BANK

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

Annual Report 2012

Hypo Alpe-Adria-Bank a.d Banja Luka

Bosnia and Herzegovina

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Mission

Working in a partnership relation with citizens, local communities, small and medium enterprises, businesses and public institutions, we are providing a wide range of financial services and products, which are simple, creative and modern. Our main objective is to bring the best result for our approx. 200 thousand clients.

- Success for all: for our customers, shareholders and employees
- Responsible banking: ethical and transparent business and consistent application of laws and international standards

Letter from the Management Board

Dear shareholders and clients,

Despite all the challenges the financial industry has faced in the past couple of years across Europe, especially in our region, our Bank is still in good shape and well positioned for the future. Admittedly, our result in 2012 was not as good as it was a year earlier.

We made a net profit of BAM 7,8 million (BAM 9,49 million before taxes). The Bank's assets amounted to BAM 1,399 billion, while the total deposits amounted to BAM 935,4 million. Total loans of the Bank were at the level of BAM 1.01 billion. Our total capital amounted to BAM 242 million and is the best proof of the commitment of our owner for developing a long-term stable and respectable financial institution in the Republic of Srpska.

The growth of card operations and e-services, SMS and e-banking, has also continued, resulting in an increase in non-interest bearing income in the amount of 14,2 percents.

We have continued with the restructuring process that has lasted for more than two years now. That process has been aimed at making the system more efficient and functional on the whole. We have continued working on restructuring the loan portfolio, on resolving the issue of non-performing loans, and cutting expenses. We have worked on increasing our non-interest bearing income, improving our business processes and in doing so we have applied the international accounting standards both in the domain of credit and operational risk.

We remained focused on doing business with citizens, small and medium-sized enterprises and entrepreneurs as well as with public institutions. We were active in the lending business also in 2012. However, we still kept to the principle of strict treatment of risks when granting new loans and looking for creditworthy clients that can offer quality security instruments. We have kept the high level of citizens'savings and domestic legal entities' deposits as the primary local source of financing.

In the first half-year we successfully completed the project of adjusting the bank's business operations with the new RS Law on Banks, mostly in the domain of protecting our borrowers. Internal and external control findings show that the bank's business operations have been aligned with the provisions of the new Law.

We have started several projects and initiatives. Service Quality is one of them. Proactive communication toward our clients and their opinion and feedback is very important to us. That is why in 2012 we established the Contact Center. By setting up the Contact Center we provided a full communication support to our clients as regards services, products and all other issues in the client-bank relation.

„Partnership Banking“ was also one of our initiatives in 2012, which was carried out in direct cooperation with our COR/PUB clients. „Advisory Banking“ is another new approach in the communication with clients launched in 2012. It is essential to us to create a partnership relation between the client and his/her personal banker to mutual benefit.

We keep up with modern IT technology

The crown of our hard work and vision for the future was the successful introduction of the new IT system TEMENOS T24+. The setup of the new IT system aimed at optimizing the business processes, ensuring faster banking transactions and better monitoring of the extensive banking database. This valuable investment was thus successfully realized to the satisfaction of both the bank and its customers.

Stable and responsible banking

As a member of Hypo Alpe Adria, Hypo Bank Banja Luka consistently applies local regulations, regulatory rules of the Republic of Srpska Banking Agency, as well as international accounting standards and the International Financial Reporting Standards. The Supervisory Board and Management Board of the Bank are paying much attention to the internal audit and internal control system. Each control of local regulators and the external auditor is taken very seriously and execution of their orders is closely monitered.

What do we want our bank to look like in the future

First and foremost, we wish to see our bank make risk-adjusted income exceeding the capital price costs. We want to see our bank become well-recognized in a couple of years for having made smart decisions in difficult times. In that way we will develop a culture of responsibility and we will evaluate ourselves, our staff, upon decisions that we make and results that we achieve, and vice versa.

We want to convince our shareholders and our clients that we are still a strong and safe institution, worth their attention and investment. That is why we need good results.

We will achieve all of this if we are able to continue implementing the started plans and strategies. What makes a bank successful are: return on assets, return on equity and operating efficiency. Our team, and we as the Management Board members, are directly responsible for achieving this. We are continuing with our cost savings policy. Our business success will depend to a large extent on whether we will invest our resources in the right places, whether we will be able to recognize and support good projects, and whether we will be able to do all that at the right time. The future is telling us to prepare for a double role: the one leading and the one following its customers.

Conclusion

We had another good business year, but also a year in which we have learned that certain things could be and need to be improved, and that our business operations could be much better.

The Management Board of the Bank wishes to thank the employees for their hard work. Thanks to their dedication to work and loyalty, our bank was able to remain profitable in the crisis period. We wish to express our gratitude to our clients, in particular our depositors, for their unwavering support and great confidence in us. We also wish to thank the Supervisory Board for their support, their trust and precious guidance.

We especially wish to thank our Group, Hypo Alpe Adria, for their huge support and the trust they have given us. Thanks to their unreserved support we managed to smoothly, and safely, service the needs of approx. 200 thousand our clients.

Change in the composition of the Management Board

In 2012 the composition of the Bank's Management Board changed. Samuel Vlčan, former director of the Bank, left. Goran Babić, a former executive director, was appointed the new director. Lidija Žigić, Herbert Walzhofer and Martin Leberle joined the Management Board of the Bank by assuming the new duties as executive directors.

Management Board Hypo-Alpe-Adria-Bank a.d. Banja Luka

Martin Leberle	Herbert Walzhofer	Lidija Žigić	Goran Babić
Executive Director	Executive Director	Executive Director	Director

Management Board of Hypo Alpe-Adria-Bank a.d. Banja Luka

Goran Babić
Director

Lidija Žigić
Executive Director

Herbert Walzhofer
Executive Director

Martin Leberle
Executive Director

Corporate Social Responsibility

For several years now, Hypo Alpe-Adria-Bank a.d. Banja Luka has been working on adjusting its business operations with the best practices of developed countries of the world, which set ground rules for social responsibility of an organization as regards the relation to employees, clients and business associates, shareholders, local community and the protection of human environment.

Even though there are still no clear directives in Bosnia and Herzegovina and the Republic of Srpska referring to the commercial companies‘ organized way of reporting in the domain of Corporate Social Responsibility - CSR, Hypo Bank wishes to introduce all the interested parties with the main activities it undertakes in the field of CSR.

Human Resources Management – HRM

Being a member of a multinational group operating in several countries of the Alps-Adriatic region, Hypo Alpe-Adria-Bank a.d. Banja Luka is a company which fully respects the individual values of each person regardless of his/her national, religious, racial, gender or other civilization-accepted differences.

Hypo Bank, as the employer, fully respects and implements all the positive legal regulations governing the area of employment. All employees exercise their rights in regard to annual leaves, sick leaves, salaries and contributions for health and social security, etc.

All new employees undergo an induction training in order to get introduced to the Bank, its vision, mission and strategy.

All vacancies are fully adjusted to legal regulations and are always published in at least 2 leading daily newspapers and the Bank’s web page.The adult-education is a continuous process, i.e. the Bank enables a regular advance training for employees, where needed most.

The Bank sets aside funds on an annual basis earmarked for a series of seminars and training, so that the employees could be briefed on the latest developments in the relevant area.

Relationship to Customers and Business Associates

Hypo Alpe-Adria-Bank a.d. Banja Luka is very much aware of the fact that a loyal client is the biggest treasure a financial institution can have. Accordingly, business ethics holds a high position on the Bank’s list of priorities.

The Bank strives to in due time inform its clients and business associates about all changes related to its business, new products, services, interest, fees, commission, etc.

Furthermore, through its marketing/PR activities, the Bank strictly adheres to the code of ethics that lays down the standards for truthfulness and the establishment of facts. It avoids any form of inducing the client to make wrong conclusions upon misinformation or inconsistencies in the contents.

As regards the customers’ rights, the Bank makes it possible for them to in an organized way file complaints about the quality of its services, products and, in general, about the relation it has to its clients by introducing the position of the Client Complaints Officer.

Clients may now file their complaints, oral or written, with all bank branches or by post and e-mail. They will receive an official answer within thirty days.

Henceforth, Hypo Bank will be governed by the principles of responsible banking as well as professional ethics and transparent business, taking into account the fact that the success of the Bank and its shareholders has to be highly correlated with the success of its clients.

Relation to the Local Community (Supporting Culture, Art, Sports, Education and Public Health Institutions)

For many years now, Hypo Bank has been supporting local communities in which it operates by setting aside a significant amount of money from its budget for educational and health institutions as well as events promoting and preserving social values in the area of culture, art, and non-commercial sports activities.

In 2012, Hypo Bank donated approximately KM 80,000 across the Republic of Srpska. This money was donated to public institutions and associations of citizens in charge of the education of children and their social welfare and health care.

Hypo Bank was last year also one of the leading financial supporters of many cultural events and art manifestations as well as non-commercial sports activities in the RS through many sponsorship activities.

The goal of Hypo Bank is to be part of the local identity of each community in which it operates and make those communities and their citizens aware of the fact that they can count on Hypo Bank and its support, as much as possible.

Children and institutions in charge of their organized education and their social welfare and health care are of top priority.

Bodies of the Bank

SUPERVISORY BOARD

Dipl. Kfm. MA Rainer Maria Sichert , Chairman
Dr. Neven Raić, Deputy Chairman
Dr. Gottwald Kranebitter, Member
Dr. Sebastian Firlinger, Member
Mag. Stephan Holzer, Member

MANAGEMENT BOARD

Goran Babić, Director
Lidija Žigić, Executive Director
Herbert Walzhofer, Executive Director
Martin Leberle, Executive Director

AUDIT COMMITTEE

Đorđe Lazović, President
Maria Rauscher, Member
Andrea Castellarin, Member
Sandra Berdnik, Member
Dejan Rajevac, Member

INTERNAL AUDIT

Slavica Vukelić

SHAREHOLDERS WITH 5% OR MORE SHARES WITH VOTING RIGHTS

Hypo Alpe-Adria-Bank International AG, Klagenfurt

Organization Chart

FINANCIAL STATEMENTS

For the Year Ended December 31, 2012 and Independent Auditor's Report

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Translation of the Auditors' Report issued in the Serbian language

INDEPENDENT AUDITORS' REPORT

To the Supervisory Board and Shareholders of Hypo Alpe-Adria-Bank a.d., Banja Luka

We have audited the accompanying financial statements (pages 2 to 63) of Hypo Alpe-Adria Bank a.d., Banja Luka (the "Bank"), which comprise the balance sheet as of December 31, 2012 and the related income statement, statement of changes in equity and cash flow statement for the year than 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 of these financial statements in accordance with the accounting regulations of the Republic of Srpska and regulations of the Banking Agency of the Republic of Srpska governing financial reporting of banks, as well as for internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and the Law on Accounting and Auditing of the Republic of Srpska. 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements of Hypo Alpe-Adria Bank a.d., Banja Luka as of and for the year ended December 31, 2012 have been prepared, in all material respects, in accordance with the accounting regulations of the Republic of Srpska and regulations of the Banking Agency of the Republic of Srpska governing financial reporting of banks, as well as with the basis of preparation of the financial statements and accounting policies disclosed in Notes 2 and 3 to the financial statements.

Banja Luka, March 11, 2013

DELOITTE D.O.O. 1 BANJA LUKA

Certified Auditor
Žarko Mionić

INCOME STATEMENT

Year Ended December 31, 2012
(Thousands of BAM)

	Note	Year Ended December 31, 2012	Year Ended December 31, 2011
Interest income	6	75,405	84,478
Interest expense	6	(34,384)	(40,325)
Net interest income		**41,021**	**44,153**
Fee and commission income	7	15,706	13,470
Fee and commission expense	7	(3,622)	(4,146)
Net fee and commission income		**12,084**	**9,324**
Fee and commission income		1,478	1,536
Fee and commission expense	8	10,766	17,380
Net fee and commission income	9	(43,661)	(45,534)
PROFIT BEFORE IMPAIRMENT LOSSES, PROVISIONS AND INCOME TAX		**21,688**	**26,859**
Provisions for potential losses, contracted liabilities and write-offs	10	(12,193)	(762)
PROFIT BEFORE TAXATION		**9,495**	**26,097**
Income tax	11	(1,670)	(2,854)
NET PROFIT FOR THE YEAR		**7,825**	**23,243**
Total comprehensive income			
Gains/(Losses) on financial instruments available for sale		3	(16)
Other losses recognized within equity		18	(689)
Net effect of the changes in deferred taxes		21	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**7,867**	**22,538**
Earnings per share (in BAM)	27	0.061	0.145

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

These financial statements were approved by management of Hypo Alpe-Adria Bank a.d., Banja Luka as at March 8, 2013.

Signed on behalf of the Bank by:

Goran Babić
Director

Martin Leberle
Executive Director

BALANCE SHEET

As of December 31, 2012
(Thousands of BAM)

	Note	December 31, 2012	December 31, 2011
ASSETS			
Cash and balances held with the Central Bank	12	258,425	245,434
Deposits held with banks	13	39,156	16,337
Loans and advances to customers	14	1,014,244	1,096,453
Securities available for sale	15	16,096	15,454
Equity investments	16	3,500	2,500
Property and equipment	17	45,247	47,568
Intangible assets	18	13,307	13,364
Investment property	19	3,503	3,556
Other assets	20	5,594	7,421
Total assets		**1,399,072**	**1,448,087**
LIABILITIES			
Deposits held by banks and other financial institutions	21	390,327	440,921
Customers' deposits	22	545,115	543,320
Borrowings	23	156,461	146,261
Subordinated liabilities	24	35,479	35,470
Other liabilities	25	21,088	38,981
Other provisions	28	8,600	8,999
Total liabilities		**1,157,070**	**1,213,952**
EQUITY	26		
Share capital		129,168	129,168
Reserves		79,582	74,743
Revaluation reserves		6,597	6,760
Retained earnings		26,655	23,464
Total equity		**242,002**	**234,135**
Total liabilities and equity		**1,399,072**	**1,448,087**
COMMITMENTS AND CONTINGENT LIABILITIES	29	**112,165**	**115,410**

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

STATEMENT OF CHANGES IN EQUITY

Year Ended December 31, 2012
(Thousands of BAM)

	Share Capital	Share Premium	Reserves	Revaluation Reserves	(Accumulated Losses)/ Retined Earnings	Total
Balance, December 31, 2010	**175,512**	**64**	**74,317**	**7,689**	**(45,957)**	**211,625**
Absorption of the loss for the year 2010	(46,344)	(64)	423	-	45,957	(28)
Amortization of revaluation reserves of properties and investment properties	-	-	-	(221)	221	-
Revaluation of securities available for sale	-	-	-	(16)	-	(16)
Other gains/(losses) recognized within equity	-	-	3	(692)	-	(689)
Net profit for the year 2011	-	-	-	-	23,243	23,243
Balance, December 31, 2011	**129,168**	**-**	**74,743**	**6,760**	**23,464**	**234,135**
Distribution of profit from the year 2011	-	-	4,839	-	(4,839)	-
Revaluation of property and investment properties	-	-	-	(205)	205	-
Revaluation of securities available for sale	-	-	-	3	-	3
Other gains/(losses) recognized within equity	-	-	-	18	-	18
Effect of changes in the deferred taxes, net	-	-	-	21	-	21
Net profit for the year 2012	-	-	-	-	7,825	7,825
Balance, December 31, 2012	**129,168**	**-**	**79,582**	**6,597**	**26,655**	**242,002**

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

CASH FLOW STATEMENT

Year Ended December 31, 2012
(Thousands of BAM)

	Note	Year Ended December 31, 2012	Year Ended December 31, 2011
Cash flows from operating activities			
Interest, fee and commission receipts		87,152	101,509
Interest paid		(35,003)	(41,440)
Collected receivables on loans previously written-off		6,409	12,493
Payments to, and on behalf of employees and accounts payable		(39,823)	(36,150)
Off-balance sheet contractual payments		(96)	89
Receipts and payments on extraordinary items		(10,675)	10,276
Loans and advances to customers		71,431	142,721
Customers' deposits		(48,969)	(98,443)
Income taxes paid		(1,914)	(3,405)
Net cash generated by operating activities		**28,512**	**87,650**
Cash flows from investing activities			
Interest receipts		685	7
Collectible securities available for sale		-	25
Investments in securities available for sale		(564)	(14,634)
Purchase of intangible assets		(1,241)	(1,243)
Purchase of property and equipment		(1,002)	(1,282)
Sale of equity investment in other related parties		-	81
Purchase of equity investment in subsidiaries		(1,000)	(2,500)
Sale of other investments		-	450
Net cash used in investing activities		**(3,122)**	**(19,096)**
Cash flows from financing activities			
Interest paid for borrowings		(1,805)	(3,175)
Borrowings received		19,804	13,570
Repayment of borrowings		(9,454)	(17,984)
Dividend payments		-	(1)
Net cash generated by/(used in) financing activities		**8,545**	**(7,590)**
Net increase in cash and cash equivalents		**33,935**	**60,964**
Cash and cash equivalents at beginning of year		**261,740**	**198,495**
Foreign exchange effects		1,906	2,281
Cash and cash equivalents at end of year	12, 13	**297,581**	**261,740**
Cash and cash equivalents comprise the following balance sheet components			
Cash and balances with the Central Bank	12	258,425	245,434
Deposits with banks	13	39,156	16,337
Less: interest accrued and provisions		-	(31)
		297,581	**261,740**

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

1. GENERAL INFORMATION

Hypo Alpe-Adria-Bank a.d., Banja Luka (the "Bank") is a legal successor of Kristal Banka a.d., Banja Luka which was initially registered as a separate legal entity as at September 30, 1992, and subsequently transformed into a shareholders' company as at May 16, 1997. Prior to its establishment as an independent bank, the Bank operated as a main branch of Jugobanka Jubanka d.d., Sarajevo, a related party of Jugobanka d.d., Beograd. Based on the decision of the Banja Luka Basic Court (number U/I 2308/03) dated October 9, 2003, the Bank commenced its operations under its current registered name.

The Bank is 99.73% owned by Hypo Alpe-Adria-Bank International AG, Klagenfurt, Austria, and member of the Hypo Alpe-Adria Group. Ultimate parent of the Bank until the end of 2009 was Bayern LB, Germany. As of December 30, 2009, the ultimate parent of the Bank became Republic of Austria, with 100% ownership of Hypo Alpe-Adria-Bank International AG. Please refer to Note 26 for further information.

The Bank is licensed in the Republic of Srpska to perform banking operations related to payment transfers, credit and deposit activities in the country and abroad, and in accordance with the Republic of Srpska banking legislation, it is to operate based on the principles of liquidity, solvency and profitability.

The Bank's registered head office is in Aleja Svetog Save 13, Banja Luka, Republic of Srpska. As of December 31, 2012, besides the head office located in Banja Luka, the Bank had 43 branch offices situated throughout Bosnia and Herzegovina (BiH), (December 31, 2011: the head office located in Banja Luka and 43 branch offices).

As at December 31, 2012, the Bank had 583 employees (2011: 509 employees).

Management	
Director from May 31, 2010 to June 21, 2012	Samuel Vlčan
Executive Director from May 31, 2010 to June 21, 2012 Director from June 21, 2012	Goran Babić
Executive Director from February 1, 2012	Lidija Žigić
Executive Director from May 15, 2012	Herbert Walzhofer
Executive Director from october 17, 2012	Martin Leberle
Supervisory Board	
President from September 20, 2010	Rainer Sichert
Vice President from May 27, 2010 to September 14, 2012 Member from March 23, 2011 to September 14, 2012	Wolfgang Mösslacher
Vice President from September 14, 2012 to December 14, 2012	Blaž Brodnjak
Vice President and member from December 14, 2012	Neven Raić
Member from May 27, 2010	Stephan Holzer
Member from May 23, 2011	Sebastian Firlinger
Member from September 14, 2012	Gottwald Kranebitter

Audit Committee	
President from May 29, 2011	Đorđe Lazović
Member from May 29, 2011	Maria Rauscher
Member from May 29, 2011	Andrea Castellarin
Member from May 29, 2011to February 25, 2012	Sabine Jaeger-Letzl
Member from May 29, 2011to February 25, 2012	Thomas Milunović
Member from February 25, 2012	Sandra Berdnik
Member from February 25, 2012	Dejan Rajevac

2. BASIS FOR PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHOD

2.1. Basis of Preparation and Presentation of Financial Statements

The Bank's financial statements have been prepared in accordance with the accounting regulations effective in the Republic of Srpska.

The Bank's financial statements as of December 31, 2012 have been prepared in compliance with Article 14 of the Law on Banks (Official Gazette of the Republic of Srpska no. 44/03) and regulations of the Banking Agency of the Republic of Srpska (BARS).

The accompanying financial statements are the annual stand-alone (unconsolidated) financial statements of the Bank. As disclosed in Note 16, Hypo Alpe-Adria-Bank a.d., Banja Luka is the Parent Company of a business group, where another member is Hypo Alpe-Adria Leasing d.o.o., Banja Luka. Investments in subsidiaries are stated at cost in these financial statements, net of any accumulated impairment. According to International Accounting Standard (IAS) 27 "Consolidated and Separate Financial Statements," the Bank will prepare its consolidated financial statements for the year 2012 no later than April 30, 2013, as in accordance with International Financial Reporting Standards.

These financial statements have been prepared at cost principle except for revaluation of certain financial instruments measured at fair value as explained in the accounting policies provided in the following passages.

The Bank reclassified certain amounts in the comparative information for the financial year 2011 for the purpose of comparability and improved and more appropriate presentation.

2.2. Application and Impact of the new and revised International Financial Reporting Standards IFRS ("IFRS") and International Accounting Standards ("IAS")

Standards and Interpretations Effective in the Republic of Srpska Current Period

The accompanying financial statements have been prepared by applying International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) which were in effect at January 1, 2009 and in accordance with accounting regulations of the Republic of Srpska based on these standards. Namely, in accordance with the provisions of the Law on Accounting and Auditing of the Republic of Srpska, currently in force, (Official Gazette of RS numbered 36/09 and 52/11), all legal entities situated on the territory of the Republic of Srpska are under an obligation to fully apply IAS, IFRS and International Standards on Auditing (ISA), as well as the Code of Ethics for Professional Accountants and the pronouncements, interpretations and guidelines of the International Accounting Standards Board (IASB) and all pronouncements, interpretations and guidelines of the International Federation of Accountants (IFAC) to its financial statements prepared for the periods commencing on or after January 1, 2010.

In addition, on July 15, 2010, the Management Board of the Association of Accountants and Auditors of the Republic of Srpska ("AAARS") enacted the "Decision on the Commencement of the Mandatory Application of IAS/IFRS Issues (published until January 1, 2009)" based on the "Decision on the Authorizations for Translation and Issuance" of the concerned Accounting and Auditing Commission of Bosnia and Herzegovina dated March 10, 2006 (Official Gazette of BIH number 81/06), granting such authorizations to the AAARS. The aforementioned issue of IAS/IFRS was approved by the International Accounting Standards Committee Foundation as the official translation into the Serbian language for Bosnia and Herzegovina (Republic of Srpska), Serbia and Montenegro. Pursuant to the aforementioned Decision, IAS/IFRS published until January 1, 2009 are mandatorily applied to the financial statements prepared and presented in the Republic of Srpska for the accounting periods commencing on or after January 1, 2010.

However, the amendments to the standards and interpretations in effect, as well as newly adopted standards and interpretations issued after January 1, 2009, have not been issued and officially adopted in the Republic of Srpska and therefore, not applied in the preparation of the accompanying financial statements. Standards and interpretations in issue, but not yet officially translated and adopted and standards and interpretations in issue but not yet in effect are disclosed in Notes 2.2 (b) and 2.2 (c).

2. BASIS FOR PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHOD (Continued)

2.2. Application and Impact of the new and revised International Financial Reporting Standards IFRS ("IFRS") and International Accounting Standards ("IAS") (Continued)

In accordance with the aforedescribed, and given the potentially material effects which the departures of accounting regulations of the Republic of Srpska from IAS and IFRS may have on the fairness presentations made in the financial statements, the accompanying financial statements cannot be treated as a set of financial statements prepared in full compliance with IAS and IFRS.

The Bank's management analyzes the amendments to the standards and interpretations in effect as well as the newly adopted standards and interpretations issued after January 1, 2009, and, once the standards and interpretations relevant for the Bank have been determined, the Bank's management intends to apply them in the preparation of financial statements as soon as they are officially translated and issued in the Republic of Srpska.

Standards and Interpretations in Issue not yet Translated and Adopted in the Republic of Srpska
International Accounting Standards Board and Interpretations issued by the International Financial Reporting Interpretations Committee but were not officially adopted and translated in the Republic of Serbia for periods for the annual periods beginning on or after January 1, 2012:

- IFRS 1 (revised) "First-Time Adoption of IFRS" (effective for annual periods beginning on or after July 1, 2009);
- 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 July 1, 2011);
- Amendments to IFRS 1 "First-Time Adoption of IFRS"- Removal of Fixed Dates for First-Time Adopters (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IFRS 1 "First-Time Adoption of IFRS" – Additional Exemptions for First-Time Adopters (effective for annual periods beginning on or after January 1, 2010);
- Amendments to IFRS 2 "Share-Based Payment" – Group Cash-Settled Share-Based Payment Transactions (effective for annual periods beginning on or after January 1, 2010);
- IFRS 3 (revised) "Business Combinations" (effective for annual periods beginning on or after July 1, 2009);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Transfers of Financial Assets (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IAS 12 "Income Taxes" – Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after January 1, 2012);
- Amendments to IAS 27 "Consolidated and Separate Financial Statements" (effective for annual periods beginning on or after July 1, 2009);
- Amendments to IAS 39 "Financial Instruments: Recognition and Measurement" – Eligible Hedged Items (effective for annual periods beginning on or after July 1, 2009);
- Amendments to various standards and interpretations resulting from the Annual quality improvement project of IFRS published on April 16, 2009 (IFRS 2,IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 18, IAS 36, IAS 38, IAS 39, IFRIC 9, IFRIC 16) primarily with a view to removing inconsistencies and clarifying wording, (amendments are to be applied for annual periods beginning on or after January 1, 2010, while the amendment to IFRIC is to become effective as of July 1, 2010);
- IFRIC 17 "Distributions of Non-Cash Assets to Owners" (effective for annual periods beginning on or after July 1, 2009);
- IFRIC 18 "Transfers of Assets from Customers" (effective for annual periods beginning on or after July 1, 2009);

2. BASIS FOR PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHOD (Continued)

2.2. Application and Impact of the new and revised International Financial Reporting Standards IFRS ("IFRS") and International Accounting Standards ("IAS") (Continued)

Standards and Interpretations in Issue not yet Translated and Adopted in the Republic of Srpska (Continued)

- "Conceptual Framework for Financial Reporting 2010" being an amendments to "Framework for the Preparation and Presentation of Financial Statements" (effective for transfer of assets from customers received on or after September 2010);
- Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" – Limited Exemption from Comparative IFRS 7 Disclosures for First-Time Adopters (effective for annual periods beginning on or after July 1, 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 January 1, 2011);
- Amendments to IAS 32 "Financial Instruments: Presentation" – Accounting for Rights Issues (effective for annual periods beginning on or after February 1, 2010);
- Amendments to various standards and interpretations "Improvements to IFRSs" resulting from the Annual quality improvement project of IFRS published on May 6, 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, (most amendments are to be applied for annual periods beginning on or after January 1, 2011);
- 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 January 1, 2011);
- IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments" (effective for annual periods beginning on or after July 1, 2010).

Standards and Interpretations in Issue not yet in Effect

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

- IFRS 9 (revised in 2010)"Financial Instruments" (effective for annual periods beginning on or after January 1, 2015);
- Amendments to IFRS 9 "Financial Instruments" and IFRS 7 "Financial Instruments: Disclosures" – Mandatory Effective Date and Transition Disclosures (effective for annual periods beginning on or after January 1, 2015);
- IFRS 10 "Consolidated Financial Statements" (effective for annual periods beginning on or after January 1, 2013);
- IFRS 11 "Joint Arrangements" (effective for annual periods beginning on or after January 1, 2013);
- IFRS 12 "Disclosures of Involvement with Other Entities" (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 10, IFRS 11 and IFRS 12 "Consolidated Financial Statements, Joint Arrangements and Disclosures of Involvement with Other Entities: Transition Guidance" (effective for annual periods beginning on or after January 1, 2013);
- IAS 27 (revised in 2011) "Separate Financial Statements" (effective for annual periods beginning on or after January 1, 2013);
- IAS 28 (revised in 2011) "Investments in Associates and Joint Ventures" (effective for annual periods beginning on or after January 1, 2013);
- IFRS 13 "Fair Value Measurement" (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IAS 19 "Employee Benefits" – Improvements to the Accounting for Post-Employment Benefits (effective for annual periods beginning on or after January 1, 2013);

2. BASIS FOR PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHOD (Continued)

2.2. Application and Impact of the new and revised International Financial Reporting Standards IFRS ("IFRS") and International Accounting Standards ("IAS") (Continued)

Standards and Interpretations in Issue not yet in Effect (Continued)

- Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" – Government Loans (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IAS 1 "Presentation of Financial Statements" – Presentation of Items of Other Comprehensive Income (effective for annual periods beginning on or after July 1, 2012);
- Amendments to IAS 32 "Financial Instruments: Presentation" – Netting financial assets and liabilities (effective for annual periods beginning on or after January 1, 2014);
- Annual improvements 2009-2011 cycle issued in May 2012 (effective for annual periods beginning on or after January 1, 2013);
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine" (effective for annual periods beginning on or after January 1, 2013); and
- Amendments to IFRS 10, IFRS 12 and IAS 27 - Exemption from Consolidation of Subsidiaries under IFRS 10 ‚Consolidated Financial Statements' (effective for annual periods beginning on or after January 1, 2014).

Departures of the Local Regulations from the IAS and IFRS Requirements
In addition to the aforementioned matters, the accounting regulations of the Republic of Srpska applied in preparation of the financial statements as of and for the year ended December 31, 2012 depart from the requirements of IFRS and IAS, in the following materially significant aspects of financial reporting:

- Based on the Guidelines on the Form and Contents of the Balance Sheet and Income Statement Items for Banks and Other Financial Organizations (Official Gazette of RS no. 67/09), loan origination fees are included within "fee and commission income" and not within effective interest rate calculation as required by IAS 18 "Income" and IAS 39 "Unconsolidated Financial Instruments: Recognition and Measurement;"
- Based on the Guidelines on the Form and Contents of the Balance Sheet and Income Statement Items for Banks and Other Financial Organizations (Official Gazette of RS no. 67/09), interest receivables are stated within calculated interest accrued and other assets, and not within loans and advances to customers, as required by IAS 39 "Unconsolidated Financial Instruments: Recognition and Measurement;"
- Based on the Guidelines on the Form and Contents of the Balance Sheet and Income Statement Items for Banks and Other Financial Organizations (Official Gazette of RS no. 67/09), interest payables are stated within other liabilities, and not within borrowings, as required by IAS 39 "Unconsolidated Financial Instruments: Recognition and Measurement;"
- Based on the Guidelines on the Treatment of Acquires Tangible Assets Received in Lieu of Partial or Entire Debt Collection enacted by the Banking Agency of the Republic of Srpska, banks are obligated to sell such tangible assets intended for sale within a year form the acquisition date, whereas as of the date after the expiry of the said deadline, the banks are under obligation to carry such assets in their books of account at the amount of BAM 1, which departs from IAS/IFRS (IAS 2 "Inventories" and IFRS 5 "Non-Current Assets Held for Sale and Discontinued Operations").

2. BASIS FOR PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING METHOD (Continued)

2.2. Application and Impact of the new and revised International Financial Reporting Standards IFRS ("IFRS") and International Accounting Standards ("IAS") (Continued)

Given the aforesaid, the Bank reclassified certain amounts in the accompanying balance sheet and income statement forms in order to eliminate the differences between the Guidelines on the Form and Contents of the Balance Sheet and Income Statement Items for Banks and Other Financial Organizations (Official Gazette of RS no. 67/09) and the requirements of IFRS and IAS, as follows:

- Interest receivables have been reclassified to loans and cash and cash equivalents, i.e. to the items they originated from;
- Interest payables have been reclassified to deposits due and borrowings, i.e. to the items they originated from;
- Loan origination fee income has been reclassified to interest income; and
- Income and expenses from increase or decrease in provisions have been reclassified in part to other operating income and other operating expenses.

In addition to the aforesaid, the Bank duly prepared the balance sheet and income statement forms up to the prescribed deadline and in the manner defined by the Guidelines on the Form and Contents of the Balance Sheet and Income Statement Items for Banks and Other Financial Organizations (Official Gazette of RS no. 67/09), and submitted them to the Agency for Intermediary, IT and Financial Services in Banja Luka, as the competent control authority on February 28, 2013.

The figures in the accompanying financial statements have been stated in Convertible Marks (BAM).

The convertible mark is the official reporting currency in the Republic of Srpska and Bosnia and Herzegovina.

In preparing the cash flow statement for the year ended December 31, 2012, the Bank used direct cash flow reporting method.

In the preparation of these financial statements, the Bank adhered to the accounting policies described in Note 3 to the financial statements, which are based on the accounting regulations of the Republic of Srpska.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1 Basis of Measurement

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of buildings, trading securities carried at fair value through profit or loss and available-for-sale securities.

3.2 Interest Income and Expenses

Interest income and expenses for all interest-bearing financial instruments are recognized within interest income and interest expense in the income statement. Interest income and expenses are accounted for on an accrual basis.

Fee and commission income, except for loan origination fees, are recognized in full when earned.

Fees relating to loan origination are deferred and amortized over the life of the loan using the effective interest rate method.

The effective interest rate method is a method that calculates the costs of repayment of financial assets or financial liabilities and the costs of recognition of interest income or interest expense over a period. The effective interest rate is the rate that precisely discounts estimated future payments or receipts through the expected life of the financial instruments or, when appropriate, in shorter period to the net carrying value of financial assets or financial liabilities.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.2 Interest Income and Expenses (Continued)

When effective interest rate is calculated, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example, the possibility of paying in advance), but does not consider future credit losses. The calculation includes all fees and amounts paid or received between two parties that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

3.3. Fee and Commission Income and Expense

Fees and commissions are generally recognized on an accrual basis when due for collection i.e. when the service has been rendered.

Fee and commission income relates to local payments and international payments operations, income from off-balance sheet operations (guarantee issuance), brokerage and dealing operations, etc.

Fee and commission expenses relate to fees paid to the Central Bank of Bosnia and Herzegovina for the local payments operations, SWIFT costs, costs of payment card operations, fees paid to the Banking Agency of Republic of Srpska for supervision of the banking sector and other fees (Note 7b).

3.4. Foreign Exchange Translation

Functional and Presentation Currency
Items included in the financial statements are measured using the currency of the primary economic environment in which the Bank operates ('the functional currency'). The financial statements are presented in BAM which is the Bank's functional and presentation currency.

Transactions and Balances
Transactions denominated in foreign currencies are translated into the functional currency at official rates effective at the date of each transaction. Assets and liabilities denominated in foreign currencies on the balance sheet date are translated into BAM by applying official rates of exchange valid on that date. Contingent liabilities denominated in foreign currencies are translated into BAM at official exchange rates effective at the balance sheet date.

Foreign exchange gains or losses arising from translation are credited or charged to the income statement. The Bank does not have monetary securities denominated in foreign currency.

Exchange rates used in these financial statements are official rates established by the Central Bank of Bosnia and Herzegovina ("CBBH").

3.5. Property and Equipment

Property and equipment are carried at their fair value, as determined by certified appraisers, subsequently decreased by the accumulated depreciation and impairment, if any.

Revaluation of the Bank's property was performed by an independent certified appraiser as of December 31, 2010 based on the market value of the assets in use.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repair and maintenance costs are charged to the income statement during the financial period in which they are incurred.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Property and Equipment (Continued)

Increases in the carrying amount arising on revaluation of buildings and equipment are credited to equity as revaluation reserve. The increase is recognized in the income statement only to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss. If an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognized in the income statement. The decrease is debited directly to revaluation reserve within equity to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

Revaluation reserves included in equity in respect of property and equipment are transferred directly to retained earnings successively (annually) or when the asset is derecognized. This may involve transferring the entire revaluation reserves when the asset is retired or disposed of.

Land is not depreciated. Depreciation of other assets is calculated based on their cost or previously revalued amounts using the straight-line method to allocate their cost or revalued amounts to the residual value of the assets over their estimated useful lives:

	Depreciation Rate	Useful Life (years)
Buildings	1.33%-2.86%	35-75
Computer equipment	12.5%-20%	5-8
Furniture and other equipment	6.67% -20%	5-15
Vehicles	25%	5

The Bank's management believes that depreciation rates applied fairly reflect the economic useful lives of property and equipment.

Gains and losses on disposal of assets are determined by comparing the proceeds to the carrying amounts and are recognized within gains or losses from sale or disposal of property and equipment.

3.6. Intangible assets

Intangible assets include computer software and licenses. The initial cost of acquisition of assets is amortized on a straight-line basis, as follows:

	Amortization Rate	Useful Life (years)
Intangible assets	14.3% - 20%	5-7

3.7. Investment Property

Investment property, which is property held to earn rental income, is carried at fair value, as determined by certified appraisers, subsequently decreased by the accumulated depreciation and impairment, if any. The cost of purchased investment property comprises its purchase price, and any costs direct acquisition-related costs.

Gains and losses on disposal of assets are determined as the difference between the proceeds and the carrying amounts and are recognized within the income statement as gains or losses from the sale or disposal of investment property.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.8. Impairment of Non-Financial Assets

All assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized in the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

3.9. Financial Assets

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of financial instruments at initial recognition.

As of December 31, 2012, the Bank had only loans and receivables and available-for-sale financial assets.

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

Financial Assets Available for Sale
Financial assets available for sale are those assets for which the Bank has the intention to hold for an indefinite period and which can be sold for liquidity purposes or due to changes in interest rate, exchange rates or change in price of capital.

Accounting Treatment
Regular purchases and sales of financial assets carried at fair value through profit or loss, assets held to maturity and the assets available for sale are recognized at the transaction date, which is the date when Bank commits to purchase or sell the asset. Investments are initially recognized at fair value increased by transaction costs for all financial assets not carried at fair value through profit or loss. Financial resources are derecognized at a time when the Bank has transferred substantially all the risks and rights arising from ownership of the assets or when the Bank's right to receive cash flows arising from financial assets has expired.

Available-for-sale financial assets and financial assets carried at fair value through profit and loss are subsequently stated at fair value. Loans and receivables as well as assets held to maturity are measured at amortized cost using the effective interest rate method. Gains or losses arising from fair value adjustments of financial assets carried at fair value through profit and loss are recognized in the income statement in the period when earned/incurred. Gains and losses arising from fair value adjustments of financial assets available for sale are directly stated in equity, until their derecognition or impairment charges, when the cumulative income or expense previously recognized in equity is recognized in the income statement. However, interest calculated using the effective interest rate method, is recognized in the income statement. Dividends are recognized in the statement of comprehensive income when the entity's right to receive payment is established.

The fair value of securities quoted in an active market are based on current bid prices. If the market for a financial asset (the market of unlisted securities) is not active, the Bank establishes fair value by valuation techniques. These involve the application of recent arm‘s length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and other valuation techniques.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Assets (Continued)

Impairment of Financial Assets
At each reporting date, the Bank assesses whether there is objective evidence that a financial asset or group of financial assets has suffered impairment.

A financial asset or a group of financial assets is considered to be impaired and impairment losses are incurred only if there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event'), the estimated future cash flows of the financial asset or group of financial assets have been affected by the event or events, and that the amount of the loss incurred can be reliably estimated. The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include the following:

- Significant financial difficulty of the counterparty;
- Delay in liability settlement of over 90 days; debtors with over 90 days in arrears in the settlement of materially significant debt amounts. Materially significant debt amounts represent the following Bank‘s receivables:
  - Amounts due from legal entities in excess of EUR 250.00 (BAM 488.96) and 2.5% of the total individual debtor exposure;
  - The lower of the amounts due from retail customers in excess of 1% of the total individual debtor exposure and EUR 10.23 (BAM 20.00);
- Counting days in arrears commences as at the date when the aggregate amount of all debtor‘s matured liabilities outstanding per all agreements/agreed amounts becomes materially significant;
- Debtors allocated risk category C according to the classification of the Banking Agency of the Republic of Srpska;
- 5A or worse credit rating;
- Loan restructuring (significant changes in loan terms, interest rate decrease, partial grace periods granted) necessary due to the credit (financial) situation (not caused by market conditions or technical changes). This includes extensions;
- Reduced security, e.g. caused by decrease in value of collaterals (particularly with regard to project financing) in instances of insufficient other cash flow sources;
- Debtor‘s non-cooperation in instances of evident and documented repayment difficulties;
- Liquidation or bankruptcy of the debtor.

The estimated period between a loss occurrence and its identification is determined by the management for each identified portfolio. In general, these periods vary between three and twelve months; in exceptional cases, longer periods are warranted.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

The amount of the loss is 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. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Assets (Continued)

Impairment of Financial Assets (Continued)
Future cash flows from a group of financial assets that are collectively assessed for impairment are estimated on the basis of the contractual cash flows of the assets and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period the historical loss experience is based upon and to remove the effects of conditions of the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data period on period (e.g., changes in unemployment rates, property prices, payment terms, or other factors indicative of changes in the probability of losses for the Bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off by derecognition of both the relevant loan and the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.

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 (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the income statement as the income from reversal of impairment allowance.

Estimation of Potential Losses for Financial Assets in Accordance with the Requirements of the Banking Agency of the Republic of Srpska
In accordance with the Decision of the Banking Agency of the Republic of Srpska on Classification of Assets and Off-Balance Sheet Items according to the Degree of Collectability, the Bank is required to classify loans, investments and other balance sheet and off-balance sheet risk exposures into categories A, B, C, D and E in accordance with the assessment of recoverability of loans and other investments based on regularity and timeliness in liability settlement on the part of the debtor, debtor‘s financial position and collaterals securitizing collection of receivables. The estimated amount of reserves for potential losses is calculated by applying the following percentages: 2% to loans classified as category A, 5% - 15% to the loans in category B, 16% - 40% to loans in category C, 41% - 60% to loans in category D and 100% to investments in category E.

The difference between allowances determined in the aforedescribed manner and estimated provisions for potential losses on loans classified into categories is recorded on the provision account within equity and allocation of these provisions is made from retained earnings up to the level of retained earnings. Banks incurring operating losses cannot use these provisions to cover losses but disclose the provision shortfall.

Assets classified as Available for Sale
At each reporting date, the Bank assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss.

If any such evidence exists for available for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the income statement to the extent of the previously recognized losses, whereas the remaining amount is recognized within equity under revaluation reserve until such security is sold.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.10. Investments in Associates and Other Equity Investments

Associated entities are those legal entities in which the Bank has a significant influence, and which are neither subsidiaries nor joint ventures.

Investment in an associate is initially recognized at cost (purchase price) as at the balance sheet date, but at each balance sheet date the Bank additionally assess the investment for impairment.

3.11. Cash and Cash Equivalents

For purposes of the cash flow statement, cash, balances with the Central Bank, foreign currency accounts with foreign and domestic banks and short-term deposits with maturities of up to 30 days held with foreign and domestic banks are all considered to be cash equivalents.

3.12. Borrowings

Borrowings are initially recognized at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowing using the effective interest method.

3.13. Provisions

Provisions for restructuring and damage claims/losses per legal suits filed are recognized when:

- the Bank has a present legal or constructive obligation as a result of past events;
- it is more likely than not that an outflow of resources will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

Where there is a number of similar obligations, the likelihood that an outflow will be required in a settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be remote. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation.

3.14. Employee Benefits

Short-Term Employee Benefits
Short-term benefits include employee salaries and benefits and all contributions to salaries, paid to the Republic of Srpska social security and pension funds, calculated by applying the specific percentage rates which are stipulated by relevant regulations. Short-term employee benefits are recognized as expenses in the period in which they are incurred.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.14. Employee Benefits (Continued)

Retirement Benefits and Annual Leave (Vacation) Entitlements
According to the Collective Bargaining Agreement with the Bank's employees, employees are entitled to receive benefits upon retirement. The retirement benefit liability recognized in the balance sheet represents the present value of the defined benefit liabilities as determined by actuarial calculations.

Provisions for retirement benefits and annual leave (vacation) entitlements are disclosed in the balance sheet within "other liabilities."

Retirement benefits provisions are based on actuarial reports and are used only for the purposes they are intended for. At the end of each year, an assessment of appropriateness of the amounts of provisions for retirement benefits and annual leave entitlements is performed. Additional provisions or reversal of such provisions are recognized in the income statement, under "other operating income" or "other operating expenses." Benefits falling due more than 12 months after the balance sheet date are discounted to their present value.

3.15. Income Taxes

Current Income Tax
Current income tax relates to the amount payable in accordance with the Income Tax Law. Current income tax is payable at the rate of 10% applied to the tax base determined in the taxa balance and reported in the annual corporate income tax return, being the amount of profit before taxation net of income and expense adjustment effects pursuant to the tax regulations of the Republic of Srpska.

The tax regulations in the Republic of Srpska allow for the reduction of the tax base for the amounts used in capital expenditures, for restoration of own manufacturing activity and for the amounts of the payroll taxes and contributions for over 30 newly employed staff members at the end of the financial year.

The tax regulations in the Republic of Srpska do not envisage that any tax losses of the current period be used to recover taxes paid within a specific carryback period. However, current period tax losses stated in tax return may be used to reduce or eliminate taxes to be paid in future periods but only for duration of no longer than five ensuing years.

Deferred Income Taxes
Deferred income taxes are calculated on all temporary differences between tax base of assets and liabilities and their carrying amounts stated in financial statements of the Bank. Deferred tax liabilities are recognized for all taxable temporary differences between the tax base of assets and liabilities at the balance sheet date and carrying values reported in the financial statements, which will result in future period taxable amounts.

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

Deferred tax assets are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences against profits earned.

Current and deferred taxes are recognized as income and expense and are included in the profit for the period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.16. Share Capital and Reserves

Share capital consists of common shares. Share capital is stated at nominal value.

Dividends on shares are recognized as liabilities in the period wherein a decision on dividend disbursement is made.

3.17. Revaluation Reserves

Revaluation surpluses are credited to revaluation reserves. When the carrying amount of an asset increases due to revaluation, such increase is to be included in equity as revaluation surplus (reserve). However, the increase is recognized in profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in profit or loss.

When an asset's carrying value decreases due to revaluation, such decrease is to be recognized as an expense. However, the decrease is to be charged within equity, as revaluation surplus up to the amount of the existing revaluation surplus relating to the asset.

3.18. Fair Value

The accompanying financial statements are prepared on a historical cost basis, including allowances and provisions made to reduce assets to their estimated recoverable amounts.

It is the Bank's policy to disclose the fair value information of those financial assets and liabilities for which published market information is readily and reliably available, and whose fair value is materially different from their recorded amounts. Sufficient market experience, stability and liquidity do not exist for the purchase and sale of loans and other financial assets or liabilities, given that published market information is not readily available. Hence, fair value cannot reliably be determined.

3.19. Related Party Transactions

According to IAS 24 related parties are parties that represent:

- The companies which directly, or indirectly through one or more intermediaries, control or are under control or joint control of the reporting entity;
- Associates in which the Bank has an interest that gives it significant influence over the entity and that are neither related parties nor joint ventures;
- Private individuals who directly or indirectly have voting power in the Bank that gives them significant influence over the Bank, or any other entity which is expected to influence or be influenced by a related party to the Bank;
- Management personnel holding key positions, i.e. individuals with authorizations and responsibilities for planning, managing and controlling the Bank's operations, including directors and key management.

When taking into account each possible transaction with a related party, attention is focused on the basis of relationship and not just the legal form (Note 30).

3.20. Custody Operations

Assets and income arising from operating activities, where the Bank performs custody operations, which include holding or keeping the funds for the benefit of individuals, creditors and other institutions are included in Bank's financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.21. Segment Reporting

An industry segment represents a group of assets and business activities engaged in providing products or services that are subject to risks and returns that are different from those of other industry segments.

A geographical segment provides products or services within a particular economic environment that are subject to risks and returns different from those of segments operating in other economic environments.

The Bank monitors its performance by industry segments (public, retail, corporate) and by geographical segments (branches) for the purposes of consolidated reporting as a Parent Bank. However, for the purpose of preparing the accompanying financial statements, the Bank does not make disclosures in accordance with IFRS 8 since the Bank does not engage in trade in shares on the domestic market to a sufficient extent and given that the majority shareholder owns dominant interest of 99.79% of the total share capital.

3.22. Equity Investments

Equity investments in related parties are measured at cost.

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES AND ASSUMPTIONS

The Bank makes estimates and assumptions of the effects that the amounts of assets and liabilities presented in the financial statements will have in the forthcoming financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Impairment Losses on Loans, Deposits with Other Banks and Other Risk-Weighted Assets and Off-Balance Sheet Items
The Bank reviews its loan portfolio and other risk-weighted assets and off-balance sheet items to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and guarantees before the decrease can be identified for individual loans within the portfolio. The methodology and assumptions used for estimating impairment provision in accordance with BARS regulations are disclosed in Note 3.9.

Employee Retirement Benefits
Expenses for long-term provisions related to the future outflows for retirement benefits are created based on the actuarial calculation performed in accordance with IAS 19. For the purposes of the assessment, the Bank engages a certified actuary, who performs the calculation based on the data from the Bank's HR Department according to the estimated time of employees' retirement. The present value of the future liabilities is calculated by applying a discount rate. These provisions are only used to settle expenses that they have originally been formed for. At the end of each year, the Bank assesses these provisions. If the amount recorded is higher/lower than estimated amount, the difference is reflected through profit and loss.

In January 2013, the certified actuary performed a new actuarial calculation as of December 31, 2012 in accordance with IAS 19. Following the new calculation the Bank has decreased previously recognized provisions by crediting the income statement. An assessment of short-term provisions for unused annual leaves (vacations) is performed based on the number of days of unused annual vacations as of the balance sheet date and the employee average monthly gross salary.

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES AND ASSUMPTIONS (Continued)

Litigation
Uprava Banke vrši procjenu iznosa rezervisanja za odliv sredstava po osnovu sudskih sporova na bazi procjene vjerovatnoće da će do odliva sredstava zaista doći prema ugovorenoj ili zakonskoj obavezi iz prošlih perioda (Napomena 29).

Income taxes
The Bank is subject to income taxes in the Republic of Srpska and Bosnia and Herzegovina. The Bank recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax amounts.

Deferred tax assets disclosed at December 31, 2012 are based on assumptions on profitability for the period of the five ensuing years. In case of a change in the assumptions on profitability, disclosed tax assets can be adjusted accordingly.

Losses on Impairment of Loans and Advances
The Bank reviews its loan portfolios at least quarterly in order to assess impairment. When establishing whether impairment loss is to be stated in the income statement, the Bank assesses the existence of objective evidence of measurable decrease in the estimated future cash flows from the loan portfolio before it is possible to determine decrease in individual loans of the portfolio. Objective evidence of portfolio impairment could include perceptible data suggesting negative changes in the financial standing of the Bank's borrowing customer, as well as changes in the national or local economic circumstances that are associated with the default receivables.

When determining future cash flows, the Bank's management uses estimates based on historical experiences of impairment losses on an asset with similar credit risk characteristics and objective impairment evidence similar to that of the portfolio. Methodology and assumptions used to estimate both amounts of the future cash flows and the time of their occurrence are regularly reviewed in order to minimize all the differences between estimated and actual losses.

Impairment of Assets Available for Sale
The Bank determines that the equity investments available-for-sale are impaired when there has been a significant and prolonged decrease in their fair value below their cost. Determining a significant and prolonged decrease demands assessment. Among other factors, the Bank assesses normal fluctuations in the prices of shares.

In addition, decrease in fair value may be appropriate when there is evidence of the deterioration of the sound financial standing of the investor, deterioration of the success of the industry or sector, changes in technology and operating and financing cash flows.

If each decrease in fair value below cost were to be considered significant and prolonged, the Bank would have incurred additional loss in the amount of BAM 91 thousand in for the year 2011, which would represent the transfer of the total fair value reserves to the income statement.

Fair Value of Property, Equipment and Investment Property
Fair value of property, equipment and investment property is regularly assessed based on the market value of similar property situated at similar locations by certified appraisers. Fair value is determined by means of capitalization valuation method (income approach) that takes into account actual or realizable annual income from the property under valuation, which is then compared to the value of the underlying investment. The actual annual income is then decreased by the costs of maintenance, depreciation, taxes and risk of rent payment default or failure to lease property. Factors applied in the assessment are specific for the market of Bosnia and Herzegovina. The net book value of property, equipment and investment property as of December 31, 2012 represents the estimated fair value (Note 17).

5. FINANCIAL INSTRUMENTS

a) Financial Risk Management
Risk management strategy of the Bank is to maintain stable performance in the future. The Bank applies policies and strategies of credit and market risk. The Bank controls a variety of risks with respect to the data structure, methodology adopted, reporting and limits arising in the decision making process. The Bank has an internal risk management model. The most important tools and methods used in the model for internal risk management are: internal credit rating system (for Corporate, Retail and Banks), collaterals, internal indicators in respect of provision / bad debts, etc. The use of risk management has a large impact on asset quality, structural liquidity, efficiency ratios and early warnings, and it reduces exposure to all types of risks.

The Bank is exposed to the following major types of risks: credit risk, market risk, liquidity risk, operational risk.

Credit Risk Management

The Bank is exposed to credit risk which is the risk of the Bank's inability to collect due loans and other receivables with interest accrued thereon within contractually defined terms. Based on classification of investments, or borrowers into risk groups, the Bank identifies, i.e. determines the possible level of credit loss, i.e. general credit risk and potential credit loss.

Assessment of impairment losses is performed for both individual borrowers and groups of related-party borrowers. Such risks are monitored on a continuous basis in accordance with the internal programs and policies, as well as BARS regulations.

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 lending limits where appropriate. This is performed in accordance with set procedures for credit approval, additional lending, investment activities, and assessment of contingent off-balance sheet liabilities. Exposure to credit risk is also managed in part by reduction of all kinds of possible risk sources related to quality, concentration, repayment securitization (all loans are securitized with collaterals – guarantees, mortgages and other sorts of collaterals), maturity and currency.

On October 1, 2009, the Bank has established a new department – Credit Risk Management Department, dedicated to risk monitoring for corporate and retail clients, as defined by the Hypo Alpe-Adria Group ("HGAA" or the "Group") policies. By introducing new policies and establishing a new department, the Bank managed to put in place clearer and stricter criteria for all new loan approvals The Bank has also increased the level of awareness of its employees related to continuous monitoring of clients, early risk identification and steps taken to address the risk. In order to increase the quality of credit risk assessment, responsibility for credit risk monitoring was delegated to an individual level (not only at the credit committee level).

The Bank approves loans in accordance with a defined process for loan approval, and based on the creditworthiness of clients and security instruments.

Creditworthiness of a borrower must be presented in the „Loan Proposal" document based on which lending decisions are made. A loan proposal form has to include the assessment of Market Department and Credit Risk Management Department.

Loan decisions are made (and the competences determined) based on total liabilities/limits defined at the Group level.

There are eight levels of authority for approving the placements of which the highest is Supervisory Board of the Parent Company (HBInt). Credit Risk Management Department has the right to vote in each committee.

In order to ensure business activities, and on the basis of assessed risk of potential losses, the Bank performs the calculation of provisions, based on risk exposure arising from loans and off-balance sheet receivables. The level of provision is determined by the degree of investment risk.

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Credit Risk Management (Continued)

Corporate Customer Rating System

Ranking system in the Bank (as in the whole Group) must be presented in accordance with the main rating system of the Group (five rating classes and five levels within the class). All internal ratings count one-year probability of default (PD) based on a weighted average of the following risk parameters:

- unconsolidated financial indicators (hard facts)
- sector and management (soft facts).

In addition, other factors such as the regularity of settlement of liabilities and assessment of creditworthiness affect the final customer rating.

Customer rating is calculated for each loan request. After the initial calculation, the rating of the customer is updated based on annual customer monitoring at least once a year.

The Bank's maximum exposure to credit risk was as follows:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Cash and balances held with the Central Bank (CBBH)	258,425	245,434
Deposits with banks	39,156	16,337
Loans and advances to customers, net	1,014,244	1,096,453
Securities available-for-sale	16,096	15,454
Other financial assets	4,534	4,906
	1,332,455	**1,378,584**

Loans and advances to customers (net) and deposits with banks are presented in the following tables:

	In thousands of BAM					
	Banks	Financial Institutions	Corporate Clients	Retail Clients	Government	Total
December 31, 2012						
Not past-due	39,158	10,243	311,769	441,789	126,442	929,401
From 1 to 90 days past-due	-	3,836	45,847	7,043	-	56,726
Over 90 days past-due	-	-	65,139	86,823	-	151,962
Total	**39,158**	**14,079**	**422,755**	**535,655**	**126,442**	**1,138,089**
SRP/SRPci	-	(731)	(30,875)	(46,535)	(23)	(78,164)
PRPLL	(2)	(88)	(2,887)	(3,076)	(472)	(6,525)
Less: Allowance for impairment	(2)	(819)	(33,762)	(49,611)	(495)	(84,689)
Net	39,156	13,260	388,993	486,044	125,947	1,053,400

Loans to financial institutions include loans approved to insurance companies, microcredit organizations and other financial institutions.

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Credit Risk Management (Continued)

	In thousands of BAM					
	Banks	Financial Institutions	Corporate Clients	Retail Clients	Government	Total
December 31, 2011						
Not past-due	16,339	5,131	321,970	393,029	117,961	854,430
From 1 to 90 days past-due	-	-	93,272	84,607	-	177,879
Over 90 days past-due	-	-	48,043	106,249	-	154,292
Total	**16,339**	**5,131**	**463,285**	**583,885**	**117,961**	**1,186,601**
SRP/SRPci	-	-	(27,801)	(39,009)	-	(66,810)
PRPLL	(2)	(106)	(2,535)	(3,955)	(403)	(7,001)
Less: Allowance for impairment	(2)	(106)	(30,336)	(42,964)	(403)	(73,811)
Net	16,337	5,025	432,949	540,921	117,557	1,112,790

Exposure to credit risk from loans and advances to customers, net and deposits with banks per rating was as follows:

	In thousands of BAM							
	Banks		Corporate Customers		Retail Customers		Total	
	Gross	Risk Provision	Gross	Risk Provision	Gross	Risk Provision	Gross	Risk Provision
December 31, 2012								
No rating	2,386	-	17,298	(7,751)	8,292	(223)	27,976	(7,974)
1A–1E	5,477	-	8,334	(47)	-	-	13,811	(47)
2A–2E	26,150	(1)	44,692	(1,645)	19,818	(576)	90,660	(2,222)
3A–3E	5,145	(1)	236,612	(4,438)	303,541	(6,127)	545,298	(10,566)
4A–4E	-	-	181,831	(1,926)	104,726	(10,871)	286,557	(12,797)
5A–5E	-	-	74,509	(19,269)	99,278	(31,814)	173,787	(51,083)
Total	**39,158**	**(2)**	**563,276**	**(35,076)**	**535,655**	**(49,611)**	**1,138,089**	**(84,689)**
Total (net)		**39,156**		**528,200**		**486,044**		**1,053,400**

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Credit Risk Management (Continued)

	In thousands of BAM							
	Banks		Corporate Customers		Retail Customers		Total	
	Gross	Risk Provision	Gross	Risk Provision	Gross	Risk Provision	Gross	Risk Provision
December 31, 2011								
No rating	6,637	-	14,581	(297)	-	-	21,218	(297)
1A–1E	1,182	-	-	-	-	-	1,182	-
2A–2E	8,370	(2)	76,175	(1,091)	25,992	(643)	110,537	(1,736)
3A–3E	-	-	84,272	(879)	293,555	(7,256)	377,827	(8,135)
4A–4E	150	-	335,454	(2,754)	205,828	(17,753)	541,432	(20,507)
5A–5E	-	-	75,895	(25,824)	58,510	(17,312)	134,405	(43,136)
Total	**16,339**	**(2)**	**586,377**	**(30,845)**	**583,885**	**(42,964)**	**1,186,601**	**(73,811)**
Total (net)		**16,337**		**555,532**		**540,921**		**1,112,790**

Impairment Losses and Provisioning Policy
Impaired loans and securities are those loans and securities for which the Bank determines that it is not to be able to collect all principal and interest accrued under the provisions of the loan/security agreement. Individually impaired assets are those assets that are individually assessed to have been impaired and have estimated losses recognized.

The Bank calculates allowance for impairment of the receivables based on the assessment of losses incurred in the Bank's loan portfolio.

Classification of receivables is based on an analysis of delays in liability settlement and indicators of return. In case of an individual loan impairment, future estimated cash flows are discounted in accordance with the requirements of IAS 39, to arrive at an appropriate amount of provision.

Write-Off Policy
Write-off policy is managed very carefully based on prior analysis of pricing options, where the Bank has estimated that the collection of receivables is not possible. Write-off proposal is given by the department in charge of the client at any time upon assessment that some receivables are uncollectible. Final write-off of receivables is the responsibility of the Board of Directors and Supervisory Board, depending on the write-off amount.

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Impairment Losses and Provisioning Policy (Continued)

Write-Off Policy (Continued)
The following table presents maximum credit risk exposure per balance sheet components:

	In thousands of BAM				
	Total Carrying Value	Without Impairment	Individual Impairment (SRP/SRPci)	Provision for Losses (PRPLL)	Total Net Carrying Value
December 31, 2012					
Cash and balances with the Central Bank (CBBH)	258,425	258,425	-	-	258,425
Deposits with banks	39,158	30,291	-	(2)	39,156
Loans and advances to customers	1,098,931	333,994	(78,164)	(6,523)	1,014,244
Securities available for sale	16,096	16,096	-	-	16,096
Other financial assets	5,731	4,120	(1,197)	-	4,534
	1,418,341	642,926	(79,361)	(6,525)	1,332,455
December 31, 2011					
Cash and balances with the Central Bank (CBBH)	245,434	245,434	-	-	245,434
Deposits with banks	16,339	6,926	-	(2)	16,337
Loans and advances to customers	1,170,262	278,329	(66,810)	(6,999)	1,096,453
Securities available-for-sale	15,454	15,454	-	-	15,454
Other financial assets	5,800	4,231	(847)	(47)	4,906
	1,453,289	550,374	(67,657)	(7,048)	1,378,584

Loans and advances to customers, net of impairment provisions were as follows:

	In thousands of BAM		
	Loans to customers, gross	Impairment	Loans to customers, net
December 31, 2012			
Portfolio risk provision	858,584	(6,523)	852,061
Specific risk provision	240,347	(78,164)	162,183
	1,098,931	(84,687)	1,014,244
December 31, 2011			
Portfolio risk provision	955,614	(6,999)	948,615
Specific risk provision	214,648	(66,810)	147,838
	1,170,262	(73,809)	1,096,453

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Impairment Losses and Provisioning Policy (Continued)

Write-Off Policy (Continued)
The breakdown of the gross amount of individually impaired loans and advances to customers and deposits with banks, along with the fair value of related collateral held by the Bank as security was as follows:

	In thousands of BAM				
	Banks	Corporate Clients	Retail Clients	Government	Total
December 31, 2012					
Gross amount	-	105,965	134,319	63	240,347
Individually impaired loans	-	(31,606)	(46,535)	(23)	(78,164)
Fair value of collaterals	-	63,607	81,056	-	144,663
December 31, 2011					
Gross amount	-	87,167	127,481	-	214,648
Individually impaired loans	-	(27,801)	(39,009)	-	(66,810)
Fair value of collaterals	-	60,241	70,815	-	131,056

Collaterals
In accordance with the standard principles of crediting business, the Bank demands collaterals for the purpose of securitizing investments against the risk of inability or unreadiness of the counterparty to settle the contractual liabilities.

Collaterals usually comprise one or a combination of more of the following security instruments:

- cash deposits in BAM or foreign currency;
- guarantees issued by Government, Government funds or first-class banks;
- guarantees issued by the parent company, other legal entities and individuals;
- letters of comfort issued by the parent company;
- mortgage over property;
- pledge of movable property;
- own blank promissory notes;
- pledge of shares and equity interests;
- a pledge of other securities (bonds) or precious metals;
- assignment of receivables (with or without notice);
- takeover of rights from insurance policy.

The Bank reserves the right to request any other type of instrument (or variations of the instruments stated above) that it considers necessary.

Assessment of fair value of impaired assets is based on the value of the security at the time of loan approval, and is updated periodically in accordance with the relevant credit Bank policy.

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Credit Exposure and Collaterals

	In thousands of BAM					
	Retail Clients		Corporate Clients		Total	
	Maximum Credit Risk Exposure	Fair Value of Collaterals	Maximum Credit Risk Exposure	Fair Value of Collaterals	Maximum Credit Risk Exposure	Fair Value of Collaterals
December 31, 2012						
Credit exposure, net	486,044	239,346	528,200	336,771	1,014,244	576,117
December 31, 2011						
Credit exposure, net	540,921	232,232	555,532	364,898	1,096,453	597,130

The analysis of the Bank's financial assets by industrial sectors at gross and net principle (less provision) is presented in the following table:

	In thousands of BAM			
	December 31, 2012	%	December 31, 2011	%
Retail customers	535,655	37.77%	583,885	40.18%
Trade	135,397	9.55%	138,837	9.55%
Mining and industry	159,616	11.25%	166,329	11.45%
Services, tourism and catering business	15,070	1.06%	23,161	1.59%
Transport and communications	9,056	0.64%	7,921	0.55%
Real estate	40,878	2.88%	50,246	3.46%
Agriculture, forestry and fishing	12,688	0.89%	12,919	0.89%
Construction industry	24,627	1.74%	34,048	2.34%
Financial institutions	289,861	20.44%	247,085	17.00%
Energy production	14,371	1.01%	16,045	1.10%
Administration and other public services	142,774	10.07%	135,333	9.31%
Other	38,348	2.70%	37,480	2.58%
Less: Allowance for impairment	(85,886)		(74,705)	
	1,332,455		1,378,584	

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Non-Performing Loans

Non-performing (NPL status) loans and investments are those that are over 90 days past-due in repayment (materially significant past-due means that the liabilities exceed 2.5% of the total exposure and that the delay from entering the materially significant past-due status is longer than 90 days) or the those where there are obvious problems in business operations. According to the classification, these are the investments that belong to categories C, D and E or assets with specific provisions in line with IAS ("NP Loans") with internal 5A or worse rating. Assets in B category and/or internal rating ranging from 4a to 4e are additionally monitored but are not considered NPL.

NPL management is centralized at the Bank level for both Banks in Bosnia and Herzegovina, and, since April 2011, and performed by three departments: Rehabilitation Department in charge of corporate and public sectors and retail customers (entirely or partially) in instances when such private individuals comprise a group of related parties with one or more legal entities which are the customers of the Rehabilitation Department; Collection Department in charge of SME and retail sector and specialized Local Task Force Rehabilitation Department (LTFR) in charge of monitoring project financing and tourism.

The Rehabilitation Department is in charge of corporate and public sector clients (with all their related parties) with 5A or worse rating and categories C, D and E within the local classification; transfer of customers from the Market Department is performed immediately upon fulfillment of these criteria. Prior to transfer to the Rehabilitation Department, the Market Department prepares a Client Transfer Protocol and the credit committees are in charge of transfer approval. In addition, the Rehabilitation Department is entitled to assume other borrowing customers with ratings better than 5A in all instances where the Rehabilitation Department estimates that the credit risk could deteriorate.

Upon identification of a client as a NPL client, the Rehabilitation Department assumes competence and responsibility for the whole Group's clients with the Bank and HETI as well as for defining collection strategy at the client group level.

Transfer of borrowing clients to the Rehabilitation Department is performed at the client group level, whereby all group members are allocated the credit rating of the worst group member. Exceptionally, the Rehabilitation Department can assume on one group member or allocate different credit ratings to the group members; however, this must be explained, documented and approves by competent bodies.

After assuming clients, the Rehabilitation Department assumes functions of both the market and Credit Risk Management departments, as it is competent for borrowing client processing and monitoring, for proposing manners of resolution and manners of possible collection of the Bank's receivables, for determination of the credit risk at the loan account/borrower level by applying the local regulations in effect and IFRS, for obtaining valid collateral appraisal, for borrower rating adjustments, for assessment and proposal of the amount of SRP and for collection of receivables using all legal means available.

The Rehabilitation Department borrowing clients are monitored every six months.

A restructured loan is a loan that is refinanced, reprogrammed or otherwise converted, or a loan in which, due to the borrower's changed conditions and repayment capabilities, or its inability to make repayment in line with initially agreed repayment schedule; or because of the revised (lower) current market rate, previously agreed deadlines (period or repayment schedule) and/or other conditions subsequently changed so that the Bank can allow the borrower easier (and for the Bank itself more secure) debt servicing.

In terms of type of organizational unit, the Rehabilitation Department consists of the following units:

- Restructuring Team,
- Workout Function, and
- SRP Reporting Function.

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Non-Performing Loans (Continued)
Restructuring Team is competent for complete monitoring of non-performing borrowers which can recover through the process of restructuring and continue regular servicing of their liabilities due to the Bank, thereby returning from NPL to PL status (normal debt servicing status).

In view of unfavorable circumstances in the economic environment wherein it operates that continued well into the year 2012, the Bank directed its business policy toward approving concessions to clients by means of wide-range possibilities for restructuring their comprehensive debts. When approving rescheduled loans due to deterioration of corporate clients' business operations, particular attention was paid to the prior business cooperation and causes that led to the problems in business operations, as well as to the assessment of the certainty of economic recovery which should occur in the future.

In the restructuring process, the Bank allows its borrowers a wide range of concessions to facilitate the recovery, including the following:

- Extension of periods for principal and/or interest repayment;
- Reduced interest rates applied;
- Additional funding;
- Reduction of the debt amount, outstanding principal and/or interest matured through write-off of portion of the Bank's receivables;
- Approval of balloon loan repayment adjusted to the realistic capability of the borrower to service debt from its own operations;
- Acceptance of other assets, i.e. borrower's property as total or partial collection of Bank's receivables;
- Approval of new grace periods together with significant reductions of interest rates within defined periods.

Workout Function is responsible for the borrowers against which the Bank has instigated enforcement procedures. The Workout Function receives the clients from the Restructuring Team where loan agreements are terminated and assumes competence for monitoring such clients until complete debt collection or write-off.

SRP Reporting Function is competent for organization and improvement of the Team's work through new standard implementation, monitoring of legal and internal regulations related to the Team's scope of work, preparation of new procedures form the Team's scope of work and participation in policy design, calculation and measurement of provisions for credit losses according to the methodology prescribed by the Banking Agency of the Republic of Srpska, monitoring of the Group policy and module requirement implementation and adherence, coordination, introduction and validation of the Group SRP tool, participation in preparing instructions for SRP tools, tool testing and user training, analyses of factors influencing movements on provisions and planning and forecasting provisions for potential losses, creation of the required reports on the calculated amount of provisions for credit losses according to the local and IFRS regulations, support to the Account Managers of the Rehabilitation Department and LTFR with preparation and completion of the loan rehabilitation documents within SRP provisions, definition of new software requirements for the Team's purposes, monitoring realization thereof, testing, and providing information to all users on the manner of working with the applications as well as for all other works related to the entire SRP process management and control.

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Non-Performing Loans (Continued)

Collection Department
Collection Department in charge of collection from SME and retail sector borrowing clients is organized and operates through the following sub-departments:

- Early Collection is in charge of portfolio monitoring, collection by telephone calls and meetings with borrowers whose matured liabilities exceed BAM 30 and are 10 to 30 days past-due;
- Prevention is in charge of portfolio monitoring, collection by telephone calls and meetings with borrowers whose matured liabilities exceed BAM 30 and are 31 to 90 days past-due;
- Loss Recovery is in charge of portfolio monitoring, collection by telephone calls and meetings with borrowers whose matured liabilities exceed BAM 30 and are over 90 days past-due;
- Administration sub-unit is in charge of past-due reminder sending, reminder text messaging, and debt balance notification sending, etc. This sub-unit also performs collateral activations, calculations of debt balances, loan reschedule request processing, loan agreement termination, collaboration with external debt collection agencies, sending and receiving mail, etc.
- Legal sub-unit (as well as Repossession) is competent for all legal suits within the Collection Department's scope of authority.
- Remarketing sub-unit is in charge of appraisal and sales of property and movable assets received as well as coordination and organization of marketing activities for sales promotion.

Restructured and refinanced loans as of December 31, 2012 and 2011 are presented below:

	In thousands of BAM	
	Number of restructured loans	Amount
December 31, 2012		
Corporate clients	15	39,963
Retail clients and entrepreneurs	5	38
Total	20	40,001
December 31, 2011		
Corporate clients	37	159,040
Retail clients and entrepreneurs	199	3,374
Total	236	162,414

5. FINANCIAL INSTRUMENTS (Continued)

a) Financial Risk Management (Continued)

Non-Performing Loans (Continued)

Off-Balance Sheet Items

Loan Commitments
The contractual amounts of the Bank's off-balance sheet financial liabilities that it has committed to extend as loans and advances to customers are summarized in the table below:

	In thousands of BAM			
	Up to 1 year	From 1 to 5 years	Over 5 years	Total
At December 31, 2012				
Loan commitments	62,217	9,051	12,163	83,431
At December 31, 2011				
Loan commitments	43,276	4,762	32,671	80,709

Other Financial Liabilities
Other financial liabilities are included in the table below based on the earliest contractual maturity date:

	In thousands of BAM			
	Up to 1 year	From 1 to 5 years	Over 5 years	Over 5 years
At December 31, 2012				
Payment guarantees, performance bonds and letters of credit	25,762	887	2,085	28,734
At December 31, 2011				
Payment guarantees, performance bonds and letters of credit	23,865	8,616	2,220	34,701

b) 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 fluctuations and hedging results, assets similar to equity or from management of assets and liabilities.

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

5. FINANCIAL INSTRUMENTS (Continued)

b) Market Risk (Continued)

General Requirements
The Bank develops its market risk strategy on the basis of strategic discussions between the competent units of Treasury and Risk Controlling. Decisions on combined business and risk strategies are only made by the Asset and Liability Management Committee (ALCO).

As part of the daily reporting procedure, the management receives value-at-risk (VaR) and performance figures for trading transactions on a daily basis and figures on the banking book investments and market risk steering on a weekly basis. There is also a daily report to the management in which the key risk and performance figures of the branches are communicated. In these, the value-at-risk at the branch level is compared to the defined limits. Limit breaches initiate defined escalation processes up to the Board of Directors 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 as part of ongoing reporting for HGAA. This is also applicable for the Bank, as a subsidiary of HGAA.

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 the 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 model calculates 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 to 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 the 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 is not currently using its own internal risk models for regulatory purposes. Instead, it uses the standard Group method.

The interest rate change risk in the investment book is determined as a present value risk, as are all market risks at the Bank. The risk of interest rate changes in the investment book is for the most part integrated into ongoing risk monitoring of market risk controlling as per value-at-risk. Contractual cancellation rights are modeled as an option, and included into the risk calculation. All stochastic items are accounted for in accordance with internal models. As per Basel II specifications, a 200 basis point interest rate shock scenario is calculated for the interest rate change risk in the investment book. The cash value changes calculated in relation to the regulatory capital are well below under the so-called "outlier criterion." In addition, a large number of possibly occurring market fluctuations can be calculated and illustrated through a calculation of standard, forward, historic and extreme scenarios.

5. FINANCIAL INSTRUMENTS (Continued)

b) Market Risk (Continued)

Risk Mitigation
In accordance with the new risk strategy from the Group, which was adopted in 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 indicate negative developments early on.

Risk Control and Monitoring
All market risks are centrally monitored by Risk Controlling, which is independent of all trading activities. In addition to regulatory requirements, this unit also ensures risk transparency and regular reporting to the management member responsible for this area. The Board of Directors 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 ALCO, which consists of the Board of Directors as well as the key personnel of Treasury, Risk Controlling and Financial Controlling, meets on a regular basis to analyze and decide on measures related to balance sheet structure and liquidity control.

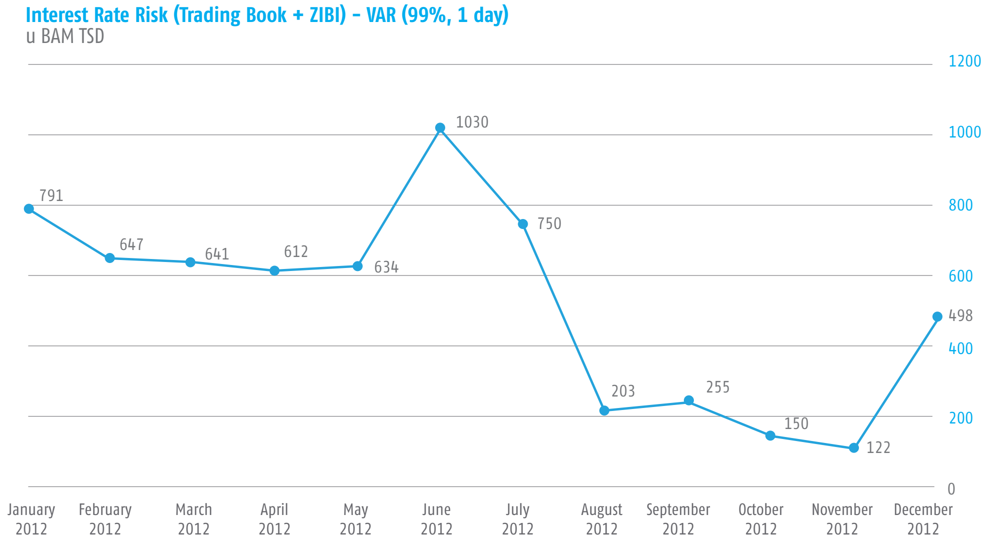
Market Risk Overview
The table shows the progression of interest rate risk (including the interest rate risk of the trading book) for the Bank in 2012. The fixed interest rate period statement for the Bank contains all interest rates relevant for balance and off-balance sheet items with their next interest rate fixing date. The stochastic cash flows are illustrated with uniform standards given by the Group and with local models for country-specific transactions. The graph shows the interest rate change risk for the Bank at overall Bank level (trading book and banking book).

5. FINANCIAL INSTRUMENTS (Continued)

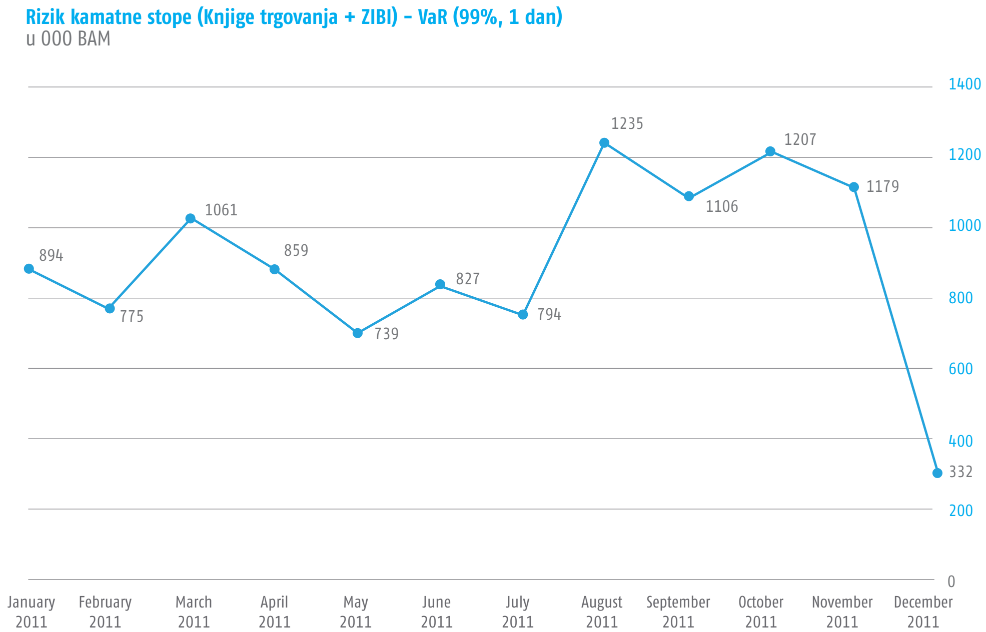
b) Market Risk (Continued)

Market Risk Overview (Continued)

Interest Rate Risk (Securities Trading Book + Banking Book) – 2012



Interest Rate Risk (Securities Trading Book + Banking Book) – 2011

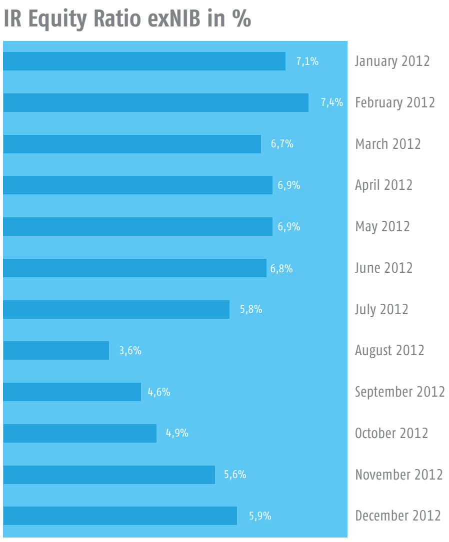


5. FINANCIAL INSTRUMENTS (Continued)

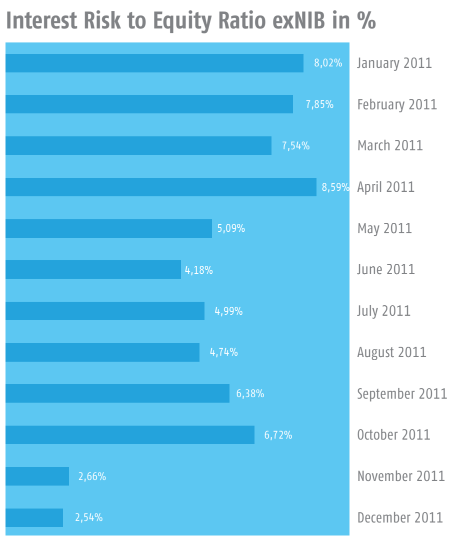
b) Market Risk (Continued)

Market Risk Overview (Continued)
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.

Initially, interest risks per defined currency are determined on the basis of the Bank's fixed interest period statement; a second step calculates the risk to capital ratio as a percentage of capital resources.



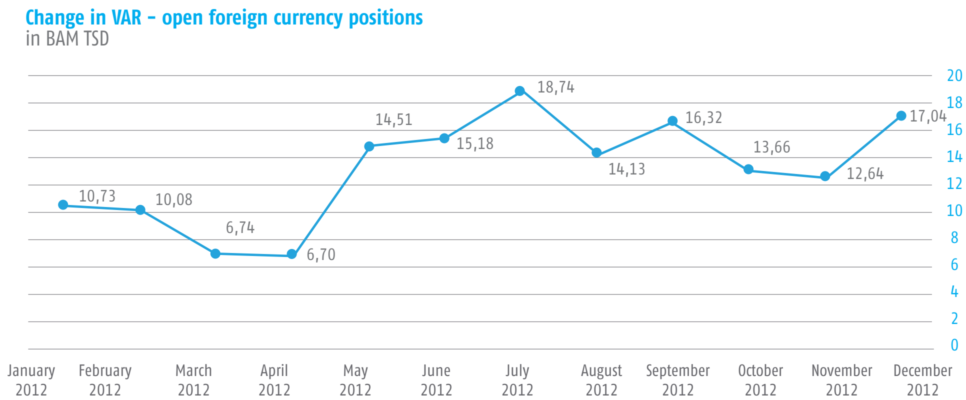
2012.



2011.

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 BAM 17.04 thousand (EUR 8.71 thousand) as of December 31, 2012, at a confidence interval of 99%.

Change in VAR – open foreign currency positions – 2012

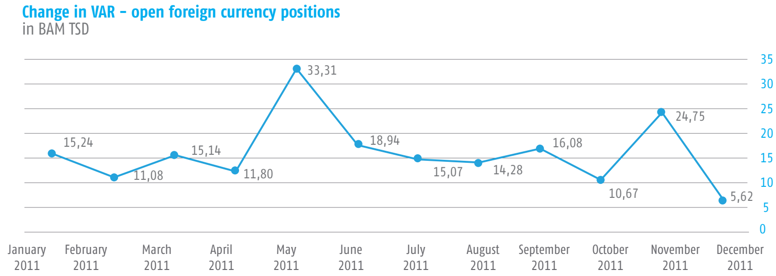


5. FINANCIAL INSTRUMENTS (Continued)

b) Market Risk (Continued)

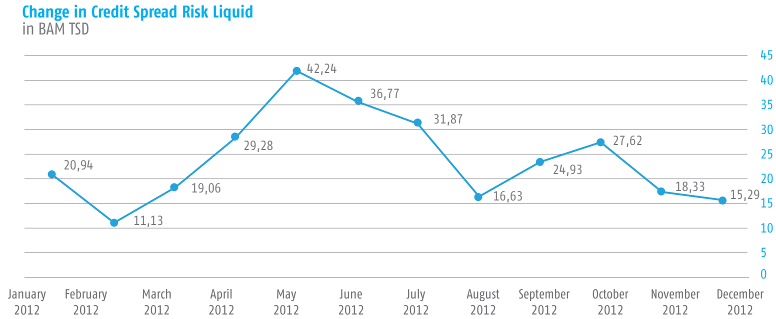
Market Risk Overview (Continued)

Change in VAR – open foreign currency positions – 2011

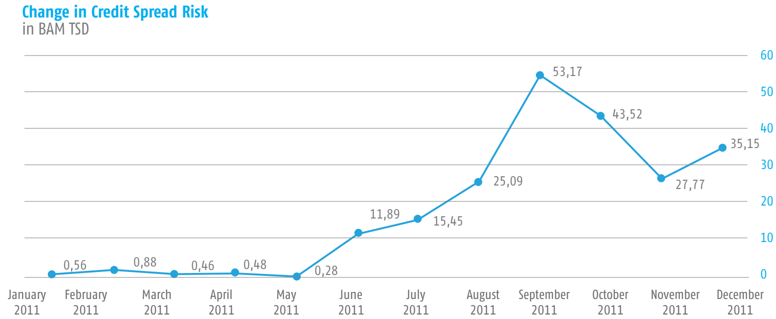


The credit spread risk for the Bank at year-end 2012 amounted to BAM thousand (EUR 7.82 thousand), with a 1-day value-at-risk and a confidence level of 99%.

Change in Credit Spread Risk – 2012



Change in Credit Spread Risk – 2011



5. FINANCIAL INSTRUMENTS (Continued)

c) Foreign Currency Risk

Foreign currency risk is Bank's exposure to possible impact of change in foreign currency exchange rate and danger that unfavorable changes may result in loss denominated in BAM (domestic currency). The level of risk is a function of height and length of the Bank's exposure to possible changes of foreign exchange rates, and depends on the amount of Bank borrowing in foreign currency and the degree of alignment of assets and liabilities of the Bank's balance sheet and off-balance sheet, for example the degree of matching of its currency flows.

Foreign currency risk exposure arises from credit, deposit, investment and trading activities. It is controlled daily in accordance with legislation and the internally set limits for each currency and for the assets and liabilities denominated in foreign currencies. During the year opened currency positions were held within the limits prescribed by the Decisions of BARS and the internal limits set according to the Group methodology. Foreign currency adjustment of financial assets and liabilities are reflected through purchase and sales of all foreign currencies and by including foreign currency clause into agreements on deposits and monitoring approval of loans with contracted currency clause. Foreign currency risk activities and responsibilities are defined in the Bank's Foreign Currency Risk Program.

Loans and deposits placed denominated in BAM with contracted currency clause are presented within appropriate foreign currency items.

The Bank had the following foreign currency assets and liabilities:

	In thousands of BAM EUR	USD	CHF	Other currencies	Total foreign currencies	Total BAM	Total
December 31, 2012							
ASSETS							
Cash and balances with the Central Bank	5,718	770	1,079	1,343	8,910	249,515	258,425
Deposits with banks	19,304	7,479	8,374	3,999	39,156	-	39,156
Loans and advances to customers	694,645	-	164,734	-	859,379	154,865	1,014,244
Securities available-for-sale	24	347	-	-	371	15,725	16,096
Other financial assets	1,452	32	7	1	1,492	3,042	4,534
Total assets	**721,143**	**8,628**	**174,194**	**5,343**	**909,308**	**423,147**	**1,332,455**
LIABILITIES							
Deposits held by banks and financial institutions	211,878	2	168,934	-	380,814	9,513	390,327
Customers' deposits	309,151	7,591	8,060	2,346	327,148	217,967	545,115
Borrowings	156,461	-	-	-	156,461	-	156,461
Subordinated liabilities	35,479	-	-	-	35,479	-	35,479
Other financial liabilities	12,838	-	2,105	-	14,943	3,208	18,151
Total liabilities	**725,807**	**7,593**	**179,099**	**2,346**	**914,845**	**230,688**	**1,145,533**
Net foreign currency balance	**(4,664)**	**1,035**	**(4,905)**	**2,997**	**(5,537)**	**192,459**	**186,922**

5. FINANCIAL INSTRUMENTS (Continued)

c) Foreign Currency Risk (Continued)

	In thousands of BAM EUR	USD	CHF	Other currencies	Total foreign currencies	Total BAM	Total
December 31, 2011							
ASSETS							
Cash and balances with the Central Bank	7,174	405	841	1,243	9,663	235,771	245,434
Deposits with banks	6,283	6,103	2,572	1,379	16,337	-	16,337
Loans and advances to customers	740,213	25	192,265	-	932,503	163,950	1,096,453
Securities available-for-sale	24	353	-	-	377	15,077	15,454
Other financial assets	1,013	75	-	-	1,088	3,818	4,906
Total assets	**754,707**	**6,961**	**195,678**	**2,622**	**959,968**	**418,616**	**1,378,584**
LIABILITIES							
Deposits held by banks and financial institutions	211,166	8	187,615	-	398,789	42,132	440,921
Customers' deposits	330,434	6,962	7,585	1,690	346,671	196,649	543,320
Borrowings	146,261	-	-	-	146,261	-	146,261
Subordinated liabilities	35,470	-	-	-	35,470	-	35,470
Other financial liabilities	13,181	2	7,262	-	20,445	12,927	33,372
Total liabilities	**736,512**	**6,972**	**202,462**	**1,690**	**947,636**	**251,708**	**1,199,344**
Net foreign currency balance	**18,195**	**(11)**	**(6,784)**	**932**	**12,332**	**166,908**	**179,240**

d) Interest Rate Risk

The Bank's operations are influenced by changes in interest rates to the extent to which interest-bearing assets and liabilities mature or have interest rates changing at different times or in different amounts.

In instances of variable interest rates, assets and liabilities of the Bank are also subject to basis risk, which represents the difference in pricing of various variable rate indexes, such as savings rate, six-month EURIBOR and the different types of reference interest rates. Risk management activities are aimed at optimizing net interest income in accordance with the Bank's business strategies, given the market interest rates

The Bank has developed a procedure for managing interest rate risk, with the aim to control and limit the potential loss of the Bank due to changes in foreign and domestic interest rates that affect the economic and market value of the Bank.

In order to achieve the objective of the interest rate risk management policy, the Bank identifies items that are sensitive to interest rate changes, prepares the data for the calculation of interest-sensitive items, establishes methods of measuring risk, establishes control mechanisms, and sets limits, determines the authorizations and responsibilities and reports.

The purpose of managing interest rate risk, as a segment of asset and liability management, is to determine the optimal interest rate, and therefore the income of the Bank, taking into account market conditions and competitive environment, while at the same time the interest rate adjusting the interest rates to the Bank's assets and liabilities. Given this objective, it is important to assess the sensitivity of revenues to the rapid changes in market interest rates.

For the purpose of protection against interest rate risk exposure, the Bank contracts variable interest rates, matches the structure of interest-bearing assets and interest-bearing liabilities and uses other means of interest rate risk management.

5. FINANCIAL INSTRUMENTS (Continued)

d) Interest Rate Risk (Continued)
The Bank manages interest risk by:

- adequately determining the level of interest margin, that is, reconciling the level of interest rates at assets and liabilities' items sensitive to interest rate, with the same maturity and time interval within which the level of interest rate is re determined, and/or
- determining maturity reconciliation of assets and liabilities sensitive to interest rate (when fixed interest rate is determined) that is, reconciles maturity (time interval for re determining of interest rates in case floating interest rate is applied).

The Bank is exposed to risks which affect its financial position and cash flows through the effects of changes in market interest rates level.

Interest rate risk presents unfavorable change of lending interest rates in relation to the level of borrowings rates.

While managing interest rate risk the Bank uses simulation of expected and extreme changes in interest rates and the influence of these changes on the income statement.

e) Liquidity Risk

Definition
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 main objective of liquidity risk management and control 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 control of liquidity risks are governed by the liquidity manual which applies across the entire HGAA. In the Bank, liquidity steering and management are the responsibility of the Treasury Function. The Treasury is responsible for operational liquidity steering and liquidity off-sets. Liquidity risk control 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 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 liabilities and to prevent damage to the Bank's reputation.

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.

5. FINANCIAL INSTRUMENTS (Continued)

e) Liquidity Risk (Continued)
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 limit transfer), supplement the risk measurement spectrum.

Based on 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.

Risk Monitoring
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 and the controlling units responsible for liquidity risk.

5. FINANCIAL INSTRUMENTS (Continued)

e) Liquidity Risk (Continued)

Maturity Analysis of Financial Assets and Liabilities

The following table presents analysis of assets and liabilities by maturity based on remaining period from balance sheet date to agreed due date:

	In thousands of BAM				
	Up to 1 month	From 1 to 3 months	From 3 to 12 months	Over 1 year	Total
At December 31, 2012					
Financial assets					
Cash and balances with the Central Bank	258,425	-	-	-	258,425
Deposits with banks	39,156	-	-	-	39,156
Loans and advances to customers	205,221	26,626	119,369	663,028	1,014,244
Securities available-for-sale	4,096	13	9,942	2,045	16,096
Other financial assets	4,534	-	-	-	4,534
Total	**511,432**	**26,639**	**129,311**	**665,073**	**1,332,455**
Financial liabilities					
Deposits held by banks	10,360	3,628	25,150	351,189	390,327
Customers' deposits	267,583	63,493	153,716	60,323	545,115
Borrowings	912	2,262	7,504	145,783	156,461
Subordinated liabilities	-	-	-	35,479	35,479
Other financial liabilities	18,151	-	-	-	18,151
Total	**297,006**	**69,383**	**186,370**	**592,774**	**1,145,533**
Liquidity gap	**214,426**	**(42,744)**	**(57,059)**	**72,299**	**186,922**
At December 31, 2011					
Financial assets					
Cash and balances with the Central Bank	245,434	-	-	-	245,434
Deposits with banks	16,337	-	-	-	16,337
Loans and advances to customers	133,741	49,666	177,529	735,517	1,096,453
Securities available-for-sale	-	9,779	4,881	794	15,454
Other financial assets	4,906	-	-	-	4.906
Total	**400,418**	**59,445**	**182,410**	**736,311**	**1,378,584**
Financial liabilities					
Deposits held by banks	45,151	25,169	8,532	362,069	440,921
Customers' deposits	227,712	113,165	124,936	77,507	543,320
Borrowings	1,363	1,389	4,744	138,765	146,261
Subordinated liabilities	-	-	-	35,470	35,470
Other financial liabilities	33,372	-	-	-	33,372
Total	**307,598**	**139,723**	**138,212**	**613,811**	**1,199,344**
Liquidity gap	**92,820**	**(80,278)**	**44,198**	**122,500**	**179,240**

5. FINANCIAL INSTRUMENTS (Continued)

f) Fair Value of Financial Assets and Liabilities

The table below summarizes the carrying amounts and fair values of the Bank's financial assets and liabilities:

	In thousands of BAM			
	Carrying Value		Fair Value	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Assets				
Deposits with banks, net	258,425	261,771	258,425	261,771
Loans and advances to customers	1,014,244	1,096,433	1,031,044	1,093,340
Liabilities				
Deposits held by banks and customers	935,442	984,241	935,626	982,405
Borrowings	156,461	146,261	144,955	146,261
Subordinated liabilities	35,479	35,470	35,479	35,470

(i) Due from Banks

Due from banks including inter-bank placements
Fair value of deposits with variable interest rate and "overnight" deposits is their stated value. The estimated fair value of fixed interest-bearing deposits is based on discounted cash flows using market prevailing for debts with similar remaining maturities.

(ii) Loans and advances to customers, net

Loans are presented net of provisions for credit losses. The estimated fair value of loans represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

(iii) Deposits from other banks, clients, other deposits, other borrowings and subordinated liabilities

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits not quoted in an active market is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

Fair value of term deposits with variable interest rates approximates their carrying values as of the balance sheet date.

Fair value of subordinated liabilities with variable interest rates approximates their carrying values as of the balance sheet date.

5. FINANCIAL INSTRUMENTS (Continued)

g) Operational Risks
Operational risk management is an important part of the Bank's operations, which allows its long-term successful business and the preservation of reputation.

As part of operational risk framework, the Bank implements the following activities:

- definition and identification of operational risk;
- development and application of methods and systems for measurement, analysis, limitations and control of operational risks in accordance with regulatory and Group requirements;
- measurement, analysis and supervision of operational risk in line with minimum standards for operational risk management;
- maintenance of database on losses from operational risks – regular data collection and reporting regular updates of new and existing policies, manuals and procedures in accordance with regulations and Group standards;
- performing qualitative estimates (scenario analyses and risk assessment) in order to identify and assess risk in business processes;
- reputation risk management aiming at risk identification, assessment, monitoring and control and reporting;
- education of all employees in order to improve their knowledge and experience, awareness and skills in dealing with operational risk or specific processes (e.g. collection of data on losses, risk assessment).

In order to improve processes for managing operational risk in the Bank, the following activities are planned:

- initiation of activities for adequate operational risk management for all projects and development of new products, processes and systems;
- education of all employees in order to improve their knowledge and experience, awareness and skills in dealing with operational risk - strengthening OpRisk culture.

h) Capital Risk Management
In accordance with the Law on Banks (Official Gazette of the Republic of Srpska, no. 44/03), the minimum amount of a bank's paid-in capital and the lowest level of the capital a bank has to maintain, cannot be lower than BAM 15,000 thousand. The Bank's subscribed capital amounted to BAM 129,168 thousand in line with these provisions.

The Bank's capital is comprised of the core capital less items deductible from the core capital and supplementary capital.

The Bank's core capital is comprised of paid-in share capital and reserves. Deductible items include: intangible assets, unabsorbed losses from prior years and current year loss, the carrying value of the Bank's treasury shares in its possession and the amount of additional reserves for credit losses as per requirements of the Banking Agency of the Republic of Srpska regulations.

The Bank's supplementary capital includes general provisions for credit losses on balance sheet items from A category, current net profit reviewed and confirmed by an independent auditor and subordinated debt up to 50% of the core capital.

5. FINANCIAL INSTRUMENTS (Continued)

h) Capital Risk Management (Continued)

With regard to capital risk management, the Bank aims to:

- provide compliance with the Banking Agency of the Republic of Srpska requirements;
- provide compliance with Hypo Group standards;
- provide solid capital basis as a support for further development of Bank's operations;
- provide possibilities of long-term business operation while providing profit for shareholders.

The Bank is under obligation to maintain capital adequacy at the minimum of 12% and the core capital at the minimum of 50% of the total capital, i.e. to adjust the scope and structure of its operations to business indicators defined by the Decision on Minimum Standards for Bank Capital Management and other the Banking Agency of the Republic of Srpska decisions relating to supervision and control of banks performance and Law on Banks of the Republic of Srpska.

The Bank's management monitors adequacy ratios and other business indicators on a regular basis. Reports on indicators are submitted to the Banking Agency of the Republic of Srpska quarterly in the prescribed form.

The Bank manages capital and performs reconciliations in accordance with its goals, market changes and risks typical for Bank's operations. Depending on the primary goal, the Bank adjusts capital structure as follows:

- by adjustments of dividend payments to shareholders, i.e., by increase in share capital arising from profit;
- by increase of capital reserves arising from profit;
- by new issues of shares which can be private and public;
- by increase in supplementary capital items.

As of December 31, 2012 and December 31, 2011, the Bank's capital adequacy indicators were in compliance with effective regulations.

	In thousands of BAM Year Ended December 31, 2012	2011
Core capital *	158,805	135,702
Supplementary capital *	58,616	76,381
Items deductible from capital *	(35,590)	(238)
Capital, net	**181,831**	**211,845**
Total risk-weighted assets *	905,538	989,397
Total risk-weighted off-balance sheet items *	66,223	66,197
Weighted operational risk *	88,949	95,380
Total risk-weighted assets and off-balance sheet items	**1,060,710**	**1,150,974**
Capital adequacy as of December 31	**17.1%**	**18.4%**

* The amounts of capital and other items presented in the table above were calculated in accordance with the BARS regulations.

6. INTEREST INCOME AND EXPENSES

Interest Income

	In thousands of BAM Year Ended December 31, 2012	2011
Interest income from the retail sector	37,197	44,041
Interest income from corporate and public sectors	38,081	39,166
Interest income from balances with the Central Bank	85	1,186
Interest income from deposits with banks	42	85
	75,405	**84,478**

Interest Expenses

	In thousands of BAM Year Ended December 31, 2012	2011
Deposits held by banks and other financial institutions	19,842	25,467
Deposits from retail customers	10,397	10,374
Deposits from public sector	1,080	2,371
Deposits from corporate customers	2,811	2,021
Other deposits	254	92
	34,384	**40,325**

7. FEE AND COMMISSION INCOME AND EXPENSES

Fee and Commission Income

	In thousands of BAM Year Ended December 31, 2012	2011
Fee income arising from domestic payment transfers	6,918	6,012
Fees earned on VISA card operations	3,424	2,682
Fee income arising from international payment transfers	1,691	1,880
Charges for early loan repayment, reminders and other loan fees	1,194	1,212
Commission from issued guarantees, letters of credit and other sureties	714	788
Fee income from currency conversion operations	1,269	739
Brokerage commissions	77	88
Other fee and commission income	419	69
	15,706	**13,470**

7. FEE AND COMMISSION INCOME AND EXPENSES (Continued)

Fee and Commission Expenses

	In thousands of BAM Year Ended December 31, 2012	2011
Fees for funds available for liquidity purposes	1,617	1,956
Fee expenses incurred on payment card operations	818	728
Fees from loans, issued guarantees and other fees	531	620
Fee expenses incurred on domestic payment transfers	473	674
Fee expenses incurred on international payment transfers	166	148
Fee expenses incurred on stock exchange operations and Central Register fees	17	20
	3,622	**4,146**

8. OTHER OPERATING INCOME

	In thousands of BAM Year Ended December 31, 2012	2011
Collection of receivables previously written-off	6,410	12,493
Rental income	718	652
Income from dormant customer current accounts	18	398
Reversal of provisions for retirement benefits	85	74
Income from the sale of securities available for sale	-	372
Reversal of provisions for employee benefits/bonuses	1,214	2,445
Reversal of provisions for litigation losses	64	110
Fair value adjustment of the acquired tangible assets	1,743	15
Other income	514	821
	10,766	**17,380**

Income from dormant accounts relates to accounts where there has been no account holder activity, either deposit to or withdrawal from the account by the account holder, for a period of one year from the date of the last account holder activity, and in case of time deposits, one year beyond the maturity date, in accordance with the Law on Banks of the Republic of Srpska.

Pursuant to the Decision of the Board of Directors, the Bank reversed provisions for employee benefits/bonuses from prior years in the amount of BAM 1,214 thousand and credited it to income. The said provisions were intended for employee bonuses, annual leave allowances and annual medical checkups.

Pursuant to the Decision of the Board of Directors, during 2012 the Bank sold tangible assets acquired in lieu of debt collection in the amount of BAM 734 thousand, which were sold for BAM 2,040 thousand, whereby the Bank realized gains on the sale and value adjustment of the acquired tangible assets in the amount of BAM 1,743 thousand.

9. OTHER OPERATING EXPENSES

	In thousands of BAM Year Ended December 31, 2012	2011
Net salaries	9,269	8,770
Taxes and contributions on salaries	6,226	6,781
Other employee benefits	274	1,449
Losses on the fair value adjustment of the acquired tangible assets	2,033	365
Provisions for potential litigation losses (Note 28)	118	479
Depreciation and amortization charge	4,283	3,687
Costs of materials, fuel, energy and services	1,829	1,815
Software lease costs	4,610	4,320
Property insurance and security	2,814	2,954
Telecommunications	1,946	1,783
Advertising, marketing and entertainment	1,439	2,154
Fees to the Banking Agency of the Republic of Srpska	1,102	1,263
Maintenance	771	914
Indirect taxes and contributions	1,575	1,825
Intellectual services by related banks	1,162	1,381
Consulting services	600	1,757
Rentals	777	690
Litigation costs	254	354
Per diems and other travel costs	484	434
Sponsorship and humanitarian aid	260	481
Non-material expenses	520	517
Non-material services	730	416
Membership fees and commissions	118	133
Losses on the sale of securities available-for-sale	-	70
Disposals and write-offs of property and equipment	8	6
Other expenses	459	736
	43,661	**45,534**

Expenses arising from the sales and fair value adjustment of acquired tangible assets in 2012 is associated with the following: expenses incurred in fair value adjustment of acquired tangible assets of BAM 1,988 thousand as a result of reducing the assets to the technicality amount due to the expiry of the prescribed period of one year from the acquisition date for the sale thereof (Note 2.2. d), and loss incurred in the sales thereof in the amount of BAM 45 thousand.

10. PROVISIONS FR POTENTIAL LOSSES, COMMITMENTS AND WRIT-OFFS

	In thousands of BAM Year Ended December 31, 2012	2011
Loans and advances to customers (Note 14)	10,782	(748)
Other assets (Note 20)	1,032	28
Provisions for commitments and contingencies, net (Note 28)	230	1,368
Deposits with banks (Note 13)	-	(1)
Write-offs	149	115
	12,193	**762**

11. INCOME TAX

a) Components of Income Tax

	In thousands of BAM Year Ended December 31, 2012	2011
Current income tax expense	1,643	2,532
Deferred tax expense	27	322
	1,670	**2,854**

b) Reconciliation between tax expense and profit before taxes multiplied by the applicable tax rate

	In thousands of BAM Year Ended December 31, 2012	2011
Profit before taxation	9,495	26,097
Income taxes at the statutory tax rate of 10%	950	2,610
Adjustments		
Tax effects of expenses not recognized for tax purposes	1,351	689
Tax effects of income not recognized for tax purposes	(72)	(170)
Tax effect of recognized provisions for potential losses representing 20% of the tax basis	(329)	(65)
Non-deductible entertainment costs	6	6
Non-deductible penalties	-	3
Tax effects of depreciation and amortization not recognized for tax purposes	22	29
Tax effects of provisions for employee benefits	(258)	(248)
Income tax expense	**1,670**	**2,854**
Effective interest rate	**18%**	**11%**

11. INCOME TAX (Continued)

Tax effects of expenses not recognized for tax purposes of BAM 1,351 thousand represent 10% of the expenses not recognized for tax purposes as deductibles in accordance with the Income Tax Law effective in the Republic of Srpska and include provisions for credit losses, other provisioning costs, revaluation losses and other miscellaneous costs.

12. CASH AND BALANCES HELD WITH THE CENTRAL BANK

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Cash on hand:		
- in local currency	8,910	12,764
- in foreign currencies	16,174	9,663
Balances with the Central Bank (in local currency)		
- obligatory reserve	81,188	90,423
- gyro account	152,153	132,584
	258,425	**245,434**

Cash and balances with Central Bank as of December 31, 2012 included related interest and fee in total amount of BAM 1 thousand (2011: BAM 33 thousand).

The obligatory reserve represents amounts required to be deposited with the Central Bank of Bosnia and Herzegovina. Pursuant to the Decision of the Central Bank of Bosnia and Herzegovina, starting from February 1, 2011, the required reserve represents 10% of average deposits and borrowings with maturities within one year and 7% of those denominated in BAM with maturities over a year.

The required reserve is maintained as the average balance on the current account with the Central Bank of Bosnia and Herzegovina. This reserve is available for liquidity purposes. The Central Bank pays a fee on the obligatory reserve in the manner specified by the Law.

13. DEPOSITS WITH BANKS

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Foreign currency accounts with foreign and domestic banks	28,266	8,308
Up to 7 days term deposits	10,825	7,940
Foreign currency cheques in the course of collection	67	91
Less: Allowance for impairment	(2)	(2)
	39,156	**16,337**

Deposits held with other banks as of December 31, 2012 included the interest accrued and fees totaling BAM 2 thousand (2011: BAM 0 thousand).

13. DEPOSITS WITH BANKS (Continued)

Foreign currency accounts held with foreign and domestic banks do not accrue interest.

As of December 31, 2012, term deposits with maturity up to 7 days related to deposits held with banks operating in the European Union, bearing interest at the annual rates ranging from 0.2% to 4.07% (2011: 0.2% to 0.25% annually).

The movements on the account of allowance for impairment are presented in the following table:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Balance at January 1	2	2
Charge for the year	64	1
Reversal	(64)	(1)
	2	**2**

14. LOANS AND ADVANCES TO CUSTOMERS

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Up to 1 year maturity:		
- in local currency	172,318	182,594
- in foreign currency	5,535	6,672
Over 1 year maturity:		
- in local currency	1,393	908
- in foreign currency	720,938	791,168
Current portion of long-term loans:		
- in local currency	2,234	45
- in foreign currency	131,118	146,039
Long-term loans matured:		
- in local currency	1,745	2,349
- in foreign currency	63,263	40,178
Receivables arising on guarantees issued:		
- in local currency	387	309
	1,098,931	1,170,262
Less: Allowance for impairment	(84,687)	(73,809)
	1,014,244	**1,096,453**

14. LOANS AND ADVANCES TO CUSTOMERS (Continued)

The movements on the account of allowance for impairment are presented in the following table:

	In thousands of BAM December 31, 2012	December 31, 2011
Balance at January 1	73,809	170,887
Charge for the year	56,359	100,708
Reversal	(45,577)	(101,456)
Charge for the year, net	10,782	(748)
Foreign exchange effects, net*	96	744
Pass-Through Agreement	-	(87,675)
Write-off	-	(9,399)
Balance at December 31	**84,687**	**73,809**

* Charge for the year includes the foreign exchange impact per item.

Loans and advances to customers as of December 31, 2012 included the related interest accrued and fees in the total amount of BAM 13,424 thousand (2011: BAM 13,402 thousand).

Loans denominated in BAM with contracted currency clause are presented within the appropriate foreign currency items.

Interest rates ranges described hereunder refer to the prevailing interest rates that truly and accurately reflect the largest portion of the loans extended.

Major portion of the loans approved for a period of up to a year pertain to overdrafts approved per the transaction accounts of corporate and retail customers totaling BAM 98,574 thousand (2011: BAM 107,197 thousand), at the interest rates ranging from 5.5% to 15.49% annually (2011: from 4.25% to 15.49% annually).

The remaining part mainly relates to short-term loans extended to enterprises in the amount of BAM 59,528 thousand at annual interest rates ranging from 4.75% to 11% (2011: BAM 55,863 thousand at annual interest rates ranging from 4% to 11.5%), short-term consumer loans approved to retail customers in the amount of BAM 14,386 thousand, at annual interest rates ranging from 5.99% to 13.99% (2011: BAM 17,386 thousand, at annual interest rates ranging from 6% to 13.99%) and short term loans to entrepreneurs totaling BAM 324 thousand, with annual interest rates ranging from 8.5% to 10.3% (2011: BAM 271 thousand at annual interest rates ranging from 7.5% do 11.5%) The remaining BAM 5,041 thousand (2011: BAM 8,548 thousand) refers to loans extended to foreign entities in the amount of BAM 1,707 thousand and matured interest and fees per loans approved to corporate and retail customers in the amount of BAM 3,334 thousand.

Loans disbursed in BAM with over 1 year maturities relate to loans approved to corporate customers at annual interest rate ranging from 6-month EURIBOR plus the margin of minimum 2.75% to 6-month LIBOR plus the margin of minimum 3.5%, and loans approved to retail customers at annual interest rates ranging from 2% to 14.74% (2011: interest rate ranging 6-month EURIBOR plus the margin of minimum 2.75% to 6-month LIBOR plus the margin of minimum 4%, and 2% to 13.99% annually).

As of December 31, 2012, loans disbursed in BAM with over 1 year maturities included loans approved to retail customers totaling BAM 432,253 thousand (including the current portion thereof) (2011: BAM 489,525 thousand).

14. LOANS AND ADVANCES TO CUSTOMERS (Continued)

The review of loans is presented in the following table:

	In thousands of BAM Maturity	Interest Rate	Total
December 31, 2012			
Consumer loans	Do 20 godina	2.00% - 14.74%	193,273
Housing loans	Do 30 godina	2.00% -12.00%	149,550
Mortgage and Lombard loans	Do 30 godina	2.25% -12.50%	53,876
Investment loans	Do 20 godina	4.20% -11.50%	22,762
Loans to the Bank's employees	Do 20 godina	2.25% -10.67%	12,250
Automobile purchase loans	Do 10 godina	4.20% -9.50%	542
			432,253
December 31, 2011			
Consumer loans	Do 10 godina	5.40% - 14.49%	220,858
Housing loans	Do 30 godina	3.60% -11.75%	161,593
Mortgage and Lombard loans	Do 20 godina	2.50% -11.75%	65,278
Investment loans	Do 10 godina	4.20% -11.50%	25,788
Loans to the Bank's employees	Do 30 godina	2.00% -11.25%	15,273
Automobile purchase loans	Do 10 godina	7.20% -10.75%	735
			489,525

As of December 22, 2011, the Pass-Through Agreement was entered into by Hypo Alpe-Adria Bank a.d, (hereinafter: the "Transferor"), Bora d.o.o., Banja Luka (hereinafter: the "Transferee") and Hypo Alpe-Adria Bank International AG (hereinafter: the „"Calculation Agent"). Pursuant to this Agreement, the Transferor undertakes to transfer all cash flows from the financial assets included in the Agreement (hereinafter: "reference assets") without any significant delays. Cash flows include all amounts realized through sales of the assets collateralizing the reference assets the Transferor purchased within the court execution procedure or directly from the owner, out of court execution procedure.

The Transferor is entitled to deduction of real costs incurred in collection of receivables if the costs are documented to the Transferee. The transfer of cash flows is performed in BAM calculated at the middle exchange rate published by CBBH as at the date of each transfer. The Transferee is entitled to interest accrued during the period from the receipt of the cash flows by the Transferee up to the transfer of the cash flows to the Transferee's account at the interest rate the Transferee calculates for demand deposits in accordance with the Decision on Interest Rates in Transactions with Legal Entities. The fee for cash flows the Transferee is obligated to pay is determined as a net carrying value of the reference assets (gross carrying value netted of allowance for impairment).

PTA has no impact on the relationships between the Bank and its customers whose loans are the subject of the PT Agreement. The Agreement transfers all the risks and rewards of collection to the Transferee whereby the Transferee is obligated to manage and service the reference assets with the due care attention and skills that would have been exercised thereto had this Agreement not been entered into. Based on this Agreement, the Bank has derecognized all the reference assets from the balance sheet, together with related allowance for impairment, and decreased liabilities arising from deposits to Hypo Alpe-Adria Bank International AG by the net amount.

The geographic risk concentration within the customer loan portfolio mostly relates to clients domiciled in the Republic of Srpska.

15. SECURITIES AVAILABLE FOR SALE

	In thousands of BAM December 31, 2012	December 31, 2011
Investments in financial institutions:		
- Euroaxis Bank, Moscow	347	353
- Banjalučka berza a.d., Banja Luka (Banja Luka Stock Exchange)	175	175
- Central Securities Registry a.d., Banja Luka	30	30
- Other financial institutions	142	141
Investments in non-financial entities	26	26
Investments in debt securities	15,376	14,729
	16,096	**15,454**

Investments in debt securities totaling BAM 15,376 thousand as of December 31, 2012 refer to the short-term and long-term bonds issued by the ministry of finance of the Republic of Srpska at the interest rates ranging between 1.5% and 6% annually and those issued by the Municipality of Gradiška at the annual interest rate of 6%.

16. EQUITY INVESTMENTS

Equity investments as of December 31, 2011 in the amount of BAM 3,500 thousand relate to the 100% equity share in the related party Hypo Alpe-Adria-Leasing d.o.o., Banja Luka, which was established in June 2011 and is involved in lease activities.

In the 2nd extraordinary meeting held on May 24, 2011, the Shareholders' Assembly of Hypo Alpe-Adria-Bank a.d. Banja Luka enacted a Decision on the foundation of Hypo Alpe-Adria-Leasing d.o.o. Banja Luka.

During 2012 Hypo Alpe-Adria-Bank a.d. Banja Luka increased the capital of the subsidiary Hypo Alpe-Adria-Leasing d.o.o. Banja Luka in the amount of BAM 1,000 thousand.

17. PROPERTY AND EQUIPMENT

	In thousands of BAM Land and Buildings	Equipment and Other Assets	Investments in Progress	Total
Cost				
Balance at January 1, 2011	47,638	16,254	305	64,197
Additions	-	402	869	1,271
Transfers	93	506	(599)	-
Disposal	-	(104)	-	(104)
Write-off	-	(1,337)	-	(1,337)
Reclassification	-	-	(1)	(1)
Balance at December 31, 2011	**47,731**	**15,721**	**574**	**64,026**
Balance at January 1, 2012	47,731	15,721	574	64,026
Additions	-	377	625	1,002
Transfers	-	685	(685)	-
Disposal	-	(88)	-	(88)
Write-off	-	(1,530)	-	(1,530)
Reclassification	-	74	-	74
Sales	-	(638)	-	(638)
Balance at December 31, 2012	**47,731**	**14,601**	**514**	**62,846**
Accumulated depreciation	-	-	-	-
Balance at January 1, 2011	6,623	8,251	-	14,874
Charge for the year	657	2,362	-	3,019
Disposal	-	(98)	-	(98)
Write-off	-	(1,337)	-	(1,337)
Sales	-	-	-	-
Balance at December 31, 2011	**7,280**	**9,178**	**-**	**16,458**
Balance at January 1, 2012	7,280	9,178	-	16,458
Charge for the year	664	2,139	-	2,803
Disposal	-	(79)	-	(79)
Write-off	-	(1,530)	-	(1,530)
Reclassification	-	74	-	74
Sales	-	(127)	-	(127)
Balance at December 31, 2012	**7,944**	**9,655**	**-**	**17,599**
Net book value:				
December 31, 2012	**39,787**	**4,946**	**514**	**45,247**
December 31, 2011	**40,451**	**6,543**	**574**	**47,568**

17. PROPERTY AND EQUIPMENT (Continued)

The Bank's property as of December 31, 2012, included land and buildings with carrying amount of BAM 2,694 thousand whereof the Bank did not possess appropriate title deeds (2011: BAM 2,741 thousand).

As of December 31, 2012, the Bank had no mortgages or other pledges assigned over its property and equipment as collaterals for loan repayment.

18. INTANGIBLE ASSETS

	In thousands of BAM Licenses and Software
Cost	
Balance at January 1, 2011	14,154
Additions	1,390
Write-off	(55)
Reclassification	(54)
Balance at December 31, 2011	**15,435**
Additions	1,369
Write-off	(217)
Disposal	(2,145)
Balance at December 31, 2012	**14,442**
Accumulated amortization	
Balance at January 1, 2011	1,512
Charge for the year	614
Write-off	(55)
Balance at December 31, 2011	**2,071**
Charge for the year	1,427
Write-off	(218)
Disposal	(2,145)
Balance at December 31, 2012	**1,135**
Net book value	
December 31, 2012	**13,307**
December 31, 2011	**13,364**

19. INVESTMENT PROPERTY

	In thousands of BAM Land and Buildings
Cost	
Balance at January 1, 2011	3,895
Balance at December 31, 2011	**3,895**
Balance at December 31, 2012	**3,895**
Accumulated depreciation	
Balance at January 1, 2011	285
Charge for the year	54
Balance at December 31, 2011	**339**
Charge for the year	53
Balance at December 31, 2012	**392**
Net book value:	
December 31, 2012	**3,503**
December 31, 2011	**3,556**

As of December 31, 2012, investment property was comprised of land with carrying value of BAM 108 thousand, whereof the Bank did not possess appropriate title deeds (2011: BAM 111 thousand).

20. OTHER ASSETS

	In thousands of BAM	
	December 31, 2012	December 31, 2011
In local currency:		
- Receivables from clients arising from litigations	1,453	1,453
- Tangible assets received in lieu of debt collection	1	1,613
- Collateral foreclosures	211	1,264
- Deferred tax assets	186	214
- Receivables for prepaid income taxes	724	454
- Receivables for prepaid income taxes in Brčko District	1,260	531
- Credit card operations	761	561
- Prepaid expenses	193	24
- Consumables, tools and fixtures	149	233
- Advances paid	25	2
- Rental receivables from clients	98	74
- Receivables for assets sold	465	-
- Receivables for consultant fees	316	221
- Other receivables	773	1,110
In foreign currencies:		
- Credit card operations	1,222	886
- Prepaid expenses	125	28
- Prepaid interest	20	4
- Other receivables	69	174
Less: Allowance for impairment	**(2,457)**	**(1,425)**
	5,594	**7,421**

As of December 31, 2012, the amount of BAM 2,320 thousand refers to non-financial assets and allowance for impairment thereof in the amount of BAM 1,260 thousand (2011: BAM 3,045 thousand and 531 thousand, respectively) out of total other assets.

The movements on the account of allowance for impairment are presented in the following table:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Balance at January 1	1,425	1,397
Charge for the year	1,081	28
Reversal	(49)	-
Increase, net	**1,032**	**28**
Balance at December 31	**2,457**	**1,425**

21. DEPOSITS HELD BY BANKS AND OTHER FINANCIAL INSTITUTIONS

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Demand deposits in local currency:		
- domestic banks and financial institutions	8,280	16,814
- related banks and financial institutions	340	709
Demand deposits in foreign currencies:		
- related banks and financial institutions	1,353	1,021
- domestic banks and financial institutions	381	282
Short-term deposits in local currency:		
- domestic banks and financial institutions	301	13,284
Short-term deposits in foreign currencies:		
- related banks and financial institutions	-	27,339
- domestic banks and financial institutions	15,635	3,503
Long-term deposits in local currency:		
- domestic banks and financial institutions	592	11,231
Long-term deposits in foreign currencies:		
- related banks and financial institutions	12,411	13,662
- domestic banks and financial institutions	351,034	353,076
	390,327	**440,921**

Deposits held by banks and other financial institutions as of December 31, 2012 included the related interest accrued in the amount of BAM 407 thousand (2011: BAM 511 thousand).

Deposits denominated in BAM with contracted currency clause are presented within appropriate foreign currency items.

Long-term deposits in foreign currencies totaling BAM 351,034 thousand relate to deposits held by Hypo Alpe-Adria-Bank International AG, Klagenfurt, which were placed for periods from 12 to 72 months at interest rates index-linked to EURIBOR/ LIBOR (1M, 3M, 6M,1Y and 7Y) as increased by the margin of 0.9% to 4% (2011: – EURIBOR/LIBOR (1M, 3M, 6M,1Y and 7Y) as increased by the margin of 0.9% to 4%).

22. CUSTOMERS' DEPOSITS

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Demand deposits in local currency:		
- Corporate customers	52,647	30,949
- Government institutions and agencies	26,001	26,771
- Foreign entities	2,949	1,907
- Other customers	10,341	9,031
- Retail customers	74,654	69,321
Demand deposits in foreign currencies:		
- Corporate customers	7,191	7,127
- Government institutions and agencies	586	31
- Foreign entities	3,773	2,653
- Other customers	1,742	617
- Retail customers	64,551	58,695
Short-term deposits in local currency:		
- Corporate customers	591	2,264
- Government institutions and agencies	2	402
- Other customers	279	342
- Retail customers	6,035	8,529
Short-term deposits in foreign currencies:		
- Corporate customers	7,984	5,657
- Government institutions and agencies	-	7,912
- Retail customers	30,632	22,481
Long-term deposits in local currency:		
- Corporate customers	10,308	8,104
- Government institutions and agencies	132	1,013
- Other customers	660	573
- Retail customers	33,368	37,307
Long-term deposits in foreign currencies:		
- Corporate customers	26,592	10,542
- Government institutions and agencies	20,318	51,240
- Other customers	3,243	923
- Retail customers	160,536	178,929
	545,115	**543,320**

22. CUSTOMERS' DEPOSITS (Continued)

Customers' deposits as of December 31, 2012 included the related interest accrued in the total amount of BAM 2,412 thousand (2011: BAM 1,666 thousand).

Deposits denominated in BAM with contracted currency clause are presented within appropriate foreign currency items.

BAM-denominated demand deposits represent the balances of local currency transaction accounts of the Bank's corporate clients, Government agencies and other organizations. The Bank calculates interest to these at annual rates ranging from 0% to 4.01% (2011: from 0% to 3.6%). In accordance with the Bank's business policy, foreign currency demand deposits accrue interest at annual interest rates ranging from 0% to 3.3% (2011: from 0% to 3.3%).

In accordance with the Bank's business policy, the Bank calculates interest to short-term retail customers' deposits both in local and foreign currencies at annual interest rates ranging from 0% to 6.5%, depending on their maturity and currency (2011: from 0.15% to 6.5%). Out of total short-term deposits as of December 31, 2012, the amount of BAM 890 thousand represents monetary security for the loans approved and guarantees issued by the Bank (2011: BAM 3,653 thousand).

The Bank calculates interest to long-term local and foreign currency deposits at annual rates ranging from 0% to 7%, depending on their maturities and currency (2011: from 0% to 6.75%). Out of total short-term deposits as of December 31, 2012, the amount of BAM 10,523 thousand represents monetary security for the loans approved and guarantees issued by the Bank (2011: BAM 11,305 thousand).

23. BORROWINGS

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Long-term foreign currency borrowings:		
- European Investment Bank, Luxembourg	61,761	49,140
- Council of Europe Development Bank, France	9,828	11,094
	71,589	**60,234**
Long-term BAM borrowings:		
- Housing Fund of the Republic of Srpska	30,699	39,672
- Republic of Srpska Development and Employment Fund, Banja Luka	38,938	30,253
- Fund for Development of Eastern Region of the Republic of Srpska, Banja Luka	15,235	16,102
	84,872	**86,027**
	156,461	**146,261**
Current portion of long-term borrowings	**10,534**	**7,204**

As of December 31, 2012, the Bank's liabilities arising from borrowings included related interest in the total amount of BAM 143 thousand (2011: BAM 292 thousand).

The loan from the European Investment Bank, Luxembourg was approved to the Bank for financing investments in legal entities. It is repayable in three equal tranches maturing for repayment on March 23, 2015, March 23, 2017 and September 7, 2020, bearing interest at the rates of 6-month EURIBOR + 0.094%, 0.119% and 0.826% annually.

Council of Europe Development Bank, France approved a loan to the Bank for financing loans to SME customers. Loan repayment is to be performed in 40 equal monthly installments within the period from January 6, 2011 until October 6, 2020. Interest is charged at the rate of 3-month EURIBOR increased by the margin of 0.18% annually.

23. BORROWINGS (Continued)

Republic of Srpska Development and Employment Fund, Banja Luka financed development projects. The repayment was agreed in accordance with the repayment schedules to the end users of the loans. Interest is charged at the rate of 6-month EURIBOR as adjusted for percentage points in accordance with the criteria for adjustment of interest rates pursuant to the Frame Agreement applied to Investment Development Bank of the Republic of Srpska (IDB RS a.d.), Banja Luka credit facilities.

RS Fund for Development of Eastern Region of the Republic of Srpska – which assist in development projects in the eastern region of the Republic of Srpska – approved a loan to the Bank. The repayment was agreed in accordance with the repayment schedules to the end users of the loans. Interest is charged at the rate of 6-month EURIBOR as adjusted for percentage points in accordance with the criteria for adjustment of interest rates pursuant to the Frame Agreement applied to Investment Development Bank of the Republic of Srpska (IDB RS a.d.), Banja Luka credit facilities.

Housing Fund of the Republic of Srpska, Banja Luka has provided a loan to the Bank for financing the purchase, reconstruction, and extension of state-owned flats. The repayment was agreed in accordance with the repayment schedules to the end users of the loans. Interest is charged at the rate of 6-month EURIBOR as adjusted in accordance with the criteria for adjustment of interest rates applied to Investment Development Bank of the Republic of Srpska (IDB RS a.d.), Banja Luka credit facilities.

24. SUBORDINATED LIABILITIES

Subordinated liabilities (debt) in the amount of BAM 35,470 thousand as of December 31, 2011 refer to the funds received from the Bank's major shareholder Hypo Alpe-Adria-Bank International AG Klagenfurt in the equivalent amount of EUR 18,135,502 based on the Subordinated Debt Agreement dated December 31, 2008. Pursuant to the Decision 03-1408-4/08 dated December 18, 2008, the Banking Agency of the Republic of Srpska gave pre-approval for the inclusion of the subordinated debt in the Bank's supplementary capital.

According to the agreement, subordinated debt bears interest at the rate of EURIBOR + 7% annually. Another Subordinated Debt Agreement was signed on September 30, 2010. Pursuant to the Decision 03-1060-4/108 dated September 29, 2010 the Banking Agency of the Republic of Srpska gave pre-approval for the inclusion of the subordinated debt in the Bank's supplementary capital.

The subordinated debt is deposited for an indefinite period and the Bank is not obliged to repay the deposited amount. According to the agreement, subordinated debt bears fixed interest of 10% annually. The amount of BAM 9 thousand represents interest accrued.

25. OTHER LIABILITIES

	In thousands of BAM December 31, 2012	December 31, 2011
Liabilities in local currency:		
- Deferred other fees	6,023	8,142
- Early loan repayments	8,543	8,298
- Payables to employees	910	2,288
- Liabilities for taxes and contributions	1,091	2,367
- Deferred interest income	100	640
- Accounts payable	1,261	798
- Unrealized payments for establishment of companies	119	129
- Deferred tax liabilities	839	878
- Accrued expenses	82	132
- Liabilities for dividends	70	70
- Employee benefits: unused short-term absences, vacations	98	76
- Liabilities arising from credit card operations	411	819
- Other liabilities	247	1,717
Foreign currency liabilities:		
- PTA liabilities to the parent bank	-	10,882
- Accounts payable	1,022	1,636
- Deferred other fees	46	46
- Early loan repayments	14	21
- Liabilities arising from credit card operations	53	29
- Other liabilities	159	13
	21,088	**38,981**

As at December 31, 2012, the amount of BAM 2,938 thousand related to the Bank‘s non-financial liabilities (2011: BAM 5,609 thousand) out of the total other liabilities.

Movements in the account of provisions for unused short-term absences-vacations are presented in the following table:

	In thousands of BAM December 31, 2012	December 31, 2011
Balance at January 1	76	63
Charge for the year	22	13
Reversal	-	-
Balance at December 31	98	76

26. EQUITY

Share Capital
The Bank's share capital includes initial shareholder investments and subsequent share issues. The Bank's shareholders are entitled to participation in the management of the Bank, as well as in the distribution of profit.

As of December 31, 2012, the Bank's share capital was comprised of 129,167,785 common shares with an individual par value of BAM 1 (2011: 129,167,785 common shares). All of the Bank's shares have been fully paid up. The District Commercial Court Decision no. 057-0-REG-11-002308 dated February 22, 2012 finalized the procedure of capital decrease registry initiated by the Shareholders' Assembly Decision on the 12th share issue by capital decrease without a full prospectus numbered S-4/2011 dated May 12, 2011. The Bank's core capital of BAM 175,512 thousand as of the decision enactment date was decreased by BAM 46,344 thousand and after decrease amounted to BAM 129,168 thousand.

As of December 31, 2012, the Bank's majority shareholder was Hypo Alpe-Adria-Bank International AG Klagenfurt, with 99.73% equity interest (December 31, 2011: 99.73%).

Reserves
The Bank's reserves as of December 31, 2012 are provided in the following table:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Legally prescribed reserves	17,518	12,917
Special reserves for regulatory losses per BARS regulations	62,064	61,826
Balance at December 31	**79,582**	**74,743**

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Total reserves per regulatory requirements for balance sheet assets and off-balance sheet items	187,096	139,366
Total impairment allowance as per IAS 39 and IAS 37 (for balance sheet assets and off-balance sheet items)	89,442	77,302
Special reserves for regulatory losses per BARS regulations	62,064	61,826
The amount of the reserve for credit losses deficiency as per BARS regulations	35,590	238

27. EARNINGS PER SHARE

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Profit	7,8245	23,243
Weighted average number of shares	129,167,785	160,021,536
Basic earnings per share in BAM	**0.061**	**0.145**

The Bank has no potential dilutive ordinary shares such as convertible debt and share options. Therefore, the Bank does not calculate diluted earnings per share.

28. OTHER PROVISIONS

As of December 31, 2012, other provisions were as follows:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Litigations	5,135	5,476
Restructuring	894	1,027
Other provisions	-	47
Retirement benefits	275	383
	6,304	**6,933**
Provisions for contingent liabilities	**2,296**	**2,066**
	8,600	**8,999**

	In thousands of BAM				
	Restructuring	Retirement Benefits	Litigations	Other	Total
January 1, 2012	**1,027**	**383**	**5,476**	**47**	**6,933**
Charge for the year	-	-	118	-	118
Reversal	-	(85)	(64)	-	(149)
Release	(133)	(23)	(395)	(47)	(598)
December 31, 2012	**894**	**275**	**5,135**	**-**	**6,304**

Provisions for litigations as well as other provisions are included in other operating income and expenses (Note 9). Movements in the account of provisions for contingent liabilities are presented in the following table:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Balance at January 1	2,066	702
Charge for the year	2,070	3,261
Reversal	(1,840)	(1,893)
Increase/(decrease) in provisions, net	230	1,368
PT Agreement	-	(4)
Balance at December 31	**2,296**	**2,066**

29. COMMITMENTS AND CONTINGENT LIABILITIES

Loans, Guarantees, Performance Bonds and Letters of Credit

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Loan commitments	83,431	80,709
Payment guarantees	27,358	29,941
Performance bonds	1,309	3,861
Letters of credit and other sureties	67	899
	112,165	**115,410**

Litigation
As of December 31, 2012, the Bank was involved in court execution procedures, lawsuits and bankruptcy procedures in progress for the purpose of collection of its receivables end exercise of other rights and interests. Certain number of administrative proceedings were also initiated for the purpose of annulment of acts enacted in administrative procedures. At the same date, the Bank was involved in a certain number of lawsuits filed against it by legal entities and individuals.

In order to collect its receivables, which relate to loans, issued guarantees and letters of credit, the Bank was engaged in 1,006 legal proceedings as of December 31, 2012, with the total value of BAM 179,387 thousand

As of December 31, 2012, the legal proceedings filed against the Bank amounted to BAM 71,655 thousand, exclusive of any penalty interest that might be assessed, given that the Bank's management was unable to estimate with any certainty the possible effects of penalty interest as of the date of issuance of these financial statements. The Bank's management estimates that the final outcome of the filed legal proceedings will be favorable, and that no material losses will result from the resolution of the aforesaid litigations. Accordingly, as of December 31, 2012, the Bank created provision against potential losses thereof in the amount of BAM 5,135 thousand (December 31, 2011: BAM 5,476 thousand).

The Bank constantly monitors legal risks, and evaluates the expected legal proceedings expenses, and creates adequate provisions thereof (Note 28).

Based on the above fact, none of the proceedings initiated against the Bank are significant enough to compromise the Bank's operations.

Compliance with Laws and Regulations
The Bank is obligated to adjust the scope and structure of its operations to prescribed business and adequacy indicators, i.e. to reconcile the scope and structure of its assets with the accounting standards and regulations of the Republic of Srpska as established by the Banking Agency of the Republic of Srpska.

As of December 31, 2012, the Bank was in full compliance with the accounting standards and regulations of the Republic of Srpska defined by the Banking Agency of the Republic of Srpska.

30. RELATED PARTY TRANSACTIONS

	In thousands of BAM December 31, 2012	December 31, 2011
Assets:		
Foreign currency accounts:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	15,967	2,897
- HYPO ALPE-ADRIA-BANK d.d., Ljubljana, Republic of Slovenia	382	164
- HYPO ALPE-ADRIA-BANK SPA, Udine, Italy	564	34
- HYPO ALPE-ADRIA-BANK SPA, Udine, Italy	1,241	785
- HYPO ALPE-ADRIA-BANK d.d., Zagreb, Republic of Croatia	117	99
- HYPO ALPE-ADRIA-BANK d.d., Mostar	1,129	220
Term deposits:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	5,934	2,347
Other assets:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	6	14
- Hypo Alpe-Adria-Leasing d.o.o., Banja Luka	6,340	12
- HYPO ALPE-ADRIA-BANK d.d., Zagreb, Republic of Croatia	11	4
- HYPO ALPE-ADRIA-BANK d.d., Mostar	910	311
- HYPO ALPE-ADRIA-BANK a.d., Podgorica, Montenegro	3	16
- BORA doo Banja Luka	196	-
- HYPO ALPE-ADRIA-BANK a.d., Beograd, Serbia	3	12
	32,803	**6,915**
Liabilities:		
Demand deposits:		
- Hypo Alpe-Adria-Leasing d.o.o., Sarajevo	1	2
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	796	795
- HYPO ALPE-ADRIA-BANK a.d., Podgorica, Montenegro	-	11
- HYPO ALPE-ADRIA-BANK a.d., Beograd, Serbia	446	1
- HYPO ALPE-ADRIA-BANK d.d., Zagreb, Republic of Croatia	91	91
- Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	358	771
- BORA doo Banja Luka	16,473	-
Short-term deposits:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	-	27,337
Long-term deposits:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	351,034	353,076
Subordinated liabilities:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	35,479	35,470

30. RELATED PARTY TRANSACTIONS (Continued)

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Other liabilities:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	720	11,978
- HYPO ALPE-ADRIA-BANK a.d., Beograd, Serbia	38	224
- HYPO ALPE-ADRIA-BANK d.d., Mostar	1,038	338
- HYPO ALPE-ADRIA-BANK d.d., Zagreb, Republic of Croatia	54	49
- ZIS Beograd, Serbia	121	8
- Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	-	2
- Hypo Alpe-Adria- Leasing d.o.o., Sarajevo	-	2
- HYPO ALPE-ADRIA-BANK a.d., Podgorica, Montenegro	2	14
- BORA d.o.o., Banja Luka	29	-
	406,680	**430,169**

30. RELATED PARTY TRANSACTIONS (Continued)

	In thousands of BAM Year Ended December 31, 2012.	 2011.
Interest income:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	34	53
- HYPO ALPE-ADRIA-BANK SPA, Udine, Italy	-	2
- Hypo Alpe-Adria-Leasing d.o.o., Banja Luka	151	-
Fee and commission income:		
- HYPO ALPE-ADRIA-BANK d.d., Mostar	192	177
- HYPO ALPE-ADRIA-BANK SPA, Udine, Italy	5	8
- Hypo Alpe-Adria-Leasing d.o.o., Sarajevo	-	6
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	52	31
- BORA doo Banja Luka	444	-
- Hypo Alpe-Adria-Leasing d.o.o., Banja Luka	28	-
Other operating income:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	-	3
- HYPO ALPE-ADRIA-BANK d.d., Mostar	250	182
- Hypo Alpe-Adria-Leasing d.o.o., Banja Luka	47	19
- HYPO ALPE-ADRIA-BANK, d.d Zagreb, Republic of Croatia	8	-
- BORA doo Banja Luka	3	-
- Hypo Alpe-Adria-Leasing d.o.o., Sarajevo	209	15
	1,423	**496**
Interest expenses:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	(15,127)	(21,102)
- Hypo Alpe-Adria-Leasing d.o.o.,, Sarajevo	(1)	(2)
- Hypo Alpe-Adria-Leasing d.o.o., Banja Luka	(2)	(2)
Fee and commission expenses:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	(2,119)	(2,448)
- HYPO ALPE-ADRIA-BANK d.d., Mostar	(101)	(90)
- HYPO ALPE-ADRIA-BANK, d.d Zagreb, Republic of Croatia	(34)	(27)
- HYPO ALPE-ADRIA-BANK SPA, Udine, Italy	(2)	(9)
- HYPO ALPE-ADRIA-BANK a.d., Beograd, Serbia	(19)	(3)
Other operating expenses:		
- HYPO ALPE-ADRIA-BANK International AG, Klagenfurt, Austria	(1,290)	(1,542)
- ZIS Beograd, Serbia	(3,452)	(3,012)
- HYPO ALPE-ADRIA-BANK d.d., Zagreb, Republic of Croatia	(617)	(632)
- BORA doo Banja Luka	(28)	-
- HYPO ALPE-ADRIA-BANK, Mostar	(690)	(338)
	(23,482)	**(29,207)**
	(22,059)	**(28,711)**

30. RELATED PARTY TRANSACTIONS (Continued)

The Bank received significant funding from its parent company in the form of demand deposits, short-term deposits, long-term deposits and subordinated debt representing 27.68% of its total liabilities (2011: 28.77%).

Management Remunerations

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Net salaries	212	237
Taxes and contributions	140	156
	352	**393**

31. EFFECTS OF THE FINANCIAL CRISIS

Consequences of the Financial Crisis

The most recent data show that Bosnia and Herzegovina is falling back to recession. Industrial production continues although somewhat slower than in Q1 2012, where the permanent consumer goods and energy production are the key factors. Furthermore, trade in goods deteriorated due to poorer imports of 510bp in Q3 2012 as compared to the same period the previous year and marked standstill in exports of goods, which was reflected in the lower level of energy production due to unfavorable weather conditions.

In 2012, a sharp downturn in GDP of 1.8% was recorded as a result of deteriorated purchasing power of the population. A stand-by arrangement was entered into with the International Monetary Fund worth EUR 405 million for the period of 2 years for prevention of further deterioration and preservation of credit rating.

However, a more significant recovery of capital expenditures is still postponed not only due to expensive and decreased funding, but also due to the political risks, including political instability threatening to put the existing arrangement with the IMF on hold (not in our case).

The year 2013 has seen further GDP decrease of 1.3%, largely due to adjusting domestic consumption within fiscal consolidation with the repeated economic rebalance (of commercial entities). Personal purchasing has remained dominant factor hindering the economic activity due to greater unemployment, net salary deflation, fiscal stringency and decrease in borrowing. Investment will also decline due to balance sheet clearance on the part of companies and limitations to public capital expenditures. Finally, exporters are facing insufficient exterior demand and more stringent trading terms with Croatia (which is the key foreign market for BiH) because of its accession to the EU/leaving the Central European Free Trade Agreement (CEFTA) set for July 2013.

At the state level, the Government‘s consolidated budget for 2013 aiming at a decreased deficit of 2.5% of GDP (as compared to 3% of GDP in 2012) has been approved. However, the Bank‘s management anticipates a slower fiscal consolidation given the poorer macro conditions, unambitious adjustments of the overall consumption and decreased customs base for imports. The authorities show definite intention to improve the economic structure by amending and supplementing the tax system and public consumption structure. Reduced payroll social security contributions are aimed at cutting down labor costs in mid-term; there is also the fact that these changes were followed by increased VAT for internal devalorization in order to reallocate the charge of the labor taxes and offset it by higher consumption taxes. In the meantime, fiscal decline (difference between the projected and actually realized) can demand not only increase in VAT but increase in personal income taxes in order to ensure the access to funds of the international financial institutions observing the objectives of the IMF.

31. EFFECTS OF THE FINANCIAL CRISIS (Continued)

Consequences of the Financial Crisis (continued)

The adopted 2013 budget meets the IMF criteria for approval of the Stand-By Arrangement tranche of EUR 60 million in December 2013, which will satisfy the short-term needs for (re)financing. The authorities are planning to cover the major portion of the need for (re)financing in 2013 of ~3% GDP with funds from the international financial institutions, i.e. EUR 184 million from the IMF, World Bank loan of EUR 80 million and EU aid to the budget of EUR 50 million. In addition, in 2013, the Republic of Srpska will have increased need for refinancing through treasury bills (EUR 35 million) than the Federation BiH (EUR 15 million), which is a situation unlike that from 2012. If we assume that international financial institutions will continue to provide financial support and less intense credit rating concerns, we hold that further sales of local debt can be executed at somewhat lower spreads, given that reduced private sector borrowing leaves banks fewer options for investments. Contrary trend, the loss of access to the funds of the international financial institutions and/or turn in the global crisis would raise costs of public borrowing.

For this year we expect current account deficit (C/A) higher than 11% of GDP, mostly as a result of deteriorating trading trends due to reduced foreign demand for exports. Our opinion can be supported by stagnation in money payments from abroad. For the year 2013, we anticipate a slightly lower current account deficit, with lower goods trading disbalance and decreased exports relative to the domestic consumption adjustments. With foreign direct investment (FDI) coverage of slightly over 30%, current account financing for 2013 largely relies on the funds of the international financial institutions to cover more than 15% (of the GDP) of the total needs for external (re)financing. Recent inflation growth of consumer price index (CPI) resulted from the marked price growth of food products. CPI inflation curve is showing an upward trend and tends to reach 3% around mid-2013, given the effects of low bases and expected further increase in excise taxes. Only in Q2 2013 significant inflation mitigation is expected as anti-inflation forces of the poor domestic demand will prevail, reaching about 3% of the average CPI inflation in 2013.

Impact on Liquidity

Throughout 2012 the liquidity of the Bank was stable. Foreign debt gradually decreased, while the local source of funding gradually increased. As on the other hand there was no significant credit activity, the Bank‘s liquidity position was satisfactory during the year.

Impact on Customers/Borrowers

General financial crisis that continued well into 2012 had a substantial impact on the decline of the purchasing power of the population as the end user of products and services and decreased both international and domestic market demand for products and services of the local companies. All this hindered the projected GDP growth and caused decrease in borrowing as compared to prior years, at all levels. With the aforesaid decrease and repayment of the existing debts, legal entities experienced deteriorating liquidity and increase in matured liabilities outstanding.

Moreover, due to the decrease in demand, significant drop of real estate value occurred, which additionally burdened debt servicing on the part of borrowers which relied on the sales of property to repay their borrowings.

31. EFFECTS OF THE FINANCIAL CRISIS (Continued)

Impact on Customers/Borrowers (continued)

In order to be able to realistically evaluate the effect of the crisis on the stability of its operations, the Bank promptly undertook several measures to prevent credit risk deterioration, as follows:

- Approval of rescheduling loans in order to adjust payment to the borrowers' actual sources, particularly for those most gravely affected by the economic crisis;
- Creation of a new department within the Bank to deal with revised property appraisals in order to reconcile the property revaluation with the market trends at least annually;
- Creation of a specialized SRP Reporting Team within the Rehabilitation Department to monitor movements on provision charges and factors influencing the assessment thereof and quality of the parameters entered for calculation of provisions.

To the extent that information is available, the Bank has properly reflected revised estimates of expected future cash flows in their impairment assessments. The structure of Bank sources provides sufficient reserves for significant restructuring/ prolongation of the existing exposures towards clients.

Impact on Collaterals (especially real estate)

The amount of provisions for impaired loans is based on management's estimate as of the balance sheet date after taking into consideration cash flows that may result from foreclosure of collateral, decreased for costs of obtaining and selling the collateral.

The local market for many types of collateral, especially real estate, has been severely affected by the recent volatility in global financial markets resulting in a lower level of liquidity and market value of property. The Bank performs a periodical evaluation of collaterals, in order to ensure that provisions are accurately estimated.

Fair Value of Financial Assets and Liabilities (excluding financial assets and liabilities directly related to the credit crisis, e.g. mortgage used as a guarantee)

Fair value of quoted investments in active markets is based on current bid prices (financial assets) or offer prices (financial liabilities). If there is no active market for a financial instrument, the Bank establishes fair value using different valuation techniques. These include the use of recent arm's length transactions between willing parties, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. The valuation models reflect current market conditions at the measurement date which may not be representative of market conditions either before or after the measurement date. As of the balance sheet date, management has reviewed its models to ensure they appropriately reflect current market conditions, including the relative liquidity of the market and credit spreads.

Valuation of Investment Property at Fair Value

Many types of real estate have been severely affected by the recent volatility in both global and local financial markets.

Fair value of land and buildings measured at revaluated amounts in accordance with IAS 16 has been updated to reflect market conditions at sufficient frequency to ensure that the carrying value does not differ significantly from the fair value at the end of reporting period.

In accordance with IAS 40, fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. A 'willing seller' is not a forced seller prepared to sell at any price or someone who is ready to wait for the price that is not reasonable under the given market conditions. The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition.

31. EFFECTS OF THE FINANCIAL CRISIS (Continued)

Valuation of Investment Property at Fair Value (Continued)
If, in exceptional cases, there is clear evidence that when the Bank first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) the fair value of the investment property is not reliably determinable on a continuous basis, then the Bank measures that investment property using the cost model in accordance with IAS 16.

The cost of an item of property, plant and equipment comprises:

- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Examples of directly attributable costs are:

- costs of employee benefits (as defined in IAS 19 Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
- costs of site preparation;
- initial delivery and handling costs;
- installation and assembly costs;
- costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
- professional fees.

32. OPERATING LEASE

Operating lease expenses in the financial year 2012 totaled BAM 777 thousand whereas in the financial year 2011 they amounted to BAM 690 thousand.

Total future minimum lease payments to be settled pursuant to the long-term contractual leases were as follows:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Up to 1 year	618	628
From 1 to 5 years	882	1,619
Over 5 years	289	216
	1,789	**2,463**

Operating lease income in the financial year 2012 totaled BAM 718 thousand, whereas in the financial year 2011 it amounted to BAM 652 thousand.

32. OPERATING LEASE (Continued)

Total future minimum lease payments to be collected pursuant to the long-term contractual leases were as follows:

	In thousands of BAM	
	December 31, 2012	December 31, 2011
Up to 1 year	287	194
From 1 to 5 years	72	-
Over 5 years	-	-
Non-warranted residual value	3,144	3,362
	3,503	**3,556**

33. TAXATION RISKS

The Republic of Srpska and Bosnia and Herzegovina currently have several tax laws in effect, as imposed by various governmental agencies. The applicable taxes include: a turnover tax, corporate tax, and payroll (social) taxes, among others. Following their introduction, the regulations governing these taxes were not enforced for substantial periods of time; in contrast to similar legislation in more developed market economies. Moreover, the regulations defining the implementation of these laws are often unclear or non-existent. Hence, few precedents with regard to tax issues have been established in the Republic of Srpska. Often, contrary opinions pertaining to legal interpretations exist both among, and within, governmental ministries and organizations, thus creating uncertainties and areas of legal contention. Tax declarations, together with other legal compliance matters (e.g., customs and currency control matters) are subject to the review and investigation by a number of authorities that are legally enabled to impose extremely severe fines, penalties and interest charges.

The interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Bank may not coincide with that of the management. As a result, transactions may be challenged by tax authorities and the Bank may be assessed additional taxes, penalties and interest, which can be significant. In accordance with the Law on Tax Authority of the Republic of Srpska, expiration period of the tax liability is five years. This practically means that tax authorities could determine payment of outstanding liabilities in the period of five years from the origination of the liability. The aforedescribed situation creates tax risks in the Republic of Srpska that are substantially more significant than those typically existing in countries with more developed tax systems.

In order to minimize taxation risk, the Bank at times hires taxation experts to aid the bank in interpreting and implementing tax regulations. With regard to the PT Agreement, during 2011 and early in 2012, the Bank relied on the services of taxation experts and contacted tax authorities on several occasions (Indirect Taxation Authority of Bosnia and Herzegovina) in order to obtain legally compliant opinions on the taxation treatment of the PTA, entered into by the Transferor of cash flows, Transferee and Calculation Agent. The Bank had not obtained any legally compliant opinion on the taxation treatment of the aforesaid agreement until the date of issuance of the accompanying financial statements. In addition to the aforesaid, the Bank holds that PTA is tax-neutral and not subject to value added taxation so that it will not have adverse effects on the Bank.

34. EVENTS AFTER THE REPORTING PERIOD

Subsequent to the balance sheet date and until the date of these financial statements' issuance, there were no events that might significantly influence the Bank's financial statements or require additional disclosures therein.

35. EXCHANGE RATES

The official exchange rates for major currencies as of December 31, 2012 and 2011 used in the translation of balance sheet components denominated in foreign currencies into BAM were as follows:

	In BAM	
	December 31, 2012	December 31, 2011
USD	1.4836	1.5116
CHF	1.6191	1.6089
EUR	1.9558	1.9558

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