

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina

Financial statements for the year ended
31 December 2008
and Independent auditors' report

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Responsibility for the Financial Statements

Pursuant to the Law on Accounting and Audit of Federation of Bosnia and Herzegovina (Official Gazette No. 32/05), the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia & Herzegovina, which give a true and fair view of the state of affairs and results of the Intesa Sanpaolo Banka Bosna and Hercegovina d.d. for that period.

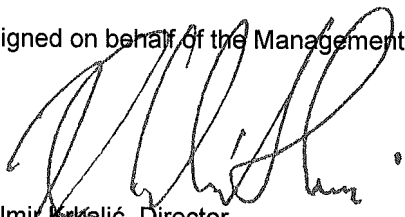
After making enquiries, the Management Board has a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the financial statements.

In preparing those financial statements, the responsibilities of the Management Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Accounting and Auditing Law of Federation of Bosnia and Herzegovina. The Management Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Management Board



Almir Krkalic, Director
Intesa Sanpaolo banka d.d. Bosna i Hercegovina
Obala Kulina bana 9a
71000 Sarajevo
Bosnia and Herzegovina

13 February 2009

INDEPENDENT AUDITORS' REPORT**To the shareholders of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina:**

We have audited the accompanying financial statements of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina (the "Bank") set out on pages 3 to 47, which comprise of the balance sheet as of 31 December 2008, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. The financial statements of the Bank as of 31 December 2007, were audited by another auditor whose report dated 25 January 2008, expressed an unqualified opinion on those statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia & Herzegovina. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's 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 ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

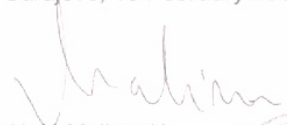
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank'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 Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies 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 audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina as of 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia & Herzegovina.

Sarajevo, 13 February 2009


Alma Malinović
Certified Auditor
Revsar d.o.o., Sarajevo



Belgrade, 13 February 2009


Mirjana Perendija Kovačević
Partner
Ernst & Young Beograd d.o.o.



Statement of Income
for the year ended 31 December 2008
(all amounts are expressed in thousands of KM)

	Notes	31 December 2008	31 December 2007
Interest income	6	62,404	44,312
Interest expense	7	(26,777)	(14,316)
Net interest income		35,627	29,996
Fee and commission income	8	11,911	9,238
Fee and commission expense	9	(3,406)	(2,699)
Net fee and commission income		8,505	6,539
Net trading income	10	419	321
Other operating income	11	4,825	869
Operating income		5,244	1,190
Administrative expenses	13	(31,802)	(22,052)
Depreciation of tangible fixed assets	23	(3,562)	(1,924)
Operating Expense		(35,364)	(23,976)
PROFIT BEFORE IMPAIRMENT LOSSES, PROVISIONS AND INCOME TAX		14,012	13,749
Impairment losses and provisions	14	(15,220)	(13,813)
Collected write-offs	12	4,911	1,669
PROFIT BEFORE INCOME TAX		3,703	1,605
Income tax	15	(912)	(77)
NET PROFIT FOR THE YEAR		2,791	1,528
Earnings per share (KM)	16	7.47	5.71

The accompanying notes form an integral part of these financial statements.

Balance sheet

as at 31 December 2008

(all amounts are expressed in thousands of KM)

	Notes	31 December 2008	31 December 2007
ASSETS			
Cash and cash equivalents	17	26,805	154,909
Obligatory reserve with the Central Bank	18	116,696	132,022
Placements with other banks	19	105,459	90,088
Loans and receivables	20	727,146	540,349
Assets available for sale	21	801	1,259
Other assets	22	6,887	8,318
Property, plant and equipment	23	27,682	24,695
TOTAL ASSETS		1,011,476	951,640
LIABILITIES			
Due to banks and other institutions	24	332,384	183,764
Subordinated debt	25	11,356	16,733
Due to customers	26	534,381	659,446
Provisions for contingent liabilities and commitments	30	3,027	3,027
Other liabilities	27	6,126	5,860
Other provisions	28	1,840	2,609
TOTAL LIABILITIES		889,114	871,439
SHAREHOLDERS' EQUITY			
Share capital		45,296	37,145
Reserves and retained earnings		77,066	43,056
TOTAL SHAREHOLDER'S EQUITY		122,362	80,201
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		1,011,476	951,640
FINANCIAL COMMITMENTS AND CONTINGENCIES	29	127,885	111,844

The accompanying notes form an integral part of these financial statements.

Signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina on 13 February 2009:


Director
 Almir Krkalic


Executive Director of Finance
 Livio Mannoni

Statement of cash flows
for the year ended 31 December 2008
(all amounts are expressed in thousands of KM)

	2008	2007
Cash Flow		
Net Income	2,791	1,528
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation and amortization	3,562	1,924
Impairment losses and provisions	15,220	13,813
Changes in other provisions, net	(60)	(356)
(Gain) / loss sale or disposal of property, plant and equipment	(1,074)	(61)
<i>Changes in operating assets and liabilities:</i>		
Net (increase) in due from Central Bank	15,326	(62,278)
Net (increase) / decrease in placements with other banks, before impairment losses	(15,388)	(21,588)
Net (increase) in loans and receivables, before impairment losses	(200,593)	(186,182)
Net decrease / (increase) in other assets, before impairment losses	14	52
Net increase / (decrease) due to banks	61,660	25,355
Net increase in demand and term deposits	(125,065)	110,095
Net increase in other liabilities	(467)	(1,036)
NET CASH FROM/(USED IN) OPERATING ACTIVITIES	(244,074)	(118,734)
Investing Activities		
Net increase in assets available for sale, before impairment losses	734	-
Net purchases of property and equipment	(7,287)	(7,187)
Proceeds from sale of property, plant and equipment	1,812	315
Cash brought from LT Gospodarska Banka d.d. Sarajevo	-	57,150
NET CASH USED IN INVESTING ACTIVITIES	(4,741)	50,278
Financing Activities		
Net proceeds from borrowings	86,960	86,007
Net proceeds from subordinated debt	(5,377)	14,843
Paid in capital	8,161	5,208
Increase in share premium	30,967	19,791
Dividends paid	-	(1)
NET CASH PROVIDED BY FINANCING ACTIVITIES	120,711	125,848
NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS	(128,104)	57,392
CASH AND CASH EQUIVALENTS AT 1 JANUARY	154,909	97,517
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	26,805	154,909

The accompanying notes form an integral part of these financial statements.

Statement of changes in shareholders' equity

for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

	<u>Share capital</u>	<u>Treasury shares</u>	<u>Share Premium</u>	<u>Fair Value reserves</u>	<u>Retained earnings and reserves</u>	<u>Total</u>
Balance as at 31 December 2006	22,900	-	-	115	13,977	36,992
Changes in equity for 2007:						
Merger with LT Gospodarska Banka d.d. Sarajevo (Note 2)	9,039	-	8,619	-	(965)	16,693
Purchase/Sale of treasury shares	-	(2)	(9)	-	-	(11)
Increase in share capital	5,208	-	19,791	-	-	24,999
Profit for the year	-	-	-	-	1,528	1,528
Balance as at 31 December 2007	37,147	(2)	28,401	115	14,540	80,201
Changes in equity for 2008:						
Purchase/Sale of treasury shares	-	2	-	-	10	12
Sale of financial assets available for sale	-	-	-	(115)	115	-
Fair value adjustments of financial assets available for sale	-	-	-	242	-	242
Increase in share capital	8,149	-	30,967	-	-	39,116
Profit for the year	-	-	-	-	2,791	2,791
Balance as at 31 December 2007	45,296	-	59,368	242	17,456	122,362

The accompanying notes form an integral part of these financial statements.

Notes to the financial statements for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

1. GENERAL

History and incorporation

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina, former UPI banka d.d. Sarajevo, Obala Kulina Bana 9a (the "Bank") is registered in Cantonal Court in Sarajevo on 20 October 2000.

The Bank was established in 1972 as an internal bank of the corporate system of the Udružena poljoprivreda, prehrambena industrija i promet (Associated Agriculture and Food Industries and Sales), aimed at supporting the operations of these sectors, which at the time employed more than 35,000 workers. Since 1990, a new phase is coming in the development of the Bank, when it was registered as a shareholding company and it is in a majority state ownership (92 %). The Bank starts with expansion of the network of corporate clients, focusing on the sector of small and medium entrepreneurship. As early as from 2000, through the emission of shares, the Bank was fully transferred into the hand of private capital.

In February 2006, Intesa Sanpaolo Holding International S.A. took over the major share package of UPI Banka d.d. Sarajevo, and became the major owner of the Bank's shares.

On 31 July 2007 LT Gospodarska banka d.d. Sarajevo (the "LTG Bank") merged into the Bank, with the effect of the LTG Bank cancellation (without initiation of liquidation process), while the Bank became its legal successor.

On 20 August 2008 the Bank changed its name into Intesa Sanpaolo Banka d.d. Bosna i Hercegovina.

Principal activities of the Bank

The Bank's main operations are as follows:

1. accepting deposits from the public and placing of deposits,
2. providing current and term deposit accounts,
3. granting short-term and long-term loans and guarantees to corporate customers, private individuals, local municipalities and other credit institutions dealing with finance lease and foreign exchange transactions,
4. money market activities,
5. performing local and international payments,
6. foreign currency exchange and other banking-related activities,
7. providing banking services through an extensive branch network in Bosnia and Herzegovina

Supervisory Board

Ezio Salvai	Chairman from 23.01.2008
Ivan Krolo	Vice-Chairman
Giancarlo Miranda	Member
Massimo Malagoli	Member
Nora Kocsis	Member from 03.04.2008.
Roberto Marzanati	Member until 03.04.2008.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

1. GENERAL (CONTINUED)

Management Board

Almir Krkalić	Director
Livio Mannoni	Executive Director of Finance
Igor Bilandžija	Executive Director of Risk Management
Neven Horvat	Executive Director of IT and Operations until 04.07.2008.

Audit Committee

Giampiero Trevisan	Chairman
Armando Sala	Member
Beata Kissne Foldi	Member
Alen Galavić	Member
Ivanka Petrović	Member
Maria Rosa Bonatti	Member until 23.01.2008.

Internal Auditor

Muamera Zuko	Until 29.04.2008
Mediha Čatović	

The shareholding structure is as follows:

Shareholders	31 December 2008			31 December 2007		
	No. of shares	Amount KM '000	%	No. of shares	Amount KM '000	%
Intesa Sanpaolo Holding International S.A.	382,024	38,202	84.34	216,236	21,624	58.22
European Bank for Reconstruction and Development	32,478	3,248	7.17	26,635	2,664	7.17
Privredna banka d.d. Zagreb	-	-	-	70,382	7,038	18.95
Other	38,458	3,846	8.49	58,215	5,821	15.66
Total	452,960	45,296	100.00	371,468	37,147	100.00

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina shareholders adopted the Decision on Increasing Share Capital in the nominal amount of KM 8,149 thousand (81,492 shares of nominal values KM 100 each) at the General Shareholders' Meeting held on 10 November 2008 in Sarajevo. The shares were sold for the price of KM 480 each which created share premium in the amount of KM 30,967 thousand. The increase of capital, after the FBiH Securities Commission issued a final approval, is executed through a new issue of ordinary (common) shares.

On 26 October 2008, Intesa Sanpaolo Holding International S.A. bought the investment held by Privredna banka d.d. Zagreb.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

1. GENERAL (CONTINUED)

All the shares (452,960) are issued and fully paid. Nominal value of one share is 100 KM and movements in number of shares are as follows:

31 December 2007	371,468
Increase in share capital	81,492
31 December 2008	452,960

The Bank has 60 priority (preference) shares with priority right in receipt of dividends. Also the Bank doesn't have any shares held by the entity or by its subsidiaries and no share reserved for issue under options and contracts for sale.

In the position of Reserves and retained earnings the Bank includes:

- reserves for undistributed profit from previous years;
- fair value reserves deriving from the revaluation of the AFS investments;
- reserve for tax-deductible profit, in the measure of 15% of Bank's profit according to the then valid Income Tax Law;
- reserve for tax-deductible profit, in the measure of 75% of Bank's profit reinvested into fixed assets;
- reserve for undistributed dividends, following Supervisory Board decisions;
- revaluation reserve for fixed assets, according to valid Law;
- reserve for treasury shares.

2. MERGER OF LT GOSPODARSKA BANKA D.D. INTO INTESA SANPAOLO BANKA D.D. BIH

Introduction

Effective from 1 August 2007, based on decisions of General Assemblies of LT Gospodarska banka d.d. Sarajevo (the LTG) and Intesa Sanpaolo Banka d.d. BiH (the Bank), former UPI banka d.d. Sarajevo, the LTG and the Bank merged. Through the transaction the LTG ceased to exist and it transferred all the assets, liabilities, equity, commitments and contingent liabilities to the Bank. Effective 1 August 2007 the LTG has been deregistered from the Trade Register with the Court of Bosnia and Herzegovina. The Bank became the legal successor of the LTG.

Banks participating in the merger procedure were as follows:

- **LT Gospodarska banka d.d. Sarajevo – the merged bank** (Cantonal Court of Sarajevo No. UF/I-256/03, registration folio number I – 124039).
Legal representative of the bank as at 31 December 2006 and the date of merger is director Drago Bilandžija.
- **Intesa Sanpaolo Banka d.d. BiH, former UPI banka d.d. Sarajevo – the receiving bank** (Employment Tribunal of Sarajevo No. U/I-3816/90, registration folio number 1-4639, i.e. Cantonal Court of Sarajevo number UF/I-4091/00, registration folio number 1-4639).
Legal representative of the bank as at 31 December 2006 was director Mirsad Letić, and since 1 January 2007 Director is Almir Krkalić.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

2. MERGER OF LT GOSPODARSKA BANKA D.D. INTO INTESA SANPAOLO BANKA D.D. BIH (CONTINUED)

The position of shareholders of both banks changed after the merger in respect to their share in the share capital of Intesa Sanpaolo Banka d.d., based on the determined share swap ratio:

Ownership structure of the LT Gospodarska banka d.d before the merger	%
Privredna banka Zagreb d.d. (PBZ)	66.99
Minority shareholders	33.01
TOTAL:	100.00

Ownership structure of Intesa Sanpaolo Banka d.d. before the merger	%
Intesa Sanpaolo Holding International SA	81.18
European Bank for Restructuring and Development (EBRD)	10.00
Minority shareholders	8.82
TOTAL:	100.00

Ownership structure of Intesa Sanpaolo Banka d.d. – after the merger	Number of shares	New structure %
Intesa Sanpaolo Holding International SA	185,909	58.22 %
Privredna banka Zagreb d.d. (PBZ)	60,511	18.95 %
<i>Total Intesa Sanpaolo Group</i>	<i>246,420</i>	<i>77.17 %</i>
European Bank for Restructuring and Development (EBRD)	22,900	7.17 %
Minority shareholders	50,066	15.66 %
TOTAL:	319,386	100.00 %

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

**2. MERGER OF LT GOSPODARSKA BANKA D.D. INTO INTESA SANPAOLO BANKA D.D.
(CONTINUED)**

Before the merger

	<u>No. of shares</u>	<u>Share capital</u>
LT Gospodarska banka d.d. Sarajevo	210,200	17,657
Intesa Sanpaolo Banka d.d. BiH	229,000	22,900

Share capital of the LTG bank as at 31 July 2007 amounted to KM 17,657 thousand in cash, for which amount the LTG bank issued:

- 210,060 common (ordinary) shares, class ES,
- 140 priority (preference) shares, class A.

Nominal value of one share amounted to KM 84.00.

Share capital of Intesa Sanpaolo Banka as at 31 July 2007 amounted to KM 22,900,000.00 in cash, for which amount the Bank issued 229,000 ordinary shares.

Nominal value of one share amounts to KM 100.00.

Selection of valuation method and share exchange ratio for the exchange of the shares of the LTG for the shares of Intesa Sanpaolo Banka d.d., former UPI Banka d.d.

The merger was executed in accordance with the Companies Act of the Federation of BiH. Pursuant to article 66 of the Companies Act, the Management Boards of UPI Banka d.d. Sarajevo and LT Gospodarska banka d.d. Sarajevo appointed KPMG BiH as auditors of the merger of LT Gospodarska banka d.d. into UPI banka d.d. The subject of the audit was the establishment of the share exchange ratio between the two banks for the purpose of the merger.

Management Boards of both banks decided to apply the method of discounted cash flows (DCF), as basis for determination of the share swap. In determining the share swap ratio for the exchange of the shares of the LTG for the shares of the Bank, Management Boards of both banks were guided by the principle that the swap should be based on the fair value of both shares, which requires the application of a method that measures their fair value with the most precision.

The fair value of both shares is based on their fair value as of December 2006.

Asset valuations have been carried out on an unconsolidated basis, excluding all effects of transactions between the banks. The value of unconsolidated investments has been valued independently and added to the results of DCF valuation and the assessment of fair value of net assets.

During the transaction existing shares of the LTG were cancelled and the Bank issued 90,326 ordinary shares and 60 priority shares to the shareholders of the LTG using determined share exchange ratio of 1 share of the LTG for 0.43 shares of Intesa Sanpaolo Banka d.d. Nominal value of one share of the Bank amounts to KM 100.00.

Residual value of KM 8,619 thousand has been recognized in the equity of Intesa Sanpaolo Banka d.d. as share premium.

For the purpose of preparing the opening balance sheet as at 1 August 2007 both banks recognized net result, net of transactions between participating entities for the period ended 31 July 2007 as retained earnings.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

**2. MERGER OF LT GOSPODARSKA BANKA D.D. INTO INTESA SANPAOLO BANKA D.D.
(CONTINUED)**

Pro-forma income statement

Income statement for the year ended 31.12.2007 presented as if the banks were combined from the beginning of the year.

	LT Gospodarska d.d. 31 July 2007	Intesa Sanpaolo Banka d.d. 31 December 2007	Eliminated internal transactions	Pro-forma Intesa Sanpaolo Banka d.d. 31 December 2007
Interest income	7,405	44,312	(12)	51,705
Interest expense	(2,602)	(14,316)	12	(16,906)
Net interest income	4,803	29,996		34,799
Fee and commission income	1,747	9,238	-	10,985
Fee and commission expense	(537)	(2,699)	-	(3,236)
Net fee and commission income	1,210	6,539	-	7,749
Net foreign exchange income	899	321	-	1,220
Other operating income	57	869	-	926
Operating income	956	1,190	-	2,146
Administrative expenses	(6,170)	(22,052)	-	(28,222)
Depreciation of tangible fixed assets	(489)	(1,924)	-	(2,413)
Operating Expense	(6,659)	(23,976)	-	(30,635)
PROFIT BEFORE IMPAIRMENT LOSSES, PROVISIONS AND INCOME TAX	310	13,749	-	14,059
Impairment losses and provisions	(1,320)	(13,813)	160	(14,973)
Collected write-offs	601	1,669	-	2,270
PROFIT BEFORE INCOME TAX	(409)	1,605	160	1,356
Income tax	-	(77)	-	(77)
NET PROFIT FOR THE PERIOD	(409)	1,528	160	1,279

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

3. ADOPTION OF NEW STANDARDS AND REVISED STANDARDS

3.1 Standards and Interpretations effective in the current period

In the current year, the Bank has adopted the following interpretations issued by the International Financial Reporting Interpretation Committee effective for the current period. These are: IFRIC 11 IFRS 2 – Group and Treasury Share Transactions, IFRIC 12 Service Concession Arrangements; and IFRIC 14 IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.

The adoption of these Interpretations has not led to any changes in the Bank's accounting policies.

3.2 Standards and Interpretations in issue not yet adopted

At the date of authorisation of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

- IAS 1 Presentation of Financial Statements (effective for accounting period beginning on or after 1 January 2009);
- IAS 23 (revised) Borrowing cost (effective for accounting period beginning on or after 1 January 2009);
- IAS 27 (amended) Consolidated and Separate Financial Statements (effective for accounting periods beginning on or after 1 July 2009);
- IFRS 2 (amended) Share-based Payment (effective for accounting period beginning on or after 1 January 2009);
- IFRS 3 (revised) Business Combinations (effective for accounting period beginning on or after 1 July 2009);
- IFRS 8 Operating segment (effective for accounting periods beginning on or after 1 January 2009);
- IFRIC 13 Customer Loyalty Programmes (effective for accounting periods beginning on or after 1 July 2008).

The directors anticipate that all of the above Standards and Interpretations will be adopted in the Bank's financial statements for the period commencing 1 January 2009 and that the adoption of those Interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These financial statements are prepared in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia and Herzegovina.

As required by local legislation, the Bank prepares financial statements in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board and as modified by the regulatory requirements prescribed by the Banking Agency of Federation of Bosnia and Herzegovina (the FBA).

The financial statements have been prepared on the historical cost basis except for certain non-current assets and financial instruments which are reported at fair value. The principal accounting policies are set out below.

The financial statements are presented in thousands of convertible mark (KM'000) which is the functional currency of the Bank.

The financial statements are prepared on an accrual basis of accounting, under the going concern assumption.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. These estimates are based on the information available as at the balance sheet date and actual results could differ from those estimates.

The Bank maintains its books of accounts and prepares financial statements for regulatory purposes in accordance with the regulations of the Banking Agency of Federation of Bosnia and Herzegovina (FBA) and Law on Banks of the Federation of Bosnia and Herzegovina.

Interest Income and Expense

Interest income and expense is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Interest charged on deposits is added to the principal where this is foreseen by the agreement.

In accordance with regulations of FBA, the Bank is obligated to remove to off-balance sheet records accrued interest and to suspend recognition of further interest accruals on assets classified as non-performing assets (interest are due and have not been collected for over 90 days after the original maturity date). Such interest accruals are also recorded in off-balance sheet records.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fee and commission income and expense

Fees and commissions consist mainly of fees earned on domestic and foreign payment transactions, and fees for loans and other credit instruments issued by the Bank.

Fees for payment transactions are recognized in the period when services are rendered.

Loan origination fees, after approval and drawdown of loans, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan over its life.

Employee benefits

On behalf of its employees, the Bank pays pension and health insurance on and from salaries, which are calculated on the gross salary paid, as well as taxes, which are calculated on the net salary paid. The Bank is paying the above contributions into the Pension and Health Fund of the entities, as per the set legal rates during the course of the year on the gross salary paid. In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with the local legislation. These expenses are recorded in the income statement in the period in which the salary expense is incurred.

Retirement severance payments

According to the local legislation and internal Rulebook on employment, the Bank makes retirement severance payments of minimum 3 average monthly salaries of the employee in question or 3 average salaries of the Federation of Bosnia and Herzegovina paid in the period of the last three months, depending on what is more favourable to the employee.

Provision for retirement benefits is calculated by independent actuary. The liability recognized in the balance sheet is the present value of the obligation, determined by discounting estimated future outflows using the projected unit credit method. Actuarial gains and losses as well as past service cost are recognized in income statement in the period in which they arise.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax expense is based on taxable income for the year. Taxable income differs from net income as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method.

Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Taxation (Continued)

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Bank has the ability and intention to settle on a net basis.

The Bank is subject to various indirect taxes which are included in administrative expenses.

Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Central Bank ("CBBH") and current accounts with other banks.

Cash and cash equivalents excludes the compulsory minimum reserve with the Central Bank as these funds are not available for the Bank's day to day operations. The compulsory minimum reserve with the CBBH is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

Financial assets

Financial assets are recognized and derecognized on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the instrument within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories: financial assets as 'at fair value through profit or loss' (FVTPL), 'held-to-maturity investments', 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at FVTPL

Financial assets are classified as at FVTPL where the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near future; or
- it is a part of an identified portfolio of financial instruments that the Bank manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets (Continued)

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset.

The fair values of financial assets and financial liabilities are determined as follows:

- the fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices;
- the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions; and
- the fair value of derivative instruments, are calculated using quoted prices. Where such prices are not available use is made of discounted cash flow analysis using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.

Financial liabilities are classified into the following specified categories: financial liabilities "at fair value through profit or loss" (FVTPL), or "other financial liabilities". Bank uses "other financial liabilities" category only.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset or, where appropriate, a shorter period.

AFS financial assets

Unlisted shares are classified as being AFS and are stated at fair value. Gains and losses arising from changes in fair value are recognised directly in equity in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is included in profit or loss for the period.

Dividends on AFS equity instruments are recognised in profit or loss when the Bank's right to receive the dividends is established.

The fair value of AFS monetary assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate at the balance sheet date. The change in fair value attributable to translation differences that result from a change in amortised cost of the asset is recognised in profit or loss, and other changes are recognised in equity.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loan and receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment of financial assets and provisions for contingent liabilities and commitments

According to the Federal Banking Agency requirements, the Bank classifies loans, other receivables, as well as contingent liabilities and commitments into the following categories:

- A – Performing assets;
- B – Special mention;
- C – Substandard;
- D – Doubtful loan and
- E – Loss.

The classification into one of the above mentioned categories depends from credit standing of the Borrower, timely performance or repayment, type of collateral obtained and days of default in servicing the loan.

For loans, receivables and off-balance sheet exposures classified as performing, a general allowance/provision equal to 2% of the outstanding exposure is made.

For exposures classified into categories from B to D the following range of provision apply:

B – Special mention	from 5 to 15%
C – Substandard	from 15 to 40%
D – Doubtful	from 41 to 60%
E – Loss	100%

Assets regarded as non-collectable are classified into category "E" written-off against the related allowance for impairment and recorded off-balance sheet. Subsequent recoveries are credited to "Collected write offs" in income statement.

Derecognition of financial assets

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. In addition, the Bank derecognises financial assets when they are classified in the category E in accordance with the Federal Banking Agency requirements as described above.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial liabilities and equity instruments issued by the Bank

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Bank are recorded at the proceeds received, net of direct issue costs.

Compound instruments

The component parts of compound instruments issued by the Bank are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for a similar non-convertible instrument. This amount is recorded as a liability on an amortised cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date. The equity component is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognised and included in equity, net of income tax effects, and is not subsequently remeasured.

Financial liabilities

Financial liabilities are classified as either financial liabilities "at FVTPL" or "other financial liabilities".

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

- it has been incurred principally for the purpose of repurchasing in the near future; or
- it is a part of an identified portfolio of financial instruments that the Bank manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a Bank's portfolio of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the Bank is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 *Financial Instruments: Recognition and Measurement* permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial liabilities at FVTPL (Continued)

Financial liabilities at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability.

Fair value is determined in the manner described in note 4.

Other financial liabilities

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability or, where appropriate, a shorter period.

Derecognition of financial liabilities

The Bank derecognizes financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Cost includes the purchase price and directly associated cost of bringing the asset to a working condition for its intended use. Maintenance and repairs, replacements and improvements of minor importance are expensed as incurred. Significant improvements and replacement of assets are capitalised. Gains or losses on the retirement or disposal of property and equipment are included in the statement of income in the period in which they occur.

Properties in the course of construction are carried at cost, less impairment loss, if any. Depreciation commences when the assets are ready for their intended use. Depreciation is calculated on a straight-line basis over the estimated useful life of the applicable assets and based upon the application of the following annual percentages to historical costs:

	31 December 2008	31 December 2007
Buildings	1.30%	1.30%
Furniture and other equipment	10.00%-20.00%	10.00%-20.00%
Computers	20.00%	20.00%
Leasehold improvements	20.00%	20.00%
Software	20.00%	20.00%

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Foreign currency translation

Transactions in currencies other than Bosnia and Herzegovina KM are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities are translated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Profits and losses arising on translation are included in the statement of income for the period.

The Bank values its assets and liabilities by middle rate of Central Bank of Bosnia and Herzegovina valid at the date of balance sheet. The principal rates of exchange set forth by the Central Bank and used in the preparation of the Bank's balance sheet at the reporting dates were as follows:

31 December 2008	EUR 1= KM 1.95583	USD 1 = KM 1.387310
31 December 2007	EUR 1= KM 1.95583	USD 1 = KM 1.331221

Off-balance sheet commitments

In the ordinary course of business, the Bank enters into credit related commitments which are recorded in off-balance sheet accounts and primarily include guarantees, letters of credit and undrawn loan commitments. Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- the amount of the provision assessed in accordance with the Federal Banking Agency requirements as described above; and
- the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18, *Revenue*.

Provisions

Provisions are recognised when the Bank has a present obligation as a result of a past event, and it is probable that the Bank will be required to settle that obligation. Management Board estimates the provisions based at the best estimate of expenditure to settle the Bank's obligation. Provisions are discounted to present value where the effect is material.

Reclassification

Certain amounts in the previous year financial statements have been reclassified to conform to the current year presentation:

In 2008 the Bank reclassified interest collected from loans written-off in previous years from the item "Collected write-offs" to "Interest Income". Such interest has been originally recorded among Off-balance Sheet Items. For consistency reasons, a similar item of KM 1.354 thousand has been reclassified in the 2007 Statement of Income.

In the current year the Bank has moved the gains/losses from sale of property from "Administrative expenses" to "Other operating income". For the same purpose, the amount of 75 thousand KM has been reclassified in the 2007 Statement of Income.

Regulatory requirements

The Bank is subject to the regulatory requirements of the Banking Agency of Federation of Bosnia and Herzegovina. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off balance sheet commitments and forming allowances to cover credit risk, liquidity, interest rate and foreign currency position. At year end the Bank was substantially in compliance with all regulatory requirements.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

5. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Bank's accounting policies, which are described in note 4, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. 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 if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Useful lives of property, plant and equipment

As described above, the Bank reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period as described in Note 4.

Impairment losses on loans and other placements

The Bank reviews its problem loans and other placements at each reporting date to assess amounts of allowances for impairment and provisions for contingent liabilities and commitments which should be recorded in the income statement. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowances and provisions.

Long-term employee benefits

The cost of the long-term employee benefits is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases, and future turnover rates. Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

Fair value of financial assets and liabilities

The directors use their judgment in selecting an appropriate valuation technique for financial instruments not quoted in an active market. Valuation techniques commonly used by market practitioners are applied. Financial instruments are valued using a discounted cash flow analysis based on assumptions supported, where possible, by observable market prices or rates. The estimation of fair value of unlisted shares includes some assumptions not supported by observable market prices or rates.

It is the opinion of the management of the Bank that the fair value of the Bank's financial assets and liabilities are not materially different from the amounts stated in the balance sheets as at 31 December 2008 and 31 December 2007. In estimating the fair value of the Bank's financial instruments, the following methods and assumptions were used:

Cash balances with the Central bank

The carrying values of cash and balances with the Central bank are generally deemed to approximate their fair value.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

5. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (CONTINUED)

Due from banks

The estimated fair value of amounts due from banks that mature in 180 days or less approximates their carrying amounts. The fair value of other amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk). The fair value of non-performing amounts due from banks is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral. Allowances are not taken into consideration when calculating fair values.

Loans and advances to customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

Amounts due to banks and customers

The fair value of term deposits payable on demand represents the carrying value of amounts payable on demand as at the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as at the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using rates currently offered for deposits of similar remaining maturities.

6. INTEREST INCOME

	31 December 2008	31 December 2007
Companies	22,898	15,056
Individuals	32,939	19,765
Domestic banks	2,516	6,685
Foreign banks	3,893	2,534
Government	152	248
Other	6	24
	62,404	44,312

Interest income includes collected interest previously recorded under off-balance accounts in the amount of KM 1,950 thousand in the year ended 31 December 2008 (2007: KM 1,354 thousand).

7. INTEREST EXPENSE

	31 December 2008	31 December 2007
Individuals	7,601	6,518
Banks and other financial institutions	10,838	4,415
Companies	8,338	3,383
	26,777	14,316

Notes to the financial statements
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(all amounts are expressed in thousands of KM)

8. FEE AND COMMISSION INCOME

	31 December 2008	31 December 2007
Domestic payment transactions	2,866	2,236
Credit card activities	2,286	2,051
Foreign payment transactions	1,858	1,391
FX transactions	1,586	1,095
Guarantees	1,296	1,025
Agency services	241	268
Other	1,778	1,172
	11,911	9,238

9. FEE AND COMMISSION EXPENSE

	31 December 2008	31 December 2007
Credit card operations	2,149	1,728
Banking Agency of FBiH services	622	503
Central Bank BiH services	205	182
Domestic payment transactions	324	190
E-banking service	106	96
	3,406	2,699

10. NET FOREIGN EXCHANGE INCOME

	31 December 2008	31 December 2007
Gains on foreign exchange transactions and translations	33,327	8,487
Loss on foreign exchange transactions and translations	(32,908)	(8,166)
	419	321

11. OTHER OPERATING INCOME

	31 December 2008	31 December 2007
Rental income	112	173
Dividend income	422	120
Gain on sale of investments	2,170	61
Gain on sale of property	1,074	75
Other income	1,047	440
	4,825	869

Notes to the financial statements
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12. COLLECTED WRITE-OFFS

	31 December 2008	31 December 2007
Suspended Interest	1,379	807
Principal	3,356	816
Other	176	46
	4,911	1,669

13. ADMINISTRATIVE EXPENSES

	31 December 2008	31 December 2007
Personnel expenses	17,624	12,341
Rent and other rent related expense	2,641	1,399
Telecommunication and post expense	2,241	1,563
Saving deposit insurance and other insurance charges	1,410	1,105
Provisions, net (Note 28)	(60)	907
Material expenses	971	805
Representation and marketing expense	869	543
Consultancy expenses	713	424
Energy	615	369
Maintenance Expenses	1,767	791
Other expenses	3,011	1,805
	31,802	22,052

The Bank does not have pension arrangements separate from Bosnia and Herzegovina pension system. This system requires that current contributions by the employer be calculated as a percentage of current gross salary payments and taxes on net salary; these expenses are charged to the profit and loss statement in the period the related compensation is earned by the employee.

The average number of personnel employed by the Bank during the years ended 31 December 2008 and 2007 was 499 and 327 respectively.

14. IMPAIRMENT LOSSES AND PROVISIONS

	31 December 2008	31 December 2007
Additions on/(Release of) impairment losses on placements with other banks	17	(161)
Additions on impairment losses on loans and advances originated by the Bank	13,796	12,167
(Release of)/additions on impairment losses on assets available for sale	(10)	15
Additions on provision for other assets	564	72
Additions on provision for commitments and contingent liabilities	853	1,720
	15,220	13,813

Notes to the financial statements
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15. INCOME TAX

	31 December 2008	31 December 2007
Profit before income tax	3,703	1,605
Non-deductible expenses and taxable income relieves	5,416	3,548
Taxable income	9,119	5,153
Income tax liability of 10% (2008.) / 30% (2007.)	912	1,546
Reinvestment allowance	-	(1,160)
Tax allowance for foreign investment	-	(309)
Income tax liability	912	77

Tax liability is based on accounting income before restatement taking into the account non-deductible expenses and non-taxable income. Tax income rate for the years ended 31 December 2008 was 10% and for 2007 was 30 %. In 2007 the Bank was eligible for a 75% reduction of its liability to corporate profit tax to the extent that it will reinvest the amount of the underlying taxable profits into fixed assets in the following period. The eligibility to special tax allowances on foreign investments and fixed assets has been abolished by the new Income Tax Law in force since 1 January 2008.

Also, in 2007 the Bank was eligible for an allowance against taxable profits in proportion to its foreign owned percentage of share capital in the first five years of such foreign investment.

Based on management's review and assessment as of 31 December 2008, apart from the taxable temporary differences arising on fair value adjustments of financial assets available for sale with respect to which deferred tax liabilities in the amount of KM 24 thousand (2007: KM 50 thousand) were recognised through equity, there were no other temporary differences which would qualify for recognition of deferred tax assets or liabilities.

16. EARNINGS PER SHARE

	31 December 2008	31 December 2007
Net profit	2,791	1,528
Weighted average number of ordinary shares outstanding	373,417	267,576
Basic earnings per share	0.00747	0.00571

17. CASH AND CASH EQUIVALENTS

	31 December 2008	31 December 2007
Current account in domestic currency with the Central Bank	5,645	130,724
Cash on hand in domestic currency	10,398	13,371
Cash on hand in foreign currency	8,985	8,582
Correspondent accounts with banks in foreign currency	1,777	2,232
	26,805	154,909

Notes to the financial statements
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18. OBLIGATORY RESERVE WITH THE CENTRAL BANK

	31 December 2008	31 December 2007
Obligatory reserve	116,696	132,022
	116,696	132,022

Minimum obligatory reserve as of 31 December 2008 is calculated in amount of 14% (as of 31 December 2007: 15%) of the average amount of total deposits and the borrowings for each working day during 10 calendar days following the period of maintaining the obligatory reserve.

After 1 November 2008, short and long terms deposits from non-resident banks and short and long term borrowings received after 1 November 2008 are excluded from the calculation of the compulsory reserve.

19. PLACEMENTS WITH OTHER BANKS

	31 December 2008	31 December 2007
Short-term placements with banks in following countries:		
Bosnia and Herzegovina	-	36
OECD countries	105,477	90,053
<i>Placements to other financial institutions, gross</i>	<i>105,477</i>	<i>90,089</i>
Less: Provisions for impairment	(18)	(1)
	105,459	90,088

The average interest rate for placements in EUR was 3.60% p.a. and 3.7% p.a. and for placements in USD 2.27% p.a. and 5.10% p.a. as of 31 December 2008 and 31 December 2007, respectively.

The movements in the provision for impairment of placements with other banks are summarized as follows:

	31 December 2008	31 December 2007
Balance as at 1 January	1	161
Merger of LT Gospodarska Banka d.d. Sarajevo	-	1
Provisions	59	223
Reversal of provisions	(42)	(384)
Balance as at 31 December	18	1

Notes to the financial statements
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20. LOANS AND RECEIVABLES

	31 December 2008	31 December 2007
Short-term loans in domestic currency	235,510	181,264
Short-term loans in foreign currency	1,775	5,836
Current portion of long-term loans	104,145	83,742
<i>Total short-term loans</i>	<u>341,430</u>	<u>270,842</u>
Long-term loans in domestic currency	176,667	161,926
Long-term loans in foreign currency	346,806	222,669
(Current portion of long-term loans)	(104,145)	(83,742)
<i>Total long-term loans</i>	<u>419,328</u>	<u>300,853</u>
<i>Total loans before provisions</i>	<u>760,758</u>	<u>571,695</u>
Provision for impairment	(33,612)	(31,346)
	<u>727,146</u>	<u>540,349</u>

Short-term loans are granted for periods of 1 to 365 days. The majority of short-term loans in domestic currency are granted to clients for working capital financing. Long-term loans are mostly granted to individuals for housing and vehicle purchases.

The movements in the provision for impairment of loans are summarized as follows:

	31 December 2008	31 December 2007
Balance as at 1 January	31,346	18,554
Merger of LT Gospodarska Banka d.d. Sarajevo	-	6,821
Provisions charged	34,082	23,147
Reversal of provision	(20,286)	(10,980)
Write-offs	(11,530)	(6,196)
Balance as at 31 December	<u>33,612</u>	<u>31,346</u>

Total amount of non-performing loans on which interest was suspended as at 31 December 2008 and 2007 was KM 26,445 thousand and KM 36,650 thousand, respectively.

	31 December 2008	31 December 2007
Manufacturing industry	119,715	107,703
Trade	118,878	80,421
Construction industry	24,263	30,111
Services, finance, sport, tourism	40,071	12,899
Administrative and other public institutions	2,680	2,349
Agriculture, forestry, mining and energy	19,550	17,070
Transport and telecommunications	17,481	7,699
Other	14,387	7,818
Citizens	403,733	305,625
	<u>760,758</u>	<u>571,695</u>

Notes to the financial statements
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(all amounts are expressed in thousands of KM)

20. LOANS AND RECEIVABLES (CONTINUED)

Interest rates for granted loans as at 31 December 2008 and 2007 are summarized as follows:

	31 December 2008		31 December 2007	
	KM '000	Annual interest rate	KM '000	Annual interest rate
<i>Domestic currency</i>				
Companies	338,498	3.00% - 12.00%	233,370	1.50% - 13.50%
Citizens	73,679	4.00% - 14.75%	109,820	4.00% - 12.75%
<i>Foreign currency</i>				
Companies	18,527	5.79% - 11.22%	32,700	6.65% - 10.75%
Citizens	330,054	4.00% - 11.00%	195,805	5.00% - 11.00%
	760,758		571,695	

21. ASSETS AVAILABLE FOR SALE

	31 December 2008	31 December 2007
Gross value	817	1,285
Impairment	(16)	(26)
	801	1,259

Assets available for sale include investments of 20.03% in share capital of Bamcard d.d. Sarajevo in the amount of KM 488 thousand, and shares of VISA Inc. in the amount of KM 266 thousand. The Bank is planning to sell this investments in the near future.

Also, assets available for sale include investments of 2% or less in various companies in Bosnia and Herzegovina recognized at cost of KM 63 thousand (2007: KM 61 thousand).

The movements in the provision for impairment of financial assets available for sale are summarized as follows:

	31 December 2008	31 December 2007
Balance as at 1 January	26	48
Provisions	5	15
Reversal of provision	(15)	-
Write offs	-	(37)
Balance as at 31 December	16	26

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22. OTHER ASSETS

	31 December 2008	31 December 2007
Prepaid income taxes	2,812	3,724
Payment to the Cantonal Privatization Agency for privatization of "Projekt" d.d. Sarajevo	1,200	1,200
Prepaid expenses	1,348	710
Fees receivable	343	581
Receivables from card operations	195	450
Other assets	1,638	2,044
<i>Total other assets</i>	<i>7,536</i>	<i>8,709</i>
Provision for impairment	(649)	(391)
	6,887	8,318

The movements in the provision for impairment of other assets are summarized as follows:

	31 December 2008	31 December 2007
Balance as at 1 January	391	188
Merger of LT Gospodarska Banka d.d. Sarajevo	-	131
Provisions	1,216	686
Reversal of provision	(652)	(614)
Write-offs	(306)	-
Balance as at 31 December	649	391

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23. PROPERTY, PLANT AND EQUIPMENT

	Land and Buildings	Computers and other equipment	Software	Construction in progress	Leasehold improvements	Building out of use	Total
Cost value							
31 December 2006	10,173	7,212	972	1,606	-	-	19,963
Merger of LT Gospodarska Banka d.d. Sarajevo	2,234	3,450	1,408	211	1,852	-	9,155
Additions	-	21	-	7,166	-	-	7,187
Disposals	(60)	(828)	-	-	-	-	(888)
Transfers from construction in progress	1,318	3,238	285	(7,400)	2,191	368	-
Transfer from other assets	-	-	-	-	519	-	519
31 December 2007	13,665	13,093	2,665	1,583	4,562	368	35,936
Additions	-	4	-	7,283	-	-	7,287
Disposals	(192)	(1,117)	(25)	(9)	-	(368)	(1,711)
Transfers from construction in progress	171	4,779	991	(7,727)	1,786	-	-
Transfer from other assets	(55)	55	-	-	-	-	-
31 December 2008	13,589	16,814	3,631	1,130	6,348	-	41,512
Accumulated Depreciation							
31 December 2006	710	3,664	652	-	-	-	5,026
Merger of LT Gospodarska Banka d.d. Sarajevo	350	2,057	1,055	-	1,463	-	4,925
Depreciation for the period	157	1,213	278	-	271	5	1,924
Disposals	(24)	(610)	-	-	-	-	(634)
31 December 2007	1,193	6,324	1,985	-	1,734	5	11,241
Transfer from other assets	(25)	25	-	-	-	-	-
Depreciation for the period	179	1,998	446	-	935	4	3,562
Disposals	(26)	(913)	(25)	-	-	(9)	(973)
31 December 2008	1,321	7,434	2,406	-	2,669	-	13,830
Net book value: 31 December 2008	12,268	9,380	1,225	1,130	3,679	-	27,682
Net book value: 31 December 2007	12,472	6,769	680	1,583	2,828	363	24,695

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24. DUE TO BANKS AND OTHER INSTITUTIONS

	31 December 2008	31 December 2007
Current portion of long-term borrowings	24,811	14,308
Short-term borrowings from other institutions	-	51
<i>Total short-term borrowings</i>	<i>24,811</i>	<i>14,359</i>
Long-term borrowings from foreign banks and other institutions	208,439	117,851
Long-term borrowings from domestic banks and other institutions	12,855	16,433
Current portion of long-term borrowings	(24,811)	(14,308)
<i>Total long-term borrowings</i>	<i>196,483</i>	<i>119,976</i>
Current accounts in domestic currency	18	533
Current accounts in foreign currency	1	-
<i>Total current accounts</i>	<i>19</i>	<i>533</i>
Short-term deposit	68,454	39,117
Long-term deposits	42,617	9,779
	332,384	183,764

Long-term borrowings from international banks and non-banking financial and non-financial institutions as at 31 December 2008 and 31 December 2007 were as follows:

	31 December 2008	31 December 2007
Commerzbank Ag Frankfurt, Germany	69,458	58,706
Societe Europeenne De Banque S.A., Luxembourg	39,454	9,784
European Fund for Southeast Europe (EFSE), Luxembourg	26,861	8,918
Intesa Sanpaolo SPA Milan, Italy	26,279	28,452
European Investment Bank	20,498	-
Vseobecna Uverova Banka A.S. Bratislava	19,564	-
Federalni zavod za zapošljavanje, Sarajevo	3,819	3,851
Razvojna banka Federacije Bosne i Hercegovine d.o.o. Sarajevo	3,368	6,727
European Bank for Reconstruction and Development, London, UK	2,497	5,716
Federalno ministarstvo finansija, Sarajevo	2,437	2,475
Vlada SBH/ŽSB, Travnik	2,117	2,114
OPEC FUND for International Development, Vienna, Austria	1,274	1,784
Hrvatska banka za obnovu i razvitak (HBOR), Zagreb, Croatia	1,133	1,384
Federalno ministarstvo šumarstva i vodoprivrede, Sarajevo	1,028	1,028
Privredna banka Zagreb d.d., Zagreb, Croatia	806	1,606
Partners for Development, Sarajevo	615	922
USAID Business Finance Office Sarajevo	-	579
Služba za zapošljavanje SBK / ŽSB	86	217
The Lutheran World Federation BiH	-	21
Izvozno kreditna agencija Bosne i Hercegovine, IGA, Sarajevo	-	51
	221,294	134,335

Interest rates for long-term borrowings from banks and other institutions were in the range from 0% to 8.11% per annum and from 0% to 8.11% per annum as of 31 December 2008 and 31 December 2007, respectively.

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25. SUBORDINATED DEBT

	31 December 2008	31 December 2007
Intesa Sanpaolo Holding International S.A. Luxembourg	-	15,003
USAID	1,568	1,730
VSEOBECNA UVEROVA BANKA A.S.	9,788	-
	11,356	16,733

The subordinated loan from USAID as of 31 December 2007 and 31 December 2008 respectively amounting to KM 1,730 thousand and KM 1,565 thousand was received in August 2003 in the amount of KM 2,408 thousand, and it is repayable in 60 quarterly instalments starting from 1 December 2003 until 1 September 2018. Interest rate is fixed at 2.3163 % p.a.

The subordinated loan from VUB (Vseobecna Uverova Banka) amounting to 9,779 KM thousand was received in 27 June 2008 and interest is payable quarterly starting from 27 June 2008 until 27 June 2013, but the principal will be repaid in whole at 27 June 2013. Interest rate is 3M EURIBOR + 3.54%.

Subject to the approval of the Banking Agency of Federation of Bosnia and Herzegovina, the subordinated debt may be used as additional capital.

26. DUE TO CUSTOMERS

	31 December 2008	31 December 2007
Demand deposits:		
Citizens:		
In KM	42,942	46,124
In foreign currencies	22,014	23,023
<i>Subtotal</i>	64,956	69,147
Legal entities:		
In KM	169,216	290,306
In foreign currencies	38,515	37,234
<i>Subtotal</i>	207,731	327,540
Total demand deposits	272,687	396,687
Term deposits:		
Citizens:		
In KM	26,282	40,232
In foreign currencies	125,397	139,343
<i>Subtotal</i>	151,679	179,575
Legal entities:		
In KM	63,916	64,330
In foreign currencies	46,099	18,854
<i>Subtotal</i>	110,015	83,184
Total term deposits	261,694	262,759
	534,381	659,446

During 2008 interest rates for demand deposits were from 0.00% to 2.50% (during 2007 were 0.25%). Short-term deposit interest rates were from 0.00% to 7.40% and from 0.00% to 5.46% during 2008 and 2007, respectively. Long-term deposit interest rates were from 0.00% to 8.00% and from 0.00% to 8.00% during 2008 and 2007, respectively.

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27. OTHER LIABILITIES

	31 December 2008	31 December 2007
Loan repayments received before due dates	2,899	2,100
Liabilities to vendors	1,447	963
Liabilities for employees bonuses	496	776
Managed fund difference (Note 31)	14	302
Credit card liabilities	191	266
Liabilities to shareholders	149	151
Deferred tax liability	24	50
Other liabilities	906	1,252
	6,126	5,860

28. OTHER PROVISIONS

	31 December 2008	31 December 2007
Provisions for litigations with the Tax authorities and clients	1,445	1,324
Provisions relating to the merger of LT Gospodarska Banka d.d. Sarajevo	-	629
Provisions for retirement employee benefits and other short-term employee benefits	395	656
	1,840	2,609

Provisions for litigations are made based on the uncertainty in the outcomes of the ongoing court case with the tax authority and other proceedings .

	Provisions for legal proceedings	Provision relating to merger of LT Gospodarska banka d.d. Sarajevo	Provisions for retirement employee benefits and other short term employee benefits	Total
Balance at 31 December 2007	1,324	629	656	2,609
Additional provision recognised	168	128	184	480
Release of provision	-	(95)	(445)	(540)
Reductions arising from payments	(47)	(662)	-	(709)
Balance at 31 December 2008	1,445	-	395	1,840

Calculation of provisions for retirement benefits (KM 157 thousand) is performed by independent actuary, applying a discount rate of 6% and 3% expected rate of increase in salaries, to working life and average salary of each employee.

Provisions for unused days of vacation (KM 238 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

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29. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Bank has been involved in a number of legal proceedings to recover collateral or outstanding credit balances, as well as related interest and expenses from defaulted credit customers and interbank counterparts. The management of the Bank believes that any legal proceedings pending as at 31 December 2008 will not result in material loss to the Bank.

	31 December 2008	31 December 2007
Contingent liabilities		
Payment guarantees	17,880	14,595
Performance guarantees	26,050	25,141
Letters of credit	1,150	942
Total contingent liabilities	45,080	40,678
Commitments		
Unused portion of overdraft loans	82,805	71,166
Total commitments	82,805	71,166
Total contingent liabilities and commitments	127,885	111,844

In the ordinary course of business, the Bank enters into credit related commitments which are recorded in off-balance sheet accounts and primarily include guarantees, letters of credit and undrawn loan commitments. Provisions for contingent liabilities are recognised when the Bank has a present obligation as a result of a past event, and it is probable that the Bank will be required to settle that obligation. Management Board estimates the provisions based at the best estimate of expenditure to settle the Bank's obligation.

Movements in provision for contingent liabilities and commitments are as follows:

	31 December 2008	31 December 2007
Balance as at 1 January	3,027	1,345
Merger of LT Gospodarska Banka d.d. Sarajevo		458
Increase in provisions	5,483	4,156
Reversal of provision	(4,630)	(2,436)
Write offs	(853)	(496)
Balance as at 31 December	3,027	3,027

30. RELATED-PARTY TRANSACTIONS

Related parties, as defined by IAS 24, are those counter parties that represent:

- enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (This includes holding companies, subsidiaries and fellow subsidiaries);
- associates – enterprises in which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;
- individuals owning, directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank, and anyone expected to influence, or be influenced by, that person in their dealings with the Bank;
- key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, including directors and officers of the Bank and close members of the families of such individuals; and
- enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the Bank and enterprises that have a member of key management in common with the Bank.

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30. RELATED-PARTY TRANSACTIONS (CONTINUED)

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

	31 December 2008	31 December 2007
Receivables		
Key management personnel and close family members	232	208
Bank accounts – Intesa Sanpaolo Group	41,417	753
Other receivables – Intesa Sanpaolo Group	18	-
Other receivables from European Bank for Reconstruction and Development (EBRD)	20	39
	41,687	1,000
Liabilities		
Deposits – Supervisory board members and close family members	-	11
Deposits – Key management personnel and close family members	462	254
Borrowings – Intesa Sanpaolo Group	240,856	102,134
Other liabilities – Intesa Sanpaolo Group	1,165	1,855
Borrowings and other liabilities to European Bank for Reconstruction and Development (EBRD)	5,746	5,720
	248,229	109,974
Financial commitments and contingencies		
Guarantees issued in favour of Intesa Sanpaolo Group	3,523	-
Income		
Interest income - Key management personnel and close family members	17	3
Interest income – Intesa Sanpaolo Group	731	83
Other Income – Intesa Sanpaolo Group	101	58
	849	144

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30. RELATED-PARTY TRANSACTIONS (CONTINUED)

	31 December 2008	31 December 2007
Expenses		
Interest expense - Key management personnel and close family members	8	6
Interest expense – Intesa Sanpaolo Group	7,851	2,439
Interest expense - European Bank for Reconstruction and Development (EBRD)	265	427
Other expenses – Intesa Sanpaolo Group	540	20
Other expense - European Bank for Reconstruction and Development (EBRD)	25	24
	8,689	2,916

Intesa Sanpaolo Holding International S.A. is the majority shareholder and exercises control over the Bank's operations.

EBRD is one of the Bank's majority shareholders.

No exposure towards related parties has been classified as non-performing. Expenses for those exposures during the period relates only to the establishment of the 2% generic provision.

A number of banking transactions are entered into with related parties in the normal course of business. These transactions were carried out on commercial terms and conditions and at market rates.

The remuneration of directors and other members of key management were as follows:

	31 December 2008	31 December 2007
Compensation for directors and other key management	746	350
Taxes and contributions on compensation	463	236
Termination benefits	-	86
Bonuses to Management board – Accrued expenses	250	250
Compensations for Supervisory Board members	-	-
Compensations for Audit Committee members	-	-
Other Management benefits	175	177
	1,634	1,099

The Bank has:

- neither guarantee with any director or other member of key management,
- nor exposure towards director or key management has been classified as non-performing.

Expenses for those exposures during the period relates only to the establishment of the 2% generic provision.

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31. MANAGED FUNDS

The Bank manages assets on behalf of third parties. These assets are recorded separately from the Bank's assets. For its services, the Bank charges a fee amounting from 0.20 to 2.50% p.a. (in 2007 from 0.6% to 2.50% p.a.) of the total amount contributed.

	31 December 2008	31 December 2007
Liabilities		
Investment Bank of Bosnia and Herzegovina Companies	1,924	2,332
Investment Guarantee Agency - IGA	15,989	22,278
Managed on behalf and for the account of the Sarajevo Canton, Ministry of Finance	2,073	2,123
	<u>82</u>	<u>118</u>
Total	20,068	26,851
Assets		
Loans to companies	16,493	23,912
Loans to citizens	3,561	2,637
	<u>20,054</u>	<u>26,549</u>
Total	20,054	26,549
Amounts due to original creditors – managed funds (Note 27)	14	302

The Bank has not issued any guarantees related to managed funds.

32. FINANCIAL INSTRUMENTS

Capital management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the face of balance sheets, are:

- To comply with the capital requirements set by the regulators of the banking markets;
- To safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business.

The Bank expects to maintain its debt to capital ratio. Solvency indicators were as follows:

	31 December 2008	31 December 2007
Debt (i)	866,765	843,210
Cash on hand, balances with the Central bank and placements with other banks	(248,960)	(377,019)
Net debt	617,805	466,191
Capital (ii)	133,718	96,934
Net debt to capital ratio	4.62	4.81

Debt (i) is defined as liabilities to banks and clients presented in detail in Notes 24 and 26. Capital (ii) includes total capital, Bank's reserves, retained earnings and subordinated debt.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management, employing techniques based on the guidelines developed by Banking Agency of Federation of Bosnia and Herzegovina (FBA) for supervisory purposes. The required information is filed with the FBA on a quarterly basis.

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32. FINANCIAL INSTRUMENTS (CONTINUED)

Capital management (Continued)

The FBA requires each bank to:

- (a) hold the minimum level of the regulatory capital of KM 15,000,000, and
- (b) maintain a ratio of total regulatory capital to the risk-weighted asset at or above the minimum of 12% for 2008. From 31 December 2008 Federal Banking Agency requested banks to include in the calculation of capital adequacy a charge for operational risk.

The Bank's regulatory capital is divided into two tiers:

- Tier 1 capital or Core Capital: share capital (net of any book values of the treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; and
- Tier 2 capital or Supplementary Capital: qualifying principle of subordinated loan capital, collective impairment allowances and unrealised gains arising on the fair valuation of equity instruments held as available for sale.

The risk-weighted assets are measured by means of a hierarchy of four weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

Charge for operational risk has been introduced since 31 December 2008. The table below summarises the composition of regulatory capital and the ratios of the Bank for the years ended 31 December. During those two years the Bank complied with all of the externally imposed capital requirements to which they are subject:

	31 December 2008	31 December 2007
Tier 1 capital		
Share Capital (net of treasury shares)	45,296	37,145
Share Premium	59,368	28,401
Statutory reserves	614	614
Retained Earnings	8,514	7,950
Other reserves not related to assets valuation	5,537	4,448
Revaluation reserve – available for sale investments	242	115
Items to be deducted: Intangible assets	(1,243)	(680)
<i>Total qualifying Tier 1 Capital</i>	<i>118,328</i>	<i>77,993</i>
Tier 2 capital		
Qualifying subordinated loan capital	11,344	16,725
Generic provisions for performing assets	16,226	11,473
Profit for the year	2,791	1,528
<i>Total qualifying Tier 2 Capital</i>	<i>30,361</i>	<i>29,726</i>
Total regulatory capital	148,689	107,719
Risk weighted assets		
On balance sheet	767,407	576,585
Off balance sheet	69,586	59,984
Total	836,993	636,569
Operational risk	2,417	-
Total weighted risk	839,410	636,569
Capital adequacy ratio	17.70%	16.90%

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32. FINANCIAL INSTRUMENTS (CONTINUED)

Financial risk management objectives

Main purpose of Risk management Department is to support financial operations, coordinate access to domestic and international financial markets, overlooking and manage financial risk through internal risk reports including analysis by size and level of the risk. Financial risk management includes: market risk (FX risk, interest rate risk, and pricing risk), credit risk, liquidity risk and interest rate cash flow risk.

Foreign currency risk

The Bank is exposed to foreign currency risk when there is no matching between assets and liabilities due to cash flows denominated in foreign currencies. Portfolio exposure to foreign currency risk arises from portfolio sensitivity to fluctuations in exchange rate values. The degree of foreign currency risk depends on the amount of open positions and the degree of potential change in foreign currency rates.

The carrying amounts of the Bank's foreign currency denominated monetary assets and liabilities at the reporting date are as follows:

	Assets		Liabilities	
	31 December 2008	31 December 2007	31 December 2008	31 December 2007
EUR	636,279	430,160	620,374	420,584
USD	20,604	22,729	20,555	22,738
CHF	1,338	2,012	1,313	1,879
HRK	1,541	1,629	1,512	1,499
GBP	196	190	179	188
Other	665	1,040	577	754

Foreign currency sensitivity analysis

The Bank is not exposed to foreign currency risk related to EUR due to the fact that Convertible Mark is pegged to EURO (1 EUR = KM 1.955830). Change in the exchange rate would require the amendments of the law and approval by Parliamentary Assembly of Bosnia and Herzegovina. Exposure is more prominent for USD and CHF. The following table details the Bank's sensitivity to a 10% increase or decrease in foreign currency rates against the relevant local currencies. The sensitivity rate of 10% is used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates.

Result of KM 4,9 thousand profit/loss on USD position at 31.12.2008 is the result of having the Bank open position in USD equal to KM 49 thousand (USD assets 20,604 thousand KM and liabilities 20,555 thousand KM). If we take in consideration foreign currency movements and predict 10% positive or negative change applied to an open position of KM 49 thousand, the Bank is exposed to a FX risk in the amount of KM 4.9 thousand. In case of a long position with a positive market movements the Bank will record a profit and loss in the opposite case.

	USD Effect (KM '000)		CHF Effect (KM '000)	
	31 December 2008	31 December 2007	31 December 2008	31 December 2007
Profit or Loss	4.9	(1)	2.5	13

The analysis outlined above is used on open foreign currency position of the Bank, which includes all asset and liability items.

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32. FINANCIAL INSTRUMENTS (CONTINUED)

Foreign currency risk (continued)

Foreign currency sensitivity analysis (continued)

If the currency position of a foreign currency is “long” (assets exceeding liabilities) and the exchange rate for this currency increases in relation to the KM, the Bank will experience a foreign exchange gain.

If the currency position of a foreign currency is “long” (assets exceeding liabilities) and the exchange rate for this currency decreases in relation to the KM, the Bank will experience a foreign exchange loss.

If the currency position of a foreign currency is “short” (liabilities exceeding assets) and the exchange rate for this currency increases in relation to KM, the Bank will experience a foreign exchange loss.

If the currency position of a foreign currency is “short” (liabilities exceeding assets) and the exchange rate for this currency decreases in relation to KM, the Bank will experience a foreign exchange gain.

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank monitors its foreign exchange (FX) position for compliance with the regulatory requirements of the Banking Agency of Federation of Bosnia and Herzegovina established in respect of limits on open positions. The Bank seeks to match assets and liabilities denominated in foreign currencies to avoid foreign currency exposures.

Interest rate risk management

The Bank is exposed to interest rate risk as the Bank borrows funds at both fixed and floating interest rates. The risk is managed by the Bank by maintaining an appropriate mix between fixed and floating rate borrowings.

The Bank’s exposures to interest rates on financial assets and financial liabilities are detailed in the liquidity risk management section of this note.

Interest rate risk reflects the possibility of loss of profit and/or erosion of capital due to a change in interest rates. It relates to all products and balances that are sensitive to changes in interest rates. This risk comprises two components: income component and investment component.

The income component arises from a lack of harmonization between the active and passive interest rates of the Bank (interest on placements is fixed, interest for liabilities is variable and vice versa).

The investment component is a consequence of the inverted relationship between price and interest rate fluctuations of securities.

The Bank strives to protect itself from interest rate risk by harmonizing the type of interest rate (fixed and variable), currency, related interest rate and the date of interest rate change for all products for which it concludes contracts (which are sensitive to interest rate changes). Any incongruity among the abovementioned elements results in exposure of the Bank to interest rate risk.

The sensitivity analyses below have been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the balance sheet date. For floating rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the balance sheet date was outstanding for the whole year. A 200 basis point increases or decrease is used when reporting interest rate risk internally to key management personnel and represents management’s assessment of the reasonably possible change in interest rates.

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32. FINANCIAL INSTRUMENTS (CONTINUED)

Interest rate risk management (continued)

If changes in interest rates market moving had been 200 basis points (2.00%) higher/lower and all other variables were held constant, the Bank's:

- profit for the year ended 31 December 2008 would decrease/increase by KM 2,778 thousand (2007: decrease/increase by KM 357 thousand). This is mainly attributable to the Bank's exposure to interest rates on its variable rate borrowings

Credit risk management

The Bank takes on exposure to credit risk which is the risk upon credit approval and when counterparty will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

Making decision on exposure to credit risk is, according to the Bank's policy, centralised and concentrated in the Credit Committee for the retail and business. Decisions of the Credit Committees are made upon consideration of proposal provided by the Risk Management Department. The terms for approval of each corporate loan are determined individually depending on client type, loan's purpose, estimated credit worthiness and current market situation. Terms of security that accompany each loan are also determined according to a client credit worthiness analysis, type of credit risk exposure, term of the placement as well as the placement amount.

Commitments arising from the issuance of letters of credit, documentary letters of credit, which are written irrevocable undertakings by the Bank on behalf of a customer (mandatory) authorising a third party (beneficiary) to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Cash requirements under open letters of credit are considerably less than the commitments under issued guarantees or stand-by letters of credit. However, the Bank records provisions against these instruments on the same basis as is applicable to loans.

Commitments to extend credit, undrawn loan commitments, unutilised overdrafts and approved overdraft loans. The primary purpose of commitments to extend credit is to ensure that funds are available to a customer as required. Commitments to extend credit represent unused portions of authorisations to extend credits in the form of loans, guarantees or stand-by letters of credit. Commitments to extend credit issued by the Bank represent issued loan commitments or guarantees, undrawn portions of and approved overdrafts loans. Commitments to extend credit or guarantees issued by the Bank which are contingent upon customers maintaining specific credit standards (including the condition that a customer's solvency does not deteriorate) are revocable commitments. Irrevocable commitments represent undrawn portions of authorised loans and approved overdraft facilities because they result from contractual terms and conditions in the credit agreements.

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

32. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk management (continued)

Financial assets

	Total gross carrying amount	Unimpaired assets	Individually impaired assets	Provisions for losses	Total net carrying amount
31 December 2008					
Cash and balances with other banks	26,805	26,805	-	-	26,805
Obligatory reserve with the Central Bank	116,696	116,696	-	-	116,696
Placements with other banks	105,477	105,477	-	(18)	105,459
Loans and advances to customers	760,758	719,648	41,110	(33,612)	727,146
Assets available for sale	817	817	-	(16)	801
	1,010,553	969,443	41,110	(33,646)	976,907
31 December 2007					
Cash and balances with other banks	154,909	154,909	-	-	154,909
Obligatory reserve with the Central Bank	132,022	132,022	-	-	132,022
Placements with other banks	90,089	90,089	-	(1)	90,088
Loans and advances to customers	571,695	527,169	44,526	(31,346)	540,349
Assets available for sale	1,285	1,285	-	(26)	1,259
	950,000	905,474	44,526	(31,373)	918,627

Notes to the financial statements
for the year ended 31 December 2008
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32. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk management (Continued)

Credit exposure and collateral

31 December 2008		Credit risk exposure		
Description	Loans given	Undrawn loan commitments and unutilized overdrafts	Commitments / Guarantees issued	Fair value of the collateral
Legal entity	357,025	34,125	45,080	233,556
Retail	403,733	48,680	-	115,278
Total	760,758	82,805	45,080	348,834
31 December 2007				
Legal entity	266,070	16,026	40,678	195,155
Retail	305,625	55,140	-	70,512
Total	571,695	71,166	40,678	265,667

Fair value of the collateral

	31.12.2008	31.12.2007
Property	329,092	246,103
Deposits	19,742	19,564
	348,834	265,667

The Collateral Policy of the Bank defines the type of collateral, way of estimating fair value of collaterals and procedure for collection of receivable through collaterals. Type of prescribed collaterals and their respective amount are based on evaluation of every client's credit worthiness. Main categories or accepted collaterals are: cash, real estate, movable property and personal guarantees.

The Bank collateral policy defines also the process of recovery of non-performing loans through collaterals in order to decrease credit risk. The property that the Bank acquired through its collection process (land and buildings in the amount of KM 36 thousand) is not shown among the Bank's property plant and equipment but it is recorded in "Other assets" position.

Notes to the financial statements
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(all amounts are expressed in thousands of KM)

32. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk management (Continued)

Delays

	Gross total loans and advances given to customers	Undue	Until 30 days	31 – 90 days	91 – 180 days	181 – 270 days	Over 270 days
31 December 2008							
Legal entities	357,025	340,070	4,193	508	984	747	10,523
Retail	403,733	395,920	4,317	838	1,838	820	-
Total	760,758	735,990	8,510	1,346	2,822	1,567	10,523
31 December 2007							
Legal entities	266,070	245,446	6,673	2,113	2,307	2,284	7,247
Retail	305,625	300,139	1,933	1,177	834	521	1,021
Total	571,695	545,585	8,606	3,290	3,141	2,805	8,268

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment agreements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to impairment assessment. The amount of renegotiated loans in 2008 was 33,210 thousand KM, and in 2007. was 25,214 thousand KM.

Loans and other assets written off and recorded off-balance sheet

Movements in loans and other assets written off and recorded off-balance sheet are as follows:

	Loans and receivables	Assets available for sale	Other assets	Commitments	TOTAL
31 December 2007	19,624	857	3,540	2,103	26,124
Write-offs in 2008	11,530	-	306	853	12,689
Collections	(4,231)	-	(176)	(504)	(4,911)
Total Write offs	(31)	-	(108)	-	(139)
31 December 2008	26,892	857	3,562	2,452	33,763

Notes to the financial statements
for the year ended 31 December 2008

(all amounts are expressed in thousands of KM)

32. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk management

Liquidity risk is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank maintains its liquidity profiles in accordance with regulations laid down by the Banking Agency of Federation of Bosnia and Herzegovina.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash-settled derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The following tables detail the Bank's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Bank can be required to pay. The table includes both interest and principal cash flows.

	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	5+ years	Total
31.12.2008						
Due to banks and other institutions	50,693	32,920	50,393	196,427	46,220	376,653
Subordinated debit	-	40	124	11,866	1,281	13,311
Due to customers	280,122	17,708	122,623	125,468	6,798	552,719
Other financial liabilities	6,000	-	-	-	136	6,136
	336,815	50,668	173,140	333,761	54,435	948,819
31.12.2007						
Due to banks and other institutions	21,403	1,012	21,658	142,368	17,564	204,005
Subordinated debit	-	228	966	20,202	1,035	22,431
Due to customers	406,176	28,543	124,415	114,898	5,239	679,271
Other financial liabilities	6,075	-	2	-	74	6,151
	433,654	29,783	147,041	277,468	23,912	911,858

Notes to the financial statements
for the year ended 31 December 2008
(all amounts are expressed in thousands of KM)

32. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk management

The following tables details the Bank's remaining contractual maturity for its commitments and contingent liabilities.

	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	5+ years	Total
31.12.2008						
Payment guarantees	1,517	5,155	6,735	4,473	-	17,880
Performance guarantees	1,049	4,631	14,293	5,933	144	26,050
Letter of credit	505	396	249	-	-	1,150
Unused portion of loans	48,939	5,633	14,968	7,102	6,163	82,805
	52,010	15,815	36,245	17,508	6,307	127,885
31.12.2007						
Payment guarantees	1,644	2,634	3,954	6,363	-	14,595
Performance guarantees	3,399	2,461	15,036	4,178	67	25,141
Letter of credit	164	308	470	-	-	942
Unused portion of loans	55,820	1,632	13,714	-	-	71,166
	61,027	7,035	33,174	10,541	67	111,844

The Bank has access to sources of financing with total unused amount of KM 48,134 thousand (2007 – KM 48,972 thousand) at the balance sheet date. The Bank expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

33. EVENTS AFTER THE BALANCE SHEET DATE

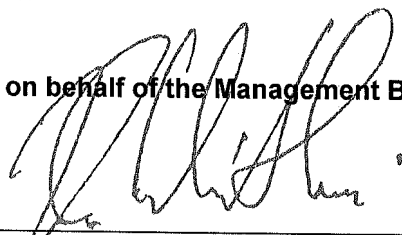
Change in the obligatory reserve rate

As of 1 January 2009 the Central Bank of Bosnia and Herzegovina has changed the minimum obligatory reserve rate for long term deposits from 14% to 10%. Obligatory reserves rate for short term deposit is the same, 14%. This change has no effect on the financial statements of the Bank for the year ending 31 December 2008.

34. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved for issue by the Management Board on 13 February 2009. The Bank's Supervisory Board and the General Assembly have the power to amend these financial statements after issue.

Signed on behalf of the Management Board:



Almir Krkalić,
Director



Livio Mannoni
Executive director of Finance