ANNUAL REPORT

2012.

INTESA SANPAOLO BANKA

Bosna i Hercegovina

Bank of INTESA SANPAOLO

Intesa Sanpaolo Banka d.d. BiH

Financial Statements
as at 31 December 2012

Content

Report on Supervisory Board activities

Vojko Cok,
Chairman of the Supervisory Board

During the year 2012, the Supervisory Board of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina (hereinafter: "the Bank") held 9 meetings on the following dates: 22.02.; 02.04.; 24.04.; 22.06.; 25.07.; 24.08.; 30.10.; 03.12. and 27.12.2012, which were recorded under sequential numbers from 45 to 53.

The Supervisory Board of the Bank carried out its activities in accordance with the Charter of the Bank and along with significant support by the Management Board and Audit Committee.

At the meetings held, the Bank's Supervisory Board considered, analyzed and discussed various general and internal acts of the Bank, including policies and procedures, prepared internally but also those Group ones from the Parent Company.

The Supervisory Board put particular efforts and attention to analyzing and discussing Bank's financial reports and followed up internal and external auditors' activities, during the year.

Among the major issues and topics that the Supervisory Board discussed are results of Stress Test on Capital Adequacy ratio, both official and unofficial. Supervisory Board will continue to follow up with this issue, staying committed in respecting the local regulation about the capital adequacy ratio and advising Management Board on further actions.

The Supervisory Board also paid special attention to AML activities and reports, provided by the Compliance and AML Department.

As per local regulatory requirement, Supervisory Board also received and considered all information related to BCM and tests performed as well as to local regulatory requirements referring to reports on written complaints that the Bank received. The Supervisory Board assessed these Bank's activities successful.

Through adoption of Operational Reports, Report of independent External Auditors the Supervisory Board of the Bank acknowledged work of the Management Board, assessing it as successful and compliant with laws, internal acts, decisions, policies, procedures and programs.

Significant involvement of the Supervisory Board of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina in all Bank's activities contributed to stability and maintenance a good position of the Bank in the market, thus, achieving good financial results.

As far as composition of the Supervisory Board is concerned, the members of the Supervisory Board of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina, during 2012 were: Mr. Vojko Cok (Chairman/ Banka Koper), Mr. Ivan Sramko (Deputy Chairman of the Board) Mr. Massimo Pierdicchi, Ms. Beata Kissne Foldi and Mr. Luca Finazzi.

Starting from statements presented in this Report, the Supervisory Board proposes to the Bank's General Shareholder's Meeting the following:

- Decision on Accepting Report on the Operation of the Bank for period 01.01.-31.12.2012. along with the Report of the External and Internal Auditor, Supervisory Board Report, Audit Committee Report and Basics of Business Plan for 2013 of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina;
- Decision on adoption of Annual Statements of Accounts for the period 01.01.–31.12.2012;
- Decision on Distribution of the Profit for 2012 of the Intesa Sanpaolo Banka d.d. Bosna i Hercegovina.

Chairman of the Supervisory Board
Vojko Čok

Menagement Board Report on Bank's Operations

Almir Krkalic,
CEO

In accordance with Article 40 of the Law on Accounting ("FBiH Official Gazette" no. 83/2009), Management Board of Intesa Sanpaolo Banka d.d. BiH presents business results of the Bank for 2012.

Intesa Sanpaolo Banka d.d. BiH continued the good performance recorded already in previous years, despite the consequences of the financial crisis that still affect the economy worldwide and in BH in particular. In line with the strategy agreed with the shareholders and considering the decreasing demand for financing, the Bank assessed carefully the creditworthiness of existing and potential new borrowers. Nonetheless, the Bank improved further its market share in credit financing, while keeping under continuous and effective control the risk level of its credit exposures, which resulted in outperforming the banking sector's average NPL/total loans ratio, both in retail and in corporate segments. At the same time, the Bank improved its market share also in collection of direct customer deposits, focusing in particular on medium and long term funding.

The following are the most important indicators evidencing the quality of the Bank's operations.

In 2012 the Bank accomplished net profit in the amount of 15,584 thousand KM, which is higher by 51,2 % in comparison with previous year. Total assets remained substantially stable at 1,325 million KM, with increasing net loans (1,041 million KM or +2,2%) and customer deposits (809 million KM or +12,3%).

Loan portfolio growth was sustained both by Retail and Corporate segments, where lending to private customers increased by 3,4% and lending to legal entities, despite slowing down its pace in comparison with the previous year's growth, still increasing by 1,7%. Retail segment positive performance is confirmed by the remarkable improvement in collection of deposits (+24,9%), which, together with a parallel growth of corporate deposits (+4,8%) contributed to the Bank's re-balancing of loans/deposits ratio, disregarding the additional contribution of stable funding from international organizations. Overall, the Bank's position in terms of available liquidity is comfortable and safe, even if we were to assume critical global scenarios, and ensures the Bank's ability to respond promptly and effectively in case of improvements in customers' demand for financing.

The Bank's improved further its capital adequacy ratio through careful management of its risk weighted assets. Even without proceeding with direct capital injections, the shareholders sustained actively the bank's stable growth through retention and reinvestment of the increasing profit.

The commercial presence of the Bank on Bosnia Herzegovina market and our attention for customers' needs is emphasized by the opening also in 2012 of one additional agency and the continuous expansion of ATM and POS network. At the same time, the Bank proceeded in developing further its product portfolio for both private individuals and legal entities.

Like in past years, focus on customers means for our Bank also promptness in providing feedbacks in case of complaints or requests for clarifications and constant monitoring of customers' satisfaction through advanced surveying tools. In this area, we proudly keep on recording the leading position on the

Bosnian market in terms of European Customer Satisfaction Index, with distinctive top rates as far as company's Image, After Sale care of customers, Service Value and Relationship with Personnel.

Customer care is not separate, for Intesa Sanpaolo Banka d.d. BiH, from social responsibility, which also in 2012 resulted in direct support to social activities and in particular in support for students' scholarship and special awarding programs for universities' students, together with cooperation with several no-profit organizations.

At the same time, in a period of difficulties for countrymen in finding or keeping their jobs, the Bank managed to increase further its workforce and strengthened its programs for employees permanent training, recording the continuous success and impact of modern training tools like "distance learning", that enable a timely circulation of information on new regulations, new products and methodologies.

Main objectives of the Management Board of the Bank and its staff in the following period are:

Strict Monitoring of Credit Assets Quality, through

- Careful selection of reliable borrowers and continuous close relationship with debtors aimed and timely detection of worsening financial indicators.
- Optimization of portfolio based on the risk/return profile.
- Improvement of collateral monitoring by further developing dedicated IT applications and collaterals-related procedures.
- Development of Early Warning System that will be integrated within Bank IT architecture.

Strengthening and Optimization of Loan and Deposit portfolios, through:

- Increase product penetration on the existing client base (new products and services: new card and loan products, cross selling).
- Increased diversification of product portfolios to increase sales: products bundling (credit card bundle with general purpose loan, general purpose loan bundled with housing loan, etc.) and product packages including targeted benefits (insurance coverage for overdraft in a case of death and car assistance program).
- Special offers promotion through specific selling actions for loans and deposits, leveraging upon the Bank's Customer Relationship Management application.
- Improving deposits' attractiveness, through combination of deposits' offer with additional products and re-balancing products and pricing by maturities, in order to achieve overall decrease of bank's costs.
- Clients acquisition through new products (AMEX), channels (upgrade of e-banking platform) and selling campaigns.

Strict Monitoring on Operational Costs, with focus of capital investments supporting first of all business developments and continuous detailed analysis of standard operational expenses.

Human Resources enhancement, through:

- Continuous training of all resources, leveraging further on distance learning tools.
- Taking advantage of Group training programs both for technical topics and for development of managerial skills.

Network optimization, through:

- Further renovation of selected branches according to Group standards.
- Further penetration in merchants' network through POSs and leveraging on successful new Inspire Debit Card.

In addition, detailed explanation of the policy of the Bank in reference to financial risks management, exposure of the Bank to the price risk, FX risk, credit risk, capital and liquidity risks can be found in details in the notes from 6.2 to 6.5 of the Financial Statements of the Bank for 2012, audited by external auditor KPMG.

Almir Krkalic, CEO

Sarajevo, February 2013

Responsibility for the Financial Statements

The Management Board has pleasure in submitting its report for the year ended 31 December 2012.

Review of operations

The result for the year ended 31 December 2012 of the Bank is set out in the income statement on page 6.

Supervisory Board, Management Board and Audit Committee

During the course of 2012 and up to the date of this report, the Supervisory Board comprised:

Supervisory Board	
Vojko Cok	Chairman
Ivan Sramko	Vice-Chairman
Massimo Pierdicchi	Member
Beata Kissne Foldi	Member
Finazzi Luca Santo	Member

During the course of 2012 and up to the date of this report, the Audit Committee comprised:

Audit Committee	
Giovanni Bergamini	Chairman
Alberto Gandini	Member
Andrea Perucchi	Member
Nicoletta Fusetti	Member
Damiano Accattoli	Member

As of 31 December 2012 the Management Board comprised a director and 2 executive directors, who served during the year and up to the date of this report as follows:

Management Board	
Almir Krkalic	Director
Dario Grassani	Executive Director of Finance
Igor Bilandžija	Executive Director of Risk Management

On behalf of the Management Board

Almir Krkalic
CEO

Dario Grassani
Executive Director of Finance

Responisbilities of the Management and Supervisory Boards for the preparation and approval of financial statements

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

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then applying them consistently; making judgements and estimates that are reasonable and prudent; and preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business. The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements, following which the Supervisory Board is required to approve the financial statements.

The financial statements set out on pages 6 to 73 were authorised by the Management Board on 18 February 2013 for issue to the Supervisory Board, and are signed below to signify this, on behalf of the Bank, by:

For and on behalf of Management Board

Almir Krkalić
Director

Dario Grassani
Executive Director of Finance

Independent Auditors' report

We have audited the accompanying financial statements of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina (the "Bank"), which comprise the statement of financial position as at 31 December 2012, and the income statement and statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management Board's Responsibility for the Financial Statements

The Management Board is responsible for the preparation and presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that is 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 information is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial information. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial information, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of the financial information in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting 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 2012, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Matter

The financial statements of the Bank as at and for the year ended 31 December 2011, which were prepared in accordance with the accounting regulations applicable to financial reporting of banks in the Federation of Bosnia and Herzegovina, were audited by another auditor who expressed an unmodified opinion on those statements in its report dated 22 February 2012.

KPMG B-H d.o.o. za reviziju
Registrovani revizori
Zmaja od Bosne 7-7A/III
71000 Sarajevo
Bosna i Hercegovina

D.O.O. ZA REVIZIJU KPMG B-H 1 SARAJEVO

18. February 2013

On behalf of KPMG B-H d.o.o. za reviziju:

Manal Bećirbegović Director	Senad Pekmez FBIH registered auditor Licence number: 3090044102/10

Intesa Sanpaolo Banka, d.d. BiH
Income statement for the year ended 31 December 2012
(all amounts are expressed in thousands of KM, unless otherwise stated)

	Notes	31 December 2012	31 December 2011
Interest income	*8*	84,446	78,314
Interest expense	*9*	(28,856)	(23,872)
Net interest income		**55,590**	**54,442**
Fee and commission income	*10*	15,842	14,397
Fee and commission expense	*11*	(4,109)	(3,570)
Net fee and commission income		**11,733**	**10,827**
Net trading income	*12*	1,702	1,309
Other operating income	*13*	689	436
Other operating income		**2,391**	**1,745**
Total operating income		**69,714**	**67,014**
Personnel expenses	*14*	(17,375)	(19,288)
Administrative expenses	*15*	(17,312)	(17,970)
Depreciation and amortisation		(4,795)	(4,822)
Operating expense		**(39,482)**	**(42,080)**
Profit before impairment losses, and other provisions and income tax		**30,232**	**24,934**
Net impairment losses and other provisions	*16*	(12,799)	(13,419)
Profit before tax		**17,433**	**11,515**
Income tax expense	*17*	(1,849)	(1,207)
Net profit for the period		**15,584**	**10,308**
Basic and diluted earnings per share (KM)	*18*	**34.80**	**23.03**

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

Intesa Sanpaolo Banka, d.d. BiH
Statement of comprehensive income for the year ended 31 December 2012
(all amounts are expressed in thousands of KM, unless otherwise stated)

	31 December 2012	31 December 2011
Profit for the year	**15,584**	**10,308**
Other comprehensive income for the year		
Fair value reserves (available-for-sale financial assets)		
Change in fair value, net of deferred tax	62	25
Total other comprehensive income	**62**	**25**
Total comprehensive income for the year	**15,646**	**10,333**

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

Intesa Sanpaolo Banka, d.d. BiH
Statement of financial position as at 31 December 2012
(all amounts are expressed in thousands of KM, unless otherwise stated)

	Notes	31 December 2012	31 December 2011	1 January 2011
Assets				
Cash and cash equivalents	*19*	136,621	163,791	66,364
Obligatory reserve with the Central Bank	*20*	70,061	71,158	97,789
Placements with other banks	*21*	39,739	31,520	190,264
Financial assets available for sale	*22 a)*	2,351	15,933	979
Financial assets at fair value through profit and loss	*22 b)*	301	-	-
Loans and receivables from customers	*23*	1,041,235	1,018,609	907,798
Income tax prepayment		1,683	2,748	2,841
Other assets	*24*	10,174	6,292	6,397
Property and equipment	*25*	20,502	22,793	23,209
Intangible assets	*26*	2,730	2,632	2,395
Total Assets		**1,325,397**	**1,335,476**	**1,298,036**
Liabilities				
Due to banks and other financial institutions	*27*	330,735	441,942	449,297
Due to customers	*28*	808,406	719,409	689,597
Financial liabilities at fair value through profit and loss	*22 b)*	56	-	-
Subordinated debt	*29*	923	1,083	1,244
Other liabilities	*30*	8,617	10,250	6,826
Provisions for liabilities and charges	*31*	3,196	4,980	3,595
Deferred tax liability	*32*	8	2	-
Total liabilities		**1,151,941**	**1,177,666**	**1,150,559**
Equity				
Share capital	*33*	44,782	44,782	44,782
Share premium		57,415	57,415	57,415
Regulatory reserves for credit losses		18,286	18,279	18,279
Other reserves		6,150	6,150	6,150
Fair value reserves		80	18	(7)
Retained earnings		46,743	31,166	20,858
Total equity		**173,456**	**157,810**	**147,477**
Total liabilities and equity		**1,325,397**	**1,335,476**	**1,298,036**

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

Intesa Sanpaolo Banka, d.d. BiH
Statement of changes in shareholders' equity for the year ended 31 December 2012
(all amounts are expressed in thousands of KM, unless otherwise stated)

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2012	**44,782**	**57,415**	**18,279**	**6,150**	**18**	**31,166**	**157,810**
Net profit for the year	-	-	-	-	-	15,584	**15,584**
Other comprehensive income							
Net gain from change in fair value of financial assets available for sale	-	-	-	-	68	-	**68**
Deferred tax	-	-	-	-	(6)	-	**(6)**
Total other comprehensive income	-	-	-	-	*62*	-	***62***
Total comprehensive income	-	-	-	-	62	15,584	**15,646**
Transfer from retained earnings to regulatory reserves	-	-	7	-	-	(7)	**-**
Balance as at 31 December 2012	**44,782**	**57,415**	**18,286**	**6,150**	**80**	**46,743**	**173,456**

As explained in Note 3(n) and 5(c) these financial statements have been prepared in accordance with the anticipated changes in regulations related to presentation of regulatory reserves for credit losses, which are expected to have retrospective application from 31 December 2012. In accordance with the draft decision issued by the Agency in February 2013, estimated amount of shortfall in the regulatory reserves has not be disclosed as an amount to be proposed for adoption by shareholders in general meeting for transfer from retained earnings to regulatory reserves for credit losses. As at 31 December 2012, shortfall in the regulatory reserves has been estimated to KM 9,270 thousand. Had the Agency not changed regulation, this amount would need to be transferred from retained earnings to regulatory reserves for credit losses upon shareholders approval. The accompanying notes form an integral part of these financial statements.

Intesa Sanpaolo Banka, d.d. BiH
Statement of changes in shareholders' equity for the year ended 31 December 2011
(all amounts are expressed in thousands of KM, unless otherwise stated)

	Issued share capital	Share premium	Regulatory reserves for credit losses	Other reserves	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2011	**44,782**	**57,415**	**18,279**	**6,150**	**(7)**	**20,858**	**147,477**
Net profit for the year	-	-	-	-	-	10,308	**10,308**
Other comprehensive income							
Net gain from change in fair value of financial assets available for sale	-	-	-	-	27	-	**27**
Deferred tax	-	-	-	-	(2)	-	**(2)**
Total other comprehensive income	-	-	-	-	*25*	-	**25**
Total comprehensive income	-	-	-	-	25	10,308	**10,333**
Balance as at 31 December 2011	**44,782**	**57,415**	**18,279**	**6,150**	**18**	**31,166**	**157,810**

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

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements
(all amounts are expressed in thousands of KM, unless otherwise stated)

	Notes	31 December 2012	31 December 2011
Cash flow from operating activities			
Profit for the period		15,584	10,308
Adjustments for:			
depreciation and amortisation		4,795	4,822
net impairment losses and provisions		12,799	13,419
net charge in provisions for liabilities and charges		(387)	359
net interest income		(55,590)	(54,442)
net change in fair value of financial assets and liabilities at fair value through profit and loss		(96)	-
net gain from disposal of property and equipment		(65)	(20)
tax expense		1,849	1,207
		(21,111)	(24,347)
Change in placement with other banks		(8,233)	158,762
Change in loans and receivables from customers		(31,867)	(119,955)
Change in other assets		(4,694)	377
Change in obligatory reserve with Central Bank		1,097	26,631
Change in financial assets at fair value through profit and loss		(149)	-
Change in due to banks		(111,207)	(7,355)
Change in due to customers		87,989	28,551
Change in other liabilities		(1,633)	3,425
Change in provisions for liabilities and charges		(243)	(19)
		(90,051)	66,070
Income tax paid		(784)	(1,114)
Interest received		80,772	74,266
Interest paid		(27,847)	(22,609)
Net cash flow used in operating activities		(37,910)	116,613
Cash flow from investing activities			
Acquisition of property and equipment		(2,214)	(3,943)
Proceeds from the sale of property and equipment		475	98
Acquisition of intangible assets		(1,035)	(1,056)
Proceeds/(acquisition) from financial assets available for sale		13,674	(14,122)
Net cash flow used in investing activities		10,900	(19,023)
Cash flow from financing activities			
Repayment of subordinated debt		(160)	(163)
Net cash flow used in financing activities		(160)	(163)
Net (decrease)/increase in cash and cash equivalents		(27,170)	97,427
Cash and cash equivalents at the beginning of the year	*19*	163,791	66,364
Cash and cash equivalents at the end of the year	*19*	136,621	163,791

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

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements
(all amounts are expressed in thousands of KM, unless otherwise stated)

1. GENERAL

Incorporation and registered activities

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

The Bank's main operations are as follows:
1. Accepting deposits from the public,
2. Granting short-term and long-term loans and guarantees to corporate customers, private individuals, local municipalities and other credit institutions
3. Money market activities,
4. Performing local and international payments,
5. Foreign currency exchange and other banking-related activities,
6. Providing banking services through an extensive branch network in Bosnia and Herzegovina.

2. BASIS OF PRESENTATION

Statement of compliance

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

These are the Bank's first financial statements prepared in accordance with IFRSs and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied ("IFRS 1"). An explanation of how the transition to IFRSs has affected the reported financial position, financial performance and cash flows of the Bank is provided in the Note 4.

These financial statements were authorised by the Management Board on 18 February 2013 for submission to Supervisory Board.

Basis of measurement

The financial statements have been prepared on the historical or amortised cost basis except for financial assets available for sale and financial assets and liabilities at fair value through profit or loss.

Functional and presentation currency

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

Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual results may differ from those estimates.

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 revision and future periods if the revision affects both current and future periods.

Information on areas with significant uncertainty in the estimates and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in these financial statements are disclosed in Note 5.

3. SUMMARY OF ACCOUNTING POLICIES

The accounting policies set our below have been consistently applied for all periods presented in these financial statements and in preparing the opening IFRS statement of financial position at 1 January 2011 for the purpose of the transition to IFRSs

Foreign currency transactions

Transactions in currencies other than Convertible Marks ("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 reporting 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 income statement for the period.

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

31 December 2011	EUR 1= KM 1.95583	USD 1 = KM 1.511577
31 December 2012	EUR 1= KM 1.95583	USD 1 = KM 1.483600

Interest income and expense

Interest income and expense are recognised in the income statement as they accrue using the effective interest rate method. Effective interest rate is the rate that discounts estimated future cash flows of financial assets or liabilities over the life of the financial instrument (or, if appropriate, shorter period) to its net carrying value. In the calculation of effective interest rates the Bank estimates future cash flows considering all contractual terms, but not future credit losses.

Calculation of the effective interest rate includes all paid or received transaction costs, fees and points, which are an integral part of the effective interest rate. Transaction costs include all incremental costs incurred directly in connection with the issuance or acquisition of financial assets or financial liabilities.

Interest income and expense recognised in the income statement include interest on financial assets and financial liabilities that are measured at amortised cost calculated using the effective interest rate method.

Fee and commission income and expenses

Fee and commission income and expenses that are integral part of the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Fee and commission income and expenses, reported as such, comprise mainly fees related to credit card transactions, the issuance of guarantees and letters of credit, domestic and foreign payment transactions and other services and are recognised in the income statement upon performance of the relevant service.

Net trading income

Net trading income comprises net gains and losses from foreign exchange trading, net gains and losses on financial instruments at fair value through profit and loss and net gains and losses from the translation of monetary assets and liabilities denominated in foreign currency at the reporting date.

3. SUMMARY OF ACCOUNTING POLICIES (continued)

Dividend income

Dividend income is recognised in the income statement when the rights to receive income is established.

Lease payments

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

Income tax expenses

The income tax charge is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at the reporting date and any adjustments to tax payable in respect of previous years.

The amount of deferred tax is calculated using the balance sheet liability method whilst taking into account the temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and amounts used for income tax purposes. Deferred tax assets and liabilities are recognised using the tax rates that are expected to apply on taxable income in the period in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the reporting date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects at the reporting date to recover or settle the carrying amount of its assets and liabilities. Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the statement of financial position. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable future profits will be available against which the deferred tax assets can be utilised. At each reporting date the Bank reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets for indications of potential impairment.

Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: loans and receivables, financial assets available for sale, financial assets and financial liabilities at fair value through profit or loss and other financial liabilities. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of financial assets and liabilities upon initial recognition and re-evaluates this classification at each reporting date.

a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determined payments that are not quoted in an active market. Loans and receivables arise when the Bank provides money to a debtor with no intention of trading with these receivable and include placements with and loans to other banks, loans and receivables from customers and balances with the Central Bank.

b) Financial assets available for sale

Financial assets available for sale are non-derivatives that are either designated in this category or not classified into any of the other categories. Financial assets classified as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates or equity prices. Financial assets available for sale include equity and debt securities.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (continued)

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

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

The Bank designates financial assets and financial liabilities at fair value through profit or loss when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminated or significantly reduced an accounting mismatch which would otherwise have arisen; or
- the asset or liability contains an embedded derivative that significantly modified the cash flows that would otherwise be required under the contract.

Financial assets and financial liabilities at fair value through profit or loss include derivative financial instruments classified as financial instruments held for trading and equity instruments designated by the management at fair value through profit or loss. The management has designated equity instruments at fair value through profit or loss because the designation eliminates or significantly reduces an accounting mismatch related to share-based payments, which would otherwise arise.

d) Other financial liabilities

Other financial liabilities comprise all financial liabilities which are not at fair value through profit and loss and include due to customers, due to banks and other financial institutions and subordinated debt.

Recognition

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

The Bank recognises financial assets available for sale and financial assets and liabilities at fair value through profit or loss on the trade date which is the date when the Bank commits to purchase or sell the instruments.

Initial and subsequent measurement

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

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

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

Other financial liabilities are initially measured at fair value including transaction costs. Subsequent to initial recognition the Bank measures other financial liabilities at amortised cost using the effective interest rate.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (continued)

Recognition of gains and losses on subsequent measurement of financial instruments

Gains and losses from changes in the fair value of available-for-sale financial assets are recognised directly in other comprehensive income until derecognition or impairment, when the cumulative amount previously recognised in other comprehensive income is transferred to the income statement. Interest income calculated using the effective interest rate method is recognised in income statement.

Foreign exchange gains and losses on available-for-sale equity instruments are part of the fair value of these instruments and are recognised in other comprehensive income. Dividend income on available-for-sale equity securities is recognised in profit or loss when the right to receive payment has been established.

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

Derecognition

The Bank derecognises financial assets (in full or partially) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realised, surrendered or have expired.

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

Identification and measurement of impairment of financial assets

(a) Financial assets carried at amortised cost

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 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. Objective 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 from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group.

For financial assets carried at amortised cost, the Bank first assesses whether objective evidence of impairment exists individually, for financial assets that are individually significant, or collectively, for financial assets that are not individually significant. Those individually significant assets which are not identified as impaired are subsequently included in the basis for collective impairment assessment. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics.

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) discounted at the original effective interest rate of financial assets valid at the time the asset become impaired. 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.

For individually significant loans, impairment allowance is determined based on 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.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(a) Financial assets carried at amortised cost (continued)

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. For the purpose of collective evaluation of impairment the Bank uses statistical models and historical data on the probability of occurrence that causes impairment, the time required to recover and the total loss incurred, adjusted for management's judgement as to whether the current economic and credit conditions are such that it is likely that the actual losses with be higher or lower of those calculated by historical modelling. The Bank regularly reviews the loss rate and the expected rate of recovery at each reporting date, to ensure accurate reporting.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognised in the income statement.

When a loan is uncollectible, it is written off against the related impairment allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised as a reversal of impairment losses in the income statement.

The Bank also calculates provisions in accordance with the relevant regulations of the Banking Agency of Federation of Bosnia and Herzegovina ("the Agency" or "FBA"). In accordance with these regulations, the relevant placements are classified into appropriate risk groups, depending on the past due days, the financial position of the borrower and collateral; and are provided for at prescribed rates. A general provision is also calculated in accordance with these regulations at a rate of 2% on exposure not specifically impaired.

If the impairment allowance calculated in accordance with the regulations of the Agency is greater than the impairment allowance calculated in accordance with IFRS, the difference is presented as an appropriation within equity.

(b) Financial assets available for sale

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the investment below its acquisition cost is considered in determining whether the assets are impaired.

If any such evidence exists for financial assets available for sale, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement, is removed from other comprehensive income and recognised in the income statement.

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is subsequently recognised in other comprehensive income.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(c) Financial assets carried at cost

Financial assets carried at cost include equity securities classified as available for sale for which there is no reliable measure of fair value. The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

An impairment loss is calculated as the difference between the carrying amount of the financial asset and the present value of expected future cash flows discounted by the current market interest rate for similar financial assets. Impairment losses on such instruments, recognised in the income statement, are not subsequently reversed through the income statement.

Fair value measurement principles

The Bank determines the fair value of debt securities (treasury bills and bonds) using an internal valuation model which considers their remaining maturity and the latest available auction prices of equivalent instruments.

The fair value of foreign currency forward derivatives is estimated using a valuation model which considers expected trends of currency’s interest rates.

The fair value of equity securities classified as available for sale and at fair value through profit or loss traded on an active market is based on closing bid prices at the reporting date for these securities.

Specific financial instruments

(a) Derivative financial instruments

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

Derivative financial instruments include foreign exchange forward contracts and are initially recognised and subsequently measured at their fair value in the statement of financial position. Fair values are obtained from discounted cash flow models.

All derivatives are classified as financial assets at fair value through profit or loss when their fair value is positive and as financial liabilities at fair value through profit or loss when it is negative

(b) Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Central Bank 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 Central Bank is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

(c) Placements with banks and obligatory reserve with the Central Bank

Placements with banks and obligatory reserve with the Central Bank are classified as loans and receivables and are carried at amortised cost less impairment losses.

(d) Loans and receivables from customers

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

(e) Equity securities

Equity securities are classified as available for sale and carried at fair value, unless there is no reliable measure of the fair value, in which case equity securities are stated at cost.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(f) Debt securities

Debt securities are classified as available-for-sale financial assets and carried at fair value.

(g) Borrowings and subordinated debt

Interest-bearing borrowings and subordinated debt are classified as other financial liabilities and are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, these are stated at amortised cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings using the effective interest rate method.

(h) Current accounts and deposits from banks and customers

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

(i) Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and impairment losses. The cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent cost is included in net book value or is accounted for as separate assets only if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day-to-day repairs and maintenance are recognised in the income statement as incurred.

Depreciation is provided on all property and equipment except for land and assets in the course of construction on a straight-line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The depreciation rates used by the Bank are as follows:

Computers	20%
Furniture and equipment	10% - 20%
Business premises	1.3%
Leasehold improvements	20%

Depreciation method and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains and losses on disposal are determined by comparing proceeds with the carrying amount, and are included in the income statement as other income or operating expense.

(j) Intangible assets

Intangible assets are stated at cost less accumulated amortisation and impairment losses. The cost includes all expenditure that is directly attributable to the acquisition of the items.

Amortisation is provided on all intangible assets except assets in the course of construction on a straight line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The depreciation rates used by the Bank are as follows:

Software	20%

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(k) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

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

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

(l) Employee benefits

Short-term benefits

On behalf of its employees, the Bank pays pension and health insurance which is calculated on the gross salary paid as well as tax on salaries which are calculated on the net salary paid. The Bank pays the above contributions into the state pension and health funds according to statutory rates during the course of the year. In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with local legislation. These expenses are recorded in the income statement in the period in which the salary expense is incurred.

Obligations for contributions to defined contribution pension plans are recognised as an expense in income statement as incurred.

Long-term employee benefits: retirement severance payments and early retirement bonuses

The Bank pays to its employees' retirement severance benefits upon retirement in an amount representing three times the average salary of the respective employee in the period of the last three months.

The obligation and costs of these benefits are determined by using a projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the estimated interest rate on government bonds.

Share-based payments

Employees of the Bank receive remuneration in the form of share-based payments, whereby employees render services as consideration for equity instruments issued by the ultimate parent company. The Bank accounts for share-based payments as a cash-settled transaction.

The fair value of the amount payable to employees in respect of the ultimate parent company shares to be given to the employees is recognised as an expense with a corresponding increase in liabilities over the period in which the employees unconditionally become entitled to payments. The liability is remeasured at each reporting date and at the settlement date. Any changes in the fair value of the liability are recognised as a personnel expense in income statement.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(m) Provisions for liabilities and charges

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

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of incurred losses. The Management determines the sufficiency of provisions on the basis of insight into specific items; current economic circumstances risk characteristics of certain transaction categories as well as other relevant factors.

Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

(n) Share capital

Issued share capital

Issued share capital comprises ordinary and preference shares and is stated in KM at nominal value.

Regulatory reserve for credit losses

The regulatory reserve for credit losses represents the surplus of impairment allowances calculated in accordance with regulations as prescribed by the Agency over impairment allowances recognised in accordance with IFRS. The reserve is presented directly within equity (as a non-distributable reserve) and until 2012 (as explained below) it is covered by transfers from retained earnings, after approval by shareholders.

Prior to 2012, the need for transfers from retained earnings to an earmarked reserve within equity (regulatory reserve for credit losses) was calculated for the whole credit risk portfolio on a net basis, thereby taking into account both instances where application of Agency regulations would have resulted in a higher provision and instances where the application of Agency regulations would have resulted in a lower provision. However, from 2012, banks are required to calculate the requirement for regulatory reserves for credit losses taking into account only instances where higher provisions would have resulted from the application of the Agency rules. Retroactive application of this change in Agency rules is not required.

Based on the draft decision issued by the Agency in February 2013 the surplus of regulatory provisions will only be presented as a deduction of regulatory capital for the purpose of capital adequacy calculation without transfer from retained earnings to regulatory reserves for credit losses. The decision is expected to have retrospective application from 31 December 2012.

Retained earnings

Retained earnings represent the accumulation of net profits after appropriations to owners and other transfers, such as transfers to regulatory reserves as described above.

Fair value reserve

The fair value reserve comprises changes in fair value of financial assets available for sale, net of deferred tax.

Other reserves

Other reserves mainly relate to accumulated appropriations from retained earnings in accordance with the Shareholder's Assembly decision.

Dividends

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

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

3. SUMMARY OF ACCOUNTING POLICIES (continued)

(o) Off-balance sheet commitments and contingent liabilities

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

(p) Managed funds for and on behalf of third parties

The Bank manages funds for and on behalf of corporate and retail clients. These amounts do not represent the Bank's assets and are excluded from the statement of financial position. For the services rendered the Bank charges a fee.

(q) Segment reporting

A business segment is a distinguishable component of the Bank that is engaged in providing products or services, which is subject to risks and rewards that are different from those of other segments. A geographical segment is engaged in providing products or services within a particular economic environment distinguished from other segments engaged in providing products or services within other economic environments.

The Bank has identified 3 primary business segments: Retail, Corporate and Treasury. The primary segmental information is based on the Bank's internal reporting structure by business segment. Geographical concentration is not presented as the Bank's operations are concentrated in Bosnia and Herzegovina.

(r) New standards and interpretations

Several new and altered Standards and Interpretations issued by the International Accounting Standards Board and its International Financial Reporting Interpretations Committee, have been authorised for issue but are not applicable to entities reporting under IFRS for period ended 31 December 2012, and have not been applied in preparation of these financial statements. Most new and altered Standards and Interpretations are not relevant to the Bank's business and will not affect the financial statements, except for below stated.

- IFRS 9 Financial Instruments (a complete version of which has not yet been adopted and International Accounting Standards Board has an active project with certain changes related to classification and measurement as well as inclusion of certain new requirements related to impairment and hedge accounting), which replaces IAS 39 Financial Instruments: Recognition and Measurement, is effective for annual periods beginning on or after 1 January 2015; early adoption is permitted. This Standard introduces significant changes with respect to the classification and measurement of financial assets. The Bank has not yet decided on the date of the initial application of the new Standard neither it has analysed the effects of its application.

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

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

4. FIRST TIME ADOPTION

As stated in note 2 (a), these are the Bank's first annual financial statements which are prepared in accordance with IFRS. Accordingly, IFRS 1 has been adopted in the preparation of these financial statements.

The financial statements as of and for the year ended 31 December 2011 were prepared in accordance with the accounting regulations applicable to financial reporting of banks in Federation of Bosnia and Herzegovina.

According to local legislation all banks in the Federation of Bosnia and Herzegovina were obliged to prepare financial statements for the year ended 31 December 2011 in accordance with IFRS and thus apply IFRS 1 in 2011. Had IFRS 1 been applied in the preparation of the Bank's financial statements for 2011, the transition date from which reported amounts would have had to be restated to comply with IFRS would have been 1 January 2010. However, the Bank chose to restate only the balance of equity brought forward as of 1 January 2011 and the component balances in the statement of financial position at that date, and accordingly its financial statements for 2011 were not prepared in accordance with IFRS. Nevertheless, in restating assets, liabilities and equity as of 1 January 2011, the Bank has reported amounts in accordance with IFRS from the transition date required for first-time adoption in 2012.

As a result of the above, no restatement is required of the statement of financial position as of 1 January and 31 December 2011 and income statement and statement of comprehensive income for the year ended 31 December 2011.

5. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated and are based on historical experience and other factors such as the expected flow of future events that can be rationally assumed in existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a possible material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

(a) Impairment losses on loans and receivables

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

Impairment losses are made mainly against the carrying value of loans to corporate and retail customers (as disclosed in Note 23) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 35) and other assets (Note 24).

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

The Bank first assess whether objective evidence of impairment exists individually for assets that are individually significant (corporate exposures above KM 50 thousand and retail exposures above KM 150 thousand) and collectively for assets that are not individually significant. However, assets assessed individually as unimpaired are then included in groups of assets with similar credit risk characteristics and then assessed collectively for impairment.

The Bank estimates impairment losses in cases where it judges that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets. Such evidence includes delinquency in payments or other indications of financial difficulty of borrowers and adverse changes in the economic conditions in which borrowers operate or in the value or enforceability of security, where these changes can be correlated with defaults.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

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

(a) Impairment losses on loans and receivables (continued)

	31 December 2012	31 December 2011
Summary of impairment allowances:		
Impairment allowance for balance sheet exposures, including IBNR (Note 23)	82,340	78,441
Provisions for off-balance-sheet, including IBNR (Note 31)	1,187	2,341
	83,527	**80,782**

As at 31 December 2012 and 31 December 2011, the gross value of impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognised were as follows:

	31 December 2012			**31 December 2011**		
	Corporate	Retail	Total	Corporate	Retail	Total
Gross exposure	91,092	32,242	**123,334**	88,850	30,832	**119,682**
Impairment allowance	(48,919)	(24,309)	**(73,228)**	(41,640)	(24,606)	**(66,246)**
Impairment rate	54%	75%	**59%**	47%	80%	**55%**

An increase in the impairment rate of 1 percentage point of the gross non-performing exposure presented above as at 31 December 2012, would lead to the recognition of an additional impairment loss of KM 1,233 thousand (2011: KM 1,197 thousand).

In addition to identified losses on impaired loans, as described above, the Bank also recognises impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified ("IBNR"). Amounts, for which specific impairment losses have been identified, are excluded from this calculation.

The amount of IBNR as at 31 December 2012 amounted to KM 9,112 thousand for balance sheet exposure and KM 1,172 thousand for off-balance sheet exposure. (2011: KM 12,195 thousand for balance sheet exposure and KM 2,322 thousand for off-balance sheet exposure. The total IBNR provision amounted to 0.87% (2011: 1.22%) of the relevant on and off-balance-sheet exposure.

(b) Taxation

The Bank provides for tax liabilities in accordance with the tax laws of Federation of Bosnia and Herzegovina. Tax returns are subject to the approval of the tax authorities which are entitled to carry out subsequent inspections of taxpayers' records.

(c) Regulatory requirements

The Agency is entitled to carry out regulatory inspections of the Bank's operations and to request changes to the carrying values of assets and liabilities, in accordance with the underlying regulations.

In addition to impairment allowance calculated and recognised in accordance with IFRS, the Bank also calculates impairment in accordance with Agency regulations.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements ***(continued)***
(all amounts are expressed in thousands of KM, unless otherwise stated)

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

(c) Regulatory requirements (continued)

The following table summarises impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2012 are calculated in accordance with the new methodology, as explained in Note 3(n):

Summary of impairment allowances	**31 December 2012**	31 December 2011
Provisions for balance-sheet exposure (Agency)	**111,389**	98,591
Provisions for off-balance–sheet (Agency)	**3,764**	3,661
	115,153	102,252
Impairment allowances under IFRS	**84,507**	83,966
Excess at period end	**30,646**	18,286

Until 2012, any increase in allowance in accordance with the Agency regulations over amounts recognised under IFRS were required to be transferred to the regulatory reserves from profit or retained earnings, upon the decision of the General Assembly. However, as explained in Note 3(n), based on the draft decision issued by the Agency in February 2013 any shortfall in regulatory provisions will be adjusted as a deduction of regulatory capital in the capital adequacy calculation without any transfer of this shortfall from retained earnings to regulatory reserves for credit losses within equity. Accordingly, no approval of the shareholders regarding this transfer is required.

As presented in the above table, total Agency provisions exceeding provisions recognized under IFRS amounted to KM 30,646 thousand as at 31 December 2012 (31 December 2011: KM 18,286 thousand). Out of this amount, KM 18,286 thousand has been recognised as a regulatory reserve for credit losses within equity as at 31 December 2012 (31 December 2011: KM 18,279 thousand). The remaining amount of KM 12,360 thousand, which represents a current year shortfall, in line with the new Agency regulation, as explained above, will not be transferred to the regulatory reserves for credit losses, but will be adjusted as a reduction of regulatory capital (as explained in note 6.5, 75% of this amount 75% or KM 9,270 thousand is presented as a deduction of regulatory capital in the capital adequacy calculation as at 31 December 2012).

(d) Litigation and claims

The Bank performs an individual assessment of all court cases and creates provisions in accordance with the assessment. The assessment of risks and proposal for provisions for legal cases is performed by the Legal Affairs Department and Finance Division, and a decision on the creation of provisions is made by the Bank's management.

As stated in Note 31, the Bank provided KM 1,518 thousand (2011: KM 2,156 thousand), which the management estimates as sufficient. Since the estimate is made considering the specificities of each individual case, it is not practicable for management to evaluate the financial impact of changes to the assumptions based on which provisions are quantified on reporting date.

6. FINANCIAL RISK MANAGEMENT

The Bank's activities expose it to a variety of financial risks: credit risk, liquidity risk, market risk and operating risk. Market risk includes currency risk, interest rate and other price risk.

The Bank has established an integrated system of risk management by introducing a set of policies and procedures for analysis, evaluation, acceptance and risk management. Taking risk is core to the financial business and the operational risks are an inevitable consequence of being in business.

The Management Board has overall responsibility for the establishment and oversight of the Bank's risk management framework.

Risk management is carried out by the Risk Management Department whose main purpose is to support financial operations, coordinate access to domestic and international financial markets, oversee and manage financial risk through internal risk reports including analysis by size and level of the risk.

6.1 Credit risk

6.1.1 Risk limit control and mitigation policies

The Bank takes on exposure to credit risk which is the risk that the 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 are 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.

The limits of credit risk are determined in relation to the Bank's regulatory capital.

According to the Bank's policy, decision-making on exposure to credit risk is centralised and concentrated on the Credit Committee. Decisions of the Credit Committees are made upon consideration of proposals provided by the Risk Management Department. The terms for approval of each corporate loan are determined individually depending on client type, the loan's purpose, estimated credit worthiness and current market situation. Conditions for collateral are also determined according to client creditworthiness analysis, type of credit risk exposure, term of the placement as well as the placement amount.

Off-balance-sheet credit instruments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and letter of credits carry the same risk as loans and are secured with similar collateral as are loans.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.2 Maximum exposure to credit risk before collateral held or other credit enhancement

	Maximum exposure	
	31 December 2012	31 December 2011
Statement of financial position		
Current accounts with Central Bank and other banks	**109,027**	139,042
Obligatory reserve with the Central Bank	**70,061**	71,158
Placements with other banks	**39,739**	31,408
Debt securities available for sale	**1,754**	15,333
Loans and receivables from customers	**1,041,235**	1,018,609
Income tax prepayment	**1,683**	2,748
Other assets without repossessed assets	**6,819**	5,629
Off-balance sheet exposure		
Undrawn lending commitments	**114,612**	109,855
Financial guarantees and letters of credit	**63,342**	64,612
Total	**1,448,272**	1,458,394

For items in the statement of financial position, the exposures set out above are based on net carrying amounts as reported in the statement of financial position.

The above table represents the maximum credit risk exposure of the Bank as at 31 December 2012 and 31 December 2011, without taking into account any collateral held or other credit enhancements attached.

The Bank holds collateral against loans and receivables to customers in the form of mortgages and other securities over assets and guarantees. Collateral value estimates are based on assessments by chartered court surveyors at the time of loan approval, reduced by a haircut at certain fixed percentage. In order to constantly verify the adequacy of the impairment allowance, collateral reassessments are performed in accordance with the principles and rules of the collateral management system, taking into proper consideration the volatility of collateral value and the time needed for its realisation, influenced by the global financial and economic crises. Collateral is not held for loans and placements to banks.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.2 Maximum exposure to credit risk before collateral held or other credit enhancement (continued) During the year the Bank obtains financial and non-financial assets by taking possession of collaterals it holds as security or calling on other credit enhancements, in case of failure by the debtors to repay their due amounts. Such process of foreclosure involves mainly real estates, equipment, vehicles, which are presented in the statement of financial position of the Bank once they meet the criteria for recognition according to the Law and the IFRSs. The policy of the Bank is to sell repossessed assets; during the period of possession and pending their final sale to third parties, the assets can be temporarily used if they are functional to the Bank's standard operations, or leased operationally to third parties.

Gross amount of repossessed assets is presented in the following table:

	31 December 2012	31 December 2011
Other assets	3,355	663
Property and equipment	1,493	1,480
	4,848	**2,143**

6.1.3 Credit risk management and policies for impairment and provisions

The Bank accounts for counterparty risks arising from the loan portfolio by making allowances for impaired loans. At each reporting date, the Bank checks the existence of objective evidence of impairment of financial assets, as previously explained in note 3.

Restructured loans and receivables

During the year the Bank has rescheduled certain loans to clients aiming at improvement of their final recoverability. Rescheduling is mainly performed in response to initial deterioration of the clients' financial position or for the prevention of further deterioration of the clients' financial position. Following the restructuring the loans remain graded as performing loans until there are clear signs of default. Whenever possible, the Bank's position was improved by obtaining additional instruments of collateral.

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

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

(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.3 Credit risk management and policies for impairment and provisions (continued)

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

	31 December 2012	31 December 2011
Corporate		
Loans to customers that are neither past due nor impaired	531,344	520,064
Past due but not impaired loans	36,386	38,493
Non-performing loans (impaired loans)	91,092	88,850
Gross exposure	**658,822**	**647,407**
Less: impairment allowance	(55,947)	(51,392)
Net exposure	**602,875**	**596,015**
Retail		
Loans to customers that are neither past due nor impaired	395,237	378,556
Past due but not impaired loans	37,274	40,255
Non-performing loans (impaired loans)	32,242	30,832
Gross exposure	**464,753**	**449,643**
Less: impairment allowance	(26,393)	(27,049)
Net exposure	**438,360**	**422,594**
Total gross exposure	**1,123,575**	**1,097,050**
Portfolio impairment allowance (IBNR)	9,112	12,195
Individual and group impairment allowance	73,228	66,246
Net exposure	**1,041,235**	**1,018,609**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.3 Credit risk management and policies for impairment and provisions (continued)

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

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

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

	Retail loans				Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
31 December 2012							
Standard monitoring	219,671	127,170	48,396	**395,237**	183,398	347,946	**531,344**
31 December 2011							
Standard monitoring	210,116	123,095	45,345	**378,556**	164,262	355,802	**520,064**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements ***(continued)***
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.3 Credit risk management and policies for impairment and provisions (continued)

b) Past due but not impaired loans

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

				Past due days	
	Gross amount	Until 30 days	31 – 60 days	61 – 90 days	Over 90 days
31 December 2012					
Corporate loans	**36,386**	**35,454**	**660**	**272**	**-**
- Large	1,716	1,098	618	-	-
- Other	34,670	34,356	42	272	-
Retail loans	**37,274**	**30,255**	**5,553**	**1,466**	**-**
- Consumer	20,926	16,788	3,372	766	-
- Housing	13,412	10,981	1,785	646	-
- Credit Cards and overdrafts	2,936	2,486	396	54	-
Total	**73,660**	**65,709**	**6,213**	**1,738**	**-**

	Gross amount	Until 30 days	31 – 60 days	61 – 90 days	Past due days Over 90 days
31 December 2011					
Corporate loans	**38,493**	**36,370**	**1,295**	**828**	**-**
- Large	3,233	2,483	-	750	-
- Other	35,260	33,887	1,295	78	-
Retail loans	**40,255**	**28,737**	**9,415**	**2,101**	**2**
- Consumer	24,690	18,848	4,802	1,040	-
- Housing	12,755	9,848	2,246	661	-
- Credit Cards and overdrafts	2,810	41	2,367	400	2
-					
Total	**78,748**	**65,107**	**10,710**	**2,929**	**2**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.3 Credit risk management and policies for impairment and provisions (continued)

c) Non-performing loans

The breakdown of the gross and net amount of the loans to customers that are impaired along with the estimated value of related collateral held by the Bank as security, are as follows:

	Retail loans				Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
31 December 2012							
Non performing loans – gross	19,219	7,306	5,717	**32,242**	12,280	78,812	**91,092**
Impairment	(17,888)	(1,306)	(5,115)	**(24,309)**	(5,500)	(43,419)	**(48,919)**
Net	1,331	6,000	602	**7,933**	6,780	35,393	**42,173**
Estimated value of collateral							
Cash deposit	40	-	-	**40**	-	-	**-**
Mortgage	521	7,036	11	**7,568**	10,398	60,036	**70,434**
Total	561	7,036	11	**7,608**	10,398	60,036	**70,434**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.3 Credit risk management and policies for impairment and provisions (continued)

c) Non-performing loans (continued)

	Retail loans				Corporate loans		
	Consumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Other	**Total**
31 December 2011							
Non performing loans – gross	19,240	5,761	5,831	**30,832**	12,868	75,982	**88,850**
Impairment	(18,156)	(1,391)	(5,059)	**(24,606)**	(4,358)	(37,282)	**(41,640)**
Net	1,084	4,370	772	**6,226**	8,510	38,700	**47,210**
Estimated value of collateral							
Cash deposit	46	-	10	**56**	-	-	**-**
Mortgage	506	5,533	-	**6,039**	10,683	58,259	**68,942**
Total	552	5,533	10	**6,095**	10,683	58,259	**68,942**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.1 Credit risk (continued)

6.1.4 Concentration of credit risk per geographic location

Geographic risk concentrations mainly relate to the region of Bosnia and Herzegovina. Geographic risk concentrations on gross amounts of balance sheet exposure are as follows:

	Bosnia and Herzegovina	OECD countries	Non-OECD countries	Total
As at 31 December 2012				
Current accounts with Central Bank and other banks	109,027	-	-	**109,027**
Obligatory reserves with the Central Bank	70,061	-	-	**70,061**
Placements with other banks	-	39,739	-	**39,739**
Debt securities available for sale	1,754	-	-	**1,754**
Loans and receivables from customers	1,041,235	-	-	**1,041,235**
Income tax prepayment	1,683	-	-	**1,683**
Other assets	5,950	869	-	**6,819**
As at 31 December 2012	**1,229,710**	**40,608**	**-**	**1,270,318**
As at 31 December 2011				
Current accounts with Central Bank and other banks	139,042	-	-	**139,042**
Obligatory reserves with the Central Bank	71,158	-	-	**71,158**
Placements with other banks	-	31,408	-	**31,408**
Debt securities available for sale	15,333	-	-	**15,333**
Loans and receivables from customers	1,018,609	-	-	**1,018,609**
Income tax prepayment	2,748	-	-	**2,748**
Other assets	4,886	743	-	**5,629**
As at 31 December 2011	**1,251,776**	**32,151**	**-**	**1,283,927**

(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.2 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.

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 show the remaining contractual maturities of the Bank's assets and liabilities as at 31 December 2012 and 31 December 2011, except for financial assets available for sale which have been classified in accordance with their secondary liquidity characteristic as maturing within one month and obligatory reserves which has been classified in the maturity period within one month. Other items of assets and liabilities that have no contractual maturities determined are classified into remaining maturity over 5 years.

	Up to 1month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2012						
Assets						
Cash and cash equivalents	136,621	-	-	-	-	136,621
Obligatory reserve with the Central Bank	70,061	-	-	-	-	70,061
Placements with other banks	38,650	-	-	489	600	39,739
Financial assets available for sale	1,742	-	-	-	609	2,351
Financial assets at fair value through profit and loss	91	-	-	210	-	301
Loans and receivables from customers	96,037	101,731	278,494	375,604	189,369	1,041,235
Income tax prepayment and other assets	11,857	-	-	-	-	11,857
Property and equipment and intangible assets	-	-	-	-	23,232	23,232
Total assets	**355,059**	**101,731**	**278,494**	**376,303**	**213,810**	**1,325,397**
Liabilities and equity						
Due to banks and other financial institutions	67,717	24,876	48,011	149,925	40,206	330,735
Due to customers	312,633	32,694	245,779	208,972	8,328	808,406
Financial liabilities at fair value through profit and loss	56	-	-	-	-	56
Subordinated debt	-	40	120	643	120	923
Other liabilities	8,449	-	-	-	168	8,617
Provision for liabilities and charges	-	-	-	-	3,196	3,196
Deferred tax liability	8	-	-	-	-	8
Share capital and reserves	-	-	-	-	173,456	173,456
Total liabilities and equity	**388,863**	**57,610**	**293,910**	**359,540**	**225,474**	**1,325,397**
Maturity gap	**(33,80)**	**44,121**	**(15,416)**	**16,763**	**(11,664)**	**-**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.2 Liquidity risk management (continued)

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total
31 December 2011						
Assets						
Cash and cash equivalents	163,791	-	-	-	-	163,791
Obligatory reserve with the Central Bank	71,158	-	-	-	-	71,158
Placements with other banks	31,520	-	-	-	-	31,520
Financial assets available for sale	15,933	-	-	-	-	15,933
Financial assets at fair value through profit and loss	-	-	-	-	-	-
Loans and receivables from customers	70,373	74,848	291,818	380,968	200,602	1,018,609
Income tax prepayment and other assets	9,040	-	-	-	-	9,040
Property and equipment and intangible assets	-	-	-	-	25,425	25,425
Total assets	**361,815**	**74,848**	**291,818**	**380,968**	**226,027**	**1,335,476**
Liabilities and equity						
Due to banks and other financial institutions	88,433	24,370	131,836	140,605	56,698	441,942
Due to customers	298,890	98,519	200,254	114,485	7,261	719,409
Financial liabilities at fair value through profit and loss	-	-	-	-	-	-
Subordinated debt	-	40	120	642	281	1,083
Other liabilities	10,110				140	10,250
Provision for liabilities and charges	-	-	-	-	4,980	4,980
Deferred tax liability	2	-	-	-	-	2
Share capital and reserve	-	-	-		157,810	157,810
Total liabilities and equity	**397,435**	**122,929**	**332,210**	**255,732**	**227,170**	**1,335,476**
Maturity gap	**(35,620)**	**(48,081)**	**(40,392)**	**125,236**	**(1,143)**	**-**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.2 Liquidity risk management (continued)

Future cash flows for interest bearing liabilities

The estimated future cash flows for the Bank's interest bearing liabilities, including expected interest as at 31 December 2012 and as at 31 December 2011 as prepared by the Bank, are shown in the following table:

	Total expected outflow						
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total	Carrying value
31 December 2012							
Liabilities							
Due to banks and other financial institutions	66,314	26,379	50,238	154,554	41,514	**338,999**	**330,735**
Due to customers	309,412	36,271	252,432	223,387	9,023	**830,525**	**808,406**
Subordinated debt	2	44	135	684	122	**987**	**923**
Total expected outflow	**375,728**	**62,694**	**302,805**	**378,625**	**50,659**	**1,170,511**	**1,140,064**

	Total expected outflow						
	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Total	Carrying value
31 December 2011							
Liabilities							
Due to banks and other financial institutions	87,942	2,347	158,370	149,544	59,982	**458,185**	441,942
Due to customers	379,940	39,982	182,737	124,106	8,130	**734,895**	719,409
Subordinated debt	2	44	137	699	287	**1,169**	1,083
Total expected outflow	**467,884**	**42,373**	**341,244**	**274,349**	**68,399**	**1,194,249**	**1,162,434**

6. FINANCIAL RISK MANAGEMENT (continued)

6.3 Market risk

The Bank is exposed to market risk which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, foreign currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

The Management Board sets limits and guidelines for monitoring and mitigating market risks which is regularly monitored by the Risk Management Department of the Bank.

6.3.1 Foreign exchange risk

Exposure to currency risk arises from credit, deposit-taking and trading activities and is controlled on a daily basis in accordance with legal and internal limits for each currency as well as in total amounts for assets and liabilities denominated in or linked to foreign currencies.

In order to manage foreign exchange rate risk more efficiently, the Bank monitors economic and other business changes in the environment in order to predict possible changes in foreign currency activities, exchange rates, and foreign currency risk.

Overall exposure to foreign exchange risks is monitored within Risk Management Department using techniques such as Value at Risk (“VaR”) and stress testing.

FX Value-at-Risk is an individual, concise, statistical measurement of possible losses in the portfolio. VaR is a measurement of loss under normal movements of risk factors on the market. The likelihood of losses higher than VaR occurring is expected to be low.

The main model assumptions are:

- Being based on the historical methodology
- 99 percent as a confidence interval for Value-at-Risk 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.

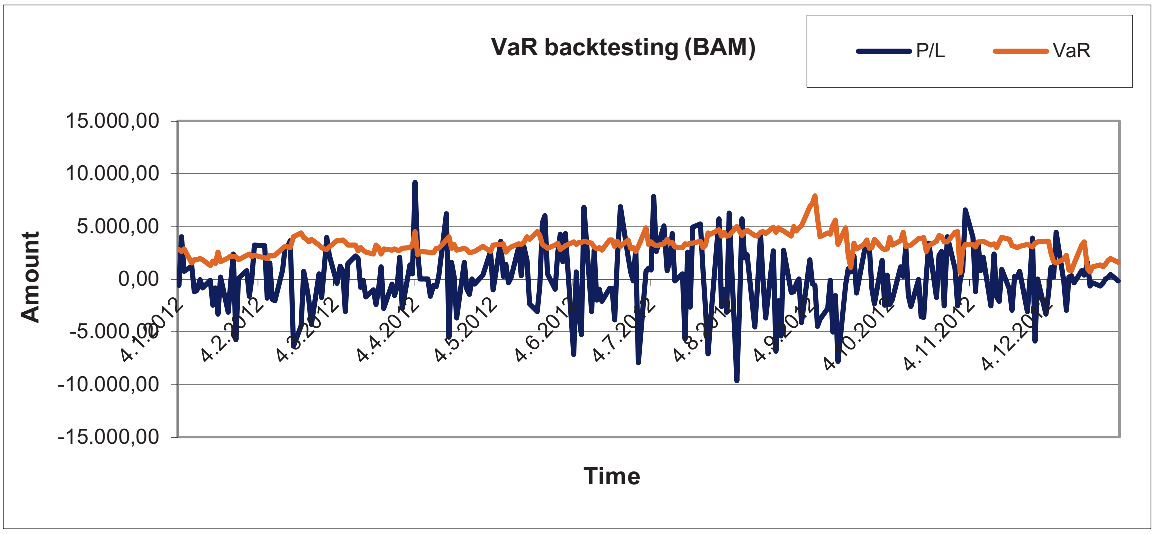
The quality of the implemented risk measurement model is constantly assessed. The Bank performs back-testing of the computed VaR measures with the actual gain and losses for the same period.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.3 Market risk (continued)

6.3.1 Foreign exchange risk (continued)



During 2012 the Bank recorded twenty back-testing exceptions (2011: twenty 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 and off-balance sheet positions 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 Bank considers that it is not currently exposed to foreign currency risk related to EUR due to the fact that Convertible Mark is pegged to EURO (1 EUR = KM 1,955830). Exposure is more prominent for USD and CHF. The Bank performs stress testing based on the assumption of a 10% increase or decrease in foreign currency rates against the relevant local currency. The sensitivity rate of 10% is used when reporting internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates. Stress testing is performed on an annual basis. The results of the most recent test performed are presented here below:

31 December 2012

Currency	Open position (in KM)	StressTest	
		10% Move Up	10% Move Down
CHF	38,000	3,800	(3,800)
GBP	13,000	1,300	(1,300)
USD	(215,000)	(21,500)	21,500
HRK	40,000	4,000	(4,000)
CAD	73,000	7,300	(7,300)
AUD	76,000	7,600	(7,600)
other	189,000	18,900	(18,900)
EUR	(23,705,000)	-	-

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.3 Market risk (continued)

6.3.1 Foreign exchange risk (continued)

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	-	-

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

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.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.3 Market risk (continued)

6.3.1 Foreign exchange risk (continued)

Foreign exchange position

The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December 2012 and 31 December 2011. Included in the table are the Bank's assets and liabilities at carrying amounts categorised by currency. The Bank has a number of agreements with foreign currency clause. The KM value of principal in such agreements is determined by the movement of foreign exchange. The principal balance of the related exposure is included in the table below in the column "EURO linked".

The Bank had the following significant currency positions:

31 December 2012	EURO	EURO linked	EURO total	USD	Other FX	KM	Total
Assets							
Cash and cash equivalents	96,665	-	96,665	1,243	6,999	31,714	136,621
Obligatory reserves with the Central Bank	-	-	-	-	-	70,061	70,061
Placement with other banks	24,155	-	24,155	15,584	-	-	39,739
Financial assets available for sale	45	-	45	-	-	2,306	2,351
Financial assets at fair value through profit and loss	210	-	210	-	-	91	301
Loans and receivables from customers	2,714	725,393	728,107	290	-	312,838	1,041,235
Income tax prepayment	-	-	-	-	-	1,683	1,683
Other asset	789	-	789	39	-	9,346	10,174
Property and equipment and intangible assets	-	-	-	-	-	23,232	23,232
Total assets	**124,578**	**725,393**	**849,971**	**17,156**	**6,999**	**451,271**	**1,325,397**
Liabilities and equity							
Due to banks and other financial institutions	327,704	-	327,704	-	-	3,031	330,735
Due to customers	362,379	100,595	462,974	15,084	6,603	323,745	808,406
Financial liabilities at fair value through profit or loss	-	-	-	-	-	56	56
Subordinated debt	-	-	-	-	-	923	923
Other liabilities	811	-	811	-	7	7,799	8,617
Provision for liabilities and charges	-	-	-	-	-	3,196	3,196
Deferred tax liability	-	-	-	-	-	8	8
Share capital and reserves	-	-	-	-	-	173,456	173,456
Total liabilities and equity	**690,894**	**100,595**	**791,489**	**15,084**	**6,610**	**512,214**	**1,325,397**
Net foreign exchange position	**(566,316)**	**624,798**	**58,482**	**2,072**	**389**	**(60,943)**	**-**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements ***(continued)***
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.3 Market risk (continued)

6.3.1 Foreign exchange risk (continued)

31 December 2011	EURO	EURO linked	EURO total	USD	Other FX	KM	Total
Assets							
Cash and cash equivalents	10,789	-	10,789	719	5,116	147,167	163,791
Obligatory reserves with the Central Bank	-	-	-	-	-	71,158	71,158
Placement with other banks	13,806	-	13,806	17,714	-	-	31,520
Financial assets available for sale	45	-	45	-	-	15,888	15,933
Financial assets at fair value through profit and loss	-	-	-	-	-	-	-
Loans and receivables from customers	925	718,109	719,034	303	138	299,134	1,018,609
Income tax prepayment	-	-	-	-	-	2,748	2,748
Other asset	566	-	566	61	39	5,626	6,292
Property and equipment and intangible assets	-	-	-	-	-	25,425	25,425
Total assets	**26,131**	**718,109**	**744,240**	**18,797**	**5,293**	**567,146**	**1,335,476**
Liabilities and equity							
Due to banks and other financial institutions	437,952	-	437,952	-	-	3,990	441,942
Due to customers	269,477	69,052	338,529	19,098	4,995	356,787	719,409
Financial liabilities at fair value through profit or loss	-	-	-	-	-	-	-
Subordinated debt	-	-	-	-	-	1,083	1,083
Other liabilities	764	-	764	1	9	9,476	10,250
Provision for liabilities and charges	-	-	-	-	-	4,980	4,980
Deferred tax liability	-	-	-	-	-	2	2
Share capital and reserves	-	-	-	-	-	157,810	157,810
Total liabilities and equity	**708,193**	**69,052**	**777,245**	**19,099**	**5,004**	**534,128**	**1,335,476**
Net foreign exchange position	**(682,062)**	**649,057**	**(33,005)**	**(302)**	**289**	**33,018**	**-**

6. FINANCIAL RISK MANAGEMENT (continued)

6.3 Market risk (continued)

6.3.2 Interest rate risk

Interest rate risk is defined as the exposure of a Bank's financial condition to adverse movements in interest rates, referring to the banking book, meaning the set of on- and off-balance sheet financial assets and liabilities which are part of the core lending and deposit collecting activities performed by the Bank.

The Bank is exposed to interest rate risk as the Bank borrows and lends 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 and lending.

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 harmonisation between the active and passive interest rates of the Bank (interest on placements is fixed, interest for liabilities is floating 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 floating), 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 mismatch among the abovementioned elements results in exposure of the Bank to interest rate risk.

The measurement adopted system operate at an analytical level commensurate to the complexity and risk of its banking book, and ensure that the risk profile can be examined from two separate, but complementary, perspectives:

- The economic value perspective, which considers the impact of changes in interest rates and related volatilities on the present value of all future cash flows;
- The earnings perspective, focused on analysing the impact that changes in interest rates and related volatilities generate on the net interest income and, therefore, on the related effects on interest margin.

The Bank uses the following methods to measure interest rate risks:

- Shift sensitivity of fair value;
- Shift sensitivity of the interest margin.

The shift sensitivity of fair value measures the changes in economic value of a financial portfolio resulting from a parallel shift in the discount curves. The total value of shift sensitivity is broken down by time bucket (bucket analysis), in order to identify the distribution of risk over the time axis. The operating limit currently in force shifts sensitivity of fair value (by +100 bp parallel shift of yield curves) for KM 3,912 thousand (EUR 2,000 thousand).

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements ***(continued)***
(all amounts are expressed in thousands of KM, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.3 Market risk (continued)

6.3.2 Interest rate risk (continued)

Results of shift sensitivity of fair value, if changes in interest rates market moving had been 100 basis points higher and all other variables were held constant at 31 December 2012 is KM 3,464 thousand (31 December 2011: KM 1,305 thousand). Results of the shift sensitivity of fair value are below the current operating limit in the amount of KM 3,912 thousand which is set up by the Bank with the aim of keeping exposure within low levels which are compatible with self-imposed risk parameters.

Results of shift sensitivity of fair value are presented in the table below:

Shift sensitivity (+100b.p)	31 December 2012	31 December 2011
EUR	2,760	881
USD	105	88
CHF	-	-
KM	587	323
Other currencies	11	12
Total	**3,464**	**1,304**

The sensitivity of the interest margin quantifies the short-term (twelve months) impact on the interest margin of a parallel, instantaneous and permanent shock in the interest rate curve. This measure highlights the effect of changes in interest rates on the portfolio being measured, excluding assumptions on future changes in the mix of assets and liabilities and, therefore, it cannot be considered a predictor of the future levels of the interest margin.

Result of shift sensitivity of the interest margin, if changes in interest rates market moving had been 100 basis points higher/lower and all other variables were held constant at 31 December 2012 is increase/decrease of KM 3,136 thousand (31 December 2011: KM 3,087 thousand). In addition, the Bank also prepares shift sensitivity of the interest margin based on the sensitivity range of +50/-50 bps which resulted in increase/decrease in income statement of KM +/-1,568 thousand as of 31 December 2012 (31 December 2011: KM +/-1,544 thousand).

In order to measure the Bank's vulnerability under stressful market conditions the interest rate risk measurement system adopted by the Bank allows a meaningful evaluation of the effect of stressful market conditions on the bank (“scenario analysis”), or rather abrupt changes in the general level of interest rates, changes in the relationships among key market rates (i.e. basis risk), changes in the slope and the shape of the yield curve (i.e. yield curve risk), changes in the liquidity of key financial markets or changes in the volatility of market rates.

6. FINANCIAL RISK MANAGEMENT (continued)

6.4 Fair values of financial assets and liabilities

The fair value of financial instruments is the amount for which an asset could be exchanged or a liability settled between knowledgeable willing parties in an arm's-length transaction. When available, fair value is based on quoted market prices. However, no readily available market prices exist for a significant portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing techniques as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates may not be realisable in a current sale of the financial instrument, in particular during periods of the global financial crises and considering the lack of liquid market in Bosnia and Herzegovina.

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 statement of financial position as at 31 December 2012 and 31 December 2011. In estimating the fair value of the Bank's financial instruments, the following methods and assumptions are used:

Cash and cash equivalents

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

Placements with other banks

Placements with banks mostly represent overnight and short term deposits, hence there is no significant difference between the fair value of these deposits and their carrying value.

Loans and receivables customers

The fair value of floating rate loans that regularly re-price, 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. Short-term loans are not discounted and their fair value is estimated to approximate their carrying amount.

Amounts due to customers

The fair value of term deposits payable on demand represents the carrying value of amounts payable on demand as at the reporting date. The fair value of term deposits at variable interest rates approximates their carrying values as at the reporting 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.

Amounts due to banks

Majority of the Bank's long term borrowings from banks has variable interest rates and its fair value approximates their carrying at the reporting date. Deposits from banks are short term deposits and their fair value is estimated to approximate their carrying amount.

6. FINANCIAL RISK MANAGEMENT (continued)

6.5 Capital management

The Bank's objectives for capital management, which is a broader concept than the 'equity' shown in the statement of financial position, are as follows:

- to comply with the capital requirements set by the regulators of the banking markets in the local environment;
- 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 position to support the development of its business activities.

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

As of 31 December 2012 the Bank is in compliance with all regulatory capital requirements and according to the local regulations had a capital adequacy ratio of 13.80% (2011: 13.68%).

The Bank's regulatory capital for monitoring adequacy according to the Agency's methodology consists of:

- 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 financial assets available for sale;
- Tier 2 capital or Supplementary Capital: qualifying principle of subordinated loan capital, collective impairment allowances and audited profit for the current period; and
- Deductible items.

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, unless otherwise stated)

6. FINANCIAL RISK MANAGEMENT (continued)

6.5 Capital management (continued)

The table below summarises the computation of regulatory capital and the capital adequacy ratio of the Bank as of 31 December 2012 and 31 December 2011 (information on risk weighted-assets is unaudited), taken from the calculations submitted to the Agency in respect of those period-ends.

	31 December 2012	31 December 2011
Tier 1 capital		
Share capital	**44,782**	44,782
Share premium	**57,415**	57,415
Statutory and other reserves	**6,150**	6,150
Retained earnings brought forward	**31,160**	20,858
Fair value reserves	**80**	18
Intangible assets	**(2,730)**	(2,632)
Total qualifying Tier 1 Capital	**136,857**	126,591
Tier 2 capital		
General provisions – FBA regulations	**22,903**	21,814
Subordinated debt	**923**	1,083
Audited profit for the period	**15,584**	10,308
Total qualifying Tier 2 Capital	**39,410**	33,205
Adjustment for shortfall in regulatory reserve	**(9,270)**	(7)
Total regulatory capital	**166,997**	159,789
Risk weighted assets (unaudited)		
On balance sheet	**1,032,941**	993,408
Off balance sheet	**100,821**	102,212
Total	**1,133,762**	1,095,620
Operational risk	**76,669**	71,955
Total weighted risk	**1,210,431**	1,167,575
Capital adequacy ratio	**13.80%**	13,68%

In accordance with Agency regulations, Tier 1 capital does not include the balance on the regulatory reserve for credit losses (KM 18,286 thousand at 31 December 2012) which is part of net equity in the statement of financial position. However, general provisions calculated in accordance with Agency rules (KM 22,903 thousand at 31 December 2012) are included as Tier 2 capital. In addition, an adjustment is made for the shortfall in regulatory reserves in respect of any additional requirements calculated at the reporting date (date of submission of the capital adequacy calculation to the Agency, which, in accordance with local regulations, is performed on a quarterly basis). Under the new methodology introduced in 2012, any shortfall at the reporting date is deducted from the regulator capital in quarterly installments from 30 June 2012 to 31 March 2013 (Previously the entire shortfall at the reporting date was deducted in arriving at regulatory capital).

In accordance with Agency regulations, audited profit for the period is included in the calculation of regulatory capital if the audited financial statements for the period have been issued and approved by the Supervisory Board before submission of final official financial reports to the Agency.

The minimum capital adequacy ratio required according to the regulations of the Agency is 12%.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS

On a regular basis, the Bank's management analyses the overall results of the Bank with reference to the contributions by individually significant operating segments. Corporate, Retail and Treasury business lines have been identified as relevant operating segments, insofar financial products managed by each of them and the respective counterparties with whom each segment enters into negotiation are specific for each segment and are not managed by / related to any of the others.

Even though lending and fund collection are actually performed by all operating segments, the financial characteristics of the loans, deposits and credit lines managed are specifically designed for each of them and are applicable only to counterparties related to each specific segment.

The financial results of each operating segment are recorded through a combined methodology of "direct" and "indirect" allocation of income and cost. Income is mainly directly allocated to the respective segment where it was generated, while costs are directly allocated whenever they are identified as immediately generated within the operating segment and are indirectly charged to the operating segments whenever they are sustained by central organisational units.

An internal transfer rate methodology is also applied for allocation of the cost of funding to the operating segments.

Income statement items in the tables presented below on segment information are in the format used for the management reporting purposes.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

Segmental information as at and for the year ending 31 December 2012

	Retail	Corporate	Treasury	Total
Interest income	41,558	42,062	826	84,446
Interest expense	(13,151)	(14,053)	(1,652)	(28,856)
Net interest income	**28,407**	**28,009**	**(826)**	**55,590**
Fee and commission income	10,645	5,174	23	15,842
Fee and commission expense	(2,947)	(740)	(422)	(4,109)
Net fee and commission income	**7,698**	**4,434**	**(399)**	**11,733**
Net profit of trading activities and foreign exchange	41	19	1,642	1,702
Other operating income	243	363	83	689
Operating income	**284**	**382**	**1,725**	**2,391**
Personnel expense	(12,586)	(4,270)	(519)	(17,375)
Other administrative expense	(13,015)	(3,830)	(467)	(17,312)
Depreciation expense	(4,173)	(575)	(47)	(4,795)
Operating expense	**(29,774)**	**(8,675)**	**(1,033)**	**(39,482)**
Profit before impairment losses, and other provisions and income tax	**6,615**	**24,150**	**(533)**	**30,232**
Impairment losses and provisions	133	(12,894)	(38)	(12,799)
PROFIT/(LOSS) BEFORE INCOME TAX	**6,748**	**11,256**	**(571)**	**17,433**
Income tax				(1,849)
NET PROFIT/(LOSS) FOR THE YEAR	**6,748**	**11,256**	**(571)**	**15,584**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	27,594	-	109,027	136,621
Obligatory reserves with Central Bank	-	-	70,061	70,061
Placements with other banks	-	-	39,739	39,739
Financial assets available for sale	-	-	2,351	2,351
Financial assets at fair value through P&L	-	-	301	301
Loans and receivables from customers	438,360	602,875	-	1,041,235
Other unallocated amounts	-	-	-	35,089
TOTAL ASSETS	**465,954**	**602,875**	**221,479**	**1,325,397**
Due to banks and other financial institutions	-	44,322	286,413	330,735
Due to customers	337,407	470,997	2	808,406
Financial liabilities at fair value through P&L	-	-	56	56
Subordinated debt	-	-	923	923
Other unallocated amounts	-	-	-	11,821
TOTAL LIABILITIES	**337,407**	**515,319**	**287,394**	**1,151,941**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

Segmental information as at and for the year ending 31 December 2011

	Retail	Corporate	Treasury	Total
Interest income	38,772	37,538	2,004	78,314
Interest expense	(11,009)	(11,642)	(1,221)	(23,872)
Net interest income	**27,763**	**25,896**	**783**	**54,442**
Fee and commission income	9,850	4,529	18	14,397
Fee and commission expense	(2,608)	(764)	(198)	(3,570)
Net fee and commission income	**7,242**	**3,765**	**(180)**	**10,827**
Net profit of trading activities and foreign exchange	-	-	1,309	1,309
Other operating income	204	126	106	436
Operating income	**204**	**126**	**1,415**	**1,745**
Personnel expense	(14,211)	(4,526)	(551)	(19,288)
Other administrative expense	(13,330)	(4,084)	(556)	(17,970)
Depreciation expense	(4,278)	(498)	(46)	(4,822)
Operating expense	**(31,819)**	**(9,108)**	**(1,153)**	**(42,080)**
Profit before impairment losses, and other provisions and income tax	**3,390**	**20,679**	**865**	**24,934**
Impairment losses and provisions	(2,647)	(10,813)	41	(13,419)
PROFIT/(LOSS) BEFORE INCOME TAX	**743**	**9,866**	**906**	**11,515**
Income tax				(1,207)
NET PROFIT/(LOSS) FOR THE YEAR	**743**	**9,866**	**906**	**10,308**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

7. OPERATING SEGMENTS (continued)

Segmental information as at and for the year ending 31 December 2011

	Retail	Corporate	Treasury	Total
Cash and cash equivalents	24,750	-	139,041	163,791
Obligatory reserves with Central Bank	-	-	71,158	71,158
Placements with other banks	-	-	31,520	31,520
Financial assets available for sale	-	-	15,933	15,933
Financial assets at fair value through P&L	-	-	-	-
Loans to customers	422,591	596,018	-	1,018,609
Other unallocated amounts				34,465
TOTAL ASSETS	**447,341**	**596,018**	**257,652**	**1,335,476**
Due to banks and other financial institutions	-	46,755	395,187	441,942
Due to customers	270,111	449,298	-	719,409
Financial liabilities at fair value through P&L	-	-	-	-
Subordinated debt	-	-	1,083	1,083
Other unallocated amounts	-	-	-	15,232
TOTAL LIABILITIES	**270,111**	**496,053**	**396,270**	**1,177,666**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

8. INTEREST INCOME

	31 December 2012	31 December 2011
Corporate clients	42,009	37,177
Retail clients	41,566	38,772
Banks and other financial institutions	487	2,018
Interest on available-for-sale financial assets	348	122
Other	36	225
	84,446	**78,314**

9. INTEREST EXPENSE

	31 December 2012	31 December 2011
Corporate clients	8,808	9,152
Retail clients	7,722	7,375
Banks and other financial institutions	12,117	7,115
Other	209	230
	28,856	**23,872**

10. FEE AND COMMISSION INCOME

	31 December 2012	31 December 2011
Domestic payment transactions	3,328	3,101
Credit card activities	3,585	3,143
Foreign payment transactions	2,682	2,413
FX transactions	1,806	1,720
Guarantees	1,703	1,563
Agency services	101	108
Other	2,637	2,349
	15,842	**14,397**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

11. FEE AND COMMISSION EXPENSE

	31 December 2012	31 December 2011
Credit card operations	2,527	2,068
Central Bank services	251	221
Domestic payment transactions	561	513
Guarantees	643	643
E-banking service	127	125
	4,109	**3,570**

12. NET TRADING INCOME

	31 December 2012	31 December 2011
Net foreign exchange (losses)/gains from the translation of monetary assets and liabilities	(112)	(85)
Net gains from foreign exchange spot trading	1,718	1,394
Net gains on financial instruments at fair value through profit and loss	96	-
	1,702	**1,309**

13. OTHER OPERATING INCOME

	31 December 2012	31 December 2011
Income from claim settled by insurance companies and recharges from customers	285	356
Gain on sale of property	65	20
Other income	339	60
	689	**436**

14. PERSONNEL EXPENSES

	31 December 2012	31 December 2011
Net salaries	11,176	13,236
Tax and contributions	5,889	5,839
Provisions for liabilities and charges (Note 31)	24	41
Other expenses	286	172
	17,375	**19,288**

Personnel expenses include KM 3,260 thousand (31 December 2011: KM 3,192 thousand) of defined pension contributions paid into the State pension plan. Contributions are calculated as percentage of the gross salary paid. The Bank has 537 employees as at 31 December 2012 (525 as at December 2011).

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

15. ADMINISTRATIVE EXPENSES

	31 December 2012	31 December 2011
Rent and other rent-related expense	3,364	3,342
Telecommunication and post expense	2,685	2,701
Saving deposit insurance and other insurance charges	1,760	1,594
Provisions for liabilities and charges (Note 31)	(411)	318
Material expenses	1,164	1,150
Representation and marketing expense	859	936
Consultancy and Federal Banking Agency expenses	1,306	1,203
Energy	918	874
Maintenance expenses	2,601	2,720
Security and transport costs	1,894	2,055
Other costs	1,172	1,077
	17,312	**17,970**

16. NET IMPAIRMENT LOSSES AND PROVISIONS

The charge to income statement in respect of impairment losses and provisions is analysed as follows:

Net impairment losses and provisions	31 December 2012	31 December 2011
-for loans to customers (Note 23)	12,914	12,382
-for other assets (Note 24)	802	(8)
-for property (Note 25)	237	-
-for off-balance sheet items (Note 31)	(1,154)	1,045
	12,799	**13,419**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements ***(continued)***
(all amounts are expressed in thousands of KM, unless otherwise stated)

17. INCOME TAX

	31 December 2012	31 December 2011
Current tax recognised in the income statement	1,849	1,207
Deferred tax recognised in the statement of comprehensive income (Note 32)	6	2
	1,855	**1,209**

Income tax recognised in the income statement comprises current tax. The current rate of income tax amounts to 10% (2011: 10%).

	31 December 2012	31 December 2011
Profit before income tax	17,433	11,515
Tax calculated at rate of 10%	1,743	1,152
Non-deductible expenses	442	289
Non-taxable income	(336)	(234)
Income tax expense	**1,849**	**1,207**
Average effective income tax rate	**10.6%**	**10.5%**

18. BASIC AND DILUTED EARNINGS PER SHARE

	31 December 2012	31 December 2011
Net profit	15,584	10,308
Weighted average number of ordinary shares outstanding	447,760	447,760
Basic earnings per share (KM)	**34.80**	**23.03**

During period ending 31 December 2012 and 31 December 2011 there were no dilution effect, accordingly basic and diluted earnings per share at both periods are the same

19. CASH AND CASH EQUIVALENTS

	31 December 2012	31 December 2011
Current account with Central Bank	14,790	132,200
Cash in hand in domestic currency	16,535	14,854
Cash in hand in foreign currency	11,059	9,895
Current accounts with other banks	94,237	6,842
	136,621	**163,791**

(all amounts are expressed in thousands of KM, unless otherwise stated)

20. OBLIGATORY RESERVE WITH THE CENTRAL BANK

	31 December 2012	31 December 2011
Obligatory reserve	70,061	71,158
	70,061	**71,158**

The minimum obligatory reserve as of 31 December 2012 is calculated in the amount of 10% of deposits and borrowings with maturity up to one year and 7% of deposits and borrowings with maturity over one year, and is calculated on a daily basis, and updated every ten calendar days, in arrears. Local inter-bank deposits, short-term and long-term deposits and borrowings from non-residents are excluded from the calculation.

21. PLACEMENTS WITH OTHER BANKS

	31 December 2012	31 December 2011
Placements with banks	39,739	31,520
	39,739	**31,520**

Placements with other banks include:

- cash deposit in the amount of KM 489 thousand placed with non –resident banks as security for a guarantee issued by that bank on behalf of a domestic customer.
- cash deposit with non-resident banks in the amount of KM 622 thousand (KM 633 thousand as at 31 December 2011) as collateral for the Bank's liabilities in respect of credit card operations.

22. FINANCIAL ASSETS

a) Financial assets available for sale

	31 December 2012	31 December 2011
Debt instruments		
Bonds issued by the Federation of Bosnia and Herzegovina	1,754	1,626
Treasury bills issued by the Federation of Bosnia and Herzegovina	-	13,707
	1,754	15,333
Equity instruments		
Equity securities at cost	553	556
Equity securities at fair value	44	44
	597	600
	2,351	**15,933**

(all amounts are expressed in thousands of KM, unless otherwise stated)

22. FINANCIAL ASSETS (continued)

Analysis of financial assets available for sale according to fair value levels

Review of financial assets available for sale (other than equity securities carried at cost decreased for possible impairment) according to fair value levels is presented in the table below:

31 December 2012	**Level 1 BAM '000**	**Level 2 BAM '000**	**Level 3 BAM '000**	**Total BAM '000**
Equity securities issued by non-resident legal entities	44	-	-	44
Bonds issued by the Federation of Bosnia and Herzegovina	1,754	-	-	1,754
	1,798	**-**	**-**	**1,798**
	-	-	-	-

31 December 2011	**Level 1 BAM '000**	**Level 2 BAM '000**	**Level 3 BAM '000**	**Total BAM '000**
Equity securities issued by non-resident legal entities	44	-	-	44
Bonds and treasury bills issued by the Federation of Bosnia and Herzegovina	15,333	-	-	15,333
	15,377	**-**	**-**	**15,377**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

22. FINANCIAL ASSETS *(continued)*

b) Financial assets and liabilities at fair value through profit and loss

	31 December 2012	31 December 2011
Financial assets		
Equity shares designated at fair value through profit or loss	210	-
Derivatives held for trading	91	-
	301	-
Financial liabilities		
Derivatives held for trading	56	-
	56	

Derivatives held for trading include forward foreign exchange contracts details of which are presented in the table below:

Financial assets	31 December 2012 Notional amount	31 December 2012 Fair value	31 December 2011 Notional amount	31 December 2011 Fair value
Derivatives classified as held for trading – OTC products				
Forward foreign exchange contracts	5,795	91	-	-
	5,795	**91**	**-**	**-**

Financial liabilities	31 December 2012 Notional amount	31 December 2012 Fair value	31 December 2011 Notional amount	31 December 2011 Fair value
Derivatives classified as held for trading – OTC products				
Forward foreign exchange contracts	3,784	56	-	-
	3,784	**56**	**-**	**-**

(all amounts are expressed in thousands of KM, unless otherwise stated)

22. FINANCIAL ASSETS *(continued)*

b) Financial assets and liabilities at fair value through profit and loss (continued)

Analysis of financial assets and liabilities at fair value through profit or loss according to fair value levels is presented in the table below:

31 December 2012	**Level 1**	**Level 2**	**Level 3**	**Total**
	BAM '000	**BAM '000**	**BAM '000**	**BAM '000**
Equity shares designated at fair value through profit and loss	210	-	-	210
Derivatives classified as held for trading OTC products				
Financial assets	-	-	91	91
Financial liabilities	-	-	56	56

(all amounts are expressed in thousands of KM, unless otherwise stated)

23. LOANS AND RECEIVABLES FROM CUSTOMERS

	31 December 2012	31 December 2011
Short-term loans		
Corporate		
- in KM and KM linked to foreign currency	300,675	283,005
- in foreign currency	1,577	3,204
Retail		
- in KM and KM linked to foreign currency	61,323	56,851
- in foreign currency	-	-
	363,575	**343,060**
Long-term loans		
Corporate		
-in KM and KM linked to foreign currency	351,335	357,614
-in foreign currency	5,235	3,584
Retail		
-in KM and KM linked to foreign currency	403,430	392,272
-in foreign currency	-	520
	760,000	**753,990**
Total loans	1,123,575	1,097,050
Less: impairment allowance	(82,340)	(78,441)
	1,041,235	**1,018,609**

Loans and advances to customers are presented including accrued interest in the amount of KM 9,492 thousand (2011: KM 9,119 thousand), and net of deferred fees in the amount of KM 3,716 thousand (2011: KM 5,577 thousand).

As of 31 December 2012, the net amount of short-term and long-term loans in domestic currency includes loans disbursed and repayable in domestic currency index-linked to the KM:EUR exchange rate in the amount of KM 23,024 thousand and KM 702,369 thousand, respectively (31 December 2011: KM 20,804 thousand and KM 697,305 thousand, respectively).

Movements in the provision for impairment of loans and receivables are summarised as follows:

Balance as at 1 January	78,441	68,735
Net charge to income statement (Note 16)	12,914	12,382
Unwinding of discount	(3,300)	-
Write-offs	(5,715)	(2,676)
Balance at the end of period	82,340	78,441

In 2012 the Bank changed the presentation of the unwinding of discount for the nonperforming portfolio. Previously, this has been presented net of impairment charge for loan losses, while in 2012 the effect is presented as part of interest income. The Management considers that it is not practical to estimate this effect in 2011 to be reclassified from impairment charge to interest income.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

23. LOANS AND RECEIVABLES FROM CUSTOMERS (*continued*)

Concentration of credit risk by industry:

Economic sector risk concentration in the gross amount of loans and receivables is as follows:

	31 December 2012	31 December 2011
Trade	264,451	272,579
Manufacturing, agriculture, forestry, mining and energy	201,705	205,336
Construction industry	52,366	48,660
Services, finance, sport, tourism	43,658	23,933
Administrative and other public institutions	23,138	22,022
Transport and telecommunications	41,573	37,257
Other	31,931	37,620
Citizens	464,753	449,643
	1,123,575	**1,097,050**

24. OTHER ASSETS

	31 December 2012	31 December 2011
Payment to the Cantonal Privatization Agency for privatization of "Projekt" d.d. Sarajevo	1,200	1,200
Prepaid expenses	2,781	2,512
Fees receivable	849	626
Receivables from card operations	2,482	1,308
Assets acquired upon foreclosure of loans	3,355	663
Other assets	1,700	2,822
Total other assets	12,367	9,131
Less: impairment allowance	(2,193)	(2,839)
	10,174	**6,292**

The movement in the impairment allowance for other assets are summarised as follows:

Balance as at 1 January	**2,839**	**3,462**
Net charge to income statement (Note 16)	802	(8)
Transfer to property and equipment impairment	-	(278)
Write-offs	(1,448)	(337)
Balance at the end of period	**2,193**	**2,839**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

25. PROPERTY AND EQUIPMENT

Cost	Land and Buildings	Computers and other equipment	Assets in the course of construction	Leasehold improvements	Total
At 1 January 2011	**12,862**	**19,858**	**51**	**8,227**	**40,998**
Additions	-	-	2,399	-	2,399
Transfer from other asset	1,544	-	-	-	1,544
Disposals	(3)	(758)	-	-	(761)
Transfers	73	2,122	(2,353)	158	-
At 31 December 2011	**14,476**	**21,222**	**97**	**8,385**	**44,180**
Additions	-	-	2,155	-	2,155
Transfer from other asset	41	18	-	-	59
Disposals	(337)	(1,324)	-	-	(1,661)
Transfers	68	1,878	(2,203)	257	-
At 31 December 2012	**14,248**	**21,794**	**49**	**8,642**	**44,733**
Accumulated depreciation					
At 1 January 2011	**1,365**	**11,222**	**-**	**5,202**	**17,789**
Transfer from other assets	278	-	-	-	278
Charge for the year	234	2,522	-	1,249	4,005
Disposals	-	(685)	-	-	(685)
At 31 December 2011	**1,877**	**13,059**	**-**	**6,451**	**21,387**
Charge for the year	213	2,610	-	1,035	3,858
Impairment loss (Note 16)	237	-	-	-	237
Disposals	(49)	(1,202)	-	-	(1,251)
At 31 December 2012	**2,278**	**14,467**	**-**	**7,486**	**24,231**
At 31 December 2011	**12,599**	**8,163**	**97**	**1,934**	**22,793**
At 31 December 2012	**11,970**	**7,327**	**49**	**1,156**	**20,502**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

26. INTANGIBLE ASSETS

	Software	Assets in the course of construction	Total
Cost			
At 1 January 2011	**6,172**	**9**	**6,181**
Additions	-	1,056	1,056
Disposals	(1,095)	-	(1,095)
Transfers	998	(998)	-
At 31 December 2011	**6,075**	**67**	**6,142**
Additions	-	1,035	1,035
Disposals	(415)	-	(415)
Transfers	966	(966)	-
At 31 December 2012	**6,626**	**136**	**6,762**
Amortisation			
At 1 January 2011	**3,786**	**-**	**3,786**
Charge for the year	817	-	817
Disposals	(1,093)	-	(1,093)
At 31 December 2011	**3,510**	**-**	**3,510**
Charge for the year	937	-	937
Disposals	(415)	-	(415)
At 31 December 2012	**4,032**	**-**	**4,032**
At 31 December 2011	**2,565**	**67**	**2,632**
At 31 December 2012	**2,594**	**136**	**2,730**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

27. DUE TO BANKS AND OTHER FINANCIAL INSTITUTIONS

	31 December 2012	31 December 2011
Due to banks		
Current accounts and deposits		
Demand deposits		
-in KM	44	3
-in foreign currencies	43	-
Term deposits		
-in KM	-	-
-in foreign currencies	82,966	107,838
	83,053	***107,841***
Borrowings		
Long-term borrowings		
-foreign banks	203,360	287,278
-domestic banks	-	68
	203,360	287,346
	286,413	395,187
Due to other financial institutions		
Long term borrowings		
-in KM	2,986	3,887
-in foreign currencies	41,336	42,868
Total borrowings from other financial institutions	**44,322**	**46,755**
	330,735	**441,942**

Current accounts, deposits and borrowings from banks presented above include accrued interest in the amount of KM 2,000 thousand KM (2011: KM 1,527 thousand).
Borrowings from other financial institutions are presented including accrued interest in the amount of KM 279 thousand (2011: KM 243 thousand).

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

28. DUE TO CUSTOMERS

	31 December 2012	31 December 2011
Demand deposits:		
Retail clients:		
-in KM	60,745	59,370
-in foreign currencies	29,483	33,884
Corporate clients:		
-in KM	174,261	243,454
-in foreign currencies	37,324	40,194
Total demand deposits	**301,813**	**376,902**
Term deposits:		
Retail clients:		
-in KM	62,871	33,989
-in foreign currencies	184,307	142,868
Corporate clients:		
-in KM	126,463	89,053
-in foreign currencies	132,952	76,597
Total term deposits	**506,593**	**342,507**
	808,406	**719,409**

Due to customers are presented including accrued interest in the amount of KM 4,991 thousand (2011: KM 4,492 thousand).

29. SUBORDINATED DEBT

	31 December 2012	31 December 2011
Ministry of Finance of Bosnia and Herzegovina	923	1,083
	923	**1,083**

The subordinated loan from Ministry of Finance 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.

With the approval of the Banking Agency of Federation of Bosnia and Herzegovina, the subordinated debt may be classified as Tier 2 capital in the calculation of capital adequacy.

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

30. OTHER LIABILITIES

	31 December 2012	31 December 2011
Loan repayments received before due dates	3,256	3,066
Liabilities to vendors	1,210	1,375
Liabilities for employees' bonuses	121	1,629
Liabilities on Agency loans (Note 37)	177	146
Credit card liabilities	539	230
Liabilities to shareholders	140	140
Other liabilities	3,174	3,664
	8,617	**10,250**

31. PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2012	31 December 2011
Provisions for legal proceedings	1,518	2,156
Provisions for retirement employee benefits and other short-term employee benefits	491	483
Provisions for off-balance-sheet credit risk	1,187	2,341
	3,196	**4,980**

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

(all amounts are expressed in thousands of KM, unless otherwise stated)

31. PROVISIONS FOR LIABILITIES AND CHARGES (continued)

Movement in provisions for liabilities and charges for six months to 31 December 2012 are summarized as follows:

	Provisions for legal proceedings (Note 15)	Provisions for retirement employee benefits and other short term employee benefits (Note 14)	Provisions for off-balance-sheet credit risk (Note 16)	Total
Balance at 1 January 2011	**1,838**	**461**	**1,296**	**3,595**
Net charge to income statement	318	41	1,045	1,404
Reductions arising from payments	-	(19)	-	(19)
Balance at 31 December 2011	**2,156**	**483**	**2,341**	**4,980**
Balance at 1 January 2012	**2,156**	**483**	**2,341**	**4,980**
Net charge to income statement	(411)	24	(1,154)	(1,541)
Reductions arising from payments	(227)	(16)	-	(243)
Balance at 31 December 2012	**1,518**	**491**	**1,187**	**3,196**

The calculation of provisions for retirement benefits of KM 245 thousand as of 31 December 2012 (2011: KM 222 thousand) is performed by an independent actuary, applying a discount rate of 5% over the working life and average salary of each employee.

Provisions for unused days of vacation of KM 246 thousand as of 31 December 2012 (2011: KM 261 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

32. DEFERRED TAX LIABILITY

The 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 is recognised in equity.

The movement of deferred tax liabilities is presented in the table below:

	Deferred tax liability
As at 1 January 2012	2
Increase in liabilities recognised in the statement of comprehensive income	6
As at 31 December 2012	**8**
As at 1 January 2011	-
Increase in liabilities recognised in the statement of comprehensive income	2
As at 31 December 2011	**2**

(all amounts are expressed in thousands of KM, unless otherwise stated)

33. SHARE CAPITAL

	31 December 2012 and 31 December 2011		
	Class ES Ordinary shares	Class EP Preference shares	Total
Number of shares	447,760	60	447,820
Pair value (KM)	100	100	100
Total	44,776	6	44,782

Each registered ordinary share carries the right of one vote per share, while preference shares are non-voting.

Preference shareholders are entitled to receive dividends when declared, with priority rights over the ordinary shareholders in receipt of dividends.

The shareholding structure of the Bank as at 31 December 2012 and 31 December 2011 is as follows:

- Intesa Sanpaolo Holding International S.A. 94.92%
- Other 5.08%

34. SHARE-BASED PAYMENTS

In 2012 the Bank purchased 78,028 equity shares representing an interest in the capital of Intesa Sanpaolo SpA (the ultimate majority shareholder of the Bank). The purchase is related to the application of a new Remuneration Policy for the Bank's employees and was accounted for according to the provisions of IFRS 2 *Share Base Payments* as a cash-settled shared-based payment transaction, insofar the transaction occurred between entities belonging to the same group.

The equity shares will be delivered to the relevant employees once and in case that vesting conditions are met. During the vesting period, the equity shares represent part of the portfolio of financial assets at fair value through profit or loss and are accordingly measured at fair value based on quotations on the Milan Stock Exchange.

(all amounts are expressed in thousands of KM, unless otherwise stated)

35. 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 2012	31 December 2011
Contingent liabilities		
Payment guarantees	29,044	34,483
Performance guarantees	30,666	30,746
Letters of credit	4,041	572
Total contingent liabilities	**63,751**	**65,801**
Commitments		
Undrawn lending commitments	115,391	111,008
Total commitments	**115,391**	**111,008**
Total contingent liabilities and commitments	**179,142**	**176,809**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

36. RELATED-PARTY TRANSACTIONS

The Bank is a member of the Intesa Sanpaolo S.p.A Group ("Intesa Sanpaolo Group"). The key shareholder of the Bank is Intesa Sanpaolo Holding International S.A., holding 94.92% (2011: 94.92) of the Bank's shares and the ultimate parent company is Intesa Sanpaolo S.p.A. The Bank considers that it has an immediate related-party relationship with its key shareholders and their subsidiaries; its associates; Supervisory Board members and Management Board members and other executive management ("key management personnel"); and close family members of key management personnel.

Related party transactions are part of the Bank's regular operations.

The overview of related party transactions as at 31 December 2012 and 31 December 2011 is presented below:

	31 December 2012	31 December 2011
Assets		
Receivables from key management personnel and their close family members	536	403
Bank accounts and loans – Intesa Sanpaolo Group	24,371	5,391
Other receivables – Intesa Sanpaolo Group	53	82
Financial assets at fair value through profit or loss - Intesa Sanpaolo Group	-	-
	24,960	**5,876**
Liabilities		
Deposits – key management personnel and their close family members	1,264	915
Borrowings and term deposits – Intesa Sanpaolo Group	115,426	143,102
Other liabilities - Intesa Sanpaolo Group	317	318
Financial liabilities at fair value through profit or loss – Intesa Sanpaolo Group	11	-
	117,018	**144,335**
Financial commitments and contingencies		
Undrawn lending commitments – Intesa Sanpaolo Group	1,734	400
Undrawn lending commitments - key management personnel and close family members	117	109
	1,851	**509**

(all amounts are expressed in thousands of KM, unless otherwise stated)

36. RELATED-PARTY TRANSACTIONS (continued)

	31 December 2012	31 December 2011
Income		
Interest income - key management personnel and close family members	39	31
Interest income – Intesa Sanpaolo Group	429	638
Other Income – Intesa Sanpaolo Group	111	112
	579	**781**

	31 December 2012	31 December 2011
Expenses		
Interest expense - key management personnel and close family members	59	16
Interest expense - Intesa Sanpaolo Group	5,085	3,031
Other expenses –Intesa Sanpaolo Group	2,324	2,317
Interest expense – European Bank for Reconstruction and Development	-	500
Other expenses – European Bank for Reconstruction and Development	-	41
	7,468	**5,905**

The remuneration of key management personnel were as follows:

	31 December 2012	31 December 2011
Net salaries for key management personnel	489	476
Taxes and contributions on net salaries	463	453
Bonuses to management	432	446
Compensations for Supervisory Board members	36	29
Other management benefits	69	71
	1,489	**1,475**

Intesa Sanpaolo Banka, d.d. BiH
Notes to the financial statements *(continued)*
(all amounts are expressed in thousands of KM, unless otherwise stated)

37. MANAGED FUNDS

The Bank manages assets on behalf of third parties. These assets are recorded separately from the Bank's assets.

	31 December 2012	31 December 2011
Liabilities		
Government organizations	9,015	9,187
Associations and Agencies	2,308	2,512
Banks and Insurance companies	3,515	1,384
Other	445	458
Total	**15,283**	**13,541**
Assets		
Loans to companies	14,614	12,799
Loans to citizens	492	596
Total	**15,106**	**13,395**
Amounts due to original creditors – managed funds (Note 30)	**177**	**146**