MF BANKA A.D., BANJA LUKA

Financial Statements
For the Year Ended December 31, 2011
and Independent Auditors' Report

CONTENTS

Deloitte.

Deloitte d.o.o. Banja Luka
Braće Mažar i majke Marije 58 i 60
78000 Banja Luka
Republic of Srpska
Bosnia and Herzegovina

Tel: +387 (0) 51 223 500; +387 (0) 51 224 500
Fax: +387 (0) 51 224 990
www.deloitte.com

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 29) of MF banka a.d., Banja Luka (hereinafter the "Bank"), which comprise the statement of financial position as of December 31, 2011 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, 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

We draw attention to the fact that the Bank is obligated to maintain the scope and structure of its business in compliance with the regulations governing banking in the Republic of Srpska, which compliance is controlled by the Banking Agency of the Republic of Srpska ("BARS"), as the regulator of the banking sector of the Republic of Srpska. As further disclosed in Note 24 c) to the financial statements, at December 31, 2011, one of the Bank's business adequacy indicators was not within prescribed limits. However, the Bank's management does not anticipate negative consequences thereof.

Our opinion is not modified in respect of this matter.

Deloitte doo

Deloitte d.o.o.,
Banja Luka
April 10, 2012

STATEMENT OF COMPREHENSIVE INCOME
Year Ended December 31, 2011
(Thousands of BAM)

	Notes	Year Ended December 31, 2011	Year Ended December 31, 2010
Interest income	3.1,6	2,638	526
Interest expense	3.1,7	(599)	(185)
Net interest income		2,039	341
Fee and commission income	3.1,8	397	277
Fee and commission expense	3.1,9	(43)	(31)
Net fee and commission income		354	246
Net trading income	10	36	546
Net impairment loss on financial assets	3.5,14	(339)	2,157
Personnel expense	11	(1,521)	(1,212)
Operating lease expenses	12	(186)	(348)
Depreciation and amortisation		(206)	(204)
Other expenses	13	(768)	(786)
Foreign exchange net	3.2	(2)	109
(Loss)/profit from operations before taxation		(593)	849
Income taxes	3.7	-	-
Net (loss)/profit for the year		(593)	849
Other comprehensive income		-	-
Total comprehensive income for the year		(593)	849
Earnings per share			
Basic and diluted (loss)/earnings per share (in BAM)	23	(2.28)	4.12

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

These financial statements were adopted by the Bank's Supervisory Board on April 9, 2012.

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

Srećko Bogunović
Director

Ankica Mirnić
Head of Accounting, Finance
and Reporting Department

STATEMENT OF FINANCIAL POSITION
As of December 31, 2011
(Thousands of BAM)

	Notes	December 31, 2011	December 31, 2010
ASSETS			
Cash and balances with the Central Bank	15	13,292	17,939
Deposits held with other banks	16	6,292	610
Loans to customers	17	35,683	12,824
Equipment and intangible assets	18	974	627
Accrued interest and other assets	19	168	71
Total assets		56,409	32,071
LIABILITIES AND EQUITY			
Bank deposits	20	5,988	-
Customers' deposits	20	30,344	11,497
Other liabilities	21	239	162
Provisions for potential losses and retirement benefits		47	27
Total liabilities		36,618	11,686
Equity			
Share capital	22	26,000	26,000
Accumulated losses		(6,209)	(5,615)
Total equity		19,791	20,385
Total liabilities and equity		56,409	32,071
Contingent liabilities and commitments	24	4,610	499

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

STATEMENT OF CHANGES IN EQUITY
For the Year Ended December 31, 2011
(Thousands of BAM)

	Share Capital	Accumulated Losses	Total
Balance, January 1, 2010	20,000	(6,464)	13,536
Increase in share capital through cash contribution	6,000		6,000
Profit for the year		849	849
Balance, December 31, 2010	26,000	(5,615)	20,385
Other decrease		(1)	(1)
Loss for the year	-	(593)	(593)
Balance, December 31, 2011	26,000	(6,208)	19,791

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

CASH FLOW STATEMENT
Year Ended December 31, 2011
(Thousands of BAM)

	Year Ended December 31, 2011	Year Ended December 31, 2010
Cash flows from operating activities		
Interest receipts	2,218	467
Interest paid	(448)	(154)
Fee and commission receipts	607	300
Fee and commission paid	(47)	(7)
Inflows from the collection of receivables previously written off	18	3,457
Payments to employees and suppliers	(2,638)	(2,120)
Operating (loss)/profit prior to changes in operating assets and liabilities	(290)	1,943
Changes in operating assets and liabilities		
Net increase in loans to customers	(23,015)	(10,772)
Net increase/(decrease) in bank deposits	5,988	(3,500)
Net increase in customers' deposits	18,742	7,760
Net cash provided by/(used in) operating activities	1,715	(4,569)
Cash flows from investing activities		
Increase in share capital	-	6,000
Purchase of intangible assets	(205)	(30)
Purchase of property and equipment	(183)	(21)
Net cash (used in)/provided by investing activities	(388)	5,949
Net increase in cash and cash equivalents	1,037	1,380
Foreign exchange (losses)/gains	(2)	109
Cash and cash equivalents, beginning of year	18,549	17,060
Cash and cash equivalents, end of year	19,584	18,549
Cash and cash equivalents comprise the following positions:		
- Cash and balances with the Central Bank	13,292	17,939
- Deposits held with other banks	6,292	610
	19,584	18,549

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

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
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 international 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 22), 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 a broad range of 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 office Borik in Banja Luka and branch offices in Laktaši, Gradiška, Derventa, Brčko, Bijeljina and Doboj.

As of December 31, 2011, the Bank had 68 employees (December 31,2010: 36 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. Basis of Preparation and Presentation of the Financial Statements

The financial statements of the Bank have been prepared at 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 amounts in the accompanying financial statements are stated in thousands of Convertible marks (BAM), which is the functional and reporting currency of the Republic of Srpska and Bosnia and Herzegovina.

In the preparation of the unconsolidated statement of cash flows for the year ended December 31, 2011, the Bank applied direct method in reporting on cash flows.

The Bank also prepares special-purpose financial statements in accordance with the accounting regulations of the Republic of Srpska governing financial reporting, departing in certain respect from IFRS and IAS requirements.

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

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

2.2. Basis of Preparation and Presentation of the Financial Statements (Continued)

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

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

Standards and Interpretations in Issue not yet Adopted

At the date of authorization 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 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);
- IFRS 13 "Fair Value Measurement" (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);
- 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 7 "Financial Instruments: Disclosures" – Transfers of Financial Assets (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2013);

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

2. BASIS OF PREPARATION AND PRESENTATION OF THE UNCONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.2. Basis of Preparation and Presentation of the Unconsolidated Financial Statements (Continued)

Standards and Interpretations in Issue not yet Adopted (Continued)

- Amendments to IFRS 9 “Financial Instruments” and IFRS 7 “Financial Instruments: Disclosures” – Mandatory Effective Date and Transition Disclosures;

- 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 12 “Income Taxes” – Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after January 1, 2012);

- Amendments to IAS 19 “Employee Benefits” – Improvements to the Accounting for Post-employment Benefits (effective for annual periods beginning on or after January 1, 2013);

- Amendments to IAS 32 “Financial Instruments: Presentation” – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2014);

- IFRIC 20 “Stripping Costs in the Production Phase of a Surface Mine” (effective for annual periods beginning on or after January 1, 2013).

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.

3. SUMMARY OF SIGNIFICANT ACOUNTING POLICIES

3.1. Income and Expense Recognition

Interest income and expense and other operating income and expenses are accounted for on an accrual basis. Fee and commission receivables, except for loan origination fees, are recognized in full when earned.

Loan origination fees are deferred and amortized over the loan repayment period, which, in the opinion of the Bank’s management, approximates the effective interest method. Based on the statutory regulations, loan origination fees are presented as part of income from fees and commissions and not as integral part of the effective interest rate as required by IAS 18 “Revenue” and IAS 39 “Financial Instruments: Recognition and Measurement”.

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 income statement.

3.3. Equipment and Intangible Assets

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

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

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

3. SUMMARY OF SIGNIFICANT ACOUNTING POLICIES (Continued)

3.3. Equipment and Intangible Assets (Continued)

	Depreciation and Amortization Rate	Useful Life (Years)
Computer equipment	25%	4
Passenger vehicles	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 it to operate in a manner intended by the Bank's management.

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

3.4. Loans to Customers

Loans originated by the Bank are stated in the statement of financial position at the amount of principal outstanding, less allowance for impairment, which is based on the assessment of specifically-identified exposures and losses that are inherent in the Bank's loan portfolio. The Bank's management applies the methodology that is entirely based on IAS 39 "Financial Instruments: Recognition and Measurement" in its risk assessment, as disclosed in Note 3.5.

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 values 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.

3.5. Allowances for Impairment of Uncollectible Receivables and Provisions

During 2011, at each month end, the Bank provided for potential losses contingent on defaults, by applying the following methodologies for the calculation of mentioned provisions based on IAS 39 "Financial Instruments: Recognition and Measurement," used for all other internal and external reporting purposes in 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 placements.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Allowances for Impairment and Provisions for Contingent Liabilities (Continued)

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.

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.

3.6. Cash and Cash Equivalents

For purposes of the cash flow statement, cash and cash equivalents refer to cash and balances with the Central Bank and balances on foreign currency accounts with domestic and foreign banks and other deposits with up to 3-month maturities from the placement date.

3.7. Taxes and Contributions

Current Income Taxes

Current income tax is an amount computed and paid in accordance with the Income Tax Law. Current income tax is the amount calculated by applying the 10% rate to the base reported in the tax balance being the amount of profit before taxation after allowing for the effects of income and expense reconciliation as provided by the Republic of Srpska tax rules.

Such adjustments mostly relate to the following: adding back certain disallowed expenses, adding back the expenses for provisions for potential losses in excess of 20% of the adjusted tax base.

The tax regulations effective 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, any current year tax losses stated in the tax balance, as a negative difference between income and expenses, may be used to reduce or eliminate taxes to be paid in future periods, but only for a duration of no longer than five ensuing years.

Deferred Income Taxes

Deferred income tax is determined using the statement of financial position 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 employer contributions, property taxes, and various other taxes and contributions, included under other operating expenses.

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, which may not be below the three monthly salaries earned in the Bank.

In the calculation of the present value of accumulated employee entitlements to retirement benefits and jubilee awards, a certified actuary used the following assumptions: a discount rate of 6.73% annually, projected salary increase of 5% annually, years of service necessary 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 surroundings in the prior period, as well as other terms necessary to exercise rights to a retirement benefit and a jubilee award.

In the opinion of the Bank, the amounts included in the financial statements represent the most valid and useful reporting values under the present market conditions.

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.

Estimates and assumptions are subject to constant review. Changes to accounting estimates are recognized in the period when they are made if their impact is limited to that period or in the future periods in cases where the change impacts future periods as well.

Basic assumptions relating to the future events and other significant sources of uncertainties in rendering an estimate as of the balance sheet 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.

4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES (Continued)

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.

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 takes 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 credit facilities.

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:

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

5. FINANCIAL INSTRUMENTS (Continued)

5.2. Credit Risk (Continued)

- 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, 2011, the major exposure to an individual customer, without taking into account collaterals, totaled BAM 4,969 thousand, which accounts for 12.42% of total credit risk (December 31, 2010: BAM 2,357 thousand).

5.2.3. Credit Risk Concentration per Geographical Areas

During both 2011 and 2010, 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, 2011
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, 2011	In %	December 31, 2010	In %
Civil engineering	1,459	4%	700	5%
Trade	10,762	30%	4,125	31%
Services, tourism, catering and accommodation industry	877	2%	350	3%
Agriculture	2,296	6%	391	3%
Mining and industry	4,335	12%	803	6%
Transport, storage, post services and telecommunications	2,646	7%	2,511	19%
Financing services	4,516	13%	-	-%
Real estate trade	225	1%	26	-%
Administration, other public services	4,410	12%	3,678	28%
Other (retail customers)	4,797	13%	723	5%
Total	36,323	100%	13,307	100%
Less: Allowance for impairment	(712)		(390)	
Plus: Interest, fee and commission receivables	280		22	
Less: Prepaid loan repayments	(44)		(25)	
Less: Loan origination fees received in advance	(164)		(90)	
Total loans, net	35,683		12,824	

5.2.5. Credit Risk Concentration per Types of Loans

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

	December 31, 2011	In %	December 31, 2010	In %
Loans on transaction accounts	1,098	3%	178	2%
Consumer loans	2,885	8%	557	4%
Working capital loans	14,463	40%	8,621	66%
Investment loans	16,749	46%	3,894	28%
Housing loans	148	-%	57	-%
Other loans-purchased short-term placements-factoring	980	3%	-	-
Total	36,323	100%	13,307	100%
Less: Allowance for impairment	(712)		(390)	
Plus: Interest, fee and commission receivables	280		22	
Less: Prepaid loan repayments	(44)		(25)	
Less: Loan origination fees received in advance	(164)		(90)	
Total loans, net	35,683		12,824	

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

5. FINANCIAL INSTRUMENTS (Continued)

5.2. Credit Risk (Continued)

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.

	Category						
December 31, 2011	**A0**	**A**	**B**	**C**	**D**	**E**	**Total**
Loans to customers							
- short-term	3,096	4,308	4,840	-	-	-	12,244
- long-term	3	21,367	1,567	184	83	20	23,224
- matured	-	18	519	3	53	262	855
Total loans	3,099	25,693	6,926	187	136	262	36,323
Off-balance sheet items	55	4,357	198	-	-	-	4,610
Total	3,154	30,050	7,124	187	136	262	40,933

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.

Portfolio as at December 31, 2011	**Total Exposure**	**Total Exposure Net of Deposits**	**Discounted Collateral Value**	**Allowance for Impairment**	**Amount of Reserves Out-standing**	**Total Deterioration**
Before the test	41,316	38,162	15,822	658	855	1,513
After the test	48,649	45,495	26,370	1,012	1,548	2,560
Difference	7,333	7,333	10,548	354	693	1,047

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 position 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 positions, it is necessary to maintain each foreign currency position within limits prescribed,
- by defining foreign currency activities.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
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)

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.

The breakdown of foreign currency positions as of December 31, 2011, net is presented in the table below:

	EUR	USD	CHF	GBP	Other	Total
Financial Assets in the Statement of financial position						
Cash and balances with depositary institutions	6,155	522	35	9	64	6,785
Other financial assets	-	-	-	-	-	-
Currency clause indexed loans	19,659	-	-	-	-	19,659
	25,814	522	35	9	64	26,444
Financial liabilities in the Satement of financial position						
Deposits and matured but outstanding off-balance sheet liabilities	3,313	16	38	-	-	3,367
Other financial liabilities	64	-	-	-	12	76
Currency clause indexed liabilities	19,732	-	-	-	-	19,732
	23,109	16	38	-	12	23,175
Assets-off-balance sheet liabilities	605					605
LONG POSITION	3,310	506	-	9	52	3,874
Expressed in %	17%	3%	-	-	-	20%
SHORT POSITION	-	-	3	-	-	-
Expressed in %	-	-	-	-	-	-
Allowed overnight position						
Below the limit in %	13%	17%	20%	20%	20%	10%

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 target 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, 2011 would have decreased/increased by BAM 186 thousand (2010: decrease/increase by BAM 29 thousand).

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
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:

	Foreign currency	BAM
Assets		
Obligatory reserve with the Central Bank	-	0.09%-1.22%
Assets in excess of obligatory reserves	-	0.11% – 1.22%
Foreign currency accounts with foreign banks	0.23 - 1.52%	-
Short-term loans to customers:		
- legal entities	-	5%-17%
- retail entities	-	7.8% -17.5%
Long-term loans to customers:		
- legal entities	-	5.9 – 17.5%
- retail entities	-	6.5 – 16.2%
Liabilities		
Demand deposits of corporate customers	0.10%-0.20%	0.10%-0.20%
Demand deposits of retail customers	0.10%	0.10%
Short-term deposits:		
- legal entities	4.55%	0.60 – 3.30%
Long-term deposits:		
- legal entities	4.00% – 5.05%	-
- retail entities	4.30% – 5.40%	5%

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, 2011:

			December 31, 2011
Monetary assets	**Interest-Bearing**	**Non-Interest Bearing**	**Total**
Cash and cash equivalents	17,731	1,853	19,584
Receivables arising from interest, fee and commission, trade and other receivables	126	42	168
Loans and deposits to customers	35,683	-	35,683
	53,540	1,895	55,435
Monetary liabilities			
Transaction deposits	36,273	59	36,332
Other liabilities	89	150	239
Provisions for potential losses	-	47	47
	36,362	256	36,618

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 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.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

5. FINANCIAL INSTRUMENTS (Continued)

5.4. Liquidity Risk (Continued)

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 Interbanking 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.

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.

As of December 31, 2011	**Within a Month**	**From 1 to 3 Months**	**From 3 to 12 Months**	**Over 1 Year**	**Total**
ASSETS					
Cash and balances with the Central Bank	13,292	-	-	-	13,292
Deposits with other banks	6,292	-	-	-	6,292
Loans to customers	6,052	5,111	7,754	16,766	35,701
Accrued interest and other assets	140	7	20	1	150
Total assets	25,776	5,118	7,774	16,767	55,435
LIABILITIES					
Deposits	12,253	4,262	14,770	5,047	36,332
Other liabilities and provisions for potential losses	21	30	98	106	255
Total liabilities	12,274	4,292	14,868	5,153	36,587
Liquidity gap	13,502	826	(7,094)	11,614	18,848
As of December 31, 2010					
Total assets	19,463	944	5,649	5,388	31,444
Total liabilities	7,256	23	3,795	602	11,676
Liquidity gap	12,207	921	1,854	4,786	19,768

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

5. FINANCIAL INSTRUMENTS (Continued)

5.4. Liquidity Risk (Continued)

December 31, 2011	**1 – 30 Days**	**1 – 90 Days**	**1 - 180 Days**
Cash balances and deposits with depository institutions	19,584	19,584	19,584
Loans, long-term receivables and lease receivables	6,052	11,181	14,765
Other financial assets	140	129	139
Total financial assets	25,776	30,894	34,488
Deposits and matured and outstanding off-balance sheet liabilities	12,253	16,515	24,881
Other financial liabilities	21	51	91
Total financial liabilities	12,482	16,566	24,972
Difference	13,294	14,328	9,516
Calculation of liability prescribed in %			
Assets / Liabilities	207	186	138
Prescribed minimum	85	80	75
Over the prescribed minimum	122	106	63

6. INTEREST INCOME

	Year Ended December 31, 2011	**2010**
Interest charged to:		
- retail customers	407	56
- corporate customers	2,132	395
- Central Bank	76	52
- other banks	23	23
	2,638	526

7. INTEREST EXPENSE

	Year Ended December 31, 2011	**2010**
Interest charged by:		
- public sector	165	110
- retail customers	78	30
- banks	-	26
- non-banking finance institutions	303	-
- corporate customers	13	19
- others	40	
	599	185

8. FEE AND COMMISSION INCOME

	Year Ended December 31, 2011	**2010**
Sale and purchase of currencies	170	153
Fee and commission income arising from domestic payment transactions	155	95
Fees from issued guarantees and other sureties	27	14
Loan origination fees	45	15
	397	277

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

9. FEE AND COMMISSION EXPENSE

	Year Ended December 31, 2011	2010
Fee and commission expenses from currency conversions	13	2
Fee and commission payable to the Central Bank for domestic payment transfers	27	26
Fee and commission expense arising from international payment transactions	1	1
Other fees and commissions	2	2
	43	31

10. OTHER OPERATING INCOME

	Year Ended December 31, 2011	2010
Collected suspended interest previously written-off	17	535
Other income	19	11
	36	546

11. PERSONNEL EXPENSES

	Year Ended December 31, 2011	2010
Gross salaries and benefits	1,447	1,147
Other benefits, remunerations to the Supervisory Board, Audit commite	71	63
Professional trainings and education of employees	3	2
	1,521	1,212

12. OPERATING LEASE EXPENSES

a) Operating Lease Expenses

	Year Ended December 31, 2011	2010
Bank's central office	123	310
Branch office Banja Luka-Borik	4	
Branch office Laktaši	11	25
Branch office Gradiška	5	-
Branch office Derventa	5	-
Branch office Brčko	10	-
Branch office Bijeljina	4	-
Branch office Doboj	3	-
Representative office Belgrade	-	13
Software lease expenses	21	-
	186	348

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

12. OPERATING LEASE EXPENSES (Continued)

The Bank's property and assets are subject to physical security, provided by a company specialized in security services. Security services costs in the years 2011 and 2010 were as follows:

	Year Ended December 31, 2011	2010
Bank's central office	96	78
Branch office Banja Luka-Borik	12	16
Branch office Laktaši	13	-
Branch office Gradiška	10	-
Branch office Derventa	7	-
Branch office Brčko	11	-
Branch office Bijeljina	4	-
Branch office Doboj	3	-
	156	94

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

	December 31, 2011	December 31, 2010
Within 1 year	239	171
From 1 to 5 years	252	316
Over 5 years	-	-
	491	487

13. OTHER EXPENSES

	Year Ended December 31, 2011	2010
Security	156	94
Equipment maintenance	129	170
Telecommunications services	92	73
Materials and services	81	66
Marketing and advertising	69	6
Fees and commissions pain to the Banking Agency of the Republic of Srpska	64	60
Membership fees	40	40
Business trip expenses incurred in the country and abroad	19	12
Entertainment	8	11
Indirect taxes and contributions	9	8
Write-off of uncollectible receivables	1	55
Fees for engaging third parties	8	41
Other	92	150
	768	786

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

14. PROVISIONS FOR POTENTIAL LOSSES

a) Charge/(Credit) for the Year, Net

	Year Ended December 31, 2011	2010
Deposits held with other banks	-	(1,367)
Loans to customers	304	(804)
Interest receivables and other assets	15	12
Employee benefits	(1)	2
Contingent liabilities and commitments	21	-
	339	(2,157)

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

December 31, 2011 and 2010

	Deposits Held with Other Banks	Loans to Customers	Interest and Other Assets	Employee Benefits	Contingent Liabilities and Commit-ments	Total
Balance, January 1, 2010	1,367	1,204	-	15	10	2,596
Charge for the year	34	1,526	21	2	10	1,593
Reversal of provisions	(1,401)	(2,339)	-	-	(10)	(3,750)
Balance, December 31, 2010	-	391	21	17	10	439
Balance, January 1, 2011	-	391	21	17	10	439
Charge for the year	-	1,344	27	-	209	1,580
Reversal of provisions	-	(1,023)	(29)	(1)	(188)	(1,241)
Balance, December 31, 2011	-	712	19	16	31	778

15. CASH AND BALANCES HELD WITH THE CENTRAL BANK

	December 31, 2011	December 31, 2010
Cash		
- in BAM	906	458
- in foreign currencies	493	422
Balances with the Central Bank in BAM:		
- Obligatory reserve	2,469	1,570
- Gyro account	9,424	15,489
	13,292	17,939

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 BiH accrues and pays interest at the rate from 0.09% to 1.22% 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 (0.11% to 1.22%).

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

16. DEPOSITS HELD WITH OTHER BANKS

	Interest Rates	December 31, 2011	December 31, 2010
Foreign currency accounts with:			
- foreign banks	0.08%-1.43%	1,838	610
- short-term deposits up to 30 days	0.23%-1.52%	4,000	-
- domestic banks		454	-
		6,292	610

17. LOANS TO CUSTOMERS

	December 31, 2011	December 31, 2010
Short-term loans in BAM – up to 1 year	12,781	2,848
Loans in BAM – over 1 year	17,398	10,143
Current portion of long-term loans in BAM	6,144	316
	36,323	13,307
Less: Allowance for impairment of loans to customers	(712)	(390)
Total	35,611	12,917
Plus: Interest, fee and commission receivables	280	22
Less: Loan repayments received in advance	(44)	(25)
Less: Loan origination fees received in advance	(164)	(90)
Total loans	35,683	12,824

The major portion of short-term loans in BAM was placed with domestic entrepreneurs and retail customers at an annual interest rate ranging from 7% to 16.18%. The majority 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 an annual interest rate ranging from 6.5% to 18%. The aforementioned loans were 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 headquartered in the Republic of Srpska.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

18. EQUIPMENT AND INTANGIBLE ASSETS

	Leasehold Improvements	Equipment	Property under Construction	Total Property and Equipment	Intangible Assets	Intangible Assets under Development	Total Intangible Assets
Cost							
Balance, January 1, 2010	-	618	-	618	493	-	493
Additions	-	24	-	24	45	-	45
Disposal	-	(81)	-	(81)	(9)	-	(9)
Balance, December 31, 2010	**-**	561	-	561	**529**	-	529
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
Accumulated depreciation and Amortization							
Balance, January 1, 2010	-	198	-	198	96		96
Charge for the year	-	101	-	101	103		103
Charge of the fixed and intangible assets disposed of	-	(30)	-	(30)	(5)		(5)
Balance, December 31, 2010	-	269	-	269	194	-	194
Balance, January 1, 2011	-	269	-	269	194	-	194
Charge for the year	2	96	-	98	108	-	108
Charge of the fixed and intangible assets disposed of	-	(2)	-	(2)		-	
Balance, December 31, 2011	2	363	-	365	302	-	302
Net book value:							
December 31, 2011	45	383	167	595	276	103	379
December 31, 2010	-	292	-	292	335	-	335

As of December 31, 2011, equipment was insured against general risks the Bank had no encumbrances or pledges against its equipment.

19. ACCRUED INTEREST AND OTHER ASSETS

	December 31, 2011	December 31, 2010
In BAM:		
- matured interest receivables	2	6
- fee and commission receivables	2	2
- advances paid	11	11
- other receivables	34	12
- inventories of material	1	2
- deferred receivables for accrued interest	99	50
- other expense deferrals	27	7
In foreign currency:		
- foreign currency advances	11	-
- other foreign currency receivables	-	2
	187	92
Less: Allowance for impairment of accrued interest and other assets	(19)	(21)
	168	71

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

20. CUSTOMERS' AND BANK DEPOSITS

	December 31, 2011	December 31, 2010
Demand deposits in BAM:		
- Government and state institutions	124	-
- corporate customers	667	925
- banks and banking institutions	2,988	-
- non-banking financial institutions	2,842	1,782
- retail customers	517	212
- non-profit organizations	2,430	1,148
- other customers	129	8
	9,697	4,075
Demand deposits in foreign currencies:		
- corporate customers	8	41
- non-banking financial institutions	1,266	4
- foreign entities	29	-
- retail customers	212	40
	1,515	85
Short-term deposits in BAM:		
- banks and banking institutions	3,000	-
- non-banking financial institutions	6,210	2,000
- retail customers	10	1
	9,220	2,001
Short-term deposits in foreign currencies:		
- retail customers	30	52
	30	52
Long-term deposits in BAM:		
- non-banking financial institutions	6,248	1,400
- Government and state institutions	5,125	-
- corporate customers	1,088	70
- non-profit organizations	200	-
- retail customers	386	30
- other customers	1,000	-
	14,047	1,500
Long-term deposits in foreign currencies:		
- Government and state institutions	-	3,009
- retail customers	1,823	775
	1,823	3,784
Total:	36,332	11,497

The Bank accrued interest on demand deposits of corporate entities and entrepreneurs in BAM and EUR at the rate of 0% to 0.2% annually, applying the 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.

Short-term deposits of corporate entities and entrepreneurs in BAM and EUR were placed at the interest rates ranging from 0.6% to 4.55% annually, whereas short-term deposits in USD were placed at the interest rates ranging from 0.1% to 0.55% annually.

Long-term deposits of corporate entities and entrepreneurs in BAM and EUR were placed at the interest rates ranging from 4% to 5.5% annually.

Long-term deposits of retail customers in BAM and EUR were placed at the interest rates ranging from 4.3% to 5.4% annually.

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 higher interest rates up to 1 percentage point as compared to the interest rates defined by the internally adopted acts of the Bank.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

21. OTHER LIABILITIES

	December 31, 2011	December 31, 2010
In BAM:		
- deferred payables for accrued interest	18	2
- accounts payable	97	109
- other liabilities	39	9
- deferred income	10	-
In foreign currency:		
- accounts payable	2	2
- deferred payables for accrued interest	61	27
- other liabilities	12	13
	239	162

22. 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, 2011 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, 2011 did not change as compared to that of December 31, 2010 and was the following:

	Number of Shares	Thousands of BAM	%
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	2,000	200	0.77
	260,000	26,000	100.00

23. EARNINGS PER SHARE

	Year Ended December 31, 2011	2010
Net (loss)/earnings for the year (in thousands of BAM)	(593)	849
Weighted average number of shares issued	260,000	205,918
Basic and diluted (loss)/earnings per share (in BAM)	(2.28)	4.12

24. CONTINGENT LIABILITIES AND COMMITMENTS

a) Payment guarantees, performance bonds and other irrevocable commitments

	December 31, 2011	December 31, 2010
Payment guarantees	309	439
Performance bonds	178	60
Irrevocable commitments for undrawn credits	3,435	-
Account overdrafts	688	-
	4,610	499

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

24. CONTINGENT LIABILITIES AND COMMITMENTS (Continued)

a) Payment guarantees, performance bonds and other irrevocable commitments (Continued)

As of December 31, 2011, provisions for potential losses based on off-balance sheet items totaled BAM 31 thousand (December 31, 2010: BAM 10 thousand, Note 14b).

b) Litigation

As of December 31, 2011, the Bank was involved in 8 litigations filed against entities in attempts to collect matured receivables. The total value of these litigations aggregated to BAM 340 thousand. As of December 31, 2011, 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, 2011, the Bank's total exposure to the Public Company “Roads of the Republic of Srpska” amounted to BAM 4,969 thousand, which is by BAM 181 thousand (25.95%) above the legally prescribed limit (Article 8, paragraph 1, item 3 of the Decision on the Minimum Standards for Risk Concentration Management in Banks). the Public Company “Roads of the Republic of Srpska” is a state-owned company and the Bank does not anticipate negative consequences thereof.

As of December 31, 2011, 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 other indicators.

25. RELATED PARTY TRANSACTIONS

	December 31, 2011	December 31, 2010
Assets:		
Receivables from loans to the Bank's management and employees	23	15
Total prepaid insurance expenses:		
- Mikrofin osiguranje a.d., Banja Luka	11	5
Assets, total	34	20
Liabilities:		
Transaction accounts of the Bank's management	122	103
Other related private individuals	276	-
	398	103
Accounts payable:		
- MF Software d.o.o., Banja Luka	-	65
	-	65
Interest payables:		
- Mikrofin osiguranje a.d., Banja Luka	61	5
- Mikrofin MKD d.o.o. Banja Luka	6	-
- MF Software d.o.o., Banja Luka	5	-
- Citizens' Association Mikrofin	4	-
- Related private individuals	11	-
	87	5
Balance of deposits placed by related parties:		
- MKD Mikrofin d.o.o., Banja Luka	6,153	1,639
- DUIF Mirofin invest a.d., Banja Luka in the name and for the account of IF Mikrofin plus a.d. Banja Luka	6	82
- OIF Mikrofin plus a.d. Banja Luka	15	-
- MF Software d.o.o., Banja Luka	21	40
- Mikrofin osiguranje a.d., Banja Luka	4,147	1,458
- Citizens' Association Mikrofin	1,112	1,148
- Profi nova a.d., Bijeljina	44	26
	11,498	4,393
Liabilities, total	11,983	4,566
(Liabilities)/assets, net	(11,949)	(4,546)

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2011
All amounts expressed in thousands of BAM, unless otherwise stated.

25. RELATED PARTY TRANSACTIONS (Continued)

	Year Ended December 31, 2011	2010
Income		
Interest income from related banks:		
- MKD Mikrofin d.o.o., Banja Luka	16	8
	16	-
Fee and commission income from related parties:		
- MKD Mikrofin d.o.o., Banja Luka	145	129
- Mikrofin osiguranje a.d., Banja Luka	5	
- MF SOFTWARE d.o.o., Banja Luka	1	1
- OIF Mikrofin plus a.d. Banja Luka	1	-
	152	130
Interest charged to the members of the Bank's Supervisory Board and management	1	-
Income, total	169	138
Expenses		
Insurance expenses - Mikrofin osiguranje a.d., Banja Luka	(12)	(5)
Interest expenses – related parties:		
- MKD Mikrofin d.o.o., Banja Luka	(17)	(3)
- Mikrofin osiguranje a.d., Banja Luka	(115)	(8)
- Citizens' Association Mikrofin	(37)	(1)
- Profi nova	(1)	-
- Bank's management	(4)	-
- Other related parties	(8)	-
	(194)	(17)
Remunerations to the members of the Supervisory Board and Bank's management	(167)	(85)
Expenses, total	(361)	(102)
Income/(expenses), net	(192)	36

26. 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.

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.

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

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

As expected, during 2011, the Bank's operations were under the impact of the global economic and financial crisis. However, in the course of 2011, 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 2012 and other areas that require estimates to be made by management, including the valuation of collateral and of securities. The 2011 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 2012 will be attention to the management of the financial portfolio adjusting to the changing economic environment.

28. 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, 2011 and 2010 were as follows:

		In BAM
	December 31, 2011	**December 31, 2010**
USD	1.5116	1.4728
CHF	1.6089	1.5678
EUR	1.9558	1.9558