BANK

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

Annual Report 2012

Hypo Alpe-Adria-Bank d.d.
Mostar

Bosnia and Herzegovina

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Mission and Business Principles

Hypo Alpe-Adria-Bank d.d. is a part of the international Hypo-Alpe-Adria banking group. We are striving to apply our international know-how to the local markets. Over 550 employees are servicing around 180,000 clients.

We are available to customers in FBiH not only in our head office in Mostar, but also in a wide business network covering the largest centres of the country. We are among leading banking groups in BiH.

We want to provide a wide range of financial products and quality service to private individuals, to small- and medium-sized enterprises, to corporate customers and to public institutions.

Our products are to offer simple and creative solutions for the financial needs of our clients.

Our mission is driven by following principles:

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

Management Board of Hypo Alpe-Adria-Bank d.d.

Dmytro Kolechko
Executive Director

Dragan Kovačević
Executive Director

Alexander Picker
Director

Management Board Letter

Distinguished business partners, Dear colleagues,

Business environment has witnessed no major improvements in 2012 – pace of economic recovery is still sluggish, new investments scarce, companies and citizens still facing huge obstacles on everyday basis.

Keenly aware of the complex market situation all the time, Hypo Alpe-Adria-Bank d.d. was able to adjust correspondingly. Namely, we have worked hard on consolidation and transformed our organisation in order to adapt to given circumstances. On the other hand, we have created a sustainable and realistic plan, which enabled us to successfully continue with our operations. In addition, we have successfully optimised business processes, business network and personnel structure and implemented various projects which gave us a solid basis for further stabilisation of the loan portfolio and business operations in general.

Retail segment. New placements in Retail amounted to KM 51.4 mil. in 2012, being by 32% lower than in 2011. Volume of deposits was by 6% lower than in 2011, but still at a high level of KM 595.2 mil. Non-interest income in Retail was by 2% higher than in previous year. Organisational units of the Bank in charge of supporting Retail business were cooperating closely throughout the year. As a result of that cooperation, the Card Strategy Project was initiated, the strategic goal of which was to significantly increase sale, activation and usage of payment cards offered by the Bank and to improve cards functionalities. In addition, Advisory Banking Concept-Affluent Banking was introduced, which largely reiterated partnership relation and communication between the Bank and its clients. The new concept introduced a new product - Hypo Visa Electron Black Card and a whole range of other products and services tailored specially for Affluent clients.

Risk Adjusted Pricing Tool was introduced in cooperation with Retail Risk Management. This tool is used for determining prices for housing loans for private individuals on individual-client basis and taking into account all risks and related costs.

A package of products specially tailored for SME clients was introduced in the last quarter of 2012.

The Service Quality Program was successfully implemented in the business network with the main purpose to upgrade quality of services provided. Novelties introduced by the Programme are: role of internal trainer, code of conduct, dress code, clients' relation code, keeping records on complaints and optimisation of business processes. The Programme was strongly promoted to clients throughout the network by the slogan "Our 6 Service Promises".

Retail and Corporate & Public Divisions worked closely together on the joint action titled Partnership Banking, the main goal of which was to enhance selling results and cross-selling. In this action, which was without precedent at the market, products and services specially tailored to clients' needs were offered to employees of the Bank's Corporate and Public clients.

Corporate & Public segment. Corporate and Public clients were in the limelight of the Bank's selling infrastructure in the year 2012. The newly adopted credit principles enabled the sales people to concentrate on the best clients and make them priority in their business. Sales management and market approach of the Bank were significantly improved after Corporate and Public organisational units had been merged. Furthermore, system of monitoring activities undertaken by client managers and their performance results was introduced. It was a clear goal of the Bank to improve the portfolio structure and prevent further increase of provisioning costs. To that end, collection of receivables from the existing portfolio was given priority in 2012. Interest rates were reduced in 2012 for existing tied deposits. In the given circumstances, activities of Corporate and Public sectors were in 2012 clearly focused on the existing portfolio and the existing clients' base.

Securities trading and custody business. In 2012 this segment confirmed itself as quality partner in securities business. Sales people underwent special training in dealing with trade orders. In addition, clients were welcome to the „Open Door" campaign, on which occasion they were explained in a direct contact how the securities business was performed.

Costs optimisation. As costs optimisation was in clear focus of all organisational units of the Bank, many easy-to-apply and efficient solutions were introduced for operational costs monitoring and reduction. Costs-cutting initiatives came mostly from Real Estate Management, IT and Human Resources Management, which thus gave full contribution to fulfilment of the costs optimisation task.

New organisational structure. The Operations Division is found especially striking in the new organisational structure implemented in 2012. Namely, this Division brings together and centralises administration and operating functions and back office business. The main motive in founding this Division through centralisation of operating activities was a wish to increase process efficiency, what was successfully achieved by relieving the branch staff from some back office activities in favour of selling activities. Then, as the employees were more trained and specialized and processes automated and made more user-friendly, it was easier to increase efficiency and reduce operational risk.

The Contact Centre, opened in September 2012, is organisationally located in the Operations Divisions. It acts as a single point of contact for all clients and for all questions they might have about banking products and services or any other queries.

The management structure underwent certain changes in 2012 as well. The new Management Board was working hard, together with all employees of the Bank, on establishment and implementation of the new strategy. They set themselves key tasks of creating a positive environment in the Bank, enhancing service quality, getting a better understanding of clients and their needs, educating the clients on the bank's role as service provider and last but not the least – restoring trust in overall banking sector in the country. As all activities undertaken by the Bank in the year 2012 were revolving around four major words: transparency and service quality, the Bank was able to start the year 2013 fresh, full of energy and prepared for new market challenges.

Management Board of Hypo Alpe-Adria-Bank d.d.

Dmytro Kolechko
Executive Director

Dragan Kovačević
Executive Director

Alexander Picker
Director

Socially Responsible Business Activities

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

Human Resources Management (HRM)
The Bank ended the business year of 2012 with total of 579 employees. Employees' qualification structure is on a very high level – 65.28% of the Bank's employees have university or two-year post-secondary school qualifications, many have a master's or doctor's degree.

The employees' age structure is young, the average age being 38.88.

For the purpose of realising the planned goals, Hypo Alpe-Adria-Bank d.d. has continued with its practice of participating in and attending educations and advanced trainings in the country and abroad with the goal to acquire new knowledge and skills that are necessary for further improvement of work organisation and development of business.

Managerial skills are developed in the Hypo Academy and at various seminars, the main purpose of which is to achieve the best practice and acquire a new „know-how“ to be applied in business processes of the Bank.

To that end, a special training was organised and implemented in cooperation with the IEDC-Bled School of Management.

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

Relation towards clients and business partners
Hypo Alpe-Adria-Bank d.d. considers clients' trust to be its most valuable asset and always tries hard to prove worthy of it.

Consequently, business ethics is one of the Bank's highest priorities. The Bank never fails to timely inform its clients and business partners about any changes related to its operations, new products, services, interests, fees, commissions and similar issues.

In its marketing and corporate communication activities, the Bank is strongly committed to code of ethics and truthfulness.

When it comes to the clients' rights, the Bank introduced the position of the Clients' Complaints Manager, who is in charge with tackling verbal and written complaints of clients about the quality of Bank's services, products and Bank's approach to its clients in general.

Complaints may be filed verbally directly or via phone or in written, via post or electronic mail.

What is more, another informative channel was opened in 2012 – the Contact Centre, where clients may obtain all information about business operations of the Bank, its products and services.

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

In 2012, the Bank donated over KM 134,000 to sport, culture and education.

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

SUPERVISORY BOARD

Rainer Sichert, President
Wolfgang Moesslacher, Deputy President
Stephan Holzer, member
Sebastian Firlinger, member
Blaž Brodnjak, member

MANAGEMENT BOARD

Alexander Picker, Director from March 9th, 2012
Dragan Kovačević, Executive Director
Dmytro Kolechko, Executive Director from June 26th, 2012
Michael Vogt, Director until March 9th, 2012
Mirzet Ribić, Deputy Director until January 31st, 2012
Herbert Walzhofer, Executive Director until March 9th, 2012

AUDIT COMMITTEE MEMBERS

Đorđe Lazović , President
Maria Rauscher, member
Andrea Castellarin, member
Sandra Baier (maiden name at the time of appointment: Berdnik) member from February 29th, 2012
Dejan Rajevac, member from February 29th, 2012
Thomas Milunović, member until February 29th, 2012
Sabine Jaeger-Letzl, member until February 29th, 2012

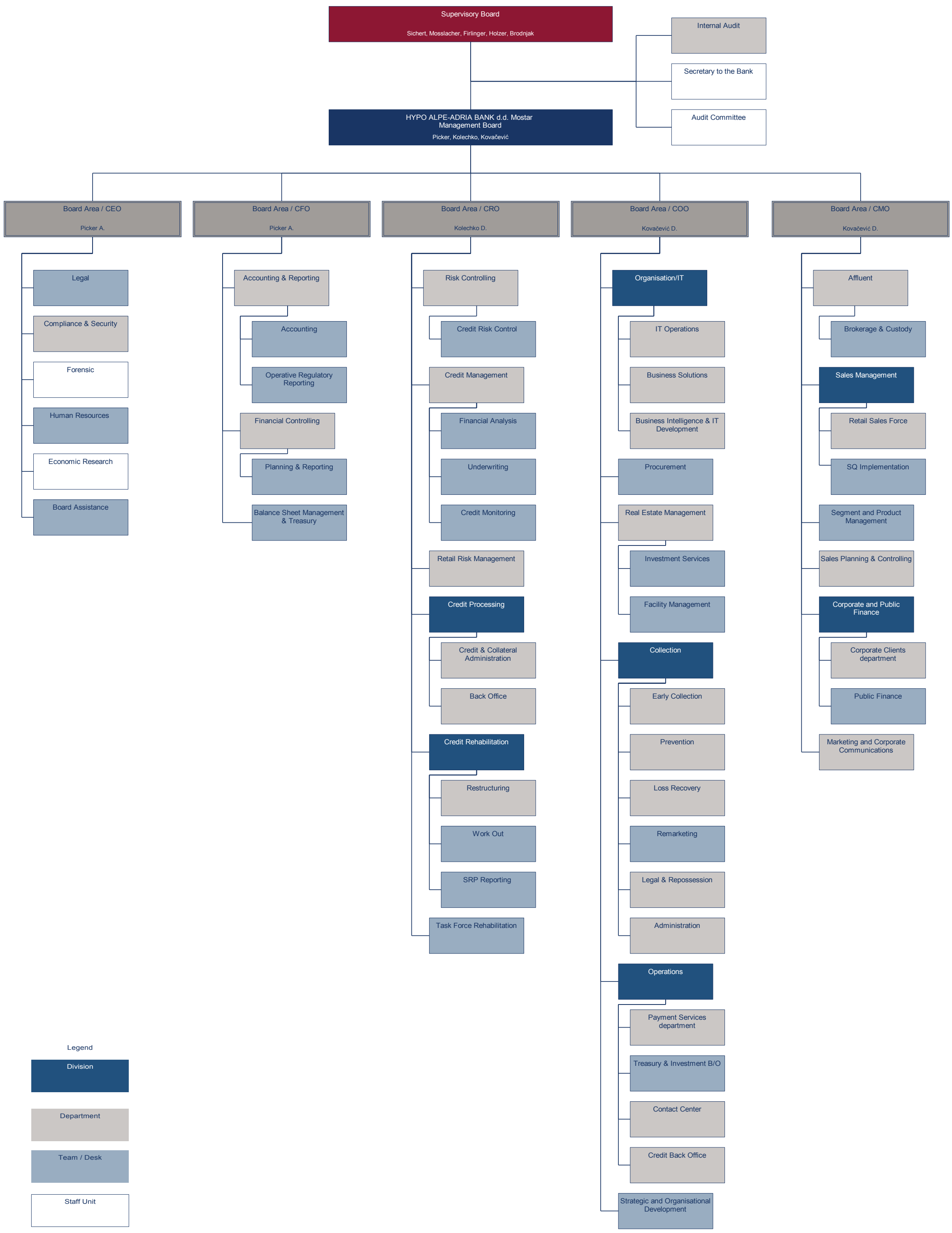
INTERNAL AUDITOR

Stana Grgić

SHAREHOLDERS WITH 5% OR MORE SHARES WITH A VOTING RIGHT

Hypo Alpe-Adria-Bank International AG, Klagenfurt

Organizational Structure



HYPO ALPE-ADRIA-BANK D.D. MOSTAR

Unconsolidated financial statements for the year ended 31 December 2012 prepared in accordance with International Financial Reporting Standards and Independent Auditors' Report

Responsibility for the Financial Statements

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

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

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

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

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

Signed on behalf of the Management Board

Alexander Picker, Chief Executive Officer

Dragan Kovačević, Executive Director

HYPO ALPE-ADRIA-BANK d.d. MOSTAR

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

14 March 2013

Independent Auditor's Report

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

We have audited the accompanying unconsolidated financial statements of Hypo Alpe-Adria-Bank d.d. Mostar (the "Bank"), set out on pages 4 to 52, which comprise of the unconsolidated balance sheet as at 31 December 2012, and the unconsolidated income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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

Auditor's Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion the unconsolidated financial statements present fairly, in all material respect the financial position of Hypo Alpe-Adria-Bank d.d. Mostar as of 31 December 2012, and of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphases of matter:

Concentration of funding
We draw attention to Note 24 of these unconsolidated financial statements which refer to the Bank's financing by Hypo Alpe-Adria Bank International AG, Klagenfurt, Austria (the Parent). The Bank is dependent upon the continued funding and other financial support from its Parent, under the currently agreed financial terms.

Consolidated financial statements

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

Our opinion is not modified in respect of the matters emphasized.

Deloitte d.o.o.

Sead Bahtanović, director and licenced auditor

Deloitte
d.o.o.
Jadranska bb
71000 Sarajevo
ID: 4200047350008

Sabina Softić, licenced auditor

Sarajevo, Bosnia and Herzegovina
14 March 2013

Unconsolidated income statement
for the year ended 31 December 2012
(all amounts are expressed in thousands of KM)

	Notes	2012	2011
Interest income	7	71,204	110,564
Interest and similar expenses	8	(35,455)	(55,619)
Net interest income		**35,749**	**54,945**
Fee and commission income	9	14,677	14,919
Fee and commission expense		(4,897)	(5,597)
Net fee and commission income		**9,780**	**9,322**
Net income on financial operations	10	3,339	6,197
Other operating income	11	7,876	11,062
Operating income		**56,744**	**81,526**
Personnel expenses	12	(19,150)	(21,793)
General and administrative expenses	13	(26,856)	(34,262)
Depreciation and amortization expense	23	(6,125)	(6,384)
Operating expenses		**(52,131)**	**(62,439)**
PROFIT BEFORE IMPAIRMENT LOSSES, PROVISIONS AND INCOME TAX		**4,613**	**19,087**
Impairment losses and provisions	14	(22,917)	(67,310)
Collected written-off receivables		7,220	7,584
LOSS BEFORE INCOME TAX		**(11,084)**	**(40,639)**
Income tax	15	-	-
NET LOSS FOR THE YEAR		**(11,084)**	**(40,639)**
Basic loss per share (KM)	37	(22.97)	(84.23)

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

Unconsolidated statement of comprehensive income
for the year ended 31 December 2012
(all amounts are expressed in thousands of KM)

	Notes	2012	2011
Loss for the year		**(11,084)**	**(40,639)**
Other comprehensive income			
Exchange differences on translating foreign operations		(26)	21
Available-for-sale financial assets			
Net gain arising on revaluation of available-for-sale financial assets during the year		573	391
Total comprehensive loss for the year		**(10,537)**	**(40,227)**

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

Unconsolidated balance sheet
for the year ended 31 December 2012
(all amounts are expressed in thousands of KM)

	Notes	31 December 2012	31 December 2011
ASSETS			
Cash and due from banks	16	270,215	146,112
Obligatory reserve at the Central Bank of Bosnia and Herzegovina	17	87,656	132,515
Placements with other banks	18	53,565	155,638
Loans and advances to customers	19	885,578	1,012,163
Financial assets available for sale	20	25,931	1,354
Investments in subsidiaries	21	2,711	2,711
Deferred tax assets	15	2,172	2,172
Other assets	22	15,178	25,582
Tangible and intangible assets	23	64,347	68,298
Total assets		**1,407,353**	**1,546,545**
LIABILITIES			
Due to other banks	24	288,863	316,010
Due to customers	25	757,999	884,103
Subordinated debt	26	65,000	65,000
Other liabilities	27	20,584	39,593
Provisions for financial commitments and contingencies	28	2,845	3,503
Total liabilities		**1,135,291**	**1,308,209**
SHAREHOLDERS' EQUITY			
Share capital		213,000	193,000
Reserves		133,571	113,571
Regulatory reserves		133,391	129,054
Investment revaluation reserves		536	(11)
Retained losses		(208,436)	(197,278)
Total shareholders' equity		**272,062**	**238,336**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**1,407,353**	**1,546,545**
FINANCIAL COMMITMENTS AND CONTINGENCIES	28	124,720	153,123

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

Signed on behalf of Hypo Alpe-Adria-Bank d.d. Mostar on 14 March 2013:

Alexander Picker
Chief Executive Officer

HYPO ALPE-ADRIA-BANK MOSTAR

Dragan Kovačević
Executive Director

Unconsolidated statement of cash flows
for the year ended 31 December 2012
(all amounts are expressed in thousands of KM)

	2012	2011
Operating Activities		
Loss before income tax	(11,084)	(40,639)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	6,125	6,384
Impairment losses and provisions	23,021	67,310
Provision for employee benefits	(286)	23
Loss on disposals of tangible and intangible assets	61	2,569
Loss on sale of available for sale investments	-	55
Dividend income	(836)	(5)
Foreign exchange adjustment	(329)	21
Cash flow before changes in operating assets and liabilities:		
Net decrease in obligatory reserve with the Central Bank of Bosnia and Herzegovina	44,859	26,063
Net decrease / (increase) in placements with other banks, before impairment losses	102,161	(90,468)
Net decrease in loans and advances to customers, before impairment losses	29,064	69,527
Net decrease / (increase) in other assets, before impairment losses	10,404	(16,438)
Net increase in due to other banks	29,597	10,403
Net decrease in due to customers	(126,104)	(35,240)
Net (decrease) / increase in other liabilities	(14,564)	5,023
Cash flows from operating activities	*92,089*	*4,588*
Income tax paid	-	-
NET CASH FROM OPERATING ACTIVITIES	**92,089**	**4,588**
Investing Activities		
Net increase of tangible and intangible assets	(2,510)	(5,568)
Gains on assets available for sale	(24,004)	12
Cash acquired from business combination	-	2,045
Proceeds from sale of tangible and intangible assets	275	76
Dividends received	836	5
NET CASH USED IN INVESTING ACTIVITIES	**(25,403)**	**(3,430)**
Financing Activities		
Increase in share capital	20,000	-
Increase in capital reserves	20,000	-
Increase / (decrease) in borrowings	17,417	(1,847)
NET CASH PROVIDED BY / (USED IN) FINANCING ACTIVITIES	**57,417**	**(1,847)**
NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS	**124,103**	**(689)**
CASH AND CASH EQUIVALENTS AT 1 JANUARY	**146,112**	**146,801**
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**270,215**	**146,112**

The accompanying notes form an integral part of these financial statements

Unconsolidated statement of changes in shareholders' equity
for the year ended 31 December 2012
(all amounts are expressed in thousands of KM)

	Share capital	Reserves	Regulatory reserves	Investment revaluation reserves	Retained losses	Total
31 December 2010	**193,000**	**113,571**	**-**	**(423)**	**(157,919)**	**148,229**
Effects of change of accounting policy (Note 4)	-	-	-	-	129,054	129,054
Regulatory requirements (Note 5)	-	-	129,054	-	(129,054)	-
Effects of merger Hypo Alpe-Adria Vrijednosnice d.o.o Mostar into the Bank (Note 32)	-	-	-	-	1,280	1,280
Net loss for the year 2011	-	-	-	-	(40,639)	(40,639)
Other comprehensive income for the year	-	-	-	412	-	412
Total comprehensive loss	-	-	-	*412*	*(40,639)*	*(40,227)*
31 December 2011	**193,000**	**113,571**	**129,054**	**(11)**	**(197,278)**	**238,336**
Correction of error (Note 3)	-	-	-	-	4,263	4,263
Regulatory requirements (Note 5)	-	-	4,337	-	(4,337)	-
Capital increase	20,000	20,000	-	-	-	40,000
Net loss for the year 2012	-	-	-	-	(11,084)	(11,084)
Other comprehensive income for the year	-	-	-	547	-	547
Total comprehensive loss	-	-	-	*547*	*(11,084)*	*(10,537)*
31 December 2012	**213,000**	**133,571**	**133,391**	**536**	**(208,436)**	**272,062**

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

(all amounts are expressed in thousands of KM)

1. GENERAL

History and incorporation
Hypo Alpe-Adria-Bank d.d. Mostar (the ''Bank") got the approval from the Banking Agency of Federation of Bosnia and Herzegovina ("FBA") dated 17 January 2000 and the Bank was registered at the County Court in Mostar on 21 January 2000.

The Bank's main office is located in Mostar, Kneza Branimira 2b. The Bank conducts its operations through the headquarters in Mostar, 46 branch offices and 12 offices in the Federation of Bosnia and Herzegovina.

Principal activities of the Bank:
The Bank's main operations are as follows:

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

Supervisory Board	
Rainer Sichert	President
Wolfgang Mősslacher	Vice-president
Stephan Holzer	Member
Sebastian Firlinger	Member
Blaž Brodnjak	Member

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

(all amounts are expressed in thousands of KM)

1. GENERAL (CONTINUED)

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

The shareholding structure is as follows:

	31 December 2012		31 December 2011	
	Paid capital	Ownership %	Paid capital	Ownership %
Hypo Alpe-Adria-Bank International AG, Klagenfurt	212,997	99.999	192,997	99.999
Small shareholders	3	0.001	3	0.001
Total	**213,000**	**100.00**	**193,000**	**100.00**

During 2012 the Management of Hypo Alpe-Adria-Bank International AG made a decision on shareholders' equity increase of the Bank for KM 40 million. The increase of Bank's shareholders' equity was realized through increase of share capital for KM 20 million and increase of capital reserves for KM 20 million.

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

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

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

2. "BRUSH" PROJECT

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

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

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

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

(all amounts are expressed in thousands of KM)

2. "BRUSH" PROJECT (CONTINUED)

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

Transfer of economic ownership along with keeping the legal one: Keeping of contract rights per contracts, whose economic risk and benefit of collection is subject of transfer, including the collection, along with the contracted obligation of transfer of such realized cash flows to Bora d.o.o.

The relationship between the Bank and the loan beneficiaries is not changed: The Bank keeps the legal ownership over receivables as well as the communication with the loan beneficiaries.

Transfer of risk of receivables collection per loans: The Bank fully transfers the risks and possible benefits per transferred cash flows from collection of receivables.

De-recognition of transferred financial assets in on-balance: By applying IAS 39, the part of financial assets which is the subject of the Agreement is derecognised.

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

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

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

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

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

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

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

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

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

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

(all amounts are expressed in thousands of KM)

2. “BRUSH” PROJECT (CONTINUED)

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

Below is an overview of reference assets and defined fee:

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

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

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

The identified difference of KM 8,536 thousand (Note 27), rose in the period 1 November 2011 till 31 December 2011 has been accounted on PTA transfer account and increased deposits toward Hypo Alpe-Adria Bank International AG immediately after issuing the Annex no. 1 in 2012.

On 19 July 2012, the Banking Agency of the Federation of Bosnia and Herzegovina („FBA“) issued approval to the Bank to transfer the contracted deposits of Hypo Alpe-Adria-Bank International AG in the amount of 367,951 thousand KM. Since the transfer of contracted deposits Hypo Alpe-Adria-Bank International AG is an integral part of the Project BRUSH and represented an event that provided evidence of conditions that existed at the balance sheet date, the Bank adjusted the amounts to be recognized in the financial statement for the year ended 31 December 2011 year as follows:

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

The identified differences in the amount of 74,161 thousand KM, the Bank recorded at the account of liabilities towards Hypo Alpe-Adria-Bank International AG (Note 24). This difference between the initially contracted value of assets and liabilities and the approved amount, related to the loans classified in accordance with the regulatory requirements in A and B category as well as loans to individuals with net worth value less than 150 thousand KM as of 31 December 2011.

In accordance with the approval, the Bank adopted amendments to the existing Agreement and other supporting documents in August 2012, and the amended overview of reference assets and defined fee can be presented as follows:

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

3. CORRECTION OF ERROR

In 2012 the Bank corrected an error relating to the capitalized interest receivables from Palace Group d.o.o. Sarajevo in amount of KM 4,263 thousand. The capitalization of interest was performed in the course of restructuring of the initial loan in 2009, when the interest receivables calculated off-balance sheet was added to the outstanding loan balance.

The Bank recognized the capitalized interest receivables as deferred income and release it as per the repayment schedule. However, as of 31 December 2011 as per Pass-through Agreement (PTA) the Bank transferred credit risk related to Palace Group d.o.o. Sarajevo to Bora d.o.o. Banja Luka, whereby deferred income was not considered during the transfer process.

4. ADOPTION OF NEW AND REVISED STANDARDS

4.1 Standards and Interpretations effective in the current period

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

- Amendments to IFRS 1 "First-time Adoption of IFRS" - Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after 1 July 2011),
- Amendments to IFRS 7 "Financial Instruments: Disclosures" - Transfers of Financial Assets (effective for annual periods beginning on or after 1 July 2011),
- Amendments to IAS 12 "Income Taxes" - Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after 1 January 2012).

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

4.2 Standards and Interpretations in issue not yet effective

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

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after 1 January 2015),
- IFRS 10 "Consolidated Financial Statements" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 11 "Joint Arrangements" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 12 "Disclosures of Interests in Other Entities" (effective for annual periods beginning on or after 1 January 2013),
- IFRS 13 "Fair Value Measurement" (effective for annual periods beginning on or after 1 January 2013),
- IAS 27 (revised in 2011) "Separate Financial Statements" (effective for annual periods beginning on or after 1 January 2013),
- IAS 28 (revised in 2011) "Investments in Associates and Joint Ventures" (effective for annual periods beginning on or after 1 January 2013),
- Amendments to IFRS 1 "First-time Adoption of IFRS" - Government Loans (effective for annual periods beginning on or after 1 January 2013),
- Amendments to IFRS 7 "Financial Instruments: Disclosures" - Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2013),
- Amendments to IFRS 9 "Financial Instruments" and IFRS 7 "Financial Instruments: Disclosures" – Mandatory Effective Date and Transition Disclosures,

4. ADOPTION OF NEW AND REVISED STANDARDS (CONTINUED)

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

- Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosures of Interests in Other Entities" - Transition Guidance (effective for annual periods beginning on or after 1 January 2013),
- Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 12 "Disclosures of Interests in Other Entities" and IAS 27 "Separate Financial Statements" - Investment Entities (effective for annual periods beginning on or after 1 January 2014),
- Amendments to IAS 1 "Presentation of financial statements" - Presentation of Items of Other Comprehensive Income (effective for annual periods beginning on or after 1 July 2012),
- Amendments to IAS 19 "Employee Benefits" - Improvements to the Accounting for Post-employment Benefits (effective for annual periods beginning on or after 1 January 2013),
- Amendments to IAS 32 "Financial instruments: presentation" - Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2014),
- Amendments to various standards "Improvements to IFRSs (2012)" resulting from the annual improvement project of IFRS published on 17 May 2012 (IFRS 1, IAS 1, IAS 16, IAS 32, IAS 34) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 January 2013),
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine" (effective for annual periods beginning on or after 1 January 2013).

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

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

Basis of preparation
The unconsolidated financial statements have been prepared on the historical cost basis. The unconsolidated financial statements are presented in Convertible marks since that are the functional currency of the Company. The Convertible mark (KM) is officially tied to the Euro (EUR 1 = KM 1.95583).

The Bank has issued these unconsolidated financial statements as required by the Law in Federation of Bosnia and Herzegovina, and its investments in associates and subsidiaries are presented in these unconsolidated financial statements at cost. The Bank will also prepare consolidated financial statements, which will be approved by the Management Board. Bank's subsidiaries will be fully consolidated. For a better understanding of the Group as a whole, users should read the consolidated financial statements.

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Change of accounting policy

Up to 31 December 2011, as it was required by local legislation and decisions of Banking Agency of the Federation of Bosnia and Herzegovina ("FBA"), the Bank was preparing the financial statements in accordance with IFRS as modified by the regulatory requirements prescribed by FBA with respect to the calculation of provision for impairment of financial instruments. These rules required banks to calculate the allowance for impairment of financial assets and provision for commitments and contingencies using the matrix system based on number of overdue days.

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

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

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

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

Based on the Guidelines on the changes to the means for creating, recording and reporting forms for the loan loss reserves, issued by FBA in January 2011, the banks are obliged to introduce a new methodology for assessment of impairment losses on the financial assets (loans and receivables), in line with the requirements of IAS 39, and provisions for commitments and contingencies, in line with the requirements of IAS 37: "Provisions, Contingent Liabilities and Contingent Assets", effective from 1 January 2011. These guidelines also eliminated the requirement for general provisions of 2% for other items of assets. Also, the banks are required to recognize the difference between the allowance for impairment losses on financial assets and provisions according to new accounting policy and the level of allowance for impairment losses on financial assets and provisions that would have been determined if the matrix system was still applied, under Regulatory reserves within the equity. The difference is determined at the end of every year and upon decision of the Bank's Assembly on allocation of net result for the year is kept at required level. The Bank cannot decrease already determined the amount of provisions for loan losses.

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

(all amounts are expressed in thousands of KM)

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Change of accounting policy (continued)
Consequently, according to IAS 8: "Accounting Policies, Changes in Accounting Estimates and Errors", the new accounting policy was applied prospectively by making an adjustment to the opening balances of the equity in 2012.

The adjustment may be presented as follows:

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

As at 31 December 2011, the Bank did not allocate any additional amounts to the regulatory reserve as the amount already allocated as at 1 January 2011 was higher than the required amount as at 31 December 2011.

With regard to the change of accounting policy, on 29 March 2012, FBA issued an instruction requesting the banks that if the difference, between the allowance for impairment losses on financial assets and provisions according to the new accounting policy described in Note 5 of this report, at the level of individual contracts is less than the level of allowance for impairment losses on financial assets and provisions that would have been determined if the matrix system had been applied, then such difference should be recognized as regulatory reserves within retained earnings.

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

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

As of 31 December 2012, the required level of regulatory reserves was BAM 125,295 thousand. Already created regulatory reserves on the same date amount KM 133,391 thousand. Hence, the Bank has created more regulatory reserves than required in the amount of KM 8,096 thousand. The Bank will in accordance with regulatory requirements take this only into consideration when calculating the capital adequacy (Note 38).

Equity investments
A subsidiary is an entity which is controlled by the Bank. Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Investments in subsidiaries in these financial statements are stated at cost less any impairment in the value of individual investment needed.

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Equity investments (continued)
Financial information about investments in subsidiaries and associates are as follows:

	Total Assets	Share capital	Net result for 2012	Accumulated gains	Reserves	Total Equity
Subsidiaries:						
Hypo Alpe-Adria-Invest d.o.o. Mostar	2,599	1,462	305	652	75	2,494

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

Interest charged on deposits is added to the principal where this is foreseen by the agreement. Interest income is suspended when it is considered that recovery of the income is unlikely. Suspended interest is recognized as income when collected.

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

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

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

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

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

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

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

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

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents

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

Financial assets and liabilities

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

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

Method of effective interest rate

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

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

Financial assets available for sale

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

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

Impairment of financial assets other than loans

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

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

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

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets and liabilities (continued)

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

With the exception of AFS equity instruments, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognized.

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

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

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

Financial liabilities

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

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

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

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

(all amounts are expressed in thousands of KM)

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial assets and liabilities (continued)

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

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

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

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

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

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

	2012	2011
Buildings	2%	2%
Office equipment	10-33.3%	10-33.3%
Vehicles	25%	25%
Software and other intangible assets	20%	20%

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

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

(all amounts are expressed in thousands of KM)

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Tangible and intangible assets (continued)

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

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

As of 31 December 2012 and 2011, respectively, tangible and intangible assets of the Bank were not impaired.

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

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

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

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

31 December 2012	1 EUR = 1.95583 KM	1 USD = 1.48360 KM
31 December 2011	1 EUR = 1.95583 KM	1 USD = 1.51157 KM

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

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

(all amounts are expressed in thousands of KM)

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

6. CRITICAL ACCOUNTING JUDGMENTS AND ESTIMATIONS

In the application of the Bank's accounting policies, which are described in note 5, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. In these financial statements, significant estimates made by Management of the Bank as of 31 December 2012 and 2011, respectively are presented below.

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

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

Useful lives of tangible and intangible assets
As described at Note 5 above, the Bank reviews the estimated useful lives of tangible and intangible assets at the end of each annual reporting period.

Impairment losses on loans and receivables
As described at Note 5 above, at each reporting date, the Bank assessed indicators for impairment of loans and receivables and their impact on the estimated future cash flows from the loans and receivables.

Provisions for employee benefits
As described at Note 5 above, in paragraph with heading employee benefits, provisions for the employee benefits are calculated using the projected credit unit method.

7. INTEREST INCOME

	2012	2011
Interest on loans and advances to individuals	38,975	46,627
Interest on loans and advances to companies	31,642	61,552
Interest on balances due from other banks	299	2,385
Interest on financial instruments available for sale	288	-
Total	**71,204**	**110,564**

(all amounts are expressed in thousands of KM)

8. INTEREST AND SIMILAR EXPENSE

	2012	2011
Interest on deposits from individuals	19,198	19,446
Interest on amounts due to other banks	7,644	24,775
Interest on deposits from companies	4,940	7,573
Interest on borrowings and subordinated debt	3,673	3,825
Total	**35,455**	**55,619**

9. FEE AND COMMISSION INCOME

	2012	2011
Fees from other services to individuals	7,584	6,426
Fees from other services to companies	3,945	4,928
Fees from services to banks	1,948	1,995
Fees from issued guarantees	1,200	1,570
Total	**14,677**	**14,919**

10. NET INCOME ON FINANCIAL OPERATIONS

	2012	2011
Foreign exchange gain, net	3,313	5,437
Income from dividends	26	815
Net loss from sale of assets available for sale	-	(55)
Total	**3,339**	**6,197**

11. OTHER OPERATING INCOME

	2012	2011
Net income from sale of repossessed collaterals	4,003	8,783
Income from re-invoiced expenses to related parties	2,426	959
Income from insurance company	306	288
Release of provision for employees benefits	294	-
Net income from rent	151	205
Other income	696	827
Total	**7,876**	**11,062**

(all amounts are expressed in thousands of KM)

12. PERSONNEL EXPENSES

	2012	2011
Gross salaries	18,203	19,776
Other personnel expenses	947	2,017
Total	**19,150**	**21,793**

The number of personnel employed by the Bank as of 31 December 2012 and 2011 were 579 and 647, respectively.

13. GENERAL AND ADMINISTRATIVE EXPENSES

	2012	2011
Repairs and maintenance	7,251	7,121
Membership and other fees	4,308	4,486
Consulting and legal fees	3,090	6,215
Rent	2,698	2,558
Utilities expenses	1,793	1,909
Security expenses	1,571	1,631
Telecommunication	1,491	1,736
Advertising, marketing and sponsorship	1,247	2,746
Other taxes and contributions	989	1,083
Consumables	858	977
Insurance	535	441
Provision for court cases (Note 27)	104	-
Loss on disposal of tangible and intangible assets	61	2,569
Other expenses	860	790
Total	**26,856**	**34,262**

14. IMPAIRMENT LOSSES AND PROVISIONS

	2012	2011
Loans and advances to customers (Note 19)	22,444	65,894
Financial commitments and contingencies (Note 28)	(645)	(496)
Loans and receivables directly written off	1,206	1,786
Placements with other banks (Note 18)	(88)	126
Total	**22,917**	**67,310**

(all amounts are expressed in thousands of KM)

15. INCOME TAX

Tax liability is based on accounting income taking into the account non-deductible expenses and non-taxable income. Tax income rate for the years ended 31 December 2012 and 31 December 2011 was 10%.
Total tax recognised in income statement may be presented as follows:

	2012	2011
Current tax	-	-
Deferred tax	-	-
	-	-

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

	2012	2011
Loss before income tax	**(11,084)**	**(40,639)**
Income tax at the rate of 10%	(1,108)	(4,064)
Effects of non-deductible expenses	50	81
Effects of non-taxable income	(3)	(81)
Effect of carry forwarded tax losses	(18,859)	(14,795)
Unrecognised deferred tax assets relating to losses incurred	**(19,920)**	**(18,859)**
Income tax expense	**-**	**-**

In accordance with the Income tax Law, the taxable losses may be carried forward for the next 5 years against the future profits.

As of 31 December 2012, the Bank has not recognized a differed tax assets related to losses incurred in 2012 in the amount of KM 1,061 thousand and in 2011 in the amount of KM 4,064 thousand which if unutilized would expire in 2017 and 2016 respectively.

The movement in deferred tax may be presented as follows:

	31 December 2012	31 December 2011
Balance as at 1 January 2011	**2,172**	**2,172**
Charge for the year	-	-
Balance as at 31 December 2012	**2,172**	**2,172**

Deferred tax assets arising from the tax losses expire as follows:

- 2014 – KM 433 thousand;
- 2015 – KM 406 thousand;
- 2016 – KM 1,333 thousand.

(all amounts are expressed in thousands of KM)

16. CASH AND DUE FROM BANKS

	31 December 2012	31 December 2011
Cash on clearing account at the Central Bank of Bosnia and Herzegovina	206,277	69,609
Current accounts with other foreign banks	26,932	40,459
Cash on hand	36,930	35,965
Checks	76	79
Total	**270,215**	**146,112**

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

	31 December 2012	31 December 2011
Minimum obligatory reserve with the Central Bank of Bosnia and Herzegovina	87,656	132,515
Total	**87,656**	**132,515**

Minimum obligatory reserve was calculated as a percentage of the average amount of total deposits and borrowings for each working day during 10 calendar days following the period of maintaining the obligatory reserve. The rates of minimum obligatory reserve are calculated using 10% of total short-term deposits and borrowings and 7% of total long-term deposits and borrowings.

Interest rates on funds kept up to minimum obligatory reserve amounts to 0.004% - 0.008% , and on excess over minimum obligatory reserves amounts to 0.005% - 0.011%. Cash held at the obligatory reserve account with the Central Bank of Bosnia and Herzegovina is not available for daily operations without specific approval from the Central Bank of Bosnia and Herzegovina and the Banking Agency of the Federation of Bosnia and Herzegovina.

18. PLACEMENTS WITH OTHER BANKS

	31 December 2012	31 December 2011
Short term deposits with banks registered in:		
OECD countries	53,614	148,930
Other countries	-	6,845
Total gross deposits due from other banks	*53,614*	*155,775*
Less Allowance for impairment losses on placements	(49)	(137)
Total	**53,565**	**155,638**

As of 31 December 2012 and 2011, respectfully, the interest rates on placements with banks stated in EUR were 0.05% - 0.25% p.a and 0.25% - 0.45% p.a. and on placements stated in USD were 0.25% - 0.15% and 0.15% - 0.16% p.a.

(all amounts are expressed in thousands of KM)

18. PLACEMENTS WITH OTHER BANKS (CONTINUED)

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

	2012	2011
Balance as of 1 January	**137**	**120**
Effects of change of accounting policy – release of allowance (Note 5)	-	(109)
Changes in allowance for impairment losses, net (Note 14)	(88)	126
Balance as of 31 December	**49**	**137**

19. LOANS AND ADVANCES TO CUSTOMERS

	31 December 2012	31 December 2011
Short-term loans:		
Current portion of long-term loans	267,039	233,147
Corporate	86,326	135,779
Retail	43,789	41,004
Total short-term loans	*397,154*	*409,930*
Long-term loans:		
Corporate	351,116	361,964
Retail	512,786	567,620
Less: current portion of long-term loans	(267,039)	(233,147)
Total long-term loans	*596,863*	*696,437*
Total loans and advances to customers before allowance for impairment losses	994,017	1,106,367
Less: allowance for impairment losses	(108,439)	(94,204)
Total	**885,578**	**1,012,163**

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

	2012	2011
Balance as at 1 January	**94,204**	**262,948**
Effects of change of accounting policy – re-recognition of receivables previously written-off in full amount according to superseded FBA's decision (E category)	-	69,981
Effects of change of accounting policy – release of allowance (Note 5)	-	(127,435)
Increase in allowances for impairment losses (Note 14)	22,444	65,894
Unwinding	(7,919)	(20,788)
"BRUSH" Project (Note 2)	-	(156,396)
Foreign exchange effects	(290)	-
Balance as at 31 December	**108,439**	**94,204**

(all amounts are expressed in thousands of KM)

19. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

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

	31 December 2012	31 December 2011
Trade	166,810	187,439
Construction	34,695	39,838
Tourism, hotels and restaurants	19,598	27,599
Manufacturing companies and industry	96,290	129,328
Other	127,063	113,407
Total	**444,456**	**497,611**

Weighted average loan interest rates are summarized as follows:

	31 December 2012	31 December 2011
Corporate	7.81%	8.51%
Retail	8.75%	8.99%

20. FINANCIAL ASSETS AVAILABLE FOR SALE

	31 December 2012	31 December 2011
Treasury bills - Government of Federation BiH	14,515	-
Bonds – Government of Federation BiH	9,382	-
Visa Inc.	1,723	1,176
Uzajamni fond HYPO BH EQUITY	186	46
S.W.I.F.T SCRL	52	59
Registry of Securities in the FBiH	43	43
Sarajevo Stock Exchange	30	30
Total	**25,931**	**1,354**

During 2012, the Bank recognized increase in revaluation reserves related to securities available for sale of KM 547 thousand, net (2011 - KM 412 thousand, net). Total revaluation reserve related to securities available sale amounts to KM 536 thousand as of 31 December 2012 (31 December 2011 - KM 11 thousand).

(all amounts are expressed in thousands of KM)

20. FINANCIAL ASSETS AVAILABLE FOR SALE (CONTINUED)

The structure of bonds and treasury bills as per nominal value, as of 31 December 2012 can be presented as follows:

Asset	No.	Discounted price	Nominal price	Due date	Interest rate
Bonds					
Budget expenses					
Government of Federation BiH	5.865	5,824	5,865	27.06.2017.	6.10%
Government of Federation BiH	1.955	1,923	1,955	30.05.2015.	5.25%
Government of Federation BiH	1.250	1,240	1,250	26.09.2014.	4.75%
Accrued interest receivables	-	55	-	-	-
Foreign Savings					
Government of Federation BiH	51.339	51	51	31.03.2013.	2.50%
Government of Federation BiH	38.629	39	39	31.08.2013.	2.50%
Government of Federation BiH	6.658	7	6	30.09.2013.	2.50%
Government of Federation BiH	106.705	104	107	30.09.2013.	2.50%
Government of Federation BiH	47.132	46	47	31.03.2014.	2.50%
Government of Federation BiH	26.800	25	27	31.08.2014.	2.50%
Government of Federation BiH	11.063	10	11	03.09.2014.	2.50%
Government of Federation BiH	61.094	56	61	30.09.2014.	2.50%
Accrued interest receivables	-	2	-	-	-
		9,382	**9,419**		
Treasury bills					
Government of Federation BiH	976	9,679	9,760	29.05.2013.	-
Government of Federation BiH	488	4,836	4,880	12.06.2013.	-
		14,515	**14,640**		
		23,897	**24,059**		

21. INVESTMENTS IN SUBSIDIARIES

Investments in subsidiaries as of 31 December 2012 and 2011 are presented at cost.

	31 December 2012	31 December 2011
Hypo Alpe-Adria Invest d.o.o. Mostar	2,711	2,711
Total	**2,711**	**2,711**

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

(all amounts are expressed in thousands of KM)

22. OTHER ASSETS

	31 December 2012	31 December 2011
Repossessed collaterals held for sale	4,215	3,113
Card operations	2,512	1,293
Prepaid income tax	1,783	1,783
Receivables from Hypo Alpe-Adria Bank a.d. Banja Luka	1,069	5,242
Transfer account BRUSH	1,008	-
Receivables from HETA d.o.o. Sarajevo – sale of repossessed collaterals	856	8,635
Advances to suppliers	675	919
Office supplies	365	447
Receivables for sold repossessed collaterals	198	1,080
Fee and commissions receivable	82	95
Receivables for dividends	-	810
Other assets	2,415	2,165
Total other assets	*15,178*	*25,582*
Less: allowance for impairment losses	-	-
Total	**15,178**	**25,582**

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

	2012	2011
Balance as of 1 January	**-**	**1,419**
Effects of change of accounting policy – re-recognition of receivables previously written-off in full amount according to superseded FBA's decision (E category)	-	28
Effects of change of accounting policy – release of allowance (Note 5)	-	(1,447)
Balance as of 31 December	**-**	**-**

(all amounts are expressed in thousands of KM)

23. TANGIBLE AND INTANGIBLE ASSETS

	Land and buildings	Office equipment and vehicles	Construction in progress	Leasehold improvements	Software and other intangibles	Total
Cost value						
31 December 2010	**49,250**	**23,367**	**14,079**	**2,118**	**5,491**	**94,305**
Merge with Hypo Alpe-Adria Vrijednosnice d.o.o. (Note 32)	-	319	7	-	41	367
Additions	-	-	5,568	-	-	5,568
Transfers from/to	188	1,654	(18,045)	121	16,082	-
Disposals	-	(3,540)	-	(429)	(3,111)	(7,080)
31 December 2011	**49,438**	**21,800**	**1,609**	**1,810**	**18,503**	**93,160**
Additions	-	-	2,510	-	-	2,510
Transfers from/to	86	1,554	(2,121)	6	475	-
Disposals	(177)	(2,773)	(3)	(636)	(12)	(3,601)
31 December 2012	**49,347**	**20,581**	**1,995**	**1,180**	**18,966**	**92,069**
Accumulated depreciation						
31 December 2010	**2,982**	**14,072**	**-**	**1,401**	**4,268**	**22,723**
Merge with Hypo Alpe-Adria Vrijednosnice d.o.o. (Note 32)	-	165	-	-	25	190
Charge for the year 2011	1,037	2,938	-	283	2,126	6,384
Disposals	-	(3,455)	-	(429)	(551)	(4,435)
31 December 2011	**4,019**	**13,720**	**-**	**1,255**	**5,868**	**24,862**
Charge for the year 2012	1,037	2,720	-	217	2,151	6,125
Disposals	(22)	(2,650)	-	(581)	(12)	(3,265)
31 December 2012	**5,034**	**13,790**	**-**	**891**	**8,007**	**27,722**
Net book value: 31 December 2012	**44,313**	**6,791**	**1,995**	**289**	**10,959**	**64,347**
31 December 2011	**45,419**	**8,080**	**1,609**	**555**	**12,635**	**68,298**

(all amounts are expressed in thousands of KM)

24. DUE TO OTHER BANKS

	31 December 2012	31 December 2011
Short-term deposits:		
In KM	570	5
In foreign currencies	33,650	2,388
Subtotal	*34,220*	*2,393*
Long-term deposits:		
In KM	-	-
In foreign currencies	170,372	246,763
Subtotal	*170,372*	*246,763*
Total deposits from banks	*204,592*	*249,156*
Long term loan from foreign bank	84,271	66,854
Total	**288,863**	**316,010**

Long term deposits as of 31 December 2012 and 2011, respectively, may be presented as follows:

	31 December 2012	31 December 2011
Hypo Alpe-Adria Bank International AG, Klagenfurt (term deposits for a period over 5 years)	48,929	153,144
Hypo Alpe-Adria Bank International AG, Klagenfurt (term deposits for a period from 3 to 5 years)	94,337	2,046
Hypo Alpe-Adria Bank International AG, Klagenfurt (term deposits for a period from up to 3 years)	23,606	-
Hercegovačka banka d.d. Mostar (in provisional administration)	3,500	15,900
Hypo Alpe-Adria Bank International AG, Klagenfurt (Note 2)	-	74,161
KIB Banka d.d. Velika Kladuša	-	1,512
Total	**170,372**	**246,763**

Interest rates on long-term deposits from other banks, ranged from EURIBOR+0.90% to EURIBOR+2.25% in 2012 and from EURIBOR+0.9% to EURIBOR+2.45% during 2011.

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

In accordance with the Letter of Intent issued by the Parent Bank on 25 January 2013, the Parent Bank agreed not to withdraw the deposits before the date of their maturity Furthermore, this Letter of Intent expires either by returning it to Parent Bank or at least after a period of 12 months from the date of issuance of Letter. The Letter of Intent also expires if there is a change in shareholder structure of the Bank, regardless in which measures, before the expiry date.

(all amounts are expressed in thousands of KM)

25. DUE TO CUSTOMERS

	31 December 2012	31 December 2011
Demand deposits from		
Individuals:		
In KM	93,113	89,934
In foreign currencies	101,251	97,337
Subtotal	*194,364*	*187,271*
Companies:		
In KM	66,180	94,731
In foreign currencies	10,019	27,580
Subtotal	*76,199*	*122,311*
Total demand deposits	**270,563**	**309,582**
Term deposits from		
Individuals:		
In KM	77,673	89,701
In foreign currencies	326,646	360,105
Subtotal	*404,319*	*449,806*
Companies:		
In KM	28,621	33,284
In foreign currencies	54,496	91,431
Subtotal	*83,117*	*124,715*
Total term deposits	**487,436**	**574,521**
Total	**757,999**	**884,103**

Interest rates for long-term deposits were in the range from 0.20% to 6.75% per annum and from 0.10% to 6.75% per annum as of 31 December 2012 and 2011, respectively.

26. SUBORDINATED DEBT

	31. December 2012	31. December 2011
Hypo Alpe-Adria Bank International AG, Klagenfurt	65,000	65,000
Total	**65,000**	**65,000**

The subordinated debt from Hypo Alpe – Adria Bank International AG Klagenfurt as of 31 December 2012 is comprised of four long term deposits in total value of KM 65,000 thousand (EUR 33,234 thousand). As stated in contract, funds are deposited permanently from the day of payment, without defined repayment obligation.

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

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

(all amounts are expressed in thousands of KM)

26. SUBORDINATED DEBT (CONTINUED)

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

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

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

27. OTHER LIABILITIES

	31 December 2012	31 December 2011
Payments in transit	10,644	10,186
Accrued expenses	3,153	9,570
Liabilities to employees for salaries	1,859	1,627
Accrued bonuses	974	974
Provision for employee benefits *	951	1,293
Restricted funds	596	3,745
Other tax liabilities	542	422
Liabilities to vendors	360	1,229
Difference in managed funds (Note 31)	236	244
Liabilities for card operations	196	246
Exercised guarantees	169	150
Provision for legal cases *	134	30
Provision for restructuring *	106	604
Transfer account – "BRUSH" Project (Note 2)	-	8,536
Membership and other fees	-	276
Other liabilities	664	461
Total	**20,584**	**39,593**

Movement of provisions can be summarized as follows:

	Restructuring provision	Employee benefits	Legal cases	Total
Balance as at 31 December 2010	**1,067**	**1,270**	**30**	**2,367**
Increase in provision	-	23	-	23
Release in provision	(463)	-	-	(463)
Balance as at 31 December 2011	**604**	**1,293**	**30**	**1,927**
Increase in provision	-	8	104	112
Release in provision	-	(294)	-	(294)
Release due to payment	(498)	(56)	-	(554)
Balance as at 31 December 2012 *	**106**	**951**	**134**	**1,191**

(all amounts are expressed in thousands of KM)

28. FINANCIAL COMMITMENTS AND CONTINGENCIES

	31 December 2012	31 December 2011
Unused loan facilities	80,077	98,643
Payment guarantees	28,624	36,618
Performance guarantees	14,230	9,505
Letters of credit	1,789	8,357
Total	**124,720**	**153,123**
Provision for financial commitments and contingencies	2,845	3,503

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

	2012	2011
Balance as of 1 January	**3,503**	**4,062**
Effects of change of accounting policy – release of provision (Note 5)	-	(63)
Release of provisions (Note 14)	(645)	(496)
Foreign exchange effects	(13)	-
Balance as of 31 December	**2,845**	**3,503**

29. RELATED-PARTY TRANSACTIONS

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

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

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

(all amounts are expressed in thousands of KM)

29. RELATED-PARTY TRANSACTIONS (CONTINUED)

	31 December 2012	31 December 2011
Receivables		
Placements - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	18,974	10,746
Other – Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	3,330	-
Placements - HYPO ALPE-ADRIA-BANK d.d., Zagreb	1,343	1,348
Other - Hypo Alpe-Adria-Bank A.D. Banja Luka	1,069	5,242
Other - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	856	8,635
Placements - HYPO ALPE-ADRIA-BANK S.P.A., Udine	356	143
Placements - HYPO ALPE-ADRIA-BANK AD BEOGRAD	148	-
Placements - HYPO ALPE-ADRIA-BANK AG, Klagenfurt	132	35
Placements - HYPO ALPE-ADRIA-BANK d.d. Ljubljana	91	-
Other - HYPO ALPE-ADRIA-BANK d.d. Zagreb	58	-
Other - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	22	1
Other - Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	5	-
Other - HYPO ALPE-ADRIA-BANK AG, Klagenfurt	5	-
Other - HYPO ALPE-ADRIA-BANK A.D. PODGORICA	4	5
Other - HYPO ALPE-ADRIA-BANK AD BEOGRAD	2	3
Other - HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	-	810
Placements - HYPO ALPE-ADRIA-BANK d.d., Ljubljana	-	244
Total	**26,395**	**27,212**
Payables		
Deposits - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	200,325	230,872
Subordinated debt - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	65,000	65,000
Deposits - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	3,210	1,471
Deposits - Hypo Alpe-Adria-Bank A.D. Banja Luka	1,454	99
Other - Hypo Alpe-Adria-Bank A.D. Banja Luka	898	273
Other - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	556	8,642
Deposits - HYPO ALPE-ADRIA-BANK d.d., Zagreb	465	89
Other - HYPO ALPE-ADRIA-BANK d.d., Zagreb	171	-
Other – BORA d.o.o. Banja Luka	167	-
Deposits - HYPO ALPE-ADRIA-BANK AD BEOGRAD	137	28
Deposits - Hypo Zastupnik d.o.o. (former: GLOBUS konsalting d.o.o.)	93	-
Deposits - HYPO ALPE-ADRIA-BANK AG, Klagenfurt	93	-
Other - Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	51	-
Other - HYPO ALPE-ADRIA-BANK AD BEOGRAD	7	7
Deposits - HYPO ALPE-ADRIA-BANK A.D. PODGORICA	6	9
Deposits - HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	-	2,375
Deposits - HYPO ALPE-ADRIA-BANK AG, Klagenfurt	-	676
Other - ZAJEDNICKI INFORMACIONI SISTEM d.o.o. BEOGRAD	-	144
Total	**272,633**	**309,685**

(all amounts are expressed in thousands of KM)

29. RELATED-PARTY TRANSACTIONS (CONTINUED)

	2012	2011
Income		
Other income - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	4,622	8,556
Fee and Commission income – BORA d.o.o. Banja Luka	1,004	-
Other income - Hypo Alpe-Adria-Bank A.D. Banja Luka	690	338
Fee and Commission income - Hypo Alpe-Adria-Bank A.D. Banja Luka	126	90
Fee and Commission income - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	59	-
Other income - Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	44	-
Fee and Commission income - HYPO ALPE-ADRIA-BANK AG, Klagenfurt	28	-
Fee and Commission income - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	19	59
Interest income - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	17	13
Interest income - Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	8	-
Interest income - HYPO ALPE-ADRIA-BANK d.d., Zagreb	7	2
Fee and Commission income - HYPO ALPE-ADRIA-BANK S.P.A., Udine	4	-
Interest income - HYPO ALPE-ADRIA-BANK S.P.A., Udine	3	1
Interest income - HYPO ALPE-ADRIA-BANK d.d., Zagreb	3	-
Other income - HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	-	810
Total	**6,634**	**9,869**
Expenses		
Interest expense - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	9,577	26,706
Administrative expenses - ZAJEDNICKI INFORMACIONI SISTEM d.o.o. BEOGRAD	3,888	6,012
Fee and commission expense - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	2,528	3,113
Administrative expenses - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	1,763	2,648
Administrative expense -HYPO ALPE-ADRIA-BANK d.d., Zagreb	808	665
Administrative expenses-Hypo Alpe-Adria-Bank A.D. Banja Luka	250	182
Fee and commission expense - Hypo Alpe-Adria-Bank A.D. Banja Luka	191	159
Administrative expenses - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	182	76
Interest expense - HETA d.o.o. Sarajevo (former HYPO-ALPE-ADRIA-LEASING d.o.o. Sarajevo)	65	83
Administrative expense - HYPO ALPE-ADRIA-NEKRETNINE d.o.o., Zagreb	31	-
Fee and commission expense - HYPO ALPE-ADRIA-NEKRETNINE d.o.o., Zagreb	15	16
Other expenses - HYPO ALPE-ADRIA-BANK INTERNATIONAL AG, Klagenfurt	5	-
Interest expense - Hypo Alpe-Adria-Leasing d.o.o. Banja Luka	4	-
Interest expense -HYPO-ALPE-ADRIA-INVEST d.o.o. Mostar	-	30
Total	**19,307**	**39,690**

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

(all amounts are expressed in thousands of KM)

29. RELATED-PARTY TRANSACTIONS (CONTINUED)

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

	2012	2011
Compensations for the Management Board	285	210
Taxes and contributions on compensations	225	165
Bonuses and other benefits	-	153
Taxes on bonuses and other benefits	-	121
Total	**510**	**649**

30. ESTIMATED FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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

It is the opinion of the Management of the Bank that the fair value of the Bank financial assets and liabilities are not materially different from the amounts stated in the balance sheets as at 31 December 2012 and 31 December 2011. In estimating the fair value of the Bank's financial instruments, the following methods and assumptions were used.

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

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

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

Level 1 – fair value measurements for those derived from quoted prices in active market;
Level 2 – fair value measurements for those derived from inputs other than quoted prices included in level 1;
Level 3 – fair value measurements for those derived from valuation techniques that are not based on observable market data.

As of 31 December 2012 and 2011, the Bank's financial instruments related to Level 1 such as available-for-sale assets amounting to KM 25,931 thousand and KM 1,354 thousand, respectively. The Bank has no level 2 and 3 financial instruments as of 31 December 2012 and 2011, respectively.

For loans and receivables, as described in Note 5, the Bank assessed indicators for impairment by applying International Accounting Standard 39.

(all amounts are expressed in thousands of KM)

31. MANAGED FUNDS

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

	31 December 2012	31 December 2011
Assets		
State institutions	441	472
Total	**441**	**472**
Liabilities		
Loans to citizens	-	7
Legal entities	677	709
Total	**677**	**716**
Differences (Note 27)	**236**	**244**

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

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

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

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

(all amounts are expressed in thousands of KM)

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

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

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

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

33. MARKET RISK

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

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

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

General Requirements

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

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

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

The subsidiaries of Hypo Alpe-Adria Group („HGAA") calculate risk as per HGAA specifications for the respective portfolios. The results are presented to the Management board as part of on-going 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 group standards. The main instrument used in this process is the Monte Carlo simulation with an exponentially weighted history of 250 days.

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

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

33. MARKET RISK (CONTINUED)

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

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

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

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

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

In addition a limit system also provides support through defined warning levels, which show negative developments early on.

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

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

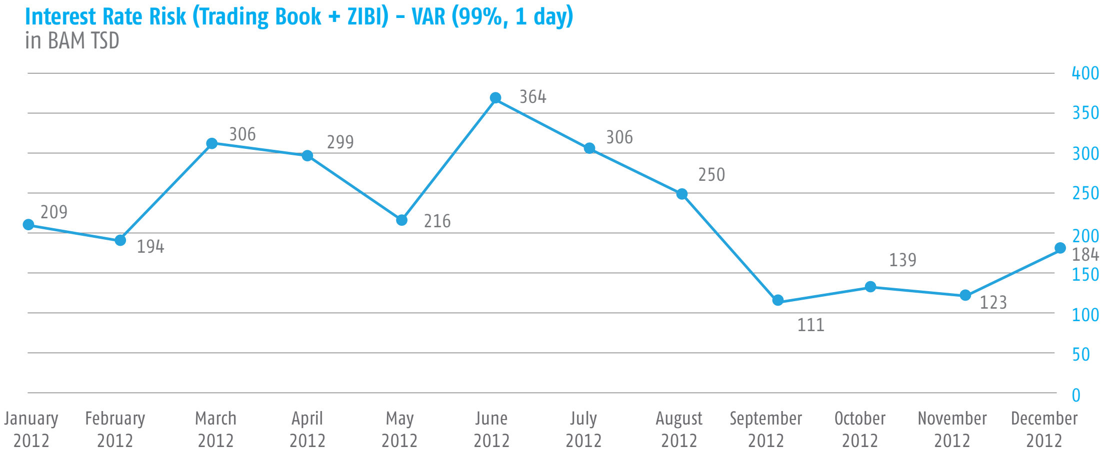
Market Risk Overview
The table shows the progression of interest rate risk (including the interest rate risk of the trading book) for the Bank in 2012.

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

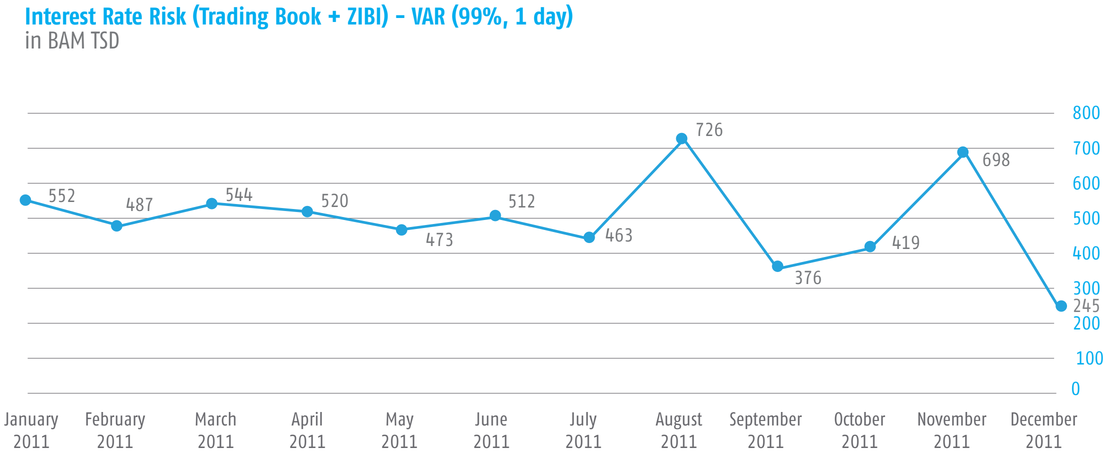
33. MARKET RISK (CONTINUED)

Market Risk Overview (continued)

Interest Rate Risk (Trading Book + Bank Book) – 2012



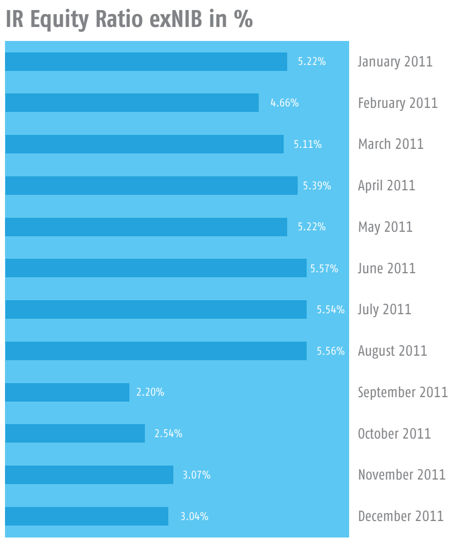
Interest Rate Risk (Trading Book + Bank Book) – 2011



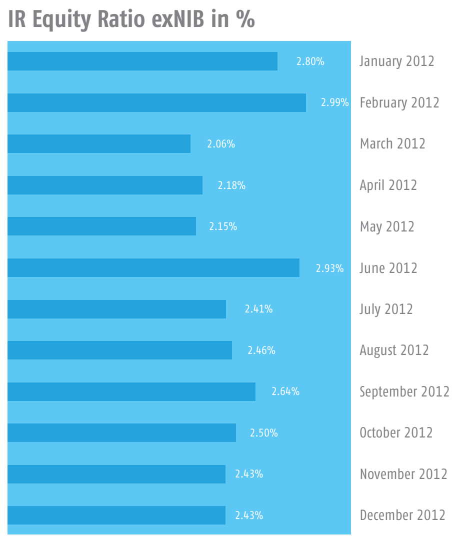
The methodology of the interest risk calculation is oriented to the specifications of the Austrian National Bank (Oesterreichische Nationalbank - OeNB) regarding the calculation of interest risk statistics.

33. MARKET RISK (CONTINUED)

Interest Risk to Equity Ratio in %



2011.

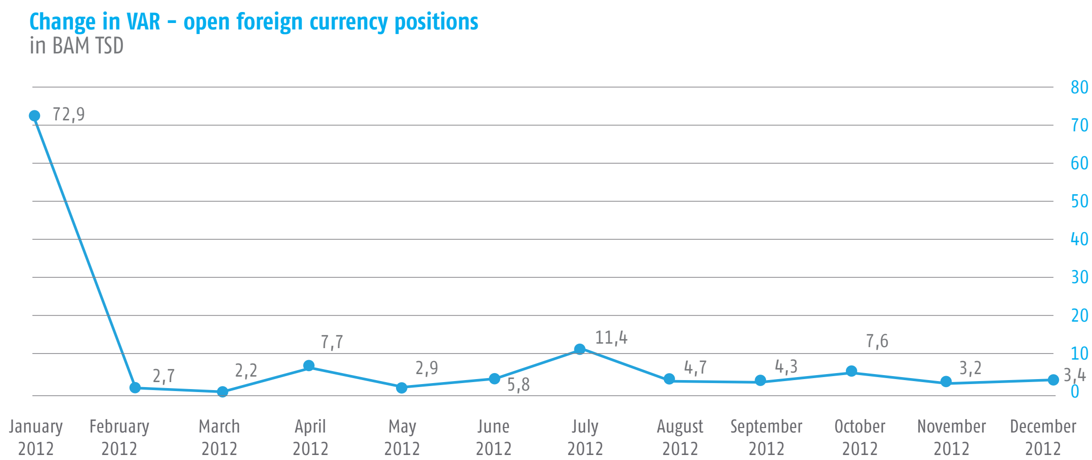


2012.

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

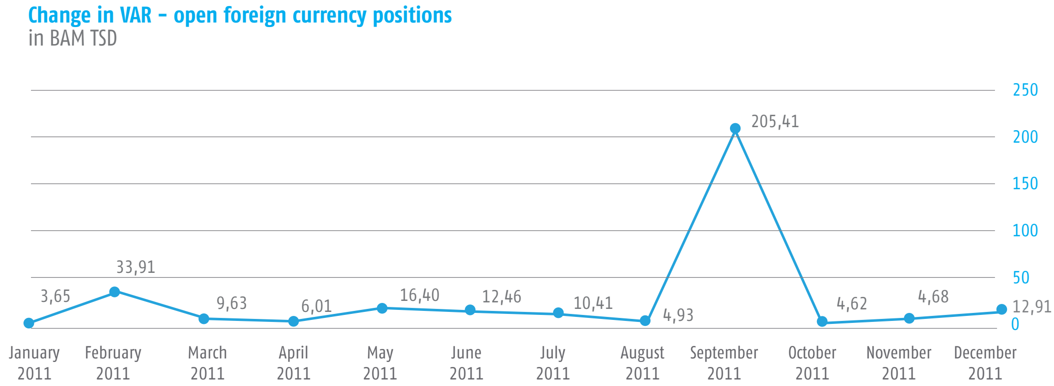
The value-at-risk for this foreign currency risk was approximately KM 3,4 thousand (EUR 1,7 thousand) as of 31 December 2012, at a confidence interval of 99%.

Change in VAR – open foreign currency positions – 2012

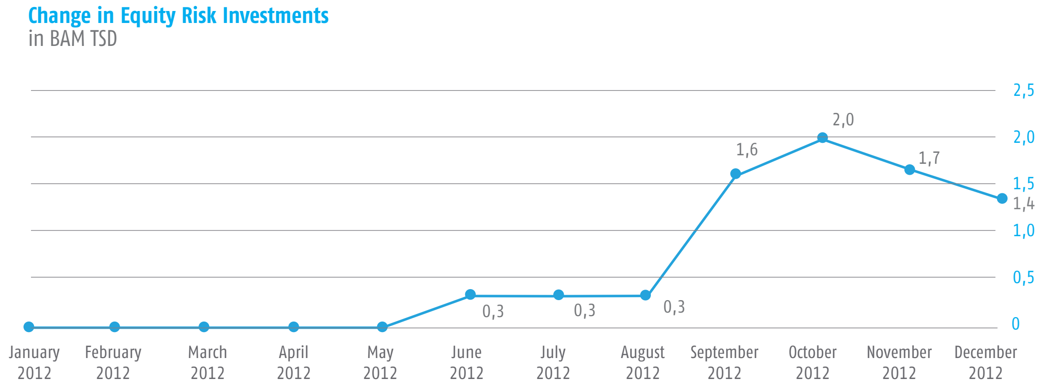


33. MARKET RISK (CONTINUED)

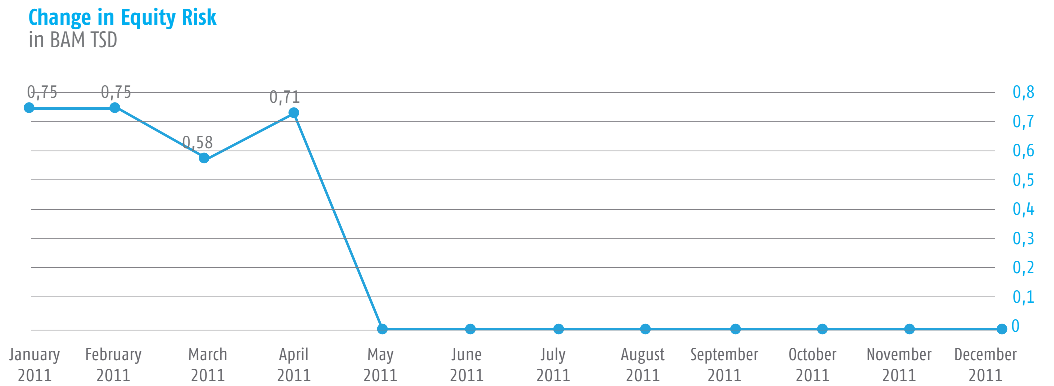
Change in VAR – open foreign currency positions – 2011



Change in VAR – Equity risk – 2012



Change in VAR – Equity risk – 2011



(all amounts are expressed in thousands of KM)

34. FOREIGN CURRENCY BALANCE SHEET AND FOREIGN CURRENCY RISK

The Bank undertakes certain transactions denominated in foreign currencies. Hence, exposures to exchange rate fluctuations arise.

Exchange rate exposures are managed within approved policy parameters utilizing forward foreign exchange contracts.

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

	Assets		Liabilities	
	2012	2011	2012	2011
EUR	54,689	112,062	684,178	654,287
USD	32,610	45,385	33,089	46,025
CHF	6,085	51,602	126,537	162,756
Other currencies	4,702	5,151	3,844	4,518

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

	KM	EUR	USD	CHF	Other currencies	Total
ASSETS						
Cash and due from banks	229,889	26,866	2,676	6,085	4,699	270,215
Obligatory reserve	87,656	-	-	-	-	87,656
Placements with other banks	-	25,426	28,139	-	-	53,565
Loans and advances to customers	884,847	731	-	-	-	885,578
Assets available for sale	24,156	52	1,723	-	-	25,931
Total financial Assets (1)	**1,226,548**	**53,075**	**32,538**	**6,085**	**4,699**	**1,322,945**
LIABILITIES						
Due to other banks	569	166,566	-	121,728	-	288,863
Due to customers	265,587	450,749	33,059	4,763	3,841	757,999
Subordinated debt	-	65,000	-	-	-	65,000
Other financial liabilities	18,642	1,863	30	46	3	20,584
Total financial Liabilities (2)	**284,798**	**684,178**	**33,089**	**126,537**	**3,844**	**1,132,446**
Balance gap as at 31 December 2012 (1) - (2)	**941,750**	**(631,103)**	**(551)**	**(120,452)**	**855**	**190,499**
Total assets as of 31 December 2011 (3)	**1,259,164**	**112,062**	**45,385**	**51,602**	**5,151**	**1,473,364**
Total liabilities as of 31 December 2011 (4)	**435,836**	**654,287**	**46,025**	**164,040**	**4,518**	**1,304,706**
Balance gap as at 31 December 2011 (3) – (4)	**823,328**	**(542,225)**	**(640)**	**(112,438)**	**633**	**168,658**

35. LIQUIDITY RISK

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

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

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

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

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

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

The most important components of liquidity potential are as follows:

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

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

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

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

35. LIQUIDITY RISK (CONTINUED)

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.

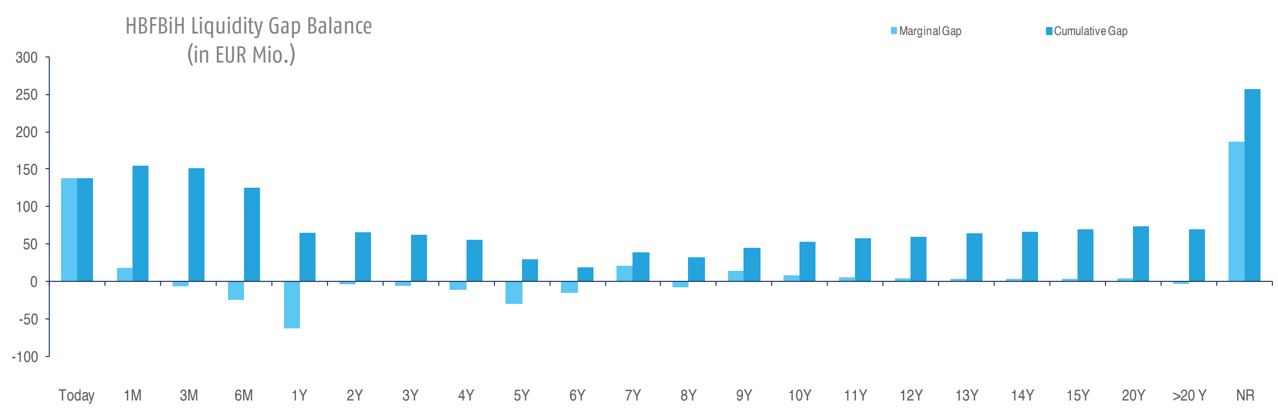
Risk Monitoring

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

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

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

Cumulative and marginal liquidity gap overview per time bucket – 2012



(all amounts are expressed in thousands of KM)

35. LIQUIDITY RISK (CONTINUED)

Cumulative and marginal liquidity gap overview per time bucket – 2011

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

Solvency indicators were as follows:

	31 December 2012	31 December 2011
Debt (i)	1,046,862	1,200,113
Equity (ii)	337,062	303,336
%	**3.11**	**3.96**

Debt (i) is defined as due to banks and due to customers presented in detail in notes 24 and 25.

Capital (ii) includes total capital, Bank's reserves and subordinated debt.

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

The Regulator places the following demands on all banks:

- Minimum ownership capital of KM 15 million.
- Maintaining capital adequacy (''Basel Indicator'') at the legally required minimum of 12%. As of 31 December 2012 the adequacy of the Bank's capital amounts to 21% (2010: 14.4%).

(all amounts are expressed in thousands of KM)

36. CREDIT RISK

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

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

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

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

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

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

Financial Assets

31 December 2012	Total gross carrying amount	Unimpaired assets	Individually impaired assets	Allowance for impairment losses	Total net carrying amount
Cash and due from other banks including obligatory reserves with CBBiH	357,871	357,871	-	-	357,871
Placements with other banks	53,614	53,614	-	(49)	53,565
Loans and advances to customers	994,017	717,280	276,737	(108,439)	885,578
Financial assets available for sale	25,931	25,931	-	-	25,931
Total	**1,431,433**	**1,154,696**	**276,737**	**(108,488)**	**1,322,945**
31 December 2011					
Cash and due from other banks including obligatory reserves with CBBiH	278,627	278,627	-	-	278,627
Placements with other banks	155,775	155,775	-	(137)	155,638
Loans and advances to customers	1,106,367	771,332	335,035	(94,204)	1,012,163
Financial assets available for sale	1,354	1,354	-	-	1,354
Total	**1,542,123**	**1,207,088**	**335,035**	**(94,341)**	**1,447,782**

(all amounts are expressed in thousands of KM)

36. CREDIT RISK (CONTINUED)

Loan exposure and collaterals

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

Description	Net exposure	Maximum loan exposure Liabilities / issued guarantees	Allowed sale / new collateral	Fair value of collateral Not allowed sale / new collateral
31 December 2012				
Cash and due from banks including obligatory reserves with CBBiH	357,871	-	-	-
Placements with other banks	53,565	-	-	-
Loans and advances to customers	885,578	124,720	1,121,783	-
Financial assets available for sale	25,931	-	-	-
31 December 2011				
Cash and due from banks including obligatory reserves with CBBiH	278,627	-	-	-
Placements with other banks	155,638	-	-	-
Loans and advances to customers	1,012,163	153,123	1,101,518	-
Financial assets available for sale	1,354	-	-	-

37. BASIC LOSS PER SHARE

Basic loss per share is calculated by dividing the net loss attributable to ordinary shareholders by weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Bank and held as treasury shares.

For the purpose of calculating basic earnings per share, preferred shares are considered as ordinary shares as they do not bear preferential dividend right.

	2012	2011
Loss attributable to ordinary shareholders (KM '000)	(11,084)	(40,639)
Weighted average number of regular shares outstanding	507,466	482,500
Basic loss per share (KM)	**(21.84)**	**(84.23)**

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

38. EVENTS AFTER THE REPORTING PERIOD DATE

On 14 February 2013, FBA has adopted a Decision on changes and adoption of Decision on minimal standards for the management of credit risk and classification of assets, according to which in Article 23, previous paragraphs 5 and 6 are deleted and were related to the following:

Paragraph 5: The competent authorities of the Bank are obliged to decide upon adoption of the annual report on income distribution for coverage of required reserves according to regulatory requirement, or on income expense, unallocated income from previous years, retained earnings and other reserves from income.

Paragraph 6: As long as the Bank does not provide coverage of the missing reserves for credit losses according to regulatory requirements, the Bank cannot do a distribution of income to any other purpose, nor the payment of dividends (except of priority shares), or any other payments form income, as well as bonuses to the members of the management.

In accordance with the Decision on temporary restriction and minimal conditions for dividend payment, discretionary bonuses and purchase of own shares by banks, the Bank cannot make dividend payment, discretionary bonuses and purchase of own shares if the net equity, from the Article 7, point (5) Decision on minimal equity standards for management of bank equity ("Official Gazette of FBiH", number 48/12-consolidated text) does not amount to at least 14.5% and if basic bank equity under Article 8. of the Decision does not amount to at least 8.5% of the total risk assets (total risk-weighted assets) calculated in accordance with the Article 14, paragraph 1 of the Decision.

39. APPROVAL OF THE FINANCIAL STATEMENTS

These unconsolidated financial statements were approved by the Management Board on 14 March 2013.

Signed on behalf of the Management Board:

Alexander Picker
Chief Executive Officer

Dragan Kovačević
Executive Director

Headoffice

Hypo Alpe-Adria-Bank d.d.
88 000 Mostar
Kneza Branimira 2b
Tel. +387 36 444 200
Fax +387 36 444 235,
www.hypo-alpe-adria.ba
e-mail: bank.bih@hypo-alpe-adria.com

Branches

88 000 Mostar
Stjepana Radića, lamela E
Tel. +387 36 448 121
Fax +387 36 324 908

88 000 Mostar
Trg Hrvatskih velikana b.b. Rondo
Tel. +387 36 449 850
Fax +387 36 449 848

88 260 Čitluk
Broćanski trg 2
Tel. +387 36 640 420
Fax +387 36 640 427

88 340 Grude
Dr. Franje Tuđmana 4
Tel. +387 39 660 391
Fax +387 39 661 745

88 320 Ljubuški
Stube IV, lamela A
Tel. +387 39 835 791
Fax +387 39 835 795

80 240 Tomislavgrad
Mijata Tomića b.b.
Tel. +387 34 352 341
Fax +387 34 352 329

88 240 Posušje
Fra Grge Martića b.b.
Tel. +387 39 685 193
Fax +387 39 680 894

88 300 Čapljina
Ante Starčevića b.b.
Tel. +387 36 810 795
Fax +387 36 808 810

88 220 Široki Brijeg
Trg Ante Starčevića 6
Tel. +387 39 702 502
Fax +387 39 702 508

80 101 Livno
PC Forum Splitska b.b.
Tel. +387 34 200 308
Fax +387 34 201 385

88 400 Konjic
Trg državnosti b.b.
Tel. +387 36 735 300
Fax +387 36 735 303

72 250 Vitez
Stjepana Radića 6,
Tel. +387 30 718 608
Fax +387 30 718 603

71 260 Kreševo
Fra Grge Martića 122,
Tel. +387 30 800 601
Fax +387 30 800 608

79 280 Uskoplje
Kralja Tomislava b.b.
Tel. +387 30 495 734
Fax +387 30 495 733

70 101 Jajce
Kulina Bana 1
Tel. +387 30 654 554
Fax +387 30 654 558

72 270 Novi Travnik
Ive Andrića 35
Tel. + 387 30 795 210
Fax + 387 30 795 214

72 270 Travnik
Trg republike 11a
Tel. +387 30 540 860
Fax +387 30 540 660

71 250 Kiseljak
Josipa Bana Jelačića b.b.
Tel. + 387 30 877 288
Fax + 387 30 877 297

72 260, Busovača
16. Kolovoza b.b.
Tel. + 387 30 735 090
Fax + 387 30 735 091

72000 Zenica
PSC Kamberovića polje
Tel. + 387 32 449 730
Fax + 387 32 449 738

70 230 Bugojno
Sultan Ahmedova b.b.
Tel. +387 30 259 561
Fax +387 30 259 564

71 000 Sarajevo - Alipašino polje
Trg solidarnosti 12
Tel. +387 33 755 722
Fax +387 33 755 725

71 000 Sarajevo
Maršala Tita 18a
Tel. +387 33 563 181
Fax +387 33 217 285

71 000 Sarajevo - Stari grad
Zelenih beretki 11
Tel.+387 33 252 480
Fax +387 33 252 488

71 000 Sarajevo - Dobrinja
Mustafe Kamerića 6-7
Tel.+387 33 775 373
Fax +387 33 775 378

71 000 Sarajevo - Pofalići
Zmaja od Bosne b.b.
Tel. +387 33 723 602
Fax +387 33 723 600

71 210 Ilidža
Rustempašina b.b.
Tel. +387 33 770 293
Fax +387 33 770 298

71 000 Sarajevo - Hrasno
Azize Šaćirbegovića 122
Tel. +387 33 715 026
Fax +387 33 715 026

71 000 Sarajevo - Ciglane
Husrefa Redžića 1
Tel. +387 33 568 710
Fax +387 33 568 719

71 000 Sarajevo - Grbavica
Trnovska 2
Tel. +387 33 568 850
Fax +387 33 568 853

71 300 Visoko
Dr. Džananovića 8
Tel. +387 32 731 001
Fax +387 32 731 002

75 101 Tuzla
Trgovinsko zanatski centar b.b, Sjenjak
Tel. +387 35 251 232
Fax +387 35 266 164

75 101 Tuzla
Maršala Tita, Lamela 2B
Tel. +387 35 302 241
Fax + 387 35 302 263

76 233 Domaljevac
Posavskih branitelja 148
Tel. +387 31 719 900
Fax +387 31 791 990

76 270 Orašje
V ulica 29
Tel. +387 31 719 803
Fax +387 31 719 808

75 300 Lukavac
Lukavačkih brigada b.b., TZC Omega"
Tel. +387 35 551 101
Fax +387 35 551 106

75 270 Živinice
Alije Izetbegovića 36
Tel. + 387 35 743 193
Fax +387 35 743 195

76 250 Gradačac
H. K. Gradaščevića b.b.
Tel. + 387 35 821 491
Fax +387 35 821 495

77 000 Bihać
Bosanska b.b.
Tel. + 387 37 229 761
Fax +387 37 229 773

77 220 Cazin
Cazinskih brigada b.b.
Tel. + 387 37 515 000
Fax + 387 37 515 007

75 320 Gračanica
22. divizije b.b.
Tel. +387 35 701 361
Fax +387 35 701 368

Responsible for content:

Hypo Alpe-Adria-Bank d.d.
88000 Mostar
Kneza Branimira 2b
Tel. +387 36 444 200
Fax +387 36 444 235
bank.bih@hypo-alpe-adria.com
www.hypo-alpe-adria.ba

Important notice:
This Annual report has been prepared with great care and the information it contains has been checked. The possible occurrence of rounding errors, typesetting and printing errors and errors in expression can however not be precluded. The English language report is a translation.