

**MF BANKA A.D. BANJA LUKA**

**Financial Statements  
For the Year Ended December 31, 2012  
and Independent Auditors' Report**

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## INDEPENDENT AUDITORS' REPORT

### To the Supervisory Board and Shareholders of MF banka a.d., Banja Luka

We have audited the accompanying financial statements (page 2 to 34) of MF banka a.d., Banja Luka (hereinafter the "Bank"), which comprise the statement of financial position as of December 31, 2012 and the related statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with 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.

#### *Auditors' Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

#### *Opinion*

In our opinion, the financial statements of MF banka a.d., Banja Luka present fairly, in all material respects, the financial position of the Bank as at December 31, 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte d.o.o.,  
Banja Luka

April 5, 2013

Audit and Consulting company Deloitte d.o.o. Banja Luka – a single member company, Braće Mažar i majke Marije 58 i 60, 78000 Banja Luka, Republic of Srpska, Bosnia and Herzegovina. District Commercial Court Banja Luka, Registry File 1-10626/00; Inscribed and paid capital: BAM 5,000; Identification No: 1913239; Tax No: 4400883000008; VAT No: 400883000008; Business accounts: 562-099-00001310-96; 552-002-00017739-98; 567-162-11000129-31; 571-010-00000438-11; 572-000-00002180-13.

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**STATEMENT OF COMPREHENSIVE INCOME**  
 Year Ended December 31, 2012  
 (Thousands of BAM)

	Notes	Year Ended December 31, 2012	Year Ended December 31, 2011
Interest income	3.1,6	7,132	2,638
Interest expenses	3.1,7	(1,988)	(599)
<b>Net interest income</b>		<b>5,144</b>	<b>2,039</b>
Fee and commission income	3.1,8	742	397
Fee and commission expenses	3.1,9	(377)	(43)
<b>Net fee and commission income</b>		<b>365</b>	<b>354</b>
Other operating income	10	238	36
Other operating expenses	11	(5,141)	(2,681)
Foreign exchange losses, net	3.2	(9)	(2)
Provisions for potential losses, net	3.5,13	18	(339)
<b>Profit/(loss) from operations before taxes</b>		<b>615</b>	<b>(593)</b>
Income taxes	3.7	(20)	-
<b>Net profit/(loss) for the year</b>		<b>595</b>	<b>(593)</b>
Other comprehensive income		-	-
<b>Total comprehensive income for the year</b>		<b>595</b>	<b>(593)</b>
<b>Earnings per share</b>			
- Basic and diluted earnings/(loss) per share (in BAM)	23	2.29	(2.28)

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

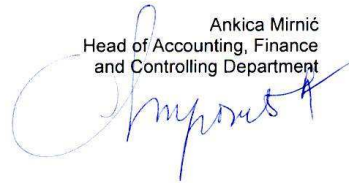
These financial statements were adopted by the Bank's Supervisory Board on February 19, 2013.

Signed on behalf of MF banka a.d., Banja Luka by:

Srećko Bogunović  
 Director




Ankica Mirnić  
 Head of Accounting, Finance  
 and Controlling Department



**STATEMENT OF FINANCIAL POSITION**  
**As of December 31, 2012**  
**(Thousands of BAM)**

	<u>Notes</u>	<u>December 31, 2012</u>	<u>December 31, 2011</u>
<b>ASSETS</b>			
Cash and balances held with the Central Bank	13	13,774	13,292
Deposits held with other banks	14	4,100	6,292
Loans to customers	15	82,998	35,851
Equipment and intangible assets	16	1,553	974
Accrued interest and other assets	17	<u>770</u>	<u>168</u>
<b>Total assets</b>		<u>103,195</u>	<u>56,577</u>
<b>LIABILITIES AND EQUITY</b>			
Bank deposits	18	5,000	5,988
Customer deposits	18	51,020	30,344
Borrowings	19	25,468	-
Other liabilities	20	1,232	407
Provisions for potential losses and retirement benefits		<u>89</u>	<u>47</u>
Total liabilities		<u>82,809</u>	<u>36,786</u>
<b>Equity</b>	21		
Share capital		26,000	26,000
Accumulated losses		<u>(5,614)</u>	<u>(6,209)</u>
Total equity		<u>20,386</u>	<u>19,791</u>
<b>Total liabilities and equity</b>		<u>103,195</u>	<u>56,577</u>
<b>Contingent liabilities and commitments</b>	24	<u>7,517</u>	<u>4,610</u>

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

**STATEMENT OF CHANGES IN EQUITY**  
**For the Year Ended December 31, 2012**  
**(Thousands of BAM)**

	<b>Share Capital</b>	<b>Accumulated Losses</b>	<b>Total</b>
Balance, January 1, 2011	26,000	(5,615)	20,385
Other decrease	-	(1)	(1)
Loss for the year	-	(593)	(593)
Balance, December 31, 2011	<u>26,000</u>	<u>(6,209)</u>	<u>19,791</u>
Profit for the year	-	595	595
Balance, December 31, 2012	<u>26,000</u>	<u>(5,614)</u>	<u>20,386</u>

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

**CASH FLOW STATEMENT**  
**Year Ended December 31, 2012**  
**(Thousands of BAM)**

	<b>Year Ended December 31, 2012</b>	<b>Year Ended December 31, 2011</b>
<b>Cash flows from operating activities</b>		
Interest receipts	7,546	2,218
Interest paid	(1,472)	(448)
Fee and commission receipts	718	607
Fee and commission paid	(377)	(47)
Inflows from the collection of receivables previously written off	238	18
Payments to employees and suppliers	(4,904)	(2,638)
<i>Operating profit/(loss) before changes in operating assets and liabilities</i>	<u>1,749</u>	<u>(290)</u>
<b>Changes in operating assets and liabilities</b>		
Net increase in loans to customers	(47,261)	(23,015)
Net increase/(decrease) in bank deposits	(988)	5,988
Net increase in customer deposits	20,581	18,742
<i>Net cash (used in)/generated by operating activities</i>	<u>(25,919)</u>	<u>1,425</u>
<b>Cash flows from investing activities</b>		
Purchase of intangible assets	(266)	(205)
Purchase of property and equipment	(712)	(183)
<i>Net cash used in investing activities</i>	<u>(978)</u>	<u>(388)</u>
<b>Cash flows from financing activities</b>		
Inflows based on borrowings	25,497	-
Repayment of borrowings	(29)	-
Outflows based on extraordinary items	(256)	-
<i>Net cash generated by financing activities</i>	<u>25,212</u>	<u>-</u>
<b>Net (decrease)/increase in cash and cash equivalents</b>	(1,685)	1,037
<b>Effects of the changes in foreign exchange rates</b>	(25)	(2)
<b>Cash and cash equivalents, beginning of year</b>	<u>19,584</u>	<u>18,549</u>
<b>Cash and cash equivalents, end of year</b>	<u><u>17,874</u></u>	<u><u>19,584</u></u>
<b>Cash and cash equivalents comprise the following positions:</b>		
- Cash and balances held with the Central Bank	13,774	13,292
- Deposits held with other banks	4,100	6,292
	<u>17,874</u>	<u>19,584</u>

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

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***1. BANK'S FOUNDATION AND BUSINESS POLICY**

MF Banka a.d., Banja Luka (hereinafter the "Bank") was established on June 12, 2007 and named IEFK Banka a.d., Banja Luka.

In the process of the Bank's registration, all requirements defined by the regulatory authorities with respect to the principal banking activities were fulfilled. In accordance with its Decision numbered 03-231-11/2007 of May 11, 2007, the Republic of Srpska Banking Agency (the "BARS" or "Agency") issued an operating license to the Bank, and pursuant to Decision numbered 03-657-4/2007 of July 12, 2007, the Agency issued to the Bank a license to conduct interbank payment transactions.

At the Shareholder Assembly held on April 6, 2010, the previous owners of the Bank enacted a Decision to sell 100% of the Bank's equity (Note 21), whereafter an Agreement on the Purchase and Sale of Capital was signed on July 8, 2010 based on which the Bank's major shareholder became MKD Mikrofin d.o.o., Banja Luka, and as of that date this entity also assumed the management and control over the Bank.

Based on the decision enacted by the new owner of the Bank and the decision of the competent court in Banja Luka as of November 26, 2010, the Bank changed its name into MF Banka a.d., Banja Luka.

In the Republic of Srpska, the Bank is licensed to perform banking activities that include payment transfers, credit and deposit operations in the country and abroad, and as in accordance with the Republic of Srpska banking legislation, the Bank is to operate based upon the principles of liquidity, solvency and profitability.

The Bank is headquartered in Banja Luka, at number 22 Vase Pelagića Street. At December 31, 2011, the Bank had a central office in Banja Luka and branch offices Borik and Centar Banja Luka and branch offices in Laktaši, Gradiška, Derventa, Brčko, Bijeljina, Doboje, Prijedor, East Sarajevo, Zvornik, Novi Grad, Teslić and Prnjavor.

As of December 31, 2012, the Bank had 111 employees (December 31, 2011: 68 employees).

**2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION****2.1. Statement of Compliance**

The accompanying financial statements are the annual stand-alone financial statements of the Bank, prepared in accordance with International Financial Reporting Standards (IFRS).

**2.2. Application and Impact of the new and revised IFRS***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 (IFRIC) 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 July 1, 2011);
- Amendments to IFRS 1 "First-Time Adoption of IFRS"- Removal of Fixed Dates for First-Time Adopters (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Transfers of Financial Assets (effective for annual periods beginning on or after July 1, 2011); and
- Amendments to IAS 12 "Income Taxes" – Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after January 1, 2012).

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



**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)****2.2. Application and Impact of the new and revised IFRS (Continued)***Standards and Interpretations in Issue not yet Translated and Adopted*

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

- IFRS 9 (revised in 2010) "Financial Instruments" (effective for annual periods beginning on or after January 1, 2015);
- Amendments to IFRS 9 "Financial Instruments" and IFRS 7 "Financial Instruments: Disclosures" – Mandatory Effective Date and Transition Disclosures (effective for annual periods beginning on or after January 1, 2015);
- IFRS 10 "Consolidated Financial Statements" (effective for annual periods beginning on or after January 1, 2013);
- IFRS 11 "Joint Arrangements" (effective for annual periods beginning on or after January 1, 2013);
- IFRS 12 "Disclosures of Involvement with Other Entities" (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 10, IFRS 11 and IFRS 12 "Consolidated Financial Statements, Joint Arrangements and Disclosures of Involvement with Other Entities: Transition Guidance" (effective for annual periods beginning on or after January 1, 2013);
- IAS 27 (revised in 2011) "Separate Financial Statements" (effective for annual periods beginning on or after January 1, 2013);
- IAS 28 (revised in 2011) "Investments in Associates and Joint Ventures" (effective for annual periods beginning on or after January 1, 2013);
- IFRS 13 "Fair Value Measurement" (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IAS 19 "Employee Benefits" (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" – Government Loans (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IAS 1 "Presentation of Financial Statements" – Presentation of Items of Other Comprehensive Income (effective for annual periods beginning on or after July 1, 2012);
- Amendments to IAS 32 "Financial Instruments: Presentation" – Accounting for Rights Issues (effective for annual periods beginning on or after February 1, 2010);
- Annual improvements 2009-2011 cycle issued in May 2012 (effective for annual periods beginning on or after January 1, 2013);
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine" (effective for annual periods beginning on or after January 1, 2013); and
- Amendments to IFRS 10, IFRS 12 and IAS 27 - Exemption from Consolidation of Subsidiaries under IFRS 10 'Consolidated Financial Statements' (effective for annual periods beginning on or after January 1, 2014).

The Bank's management has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The management 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.

**2.3. Basis of Preparation and Presentation of the Financial Statements**

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

The financial statements are stated in Convertible marks (thousands of BAM), which is the functional and reporting currency of the Republic of Srpska and Bosnia and Herzegovina.

In the preparation of the statement of cash flows for the year ended December 31, 2012, the Bank applied direct method in reporting on cash flows.

In the preparation of the accompanying financial statements, the Company adhered to the accounting policies described in Note 3 to the unconsolidated financial statements.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****3.1. Income and Expense Recognition**

Interest income and expenses for all interest-bearing financial instruments, except for financial instruments classified as available for sale or carried at fair value through profit and loss, are stated at fair value of assets received or paid, and are presented as interest income and expenses, and fee and commission income expenses.

Interest income is deferred on a time basis and recognized using the effective interest method, which represents the rate that exactly discounts (reduces) the estimated future cash receipts over the expected life of financial instruments to the net carrying amount of such assets upon initial recognition.

Loan origination fees are deferred and amortized over the loan repayment period by applying the effective interest rate method and are presented within interest income.

**3.2. Foreign Exchange Translation**

Transactions denominated in foreign currencies are translated into BAM at the Bank's exchange rates prevailing at the date of each transaction. Assets and liabilities denominated in foreign currencies are translated into BAM at the statement of financial position date by applying the official rates of exchange in effect on that date. Contingent liabilities denominated in foreign currencies are translated into BAM at the official exchange rates prevailing at the statement of financial position date. Foreign exchange gains or losses arising upon translation are credited or charged to the statement of comprehensive income.

**3.3. Equipment and Intangible Assets**

Items of equipment and intangible assets are recorded at cost net of any accumulated depreciation and amortization, and any accumulated impairment losses. Cost represents the prices billed by suppliers, increased by all acquisition-related costs and all costs incurred in bringing the assets to the location and condition necessary for their intended use.

Depreciation and amortization are calculated on a straight-line basis at the following prescribed, annual rates in order to write off the assets over their estimated useful lives:

	<u>Depreciation and Amortization Rate</u>	<u>Useful Life (Years)</u>
Computer equipment	25%	4
Automobiles	15.5%	6.5
Telephone switchboards	7%-10%	10 – 14.3
Furniture	10%-12.5%	8 - 10
Intangible assets	20%	5

The Bank's management believes that the amortization and depreciation rates that have been applied fairly reflect the future consumption of economic benefits from fixed and intangible assets.

The depreciation and amortization of assets commences when the assets are available for use and placed on the location and in condition necessary for them to operate in a manner intended by the Bank's management.

If the cost of equipment is less than BAM 200, it is treated as tools or fixtures and is fully written-off once placed into use.

**3.4. Impairment of Assets**

At each statement of financial position date, the Bank's management reviews the carrying amounts of the Bank's tangibles in order to determine the indications of impairment loss. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. In cases where it is impossible to assess the recoverable amount of an individual asset, the Bank assess the recoverable value of the cash generating unit to the asset belongs.

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. For the purpose of assessing value in use, estimated future cash flows are discounted to the present value by applying the discount rate prior to taxation reflecting the present market estimate of time value of cash and risks specifically related to the asset in question.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Impairment of Assets (Continued)**

If the estimated recoverable amount of an asset (or cash generating unit) is below its carrying value, the carrying amount of the asset (or cash generating unit) is reduced to its recoverable amount. An impairment loss is immediately recognized as an expense of the current period.

When an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) 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 (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, 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 December 31, 2012, in the assessment of the Bank's management, there were no indications that the value of equipment and intangible assets had suffered impairment.

**3.5. Financial Assets**

All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis, i.e. requiring delivery of assets within the time frame established by regulation or convention in the marketplace, and are initially measured at fair value including transaction costs. Financial assets are classified into the following specified categories: loans and receivables and financial assets available for sale. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

*Effective Interest Method*

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

Income is recognized on an effective interest basis for debt instruments other than those financial assets classified as at fair value through profit and loss.

*Financial Assets Available for Sale*

Available-for-sale financial assets comprise investments in equity instruments of enterprises and other legal entities that are listed in an active market stated at fair value at the end of each reporting period. Investments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost. Gains and losses arising from the changes in the fair value directly affect the equity, i.e. the investment revaluation reserves, except for impairment losses, interest calculated using the effective rate method and foreign exchange gains or losses on monetary assets, which are recognized in profit and loss. When the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

The fair value of available-for-sale monetary financial assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate prevailing at the statement of financial position date. The foreign exchange gains and losses that are recognized in profit or loss are determined based on the amortized cost of the monetary asset. Other foreign exchange gains and losses are recognized within equity.

*Loans and Receivables*

Loans and other receivables with fixed or determinable payments that are not quoted in an active market can be classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.5. Financial Assets (Continued)***Loans and Receivables (Continued)*

For the purpose of determining amortized cost, i.e. fair value of loans in accordance with IAS/IFRS, the Bank uses contractually agreed effective interest rate that adjusts the net present value of future cash flows to the nominal value of the loan approved, net of principal repaid.

Loans are contractually agreed with a variable interest rate according to the Bank's business policy. The Bank receives as collaterals payment orders, guarantees, bills of exchange, mortgages on property and pledges on movables, deposits and the like.

*Cash and Cash Equivalents*

Cash and cash equivalents include cash on hand, monetary assets held with the Central Bank and balances on foreign currency accounts held with domestic and foreign banks and other deposits maturing within less than three months from the placement date.

*Impairment of Financial Assets*

Financial assets, other than those at fair value through profit and loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when 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 affected.

For equity investments not quoted in an active market and classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, including redeemable securities classified as assets available for sale, and finance lease receivables, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- breach of contract, such as a default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables from loans approved, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Bank's past experience of collecting payments, an increase in the number of delayed payments past the maturity dates, as well as observable changes in national or local economic conditions that correlate with default on receivables.

For financial assets carried at amortized cost, the amount of the impairment loss recognized 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.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

Except for securities available for sale, 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 amortized cost would have been had the impairment not been recognized.

In respect of AFS equity securities, impairment losses previously recognized in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognized within equity.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.5. Financial Assets (Continued)***Derecognition of Financial Assets*

The Bank derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when 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 retains control over a financial asset, it continues to recognize such an asset.

**3.6. Financial Liabilities**

Financial liabilities comprise long-term and short-term trade payables and other liabilities.

Financial liabilities are initially recognized at the amounts received. Subsequent to the initial recognition, financial liabilities are measured at the initially recognized amounts net of principal repayment and increased by capitalized interest less any write-off granted by the creditor. Financial liabilities are stated at amortized cost using the effective interest rate. Interest accrued on financial liabilities is charged to finance of the respective period and presented within other current liabilities.

The Bank derecognizes financial liabilities when the Bank's obligations are discharged, cancelled or they have expired.

**3.7. Taxes and Contributions***Current Income Tax*

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

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

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

*Deferred Income Taxes*

Deferred income tax is determined using the balance sheet liability method, for temporary differences arising between the tax bases of assets and liabilities components, and their carrying values in the consolidated financial statements. The currently-enacted tax rates at the statement of financial position date are used to determine the deferred income tax amount. Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for deductible temporary differences, and the tax effects of income tax losses and credits available for carry forward, to the extent that it is probable that future taxable profit will be available against which deferred tax assets may be utilized.

*Indirect Taxes and Contributions*

Indirect taxes and contributions include payroll contributions charged to the employer, property taxes, and various other taxes and contributions, included in other operating expenses.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.8. Employee Benefits**

In accordance with regulatory requirements, the Bank is obligated to pay contributions to government social security funds and pension funds that are calculated by applying specific, legally prescribed percentages. These obligations involve the payment of taxes and contributions on behalf of employees, by the employer, in an amount calculated in accordance with the statutory regulations. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to the applicable government funds. These taxes and contributions payable on behalf of the employees and employer are charged as expenses in the period in which they arise.

In accordance with the requirements of IAS 19 "Employee Benefits," the Bank performs the actuarial valuation of provisions so as to determine the present value of accumulated employee retirement benefits. Upon retirement, the Bank's employees become entitled to retirement benefits in an amount equaling three monthly salaries earned by the vesting employee.

Expenses of retirement benefits are determined using the projected unit credit method for actuarial valuation as of the balance sheet date. Accordingly, the Bank engaged an independent certified actuary to calculate the present value of accumulated employee entitlements to retirement benefits as of December 31, 2012 on behalf of the Bank. In the calculation of the present value of accumulated employee entitlements to retirement benefits, the certified actuary used the following assumptions: projected salary growth of 9% annually, years of service required for retirement – 40 years for men and 35 years for women, projected employee turnover based on data on historical employee turnover in the prior period, officially published mortality rates in the region in the prior period, as well as other requirements necessary to exercise rights to a retirement benefit. In the opinion of the management, the amounts presented in the financial statements reflect the real value which is most reliable and useful for the needs of the financial reporting under the current circumstances.

**3.9. Leases**

Leases are classified as finance leases whenever the terms of the lease transfer substantially all risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

*The Bank as a Lessor*

Lease income from operating leases (rentals) is recognized in income on a straight-line basis over the lease term. Initial direct costs incurred by lessors in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as the lease income.

*The Bank as a Lessee*

Lease payments under an operating lease are recognized as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit. Contingent fees arising from operating leases are recognized as expenses in the periods in which they arise.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

**4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES**

The presentation of the financial statements requires the Bank's management to make best estimates and reasonable assumptions that influence the assets and liabilities amounts, as well as the disclosure of contingent liabilities and receivables as of the date of preparation of the financial statements, and the income and expenses arising during the accounting period. These estimations and assumptions are based on information available to the management, as of the date of preparation of the financial statements. However, actual future amounts may depart from the estimates.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (Continued)**

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

Basic assumptions relating to the future events and other significant sources of uncertainties in rendering an estimate as of the statement of financial position date, which bears the risk that may lead to significant restatement of the net book value of assets and liabilities in the ensuing financial year, were as follows:

*Estimated Useful Life of Equipment and Intangible Assets*

The estimate of useful life of equipment and intangible assets is founded on the historical experience with similar assets, as well as foreseen technical advancement and changes in economic and industrial factors. The adequacy of the estimated remaining useful life of fixed assets is analyzed annually, or in cases where there are indications of significant changes in certain assumptions.

*Impairment of Assets*

At each statement of financial position date, the Bank's management reviews the carrying amounts of the Bank's assets for the indications of impairment loss. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount.

*Allowance for Impairment of Receivables*

Allowance for impairment for bad and doubtful debts is calculated based on estimated losses resulting from the inability of customers to make required payments. The Bank calculates the impairment of its receivables in accordance with IAS 39 "Financial Instruments: Recognition and Measurement" and IAS 37 "Provisions, Contingent Assets and Contingent Liabilities". The management assesses that allowance for impairment of receivables in addition to the amount already recognized in the financial statements is not necessary.

At each month end, the Bank calculates impairment losses contingent on defaults and irrecoverability and provisions thereof by applying the following two methodologies:

- 1) methodology for calculation of the aforesaid provisions prescribed by the BARS and used exclusively for reporting to the regulator (BARS), and
- 2) methodology for calculation of the aforesaid provisions based on IAS 39 "Financial Instruments: Recognition and Measurement," used for all other internal and external reporting purposes of the Bank.

According to IAS 39 "Financial Instruments: Recognition and Measurement," the Bank reviews the credit portfolio in order to determine allowance for impairment and provisions on a monthly basis. In determining whether the impairment losses on placements should be recognized in the statement of comprehensive income, the Bank assesses whether there is information/evidence indicating the existence of a measurable decrease in the estimated future cash flows of a portfolio basis, before such losses can be identified at the level of individual investments.

Information that may indicate the losses on placements include customer credit rating, irregularity and defaults in settling liabilities, market and economic conditions on a local level conditioning defaults in settling liabilities and the like. Management's assessments regarding the impairment in financial placements included in the Bank's portfolio by way of assessing future cash flows are based on actual losses from the past, incurred on financial assets with similar causes of impairment.

The procedure used to assess impairment is based on the internal classification for all receivables, except for those due from retail customers in the amount that is below BAM 5, i.e. for those due from corporate customers that are below BAM 100. In the classification, the Bank treats all entities within the group of related parties as belonging to the least favorable classification category.

The procedure of impairment assessment is performed individually for each loan that meets the criteria defined in the Rules on Internal Classification, and on portfolio basis for all other loans, i.e. for all other loans that do not meet these conditions.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (Continued)***Allowance for Impairment of Receivables (Continued)*

The Bank calculates impairment for all customers that are over 90 days in default with payments. The Bank recognizes impairment losses up to the amount of recoverable value of loans/placements measured at amortized cost.

Impairment loss is the difference between its present value (amortized cost) and its recoverable value. The recoverable value is the present value of expected cash inflows from assets, increased by the expected future inflows from collaterals, net of present value of collection charges.

Impairment losses are charged to the statement of comprehensive income. The amounts of impairment losses on loans/ placements are reflected on the allowance account.

Where an impairment loss subsequently reverses due to events that emerged after its recognition, the reversal is credited to statement of comprehensive income, but the amount of reversal may not exceed the amount of amortized value that would have been determined had no impairment loss been previously recognized.

*Fair Value*

It is the policy of the Bank to disclose the fair values of those asset and liability components for which published market information is readily available, and for which their fair value is materially different from the recorded amounts. In the Republic of Srpska, there is insufficient market experience, stability and liquidity for the purchase and sale of financial assets or liabilities for which quoted prices on an active market are not presently, readily available. Hence, fair value cannot be reliably determined. The Bank's management assesses its overall risk exposure, and in instances in which it estimates that the value of assets stated in its books may not have been realized, it recognizes a provision. As per the Bank's management, amounts expressed in the financial statements reflect the fair value which is most reliable and useful for the needs of the financial reporting.

**5. FINANCIAL INSTRUMENTS****5.1. Financial Risk Management**

The Bank is exposed to various types of financial risks based on its activities which include, but are not limited to, analyzing, assessing, assuming a certain level of risk or combination of risks, as well as managing these. Assumption of risks is inherent in financial business, while operational risks accompany any business. The Bank aims to strike a balance between risks assumed and return on its investments, and to reduce to the minimum potential adverse effects of these risks on the Bank's financial result.

The Bank's risk management policies are used to identify and analyze these risks, to establish adequate limitations and controls, to review risks and to act with the limitations set by the reliable and updated information systems. The Bank regularly reexamines its risk management policies and systems, making sure that these respond to the changes on the market, changes of products and new best practices.

The organizational structure of risk management in the Bank clearly defines responsibilities, effective duty segregation and prevents conflicts of interest on all levels with the Board of Directors, as well as in connection with customers and other related parties.

The most significant risks to which the Bank is exposed are credit risk, market risk, liquidity risk and operational risk.

**5.2. Credit Risk**

The Bank assumes credit risk which relates to potential negative effects on the financial result of the Bank contingent on the failure of debtors to meet their liabilities towards the Bank. Credit risk is the most significant risk for the Bank's business operations, and the Bank manages its risk exposure aware its importance. The credit risk exposure occurs primarily based on crediting activities i.e. in loan origination activity. Credit risk is also present in off-balance sheet instruments such as guarantees and undrawn loan facilities.



**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***5. FINANCIAL INSTRUMENTS (Continued)****5.2. Credit Risk (Continued)**

Credit risk represents the risk of negative effects on the Bank's financial result and capital as a result of the customer's inability to settle its matured liabilities to the Bank. Credit risk entails:

- Default risk - the risk of loss that may arise if a debtor fails to settle liabilities toward the Bank;
- Downgrade risk - the risk of loss that may arise if a risk level of a debtor is downgraded (deterioration of in the customer credit rating) on the line items of assets that are recorded in the credit portfolio;
- Risk of change in the value of assets - the risk of loss that may arise on items of assets that are recorded in the credit portfolio in the event of a decline in their market value compared to the price at which assets were acquired;
- Counterparty risks - risks that can arise from the Bank's exposure toward a single individual, a group of related parties or to entities that are related with the Bank.

Credit risk management, classification of the Bank's assets, credit risk concentration, as well as documents substantiating credit activities are in accordance with the minimum standards prescribed by Banking Agency of the Republic of Srpska.

**5.2.1. Credit Risk Management**

The Bank assesses the risk from potential losses arising as a consequence of a decline in a customer's crediting rating. Credit risk relates to the probability that debtors will not be able to fulfill their obligations on time from their own primary resources or with no less than 90 days in arrears. The amount of losses due to the failure to settle cash liabilities is reflected in the Bank's statement of financial position through the allowance account.

The Bank manages, sets limits to and controls credit risk exposure to a single counterparty or a group of related counterparties. The allowance for impairment of balance sheet assets and provisions for losses on off-balance sheet items is calculated for losses that occurred as of the balance sheet date, and when there is objective evidence of uncollectibility.

For the purpose of a better credit risk management and control, the Bank established adequate and prudent limits in respect to the Bank's capital:

- The Bank's exposure to credit risk through individual counterparties or a group of related parties which is not covered by a collateral, cannot exceed 5% of the Bank's share capital;
- The Bank's exposure to credit risk through individual counterparties or a group of related parties which exceeds 5% of the Bank's share capital must be collateralized;
- The sum of the Bank's large exposures (the Bank's large exposure = each total credit risk exposure of the Bank to individual counterparties or a group of related parties that exceeds 15% of the Bank's share capital) must not exceed 300% of the amount of the Bank's share capital; and
- The sum of the Bank's large exposures taking form of guarantees issued must not exceed 200% of the amount of the Bank's share capital.

**5.2.2. Credit Risk Concentration per Customer Types**

As at December 31, 2012, the major exposure to an individual customer, without taking into account collaterals, totaled BAM 4,465 thousand, which accounts for 4.79% of total credit risk exposure (December 31, 2011: BAM 4,969 thousand).

**5.2.3. Credit Risk Concentration per Geographical Areas**

During both 2012 and 2011, the Bank's credit portfolio was focused to the Republic of Srpska area i.e. the City of Banja Luka.

## NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended December 31, 2012

(All amounts expressed in thousands of BAM, unless otherwise stated.)

## 5. FINANCIAL INSTRUMENTS (Continued)

## 5.2. Credit Risk (Continued)

## 5.2.4. Credit Risk Concentration per Industry Sectors

The Bank has diversified portfolio which encompasses various industries:

	December 31, 2012	In %	December 31, 2011	In %
Construction industry	3,553	4%	1,468	4%
rade	19,462	23%	10,829	30%
Services, tourism, catering and accommodation industry	1,674	2%	882	2%
Agriculture	4,388	5%	2,309	6%
Mining and industry	9,017	11%	4,362	12%
Transport, storage, postal services and telecommunications	5,331	6%	2,662	7%
Finance services	4,726	6%	4,543	12%
Real estate trade	491	1%	227	1%
Administration, other public services	2,926	3%	4,437	12%
Other (retail customers)	34,040	40%	4,826	13%
<b>Total</b>	<b>85,608</b>	<b>100%</b>	<b>36,545</b>	<b>100%</b>

## 5.2.5. Credit Risk Concentration per Types of Loans

The Bank regularly monitors and diversifies placed loans according to their purpose.

	December 31, 2012	In %	December 31, 2011	In %
Loans on transaction accounts	5,293	6%	1,105	3%
Consumer loans	24,337	28%	2,903	8%
Working capital loans	15,960	19%	14,552	40%
Investment loans	34,939	41%	16,850	46%
Housing loans	1,966	2%	148	-
Other loans-purchased short-term investments-factoring	3,113	4%	987	3%
<b>Total</b>	<b>85,608</b>	<b>100%</b>	<b>36,545</b>	<b>100%</b>

## 5.2.6. Loan and Off-Balance Sheet Item Quality According to BARS Categories

Pursuant to the BARS Decision, the Bank classifies loans to customers according to the number of days they are in default.

December 31, 2012	Category					Total
	A	B	C	D	E	
Loans to customers						
· short-term	15,617	3,916	107	168	-	19,808
· long-term	49,641	12,318	1,268	720	32	63,979
· matured	172	592	95	480	482	1,821
Total loans	65,430	16,826	1,470	1,368	514	85,608
Off-balance sheet items	7,164	340	13	-	-	7,517
<b>Total</b>	<b>72,592</b>	<b>17,166</b>	<b>1,483</b>	<b>1,368</b>	<b>514</b>	<b>93,123</b>

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***5. FINANCIAL INSTRUMENTS (Continued)****5.2. Credit Risk (Continued)****5.2.7. Stress Test**

In the course of credit risk assessment, the Bank applied the worst possible scenario of events for its portfolio. The Bank performed the stress test under the following assumptions: 30% BAM devaluation, 40% collateral devaluation, and increase in allowance for impairment for customers with registered defaults in settling their matured liabilities.

<b>Portfolio as at December 31, 2012</b>	<b>Total Exposure</b>	<b>Total Exposure Net of Deposits</b>	<b>Discounted Collateral Value</b>	<b>Allowance for Impairment</b>	<b>Amount of Reserves Out- standing</b>	<b>Total Deterioration</b>
Before the test	93,442	90,746	70,468	2,763	2,609	5,373
After the test	113,074	110,082	45,278	3,473	3,264	6,737
Difference	19,632	19,336	25,190	710	655	1,364

**5.3. Market Risk**

The Bank assumes market risks which represent the risk that the fair value or future cash flows from financial instruments may oscillate due to changes in market values. Market risks occur in open positions exposed to risk based on maturities, interest rates, currencies and capital products exposed to general and special movements and changes related to the degree of market rate and price volatility (such as interest rates, credit margins, foreign exchange rates and prices of capital).

**5.3.1. Foreign Exchange Risk**

Foreign exchange risk represents the probability of adverse effects on the Bank's financial result and equity arising from volatility in exchange rates.

The strategy of the Bank, applied in foreign exchange risk management, is based on the maintenance of foreign currency balance within the limits prescribed by the Law on Banks of the Republic of Srpska and Decision on the Minimum Standards for Currency Risk Management in Banks (Official Gazette of RS 12/03) as follows:

- in case of open balances, it is necessary to maintain each foreign currency balance within limits prescribed,
- by defining foreign currency activities.

For the needs of controlling and identifying foreign currency exposure, the Bank monitors the balance and structure of foreign currency cash in the treasury, foreign currency assets and structure per currencies on the accounts with foreign banks, ensures the matching between the foreign currency position denominated in unstable currencies and monitors foreign currency matching between financial assets and financial liabilities.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***5. FINANCIAL INSTRUMENTS (Continued)****5.3. Market Risk (Continued)****5.3.1. Foreign Exchange Risk (Continued)**

The breakdown of foreign currency balances as of December 31, 2012, net is presented in the table below:

	<u>EUR</u>	<u>USD</u>	<u>CHF</u>	<u>GBP</u>	<u>Other</u>	<u>Total</u>
<b>Financial Assets in the Statement of financial position</b>						
Cash and balances with depository institutions	4,539	561	49	5	61	5,215
Other financial assets	239	-	-	-	-	239
Currency clause indexed loans	60,994	-	-	-	-	60,994
	<u>65,772</u>	<u>561</u>	<u>49</u>	<u>5</u>	<u>61</u>	<u>66,448</u>
<b>Financial liabilities in the Statement of financial position</b>						
Deposits and matured but outstanding off-balance sheet liabilities	4,669	88	38	-	-	4,795
Borrowings	21,514	-	-	-	-	21,514
Other financial liabilities	171	4	-	-	12	187
Currency clause indexed liabilities	37,618	-	-	-	-	37,618
	<u>63,972</u>	<u>92</u>	<u>38</u>	<u>-</u>	<u>12</u>	<u>64,114</u>
<b>Assets/off-balance sheet liabilities</b>	473	51	-	-	-	524
<b>LONG POSITION</b>	2,273	520	11	5	49	2,858
Expressed in %	12%	3%	-	-	-	15%
<b>SHORT POSITION</b>	-	-	-	-	-	-
Expressed in %	-	-	-	-	-	-
<b>Allowed overnight position</b>	30%	20%	20%	20%	20%	30%
Below the limit in %	<u>18%</u>	<u>17%</u>	<u>20%</u>	<u>20%</u>	<u>20%</u>	<u>15%</u>

*Foreign Currency Sensitivity Analysis*

The Bank is mostly exposed to EUR. Since Convertible Mark (BAM) is pegged to EUR, the Bank is not exposed to risk of fluctuations in the EUR exchange rate.

**5.3.2. Interest Rate Risk**

The Bank is exposed to multiple risks, which influence its financial position and cash flows through the effects of changes in the amount of interest rate fluctuations on the market. Interest rate risk is the risk from adverse effect on the Bank's financial result and equity contingent on the changes in interest rates.

The basic objective of interest rate risk management is to minimize adverse effects of changes in interest rates. Interest rates applied to loans depend on the movements in interest rates on the money market and on the Bank's business policy.

*Interest Rate Sensitivity Analysis*

The sensitivity analyses below have been determined based on the exposure to interest rates for instruments at the statement of financial position date. For floating rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the statement of financial position date remained the same for the whole year. A 10% increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

Had interest rates been 10% higher/lower and all other variables were held constant, the Bank's profit for the year ended December 31, 2012 would have decreased/increased by BAM 200 thousand (2011: profit decreased/increased by BAM 186 thousand).

## NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended December 31, 2012

(All amounts expressed in thousands of BAM, unless otherwise stated.)

## 5. FINANCIAL INSTRUMENTS (Continued)

## 5.3. Market Risk (Continued)

## 5.3.2. Interest Rate Risk (Continued)

The table below shows the review of the annual interest rates applied to most significant financial instruments:

	<u>Foreign currency</u>	<u>BAM</u>
<b>Assets</b>		
Obligatory reserve with the Central Bank	-	0.01%-0.11%
Assets in excess of obligatory reserves	-	0.013% – 0.14%
Foreign currency accounts with foreign banks	0.00 - 0.23%	-
Short-term loans to customers:		
- corporate customers	-	1.50%-17%
- retail customers	-	8.50% -18%
Long-term loans to customers:		
- corporate customers	-	2.50% – 18%
- retail customers	-	3.6% – 20%
<b>Liabilities</b>		
Demand deposits of corporate customers	0.10%-0.20%	0.10%-2.52%
Demand deposits of retail customers	0.10%-3%	0.10%-3%
Short-term deposits:		
- corporate customers	-	1.25%-5.07%
- retail customers	2.20%-4%	1.75%-4%
Long-term deposits:		
- corporate customers	5.5%	0%-5.05%
- retail customers	1.50%-6.60%	4.30%-5.50%
Borrowings:		
EFSE	5.142%-5.689%	
KfW	4.6875%-4.875%	
RS Development and Employment Fund	-	1.20%-2.419%
RS Housing Fund	-	1.90%-2.40%
Fund for Development of Eastern Region of RS	-	1.50%

The Bank is exposed to various risks which, through the effects of changes in the amounts of market interest rates, influence its financial position and cash flows. The table below shows the review of interest-bearing and non-interest bearing assets and liabilities as of December 31, 2012:

	<b>December 31, 2012</b>		
	<u>Interest-Bearing</u>	<u>Non-Interest Bearing</u>	<u>Total</u>
<b>Monetary assets</b>			
Cash and cash equivalents	11,086	6,788	17,874
Receivables arising from interest, fee and commission, trade and other receivables	-	770	770
Loans and deposits to customers	85,608	-	85,608
Equipment and intangible assets	-	1,553	1,553
Total	<u>96,694</u>	<u>9,109</u>	<u>105,805</u>
<b>Monetary liabilities</b>			
Transaction deposits	53,587	2,433	56,020
Borrowings	25,468	-	25,468
Other liabilities	-	1,232	1,232
Provisions for potential losses	-	89	89
Total	<u>79,055</u>	<u>3,754</u>	<u>82,809</u>

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***5. FINANCIAL INSTRUMENTS (Continued)****5.4. Liquidity Risk**

Liquidity risk is the risk which emerges when the Bank is unable to settle all liabilities when due and in full. The basic objective of liquidity management is to ensure that the Bank has resources obtainable at reasonable costs necessary to discharge all liabilities for expected and unexpected fluctuations in the statement of financial position.

Additionally, the process of liquidity management in the Bank needs to ensure liquid resources sufficient to finance the development of its credit portfolio.

The strategy of liquidity risk management in the Bank is implemented by establishing control over maturity matching between assets and sources of assets, based on actual and accurate projections of cash inflows and outflows, regular and extraordinary, over different time periods.

The strategy of asset liquidity risk management encompasses:

- Strivings to keep within the line items of assets, liquid forms of assets easily exchanged on the market for cash at no loss in case of a liquidity crisis (the Bank's aim is to maintain sufficient available resources to discharge its contingent liabilities at any time);
- Diversification of investments per separate customers, per industries and per placement maturities.

The strategy of liability management in respect to liquidity comprises the following:

- Strivings to ensure deposit stability with increasing participation of long-term deposits,
- Maximum diversification of resources according to their maturity, stability, origin, market and instruments,
- Particular attention is paid to large deposits,
- Undertaking arrangements with domestic and foreign banks on mutual extension of Interbank liquidity loans which makes it possible to invest liquidity surpluses at an adequate interest rate, i.e. in case of insufficient liquidity funds, these resources are available to the Bank at favorable terms.

Primary sources of funds are local deposits acquired by the Bank by applying adequate interest rate policy.

The adoption, comprehensiveness and implementation of the Liquidity Risk Management Program is the responsibility of Bank's Supervisory Board and its management.

Everyday monitoring of daily liquidity in the Bank is the responsibility of the Treasury and Transactional Operations Department and Liquidity Commission; short-term liquidity is the responsibility of the Liquidity Commission; and long-term liquidity is the responsibility of the ALCO (the Asset and Liability Management Committee).

Responsible persons monitor the liquidity position and composition of asset and liability maturities and:

- perform operational management of liquid assets on daily basis,
- compare the positions with projected position so as to determine trends in the liquidity positions and undertake adjustment measures so the liquidity position and maturity gaps would be in compliance with the law and the limits set by the Bank's Supervisory Board.

## NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended December 31, 2012

(All amounts expressed in thousands of BAM, unless otherwise stated.)

## 5. FINANCIAL INSTRUMENTS (Continued)

## 5.4. Liquidity Risk (Continued)

The table below shows a GAP analysis of assets and liabilities according to respective maturity based on the outstanding period before the agreed due date by matching receivables and payables per maturity periods in accordance with BARS regulations.

As of December 31, 2011	Within a Month	From 1 to 3 Months	From 3 to 12 Months	Over 1 Year	Total
<b>ASSETS</b>					
Cash and balances with the Central Bank	13,774	-	-	-	13,774
Deposits with other banks	4,100	-	-	-	4,100
Loans to customers	8,390	6,481	24,632	43,495	82,998
Accrued interest and other assets	455	50	108	157	770
<b>Total assets</b>	<b>26,719</b>	<b>6,531</b>	<b>24,740</b>	<b>43,652</b>	<b>101,642</b>
<b>LIABILITIES</b>					
Deposits	12,029	14,903	23,927	5,161	55,805
Borrowings	14	19	6,523	18,912	25,468
Other liabilities	374	190	271	419	1,728
<b>Total liabilities</b>	<b>12,417</b>	<b>15,112</b>	<b>30,721</b>	<b>24,492</b>	<b>82,742</b>
<b>Liquidity gap</b>	<b>14,302</b>	<b>(8,581)</b>	<b>(5,981)</b>	<b>19,160</b>	<b>18,900</b>
<b>As of December 31, 2011</b>					
Total assets	25,984	5,118	7,774	16,767	55,643
Total liabilities	12,482	4,292	14,868	5,153	36,795
<b>Liquidity gap</b>	<b>13,502</b>	<b>826</b>	<b>(7,094)</b>	<b>11,614</b>	<b>18,848</b>
<b>December 31, 2012</b>					
			<b>1 – 30 Days</b>	<b>1 – 90 Days</b>	<b>1 – 180 Days</b>
Cash balances and deposits with depository institutions			17,874	17,874	17,874
Loans, long-term receivables and lease receivables			8,390	14,871	23,629
Other financial assets			455	505	537
<b>total financial assets</b>			<b>26,719</b>	<b>33,250</b>	<b>42,040</b>
Deposits and matured and outstanding off-balance sheet liabilities			12,029	26,932	41,501
Borrowings			14	33	2,995
Other financial liabilities			374	564	604
<b>total financial liabilities</b>			<b>12,417</b>	<b>27,529</b>	<b>45,100</b>
Difference /financial assets exceeding liabilities			14,302	5,721	-
Difference /financial liabilities exceeding assets			-	-	3,060
<b>Calculation of liability prescribed in %</b>					
Assets / Liabilities			213	121	93
prescribed minimum			85	80	75
excess of the prescribed minimum			128	41	18

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***6. INTEREST INCOME**

	<b>Year Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
Interest income from:		
- public sector	230	339
- retail customers	3,071	405
- corporate customers	3,803	1,791
- Central Bank	4	76
- other banks	3	23
- non-profit organizations	18	4
- other	3	-
	<u>7,132</u>	<u>2,638</u>

**7. INTEREST EXPENSES**

	<b>Year Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
Interest expenses charged by:		
- public sector	307	165
- retail customers	168	78
- banks	174	-
- non-banking finance institutions	744	303
- corporate customers	99	13
- non-profit organizations	9	-
- other	38	40
- interest on borrowings	449	-
<b>Total</b>	<u>1,988</u>	<u>599</u>

**8. FEE AND COMMISSION INCOME**

	<b>Year Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
Sale and purchase of currencies	108	91
Fee and commission income arising from domestic payment transactions	542	239
Loan origination fees	92	67
	<u>742</u>	<u>397</u>

**9. FEE AND COMMISSION EXPENSES**

	<b>Year Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
Sale and purchase of currencies	40	13
Fee and commission payable to the Central Bank for domestic payment transfers	51	27
Fee and commission expense arising from international payment transactions	6	1
Payment/credit card operation fees	216	-
Loan processing fees	55	-
Other fees and commissions	9	2
	<u>377</u>	<u>43</u>



**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***10. OTHER OPERATING INCOME**

	<b>Year Ended December 31, 2012</b>	<b>2011</b>
Collected suspended interest previously written-off	204	17
Other income	34	19
	<u>238</u>	<u>36</u>

**11. OTHER OPERATING EXPENSES**

	<b>Year Ended December 31, 2012</b>	<b>2011</b>
Gross salaries and benefits	2,737	1,447
Other benefits, remunerations to the Supervisory Board, Audit Committee	90	71
Professional trainings and education of employees	5	3
Materials and services	220	81
Business trip expenses incurred in the country and abroad	31	19
Telecommunication and postage services	176	92
Equipment maintenance	235	129
Marketing and advertising	142	69
Rental costs	431	186
Membership fees	45	40
Entertainment	25	8
Security services	309	156
Depreciation and amortization	329	206
Taxes and contributions	54	9
Fees payable to the RS Banking Agency	76	64
Write-off of uncollectible receivables	9	1
Fees for third party engagements	7	8
Other	220	92
	<u>5,141</u>	<u>2,681</u>

**12. PROVISIONS FOR POTENTIAL LOSSES****a) Provisions Charged/(Credited) to the Income, Net**

	<b>Year Ended December 31, 2012</b>	<b>2011</b>
Loans to customers	(86)	304
Interest receivables and other assets	26	15
Employee benefits	6	(1)
Contingent liabilities and commitments	36	21
<b>Total</b>	<u>(18)</u>	<u>339</u>

## NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended December 31, 2012

(All amounts expressed in thousands of BAM, unless otherwise stated.)

## 12. PROVISIONS FOR POTENTIAL LOSSES (Continued)

## b) Movements for the Year on the Long-Term Provisions for Potential Losses and Commitments:

	Loans to Customers	Interest and Other Assets	Employee Benefits	December 31, 2012 and 2011	
				Contingent Liabilities and Commit- ments	Total
Balance, January 1, 2011	390	22	17	10	439
Charge for the year	1,324	47	-	209	1,580
Reversal of provisions	(1,020)	(32)	(1)	(188)	(1,241)
Balance, December 31, 2011	694	37	16	31	778
Purchase of portfolio (Note 15)	2,002	20	-	-	2,022
Charge for the year	3,300	131	6	223	3,660
Reversal of provisions	(3,386)	(105)	-	(187)	(3,678)
Balance, December 31, 2012	2,610	83	22	67	2,782

## 13. CASH AND BALANCES HELD WITH THE CENTRAL BANK

	December 31, 2012	December 31, 2011
Cash		
- in BAM	1,573	906
- in foreign currencies	1,115	493
Balances with the Central Bank in BAM:		
- Obligatory reserve	4,169	2,469
- Gyro account	6,917	9,424
<b>Total</b>	<b>13,774</b>	<b>13,292</b>

Pursuant to the decision of the Central Bank of Bosnia and Herzegovina regarding reserve requirements, the Bank has to calculate and maintain an obligatory reserve of the average balance of the Bank's total deposits (which serve as a basis for computing the obligatory reserve) according to the average balance found at the end of work days of ten calendar days preceding the projection. The obligatory reserve is calculated as the sum of 10% of the total deposits maturing within a year and 7% with over one year maturities. The basis for computing the obligatory reserve includes calculated interest, fees and commissions due.

This reserve is available for liquidity purposes. The Central Bank of Bosnia and Herzegovina accrues and pays interest at the rate ranging from 0.01% to 0.11% to the amount of obligatory reserve, while the amount of resources exceeding the calculated obligatory reserve accrues interest at the rate determined as the average of interest rates realized over the same period by the Central Bank on the market based on its up-to-one month deposits (0.013% to 0.14%).

## 14. DEPOSITS HELD WITH OTHER BANKS

	Interest Rates	December 31, 2012	December 31, 2011
Due from banks:			
- foreign banks	0.00%-0.23%	3,626	1,838
- short-term deposits up to 30 days	0.23%-1.52%	-	4,000
- domestic banks		474	454
<b>Total</b>		<b>4,100</b>	<b>6,292</b>

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***15. LOANS TO CUSTOMERS**

	<u>December 31, 2012</u>	<u>December 31, 2011</u>
Short-term loans in BAM – up to 1 year	20,356	13,000
Long-term loans in BAM – over 1 year	45,755	17,239
Current portion of long-term loans in BAM	19,498	6,306
	<u>85,608</u>	<u>36,545</u>
Less: Allowance for impairment of loans to customers	<u>(2,610)</u>	<u>(694)</u>
<b>Total</b>	<u>82,998</u>	<u>35,851</u>

The major portion of short-term loans in BAM was placed with domestic corporate and retail customers at annual interest rates ranging from 1.50% to 18%. Most of these loans are collateralized by mortgages assigned over property or pledges over movables.

Long-term loans in BAM were placed with enterprises, municipalities and retail customers for a period from one to ten years at annual interest rates ranging from 2.5% to 20%. The aforementioned loans are collateralized by mortgages assigned over property or pledges over movables.

The geographical concentration of loans approved to customers as included in the Bank's loan portfolio mostly comprises customers domiciled in the Republic of Srpska.

In 2012, the Bank entered into nine agreements on the assignment/assumption of receivables for a consideration, whereby it purchased 2,654 loan accounts from the related party MKD Mikrofin d.o.o., Banja Luka. The sales price of the portfolio sold was equal to the amount of net receivables as at the transaction date, measured in accordance with the requirements of IAS 39 – "Financial Instruments: recognition and Measurement" and according to the internal methodology of MKD Mikrofin d.o.o., Banja Luka. Accordingly, the Bank realized neither positive nor negative effects on the comprehensive income statement from the aforesaid transactions. The effects of the aforesaid transactions are presented in the table below:

	<u>Loans to Customers</u>	<u>Interest Accrued</u>
Balance of receivables	24,468	352
Less: Allowance for impairment	<u>(2,004)</u>	<u>(18)</u>
	<u>22,464</u>	<u>334</u>

## NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended December 31, 2012

(All amounts expressed in thousands of BAM, unless otherwise stated.)

## 16. EQUIPMENT AND INTANGIBLE ASSETS

	Leasehold Improve- ments	Equipment	Property under Construction	Total Equipment	Intangible Assets	Intangible Assets under Deve- lopment	Total Intangible Assets
<b>Cost</b>							
Balance, January 1, 2011	-	561	-	561	529	-	529
Additions	47	188	167	402	49	103	152
Disposal	-	(3)	-	(3)	-	-	-
Balance, December 31, 2011	47	746	167	960	578	103	681
Additions	54	846	(152)	748	263	(103)	160
Balance, December 31, 2012	101	1,592	15	1,708	841	-	841
<b>Accumulated Depreciation / Amortization</b>							
Balance, January 1, 2011	-	269	-	269	194	-	194
Charge for the year	2	96	-	98	108	-	108
Disposal	-	(2)	-	(2)	-	-	-
Balance, December 31, 2011	2	363	-	365	302	-	302
Charge for the year	17	175	-	192	137	-	137
Balance, December 31, 2012	19	538	-	557	439	-	439
<b>Net book value:</b>							
December 31, 2012	82	1,054	15	1,151	402	-	402
December 31, 2011	45	383	167	595	276	103	379

As of December 31, 2012, equipment was insured against general risks. The Bank had no encumbrances or pledges against its equipment.

## 17. ACCRUED INTEREST AND OTHER ASSETS

	December 31, 2012	December 31, 2011
In BAM:		
- matured interest receivables	30	3
- advances paid	8	11
- other receivables	41	52
- inventories of material	59	1
- deferred receivables for accrued interest	378	99
- other expense deferrals	86	27
In foreign currencies:		
- deferred receivables for expenses accrued	229	-
- foreign currency advances	11	11
- other foreign currency receivables	12	-
	853	205
Less: Allowance for impairment of accrued interest and other assets	(83)	(37)
<b>Total</b>	<b>770</b>	<b>168</b>

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***18. CUSTOMER AND BANK DEPOSITS**

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
Demand deposits in BAM:		
- Government and state institutions	86	124
- corporate customers	1,771	3,654
- non-banking financial institutions	5,743	5,233
- retail customers	1,579	517
- non-profit organizations	53	35
- other customers	150	127
	<u>9,381</u>	<u>9,690</u>
Demand deposits in foreign currencies:		
- corporate customers	68	8
- non-banking financial institutions	11	1,271
- foreign entities	2	29
- retail customers	474	212
	<u>555</u>	<u>1,520</u>
Short-term deposits in BAM:		
- Government and state institutions	1,000	-
- banks and banking institutions	5,000	3,000
- non-banking financial institutions	16,750	6,210
- retail customers	70	10
	<u>22,820</u>	<u>9,220</u>
Short-term deposits in foreign currencies:		
- retail customers	44	30
	<u>44</u>	<u>30</u>
Long-term deposits in BAM:		
- non-banking financial institutions	4,218	6,249
- Government and state institutions	6,625	5,125
- corporate customers	3,347	1,088
- non-profit organizations	2,580	200
- retail customers	1,348	386
- other customers	900	1,000
	<u>19,018</u>	<u>14,048</u>
Long-term deposits in foreign currencies:		
- corporate customers	782	-
- retail customers	3,419	1,823
	<u>4,201</u>	<u>1,823</u>
	<u>-</u>	<u>-</u>
<b>Total</b>	<u><b>56,020</b></u>	<u><b>36,332</b></u>

Demand deposits of corporate entities and entrepreneurs in BAM and foreign currencies accrued interest at the rate of 0.1% to 0.2% annually, applying the conformity method, whereas interest on demand deposits of retail customers and transaction accounts is calculated using straight-line method.

Savings demand deposits – open savings in BAM and EUR accrued interest at the rate of 3% annually by applying the conformity method, whereby the minimum initial placement must be BAM 1 thousand or EUR 500. In case a saving placement dropped below the aforesaid limit, interest is automatically calculated at the rate of 0.1% annually.

Short-term deposits of corporate entities and entrepreneurs in BAM and EUR were placed at the interest rates ranging from 1.23% to 5.07% annually.

Short-term deposits of retail customers in BAM and EUR were placed at the interest rates ranging from 1.75% to 4.00% annually.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***18. CUSTOMER AND BANK DEPOSITS (Continued)**

Long-term deposits of retail customers in BAM and EUR were placed at the interest rates ranging from 0% to 5.5% annually (certain earmarked deposits were placed as collaterals to securitize loan repayment and contractually defined as non-interest bearing).

Long-term deposits of retail customers in BAM and EUR were placed at the interest rates ranging from 4.3% to 6.6% annually, whereas USD deposits accrued interest at the annual rate of 1.5%.

The Bank applies the conformity method to calculate the interest on term deposits, whereas it may apply the proportionate interest calculation method on deposits placed by other banks, in accordance with the contractually agreed terms.

The Bank applies the conformity method to calculate the interest on term deposits. Depending on the market conditions, and in cases of particular significance for the Bank, the management may enact specific decisions on the implementation of interest rates up to 1 percentage point higher than the interest rates defined by the internally adopted acts of the Bank.

**19. BORROWINGS**

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
In BAM:		
- RS Development and Employment Fund	2,232	-
- RS Housing Fund	772	-
- Fund for Development of Eastern Region of RS	950	-
	<u>3,954</u>	<u>-</u>
In foreign currencies		
- EFSE	9,779	-
- KfW	7,823	-
- EBRD	3,912	-
	<u>21,514</u>	<u>-</u>
<b>Total</b>	<u>25,468</u>	<u>-</u>
Current portions:		
- EFSE	3,258	-
- KfW	2,608	-
- EBRD	1,118	-
- IRB	131	-
<b>Total current portions</b>	<u>7,115</u>	<u>-</u>

During the financial year 2012 the bank received funds from the aforelisted Funds in the aggregate amount of BAM 3,954 thousand as of December 31, 2012, which were disbursed in 21 loans approved to customers.

The bank entered into loan agreements with foreign creditors at the following terms:

- EFSE, the Netherlands: loan amount: EUR 5 million; loan repayment period: 3.7 years with a one-year grace period; interest rate applied: EURIBOR or LIBOR plus maximum markup of 4.75%;
- KfW, Germany: loan amount: EUR 4 million; loan repayment period: 3.4 years with a 10-month grace period; interest rate applied: plus maximum markup of 4.5%;
- EBRD, UK: loan amount: EUR 4 million; loan repayment period: 3.4 years with a one-year grace period; interest rate applied: EURIBOR plus maximum markup of 4.75%.

The borrowed funds are intended for financing loans to customers for the following purposes: purchase of property, plant and equipment, financing working capital, materials, investments, startup micro, small and medium-sized enterprises and entrepreneurs.

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***20. OTHER LIABILITIES**

	<u>December 31, 2012</u>	<u>December 31, 2011</u>
In BAM:		
- deferred payables for accrued interest	(345)	(18)
- trade payable	(108)	(97)
- other liabilities	(83)	(50)
- deferred income	(514)	(169)
In foreign currency:		
- trade payable	(13)	(2)
- deferred payables for accrued interest	(156)	(61)
- other liabilities	(13)	(11)
<b>Total</b>	<u>(1,232)</u>	<u>(407)</u>

Deferred income in BAM as of December 31, 2012 totaling BAM thousand mostly pertains to the loan processing fees collected in advance from customers.

**21. CAPITAL*****Share Capital***

Share capital of the Bank was formed from the initial investments of shareholders and the subsequent share subscriptions paid in cash. The Bank's share capital as of December 31, 2012 totaled BAM 26,000 and was comprised of 260,000 shares with a par value of BAM 100 per share.

The ownership structure of the Bank's share capital according to the excerpt provided by the Central Registry of Securities of the Republic of Srpska as of December 31, 2012 did not change as compared to that of December 31, 2011 and was the following:

	<u>Share Count</u>	<u>Thousands of BAM</u>	<u>%</u>
MKD Mikrofin d.o.o., Banja Luka	258,000	25,800	99.23
DUIF Mikrofin invest d.o.o., Banja Luka on behalf and for the account of OIF Mikrofin plus a.d. Banja Luka	<u>2,000</u>	<u>200</u>	<u>0.77</u>
	<u>260,000</u>	<u>26,000</u>	<u>100.00</u>

**22. EARNINGS PER SHARE**

	<u>Year Ended December 31, 2012</u>	<u>2011</u>
Net profit/(loss) for the year (in thousands of BAM)	595	(593)
Weighted average number of shares issued	<u>260,000</u>	<u>260,000</u>
Basic and diluted earnings/(loss) per share (in BAM)	<u>2.29</u>	<u>(2.28)</u>

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***23. CONTINGENT LIABILITIES AND COMMITMENTS****a) Payment guarantees, performance bonds and other irrevocable commitments**

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
Payment guarantees	2,113	309
Performance bonds	247	178
Irrevocable commitments for undrawn loans	3,147	3,435
Account overdrafts	2,010	688
<b>Total</b>	<b>7,517</b>	<b>4,610</b>

As of December 31, 2012, provisions for potential losses based on off-balance sheet items totaled BAM 67 thousand (December 31, 2011: BAM 31 thousand, Note 12 b).

**b) Litigation**

As of December 31, 2012, the Bank was involved in 44 legal suits filed against debtors in attempts to collect matured receivables. The total value sought in these proceedings aggregated to BAM 857 thousand. As of December 31, 2012, there were no lawsuits filed against the Bank.

**c) Compliance with Laws and Regulations**

The Bank is obligated to reconcile the scope of its business with the legally prescribed ratios, i.e. to maintain the scope and structure of its placements in compliance with the accounting standards and regulations of the Republic of Srpska, established and controlled by the Banking Agency of the Republic of Srpska.

As of December 31, 2012, the Bank was in compliance with the accounting standards and regulations of the Republic of Srpska, established and controlled by the BARS in respect of all the prescribed parameters.



## NOTES TO THE FINANCIAL STATEMENTS

For the Year Ended December 31, 2012

(All amounts expressed in thousands of BAM, unless otherwise stated.)

## 24. RELATED PARTY TRANSACTIONS

	December 31, 2012	December 31, 2011
<b>Assets:</b>		
Receivables from loans to the Bank's management and employees	52	23
<b>Total prepaid insurance expenses:</b>		
- Mikrofin osiguranje a.d., Banja Luka	27	11
<b>Total prepaid license fees:</b>		
- MF Software d.o.o., Banja Luka	44	-
<b>Assets, total</b>	<b>123</b>	<b>34</b>
<b>Liabilities:</b>		
Transaction accounts of the Bank's management	260	122
Other related private individuals	520	276
	780	398
<b>Trade payables:</b>		
- MF Software d.o.o., Banja Luka	8	-
- MKD Mikrofin d.o.o., Banja Luka	7	-
<b>Other payables:</b>		
- other liabilities	7	-
	22	-
<b>Interest payables:</b>		
- Mikrofin osiguranje a.d., Banja Luka	116	61
- Mikrofin MKD d.o.o., Banja Luka	7	6
- MF Software d.o.o., Banja Luka	-	5
- OIF Mikrofin plus a.d., Banja Luka	1	-
- Citizens' Association Mikrofin	3	4
- Related private individuals	12	11
	139	87
<b>Balance of deposits placed by related parties:</b>		
- MKD Mikrofin d.o.o., Banja Luka	5,026	6,153
- DUIF Mikrofin invest a.d., Banja Luka	1	6
- OIF Mikrofin plus a.d. Banja Luka	296	15
- MF Software d.o.o., Banja Luka	55	21
- Mikrofin osiguranje a.d., Banja Luka	4,319	4,147
- Citizens' Association Mikrofin	1,046	1,112
- Profi nova a.d., Bijeljina	46	44
- other	4	-
	10,793	11,498
<b>Liabilities, total</b>	<b>11,734</b>	<b>11,983</b>
<b>Liabilities, net</b>	<b>(11,611)</b>	<b>(11,949)</b>

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***24. RELATED PARTY TRANSACTIONS (Continued)**

	<b>Year Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Income</b>		
Interest income from related parties:		
- MKD Mikrofin d.o.o., Banja Luka	-	16
Fee and commission income from related parties:		
- MKD Mikrofin d.o.o., Banja Luka	238	145
- Mikrofin osiguranje a.d., Banja Luka	7	5
- MF SOFTWARE d.o.o., Banja Luka	1	1
- OIF Mikrofin plus a.d. Banja Luka	-	1
Interest charged to the members of the Bank's Supervisory Board and management	3	1
<b>Income, total</b>	<b>249</b>	<b>169</b>
<b>Expenses</b>		
Rental costs – MKD Mikrofin d.o.o., Banja Luka	(243)	-
Rental costs – Drveks d.o.o., Laktaši	(16)	-
Software lease – MF SOFTWARE d.o.o., Banja Luka	(61)	-
Licenses – MF SOFTWARE d.o.o., Banja Luka	(13)	-
Insurance expenses – Mikrofin osiguranje a.d., Banja Luka	(43)	(12)
Interest expenses – related parties:		
- MKD Mikrofin d.o.o., Banja Luka	(7)	(17)
- Mikrofin osiguranje a.d., Banja Luka	(166)	(115)
- OIF Mikrofin plus	(4)	-
- Citizens' Association Mikrofin	(37)	(37)
- Profi nova a.d., Bijeljina	(2)	(1)
- Bank's management	(3)	(4)
- Other related parties	(19)	(8)
		(194)
Remunerations to the members of the Supervisory Board and Bank's management	(206)	(167)
Other related parties	(5)	-
<b>Expenses, total</b>	<b>(825)</b>	<b>(361)</b>
<b>Expenses, net</b>	<b>(576)</b>	<b>(192)</b>

**25. TAXATION RISKS**

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

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***25. TAXATION RISKS (Continued)**

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

**26. CURRENT ECONOMIC SITUATION AND ITS IMPACT ON THE BANK'S OPERATIONS**

During 2012, the Bank's operations were under the impact of the global economic and financial crisis. However, in the course of 2012, the Bank did not face any significant liquidity problems.

So far, the ongoing financial crisis has had a limited impact on the financial position and performance of the Bank, mainly due to the internal risk management policies and regulatory restrictions. The Bank has adopted new policies on credit approvals, collateral acceptance and evaluation policies and the treasury operations. The Bank monitors closely the credit, liquidity, interest rate and foreign exchange risks on a regular basis. The management expects that the planned share issue will further improve capital adequacy. It is expected that liquidity will remain at the satisfactory level.

The deteriorating economic situation in the country will probably impact the position of certain industries and the abilities of some clients to meet their loan obligations. This may consequently influence the amount of the Bank's provisions for impairment losses in 2013 and other areas that require estimates to be made by management, including the valuation of collateral and of securities. The 2012 financial statements contain significant estimates with respect to impairment charges, collateral valuation and the fair value of securities. Actual results may differ from these estimates. The key priorities of the Bank in 2013 will be attention to the management of the financial portfolio adjusting to the changing economic environment.

**27. EVENTS AFTER THE REPORTING PERIOD**

As of February 6, the Bank executed an agreement on assignment/assumption of a portion of receivables for a consideration, whereby the Bank purchased 313 loan accounts from the related party MKD Mikrofin d.o.o., Banja Luka, which transferred all rights and liabilities arising from the aforesaid to the Bank. The sales price of the portfolio sold was equal to the amount of net receivables as at the transaction date, measured in accordance with the requirements of IAS 39 – "Financial Instruments: recognition and Measurement" and according to the internal methodology of MKD Mikrofin d.o.o., Banja Luka.

The total value of the aforescribed transaction of a loan portfolio portion purchase by the bank was as follows:

	<b>Loans to Customers</b>	<b>Interest Accrued</b>	<b>Total</b>
Receivables	3,183	35	3,218
Less: Allowance for impairment of receivables	(133)	-	(133)
	<u>3,050</u>	<u>35</u>	<u>3,085</u>

**NOTES TO THE FINANCIAL STATEMENTS****For the Year Ended December 31, 2012***(All amounts expressed in thousands of BAM, unless otherwise stated.)***28. COMMITMENTS FOR LEASE OF BUSINESS PREMISES**

The minimum operating lease liabilities for business premises recognized as expenses for the year ended December 31, 2012 amounted to BAM 431 thousand (2011: BAM 186 thousand).

The Bank's commitments arising from cancellable agreements on the lease of business premises were as follows:

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
Within 1 year	248	239
From 1 to 5 years	193	252
Over 5 years	-	-
<b>Total</b>	<b>441</b>	<b>491</b>

**29. EXCHANGE RATES**

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

	<b>December 31, 2012</b>	<b>In BAM December 31, 2011</b>
USD	1.4335	1.5116
CHF	1.5835	1.6089
EUR	1.9558	1.9558