HYPO ALPE ADRIA
S VAMA. UZ VAS. ZA VAS.

Annual Report 2011

Hypo Alpe-Adria-Bank d.d. Mostar

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Mission and principles

Hypo Alpe-Adria-Bank d.d. is a part of the international Hypo Alpe-Adria banking group. We are striving to apply our international know-how to the local markets. In Bosnia and Herzegovina, over 600 employees are servicing around 180.000 clients. We are available to customers in FBiH not only in our headoffice in Mostar, but also in widely spread business network covering the largest centres of the country. Overall we are among the three leading banking groups in BiH. We want to provide a wide range of financial products and quality service to private individuals, to small- and medium-sized enterprises, to corporate customers and to public institutions. Our products are to offer simple and creative solutions for the financial needs of our clients. Our mission is driven by the following principles:

- success solutions for all stakeholders, i.e. clients, employees and shareholders,
- responsible banking, i.e. transparent business activity with high integrity, consistent with both international standards and local regulations.

Management Board of the Bank

Dmytro Kolechko
Executive Director

Dragan Kovačević
Executive Director

Alexander Picker
Director

Note:
On 31 December 2011, members of the Management Board of the Bank were:

Herbert Walzhofer – *Executive Director*
Responsible for: Public Finance, Corporate Banking, Branch Coordination and Sales Steering, Distribution Channels Management, Products Management, SME, Retail

Dragan Kovačević – *Executive Director*
Responsible for: Financial Controlling, Collection, Accounting, Treasury, IT/Operations, Logistics

Michael Vogt – *Director*
Responsible for: Risk Controlling, Legal, Human Resources Management, Corporate Communications, Marketing/PR, Compliance, AML & Security, Credit Management, Credit Processing, Rehabilitation, Task Force Restructuring and Liquidation

Management Board letter

For all of us 2011 turned out to be a highly demanding year in economic terms. For Hypo Alpe-Adria-Bank d.d. it was a year of restructuring and a year for creating a new base for our future business. In May 2011, we implemented a new core banking solution, an international system, called T-24. Additionally, a series of projects was started with the aim of enhancing sales and providing tailor-made products to our clients. The work in our branches was changed and oriented towards the client with our "Sales Force Effectiveness" project.

Despite the issues during the restructuring efforts we could enter into a new dimension of our retail business and a new quality of service was the final outcome. This was due to the persistency of our sales staff in combination with the efforts of the back office support units.

In comparison to 2010 we could increase the number of loans to individuals, by 26% and by volumes the total amount achieved in 2011 topped the 2010 result by even 55%.

Furthermore, a strong growth was recorded in our card business segment, where the number of card users grew heavily. Also the deposit side showed a constant growth and reached the amount of KM 633 million at the end of the year.

2011 was also the year of more cooperation in our public finance segment, particularly in the area of project finance. Strategically important companies in Bosnia and Herzegovina, e.g. JP Elektrodistribucija BiH d.d. Sarajevo, became our customers.

Project financings in our corporate segment, however, showed a slight decrease and more effort was taken in refinancing of loans. This was due to our conservative risk approach also in 2011, particularly regarding credit risk.

As the ratio of problematic loans reached a peak in the third quarter of 2011 all over the country, we also were faced with these problems and reacted at the end of the year with the "BRUSH" project, cleaning some of our problem portfolio.

Nevertheless, we are positive that with our market share, with our clients and with our prolonged intensive efforts on the improvement of the loan portfolio, we can weather the crisis and remain among the leading banks in the country. We do rather see the crisis as an opportunity to become a better bank than as a problem.

Hypo Alpe-Adria-Bank d.d. is adequately funded by its mother institution and is maintaining a high level of liquidity. This is a safeguard for our ability to provide adequate financial services to private individuals, to corporate and public customers.

Still, we are not satisfied with the financial result of the bank and we see 2012 as the turnaround year to achieve sustainable profitability, on which we are working all together with optimism.

Dmytro Kolechko	**Dragan Kovačević**	**Alexander Picker**
Executive Director	Executive Director	Director

Overview of economic development in 2011, including the projection for the coming period

Accession to the EU. The general elections held in BiH in October 2010 were followed by 16-month long negotiations of political parties from both BiH entities on creating the state-level Government. As a result of the political deadlock, implementation of reforms required for BiH access to the European Union were lagging behind. Finally, the state Government - the Council of Ministers of BiH was established in February 2012. Thus, foundations were laid for the BiH access to the EU. The newly established state Government set as its main goal to meet the conditions of the EU within a couple of months and to apply for the EU membership.

BiH credit rating 2011

In May 2011, Moody's Investors Service changed the outlook on the B2 credit rating of Bosnia and Herzegovina from stable to negative, citing the political situation and related delays in economic and constitutional reform, as well as increased risk of further division of the country, considered likely to cause delays in payment per the securities issued by the state.

	Moody's Investors Service	Standard & Poor's
Rating	B2 / negative outlook	B / watch - negative
Date	16. 5. 2011.	30.11.2011.
Status	changed outlook	changed outlook
Source: CBBH, Moody's Investors Service, Standard & Poor's		

The Moody's decision on credit rating downgrade was soon followed by the Standard & Poor's decision on cutting the BiH sovereign credit rating from „B+" to „B"/watch negative on 30 November 2011.

Now, when the political instability came to an end, the credit rating is not likely to worsen again.

After the GDP of BiH outgrew its negative growth rate in the year 2010 (0.7%), the economic recovery of the country continued. Namely, the export rate and industrial production grew in 2011. The GDP growth rate is estimated to reach 1.0% in 2011 (preliminary data: 1.8%). On the other hand, negative internal circumstances, together with the external factors might easily cause economic activities to shrink again in the year 2012 (-1.8%[1]).

Recovery of industrial production recognizable. With the production increased in mining and power-supply industry as an answer to increased demand and higher prices at the export markets of alumina and steel, the overall industrial production of BiH closed the year 2011 with the growth of 5.6% (yoy[2]). However, with the European Monetary Union struggling the crisis itself, just like the Western European markets, which are the largest consumers of the BiH products, the growing rate will be difficult to keep. Consequently, the country's industrial production is expected to decrease again in the year 2012 at the rate of -2.7%[3].

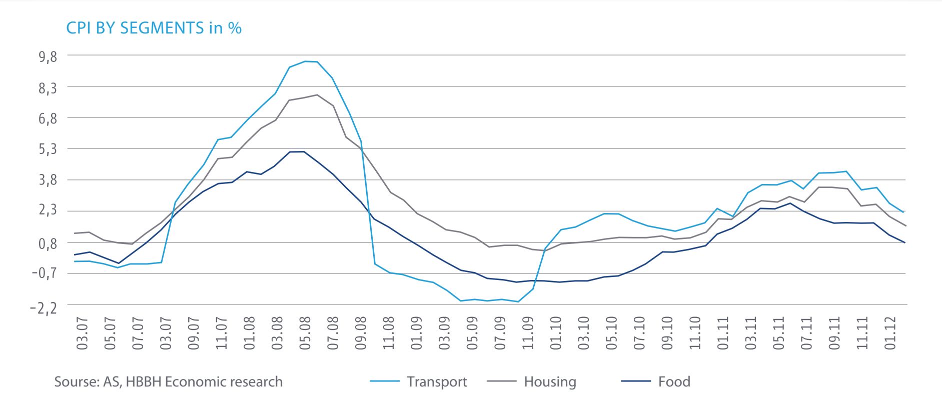
[1] The Economic Research Department is revising data and projections, which will be presented in regular publications of the Department.
[2] (yoy) comparison of the current year results with the results of the previous year – annual growth
[3] Ibid 1

Continuous growth of trade deficit. The import rate fastened in 2011 (14.0% in 2011 yoy compared to 13.7% in 2010 yoy), whereas export rate slowed down (15.9% in 2011 yoy compared to 28.8% in 2010 yoy). The trade balance was shifted in favour of import, which significantly increased due to increased import of oil and oil products, to some extent caused by recovery started in power supply sector and by significant import of electric energy. On the other hand, export of intermediary products slowed down significantly as the demand from foreign markets dropped. The export rate is not expected to improve in 2012 either, given that the European market is ridden by the crisis, foreign fiscal consolidation and lower prices of commodities and services. Additional worrying factor is that Bosnia and Herzegovina's main export partners are Croatia and Italy, which themselves face huge economic problems. Still, import rate is also expected to drop significantly, particularly having in consideration weakened consumers power and lack of investment in capital funds.

Signs of recovery in construction industry. Value of construction works executed in BiH grew in average by 26.9% (yoy). Seemingly significant improvement of the construction industry in the year 2011 should however not be viewed without considering the effect of a very low base inherited from the previous year and the fact that the recovery is not as much recognizable at the construction-sites themselves. The growth of the industry in Republika Srpska is attributable to increased volume of roads construction, whereas construction of housing facilities still stagnates due to low purchasing power of citizens and stricter financing conditions imposed by the banks. Construction of shopping centres, which used to participate in the overall construction industry to a great extent, is also at a standstill.

Inflation still on an upturn. Inflation in BiH grew in the year 2011 in average by 3.7% compared to the same period of the previous year, mostly as a result of the increased prices of food and oil in the world, then of telecommunication and transport services and housing, as well as of increased excise tax on tobacco products.

With the importing inflatory pressure mitigating, growing tendency of inflation is expected to reduce in the next year (2.4% yoy[4]). Still, permanently weak domestic production will continue making pressure on demand, as a result of high unemployment rate, highly indebted citizens, stricter financing terms and consumer pessimism. Another risk is seen in potential increase of the VAT rate.



Negative trends at the labour market. The decrease of household income was mostly caused by reduced rate of realistic growth of net salaries by 2.0% at the level of BiH and decreased cash inflow from abroad. On the other hand, unemployment rate grew from 27.2% in 2010 to 27.6% in 2011. The industries mostly affected by increase of the unemployment rate are construction, production and services industry, whereas brokerage, transport and public sector increased the number of the employed. Unemployment rate will further increase in the year 2012 (to 29.9%) if the authorities really decide to severely cut the number of public service workers. Number of workers in the real sector is expected to decrease as well as a consequence of effects from the past and a failure of the state authorities to support creation of a better business environment. This was not unexpected tough, especially considering a sluggish rate of recovery of economy in the country on one hand and on the other, the conditions expected to be imposed for the new IMF arrangement.

[4] The Economic Research Department is revising data and projections, which will be presented in regular publications of the Department.

Mandatory reserve requirement reduced. The Central Bank BiH reduced the mandatory reserve requirement by 4 p.p., to 10% and released additional KM 300 million of liquidity. However, this intervention did not yield results as expected. Even tough the balance of funds kept with the Central Bank was slightly reduced, banks were maintaining much higher reserves than required. Volume of loans placed by commercial banks to Corporate was in 2011 by 2.8% higher than in previous year, whereas loans placed to Retail increased by 6%. This increase of loans shows that the funds were used for strengthening the companies' liquidity and increasing the consumer spending. However, real effects will not be visible before comeback of large investments projects.

Changed consumers' behaviour. The market volatility, caused by turbulences in global financial sector and by effects of lending expansion from the beginning of 2000-ies, clearly reflects itself in consumers' behaviour. Namely, citizens started spending more cautiously and saving more, so that the total Retail deposits kept with the banks grew in 2011 by 8.9% (yoy).

NPL growth partly halted. – The non-performing loans, accumulated as a consequence of the lending boom from the past and ever more weakening local economy, reached its peak in September 2011, when the NPL ratio came to the maximum of 12.6% of the total loans placed in BiH. The local authorities were of no help, demonstrating absolutely no willingness to strongly launch the structural reforms. The banks on their part put uttermost of their efforts in attempts of establishing control over this burning issue, which efforts finally paid off in the last quarter of the year, which was closed with the NPL ratio of 11.7%. Undoubtedly, this ratio still gives reasons to worry on one hand, but on the other, raises hope that the NPL ratio will not escalate in 2012 again.

Restored profitability of the banking sector. After the banking sector closed the year 2010 with a relatively poor result (ROAE –5.5%), it was restored to profitability in the year 2011 (ROAE 7.2%). As the market does not display any signs of significant economic recovery, the credit for the restored profitability may be attributed to restructuring of large banking groups, reduced inclination to risk and more care paid to assets quality and release of some credit risk provisions accumulated in previous years.

Securities trade

Stock-exchange of Banja Luka (BLSE)

The total trading volume at the Stock-exchange of Banja Luka amounted in 2011 up to KM 425,456,984, showing an increase of 141% yoy and about 25,770 transactions. The growth is mainly a result of issuing the state-entities' treasury bills and a low comparison base from 2010.

Symbol	Issuer	Price on 31/12/11	Average Price in December	No. of trans.	Value (BAM)
TRZN-R-A	TRŽNICA AD BANJA LUKA	0.55	1.4943	813	22,885,729
RSRS-O-E	REPUBLIKA SRPSKA-war damages 5	37.85	34.9714	3,624	7,865,254
TLKM-R-A	TELEKOM SRPSKE AD BANJA LUKA	1.46	1.6028	1,892	7,863,181
RSDS-O-C	REPUBLIKA SRPSKA-pre-war time savings 3	90.5	86.6903	483	6,419,517
RSRS-O-C	REPUBLIKA SRPSKA-war damages 3	39.48	37.7909	1,861	5,600,311
RSRS-O-D	REPUBLIKA SRPSKA-war damages 4	37.78	37.7267	1,527	3,957,842
ZPTP-R-A	ZIF ZEPTER FOND AD BANJA LUKA	5.89	6.0866	2,326	2,923,782
RSRS-O-A	REPUBLIKA SRPSKA-war damages 1	41.71	39.2911	987	2,556,327
HEDR-R-A	HIDROELEKTRANE NA DRINI AD VIŠEGRAD	0.499	0.6544	466	2,148,795
SODJ-R-A	JAHORINA OSIGURANJE AD PALE	370.37	352.1520	12	1,832,247
Other				11,564	28,856,903

BIRS (RS Stock-exchange Index) dropped down to 8.34% (yoy) in 2011. In the same period, FIRS (RS Investments Funds' Index) and ERS10 (Elektroprivreda RS Index) jumped by 11.61% and 9.08% (yoy).

Indices and market capitalisation	Last day of the previous period	Last day of the period	Change in %
Market capitalisation	3,732,304,036 KM	3,835,425,219 KM	2.76%
BIRS	956.12	876.36	-8.34%
FIRS	1,632.46	1,822.07	11.61%
ERS10	801.34	874.10	9.08%

A novelty at the local market, treasury bills helped the market to recover. The governments of the two state entities could not count on international organisations' funds and decided therefore to start issuing treasury bills. After the Government of Republika Srpska sold at the local market KM 64 mil. through 6-month and 9-month treasury bills in May and June, the Government of the Federation of BiH sold KM 65 through 6-month treasury bills at the price of 2.32% or +59 bp at 6M Euribor (in RS: spread of 76 bp). The National Assembly of Republika Srpska has recently adopted the Decision on RS entering into long- and short-term debts in the amount of KM 100 mil. by issuing entities' bonds and treasury bills with the purpose of financing the entity's budget 2012.

Stock-exchange of Sarajevo (SASE)

The total trading volume at the Stock-exchange of Sarajevo amounted in 2011 up to KM 244,787,112.10, participating in the total value traded with at all stock-exchanges of BiH with 36.97%, showing an increase of 125.5% (yoy) compared to the year 2010. The total of 56,693,439 securities were traded with in 15,900 transactions.

Issuer	Volume	No. of trans.	Exchange rate change in %
ZIF BIG Investiciona grupa dd Sarajevo	11,813,373.44 KM	1,394	19.40%
Opresa dd Sarajevo	8,657,959.92	3	2.80%
Fabrika duhana Sarajevo dd Sarajevo	5,630,453.52	1,743	-33.20%
BH Telecom d.d. Sarajevo	4,999,084.76	1,236	-3.44%
Bosnalijek d.d. Sarajevo	4,611,171.44	1,250	-42.09%
ZIF Herbos fond dd Mostar	3,908,261.51	158	-3.45%
ZIF MI Group dd Sarajevo	3,902,945.68	461	-2.14%
FBiH obveznice ratna potraživanja ser. A	3,613,740.23	286	7.69%
JP Elektroprivreda BIH dd Sarajevo	3,221,616.87	600	-36.31%
BOR BANKA DD SARAJEVO	2,711,379.90	29	0.00%

SASX-30 (Primary Free Market Index) increased by 2.66% (yoy) compared to the previous year, whereas BIFX (Investments Funds' Index) –grew by 1.36% (yoy) and SASX-10 dropped by 16.18% (yoy).

Indicator	Last day of the previous period	Last day of the period	Exchange rate change in %
Market capitalisation	7,210,603,026.80 KM	4,371,013,728.43	-39.38%
BIFX	1,520.80	1,541.52	1.36%
SASX-10	944.07	791.30	-16.18%
SASX-30	925.95	950.61	2.66%

Insurance

Compared to the neighbouring and the developed countries, BiH still has quite underdeveloped insurance market, which is to the greatest extent a reflection of the level of development of the country itself and very hard living conditions of its citizens. A certain improvement in insurance segment with increased number of concluded life insurance policies and the improved regulations does not change the fact that the insurance market in BiH is not developed enough. Five biggest insurance companies control almost 90% of the total insurance market of BiH. The consolidated assets of all insurance companies participated in the total assets of the financial services sector in BiH with 3.86% (December 2010[5]).

The premium total in BiH amounted in 2010 up to KM 472,008,481, showing an increase of 2.92% compared to the year 2009. The share of the insurance companies from the Federation of BiH in the premium total was 74.02%, whereas the share of the insurance companies from RS was 25.98%. The profit total earned in BiH on insurance and reinsurance amounted in 2010 up to KM 24,723,791, being by 24.09% higher than in 2009. The insurance companies in RS earned in 2010 the profit of KM 14,186,232, showing an increase of 366.22% compared to 2009, whereas insurance and reinsurance companies from the Federation of BiH earned in 2010 KM 10,537,559, showing a decrease of 34.35% compared to the previous year.

[5] Reports 2011 will be available in August 2012

Corporate social responsibility

Hypo Alpe-Adria-Bank d.d. has been acting as a socially responsible institution ever since it has entered the market of Bosnia and Herzegovina, striving all the time to align its activities with the best practices of the developed world countries as much as possible, especially when it comes to relation with its staff, clients, business partners, shareholders, local community and environmental protection.

Human Resources Management

A member of an international banking group, which takes into account the specific quality and complexity of the banking business in BiH, Hypo Alpe-Adria-Bank d.d. has always been paying high attention to human resources management and development, wanting to build a partnership relation with its clients and a positive and friendly working atmosphere. The Bank closed the year 2011 with 647 employees with a very high qualifications level – 63.83% of the employees have a University degree and 36.17% a secondary-school degree. The average age of the Bank's staff is 38.15.

In order to acquire new know-how required for further improvement of work organisation and operations, but also to improve the skills they already have, employees of Hypo Alpe-Adria-Bank d.d. attended various training programmes in the country and abroad.

Managers attended a special academy for managers in duration of a couple of years, called the Hypo Academy, as well as a special training programme organised in cooperation with the IEDC-Bled School of Management and a whole range of other seminars. The common purpose of these training programmes was to achieve the best practices and acquire new „know-how" to be applied in the business processes of the Bank.

Reorganisation of business activities and a permanent process of adjustment to the market requirements called for organisation of various specialized educative programmes designed for particular target groups, such as for example risk management for the employees involved in the lending process in segments of Corporate Banking, Public, SME and Retail.

Relation with clients and business partners

Hypo Alpe-Adria-Bank d.d. considers clients' trust to be its most valuable asset and always tries hard to prove worthy of it. Consequently, business ethics is one of the Bank's highest priorities. The Bank never fails to timely inform its clients and business partners about any changes related to its operations, new products, services, interests, fees, commissions and similar issues. In its marketing and corporate communication activities, the Bank is strongly committed to code of ethics and truthfulness. When it comes to the clients' rights, the Bank introduced the position of the Clients' Complaints Manager, who is in charge with tackling verbal and written complaints of clients about the quality of Bank's services, products and Bank's approach to its clients in general. Complaints may be filed verbally directly or via phone or in written, via post or e-mail.

The Bank will continue adhering to principles of responsible, moral and transparent banking, always bringing its own success and success of its owners in high correlation with the success of its clients.

Support to local community (cultural, art, sport, educational and health-service public institutions)

Hypo Alpe-Adria-Bank has for many years already been very supportive of the local community, providing significant and budget-fitting financial support to education and health-service public institutions and social-values promoting cultural, art and non-commercial sport events, driven by a wish to support the local community and to be an integral part of the local identity.

The year 2011 was not an exception - the Bank gave donations to education and health-service public institutions and associations for children and youth in the total amount of KM 72,000. In the HypoArt project, a significant donation was given to the Academy of Fine Arts of Sarajevo.

Bodies of Hypo Alpe-Adria-Bank d.d.

Supervisory Board

Supervisory Board till 25 March 2011
Rainer Sichert, President
Wolfgang Moesslacher, Deputy President
Stephan Holzer, member
Patrick Luger, member
Meliha Povlakić, member

Supervisory Board since 25 March 2011
Rainer Sichert, President
Wolfgang Moesslacher, Deputy President
Stephan Holzer, member
Sebastian Firlinger, member
Blaž Brodnjak, member

Audit Committee

Audit Committee members till 14 March 2011
Nensi Marin, President
Hans-Dieter Kerstnig, member
Zoran Besak, member
Danijel Gregorić, member
Vesna Pavlović, member

Audit Committee members since 14 March 2011
Đorđe Lazović, President
Maria Rauscher, member
Andrea Castellarin, member
Thomas Milunović, member
Sabine Jaeger-Letzl, member

MANAGEMENT BOARD

Michel Vogt, Director (until 09 March 2012)
Alexander Picker, Chief Executive Officer (from 09 March 2012)
Mirzet Ribić, Deputy General Director (until 31 January 2012)
Dragan Kovačević, Executive Director (from 15 December 2011)
Dmytro Kolechko, Executive Director (from 26 June 2012)
Herbert Walzhofer, Executive Director (from 15 February 2011 till 09 March 2012)
Thomas Karl Tomsich, Executive Director (until 31 January 2011)

Organisational structure:

As of December 31st, 2011

HYPO ALPE-ADRIA-BANK D.D.
MOSTAR

Unconsolidated financial statements for the year ended 31 December 2011 prepared in accordance with International Financial Reporting Standards and Independent Auditors' Report

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Pursuant to the Law on Accounting and Audit of Federation of Bosnia and Herzegovina (Official Gazette No. 83/09), the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with International Financial Reporting Standards (IFRS) which give a true and fair view of the state of affairs and results of the Bank for that period. IFRS are published by the International Accounting Standards Board (IASB).

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

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

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

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

Signed on behalf of the Management Board

HYPO ALPE-ADRIA-BANK d.d. MOSTAR

Alexander Picker, Chief Executive Officer

Dragan Kovačević, Executive Director

Hypo Alpe-Adria-Bank d.d. Mostar
Kneza Branimira 2b
88000 Mostar
Bosnia and Herzegovina
31 August 2012

Independent Auditor's Report

To the shareholders of Hypo Alpe-Adria-Bank d.d. Mostar:

We have audited the accompanying unconsolidated financial statements of Hypo Alpe-Adria-Bank d.d. Mostar (the "Bank"), set out on pages 4 to 51, which comprise of the unconsolidated balance sheet as at 31 December 2011, and the unconsolidated income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion the unconsolidated financial statements present fairly, in all material respect the financial position of Hypo Alpe-Adria-Bank d.d. Mostar as of 31 December 2011, and of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphases of matter

Concentration of funding
We draw attention to Note 24 of these unconsolidated financial statements which refer to the Bank's financing by Hypo Alpe-Adria Bank International AG, Klagenfurt, Austria (the Parent). The Bank is dependent upon the continued funding and other financial support from its Parent, under the currently agreed financial terms. Additionally, as disclosed in Note 38, the Parent increased the Bank's shareholders' equity by KM 20 million on 6 March 2012 and additional KM 20 million on 10 May 2012.

Consolidated financial statements

We draw attention to the fact that the Bank has prepared these unconsolidated financial statements as required by the Law in Federation of Bosnia and Herzegovina, and that consolidated financial statements of the Group prepared in accordance with International Financial Reporting Standards have been issued separately. In the accompanying unconsolidated financial statements investments in subsidiaries and associates are valued at cost. For a better understanding of the Group as a whole, users should read the consolidated financial statements.

Our opinion is not qualified in respect of these matters.

Deloitte d.o.o.

Sead Bahtanović, director and licenced auditor

Sabina Softić, licenced auditor

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Jadranska bb
71000 Sarajevo
ID: 4200047390000

Sarajevo, Bosnia and Herzegovina
31 August 2012

Unconsolidated income statement

for the year ended 31 December 2011

(all amounts are expressed in thousands of KM)

	Notes	2011	2010
Interest income	6	110,564	122,305
Interest and similar expenses	7	(55,619)	(62,349)
Net interest income		**54,945**	**59,956**
Fee and commission income	8	14,919	16,758
Fee and commission expense		(5,597)	(5,596)
Net fee and commission income		**9,322**	**11,162**
Net income on financial operations	9	6,197	3,012
Other operating income	10	11,062	5,874
Operating income		**81,526**	**80,004**
Personnel expenses	11	(21,793)	(19,016)
General and administrative expenses	12	(34,262)	(23,980)
Depreciation and amortization expense	23	(6,384)	(5,270)
Other operating expenses	13	-	(30)
Operating expenses		**(62,439)**	**(48,296)**
PROFIT BEFORE IMPAIRMENT LOSSES, PROVISIONS AND INCOME TAX		**19,087**	**31,708**
Impairment losses and provisions	14	(67,310)	(178,182)
Collected written-off receivables		7,584	7,690
LOSS BEFORE INCOME TAX		**(40,639)**	**(138,784)**
Income tax	15	-	113
NET LOSS FOR THE YEAR		**(40,639)**	**(138,671)**
Basic loss per share (KM)	37	(84.23)	(287.40)

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

Unconsolidated statement of comprehensive income

for the year ended 31 December 2011

(all amounts are expressed in thousands of KM)

	Notes	2011	2010
Loss for the year		**(40,639)**	**(138,671)**
Other comprehensive income			
Exchange differences on translating foreign operations		21	19
Available-for-sale financial assets			
Net gain / (loss) arising on revaluation of available-for-sale financial assets during the year		391	(149)
Total comprehensive loss for the year		**(40,227)**	**(138,801)**

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

Unconsolidated balance sheet
as at 31 December 2011
(all amounts are expressed in thousands of KM)

	Notes	31 December 2011	31 December 2010
ASSETS			
Cash and due from banks	16	146,112	146,801
Obligatory reserve at the Central Bank of Bosnia and Herzegovina	17	132,515	158,578
Placements with other banks	18	155,638	65,187
Loans and advances to customers	19	1,012,163	1,389,886
Financial assets available for sale	20	3,034	2,664
Investments in subsidiaries	21	2,711	3,711
Deferred tax assets	15	2,172	2,172
Other assets	22	23,902	6,006
Tangible and intangible assets	23	68,298	71,582
TOTAL ASSETS		**1,546,545**	**1,846,587**
LIABILITIES			
Due to other banks	24	316,010	683,941
Due to customers	25	884,103	919,343
Subordinated debt	26	65,000	65,000
Other liabilities	27	39,593	26,012
Provisions for financial commitments and contingencies	28	3,503	4,062
Total liabilities		**1,308,209**	**1,698,358**
SHAREHOLDERS' EQUITY			
Share capital		193,000	193,000
Reserves		113,571	113,571
Regulatory reserves		129,054	-
Investment revaluation reserves		(11)	(423)
Retained losses		(197,278)	(157,919)
Total shareholders' equity		**238,336**	**148,229**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**1,546,545**	**1,846,587**
FINANCIAL COMMITMENTS AND CONTINGENCIES	28	153,123	149,548

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

Signed on behalf of Hypo Alpe-Adria-Bank d.d. Mostar on 31 August 2012:

HYPO ALPE-ADRIA-BANK MOSTAR

Alexander Picker
Chief Executive Officer

Dragan Kovačević
Executive Director

Unconsolidated statement of cash flows
for the year ended 31 December 2011
(all amounts are expressed in thousands of KM)

	2011	2010
Operating Activities		
Loss before income tax	(40,639)	(138,784)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,384	5,270
Impairment losses and provisions	67,310	178,182
Provision for employee benefits	23	17
Loss on disposals of tangible and intangible assets	2,569	16
Loss on sale of available for sale investments	55	–
Dividend income	(5)	(7)
Foreign exchange adjustment	21	76
Cash flow before changes in operating assets and liabilities:		
Net decrease in obligatory reserve with the Central Bank of Bosnia and Herzegovina	26,063	12,165
Net (increase) / decrease in placements with other banks, before impairment losses	(90,468)	30,906
Net decrease in loans and advances to customers, before impairment losses	69,527	116,137
Net (increase) / decrease in other assets, before impairment losses	(16,438)	13,135
Net decrease / (increase) in due to other banks	10,403	(348,508)
Net decrease in due to customers	(35,240)	(3,960)
Net increase / (decrease) in other liabilities	5,023	(614)
Cash flows from / (used in) operating activities	4,588	(135,969)
Income tax paid	–	–
NET CASH FROM / (USED IN) OPERATING ACTIVITIES	**4,588**	**(135,969)**
Investing Activities		
Purchase of tangible and intangible assets	(5,568)	(10,297)
Proceeds from sale of assets available for sale	12	–
Cash acquired from business combination	2,045	–
Proceeds from sale of tangible and intangible assets	76	–
Dividends received	5	7
NET CASH USED IN INVESTING ACTIVITIES	**(3,430)**	**(10,290)**
Financing Activities		
Increase in capital reserves	–	105,000
Decrease in borrowings	(1,847)	–
NET CASH (USED IN) / PROVIDED BY FINANCING ACTIVITIES	**(1,847)**	**105,000**
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(689)**	**(41,259)**
CASH AND CASH EQUIVALENTS AT 1 JANUARY	**146,801**	**188,060**
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**146,112**	**146,801**

The accompanying notes form an integral part of these financial statements

Unconsolidated statement of changes in shareholders' equity
for the year ended 31 December 2011
(all amounts are expressed in thousands of KM)

	Share capital	Reserves	Regulatory reserves	Investment revaluation reserves	Retained losses	Total
31 December 2009	**193,000**	**8,571**	**-**	**(293)**	**(19,248)**	**182,030**
Capital increase	-	105,000	-	-	-	105,000
Net loss for the year 2010	-	-	-	-	(138,671)	(138,671)
Other comprehensive loss for the year	-	-	-	(130)	-	(130)
Total comprehensive loss	-	-	-	*(130)*	*(138,671)*	*(138,801)*
31 December 2010	**193,000**	**113,571**	**-**	**(423)**	**(157,919)**	**148,229**
Effects of change of accounting policy (Note 4)	-	-	-	-	129,054	129,054
Regulatory requirements (Note 4)	-	-	129,054	-	(129,054)	-
Effects of merger Hypo Alpe-Adria Vrijednosnice d.o.o Mostar into the Bank (Note 32)	-	-	-	-	1,280	1,280
Net loss for the year 2011	-	-	-	-	(40,639)	(40,639)
Other comprehensive income for the year	-	-	-	412	-	412
Total comprehensive loss	-	-	-	*412*	*(40,639)*	*(40,227)*
31 December 2011	**193,000**	**113,571**	**129,054**	**(11)**	**(197,278)**	**238,336**

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

(all amounts are expressed in thousands of KM)

1. GENERAL

History and incorporation

Hypo Alpe-Adria-Bank d.d. Mostar (the ''Bank'') got the approval from the Banking Agency of Federation of Bosnia and Herzegovina ("FBA") dated 17 January 2000 and the Bank was registered at the County Court in Mostar on 21 January 2000.
The Bank's main office is located in Mostar, Kneza Branimira 2b. The Bank conducts its operations through the headquarters in Mostar, 46 branch offices and 12 offices in the Federation of Bosnia and Herzegovina.

Principal activities of the Bank:

The Bank's main operations are as follows:

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

Supervisory Board	
Rainer Sichert	President
Wolfgang Mősslacher	Vice-president
Stephan Holzer	Member
Sebastian Firlinger	Member (from 25 March 2011)
Blaž Brodnjak	Member (from 25 March 2011)
Meliha Povlakić	Member (until 25 March 2011)
Patrick Luger	Member (until 25 March 2011)

Board of Directors	
Michel Vogt	Director (until 09 March 2012)
Alexander Picker	Chief Executive Officer (from 09 March 2012)
Mirzet Ribić	Deputy General Director (until 31 January 2012)
Dragan Kovačević	Executive Director (from 15 December 2011)
Dmytro Kolechko	Executive Director (from 26 June 2012)
Herbert Walzhofer	Executive Director (from 15 February 2011 till 09 March 2012)
Thomas Karl Tomsich	Executive Director (until 31 January 2011)
Jasna Gvožđar	Executive Director (until 31 December 2010)

(all amounts are expressed in thousands of KM)

1. GENERAL (CONTINUED)

The global ultimate parent for the Bank, as well as for the Hypo Alpe-Adria-Bank International AG, Klagenfurt is the Government of the Republic of Austria.

The shareholding structure is as follows:

	31 December 2011		31 December 2010	
	Paid capital	Ownership %	Paid capital	Ownership %
Hypo Alpe-Adria-Bank International AG, Klagenfurt	192,997	99.999	192,997	99.999
Small shareholders	3	0.001	3	0.001
Total	193,000	100.00	193,000	100.00

Debt and/or equity instruments of the Bank are not traded in a public market and these financial statements are not under the regulative of the Security Commission for the purpose of issuing any class of instruments in a public market. Therefore, the Bank considers that it operates in a single business segment, and a single geographical segment, that is the provision of banking services in Bosnia and Herzegovina.

2. "BRUSH" PROJECT

In 2011, the Hypo Alpe-Adria International AG initiated a project called „BRUSH". The „BRUSH" project had the following goals:

- Alignment with all legally prescribed limits related to the original capital of the Bank
- Full control of credit risk of the Bank and its influence on Bank's profitability
- Reduction of future additional loan loss provisions
- Increase of Bank's profitability through increase of net interest income of the Bank
- Stabilisation of the Bank's capital,
- Optimal use of Bank's capital (financing of growth instead of covering losses)

The "BRUSH" project has been implemented through what is referred to as the Pass-through Agreement ("PTA") signed on 22 December 2011.

The PTA defines a transaction between the contracting parties the Bank („Transferor"), Bora d.o.o. Banja Luka („Transferee") and Hypo Alpe-Adria International AG (joint owner – which is mentioned in the Agreement also as a "Calculation Agent") regarding the transfer of economic risk and benefits related to the collection of receivables from the relevant portfolio (reference assets) of the Transferor to the Transferee in exchange for taking over the payment liabilities to the joint owner to the amount equal to the net book value of that portfolio.

The major points defined through PTA can be presented as follows:

Transfer of economic ownership along with keeping the legal one: Keeping of contract rights per contracts, whose economic risk and benefit of collection is subject of transfer, including the collection, along with the contracted obligation of transfer of such realized cash flows to Bora d.o.o.
The relationship between the Bank and the loan beneficiaries is not changed: The Bank keeps the legal ownership over receivables as well as the communication with the loan beneficiaries
Transfer of risk of receivables collection per loans: The Bank fully transfers the risks and possible benefits per transferred cash flows from collection of receivables
De-recognition of transferred financial assets in on-balance: By applying IAS 39, the part of financial assets which is the subject of the Agreement is derecognised.

(all amounts are expressed in thousands of KM)

2. "BRUSH" PROJECT (CONTINUED)

All cash flows received based on financial assets which are the subject of the Agreement are remitted to Bora d.o.o. which is in accordance with the International Accounting Standard 39 – "Financial Instruments: Recognition and Measurement" (IAS 39) which defines in paragraph 19 that such cash flows are received "on behalf of potential recipients"

Status of meeting the conditions of IAS 39 for de-recognition of financial assets being encompassed by the PTA:

Pre-conditions for de-recognition	Status
Clearly defined financial assets which is the subject of Agreement	√ Loan contracts identified – reference assets
IAS 39.18 (b) keeping of contract rights to the receiving of cash flows from financial assets along with taking over the contract obligation of disbursing the cash flows to one or several receipts within the agreement	√ Defined in the PTA between the Bank and BORA d.o.o.
IAS 39.19 Obligation of disbursement only upon receipt of the cash flows which must be remitted to the receipt with no delay; original assets may not be sold nor pledged	
IAS 39.20 Transfer of all risks and benefits	√ All risks and benefits related to collection transferred to BORA d.o.o.

The PTA meets with the requirements of IAS 39 for the de-recognition of financial assets in the Transferor's books, which requires the removal of the above-mentioned portfolio from the Transferor's books and its recognition into Transferee's books.

The Bank keeps the legal ownership over receivables, as well as the communication with the loan beneficiaries (IAS 39, point 18.b)

In accordance with the PTA, the Bank is still obliged to continue with all collection activities of such receivables. The afore-stated activities shall be collected from the Transferee which is regulated in a separate Service Level Agreement. Based on the afore-mentioned, the Bank recognised those financial assets into books within its off-balance records.

The fee for the above-mentioned transfer of cash flows is defined in the PTA:

The fee for cash flows from Article. 2. of the PTA corresponds to the net value of receivables in accordance with the IAS 39, based on loans from Reference Assets on 31 October 2011, presented by the Transferor in the Attachment no. 1 of this Agreement upon methodology which is used by the Transferor according to the legislation of Bosnia and Herzegovina.

The fee from the above item shall be executed by taking over the debts by the Transferee in accordance with the Attachment no. 4. up to the amount of the fee, which the Transferor has towards the Hypo Alpe-Adria-Bank International AG.

The Calculation Agent will send the notification to the contracting parties about the announcement of the updated Attachment no. 1 of this Agreement which contains the total value of Reference Assets from the Effective Date ("total value").If total value exceeds the fee for transfer, executed as being foreseen in the previous paragraph, such difference shall be executed in a way that the Transferee shall take over additional debt which the Transferor has towards the Hypo Alpe-Adria-Bank International AG to the amount which corresponds to such difference within 25 working days from the day of sending the notification by Calculation Agent.

(all amounts are expressed in thousands of KM)

2. "BRUSH" PROJECT (CONTINUED)

If total value is lower than the fee for transfer, executed as being foreseen in the previous paragraph, the difference shall be executed by repeated transfer of debt, which the Transferee has taken over from the Transferor in accordance with the previous paragraph, from the Transferee to the Transferor within 25 working days from the day of sending the notification by Calculation Agent.

Below is an overview of reference assets and defined fee:

Amount defined in the Agreement	Loans receivables	Allowance for impairment losses	FOREX	Net book value
Balance as of 31 October 2011	606,568	(156,288)	368	450,648
Balance as of 31 December 2011	599,304	(157,192)	-	442,112
				8,536

The fee basis for definition in PTA represents net book value of reference assets as of 31 October 2011 and since the referenced assets have been removed from general ledger as of 31 December 2011, the identified difference of KM 8,536 thousand between the period have been influenced by:

- reduction of gross exposure due to collection;
- exchange rate difference rose between 1 November 2011 and 31 December 2011 for loan receivables denominated in foreign currencies;
- changes of before impairment losses for loan and advances to customers.

The identified difference of KM 8,536 thousand (Note 27), rose in the period 1 November 2011 till 31 December 2011 has been accounted on PTA transfer account and increased deposits toward Hypo Alpe-Adria Bank International AG immediately after issuing the Annex no. 1 in 2012.
On 19 July 2012, the Banking Agency of the Federation of Bosnia and Herzegovina ("FBA") issued approval to the Bank to transfer the contracted deposits of Hypo Alpe-Adria-Bank International AG in the amount of 367,951 thousand KM. Since the transfer of contracted deposits Hypo Alpe-Adria-Bank International AG is an integral part of the Project BRUSH and represents an event that provide evidence of conditions that existed at the balance sheet date, the Bank adjusted the amounts to be recognized in the financial statement for the year ended 31 December 2011 year as follows:

The amount of contracted deposits of Hypo Alpe-Adria Bank International AG initially defined in the Agreement	442,112
The amount of contracted deposits of Hypo Alpe-Adria Bank International AG in accordance with issued FBA approval	367,951
	74,161

The identified differences in the amount of 74,161 thousand KM, the Bank recorded at the account of liabilities towards Hypo Alpe-Adria-Bank International AG (Note 24). This difference between the initially contracted value of assets and liabilities and the approved amount, relates to the loans classified in accordance with the regulatory requirements in A and B category as well as loans to individuals with net worth value less than 150 thousand KM of 31 December 2011.
In accordance with the approval, the Bank adopted amendments to the existing Agreement and other supporting documents in August 2012, and the amended overview of reference assets and defined fee can be presented as follows:

Amount defined in the Agreement	Loans receivables	Allowance for impairment losses	FOREX	Net book value
Balance as of 31 December 2011	524,347	(156,396)	-	367,951

3. ADOPTION OF NEW AND REVISED STANDARDS

3.1 Standards and Interpretations effective in the current period

The following amendments to the existing standards issued by the International Accounting Standards Board and interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period:

- Amendments to IFRS 1 "First-time Adoption of IFRS"- Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (effective for annual periods beginning on or after 1 July 2010),
- Amendments to IAS 24 "Related Party Disclosures" - Simplifying the disclosure requirements for government-related entities and clarifying the definition of a related party (effective for annual periods beginning on or after 1 January 2011),
- Amendments to IAS 32 "Financial Instruments: Presentation" – Accounting for rights issues (effective for annual periods beginning on or after 1 February 2010),
- Amendments to various standards and interpretations "Improvements to IFRSs (2010)" resulting from the annual improvement project of IFRS published on 6 May 2010 (IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34, IFRIC 13) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 July 2010 or 1 January 2011 depending on standard/interpretation),
- Amendments to IFRIC 14 "IAS 19 - The Limit on a defined benefit Asset, Minimum Funding Requirements and their Interaction" - Prepayments of a Minimum Funding Requirement (effective for annual periods beginning on or after 1 January 2011),
- IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments" (effective for annual periods beginning on or after 1 July 2010).

The adoption of these amendments to the existing standards and interpretations has not led to any changes in the Bank's accounting policies.

3.2 Standards and Interpretations in issue not yet effective

At the date of authorisation of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 10 "Consolidated Financial Statements" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 11 "Joint Arrangements" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 12 "Disclosures of Involvement with Other Entities" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 13 "Fair Value Measurement" (effective for annual periods beginning on or after 1 January 2013),
- IAS 27 (revised in 2011) "Separate Financial Statements" (effective for annual periods beginning on or after 1 January 2013),
- IAS 28 (revised in 2011) "Investments in Associates and Joint Ventures" (effective for annual periods beginning on or after 1 January 2013),
- Amendments to IFRS 1 "First-time Adoption of IFRS"- Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after 1 July 2011),
- Amendments to IFRS 7 "Financial Instruments: Disclosures"- Transfers of Financial Assets (effective for annual periods beginning on or after 1 July 2011),
- Amendments to IAS 1 "Presentation of financial statements" - Presentation of Items of Other Comprehensive Income (effective for annual periods beginning on or after 1 July 2012),

3. ADOPTION OF NEW AND REVISED STANDARDS (CONTINUED)

3.2 Standards and Interpretations in issue not yet effective (continued)

- Amendments to IAS 12 "Income Taxes" - Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after 1 January 2012),
- Amendments to IAS 19 "Employee Benefits" - Improvements to the Accounting for Post-employment Benefits (effective for annual periods beginning on or after 1 January 2013),
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine" (effective for annual periods beginning on or after 1 January 2013).

The Bank has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Bank anticipates that the adoption of these standards, revisions and interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board.

Going concern

The financial statements have been prepared on the going concern basis, which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

Basis of preparation

The unconsolidated financial statements have been prepared on the historical cost basis. The unconsolidated financial statements are presented in Convertible marks since that are the functional currency of the Company. The Convertible mark (KM) is officially tied to the Euro (EUR 1 = KM 1.95583).
The Bank has issued these unconsolidated financial statements as required by the Law in Federation of Bosnia and Herzegovina, and its investments in associates and subsidiaries are presented in these unconsolidated financial statements at cost. The Bank has also prepared consolidated financial statements in accordance with IFRS, which were approved by the Management and issued in 31 August 2012. For a better understanding of the Group as a whole, users should read the consolidated financial statements.

Change of accounting policy

Up to 31 December 2010, as it was required by local legislation and decisions of Banking Agency of the Federation of Bosnia and Herzegovina ("FBA"), the Bank was preparing the financial statements in accordance with IFRS as modified by the regulatory requirements prescribed by FBA with respect to the calculation of provision for impairment of financial instruments. These rules required banks to calculate the allowance for impairment of financial assets and provision for commitments and contingencies using the matrix system based on number of overdue days.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Change of accounting policy (continued)

The matrix system applied on outstanding loan receivables, as well as on commitments and contingencies, was as follows:

- 0 - 30 overdue days - 2%,
- 31 - 50 overdue days - 5%,
- 51 - 70 overdue days - 10%,
- 71 - 90 overdue days - 15%,
- 91 - 120 overdue days - 16%,
- 121 - 140 overdue days - 20%,
- 141 - 160 overdue days - 30%,
- 161 - 180 overdue days - 40%,
- 181 - 210 overdue days - 41%,
- 211 - 230 overdue days - 45%,
- 231 - 250 overdue days - 50%,
- 251 - 270 overdue days - 60%,
- Above 271 overdue days - 100%.

This was not in accordance with International Accounting Standard (“IAS”) 39: ‘Financial Instruments: Recognition and Measurement’, which requires assessment at each reporting period date as to whether there is any objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss should be measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate.

Additionally, the banks had to recognize the general provision of 2% for some other financial and non-financial assets.

Based on the Guidelines on the changes to the means for creating, recording and reporting forms for the loan loss reserves, issued by FBA in January 2011, the banks are obliged to introduce a new methodology for assessment of impairment losses on the financial assets (loans and receivables), in line with the requirements of IAS 39, and provisions for commitments and contingencies, in line with the requirements of IAS 37: “Provisions, Contingent Liabilities and Contingent Assets”, effective from 1 January 2011. These guidelines also eliminated the requirement for general provisions of 2% for other items of assets. Also, the banks are required to recognize the difference between the allowance for impairment losses on financial assets and provisions according to new accounting policy and the level of allowance for impairment losses on financial assets and provisions that would have been determined if the matrix system was still applied, under Regulatory reserves within the equity. The difference should be determined at the end of every year and upon decision of the Bank’s Assembly on allocation of net result for the year kept at required level.

Due to the fact that new accounting policy for impairment losses on financial assets and provisions by its nature is based on the approximations and the accounting estimates made by Management, the Bank was not able to determine the effects of the change in the accounting balances to the individual balances on the income statements, statement of comprehensive income, and changes in equity for the years ended 31 December 2009 and 2010.

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Change of accounting policy (continued)

Consequently, according to IAS 8: "Accounting Policies, Changes in Accounting Estimates and Errors", the new accounting policy was applied prospectively by making an adjustment to the opening balances of the equity in 2011. The adjustment may be presented as follows:

	Effect on Regulatory reserves (within the equity)
Release of allowance for impairment losses on loans and advances to customers (Note 19)	127,435
Release on allowance for impairment losses on other assets and receivables (Note 22)	1,447
Release of allowance for impairment losses on placements with other banks (Note 18)	109
Release of provision for commitments and contingencies (Note 28)	63
	129,054

With regard to the change of accounting policy, FBA required the banks to create a regulatory reserve consisting of the difference between the allowance for impairment losses on financial assets and provisions according to the new accounting policy and the level of allowance for impairment losses on financial assets and provisions that would have been determined if the matrix system had been applied at the date of new accounting policy application. As at 31 December 2011, the Bank did not allocate any additional amounts to the regulatory reserve as the amount already allocated as at 1 January 2011 is higher than the required amount as at 31 December 2011.

Equity investments

A subsidiary is an entity which is controlled by the Bank. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
Investments in subsidiaries in these financial statements are stated at cost less any impairment in the value of individual investment needed.

Financial information about investments in subsidiaries and associates are as follows:

	Total Assets	Share capital	Net result for 2011	Accumulated gains	Total Equity
Subsidiaries:					
Hypo Alpe-Adria-Invest d.o.o. Mostar	3,098	1,462	193	645	2,169

Interest income and expense

Interest income is recorded on an accrual basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.
Interest charged on deposits is added to the principal where this is foreseen by the agreement. Interest income is suspended when it is considered that recovery of the income is unlikely. Suspended interest is recognized as income when collected.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fee and commission income and expense

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

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

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

Taxation

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

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

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

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

Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Central Bank of Bosnia and Herzegovina ('CBBH') and current accounts with other banks. Cash and cash equivalents excludes the compulsory minimum reserve with CBBH as these funds are not available for the Bank's day to day operations. The compulsory minimum reserve with the CBBH is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

Financial assets and liabilities

Financial assets are recognised and derecognised on the trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the instrument within the timeframe established by the market concerned.

Financial assets are classified into the following specified categories: 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets and liabilities (continued)

Method of effective interest rate

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

Income is recognized on an effective interest basis for financial instruments: 'available-for-sale' and 'loans and receivables'.

Financial assets available for sale

Listed shares and listed redeemable notes held by the Bank that are traded in an active market are classified as being available for sale and are stated at fair value. Fair value is determined in the manner described in previous paragraphs. Gains and losses arising from changes in fair value are recognised directly in equity in the investments revaluation reserve with the exception of impairment losses, interest calculated using the effective interest rate method and foreign exchange gains and losses on monetary assets, which are recognised directly in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously recognised in the investments revaluation reserve is included in profit or loss for the period.

Dividends on available for sale equity instruments are recognised in profit or loss when the Bank's right to receive payments is established.

Impairment of financial assets other than loans

Financial assets, other than those at FVTPL if any, are assessed for indicators of impairment at each reporting period date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For all other financial assets objective evidence of impairment could include:

- significant financial difficulty of the counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

With the exception of AFS equity instruments, 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 recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognized.

In respect of AFS equity securities, any increase in fair value subsequent to an impairment loss is recognized directly in equity, unless it is a permanent impairment that is recognized directly in the income statement.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets and liabilities (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loan and receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees received from customers, incurred in securing a loan are treated as part of the cost of the transaction.

Derecognition of financial assets

Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank continues to recognize the financial asset.

Financial liabilities

Classification as debt or equity

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

Equity instruments

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

Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- the amount of the obligation under the contract, as determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets;* or
- the amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies set out at above.

Financial liabilities

Financial liabilities are classified as either financial liabilities ”at FVTPL” or “other financial liabilities”. The Bank creates one category of financial liabilities, for which basis of accounting is disclosed below.

Other financial liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

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

(all amounts are expressed in thousands of KM)

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets and liabilities (continued)

Derecognition of financial liabilities

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

Tangible and intangible assets

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

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

	2011	2010
Buildings	2%	1.3%
Office equipment	10-33.3%	10-33.3%
Vehicles	25%	25%
Software and other intangible assets	20%	20%

In year 2011, the Management has revised useful lives of tangible and intangible assets, as it believes that such change better reflects usage pattern of the assets. The effect of this change in 2011 was an increase in depreciation expense in the amount of KM 395 thousand.

Impairment

At each reporting period date, the Bank reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any).

Recoverable amount is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognized as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

As of 31 December 2011 and 2010, respectively, tangible and intangible assets of the Bank were not impaired.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Employee benefits

During its normal operating activities, the Bank pays payroll taxes and contributions on behalf of its employees, as well as meal and vacation allowances according to the local legislation. These expenses are recognized in the income statement in the same period as the related salary costs.

According to the local legislation and internal Employment rulebook, the Bank makes retirement severance payments of minimum three average monthly salaries of the employee in question or three average salaries of the Bank paid in the period of the last three months, depending on what is more favorable to the employee.

Foreign currency translation

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

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

31 December 2011	EUR 1 = KM 1.95583	USD 1 = KM 1.511577
31 December 2010	EUR 1 = KM 1.95583	USD 1 = KM 1.472764

Provisions

Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that the Bank will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the reporting period date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Regulatory requirements

The Bank is subject to the regulatory requirements of the Banking Agency of the Federation of Bosnia and Herzegovina.

5. CRITICAL ACCOUNTING JUDGMENTS AND ESTIMATIONS

In the application of the Bank's accounting policies, which are described in note 4, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. In these financial statements, significant estimates made by Management of the Bank as of 31 December 2011 and 2010, respectively are presented below.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Key sources of estimation uncertainty

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

Useful lives of tangible and intangible assets

As described at Note 4 above, the Bank reviews the estimated useful lives of tangible and intangible assets at the end of each annual reporting period.

Impairment losses on loans and receivables

As described at Note 4 above, at each reporting date, the Bank assessed indicators for impairment of loans and receivables and their impact on the estimated future cash flows from the loans and receivables.

Provisions for employee benefits

As described at Note 4 above, in paragraph with heading employee benefits, provisions for the employee benefits are calculated using the projected credit unit method.

(all amounts are expressed in thousands of KM)

6. INTEREST INCOME

	2011	2010
Interest on loans and advances to companies	61,552	69,533
Interest on loans and advances to individuals	46,627	51,210
Interest on balances due from other banks	2,385	1,562
Total	**110,564**	**122,305**

7. INTEREST AND SIMILAR EXPENSE

	2011	2010
Interest on amounts due to other banks	24,775	26,350
Interest on deposits from individuals	19,446	19,876
Interest on deposits from companies	7,573	11,829
Interest on borrowings and subordinated debt	3,825	4,284
Other	-	10
Total	**55,619**	**62,349**

8. FEE AND COMMISSION INCOME

	2011	2010
Fees from other services to individuals	6,426	6,491
Fees from other services to companies	4,928	6,270
Fees from services to banks	1,995	1,544
Fees from issued guarantees	1,570	2,453
Total	**14,919**	**16,758**

9. NET INCOME ON FINANCIAL OPERATIONS

	2011	2010
Foreign exchange gain, net	5,437	3,005
Income from dividends	815	7
Net loss from sale of assets available for sale	(55)	-
Total	**6,197**	**3,012**

10. OTHER OPERATING INCOME

	2011	2010
Net income from sale of repossessed collaterals	8,783	75
Income from re-invoiced expenses to related parties	959	-
Income from insurance company	288	4,749
Net income from rent	205	293
Net income from unused accounts – individuals	10	148
Other income	817	609
Total	**11,062**	**5,874**

(all amounts are expressed in thousands of KM)

11. PERSONNEL EXPENSES

	2011	2010
Gross salaries	19,776	17,232
Other personnel expenses	2,017	1,784
Total	**21,793**	**19,016**

The average number of personnel employed by the Bank during the years ended 31 December 2011 and 2010 were 647 and 568, respectively.

12. GENERAL AND ADMINISTRATIVE EXPENSES

	2011	2010
Repairs and maintenance	7,121	2,665
Consulting and legal fees	6,215	2,217
Membership and other fees	4,486	5,750
Advertising, marketing and sponsorship	2,746	2,505
Loss on disposal of tangible and intangible assets	2,569	16
Rent	2,558	3,167
Utilities expenses	1,909	1,897
Telecommunication	1,736	988
Security expenses	1,631	1,953
Other taxes and contributions	1,083	268
Consumables	977	1,012
Insurance	441	733
Other expenses	790	809
Total	**34,262**	**23,980**

13. OTHER OPERATING EXPENSES

	2011	2010
Litigation losses	-	30
Total	**-**	**30**

14. IMPAIRMENT LOSSES AND PROVISIONS

	2011	2010
Loans and advances to customers (Note 19)	65,894	178,224
Financial commitments and contingencies (Note 28)	(496)	(234)
Other assets (Note 22)	-	469
Placements with other banks (Note 18)	126	(277)
Loans and receivables directly written off	1,786	-
Total	**67,310**	**178,182**

(all amounts are expressed in thousands of KM)

15. INCOME TAX

Tax liability is based on accounting income taking into the account non-deductible expenses and non-taxable income. Tax income rate for the years ended 31 December 2011 and 31 December 2010 was 10%.

Total tax recognised in income statement may be presented as follows:

	2011	2010
Current tax	-	-
Deferred tax	-	113
	-	**113**

Adjustment between income tax presented in tax balance and accounting income tax is presented as follows:

	2011	2010
Loss before income tax	**(40,639)**	**(138,784)**
Income tax at the rate of 10%	(4,064)	(13,878)
Effects of non-deductible expenses	81	452
Effects of non-taxable income	(81)	-
Effect of carry forwarded tax losses	(14,795)	(1,369)
Unrecognised deferred tax assets relating to losses incurred	**(18,859)**	**(14,795)**
Income tax expense	**-**	**-**

In accordance with the Income tax Law, the taxable losses may be carried forward for the next 5 years against the future profits. As of 31 December 2011, the Bank has not recognized a differed tax assets related to losses incurred in 2011 in the amount of KM 4,064 thousand and in 2010 in the amount of KM 13,426 thousand which if unutilized would expire in 2016 and 2015 respectively.

The movement in deferred tax may be presented as follows:

	31 December 2011	31 December 2010
Balance as at 1 January	**2,172**	**2,059**
Charge for the year	-	113
Balance as at 31 December	**2,172**	**2,172**

16. CASH AND DUE FROM BANKS

	31 December 2011	31 December 2010
Cash on clearing account at the Central Bank of Bosnia and Herzegovina	69,609	95,397
Current accounts with other foreign banks	40,459	18,739
Cash on hand	35,965	32,601
Checks	79	64
Total	**146,112**	**146,801**

(all amounts are expressed in thousands of KM)

17. OBLIGATORY RESERVE AT THE CENTRAL BANK OF BOSNIA AND HERZEGOVINA

	31 December 2011	31 December 2010
Minimum obligatory reserve with the Central Bank of Bosnia and Herzegovina	132,515	158,578
Total	**132,515**	**158,578**

Minimum obligatory reserve was calculated as a percentage of the average amount of total deposits and borrowings for each working day during 10 calendar days following the period of maintaining the obligatory reserve. The rates of minimum obligatory reserve were as follows:

- from 1 January 2010 to 31 January 2011 – 14% of total short-term deposits and borrowings and 7% of total long-term deposits and borrowings;
- from 1 February to 31 December 2011 – 10% of total short-term deposits and borrowings and 7% of total long-term deposits and borrowings.

Interest rate on funds kept up to minimum obligatory reserve range from 0.11% to 1.22% in 2010 and from 0.5% to 0.2% in 2011. Cash held at the obligatory reserve account with the Central Bank of Bosnia and Herzegovina is not available for daily operations without specific approval from the Central Bank of Bosnia and Herzegovina and the Banking Agency of the Federation of Bosnia and Herzegovina.

18. PLACEMENTS WITH OTHER BANKS

	31 December 2011	31 December 2010
Short term deposits with banks registered in:		
OECD countries	148,930	63,718
Other countries	6,845	1,589
Total gross deposits due from other banks	*155,775*	*65,307*
Less Allowance for impairment losses on placements	(137)	(120)
Total	**155,638**	**65,187**

As of 31 December 2011 and 2010, respectfully, the interest rates on placements with banks stated in EUR were 0.25% - 0.45% p.a and 0.10% - 0.70% p.a. and on placements stated in USD were 0.15% - 0.16% and 0.10% - 0.50% p.a.

The movements in the allowance for impairment losses are summarized as follows:

	2011	2010
Balance as of 1 January	**120**	**348**
Effects of change of accounting policy – release of allowance (Note 4)	(109)	-
Changes in allowance for impairment losses (Note 14)	126	(277)
Foreign exchange effects	-	49
Balance as of 31 December	**137**	**120**

(all amounts are expressed in thousands of KM)

19. LOANS AND ADVANCES TO CUSTOMERS

	31 December 2011	31 December 2010
Short-term loans:		
Current portion of long-term loans	233,147	420,539
Corporate	135,779	261,436
Retail	41,004	41,072
Total short-term loans	409,930	723,047
Long-term loans:		
Corporate	361,964	753,537
Retail	567,620	596,789
Less: current portion of long-term loans	(233,147)	(420,539)
Total long-term loans	696,437	929,787
Total loans and advances to customers before allowance for impairment losses	1,106,367	1,652,834
Less: allowance for impairment losses	(94,204)	(262,948)
Total	**1,012,163**	**1,389,886**

Loans to customers are made principally within Federation of Bosnia and Herzegovina. Movements in the allowance for impairment losses are summarized as follows:

	2011	2010
Balance as at 1 January	**262,948**	**123,179**
Effects of change of accounting policy – re-recognition of receivables previously written-off in full amount according to superseded FBA's decision (E category)	69,981	-
Effects of change of accounting policy – release of allowance (Note 4)	(127,435)	
Increase in allowances for impairment losses (Note 14)	65,894	178,224
Unwinding	(20,788)	-
"BRUSH" Project (Note 2)	(156,396)	-
Write-offs	-	(38,455)
Balance as at 31 December	**94,204**	**262,948**

An industry analysis of the portfolio of loans and advances to corporate customers before allowance for impairment losses comprises of:

	31 December 2011	31 December 2010
Trade	187,439	420,807
Construction	39,838	247,923
Tourism, hotels and restaurants	27,599	106,616
Manufacturing companies and industry	129,328	81,450
Other	113,407	158,177
Total	**497,611**	**1,014,973**

(all amounts are expressed in thousands of KM)

19. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

Weighted average loan interest rates are summarized as follows:

	31 December 2011	31 December 2010
Corporate	8.51%	8.81%
Retail	8.99%	9.21%

20. FINANCIAL ASSETS AVAILABLE FOR SALE

	31 December 2011	31 December 2010
Cenex Group d.j.l. Sarajevo	1,680	1,680
Visa Inc.	1,176	794
S.W.I.F.T SCRL	59	59
Uzajamni fond HYPO BH EQUITY	46	48
Kristal Konsalting A.D. Banja Luka	-	42
Fabrika duhana d.d. Sarajevo	-	16
Registry of Securities in the FBiH	43	25
Sarajevo Stock Exchange	30	-
Total	**3,034**	**2,664**

During 2011, the Bank recognized increase in revaluation reserves related to securities available for sale of KM 412 thousand, net. Total revaluation reserve related to securities available sale amounts to KM 11 thousand as of 31 December 2011.

21. INVESTMENTS IN SUBSIDIARIES

Investments in subsidiaries as of 31 December 2011 and 2010 are presented at cost.

	31 December 2011	31 December 2010
Hypo Alpe-Adria Invest d.o.o. Mostar	2,711	2,711
Hypo Alpe-Adria Vrijednosnice d.o.o. Sarajevo (Note 32)	-	1,000
Total	**2,711**	**3,711**

Name	Industry	Domicile	% held
Hypo Alpe-Adria Invest d.o.o.	Financial services	Bosnia and Herzegovina	100

(all amounts are expressed in thousands of KM)

22. OTHER ASSETS

	31 December 2011	31 December 2010
Receivables for sold repossessed collaterals	9,715	515
Receivables from Hypo Alpe-Adria Bank a.d. Banja Luka	5,242	-
Prepaid income tax	1,783	1,783
Repossessed collaterals held for sale	1,433	825
Card operations	1,293	2,124
Advances to suppliers	919	561
Receivables for dividends	810	-
Office supplies	447	358
Fee and commissions receivable	95	73
Other assets	2,165	1,186
Total other assets	*23,902*	*7,425*
Less: allowance for impairment losses	-	(1,419)
Total	**23,902**	**6,006**

The movements in allowance for impairment losses are summarized as follows:

	2011	2010
Balance as of 1 January	**1,419**	**1,201**
Effects of change of accounting policy – re-recognition of receivables previously written-off in full amount according to superseded FBA's decision (E category)	28	-
Effects of change of accounting policy – release of allowance (Note 4)	(1,447)	-
Increase in allowances (Note 14)	-	469
Write-offs	-	(251)
Balance as of 31 December	**-**	**1,419**

(all amounts are expressed in thousands of KM)

23. TANGIBLE AND INTANGIBLE ASSETS

	Land and buildings	Office equipment and vehicles	Construction in progress	Leasehold improvements	Software and other intangibles	Total
Cost value						
31 December 2009	**48,823**	**25,042**	**5,836**	**1,783**	**5,333**	**86,817**
Additions	34	-	10,260	3	-	10,297
Transfers from/to	393	960	(2,017)	343	321	-
Disposals	-	(2,635)	-	(11)	(163)	(2,809)
31 December 2010	**49,250**	**23,367**	**14,079**	**2,118**	**5,491**	**94,305**
Merge with Hypo Alpe-Adria Vrijednosnice d.o.o. (Note 32)	-	319	7	-	41	367
Additions	-	-	5,568	-	-	5,568
Transfers from/to	188	1,654	(18,045)	121	16,082	-
Disposals	-	(3,540)	-	(429)	(3,111)	(7,080)
31 December 2011	**49,438**	**21,800**	**1,609**	**1,810**	**18,503**	**93,160**
Accumulated depreciation						
31 December 2009	**2,345**	**13,393**	**-**	**1,078**	**3,417**	**20,233**
Charge for the year 2010	637	3,285	-	334	1,014	5,270
Disposals	-	(2,606)	-	(11)	(163)	(2,780)
31 December 2010	**2,982**	**14,072**	**-**	**1,401**	**4,268**	**22,723**
Merge with Hypo Alpe-Adria Vrijednosnice d.o.o. (Note 32)	-	165	-	-	25	190
Charge for the year 2011	1,037	2,938	-	283	2,126	6,384
Disposals	-	(3,455)	-	(429)	(551)	(4,435)
31 December 2011	**4,019**	**13,720**	**-**	**1,255**	**5,868**	**24,862**
Net book value: 31 December 2011	**45,419**	**8,080**	**1,609**	**555**	**12,635**	**68,298**
Net book value: 31 December 2010	**46,268**	**9,295**	**14,079**	**717**	**1,223**	**71,582**

Notes to the unconsolidated financial statements
for the year ended 31 December 2011
(all amounts are expressed in thousands of KM)

24. DUE TO OTHER BANKS

	31 December 2011	31 December 2010
Short-term deposits:		
In KM	5	1,381
In foreign currencies	2,388	1,137
Subtotal	*2,393*	*2,518*
Long-term deposits:		
In KM	-	13,900
In foreign currencies	246,763	598,822
subtotal	*246,763*	*612,722*
Total deposits from banks	*249,156*	*615,240*
Long term loan from foreign bank	66,854	68,701
Total	**316,010**	**683,941**

Long term deposits as of 31 December 2011 and 2010, respectively, may be presented as follows:

	31 December 2011	31 December 2010
Hypo Alpe-Adria Bank International AG, Klagenfurt (term deposits for a period over 5 years)	153,144	568,384
Hypo Alpe-Adria Bank International AG, Klagenfurt (Note 2)	74,161	-
Hypo Alpe-Adria Bank International AG, Klagenfurt (term deposits for a period from 3 to 5 years)	2,046	28,965
Hercegovačka banka d.d. Mostar (in provisional administration)	15,900	13,900
KIB Banka d.d. Velika Kladuša	1,512	1,473
Total	**246,763**	**612,722**

Interest rates on long-term deposits from other banks, ranged from EURIBOR+0.9% to EURIBOR+2.45% in 2011 and from EURIBOR+0.9% to EURIBOR+3.04% during 2010.

Long term deposits relate to deposits from Parent Company, Hypo Alpe-Adria Bank International AG, Klagenfurt, with the maturity for the period from one to three years, from three to five years and over five years.

(all amounts are expressed in thousands of KM)

25. DUE TO CUSTOMERS

	31 December 2011	31 December 2010
Demand deposits from		
Individuals:		
In KM	89,934	75,343
In foreign currencies	97,337	91,478
Subtotal	*187,271*	*166,821*
Companies:		
In KM	94,731	156,754
In foreign currencies	27,580	31,246
Subtotal	*122,311*	*188,000*
Total demand deposits	**309,582**	**354,821**
Term deposits from		
Individuals:		
In KM	89,701	80,214
In foreign currencies	360,105	328,942
Subtotal	*449,806*	*409,156*
Companies:		
In KM	33,284	53,306
In foreign currencies	91,431	102,060
Subtotal	*124,715*	*155,366*
Total term deposits	**574,521**	**564,522**
Total	**884,103**	**919,343**

Interest rates for long-term deposits were in the range from 0.10% to 6.75% per annum and from 0.75% to 8.00% per annum as of 31 December 2011 and 2010, respectively.

26. SUBORDINATED DEBT

	31. December 2011	31. December 2010
Hypo Alpe-Adria Bank International AG, Klagenfurt	65,000	65,000
Total	**65,000**	**65,000**

The subordinated debt from Hypo Alpe – Adria Bank International AG Klagenfurt as of 31 December 2011 is comprised of four long term deposits in total value of KM 65 million (EUR 33,234 thousand). As stated in contract, funds are deposited permanently from the day of payment, without defined repayment obligation.

Amount of KM 10 million (EUR 5,113 thousand) was deposited in July 2009. Interest rate is calculated based on 6 month EURIBOR + 10%.

Amount of KM 10 million (EUR 5,113 thousand) was deposited in June 2008. Interest rate is calculated based on 6 month EURIBOR + 6%.

Amount of KM 25 million (EUR 12,782 thousand) was deposited in September 2007. Interest rate is calculated based on 6 month EURIBOR + 2.63%.

Amount of KM 20 million (EUR 10,226 thousand) was deposited in July 2007. Interest rate is calculated based on 6 month EURIBOR + 2.63%.

As per approval from Federal Banking Agency, subordinated debt may be used as additional capital for regulatory purposes.

(all amounts are expressed in thousands of KM)

27. OTHER LIABILITIES

	31 December 2011	31 December 2010
Payments in transit	10,186	10,498
Accrued expenses	9,570	5,562
Transfer account – "BRUSH" Project (Note 2)	8,536	-
Restricted funds	3,745	410
Liabilities to employees for salaries	1,627	1,361
Other liabilities for employee benefits *	1,293	1,270
Liabilities to vendors	1,229	460
Accrued bonuses	974	969
Provision for restructuring *	604	1,067
Other tax liabilities	422	834
Membership and other fees	276	952
Liabilities for card operations	246	1,231
Difference in managed funds (Note 31)	244	20
Exercised guarantees	150	150
Provision for litigation losses *	30	30
Other liabilities	461	1,198
Total	**39,593**	**26,012**

Movement of provisions can be summarized as follows:

	Restructuring provision	Employee benefits	Legal provision	Total
Balance as at 31 December 2009	**1,556**	**1,253**	**317**	**3,126**
Increase	-	17	-	17
Release	(489)	-	(287)	(776)
Balance as at 31 December 2010	**1,067**	**1,270**	**30**	**2,367**
Increase	-	23	-	23
Release	(463)	-	-	(463)
Balance as at 31 December 2011 *	**604**	**1,293**	**30**	**1,927**

(all amounts are expressed in thousands of KM)

28. FINANCIAL COMMITMENTS AND CONTINGENCIES

	31 December 2011	31 December 2010
Unused loan facilities	98,643	97,490
Payment guarantees	36,618	39,130
Performance guarantees	9,505	10,338
Letters of credit	8,357	2,590
Total	**153,123**	**149,548**
Provision for financial commitments and contingencies	3,503	4,062

Movements in provision for financial commitments and contingencies may be summarized as follows:

	2011	2010
Balance as of 1 January	**4,062**	**4,239**
Effects of change of accounting policy – release of provision (Note 4)	(63)	
Release of provisions (Note 14)	(496)	(234)
Foreign exchange effects	-	57
Balance as of 31 December	**3,503**	**4,062**

29. RELATED-PARTY TRANSACTIONS

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

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

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

Notes to the unconsolidated financial statements
for the year ended 31 December 2011
(all amounts are expressed in thousands of KM)

29. RELATED-PARTY TRANSACTIONS (CONTINUED)

	31 December 2011	31 December 2010
Receivables		
Placements - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	10,746	11,055
Other - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	8,635	32
Other - Hypo Alpe-Adria-Bank A.D. Banja Luka	5,242	158
Placements - HYPO ALPE-ADRIA-BANK d.d., Zagreb	1,348	3,204
Other - HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	810	6
Placements - HYPO ALPE-ADRIA-BANK d.d., Ljubljana	244	321
Placements - HYPO ALPE-ADRIA-BANK S.P.A., Udine	143	190
Placements - HYPO ALPE-ADRIA-BANK AG, Klagenfurt	35	567
Other - HYPO ALPE-ADRIA-BANK A.D. PODGORICA	5	9
Other - HYPO ALPE-ADRIA-BANK AD BEOGRAD	3	4
Other - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	1	1
Total	**27,212**	**15,547**
Payables		
Deposits - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	156,711	598,818
Deposits - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt (Note 2)	74,161	-
Subordinated debt - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	65,000	65,000
Other - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	8,642	351
Deposits - HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	2,375	1,429
Deposits - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	1,471	3,269
Deposits - HYPO ALPE-ADRIA-BANK AG, Klagenfurt	676	716
Other - Hypo Alpe-Adria-Bank A.D. Banja Luka	273	68
Other - ZAJEDNICKI INFORMACIONI SISTEM d.o.o. BEOGRAD	144	118
Deposits - Hypo Alpe-Adria-Bank A.D. Banja Luka	99	100
Liabilities due to banks - HYPO ALPE-ADRIA-BANK d.d., Zagreb	89	72
Deposits - HYPO ALPE-ADRIA-BANK AD BEOGRAD	28	86
Deposits - HYPO ALPE-ADRIA-BANK A.D. PODGORICA	9	76
Other - HYPO ALPE-ADRIA-BANK AD BEOGRAD	7	4
Other - HYPO ALPE-ADRIA-BANK d.d., Zagreb	-	166
Deposits - Hypo Alpe-Adria-Vrijednosnice d.o.o. Sarajevo	-	2,075
Total	**309,685**	**672,348**

(all amounts are expressed in thousands of KM)

29. RELATED-PARTY TRANSACTIONS (CONTINUED)

	2011	2010
Income		
Other income - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	8,556	216
Other income - HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	810	
Other income - Hypo Alpe-Adria-Bank A.D. Banja Luka	338	88
Fee and Commission income - Hypo Alpe-Adria-Bank A.D. Banja Luka	90	-
Fee and Commission income - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	59	47
Interest income - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	13	35
Fee and Commission income - HYPO ALPE-ADRIA-BANK AG, Klagenfurt		17
Interest income - HYPO ALPE-ADRIA-BANK d.d., Zagreb	2	27
Interest income - HYPO ALPE-ADRIA-BANK S.P.A., Udine	1	31
Other income - Hypo Alpe-Adria-Vrijednosnice d.o.o. Sarajevo	-	57
Total	**9,869**	**518**
Expenses		
Interest expense - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	26,706	29,082
Administrative expenses - ZAJEDNICKI INFORMACIONI SISTEM d.o.o. BEOGRAD	6,012	8,552
Fee and commission expense - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	3,113	3,107
Administrative expenses - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	2,648	1,086
Administrative expense -HYPO ALPE-ADRIA-BANK d.d., Zagreb	665	734
Administrative expenses-Hypo Alpe-Adria-Bank A.D. Banja Luka	182	-
Fee and commission expense - Hypo Alpe-Adria-Bank A.D. Banja Luka	159	181
Interest expense - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	83	3,201
Administrative expenses - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	76	81
Interest expense -HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	30	28
Fee and commission expense - HYPO ALPE-ADRIA-NEKRETNINE d.o.o., Zagreb	16	-
Interest expense -Hypo Alpe-Adria-Vrijednosnice d.o.o. Sarajevo	-	65
Fee and commission expense - HYPO ALPE-ADRIA-BANK d.d., Zagreb	-	21
Fee and commission expense - HYPO ALPE-ADRIA-BANK S.P.A., Udine	-	4
Interest expense - Hypo Alpe-Adria-Bank A.D. Banja Luka	-	7
Total	**39,690**	**46,149**

All of the transactions stated above have been made under arm's-length commercial banking conditions.

(all amounts are expressed in thousands of KM)

29. RELATED-PARTY TRANSACTIONS (CONTINUED)

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

	2011	2010
Compensations for the Management and Supervisory Board	210	442
Taxes and contributions on compensations	165	265
Bonuses and other benefits	153	-
Taxes on bonuses and other benefits	121	-
Total	**649**	**707**

30. ESTIMATED FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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. If available, the 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.

It is the opinion of the Management of the Bank that the fair value of the Bank financial assets and liabilities are not materially different from the amounts stated in the balance sheets as at 31 December 2011 and 31 December 2010. In estimating the fair value of the Bank's financial instruments, the following methods and assumptions were used.

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

- The fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices.
- The fair values of other financial assets and financial liabilities are determined in accordance with generally accepted pricing models based on discounted cash flows analysis using prices from observable current market transactions and dealer quotes for similar instruments.

Analyses of financial instruments that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 as follows:

Level 1 – fair value measurements for those derived from quoted prices in active market;

Level 2 – fair value measurements for those derived from inputs other than quoted prices included in level 1;

Level 3 – fair value measurements for those derived from valuation techniques that are not based on observable market data.

As of 31 December 2011 and 2010, the Bank's financial instruments related to Level 1 such as available-for-sale assets amounting to KM 3,034 thousand and KM 2,664 thousand, respectively. The Bank has no level 2 and 3 financial instruments as of 31 December 2011 and 2010, respectively.
For loans and receivables, as described in Note 4, the Bank assessed indicators for impairment by applying International Accounting Standard 39.

(all amounts are expressed in thousands of KM)

31. MANAGED FUNDS

The Bank manages assets on behalf of third parties. These assets are recorded separately from the Bank's assets. For its services, the Bank charges a fee amounting to 1% of the total amount contributed.

	31 December 2011	31 December 2010
Assets		
State institutions	472	824
Total	**472**	**824**
Liabilities		
Loans to citizens	7	20
Legal entities	709	824
Total	**716**	**844**
Differences (Note 27)	**244**	**20**

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

32. BUSINESS COMBINATION WITH HYPO ALPE-ADRIA VRIJEDNOSNICE D.O.O. SARAJEVO

Based on decision of the Supervisory Board of the Bank dated 30 December 2010, the wholly-owned subsidiary – Hypo Alpe-Adria Vrijednosnice d.o.o. Sarajevo has been merged into the Bank starting from 1 February 2011. As of that date, the Bank has introduced assets and liabilities from the merged subsidiary in its accounting records.

	1 February 2011
ASSETS	
Trade and other receivables	8
Advances paid	3
Investments	46
Tangible and intangible assets	177
Cash and cash equivalents	2,045
TOTAL ASSETS	**2,279**
LIABILITIES	
Trade payables	12
Other liabilities	1
Provision	14
TOTAL LIABILITIES	**27**
EQUITY	
Owner's equity	1,000
Retained earnings	1,280
Loss for the period ended 31 January 2011	(28)
TOTAL EQUITY	**2,252**
TOTAL EQUITY AND LIABILITIES	**2,279**

(all amounts are expressed in thousands of KM)

32. BUSINESS COMBINATION WITH HYPO ALPE-ADRIA VRIJEDNOSNICE D.O.O. SARAJEVO (CONTINUED)

Registered amount of the owner's equity of Hypo Alpe-Adria Vrijednosnice d.o.o. Sarajevo was KM 1,000 thousand. On 1 February 2011, the Bank has recorded the effect of the merger of Hypo Alpe-Adria Vrijednosnice d.o.o. Sarajevo as retained earnings of KM 1,280 thousand:

Elimination of the owner's equity of Hypo Alpe-Adria Vrijednosnice d.o.o. Sarajevo	1,000
Elimination of investment in subsidiary in the Bank	(1,000)
Booking of accumulated gain of Hypo Alpe-Adria Vrijednosnice d.o.o. Sarajevo	1,280
	1,280

As of 27 January 2011, the Bank obtained approval from the Security Commission for dealing with brokerage service, effective from 1 February 2011.

33. MARKET RISK

Market risks consist of potential losses due to a change in market prices. The Bank classifies market price risks according to the risk factors in changes to interest rates, credit spread, currency, volatility and share price risks, as well as risks from alternative investments.

Market price risks may result from securities (and products similar to securities), money and foreign currency products, derivatives, currency exchange and results hedging, assets similar to equity or from management of assets and liabilities.

Besides market risks, market liquidity risks may also be incurred if, in the event of low market demand, the Bank is unable to liquidate trading positions during liquidity shortfalls (or due to risk-based offsetting requirements) in the short term. For existing positions, these are taken into account as part of the risk limitations for market risks.

General Requirements

The Bank develops its market risk strategy on the basis of strategic discussions between the treasury units in charge and Risk controlling. Decisions on combined business and risk strategies are only made in the Asset-Liability Committee (ALCO).

As part of the daily reporting procedure, the Management board receives value-at-risk and performance figures for trading transactions on a daily basis and figures on banking book investments and market risk steering on a weekly basis.

There is also a daily report to the Management board in which the key risk and performance figures of the subsidiaries are communicated. In these, the value-at-risk at the subsidiary level is compared to the defined limits. Limit breaches initiate defined escalation processes up to Management board level.

The subsidiaries of Hypo Alpe-Adria Group („HGAA") calculate risk as per HGAA specifications for the respective portfolios. The results are presented to the Management board as part of ongoing reporting for HGAA. This is also applicable for the Bank, as a subsidiary of HGAA.

33. MARKET RISK (CONTINUED)

Risk Measurement

The Bank calculates its market risk as part of daily monitoring with value-at-risk methods on the basis of a one-day holding period, with a confidence level of 99% in full accordance to group standards. The main instrument used in this process is the Monte Carlo simulation with an exponentially weighted history of 250 days.

For the purpose of determining risk capital requirements for the risk bearing capacity calculation, values are scaled to the uniform confidence level of 99.895%, assuming liquidation over a time period of 126 days.

The models calculate potential losses taking into account historic market fluctuations (volatilities) and market context (correlations).

The reliability of market risk measurement methods is regularly examined with regard to the quality of individual risk methods. As part of back testing, the risk forecast is compared with the result (profit or loss). In accordance with the Basel 'traffic light' approach, the forecast quality of the risk model is appropriate.

While the VaR that is determined for monitoring requirements is used to forecast potential losses under normal market conditions, future-oriented analyses using extreme assumptions are also carried out. Market positions are subjected to exceptional market price changes, crisis situations and worst case scenarios as part of so-called "stress tests", and analyzed for hazardous risk potentials using the simulated results.

The stress scenarios are monitored for appropriateness and adjusted if required.

The Bank does not currently use its own internal risk models for regulatory purposes. Instead, it uses the standard Group method.

Risk Mitigation

In accordance with the new risk strategy from the Group, which is effective as of August 2010, a limit of 10% of risk capital has been set for market risk. The amount of risk capital set represents the maximum loss that may be incurred for absorbing market risk. Market risk capital is distributed over individual market risk factors (interest rate, currency, shares, credit spread, volatility and alternative investments) by setting risk factor limits. Risk factor limits are also further defined and differentiated through defined partial portfolios.
In addition a limit system also provides support through defined warning levels, which show negative developments early on.

Risk Control and Monitoring

All market risks are centrally monitored by Risk Control, which is independent of all trading activities. In addition to regulatory requirements, this unit also ensures risk transparency and regular reporting to the Management Board member responsible for this area. The Management Board also receives a separate monthly report on the actual market risk situation as well as on back testing and stress test results with a commentary on potentially significant developments.

The control of interest rate risk is carried out on an institutionalized basis in compliance with the regulatory requirements related to interest rate risk statistics. The Asset Liability Committee, which consists of the Management Board as well as key staff in Treasury, Risk Control and Financial Control, meets on a regular basis to analyze and decide on measures related to balance sheet structure and liquidity control.

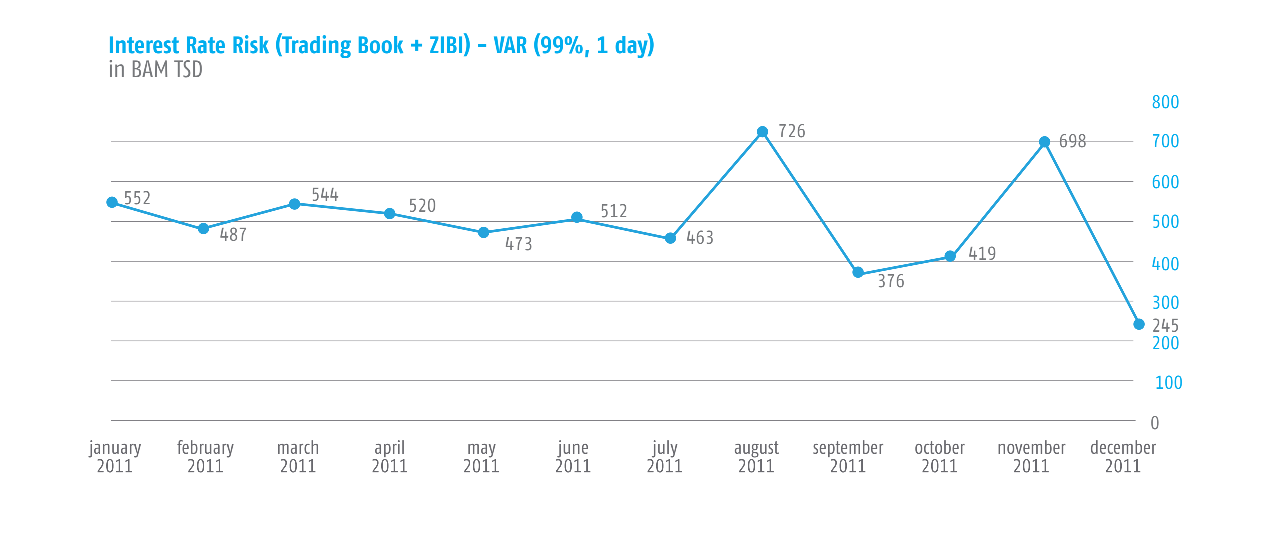
33. MARKET RISK (CONTINUED)

Market Risk Overview

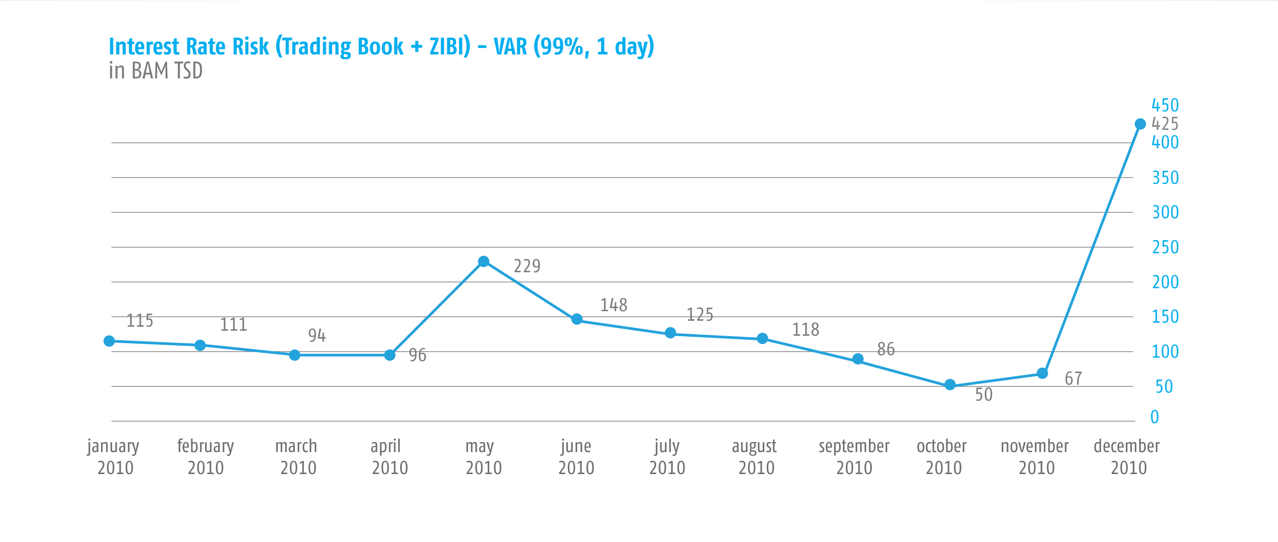
The table shows the progression of interest rate risk (including the interest rate risk of the trading book) for the Bank in 2011.

The graph shows the interest rate change risk for the Bank at overall Bank level (trading book and banking book).

Interest Rate Risk (Trading Book + Bank Book) – 2011



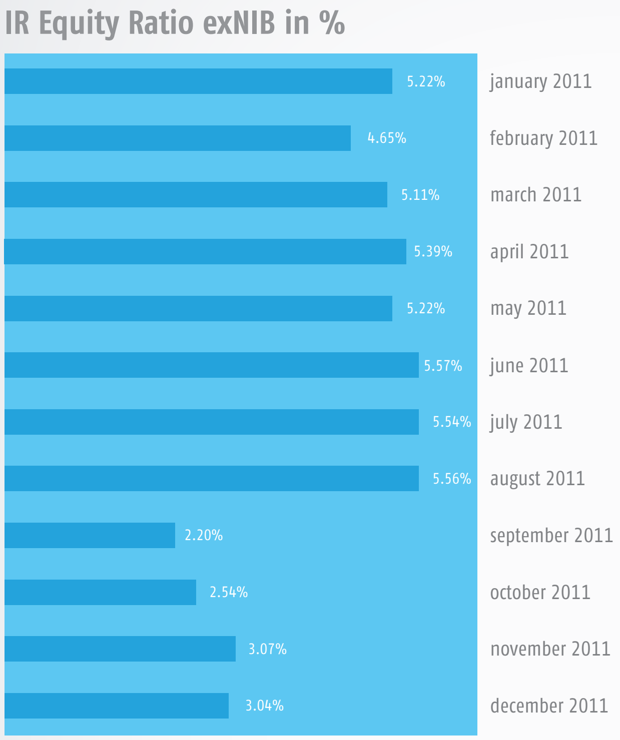
Interest Rate Risk (Trading Book + Bank Book) – 2010



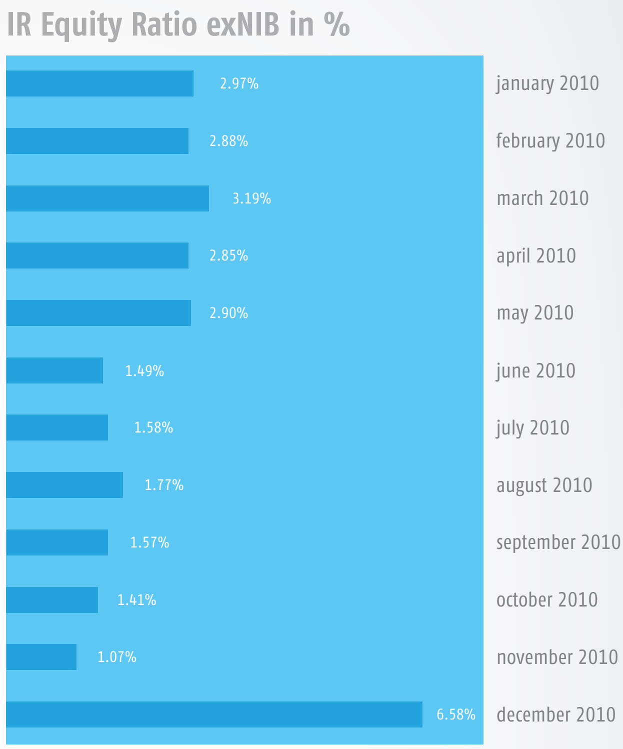
The methodology of the interest risk calculation is oriented to the specifications of the Austrian National Bank (Oesterreichische Nationalbank - OeNB) regarding the calculation of interest risk statistics.

33. MARKET RISK (CONTINUED)

Interest Risk to Equity Ratio in %



2011

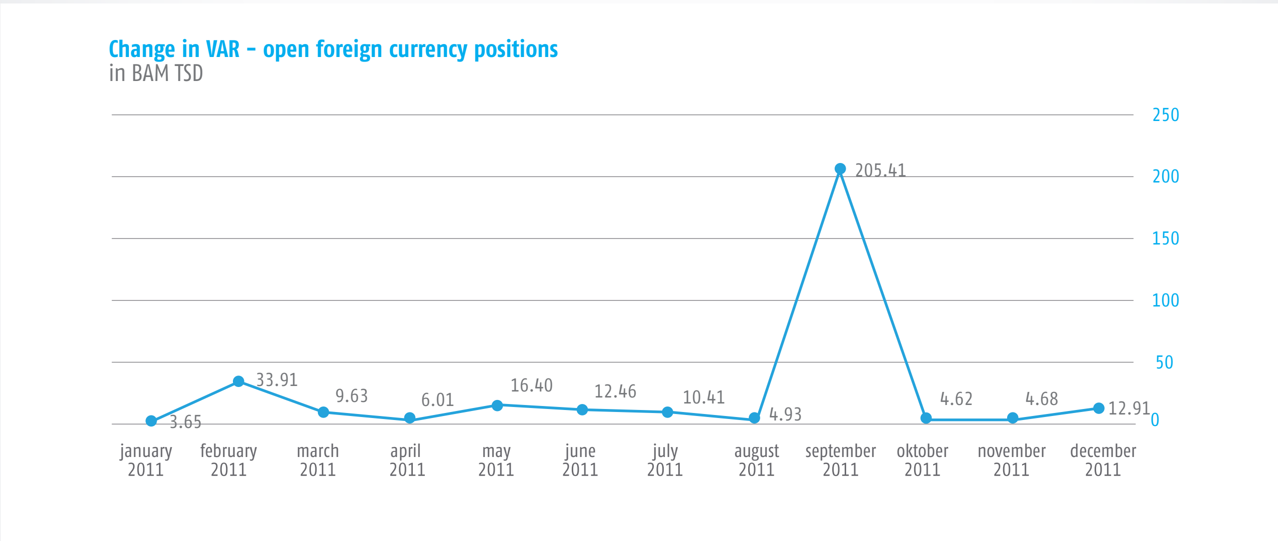


2010

The data basis for determining the value-at-risk for open foreign currency positions at the Bank level is based on the figures of the OeNB report and contains operational business activities.

The value-at-risk for this foreign currency risk was approximately KM 12,910 thousand (EUR 6,600 thousand) as of 31 December 2011, at a confidence interval of 99%.

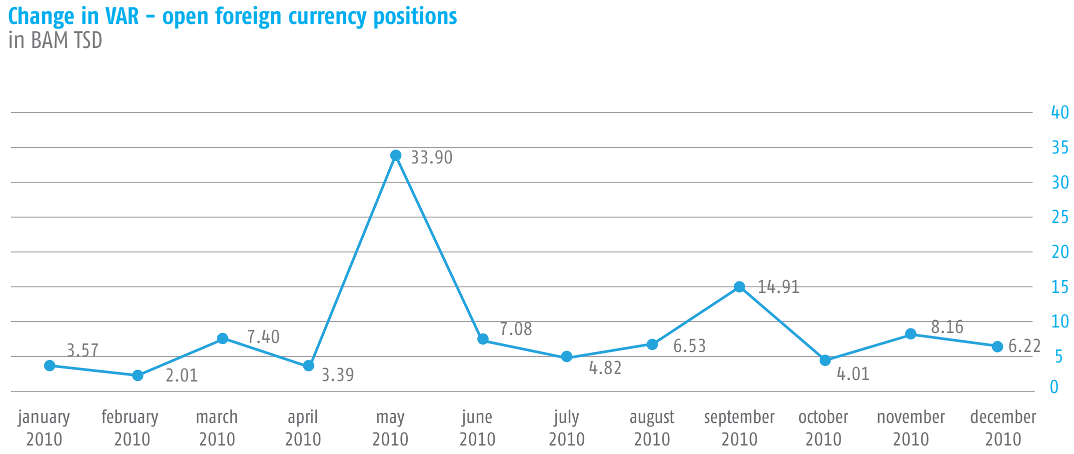
Change in VAR – open foreign currency positions – 2011



(all amounts are expressed in thousands of KM)

33. MARKET RISK (CONTINUED)

Change in VAR – open foreign currency positions – 2010



34. FOREIGN CURRENCY BALANCE SHEET AND FOREIGN CURRENCY RISK

The Bank undertakes certain transactions denominated in foreign currencies. Hence, exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilizing forward foreign exchange contracts. The carrying amounts of the Bank's foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Assets		Liabilities	
	2011	2010	2011	2010
EUR	112,062	48,102	654,287	810,729
USD	45,385	42,041	46,025	41,561
CHF	51,602	7,951	162,756	369,513
Other currencies	5,151	5,183	4,518	4,291

(all amounts are expressed in thousands of KM)

34. FOREIGN CURRENCY BALANCE SHEET AND FOREIGN CURRENCY RISK (CONTINUED)

The structure of balance sheet as per foreign currencies can be presented as follows:

	KM	EUR	USD	CHF	Other currencies	Total
ASSETS						
Cash and due from banks	91,205	34,333	4,128	11,329	5,117	146,112
Obligatory reserve	132,515	-	-	-	-	132,515
Placements with other banks	-	75,398	40,037	40,203	-	155,638
Loans and advances to customers	1,009,890	2,272	1	-	-	1,012,163
Assets available for sale	1,800	59	1,175	-	-	3,034
Other financial assets	23,754	-	44	70	34	23,902
Total financial Assets (1)	**1,259,164**	**112,062**	**45,385**	**51,602**	**5,151**	**1,473,364**
LIABILITIES						
Due to other banks	25,540	137,850	1,512	151,100	8	316,010
Due to customers	315,383	515,342	44,464	4,404	4,510	884,103
Subordinated debt	65,000	-	-	-	-	65,000
Other financial liabilities	29,913	1,095	49	8,536	-	39,593
Total financial Liabilities (2)	**435,836**	**654,287**	**46,025**	**164,040**	**4,518**	**1,304,706**
Balance gap as at 31 December 2011 (1) - (2)	**823,328**	**(542,225)**	**(640)**	**(112,438)**	**633**	**168,658**
Total assets as of 31 December 2010 (3)	**1,665,845**	**48,102**	**42,041**	**7,951**	**5,183**	**1,769,122**
Total liabilities as of 31 December 2010 (4)	**468,202**	**810,729**	**41,561**	**369,513**	**4,291**	**1,694,296**
Balance gap as at 31 December 2010 (3) – (4)	**1,197,643**	**(762,627)**	**480**	**(361,562)**	**892**	**74,826**

35. LIQUIDITY RISK

The Bank defines liquidity risk as the risk of not being able to meet due payment obligations on time or, in full amount; or – in the event of a liquidity crisis – only being able to procure refinancing at increased market rates, or only being able to sell assets at a discount to market prices.

General Requirements

The strategic principles of handling liquidity risks at the Bank are defined in the risk strategy. The overriding objective of liquidity risk management and controlling is to ensure that the Bank maintains its capacity to make payments and undertake refinancing activities at any time. The content-related and organizational conditions for the management and controlling of liquidity risks are governed by a liquidity manual which applies across the entire HGAA.

In the Bank, liquidity steering and management are the responsibility of the Treasury function. The Treasury unit is responsible for operational liquidity steering and liquidity off-sets. Liquidity risk controlling is the responsibility of the Risk Controlling of the Bank. Risk measurement, limitation as well as timely and consistent reporting are carried out.

The Bank has adopted emergency liquidity planning which has been set out in written form. It sets out the processes and control or hedging instruments which are required to avert imminent or tackle acute crises. In the event of a liquidity crisis, the priorities of the Bank are to rigorously maintain the capacity to pay and to prevent damage to the Bank's reputation.

35. LIQUIDITY RISK (CONTINUED)

Risk Measurement

The main methodological tool for measuring, analyzing, monitoring and reporting on liquidity risk within the Bank is the liquidity overview. It is used to illustrate liquidity gaps resulting from deterministic and modeled future payment flows and the realizable liquidity coverage potential in firmly defined time frames.

The liquidity potential quantifies the capacity of the Bank – in amounts and dates – to procure liquid funds at the earliest opportunity and at cost-effective terms and conditions. It highlights possibilities regarding the coverage of liquidity gaps and hence all liquidity risks related to payment flows.

The most important components of liquidity potential are as follows:

- free access to Central bank and interbank funds;
- other available and eligible securities;
- issue potential in cover register;
- senior bond issues;
- committed lines of parent company, as well as;
- securitization potential.

In addition to the normal scenario, other scenario analyses under stress conditions, such as name crises (rating deterioration, reputation risks) as well as market crises (restrictive funding options on capital markets, increased cash flow outflow as well as transfer limits), supplement the risk measurement spectrum.

On the basis of the liquidity overviews, key indicators are determined for the different scenarios, which allow a compact assessment of the liquidity situation. Liquidity ratios (showing tightest liquidity position) and "time-to-wall" key figures (showing maximum liquidity time horizon) for up to one year are calculated to evaluate the liquidity situation – although particular importance is attached to the utilization over the first 4 weeks.

For the purpose of limiting structural liquidity, cash value losses in the event of an increase in the funding spread due to a rating deterioration are compared in the risk-bearing capacity calculation to the economic equity.

Risk Control

A bundle of different liquidity reserves ensures that the Bank maintains its ability to pay even during crisis situations. They are subjected to different stresses in order to maintain an overview of available liquidity resources through the respective units even during crisis situations. Moreover, the Bank holds its own liquidity buffer for stress situations, composed of securities eligible in accordance with requirements of the European Central Bank (ECB) and/or securities that can be quickly liquidated as well as guaranteed interbank credit facilities.

A cash flow statement composed of deterministic, stochastic and forecast data forms the basis of this process. Short term forecast data is elicited directly from client transactions by the operating units for the purposes of short-term control, while planned budget information is used for medium-term control.

Any occurring gaps are compared to the liquidity potential – a well-diversified bundle of liquidity reserves available for liquidity management. The liquidity reserves are subjected to a regular review and stresses, depending on the market situation (as described above).

Except the structure, controlling department focuses on meeting the minimum reserve as well as 1st and 2nd grade liquidity reserves.

35. LIQUIDITY RISK (CONTINUED)

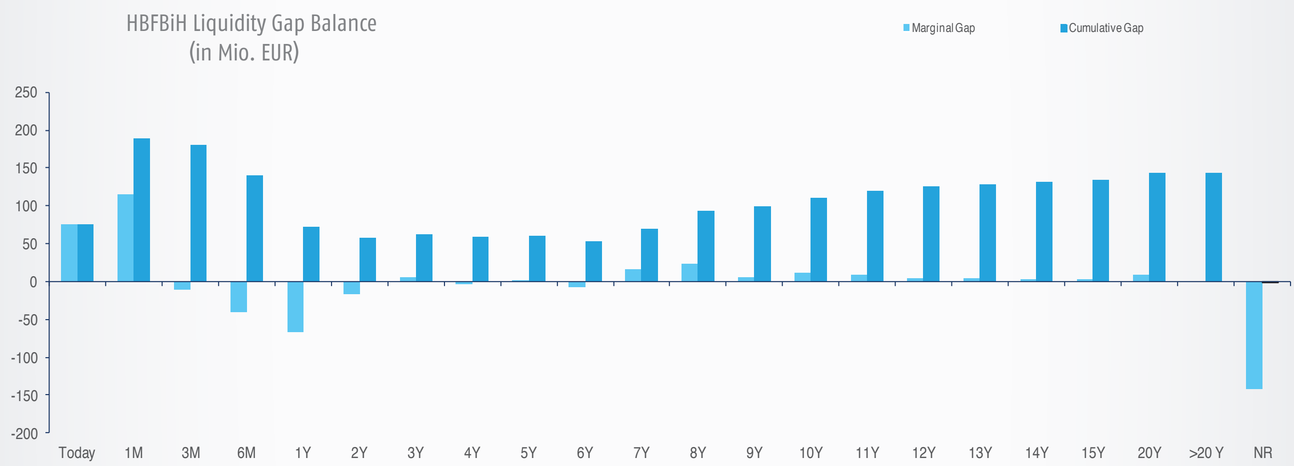
Risk Monitoring

The monitoring of liquidity risk is carried out, on the one hand, on the basis of the liquidity ratio and "time-to-wall" key indicators (maximum liquidity time horizon) under normal and stress conditions, and on the other hand, through the integration of the structural liquidity risk into overall bank control (risk-bearing capacity).

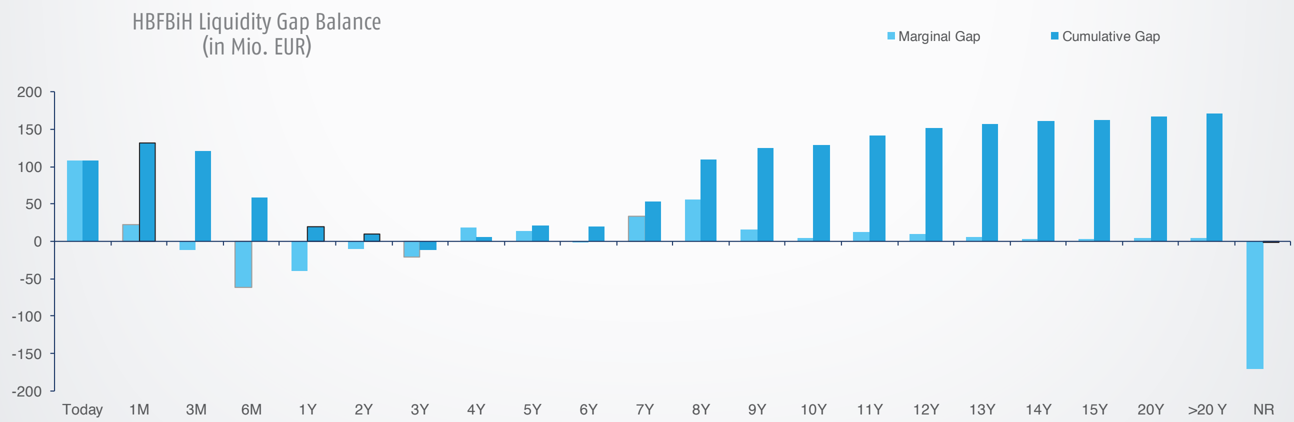
Limits for short-term liquidity as well as for the limitation of long-term structural liquidity have been set, both at Group level and for the individual subsidiaries, and are monitored constantly. To ensure that existing liquidity gaps can be closed at any time through the mobilization of the liquidity potential, threshold values are being defined for all scenarios and if these are exceeded, measures must be introduced to reduce the identified liquidity risks.

The liquidity overviews as well as other relevant key indicators form a part of regular risk reports to the Management board and the controlling units responsibile for liquidity risk.

Cumulative and marginal liquidity gap overview per time bucket – 2011



Cumulative and marginal liquidity gap overview per time bucket – 2010



(all amounts are expressed in thousands of KM)

35. LIQUIDITY RISK (CONTINUED)

The Bank has access to sources of financing for liquidity issue in total amount of KM 203,406 thousand at the balance sheet date (2010: KM 287,507 thousand). The Bank expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets. The Bank expects to maintain its debt to capital ratio. Solvency indicators were as follows:

	31 December 2011	31 December 2010
Debt (i)	1,200,113	1,603,284
Equity (ii)	303,336	213,229
%	**3.96**	**7.52**

Debt (i) is defined as due to banks and due to customers presented in detail in notes 24 and 25. Capital (ii) includes total capital, Bank's reserves and subordinated debt.

The adequacy of capital and its use is monitored by the Board of Directors using techniques based on the Decisions of the Banking Agency of the Federation of Bosnia and Herzegovina ("the Regulator"). Information is supplied to the Regulator on a quarterly basis. The Regulator places the following demands on all banks:

1. Minimum ownership capital of KM 15 million.
2. Maintaining capital adequacy ("Basel Indicator") at the legally required minimum of 12%. As of 31 December 2011 the adequacy of the Bank's capital amounts to 14.4% (2010: 13%).

36. CREDIT RISK

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

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. The lending limits are annually reviewed and approved by Assets and Liabilities Committee.

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

The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Bank's maximum exposure to credit risk without taking account of the value of any collateral obtained.

The Bank does not have any significant credit risk exposure to any single counterparty. The Bank defines counterparties as having similar characteristics if they are related entities.

(all amounts are expressed in thousands of KM)

36. CREDIT RISK (CONTINUED)

The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Bank's maximum exposure to credit risk without taking account of the value of any collateral obtained.

Financial Assets

31 December 2011	Total gross carrying amount	Unimpaired assets	Individually impaired assets	Allowance for impairment losses	Total net carrying amount
Cash and due from other banks including obligatory reserves with CBBiH	278,627	278,627	-	-	278,627
Placements with other banks	155,775	-	155,775	(137)	155,638
Loans and advances to customers	1,106,367	771,332	335,035	(94,204)	1,012,163
Financial assets available for sale	3,033	3,033	-	-	3,033
Total	**1,543,802**	**1,052,992**	**490,810**	**(94,341)**	**1,449,461**
31 December 2010					
Cash and due from other banks including obligatory reserves with CBBiH	305,379	305,379	-	-	305,379
Placements with other banks	65,164	-	65,307	(120)	65,187
Loans and advances to customers	1,652,834	807,774	845,060	(262,948)	1,389,886
Financial assets available for sale	2,664	2,664	-	-	2,664
Total	**2,026,041**	**1,115,817**	**910,367**	**(263,068)**	**1,763,116**

(all amounts are expressed in thousands of KM)

36. CREDIT RISK (CONTINUED)

Loan exposure and collaterals

The Bank estimates the fair value of collateral based on recoverable amount of collateral in case that collateral needs to be liquidated under the current market conditions. Different types of collateral bear different level of risks for the Bank.

	Maximum loan exposure		Fair value of collateral	
Description	Net exposure	Liabilities/issued guarantees	Allowed sale/ new collateral	Not allowed sale/ new collateral
31 December 2011				
Cash and due from banks including obligatory reserves with CBBiH	278,627	-	-	-
Placements with other banks	155,638	-	-	-
Loans and advances to customers	1,012,163	153,123	1,101,518	-
Financial assets available for sale	3,033	-	-	-
31 December 2010				
Cash and due from banks including obligatory reserves with CBBiH	305,379	-	-	-
Placements with other banks	65,187	-	-	-
Loans and advances to customers	1,389,886	149,548	1,250,204	-
Financial assets available for sale	2,664	-	-	-

37. BASIC LOSS PER SHARE

Basic loss per share is calculated by dividing the net loss attributable to ordinary shareholders by weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Bank and held as treasury shares. For the purpose of calculating basic earnings per share, preferred shares are considered as ordinary shares as they do not bear preferential dividend right.

	2011	2010
Loss attributable to ordinary shareholders (KM '000)	(40,639)	(138,671)
Weighted average number of regular shares outstanding	482,500	482,500
Basic loss per share (KM)	(84.23)	(287.40)

Diluted earnings per share are not presented, as the Bank has not issued dilutive or ant dilutive equity instruments.

38. EVENTS AFTER THE REPORTING PERIOD

Increase of share capital

In order to strengthen the Bank's equity position, the Management of Hypo Alpe-Adria-Bank International AG made a decision on shareholders' equity increase of the Bank for KM 40 million. The increase of Bank's shareholders' equity was realized through increase of share capital for KM 20 million and increase of capital reserves for KM 20 million.

Based on Assembly decision as of 6 March 2012, Hypo Alpe-Adria-Bank International AG, Klagenfurt increased the shareholders' equity of the Bank through an increase in reserves of KM 20 million. For that purpose the Bank did not issue additional shares.

On 10 May 2012 the majority owner of the Bank, Hypo Alpe-Adria-Bank International AG, Klagenfurt, paid in KM 20 million in the Bank's share capital and the transaction was register with the Registry of Securities of the Federation of Bosnia and Herzegovina on 23 May 2012.

Changes within the Board of Directors

As of 9 March 2012, Mr. Alexander Picker was appointed as a new Chief Executive Officer of the Bank, replacing Mr. Michel Vogt.

As of 26 June 2012, Mr. Dmytro Kolechko, was appointed as a new Executive Director.

Regulatory requirements

With regard to the change of accounting policy as described in Note 4, on 29 March 2012, FBA issued an instruction requesting the banks that if the difference, between the allowance for impairment losses on financial assets and provisions according to the new accounting policy described in Note 4 of this report, at the level of individual contracts is less than the level of allowance for impairment losses on financial assets and provisions that would have been determined if the matrix system had been applied, then such difference should be recognized as regulatory reserves within retained earnings.

On 5 July 2012 FBA defined dynamics of allocation to the regulatory reserves in the following manner:

- as of June 30 2012 at least one quarter (1/4) of the total amount of identified difference at the reporting difference;
- as of 30 September 2012 at least one-half (1/2) of the total amount of identified difference at the reporting difference;
- as of 31 December 2012 at least three-quarters (3/4) of the total amount of identified difference at the reporting difference;
- as of 31 March 2013 the total amount of identified difference at the reporting difference.

Brush Project

As disclosed in Note 2, on 19 July 2012, the Banking Agency of the Federation of Bosnia and Herzegovina issued approval to the Bank to transfer the contracted deposits of Hypo Alpe-Adria-Bank International AG in the amount of 367,951 thousand KM. In accordance with the approval, the Bank adopted amendments to the existing Agreement and other supporting documents in August 2012.

39. APPROVAL OF THE FINANCIAL STATEMENTS

These unconsolidated financial statements were approved by the Management Board on 31 August 2012.

Signed on behalf of the Management Board:

Alexander Picker
Chief Executive Officer

Dragan Kovačević
Executive Director

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