UNICREDIT BANK A.D., BANJA LUKA

Financial statements
for the year ended
31 December 2012

This version of our report is a translation from the original, which was prepared in the 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,

On behalf of the Management of UniCredit Bank a.d. Banja Luka I have a great honour and pleasure to inform you about the achievements and business results accomplished during 2012 which are evident in all key performance indicators.

The Bank ended 2012 successfully and generated profit before tax in the amount of BAM 15.4 mln, of which income tax amounted to BAM 1.6 mln and current profit BAM 13.8 mln. Realised gross profit is 65% higher compared to the previous year which clearly demonstrates that the Bank, despite unfavourable business conditions on the BH market, which were additionally aggravated by deepening and continuing of the effects of the general, global crisis, and in 2012 continued with the positive trend and good results initiated in the previous year.

It is noteworthy to mention that good financial result is not the most important on the value system scale of our bank and UniCredit Group which we belong to, but its achievement is the necessary assumption for further growth and development of the Bank, and better and greater contribution to the community that we are operating in.

Good financial results in 2012 were realised by the improvement of the process of credit financing to our customers, increasing the volume of loans and deposits, and thereby total assets and liabilities, as well as its efficient management, and further cost rationalisation which has been accomplished in significant part through business network optimization.

The Bank's total assets are higher by BAM 208.0 mln or 30% compared to the previous year, which is, in the large part, the result of volume increase of loans and placements granted to customers and banks by the amount of BAM 171.0 mln or 30% and increase of placements in securities by the amount of BAM 8.1 mln BAM or 17%.

The increase of liabilities is the result of increase of deposits and loans taken from customers and banks by the amount of BAM 179.9 mln or 30% and payment of funds for the purchase of the 9^{th} issue shares addressed to the qualified investor – UniCredit Bank Austria in the amount of BAM 15.0 mln which influenced on the increase of other liabilities by 152% as compared to the previous year.

During 2012 the Bank had a strong Group support in various segments of business operations, among which is already mentioned increase of share capital that will be completed by the end of January, 2013.

Retail

Although the credit activity was not as intense as in 2011 and total volume of the loan portfolio decreased by BAM 10 mln in 2012, the growth of loan market share has still been accomplished which reflects the entire market situation as well. In spite of loan portfolio decrease the total retail customers operating income is higher than it was in the previous year primarily due to good management of external pricing and margins, while the loan loss provisions were lower than the budgeted figures. 2012 was marked by intense activity on deposit collection, so the growth was achieved in the amount of BAM 15 mln primarily in the part regarding the term deposits.

Having introduced new products such as favourite savings, premium package, instalment card and others, the range of products and services offered to retail customers improved, resulting in an increase in the number of customers and opened accounts, and an increase in the number of issued credit and debit cards, as well as electronic banking as compared to 2011.

Within the business network optimization plan adopted at the beginning of 2012 and based on branch operations efficiency assessment, 4 agencies and 2 branches were closed. The specified plan envisaged the reorganisation and relocation of branches in the area of the city of Banja Luka whereby instead of 3 agencies, with limited offer services, 3 branches which are capable in terms of staff and organisation to offer all types of products and services, not only to retail customers but to corporate customers as well.

Customer satisfaction survey also shows improvement as compared to the results achieved in 2011 and this year we became the market leader in terms of customer satisfaction in 2012.

Corporate and Investment Banking (CIB)

The decline of industrial production and real earnings in the course of 2012 in the Republika Srpska is evident, with an increase of the costs of living, while the unemployment remained the same as in the prior year, whereby the public and service sector recorded growth, and the real sector decline of the number of employees.

In these conditions the CIB strategy was directed to improvement of business relationship with targeted market segments. Clients who have been in the focus of our operations were the clients with the best performance indicators, then the largest importers and exporters, and public institutions and the RS Government.

With such a strategy, Corporate banking resulted in significantly larger volumes, both in the part of loans and in the part of deposits. At the end of 2012 the loan volume was increased by 41 % as compared to the end of previous year, while the deposit volume in the same period grew by 33 %. In addition to that higher level of payment transactions was recorded as well and also the larger number of other products and services users.

Higher commitment to targeted clients has been evident also through significantly improved satisfaction index of Corporate and Investment Banking customers.

In the following period, in addition to focus on the market segments specified earlier, we will intensify the business relationship also with customers who are participating in the largest projects in the RS. The advantage that we have in relation to the competitive banks is based on young staff ready to improve own knowledge and skills, specialist know how that can be transferred from the Group, but also on possibilities to participate in financing of the largest projects in cooperation with other CIB teams from the Group in the Central and Eastern Europe.

Risk Management

In 2012 the Bank achieved a significant growth in loan volume and thus provided continuity of development and extension of the positive trend from the previous year. In addition to that there was a growth of restructured and work out loans in all business segments in 2012.

The growth of this part of portfolio was due to further deepening and consequences of the economic crisis the Republika Srpska has found itself in the past number years. The small business segment has been especially affected, primarily due to a lack of liquidity, and also due to lack of economic and financial strength to fight with the negative effects of the crisis and inability to amortise negative effects through newly created volume.

In contrast to the Small business segment, Corporate banking segment realised a significant growth of loan volume and annulled the growth of restructured and workout placements thereby and consequently improved the parameters that are used to measure the assets quality, while the retail banking segment compensated the major part of restructured and workout loans growth through intensive collection activities.

However, in spite of non-performing loans growth, their share in the total Bank portfolio is still lower compared to the banking sector in the Republika Srpska and in comparison to the previous business year.

The specified is the result of adequate management of the entire credit process and built risk culture in the previous period.

In order to maintain and further improve the quality, structure and stability of the loan portfolio in the following period, in the current year the Bank undertook a set of measures and implementation of tools which would provide further creation and improvement of the actual credit process. Collateral management function has been established as well which is supposed to provide better assessment of the security instruments quality and consequently to prevent the development of bad scenarios with the negative effects on the profit or loss of the Bank.

In the area of market risk and liquidity risk management there was a technological and methodological improvement as compared to the previous year. In addition to development and implementation of those risks measurement in compliance with the Group frequency, the Bank has been constantly implementing activities on improvement of data quality and business processes in this domain.

With further improvement of operating risk management system, losses due to operating risks are still on the lower level in comparison to the previous years and in relation to the defined operating risk limit, which is also the result of internal controls improvement, improvement of processes as well as risk transfer to insurance providers.

Expectations in 2013

Unfavourable trends, caused by world economic-financial crisis had an additional negative influence on the economic trend and general macroeconomic environment in the Republika Srpska and Bosnia and Herzegovina in the previous years, thereby making the year 2013 another challenging and difficult year, both for the banking sector and for the entire economy, and the recovery of the local economy sluggish and gradual.

Even though the environment is such, bearing in mind a good starting point, made by successful business results made in the previous two years, we expect that also in 2013 we will keep stability in operations and initiated positive trends in the most important segments of business operations. The achievement of these objectives will be contributed by the implementation of several already started projects, which should be finalised by the end of 2013, and which relate to the following:

- Improvement of customer business relationship in the sense of Bank's transformation from traditional transaction to modern financial operating system, completely oriented towards the customers and
- improvement of internal processes and reporting to domestic competent institutions and UniCredit Group.

At the very end, I would like to thank on my personal behalf and on behalf of the Bank Management to all employees of UniCredit Bank Banja Luka, who provided a key contribution to the achievement of excellent business results in 2012 with their professionalism and commitment. I would also like to thank to our clients and business partners, as well as members of the Supervisory Board and the Audit Committee whose support has been of a great importance for our business success of the previous year.

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 for issue to the Supervisory Board at the Management Board meeting held on 13 February 2013, and are signed below to acknowledge this by:

For and on behalf of the Management Board

Ivan Vlaho

Director(CEO)

UniCredit Bank a.d. Banja Luka

Ljubiša Tešić
Executive Director for Finance Management (CFO)

This version of our report is a translation from the original, which was prepared in the 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.

Independent Auditor's report to the shareholders of 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 2012, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Board 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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Independent Auditor's report to the shareholders of 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 2012, 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,***
podružnica Banja Luka
Registered Auditors
Jovana Dučića 13
78 000 Banja Luka
Bosna i Hercegovina

13 February 2013

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

D.O.O. ZA REVIZIJU
KPMG B-H
PODRUŽNICA BANJA LUKA

Manal Bećirbegović
Executive Director

Domagoj Hrkać
Authorised auditor

Licence number: 3070462100

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Statement of comprehensive income
For the year

	Note	2012 BAM '000	2011 BAM '000
Interest income	6	49,959	41,504
Interest expense	7	(10,003)	(9,685)
Net interest income		**39,956**	**31,819**
Fee and commission income	8	13,678	13,237
Fee and commission expense	9	(1,108)	(981)
Net fee and commission income		**12,570**	**12,256**
Net gains from financial instruments at fair value through profit or loss and foreign exchange differences from translation of monetary assets and liabilities	10	183	167
Other operating income		-	26
Net gains from investment securities	11	-	35
Total operating income		**52,709**	**44,303**
Personnel expenses	12	(13,522)	(13,141)
Depreciation and amortisation	22,23	(4,476)	(5,915)
Other expenses	13	(10,850)	(10,289)
Total operating expenses		**(28,848)**	**(29,345)**
Profit before impairment and provisions		**23,861**	**14,958**
Net impairment losses and provisions for credit risk	14	(7,135)	(5,541)
Provisions for risks and charges	15	(333)	(45)
Impairment losses on property and equipment	22	(919)	-
Profit before tax		**15,474**	**9,372**
Income tax expense	16	(1,634)	(1,171)
Profit for the year		**13,840**	**8,201**
Other comprehensive income			
Net change in fair value reserves		69	(127)
Total comprehensive income for the year		**13,909**	**8,074**
Basic and diluted earnings per share (in BAM)	31	118.07	79.67

The notes set out on pages 13 to 79 form an integral part of these financial statements

Statement of financial position
As at 31 December

	Note	2012 BAM '000	2011 BAM '000
Assets			
Cash reserves	*17*	47,177	22,012
Obligatory reserve with the Central Bank	*18*	36,854	32,216
Loans and receivables from banks	*19*	135,765	38,128
Financial assets available for sale	*21a*	55,728	47,611
Financial assets at fair value through profit or loss	*21c*	-	-
Loans and receivables from customers	*20*	607,855	534,460
Financial assets held to maturity	*21b*	170	200
Property and equipment	*22*	17,839	19,093
Intangible assets	*23*	4,658	5,329
Accrued interest and other assets	*24*	5,593	4,574
Deferred tax assets	*29*	19	19
Total assets		**911,658**	**703,642**
Liabilities			
Deposits and loans from banks	*25*	289,399	194,687
Deposits and loans from customers	*26*	482,805	397,581
Financial liabilities at fair value through profit or loss	*21c*	-	-
Accrued interest and other liabilities	*27*	24,544	9,864
Provisions for liabilities and charges	*28*	1,473	1,597
Income tax liability		354	735
Deferred tax liability	*29*	243	247
Total liabilities		**798,818**	**604,711**
Equity			
Issued share capital	*30*	82,055	82,055
Share premium		373	373
Regulatory reserve for credit losses		9,288	5,861
Fair value reserve		(72)	(141)
Legal reserve		5,161	387
Revaluation reserve		-	2,195
Retained earnings (brought forward)		2,195	-
Net profit for the year (undistributed)		13,840	8,201
Total equity		**112,840**	**98,931**
Total liabilities and equity		**911,658**	**703,642**

The notes set out on pages 13 to 79 form an integral part of these financial statements

Statement of changes in equity
For the year

	Issued share capital	Share premium	Regulatory reserve for credit losses	Fair value reserve	Legal reserve	Revaluation reserve	Retained earnings	Profit for the year	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Balance as at 1 January 2012	**82,055**	**373**	**5,861**	**(141)**	**387**	**2,195**	**-**	**8,201**	**98,931**
Transfers between reserves	-	-	3,427	-	4,774	**(2,195)**	2,195	(8,201)	-
Net profit for the year	-	-	-	-	-	**-**	-	13,840	**13,840**
Other comprehensive income									
Net loss from change in fair value of financial assets available for sale	-	-	-	76	-	**-**	-	-	**76**
Deferred tax (Note 29)	-	-	-	(7)	-	**-**	-	-	**(7)**
Total other comprehensive income	-	-	-	*69*	-	**-**	-	-	***69***
Total comprehensive income	-	-	-	69	-	**-**		13,840	**13,909**
Balance as at 31 December 31 2012	**82,055**	**373**	**9,288**	**(72)**	**5,161**	**-**	**2,195**	**13,840**	**112,840**

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 in the amount of BAM 12,007 thousand at 31 December 2012 (2011: BAM 9,288 thousand). The shortfall of BAM 2,719 thousand (2010: BAM 3,427 thousand) is intended to be made up by a transfer from current year profit to be proposed for adoption by shareholders in general meeting.

The Bank has reassessed treatment and classification revaluation reserve and decided to transfer outstanding amount of revaluation reserve to retained earnings.

The notes set out on pages 13 to 79 form an integral part of these financial statements

Statement of changes in equity (continued)
For the year

	Issued share capital	Share premium	Regulatory reserve for credit losses	Fair value reserve	Legal reserve	Revaluation 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**	**(14)**	**2,374**	**2,195**	**378**	**70,856**
Issue of share capital	20,001	-	-	-	-	-	-	**20,001**
Transfer between reserves	-	-	2,365	-	(1,987)	-	(378)	**-**
Net profit for the year	-	-	-	-	-	-	8,201	**8,201**
Other comprehensive income								
Net gain from change in fair value of financial assets available for sale	-	-	-	(141)	-	-	-	**(141)**
Deferred tax (Note 29)	-	-	-	14	-	-	-	**14**
Total other comprehensive income	-	-	-	*(127)*	-	-	-	***(127)***
Total comprehensive income	-	-	-	(127)	-	-	8,201	**8,074**
Balance as at 31 December 2011	**82,055**	**373**	**5,861**	**(141)**	**387**	**2,195**	**8,201**	**98,931**

During 2011, shortfall of BAM 2,365 thousand in the amount of the regulatory reserve estimated by the Bank as required to be held at 31 December 2010 was transferred from the legal reserve and from the profit for 2010.

Statement of cash flows

For the year

	Note	2012 BAM '000	2011 BAM '000
Cash flow from operating activities			
Profit before tax		**15,474**	**9,372**
Adjustments:			
- depreciation and amortisation	*22,23*	4,476	5,915
- net impairment losses and provisions for credit risks	*14*	7,135	5,542
- net increases provisions for liabilities and charges	*15*	333	45
- net foreign exchange gain	*10*	(183)	(167)
- gain from sale of equipment		-	(56)
- impairment of property and equipment	*22*	919	-
Changes in operating assets and liabilities			
Increase in placements with and loans to other banks		(97,637)	(7,646)
Increase in loans to customers		(80,661)	(118,504)
(Increase) / decrease in accrued interest and other assets		(1,019)	2,111
(Increase) / decrease in obligatory reserve with Central Bank		(4,638)	15,758
Increase in deposits from banks		94,712	122,258
Increase / (decrease) in deposits from customers		85,224	(26,323)
Increase in other liabilities		14,680	3,091
Net cash inflow from operating activities before tax		**38,815**	**11,396**
Income taxes paid		(2,015)	(737)
Net cash inflow from operating activities		**36,800**	**10,659**
Cash flow from investing activities			
Purchase of property, equipment and intangible assets	*22,23*	(3,472)	(1,748)
Increase in financial assets available for sale		(8,193)	(47,149)
Decrease / (increase) of financial assets held to maturity		30	(200)
Increase in share capital		-	20,001
Net cash outflow from investment activities		**(11,635)**	**(29,096)**
Net increase / (decrease) in cash and cash equivalents		**25,165**	**(18,437)**
Cash and cash equivalents at the beginning of the year	*17*	**22,012**	**40,449**
Cash and cash equivalents at the end of the year	*17*	**47,177**	**22,012**

The notes set out on pages 13 to 79 form an integral part of these financial statements

Notes to financial statements

1. Reporting entity

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

As at 31 December 2012, the Bank consisted of the Head Office in Banja Luka registered at Marije Bursac 7, 35 branch offices and 3 agencies (31 December 2011: 37 branch offices and 7 agencies).

As at 31 December 2012 the Bank had 426 employees (2011: 443 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 of the Bank for 2012 were authorised for issue by the Management Board on 13 February 2013 for approval by the Supervisory Board.

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.

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. Influence of debt crisis

Despite certain improvements, weaknesses in the global economy continued in 2012.

The weak global economy influenced economic events in Republika Srpska. Based on reported macroeconomic indicators, it is evident that during the first 3 quarters of 2012 Republika Srpska recorded a decrease in economic activity compared to the same period in the prior year, which differs from the general European and global trends that are showing signs of an economic recovery. In 2011, the quarterly rates of real GDP growth were reported at 1.4%; 1.1%; 0.8% and 0.0%, which shows that the growth of GDP slowed down in 2011. In the first and second quarters of 2012 GDP growth was recorded as negative with rates of 0.9% and 0.3% respectively, compared to the same periods in 2011.

Notes to financial statements (continued)

2. Basis for preparation of the financial statements (continued)

2.4. Influence of debt crisis (continued)

At the same time, the EU reported real GDP growth rates in the first two quarters of 2012 of 0.1% and -0.3% respectively. Republika Srpska's main exporting markets reported real GDP growth rates for the second quarter of 2012 in comparison to the same period year before of: Serbia -0.6%, Italy -2.6%, Croatia -2.2,%, Austria 0.8%, Germany 1.0%, Slovenia -2.2%.

The analysis of quarterly GDP growth rates in these countries indicates a slowdown of real GDP growth in 2011, and that this trend continued in 2012 (except for Germany and Austria). The data indicates that the economic movements of those countries significantly influence the economic movements in Republika Srpska.

Republika Srpska recorded an average inflation rate of 3.9% in 2011. During 2012 the inflation trends stabilised and in September the reported inflation was 2.0% with the estimated annual inflation rate for 2012 of 2.1%, while the projection for 2013 is 1.9%.

The share of Republika Srpska public debt in the GDP has increased from 39.8% in 2009 to 41.2% 2011. Projections for 2012 and 2013 are 44.1% and 45.6% respectively. According to the Maastricht criteria, defining the EU membership conditions, public debt should not exceed 60% of GDP.

Although the banking and financial sector of Republika Srpska and Bosnia and Herzegovina as a whole did not recorded significant losses at the beginning of the crisis due to the underdevelopment of the financial and capital market, negative impacts are visible through lack of funding available and an increase in financing costs on foreign markets, lower inflow of foreign remittances to private individuals, liquidity issues, etc.

The above mentioned effects will influence the economy and the level of banking operations. This means that, in the next period, banks will be more focused on self-sustainability, with a balanced growth of deposit-taking and credit activities, and a more prudent approach when assuming banking risks. The 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, and a decrease of the deposit basis, while, on the other hand, it can positively influence the liquidity of the corporate sector.

Furthermore, a prolonged debt crisis can have an adverse effect on real estate market and the valuations of assets used as collateral for loans and thereby generate further impact on impairment losses.

Influence on liquidity

During 2012 the Bank had no liquidity issues.

Influence on the customers

The Bank places great importance on the lending function and maintains a careful investment policy in order to decrease the credit risk. The Bank regularly monitors individual loan loss provisions depending to the type of loans or receivables. Although the influence and the length of the financial crisis cannot be foreseen, the Bank has implemented certain activities in order to monitor the quality of the existing customer portfolio, as well as risk management and monitoring.

2.5. 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 BAM 1 = EUR 0.51129 EUR, which prevailed throughout 2012 and 2011.

Notes to financial statements (continued)

3. Significant accounting policies

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

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, 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.

Interest income and expense recognised in profit or loss include:

- Interest on financial assets and financial liabilities that are measured at amortised cost calculated using the effective interest rate method.
- Interest on debt securities available for sale calculated using the effective interest rate method.

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 or loss, 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 or loss and foreign exchange differences from translation of monetary assets and liabilities, include non-realised and realised 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 realised 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.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

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 of 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 and any adjustments to tax payable in respect of previous years, in accordance with tax legislation of Republika Srpska.

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.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

3.6. Financial instruments (continued)

Financial assets and financial liabilities at fair value through profit or loss include derivative financial instruments classified as financial instruments held for trading.

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.

Financial assets available for sale, financial assets held to maturity and financial assets and liabilities at fair value through profit or loss are recognised on the trade date.

Financial assets are initially recognised at fair value through profit or loss including, for financial assets and financial liabilities that are not classified as fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset.

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.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

3.6. Financial instruments (continued)

Recognition of gains and losses on subsequent measurement of financial instruments

Interest accrued using effective interest rate is recognised in profit or loss.

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 profit or loss.

Gains and losses arising from changes in the fair value of available-for-sale monetary assets are recognised directly in other comprehensive income, until the end of recognition or permanent impairment of these financial assets when the corresponding amount of the accumulated effect of change in fair market value, previously recognised in other comprehensive income, is transferred 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.

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.

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 reported (“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 the Banking Agency of Republika Srpska (“BARS”) regulations for the purpose of determining reserve requirements within equity (se below). Loans, placements and other financial assets of the Bank are classified into categories prescribed by 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 specific provisions for potential losses (regulatory reserve for credit losses) is calculated applying percentages prescribed by BARS. Generic provisions are calculated at the rate of 2% according to those regulations.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

3.6. Financial instruments (continued)

1) Loans and receivables (continued)

If the provisions calculated in accordance with BARS regulations are higher than the impairment allowances calculated in compliance with the IFRS and the balance on regulatory reserves within equity brought forward from the previous year end, that difference represents the shortfall in the regulatory reserve requirement for credit losses to be covered, in the following year, by the allocation of current year profit or other unallocated profits, retained earnings, legal reserve or any other reserve formed from profit.

Transfers to regulatory reserves are made directly within equity upon the approval by the shareholders in the general meeting, in compliance with BARS instructions.

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 other comprehensive income and recognised in profit or loss.

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. However, any additional increase of the fair value of debt instruments available for sale, whose value was previously impaired, is recognised directly in other 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 realised, 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.

The fair value of sovereign debt securities classified as available for sale traded on an active market is based on closing bid prices at the reporting date for these securities. If the market for a financial asset is not active, the Bank establishes fair value by using valuation techniques.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

3.6. Financial instruments (continued)

Specific instruments

a) Financial derivatives

The Bank uses derivative financial instruments to hedge economically its exposure to foreign exchange and interest rate risks arising from operating, financing and investing activities. The Bank does not hold or issue derivative financial instruments for speculative trading purposes. All derivatives are classified as financial instruments at fair value through profit or loss.

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

Current accounts with other banks, 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.

d) Loans to customers

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

e) Equity securities

Equity securities are classified as available-for-sale financial assets 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 were 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 and subsequently these are stated at amortised cost on an effective interest rate basis.

i) Financial guarantees and loan commitments

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable).

Notes to financial statements (continued)

3. Significant accounting policies (continued)

3.6. Financial instruments (continued)

i) Financial guarantees and loan commitments

Loan commitments are firm commitments to provide credit under pre-specified terms and conditions.

Offsetting of financial instruments

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

Income and expenses are presented on a net basis only when permitted by the accounting regulations, or for gains and losses arising from a group of similar transactions such as within the Bank's trading activity.

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 and equipment is presented at historical or assumed purchase cost less accumulated depreciation and impairment losses. The historical cost includes the costs directly related with property acquiring.

Equipment is measured at the purchase value less accumulated depreciation and property 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.

(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:

	2012	**2011**
Buildings	2% - 5%	1.3% -1.5%
Office furniture and equipment	12.5% - 20%	12.5% - 20%
Electronic equipment	15.5% - 25%	15.5% - 25%
Other	12.5% - 25%	12.5% - 25%
Leasehold improvements	20%	depending on the lease period

In 2012 the bank has changed the estimated useful life of buildings and leasehold improvements, and performed the classification of equipment according to the specified groups. The Bank has accounted for this change in estimate prospectively. The effect of changes on the statement of financial position and statement of comprehensive income are explained in Note 4e.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

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:

	2012	**2011**
Intangible investment – software and licences	13% - 20%	11,67%-16,67%

In 2012 the bank has changed the estimated useful life of assets. The Bank has accounted for this change in estimate prospectively. 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 in progress 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.

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.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

3.11. 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, upon allocation of profit according to the annual accounts, joint stock companies in Republika Srpska are required to allocate a minimum of 5% of their annual profit to statutory reserves, until the amount of such reserves reaches the level of 10% of the joint stock company's share capital. The Law has not defined the deadline until which the joint stock companies were supposed to form the amount of reserves of at least 10% of the 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, if provision calculated in accordance with BARS is higher.

The balance of regulatory reserves at the reporting date represents the amount by which the impairment losses calculated in accordance with BARS were higher than estimated in accordance with IFRS in previous periods. The shortfall in regulatory reserves incurred as the result of the current business period is allocated after the reporting date, based on the decision of Bank's shareholders, and is recognised and is recognised as movement within equity when such decision is made.

Fair value reserve

The fair value reserve represents the change in the fair value of financial assets available for sale, net of related deferred tax.

Dividends

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

Retained earnings and revaluation reserves

Retained earnings comprise profits not otherwise allocated or appropriated and in 2012 include profits transferred from previously required revaluation reserves no longer required.

3.12. 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.

3.13. 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.

Notes to financial statements (continued)

3. Significant accounting policies (continued)

3.14. Segment reporting

A business segment represents a part of assets, liabilities 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 three main segments: Retail, Corporate and Investment Banking and Other.

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).

3.15. Employee benefits

a) *Employee salaries*

Gross salary costs and mandatory social security contributions are charged to profit or loss as incurred. For defined contribution plans, the Bank pays contributions to obligatory pension funds managed by state-owned management companies. These contributions are recognised as personnel costs in profit or loss as they accrue.

b) *Jubilee awards*

The Bank pays out jubilee awards to its employees. The liabilities thereof 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 modelled 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) *Retirement bonuses*

In accordance with internal regulations on salaries, the Bank pays retirement bonuses 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 retirement bonuses 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 modelled interest rate, which is more adequate in existing market conditions than the interest rate on state long-term debt securities.

3.16. Dividend income

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

3.17. Earnings per share

The Bank publishes basic and diluted earnings per share (EPS) data. Basic EPS are calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period.

3.18. 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.

Notes to financial statements (continued)

3. Significant accounting policies (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 2012, 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 and International Accounting Standards Board has an active project with certain changes related to classification and measurement as well as inclusion of certain new requirements related to impairment and hedge accounting), 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.

IFRS 13 *Fair Value Measurement*, which is effective prospectively for annual periods beginning on or after 1 January 2013, replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. IFRS 13 explains 'how' to measure fair value when it is required or permitted by other IFRSs. The Bank will adopt IFRS 13 from 1 January 2013 and does not expect that the new Standard will have significant impact on the financial statements.

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 20) and as provisions for liabilities and charges arising from off-balance sheet exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 27).

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, and 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 judgements (continued)

a) Impairment losses on loans and receivables (continued)

	Note	2012 BAM '000	2011 BAM '000
Summary of impairment allowances (IFRS)			
Impairment allowance for loans to customers	*20b*	47,654	44,660
Provisions for liabilities and charges	*27*	959	527
		48,613	**45,187**
Impairment allowance for interest and fee receivables		3,940	4,672
Impairment allowance for other assets	*24*	843	844
Impairment of available-for-sale financial assets		277	274
		53,673	**50,977**

In addition to impairment allowance calculated and recognised in accordance with IFRS, the Bank also calculates impairment in accordance with BARS regulations where the difference in relation to IFRS impairment is recognised as reserve for credit losses in the position of equity and reserves.

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

	2012 BAM '000	2011 BAM '000
Summary of impairment allowances (BARS)		
Impairment allowance for loans to customers	57,878	53,245
Provisions for liabilities and charges	2,305	1,277
	60,183	**54,522**
Impairment allowance for interest and fee	3,959	4,439
Impairment allowance for other assets	1,538	1,304
Total loans and receivables	**65,680**	**60,265**

Regulatory reserve for credit risk requirement as of 31 December:

	2012 BAM '000	2011 BAM '000
Impairment allowances under BARS	65,680	60,265
Impairment allowances under IFRS	53,673	50,977
Shortfall at period end	12,007	9,288
Shortfall at previous period end	(9,288)	(5,861)
Required additional provisions	**2,719**	**3,427**

The shortfall in regulatory reserve for credit losses at 31 December 2012 amounts to BAM 2,719 thousand which will be covered from unallocated current and prior period profit according to the decision of the General Assembly after the balance date, in order to meet the regulatory requirement.

Notes to financial statements (continued)

4. Significant accounting estimates and judgements (continued)

a) Impairment losses on loans and receivables (continued)

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.

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:

	2012 BAM '000			2011 BAM '000		
	Corporate	Retail	Total	Corporate	Retail	Total
Gross exposure	57,836	18,191	**76,027**	53,651	16,841	**70,492**
Impairment rate	39.8%	81.5%	**49.8%**	41.5%	82.0%	**51.2%**

An increase in the impairment rate of 1 percentage point of the gross non-performing exposure presented above as at 31 December 2012, would lead to the recognition of an additional impairment loss of BAM 760.3 thousand (2011: BAM 704.9 thousand).

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

The amount of IBNR as at 31 December 2012 assessed on a portfolio basis amounted to BAM 10,765 thousand (2011: BAM 9,079 thousand) of the relevant on and off-balance sheet exposure. Total IBNR provision amounted to 1.7% (2011: 1.7%) of net loans to customers and 1.5% (2011: 1.5%) 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 28, the Bank provided BAM 1,239 thousand (2011: BAM 1,080 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

For certain groups of property and equipment, and for intangible assets the Bank has changed the estimate of the expected useful life of those assets. The Bank has applied the new depreciation and amortisation rates resulting from such change with affect from 2012. If the Bank had applied depreciation rates as in 2011 depreciation expense in 2012 would be BAM 296 thousand lower than the cost reported in the financial statements, and 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 2011, as explained below. The stated changes do not affect the result and the net assets of the Bank.

Statement of financial position

- Provisions for jubilee awards in the amount of BAM 198 thousand included in “provision for liabilities and charges” (Note 28) have been reclassified to “accrued interest and other liabilities” (Note 27).

Statement of comprehensive income

- Change in provision for severance payments in the amount of BAM 45 thousand has been reclassified from “Personnel expenses” (Note 12) to “Provision for liabilities and charges” (Note 15).

Notes to financial statements (continued)

5. Financial information by segment

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

1. "Retail": individuals and small business
2. "Corporate and Investment Banking": large and mid-sized companies, state and public sector
3. "Other": capital and reserves, Assets and Liability Management, investments in other legal entities, other centralised services and other assets and liabilities not associated with other segments.

Segmental information is presented in accordance with management reports.

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

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

Statement of comprehensive income by segment

31 December 2012	**Retail BAM '000**	**Corporate and Investment Banking BAM '000**	**Other BAM '000**	**Total BAM '000**
Net interest income	22,841	10,007	7,108	39,956
Net fee and commission income	8,863	3,961	(254)	12,570
Net gains and losses from financial instruments at fair value through the profit or loss and foreign exchange differences from translation of monetary assets and liabilities	-	183	-	183
Total operating income	**31,704**	**14,151**	**6,854**	**52,709**
Operating expenses	(23,382)	(5,466)	-	(28,848)
Net impairment losses and provisions for credit risks	(3,311)	(3,819)	(5)	(7,135)
Provisions for risks and charges	-	-	(333)	(333)
Impairment losses on property and equipment	-	-	(919)	(919)
Segment result	**5,011**	**4,866**	**5,597**	**15,474**
Income tax	-	-	(1,634)	(1,634)
Net profit for the year	**5,011**	**4,866**	**3,963**	**13,840**

Notes to financial statements (continued)

5. Financial information by segment (continued)

31 December 2011	**Retail BAM ’000**	**Corporate and Investment Banking BAM ’000**	**Other BAM ’000**	**Total BAM ’000**
Net interest income	19,192	8,174	4,453	31,819
Net fee and commission income	8,334	4,361	(439)	12,256
Net gains and losses from financial instruments at fair value through the profit or loss and foreign exchange differences from translation of monetary assets and liabilities	(1)	168	-	167
Net gains from financial assets available for sale and other income	-	-	61	61
Total operating income	**27,525**	**12,703**	**4,075**	**44,303**
Operating expenses	(23,518)	(5,827)	-	(29,345)
Net impairment losses and provisions for credit risks	(4,578)	(963)	-	(5,541)
Provisions for risks and charges	-	-	(45)	(45)
Segment result	**(571)**	**5,913**	**4,030**	**9,372**
Income tax	-	-	(1,171)	(1,171)
Net profit for the year	**(571)**	**5,913**	**2,859**	**8,201**

Notes to financial statements (continued)

5. Financial information by segment (continued)

Statement of financial position by segments

31 December 2012	**Retail BAM '000**	**Corporate and Investment Banking BAM '000**	**Other BAM '000**	**Total BAM '000**
Assets by segments	330.508	323.337	257.420	911.265
Equity shareholdings	-	-	374	374
Deferred tax assets	-	-	19	19
Total assets	**330.508**	**323.337**	**257.813**	**911.658**
Liabilities by segments	220.496	262.238	428.327	911.061
Deferred and current tax liabilities	-	-	597	597
Total liabilities and equity	**220.496**	**262.238**	**428.924**	**911.658**

31 December 2011	**Retail BAM '000**	**Corporate and Investment Banking BAM '000**	**Other BAM '000**	**Total BAM '000**
Assets by segments	338,424	241,377	123,443	703,244
Equity shareholdings	-	-	379	379
Deferred tax assets	-	-	19	19
Total assets	**338,424**	**241,377**	**123,841**	**703,642**
Liabilities by segments	205,701	191,496	306,198	703,395
Deferred and current tax liabilities	-	-	247	247
Total liabilities and equity	**205.701**	**191.496**	**306.445**	**703.642**

Notes to financial statements (continued)

6. Interest income

a) Analysis by source:

	2012 BAM ’000	2011 BAM ’000
Retail	27,441	26,237
Companies and entrepreneurs	15,174	12,620
Banks and banking institutions	160	507
Public sector	7,184	2,140
	49,959	**41,504**

b) Analysis by product

	2012 BAM ’000	2011 BAM ’000
Loans to customers	46,321	40,585
Placements with and loans to banks	135	203
Obligatory reserve with the Central Bank	25	261
Debt securities	3,478	455
	49,959	**41,504**

7. Interest expense

a) Analysis by recipient:

	2012 BAM ’000	2011 BAM ’000
Retail	2,842	3,185
Companies and entrepreneurs	2,274	2,346
Banks and other financial institutions	3,080	2,620
Public sector	925	936
Other organisations	882	598
	10,003	**9,685**

b) Analysis by product:

	2012 BAM ’000	2011 BAM ’000
Current accounts and deposits - retail	2,842	3,185
Borrowings	2,477	2,409
Current accounts and deposits - corporate	1,709	1,831
Current accounts and deposits - banks	2,093	1,662
Other	882	598
	10,003	**9,685**

Notes to financial statements (continued)

8. Fee and commission income

	2012 BAM '000	2011 BAM '000
Domestic payment transactions	4,647	4,333
Foreign payment transactions	1,423	1,546
Payment of foreign pensions and remittances of individuals	1,670	1,357
Guarantees and other sureties	1,077	1,385
Card operations	853	745
Loan fees	291	453
Foreign exchange spot trading gains and cash operations	2,423	2,894
Other	1,294	524
	13,678	**13,237**

9. Fee and commission expense

	2012 BAM '000	2011 BAM '000
Domestic payment transactions	192	153
Foreign payment transactions	67	61
Guarantees and letters of credit	16	26
Card operations	506	523
Cash operations	298	109
Loan fees	24	41
Other	5	68
	1,108	**981**

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

	2012 BAM '000	2011 BAM '000
Positive unrealised foreign exchange differences	36,802	31,593
Negative unrealised foreign exchange differences	(36,619)	(31,426)
Net gains/losses from financial instruments at fair value	-	-
	183	**167**

Notes to financial statements (continued)

11. Net gains from investment securities

	2012 BAM '000	2011 BAM '000
Net gains from financial assets available for sale	-	35

12. Personnel expenses

	2012 BAM '000	2011 BAM '000
Net salaries	6,437	6,564
Contributions on salaries and benefits	3,691	3,712
Taxes on salaries and benefits	744	731
Other personnel expenses	2,650	2,134
Total personnel expenses	**13,522**	**13,141**

Personnel expenses include contributions for pension and disability insurance paid in 2012 in the amount of BAM 2,320 thousand (2011: BAM 2,013 thousand).

13. Other expenses

	2012 BAM '000	2011 BAM '000
Materials	1,117	967
Services related expense	2,662	2,908
Insurance, maintenance and advisory expenses	6,160	5,674
Other taxes and contributions	776	662
Other operating expenses	135	78
	10,850	**10,289**

14. Net impairment losses and provisions for credit risk

	2012 BAM '000	2011 BAM '000
Loans and receivables from customers (Note 20)	6,704	5,558
Other assets (Note 24)	(1)	26
Off-balance sheet exposures (Note 27)	432	(43)
	7,135	**5,541**

Notes to financial statements (continued)

15. Provisions for risks and charges

	2012 BAM ’000	2011 BAM ’000
Retirement bonuses (Note 28)	-	45
Court cases (Note 28)	333	-
	333	**45**

16. Income tax

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

a) Income tax expense recognised in the income statement

	2012 BAM ’000	2011 BAM ’000
Current income tax	1,634	1,282
Deferred income tax, net (Note 29)	-	(111)
Total	**1,634**	**1,171**

b) Reconciliation of income tax expense

	2012 BAM ’000	2011 BAM ’000
Profit before tax	15,474	9,372
Income tax at rate of 10%	1,547	937
Income not subject to tay	(415)	(106)
Impairment losses on loans and other assets and other expenses not deductible for tax purposes	829	596
Incremental effect of impairment losses on loans and other assets deductible for tax purposes at 20% of the adjusted tax base	(327)	(256)
Income tax expense	**1,634**	**1,171**
Average effective income tax rate	**10.6%**	**12.5%**

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.

Tax liabilities are recognised in accordance with the tax return prepared by the Bank. However, the tax position of the Bank is subject to subsequent inspection by the tax authorities in the five year period following the year for which the tax return was issued. The Bank's Management Board is not aware of any circumstances, which may give rise to a potential material liability in this respect.

Notes to financial statements (continued)

17. Cash reserves

	2012 BAM '000	2011 BAM '000
Cash in domestic currency	8,608	7,210
Funds with the Central Bank – giro account	34,570	10,024
Cash in foreign currency	3,999	4,778
	47,177	**22,012**

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

18. Obligatory reserve with the Central Bank

	2012 BAM '000	2011 BAM '000
Obligatory reserve with the Central Bank in domestic currency	**36,854**	**32,216**

The Central Bank of Bosnia and Herzegovina (the "Central Bank") has prescribed a method for calculating and holding obligatory reserves, 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% 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 reserves 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 2012 this rate ranged from 0.004% to 0.08%);

- 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 0.005% to 0.11%).

19. Loans and receivables from banks

	2012 BAM '000	2011 BAM '000
- foreign banks	132,824	38,126
- domestic banks	2,941	2
	135,765	**38,128**

Loans to and receivables from banks include BAM 77,472 thousand (2011: BAM 36,960 thousand) of loans to and receivables from related banks.

Notes to financial statements (continued)

20. Loans and receivables from customers

a) Analysis by product

	2012 BAM '000	2011 BAM '000
Corporate		
- in BAM	149,976	136,739
- in foreign currency	93,085	123,667
- with foreign currency clause	102,935	13,804
Total gross	**345,996**	**274,210**
Impairment allowance	(25,559)	(23,668)
	320,437	**250,542**
Retail		
- in BAM	105,335	129,724
- in foreign currency	102	111
- with foreign currency clause	206,616	177,741
Total gross	**312,053**	**307,576**
Impairment allowance	(22,095)	(20,992)
	289,958	**286,584**
Net loans	**610,395**	**537,126**
Due interest receivables	1,370	1,600
Deferred fee income	(3,910)	(4,266)
Loans and receivables from customers	**607,855**	**534,460**

b) Movement in impairment allowance

	Loans to corporate BAM '000	Loans to retail BAM '000	Total loans BAM '000
Balance as at 1 January 2011	**20,596**	**19,139**	**39,735**
Net loss recognised in the profit or loss (Note 14)	3,697	1,861	**5,558**
Write offs	(625)	(8)	**(633)**
Balance as at 31 December 2011	**23,668**	**20,992**	**44,660**
Net loss recognised in the profit or loss (Note 14)	5,523	1,181	**6,704**
Write offs	(3,632)	(78)	**(3,710)**
Balance as at 31 December 2012	**25,559**	**22,095**	**47,654**

Notes to financial statements (continued)

20. Loans and receivables from customers

c) Geographic concentration of credit risk

Credit risk relates entirely to companies, individuals and other entities located in Bosnia and Herzegovina.

d) Concentration of credit risk by industry

he Bank's loan portfolio as at 31 December 2012 is analysed by industry in the table below:

	2012 BAM '000	2011 BAM '000
Loans to corporate		
Mining and energy	3,522	12,913
Agriculture	16,767	19,559
Civil engineering	20,797	16,522
Industry	50,136	48,576
Trade	132,998	140,338
Services	3,210	1,594
Transport	8,767	9,757
Finance	1,173	1,450
Other (including Government and local authorities)	108,626	23,501
	345,996	**274,210**
Retail loans	312,053	307,576
Total gross loans	**658,049**	**581,786**
Impairment allowance	(47,654)	(44,660)
Total net loans	**610,395**	**537,126**

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.

Notes to financial statements (continued)

21. Financial assets

21. a) Financial assets available for sale

	2012 BAM '000	2011 BAM '000
Equity securities, quoted		
Dunav osiguranje a.d. Banja Luka	15	19
Krajina Osiguranje d.d. Banja Luka	13	14
Debt securities, quoted		
Bonds of the Municipality of Šamac	10	10
RS bonds issued by public offer	45,811	45,130
RS for verified frozen FX savings	4,598	2,092
RS Ministry of Finance Treasury Bills	4,935	-
Total quoted securities	**55,382**	**47,265**
Equity securities, unquoted		
Banja Luka Stock Exchange a.d., Banja Luka	237	237
Central Registry of Securities	101	101
SWIFT	8	8
Total unquoted securities	**346**	**346**
Total financial assets available for sale	**55,728**	**47,611**

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

Other than for unquoted equity securities carried at cost 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 (e.g. prices) or indirectly (e.g. 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.

Notes to financial statements (continued)

21. Financial assets (continued)

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

31 December 2012	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	-	45,811	-	**45,811**
RS for verified old FX savings	-	4,598	-	**4,598**
RS Ministry of Finance Treasury Bills	-	4,935	-	**4,935**
Total	**-**	**55.344**	**10**	**55.354**
31 December 2011				
Bonds of the Municipality of Šamac	-	-	10	**10**
RS bonds issued by public offer	-	45,130	-	**45,130**
RS for verified frozen FX savings	-	2,092	-	**2,092**
Total	**-**	**47,222**	**10**	**47,232**

During 2012, as well as in the previous year, there was no migration of financial assets available for sale between levels of fair value measurement.

External rating of debt securities

Debt securities are rated as B+/B- in accordance to Standard & Poor’s credit agency ratings.

21. b) Financial assets held to maturity

	2012 BAM ’000	2011 BAM ’000
Bonds of Atlantik doo Banja Luka, quoted	170	200
Total financial assets held to maturity	**170**	**200**

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

	2012 **BAM ’000** Nominal value	**2012** **BAM ’000** Fair value	**2011** **BAM ’000** Nominal value	**2011** **BAM ’000** Fair value
Currency swaps	113,964	-	26,757	-

Currency swaps refer to BAM/EUR transactions whose fair value, given the fixed rate under the currency board, amounts to zero (2011: -).

Notes to financial statements (continued)

22. Property and equipment

	Land and buildings BAM '000	Equipment and other assets BAM '000	Leasehold improvements BAM '000	Assets acquired but not brought into use BAM '000	Total BAM '000
Cost or valuation					
Balance as at 1 January 2012	26.640	16.157	1.645	317	44.759
Additions	-	-	-	2,004	2,004
Transfers	27	1,864	-	(1,891)	-
Disposals and write-offs	(219)	(886)	(5)	-	(1,110)
Balance as at 31 December 2012	**26,448**	**17,135**	**1,640**	**430**	**45,653**
Depreciation					
Balance as at 1 January 2012	10,866	13,416	1,384	-	25,666
Depreciation	303	1,892	159	-	2,354
Impairment of assets	757	82	80	-	919
Disposals and write-offs	(238)	(881)	(6)	-	(1,125)
Balance as at 31 December 2012	**11,688**	**14,509**	**1,617**	**-**	**27,814**
Net carrying amount:					
Balance as at 1 January 2012	**15,774**	**2,741**	**261**	**317**	**19,093**
Balance as at 31 December 2012	**14,760**	**2,626**	**23**	**430**	**17,839**

Assets acquired but not brought into use as of 31 December 2012 in the amount of BAM 430 thousand represent equipment not yet been brought into use.

During 2012 the Bank recognised an impairment loss on assets within property and equipment in the total amount of BAM 919 thousand. The impairment expense is presented as Impairment losses on property and equipment on profit or loss.

During the year, there were no capitalised borrowing costs related to the acquisition of property and equipment.

Property and equipment are not pledged as collateral for any borrowings.

Notes to financial statements (continued)

22. Property and equipment (continued)

	Land and buildings BAM '000	Equipment and other assets BAM '000	Leasehold improvements BAM '000	Assets acquired but not brought into use 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
Transfers	-	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 acquired but not brought into use as of 31 December 2011 in the amount of BAM 317 thousand represent equipment not yet been brought into use.

During the year, there were no capitalised borrowing costs related to the acquisition of property and equipment.

Property and equipment are not pledged as collateral for any borrowings.

Notes to financial statements (continued)

23. Intangible assets

	Software BAM '000	Other BAM '000	Assets acquired but not brought into use BAM '000	Total BAM '000
Cost				
Balance as at 1 January 2012	13,593	3,434	15	17,042
Additions	-	-	1,468	1,468
Transfers	201	498	(699)	-
Balance as at 31 December 2012	**13,794**	**3,932**	**784**	**18,510**
Amortisation				
Balance as at 1 January 2012	8,399	3,314	-	11,713
Amortisation	1,787	335	-	2,122
Disposals and write-offs	12	5	-	17
Balance as at 31 December 2012	**10,198**	**3,654**	**-**	**13,852**
Net carrying amount:				
Balance as at 1 January 2012	**5,194**	**120**	**15**	**5,329**
Balance as at 31 December 2012	**3,596**	**278**	**784**	**4,658**

Assets acquired but not brought into use as at 31 December 2012 in the amount of BAM 784 thousand relate to software and other intangible assets not yet put into use.

During the year, the Bank did not capitalise any borrowing costs related to acquisition of software.

At reporting date, the Bank did not have any internally generated intangible assets.

Notes to financial statements (continued)

23. Intangible assets (continued)

	Software BAM '000	Other BAM '000	Assets acquired but not brought into use BAM '000	Total BAM '000
Cost				
Balance as at 1 January 2011	12,835	2,948	202	15,985
Additions	-	319	738	1,057
Transfers	758	167	(925)	-
Balance as at 31 December 2011	**13,593**	**3,434**	**15**	**17,042**
Amortisation				
Balance as at 1 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:				
Balance as at 1 January 2011	**5,312**	**664**	**202**	**6,178**
Balance as at 31 December 2011	**5,194**	**120**	**15**	**5,329**

Assets acquired but not brought into use as at 31 December 2011 in the amount of BAM 15 thousand relate to software and other intangible assets not yet put into use.

During the year, the Bank did not capitalise any borrowing costs related to acquisition of software.

At reporting date, the Bank did not have any internally generated intangible assets.

Notes to financial statements (continued)

24. Accrued interest and other assets

	2012 BAM '000	2011 BAM '000
Accrued interest	498	490
Receivables for fees in local currency	117	115
Other receivables	5,821	4,813
Impairment allowance	(843)	(844)
Total accrued interest and other assets	**5,593**	**4,574**

Movement in impairment allowance for other assets:

	Total BAM '000
Balance as at 1 January 2011	**802**
Net loss recognised in profit or loss (Note 14)	26
Write-offs and transfers	16
Balance as at 31 December 2011	**844**
Net loss recognised in profit or loss (Note 14)	(1)
Write-offs and transfers	-
Balance as at 31 December 2012	**843**

Notes to financial statements (continued)

25. Deposits and loans from banks

	2012 BAM '000	2011 BAM '000
Demand deposits		
- in BAM	40	12
- in foreign currency	1	17
	41	**29**
Term deposits		
- in BAM	37,960	38,080
- in foreign currency	211,230	132,214
	249,190	**170,294**
Total deposits	**249,231**	**170,323**
Loans		
- Fund for Italian Participation in the Stabilisation, Reconstruction and Development of the Balkans - "MCI Fund"	760	817
- European Investment Bank	39,408	23,547
Total loans	**40,168**	**24,364**
Total deposits and loans from banks	**289,399**	**194,687**

Deposits and loans from banks include BAM 249,179 thousand due to related parties (2011: BAM 170,214 thousand).

Notes to financial statements (continued)

26. Deposits and loans from customers

	2012 BAM '000	2011 BAM '000
Corporate		
Demand deposits		
- in BAM	124,050	109,031
- in foreign currency	46,564	21,288
	170,614	**130,319**
Term deposits		
- in BAM	6,689	5,276
- with foreign currency clause	28,314	12,592
- in foreign currency	12,281	9,805
	47,284	**27,673**
Total corporate	**217,898**	**157,992**
Retail		
Demand deposits		
- in BAM	69,321	78,580
- in foreign currency	42,178	28,426
	111,499	**107,006**
Term deposits		
- in BAM	10,321	9,168
- with foreign currency clause	11	-
- in foreign currency	71,400	63,962
	81,732	**73,130**
Total retail	**193,231**	**180,136**
Total deposits	**411,129**	**338,128**
Loans from customers		
- IRB RS Housing Fund of Republika Srpska	30,537	29,808
- IRB RS Fund for the Development of the Eastern Part of RS	8,314	6,445
- IRB RS Development and Employment Fund	20,339	23,200
- IRB RS World Bank Funds	2,707	-
- Green for Growth Fund (GGF) Amsterdam	9,779	-
Total loans from customers	**71,676**	**59,453**
Total deposits and loans from customers	**482,805**	**397,581**

Deposits and loans from customers include BAM 360 thousand due to related parties (2011: BAM 513 thousand).

Notes to financial statements (continued)

27. Accrued interest and other liabilities

	2012 BAM '000	2011 BAM '000
Accrued interest	2,777	1,837
Liabilities to employees	1,343	780
Liabilities to suppliers	2,340	2,278
Provisions for off-balance-sheet contingent liabilities	959	527
Jubilee awards	198	198
Prepayments of share capital (Note 38)	15,000	-
Other liabilities	1,927	4,244
	24,544	**9,864**

Movement in provisions:

	Off-balance-sheet contingent liabilities BAM '000	Jubilee awards BAM '000	Total BAM '000
Balance as at 1 January 2011	570	143	713
Net (release)/charge recognised in profit or loss	(43)	32	(11)
Provisions used during the period and transfers	-	23	23
Balance as at 31 December 2011	**527**	**198**	**725**
Net charge recognised in profit or loss	432	-	432
Balance as at 31 December 2012	**959**	**198**	**1,157**

Charges and releases in provisions for off-balance-sheet exposures are recognised as net impairment losses and provisions for credit risks in profit or loss (Note 14) and for jubilee awards as personnel expenses (Note 12).

Notes to financial statements (continued)

28. Provisions for liabilities and charges

	2012 BAM '000	2011 BAM '000
Retirement bonuses	234	517
Court cases	1,239	1,080
	1,473	**1,597**

Movement in provisions

	Court cases BAM '000	Retirement bonuses BAM '000	Total BAM '000
Balance as at 1 January 2011	1,205	472	1,677
Net loss recognised in comprehensive income	-	45	45
Utilisation	(125)	-	(125)
Balance as at 31 December 2011	**1,080**	**517**	**1,597**
Net loss recognised in comprehensive income	333	-	333
Utilisation	(174)	(283)	(457)
Balance as at 31 December 2012	**1,239**	**234**	**1,473**

Provisions for liabilities and charges are recognised in comprehensive income as Provisions for risks and charges (Note 15).

29. Deferred tax asset and liabilities

Net deferred tax liability

Deferred taxes are calculated for temporary differences according to the balance sheet method using the effective tax rate of 10 % (2011: 10%), Changes in temporary differences and components of deferred tax liabilities are recognised in equity or in comprehensive income as follows:

	2012 BAM '000	2011 BAM '000
Deferred tax asset		
Fair value reserve	19	19
Deferred tax liabilities		
Fair value reserve	-	(3)
Reserves	(243)	(244)
Net deferred tax liabilities	**(224)**	**(228)**

Notes to financial statements (continued)

29. Deferred tax asset and liabilities (continued)

Movement in deferred tax is as follows:

	Deferred tax assets	Deferred tax liabilities	Net deferred tax liabilities
	BAM '000	BAM '000	BAM '000
Balance as at 1 January 2011	**2**	**(355)**	**(353)**
Cancellation of deferred tax liabilities based on differences of amortisation rates in the profit or loss (Note 16a)	-	111	111
Changes in fair value of financial assets available for sale recognised in equity and reserves	17	(3)	14
Balance as at 31 December 2011	**19**	**(247)**	**(228)**
Balance as at 1 January 2012	**19**	**(247)**	**(228)**
Decrease in deferred tax liabilities	-	(3)	(3)
Changes in fair value of financial assets available for sale recognised in equity and reserves	-	7	7
Balance as at 31 December 2012	**19**	**(243)**	**(224)**

30. Share capital

	Ordinary shares BAM '000
Balance as at 1 January 2011	62,054
Increase of share capital through 8th issue of shares by private offer	20,001
Balance as at 31 December 2011	**82,055**
Balance as at 31 December 2012	**82,055**
Nominal value (BAM)	700
Number of shares	117,221

Notes to financial statements (continued)

30. Share capital (continued)

The shareholders of the Bank as at 31 December 2012 comprise 77 domestic and foreign legal entities and individuals. As of the report date there is only one shareholder holding more than 1% of the total shares:

	% of equity holding
UniCredit Bank Austria AG, Vienna	**97.85%**
Others	2.15%
	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 2012, members of Supervisory Board, Audit Committee and Management Board did not possess any shares in the Bank.

31. Earnings per share

	2012	**2011**
Total number of shares	117,221	117,221
Weighted average number of shares	117,221	102,935
Net profit in BAM 000	13,840	8,201
Basic and diluted earnings per share in BAM	118,07	79,67

32. Commitments and contingencies

	2012 BAM '000	**2011 BAM '000**
Performance guarantees:		
- in BAM	16,881	14,484
- in foreign currency	9,861	967
Other guarantees:		
- in BAM	8,494	6,721
- in foreign currency	3,858	2,725
Contingent liabilities based on unused loans and guarantees :		
- in BAM	59,253	36,156
- in foreign currency	25,020	13,961
Letters of credit in foreign currency	372	372
Other sureties	2,900	-
Total	**126,639**	**75,386**

As at 31 December 2012, impairment allowances in respect of commitments and contingencies amounted to BAM 959 thousand (2011: BAM 527 thousand). The movement in impairment allowances is presented in Note 27.

Notes to financial statements (continued)

33. Transactions with related parties

The Bank considers its directly related parties to be its majority shareholder and its affiliates, their subsidiaries; Supervisory Board members, Management Board members and other senior Bank managers (collectively „key management"); close family members of the key management and legal entities under the control or significant influence of the key management and their close family members.

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

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

	2012 BAM '000	2011 BAM '000
Assets:		
Current accounts:		
- UniCredit Bank Austria AG, Vienna	1,689	588
- UniCredit Bank Serbia A.D., Belgrade	19	2
- Zagrebačka banka d.d., Zagreb	1,148	345
- Hypo Vereinsbank AG – (HVB), Munich	48,997	1,003
- Unicredito Italiano SpA, Milan	3,134	103
- UniCredit Bank d.d. Mostar	27	2
	55,014	**2,043**
Short term deposits:		
- UniCredit Bank Austria AG, Vienna	19,558	34,917
- UniCredit Bank d.d., Mostar	2,900	-
	22,458	**34,917**
Total assets	**77,472**	**36,960**
Liabilities:		
Short-term deposits:		
- UniCredit Bank Austria AG, Vienna	211,241	132,214
- UniCredit d.d., Mostar	37,938	38,000
Paid unsubscribed share capital		
- UniCredit Bank Austria AG, Vienna	15,000	-
Liabilities due for services delivered		
- UBIS (UniCredit Business Integrated Solutions), Vienna	66	-
- UniCredit d.d., Mostar	68	-
- Zagrebačka banka d.d., Zagreb	32	-
Total liabilities	**264,345**	**170,214**
Net liabilities	**(186,873)**	**(133,254)**

Notes to financial statements (continued)

33. Transactions with related parties (continued)

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

	2012 BAM '000	2011 BAM '000
Items included in the statement of comprehensive income:		
Interest income:		
-UniCredit Bank Austria AG, Vienna	100	167
-UniCredit bank d.d., Mostar	25	6
Total interest income	**125**	**173**
Fee and commission income:		
-UniCredit Bank Austria AG, Vienna	42	69
-UniCredit bank d.d., Mostar	11	-
Total fee and commission income	**53**	**69**
Interest expense:		
-UniCredit Bank Austria AG, Vienna	1,925	1,498
-UniCredit bank d.d., Mostar	436	481
-ZAO UniCredit Bank, Moscow	136	-
Total interest expense	**2,497**	**1,979**
Fee and commission expense:		
-UniCredit Bank Austria AG, Vienna	8	71
-Unicredito Italiano SPA, Milan	3	2
-Zagrebačka banka d.d., Zagreb	88	2
-UniCredit bank d.d., Mostar	39	41
Total fee and commissions expense	**138**	**116**
Software maintenance costs:		
-BTS – Banking Transaction services s.r.o., Prague	59	75
-UBIS (ex, UGIS; WAVE, BAGIS), Vienna	1,400	1,400
-UniCredit bank d.d., Mostar	235	-
Total software maintenance costs	**1,694**	**1,475**
Net expense	**(4,151)**	**(3,328)**

Notes to financial statements (continued)

33. Transactions with related parties (continued)

The remuneration of members of the Supervisory and Management Boards, and other key management are presented below:

	2012 BAM'000	2011 BAM '000
Supervisory Board	-	-
Management Board		
- Gross salaries	647	554
- Bonuses	77	-
Total Management Board	**724**	**554**
Other key management		
- Gross salaries	801	1,094
- Bonuses	123	-
Total other key management	**924**	**1,094**
Total key management	**1,648**	**1,648**

Loans and deposits, and income and expenses arising from loans and deposits of the members of the Supervisory Board, Management Board and other key management are as follows:

	2012 BAM'000	2011 BAM '000
Supervisory Board	-	-
Management Board		
- Loans as at 31 December	12	-
- Interest income for the year	-	-
- Deposits as at 31 December	121	92
- Interest expense for the year	1	2
Other key management		
- Loans as at 31 December	638	689
- Interest income for the year	45	48
- Deposits as at 31 December	239	421
- Interest expense for the year	3	4
Total key management		
- Loans as at 31 December	***650***	***689***
- Interest income for the year	***45***	***48***
- Deposits as at 31 December	***360***	***513***
- Interest expense for the year	***4***	***6***

Other key management comprise 14 employees of the Bank (2011: 21 employees of the Bank).

Notes to financial statements (continued)

34. 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.

34.1. 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 business operations with all client 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)

34. Risk management (continued)

34.1. 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 minimise 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)

34. Risk management (continued)

34.1. Credit risk (continued)

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

	2012	2011
	BAM '000	BAM '000
Balance sheet assets		
Resources with Central Bank –bank account (Note 17)	34,570	10,024
Obligatory reserve with the Central Bank (Note 18)	36,854	32,216
Loans to and placements with banks (Note 19)	135,765	38,128
Loans to customers - legal entities (Note 20)	320,437	250,542
Loans to customers - individuals (Note 20)	289,958	286,584
Accrued interest (Note 20)	1,370	1,600
Financial assets available for sale (Note 21a)– debt securities	55,354	47,232
Financial assets held to maturity (Note 21b)	170	200
Other assets (Note 24)	5,593	4,574
Total balance sheet items exposed to credit risk	**880,071**	**671,100**
Off-balance sheet (Note 32)		
Guarantees and other sureties	42,366	25,269
Approved overdrafts, global loans and guarantees	84,273	50,117
Total off-balance-sheet exposure to credit risk	**126,639**	**75,386**
	1,006,710	**746,486**

The table represents the maximum exposure to credit risk of the Bank as at 31 December 2012 and 31 December 2011, 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, 60.6% of total maximum exposure originates from loans to customers (2011: 71.9%), and 13.5% originates from loans to other banks (2011: 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)

34. Risk management (continued)

34.1. Credit risk (continued)

The Bank takes collateral for loans and receivables in the form of mortgages on real estate, 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.

34.1.2. 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
- Incurred but not reported losses

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 fulfil their obligations toward the Bank, are as follows:

- failure to settle or delay in payment of interest or principal
- failure to meet conditions of agreements
- bankruptcy or receivership
- 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-fulfilment of liabilities) determined by Basel II and reconciled with IFRS requirements.

Notes to financial statements (continued)

34. Risk management (continued)

34.1. Credit risk (continued)

34.1.2. 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:

	2012			2011		
	BAM '000			BAM '000		
	Loans	**Provisions**	**%**	**Loans**	**Provisions**	**%**
Performing and past due but not impaired loans not specifically impaired						
- loans to corporate	288,160	2,550	0.9%	220,559	1,385	0.6%
- loans to retail	293,862	7,274	2.5%	290,735	7,184	2.5%
Non-performing loans						
- loans to corporate	57,836	23,009	39.8%	53,651	22,283	41.5%
- loans to retail	18,191	14,821	81.5%	16,841	13,808	82.0%
Total loans	**658,049**	**47,654**	**7.2%**	**581,786**	**44,660**	**7.7%**

Provision coverage of the non-performing portfolio amounts to 49.8% (2011: 51.2%).

Notes to financial statements (continued)

34. Risk management (continued)

34.1. Credit risk (continued)

34.1.2. 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:

	2012 BAM '000	2011 BAM '000
Corporate		
Loans to customers that are neither due nor impaired	284,962	218,814
Past due but not impaired loans	3,198	1,745
Non-performing loans (impaired loans)	57,836	53,651
Gross exposure	**345,996**	**274,210**
Impairment allowance:		
- Portfolio (IBNR), individual and group impairment allowance	(25,559)	(23,668)
Net exposure	**320,437**	**250,542**

	2012 BAM '000	2011 BAM '000
Retail		
Loans to customers that are neither due nor impaired	293,802	290,707
Past due but not impaired loans	60	28
Non-performing loans (impaired loans)	18,191	16,841
Gross exposure	**312,053**	**307,576**
Impairment allowance :		
- Portfolio (IBNR), individual and group impairment allowance	(22,095)	(20,992)
Net exposure	**289,958**	**286,584**
Total gross exposure	**658,049**	**581,786**
Portfolio impairment allowance (IBNR)	(9,824)	(8,569)
Individual and group impairment allowance	(37,830)	(36,091)
Net exposure	**610,395**	**537,126**

Notes to financial statements (continued)

34. Risk management (continued)

34.1. Credit risk (continued)

34.1.2. 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:

	Retail loans				**Corporate loans**			
	Customer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2012	BAM '000	BAM '000	BAM '000	**BAM '000**	BAM '000	BAM '000	BAM '000	**BAM '000**
Standard monitoring	213,738	61,626	18,438	**293,802**	204,897	49,245	30,820	**284,962**
2011								
Standard monitoring	212,507	60,389	17,811	**290,707**	125,896	47,799	45,119	**218,814**

Notes to financial statements (continued)

34. Risk management (continued)

34.1. Credit risk (continued)

34.1.2. 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. Additionally, certain corporate loans overdue for over 90 days are also not considered impaired. The gross amount of loans to and receivables from customers that were past due but not impaired were as follows:

	Retail loans				Corporate loans			
	Customer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2012	BAM '000	BAM '000	BAM '000	**BAM '000**	BAM '000	BAM '000	BAM '000	**BAM '000**
Past due up to 30 days	19	-	-	19	-	377	83	460
Past due 30 – 60 days	22	-	-	22	100	-	-	100
Past due 60 – 90 days	19	-	-	19	-	215	-	215
Past due over 90 days	-	-	-	-	-	2,309	114	2,423
Total	**60**	**-**	**-**	**60**	**100**	**2,901**	**197**	**3,198**
Value of collateral	1	-	-	**1**	-	2,357	113	**2,470**
2011								
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**

Notes to financial statements (continued)

34. Risk management (continued)

34.1. Credit risk (continued)

34.1.2. 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:

	Retail loans				Corporate loans			
	Customer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2012	BAM '000	BAM '000	BAM '000	**BAM '000**	BAM '000	BAM '000	BAM '000	**BAM '000**
Non-performing loans	14,401	1,769	2,021	**18,191**	6,568	27,651	23,617	**57,836**
Value of collateral	1,995	1,667	-	**3,662**	6,324	27,843	18,192	**52,359**
2011								
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**

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

As at 31 December 2012, assets acquired in settlement of non-performing loans amounted to BAM 174 thousand (2011: BAM 174 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 2012 amounted to a total of BAM 26,801 thousand (2011: BAM 27,176 thousand).

	2012	**2011**
	BAM '000	**BAM '000**
Restructured loans	26,801	27,176
Loan portfolio	658,049	581,786
Restructured loans recorded as % of loan portfolio	4.1%	4.7%

Notes to financial statements (continued)

34. Risk management (continued)

34.2. Liquidity risk

The table below analyses 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 2012 and 31 December 2011 is as follows:

2012	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	47,177	-	-	-	-	47,177
Obligatory reserve with the Central bank	36,854	-	-	-	-	36,854
Loans to and receivables from banks	132,865	-	2,900	-	-	135,765
Loans to and receivables from customers	95,836	31,717	87,073	238,517	154,712	607,855
Financial assets available for sale	45,829	-	9,516	6	377	55,728
Financial assets held to maturity	-	-	64	106	-	170
Property and equipment	-	-	-	-	17,839	17,839
Intangible assets	-	-	-	-	4,658	4,658
Accrued interest and other assets	2,708	1,292	1,593	-	-	5,593
Deferred tax assets	-	-	19	-	-	19
Total assets	**361,269**	**33,009**	**101,165**	**238,629**	**177,586**	**911,658**
Liabilities, equity and reserves						
Deposits and loans from banks	142,877	15,133	56,743	59,906	14,740	289,399
Deposits and loans from customers	289,075	10,234	62,633	91,602	29,261	482,805
Accrued interest and other liabilities	3,727	669	4,327	748	15,073	24,544
Provisions for liabilities and charges	-	234	-	1,239	-	1,473
Profit tax liability	-	354	-	-	-	354
Deferred tax liability	-	-	-	243	-	243
Equity and reserves	-	-	-	-	112,840	112,840
Total liabilities, equity and reserves	**435,679**	**26,624**	**123,703**	**153,738**	**171,914**	**911,658**
Maturity gap	**(74,410)**	**6,385**	**(22,538)**	**84,891**	**5,672**	**-**

Notes to financial statements (continued)

34. Risk management (continued)

34.2. Liquidity risk (continued)

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, equity and reserves						
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	4,135	940	43	9,864
Provisions for liabilities and charges	-	-	517	1,080	-	1,597
Liability for profit tax	-	735	-	-	-	735
Deferred tax liability	-	-	-	247	-	247
Equity and reserves	-	-	8,201	-	90,730	98,931
Total liabilities, equity and reserves	**228,903**	**77,374**	**109,536**	**132,428**	**155,401**	**703,642**
Maturity gap	**(5,427)**	**(50,680)**	**(11,470)**	**88,098**	**(20,521)**	**-**

Notes to financial statements (continued)

34. Risk management (continued)

34.3. 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.

Market risk exposure management includes the activities related to the operations of the Financial Markets and Assets and Liabilities Management function, and it 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. Market risk measuring is based on the VaR („ Value at Risk) methodology. 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 in market conditions with a confidence level of 99%. UniCredit group uses historic volatility simulation as an assessment model based on the last 500 daily return observations, VaR model quality is continuously monitored by back testing. Beside the VaR methodology, Market Risk Management also uses open FX position limits and base point calculation as a supplement to set VaR limits.

Factors which are also of importance for the assessment of market risk impact on the Banks' portfolio are stress-oriented warning levels and limits. The Bank performs stress liquidity tests within Risk Management in accordance with group parameters for: foreign currency, interest rate and liquidity risks, and the results are included in regular ALCO reports.

The bank performs activities on market risk limit review closely cooperating with UniCredit Bank Austria AG, Vienna. These activities are performed at least on annually, and if needed more often in accordance with business changes as a result of changes of legal regulations, business strategies goals development as well as targeted risk profile.

The set of documents with rules for operations performed by Financial Markets and Market Risk Management is made in the form of a Financial Markets Rule Book which is divided into three parts (General, Specific and Unit). Only the permitted risk bearers are enabled to enter into the risk positions. New products approval is established with Risk Management involved in the decision-making process where the Risk Management of UniCredit Bank Austria AG, Vienna provides the final approval on the new products implementation.

Overview of total VaR items of the Bank:

BAM '000	**2012**	**2011**
- average for the period	151	48
- maximum for the period	266	137
- minimum for the period	96	14

In addition to group market risk techniques, methods and measuring models, the Bank continuously works on the improvement of the business processes and data quality.

34.3.1. Currency risk

Currency risk is the risk of the possibility of occurrence of negative effects on the financial results and net assets capital due to changes in exchange rates. The 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 Management is responsible for daily monitoring of foreign exchange risk calculations in accordance with Group guidelines in compliance with defined rules for trends monitoring through the conversion accounts for individual currency.

The Bank intends to direct its business activities aimed at minimising the mismatch between assets and liabilities denominated in the foreign currency or with the foreign currency clauses, keeping daily operations within set limits. These limits are explained (including their calculation and procedures) in the General Part of the Financial Markets Rule Book.

Notes to financial statements (continued)

34. Risk management (continued)

34.3. Market risk management (continued)

34.3.1. Currency risk (continued)

All sensitivities stemming from positions in or linked to foreign currencies are covered by general daily VaR limit also, which among other risks, limits the maximum permitted loss of open positions in the foreign currencies.

Stress testing for currency risk is performed by the including appreciation and depreciation shocks for all the more significant particular currencies and currency buckets and the results are covered by regular ALCO reports.

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 thereto with a foreign currency clause. According to local regulations the currency risk ratio is the proportion between the total open foreign currency items and the Bank's capital.

In accordance with the decision which regulates the minimum standards for currency risk management, the Bank is required to maintain relations between assets and liabilities in each individual currency so that its total open foreign currency position at the end of each working day is not higher than 30 % of its equity. According to internal regulations the Bank measures the risk of exposure to change in foreign currency rate through openness of positions in foreign currency in relation to limits defined in the absolute amounts.

	2012	**2011**
Currency risk ratios:		
- as at 31 December	0.13%	16.1%
- maximum for the month of December	25.5%	20.5%
- minimum for the month of December	0.13%	1.7%

The major part of business transactions exposes the Bank to the risk of EUR exchange rate change, however due to the Currency Board regime currently in place, according to which the ratio of the local currency to EUR is fixed, one can consider that there is no foreign exchange rate risk to the Bank in respect of its EUR positions, so long as the currency board regime is maintained.

The Bank protects itself from exposure to currency risk in other foreign currencies than EUR by managing foreign currency position, within the assets and liabilities management, in the way that the positions opened through operations with clients are closed by opposite transactions, so that the open position of the Bank is reduced to the minimum.

The analysis of assets and liabilities shown in foreign currency amounts, as at 31 December 2012, is presented in the table below:

Notes to financial statements (continued)

34. Risk management (continued)

34.3. Currency risk (continued)

	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
2012							
Assets							
Cash reserves	2,813	-	292	894	3,999	43,178	47,177
Minimum reserve with Central bank	-	-	-	-	-	36,854	36,854
Loans to and receivables from banks	116,649	-	14,408	1,806	132,863	2,902	135,765
Loans to and receivables from customers	87,852	296,913	-	-	384,765	223,090	607,855
Financial assets available for sale	-	4,945	-	-	4,945	50,783	55,728
Financial assets held until maturity	-	-	-	-	-	170	170
Buildings and equipment	-	-	-	-	-	17,839	17,839
Intangible assets	-	-	-	-	-	4,658	4,658
Accrued interest and other assets	1,497	-	120	17	1,634	3,959	5,593
Deferred tax assets	-	-	-	-	-	19	19
Total assets	**208,811**	**301,858**	**14,820**	**2,717**	**528,206**	**383,452**	**911,658**
Liabilities and equity							
Deposits and loans from banks	251,398	60	1	-	251,459	37,940	289,399
Deposits and loans from customers	156,183	90,223	17,696	8,322	272,424	210,381	482,805
Accrued interest and other liabilities	3,061	-	32	36	3,129	21,415	24,544
Provisions for liabilities and charges	234	-	-	-	234	1,239	1,473
Profit tax liability	-	-	-	-	-	354	354
Net deferred tax liability	-	-	-	-	-	243	243
Equity and reserves	3,382	-	-	-	3,382	109,458	112,840
Total liabilities, equity and reserves	**414,258**	**90,283**	**17,729**	**8,358**	**530,628**	**381,030**	**911,658**
Net foreign currency position	**(205,447)**	**211,575**	**(2,909)**	**(5,641)**	**(2,422)**	**2,422**	**-**

The depreciation of foreign currencies (except for EUR) against BAM by 10%, if all other variables remained the same, would result in an increase of profit by the amount of BAM 855 thousand based on the foreign currency positions at 31 December 2012 (2011: decrease of BAM 439 thousand).

The appreciation of 10% in foreign currencies other than EUR would result with a decrease of profit in the amount of BAM 855 thousand based on the foreign currency positions at 31 December 2012 (2011: increase of BAM 439 thousand).

Notes to financial statements (continued)

34. Risk management (continued)

34.3. 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
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							
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	7,953	9,864
Provisions for liabilities and charges	-	-	-	-	-	1,597	1,597
Liability for profit tax	-	-	-	-	-	735	735
Deferred tax liability	-	-	-	-	-	247	247
Equity and reserves	3,382	-	-	-	3,382	95,549	98,931
Total liabilities, equity and reserves	**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**	**-**

Foreign exchange rate

The official exchange rates applied for recalculation of the balance sheet positions as at 31 December 2012 and 2011 for the following more significant currencies was:

	31 December 2012	31 December 2011
USD	1.483600	1.511577
CHF	1.619065	1.608942
EUR	1.955830	1.955830

Notes to financial statements (continued)

34. Risk management (continued)

34.3.2. Interest rate risk

The Bank is exposed to risk from interest rate fluctuations which have an impact on the financial position of the Bank and its cash flows. The Bank's business operations are influenced by interest rates changes, to the extent that interest bearing assets and liabilities mature or their interest rates change at different times or in different amounts, Interest rate margins may grow as the result of those fluctuations however at the same time they may be reduced and cause losses in the event of unexpected fluctuations.

The main sources of interest rate risk are as follows:

- repricing risk resulting from unfavourable changes in the fair value of assets and liabilities during the remaining period until the next interest rate change (items with fixed interest rate are classified according to the remaining maturity);
- risk of change in inclination and shape of the yield curve (yield curve risk);
- risk of different changes in interest earned and interest paid (basis risk) of instruments having identical maturity and denominated in identical currency, where the interest rates are based on different reference rate types (e.g. EURIBOR vs. LIBOR).

Exposure to risk of interest rate changes is monitored by reports and in accordance with Group guidelines and it is in the domain of Market Risk Management. The methodology which is used for risk assessment of interest rate changes is based on the GAP analysis of time differences. Differences between interest-bearing assets and liabilities in different time "baskets" show how two sides of the balance sheet may react differently on the change of interest rates:

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

Risk is measured calculating the change in net present value of the portfolio in case of reference rate curve shift by 0.01% (1 base point) and it is limited by BPV limit (basis point value limit) as a sensitivity measure. BPV limits are defined in summary, per currency and per time baskets. BPV limits for daily operations matching are regulated by UniCredit Group. Interest risk is also monitored through the specified VaR model.

Stress testing conducted by the Bank in compliance with UniCredit Group parameters for interest rate risk category includes scenarios of various shocks on interest curves. Shocks include change in interest rate level (parallel shifts), curve rotations, change in curve inclination and jumps on specific segments of interest curves.

The Bank estimates the interest rate exposure also based on net interest income sensitivity analysis.

Sensitivity analysis

Simulation is performed by measuring the impact of change in the interest rate 1pp on the net interest income for the time period of 12 months based on simultaneous growth or drop of interest rates against all positions in the Bank's balance sheet sensitive to the interest rate change. Changes in net interest income due to changes in interest rates should not exceed 10% of planned net interest income.

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 2012 i,e, for 2011.

It was estimated from the specified assumptions that an interest rate decrease by 1pp would cause a decrease in the interest rate income for 2012 in the amount of BAM 1,471 thousand, in percentage around 3%. Simulation of the impact of interest rate change on net interest income in the previous year resulted in decrease of net interest income in the amount of approximately BAM 717 thousand or 2%.

Notes to financial statements (continued)

34. Risk management (continued)

34.3.2- Interest rate risk (continued)

The effects are presented in the following table:

	2012	**2011**
Potential decrease in net interest income (BAM ‘000)	(1,471)	(717)
% of decrease in planned net interest income	(3%)	(2%)

Economic capital sensitivity analysis

At the end of 2012 the Bank improved the methods of interest rate risk measurement by introducing economic capital sensitivity analysis in compliance with the Group and Basel II regulatory framework and the result thereof is included in the regular ALCO report.

An overview of the Bank’s exposure to interest rate risk as at 31 December 2012 and 31 December 2011 is shown on the following pages.

Notes to financial statements (continued)

34. Risk management (continued)

34.3.2. Interest rate risk (continued)

a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates

The Bank is exposed to various risks which through 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 2012 and 2011, 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
2012								
Assets								
Cash reserves	34,570	-	-	-	-	12,607	47,177	-
Minimum reserve with Central bank	36, 854	-	-	-	-	-	36,854	-
Loans to and receivables from banks	132,865	-	2,900	-	-	-	135,765	-
Loans to and receivables from customers	166,611	322,506	85,630	18,518	14,590	-	607,855	-
Financial assets available for sale	-	-	4,935	4,598	45,821	374	55,728	55,354
Financial assets held until maturity	-	-	-	170	-	-	170	170
Buildings and equipment	-	-	-	-	-	17,839	17,839	-
Intangible assets	-	-	-	-	-	4,658	4,658	-
Accrued interest and other assets	-	-	-	-	-	5,593	5,593	-
Deferred tax assets	-	-	-	-	-	19	19	-
Total assets	**370,900**	**322,506**	**93,465**	**23,286**	**60,411**	**41,090**	**911,658**	**55,524**
Liabilities and equity								
Deposits and loans from banks	157,877	90,845	39,917	-	-	760	289,399	**-**
Deposits and loans from customers	204,947	67,987	45,744	56,021	3,463	104,643	482,805	**-**
Accrued interest and other liabilities	-	-	-	-	-	24,544	24,544	**-**
Provisions for liabilities and charges	-	-	-	-	-	1,473	1,473	**-**
Liability for profit tax						354	354	**-**
Deferred tax liability	-	-	-	-	-	243	243	**-**
Equity and reserves	-	-	-	-	-	112,840	112,840	**-**
Total liabilities, equity and reserves	**362,824**	**158,832**	**85,661**	**56,021**	**3,463**	**244,857**	**911,658**	**-**
Bank's interest rate mismatch	8,076	163,674	7,804	(32,735)	56,948	(203,767)	-	55,524

Notes to financial statements (continued)

34. Risk management (continued)

34.3.2 Interest rate risk (continued)

a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates (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
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	-	-	-	-	-	9,864	9,864	-
Provisions for liabilities and charges	-	-	-	-	-	1,597	1,597	-
Liability for profit tax						735	735	
Deferred tax liability	-	-	-	-	-	247	247	-
Equity	-	-	-	-	-	98,931	98,931	-
Total liabilities, equity and reserves	**371,446**	**58,011**	**93,257**	**45,476**	**5,189**	**130,263**	**703,642**	**174,412**
Bank's interest rate mismatch	112,733	(50,241)	14,662	(37,125)	48,005	(88,034)	-	(76,534)

Notes to financial statements (continued)

34. Risk management (continued)

34.3.2. Interest rate risk (continued)

a) Period of interest rate changes, interest risk analysis and amounts subject to fixed interest rates (continued)

The estimated future cash flow for the Bank's interest bearing liabilities as at 31 December 2012 and 31 December 2011 are shown in the following table:

2012	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	142,891	15,569	56,997	59,904	14,743	290,104
Transaction accounts and deposits from customers	65,830	52,053	110,185	171,237	97,757	497,062
Other liabilities	7,452	66	3,158	2,472	17,376	30,524
Total liabilities	**216,173**	**67,688**	**170,340**	**233,613**	**129,876**	**817,690**
2011						
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**

b) Effective interest rates

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

	2012	2011
	%	%
Cash reserves	0.03	0.53
Minimum reserve with Central bank	0.03	0.59
Placements with and loans to banks	0.20	0.68
Loans to customers	7.89	8.56
Debt securities available for sale	6.61	5.27
Transaction accounts and deposits from banks	1.16	1.93
Transaction accounts and deposits from customers	1.38	1.57
Loans taken	2.43	2.27

Notes to financial statements (continued)

34. Risk management (continued)

34.3.3. Risk of changes in interest rate margin

In the course of 2012 the Bank improved market-risk-measuring techniques in the part regarding the measuring the impact of interest rate margin changes in securities with fixed yield. The risk of change in securities price due to issuer risk change (margin perceived by the market) is measured and limited by CPV limit - basis point credit margin value. This limit has been applied since 2013. CPV limit is similar to BPV and limits the risk of change in net present value of securities portfolio if the impact of interest margin change shifts by 0.01% (1 base point). BPV limit limits total sensitivity of bank's positions to changes in interest rates and CPV limit additionally limits investments in securities with regard to the volume and duration.

34.4. 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.

The Bank uses the Group tool ARGO to record data on operational risk loss; reporting and the data analysis related to the operational risks.

The Bank's management and the Group are regularly informed and receive reports in respect of the aforementioned processes and indicators which constitute 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.

34.5. Capital management

The Bank's objectives in capital management are:

- compliance with capital requirements set by regulators of banks and capital markets,
- to maintain the Bank's ability to continue the business operations so that it could ensure the yields for shareholders and benefits for other 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 defined 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, serving to calculate the Bank's capital adequacy ratio, represents the sum of tier 1 and tier 2 capital, decreased by deductible items consisting of, *inter alia,* the amount of additional loan loss provision for loans and other assets calculated in accordance with BARS regulations.

Notes to financial statements (continued)

34. Risk management (continued)

34.5. 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.

Additional capital (tier 2) of the Bank consists of generic 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, additional, net capital and capital adequacy calculated pursuant to the BARS regulations, are presented in the following table:

	2012 BAM '000	2011 BAM '000
Tier 1 capital		
Ordinary shares	82,055	82,055
Share premium	373	373
Reserves	7,284	2,441
Intangible assets	(4,658)	(5,329)
Total tier 1 capital	**85,054**	**79,540**
Tier 2 capital		
General provisions	13,156	10,630
Audited profit	13,840	8,201
Total tier 2 capital	**26,996**	**18,831**
Additional loan loss provisions required by the regulator	**(2,719)**	**(3,423)**
Net capital	**109,331**	**94,948**
Risk weighted assets		
Credit risk weighted assets	556,182	539,369
Weighted operational risk	55,943	49,251
Total weighted risk	**612,125**	**588,620**
Capital adequacy	**17.6**	**16.1**

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

Additional loan loss provisions required by the regulator presented in financial statements for 2012 will be covered from the profit realised in the year on the basis of the decision of the Bank's competent bodies.

Notes to financial statements (continued)

35. 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:

	2012 BAM '000	2011 BAM '000
Commission placements – MCI	731	714

In 2012, the Bank had revenues from fees related to transaction on behalf and for the account of the third parties in the amount of BAM 61 thousand (2011: -),

36. Liabilities for future payments under operating lease

The Bank has the liabilities for future payments under operating lease 32 lease contracts. The contracts are related to the lease of the Bank's branch premises and ATMs.
The future minimum lease payments under the above-mentioned operating lease contracts are summarised in the table below:

	2012 BAM '000	2011 BAM '000
Up to 1 year	573	732
From 1 to 5 years	1,038	3,550
Over 5 years	79	108
	1,690	**4,390**

37. 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 parties 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 neutralisation 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.

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 2012 the Bank had corporate loans with a fixed interest rate granted in the amount of BAM 11.0 million (2011: BAM 13 million). Under the assumption that the annual market interest rate for legal entities amounted to 7.54% for long-term foreign currency loans (2011: 7.79%), the expected future cash flows from loans with fixed interest rates are discounted to the present value.

Notes to financial statements (continued)

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

Loans and placements to customers (continued)

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 those loans was higher by BAM 478 thousand than the book value, (2011: higher by BAM 359 thousand).

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.

Current 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.

Under the assumption that the average market interest rate in local currency on long-term deposits of legal entities is 3.3 % (2011: 2.9 %) 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 to 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 217,139 thousand, which is by BAM 985 thousand less than the carrying value (2011: BAM 157,538 thousand which was by BAM 454 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% (2011: 3.2%) 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 191,993 thousand, which is by BAM 1,011 thousand less than the carrying value (2011: BAM 179,672 thousand which is by BAM 464 thousand less than the carrying value).

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. However, taking into consideration that the loans funded from this credit line were also placed with a fixed interest rate, it is considered that the complete alignment exists here and there was no influence of interest rate changes, and therefore the Bank did not perform an assessment of fair value of these liabilities.

Notes to financial statements (continued)

38. Events after the reporting date

In accordance with article 60, line 1, point a) of the Law of the Securities Market, the Securities Commission of Republika Srpska adopted a decision on 29 January 2013 allowing the largest shareholder of the Bank its parent UniCredit Bank Austria AG, Vienna, to subscribe additional share capital through a 9^{th} issue of shares in the total number of 21,429 shares with a nominal value of BAM 700 per share, thereby increasing the Banks share capital by BAM 15,000 thousand.

With the Decision, the Securities Commission has obliged the issuer, within the period of one year from the date of subscription of shares in Register, to issue a prospectus for the listing of shares on the Banjaluka Stock Exchange a.d. Banja Luka in accordance with the Law of the Securities Market.

Accordingly, after the reporting date, the amount of BAM 15,000 which had been received by the Bank in cash from UniCredit Bank Austria AG, Vienna, before the report date as prepayment in respect of the share issue and recognised as liability at that date, was transferred to equity.