58,011**	**93,257**	**45,476**	**5,189**	**130,263**	**703,642**	**174,412**
Interest rate gap	112,733	(50,241)	14,662	(37,125)	48,005	(88,034)	-	(76,534)

Notes to financial statements (continued)

33. Risk management (continued)

33.4. Interest rate risk (continued)

a) Period of interest rate changes, interest risk analysis and amounts onto which fixed interest rates are applied (continued)

	Up to one month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Non-interest bearing	Total	Fixed interest rate
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
31.12.2010								
Assets								
Cash reserves	28,526	-	-	-	-	11,923	40,449	-
Minimum reserve with Central bank	47,974	-	-	-	-	-	47,974	-
Loans to and receivables from banks	29,289	-	1,193	-	-	-	30,482	-
Loans to and receivables from customers	296,214	82,295	32,261	6,134	6,417	-	423,321	14,064
Financial assets available for sale	50	-	50	-	10	352	462	110
Buildings and equipment	-	-	-	-	-	22,485	22,485	-
Intangible assets	-	-	-	-	-	6,178	6,178	-
Accrued interest and other assets	-	-	-	-	-	4,777	4,777	-
Deferred tax assets	-	-	-	-	-	2	2	-
Total assets	**402,053**	**82,295**	**33,504**	**6,134**	**6,427**	**45,717**	**576,130**	**14,174**
Liabilities and equity								
Deposits and loans from banks	90	17,603	53,639	-	-	1,097	72,429	-
Deposits and loans from customers	289,491	49,687	24,425	32,238	6,856	21,207	423,904	61,629
Accrued interest and other liabilities	-	-	-	-	-	6,575	6,575	-
Provisions for liabilities and charges	-	-	-	-	-	1,820	1,820	-
Liability for profit tax						191	191	
Deferred tax liability	-	-	-	-	-	355	355	-
Equity	-	-	-	-	-	70,856	70,856	-
Total liabilities and equity	**289,581**	**67,290**	**78,064**	**32,238**	**6,856**	**102,101**	**576,130**	**61,629**
Interest rate gap of the Bank	**112,472**	**15,005**	**(44,560)**	**(26,104)**	**(429)**	**(56,384)**	**-**	**(47,455)**

Notes to financial statements (continued)

33. Risk management (continued)

33.4. Interest rate risk (continued)

a) Period of interest rate changes, interest risk analysis and amounts onto which fixed interest rates are applied (continued)

The estimated future cash flow for the Bank's interest bearing liabilities as at 31 December 2011 and 31 December 2010 are shown in the following table:

31.12.2011	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Liabilities						
Transaction accounts and deposits from banks	85,935	55,697	33,120	14,139	7,403	**196,294**
Transaction accounts and deposits from customers	63,567	57,418	75,833	141,583	73,414	**411,815**
Other liabilities	4,354	1,119	4,602	1,765	-	**11,840**
Total liabilities	**153,856**	**114,234**	**113,555**	**157,487**	**80,817**	**619,949**
31.12.2010						
Transaction accounts and deposits from banks	275	17,603	36,766	10,014	8,732	**73,390**
Transaction accounts and deposits from customers	156,336	38,029	101,802	111,363	28,573	**436,103**
Other liabilities	2,022	250	2,050	1,513	-	**5,835**
Total liabilities	**158,633**	**55,882**	**140,618**	**122,890**	**37,305**	**515,328**

b) Effective interest rates

The following table presents the effective interest rates calculated as the weighted average for the reporting period for financial instruments:

	2011	2010
	%	%
Cash reserves	0.53	0.32
Minimum reserve with Central bank	0.59	0.41
Placements with and loans to banks	0.68	0.42
Loans to customers	8.56	9.10
Debt securities available for sale	5.27	5.75
Transaction accounts and deposits from banks	1.93	2.55
Transaction accounts and deposits from customers	1.57	2.29
Loans taken	2.27	2.27

Notes to financial statements (continued)

33. Risk management (continued)

33.5. Operational risk

Operational risk is the risk of loss due to inadequate or poor internal processes, systems and procedures, as well as due to errors made by employees during their work or the result of externally caused events. Definition of operational risks includes legal risk, however it excludes strategic and reputational risk.

Operational risk events are events resulting from inadequate or failed internal processes, people and systems or from systemic or other external events: internal or external fraud, relations with employees and safety at workplace, customer complaints, distribution of products, fines and penalties for violations of regulations, damage to tangible assets of the Bank, work disruptions and errors in the system and management processes.

In accordance with rules and methodology of the Group as well as local regulations, the Bank has established and improved the operational risk management system. The system includes tools and mechanisms for continuous monitoring of damages that the Bank bears by operational risk and the Bank's exposure to operational risks, the assessment of operational risk within processes and products, and defining the ways to avoid, control or transfer operational risk to third parties, as well as a reporting system. To record data about damages from operational risks, reporting and the data analysis related to the operational risks, the Bank uses the Group tool ARGO.

The Bank's management and the Group are regularly informed and receive reports in respect of the aforementioned processes and indicators which are the constituent of the operational risk management system. In addition, the operational risk management system is aligned with the standards of the UniCredit Group and local and international regulations

33.6. Capital management

The Bank's objectives in capital management are:

- to comply with capital requirements set by regulators of banking markets where the Bank's units are operating,
- to maintain the Bank's ability to continue the business operations so that it could ensure the yields for shareholders and benefits for interested parties, and
- to maintain a strong capital basis to support the development of its business activities

The Bank monitors capital adequacy using techniques based on the regulatory requirements of BARS. Minimum equity standards prescribed by law and other regulations are: maintenance of minimum level of net capital, maintenance of the ratio of total net capital and risk weighted assets at the prescribed minimum of 12%.

Net capital of the Bank, which is the amount that serves to calculate the Bank's capital adequacy ratio, represents the sum of core and supplementary capital, decreased by deductible items consisting of, *inter alia,* the amount of insufficient impairment allowance for loans and other assets in accordance with regulations of the BARS.

Notes to financial statements (continued)

33. Risk management (continued)

33.6. Capital management (continued)

The core capital (tier 1) of the Bank consists of: share capital (ordinary shares), share premium, revaluation reserves, revenue reserves and undistributed profit from previous years, reduced by intangible investments.

Supplementary capital (tier 2) of the Bank consists of general loan loss provision calculated by BARS methodology on Bank's assets classified in Category A (performing assets) and the calculated current year profit, verified by an external auditor.

Core, supplementary, net capital and capital adequacy calculated pursuant to the BARS regulations, are presented in the following table (not audited):

	2011 BAM '000	**2010 BAM '000**
Tier 1 capital		
Ordinary shares	82,055	62,054
Share premium	373	373
Reserves	2,441	4,555
Intangible assets	(5,329)	(6,178)
Total tier 1 capital	**79,540**	**60,804**
Tier 2 capital		
General provision	10,630	8,684
Audited profit	8,201	378
Total tier 2 capital	**18,831**	**9,062**
Insufficient reserves per regulatory requirement	**(3,423)**	**(2,365)**
Net capital	**94,948**	**67,501**
Risk weighted assets		
Credit risk weighted assets	539,369	448,748
Weighted operational risk	49,251	47,095
Total weighted risk	**588,620**	**495,843**
Capital adequacy	**16.1**	**13.6**

Information on total weighted risk is as submitted to the BARS and is not audited.

Insufficient reserves required by the regulator presented in financial statements for 2011 will be covered from the profit realized in the year on the basis of the decision of the Bank's competent General Assembly.

Notes to financial statements (continued)

34. Funds managed for and on behalf of third parties

The Bank manages funds related to transactions for and on behalf of third parties; it records these funds in off-balance sheet separated from its assets. The Bank charges a fee for managing funds for and on behalf of third parties. Income and expenses for these funds are posted as income or expense of the owner, i.e. user.

Placements related to the activities for and on behalf of third parties are presented in the table below:

	2011 BAM '000	2010 BAM '000
Commission deals - Telekom RS	-	3,387
Commission deals – IFAD I	-	13,797
Commission placements – MCI	714	600
Total	**714**	**17,784**

In 2011, the Bank did not have revenues from fees related to transaction on behalf and for the account of the third parties (2010: BAM 38 thousand).

Commission-related transactions that the Bank performed for Telekom RS and in the IFAD Project are not active because of which, since 2011, the Bank has booked them in the other off-balance records.

35. Assumed liabilities related to operating lease

The Bank has the assumed liabilities evolving from 32 lease contracts. The contracts are related to the lease for Bank's branches premises lease and for installed ATMs premises rental.
The future minimum lease payments under the above-mentioned operating lease contracts are summarised in the table below:

	2011 BAM '000	2010 BAM '000
Up to 1 year	732	749
From 1 to 5 years	3,550	3,747
Over 5 years	108	117
	4,390	**4,613**

36. Fair value of financial assets and liabilities

Fair value represents the amount for which some assets can be exchanged or the liability settled between notified and amenable sides in usual market conditions. It can also be defined as the value at which it is possible to dispose of assets / liabilities, or the appraised value of the neutralization of the market risk which originates from the assets / liabilities in the appropriate time-frame.
Assumptions used in the assessment of fair values of particular financial instruments are listed below.

Loans and placements to customers

The fair value of loans is calculated based on discounted expected future cash flows of principal and interest. Expected future cash flows are estimated taking into consideration credit risks and all indicators of impairment that are determined in accordance with relevant standards

Notes to financial statements (continued)

36. Fair value of financial assets and liabilities (continued)

Loans and placements to customers (continued)

The estimated fair values of loans reflect changes in loan status from the moment the loans were approved and the changes in interest rates for loans with a fixed interest rate. In 2011 the Bank had corporate loans with a fixed interest rate in the amount of BAM 13 million (2010: BAM 14 million). Under the assumption that the annual market interest rate for legal entities amounted to 7,79% p.a. for long-term foreign currency loans (2010: corporate market interest rate was 8,40% p.a. for long-term foreign currency loans), the expected future cash flows from loans with fixed interest rates are discounted onto present value.

The Management Board estimated fair value in accordance with assumptions for the above-mentioned loans of legal entities and it was determined that the fair value of the loans was higher by BAM 359 thousand than the book value, and in 2010, there was no significant difference between the carrying and fair value of these instruments.

In dealing with individuals, the Bank grants loans with a contracted clause on variability of the interest rate in accordance with a Bank decision. An exception is loans given to individuals from the credit line of the Housing Fund which have a fixed interest rate. Given that these loans are aligned with the source of funding in terms of maturity, currency and interest structure, the Bank does not perform an estimate of fair value either of the financial asset or corresponding liabilities

Loans to and placements with banks

Fair value of placements with banks does not differ significantly from their carrying value since these are mostly short-term deposits.

Currentn accounts and deposits from banks and customers

The estimated fair value of deposits with fixed maturity is based on discounted cash flows according to currently valid interest rates for deposits with similar remaining maturity.

For sight deposits which have no defined maturity, fair value is the amount payable at sight on the balance sheet date.

Value of short-term relations with depositors is not considered when assessing the fair value.
Given that the average market interest rate in local currency on long-term deposits of legal entities is 2.9 % and (2010: legal entities, long-term 3.5 %) and taking into account events on the market, the expected future cash flows on long-term deposits of legal entities with the fixed interest rate have been discounted on current value.

Based on the above assumption, the Management Board has estimated the fair value of deposits from legal entities in the amount of BAM 157,538 thousand, which is by BAM 454 thousand less than the carrying value (2010: BAM 186,544 thousand which was by BAM 1,030 thousand less than the carrying value).

The fair value of deposits from individuals was estimated under the assumption that the average market interest rate in foreign currency on long-term deposits of individuals amounts to 3.2% and (2010: individuals long-term, 3.7%) and considering the events in the market, the expected future cash flows on long-term deposits of individuals with a fixed interest rate was discounted to present value.

Based on the above assumption, the Management Board has estimated the fair value of deposits of individuals in the amount of BAM 179,672 thousand, which is by BAM 464 thousand less than the carrying value (2010: BAM 179,112 thousand which is by BAM 9 thousand less than the carrying value).

Notes to financial statements (continued)

36. Fair value of financial assets and liabilities (continued)

Borrowings

The majority of the Bank's long-term loans were agreed with a variable interest rate, and its fair value is estimated as the present value of future cash flows, discounted at the interest rate available at the balance sheet date for the Bank, for the new loan of similar type and the remaining maturity.

Accordingly, Management has estimated that there is no significant difference between the carrying value and fair value of the instruments.

An exception is the credit line from the Housing Fund of Republika Srpska, which was contracted with a fixed interest rate, but, taking into consideration that the loans funded from this credit line were also placed with a fixed interest rate, it is considered that there was the complete alignment and no influence of changes in interest rate, and thus the Bank did not perform a assessment of fair value of these liabilities.