REVSAR Društvo za reviziju i poslovni konsalting Sarajevo

*Kvalitet je uz nas!*

# FINANCIAL REPORT

for the year ended 31 December 2011 and

Independent Auditors' Report

## INTESA SANPAOLO BANKA D.D. BOSNA I HERCEGOVINA

# INTESA SANPAOLO BANKA D.D.
# BOSNA I HERCEGOVINA

## FINANCIAL STATEMENTS
## FOR THE YEAR ENDED
## 31 DECEMBER 2011

## 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. 83/2009), 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

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina
52 1

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

22. February 2012

REVSAR

*This is English translation of the Report originally issued in Bosnian language (For management purposes only)*

# 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 (hereinafter: the Bank), which comprise the balance sheet as at 31 December 2011, and the income statement, statement of comprehensive income, 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.

**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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditors' Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 give a true and fair view of the financial position of the Bank as at 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia & Herzegovina.

REMZIJA BEJTOVIĆ

Alma Delić, Certified auditor,
licence number 3090143102

Remzija Bejtović,
Director

DRUŠTVO ZA REVIZIJU »REVSAR« d.o.o. SARAJEVO

Hajrudin Hadžović, Certified auditor,
licence number 3090262100

Sarajevo, 22 February, 2012

Subject to detailed review of disclosures in the Financial statements and completion of the final audit procedures

## STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2011

*(all amounts are expressed in thousands of KM)*

| | Notes | 2011 | 2010 |
|---|---|---|---|
| Interest income | 5 | 78,314 | 71,642 |
| Interest expense | 6 | (23,872) | (22,015) |
| **Net interest income** | | **54,442** | **49,627** |
| Fee and commission income | 7 | 14,397 | 12,396 |
| Fee and commission expense | 8 | (3,570) | (3,275) |
| **Net fee and commission income** | | **10,827** | **9,121** |
| Net foreign exchange income | 9 | 1,309 | 1,467 |
| Other operating income | 10 | 436 | 909 |
| **Operating income** | | **1,745** | **2,376** |
| Personnel expenses | 11 | (19,288) | (18,260) |
| Administrative expenses | 12 | (17,970) | (17,253) |
| Depreciation of fixed assets | 23 | (4,822) | (4,902) |
| **Operating Expense** | | **(42,080)** | **(40,415)** |
| **PROFIT BEFORE IMPAIRMENT LOSSES, PROVISIONS AND INCOME TAX** | | **24,934** | **20,709** |
| Impairment losses and provisions | 13 | (13,419) | (18,508) |
| Recoveries of written off loans | 14 | - | 4,743 |
| **PROFIT BEFORE INCOME TAX** | | **11,515** | **6,944** |
| Income tax | 15 | (1,207) | (883) |
| **NET PROFIT FOR THE YEAR** | | **10,308** | **6,061** |
| **Earnings per share (KM)** | 16 | **23,03** | **13,47** |

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

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina
On 22 February 2012:

Almir Krkalić
**Director**

INTESA SANPAOLO BANKA d.d.
Bosna · Hercegovina
52 1

Dario Grassani
**Executive Director of Finance**

***(all amounts are expressed in thousands of KM)***

| | 2011 | 2010 |
|---|---|---|
| **Profit for the year** | 10,308 | 6,061 |
| **Other comprehensive income for the year** | | |
| Net gains/(losses) on financial assets available for sale: | | |
| Gains arising during the year | 33 | 93 |
| Losses during the year | - | (18) |
| Reclassification adjustments for gains included in the statement of income | (7) | (87) |
| Income tax relating to items of other comprehensive income | (1) | (1) |
| **Total comprehensive income for the year, net of tax** | **10,333** | **6,048** |

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

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina
On 22 February 2012:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina
52 1

Almir Krkalić
**Director**

Dario Grassani
**Executive Director of Finance**

*(all amounts are expressed in thousands of KM)*

| | Notes | 31 December 2011 | 31 December 2010 restated |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and cash equivalents | 17 | 163,791 | 66,364 |
| Obligatory reserve with the Central Bank | 18 | 71,158 | 97,789 |
| Placements with other banks | 19 | 31,520 | 190,264 |
| Loans and receivables | 20 | 1,018,609 | 907,798 |
| Assets available for sale | 21 | 15,933 | 979 |
| Other assets | 22 | 9,040 | 9,238 |
| Property, plant and equipment | 23 | 25,425 | 25,604 |
| **TOTAL ASSETS** | | **1,335,476** | **1,298,036** |
| **LIABILITIES** | | | |
| Due to banks and other institutions | 24 | 441,942 | 449,297 |
| Subordinated debt | 25 | 1,083 | 1,244 |
| Due to customers | 26 | 719,409 | 689,597 |
| Other liabilities | 27 | 10,252 | 6,826 |
| Other provisions | 28 | 2,639 | 2,299 |
| Provisions for contingent liabilities and commitments | 29 | 2,341 | 1,296 |
| **TOTAL LIABILITIES** | | **1,177,666** | **1,150,559** |
| **SHAREHOLDERS' EQUITY** | | | |
| Share capital | | 44,782 | 44,782 |
| Reserves and retained earnings | | 113,028 | 102,695 |
| **TOTAL SHAREHOLDER'S EQUITY** | | **157,810** | **147,477** |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | | **1,335,476** | **1,298,036** |
| **FINANCIAL COMMITMENTS AND CONTINGENCIES** | 29 | 176,809 | 127,149 |

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

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d.Bosna i Hercegovina
On 22 February 2012:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina
52 1

Almir Krkalić
**Director**

Dario Grassani
**Executive Director of Finance**

INTESA SANPAOLO BANKA, D.D. BIH
STATEMENT OF CASH FLOWSFOR THE YEAR ENDED 31 DECEMBER 2011
*(all amounts are expressed in thousands of KM)*

| | 2011 | 2010 |
|---|---|---|
| **Operating activities** | | |
| Net Income | 10,308 | 6,061 |
| *Adjustments to reconcile net income to net cash provided by operating activities:* | | |
| Depreciation and amortization | 4,822 | 4,902 |
| Impairment losses and provisions | 13,419 | 18,508 |
| Changes in other provisions, net | - | 293 |
| (Gain) on sale or disposal of property, plant and equipment | 20 | (62) |
| *Changes in operating assets and liabilities:* | | |
| Net (increase)/decrease in due from Central Bank | 26,631 | (9,017) |
| Net (increase)/decrease in placements with other banks, before impairment losses | 158,762 | (55,588) |
| Net (increase)/decrease in loans and receivables, before impairment losses | (124,003) | (109,546) |
| Net (increase)/decrease in other assets, before impairment losses | 459 | (1,419) |
| Net (decrease)/increase due to banks | (30,036) | 21,902 |
| Net increase in demand and term deposits | 29,814 | 26,854 |
| Net (decrease)/increase in other liabilities | 3,765 | (451) |
| **NET CASH FROM/(USED IN) OPERATING ACTIVITIES** | **93,961** | **(97,563)** |
| **Investing Activities** | | |
| Net increase in assets available for sale, before impairment losses | (14,111) | (459) |
| Net purchases of property and equipment | (3,455) | (2,414) |
| Proceeds from sale of property, plant and equipment | (1,486) | 330 |
| **NET CASH USED IN INVESTING ACTIVITIES** | **(19,052)** | **(2,543)** |
| **Financing Activities** | | |
| Net proceeds from borrowings | 22,681 | 66,125 |
| Net repayments of subordinated debt | (163) | (158) |
| **NET CASH PROVIDED BY FINANCING ACTIVITIES** | **22,518** | **65,967** |
| **NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS** | **97,427** | **(34,139)** |
| **CASH AND CASH EQUIVALENTS AT 1 JANUARY** | **66,364** | **100,503** |
| **CASH AND CASH EQUIVALENTS AT 31 DECEMBER** | **163,791** | **66,364** |
| **Operational cash flow from interest and dividends** | | |
| Interest paid | 24,121 | 24,045 |
| Interest received | 72,850 | 67,357 |
| Dividend received | **35** | - |

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

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina
On 22 February 2012:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina
52 1

Almir Krkalić
**Director**

Dario Grassani
**Executive Director of Finance**

## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITYFOR THE YEAR ENDED 31 DECEMBER 2011

*(all amounts are expressed in thousands of KM)*

| | Share capital | Treasury shares | Share Premium | Fair Value reserves | Retained earnings and reserves | Total |
|---|---|---|---|---|---|---|
| **Balance as at 31 December 2009** | 45,296 | (514) | 57,415 | 6 | 20,947 | 123,150 |
| Total comprehensive income | - | - | - | (13) | 6,061 | 6,048 |
| Purchase/Sale of treasury shares | (514) | 514 | - | - | - | - |
| **Balance as at 31 December 2010** | **44,782** | **-** | **57,415** | **(7)** | **27,008** | **129,198** |
| | | | | | | |
| **Balance as at 31 December 2010 Before restatement** | **44,782** | **-** | **57,415** | **(7)** | **27,008** | **129,198** |
| **Restatement *** | | | | | **18,279** | **18,279** |
| **Balance as at 31 December 2010 after restatement** | **44,782** | **-** | **57,415** | **(7)** | **45,287** | **147,477** |
| Total comprehensive income | - | - | - | 25 | 10,308 | 10,333 |
| **Balance as at 31 December 2011** | **44,782** | **-** | **57,415** | **18** | **55,595** | **157,810** |

*Restatement is effect of adoption of new accounting policies for impairment of financial assets and provisions for contingent liabilities.

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

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina
On 22 February 2012:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina
52 1

Almir Krkalić
**Director**

Dario Grassani
**Executive Director of Finance**

*(all amounts are expressed in thousands of KM)*

## 1. GENERAL

**History and incorporation**

Intesa Sanpaolo Bankad.d. Bosna i Hercegovina, former UPI banka d.d. Sarajevo, Obala Kulina Bana 9a (the "Bank") is registered in the 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 poljoprivredna, 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 the year 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 bankad.d. Sarajevo (the "LTG Bank"), also subsidiary of Intesa Sanpaolo Holding, 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**

| | |
|---|---|
| VojkoČok | Chairman |
| Massimo Pierdicchi | Vice-Chairman until July 20, 2011 and Member from July 21, 2011 |
| Ivan Sramko | Vice-Chairman from July 21, 2o11 |
| BeataKissneFoldi | Member |
| Nora Kocsis | Member until July 20, 2011 |
| Finazzi Luca Santo | Member |

*(all amounts are expressed in thousands of KM)*

## 1. GENERAL (continued)

**Management Board**

| | |
|---|---|
| Almir Krkalić | Director |
| Dario Grassani | Executive Director of Finance |
| Igor Bilandžija | Executive Director of Risk Management |

**Audit Committee**

| | |
|---|---|
| Giovanni Bergamini | Chairman |
| Alberto Gandini | Member |
| Andrea Perucchi | Member |
| Nicoletta Fusetti | Member |
| Damiano Accattoli | Member |

**Internal Auditor**

Muamera Zuko

**The shareholding structure is as follows:**

| | 31 December 2011 | | | 31 December 2010 | | |
|---|---|---|---|---|---|---|
| **Shareholders** | **No. of shares** | **Amount KM '000** | **%** | **No. of shares** | **Amount KM '000** | **%** |
| Intesa Sanpaolo Holding International S.A. | 425,053 | 42,505 | 94.92 | 391,661 | 39,166 | 87.46 |
| European Bank for Reconstruction and Development | - | - | - | 32,478 | 3,248 | 7.25 |
| Other | 22,767 | 2,277 | 5.08 | 23,681 | 2,368 | 5.29 |
| **Total** | **447,820** | **44,782** | **100.00** | **447,820** | **44,782** | **100.00** |

## 1. GENERAL (continued)

Nominal value of one share is KM 100.
In May 2011 EBRD sold shares to the majority shareholder Intesa Sanpaolo Holding International S.A., Luxembourg, based on agreement on acquisition of equity. The sale was realized by EBRD through the Extraordinary Auction at the Sarajevo Stock Exchange.

The Bank has 60 priority (preference) shares with priority right in receipt of dividends. Also the Bank does not 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 (until 2002 year);
- Reserve for tax-deductible profit, in the measure of 75% of Bank's profit reinvested into fixed assets (until 2000 year);
- Reserve for undistributed dividends, following Supervisory Board decisions (until 1999 year);
- Revaluation reserve for fixed assets, according to valid Law (until 2001 year);
- Reserve for treasury shares.
- Reserve in capital formed upon applying new regulation with respect to the assessment of provisions for impairment of financial assets and contingent liabilities.

## 2. ADOPTION OF NEW STANDARDS AND REVISED STANDARDS

### 2.1 Standards and Interpretations effective in the current period

Amendments resulting from Improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

- IFRIC 14 Prepayments of a Minimum Funding Requirement (Amended)
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
- IAS 24 Related Party Disclosures (Amended)
- IAS 32 Classification on Rights Issues (Amended)
- IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for the first time adopters (Amended)

*Improvements to IFRSs*

Other amendments resulting from Improvements to IFRSs to the following standards and interpretations did not have any impact on the accounting policies, financial position or performance of the Group:

- IFRS 1 First-time adoption
- IFRS 3 Business Combinations
- IFRS 7 Financial Instruments – Disclosures
- IAS 1 Presentation of Financial Statements
- IAS 27 Consolidated and Separate Financial Statements
- IAS 34 Interim Financial Reporting
- IFRIC 13 Customer Loyalty Programmers

### 2.2Standards and Interpretations in issue not yet adopted

Standards issued but not yet effective up to the date of issuance of the Bank's financial statements are listed

below. This listing is of standards and interpretations issued, which the Bank reasonably expects to be applicable at a future date. The Bank intends to adopt those standards when they become effective. The Bank is in the process of assessing the impact of this amendment on the financial position or performance of the Bank.

- **IAS 1 Financial Statement Presentation (Amended) – Presentation of Items of Other Comprehensive Income**

  The amendment is effective for annual periods beginning on or after 1 July 2012. The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time would be presented separately from items that will never be reclassified. The amendment affects presentation only and has no impact on the Bank's financial position or performance.

- **IAS 12 Income Taxes (Amended) – Recovery of Underlying Assets**

  The amendment is effective for annual periods beginning on or after 1 January 2012. The amendment clarified the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 always be measured on a sale basis of the asset.

## 2. ADOPTION OF NEW STANDARDS AND REVISED STANDARDS (continued)

### 2.2 Standards and Interpretations in issue not yet adopted (continued)

- **IAS 19 Employee Benefits (Amended)**

  The amendment is effective for annual periods beginning on or after 1 January 2013. The IASB has issued numerous amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. Early application is permitted.

- **IAS 27 Separate Financial Statements (Revised)**

  The Standard is effective for annual periods beginning on or after 1 January 2013. As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. Earlier application is permitted.

- **IAS 28 Investments in Associates and Joint Ventures (Revised)**

  The Standard is effective for annual periods beginning on or after 1 January 2013. As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. Earlier application is permitted.

- **IAS 32 Financial Instruments: Presentation (Amended) - Offsetting Financial Assets and Financial Liabilities**

  The amendment is effective for annual periods beginning on or after 1 January 2014.This amendment clarifies the meaning of "currently has a legally enforceable right to set-off" and also clarifies the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments to IAS 32 are to be retrospectively applied. Earlier application is permitted. However, if an entity chooses to early adopt, it must disclose that fact and also make the disclosures required by the IFRS 7 Offsetting Financial Assets and Financial Liabilities amendments.

- **IFRS 7 Financial Instruments: Disclosures (Amended) - Enhanced Derecognition Disclosure Requirements**

  The amendment is effective for annual periods beginning on or after 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognised assets to enable the user to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognised assets. The amendment has only disclosure effects.

- **IFRS 7 Financial Instruments: Disclosures (Amended) - Offsetting Financial Assets and Financial Liabilities**

  The amendment is effective for annual periods beginning on or after 1 January 2013.The amendment introduces common disclosure requirements. These disclosures would provide users with information that is useful in evaluating the effect or potential effect of netting arrangements on an entity's financial position. The amendments to IFRS 7 are to be retrospectively applied.

## 2. ADOPTION OF NEW STANDARDS AND REVISED STANDARDS (continued)

### 2.2 Standards and Interpretations in issue not yet adopted (continued)

- **IFRS 9 Financial Instruments - Classification and Measurement**

  The new standard is effective for annual periods beginning on or after 1 January 2015. IFRS 9 as issued reflects the first phase of the IASBs work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. Phase 1 of IFRS 9 will have a significant impact on (i) the classification and measurement of financial assets and (ii) a change in reporting for those entities that have designated financial liabilities using the FVO. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The completion of this project is expected over the first half of 2012. Early application is permitted.

- **IFRS 10 Consolidated Financial Statements**

  The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 Consolidation — Special Purpose Entities. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27.

- **IFRS 11 Joint Arrangements**

  The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 11 replaces IAS 31 Interests in Joint Ventures and SIC-13 Jointly-controlled Entities — Non-monetary Contributions by Venturers. IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method.

- **IFRS 12 Disclosures of Involvement with Other Entities**

  The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required.

- **IFRS 13 Fair Value Measurement**

  The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. This standard should be applied prospectively and early adoption is permitted.

- **IFRIC Interpretation 20 Stripping Costs in the Production Phase of a Surface Mine**

  The interpretation is effective for annual periods beginning on or after 1 January 2013.This interpretation only applies to stripping costs incurred in surface mining activity during the production phase of the mine ('production stripping costs'). Costs incurred in undertaking stripping activities are considered to create two possible benefits a) the production of inventory in the current period and/or b) improved access to ore to be mined in a future period (striping activity asset). Where cost cannot be specifically allocated between the inventory produced during the period and the stripping activity asset, IFRIC 20 requires an entity to use an allocation basis that is based on a relevant production measure. Early application is permitted.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### 3.1. 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 (FBA).

During 2011, the Bank applied new accounting policies in accordance with the Decision of minimum standards of credit risk management and classification of assets dated from January 2011 with respect of assessment of impairment of financial assets and contingent liabilities. Previously the Bank used the guidance of Federal Banking Agency described in Note 3.3. Based on new regulation the banks are required to apply IAS 39 and 37 for the assessment of impaired of financial assets and provisions for contingent liabilities as described in Note 3.3. – Impairment of financial assets and provisions for contingent liabilities.

The Bank restated opening balances of the Balance Sheet items and equity components as of December 2010 for the effect of applying new accounting policies. The difference arising between the previous balance of provisions and new assessed amount was credited to the special reserve within equity.

Since it was not practicable to restate the balance of earliest period of Financial Statement 31 December 2009, and as permitted by FBA, the Income Statement for the year 2010, presented as comparison information, was not restated, and accordingly it is not totally comparable with 31 December 2011 in the position of Impairment losses and provisions and Recoveries of written off loans.

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.

*(all amounts are expressed in thousands of KM)*

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.2. Restatement of opening balances

As disclosed in Note 3.1. the Bank restated opening balances of the Balance Sheet items and equity components as of December 2010 for the effect of applying new accounting policies. The difference arising between the previous balance of provisions and new assessed amount was credited to the special reserve within equity.

The Bank restated opening balance as of 31 December 2010 with respect of adoption of new regulation in respect with assessment of impairment of financial assets and provisions for contingent liabilities.

The adjustment comprised of:

- Recognition on Balance Sheet previously fully written off assets classified in category "E" and 100% provisioned in accordance with previous Federal Banking Agency regulation and
- recording differences in provisions arising upon application of new regulation

The summary of the adjustments are presented below:

| Note | Assets | Gross Assets | Provisions | Net Assets | Recognition of assets / provisions previously written off | Reversal of provisions | Gross Assets | Provisions | Net Assets |
|---|---|---|---|---|---|---|---|---|---|
| | | Previously reported | | | Adjustments | | Restated | | |
| 20 | Loans and receivables | 934,077 | (43,217) | 890,860 | 42,456 | (16,938) | 976,533 | (68,735) | 907,798 |
| 21 | Assets available for sale | 999 | (20) | 979 | 857 | - | 1,856 | (877) | 979 |
| 22 | Other assets | 9,730 | (492) | 9,238 | 2,970 | - | 12,700 | (3,462) | 9,238 |
| 29 | Provisions for contingent liabilities | - | (2,637) | - | - | (1,341) | - | (1,296) | - |
| | Reserve in Capital – Total adjustment | - | - | - | - | 18,279 | - | - | - |

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.2. Restatement of opening balances (continued)

**Income Statement Reclassifications**

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

The Bank reclassified income from service fees related to Frameworks Agreements for loans from Interest income position to Fee and Commission Income position. For consistency reasons, a similar item of 103 thousand KM has been reclassified in the 2010 Statement of Income.

The Bank reclassified expenses related to receive guarantees from Interest Expense position to Fee and Commission Expenses. For consistency reasons, a similar item of 548 thousand KM has been reclassified in the 2010 Statement of Income.

### 3.3. Summary of accounting policies

**Recognition of income and expense**

Revenues are recognised when they are collected or, in case of sale of goods or products, when it is probable that the economic benefits will be received and these benefits may be measured reliably, in the case of services, when these have been rendered. In particular:

- interest is recognised on accrual on the basis of the contractual interest rate or the effective interest rate in the case of application of amortised cost;
- dividends are posted in the income statement in the financial year when their distribution is approved;
- commission income / expense from services is recorded, on the basis of the existence of contractual agreements, in the period in which the services have been rendered;
- revenues from the sale of financial instruments, determined by the difference between transaction amount paid or received and the fair value of the instrument, are recognised in the income statement at the time of the transaction;
- profits and losses from securities trading are recognised in the income statement at the date of sale, on the basis of the difference between the consideration paid or collected and the carrying value of such instruments;

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.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of accounting policies (continued)

**Retirement severance payments**

According to the local legislation and internal Rulebook on employment, the Bank makes retirement severance payments of minimum three average monthly salaries of the employee in question or three 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 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.

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 exclude 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.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of accounting policies (continued)

**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' (HTM), '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.

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.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of accounting policies (continued)

**Financial assets (continued)**

***Financial assets at FVTPL (continued)***

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 (mid price ), without any deduction for transaction costs (so called 'first level' of fair value);
- 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 (so called ' second level' of fair value which uses only insignificant adjustments to the market inputs);
- 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 (so called 'second level' of fair value'), and
- Certain financial instruments are recorded at fair value using valuation techniques in which current market transactions or observable market data are not available. Their fair value is determined from input not directly visible on the market or prices of similar assets or deduced from non-active markets that are subject to significant adjustments (so called "third level" of fair value)

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

***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***

Available–for–sale investments include equity and debt securities. Equity investments classified as available–for –sale are those which are neither classified as held–for–trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions. The bank has not designated any loans or receivables as available–for–sale. After initial measurement,.available–for–sale financial investments are subsequently measured at fair value.

Unrealized gains and losses are recognized directly in equity (other comprehensive income) in the 'Fair value reserves'. When the investment is disposed of, the cumulative gain or loss previously recognized in equity is recognized in the income statement in 'Other operating income'. Where the bank holds more than one investment in the same security they are deemed to be disposed of on a first–in first–out basis.

Interest earned whilst holding available–for–sale financial investments is reported as interest income using the EIR.

Dividends earned whilst holding available–for–sale financial investments are recognised in the income statement as 'Other operating income' when the right of the payment has been established.

*(all amounts are expressed in thousands of KM)*

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of accounting policies (continued)

**Financial assets (continued)**

***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.

***Impairment of financial assets and provisions for contingent liabilities and commitments***

According to the Federal Banking Agency *Decision of minimum standards of credit risk management and classification of assets dated from* 2003 the Bank classified 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.

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

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

| | |
|---|---|
| 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 were classified into category "E" and were fully provisioned and recorded in off-balance sheet. Subsequent recoveries were credited to "Collected write offs" in Income Statement.

After applying new regulation, *Decision of minimum standards of credit risk management and classification of assets* December 2010 and December 2011 (revised text), the process for assessment of impairment of financial assets and provisions for contingent liabilities and commitments are in accordance requirements of IAS 39 and IAS 37.

In particular, The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of accounting policies (continued)

**Financial assets (continued)**

***Impairment of financial assets and provisions for contingent liabilities and commitments (continued)***

For amounts due from banks and loans to customers carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

In particular, the Bank determines the allowances appropriate for each individually significant loan on an individual basis. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of other financial support and the realisable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated on monthly basis.

Allowances are assessed collectively for losses on loans to customers that are not individually significant and for individually significant loans where there is not yet objective evidence of individual impairment. Allowances are evaluated at each reporting date with each portfolio receiving a separate review.

Collective assessment takes account of impairment that is likely to be present in the portfolio even though there is no objective evidence of impairment in an individual assessment. Impairment losses are estimated by taking into consideration the following information: historical losses in the portfolio or in portfolios having comparable (even if less favourable) credit risk characteristics; current economic conditions; the appropriate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance; expected receipts and recoveries once impaired. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

*(all amounts are expressed in thousands of KM)*

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of accounting policies (continued)

**Financial assets (continued)**

***Impairment of financial assets and provisions for contingent liabilities and commitments (continued)***

According to the Decision of minimum standards of credit risk management and classification of assets, the Bank is required to classify loans, other receivables, contingent liabilities and commitments into the categories A, B, C, D and E based on guidance prescribed in the Decision as well as to apply specific percentages to calculate the reserve for credit losses. If the calculated amount of the reserve for credit losses is higher than the total amount of allowances for impairment of financial assets and provisions for contingent liabilities and commitments recognized in balance sheet, the Bank is required to deduct the amount of shortfall from the regulatory capital in the calculation in the capital adequacy and other applicable regulatory ratios.

***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 substantvially 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.

**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 first following month after the assets are ready for their 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 2011 | 31 December 2010 |
|---|---|---|
| Buildings | 1.30% - 3.00% | 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% |

Property and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in 'Other operating income' in the income statement in the year the asset is derecognised.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of 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.

**Payables**

Amounts due to banks and due to customers (including subordinated debt) represent financial liabilities and include various forms of interest-bearing and non-interest-bearing funding on the interbank market and with customers and funding.

Initial recognition of such financial liabilities occurs at the date of subscription of the contract, which normally coincides with the time of collection of the sums deposited. Initial recognition is based on the fair value of the liabilities, normally equal to the amount collected, increased by any additional charges/revenues directly attributable to the single funding. Internal administrative costs are excluded.

After initial recognition, financial liabilities are measured at amortised cost using the effective interest rate method. An exception is made for short-term liabilities, which are stated at the payable amount as the time value is immaterial.

Financial liabilities are derecognised from the statement of financial position when they have expired or extinguished. The difference between book value of the liability and amount paid for repurchase is recorded in the income statement.

**Other Provisions and Provisions for contingent liabilities**

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

Other provisions record provisions relating to legal obligations, labour relationships or to litigation, also fiscal.

They are recognized in an amount that represents the best possible estimate of the expenditure required to settle the obligation that exists at the end of the reporting period. The best estimate required to settle the obligation is the amount that an entity would rationally pay at the end of the reporting period.

Provisions are measured according to the rule set forth in IAS 37 concerning the one-to-one correlation of the event and the associated provision and require management on a case-by-case basis.

Provisions made on an individual and collective basis, relative to estimated possible disbursements connected to credit risk relative to guarantees and commitments are recorded under the caption "provisions for contingent liabilities and commitments"

***Derecognition of financial liabilities***

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

*(all amounts are expressed in thousands of KM)*

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### 3.3. Summary of accounting policies (continued)

**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 IAS 37 and
- the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

**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 2011** | EUR 1= KM 1.95583 | USD 1 = KM 1,511577 |
| **31 December 2010** | EUR 1= KM 1.95583 | USD 1 = KM 1,472764 |

**Segment reporting**

Management has monitored the operating results of the Bank as a single segment for the purpose of making decisions about resource allocations and performance assessment.

**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 in compliance with all regulatory requirements.

## 4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Bank's accounting policies, which are described in note 3, 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.

**Impairment losses on loans and other placements**

The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indicators that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganization, default or delinquency in interest or principal payments and were observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Detail explanation of assessed process is described in Note 3.3. - *Impairment of financial assets and provisions for contingent liabilities and commitments.*

**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.

## 4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (continued)

**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 2011 and 31 December 2010. In estimating the fair value of the Bank's financial instruments, the following methods and assumptions are 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.

**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).

**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.

*(all amounts are expressed in thousands of KM)*

## 5. INTEREST INCOME

| | 2011 | 2010 |
|---|---|---|
| Companies | 37,177 | 31,642 |
| Individuals | 38,772 | 38,291 |
| Banks and other financial institutions | 2,018 | 1,517 |
| Interest for AFS | 122 | 42 |
| Other | 225 | 150 |
| | **78,314** | **71,642** |

## 6. INTEREST EXPENSE

| | 2011 | 2010 |
|---|---|---|
| Companies | 9,152 | 9,496 |
| Individuals | 7,375 | 7,884 |
| Banks and other financial institutions | 7,115 | 4,232 |
| Other | 230 | 303 |
| | **23,872** | **22,015** |

## 7. FEE AND COMMISSION INCOME

| | 2011 | 2010 |
|---|---|---|
| Domestic payment transactions | 3,101 | 2,857 |
| Credit card activities | 3,143 | 2,734 |
| Foreign payment transactions | 2,413 | 2,106 |
| FX transactions | 1,720 | 1,019 |
| Guarantees and letter of credits | 1,563 | 1,296 |
| Agency services | 108 | 126 |
| Other | 2,348 | 2,258 |
| | **14,396** | **12,396** |

## 8. FEE AND COMMISSION EXPENSE

| | 2011 | 2010 |
|---|---|---|
| Credit card operations | 2,068 | 1,948 |
| Central Bank BiH | 221 | 208 |
| Commission on received guarantees and other services | 643 | 548 |
| Domestic payment transactions | 513 | 450 |
| E-banking service | 125 | 121 |
| | **3,570** | **3,275** |

## 9. NET FOREIGN EXCHANGE INCOME

| | 2011 | 2010 |
|---|---|---|
| Gains on foreign exchange transactions and translations | 27,838 | 30,356 |
| Loss on foreign exchange transactions and translations | (26,529) | (28,889) |
| | **1,309** | **1,467** |

*(all amounts are expressed in thousands of KM)*

## 10. OTHER OPERATING INCOME

| | 2011 | 2010 |
|---|---|---|
| Rental income | 6 | - |
| Dividend income | 35 | - |
| Gain on sale of AFS investments | 7 | 87 |
| Gain on sale of property | 20 | 62 |
| Recoveries of claims from legal proceedings | - | 391 |
| Other income | 368 | 369 |
| | **436** | **909** |

## 11. PERSONNEL EXPENSES

| | 2011 | 2010 |
|---|---|---|
| Wages and salaries | 13,236 | 12,547 |
| Social security costs | 5,839 | 5,512 |
| Provisions, net, for retirement and other employee benefits (Note 28) | 41 | 35 |
| Other expenses | 172 | 166 |
| | **19,288** | **18,260** |

The Bank does not have pension arrangements separate from Bosnia and Herzegovina pension system. This system requires that current contributions by the employer should 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 2011 and 31 December 2010 was 521 and 515 respectively.

## 12. ADMINISTRATIVE EXPENSES

| | 2011 | 2010 |
|---|---|---|
| Rent and other rent related expense | 3,342 | 3,314 |
| Telecommunication and post expense | 2,701 | 2,541 |
| Saving deposit insurance and other insurance charges | 1,594 | 1,472 |
| Provisions, net, for legal proceedings (Note 28) | 318 | 258 |
| Material expenses | 1,150 | 1,125 |
| Representation and marketing expense | 936 | 942 |
| Consultancy and the Banking Agency of FBiH expenses | 1,203 | 1,318 |
| Energy | 874 | 771 |
| Maintenance expenses | 2,720 | 2,508 |
| Security and transport costs | 2,055 | 1,868 |
| Other expenses | 1,077 | 1,136 |
| | **17,970** | **17,253** |

*(all amounts are expressed in thousands of KM)*

## 13. IMPAIRMENT LOSSES AND PROVISIONS

| | 2011 | 2010 |
|---|---|---|
| Additions on impairment losses on placements with other banks, net (Note 19) | (18) | 3 |
| Additions on impairment losses on loans and advances originated by the Bank, net (Note 20) | 12,382 | 17,717 |
| Additions (Release) of impairment losses on assets available for sale, net (Note 21) | (7) | 9 |
| Additions on provision for other assets, net (Note 22) | 17 | 148 |
| Additions on provision for commitments and contingent liabilities, net (Note 30) | 1,045 | 631 |
| | **13,419** | **18,508** |

## 14. RECOVERIES OF WRITTEN OFF LOANS

| | 2011 | 2010 |
|---|---|---|
| Suspended Interest | - | 490 |
| Principal | - | 4,139 |
| Other | - | 114 |
| | **-** | **4,743** |

According the new Federal Banking Agency regulation, as described in Note 3.3 Impairment of financial assets and provision for contingent liabilities, income from recoveries of fully provisioned assets in 2011 is reported as part of position 13, Impairment losses and provisions.

As described in Note 3.2. in accordance with previous regulation of FBA the Bank fully written off loans in E category reordered in Off Balance Sheet. Collection of those receivables was reported as "Recoveries of written off loans" in Income Statement.

## 15. INCOME TAX

| | 2011 | 2010 |
|---|---|---|
| Profit before income tax | 11,515 | 6,944 |
| Non-deductible expenses and taxable income relieves | 555 | 1,891 |
| Taxable income | 12,070 | 8,835 |
| **Income tax liability at the rate of 10%** | **1,207** | **883** |

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 2011 and 31 December 2010 was 10%.

*(all amounts are expressed in thousands of KM)*

## 16. EARNINGS PER SHARE

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Net profit | 10,308 | 6,061 |
| Weighted average number of ordinary shares outstanding | 447,760 | 449,886 |
| Basic earnings per share | **0.02303** | **0.01347** |

The Bank does not have dilutive potential ordinary shares.

## 17. CASH AND CASH EQUIVALENTS

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Current account in domestic currency with the Central Bank | 132,200 | 40,998 |
| Cash on hand in domestic currency | 14,854 | 14,040 |
| Cash on hand in foreign currency | 9,895 | 7,569 |
| Correspondent accounts with banks in foreign currency | 6,842 | 3,757 |
| | **163,791** | **66,364** |

## 18. OBLIGATORY RESERVE WITH THE CENTRAL BANK

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Obligatory reserve | 71,158 | 97,789 |
| | **71,158** | **97,789** |

Minimum obligatory reserve as of 31 December 2011 is calculated in amount of 14% for deposits and borrowings with maturity up to one year and 7% for deposits and borrowings with maturity over one year for each working day during 10 calendar days following the period of maintaining the obligatory reserve. Mandatory reserve does not include local inter-bank deposits, short term and long term deposits from non-residents and short term and long term loans from non-residents, with effect from 1 November 2008.

## 19. PLACEMENTS WITH OTHER BANKS

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Short-term placements with banks from OECD countries | 31,528 | 190,290 |
| Less: Provisions for impairment | (8) | (26) |
| | **31,520** | **190,264** |

The average interest rate for placements in EUR was 0.86% p.a. and 0.51% p.a. and for placements in USD 0.25% p.a. and 0.24% p.a. as of 31 December 2011 and 31 December 2010, respectively.

*(all amounts are expressed in thousands of KM)*

## 19. PLACEMENTS WITH OTHER BANKS (continued)

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

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Balance as at 1 January** | 26 | 23 |
| Provisions, net change (Note 13) | (18) | 3 |
| **Balance as at 31 December** | 8 | 26 |

## 20. LOANS AND RECEIVABLES

| | 31 December 2011 | 31 December 2010 restated |
|---|---|---|
| Short-term loans in domestic currency | 339,856 | 313,419 |
| Short-term loans in foreign currency | 3,204 | 2,935 |
| Current portion of long-term loans | 170,810 | 137,648 |
| Total short-term loans | 513,870 | 454,002 |
| Long-term loans in domestic currency | 748,717 | 647,810 |
| Long-term loans in foreign currency | 5,273 | 12,369 |
| (Current portion of long-term loans) | (170,810) | (137,648) |
| Total long-term loans | 583,180 | 522,531 |
| *Total loans before provisions* | *1,097,050* | *976,533* |
| Provision for impairment | (78,441) | (68,735) |
| | **1,018,609** | **907,798** |

Restatements of opening balances are disclosed in Note 3.2.

As of 31 December 2011, short-term and long-term loans in domestic currency include loans disbursed and repayable in domestic currency index-linked to the KM:EUR exchange rate in the amount of KM 26,506 thousand and KM 742,412 thousand, respectively (2010: KM16,331 thousand and KM 628,348 thousand, respectively).

Short-term loans are granted for periods of up 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, and to corporate clients for investment purposes.

*(all amounts are expressed in thousands of KM)*

## 20. LOANS AND RECEIVABLES (continued)

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

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Balance as at 1 January before restatement** | **43,217** | **39,289** |
| Provisions for loans in off balance sheet (Note 3.2.) | 42,456 | - |
| Release of provisions based on IAS 39 (Note 3.2.) | (16,938) | - |
| **Balance as at 1 January after restatement** | **68,735** | - |
| Provisions charged (Note 13) | 12,382 | 17,717 |
| Reversal of provisions credited to deferred income | - | (236) |
| Permanent write off loans and receivables (Note 33) | (2,676) | - |
| Write-offs (Note 33) | - | (13,553) |
| **Balance as at 31 December** | **78,441** | **43,217** |

| | 31 December 2011 | 31 December 2010 restated |
|---|---|---|
| Manufacturing industry | 172,474 | 160,718 |
| Trade | 272,579 | 209,680 |
| Construction industry | 48,660 | 43,490 |
| Services, finance, sport, tourism | 23,933 | 21,862 |
| Administrative and other public institutions | 22,022 | 22,067 |
| Agriculture, forestry, mining and energy | 32,862 | 24,096 |
| Transport and telecommunications | 37,257 | 41,756 |
| Other | 37,620 | 36,525 |
| Citizens | 449,643 | 416,339 |
| **Loans and receivables, gross** | **1,097,050** | **976,533** |

| | 31 December 2011 | 31 December 2010 restated |
|---|---|---|
| Corporate Lending | 647,407 | 560,194 |
| Consumer Lending | 254,088 | 235,196 |
| Residential Mortgages | 141,569 | 130,064 |
| Credit and Debit Cards | 53,986 | 51,079 |
| **Loans and receivables, gross** | **1,097,050** | **976,533** |

*(all amounts are expressed in thousands of KM)*

## 20. LOANS AND RECEIVABLES (continued)

Interest rates for granted loans as at 31 December 2011 and 2010 are summarized as follows:

| | 31 December 2011 | | 31 December 2010 | |
|---|---|---|---|---|
| | KM '000 | Annual interest rate | KM '000 | Annual interest rate |
| *Domestic currency* | | | | |
| Companies | 639,449 | 3.32% - 10.86% | 546,194 | 2.70% - 12.00% |
| Citizens | 449,124 | 2.00% - 12.97% | 415,303 | 2.00% - 12.75% |
| *Foreign currency* | | | | |
| Companies | 7,958 | 4.00% - 13.00% | 14,000 | 3.76% - 7.02% |
| Citizens | 519 | 5.50% - 10.99% | 1,036 | 5.00% - 10.00% |
| | **1,097,050** | | **976,533** | |

## 21. ASSETS AVAILABLE FOR SALE

| | 31 December 2011 | 31 December 2010 restated |
|---|---|---|
| Debt instruments – the Government of Federation of Bosnia and Herzegovina bonds and treasury bills | 15,333 | 440 |
| Equity instruments | 660 | 1,416 |
| Total gross value | 15,993 | 1,856 |
| Impairment | (60) | (877) |
| | **15,933** | **979** |

Restatements of opening balances are disclosed in Note 3.2.

Assets available for sale include investments of 20.03% in share capital of Bamcard d.d. Sarajevo in the amount of KM 488 thousand (2010: KM 488 thousand).

Also, assets available for sale include investments of less than 1% in various companies in Bosnia and Herzegovina recognized at cost of KM 172 thousand (2010: KM 928 thousand).

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

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Balance as at 1 January before restatement** | **20** | **11** |
| Provisions for AFS in off balance sheet (Note 3.2) | 857 | - |
| **Balance as at 1 January after restatement** | **877** | - |
| Permanent write off AFS (Note 33) | (810) | - |
| Provisions (Note 13) | (7) | 9 |
| **Balance as at 31 December** | **60** | **20** |

*(all amounts are expressed in thousands of KM)*

## 22. OTHER ASSETS

| | 31 December 2011 | 31 December 2010 restated |
|---|---|---|
| Prepaid income taxes | 2,748 | 2841 |
| Payment to the Cantonal Privatization Agency for Privatization of "Projekt" d.d. Sarajevo | 1,200 | 1,200 |
| Prepaid expenses | 2,529 | 2,167 |
| Fees receivable | 626 | 442 |
| Receivables from card operations | 1,308 | 715 |
| Assets acquired on foreclosed loans | 646 | 1,975 |
| Other assets | 2,822 | 3,360 |
| **Total other assets** | **11,879** | **12,700** |
| Provision for impairment | (2,839) | (3,462) |
| | **9,040** | **9,238** |

Restatements of opening balances are disclosed in Note 3.2.

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

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Balance as at 1 January before restatement** | **492** | **590** |
| Provisions for Other assets in off balance sheet (Note 33) | 2,970 | - |
| **Balance as at 1 January after restatement** | **3,462** | - |
| Permanent write off (Note 33) | (362) | |
| Provisions (Note 13) | 17 | 148 |
| Transfer to provisions for assets received in collection (Note 23) | (278) | - |
| Write-offs (Note 33) | - | (246) |
| **Balance as at 31 December** | **2,839** | **492** |

*(all amounts are expressed in thousands of KM)*

## 23. PROPERTY, PLANT AND EQUIPMENT

| | Land and Buildings | Computers and other equipment | Software | Construction in progress | Leasehold improvements | Total |
|---|---|---|---|---|---|---|
| *Cost value* | | | | | | |
| **31 December 2009** | **12,940** | **18,520** | **5,556** | **224** | **8,151** | **45,391** |
| Additions | - | - | - | 2,414 | - | **2,414** |
| Disposals | (157) | (413) | - | (56) | - | **(626)** |
| Transfers from construction in progress | 79 | 1,751 | 616 | (2,522) | 76 | - |
| **31 December 2010** | **12,862** | **19,858** | **6,172** | **60** | **8,227** | **47,179** |
| Additions | - | - | - | 3,455 | - | **3,455** |
| Transfer from assets received in collections | 1,267 | - | - | - | - | **1,267** |
| Disposals | (3) | (758) | (1,095) | - | - | **(1,856)** |
| Transfers from construction in progress | 73 | 2,122 | 998 | (3,351) | 158 | - |
| **31 December 2011** | **14,199** | **21,222** | **6,075** | **164** | **8,385** | **50,045** |
| ***Accumulated Depreciation*** | | | | | | |
| **31 December 2009** | **1,249** | **9,011** | **2,931** | - | **3,840** | **17,031** |
| Depreciation for the period | 167 | 2,518 | 855 | - | 1,362 | **4,902** |
| Disposals | (51) | (307) | - | - | - | **(358)** |
| **31 December 2010** | **1,365** | **11,222** | **3,786** | - | **5,202** | **21,575** |
| Depreciation for the Period | 233 | 2,522 | 818 | - | 1,249 | **4,822** |
| Disposals | - | (684) | (1,093) | - | - | **(1,777)** |
| **31 December 2011** | **1,598** | **13,060** | **3,511** | - | **6,451** | **24,620** |
| **Net book value: 31 December 2010** | **11,497** | **8,636** | **2,386** | **60** | **3,025** | **25,604** |
| **Net book value: 31 December 2011** | **12,601** | **8,162** | **2,564** | **164** | **1,934** | **25,425** |

*(all amounts are expressed in thousands of KM)*

## 24. DUE TO BANKS AND OTHER INSTITUTIONS

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Current portion of long-term borrowings | 136,798 | 53,771 |
| Total short-term borrowings | 136,798 | 53,771 |
| Long-term borrowings from foreign banks and other institutions | 330,114 | 304,258 |
| Long-term borrowings from domestic banks and other institutions | 3,987 | 7,162 |
| Current portion of long-term borrowings | (136,798) | (53,771) |
| Total long-term borrowings | 197,303 | 257,649 |
| Current accounts in domestic currency | 3 | 3 |
| Current accounts in foreign currency | - | 4 |
| Total current accounts | 3 | 7 |
| Short-term deposit | 107,573 | 136,928 |
| Long-term deposits | 265 | 942 |
| | **441,942** | **449,297** |

Long-term borrowings from international banks and other institutions as at 31 December 2011 and 31 December 2010 are as follows:

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| European Investment Bank | 140,287 | 93,645 |
| Commerzbank Ag Frankfurt, Germany | 68,467 | 68,465 |
| European Fund for Southeast Europe (EFSE), Luxembourg | 42,833 | 44,787 |
| Société Européenne De Banque S.A., Luxembourg | - | 29,500 |
| European Bank for Reconstruction and Development, London, UK | 39,494 | 25,436 |
| Vseobecna Uverova Banka A.S. Bratislava | 19,660 | 19,640 |
| Intesa Sanpaolo SPA Milan, Italy | 15,425 | 18,595 |
| KfWKreditanstalt fur Wiederaufbau | 3,948 | 3,936 |
| Federalnoministarstvofinansija, Sarajevo | 2,430 | 2,446 |
| Vlada SBH/ŽSB, Travnik | - | 2,134 |
| Federalni zavod za zapošljavanje, Sarajevo | 438 | 1,229 |
| Federalno ministarstvo šumarstva i vodoprivrede, Sarajevo | 1,028 | 1,028 |
| Razvojna banka Federacije Bosne i Hercegovine d.o.o. Sarajevo | 65 | 295 |
| OPEC FUND for International Development, Vienna, Austria | - | 255 |
| Služba za zapošljavanje SBK / ŽSB | 26 | 29 |
| | **334,101** | **311,420** |

Interest rates for long-term borrowings from banks and other institutions were in the range from 0% to 4.59% per annum and from 0% to 4.13% per annum as of 31 December 2011 and 31 December 2010, respectively.

Interest rate for short term deposits was in the range from 1.09% to 3.72% per annum and from 1.14% to 3.72% per annum as of 31 December 2011 and 31 December 2010, respectively.

*(all amounts are expressed in thousands of KM)*

## 25. SUBORDINATED DEBT

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Ministarstvo finansija trezora BiH | 1,083 | 1,244 |
| | **1,083** | **1,244** |

The subordinated loan from Ministry of Finance and Trezor as of 31 December 2010 and 31 December 2011, respectively amounting to KM 1,244 thousand and KM 1,083 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.

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

## 26. DUE TO CUSTOMERS

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Demand deposits:** | | |
| Citizens: | | |
| In KM | 59,370 | 51,785 |
| In foreign currencies | 33,884 | 33,206 |
| *Subtotal* | 93,254 | 84,991 |
| Legal entities: | | |
| In KM | 243,454 | 246,007 |
| In foreign currencies | 40,194 | 39,044 |
| *Subtotal* | 283,648 | 285,051 |
| **Total demand deposits** | **376,902** | **370,042** |
| **Term deposits:** | | |
| Citizens: | | |
| In KM | 33,989 | 28,833 |
| In foreign currencies | 142,868 | 132,587 |
| *Subtotal* | 176,857 | 161,420 |
| Legal entities: | | |
| In KM | 89,053 | 88,631 |
| In foreign currencies | 76,597 | 69,504 |
| *Subtotal* | 165,650 | 158,135 |
| **Total term deposits** | **342,507** | **319,555** |
| | **719,409** | **689,597** |

During 2011 interest rates for demand deposits were from 0.00% to 2.50% per annum (during 2010 were from 0.00% to 2.50% per annum).

Short-term deposit interest rates were from 0.00% to 5.56% and from 0.00% to 7.20% per annum, during 2011 and 2010 respectively. Long-term deposit interest rates were from 0.00% to 8.00% and from 0.00% to 8.00% per annum, during 2011 and 2010 respectively.

*(all amounts are expressed in thousands of KM)*

## 26. DUE TO CUSTOMERS (continued)

As of 31 December 2011, 'Due to Customers' includes deposits held as collateral for loans, guarantee and L/C in the amount of KM 17.889 thousand (2010: KM 15.729 thousand).

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Large Corporate customers: | 373,928 | 342,198 |
| Current Accounts | 226,670 | 232,438 |
| Term Deposits | 147,258 | 109,760 |
| Small and medium-sized enterprises: | 75,371 | 100,988 |
| Current Accounts | 56,060 | 52,613 |
| Term Deposits | 19,311 | 48,375 |
| Retail Customers: | 270,110 | 246,411 |
| Current Accounts | 93,254 | 84,991 |
| Term Deposits | 176,856 | 161,420 |
| | **719,409** | **689,597** |

## 27. OTHER LIABILITIES

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Loan repayments received before due dates | 3,066 | 2,631 |
| Liabilities to vendors | 1,375 | 1,054 |
| Liabilities for employees bonuses | 1,629 | 1,100 |
| Managed fund difference (Note 31) | 146 | 182 |
| Credit card liabilities | 230 | 61 |
| Liabilities to shareholders | 140 | 141 |
| Deferred tax liability | 1 | 1 |
| Other liabilities | 3,665 | 1,656 |
| | **10,252** | **6,826** |

Deferred tax liability relates to taxable temporary differences arising on fair value adjustments of financial assets available for sale. The effect of the fair value adjustment, net of relating tax for KM 1 thousand (2010: KM 1 thousand), is recognized through equity.

*(all amounts are expressed in thousands of KM)*

## 28. OTHER PROVISIONS

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| Provisions for litigations with the Tax authorities and clients | 2,156 | 1,838 |
| Provisions for retirement employee benefits and other short-term employee benefits | 483 | 461 |
| | 2,639 | 2,299 |

Provisions for litigations depend on the uncertainty in the outcomes of the ongoing court cases with the tax authority and other proceedings.

| | Provisions for legal proceedings (Note 12) | Provisions for retirement employee benefits and other short term employee benefits (Note 11) | Total |
|---|---|---|---|
| **Balance at 31 December 2010** | 1,838 | 461 | 2,299 |
| Additional provision recognised | 370 | 74 | 444 |
| Release of provision | (52) | (33) | (85) |
| Reductions arising from payments | - | (19) | (19) |
| **Balance at 31 December 2011** | 2,156 | 483 | 2,639 |

Calculation of provisions for retirement benefits of KM 222 thousand as of 31 December 2011 (2010: KM 215 thousand) is performed by an 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 of KM 261 thousand as of 31 December 2011 (2010: KM 246 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

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 2011 will not result in material loss to the Bank.

*(all amounts are expressed in thousands of KM)*

## 29. FINANCIAL COMMITMENTS AND CONTINGENCIES

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.

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Contingent liabilities** | | |
| Payment guarantees | 34,483 | 23,833 |
| Performance guarantees | 30,746 | 24,330 |
| Letters of credit | 572 | 6,195 |
| **Total contingent liabilities** | **65,801** | **54,358** |
| **Commitments** | | |
| Unused portion of overdraft loans | 111,008 | 72,791 |
| **Total commitments** | **111,008** | **72,791** |
| **Total contingent liabilities and commitments** | **176,809** | **127,149** |

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.

Restatements of opening balances of provisions are disclosed in Note 3.2.

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

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Balance as at 1 January before restatement** | **2,637** | **2,709** |
| Release of provisions according IAS 37 | (1,341) | - |
| **Balance as at 1 January after restatement** | **1,296** | - |
| Increase in provisions (Note 13) | 1,045 | 631 |
| Write offs (Note 33) | - | (703) |
| **Balance as at 31 December** | **2,341** | **2,637** |

## 30. RELATED-PARTY TRANSACTIONS

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

a. 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);

b. associates – enterprises in which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;

c. 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;

d. key management personnel, that is, those persons who have 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

e. 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.

*(all amounts are expressed in thousands of KM)*

## 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 2011 | 31 December 2010 |
|---|---|---|
| **Receivables** | | |
| Key management personnel and close family members | 403 | 423 |
| Bank accounts and loans –Intesa Sanpaolo Group | 5,391 | 37,264 |
| Other receivables –Intesa Sanpaolo Group | 82 | 110 |
| | **5,876** | **37,797** |
| **Liabilities** | | |
| Deposits - Key management personnel and close family members | 915 | 731 |
| Borrowings and term deposits –Intesa Sanpaolo Group | 143,102 | 204,356 |
| Other liabilities -Intesa Sanpaolo Group | 318 | 1,326 |
| Borrowings and other liabilities to European Bank for Reconstruction and Development (EBRD) | - | 25,436 |
| | **144,335** | **231,849** |
| **Financial commitments and contingencies** | | |
| Guarantees issued in favour of Intesa Sanpaolo Group | - | 1,883 |
| Commitments to lend - Key management personnel and close family members | 109 | 73 |
| Commitments to lend –Intesa Sanpaolo Group | 400 | - |
| | **509** | **1,956** |
| **Income** | | |
| Interest income - Key management personnel and close family members | 31 | 23 |
| Interest income - Intesa Sanpaolo Group | 638 | 412 |
| Other Income - Intesa Sanpaolo Group | 112 | 120 |
| | **781** | **555** |

*(all amounts are expressed in thousands of KM)*

## 30. RELATED-PARTY TRANSACTIONS (continued)

| **Expenses** | **31 December 2011** | **31 December 2010** |
|---|---|---|
| Interest expense - Key management personnel and close family members | 16 | 6 |
| Interest expense - Intesa Sanpaolo Group | 3,031 | 3,340 |
| Interest expense - European Bank for Reconstruction and Development (EBRD) | 2,317 | 1,712 |
| Other expenses –Intesa Sanpaolo Group | 500 | 570 |
| Other expense - European Bank for Reconstruction and Development (EBRD) | 41 | 62 |
| | **5,905** | **5,690** |

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

In May 2011, EBRD sold shares to majority shareholder Intesa Sanpaolo Holding International S.A., Luxembourg, based on agreement on acquisition of equity. The sale was realized by EBRD through the Extraordinary Auction at the Sarajevo Stock Exchange, after which EBRD is no longer considered to be related party. However, transactions with EBRD affecting income statement during 2011 by the date of selling the shares are included in Income and Expenses within Note 30.

No exposure towards related parties has been classified as non-performing.

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

| | **31 December 2011** | **31 December 2010** |
|---|---|---|
| Compensation for directors and other key management | 476 | 481 |
| Taxes and contributions on compensation | 453 | 495 |
| Bonuses to the Management Board - accrued expenses | 446 | 448 |
| Compensations for Supervisory Board members | 29 | 29 |
| Other Management benefits | 71 | 165 |
| | **1,475** | **1,618** |

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.

During the period all exposure were classified as performing.

*(all amounts are expressed in thousands of KM)*

## 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 0.0% to 2.5% p.a. (in 2010 from 0.0% to 2.50% p.a.) of the total amount contributed.

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Liabilities** | | |
| Government organizations | 9,187 | 9,105 |
| Associations and Agencies | 2,512 | 4,492 |
| Banks and insurance companies | 1,384 | 3,555 |
| Other | 458 | 920 |
| **Total** | **13,541** | **18,072** |
| **Assets** | | |
| Loans to companies | 12,799 | 16,813 |
| Loans to citizens | 596 | 1,077 |
| **Total** | **13,395** | **17,890** |
| **Amounts due to original creditors – managed funds (Note 27)** | **146** | **182** |

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

## 32. CAPITAL MANAGEMENT

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on theface 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 are as follows:

| | 31 December 2011 | 31 December 2010 restated |
|---|---|---|
| Debt (i) | 1,161,351 | 1,138,894 |
| Cash on hand, balances with the Central bank and placements with other banks | (266,469) | (354,417) |
| Net debt | 894,882 | 784,477 |
| Capital (ii) | 158,893 | 148,721 |
| Net debt to capital ratio | **5,63** | **5.27** |

## 32. CAPITAL MANAGEMENT (continued)

Debt (i) is defined as liabilities to banks and clients presented in detail in Notes and 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 and employing techniques based on the guidelines developed by the Banking Agency of Federation of Bosnia and Herzegovina (FBA) for supervisory purposes. The required information is filed with the FBA on a quarterly basis.

The FBA requires each bank to:

(a) hold the minimum level of the regulatory capital of KM 15,000 thousand, and
(b) maintain a ratio of total regulatory capital to the risk-weighted asset at or above the minimum of 12% for 2011. From 31 December 2008, Federal Banking Agency requested banks to include in the calculation of capital adequacy a charge for operational risk.

As of 31 December 2009, the Federal Banking Agency changed the methodology for the calculation of the charge for operational risk, which is based on gross income.

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; unrealised gains/losses arising on the fair valuation of equity instruments held as available for sale and
- Tier 2 capital or Supplementary Capital: qualifying principle of subordinated loan capital, collective impairment allowances and profit for the year.

According to the Decision of minimum standards of credit risk management and classification of assets, the Bank is required to classify loans, other receivables, contingent liabilities and commitments into the categories A, B, C, D and E based on guidance prescribed in the Decision as well as to apply specific percentages to calculate the reserve for credit losses. If the calculated amount of the reserve for credit losses is higher than the total amount of allowances for impairment of financial assets and provisions for contingent liabilities and commitments recognized in balance sheet, the Bank is required to deduct the amount of shortfall from the regulatory capital in the calculation in the capital adequacy and other applicable regulatory ratios.

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.

*(all amounts are expressed in thousands of KM)*

## 32. CAPITAL MANAGEMENT (continued)

The table below summarises the composition of regulatory capital and the ratios of the Bank. The Bank complies with all of the externally imposed capital requirements.

| | 31 December 2011 | 31 December 2010 |
|---|---|---|
| **Tier 1 capital** | | |
| Share Capital | 44,782 | 44,782 |
| Treasury shares | - | - |
| Share Premium | 57,415 | 57,415 |
| Statutory reserves | 614 | 614 |
| Retained Earnings | 20,858 | 14,797 |
| Other reserves not related to assets valuation | 5,535 | 5,536 |
| Revaluation reserve – available for sale investments | 19 | (7) |
| Items to be deducted: Intangible assets | (2,631) | (2,395) |
| Total qualifying Tier 1 Capital | 126,592 | 120,742 |
| **Tier 2 capital** | | |
| Qualifying subordinated loan capital | 1,083 | 1,244 |
| Generic provisions for performing assets | 21,814 | 19,459 |
| Profit for the year | 10,308 | 6,061 |
| Total qualifying Tier 2 Capital | 33,205 | 26,764 |
| **Deductible item** | | |
| Negative difference between allowances for impairment and provisions for contingent liabilities and commitments and the regulatory reserves for credit losses | (7) | - |
| **Total regulatory capital** | **159,790** | **147,506** |
| **Risk weighted assets** | | |
| On balance sheet | 993,408 | 955,585 |
| Off balance sheet | 102,212 | 72,649 |
| **Total** | **1,095,620** | **1,028,234** |
| **Operational risk** | **71,955** | **61,559** |
| **Total weighted risk** | **1,167,575** | **1.089.793** |
| **Capital adequacy ratio** | **13,68%** | **13,53%** |

## 33. FINANCIAL INSTRUMENTS

### Financial risk management objectives

Main purpose of Risk Management Department is to support financial operations, coordinate access to domestic and international financial markets, overlook and manage financial risk trough 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.

FX Value-at-Risk is individual, concise, statistic measurement of possible losses in the portfolio. Value-at-Risk is loss measurement in normal movements of risk factors on the market. Losses higher than the Value-at-Risk occur only with a low indicated likelihood.
The main model assumptions are:

- Being based on the Historical methodology,
- 99 percent as a confidence interval for VaR computation,
- One-day held period.

The model covers foreign currency risk – valid for foreign currency transactions and positions denominated on foreign currencies; resulting from foreign currency rate volatility.

The model can compute VaR at different aggregation levels – from a single position to any sub-portfolio level. Therefore, the model allows a detailed analysis of risk profiles of multi-level portfolio hierarchy and diversity effects occurring. Furthermore, VaR measurement can be expounded based on risk source (risk factors). These features of a more detailed risk monitoring allow determining an efficient limit structure which can be compared through different organisational units.

Key data and their sources, necessary for daily VaR computation based on this model are as follows:

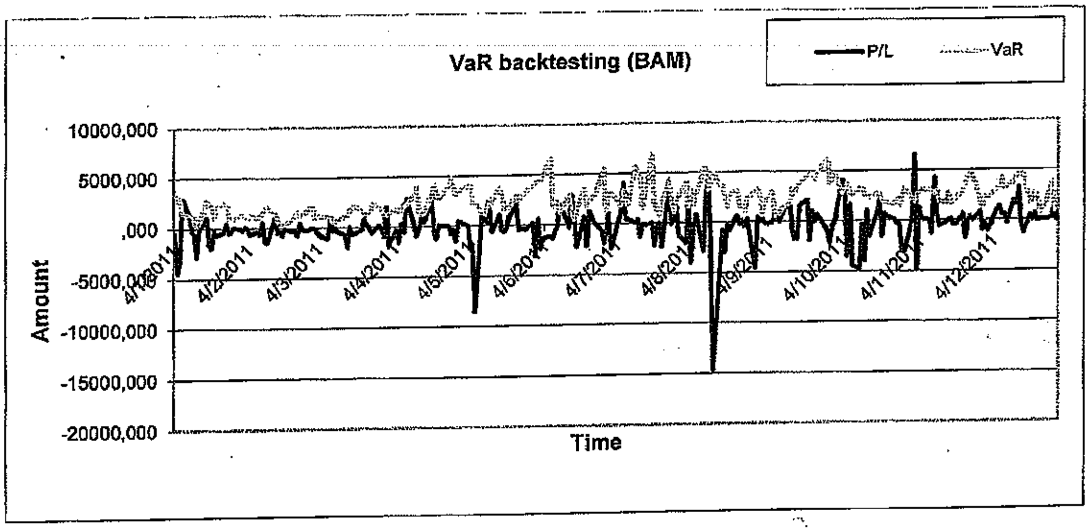
- **Open foreign currency position** – prepared by the Planning and Control Department, checked by the Integrated Risk Management Department, and sent to the Parent Company.
- **Market data:**
- **Local market data** – all local market data unavailable to the Integrated Risk Management Department shall be prepared on a daily basis by the Treasury Division, sent to the Integrated Risk Management Department and to the Parent Company.
- **International market data** – all international market data unavailable to the Integrated Risk Management Department shall be prepared on a daily basis by the Treasury Division, sent to the Integrated Risk Management Department and to the Parent Company.

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

### Financial risk management objectives (continued)

The quality of the implemented risk measurement model must be constantly assessed. Back testing is way to achieve this goal. The essence of back testing procedure is comparing the computed VaR measure with the P&L for the same period. Based on back testing results opinion on the internal model quality shall be created.




During 2011 the Bank recorded twenty for back-testing exceptions (2010: nine exception), when actual losses exceeded daily VAR amount.

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 2011 | 31 December 2010 | 31 December 2011 | 31 December 2010 |
| EUR | 736,601 | 820,944 | 771,713 | 832,539 |
| USD | 18,465 | 16,658 | 18,983 | 16,573 |
| CHF | 2,929 | 2,073 | 2,761 | 2,008 |
| HRK | 955 | 1,546 | 916 | 1,478 |
| GBP | 289 | 295 | 283 | 274 |
| Other | 1,133 | 866 | 1,164 | 643 |

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

### Financial risk management objectives (continued)

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.

**31 December 2011**

| Currency | Open position (in KM) | Stress Test | |
|---|---|---|---|
| | | 10% Move Up | 10% Move Down |
| CHF | 168,000 | 16,800 | (16,800) |
| GBP | 6,000 | 600 | (600) |
| USD | 140,000 | 14,000 | (14,000) |
| HRK | 39,000 | 3,900 | (3,900) |
| CAD | 4,000 | 400 | (400) |
| AUD | 7,000 | 700 | (700) |
| Other | (42,000) | (4,200) | 4,200 |
| EUR | 16,459,000 | - | - |

**31 December 2010**

| Currency | Open position (in KM) | Stress Test | |
|---|---|---|---|
| | | 10% Move Up | 10% Move Down |
| CHF | 65,000 | 6,500 | (6,500) |
| GBP | 21,000 | 2,100 | (2,100) |
| USD | 85,000 | 8,500 | (8,500) |
| HRK | 68,000 | 6,800 | (6,800) |
| CAD | 10,000 | 1,000 | (1,000) |
| AUD | 17,000 | 1,700 | (1,700) |
| Other | 196,000 | 19,600 | (19,600) |
| EUR | (11,595,000) | - | - |

Result of KM thousand profit/loss on USD position at 31 December 2011 is the result of having the Bank open position in USD equal to KM 140,000 (USD assets KM 18,465 thousand and liabilities KM 18,983 thousand). If we take in consideration foreign currency movements and predict 10% positive or negative change applied to an open position of KM 140 thousand, the Bank is exposed to a FX risk in the amount of KM 14 thousand. In case of a long position with a positive market movements the Bank will record a profit and loss in the opposite case.

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

## 33. FINANCIAL INSTRUMENTS (continued)

**Financial risk management objectives (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.

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 2011 with parallel interest rate shock in 200 bps would decrease 2,621 / 2,621 increase (2010: decrease/increase by KM 3,787 thousand). This is mainly attributable to the Bank's exposure to interest rates on its variable rate borrowings.

## 33. FINANCIAL INSTRUMENTS (continued)

### 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.

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

### Credit risk management (continued)

### Financial assets

The credit quality of financial assets is managed by the bank using internal credit ratings. The table below shows the credit quality by class of financial assets exposed to the credit risk, based on the bank's internal credit rating system. The amounts presented are gross of impairment allowances.

| 31 December 2011 | Neither past due nor impaired | Past due but not impaired | Individually impaired | Total |
|---|---|---|---|---|
| Cash and balances with other banks | 163,790 | - | - | 163,790 |
| Obligatory reserve with the Central Bank | 71,158 | - | - | 71,158 |
| Placements with other banks | 31,527 | - | - | 31,527 |
| Loans and advances to customers | 898,620 | 78,748 | 119,682 | 1,097,050 |
| Assets available for sale | 15,945 | - | 47 | 15,992 |
| | **1,181,040** | **78,748** | **119,729** | **1,379,517** |

| 31 December 2010 | Neither past due nor impaired | Past due but not impaired | Individually impaired | Total |
|---|---|---|---|---|
| Cash and balances with other banks | 66,364 | - | - | 66,364 |
| Obligatory reserve with the Central Bank | 97,789 | - | - | 97,789 |
| Placements with other banks | 190,290 | - | - | 190,290 |
| Loans and advances to customers | 787,743 | 95,181 | 93,609 | 976,533 |
| Assets available for sale | 999 | - | 857 | 1,856 |
| | **1,143,185** | **95,181** | **94,466** | **1,332,832** |

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

**Credit risk management (continued)**

**Credit exposure and collaterals**

| **31 December 2011** | Credit risk exposure | | | |
|---|---|---|---|---|
| **Description** | **Loans given** | **Undrawn loan commitments and unutilized overdrafts** | **Commitments / Guarantees issued** | **Fair value of the collateral** |
| Legal entity | 647,407 | 57,631 | 65,801 | 770,839 |
| Retail | 449,643 | 53,377 | - | 503,020 |
| **Total** | **1,097,050** | **111,008** | **65,801** | **1,273,859** |
| **31 December 2010 restated** | | | | |
| Legal entity | 560,194 | 32,341 | 54,358 | 421,309 |
| Retail | 416,339 | 40,450 | - | 129,200 |
| **Total** | **976,533** | **72,791** | **54,358** | **550,509** |

| ***Fair value of the collateral of loans and commitments*** | **31.12.2011** | **31.12.2010** |
|---|---|---|
| Property | 12,377 | 535,761 |
| Deposits | 635,542 | 14,748 |
| | **647,919** | **550,509** |

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 646 thousand; 2010: KM 1,230 thousand) is not shown among the Bank's property plant and equipment but it is recorded in "Other assets" position (Note 22).

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

**Credit risk management (continued)**

***Fair value of the collateral of loans and commitments (continued)***

Analysis of past due but not impaired loans by days of delay:

| | | Past due days | | | |
|---|---|---|---|---|---|
| | Gross amount | Until 30 days | 31 – 60 days | 61 – 90 days | Over 90 days |
| **31 December 2011** | | | | | |
| Legal entities | 38,493 | 36,370 | 1,295 | 828 | - |
| Retail | 40,255 | 28,735 | 9,416 | 2,101 | 3 |
| **Total** | **78,748** | **65,105** | **10,711** | **2,929** | **3** |

| | | Past due days | | | |
|---|---|---|---|---|---|
| | Gross amount | Until 30 days | 31 – 60 days | 61 – 90 days | Over 90 days |
| **31 December 2010** | | | | | |
| Legal entities | 46,642 | 39,934 | 3,966 | 981 | 1,761 |
| Retail | 48,539 | 34,496 | 11,402 | 2,616 | 25 |
| **Total** | **95,181** | **74,430** | **15,368** | **3,597** | **1,786** |

*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 2011 was KM 57,293thousand and in 2010was KM 52,737thousand.

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

According previous FBA regulation the Bank had obligation to record assets fully provisioned in off-balance sheet records. In 2010 movements in loans and other assets written off and recorded off-balance sheet were as follows:

| | Loans and receivables and commitments | Assets available for sale | Other assets | Total |
|---|---|---|---|---|
| **31 December 2009** | **34,824** | **857** | **3,567** | **39,248** |
| Currency differences and reclassification of beginning balances | 2 | - | 88 | 90 |
| Write-offs in 2010 | 14,256 | - | 246 | 14,502 |
| Collections | (4,628) | - | (115) | (4,743) |
| Collections – deferred income | (273) | - | - | (273) |
| Total write offs | (1,725) | - | (141) | (1,866) |
| **31 December 2010** | **42,456** | **857** | **3,645** | **46,958** |

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

**Credit risk management (continued)**

***Loans and other assets written off and recorded off-balance sheet (continued)***

With 31 December 2010 the Bank restated Off balance sheet assets from Off balance to Balance Sheet:

- amounts of Loans and receivables (39,440 thousand KM) and commitments (3,016 thousand KM) are shown in Loans and receivables position (total amount 42,456 thousand KM)
- from the total amount of Other assets classified in E category in 2010 (3,645 thousand KM) the Bank restated amount of 2,970 thousand KM in Balance Sheet. Difference relates to property received in collection process for which the Bank has not indications for selling.
- The amount of Assets available for sale (857 thousand KM) is restated into same position in Balance Sheet.

From 2011 fully provisioned assets is part of Balance Sheet records. In 2011 the Bank did permanent write offs as follows:

| | Loans and receivables Note 20 | Assets available for sale Note 21 | Other assets Note 22 | Commitments | Total |
|---|---|---|---|---|---|
| Total write offs | 2,676 | 810 | 362 | - | 3,848 |

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

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

**Liquidity risk management (continued)**

| | Less than 1 month | 1-3 months | 3 months to 1 year | 1-5 years | 5+ years | Total |
|---|---|---|---|---|---|---|
| **31 December 2011** | | | | | | |
| Cash and balances with Central bank | 228,193 | - | - | - | - | **228,193** |
| Placement with other banks | 37,980 | - | - | - | - | **37,980** |
| Loans and receivables | 147,514 | 80,541 | 311,895 | 424,482 | 231,333 | **1,195,765** |
| Assets available for sale | - | 6,908 | 8,327 | 212 | - | **15,447** |
| Other financial assets | 4,510 | - | - | - | - | **4,510** |
| **TOTAL ASSETS** | **418,196** | **87,448** | **320,221** | **424,694** | **231,333** | **1,481,895** |
| **31 December 2010** | | | | | | |
| Cash and balances with Central bank | 164,153 | - | - | - | - | **164,153** |
| Placement with other banks | 189,682 | - | - | - | 1,246 | **190,928** |
| Loans and receivables | 55,783 | 61,612 | 292,625 | 435,996 | 402,679 | **1,248,695** |
| Assets available for sale | 2 | 4 | 19 | 174 | 1,557 | **1,756** |
| Other financial assets | 2,465 | - | - | - | 1,229 | **3,694** |
| **TOTAL ASSETS** | **412,085** | **61,616** | **292,644** | **436,17** | **406,711** | **1,609,226** |

| | Less than 1 month | 1-3 months | 3 months to 1 year | 1-5 years | 5+ years | Total |
|---|---|---|---|---|---|---|
| **31 December 2011** | | | | | | |
| Due to banks and other institutions | 87,781 | 1,156 | 146,995 | 115,949 | 57,571 | **409,452** |
| Subordinated debit | 2 | 44 | 137 | 699 | 287 | **1,171** |
| Due to customers | 380,101 | 41,173 | 194,112 | 157,701 | 10,541 | **783,628** |
| Other financial liabilities | 8,461 | - | - | - | - | **8,461** |
| **TOTAL LIABILITIES** | **476,345** | **42,373** | **341,244** | **274,349** | **68,399** | **1,202,711** |
| **31 December 2010** | | | | | | |
| Due to banks and other institutions | 83,525 | 28,438 | 81,383 | 224,764 | 66,175 | 484,285 |
| Subordinated debit | - | 40 | 122 | 702 | 561 | 1,425 |
| Due to customers | 380,134 | 23,266 | 122,755 | 171,601 | 11,944 | 709,700 |
| Other financial liabilities | 2,724 | - | - | - | 148 | 2,872 |
| **TOTAL LIABILITIES** | **466,383** | **51,744** | **204,260** | **397,067** | **78,828** | **1,198,282** |

Expected maturities are not expected to defer from the contractual maturities, except in the area of demand deposits which may be extended according to clients' preferences.

*(all amounts are expressed in thousands of KM)*

## 33. FINANCIAL INSTRUMENTS (continued)

### Liquidity risk management (continued)

The following tables presents in 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 December 2011** | | | | | | |
| Guarantees | 6,377 | 13,951 | 33,093 | 11,693 | 115 | 65,229 |
| Letter of credit | 538 | 34 | - | - | - | 572 |
| Unused portion of loans | 4,823 | 8,805 | 82,170 | 15,210 | - | 111,008 |
| | **11,738** | **22,790** | **115,263** | **26,903** | **115** | **176,809** |
| **31 December 2010** | | | | | | |
| Guarantees | 2,343 | 8,195 | 27,656 | 9,854 | 115 | 48,163 |
| Letter of credit | 540 | 1,517 | 4,138 | - | - | 6,195 |
| Unused portion of loans | 3,618 | 8,079 | 56,935 | 4,159 | - | 72,791 |
| | **6,501** | **17,791** | **88,729** | **14,013** | **115** | **127,149** |

The following tables details the Bank's commitments and contingent liabilities allocated according to the earliest date they can be drawn:

| | Less than 1 month | 1-3 months | 3 months to 1 year | 1-5 years | 5+ years | Total |
|---|---|---|---|---|---|---|
| **31.12.2011** | | | | | | |
| Guarantees | 9,908 | 13,114 | 31,107 | 10,992 | 108 | 65,229 |
| Letter of credit | 540 | 32 | - | - | - | 572 |
| Unused portion of loans | 11,194 | 8,277 | 77,240 | 14,297 | - | 111,008 |
| | **21,642** | **21,423** | **108,347** | **25,289** | **108** | **176,809** |
| **31.12.2010** | | | | | | |
| Guarantees | 5,550 | 7,622 | 25,720 | 9,164 | 107 | 48,163 |
| Letter of credit | 936 | 1,411 | 3,848 | - | - | 6,195 |
| Unused portion of loans | 8,460 | 7,513 | 52,950 | 3,868 | - | 72,791 |
| | **14,946** | **16,546** | **82,518** | **13,032** | **107** | **127,149** |

The Bank has access to sources of financing with total unused amount of KM 48,972 thousand (2010: KM 86,862 thousand) at the balance sheet date. The Bank expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

## 34. TAX RISKS

The tax system in Bosnia and Herzegovina is in the process of continuous revisions and changes. There are still, however, different interpretations of tax regulations. In different circumstances, Tax Authorities may have different approaches in certain tax areas and may identify additional tax liabilities and penalty interests. In Bosnia and Herzegovina tax period remains open for a period of five years. Outdating of the right of Tax Authorities to impose taxes, interests and fines is discontinued with every official action of the Tax Authorities to impose and collect taxes. After each of such discontinuation, new outdating period starts and the time before that discontinuation is not included in the legal outdating period. The Management of the Company believes that tax liabilities are correctly presented in these financial statements.

## 35. EVENTS AFTER THE BALANCE SHEET DATE

No events have occurred since the balance sheet date, which significantly affect the state of affairs of the Bank at the balance sheet date or which require additional disclosure.

## 36. APPROVAL OF THE FINANCIAL STATEMENTS

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

Approved by and signed on behalf of the Management Board:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina
52 1

Almir Krkalić,
Director

Dario Grassani
Executive director of Finance