ProCredit Bank
Bosnia and Herzegovina

Annual Report 2011

Key Figures

	EUR '000		BAM '000		Change
	2011	2010*	2011	2010*	BAM
Balance Sheet Data					
Total Assets	158,888	155,729	310,758	304,580	2.0%
Gross Loan Portfolio	126,088	119,158	246,607	233,052	5.8%
Business Loan Portfolio	102,582	94,062	200,633	183,969	9.1%
EUR < 10,000	12,993	15,940	25,413	31,176	-18.5%
EUR > 10,000 < 30,000	20,731	19,529	40,547	38,196	6.2%
EUR > 30,000 < 150,000	39,069	35,949	76,413	70,310	8.7%
EUR > 150,000	29,788	22,644	58,260	44,288	31.5%
Agricultural Loan Portfolio	9,180	10,161	17,954	19,873	-9.7%
Housing Improvement Loan Portfolio	6,466	6,695	12,647	13,094	-3.4%
Other	7,860	8,240	15,373	16,116	-4.6%
Loan Loss Provisions	-3,449	-3,596	-6,746	-7,033	-4.1%
Net Loan Portfolio	122,639	115,562	239,861	226,019	6.1%
Customer Deposits	107,476	111,676	210,205	218,420	-3.8%
Liabilities to Banks and Financial Institutions (excluding PCH)	14,172	18,782	27,718	36,735	-24.5%
Total Equity	18,261	15,985	35,715	31,264	14.2%
Income Statement					
Operating Income	12,279	11,857	24,016	23,191	3.6%
Operating Expenses	12,171	14,673	23,804	28,698	-17.1%
Operating Profit Before Tax	108	-2,816	212	-5,507	103.8%
Net Profit	231	-2,675	451	-5,232	108.6%
Key Ratios					
Cost Income Ratio	99.1%	123.7%			
Return on Equity	1.4%	-15.7%			
Capital Ratio	17.2%	16.2%			
Operational Statistics					
Number of Clients	78,476	85,663			-8.4%
of which Business Clients	13,604	19,024			-28.5%
Number of Loans Outstanding	17,427	20,746			-16.0%
Number of Deposit Accounts	82,722	97,249			-14.9%
Number of Staff	425	460			-7.6%
Number of Branches and Outlets	25	26			-3.8%

Exchange rate as of December 31:
2011: EUR 1 = BAM 1.9558
2010: EUR 1 = BAM 1.9558

* Some of the figures differ from those published in the 2010 Annual Report, due to changed calculation method

Mission Statement

ProCredit Bank is a development-oriented full-service bank. We offer excellent customer service to private individuals and enterprises. In our operations, we adhere to a number of core principles: we value transparency in our communication with customers, we do not promote consumer lending and we provide services which are based both on an understanding of each client's situation and on sound financial analysis. This responsible approach to banking allows us to build long-term partnerships with our clients based on mutual trust.

In our operations with business clients, we focus on very small, small and medium-sized enterprises, as we are convinced that these businesses create jobs and make a vital contribution to the economies in which they operate. By offering simple and accessible deposit facilities and other banking services and by investing substantial resources in financial education we aim to promote a culture of savings and responsibility which can help to bring greater stability and security to ordinary households.

Our shareholders expect a sustainable return on investment over the long term, rather than being focused on short-term profit maximisation. We invest extensively in the training and development of our staff in order to create an open and efficient working atmosphere, and to provide friendly and competent service for our customers.

Letter from the Supervisory Board

In 2011 the economic recovery in Bosnia and Herzegovina (BiH) was sluggish, with GDP growth of 1.6% and a 27% unemployment rate at year-end.[1] Small and medium-sized enterprises (SMEs) continued to face numerous obstacles, such as high taxes, low liquidity levels, and a decreased number of payment orders. In this difficult environment, ProCredit Bank completed its financial consolidation process and at the same time successfully focused on strengthening its relationships with its core clientele. In line with its primary role as a "house bank" for SMEs in BiH, ProCredit Bank continued to provide high-quality banking services, giving individual attention to every client.

Despite the challenging economic and financial circumstances in the market, ProCredit Bank achieved solid results. Our individualised approach to our clients' businesses demonstrated its advantages in the excellent quality of the loan portfolio throughout the year: at the end of 2011, our non-performing loans (PAR›90) stood at 1.78%. At the same time, our loan portfolio grew by BAM 13.6 million (EUR 6.9 million), or 5.82%, for a total of BAM 246.6 million (EUR 126.1 million) at year-end.

As a true "house bank", we launched a wide range of tailored services for SMEs on favourable terms and conditions, including working capital loans and loans for financing current liabilities. We also remained a neighbourhood bank for private individuals, offering clear and easy-to-understand information and deposit services. As a result, the share of term deposits held by private individuals increased by 9.6 percentage points, i.e. from 74.1% at the end of 2010 to 83.7% one year later. The total deposit base amounted to BAM 210.2 million (EUR 107.5 million) by end-December 2011.

In our efforts to increase efficiency and raise the quality of our services in 2011, we began to reorganise and redesign our front offices in the branches. The structural improvements served to facilitate and enhance open communication, which is crucial for efficient operations. In order to reinforce our client-oriented approach, our branches began offering "one-stop banking" services, which further increase customer comfort.

Furthermore, to enhance our relationships with our customers and improve service quality in 2011, we continued to invest systematically in the professional and personal development of our staff, by organising trainings and seminars both locally and at the ProCredit Academies throughout the year. ProCredit Bank launched the Young Bankers Programme, which represents a unique opportunity for young university graduates interested in further professional development to gain theoretical knowledge and practical on-the-job training. After a careful screening process, 19 young, highly motivated individuals were selected to participate in the rigorous six-month programme. They received not only a scholarship, but also an opportunity to become integrated into the ProCredit team and to learn about ProCredit corporate culture and values.

Our main focus for the coming year will be to further strengthen our client relationships, increase efficiency and provide transparent banking services that meet the specific needs of SMEs. At the same time, we will continue to build a savings culture in the country by offering straightforward deposit services to retail clients.

On behalf of the Supervisory Board, I would like to express my gratitude towards the employees and Management Board of ProCredit Bank. I would also like to thank our shareholders for their continued support of our vision.

Dr. Klaus Glaubitt
Chairman of the Supervisory Board

Members of the Supervisory Board as of December 31, 2011:
Dr. Klaus Glaubitt
Helen Alexander
Dr. Claus-Peter Zeitinger
Rainer Ottenstein
Philipp Pott

Members of the Management as of December 31, 2011:
Dr. Frieder Wöhrmann
Edina Vuk
Edin Hrnjica
Vedran Hadžiahmetović
Maja Hrnjić

[1] Economic Intelligence Unit, Country Report, December 2011

The Bank and its Shareholders

ProCredit Bank Bosnia and Herzegovina (BiH) is a member of the ProCredit group, which is led by its Frankfurt-based parent company, ProCredit Holding. ProCredit Holding is the majority owner of ProCredit Bank BiH and holds 94.19% of the shares.

ProCredit Bank BiH was founded in October 1997 as Micro Enterprise Bank (MEB) by an alliance of international development-oriented investors, many of which are shareholders in ProCredit Holding today. Their goal was to establish a new kind of financial institution that would meet the demands of small and very small businesses in a socially responsible way. The primary aim was not short-term profit maximisation but rather to deepen the financial sector and contribute to long-term economic development while also achieving a sustainable return on investment.

Over the years, ProCredit Holding has consolidated the ownership and management structure of all the ProCredit banks to create a truly global group with a clear shareholder structure and to bring to each ProCredit institution all the best practice standards, synergies and benefits that this implies.

Today's shareholder structure of ProCredit Bank BiH is outlined below. Its current share capital is EUR 23.7 million.

Shareholder (as of Dec. 31, 2011)	Sector	Headquarters	Share	Paid-in Capital (in EUR million)
ProCredit Holding	Investment	Germany	94.19%	22.37
Commerzbank AG	Banking	Germany	5.81%	1.38
Total Capital			**100%**	**23.75**

ProCredit Holding is the parent company of a global group of 21 ProCredit banks. ProCredit Holding was founded as Internationale Micro Investitionen AG (IMI) in 1998 by the pioneering development finance consultancy company IPC.

ProCredit Holding is committed to expanding access to financial services in developing countries and transition economies by building a group of banks that are the leading providers of fair, transparent financial services for very small, small and medium-sized businesses as well as the general population in their countries of operation. In addition to meeting the equity needs of its subsidiaries, ProCredit Holding guides the development of the ProCredit banks, provides their senior management, and supports the banks in all key areas of activity, including banking operations, human resources and risk management. It ensures that ProCredit corporate values, international best practice procedures and Basel II risk management principles are implemented group-wide in line with standards also set by the German supervisory authorities.

IPC is the leading shareholder and strategic investor in ProCredit Holding. IPC has been the driving entrepreneurial force behind the ProCredit group since the foundation of the banks.

ProCredit Holding is a public-private partnership. In addition to IPC and IPC Invest (the investment vehicle of the staff of IPC and ProCredit), the other private shareholders of ProCredit Holding include the Dutch DOEN Foundation, the US pension fund TIAA-CREF, the US Omidyar-Tufts Microfinance Fund and the Swiss investment fund responsAbility. The public shareholders of ProCredit Holding include KfW (the German promotional bank), IFC (the private sector arm of the World Bank), FMO (the Dutch development bank), BIO (the Belgian Investment Company for Developing Countries) and Proparco (the French Investment and Promotions company for Economic Cooperation).

The legal form of ProCredit Holding is a so-called KGaA (Kommanditgesellschaft auf Aktien, or in English a partnership limited by shares). This is a legal form not uncommonly used in Germany which can basically be regarded as a joint stock

company in which the role of the management board is assumed by a General Partner, and in which the General Partner has consent rights over certain key shareholder decisions. In the case of ProCredit Holding, the General Partner is a small separate company which is owned by the core shareholders of ProCredit Holding AG & Co. KGaA: IPC, IPC Invest, DOEN, KfW and IFC. The KGaA structure will allow ProCredit Holding to raise capital in the future without unduly diluting the influence of core shareholders in ensuring the group maintains dual goals: development impact and commercial success.

ProCredit Holding has an investment grade rating (BBB-) from Fitch Ratings Agency. As of the end of 2011, the equity base of the ProCredit group is EUR 469 million. The total assets of the ProCredit group are EUR 5.5 billion.

COMMERZBANK **Commerzbank** is a leading bank for private and corporate customers in Germany. With the segments Private Customers, Mittelstandsbank, Corporates & Markets, Central & Eastern Europe as well as Asset Based Finance, the bank offers its customers an attractive product portfolio, and is a strong partner for the export-oriented SME sector in Germany and worldwide.

With a future total of some 1,200 branches, Commerzbank has one of the densest networks of branches among German private banks. It has a presence in over 60 locations in 52 countries and serves more than 14 million private clients as well as 1 million business and corporate clients worldwide. In 2011, it posted gross revenues of EUR 10.1 billion with some 58,160 employees.

Commerzbank is the largest German bank in Central & Eastern Europe and serves around 4.5 million clients in this region. In Poland the bank holds a 70% stake in BRE Bank, Poland's third-largest financial institution. In Ukraine it is the majority shareholder of Bank Forum, a full service bank with a nationwide network.

Special Feature

ProCredit Bank supports recent economics graduates

First generation of "Young Bankers"

In Bosnia and Herzegovina it is particularly challenging for recent graduates in economics to gain a deeper understanding of the banking sector and to develop the appropriate skills that will pave the way to a successful career in banking. With this challenge in mind, ProCredit Bank created the Young Bankers Programme which gives aspiring bankers the unique opportunity to gain extensive theoretical knowledge and practical on-the-job training with ProCredit Bank.

In October 2010, 19 young people were carefully selected from a total of 88 applicants. These highly motivated individuals had received the highest scores in the maths and logic tests, and had demonstrated the best performance in the interviews held. All aged 21 to 25 with a background in economics, they not only received scholarships, but also the opportunity to become part of the ProCredit team and familiarise themselves with ProCredit Bank's corporate culture and values.

"In this constantly changing world, we are challenged to develop new skills, knowledge and approaches in order to succeed. This was a wonderful opportunity for me to gain knowledge about the banking sector and the provision of banking services. The practical knowledge I gained during the programme will certainly open many doors for me in the future."
said one of the programme participants.

In a period of six months, participants received instruction and training in banking services and

customer care, lending, business and risk, marketing, risk management, audit, treasury, cash operations, etc. During the programme, the prospective young bankers covered various research topics such as ways of increasing the number of transactions made through e-banking, a review of the market offer to SMEs in Bosnia and Herzegovina, etc. They also had a chance to receive practical banking experience at various ProCredit business units.

"It was great to see the enthusiasm and excitement of these young bankers when dealing with clients and performing real tasks. It became clear that this programme is a realistic way for participants to obtain not only knowledge and practical experience, but also employment opportunities within our institution. On the other hand,the programme enables us to identify highly qualified young individuals, ready to meet the challenges of responsible banking,"
said Alma Delić, Head of Human Resources.

The Young Bankers Programme will find its continuation in 2012, which will additionally ensure that ProCredit Bank continues to provide professional and superior service to its clients.

Management Business Review

Management
from left to right:

Maja Hrnjić
Director of Operations

Edin Hrnjica
Executive Director

Dr. Frieder Wöhrmann
Director

Vedran Hadžiahmetović
Executive Director

Edina Vuk
Executive Director

Political and Economic Environment

More than a year after the inconclusive parliamentary elections, the absence of a state-level governing coalition delayed passage of the constitutional and judiciary reforms that BiH is required to implement in order to advance its bid for EU candidate status by 2013. These reforms are seen as vital for building public trust in the judicial system and for furthering democratic development, which forms the basis of political stability. There was also considerable debate about the continued presence of the Office of the High Representative (OHR), which, one and a half decades after the Dayton-Paris Peace Agreement, is perceived by many as limiting the country's sovereignty.

Economic recovery from the 2009 recession remained sluggish in 2011, with real GDP growing by just 1.6%. In view of the downturn in the eurozone, real GDP growth in BiH is expected to slow to 1% in 2012. In addition, unemployment climbed to 27% by year-end[1] and inflation picked up, with the consumer price index (CPI) increasing by an estimated 3.8% (2010: 2.1%), mainly due to a sharp rise in international oil prices. In November 2011, the international rating agency Standard & Poor's lowered BiH's sovereign credit rating from "B+" to "B", with negative outlook.

However, lower international commodity prices and the slump in domestic demand[2] could decelerate the annual inflation rate to an average of 3% in 2012. Furthermore, the anticipated weakening of the euro, to which the marka is pegged, should help to make BiH exports more competitive. On the domestic front, the planned cuts in public sector salaries are expected to exert downward pressure on wages in general, which will likewise boost the country's attractiveness to investors.

Although our customers faced a number of challenges due to the political and economic turmoil, they continued to invest in their businesses in order to survive in the market and increase their competitiveness. To support its clients and help them to grow again in these difficult times, ProCredit Bank continued to provide personalised advice and tailored financial services.

Financial Sector Developments

In 2011, 27 commercial banks and 24 microcredit organisations were operating in BiH.[3] While there are several leasing and insurance companies active in the market, the financial sector remains dominated by the mostly foreign-owned commercial banks, which account for more than 80% of total sector assets. The three largest bank groups, i.e. Raiffeisen, UniCredit and Hypo Alpe Adria, held approximately 60% of both the loan and the deposit markets.

As of end-2011, total sector assets had grown by a modest 3.5%, to BAM 21.9 billion (EUR 11.2 billion). The consolidated loan portfolio amounted to BAM 15.3 billion (EUR 7.8 billion) while the deposit portfolio totalled BAM 13.0 billion (EUR 6.6 billion).[4] As in the previous year, private sector debt made up approximately 50% of GDP, which is relatively low when compared to EU countries, but above average for the Western Balkans.

The moderate 5.3% increase in total loan volume reflected both the strengthened loan evaluation procedures implemented by the banking sector and the economic stagnation in the real economy. In an effort to stimulate overall lending, banks continued to lower interest rates. Loans to private enterprises grew by 2.7%, with slightly higher demand for short-term loans. Due to the slow pace of recovery in the real economy, non-performing loans climbed to 11.8% by end-December 2011.

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1 Economic Intelligence Unit, Country Report, December 2011

2 Agency of Statistics of BiH. Basic indicators available at www.bhas.ba, December 2011

3 Over the course of 2011, the Development Bank of the Federation of BiH was defined as a non-commercial institution, while Poštanska banka and Hercegovačka banka operated under provisional supervision by the authorities. Also, in 2011, Sber Bank announced a takeover of the Volksbank group, which is going to affect the two Volksbanks in BiH (Volksbank d.d. Sarajevo and Volksbank a.d. Banja Luka).

4 Unless otherwise indicated, the financial sector data presented here are based on statistics of the Central Bank of BiH: www.cbbh.ba

After recording net losses in 2010, the banking sector achieved a profit in 2011. The modest overall ROE of 5.9% was a direct consequence of the relatively low margins at which banks in the BiH market operate. The total spread between the rates on loans and savings and time deposits stood at around 5%, while the margin at which the loans were being placed was 5.6% over the 12-month EURIBOR.

Aggregate deposits grew only slightly, by 3.7%, in 2011. Retail deposits, which represent some 50% of total deposits, grew by 8.7%, indicating stable confidence in the banks and trust in Deposit Insurance Agency coverage (up to BAM 35,000).

Microcredit organisations represent the third largest group of financial intermediaries in the financial sector after banks and leasing companies. After the operational decline and a total loss of some BAM 39 million in 2010 (EUR 19.9 million), the overall microfinance sectors returned to profitability in 2011. Relatively high yields on loans (the effective interest rates ranged between 20-32%) materialised quickly, while the quality of the loan portfolio seems to have stabilised. Despite the levels of indebtedness and cross-lending between the institutions, the expected consolidation did not happen in 2011; given the limitations of the market, however, the pressure to consolidate will certainly be felt sooner or later.[5]

ProCredit Performance

In 2011, ProCredit Bank managed to achieve stability despite the economically difficult circumstances, sustaining quality portfolios in all business lines. Building strong, long-lasting customer relationships continued to form the basis of our business strategy in 2011. Although the bank achieved a modest profit at year-end, we believe that our success can be measured in terms of the substantial number of companies that grew with us. The bank remained well capitalised throughout the year, and able to cover all of the risks to which it was exposed.

Taking into account that enterprises want a flexible banking partner that understands their needs and the challenging environment in which they operate, we continued to be a reliable banking partner to very small, small and medium-sized enterprises, offering a wide range of services to support their future development. We offered tailor-made services, including working capital loans, loans for financing current liabilities, etc. Believing that each sector of the economy requires an individual approach, we created offers specially suited to the needs of the economic sectors we serve, such as accounting, wood processing, pharmaceuticals and health care.

In August, the European Investment Bank (EIB) and ProCredit Bank signed a credit line agreement for an amount of EUR 15 million for the purpose of further strengthening and developing small and medium enterprises. In accordance with EIB criteria, ProCredit Bank disbursed monies from this fund to finance medium-term and long-term projects of small and medium enterprises in Bosnia and Herzegovina. With the implementation of this credit line, ProCredit continued to reinforce its strategic position as an institution that supports SMEs.

With respect to its deposit business, the bank continued to be recognised for its transparent and simple savings services. Our clients' confidence in the bank and our shareholders was demonstrated by the steady flow of deposits during the year.

Optimising the delivery of our services remained one of our primary goals in 2011. In order to streamline our front offices and reduce waiting times for our customers, we introduced "one-stop banking". This convenient service allows the bank to serve all of its clients more professionally, flexibly and efficiently. Considerable effort was also invested in developing better e-banking and card services and automating processes, making it even more convenient for private individuals to do their financial business with ProCredit Bank.

Lending

In 2011, ProCredit Bank's loan portfolio grew by BAM 13.6 million (EUR 6.9 million), or by 5.82%, for a total volume of BAM 246.6 million (EUR 126.1 million). The number of loans outstanding decreased by 16.0% to 17,427, due to the decrease in the number of very small loans (below EUR 10,000) and agricultural loans, mainly as a

consequence of the difficult business environment and the higher collateral requirements introduced by the bank.

By year-end, ProCredit Bank had disbursed 8,020 loans totalling BAM 175 million (EUR 90 million). The average loan amount was BAM 21,882 (EUR 11,188), which represents an increase of 10.4% in comparison to 2010.

The gross loan portfolio amounted to BAM 246.6 million (EUR 126.1 million) at year-end, of which the SME sector accounted for 71.1% (2010: 65.6%). The volume of agricultural loans and business loans below EUR 10,000 decreased by 15.0%, while loan exposures with maturities of up to 12 months (overdrafts and credit lines) made up 11.6% of the total portfolio, a year-on-year increase of 20.7%.

Our main focus in 2011 with respect to lending was to provide a full range of services to SMEs. We therefore continued our efforts to increase the portfolio of loans above EUR 10,000, concentrating on supporting sustainable businesses. The market trend in 2011 indicated that SMEs were primarily seeking working capital financing, while demand for medium- and long-term investment

[5] MCO Sector; source: Association of Microcredit Organisations.

loans declined. In order to satisfy this demand and meet the needs of our clients, we introduced a number of services, including credit lines and some specific short-term financing credit lines.

At the same time, ProCredit Bank continued to serve very small businesses and agriculture producers able to demonstrate sound and stable business operations.

In its medium-sized lending the bank was able to maintain the solid performance achieved in 2010. In 2011 the bank disbursed 83 medium loans for a total of BAM 44.6 million (EUR 22.8 million). Accounting for 24% of the total portfolio (2010: 19%), the average loan amount in the medium category came to BAM 583,000 (EUR 298,000). At the same time, we disbursed 1,565 small loans for a total volume of BAM 95.8 million (EUR 49.0 million), with the average loan amount climbing to BAM 63,200 (EUR 32,300). At the close of 2011, small loans made up 47% of the total portfolio.

The number of outstanding bank guarantees and letters of credit extended to SME companies came to 309 (2010: 256) while the volume climbed to BAM 16.0 million (EUR 8.2 million), for an increase of 37.3% compared to the previous year's figures.

The share of very small and agricultural loans relative to the total portfolio decreased to 10.3% (2010: 13.4%) and 7.3% (2010: 8.5%), respectively.

ProCredit Bank continued to offer housing and home improvement loans to customers with regular salaries. These two loan types, along with other loans to regular salary earners, including overdraft limits on current accounts, amounted to 11.4% (2010: 12.5%) of the total portfolio. PAR›30 for this category stood at 4.1% (2010: 2.8%).

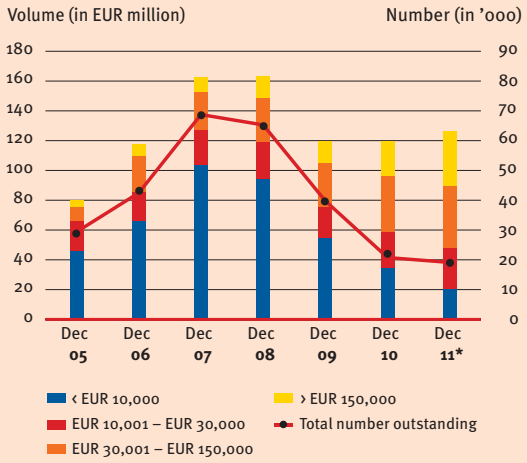
Measures applied to enhance arrears management served to improve the quality of the portfolio and increased the recovery rate of delinquent loans. PAR›30 for the total portfolio fell slightly, to 3.15%, as of year-end (2010: 3.20%), while restructured loans constituted 7.70% of the total portfolio (2010: 6.70%). Net write-offs totalled BAM 1.3 million (EUR 0.6 million) and were equivalent to 0.5% of the year-end portfolio. Loan loss provisions amounted to BAM 6.7 million (EUR 3.4 million), and thus covered the PAR›30 by a margin of 86.98%.

Deposits and Other Banking Services

In 2011, ProCredit Bank continued its efforts to strengthen its long-term relationships with its private individual savings customers and to increase their share of deposits in the total deposit base, while retaining a sufficient liquidity and maturity structure.

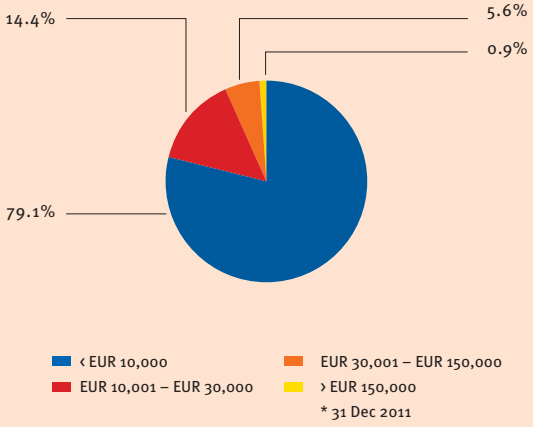
As a result of these efforts, our private individual clients' contribution to total term deposits increased by 9.5% percentage points, from 74.1%

Loan Portfolio Development



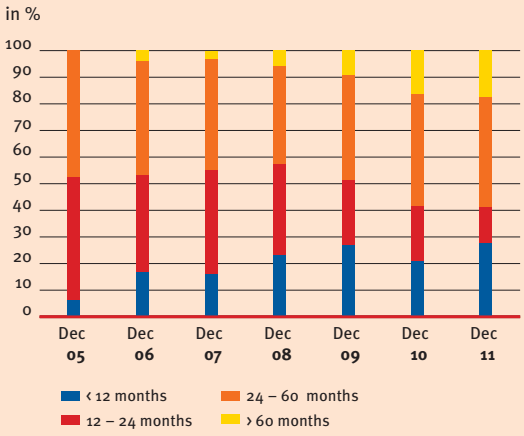
* Starting from 2011 the method of calculation for size categories has been changed

Number of Loans Outstanding – Breakdown by Loan Size*

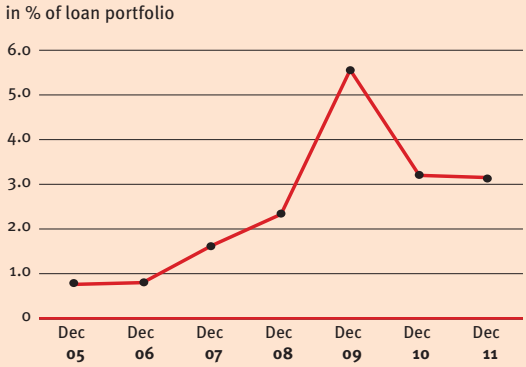


Starting from 2011 the method of calculation for size categories has been changed: breakdown by initial loan amount

Business Loan Portfolio – Breakdown by Maturity



Loan Portfolio Quality (arrears ›30 days)



Net write-offs: in 2008: EUR 2,538,340 in 2010: EUR 4,404,495
in 2007: EUR 703,616 in 2009: EUR 5,492,202 in 2011: EUR -648,493

to 83.7% year-on-year. The total deposit base decreased by approximately 3.8% compared to the previous year, amounting to nearly BAM 210.2 million (EUR 107.5 million) by end-December, composed of BAM 126.6 million (EUR 64.7 million) in term deposit accounts, followed by BAM 54.1 million (EUR 27.7 million) in current accounts and BAM 26.8 million (EUR 13.7 million) in savings accounts.

By the end of December, the number of active MasterCard and VISA payment cards issued by ProCredit Bank had decreased from 7,286 to 7,064 year-on-year. Nevertheless, due to the bank's efforts to promote card usage among active card holders, the level of ATM card transactions remained stable, totalling 280,000 transactions with a volume of BAM 46.3 million (EUR 23.7 million), performed on 39 ATMs. Point of Sale (POS) transactions increased both in terms of number and volume, from 124,000 to 144,000 and from BAM 7.3 million (EUR 3.7 million) to BAM 10.1 million (EUR 5.1 million), respectively, year-on-year. Following our strategy of building and maintaining long-term partnerships with our SME clients, we increased our POS terminal network by 131%, from 78 terminals at the end of 2010 to 180 year-on-year. Meanwhile, our online banking system, ProB@anking, had 2,192 registered users, who carried out transactions totalling nearly BAM 312.2 million (EUR 159.6 million).

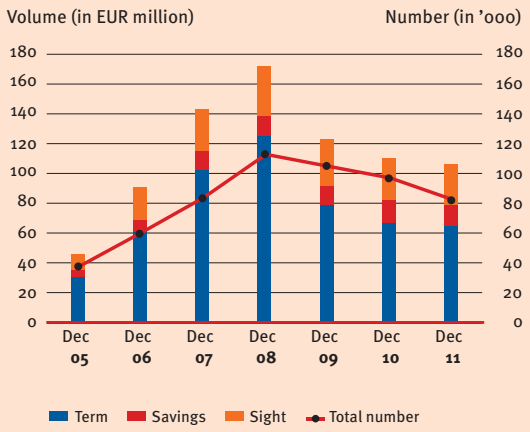
In its payment business, ProCredit Bank executed 1,303,935 domestic money transfers with a total volume of BAM 1.6 billion (EUR 810 million). At the same time, 44,795 international money transfers were performed in 2011, amounting to BAM 430 million (EUR 220 million).

Financial Results

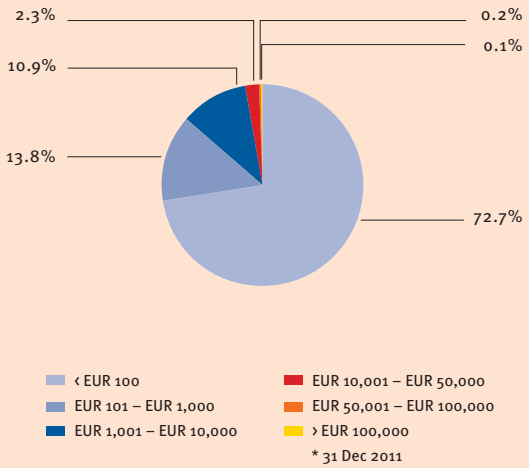
Despite the highly competitive market in Bosnia and Herzegovina, ProCredit Bank succeeded in maintaining a solid financial performance and strengthening its position as a "house bank" for SME clients. As a result, its loan portfolio grew by 5.82%, amounting to BAM 246.6 million (EUR 126.1 million) by year-end. SMEs took out the largest share of loans, with exposures over EUR 10,000 increasing to 71.1% of the total portfolio (2010: 65.6%).

In order to support loan portfolio growth, the bank continued its efforts to mobilise additional customer deposits, which amounted to BAM 210.2 million (EUR 107.5 million) at year-end. The increase in customer deposits provided the bank with additional loanable funds, enabling it to reduce its liabilities towards banks and financial institutions by 24.5% to BAM 27.7 million (EUR 14.2 million). At the same time, the bank maintained a very strong liquidity position and closed the year with a comfortable liquid to total assets ratio of 20%.

Customer Deposits

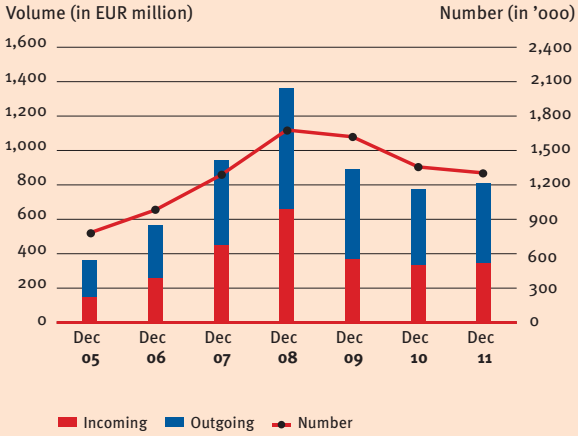


Number of Customer Deposits – Breakdown by Size*

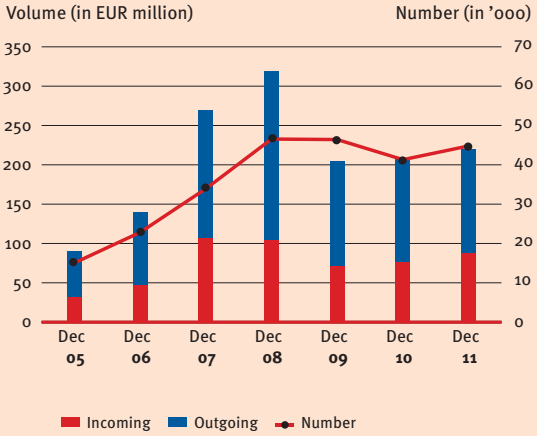


* 31 Dec 2011

Domestic Money Transfers



International Money Transfers



Total operating income for the year came to BAM 24.0 million (EUR 12.3 million). Net interest income and net fee income represented 72.5% and 17% of this amount, respectively, which confirms that the bank managed to keep these income categories at stable levels relative to total operating income despite the depressed level of business activity in the economy. Net trading income increased by 47.7% compared to the previous year, making up 1.5% of the total operating income. These figures attest to the bank's commitment to further strengthen fee income-generating mechanisms.

Efficient cost management enabled the bank to reduce its overall operating expenses to BAM 23.8 million (EUR 12.2 million) down from BAM 28.7 million (EUR 14.7 million) in 2010.

The increased efficiency of arrears management and recovery led to the release of allowances for impairment losses, resulting in positive net income of BAM 1.4 million (EUR 0.7 million).

ProCredit Bank BiH also managed to grow its assets and to keep expenses under control, which ultimately resulted in a net profit of BAM 0.5 million (EUR 0.2 million). In addition, the bank's shareholders increased their paid-in equity by BAM 4 million (EUR 2 million) in June 2011, further improving the capital adequacy ratio, which

remained above the required level throughout the year and stood at 17.20% by end-December.

FitchRatings awarded ProCredit Bank BiH a long-term foreign currency rating of "B" and a long-term local currency rating of "B+", both with a stable outlook.

Outlook

The economic outlook for BiH in 2012 is not particularly bright and is strongly dependent on the political will to resolve the ongoing issues. The recovery that started in 2011 is at risk of being derailed as the region becomes mired in the eurozone crisis, which contributed to BiH's weak GDP growth (1.6%) in 2011; in this light, the IMF predicts growth of as little as 1% in 2012. Throughout 2011, companies refrained from making large investments, applying mostly for short-term liquidity loans, but in the last quarter they started investing in their businesses again, a trend that will hopefully continue.

ProCredit Bank therefore intends to concentrate on strengthening and increasing its future lending activities, while focusing on the development of small businesses that have strong growth potential. In line with our client-oriented approach, we will continue to work closely with our customers, providing them with personalised, professional service. And, as always, we will continue to develop banking services that are tailored to our clients' needs, including liquidity management, documentary business, and Internet-based banking and transaction services. We will also continue to foster a savings culture and promote financial literacy throughout the country.

ProCredit Bank will continue its efforts to streamline and optimise its front offices in the coming year. The corresponding structural improvements will facilitate open communication and make a visit to our bank a more satisfying experience for our clients. We will also strongly invest in our dedicated staff by organising professional trainings and seminars, both locally and at the ProCredit Academies throughout 2012.

Despite the subdued economic forecast, we are confident that our client-oriented approach and committed staff will make 2012 a successful year for our institution.

Risk Management

While ultimate responsibility for risk management lies with the Management Board, it is the Risk Management Department which develops and implements mechanisms to identify, assess, and mitigate the bank's exposure to risk. Risks are regularly assessed through the Assets and Liabilities Committee (ALCO), Credit Risk Committee and Operational Risk Committee. The Credit Risk Committee closely monitors loan portfolio quality, the ALCO manages the short- and long-term liquidity position and exposures to market risk, and the Operational Risk Committee monitors the bank's exposure to operational risks and proposes measures to mitigate them. Its brief is to determine policies on people risks, process risks, IT and systems-related risks, external risks and other aspects of operational risk, and to monitor for adherence to these policies. It also discusses significant entries in the bank's Risk Event Database. The Risk Management Committee, which is led by a Management Board member, reviews the work and proposals of the other committees and is responsible for making strategic proposals to the Management Board.

The risk management policies in effect at ProCredit Bank Bosnia and Herzegovina (BiH), which have been approved by the bank's Board of Directors, are in full compliance with the legal regulations valid in BiH, including the requirements imposed by the Law on Banks, the Federal Banking Agency and the Central Bank of Bosnia and Herzegovina. The policies are based on the Group Handbook on Risk Management and Control, which in turn is based on the German Federal Financial Supervisory Authority's policy document "Minimum Requirements for Risk Management". ProCredit Bank Bosnia and Herzegovina reports its risk position to the Group Risk Management Committee (GRMC) at monthly intervals. The group's risk management departments also monitor the bank's key risk indicators on an ongoing basis, providing guidance whenever required.

Risk management throughout the ProCredit group is based on the concept of "risk-bearing capacity", i.e. the principle that each bank's aggregated risk exposures must not exceed its capacity to bear risk, and that the resources available to cover risk are sufficient to absorb any losses that may arise and protect creditors' investments. Statistical models and other procedures are used to quantify the risks incurred, and targets are set for each risk category and a limit for the aggregate exposure. During 2011 ProCredit Bank's overall risk exposure was relatively stable with respect to its risk-bearing capacity, fluctuating between 31% and 34%. This represents an improvement over the 34.9% level reported at end-December 2010, was partly attributable to a EUR 2 million capital increase in June 2011, which had a stabilising effect. The level of all risks remained well within the predefined targets in every category. Credit risk occasionally exceeded 20%, but never came close to an actual breach of the limit.

ProCredit Bank's culture of internal and external transparency is crucial to our risk management

efforts. Thanks to our clearly defined procedures and our encouragement of open communication, our well-trained staff are in a strong position to detect risks and take the steps necessary to mitigate them.

Credit Risk Management

Lending to enterprises is ProCredit Bank's main asset-side operation and consequently classical credit risk, i.e. the risk that borrowers will be unable to repay, is the most important risk that the bank faces. Credit risk accounts for the largest share of risk in the context of risk bearing capacity calculation.

ProCredit Bank's Credit Risk Management Policy and Collateral Valuation Policy, which are based on the corresponding ProCredit group policies, are in full compliance with BiH banking regulations. Furthermore, the bank makes use of internally developed technology to manage credit risk at all stages of the lending process. Regardless of the loan amount, each applicant is assessed on an individual basis, and the bank sets a credit exposure limit for every single customer. Credit decision-making authority is clearly defined; all decisions to issue a loan, or change its terms, are taken by a credit committee and all credit risk assessments are carefully documented. Above all, the bank seeks to build and maintain long-term relationships with its customers, thus ensuring that

it is fully aware of their financial situation, and great care is taken to avoid over-indebting them. Intensive monitoring further enables us to identify potential repayment problems at an early stage.

Credit risk is also mitigated by the fact that our portfolio is highly diversified. The businesses we serve operate in a wide range of sectors. To ensure that the bank does not take on too many exposures in any given industry or geographic area, we monitor sectoral and regional risk concentrations on a regular basis and set risk exposure limits accordingly. Moreover, the majority of our credit exposures are in the "small" category (EUR 10,000 to EUR 150,000). As of end-2011, this category accounted for 47.4% of the total outstanding portfolio, while the ten largest exposures accounted for only 7.95% of the portfolio.

As the vast majority of the bank's loans are repayable in monthly instalments, a borrower's failure to meet a payment deadline is treated as an initial sign of potential default and draws an immediate response from the bank. When a payment of an instalment is overdue by more than 30 days, the loan in question is assigned to the portfolio at risk (PAR›30), which serves as the key indicator for the quality of the loan portfolio and for measuring classical credit risk.

In 2011 the bank's overall PAR›30 decreased from 3.20% at the start of the year to 3.15% at year-end. It should be noted that ProCredit Bank has a lower percentage of non-performing loans (categories C and D) than the average for the BiH banking sector as a whole, where according to figures published by the Central Bank, in Q4 2011 non-performing loans (NPLs) accounted for 11.8% of total sector loans, whereas ProCredit Bank's non-performing loans represented 1.78% of its total loans.

One of the ways in which ProCredit Bank has met the challenge to portfolio quality posed by the financial crisis is to offer loan restructuring to those clients that are judged to have the potential to regain stability. Restructurings follow a thorough analysis of each client's changed payment capacity. The decision to restructure a credit exposure is always taken by a credit committee and aims at full recovery. As of end-2011, loans in the "watch" category were EUR 4.8 million, while "impaired" category was EUR 1.3 million.

ProCredit Bank Bosnia and Herzegovina takes a conservative approach to loan loss provisioning. Allowances for individually significant exposures with signs of impairment are set aside based on the results of an individual assessment of impairment, while provisioning for impaired loans that are not individually significant is calculated according to historical default rates. For all unimpaired credit exposures, portfolio-based allowances for impairment are made. At the end of the year the coverage ratio (loan loss provisions as a percentage of PAR›30) stood at 86,98%, and as a percentage of the total loan portfolio, provisions amounted to 2.74%.

Gross write-offs for 2011 totalled EUR 1.1 million, or 0.87% of the gross loan portfolio. Although the loans in question were written off the balance sheet, recovery efforts continued, reducing the net figure (gross write-offs less recoveries) to EUR 0.2 million by year-end.

Counterparty and Issuer Risk Management

Counterparty and issuer risks evolve especially from the bank's need to invest its liquidity reserve, to conclude foreign exchange transactions, or to buy protection on specific risk positions. Excess liquidity is placed in the interbank market with short maturities, typically up to one day, while the maximum possible maturity was reduced to up to two weeks. Foreign exchange transactions are also concluded with short maturities, typically up to two days.

The risk of incurring losses caused by the unwillingness or inability of a counterparty or issuer to fulfil its obligations is managed according to the ProCredit Group Counterparty Risk Management Policy (incl. Issuer Risk), which defines the counterparty selection and limit setting process, as well as according to the Group Treasury Policy, which specifies the set of permissible transactions and the rules for their processing. These policies are fully in line with BiH regulations. As a matter of principle, only large international banks and local banks with a good reputation and financial standing are eligible counterparties. The bank's ALCO must approve every counterparty and specifies the maximum exposure to that

counterparty. Limits above certain thresholds are conditional on approval by the Group ALCO, but currently there are no such limits. In 2011, in response to the latest sovereign debt crisis and downgrade of counterparty ratings, counterparty limits, types of transactions and maximum maturities were reviewed and in some cases adjusted.

Country Risk Management

Given ProCredit Bank's focus on lending to businesses in the local market, it does not normally enter into cross-border transactions with high-risk countries, and therefore its exposure to country risk is limited. The group as a whole is exposed to country risk insofar as PCH provides funding to ProCredit banks and these operate in transition economies or developing countries, where transfer, convertibility, expropriation, bank regulatory, macroeconomic and security risks play a role. The incurred country risk is however limited through a high degree of diversification across regions and countries and a group exposure limit system defined within the Group Country Risk Management Policy. Furthermore, ProCredit Bank has years of experience in the local market and the business model has proven to be relatively resistant to macroeconomic and political shocks.

Liquidity Risk Management

Several factors inherent to the bank's business model offset liquidity risk. Firstly, the bank's diversified, high quality portfolio of loans means that incoming cash flows are highly predictable. Secondly, our customer deposits are spread across a large number of depositors each holding relatively small amounts. As of December 2011 the average balance in deposit accounts was EUR 1,282, and the ten largest depositors made up only 12.2% of total deposit volume.

To determine the robustness of the bank's liquidity in the face of potential shocks, the bank performs regular stress tests based on scenarios defined as a group standard by the Group Liquidity Risk Management Policy. In light of the 2011 sovereign debt crisis, the assumptions on which the stress tests are based were challenged and the calculation and targets of the group liquidity reserve were revised. If negative gaps are found in the first time bucket, contingency plans are promptly discussed and approved by the ALCO. Whenever necessary to bridge liquidity shortages, ProCredit Bank Bosnia and Herzegovina, like the other group banks, is able to obtain short-term funding from ProCredit Holding.

Currency Risk Management

ProCredit Bank Bosnia and Herzegovina has a low level of exposure to currency risk because it does not enter into speculative open currency positions, nor does it engage in derivative transactions except for hedging and liquidity purposes. Management of risk in this area is limited to protecting the institution from adverse movements in exchange and interest rates. Currency risk is managed in accordance with the Group Foreign Currency Risk Management Policy and local regulations. The bank continuously monitors exchange rate movements and foreign currency markets, and manages its currency positions on a daily basis. Any exceptions to the group policy or violations of group limits are subject to approval by the Group ALCO.

The bank's ALCO continuously monitors exchange rate movements and foreign currency markets, and determines its currency positions on a daily basis. Based on the department's reports, the bank's ALCO takes strategic currency decisions. Stress tests are regularly carried out to assess the impact of exchange rate movements on open currency positions (OCP) in each operating currency.

The Group Foreign Currency Risk Management Policy allows ProCredit banks to hold strategic open currency positions for the purpose of hedging equity, in which case these positions are closely monitored at both local and group level. As of year-end, the bank had an OCP of 17.7% (long position). In order to comply with the requirements of the Federal Banking Agency, strategic long positions were approved as a hedging instrument against the depreciation of the local currency, although this was not deemed to be a significant risk in 2011, especially bearing in mind that the Bosnia and Herzegovina convertible mark is pegged to the euro.

Interest Rate Risk Management

During 2011 interest rates exhibited a stable trend. Maturity gap analysis and stress testing are used to measure and analyse the impact of interest rate shifts on the economic value and interest income. As a policy measure to mitigate interest rate risk, ProCredit Bank attracts long-term fixed rate funding and offers loans with variable interest rates, allowing the bank to raise (or lower) the rates it charges in line with shifts in the market interest rates. In 2011 the bank achieved its goal of matching repricing profiles between assets and liabilities.

Operational Risk Management

The operational risk policy of ProCredit Bank Bosnia and Herzegovina is in full compliance with local regulations as well as with the Group Operational Risk Policy and the Group Fraud Prevention Policy. To minimise operational risk and the risk of fraud, all processes are precisely documented and subject to effective control mechanisms. Job descriptions are comprehensive, duties are strictly segregated, and dependency on key individuals is avoided. When recruiting, the bank pays close attention to personal integrity, a quality which is reinforced through the bank's strictly enforced code of conduct and through comprehensive training programmes designed to promote a culture of transparency and risk-awareness.

The group-wide Risk Event Database (RED) ensures that operational and fraud risks are addressed in a systematic and transparent manner, with all remedial and preventive action clearly documented and accessible to management control, both at bank level and at group level. Staff are required to report all events which represent an actual or potential loss exceeding EUR 100 using the RED interface. Those reported events that entail the most extensive risks, or which are considered most likely to be repeated, are subjected to in-depth analysis by the Operational Risk Committee, which then proposes appropriate preventive measures.

As part of their initial training, all new staff members are taught how to recognise and avoid operational and fraud risk and how to maintain information security. In 2011, ProCredit Bank Bosnia and Herzegovina reported 80 risk events representing a total net risk amount of EUR 18,570. The main types of reported events included an outage of the core banking application, damage to one of the bank's vehicles, incorrect execution of an international payment, cash shortage in the vault, and card-related fraud.

Every year the bank conducts a risk assessment procedure by completing a group-wide questionnaire on fraud risk and operational risk. Each of the risks described here must be mitigated by appropriate controls, the adequacy of which is the subject of the assessment. If the controls are judged to be insufficient, an action plan for remedying the situation is drawn up. The completed assessment is sent to the Group Operational Risk Management Department.

A group-wide New Risk Approval (NRA) process is applied to all materially new or changed products, services or business processes. Only after the elimination of any obstacles or deficiencies revealed by the NRA process does management give its approval for the innovation to go ahead.

The bank's Business Continuity Policy ensures that the bank can maintain or restore its operations in a timely manner in the event of a serious disruption. As well as defining the steps to be taken to restore normal operations, the bank's Business Continuity Plan specifies the procedure for moving critical operations to temporary locations, the resources that need to be mobilised in each type of case and the expected cost of disruptions in specific areas. It also offers guidance on avoiding disruption in the first place.

Anti-Money Laundering

ProCredit Bank Bosnia and Herzegovina fully endorses the fight against money laundering and terrorist financing, and has implemented the Group Anti-Money Laundering Policy, which meets the requirements of German and EU legislation as well as the stipulations of the Bosnia and Herzegovina authorities. This has been ensured through a programme of written policies, procedures and instructions; compliance with the measures is overseen by the designated Anti-Money Laundering Officer (AMLO). In addition, AML training is provided to relevant employees. Independent auditors verify the implementation of the adopted programme. The Group Anti-Money Laundering Department (Group AML) conducts an annual risk assessment of all ProCredit banks and updates the group policy accordingly.

At ProCredit Bank Bosnia and Herzegovina, responsibility for AML activities is exercised by the AML Department, an independent department that reports directly to the Management Board. An additional automated safeguard is provided by the use of two modules of the AML software manufactured by Tonbeller AG: Siron Embargo and Siron PEP, which contain all internationally relevant embargo and sanction lists. In addition, any attempt to execute a transaction that arouses suspicion of money laundering, terrorist financing or some other criminal activity must be reported to the authorities. No customer is accepted and no transaction is executed unless the bank understands and agrees to the underlying purpose of the business relationship. According to local regulations, any cash transaction exceeding BAM 30,000 must be reported to the local authorities. Front-office staff receive intensive training in how to recognise suspicious transactions.

Capital Adequacy

The bank's capital adequacy is calculated on a monthly basis and reported both to the management and to the Group Risk Management Committee, together with rolling forecasts to ensure future compliance with capital adequacy requirements. Strong support from our shareholders once again enabled the bank to maintain a comfortable capital cushion. In June 2011 there was a EUR 2 million increase in paid-in capital. At year-end 2011 the capital adequacy ratio (tier 1 and tier 2 capital / risk-weighted assets) stood at 17.20%, well above the group-wide minimum standard of 12%, which is also the locally required minimum. ProCredit Bank's overall risk rating, issued by FitchRatings, remained unchanged in 2011 at B.

Branch Network

At the end of 2011, ProCredit Bank Bosnia and Herzegovina had a total of 25 offices located in 16 different towns and cities, thus providing country-wide coverage. The network is organised into five regions.

The structure of our branch network is designed to enable us to be close to our customers and respond in a differentiated manner to their needs. Our enterprise lending business is concentrated in a number of specialised branches, where the majority of our business client advisers and credit analysts are based. These branches provide not only credit but also all of the bank's other services for business clients and private individuals, including various types of account services, foreign exchange, money transfers and utilities payments.

In addition to these full-scale branches, the bank also operates smaller service points in strategic, often densely populated neighbourhoods. The service points are designed to be convenient places for both private clients and business clients to do their day-to-day retail banking business, but do not process loan applications. Potential borrowers may submit their applications at a service point, if it is more convenient to do so, but the actual credit analysis and approval takes place at the nearest full-fledged branch.

At the other end of the scale, the bank operates a small number of business centres, which are specifically oriented towards serving the more complex needs of our larger-scale business clients, i.e. up to medium-sized enterprises. These specialised branches are located in the capital, Sarajevo, and in the regional centres Banja Luka, Mostar, Bijeljina and Tuzla.

Five of the bank's branches in three different regions focus their efforts on serving agricultural businesses and have built up a sizeable farming clientele.

The interior design of the branches is geared to maximising customer convenience. Our business clients are directed to separate areas, where they can receive information about banking services

tailored to their needs as well as professional advice from our experts; rooms for confidential negotiations have also been created where appropriate. At the same time, we have introduced a "one-stop" system that allows customers to perform cash and non-cash transactions at a single front office desk. This streamlined service is available at all of our branches.

In order to increase the outreach and efficiency of our branch network, we have introduced various innovative technologies and we encourage our customers to make active use of our technology-based services, particularly in connection with payments, such as e-banking via the Internet. In enabling clients to perform their routine banking transactions from other locations and outside normal banking hours, we not only make life more convenient for them, but are also able to devote more time to talking to them in person at the branches about more complex facilities, such as long-term savings options or company payroll services.

Among our most popular technology-based services are the VISA debit cards, which both business clients and private individuals can use to withdraw cash at any of our 39 ATMs, or to make cashless purchases using POS terminals operated by local merchants, many of whom are themselves customers of ProCredit Bank Bosnia and Herzegovina.

In 2012 we plan to direct our efforts towards creating new services aimed at the SME sector, continuing to offer convenient and efficient payment services. ProCredit Bank will further improve its credit and debit card offer for businesses, increasing the variety of card types and reducing the issuing time. We will also continue to promote technology-based services and train our clients to use them, with the goal of improving availability and efficiency of service delivery. In addition, we shall work towards completing the redesign of our branches so as to create an even more comfortable, pleasant and convenient environment for our customers.

Organisation, Staff and Staff Development

ProCredit Bank is aware that the quality of our relationship with our customers and the quality of service we provide to them depend crucially on the ability of our staff to understand their needs and respond to them in a responsible manner. For this reason, the bank takes great care to ensure that the people we hire identify wholeheartedly with its mission, and are dedicated to developing the skills they need in order to serve our clients well.

Recruitment is overseen by the Personnel Committee, which includes members of the bank's management. It is co-ordinated on a centralised basis by the HR department, following a carefully designed procedure. In line with the ProCredit group's recruitment policy, all shortlisted applicants are now invited to take a "maths and logic" test, which is set by ProCredit Holding. While these technical skills are obviously necessary, they are not sufficient criteria in themselves. More importantly, the bank seeks candidates who are intrinsically motivated to work for an ethical, development-oriented financial institution, and for whom the beneficial impact of their work on the society in which they live is more important than personal financial gain. In order to assess candidates' interpersonal skills and above all their potential commitment to ProCredit's objectives and principles, they are invited to take part in group discussions, followed by individual in-depth interviews with senior staff.

For university graduates and individuals with practical working experience who are interested in finding out whether a career with ProCredit is right for them, the bank has set up the "Young Bankers Programme". For the duration of this six-month course, which covers maths, basic accounting and various banking-specific subjects as well as soft skills, participants receive a stipend. It is a unique opportunity both for them and for the bank to gauge whether their aptitudes and personal qualities fit in well with the special "ProCredit way of working". The Young Bankers Programme was launched in September 2011 with an initial intake of 19 university graduates.

Given the importance of human resources for the future of the bank, highly qualified people have been chosen to serve as the head of the HR department and as employees of its three sub-units – Recruitment, Training and Development, and Administration. Aside from the Young Bankers Programme, the Training and Development unit organises ongoing training to advance the professional and personal development of the staff. During the year, our employees participated in a total of 251 internal training days, not including attendance at the international ProCredit Academies.

Continuing the group-wide initiative to raise the level of mathematical knowledge among its staff, in 2011 ProCredit Bank's training activities focused on advanced financial mathematics and accounting. During the year, 250 of the bank's employees reached the ProCredit group's "Maths 2" standard (financial mathematics), while another 280 successfully completed the group-wide Basic Accounting course.

A large proportion of the training provided to current and potential middle managers takes place outside Bosnia and Herzegovina at the international ProCredit Academies. In 2011, ten colleagues from ProCredit Bank Bosnia and Herzegovina graduated from the ProCredit Regional Academy for Eastern Europe in Veles, Macedonia, while another two completed the first year of their two-year course.

The bank's organisational structure is designed to support the building of long-term customer relationships. At head office level, the Small and Medium Business Sector is devoted to handling all of the banking needs specific to business customers, while the Retail Sector focuses on serving employees of our business clients, as well as very small companies and agricultural producers.

The internal organisation of the branches reflects this customer orientation. Business Client Advisers at the branches are responsible for advising Small and Very Small enterprises on all of the bank's services and for acquiring new customers, while the function of Credit Analysts is to evaluate applications for credit services submitted by comparatively large, complex business clients. To handle transactions, the new front office position of Banking Officer was introduced to serve as a single point of contact for clients, enabling them to carry out day-to-day payment operations quickly and efficiently.

Given the bank's continued focus on consolidation and quality in 2011, recruitment of new personnel took place on a relatively limited scale. Nonetheless, 45 people joined the bank in 2011, bringing the total at year-end to 425 (including support staff).

ProCredit Bank Bosnia and Herzegovina understands that the key to providing high quality service lies in building a team of motivated, professionally competent staff who are jointly committed to the bank's mission and objectives, and who work well together on the basis of mutual trust and respect.

Business Ethics and Environmental Standards

Business Ethics

Part of the overall mission of the ProCredit group is to set standards in the financial sectors in which we operate. We want to make a difference not only in terms of the target groups we serve and the quality of the financial services we provide, but also with regard to business ethics. Our strong **corporate values** play a key role in this respect. Six essential principles guide the operations of the ProCredit institutions:

- **Transparency**: We provide transparent information to our customers, to the general public and to our employees. For example, we ensure that customers fully understand the terms of the contracts they conclude with us, and we engage in financial education in order to raise public awareness of the dangers of intransparent financial offers.
- **A culture of open communication**: We are open, fair and constructive in our communication with each other, and deal with conflicts at work in a professional manner, working together to find solutions.
- **Social responsibility and tolerance**: We offer our clients sound, well founded advice. Before offering loans to our clients, we assess their economic and financial situation, their business potential and their repayment capacity. On this basis we help them to choose appropriate loan options from which they can genuinely benefit, and to avoid becoming overindebted. Promoting a savings culture is another important part of our mission, as we believe that private savings play an especially crucial role in societies with relatively low levels of publicly funded social welfare provision. And we are committed to treating all customers and employees with fairness and respect, regardless

of their origin, colour, language, gender or religious or political beliefs.

- **Service orientation**: Every client is served in a friendly, competent and courteous manner. Our employees are committed to providing excellent service to all customers, regardless of their background or the size of their business.
- **High professional standards**: Our employees take personal responsibility for the quality of their work and always strive to grow as professionals.
- **A high degree of personal integrity and commitment**: Complete honesty is required of all employees in the ProCredit group at all times, and any breaches of this principle are dealt with swiftly and rigorously.

These six values represent the backbone of our corporate culture and are discussed and actively applied in our day-to-day operations. Moreover, they are reflected in the ProCredit Code of Conduct, which transforms the group's ethical principles into practical guidelines for all staff. To make sure that new employees fully understand all of the principles that have been defined, induction training includes sessions dedicated to the Code of Conduct and its significance for all members of our team. Regular refresher training sessions help to ensure that employees remain committed to our high ethical standards and are kept abreast of new issues and developments which have an ethical dimension for our institution. These events allow existing staff to analyse recent case studies and discuss any grey areas.

We also ensure that requests for loans are evaluated in terms of the applicant's compliance with ethical business practices. No loans are issued to enterprises or individuals if it is suspected that they are making use of unsafe or morally objectionable forms of labour, in particular child labour.

Another aspect of ensuring that our institution adheres to the highest ethical standards is our consistent application of best practice systems and procedures to protect ourselves from being used as a vehicle for money laundering, the financing of terrorism or other illegal activities. Staff members are trained to apply the "know your customer" principle, and to carry out sound monitoring and reporting in line with the applicable regulations. Anti-money laundering and fraud prevention policies are regularly updated and exercised throughout the group to ensure compliance with local and international regulatory standards.

Environmental Standards

All of the banks belonging to the ProCredit group set high standards regarding the impact of their operations on the environment. ProCredit banks take a three-pronged approach to environmental challenges:

Pillar 1:
Internal environmental management system

ProCredit Bank Bosnia and Herzegovina is putting in place an approach to better understand and improve the sustainability of its own energy use and environmental impact. Environmental issues are an essential component of the training provided to ProCredit Bank staff at the local, regional and international level. In addition, there have been special green initiatives to raise environmental awareness among staff, such as a series of educational brochures on saving energy, water and paper, as well as signs reminding staff to turn off lights and equipment when not in use.

Pillar 2:
Management of environmental risk in lending

ProCredit Bank Bosnia and Herzegovina has implemented an environmental management system based on continuous assessment of the loan portfolio according to environmental criteria, an in-depth analysis of all economic activities which potentially involve environmental risks, and the rejection of loan applications from enterprises en-

gaged in activities which are deemed environmentally hazardous and appear on our institution's exclusion list. By incorporating environmental issues into the loan approval process, ProCredit Bank Bosnia and Herzegovina is also able to raise its clients' overall level of environmental awareness.

Pillar 3:
Promotion of "green finance"

ProCredit Bank Bosnia and Herzegovina aims to promote economic development that is as environmentally sustainable as possible. In May 2011, we launched a programme of green finance products consisting of energy efficiency loans for private individuals as well as for businesses. This initiative has also involved building relationships with suppliers of environmentally friendly equipment and services, and encouraging them to offer products bearing the EU standard energy efficiency labels. The bank aims to use its green finance products and approach to increase public awareness and understanding of environmental issues in Bosnia and Herzegovina.

The ProCredit Group: Responsible Neighbourhood Banks for Small Businesses and Ordinary People

The ProCredit group comprises 21 financial institutions providing banking services in transition economies and developing countries. ProCredit banks are responsible neighbourhood banks. This means, in the neighbourhoods in which we work, we aim to:

- be the house bank of choice for the very small, small and medium-sized enterprises which create jobs and drive economic development, and
- provide secure, fair and transparent savings and banking services to ordinary people who are looking for an affordable bank they can trust.

At the end of 2011 our 16,183 employees, working in some 775 branches, were serving 2.9 million customers in Eastern Europe, Latin America and Africa.

The history of the ProCredit group is a rich one and forms the basis of what we are today. The first ProCredit banks were founded more than a decade ago with the aim of making a development impact by providing loans to help small business to grow and offering deposit facilities that would encourage lower-income individuals and families to save. The group has grown strongly over the years, and today we are one of the leading providers of banking services to small business clients in most of the countries in which we operate.

Our origins lie in our pioneering microfinance positioning. This positioning has developed as our markets and our clients have developed so our socially responsible approach remains as relevant today as ever. Its importance has been underscored by the financial crisis and subsequent macroeconomic decline which most of our countries of operation experienced. As enterprises adjust to and expand again in their new economic reality and ordinary people rebuild their trust in banks, it is clear that our customers need a reliable banking partner now more than ever. This has also given us the impetus to further strengthen our comprehensive customer-oriented approach with more highly specialised and well trained staff.

Unlike most other banks operating in our markets, we have always avoided aggressive consumer lending and speculative lines of business. Instead, the ProCredit banks work in close contact with their clients to gain a full understanding of the problems and opportunities of small businesses. Our credit technology, developed over many years with the support of the German consulting company IPC, relies on the careful individual analysis of credit risks. By making the effort to know our clients well and maintain long-term relationships based on trust and understanding, we are able to support them not only when the economy is buoyant, but also during a downturn and recovery. Over the last two years, the ability of our business client advisers to proactively make appropriate adaptations to payment plans where necessary to reflect clients' new and more challenging sales environments has played an important role in maintaining good loan portfolio quality. This is in contrast to many of the markets in which we operate where Non Performing Loan portfolios have been very high, also in the SME sector, which suggests that bank behaviour has in many cases increased the risk of bankruptcy rather than help businesses emerge more strongly from the economic shock.

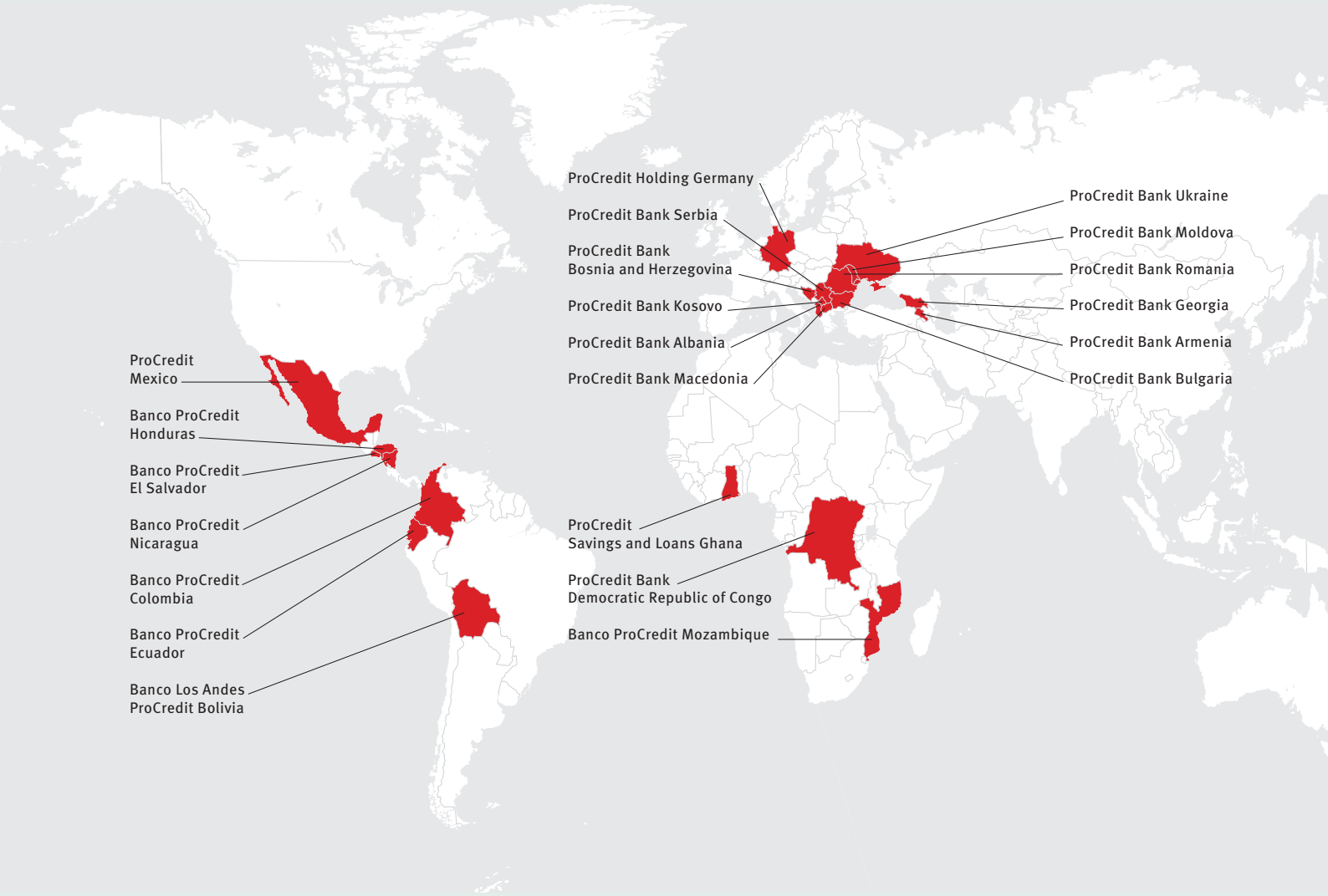
We not only extend loans, but also offer our enterprise clients a broad range of other banking services such as cash management, domestic and international money transfers, payroll services, POS terminals and payment and credit cards. Using our rigorous approach to financial analysis, we promote, in so far as we can, financial education and enhanced financial record keeping amongst our clients. These services are geared towards assisting our business clients to operate more efficiently and more formally and thus help to strengthen the real economy and the banking sector as a whole. In these terms ProCredit has a "whole customer" service orientation rather than a "product selling" approach. Our staff and our branches are becoming more specialised and better equipped to cater to the needs of different client categories.

Today we have less of a focus on "micro-micro loans" than we did in the past. The minimum loan size for enterprise clients is EUR/USD 2,000 in most countries since we found that below this limit there is such broad access to loans from consumer finance providers that "excess" had become more of a challenge for many clients than "access". For these groups we prefer to offer deposit accounts and other banking services rather than credit.

We would judge our development impact not just by the number of loans disbursed, but also by the sustainability of the enterprises we work with – in economic, social and environmental terms; by the stability and quality of the income that associated families and employees enjoy; by the reduction of household vulnerability because people save; by the calibre of our staff; and by the impact we have in promoting transparent financial institutions more widely.

Our targeted efforts to foster a savings culture in our countries of operation have enabled us to build a stable deposit base. ProCredit deposit facilities are appropriate for a broad range of lower- and middle-income customers. We place particular emphasis on working with the owners, employees and families associated with our core target group of very small, small and medium-sized businesses. ProCredit banks offer simple savings accounts and place great emphasis on promoting financial literacy in the broader community. In addition to deposit facilities, we offer our clients a full range of standard retail banking services. Over 2011 ProCredit institutions managed to maintain a high level of liquidity given the stability of their loyal retail deposit base.

The ProCredit group has a simple business model: providing banking services to a diverse range of enterprises and the ordinary people who live and work around our branches. As a result, our banks have a transparent, low-risk profile. We do not rely heavily on capital market funding and have



The international group of ProCredit institutions; see also www.procredit-holding.com

no exposure to complex financial products. Furthermore, our staff are well trained, flexible and able to provide competent advice to clients, guiding them through difficult times as well as good times. Despite the turmoil of the global financial markets, the performance of the ProCredit group has been remarkably stable: we ended 2011 with a good liquidity position, comfortable capital adequacy, PAR over 30 days of 3.8%, and a Return on Equity of 10.4%. Given the depressed macroeconomic situation in many of our countries of operation, this was a strong performance.

Our shareholders have always taken a conservative, long-term view of business development, aiming to strike the right balance between a shared developmental goal – reaching as many small enterprises and small savers as possible – and achieving commercial success.

Strong shareholders provide a solid foundation for the ProCredit group. It is led by ProCredit Holding AG & Co. KGaA, a German-based company that was founded by IPC in 1998. ProCredit Holding is a public-private partnership. The private shareholders include: IPC and IPC Invest, an investment vehicle for ProCredit staff members; the Dutch DOEN Foundation; the US pension fund TIAA-CREF; the US Omidyar-Tufts Microfinance Fund; and the Swiss investment fund responsAbility. The public shareholders include the German KfW Bankengruppe (KfW banking group); IFC, the private sector arm of the World Bank; the Dutch development bank FMO; the Belgian Investment Company for Developing Countries (BIO); and Proparco, the French Investment and Promotions Company for Economic Co-operation. The group also receives strong support from the EBRD and Commerzbank, our minority shareholders in Eastern Europe, and from the Inter-American Development Bank (IDB) in Latin America. With the strong support of its shareholders and other partners, the ProCredit group ended the year with a total capital adequacy ratio of 15% – a figure that reflects their confidence in the group.

ProCredit Holding is not only a source of equity for its subsidiaries, but also a guide for the development of the ProCredit banks, providing the personnel for their senior management and offering support in all key areas of activity. The holding company ensures the implementation of ProCredit corporate values, best practice banking operations and Basel II risk management principles across the group. The group's business is run in accordance with the rigorous regulatory standards imposed by the German banking supervisory authority (BaFin).

ProCredit Holding and the ProCredit group place a strong emphasis on human resource management. Our "ethical neighbourhood bank" concept is not limited to our target customers and how we reach them; it above all concerns the way in which

we work with our staff and how we encourage them to work with their customers. The strength of our relationships with our customers will continue to be central to working with them effectively in 2012 and achieving steady business results. In 2011 there was a strong focus on staff quality, recruitment and training. The 6-month Young Banker stipend programme, which all ProCredit banks offer to all potential new recruits, continues to develop. This symbolises our commitment to skill development in all our countries of operation.

A responsible approach to neighbourhood banking requires decentralised decision-making and a high level of judgment and adaptability from all staff members, especially our branch managers. Our corporate values embed principles such as open communication, transparency and professionalism into our day-to-day business. Key to our success is therefore the recruitment and training of dedicated staff. We maintain a corporate culture that promotes the professional development of our employees while fostering a deep sense of personal and social responsibility.

A central plank in our approach to training is the ProCredit Academy in Germany, which provides an intensive part-time training programme over a period of three years for high-potential staff from each of the ProCredit institutions. The curriculum includes technical training and also exposes participants to subjects such as anthropology, history, philosophy and ethics in an open and multicultural learning environment. Our goal in covering such varied topics is to give our future managers the opportunity to develop their knowledge and views of the world. At the same time, we aim to improve their communication and staff management skills. The group also operates two Regional Academies in Latin America (Colombia) and in Eastern Europe (for our African and Eastern European colleagues) to support the professional development of middle managers at the local level.

The group's strategy for 2012 is to consolidate the tremendous efforts we have made over the last two years to strengthen our institutions and our client relationships. We will further expand our business as the "house bank" of choice for small and very small enterprises, offering tailored loans and other banking services. At the same time we will continue to improve the speed and convenience of our services for all clients.

2012 will also be the year that we begin operations at our planned ProCredit Bank in Germany and bring the group under the supervision of the German Federal supervising authorities (BaFin, the Bundesanstalt für Finanzdienstleistungsaufsicht, and the Bundesbank). The group is well prepared, having overhauled its reporting and risk management systems to bring all institutions into line with the requirements of German banking regulations (KWG). Nevertheless full implementation will require our attention.

Strong investment in our staff remains the key priority. Together we look forward to further strengthening the development impact and commercial success of the group.

ProCredit in Eastern Europe

ProCredit banks operate in 11 countries across Eastern Europe. As a leading provider of banking services to very small, small and medium-sized businesses, we position ourselves as the "house bank for small business" in the region. ProCredit banks provide a high standard of transparent, professional services to all their clients – the ordinary people who live and work in the vicinity of the 475 ProCredit branches across the region.

The macroeconomic environment continued to be challenging in 2011 for most of the South Eastern and Eastern European countries in which ProCredit works, particularly in the last quarter of 2011 in the wake of deep uncertainty about the economic future of Greece and the euro zone. There was little GDP or banking sector growth in most Balkan countries in South Eastern Europe. Only in Serbia and Albania did banking sectors grow by more than 5%. The countries further east (Armenia, Georgia, Moldova and Ukraine) experienced more steady GDP growth of 4-5%, with growth in the banking sector in Georgia being notably strong. Non-performing loans (NPLs, i.e. loans more than 90 days overdue) of banking sectors were also persistently high, at well over 10% in most markets where ProCredit operates. Many Western bank groups were reducing risk-weighted assets in the region with more stringent central capital adequacy requirements. Generally, government spending remained tight, consumer confidence low and investment activity by the small and medium enterprise sector depressed in 2011. Prospects for 2012 are similar since there is unlikely to be an economic turnaround in the euro zone which could drive growth in the region. The role of ProCredit banks against this still vulnerable economic backdrop is a valuable one as our clients and the financial markets in which we operate adjust to the new economic reality in the region.

For the financial sectors in which we work, ProCredit banks have represented consistency, good risk management and a high degree of financial transparency throughout the recent unsettled years. ProCredit banks have been notable in continuing to lend steadily and responsibly to support small businesses while banking sectors as a whole have tended to be erratic.

For our business clients, ProCredit banks remain a reliable and responsible partner. We specialise in working with very small, small and medium enterprises, because these clients are central to developing the economy and employment opportunities. Our approach is based on building relationships with our clients and a thorough understanding of their business.

In the current climate, we support our business clients with prudent business development and efficient cash management. Given the overall weak investment climate in 2011, we put particular emphasis on efficient working capital facilities in the form of credit lines and overdrafts. We work with each client to identify their credit capacity based on their ability to repay their debt even in volatile times.

The outstanding loan portfolio of the 11 ProCredit banks in Eastern Europe stood at EUR 2.9 billion at the end of 2011 (an increase of 7.2% from the end of 2010). Growth was particularly strong in our core "Small Business" client category (defined as business clients with a credit capacity of EUR 30,000-150,000) which grew by 14.1% in 2011. We have approximately 321,000 business clients in total across the region. ProCredit staff have been proactive in acquiring new clients and serving existing clients. Our lending activities aim to foster local production and service industries, and include the provision of agricultural loans. We are keen to support a sector that has been particularly neglected by other banks and that is vital for employment and social cohesion outside the main urban areas.

For clients facing difficulties we support businesses to restructure to avoid bankruptcy where appropriate. Given our thorough understanding of our clients' businesses, we are able, where necessary, to adapt loan repayment schedules if the sales pattern of a business has changed significantly. This has meant that arrears and write-off figures for the ProCredit banks in Eastern Europe are low relative to banking sectors as a whole. The combined portfolio at risk (PAR) ›30 days for the Eastern European institutions as a percentage of their loan portfolio was 4.2% at the end of 2011 (PAR›90 days stood at 3.1%). Write-offs for the group in the region amounted to 1.4% of the loan portfolio. In these terms ProCredit continues to demonstrate that with a responsible approach to lending, based on an assessment of the real situ-

ation of an enterprise, a high degree of financial stability can be achieved for clients and in bank performance.

ProCredit banks have also had to strengthen their structures for the recovery of written-off and non-performing loans, however. The weaknesses of the legal system in many countries in the region in supporting banks to realise registered collateral have become very apparent since the financial crisis. The ultimate success and timeliness of recovery efforts will be an important factor in determining banks' willingness to expand SME finance in the future.

For our private clients, ProCredit banks have also been a symbol of stability and transparency in turbulent years. ProCredit has focused for many years on promoting a savings culture because setting money aside can help clients build a buffer against the vagaries of life. The ratio of deposits to GDP in Eastern European countries is still well below Western European levels.

We offer simple and reliable retail banking services. Our belief in transparent, direct communication is particularly important in fostering clients' trust. We understand that our clients want to know in simple language how to save safely; they also want to access their money when they need it and they want access to convenient and efficient transaction services. Our experience confirms that customers appreciate the transparent, responsible approach we take.

ProCredit banks fund most of their lending activities with local savings. The ratio of deposits to loans in the ProCredit banks in the region is 84%. Not only did we not have to rely on unpredictable capital markets for funds in 2011, but ProCredit banks in the region remained highly liquid throughout the year and our cost of funds declined.

Looking forward, in addition to the savings services they provide, ProCredit banks will continue to be conservative with consumer loans for their

private clients, but will expand their provision of convenient banking services, such as e-banking and direct debit, and will continue to provide responsible housing improvement, energy efficiency and other loans which help build a family's assets.

For our staff, ProCredit banks offer unique opportunities for professional development and job satisfaction given our strong client orientation, open communication culture and unusual commitment to staff training. In terms of institution building activities, ProCredit banks in Eastern Europe were focused on consolidating many of the measures introduced in 2010 to improve the quality and efficiency of our services.

Our staff is the key element in our approach to being a stable, down-to-earth and personal banking partner. The ProCredit group invests heavily to achieve high standards in staff recruitment and development. The six-month "Young Banker" stipend programme introduced by all ProCredit banks in the region is fast becoming a well-known and innovative feature of bank recruitment in many countries, with its strong emphasis not just on a broad-based technical training, but also on individual ethics and the responsibilities of a banking sector to promote sustainable economic development.

To complement the international ProCredit Academy in Germany, we have an Eastern European academy, located near Skopje in Macedonia, which is dedicated to the training of ProCredit middle managers. The regional academy is an important channel for rapid and consistent communication region-wide and one that helps us adapt quickly to face new challenges. Investment in our staff is an ongoing commitment and will remain a central plank in the ProCredit Bank approach. A qualified, motivated and professional team lies at the root of our lasting success across Eastern Europe.

Name	Highlights*	Contact
ProCredit Bank Albania	Founded in October 1998 40 branches 24,658 loans / EUR 178 million in loans 180,000 deposit accounts / EUR 232 million 635 employees	Legal address: Rr. "Dritan Hoxha". Nd. 92, H.15, Njësia Bashkiake Nr. 11, Tirana P.O. Box 1026 Tel./Fax: +355 4 2 389 300 / 22 33 918 info@procreditbank.com.al www.procreditbank.com.al
ProCredit Bank Armenia	Founded in December 2007 11 branches 5,613 loans / EUR 48 million in loans 20,733 deposit accounts / EUR 22 million 284 employees	105/1 Teryan St., area 11 0009 Yerevan Tel./Fax: + 374 10 514 860 / 853 info@procreditbank.am www.procreditbank.am
ProCredit Bank Bosnia and Herzegovina	Founded in October 1997 30 branches 17,427 loans / EUR 126 million in loans 82,722 deposit accounts / EUR 108 million 425 employees	8 Emerika Bluma 71000 Sarajevo Tel./Fax: +387 33 250 950 / 971 info@procreditbank.ba www.procreditbank.ba
ProCredit Bank Bulgaria	Founded in October 2001 83 branches 33,337 loans / EUR 586 million in loans 217,586 deposit accounts / EUR 437 million 1,391 employees	26 Todor Aleksandrov Blvd. 1303 Sofia Tel./Fax: +359 2 813 5100 / 5110 contact@procreditbank.bg www.procreditbank.bg
ProCredit Bank Georgia	Founded in May 1999 61 branches 43,968 loans / EUR 316 million in loans 435,440 deposit accounts / EUR 238 million 1,525 employees	154 D. Agmashenebeli Ave. 0112 Tbilisi Tel./Fax: +995 32 220 22 22 / 220 22 23 info@procreditbank.ge www.procreditbank.ge
ProCredit Bank Kosovo	Founded in January 2000 63 branches 85,656 loans / EUR 517 million in loans 426,851 deposit accounts / EUR 664 million 1,071 employees	16 "Mother Tereze" Boulevard 10000 Prishtina Tel./Fax: +381 38 555 777 / 248 777 info@procreditbank-kos.com www.procreditbank-kos.com
ProCredit Bank Macedonia	Founded in July 2003 35 branches 22,796 loans / EUR 164 million in loans 108,797 deposit accounts / EUR 144 million 461 employees	109a Jane Sandanski Blvd. 1000 Skopje Tel./Fax: +389 2 321 99 00 / 01 info@procreditbank.com.mk www.procreditbank.com.mk
ProCredit Bank Moldova**	Founded in December 2007 23 branches 11,177 loans / EUR 90 million in loans 45,831 deposit accounts / EUR 33 million 540 employees	65 Stefan cel Mare Ave. office 901, Chisinau Tel./Fax: +373 22 836 555 / 273 488 office@procreditbank.md www.procreditbank.md
ProCredit Bank Romania	Founded in May 2002 28 branches 24,541 loans / EUR 192 million in loans 111,314 deposit accounts / EUR 159 million 783 employees	62-64 Buzesti St., Sector 1 011017 Bucharest Tel./Fax: +40 21 201 6000 / 305 5663 headoffice@procreditbank.ro www.procreditbank.ro
ProCredit Bank Serbia	Founded in April 2001 62 branches 79,403 loans / EUR 532 million in loans 282,248 deposit accounts / EUR 274 million 1,315 employees	17 Milutina Milankovica 11070 Belgrade Tel./Fax: +381 11 20 77 906 / 905 info@procreditbank.rs www.procreditbank.rs
ProCredit Bank Ukraine	Founded in January 2001 40 branches 14,478 loans / EUR 176 million in loans 133,857 deposit accounts / EUR 147 million 1,337 employees	107a Peremohy Ave. 03115 Kyiv Tel./Fax: +380 44 590 10 00/01 info@procreditbank.com.ua www.procreditbank.com.ua

* The figures in this section have been compiled on the basis of the financial and operational reporting performed in accordance with group-wide standards; they may differ from the figures reported in the bank's local statements.

** Not including finance company ProCredit Moldova.

Our Clients

Senad Džaferović, Producer of Soft Drinks and Carbonated Beverages

Senad Džaferović, 50, a mechanical technician, founded Bondaryd.o.o. in 1998 and currently acts not only as its owner, but as its managing director as well. Bondary was the first domestic company in Bosnia and Herzegovina to produce soft drinks and carbonated beverages.

"I invested all my savings in this business idea and started production on small premises with three employees",

he recalls.

According to Senad, the beverage manufacturing process and the mixing of ingredients requires precision and balance. By co-operating with the best suppliers in the industry, he is able to ensure the superior quality of the water and ingredients used in the production of his beverages. Bondary currently produces 25 different kinds of soft drinks and carbonated beverages which are sold throughout the Sarajevo Canton.

Bondary first approached ProCredit Bank in 2005. Pleased with bank staff's flexibility and professionalism, he took out a loan for EUR 25,000 to buy land to build new production facilities. Since then, demand for his products has grown and his company currently supplies the largest domestic supermarket chain in Sarajevo.

"Our success resulted in the continuous expansion of our product range, as well as the acquisition of numerous new clients at the local level. I am truly pleased that I am now able to hire new employees. At the present time, we employ eight skilled workers."

Senad is currently in negotiations with the largest Slovenian supermarket chain in Sarajevo and hopes to soon begin supplying them with his products.

"This would truly be a milestone for my company,"
says Senad.

Senad takes advantage of ProCredit Bank's overdraft and payment transaction services in his business dealings. He particularly appreciates the staff's efforts to understand his business goals and needs.

"I plan to invest in an orchard and grow fruit that I can then use for my own production purposes. I am confident that ProCredit Bank will continue to support this and my future business endeavours."

Midhat Čehajić, Owner of Fining d.o.o., a Crane Production Company

Midhat Čehajić, 61, started Fining d.o.o. Gračanica in 2002, aiming to satisfy growing demand for cranes in the construction sector. Having previously worked for a company specialised in the sale of construction equipment and the delivery of cranes, he understood what was needed to be successful in the market.

In its infancy, the company consisted of only two employees occupying a rented space. Supported by effective marketing, which emphasised the high quality that would become their trademark, Fining continued to grow. Two years ago, the company moved to new premises, combining production facilities and offices, and today has 23 employees.

"To date, we have delivered more than 150 mobile lifting frames, not only within Bosnia and Herzegovina, but also to Croatia, Serbia, Montenegro and Albania,"
says Midhat.

Since 2009, Fining has been an authorised sales representative of the largest German crane production company, Demag Cranes.

"The goal of our successful partnership, known in the construction industry as Demag-Fining, is to offer the highest quality cranes available."

Midhat has been a client of ProCredit Bank since the beginning of 2011. He first became aware of the bank through a marketing campaign and decided to speak to a client adviser. Soon after, he was approved for a loan in the amount of BAM 200,000 that he used to purchase machines needed to facilitate production processes and further improve the quality of the output. In addition, he has a current account and takes advantage of ProB@nking and flat fee payment.

Midhat is particularly pleased with the efficiency and professionalism of ProCredit staff. In his opinion, it is important that he receive prompt professional advice when he needs it. He remains optimistic about his future plans. In 2012, Midhat plans to hire additional employees and expand his production facilities.

"Our goal is to become one of the leading companies for cranes in Bosnia and Herzegovina. I am confident that I can rely on ProCredit Bank for continued support."

Fahira Kubat, Owner and Director of a Sportswear Company

In 2005, after gathering 13 years of experience in the textile industry, Fahira Kubat, 39, decided to start Hasky Sport d.o.o, a sportswear company.

"My family encouraged me to start my own sportswear line," says Fahira. "I was hesitant at first because you really have to fight hard in this line of work."

And fight she did. In the beginning, the most difficult challenge she faced was competition from larger firms, as well as finding qualified employees and securing financing to expand her business. She started with only seven employees and a few orders, but her dedication and passion for her work helped her acquire new clients quickly. Fahira and her team have done a stellar job of expanding their sportswear collection to include t-shirts, skirts, shorts and track suits.

"We now produce clothing for sports teams throughout the country. We allow clients to participate in the design process, which really appeals to my customers and has helped me to build a strong relationship to them. This has positively impacted the growth of my business. Right now we employ 20 people."

She heard about ProCredit Bank in 2007 from a friend, and was impressed with the professional approach and friendliness of the staff. Soon after, she took out a loan for BAM 40,000 (just under EUR 20,000) which she used to buy additional machines and materials.

"I am pleased that ProCredit Bank approved my first loan and gave my business a boost. Without the financing we received, we simply wouldn't be where we are today."

Since then, Fahira has turned to ProCredit Bank for financing on several occasions. Her company also takes advantage of ProCredit's payment services, cards and e-banking.

In 2012, Fahira plans to expand her business premises and hire 15 more employees. Looking to the future, she knows she can rely on ProCredit Bank to provide the right advice and financial support when she needs it.

Sadrija Jasavić, Producer of Windows and Blinds

Sadrija Jasavić, 50, mechanical engineer and owner of Jasad.o.o, lives in Sarajevo with his wife Suzana and their 19 year-old daughter. After having spent 10 years in Germany, he found a job in Sarajevo working for a company that produced windows and blinds. As an employee of this company, he invested a great deal of energy working long hours for a low salary.

After a few years in which he gathered experience in the industry, his professional attitude, punctuality and dedication to his customers enabled him to build many strong client relationships. He therefore decided to invest his savings in a production company of his own in 2005. His clients naturally followed him. By having his own company, Sadrija significantly improved his family's standard of living while also providing employment for his wife, who currently acts as the company secretary.

Sadrija first visited ProCredit Bank after receiving a recommendation from his accountant. He was impressed by the very friendly yet professional service provided by the bank staff, as well as by the sound financial advice he received. This encouraged Sadrija to take out a loan with ProCredit Bank for EUR 35,000 to buy machinery and equipment to produce windows.

This technology significantly increased both the production rate and the quality of his company's output. Like many credit clients, he also uses a broad range of the bank's other services for his business, including a current account and payment facilities.

"I am glad that there is a bank catering to entrepreneurs that efficiently provides resources and financial advice,"

Sadrija says.

Although 2011 proved to be a very difficult year for the economy as a whole, Sadrija was pleased with his company's results and hopes to retain the same level of work in 2012.

"I don't plan on making significant investments this year; however, I will do my best to increase sales by maintaining the high quality of our products and the efficiency of our work."

Financial Statements

Financial Statements for the year ended 31 December 2011

Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements

The Management Board of the Bank is required to prepare financial statements of the Bank for each financial year which give a true and fair view of the financial position of the Bank and of the results of its operations and cash flows, in accordance with International Financial Reporting Standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and for then applying them consistently; for making judgements and estimates that are reasonable and prudent; and for preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements, following which the Supervisory Board is required to approve the annual financial statements for submission to the General Assembly of Shareholders for adoption.

The financial statements set out on pages 4 to 66 were authorised by the Management Board on 2 April 2012 for issue to the Supervisory Board and are signed below to signify this.

On behalf of ProCredit Bank d.d., Sarajevo:

Frieder Woehrmann
Director

Edina Vuk
Executive Director

pwc

Independent Auditor's report

To the Shareholders and Board of Directors of ProCredit Bank d.d. Sarajevo:

We have audited the accompanying financial statements of ProCredit Bank d.d. Sarajevo (the "Bank") which comprise the statement of financial position as of 31 December 2011 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, 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 thesefinancial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

PricewaterhouseCoopers

PricewaterhouseCoopers d.o.o. Sarajevo

PRICEWATERHOUSECOOPERS D.O.O. SARAJEVO

Selimović Alida

Alida Selimović, certified auditor

2 April 2012

PricewaterhouseCoopers d.o.o., Fra Andjela Zvizdovića 1, Tower B, 13th floor, 71000 Sarajevo, Bosnia and Herzegovina
T: +387 (0) 33 295 234, F: +387 (0) 33 295 235, www.pwc.com/ba

Statement of Comprehensive Income

For the year ended 31 December 2011

(all amounts are in BAM thousands, unless otherwise indicated)	Notes	2011	2010
Interest and similar income	6	26,937	27,673
Interest expense and similar charges	6	(9,526)	(10,626)
Net interest income		**17,411**	**17,047**
Net impairment release of provision	12	1,447	1,152
Net interest income after provision for impairment		**18,858**	**18,199**
Fee and commission income	7	5,268	5,265
Fee and commission expense	7	(1,177)	(1,098)
Foreign exchange gains	8	359	243
Other operating income	9	708	582
Personnel expenses	10	(11,648)	(14,244)
Depreciation and amortisation	17,18	(1,813)	(3,294)
Other operating expenses	11	(10,343)	(11,160)
Profit/(loss) before tax		**212**	**(5,507)**
Income tax benefit	13	239	275
Profit/(loss) for the year		**451**	**(5,232)**
Other comprehensive income		–	–
Total comprehensive income / (loss) for the year		**451**	**(5,232)**

The accompanying notes on pages 52 to 79 form an integral part of these financial statements.

Statement of Financial Position

For the year ended 31 December 2011

(all amounts are in BAM thousands, unless otherwise indicated)	Notes	At 31 Dec 2011	At 31 Dec 2010
Assets			
Cash and cash equivalents	14	41,390	44,157
Obligatory reserves with Central Bank	15	20,291	24,356
Loans and advances to customers	16	239,861	226,019
Financial assets available for sale		31	227
Deferred tax assets	19	2,050	1,811
Other assets	20	1,403	1,661
Property and equipment	17	4,785	5,401
Intangible assets	18	947	948
Total assets		**310,758**	**304,580**
Liabilities			
Deposits from customers	21	210,205	218,420
Borrowings	22	47,482	36,936
Other liabilities	25	1,012	1,653
Subordinated debt	23	16,079	16,085
Provisions	24	265	222
Total liabilities		**275,043**	**273,316**
Equity			
Share capital	26	46,458	42,458
Share premium		293	293
(Accumulated losses)		(11,036)	(11,487)
Total equity		**35,715**	**31,264**
Total liabilities and equity		**310,758**	**304,580**

The accompanying notes on pages 52 to 79 form an integral part of these financial statements.

Statement of Changes in Equity

For the year ended 31 December 2011

(all amounts are in BAM thousands, unless otherwise indicated)	Share capital	Share premium	Statutory reserve	Retained earnings	Total equity
Balance at 1 January 2011	42,458	293	–	(11,487)	31,264
Issue of share capital	4,000	–	–	–	4,000
Profit for the year	–	–	–	451	451
Appropriations from statutory reserve	–	–	–	–	–
Balance at 31 December 2011	**46,458**	**293**	–	**(11,036)**	**35,715**
Balance at 1 January 2010	40,458	293	1,633	(7,409)	34,975
Restatement for tax expense incorrectly calculated for prior periods (Note 2.5.)	–	–	–	(479)	(479)
Balance as at 1 January 2010 (restated)	**40,458**	**293**	**1,633**	**(7,888)**	**34,496**
Issue of share capital	2,000	–	–	–	2,000
Loss for the year	–	–	–	(5,232)	(5,232)
Appropriations from statutory reserve	–	–	(1,633)	1,633	–
Balance at 31 December 2010	**42,458**	**293**	–	**(11,487)**	**31,264**

The accompanying notes on pages 52 to 79 form an integral part of these financial statements.

Statement of Cash Flows

For the year ended 31 December 2011

(all amounts are in BAM thousands, unless otherwise indicated)	Note	Year ended 31 Dec 2011	Year ended 31 Dec 2010
Operating activities			
Profit / (loss) before tax		212	(5,507)
Adjustments:			
Depreciation and amortisation		1,813	3,294
Impairment release provisions	12	(1,447)	(1,152)
Changes in other provisions		43	(110)
Disposal of property and equipment		50	124
Cash flows from operating activities before changes in operating assets and liabilities		**671**	**(3,351)**
(Increase)/decrease in operating assets			
Obligatory reserve with Central Bank		4,065	2,335
Loans and advances to customers		(12,395)	(4,624)
Other assets		258	903
Increase/(decrease) in operating liabilities			
Deposits from customers		(8,215)	(24,307)
Other liabilities		(641)	206
Net cash used in operating activities		**(16,257)**	**(28,838)**
Investing activities			
Purchase of property and equipment		(862)	(792)
Purchase of intangible assets		(384)	(377)
Decrease of financial investments available for sale		196	–
Net cash outflow from investing activities		**(1,050)**	**(1,169)**
Financing activities			
Issued share capital		4,000	2,000
Proceeds from borrowings and subordinated debt		45,006	5,000
Repayments of borrowings and subordinated debt		(34,466)	(8,455)
Net cash inflow from financing activities		**14,540**	**(1,455)**
Net decrease in cash and cash equivalents		**(2,767)**	**(31,462)**
Cash and cash equivalents at 1 January		44,157	75,619
Cash and cash equivalents at 31 December	**14**	**41,390**	**44,157**

The accompanying notes on pages 52 to 79 form an integral part of these financial statements.

Notes to the Financial Statements

For the year ended 31 December 2011

(all amounts are in BAM thousands, unless otherwise indicated)

1. Reporting entity

ProCredit Bank d.d., Sarajevo (further "the Bank") is incorporated to perform all banking activities in accordance with the law. ProCredit Holding AG & Co. KGaA. is the parent company and ultimate controlling party of ProCredit Bank d.d. Sarajevo (head office: Sarajevo, address: Emerika Bluma 8, Bosnia and Herzegovina).
The Bank has been registered as a joint stock company domiciled in Bosnia and Herzegovina. ProCredit Bank d.d., Sarajevo is part of a global network of financial institutions, managed and controlled by ProCredit Holding AG & Co. KGaA.
The Bank is incorporated to perform all banking activities in accordance with the law and the main activities include commercial lending, receiving of deposits, foreign exchange deals, and payment operation services in the country and abroad and retail banking services. In addition, it provides trade finance facilities to companies for export and import purposes.

2. Basis of preparation

2.1 Statement of compliance

The financial statements of ProCredit Bank d.d., Sarajevo have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).
These financial statements were authorised for issue by the Management Board on 2 April 2012.

2.2 Basis for measurement

The financial statements have been prepared on the historical cost basis.

2.3 Functional and presentation currency

The Bank's financial statements are presented in Bosnian Marks ("BAM"), which is the Bank's functional and presentation currency, rounded to the nearest thousand.

2.4 Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.
Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future period affected. Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 5.

2.5 Correction of an error

In 2011 the Bank received an assessment from the tax authorities in respect of taxes (mainly withholding taxes on loans received) which results in BAM 479 thousand additional tax, relating mainly to the period 2006-2009. As the error relates to the periods prior to the earliest prior period presented (2010), the restatement has been accounted for by adjusting the opening retained earnings (accumulated losses) as at 1 January 2010.
The effect of the restatement on opening retained earnings (accumulated losses) is to increase opening accumulated losses by BAM 479 thousand and increase other liabilities in the balance sheet by the same amount. In accordance with IFRS, when an entity has made a restatement there is a requirement to present a third statement of financial position as of 1 January 2010 and related note disclosures. Management considered materiality of the restatement and financial statement line items effected, and concluded that it is sufficient to present the restatement in the statement of changes in equity.

3. Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

3.1 Foreign currency

Transactions in foreign currencies are translated into the respective functional currency of the operation at the exchange rate at the date of transaction. Monetary assets and monetary liabilities denominated in foreign currency at the reporting date are retranslated into the functional currency using the exchange rates prevailing at the reporting date. Income and expenses denominated in foreign currency are translated into functional currency at the exchange rates valid at the dates of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss. Non-monetary assets and items that are measured in terms of historical cost in foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at the reporting date.

Exchange rates	31 Dec 2011 BAM	31 Dec 2010 BAM
USD	1.511577	1.472764
EUR	1.955830	1.955830

3.2 Interest income and expense

Interest income and expense are recognised in profit or loss for all interest bearing instruments on an accrual basis using the effective interest rate, i.e. at the rate that discounts estimated future cash flows to net present value over the life of the underlying contract. Such income and expense are presented as interest and similar income or interest expense and similar charges in profit or loss. Interest income and expense also include fee and commission income and expense in respect of loans to and receivables from customers or borrowings from other banks, recognised on an effective interest basis.
The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts

estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

3.3 Fee and commission income and expenses

Fees and commission income and expenses mainly comprise fees received from enterprises arising from domestic and foreign payments, the issue of guarantees and letters of credit and credit card business. Fees and commissions, except for those which form part of the effective interest rate of the instrument, are generally recognised on an accrual basis when the service has been provided.

3.4 Dividends

Dividend income is recognised when the right to receive income is established.

3.5 Income tax expense

Income tax charge is based on taxable profit for the year and comprises current and deferred tax.
Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The statutory corporate profit tax rate for 2011, applicable to taxable profits, is 10% (2010: 10%).
Deferred income tax is provided, using the balance sheet liability method, for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. The movement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities, based on tax rates enacted or substantially enacted at the reporting date. Currently enacted tax rates are used in the determination of deferred income tax.
Deferred tax assets are recognised for unused tax losses to the extent that it is probable that future taxable profit will be available against which the deferred tax assets can be utilised.

3.6 Financial assets and financial liabilities

Classification

The Bank classifies its financial assets and liabilities in the following categories: loans and receivables, held-to-maturity investments, financial assets at fair value through profit or loss, available-for-sale financial assets and other financial liabilities. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of its investments upon initial recognition. At the reporting date the Bank had neither held-to-maturity investments nor financial assets at fair value through profit or loss.

a) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money, goods or services directly to a debtor with no intention of trading with the receivable and include loans to and receivables from Banks, loans to and receivables from customers and obligatory reserves with the Central Bank.

b) Financial assets available for sale
Available-for-sale financial assets are non-derivative investments that are designated as available for sale or are not classified as another category of financial assets.
Financial assets designated as available for sale are intended to be held for an indefinite period of time but may be sold as a response to liquidity needs or changes in interest rates. Available-for-sale financial assets include equity securities.

c) Other financial liabilities
Other financial liabilities comprise all financial liabilities which are not designated at fair value through profit or loss. Other financial liabilities include borrowings, deposits, subordinated liabilities and other liabilities.

Recognition and derecognition

Purchases and sales of financial assets available for sale are recognised on the trade date which is the date when the Bank commits to purchase or sell the instrument.
Loans and receivables and other financial liabilities are recognised when cash is advanced to borrowers or received from lenders.
The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets have otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.
The Bank derecognises a financial liability only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability significantly change, the Bank will cease recognising that liability and will instantaneously recognise a new financial liability, with new terms and conditions.

Initial and subsequent measurement

Loans and receivables are initially recognised at fair value plus transaction costs. Subsequently, they are measured at amortised cost using the effective interest method.
Available-for-sale financial assets are initially recognised at fair value plus transaction costs that are directly attributable to its acquisition or issue.
Available-for-sale financial assets are subsequently measured at their fair value. Gains and losses from a change in the fair value of available-for-sale financial assets are recognised directly in a fair value reserve within equity. Equity instruments classified as available for sale that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are stated at cost.

Impairment of financial assets

a) Loans and receivables
The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. If there is objective evidence that impairment of a loan or a portfolio of loans has occurred which influences the future cash flow of the financial asset(s), the respective losses are immediately recognised. Impairment losses on loans and receivables are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows, includ-

ing amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of loans. Depending on the size of the loan, such losses are either calculated on an individual loan basis or are collectively assessed for a portfolio of loans. The carrying amount of loans and receivables is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Losses from expected future events are not recognised. Interest on impaired assets continues to be recognised through unwinding of the discount in interest income.

Individually assessed loans and advances

For individually significant loans, it is assessed whether objective evidence of impairment exists, i.e. any factors which might influence the customer's ability to fulfil his/her contractual payment obligations towards the Bank:

- delinquencies in contractual payments of interest or principal
- breach of covenants or conditions
- initiation of bankruptcy proceedings
- any specific information on the customer's business (e.g. reflected by cash flow difficulties experienced by the client)
- changes in the customer's market environment
- the general economic situation.

Additionally, the aggregate exposure to the client and the realisable value of collateral held are taken into account when deciding on the allowance for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of its estimated future cash flows discounted at the financial asset's original effective interest rate (specific impairment). If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral.

Collectively assessed loans and advances

There are two cases in which loans are collectively assessed for impairment:

- individually insignificant loans that show objective evidence of impairment;
- the group of loans which do not show signs of impairment, in order to cover all losses which have already been incurred but not detected on an individual loan basis.

For the purposes of the evaluation of impairment of individually insignificant loans, the loans are grouped on the basis of similar credit risk characteristics, i.e. according to the number of days they are in arrears. Arrears of 30 or more days are considered to be a sign of impairment. This characteristic is relevant for the estimation of future cash flows for the so defined group of such assets, based on historical loss experiences with loans that showed similar characteristics.

The collective assessment of impairment for individually insignificant loans and for unimpaired loans (portfolio-based impairment) belonging to a group of financial assets is based on a quantitative analysis of historical default rates for loan portfolios with similar risk characteristics in the individual subsidiaries (migration analysis), grouped into geographical segments with a comparable risk profile. After a qualitative analysis of this statistical data, the holding company's management prescribed appropriate rates to the Banks of the ProCredit group as the basis for their portfolio-based impairment allowances. Deviations from this guideline were allowed, if necessitated by the specific situation of a ProCredit institution.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether individually significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment (impairment for collectively assessed loans).

Reversal of impairment

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 recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in profit or loss.

Writing off loans and advances

When a loan is uncollectible, it is written off against the related allowance for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of the amounts previously written off decrease the amount of the allowance for loan impairment in profit or loss.

Loans and advances with renegotiated terms

Loans and advances with renegotiated terms which are considered to be individually significant are provisioned on an individual basis. The amount of the loss is measured as a difference between the restructured loan's carrying amount and the present value of its estimated future cash flows discounted at the loan's original effective interest rate (specific impairment). Loans and advances with renegotiated terms which are individually insignificant are collectively assessed for impairment.

b) Financial assets available for sale

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired.

In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit and loss – is removed from other comprehensive income and recognised in profit or loss.

Impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss at any point thereafter. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit and loss, the impairment loss is reversed through profit or loss.

3.7 Cash and cash equivalents

Cash and cash equivalents are items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents include mandatory reserve deposits with the Central Bank and all interbank placements and reverse sale and repurchase agreements with other banks with original maturities of less than three months. Funds restricted for a period of more than three months on origination are excluded from cash and cash equivalents. Cash and cash equivalents are carried at amortised cost.

3.8 Property and equipment

Property and equipment are tangible assets that are held for use in the supply of services, or administrative purposes.
Property and equipment are stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.
Subsequent cost is included in the asset's carrying amount, or is recognised as a separate asset, only when it is probable that future economic benefits associated with the item will flow to the Bank and the rest of the item can be measured reliably. All other repairs and maintenance costs are charged to profit or loss during the financial period in which they are incurred.
Property and equipment are periodically reviewed for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.
Assets in the course of construction are reported at their cost of construction including costs charged by third parties. Upon completion, all accumulated costs of the asset are transferred to the relevant tangible property and equipment category and subsequently subject to the applicable depreciation rates.
Gains and losses on disposal of property and equipment are recognised in profit or loss. In the beginning of 2011 the Bank decreased estimated useful life of computers and telephone equipment and furniture and equipment.
Depreciation is charged on all assets except assets in the course of construction on a straight line basis so as to write off the cost of the assets over their estimated useful lives to their estimated recoverable amounts at the following annual rates:

in %	2011	2010
Buildings	2.5	2.5
Computers and telephone equipment	14-20	20-33
Furniture and equipment	10 -20	17 -25
Leasehold improvements	Over the lease period	Over the lease period

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

3.9 Intangible assets

Intangible assets that are acquired by the Bank are stated at cost less accumulated amortisation and impairment losses.
Subsequent expenditure is capitalised only if all of the features required by IAS 38 are satisfied. All other expenditure is expensed as incurred.
Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives as follows:

	2011	2010
Software	5 years	5 years
Licenses and other intangible assets	5 years	5 years

3.10 Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

3.11 Leases

To date, premises rental contracts entered into by the Bank are operating leases. The total payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

3.12 Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.
Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of incurred losses. The management determines sufficiency of provisions on the basis of insight in specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.
Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle obligations is no longer probable, the provision is reversed.

3.13 Employee benefits

a) Defined contribution plans
The Bank, in the normal course of business, makes payments on behalf of its employees for pensions, health care, employment and personnel tax that are calculated on the basis of gross salaries and wages, food allowances and travel expenses according to the legislation. The Bank makes these contributions to the Government's health and retirement funds, at the statutory rates in force during the year, based on gross salary payments.
The Bank pays contributions to public pension insurance funds on a mandatory basis. Once the contributions have been paid, the Bank has no further payment obligations. The regular contributions constitute costs for the year in which they are due and as such are included in staff costs. The cost of these payments is charged to profit or loss in the same period as the related salary cost.

b) Short-term benefits
Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A provision is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

c) Post-employment benefits

According to local legal requirements, employees of the Bank are entitled to receive one-time benefit on retirement, dependent on factors such as age, years of service and the salary they had with the Bank.

Such payments are treated as post-employment benefits and the liability recognised in the statement of financial position is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets (if any), together with adjustments for unrecognised actuarial gains or losses and past service costs.

This obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by applying a discount rate which is similar to the rate of return on corporate bonds in the Federation of Bosnia and Herzegovina (around 6%) and the average interest rate of time deposit accounts held with commercial Banks around 4%.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised immediately in profit and loss as well as all past service costs.

3.14 Deposits, borrowings and subordinated liabilities

Deposits, borrowings and subordinated liabilities are the Bank's sources of funding.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument.

Deposits, borrowings and subordinated liabilities are initially measured at fair value net of transaction costs, and subsequently measured at their amortised cost using the effective interest method.

3.15 Statutory reserve

Statutory reserve is created in accordance with the Company Law of the Federation of Bosnia and Herzegovina, which requires 10% of the profit for the year to be appropriated to this reserve until reaching 25% of issued share capital. If the statutory reserve does not reach 25% of issued share capital within 5 business years, a joint stock company is required to increase its appropriations to this reserve to 20% of its profit for the year at the end of the fifth and any following business years until reaching 25% of the issued share capital. This reserve can be used for covering current and prior year losses.

3.16 Retained earnings/accumulated losses

Any profit (after appropriations) or loss for the year is transferred to retained earnings/accumulated losses.

3.17 Share capital

Share capital represents the nominal value of paid-in ordinary shares classified as equity and denominated in BAM. Dividends are recognised as liability in the period in which they are declared.

3.18 Off- balance-sheet commitments and contingencies

In the ordinary course of business, the Bank enters into related commitments which are recorded in off-balance-sheet accounts and primarily comprise guarantees, letters of credit, undrawn loans commitments and credit card limits. Such financial commitments are recorded in the Bank's statement of financial position if and when they become payable.

3.19 Adoption of new standards and interpretations

The following new standards and interpretations became effective for the ProCredit Bank from 1 January 2011:

- **Amendment to IAS 24, Related Party Disclosures (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011)**. IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities. As a result of the revised standard, the Bank now also discloses contractual commitments to purchase and sell goods or services to its related parties.
- **Improvements to International Financial Reporting Standards (issued in May 2010 and effective from 1 January 2011).** The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: IFRS 1 was amended (i) to allow previous GAAP carrying value to be used as deemed cost of an item of property, plant and equipment or an intangible asset if that item was used in operations subject to rate regulation, (ii) to allow an event driven revaluation to be used as deemed cost of property, plant and equipment even if the revaluation occurs during a period covered by the first IFRS financial statements and (iii) to require a first-time adopter to explain changes in accounting policies or in the IFRS 1 exemptions between its first IFRS interim report and its first IFRS financial statements; IFRS 3 was amended (i) to require measurement at fair value (unless another measurement basis is required by other IFRS standards) of non-controlling interests that are not present ownership interest or do not entitle the holder to a proportionate share of net assets in the event of liquidation, (ii) to provide guidance on the acquiree's share-based payment arrangements that were not replaced, or were voluntarily replaced as a result of a business combination and (iii) to clarify that the contingent considerations from business combinations that occurred before the effective date of revised IFRS 3 (issued in January 2008) will be accounted for in accordance with the guidance in the previous version of IFRS 3; IFRS 7 was amended to clarify certain disclosure requirements, in particular (i) by adding an explicit emphasis on the interaction between qualitative and quantitative disclosures about the nature and extent of financial risks, (ii) by removing the requirement to disclose carrying amount of renegotiated financial assets that would otherwise be past due or impaired, (iii) by replacing the requirement to disclose fair value of collateral by a more general requirement to disclose its financial effect, and (iv) by clarifying that an entity should disclose the amount of foreclosed collateral held at the reporting date, and not the amount obtained during the reporting period; IAS 1 was amended to clarify the requirements for the presentation and content of the statement of changes in equity IAS 27 was amended by clarifying the transition rules for amendments to IAS 21, 28 and 31 made by the revised IAS 27 (as amended in January 2008); IAS 34 was amended to add additional examples of significant events and transactions requiring disclosure in a condensed interim financial report, including transfers between the levels of fair value hierarchy, changes in classification of financial assets or changes in business or economic environment that affect the fair values of the entity's financial instruments; and IFRIC 13 was amended to clarify measurement of fair value of award credits. The above amendments resulted in additional or revised disclosures, but had no mate-

rial impact on measurement or recognition of transactions and balances reported in these financial statements. The financial effect of collateral required to be disclosed by the amendments to IFRS 7 is presented in these financial statements by disclosing collateral values separately for (i) those financial assets where collateral and other credit enhancements are equal to, or exceed, carrying value of the asset ("over-collateralised assets") and (ii) those financial assets where collateral and other credit enhancements are less than the carrying value of the asset ("under-collateralised assets").

Other revised standards and interpretations effective for the current period.

IFRIC 19 "Extinguishing financial liabilities with equity instruments", amendments to IAS 32 on classification of rights issues, clarifications in IFRIC 14 "IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction" relating to prepayments of minimum funding requirements and amendments to IFRS 1 "First-time adoption of IFRS", did not have any impact on these financial statements.
Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2012 or later, and which the Bank has not early adopted.

- **IFRS 9, Financial Instruments Part 1: Classification and Measurement**. IFRS 9, issued in November 2009, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

– Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
– An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
– All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
– Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.
– **IFRS 10, Consolidated Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013)**, replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities". IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance.
– **IFRS 11, Joint Arrangements, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013)**, replaces IAS 31 "Interests in Joint Ventures" and SIC-13 "Jointly Controlled Entities—Non-Monetary Contributions by Ventures". Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures.
– **IFRS 12, Disclosure of Interest in Other Entities, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013)**, applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgments and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in Company activities and cash flows, summarised financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities.
– **IFRS 13, Fair value measurement, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013)**, aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRS.
– **IAS 27, Separate Financial Statements, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013)**, was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10, Consolidated Financial Statements.
– **IAS 28, Investments in Associates and Joint Ventures, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013)**. The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged.
– **Disclosures—Transfers of Financial Assets – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011)**. The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets

and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood.

- **Amendments to IAS 1, Presentation of Financial Statements (issued June 2011, effective for annual periods beginning on or after 1 July 2012)**, changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Bank expects the amended standard to change the presentation of its financial statements, but to have no impact on the measurement of transactions and balances.
- **Amended IAS 19, Employee Benefits (issued in June 2011, effective for periods beginning on or after 1 January 2013)**, makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income.
- **Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013)**. The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off.
- **Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014)**. The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement.
- **Other revised standards and interpretations: The amendments to IFRS 1 "First-time adoption of IFRS"**, relating to severe hyperinflation and eliminating references to fixed dates for certain exceptions and exemptions, the amendment to IAS 12 "Income taxes", which introduces a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale, and IFRIC 20, "Stripping Costs in the Production Phase of a Surface Mine", which considers when and how to account for the benefits arising from the stripping activity in mining industry, will not have any impact on these financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

4. Financial risk management

The Bank's activities expose it to a variety of financial risks; credit risk, liquidity risk and market risk. The Bank has established an integrated system of risk management by introducing a set of policies and procedures for analysis, evaluation, acceptance and risk management. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business.

The Management Board has overall responsibility for the establishment and oversight of the Bank's risk management framework.
Risk management is carried out by the Bank's Risk Sector under policies approved by the Management Board. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, and products and services offered.
The most important types of risk are credit risk, liquidity risk, market risk and other operational risk. Market risk includes currency risk, interest rate and other price risk.
Risk steering and risk controlling processes are adjusted in a timely manner to reflect changes in the operating environment.

4.1 Credit risk

The Bank is subject to credit risk through its lending activities and in cases where it acts as an intermediary on behalf of customers or third parties. Credit risk arises from customer credit exposures, credit exposure from interbank placements and issuer risk. It is divided into credit default risk and credit portfolio risk in order to facilitate focused risk management. Credit exposures to regulated financial and public institutions and issuers of securities are treated separately as a counterparty risk. The goal is to prevent the Bank from incurring losses caused by a counterparty's or issuer's lack of willingness or capacity to fulfil its obligations. The Bank seeks to minimise its exposure to counterparty risk thorough approval and selection processes for new counterparties and issuers, by limiting exposure to any single counterparty or group of counterparties as well as limiting the exposure to any single issuer or issuer class and through review of approved counterparties and established limits.

4.1.1 Risk limit control and mitigation policies

The Bank takes on exposure to credit risk, which is the most important risk for the Bank's business; management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in lending activities that lead to loans and advances and there is also credit risk in off-balance sheet financial instruments, such as loan commitments.
Credit default risk from customer credit exposures is defined as the risk of losses due to a potential non-fulfilment of the contractual payment obligations associated with a customer credit exposure.
For risk management reporting purposes the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk and sector risk).
Credit risk management and control are centralised in the Risk and Credit Risk Department and managed by the Credit Risk Committee.
The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments.
Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

(a) Collateral
The Bank measures the exposure to credit risk associated with certain kinds of collateral. Accordingly, the Bank monitors its reliance on different kinds of collateral. To the extent that real estate prices drop significantly, the Bank expects that its credit risk losses on impaired lending may increase significantly as the value of collateral decreases.
The Bank employs a range of policies and practices to mitigate credit risk. The Bank implements guidelines on the acceptability of

specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Cash
- Bank and corporate guarantees
- Mortgages on residential properties
- Charges on business assets such as premises, inventory and accounts receivable
- Charges on financial instruments such as debt securities and equities.

In order to minimise the credit loss the Bank will seek additional collateral from the counterparty as soon as impairment indicators are noticed for the relevant individual loans and advances. Debt securities, treasury bills and other eligible bills are generally unsecured.

(b) Credit-related contingencies
The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans and are secured with similar collateral as are loans.

4.1.2 Credit risk management

The Bank accounts for counterparty risks arising from the loan portfolio by making allowances for impaired loans. Individually impaired loans are loans for which the Bank determines that there is objective evidence of impairment and it does not expect to collect all principal and interest due according to the contractual terms of the loan. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired.
Credit exposures in arrears are defined as credit exposures for which contractual interest and/or principal payments are overdue.
The quality of the loan portfolio is monitored on an ongoing basis. The measure for loan portfolio quality is the portfolio at risk (PAR), which the Bank defines as all credit exposures outstanding with one or more payment of interest and/or principal in arrears by more than 30 days.
Typically, the primary sign of impairment of a credit exposure is that it is in arrears by more than 30 days. This means that any principal and/or interest payment from a client that is overdue by more than 30 days is viewed as evidence of impairment.
The Bank also views a credit exposure as being impaired if it obtains objective evidence for impairment – even if the credit exposure is not in arrears by more than 30 days.
If the loan is impaired, the total credit exposure towards the client is taken into consideration and the contamination principle applies. This means that once one loan is impaired, every individual loan to the client and to related parties will be reviewed in order to determine the extent to which other loans to the client or the group are also impaired.
The Bank assesses the probability of default of individual counterparties using internal rating tools tailored to the various categories of counterparty. They have been developed internally and combine statistical analysis with credit analyst judgment and are validated, where appropriate, by comparison with externally available data. Clients of the Bank are segmented into four rating classes. The Bank's rating scale, which is shown below, reflects the range of default probabilities defined for each rating class. This means that, in principle, exposures migrate between classes as the assessment of their probability of default changes. The rating tools are kept under review and upgraded as necessary.
The Bank regularly validates the performance of the rating tools and their predictive power with regard to default events.

Bank's internal ratings scale

Bank's rating	Description of the grade
<=30 days	Investment grade
31-90 days	Standard monitoring
91-180 days	Special monitoring
>180 days	Sub-standard

The criteria for classification of financial assets or contingent liabilities into these groups are as follows:

Financial assets or contingent liabilities are assigned to the **Investment grade** group if they consist of exposures:
- to debtors which are not likely to default and which meet their payment obligations in a timely manner, with a maximum delay in payment of 30 days, and
- which are secured by pledged collateral graded as first class collateral.

Financial assets or contingent liabilities are assigned to the **Standard monitoring** group if they consist of exposures to debtors:
- whose cash flows are assessed as adequate to duly fulfil their due obligations, regardless of whether or not their present financial position is assessed as weak, without signs of further deterioration in the future; and
- which settle their liabilities with a delay of between 31 and 90 days.

Financial assets or contingent liabilities are assigned to the **Special monitoring** group if they are consist of exposures to debtors:
- whose cash flows are assessed to be not sufficient for regular repayment of matured liabilities, or
- which settle their liabilities with a delay of between 91 to 180 days, or
- which are clearly undercapitalised, or
- which do not have sufficient long-term capital resources to finance long-term investments, or
- from which the Bank does not currently receive satisfactory information or adequate documentation concerning repayment of liabilities.

Financial assets or contingent liabilities are assigned to the **Substandard** group if they consist of exposures to debtors:
- for which there is a strong likelihood of loss of part or all of the financial asset, or of payment in respect of contingent liabilities, or
- which settle their liabilities with a delay of more than 180 days, or
- which are insolvent, or
- for which a motion for commencement of process of liquidation or declaration of bankruptcy has been initiated and filed at the provisional court, or
- which are in the process of reform or in the process of liquidation, or
- which have declared bankruptcy, or
- from which no repayment is expected, or
- for whose collateral the Bank may have questionable legal grounds for seizure.

Loans and advances with renegotiated terms include extended payment arrangements, approved external management plans, modification and deferral of payments. Once the loan is restructured, it remains in this category independent of the satisfactory performance after restructuring. Restructuring policies and practices are based on indicators or criteria which, in the judgment of local management, indicate that payment will most likely continue. These policies are kept under continuous review.
Loans and advances with renegotiated terms include extended payment arrangements, approved external management plans, modification and deferral of payments.
Restructuring of a credit exposure is generally necessitated by economic problems encountered by the client that adversely affect payment capacity, mostly caused by the significantly changed macro-economic environment in which the Bank's clients currently operate. Restructurings follow a thorough, careful and individual analysis of the client's changed payment capacity.
Restructured credit exposures are not generally considered to be in arrears but are treated according to their current status. The Bank draws a distinction between standard restructured, watch restructured and impaired restructured credit exposures. Restructurings of credit exposures are generally necessitated by economic or payment problems encountered by the client. The decision to restructure a credit exposure is always taken by a credit committee or arrears committee and aims at full recovery of the credit exposure. If a credit exposure is restructured, amendments are made to the parameters of the loan. Otherwise, these credit exposures for which the terms have been renegotiated would be past due or impaired.

4.1.2 Impairment and provisioning policies

The internal rating systems described in Note 4.1.2 focus more on credit-quality mapping from the inception of the lending and investment activities. In contrast, impairment provisions are recognised for financial reporting purposes only for losses that have been incurred at the reporting date based on objective evidence of impairment. The impairment provision shown in the statement of financial position at year-end is derived from each of the internal rating grades. However, the majority of the impairment provision comes from the bottom two grades. The table below shows the percentage of the Bank's on balance sheet items relating to loans and advances and the associated impairment provision for each of the Bank's internal rating categories:

Bank's rating *in %*	Loans and advances to customers	Impairment provision	Other assets	Impairment provision
2011				
Investment grade	96.9	1.5	83.2	1.1
Standard monitoring	1.4	30.1	4.6	50.0
Special monitoring	0.8	48.5	2.7	75.0
Sub-standard	0.9	56.0	9.5	100.0
	100	**3.0**	**100**	**4.6**
2010				
Investment grade	96.8	1.6	91.4	1.1
Standard monitoring	1.8	31.0	5.7	50.0
Special monitoring	0.8	54.3	0.6	75.0
Sub-standard	0.6	74.4	2.3	100.0
	100	**3.0**	**100**	**1.8**

The internal rating tool assists management to determine whether objective evidence of impairment exists under IAS 39, based on the criteria set out in Note 3.6.
The Bank's policy requires the review of individual financial assets that are above materiality thresholds at least annually or more regularly when required by individual circumstances. Impairment allowances on individually assessed accounts are determined by an evaluation of the incurred loss at reporting date on a case-by-case basis, and are applied to all individually significant accounts.
The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.
Collectively assessed impairment allowances are provided for: (i) portfolios of homogenous assets that are considered individually insignificant; and (ii) losses that have been incurred but have not yet been identified, by using the available historical experience, experienced judgment and statistical techniques.

4.1.3 Maximum exposure to credit risk before collateral held or other credit enhancement

Maximum exposure	2011	2010
Placements at the Central Bank and other banks	50,068	53,274
Loans and advances to customers	239,861	226,019
-Overdrafts	976	998
-Housing	15,761	17,536
-Consumer	10,289	9,744
-Very small business	51,174	55,325
-Small	74,807	68,147
-Medium	69,841	55,790
-Agricultural	17,013	18,479
Other financial assets	1,325	1,390
Credit risk exposure relating to off-balance sheet items are as follows:		
Loan commitments	19,406	15,273
Financial guarantees and letters of credit	16,039	12,250
Total	**326,699**	**308,206**

The above table represents a worst case scenario of credit risk exposure to the Bank at 31 December 2011 and 31 December 2010, without taking account of any collateral held or other credit enhancements attached.

For on-balance sheet assets, the exposures set out above are based on net carrying amounts as reported in the statement of financial position.

4.1.4 Assets exposed to credit risk

Set out below is an analysis of the gross and net (of allowances for impairment) amounts of loans and advances to customers

	31 Dec 2011	31 Dec 2010
Neither past due nor impaired (no arrears)	224,732	210,184
Individually assessed	1,491	866
Collectively assessed	223,241	209,318
Past due but not impaired (1-30 days)	14,290	15,341
Individually assessed	3,612	600
Collectively assessed	10,678	14,741
Impaired (arrears of more than 30 days)	7,585	7,527
Individually assessed	4,426	3,192
Collectively assessed	3,159	4,335
Gross	**246,607**	**233,052**
Specific impairment	938	350
Collective impairment	5,808	6,683
Total impairment	6,746	7,033
Net	**239,861**	**226,019**

(a) Assets neither past due nor impaired (no arrears)

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the Bank.

31 December 2011							Loans and advances to customers	
	Overdraft	Housing	Others	Very small	Small	Medium	Agricultural	Total
No arrears	915	14,777	9,686	45,826	71,458	67,333	14,737	224,732
Total	**915**	**14,777**	**9,686**	**45,826**	**71,458**	**67,333**	**14,737**	**224,732**

31 December 2010							Loans and advances to customers	
	Overdraft	Housing	Others	Very small	Small	Medium	Agricultural	Total
No arrears	948	16,846	9,044	48,794	65,771	53,872	14,909	210,184
Total	**948**	**16,846**	**9,044**	**48,794**	**65,771**	**53,872**	**14,909**	**210,184**

Information disclosed in the above tables is presented in gross amounts.

(b) Assets past due but not impaired (1-30 days)
The gross amounts of loans and advances to customers by class that were past due but not impaired were as follows:

31 December 2011							Loans and advances to customers	
	Overdraft	Housing	Others	Very small	Small	Medium	Agricultural	Total
Past due but not impaired (1 -30 days)	47	764	595	4,735	2,679	3,277	2,193	14,290
Total	**47**	**764**	**595**	**4,735**	**2,679**	**3,277**	**2,193**	**14,290**
Collateral								
Pledge, mortgage and cash collateral	–	259	220	3,089	2,588	3,251	1,454	10,861
Other collateral*	47	505	375	1,646	91	26	739	3,429

31 December 2010							Loans and advances to customers	
	Overdraft	Housing	Others	Very small	Small	Medium	Agricultural	Total
Past due but not impaired (1 -30 days)	38	752	632	5,804	2,306	2,369	3,440	15,341
Total	**38**	**752**	**632**	**5,804**	**2,306**	**2,369**	**3,440**	**15,341**
Collateral								
Pledge, mortgage and cash collateral	–	171	68	2,293	2,083	2,361	1,101	8,077
Other collateral*	38	581	564	3,511	223	8	2,339	7,264

Information disclosed in the above tables is presented in gross amounts.

* Other collateral includes guarantors, co-signers and promissory notes.

(c) Assets impaired (arrears of more than 30 days)
The breakdown of the gross amount of individually impaired loans and advances to customers by class is as follows:

31 December 2011							Loans and advances to customers	
	Overdraft	Housing	Others	Very small	Small	Medium	Agricultural	Total
Standard monitoring	42	513	168	1,066	1,162	–	521	3,472
Special monitoring	11	97	101	1,077	336	–	244	1,866
Sub-standard	8	109	64	879	573	326	288	2,247
Total	**61**	**719**	**333**	**3,022**	**2,071**	**326**	**1,053**	**7,585**
Collateral								
Pledge, mortgage and cash collateral	–	250	17	1,614	1,931	326	425	4,563
Other collateral*	61	469	316	1,408	140	–	628	3,022

31 December 2010							Loans and advances to customers	
	Overdraft	Housing	Others	Very small	Small	Medium	Agricultural	Total
Standard monitoring	28	145	273	1,924	856	335	658	4,219
Special monitoring	31	98	77	882	288	-	390	1,766
Sub-standard	28	44	79	730	198	23	440	1,542
Total	**87**	**287**	**429**	**3,536**	**1,342**	**358**	**1,488**	**7,527**
Collateral								
Pledge, mortgage and cash collateral	–	28	51	1,225	1,187	326	266	3,083
Other collateral*	87	259	378	2,311	155	32	1,222	4,444

Information disclosed in the above tables is presented in gross amounts.

(d) Loans and advances with renegotiated terms
Renegotiated loans that would otherwise be past due or impaired totalled BAM 7,388 thousand at 31 December 2011 (2010: BAM 7,125 thousand).

	2011	2010
Loan portfolio	246,607	233,052
Restructured loans	7,388	7,125
Restructured loans in % of loan portfolio	3.0%	3.1%

* Other collateral includes guarantors, co-signers and promissory notes.

(e) Loans and advances to customers

The Bank holds collateral against loans and advances to customers in the form of mortgage interest over property, pledge over moveable assets, cash deposits, as well as other collateral in form of guarantees, co-debtorship and bills of exchange. Estimates of fair value of property and moveable assets pledged as collateral are based on the value of collateral assessed at the time of borrowing, weighted by the value of the loan in the total exposure secured by the same collateral, up to the outstanding balance of related secured exposure. The value of other collateral, which includes guarantees, co-debtorship and bills of exchange, is weighted in the same manner up to the outstanding balance of the related secured exposure.

Collateral is not held against loans and advances to Banks and financial assets available for sale.

The breakdown of the gross amount of loans and advances by class, along with the value of related collateral held by the Bank as security, is as follows:

	Overdraft	Housing	Others	Very small	Small	Medium	Agricultural
31 December 2011							
Individually impaired loans	–	402	133	2,684	3,415	2,584	311
Collectively impaired loans	1,023	15,857	10,481	50,900	72,793	68,352	17,672
Collateral							
Pledge, mortgage and cash collateral	22	9,192	3,948	37,071	67,073	68,313	13,678
Other collateral*	1,001	7,067	6,666	16,513	9,135	2,623	4,305
31 December 2010							
Individually impaired loans	7	186	167	1,908	1,833	358	199
Collectively impaired loans	1,066	17,700	9,938	56,226	67,585	56,241	19,638
Collateral							
Pledge, mortgage and cash collateral	11	8,249	2,637	31,832	62,875	53,824	9,407
Other collateral*	1,062	9,637	7,468	26,302	6,543	2,775	10,430

Management considers the loans covered by collateral as impaired because experience shows that a significant proportion of the collateral cannot be enforced due to administrative and legal difficulties. The impairment provisions reflect the probability that management will not be able to enforce its rights and repossess collateral on defaulted loans.

As at 31 December 2011 the Bank did not hold any repossessed property or other type of collateral. It applies also for 31 December 2010.

* Other collateral includes guarantors, co-signers and promissory notes.

4.1.5 Concentration of risks of financial assets with credit risk exposure

The Bank monitors concentrations of credit risk by economic sector and by geographic location. The structure of the loan portfolio is regularly reviewed within the Risk Department and Credit Risk Committee in order to identify potential events which could have an impact on large areas of the loan portfolio (common risk factors) and, if necessary, limit the exposure towards certain sectors of the economy.

Credit portfolio risk is limited by the Bank's credit strategy; in particular the focus on small and very small loans and the broad geographical and economic sector diversification of the loan portfolio. An analysis of such concentrations at the reporting date is shown below:

Economic sector risk concentrations

	Wholesale and retail	Agriculture, forestry and fishing	Production	Individuals	Construction	Tourism, catering	Other	Total
Loans and advances to customers								
-Overdrafts	–	27	–	949	–	–	–	**976**
-Housing	–	–	40	15,721	–	–	–	**15,761**
-Consumer	–	–	–	10,289	–	–	–	**10,289**
Loans to corporate entities:								
-Very small	22,653	1,773	8,287	–	3,159	2,894	12,408	**51,174**
-Small	36,624	1,109	16,077	–	4,874	2,791	13,332	**74,807**
- Medium	28,845	805	24,812	–	4,102	4,600	6,677	**69,841**
- Agricultural	67	14,299	250		25	1	2,371	**17,013**
Financial assets available for sale	–	–	–	–	–	–	31	**31**
Other assets	–	–	–	–	–	–	1,403	**1,403**
As at 31 December 2011	**88,189**	**18,013**	**49,466**	**26,959**	**12,160**	**10,286**	**36,222**	**241,295**
As at 31 December 2010	**85,986**	**19,879**	**38,543**	**28,143**	**11,331**	**11,662**	**32,363**	**227,907**

The Bank follows a guideline that limits concentration risk in the loan portfolio by ensuring that large credit exposures (those exceeding 10% of regulatory capital) require the approval by the Group Risk Management Committee.
Larger credit exposures are analysed and monitored, both by the responsible employees through regular monitoring activities enabling early detection of risks, and through the regular reviews carried out by the Credit Risk Management Committee of the Bank. Full information about any related parties is typically collected prior to lending.

Geographic risk concentrations of the assets mainly relate to the region of Bosnia and Herzegovina.

	Bosnia and Herzegovina	OECD countries	Non-OECD countries	Total
Placements at the CB and other banks	39,369	10,517	182	**50,068**
Loans and advances to customers				
–Overdrafts	976	–	–	**976**
–Housing	15,761	–	–	**15,761**
–Consumer	10,289	–	–	**10,289**
–Very small	51,174	–	–	**51,174**
–Small	74,807	–	–	**74,807**
–Medium	69,841	–	–	**69,841**
–Agricultural	17,013	–	–	**17,013**
Financial assets available for sale	–	–	31	31
Other assets	1,403	–	–	**1,403**
As at 31 December 2011	**280,633**	**10,517**	**213**	**291,363**
As at 31 December 2010	**277,952**	**2,788**	**441**	**281,181**

4.2 Market risk

The Bank takes on exposure to market risk. Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange prices and credit spreads, and the resulting changes in an obligor's or issuer's credit standing, will have an effect on the Bank's income. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk. Market risks arise from open positions in interest rate, foreign currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.
The Management Board sets limits and guidelines for managing, analysing and controlling market risk exposures within acceptable parameters while optimising the return on risk. The Assets and Liabilities Committee (ALCO) manages the short- and long-term liquidity position and exposures to market risk, which are regularly monitored by Risk Committees of the Bank. The Risk Department is responsible for the development and implementation of risk management policies.
The Bank has a low level of exposure to market risk because it does not engage in speculative transactions or in proprietary trading. Management of risk in this area is limited to protecting the institution from adverse movements in exchange and interest rates: the Bank does not trade in securities or in commodities, nor does it engage in derivative transactions except for hedging purposes.

4.2.1 Currency risk

The Bank is exposed to currency risk through transactions in foreign currencies. Foreign currency exposure arises from credit, deposit-taking and trading activities. The Management Board sets limits on the level of exposure by currency and in total for overnight positions, which are monitored on a daily basis by the Treasury Department. Based on the department's reports, the Bank's ALCO takes strategic currency decisions. Bosnia and Herzegovina is under a currency board regime according to which the local currency (BAM) is pegged to the EUR. The Bank's balance sheet positions are mainly in local currency and EUR so the Bank's exposure toward currency risk is low. The table below summarises the Bank's exposure to currency risk at 31 December 2011. Included in the table are the Bank's assets and liabilities at carrying amounts categorised by currency.
The assets and liabilities of the Bank are denominated in more than one currency. If the assets and liabilities in one currency do not match, the Bank has an open currency position (OCP) and is exposed to potentially unfavourable changes in exchange rates.

Concentration of currency risk of on- and off-balance sheet assets and liabilities

The Bank had the following significant currency positions:

As at 31 December 2011	EUR and EUR linked	USD	BAM	Other	Total
Assets					
Cash and cash equivalents	11,903	2,138	26,080	1,269	**41,390**
Obligatory reserve with Central Bank	–	–	20,291	–	**20,291**
Loans and advances to customers	181,245	–	58,616	–	**239,861**
Other financial assets	155	27	1,143	–	**1,325**
Total assets	**193,303**	**2,165**	**106,130**	**1,269**	**302,867**
Liabilities and equity					
Deposits from customers	121,960	2,101	85,193	951	**210,205**
Borrowings	44,291	–	3,191	–	**47,482**
Subordinated debt	16,079	–	–	–	**16,079**
Other financial liabilities	155	2	773	–	**930**
Total liabilities and equity	**182,485**	**2,103**	**89,157**	**951**	**274,696**
Net foreign exchange position	**10,818**	**62**	**16,973**	**318**	**28,171**
Contingencies and commitments	3,878	37	31,407	–	**35,322**

A 10% fall in the value of currencies (other than EUR) against the BAM, with other variables remaining constant, would result in a decrease in the result for the year by BAM 32 thousand (2010: BAM 88 thousand).
A 10% rise in the value of such currencies would result with an increase in the result for the year of BAM 32 thousand (2010: BAM 88 thousand).

As at 31 December 2010	EUR and EUR linked	USD	BAM	Other	Total
Assets					
Cash and cash equivalents	6,253	1,880	35,125	899	**44,157**
Obligatory reserve with Central Bank	–	–	24,356	–	**24,356**
Loans and advances to customers	190,300	–	35,719	–	**226,019**
Other financial assets	121	22	1,247	–	**1,390**
Total assets	**196,674**	**1,902**	**96,447**	**899**	**295,922**
Liabilities and equity					
Deposits from customers	120,084	1,874	96,444	18	**218,420**
Borrowings	28,700	–	8,236	–	**36,936**
Subordinated debt	16,085	–	–	–	**16,085**
Other financial liabilities	168	–	1,004	–	**1,172**
Total liabilities and equity	**165,037**	**1,874**	**105,684**	**18**	**272,613**
Net foreign exchange position	**31,637**	**28**	**(9,237)**	**881**	**23,309**
Contingencies and commitments	2,953	305	24,130	36	**27,424**

4.2.2 Interest rate risk

Interest rate risk specifies the risk that movements in market interest rates will adversely affect the Bank's capital and interest earnings. Two subcategories are identified: the economic value risk and interest earnings risk. The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in future cash flows or fair values of financial instruments because of a change in market interest rates. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest earning assets and interest bearing liabilities mature at different times and different amounts. The Bank's ALCO is responsible for managing the compliance with set limits. Both the Bank's ALCO and the Bank's Risk Management Committee have the authority to approve interest rate exposure modifications within the set limits. Principally, the interest rate risk is managed through monitoring interest rate gaps and by setting pre-approved limits for repricing bands.
Interest rate risk arises from differences between the maturities of assets and those of liabilities. Currently, the average maturity of loans is shorter than the average maturity of customer deposits, as a result of the implementation of loans with variable interest rates. There is a danger that the refinancing of loans will become more expensive if deposit interest rates decrease. However, interest rates in Bosnia and Herzegovina remained stable in 2011.
Among the various tools used to measure and analyse interest rate risk is maturity gap analysis. All interest rate-sensitive on- and off-balance sheet assets and liabilities are classified in predefined time buckets according to their remaining contractual maturity or

next scheduled interest rate adjustment, and the gap (assets minus liabilities) is calculated for each time bucket. Stress testing is also used to analyse the impact of interest rate shifts on interest income.

Throughout 2011, the Bank continued its policy of minimising interest rate risk in its banking book. The Bank's goal is to match repricing profiles between assets and liabilities, and only uses derivatives to hedge its interest rate risk position in exceptional cases.

Scenario analyses of yield curve shifts are carried out separately for each material operating currency, such as total economic value impact in present value and cumulative interest earnings impact (profit or loss) for a 3-month and 1-year period in present value. The analyses are completed separately for both the most probable scenario and the worst case scenario, which assumes risk of concentration in financial market-based interest rates.

The scenario analysis provides an estimation of how the changes in the interest rate structure may affect the earnings and the economic value of the Bank.

The Bank seeks to ensure that the balance sheet structure is as balanced as possible across all maturities.

Interest sensitivity of assets and liabilities

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

As at 31 December 2011	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non–interest bearing	Total
Assets							
Cash and cash equivalents	29,547	–	–	–	–	11,843	**41,390**
Obligatory reserve with Central Bank	20,291	–	–	–	–	–	**20,291**
Loans and advances to customers	36,349	48,700	59,244	87,788	7,727	53	**239,861**
Other financial assets	–	–	–	–	–	1,325	**1,325**
Total assets	**86,187**	**48,700**	**59,244**	**87,788**	**7,727**	**13,221**	**302,867**
Liabilities and equity							
Deposits from customers	32,688	10,355	23,732	87,592	492	55,346	**210,205**
Borrowings	–	35,945	7,921	–	3,170	446	**47,482**
Subordinated debt	–	–	–	8,801	6,846	432	**16,079**
Other financial liabilities	–	–	–	–	–	930	**930**
Total liabilities and equity	**32,688**	**46,300**	**31,653**	**96,393**	**10,508**	**57,154**	**274,696**
Interest sensitivity gap	**53,499**	**2,400**	**27,591**	**(8,605)**	**(2,781)**	**(43,933)**	**28,171**

As at 31 December 2011	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Non–interest bearing	Total
Assets							
Cash and cash equivalents	26,832	–	–	–	–	17,325	**44,157**
Obligatory reserve with Central Bank	24,356	–	–	–	–	–	**24,356**
Loans and advances to customers	30,909	29,564	55,069	99,300	11,112	65	**226,019**
Other financial assets	–	–	–	–	–	1,390	**1,390**
Total assets	**82,097**	**29,564**	**55,069**	**99,300**	**11,112**	**18,780**	**295,922**
Liabilities and equity							
Deposits from customers	35,747	18,981	58,338	48,383	412	56,559	**218,420**
Borrowings	3,939	11,533	7,921	2,151	3,170	8,222	**36,936**
Subordinated debt	–	–	–	8,801	6,846	438	**16,085**
Other financial liabilities	–	–	–	–	–	1,172	**1,172**
Total liabilities and equity	**39,686**	**30,514**	**66,259**	**59,335**	**10,428**	**66,391**	**272,613**
Interest sensitivity gap	**42,411**	**(950)**	**(11,190)**	**39,965**	**684**	**(47,611)**	**23,309**

Based on the above interest rate sensitivity, at 31 December 2011, if interest rates had been 1% lower with all other variables remaining constant, the result for the year would have been BAM 360 thousand (2010: BAM 499 thousand) higher. Conversely, a 1% increase in interest rates would have reduced the result for the year by the same amount.

The interest rate sensitivity analysis includes all variable interest rate assets and liabilities and assumes that all short-term fixed rate assets and liabilities are reinvested upon maturity.

4.3 Liquidity risk

Liquidity risk in the narrowest sense (risk of insolvency) is the danger that the Bank will no longer be able to meet its current and future payment obligations in full, or in a timely manner. Liquidity risk in a broader sense (funding risk) is the danger that additional funding can no longer be obtained, or can only be obtained at increased market interest rates. The Bank's ALCO is responsible for deciding on all final proposals undertaken to manage liquidity and is also responsible for making strategic proposals to the Management Board.

The Supervisory Board has approved the Bank's Liquidity Risk Management Programme. The Bank manages liquidity risk by seeking to apply the optimum combination of maturity and foreign currency structure of the assets and liabilities. To determine the robustness of the Bank's liquidity in the face of potential shocks, the Risk Department performs regular stress tests based on scenarios defined in the Liquidity Risk Management Policy. If negative gaps are found, contingency plans are discussed by the ALCO and approved by the Management Board. Throughout 2011, all of the Bank's liquidity indicators remained in compliance with the defined limits. Several factors inherent to the Bank's business model serve to offset liquidity risk. Firstly, the Bank has a diversified portfolio of loans that are mostly repaid in monthly instalments. Secondly, customer deposits are diversified, i.e. they are spread across a large number of depositors each holding relatively small amounts.

Sources of liquidity are regularly reviewed by the Treasury Department and the Risk Department, on the basis of which measures are decided upon by the ALCO and the Risk Management Committee of the Bank with the aim of maintaining broad diversification by currency, geography, provider, product and term.

The primary responsibility for identifying, assessing, addressing, monitoring and communicating the Bank's liquidity and funding risk lies with the Management Board. The Treasury Department manages the liquidity situation on a daily basis. Liquidity risk is monitored in the regular ALCO meetings, in which members of the Management Board participate. The Risk Management Department is responsible for controlling and monitoring liquidity risk, ensuring that it is in line with the Liquidity Risk Management Programme and the limits which it sets, and is also responsible for monitoring to ensure that the measures defined by the ALCO are being put into practice.

The key tools for measuring liquidity risks are liquidity gap analyses, which estimate future funding needs or the levels of excess liquidity, applying different assumptions. Based on the maturity gap analyses, certain key liquidity indicators are calculated on at least a monthly basis and are closely monitored. One important indicator of short-term liquidity is the sufficient liquidity indicator (SLI), which compares the amounts of assets and liabilities available within the next 30 days, and must not fall below 1 for each material currency. This implies that the Bank always has sufficient funds to be able to repay the liabilities expected to be due within the next 30 days. At 31 December 2011 this ratio was 2.8 , while at 31 December 2010 it was 2.2.

Another short-term key indicator is the highly liquid assets indicator, which relates highly liquid assets to customer deposits. The indicator must always exceed 20%, which implies that the Bank always holds funds which can quickly be converted into cash in order to repay 20% of all customer deposits. At 31 December 2011 this ratio was 30%, while at 31 December 2010 it was 33%.

The Bank also analyses its liquidity situation from a more structural perspective, taking into account the liquidity gaps of the different time buckets and additional sources of potential liquidity. This analysis also takes into account credit lines which can be drawn by the Bank with some lead time, potential outflows due to unused approved exposures, and other assets which take some time to liquidate.

Depositor concentrations are monitored in order to avoid dependencies on a few large depositors. According to the Bank's internal guidelines a significant depositor concentration exists if the 10 largest deposits exceed 20% of total customer deposits. At 31 December 2011 this ratio was 12% while at 31 December 2010 it was 18%.

In 2011 the Bank's loan portfolio grew, but so did its borrowings and deposits. As a consequence, during 2011 the Bank's overall liquidity situation has not changed, and the Bank still has an excess of liquid funds.

The table below divides the assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. Other assets and liabilities which do not have contractual maturity are classified into relevant maturity groupings in accordance with the Bank's plan.

As at 31 December 2011	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	41,390	–	–	–	–	**41,390**
Obligatory reserve with Central Bank	20,291	–	–	–	–	**20,291**
Loans and advances to customers	38,725	17,405	75,171	130,881	20,420	**282,602**
Other financial assets	1,325	–	–	–	–	**1,325**
Total assets	**101,731**	**17,405**	**75,171**	**130,881**	**20,420**	**345,608**
Liabilities and equity						
Deposits from customers	87,565	11,573	26,314	94,464	570	**220,486**
Borrowings	–	30,021	12,034	3,270	3,326	**48,651**
Subordinated debt	–	–	1,956	14,109	11,211	**27,276**
Other financial liabilities	930	–	–	–	–	**930**
Total liabilities and equity	**88,495**	**41,594**	**40,304**	**111,843**	**15,107**	**297,343**
Net liquidity gap	**13,236**	**(24,189)**	**34,867**	**19,038**	**5,313**	**48,265**
Contingencies and commitments	5,858	16,147	10,660	2,657	–	**35,322**
Financial guarantees and letters of credit	602	2,731	9,984	2,657	–	**15,974**
Loan commitments	5,256	13,416	676	–	–	19,348

As at 31 December 2010	Up to 1 month	1 – 3 months	3 – 12 months	1 – 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	44,157	–	–	–	–	**44,157**
Obligatory reserve with Central Bank	24,356	–	–	–	–	**24,356**
Loans and advances to customers	33,479	17,790	69,722	127,000	21,898	**269,889**
Other assets	1,390	–	–	–	–	**1,390**
Total assets	**103,382**	**17,790**	**69,722**	**127,000**	**21,898**	**339,792**
Liabilities and equity						
Deposits from customers	92,165	19,982	62,037	52,709	850	**227,743**
Borrowings	3,939	8,169	10,687	12,205	3,454	**38,454**
Subordinated debt	–	–	1,966	13,372	13,472	**28,810**
Other liabilities	1,172	–	–	–	–	**1,172**
Total liabilities and equity	**97,276**	**28,151**	**74,690**	**78,286**	**17,776**	**296,179**
Net liquidity gap	**6,106**	**(10,361)**	**(4,968)**	**48,714**	**4,122**	**43,613**
Contingencies and commitments	2,483	4,866	17,750	2,325	–	27,424
Financial guarantees and letters of credit	909	2,184	6,780	2,325	–	12,198
Loan commitments	1,574	2,682	10,970	–	–	15,226

Off-balance sheet items maturity

(a) Loan commitments
The dates of the contractual amounts of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers and other facilities are summarised in the table below.

(b) Financial guarantees and letters of credit
Financial guarantees and letters of credit are also included in the table below based on the earliest contractual maturity date.

(c) Operating lease commitments
Where the Bank is the lessee, the future minimum lease payments under non-cancellable operating leases are summarised in the table below.

	No later than 1 year	1 – 5 years	Over 5 years	Total
As at 31 December 2011				
Operating lease commitments	2,593	7,920	1,585	**12,098**
Total	**2,593**	**7,920**	**1,585**	**12,098**
As at 31 December 2010				
Operating lease commitments	2,871	8,852	1,969	**13,692**
Total	**2,871**	**8,852**	**1,969**	**13,692**

4.4 Operational risk

Operational risk is recognised as an important risk factor for the Bank, given that it relies on decentralised processing and decision-making. In line with Basel II, the Bank defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems and/or external events. This category includes all "risk events" in the areas of personnel, processes, and information technology. To further expand the processes for managing operational risks, a new Operational Risk Policy was implemented in the Bank in 2009. The principles outlined in this document have been designed to effectively manage the Bank's operational risk exposure. They are in compliance with the Basel II requirements for the "standard approach".
The overall framework for managing operational risks is best described as a complementary and balanced system comprising the following key components: Corporate Culture, Governance Framework, Policies and Procedures, Risk Assessments, New Risk Approvals (NRAs), Key Risk Indicators and the Risk Event Database. While the Corporate Culture, the Governance Framework, and Policies and Procedures define the basic cultural and organisational parameters, Risk Assessments, New Risk Approvals (NRAs), Key Risk Indicators and the Risk Event Database form the key instruments with which the risk management process is executed.

The overall objectives of the ProCredit Bank's approach to the management of operational risks are:

- to understand the drivers of the bank's operational risks;
- to be able to identify critical issues as early as possible;
- to avoid losses caused by operational risks; and
- to ensure efficient use of the bank's capital.

To deliver on these goals the following tools and processes have been implemented within the framework outlined above. They are presented in the sequence in which they are used within the operational risk management process. This process is subdivided into the following phases: identification, evaluation, treatment, monitoring, documentation and communication, and follow up.

- **Identification**
  - Annual operational risk assessments
  - Detailed process reviews as appropriate
  - New risk approval (NRA) process
  - Risk identification and documentation in the Risk Event Database (RED)
  - Ad hoc identification of potential risks
- **Evaluation / quantification**
  - Agreed standards to quantify risks

- **Mitigation and treatment**
  - Implementation of measures to avoid, reduce or mitigate the risks depending on priorities, efficiency considerations and regulations
  - Transfer of risk to an insurer or other party
- **Monitoring and control**
  - Process owners' responsibility to monitor risks
  - Key risk indicators (KRIs) and operational risk reports, risk-bearing capacity calculation and monitoring
- **Communication, escalation, documentation**
  - Escalation levels to management bodies, regular reporting, risk committees
  - RED, management summary documents for risk events
- **Issue tracking / follow-up tables for material action plans**
  - Follow-up tools used in the bank

As part of their initial training, all new staff members are taught how to recognise and avoid operational risk and how to maintain information security.
As of 31 December 2011, no significant legal proceedings were pending.

4.5 Fair values of financial assets and liabilities

The table below summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Bank's statement of financial position at their fair value.

	Carrying value		Fair value	
	2011	2010	2011	2010
Assets				
Loans and advances to customers	239,861	226,019	238,510	224,628
Liabilities				
Deposits from customers	210,205	218,420	212,028	220,910
Borrowings	47,482	36,936	46,055	34,064
Subordinated debt	16,079	16,085	22,116	17,094

Financial assets available for sale are carried at cost as they do not have a quoted market price in an active market and their fair value cannot be reliably measured.

(i) Loans and advances to customers
The fair value of loans and advances is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans. The carrying value of loans with variable interest rate approximates their fair value.

(ii) Deposits from customers, borrowings and subordinated debt
The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand.
The estimated fair value of fixed interest-bearing deposits and other borrowings not quoted in an active market is based on discounted cash flows using interest rates for new debts with similar remaining maturity.
The fair value of the term deposits at variable interest rates approximates their carrying values as of the reporting date.

4.6 Capital management

The Bank's objectives when managing capital, which is a broader concept than the item Equity in the statement of financial position, are:

- To comply with the capital requirements set by the regulators of the banking market in local environment;
- To safeguard the bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the balance of capital are monitored regularly by the ALCO and the Bank's Management Board and reported to the Group Risk Management Committee, based on the relevant internal acts and regulations prescribed by the supervisory authority (Banking Agency of the Federation of Bosnia and Herzegovina). The required information and reports are submitted to the Banking Agency on a quarterly basis. Aside from ratios prescribed by local regulator and Basel II capital ratios, the leverage ratio and risk bearing capacity are monitored on a monthly basis by the Bank's Risk Management Committee and the ProCredit Group Risk Management Committee.

The table below summarises the composition of regulatory capital and the capital adequacy ratio of the Bank for the years ended 31 December 2011 prepared in accordance with Banking Agency regulations.
Net capital of the Bank consists of: a) Core capital (Tier 1), and b) Supplementary capital (Tier 2).
Core capital (Tier 1) of the Bank includes: Shareholders' capital (46,458) and share premium issues (293), deducted with uncovered losses transferred from previous year (5,232) and Amount of intangible assets (947).
Supplementary capital (Tier 2) of the Bank includes: General reserves for credit losses for Bank's assets evaluated as Category A - Good Assets (5,808) and Amount of subordinated debt (16,079), less absent loan loss reserves for regulatory requirement (293).

	2011	2010
Bank's net capital according to Banking Agency regulations	**52,807**	**47,633**
Risk of Risk Weighted Assets and Loan Equivalent	265,877	248,410
Weighted operational risk	40,334	46,331
Total weighted risk	**306,211**	**294,741**
Capital adequacy ratio	**17.2%**	**16.2%**

The minimum capital requirement according to Banking Agency regulations amounts to 12%.

5. Critical accounting estimates and judgments

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Impairment losses on loans and advances

The Bank reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in profit or loss, the Bank makes judgments as to whether there are any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a Bank, or national or local economic conditions that correlate with defaults on assets in the Bank. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Assets accounted for at amortised cost are evaluated for impairment on the basis described in Note 3.6.

(b) Taxation

The Bank is subject to income taxes in Bosnia and Herzegovina. Tax returns are subject to the approval of the tax authorities who are entitled to carry out subsequent inspections of taxpayers' records. The interpretation of tax legislation by the 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 the tax authorities and the Bank may be assessed as liable for additional taxes, penalties and interest, which can be significant. In accordance with the Law on Tax Authority of the Federation of Bosnia and Herzegovina, tax liabilities are normally open to inspection by the tax authorities for a period of five years from the origination of the liability.

(c) *Regulatory requirements*

The Banking Agency of the Federation of Bosnia and Herzegovina is entitled to carry out regulatory inspections of the Bank's operations and to request changes to the carrying values of assets and liabilities, in accordance with the underlying regulations.

6. Net interest income

	2011	2010
Interest and similar income		
Loans and advances to customers	26,754	27,412
Cash and cash equivalents	59	148
Obligatory reserve with the Central Bank	124	113
	26,937	**27,673**
Interest expense and similar charges		
Current accounts and deposits from customers	(6,367)	(7,955)
Borrowings and subordinated debt	(3,159)	(2,671)
	(9,526)	**(10,626)**

7. Net fee and commission income

	2011	2010
Fee and commission income		
Foreign payment transactions	1,107	1,048
Domestic payment transactions	956	1,014
Guarantees and letters of credit	407	397
Foreign exchange transactions	881	790
Western Union and card business	270	271
Accounts maintenance fees	763	908
Other payment transaction fees	340	378
Other fees and commissions from customers	544	459
	5,268	**5,265**
Fee and commission expense		
Banks	(224)	(239)
Other	(953)	(859)
	(1,177)	**(1,098)**

8. Foreign exchange gains

	2011	2010
Positive foreign exchange differences	63,540	69,397
Negative foreign exchange differences	(63,181)	(69,154)
	359	**243**

9. Other operating income

	2011	2010
Net gain from disposal of property and equipment	107	229
Other	601	353
	708	**582**

10. Personnel expenses

	2011	2010
Salaries and wages	6,355	7,652
Taxes and contributions	4,386	5,033
Post-employment contributions (Note 25)	(4)	(13)
Food allowances and transportation	1,196	1,529
Reimbursement of expenses	(351)	(99)
Other	66	142
	11,648	**14,244**

The number of persons employed by the bank at year-end was 427 (2010: 501).

11. Other operating expenses

	2011	2010
Rent	2,650	2,981
Promotion and marketing	539	625
Consulting services	607	668
Insurance	1,549	1,676
Post and telecommunication services	543	589
Stationery	169	195
Maintenance of fixed assets and equipment	760	757
Utilities and electricity	607	630
Administrative, court and other legal fees	461	472
Transport	182	247
ProCredit group management fee	755	817
ProCredit group consulting services	410	408
Net impairment losses for maintenance fee and off balance	(17)	14
Other consumables	102	20
One-time working contracts	223	56
Other	803	1,005
	10,343	**11,160**

12. Net impairment losses

	2011	2010
Loans to individuals (Note 16)	155	(157)
Loans to corporate entities (Note 16)	(1,662)	(1,014)
Other assets (Note 21)	60	19
	(1,447)	**(1,152)**

13. Income tax

Income tax recognised in profit or loss includes current and deferred tax.

	2011	2010
Current tax expense	–	–
Net deferred tax credit (Note 19)	(239)	(275)
Total income tax benefit	**(239)**	**(275)**

Further information about deferred income tax is presented in Note 20. The official tax rate is 10% (2010: 10%).

Reconciliation of the accounting profit and income tax expense

	2011	2010
Profit / (loss) before tax	**212**	**(5,507)**
Tax calculated at a tax rate of 10% (2010:10%)	21	(551)
Tax effects of items which are not deductible:		
– non-taxable income	(430)	(6)
– non-deductible expenses	170	282
Income tax benefit for the year	**(239)**	**(275)**

In accordance with the Law on Corporate Profit Tax, tax losses can be carried forward for relief against profit of future accounting periods, but not for longer than 5 years.

Tax losses can be carried forward as follows:

	2011	2010
Up to 5 years	3,812	–
Up to 4 years	4,785	15,382
Up to 3 years	12,178	–
Up to 2 years	–	–
Up to 1 year	–	–
	20,775	**15,382**

The Bank's tax liabilities are ascertained in tax statements prepared by the Bank and might be a matter of subsequent inspection and consequent adjustment by tax authorities in a five year period after recognition. The Bank's Management Board is not aware of any circumstances which may give rise to a potential material liability in this respect.

14. Cash and cash equivalents

	2011	2010
Cash in hand	11,605	15,227
Current accounts with other banks	10,700	3,002
Balances with the Central Bank other than obligatory reserve	19,085	25,928
	41,390	**44,157**

15. Obligatory reserve with the Central Bank

	2011	2010
Obligatory reserve with the Central Bank	20,291	24,356
	20,291	**24,356**

The Central Bank of Bosnia and Herzegovina determines the requirement for banks to hold obligatory reserves in the form of amounts required to be deposited with the Central Bank. The obligatory reserve requirement at 31 December 2011 amounted to 7% for liabilities with maturity above 1 year, and 10% for liabilities with maturity up to 1 year. The obligatory reserve is maintained through the average balance in the ordinary reserve account with the Central Bank.

16. Loans and advances to customers

	2011	2010
Loans to individuals		
– short term	3,971	3,045
– long term	74,446	84,655
	78,417	**87,700**
Loans to corporate entities		
– short term	41,801	25,119
– long term	126,389	120,233
	168,190	**145,352**
Gross loans and advances to customers	**246,607**	**233,052**
Less: allowance for impairment	(6,746)	(7,033)
Net loans and advances to customers	**239,861**	**226,019**
Current (net)	113,298	103,145
Non-current (net)	126,563	122,874

Loans and advances to customers are presented including accrued interest in the amount of BAM 1,625 thousand (2010: BAM 1,561 thousand), and net of deferred fees in the amount of BAM 1,528 thousand (2010: BAM 1,500 thousand).

The movement in impairment allowance for loans and advances to customers is as follows:

Individuals	Overdraft	Housing	Others	Total
Balance at 1 January 2011	76	350	372	**798**
Net charge/(release) to profit or loss (Note 12)	39	145	(29)	**155**
Amounts written off	(68)	6	(50)	**(112)**
Unwinding of discount	–	(3)	(1)	**(4)**
Balance at 31 December 2011	**47**	**498**	**292**	**837**

Corporate entities	Very small business	Small business	Medium business	Agricultural	Total
Balance at 1 January 2011	2,794	1,271	809	1,361	**6,235**
Net charge/(release) to profit or loss (Note 12)	(1,077)	83	316	(984)	**(1,662)**
Net effect of amounts collected and written off	742	63	(15)	590	**1,380**
Unwinding of discount	(14)	(17)	(13)	–	**(44)**
Balance at 31 December 2011	**2,445**	**1,400**	**1,097**	**967**	**5,909**

Individuals	Overdraft	Housing	Others	Total
Balance at 1 January 2010	103	528	442	**1,073**
Net charge/(release) to profit or loss (Note 12)	53	(166)	(44)	**(157)**
Amounts written off	(80)	(12)	(26)	**(118)**
Balance at 31 December 2010	**76**	**350**	**372**	**798**

Corporate entities	Very small business	Small business	Medium business	Agricultural	Total
Balance at 1 January 2010	6,538	1,331	636	4,254	**12,759**
Net charge/(release) to profit or loss (Note 12)	(233)	71	(4)	(849)	**(1,015)**
Amounts written off	(3,511)	(131)	180	(2,044)	**(5,506)**
Unwinding of discount	–	–	(3)	–	**(3)**
Balance at 31 December 2010	**2,794**	**1,271**	**809**	**1,361**	**6,235**

17. Property and equipment

The cost of property and equipment and related depreciation for 2011 is presented below:

2011	Buildings	Leasehold improvements	Furniture & Equipment	Assets in course of construction	Total
Cost					
Balance at 1 January 2011	448	4,216	14,082	570	19,316
Additions	–	195	651	16	862
Transfers	–	60	234	(294)	–
Disposals and write offs	–	(79)	(503)	–	(582)
Balance at 31 December 2011	**448**	**4,392**	**14,464**	**292**	**19,596**
Accumulated depreciation					
Balance at 1 January 2011	308	2,551	11,056	–	13,915
Charge for the year	6	361	1,061	–	1,428
Disposals and write offs	–	(78)	(454)	–	(532)
Balance at 31 December 2011	**314**	**2,834**	**11,663**	**–**	**14,811**
Carrying amount at					
31 December 2011	**134**	**1,558**	**2,801**	**292**	**4,785**
1 January 2011	**140**	**1,665**	**3,026**	**570**	**5,401**

Assets in the course of construction mainly relate to equipment not yet put into use.

The cost of property and equipment and related depreciation for 2010 is presented below:

2010	Buildings	Leasehold improvements	Furniture & Equipment	Assets in course of construction	Total
Cost					
Balance at 1 January 2010	728	4,034	14,821	521	20,104
Additions	–	177	359	256	792
Transfers	(280)	22	185	(207)	(280)
Disposals and write offs	–	(17)	(1,283)	–	(1,300)
Balance at 31 December 2010	**448**	**4,216**	**14,082**	**570**	**19,316**
Accumulated depreciation					
Balance at 1 January 2010	315	2,087	9,806	–	12,208
Charge for the year	8	470	2,420	–	2,898
Transfers	(15)	–	–	–	(15)
Disposals and write offs	–	(6)	(1,170)	–	(1,176)
Balance at 31 December 2010	**308**	**2,551**	**11,056**	**–**	**13,915**
Carrying amount at					
31 December 2010	**140**	**1,665**	**3,026**	**570**	**5,401**
1 January 2010	**413**	**1,947**	**5,015**	**521**	**7,896**

18. Intangible assets

2011	Software	Licences and other intangible assets	Total
Cost			
Balance at 1 January 2011	304	2,592	2,896
Additions	33	351	384
Balance at 31 December 2011	**337**	**2,943**	**3,280**
Accumulated amortisation			
Balance at 1 January 2011	251	1,697	1,948
Charge for the year	19	366	385
Balance at 31 December 2011	**270**	**2,063**	**2,333**
Carrying amount at			
31 December 2011	**67**	**880**	**947**
1 January 2011	**53**	**895**	**948**

2010	Software	Licences and other intangible assets	Total
Cost			
Balance at 1 January 2010	265	2,254	2,519
Additions	39	338	377
Balance at 31 December 2010	**304**	**2,592**	**2,896**
Accumulated amortisation			
Balance at 1 January 2010	172	1,380	1,552
Charge for the year	79	317	396
Balance at 31 December 2010	**251**	**1,697**	**1,948**
Carrying amount at			
31 December 2010	**53**	**895**	**948**
1 January 2010	**93**	**874**	**967**

19. Deferred tax assets

Deferred income taxes are calculated on all temporary differences under the balance sheet method using an effective tax rate of 10% (2010: 10%).
In accordance with the Law on Corporate Profit Tax, tax losses can be carried forward for relief against profit of future accounting periods, but for not longer than 5 years. The Bank has recognised deferred tax assets relating to unused tax losses carried forward, as the Management Board estimates that there will be future taxable profit against which the Bank can utilise these benefits.

Movement in deferred tax assets

	Loan impairment	Other items	Tax loss carried forward	Total
Balance at 1 January 2011	(85)	5	1,891	1,811
Origination and reversal of temporary differences	14	(5)	230	239
Balance at 31 December 2011	**(71)**	**–**	**2,121**	**2,050**
Balance at 1 January 2010	67	4	1,465	1,536
Origination and reversal of temporary differences	(152)	1	426	275
Balance at 31 December 2010	**(85)**	**5**	**1,891**	**1,811**

20. Other assets

	2011	2010
Prepaid rent	5	145
Prepaid income tax	247	247
Advance payments	126	139
Receivables from card operators	280	252
Other property (Note 18)[1]	265	265
Other assets[2]	545	643
Impairment allowance	(65)	(30)
	1,403	**1,661**

Movement in allowances for other assets' impairment are as follows:

	2011	2010
Balance at 1 January	30	112
Net charge to profit or loss (Note 12)	60	19
Amounts written off	(25)	(101)
Balance at 31 December	**65**	**30**

[1] Relates to a building in Samac that is considered an asset available for sale.
[2] Receivables from government, banks, legal entities, etc.

21. Deposits from customers

	2011	2010
Business customers		
– Current accounts and demand deposits	34,367	37,074
– Term deposits	20,904	34,060
Individual customers		
– Current accounts and demand deposits	46,619	48,930
– Term deposits	108,315	98,356
	210,205	**218,420**
Current	120,895	169,504
Non-current	89,310	48,916

Deposits from business customers include BAM 5,111 thousand (2010: BAM 10,604 thousand) indexed to EUR.

22. Borrowings

	2011	2010
The Commission of the European Union	–	7,801
Kreditanstalt für Wiederaufbau	1,831	3,939
The European Fund for Southeast Europe	4,945	9,881
Commerzbank	11,776	6,878
ProCredit Holding	19,764	201
International Fund for Agricultural Development	3,191	3,225
Blue Orchard	5,975	–
Nova Banka AD Banja Luka	–	5,011
	47,482	**36,936**
Current	41,379	22,031
Non-current	6,103	14,905

The Bank has not had any defaults of principal or interest with respect to its borrowings.

Description of borrowings

- Loan agreement for the Granting of Individual Loans between Kreditanstalt für Wiederaufbau (KfW) and ProCredit Bank d.d. Sarajevo amounted to EUR 250,000, interest rate Euribor +2%, final maturity is 30 September 2012.
- Loan agreement between Kreditanstalt für Wiederaufbau (KfW) and ProCredit bank d.d. Sarajevo amounted to EUR 1,900,000, interest rate Euribor + 1.75%, final maturity is 30 September 2012.
- Loan agreement between Kreditanstalt für Wiederaufbau (KfW) and ProCredit bank d.d. Sarajevo amounted to EUR 2,750,000, interest rate Euribor + 2.25%, final maturity is 30 September 2012.
- Loan agreement between the European Fund for Southeast Europe (EFSE) and ProCredit Bank d.d. Sarajevo amounted to EUR 4,650,000, interest rate Euribor + 2%, final maturity is 22 September 2012.
- Loan agreement between the European Fund for Southeast Europe (EFSE) and ProCredit Bank d.d. Sarajevo amounted to EUR 1,982,437.51, interest rate Euribor, final maturity is 22 September 2012.
- Loan agreement between the European Fund for Southeast Europe (EFSE) and ProCredit Bank d.d. Sarajevo amounted to EUR 6,848,892.27, interest rate 5.60%, final maturity is 22 September 2012.
- Loan agreement between the European Fund for Southeast Europe (EFSE) and ProCredit Bank d.d. Sarajevo amounted to EUR 1,664,063.67, interest rate Euribor, final maturity is 22 September 2012.
- Loan agreement between ProCredit Holding AG & Co. KGaA and ProCredit Bank d.d. Sarajevo amounted to EUR 10,000,000, interest rate 4.03%, final maturity is 23 January 2012.
- Loan agreement between ProCredit Holding AG & Co. KGaA and ProCredit Bank d.d. Sarajevo amounted to EUR 10,000,000, interest rate 3.55%, final maturity is 2 November 2012.
- Loan agreement between the International Fund for Agricultural Development (IFAD) and ProCredit Bank d.d. Sarajevo amounted to BAM 1,066,657, interest rate Euribor, final maturity is 22 September 2012.
- Loan agreement between the International Fund for Agricultural Development (IFAD) and ProCredit Bank d.d. Sarajevo amounted to BAM 554,035.89, interest rate 2%, final maturity is 25 December 2020.
- Loan agreement between Commerzbank AG and ProCredit Bank d.d. Sarajevo amounted to EUR 3,500,000, interest rate Euribor + 1.40%, final maturity is 25 April 2012.
- Loan agreement between Blue Orchard and ProCredit Bank d.d. Sarajevo amounted to EUR 3,000,000, interest rate Euribor + 3.60%, final maturity is 28 February 2013.

23. Subordinated debt

	2011	2010
Subordinated debt	16,079	16,085
	16,079	**16,085**
Current	432	438
Non-current	15,647	15,647

A subordinated loan agreement was signed between ProCredit Bank d.d. Sarajevo and ProCredit Holding AG on 31 August 2005. The loan bears interest at 8.9% p.a. The loan shall expire on 7 September 2015 and is repayable upon maturity.
An additional subordinated loan agreement was signed between ProCredit Bank d.d. Sarajevo and ProCredit Holding AG on 26 September 2007. The loan bears interest at 10.51% p.a. The loan shall expire on 26 September 2022 and is repayable upon maturity.
The Bank has not had any defaults of principal or interest or other breaches with respect to its subordinated debt.

24. Provisions

	2011	2010
Provisions for contingencies and commitments (Note 27)	123	99
Provisions for severance payments	94	98
Provisions for court cases	48	25
	265	**222**

Movement in provisions for contingencies and commitments is as follows:

	2011	2010
Balance at 1 January	99	221
Net (release)/charge to profit or loss	24	(122)
Balance at 31 December	**123**	**99**

Movement in provisions for severance payments is as follows:

	2011	2010
Balance at 1 January	98	111
Net (release)/charge to profit or loss (Note 10)	(4)	(13)
Balance at 31 December	**94**	**98**

Movement in provisions for court cases is as follows:

	2011	2010
Balance at 1 January	25	–
Net charge to profit or loss	23	25
Balance at 31 December	**48**	**25**

25. Other liabilities

	2011	2010
Payables to suppliers	194	191
Accrued expenses	277	317
Other liabilities	541	1,145
	1,012	**1,653**

26. Share capital

	Share capital	
In BAM'000	**2011**	**2010**
On issue at 1 January	42,458	40,458
New shares issued	4,000	2,000
At 31 December	**46,458**	**42,458**

	Ordinary shares	
In number of shares	**2011**	**2010**
On issue at 1 January	4,245,777	4,045,777
New shares issued	400,000	200,000
At 31 December	**4,645,777**	**4,245,777**

The Bank's share capital consists of 4,645,777 ordinary shares. All shares have a par value of BAM 10 and are fully paid.
Share premium represents the excess of paid-in amount over the nominal value of the issued shares.
Statutory reserves represent additional capital set aside by appropriation from net income. These reserves are used to cover losses and are not distributable.
The shareholder structure of the Bank was as follows:

Name	% of voting share capital	
	2011	**2010**
ProCredit Holding AG & Co. KGaA	94.2	93.6
Commerzbank AG	5.8	6.4
	100%	**100%**

27. Commitments and contingencies

The following table indicates the contractual amounts of the Bank's contingencies and commitments by category:

	2011	2010
Guarantees		
– in domestic currency	12,108	8,940
– in foreign currency	3,818	2,858
Letters of credit	113	452
Undrawn lending commitments	19,406	15,273
	35,445	27,523
Less: Provision for contingencies and commitments (Note 24)	(123)	(99)
	35,322	**27,424**

28. Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and borrowings.
These transactions were carried out on commercial terms and at market rates. The volumes of related party transactions and outstanding balances at year-end are as follows:

Related party transactions for 2011

	ProCredit Holding	Other group companies	Bank's management	Bank's management close family members	Total
Current accounts					
ProCredit Bank Bulgaria	–	38	–	–	38
ProCredit Bank Kosovo	–	10	–	–	10
Balance at 31 December	**–**	**48**	**–**	**–**	**48**
Other assets					
ProCredit Bank Kosovo	–	44	–	–	**44**
Quipu GmbH	–	4	–	–	4
ProCredit Holding	5	–	–	–	5
Balance at 31 December	**5**	**48**	**–**	**–**	**53**
Other liabilities					
ProCredit Bank Kosovo	–	28	–	–	28
ProCredit Academy Germany	–	1	–	–	1
ProCredit Holding	5	–	–	–	5
Balance at 31 December	**5**	**29**	**–**	**–**	**34**
Loans					
Loans outstanding at 1 January	–	–	134	–	134
Loans issued during the year	–	–	11	–	11
Loan repayments during the year	–	–	(25)	–	(25)
Other decreases	–	–	(29)	–	(29)
Loans outstanding at 31 December	**–**	**–**	**91**	**–**	**91**
Interest income earned	–	–	6	–	6
Impairment losses for loans	–	–	(1)	–	(1)
Deposits					
Balance at beginning of year	–	–	28	17	45
Deposits received during the year	–	–	301	5	306
Deposits repaid during the year	–	–	(301)	–	(301)
Other decreases	–	–	(9)	(2)	(11)
Balance at 31 December	**–**	**–**	**19**	**20**	**39**
Interest expenses on deposits	–	–	–	1	**1**
Borrowings					
Loans outstanding at 1 January	16,085	–	–	–	16,085
Loans issued during the year	30,033	–	–	–	30,033
Loans repayments during the year	(10,288)	–	–	–	(10,288)
Balance at 31 December	**35,830**	**–**	**–**	**–**	**35,830**
Interest expenses on borrowings	**1,859**	**–**	**–**	**–**	**1,859**
Other expenses to group companies	**81**	**632**	**–**	**–**	**713**
Consulting fee[1]	**996**	**–**	**–**	**–**	**996**

[1] Consulting fee relates to management fees for providing management services and support without VAT

Related party transactions for 2010

	ProCredit Holding	Other group companies	Bank's management	Bank's management close family members	Total
Current accounts					
ProCredit Bank Bulgaria	–	145	–	–	145
ProCredit Bank Kosovo	–	8	–	–	8
Balance at 31 December	**–**	**153**	**–**	**–**	**153**
Other assets					
ProCredit Bank Kosovo	–	60	–	–	60
ProCredit Bank Romania	–	3	–	–	3
ProCredit Academy Macedonia	–	43	–	–	43
ProCredit Holding	4	–	–	–	4
Balance at 31 December	**4**	**106**	**–**	**–**	**110**
Other liabilities					
ProCredit Bank Kosovo	–	34	–	–	34
ProCredit Academy Germany	–	2	–	–	2
ProCredit Academy Macedonia	–	1	–	–	1
ProCredit Holding	29	–	–	–	29
Balance at 31 December	**29**	**37**	**–**	**–**	**66**
Loans					
Loans outstanding at 1 January	–	–	280	–	280
Loans issued during the year	–	–	27	–	27
Loan repayments during the year	–	–	(55)	–	(55)
Other decreases	–	–	(118)	–	(118)
Loans outstanding at 31 December	**–**	**–**	**134**	**–**	**134**
Interest income earned	–	–	9	–	9
Impairment losses for loans	–	–	(2)	–	(2)
Deposits					
Balance at beginning of year	–	–	83	3	86
Deposits received during the year	–	–	409	29	438
Deposits repaid during the year	–	–	(464)	(13)	(477)
Other decreases	–	–	–	(2)	(2)
Balance at 31 December	**–**	**–**	**28**	**17**	**45**
Interest expenses on deposits	–	–	1	–	**1**
Borrowings					
Loans outstanding at 1 January	16,083	–	–	–	16,083
Loans issued during the year	1,523	–	–	–	1,523
Loans repayments during the year	(1,521)	–	–	–	(1,521)
Balance at 31 December	**16,085**	**–**	**–**	**–**	**16,085**
Interest expenses on borrowings	**1,524**	**–**	**–**	**–**	**1,524**
Other expenses to group companies	**89**	**253**	**–**	**–**	**342**
Consulting fee[1]	**1,047**	**–**	**–**	**–**	**1,047**

[1] Consulting fee relates to management fees for providing management services and support without VAT

Key management compensation

During the reporting period, total compensation paid to the management of the Bank amounted to:

	2011	2010
Salaries and other short-term benefits	209	246
Other long-term employee benefits	2	2
	211	**248**

Additional information

The address of its registered office is as follows:

Head office: Sarajevo
Address: Emerika Bluma 8
Bosnia and Herzegovina

Branch offices:
Sarajevo
Address: Topal Osman paše 26
Ilidža
Address: Ibrahima Ljubovića 20
Bihać
Address: Safvet-bega Bašagića 18
Tuzla
Address: Džafer Mahala 29
Mostar
Address: Biskupa Čule bb
Banja Luka
Address: Kralja Petra I Karađorđevića 91
Bijeljina
Address: Karađorđeva 6/Atinska 1
Travnik
Address: Bosanska bb
Zenica
Address: Maršala Tita bb

Sub-branch offices:
Gradačac
Address: H. K. Gradaščevića bb
Zavidovići
Address: 8. Marta bb
Prijedor
Address: Svetosavska 12
Doboj
Address: Svetog Save 95
Posušje
Address: Fra Grge Martića bb

Service Points:
Sarajevo
Address: Muvekita 1
Mostar
Address: Braće Fejića bb
Banja Luka
Address: Brace Potkonjaka 2
Bijeljina
Address: Trg Kralja Petra I Karađorđevića 1
Pale
Address: Milana Simovića bb
Zalužani-Trn
Address: Put srpskih branilaca 167
Otoka
Address: Gradačačka 1
Ciglane
Address: Husrefa Redžića 1
Ilidža
Address: Hrasnička cesta 4
Brčko
Address: Bosne Srebrene 22
Tuzla / outlet;
Address: Bulevar 15.maja bb

Employees
As of 31 December 2011 ProCredit Bank d.d., Sarajevo employed 427 persons (2010: 501 persons).

Directors
The names of the Directors of the Bank serving during the financial year and to the date of this report are as follows:

Director
Frieder Wöhrmann

Executive Director
Edina Vuk

Executive Director
Edin Hrnjica

Executive Director
Vedran Hadžiahmetović

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