UniCredit Bank

Clear answers for real benefits.

2012 Annual Report

UniCredit

Customer testimonials are the common thread of this year's annual report to illustrate the concrete solutions we provide every day. These true stories were told first-hand and collected by the colleagues who worked with them to offer real benefits.

Each story lends an authentic voice to how we are having a positive impact on our stakeholders. We are making a difference by recognizing everyday challenges and opportunities, and by contributing to the economic, social and cultural well-being of the communities we serve.

This report's creative concept reflects our commitment by displaying two pieces that fit together. This represents the union between the real-life needs of our clients and the practical solutions that we offer.

Above all, we believe that being a commercial bank means engaging in meaningful dialogue with those with whom we come into contact. This enables us to provide simple, quick and effective responses that perfectly meet customer needs.

Inside you will find some of these stories. We hope the next one will be yours.

2012 Annual Report


A bank account that's always within a reach
FREEDOM
"The Pekao24Mobile app is user-friendly, quick and efficient. It's particularly handy when it comes to managing my account, such as checking my balance, following specific transactions and managing transfers or deposits. And its wheel-type interface is modern, eye-catching and very functional. I would say the app meets all my needs."
Daniel Lipski, customer of Bank Pekao in Poland

Contents

Overview 2011 / 2012

UniCredit bank Serbia, joint stock company

	2012 000 RSD	2011 000 RSD	2012 000 EUR	2011 000 EUR
Business results				
Operating income	12.611.930	11.410.785	110.905	109.047
Profit/(Loss) before tax	4.921.660	5.046.618	43.279	48.228
Net profit(Loss) for the period	4.399.747	4.540.133	38.690	43.388
Key figures				
Return on equity before tax	11.17%	13.57%	11.17%	13.57%
Return on equity after tax	9.98%	12.21%	9.98%	12.21%
Cost-Income ratio	35.46%	33.70%	35.46%	33.70%
Net fee and commission income to operating income	15.12%	14.54%	15.12%	14.54%
Balance sheet figures				
Balance sheet total	243.553.784	198.568.042	2.141.729	1.897.614
Loans to customes	152.089.577	131.157.030	1.337.424	1.253.401
Shareholders` equity	45.807.502	42.321.059	402.816	404.441
Indices (in accordance with NBS regulations)				
Core capital	36.470.296	40.435.597	320.707	386.422
Total capital	28.146.392	29.982.103	247.510	286.524
Risk Weighted assets	152.062.875	139.746.042	1.337.189	1.335.482
Capital adequacy ratio	18.51%	21.45%	18.51%	21.45%
Stuff number (heads)	1008	977	1008	977
Network - number of locations	75	75	75	75

LISTENING

Making a difference from anywhere, even in a taxi

“One day while driving my taxi, I struck up conversation with my passengers and found out they worked at UniCredit.
I told them that I was one of their customers and that I owned a fleet of taxis.
I also explained that I was trying to expand my business and had asked for a loan, but had yet to learn if my request was successful.
The next day one of them called me to follow up with the information I needed. She cared about helping me solve my problem, and I could not have been more satisfied with her support.
I thanked her and said that if she ever needed a taxi in Vienna - even to Milan - I would be there for her, as she was for me.”

Taxi driver, customer of UniCredit Bank in Vienna

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Executive Board

Despite the difficult market conditions which in the previous business year have characterized not only Serbia, but also the countries in the environment, UniCredit Bank has succeeded to achieve solid financial results, as well as to increase its market share when most important parameters are concerned. Regardless of the crisis, the Bank has continued to invest in the improvement of its business in Serbia through investments in employees and modernization of its operations, by placing the customer orientation in the very focus of its activities. At the end of 2012 UniCredit Bank Serbia net profit after taxes amounted RSD 4.4 billion. Furthermore, the Bank increased its client base by around 4.5%, in that way exceeding the overall number of 195 thousand customers at end of 2012.

During the last year UniCredit Bank continued to provide undiminished financial support both to the corporate and the retail clients, providing in that way an additional confirmation of its strong committment to the local market. Compared to the previous year, the volume of overall loans increased by 17.3% to the amount of approximatelly RSD 162 billion. Both corporate and retail loans contributed equaly to this growth. Market share when approved loans are concerned grew from 7.6% at the end of 2011 to 8.2% at the end of 2012. In addition, a significant increase of market share from 5.7% (2011) to 6.5% at the end of 2012 has been recorded when overall deposits, which exceeded RSD 111 billion, are concerned.

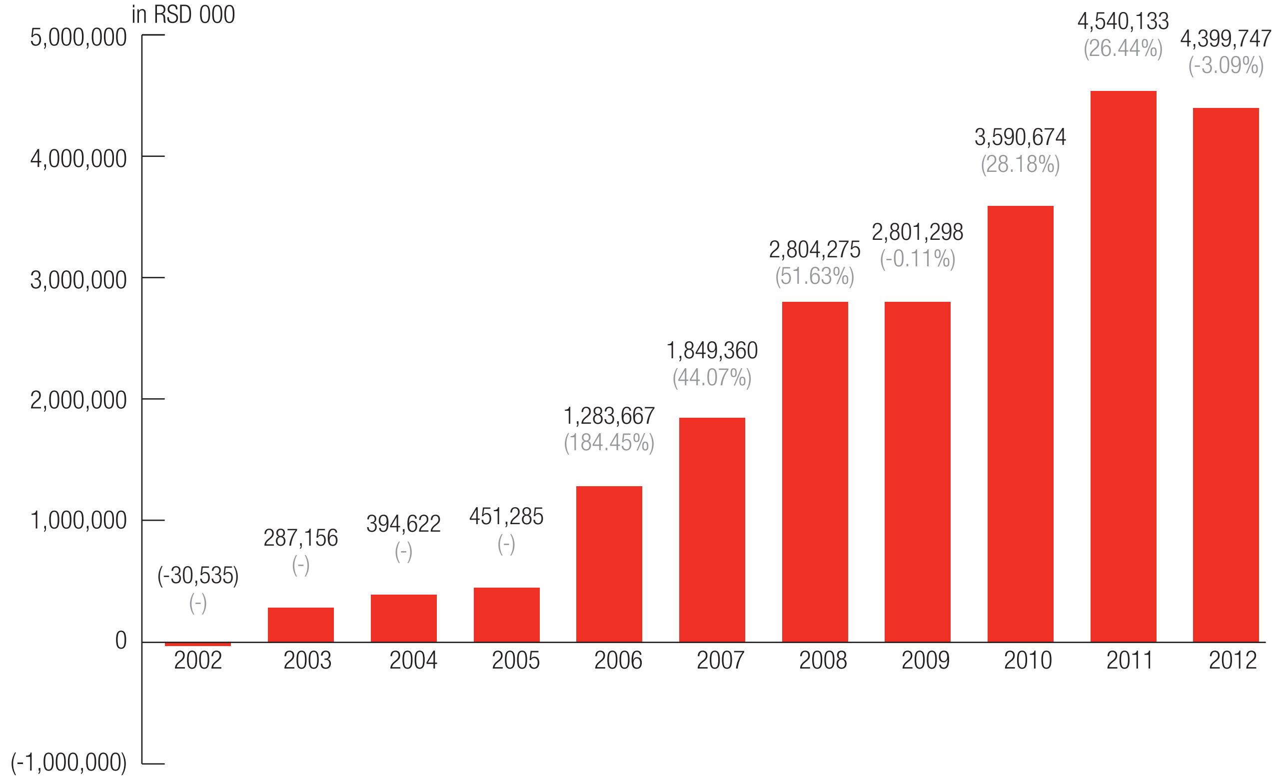
In comparison to 2011, at the end of 2012 total assets increased by 23%, exceeding in that way the figure of RSD 243.5 billion. Despite the financial crisis the Bank continued to invest in the improvement and development of its business and increase in the quality of services, which demonstrates an increase of operative costs in 2012 by around 15%. Investements in employees, namely in their professional development, have participated highly in these costs. Regardless of the negative trend when it comes to employment, UniCredit Bank has managed to record a modest increase in the number of employees, reaching 1,008.

We are very pleased that despite all the challenges we have been facing during the last year, we managed to prove our resistance to all turbulences and achieve solid financial results, while mainitaining at the same time stable business performance. Thanks to our client orientation and understanding of their needs we are constantly managing to create products and services according to their measure. Therefore, the number of our clients continues to grow and in line with that the portfolio of loans and deposits as well. Through numerous activities we are continuing to confirm our status as a socially responsible citizen, investing in projects of wider importance for local communities.

Being part of UniCredit, one of Europe's leading banking groups, we are also keen to let our customers in Serbia benefit from the advantages of a large network in 20 countries, cutting-edge advisory and financial capabilities, and most importantly in times of a difficult economic environment, our financial solidity and supportive everyday behavior in every customer-related activity. With our high customer orientation, and also with healthy portion of ambition and positive energy, we are looking forward to move together with our customers towards new goals and challenges.

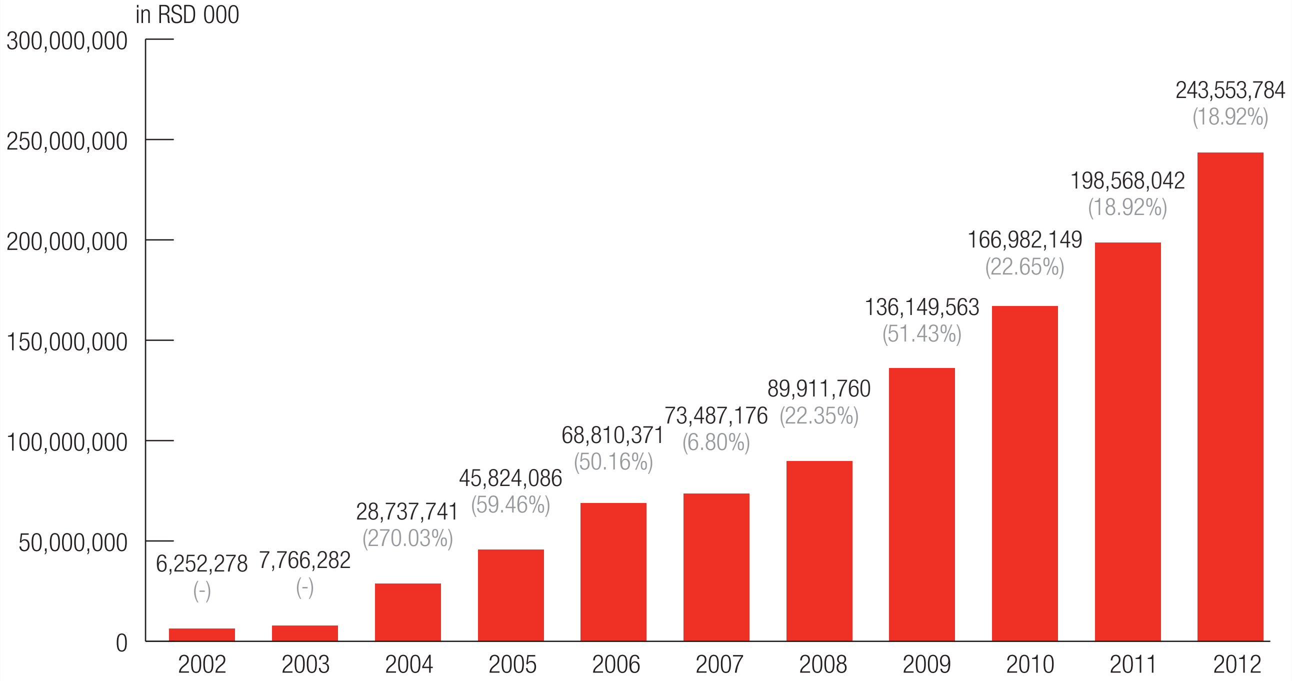
Analysis of results

Net profit after tax
in RSD 000



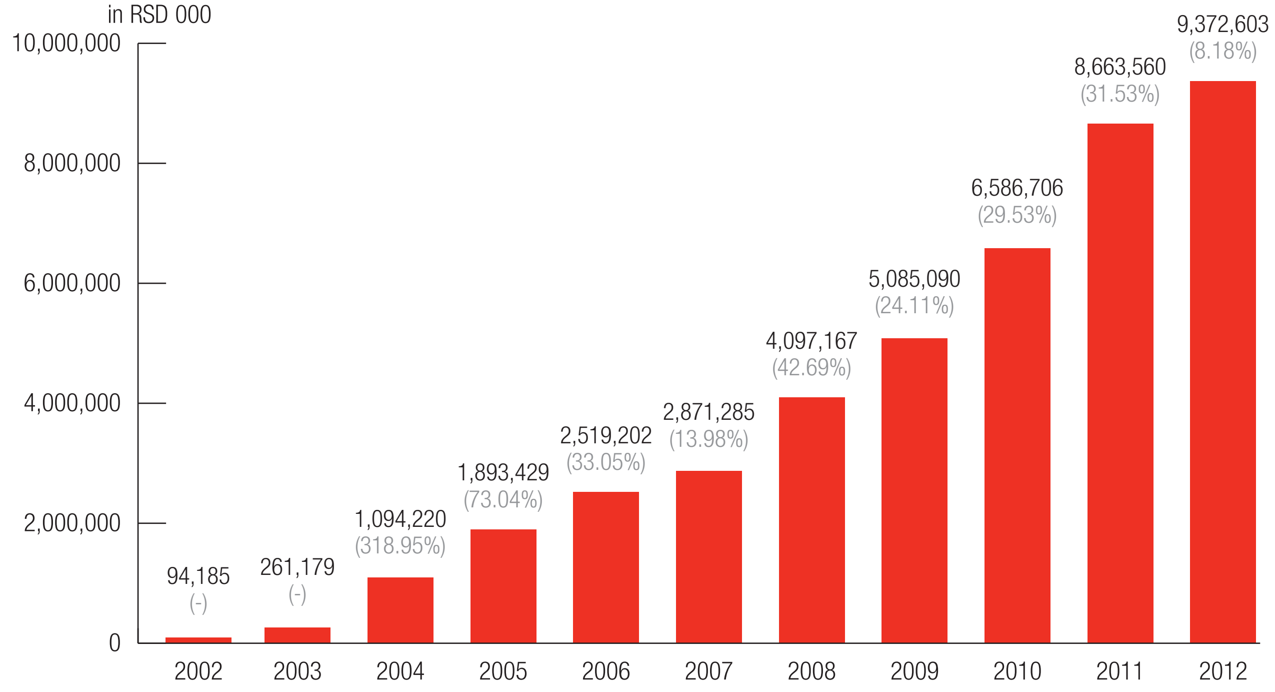
In 2012 net profit after tax decreased year-on-year by 3%.

Total assets
in RSD 000



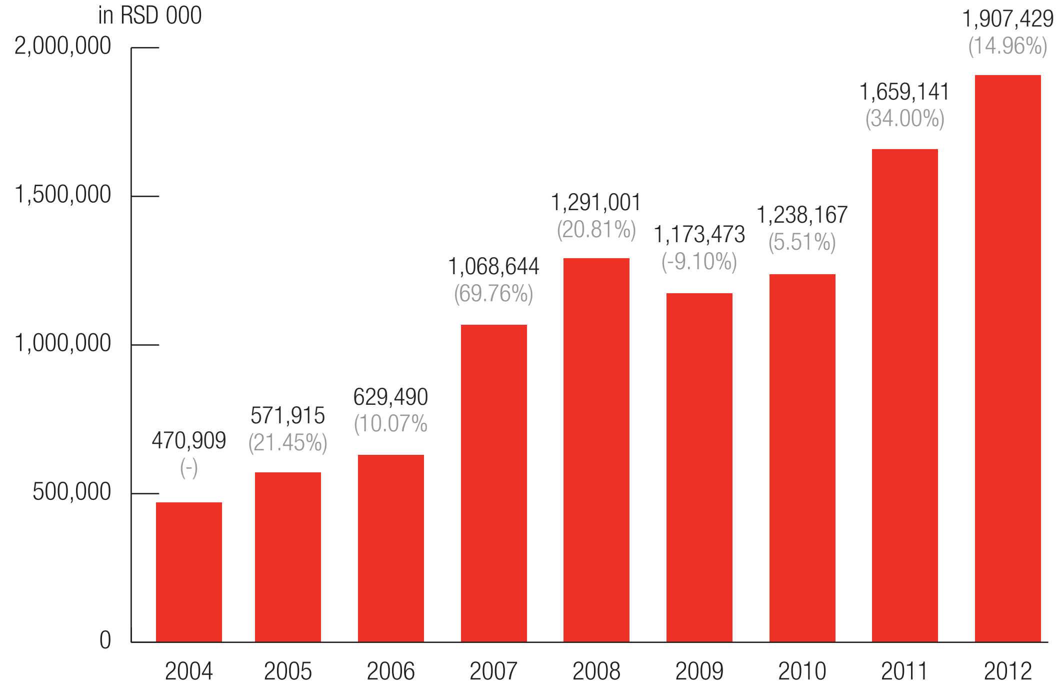
Total assets increased for 23% in 2012 and reached mio RSD 243,554

Net interest income
in RSD 000



Net interest income increased for 8% in 2012 and reached mio RSD 9,373

Net fee income
in RSD 000

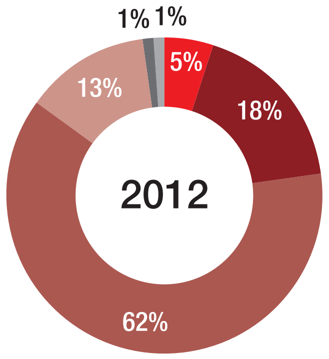


Net fee income increased by 15% comparing to 2011.

Analysis of results (CONTINUED)

Structure of assets 2011.
in RSD 000

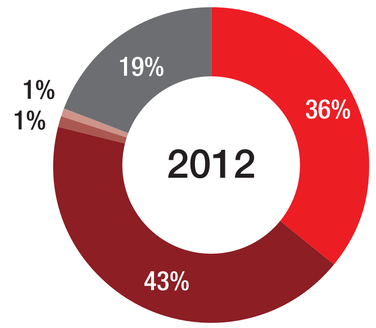
Cash, cash equivalents and non-pledged trading assets	5%	13,004,641
Loans and advances to banks	18%	44,593,753
Loans and advances to clients	62%	152,089,577
Investment securities	13%	30,467,071
Property, equipment and intangible assets	1%	2,151,835
Other assets	1%	1,246,907
	100.00%	243,553,784



Loans and advances to clients have the major share with 62% in total assets.

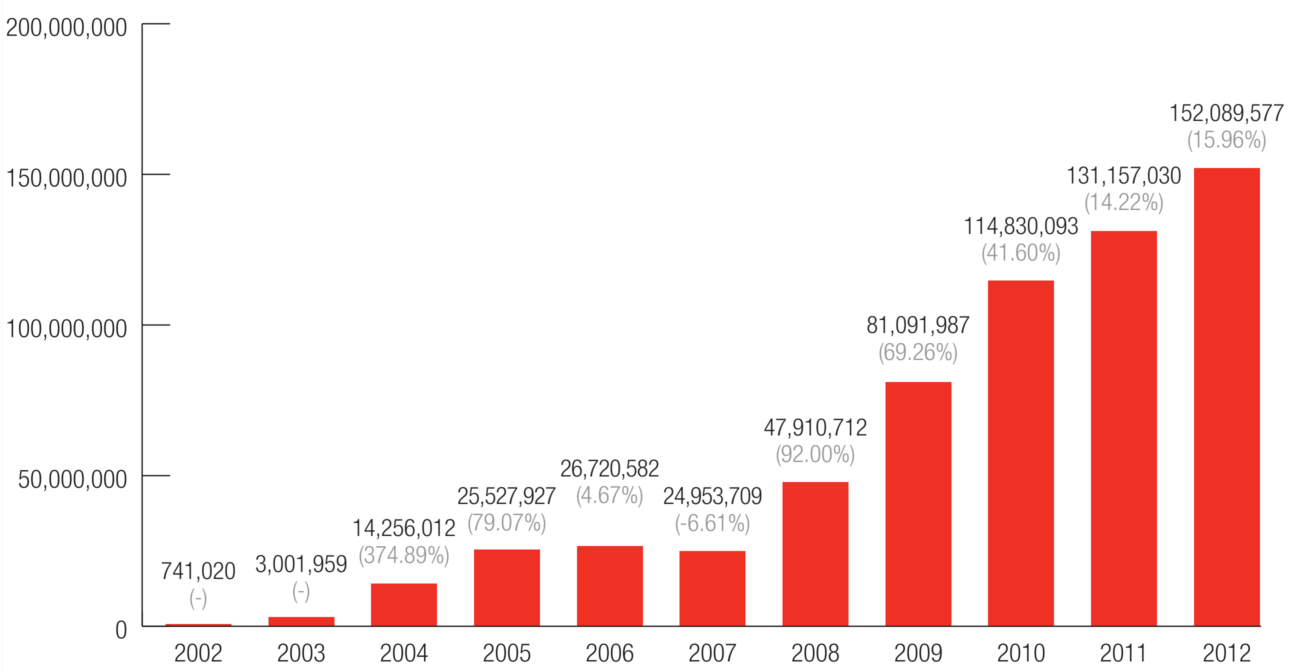
Structure of liabilities 2011.
in RSD 000

Due to other banks	36%	87,119,760
Due to customers	43%	104,572,393
Subordinated liabilities	1%	3,436,923
Other liabilities	1%	2,617,206
Shareholdders' equity	19%	45,807,502
	100%	243,553,784



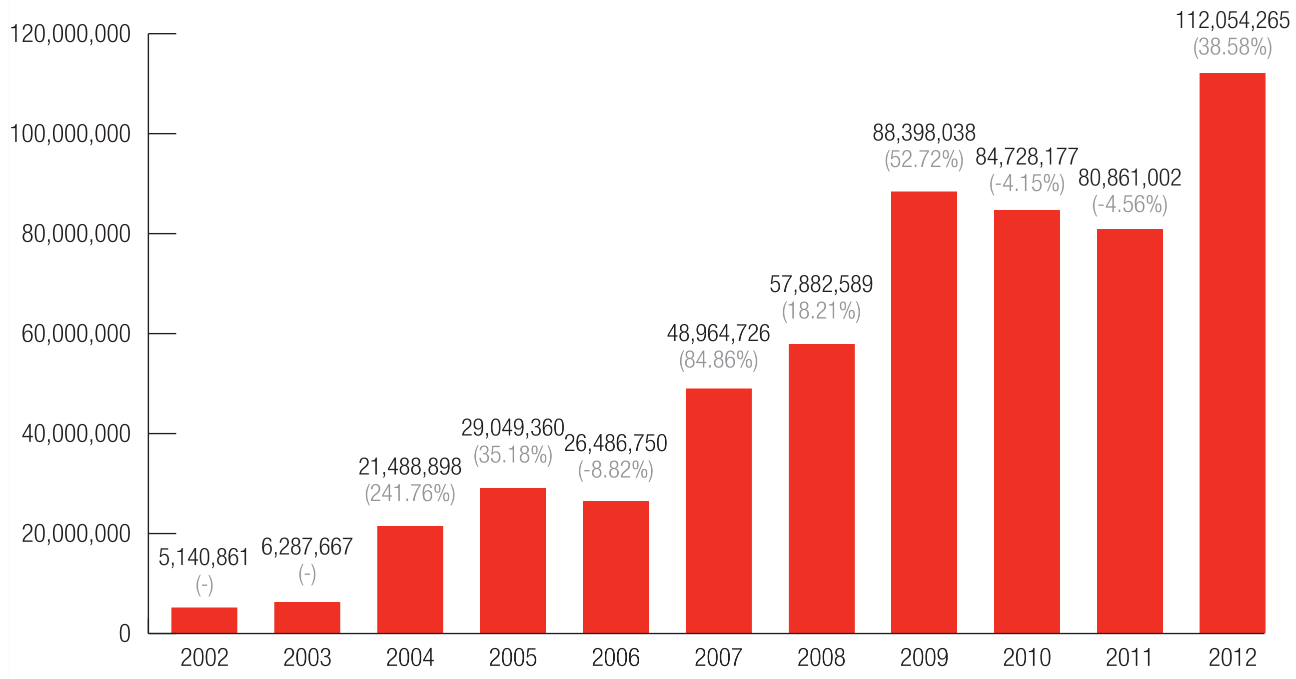
Deposits from customers have the major share in total liabilities with 43%

Total loans
in RSD 000



Total loans to clients increased for 16% in 2012 compared to 2011 and were MRSD 152,090.

Total deposits
in RSD 000



Total deposits reached mio RSD 112.054 in 2012.

PEACE OF MIND

How to save a Customer's holiday

"When I lost my Visa card while on vacation abroad, UniCredit Bank's emergency cash disbursal service saved me from what could have been a disastrous situation.
I used the service twice while visiting Paris and Moscow and it exceeded my expectations, allowing me to pay for my hotel, entertainment and other expenses. I was impressed by the service's quality and speed – I was able to have cash in-hand in less than an hour.
This experience taught me that my bank is 100 percent prepared to support me at anytime, even in the most difficult of situations. I know now that I can count on UniCredit's professional advice and real solutions for whatever I need."

Yurov Valeriy Anatolievich,
customer of UniCredit Bank in Ukraine

Reports of the Divisions and Departments

CIB&PB Division 2012

2012 was very challenging as policy of selective lending growth continued, with focus on solid grounded and stable companies. Despite of the tough market conditions linked to the severe effects of on-going economic crisis and the spill over effect to Serbia, loan portfolio grew by 12% in comparison to year end 2011, reaching the amount of EUR 1.520 million. Financing of the public sector in Serbia reached EUR 420 million in 2012, out of which loan exposure amounted to EUR 160 million while exposure in securities is EUR 260 million. The bank continued with its active role in every public tender for financing during 2012. Major focus next year will be on reputable international and proven domestic companies, with particular attention paid to side business.

As in 2011, the bank was very active in the "state subsidy program" launched by the Government in order to support local economy buffering the effects of crisis, and reported good reputation among the governmental bodies and local community thanks to the excellent results achieved within this state initiative. The bank ranked 3rd in terms of subsidized lending and gained a market share of 10%.

As for Liabilities inside Corporate Banking Department, the volumes of deposits increased by 15% in comparison with 2011 end, reaching the amount of 510 milion Euro, mainly thanks to large transactions, as well as commercial activities targeted at deposit collection, which allowed significant inflow of funds.

The Bank ended up the year with a customer base of 3061 clients. Significant efforts were made in acquiring new clients through a series of commercial actions targeted towards international companies that are group clients, large domestic corporates, etc.

As planned at the end of 2011, innovative products such as Mobile payments and Salary booking were successfully introduced and implemented in first two quarters of 2012. During 2013 products like External Direct Debit should be successfully implemented.

Serbian foreign exchange market was characterized by heavy depreciation of the local currency during the first three quarters of 2012 and a modest appreciation in the fourth quarter. RSD depreciated during the year loosing 9% to EUR despite significant interventions of NBS amounting as much as EUR 1.7 billion. Despite economic crises and retreat of foreign investors due to political uncertainty and elections, Markets Department continues to outperform constantly increasing competition and manages to firmly hold a leading position in the local FX market, with stable market share of nearly 15%. In case of foreign financial institutions investing in Serbian financial market, the Bank has the absolute dominance with 59% market share confirming leading position of UniCredit Bank in Serbia in this business segment.

National bank of Serbia continued with its tightening of monetary policy throughout the year, by increasing the key policy rate to 11.25%. Main reason for such policy is minimizing the pressure on inflation. In attempt to extend the yield curve the Ministry of Finance has introduced the 5yr RSD coupon bond and restored the 3 month RSD t-bill previously abandoned, in the first half of the year. As far as EUR bonds are concerned the Ministry introduced the 2 yr EUR bond. UniCredit Serbia continues to achieve excellent growth in market share, especially for maturities available for non-residents where it has reached a market share of 39%.

According to the official NBS data UniCredit Serbia holds the 1st place in Corporate Customers Sales, with the market share of 18% in FX business. The Bank has actively promoted market risks hedging and always strives in being the innovator on the market when it comes to slightly more complex products. The special emphasis was put on hedging against exchange rate risk due to large RSD devaluation through interactive workshops, targeting both large and medium size companies. In terms of interest rate hedging the bank has managed to keep its leading position with widest variety of products. Current strategic market position obliges the Bank to maintain the leading position and be the market frontrunner.

Retail Division

Even with the challenging environment highly affected by the crises, during 2012, Retail Division managed to maintain an upward trend by recording 2.4% growth in Revenue, compared with previous year. Loan and deposit volumes has followed the same scenario, by increasing for 12.1% on lending and 18.7% on deposit side, this increase is also reflected in improvement in market share in lending activity. Also, it is recorded continuance of growth of market share on Mortgage loans market. Namely, market share is increased for 10 bps compared with 2011.

During 2012, within retail banking division we have implemented new benefit for credit cards - deferred payment without interest calculation, cards with chip, Mondial cards for students and pensioners. In order to activate cross selling cooperation with corporate and investment banking is intensified, continuance of cooperation with insurance companies and cooperation with new insurance company has been started. Also, it was introduced new Cash loan with fixed interest rate and product package for pensioners which consist from Senior package account and products with life insurance as well as with 75 years as maximum age in the moment of product maturity - Overdraft and Cash loans with fixed and variable interest rate.

Also during 2012 we have started the project of transaction migration which has been realized through the set of electronic banking services under the name "Bank on a button".
Project is focused on cash transaction, FX transaction and payment of different type of bills (phone, electricity...). Main goal of the project was to decrease number of transaction on cash desk in branch and their migration to electronic transaction channels such as ATM, OLB and M banking. The goal was ALSO to increase available time for selling in the branch, as well as to improve customer satisfaction.

In regards to "Lady Branch" project, we were focused on promotion of it in other regional centres in Serbia. Parallel activities were done in area of establishing partnership network with the main goal to enable benefits for users of Lady Maestro card.
We have established the network with over 30 partners in different cities in Serbia and over 1.500 Lady Maestro cards have been issued.

Bank has continued supporting measures of the Serbian Government to preserve financial stability through active participation in the program of subsidized loans - housing and small business loans.

When we are talking about selling of non risk bearing products, during 2012 main focus was on selling of M banking, SMS card alarm, Pre paid card, while on the lending side the most sold products were mortgage and cash loans. Beside constant product innovations, we were focused on further education and training of our employees. Together with transparent relationship with our clients, this remains our main drivers for success.

During 2012, in order to further strengthen relationship with clients and to acquire new clients, with approach focused on creating adequate targeted offers, Retail Division has continued active usage and development of "Customer relationship management" as a precondition for further bank's strategic positioning on the local market.

Global Banking Services Division

Through 2012, GBS Division structurally went through many new implemented changes and processes, as well as new methods of organizing day-to-day business. It has proven particularly successful in the area of banking operations since it produced higher level of efficiency.

Continuing with focus on cost control, operational efficiency and customer satisfaction, significant efforts were also done in improvement of internal control system on the Bank level as well as further improvement of governance model of the Bank.

Despite all negative impacts like FX rate, increase of VAT, cost recasting, etc. non HR costs were slightly below budget which shows sustainable cost control strategy providing business growth with controlled cost growth.

Several very important IT applications were developed, providing further support for Business development. Best example is CRM (Retail and Corporate), where UniCredit Bank Serbia was recognized as the best practice within the Group in terms of project development and cost optimization.

Increase of average quantity of daily operation tasks based on increased number of transactions, centralization of back office activities in Operations and new activities based on regulatory or ICS reasons, were handled by more intensive automation (such as OCR implementation), better process organization, deeper management monitoring techniques and more extensive internal employee trainings.

GBS made significant support to Business side which led to excellent results in Internal Client satisfaction.

Human Resources

Aiming at providing strategic support to Bank's growth, in 2012 HR continued to prioritize the official HR mission of our Group:

"Create an Environment where our People generate sustainable value for our Customers, Feel great about our European Company and are connected with the communities we live in. These postulates will allow us to attract develop and retain the best talents."

"Creating an Environment" - foster openness, flexibility and cooperation – easy to deal with.

With the aim to improve also the Environment, the Bank took a set of initiatives such as:

- intensified communication of the Bank/Group results and HR Strategy for 2013 through Management Listening Road Show, quarterly management meetings;
- involving people in changes within the Bank through the various projects, done in order to support customers satisfaction, leadership, management and supervision improvement, defining clear goals and objectives and increasing employees' engagement and commitment

"Generate sustainable value for our customers" – we achieve this through the improvement of our business model. We start from the customer. We consolidated the role of HR Business Partners.

We defined Human Resources Strategy which will enable HR activities to better support business needs. The strategy is based on the analysis of the 3 key indicators: local market, Group culture, business needs.

Integrated results of the analysis have brought to an overall approach, thus we have created action for implementation in the areas of hiring, performance management, engagement, training and development, career path, compensation and work/home balance.

Following these strategic imperatives, during 2012, various trainings were conducted, particularly focused on customer relationship management, leadership skills and people management.

Special focus was on soft skills trainings and on the plans for technical trainings which will be managed centrally from HR Department. Training needs analyses have been conducted and HR is also working on Training Catalogue and Plan that will include trainings in line with employee's development needs and business strategy. The technical trainings which were in focus in 2012 were: Senior Leadership and Risk management trainings, IT security trainings Project Management trainings and CRM trainings. The Bank also conducted soft skills trainings: Presentation skills, Time and Goal management, Communication skills, Giving and receiving feedback. During last quarter of 2012, 228 employees were trained (25% of population).

New Performance appraisal application has been implemented, and has made a significant step toward fostering high performance culture.

"Feel great about our European Company" - We are concentrating on Europe, by bringing the value to Europe and Serbia. We participated on many HR international projects learning from geographical and cultural diversity in HR practices throughout the Group.
For promoting the international exchange of knowledge and experience, even in the presence of cost constrains, UniCredit Bank Serbia was able to participate in the project "Our CEE has no boundaries". (11 participants IN, 5 participants OUT). 4 Serbian employees enrolled in UniQuest7. UniQuest is program designed to identify and develop talented young professionals from all across the Group who are likely to succeed in an international, cross-cultural working environment and who might be promoted to managerial positions in their career with UniCredit Group.

Boosting risk culture: all 30 Talents attended „Risk Academy" and two of them received formal appreciation by the Group.

"Connected with the communities we live in" - We must develop the communities, be closer to the communities. For HR this means being an "Employer of choice" with high recruiting standards in hiring. Also, this means to provide structured programs for Internships and partnership with the best Universities. The Bank has continued cooperation with Faculty of Law and Faculty of Economics, with the goal to become an employer of choice for the best students in Serbia, also providing the support for IMQF program. In 2012 UniCredit bank approved one more scholarship for IMQF program.

The Bank has shown interest in promoting social and economic development organizations supporting diversity in Serbia: Women Government (social network of business women in the Country).

Out of the HR strategy program, special focus in terms of action plan execution has been given to Compensation and Incentive System. In 2012, we implemented changes based on Group compensation framework. The main goal was to strengthen the link between compensation and performance (including medium and long term goal achievement measured by SMART objectives) and develop retention plans for lower management levels.

We have strengthened compensation for employees below top-management by introducing new Incentive plan for talents and key people. This allowed the bank not only to award sustainable performance but also to give the employees the opportunity to benefit from their improved long-term performance, also incorporating professional positions from various Bank structures (non-managerial). By doing so, the performance award pool was allocated to these structures to boost young talent development and to show appreciation for the commitment and outstanding performance.

Human Resources (CONTINUED)

- Deferred Short term incentive payments, in light of the Bank's overall performance for the year and for awarding the most senior leaders in the Bank.
- Enforcing the approach to compensation which is based on results, by further developing the link between compensation and performance and awarding all employees in accordance with their performance for 2012, and establishing a more transparent, more measurable and more achievable objectives as drivers for short term compensation packages.

Identity and Communication / Customer satisfaction Department

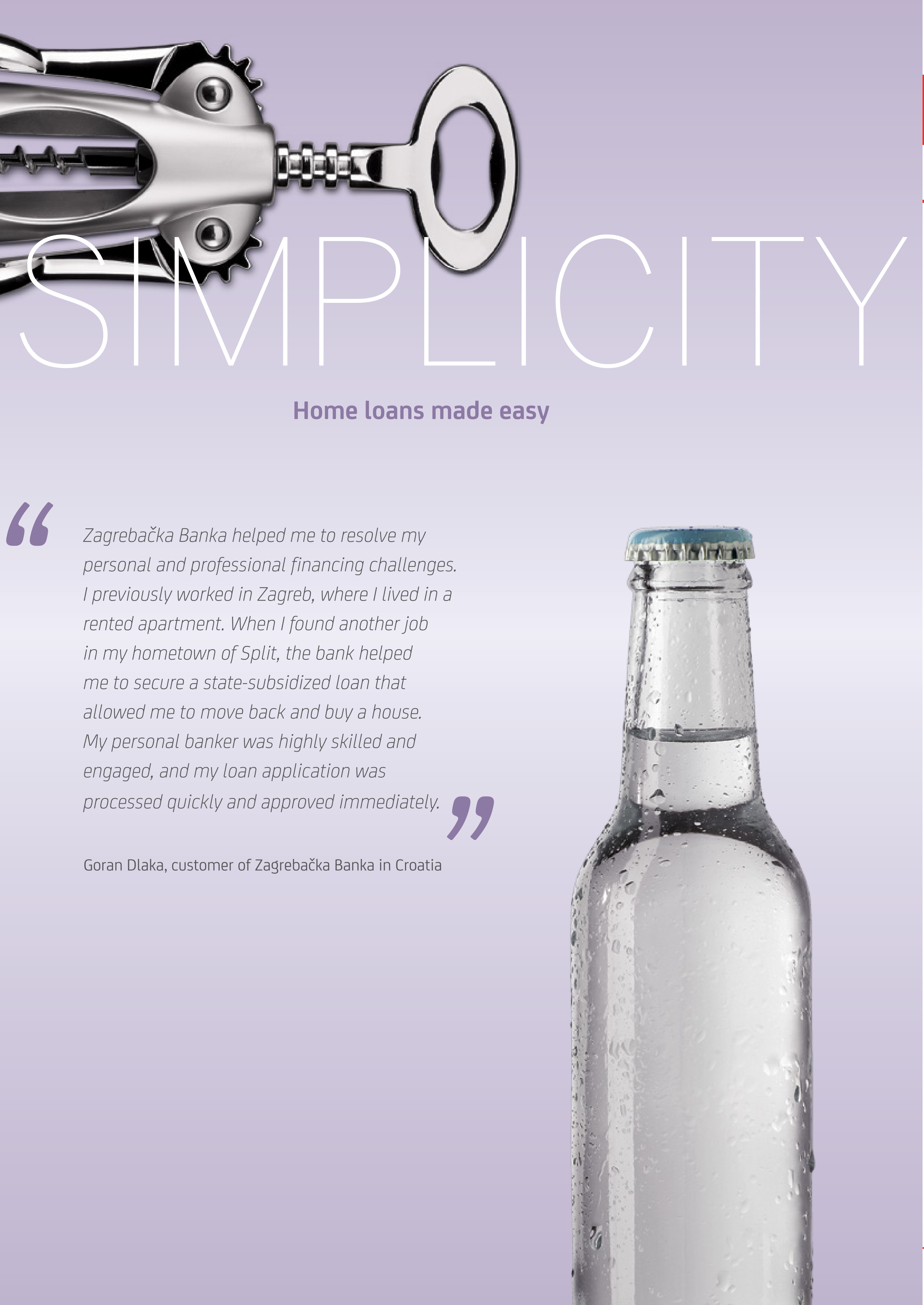
Speaking about our brand, the year of 2012 was very significant. We had a task to incorporate in a simple manner our redesigned visual platform in all the materials that we use for communication with our clients and associates. Positioning slogan, "Life is full of ups and downs. We are there for both. " arising directly from our efforts to be a "Real Life Banking ", is illustrated by new products and services which support our new mission, and we have devised a way to follow all that visually but based on the characteristics of local markets. Behind this idea is the desire to better understand the needs of our clients and to send them a message that we have an important goal: establishment and upgrading of relations based on trust. In everyday communication, we have the opportunity to really take a peek into the emotions of people. Way in which we can build trust through communication, is to be honest, but to show compassion as well and, together with a unique model of approach in creating products and services, we support it through marketing activities.

The first in a series of major campaigns in the 2012 was the" Bank on a button", promotion of set of electronic banking services of UniCredit Bank (e banking, m banking and ATMs) where we through the unique visual identity and name of the service have presented a good alternative to the usual system of conducting transactions which involves going to the cash desk. The second campaign was ''Buying in installments" where customers with MasterCard and Dina credit cards have the possibility to purchase products and services on installments, without paying interest rate. This new functionality of the mentioned cards is visually evoked in the meter with several parts, which symbolically represents the extension of the monthly obligations, that is, extension of the budget and greater opportunities to satisfy a multitude of needs. After that, came a campaign that has promoted Cash loans for pensioners. Conceptual design was based on the simple idea that retirement is not a constraint for an active life. Bearing in mind that this product category is insufficiently developed at the market and that this segment of the population is "left behind" we wanted to show with a creative solution in the campaign that they must not forget their pleasure or necessity and that they have opportunities to enjoy as much as others. The last campaign in the series was related to the New Year and Christmas holidays and in this spirit, we have redesigned our MasterCard Prepaid card as an ideal gift for all occasions. People who buy our MasterCard Prepaid cards may or may not be clients of our bank and that was the reason to point out with communication that the real gift is one we give the choice to spend it as they wish.

Like in previous years, UniCredit Bank in 2012, thrue different activities on a national and local level aimed at intensifying communication with the media nad consequently to increase its present in them. Remarkable dependence of PR and advertising is still characterized for the media market in Serbia, which has greatly hampered the work to companies with limited budgets, in terms of information placement. Therefore, more than in previous years, it was necessary to put a lots of efforts in maintaining the existing relationships with the media and the construction of new and innovative approaches to the information placement. Despite the difficult financial situation in most of the media in Serbia and altered media landscape, which has resulted in a further change in the principles of their business, UniCredit Bank is 2012 has managed to position itself among the banks with the highest number of publications.Thanks to good relations with the jurnalists that we are building for years trying to meet their requests we have received the award for "the best communicator with the media among large companies" on what we can be extremely proud.

UniCredit Bank during 2012, like in previous years, was focused on the needs of clients, seeking to find a solution to all the challenges that clients face in the economic environment and conditions under which the market operates in Serbia. The fact that the results of the customer satisfaction survey, conducted by the Bank for a number of years, show that preserved a high level of customer satisfaction of the customers of both, Retail Division and Corporate Customers, supports that the bank has managed to maintain the quality of products and services, a high degree of loyalty of its clients and to build a relationship based on mutual trust.

We also continued to create the image of UniCredit Bank as a socially responsible company that has long-term plans in Serbia. During 2012, we focused on the communities in which the Bank is present and by supporting local initiatives, events of general interest, health and educational institutions, and we sought to contribute to their further development and improvement. Our effort, work and commitment have been recognized by the public, so we were awarded by the Association "My Serbia" with prize called "My Choice" for corporate social responsibility.



Financial Statements

in accordance with International Financial Reporting Standards (IFRSs)

Independent Auditors' Report

Independent Auditors' Report

**TO THE SHAREHOLDERS OF
UNICREDIT BANK SERBIA JSC BELGRADE**

We have audited the accompanying financial statements of UniCredit Bank Serbia JSC Belgrade ("the Bank"), which comprise the statement of finacial position as at 31 December 2012, the statements of comprehensive income, changes in equity and cash flows for the year than ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 our judgment, including the assessment of the risk of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2012, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG d.o.o. Beograd

Belgrade, 26 April 2013

This is a translation of the original document issued in the Serbian language. All due care has been taken to produce a translation that is a faithful as possible to the original. However, if any question arise related to interpretation of the information contained in the translation, the Serbian version of the document shall prevail.

Statement of financial position as at 31 December 2012

(In thousands of RSD)

	Note	2012	2011
Assets			
Cash and cash equivalents	14	9,063,823	3,912,139
Non-pledged trading assets	15	3,940,818	3,893,542
Loans and advances to banks	16	44,593,753	40,332,426
Loans and advances to customers	17	152,089,577	131,157,030
Investment securities	18	30,467,071	16,068,959
Property and equipment	19	1,151,981	1,235,542
Intangible assets	20	999,854	750,368
Deferred tax assets	21	37,507	32,961
Other assets	22	1,209,400	1,185,075
Total assets		**243,553,784**	**198,568,042**
Liabilities			
Trading liabilities	15	597,286	37,347
Derivative liabilities held for risk management	23	259,718	63,418
Deposits and loans from banks	24	87,119,760	71,766,766
Deposits and loans from customers	25	104,572,393	79,576,141
Subordinated liabilities	26	3,436,923	3,142,149
Differed tax liabilities	21	322	-
Provisions	27	151,610	134,737
Other liabilities	28	1,608,270	1,526,425
Total liabilities		**197,746,282**	**156,246,983**
Equity			
Share capital and share premium		24,169,776	24,169,776
Retained earnings		21,457,759	18,193,012
Reserves		179,967	(41,729)
Total equity attributable to equity holders of the Bank	29	**45,807,502**	**42,321,059**
Total liabilities and equity		**243,553,784**	**198,568,042**

Belgrade, 26 April 2013
For and on behalf of the management
of UniCredit Bank Serbia JSC Belgrade

Mr. Claudio Cesario
President of Management Board

Mr. Branislav Radovanović
Deputy President of Management Board

Ms. Ljiljana Berić
Chief Financial Officer

Ms. Mirjana Kovačević
Head of Accounting Department

The notes on pages 8 to 80 form an integral part of these financial statements.
Independent Auditor's Report – pages 1 - 2.

Statement of comprehensive income for the year ended 31 December 2012

(In thousands of RSD)

	Note	2012	2011
Interest income	7	16,364,967	14,128,233
Interest expense	7	(6,992,364)	(5,464,673)
Net interest income		**9,372,603**	**8,663,560**
Fee and commission income	8	2,387,960	2,039,328
Fee and commission expense	8	(480,531)	(380,187)
Net fee and commission income		**1,907,429**	**1,659,141**
Net trading income	9	1,252,682	1,047,266
Net income from other financial instruments at fair value through profit and loss		37,746	11,521
Other revenue		41,470	29,297
Revenue		**12,611,930**	**11,410,785**
Net impairment loss on financial assets	10	(3,218,538)	(2,518,563)
Personnel expenses	11	(1,966,545)	(1,692,155)
Operating lease expenses		(373,977)	(345,404)
Depreciation and amortisation	19,20	(391,777)	(351,053)
Other expenses	12	(1,739,433)	(1,456,992)
Profit before income tax		**4,921,660**	**5,046,618**
Income tax expense	13	(521,913)	(506,485)
Profit for the period		**4,399,747**	**4,540,133**
Other comprehensive income, net of income tax			
Net change of financial assets measured at fair value through other comprehensive income:			
Net change in fair value on available-for-sale financial assets	29.2	221,696	(42,105)
Other comprehensive income for the period, net of income tax		**221,696**	**(42,105)**
Total comprehensive income for the period		**4,621,443**	**4,498,028**
Profit attributable to:			
Equity holders of the Bank		4,399,747	4,540,133
Profit for the period		**4,399,747**	**4,540,133**
Total comprehensive income attributable to:			
Equity holders of the Bank		4,621,443	4,498,028
Total comprehensive income for the period		**4,621,443**	**4,498,028**

The notes on pages 8 to 80 form an integral part of these financial statements.
Independent Auditor's Report – pages 1 - 2.

Statement of changes in equity for the year ended 31 December 2012

(In thousands of RSD)

	Note	Share capital	Share premium	Fair value reserves	Retained earnings	Total
Balance as at 1 January 2011	29	17,857,620	562,156	376	13,652,879	32,073,031
Total comprehensive income for the year						
Profit		-	-	-	4,540,133	4,540,133
Other comprehensive income, net of income tax	29.2	-	-	(42,105)	-	(42,105)
Total comprehensive income for the year		-	-	(42,105)	4,540,133	4,498,028
Transactions with equity holders, recognised directly in equity						
Contributions by and distributions to equity holders						
Increase of share capital	29	5,750,000	-	-	-	5,750,000
Total contributions by and distributions to equity holders		**5,750,000**	-	-	-	**5,750,000**
Balance as at 31 December 2011	29	**23,607,620**	**562,156**	**(41,729)**	**18,193,012**	**42,321,059**
Balance as at 1 January 2012	29	**23,607,620**	**562,156**	**(41,729)**	**18,193,012**	**42,321,059**
Total comprehensive income for the year						
Profit		-	-	-	4,399,747	4,399,747
Dividend payments	29	-	-	-	(1,135,000)	(1,135,000)
Other comprehensive income, net of income tax	29.2	-	-	221,696	-	221,696
Total comprehensive income for the year		-	-	**221,696**	**3,264,747**	**3,486,443**
Transactions with equity holders, recognised directly in equity						
Contributions by and distributions to equity holders						
Increase of share capital	29	-	-	-	-	-
Total contributions by and distributions to equity holders		-	-	-	-	-
Balance as at 31 December 2012	29	**23,607,620**	**562,156**	**179,967**	**21,457,759**	**45,807,502**

The notes on pages 8 to 80 form an integral part of these financial statements.
Independent Auditor's Report – pages 1 - 2.

Statement of cash flows for the year ended 31 December 2012

(In thousands of RSD)

	Note	2012	2011
Cash flows from operating activities			
Profit for the period		4,399,747	4,540,133
Adjustments for:			
Depreciation and amortisation	19, 20	391,777	351,053
Impairment losses	10	3,218,538	2,518,563
Net interest income	7	(9,372,603)	(8,663,560)
Net gain on investment securities at fair value through profit and loss		(37,746)	(11,521)
Net (gain)/loss on trading securities	9	(109,521)	18,351
Income from unused provisions			-
Tax expenses	13	521,913	506,485
		(987,895)	**(740,496)**
Changes in:			
Trading assets	15	(47,276)	(3,867,940)
Loans and advances to banks	16	(4,261,327)	(19,480,217)
Loans and advances to customers	17	(24,565,705)	(18,453,044)
Other assets	22	(24,325)	(278,829)
Trading liabilities	15	559,939	25,533
Deposit from banks	24	15,352,994	10,989,543
Deposit from customers	25	24,996,252	10,724,196
Other liabilities		439,949	(312,017)
		11,462,606	**(21,393,271)**
Interest received		12,305,806	10,856,158
Interest paid		(6,338,046)	(4,905,608)
Income tax paid		(606,372)	(494,225)
Net cash used in operating activities		**16,823,994**	**(15,936,946)**
Cash flows from investing activities			
Acquisition of investment securities		(9,973,935)	(778,606)
Proceeds from sale of investment securities		-	10,125,803
Acquisition of property and equipment	19	(84,791)	(200,792)
Acquisition of intangible assets	20	(478,584)	(260,045)
Net cash used in investing activities		**(10,537,310)**	**8,886,360**
Cash flows from financing activities			
Proceeds from new share issue	29	-	5,750,000
Dividends paid	29	(1,135,000)	-
Net cash from financing activities		**(1,135,000)**	**5,750,000**
Net increase/(decrease) in cash and cash equivalents		5,151,684	(1,300,586)
Cash and cash equivalents at 1 January	14	3,912,139	5,212,725
Cash and cash equivalents at 31 December		**9,063,823**	**3,912,139**

The notes on pages 8 to 80 form an integral part of these financial statements.
Independent Auditor's Report – pages 1 - 2.

Notes to the Financial statements

Notes to the Financial statements

1) Activity

UniCredit Bank Serbia JSC (hereinafter: "the Bank") was initially established as HVB Bank Yugoslavia ("HVB") in 2001, upon obtaining an operating banking license issued by the National Bank of Yugoslavia on 2 July 2001. Following the merger of HVB and Eksport-Import banka Eksimbanka on 1 October 2005, the Bank changed its name to UniCredit Bank Serbia JSC Belgrade on 30 March 2007.

The Bank is a member of UniCredit Bank Austria AG, situated in Vienna, which is a member of the UniCredit Group. UniCredit Bank Austria AG is the owner of 100% of the Bank's equity.

The Bank is registered in the Republic of Serbia to carry out business activities in payment, credit, and deposit services in the country and abroad.

As of 31 December 2012 the Bank was comprised of a Head Office situated in Belgrade and of seventy-five branch offices located in major cities throughout the Republic of Serbia (31 December 2011: seventy five branch offices).

At 31 December 2012 the Bank had 1,008 employees (31 December 2011: 977).

2) Basis of preparation

(a) Statements of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following material items in the statement of financial position:

- available for sale financial assets are measured at fair value,
- derivate financial instruments are measured at fair value,
- assets and liabilities held for trading are measured at fair value.

(c) Functional and presentation currency

These financial statements are presented in thousands of Serbian Dinars ("RSD"), which is the Bank's functional currency. Except as otherwise indicated, financial information presented in Serbian Dinar has been rounded to the nearest thousand.

(d) Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

The 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 periods affected. Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in Note 5.

(e) New standards, interpretations and amendments to published standards

As of the financial statements issuance date, the following standards, interpretations and amendments were issued, but were not effective for the financial year ending 31 December 2012:

- IFRS 9 – Financial Instruments (effective for financial periods starting 1 January 2015). This standard replaces IAS 39 – Financial Instruments: Recognition and Measurement, deals with classification and measurement of financial assets. The standard eliminates existing categories present in IAS 39: assets held to maturity, available for sale and loans and receivables.
- Financial assets would be classified in one of these two categories at initial recognition:
  - Financial assets measured at amortized cost,
  - Financial assets measured at fair value.

A financial asset is measured at amortized cost if the following two criteria are met: it is held within a business model whose objective is to hold assets in order to collect contractual cash flows and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other assets would be measured at fair value.

Gains and losses based on the valuation of financial assets at fair value through profit and loss will be recognized in the income statement, with the exception of investments in capital instruments not held for trading, where IFRS 9 allows, during initial recognition, later unchangeable choice that all fair value changes be recognized within other comprehensive income. Amount recognized within other comprehensive income cannot be recognized in the income statement.

Notes to the Financial statements (CONTINUED)

2) Basis of preparation (continued)

The IASB decided to consider making limited amendments to IFRS 9 to address practice and other issues. The Bank has commenced the process of evaluating the potential effect of this standard but is awaiting finalization of the limited amendments before the evaluation can be completed. Given the nature of the Bank's operations, this standard is expected to have a pervasive impact on the Bank's financial statements.

- New standard IFRS 13- Fair Value Measurement (effective prospectively for annual periods beginning on or after 1 January 2013).

IFRS 13 provides a single source of guidance on how fair value is measured, and replaces the fair values measurement guidance that is currently dispersed throughout IFRS. Subject to limited exceptions, IFRS 13 is applied when fair value measurement of disclosures are required or permitted by other IFRSs. The Bank is currently reviewing its methodologies for determining fair values. Although many of the IFRS 13 disclosure requirements regarding financial assets and financial liabilities are already required, the adoption of IFRS 13 will require the Bank to provide additional disclosures. These include fair value hierarchy disclosures for non-financial assets/liabilities and disclosures on fair value measurements that are categorized in Level 3.

- Amendments to IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods);
- New standard IFRS 10 - Consolidated Financial Statements and IAS 27 (2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2013);
- New standard IFRS 11- Joint Arrangements (effective for annual periods beginning on or after 1 January 2013);
- New standard IFRS 12- Disclosure of Interests in Other Entities (effective for annual periods beginning on or after 1 January 2013);
- Amendments to IAS 19 - Employee Benefits (effective for annual periods beginning on or after 1 January 2013);
- Revised IAS 27 -Separate Financial Statements (effective for annual periods beginning on or after 1 January 2013);
- Revised IAS 28 -Investments in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2013);
- Amendments to IAS 32- Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2014);
- IFRIC 20- Stripping Costs in the Production Phase of a Surface Mine (effective for annual periods beginning on or after 1 January 2013).

Management of the Bank is considering the impact of these standards on the future financial statements.

3) Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, and have been applied consistently by the Bank.

(a) Consolidation

The Bank does not have control over any other entity and does not prepare consolidated financial statements.

(b) Going concern

The financial statements are prepared in accordance with the going concern concept, which assumes that the Bank will continue its operation, in the foreseeable future.

(c) Foreign currency

Transactions in foreign currencies are translated into Serbian Dinars at the spot exchange rates at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies which are stated at cost, are translated at the rate ruling at the reporting date. Foreign exchange differences arising on translation are recognized in the statement of comprehensive income. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of transaction.

Exchange rates for major currencies used in the translation of the statement of financial position items denominated in foreign currencies, as determined by the National Bank of Serbia, were as follows:

In RSD	2012	2011
USD	86.1763	80.8662
EUR	113.7183	104.6409
CHF	94.1922	85.9121
JPY	1.000689	1.041825

(d) Interest

Interest income and expense are recognized in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument but not future credit losses.

The calculation of the effective interest rate includes all transaction costs and fees and points paid or received that are an integral part of the effective interest rate.

Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in the statement of comprehensive income include:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest on available-for-sale investment securities calculated on an effective interest basis;
- the effective portion of fair value changes in qualifying derivatives designated in fair value hedges of interest rate risk.

Interest income and expenses on all trading assets and liabilities are considered to be incidental to the Bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

(e) Fees and commission

Fees and commission income and expenses that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income are recognised as the related services are performed. Fee and commission income include transfer payments in foreign currency, domestic payments transactions, loan administration, guarantee, letter of credit business and other banking services. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognised on a straight-line basis over the commitment period.

Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

(f) Net trading income

Net trading income comprises gains less losses related to trading assets and liabilities, and includes all realised and unrealised fair value changes and foreign exchange differences.

(g) Net income from other financial instruments at fair value through profit or loss

Net income from other financial instruments at fair value through profit or loss relates to financial assets and liabilities designated at fair value through profit or loss, and include all realised and unrealised fair value changes.

Notes to the Financial statements (CONTINUED)

3) Significant accounting policies (continued)

(h) Lease payments

Payments made during the year under operating leases are charged to the income statement on a straight-line basis over the period of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

(i) Tax expense

Tax expense comprises current tax and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

(i) Current income tax

Current tax is expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Current income tax represents the amount calculated in accordance with the Serbian Tax Law. The income tax rate for 2012 is 10% (2011: 10%). Taxable profit includes the profit shown in the statutory Statement of income and adjustments for permanent differences, as defined by the Serbian Tax Law.

On 15 December 2012 the Serbian Parliament adopted the Law on Amendments to the Corporate Income Tax Law (CIT Law). The adopted amendments introduce, among other, increase of the tax rate from 10% to 15%. This amendment is effective as of 1 January 2013 and will be applicable to the tax return for 2013. Current tax liability for 2012 is determined by applying 10% tax rate, however deferred tax assets and liabilities as at 31 December 2012 are measured by using 15%.

Tax credit for investments in fixed assets, used for the prevailing business activity and all other activities inscribed by the founding documentation, amounts 20% of the paid investment. Up to 2012 tax year, 50% of tax credit could be utilized by offsetting tax liability. According to the amendments of the CIT Law, effective as of 1 January 2013, tax liability could be offset by 33% of tax credit. This reduction is applicable to the tax return for 2013.

Non-utilized part of the tax credit can be carried forward for ten years and offset with the future tax liabilities.

(ii) Deferred income tax

Deferred income tax is recognised in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted by the reporting date.

A deferred tax asset is recognised for unused tax losses, tax credits and deductable temporary differences to the extent that it is probable that the future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities as at 31 December 2012 are measured by using 15% rate.

(iii) Other taxes and contributions

According to the relevant legislation in the Republic of Serbia, the Bank pays various taxes and contributions, such as VAT and contributions on salaries and wages. These are included under “Other operating expenses”.

(j) Financial assets and liabilities

(i) Recognition and initial measurement

The Bank initially recognises loans and advances, deposits, borrowings and subordinated liabilities on the date at which they are originated. All other financial assets and liabilities are initially recognised on the settlement date at which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or liability is measured initially at fair value plus transaction costs that are directly attributable to its acquisition or issue.

/ii/ Classification

The Bank classified its financial assets into the following categories:
- loans and receivables;
- held-to-maturity investments;
- available-for-sale financial assets;
- financial assets at fair value through profit or loss

See accounting policies 3(k), 3(l), 3(m) and 3(n).

The Bank classifies its financial liabilities as measured at amortised cost or held for trading. See accounting policies 3(k) and 3(s).

(iii) Derecognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risk and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualifies for derecognition that is created or retained by the Bank is recognised as a separate asset or liability in the statement of financial position. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of the consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

The Bank enters in transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to repurchase transactions as the Bank retains all or substantially all the risks and rewards of ownership of such assets.

In transactions in which the Bank neither retains nor transfers substantially all the risk and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of transferred asset.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

/iv/ Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on net basis only when permitted under IFRSs, or for gains and losses arising from a group of similar transactions such as in the Bank’s trading activity.

(v) Amortized cost measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

(vi) Fair value measurement

The fair values stated for financial instruments are the amounts for which the asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction on a measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm’s length basis.

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm’s length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and other optional models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument of based on other available observable market data.

Notes to the Financial statements (CONTINUED)

3) Significant accounting policies (continued)

Assets and long positions are measured at a bid price and liabilities and short positions are measured at an asking price. When the Bank has position with offsetting risks, mid-market prices are used to measure the offsetting risk positions and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank and counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received. However, in some cases, the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets, then the difference is recognized in profit or loss on initial recognition of the instrument. In other cases the difference is not recognized in profit or loss immediately but is recognized over the life of the instrument on an appropriate basis or when the instrument is redeemed, transferred or sold, or the fair value becomes observable.

/vii/ Identification and measurement of impairment

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Bank considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and advances and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

In assessing collective impairment the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognized in profit or loss and reflected in an allowance account against loans and advances. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition costs, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

The Bank writes off certain loans and advances and investment securities when they are determined to be uncollectible (see note 4(b)).

(k) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

(l) Trading assets and liabilities

Trading assets and liabilities are those assets and liabilities that the Bank acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking.

Trading assets and liabilities are measured at fair value with changes in fair value recognised as part of net trading income in profit or loss.

(m) Derivatives held for risk management purposes and hedge accounting

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivatives held for risk management purposes are measured at fair value in the statement of financial position.

The Bank designates certain derivatives held for risk management as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Bank formally documents the relationship between the hedging instrument and hedged item, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Bank makes as assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instrument is expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged item during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125 percent.

(i) Fair value hedges

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability that could affect profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss together with changes in the fair value of the hedged item that are attributable to the hedged risk (in the same line item in the statement of comprehensive income as the hedged item).

(n) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. They arise when the Bank provides money or services directly to a debtor with no intention of trading the receivable.

Loans and advances comprise loans and advances to banks and customers.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Amortized cost is calculated by taking into account any issue costs and any discount or premium on settlement.

Loans and advances are presented net of specific and collective allowances for impairment. Specific and collective allowance are made against the carrying amount of loans and advances that are identified as being impaired in order to reduce their value to recoverable amount. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the statement of comprehensive income in impairment charge for credit losses.

(o) Investment securities

Investment securities are initially measured at fair value plus, in case of investment securities not at fair value through profit or loss, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held-to-maturity, fair value through profit or loss, or available-for-sale.

/i/ Held-to-maturity financial assets

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and the ability to hold them to maturity, and which are not designated as at fair value through profit or loss or as available-for-sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method. Any sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and prevent the Bank from classifying investment securities as held-to-maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value,
- sales or reclassifications after the Bank has collected substantially all of the asset's original principal, and
- sales or reclassifications attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

Notes to the Financial statements (CONTINUED)

3) Significant accounting policies (continued)

/ii/ Fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets that are classified as held for trading or upon initial recognition are designated by the Bank as at fair value through profit or loss. Financial assets at fair value through profit or loss are those that the Bank acquired or incurred principally for the purpose of selling or repurchasing it in the near term, part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking or derivatives.

/iii/ Available- for- sale financial asset

Available for sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as another category of financial asset. Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Unquoted equity securities whose fair value cannot be reliably measured are carried at cost. All other available-for-sale investments are carried at fair value.

Interest income is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss. Impairment losses are recognized in profit or loss.

Other fair value changes, other than impairment losses, are recognised in other comprehensive income until the investment is sold or impaired, where upon the cumulative gains and losses previously recognized in other comprehensive income are reclassified to profit or loss.

A non-derivative financial asset may be reclassified from the available-for-sale category to the loans and receivables category if it otherwise would have met the definition of loans and receivables and if the Bank has the intention and ability to hold that financial assets for the foreseeable future or until maturity.

(p) Property and equipment

(i) Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset.

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Any gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item or property and equipment, and are recognised net within other income in profit or loss.

(ii) Subsequent costs

Subsequent expenditure is capitalized only when it is probable that the future economic benefits of expenditure will flow to the Bank.

The cost of replacing part of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

(iii) Depreciation

Items of property and equipment are depreciated from the following month when they are available for use. Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives.

The estimated depreciation rates for the current and comparative periods are as follows:

Description	Estimated useful life (in years)	% p.a.
Buildings	50	2
IT equipment	5	20
Motor vehicles	6	15.5
Furniture and other equipment	3 - 14	7 – 30

Depreciation methods, useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

(q) Intangible assets

Intangible assets comprise of software, licences and other intangible assets.

Intangible assets acquired by the Bank are stated at cost less accumulated amortisation and any accumulated impairment losses.

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the intangible asset, from the date that it is available for use. The estimated useful life of intangible assets is five years and amortisation rate used is 20%.

Amortisation methods, useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

(r) Leased assets - lessee

Leases in terms of which the Bank assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Assets held under other leases are classified as operating leases and are not recognised in the Bank's statement of financial position.

(s) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Indefinite-lived intangible assets are tested annually for impairment. An impairment loss is recognized if the carrying amount of an asset or cash-generating unit (CGU) exceeds its recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in profit or loss.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(t) Deposits, borrowings and subordinated liabilities

Deposits, borrowings from banks and customers and subordinated liabilities are the Bank's source of debt funding.

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

Deposits, borrowings and subordinated liabilities are initially measured at fair value plus directly attributable transaction costs and subsequently measured at their amortized cost using the effective interest method.

(u) Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(v) Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within contingent liabilities.

Notes to the Financial statements (CONTINUED)

3) Significant accounting policies (continued)

(x) Employment benefits

In accordance with regulatory requirements, the Bank is obligated to pay contributions to tax authorities and to various state social security funds, which guarantee social security insurance benefits to employees. These obligations involve the payment of taxes and contributions on behalf of the employee, by the employer, in an amount computed by applying the specific, legally-prescribed rates. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to government funds. These taxes and contributions payable on behalf of the employee and employer are charged to personnel expenses in the period in which they arise.

Pursuant to the Labour law, the Bank has an obligation to disburse an employment retirement benefit to a retiree. The retirement benefit obligation recognized in the statement of financial position as at 31 December 2012 represents the present value of the defined benefit obligation determined through actuarial valuations by using assumptions that are not only based on mortality tables, employee fluctuation and disability rates, expected rate of salary increases of 4% for whole period, annual discount rate of 11.25%, but also on margins on annuities to a vanishing point as prepared by the actuary.

The Bank has no other defined benefits plans and no share-based remuneration plans.

4) Financial risk management

(a) Introduction and overview

The Bank has exposure to the following risks:

- Credit Risk
- Liquidity Risk
- Market Risks (comprising interest rate and foreign currency risk)
- Country Risk
- Operational Risk

Credit risk is the risk of possible negative effects on financial result and capital of the Bank caused by the Borrower's default on its obligations to the Bank. Credit risk includes risks which represent the likehood of occurrence of adverse effects on financial result and capital due to:

- Residual risk –the fact that credit risk mitigation techniques are less efficient than anticipated or their implementation does not have sufficient influence on reduction of risks to which the bank is exposed.
- Dilution risk – reduced value of purchased receivables as a result of cash or non-cash liabilities of the former creditor to the debtor
- Settlement/delivery risk – unsettled transactions or counterparty's failure to fulfil his part of the deal in a transaction or settlement of monetary liabilities under that transaction
- Counterparty risk – consequence of failure to fulfil his part of the deal in a transaction before final settlement of cash flows of the transaction or settlement of monetary liabilities under that transaction.

Liquidity risk is the possibility of occurrence of adverse effects on financial result and capital of the bank caused by the bank's inability to fulfill its due obligations as a result of withdrawal of existing sources of financing and/or impossibility of securing new sources of financing, or difficulties in converting assets into liquid funds due to market disturbances.

Market risks include interest rate risk, foreign exchange risk and other market risks. Interest rate risk is a risk of negative effects on financial result and capital of the Bank caused by changes in the level of interest rate. Foreign exchange risk is the risk of negative effects on financial result and capital of the Bank caused by changes in the exchange rate. Other market risks include price risk on equity securities, price risk on debt securities, settlement/delivery risk and counterparty risk.

Risk relating to the country of origin of the person to which the Bank is exposed to (country risk) is the risks of negative effects on the financial result and capital of the Bank due to the Bank's inability to collect receivables from such entity from reasons arising from political, economic or social circumstances in such entity's country of origin.

Operational risk is the risk of negative effects on financial result and capital of the Bank caused by human error, inadequate internal procedures and processes, inadequate management of the information system and other systems in the Bank, as well as by unpredictable external events.

Risk Management Framework

The most important role in the risk management is assigned to the Supervisory Board (SB) of the Bank, which is responsible for risk management system establishing and monitoring. SB is defining strategies and policies for managing key risk types that the Bank is exposed to in its operations. Also, SB is in charge of approval of large exposures to single person or group of related entities towards whom the Bank's exposure is over 10% of capital of the Bank also for the case of increasing of that exposure over 20% of capital of the Bank. Audit Committee is supporting SB in its functioning by considering the most important internal regulations of the Bank before final approval by SB. Management Board of the Bank is in charge of implementation of approved risk strategies and policies and for approval of procedures for identification, measuring, estimation and managing of risks. Important role in loan approval process is assigned to the Credit Committee, which is in charge of making decisions about credit applications within its competence level, or giving recommendation for higher credit approval competence level. ALCO is monitoring Market and Liquidity Risks.

Internal organization of the Bank ensures functional and organizational separation of risk management and other regular business activities.

The Bank has a separate Risk Management Division in its organizational structure, with a comprehensive and very important function of maintaining and developing a stable and profitable loan portfolio. Risk Management Division now covers the management of credit, market, operational and liquidity risk through the activity of five departments: Strategic Risk Management and Control, Retail Credit Operations, Corporate Underwriting, Corporate Special Credit, and Market and Operational Risk department. During 2012 the focus was on reorganizing the division with the introduction of comprehensive collateral management activities and creating Retail Credit Operations with end-to-end responsibilities for all Retail credit processes in order to assure a more adequate approach to this customer segment.

All departments report directly to the member of the Management Board in charge of Risk Management, thereby ensuring increased supervision of all phases of the credit process as well as global overview and assessment of all risks the Bank is exposed to.

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

Compliance Risk

The Bank established a separate organizational unit which is responsible for its compliance with statutory requirements ("Compliance Department"). The Bank's internal regulations specify that the Compliance Department is responsible for identifying and assessing the Bank's principal risks of compliance, for reporting to the Executive Board and Audit Committee, and for proposing plans for managing principal risks, in accordance with its authorizations.

Internal Audit Department

The Internal Audit Department conducts its activities based on the annual operating plan and strategic three year internal audit plan approved by the Managing Board. The frequency of internal audit (frequency or length of audit cycle) of a particular business area varies from one to three years, and directly depends on estimated level of risk. The Internal Audit Department regularly monitors implementation of recommendations (action plans) made in internal audit reports and reports to the Executive Board, to the Audit Committee and the Managing Board, all potential delays in the implementation of measures.

(b) Credit risk

Credit process in the Bank is based on strict segregation of the competences and responsibilities in credit operations between risk taking activities, "business" function responsibilities on one side and credit risk management function on the other side. Business function is represented with sectors that are dealing with client acquisition and relationship management, while credit risk management function is represented by mentioned Departments in the CRO Division in charge of loan underwriting, monitoring, restructuring and collection. According to "four eye" principle, decision on credit application is proposed by business side (first vote) and final decision or recommendation for credit approval decision is given by risk management function (second vote). Exception can be made for standardized products in retail segment, when due to a large number of relatively small loan amounts and simplification of the procedure, approval process can be completely realized within business function, with mandatory applied "4 eyes principle", in accordance with predefined criteria and parameters, approved by risk management function.

With the aim to ensure adequate and timely risk management, in the area of credit activity the Bank applies following internal regulations: Risk Management Rulebook, Rules on Competences for Credit Business, documents which define rules for internal credit rating assignment, Rules of Procedure for Credit Committee, Collateral Policy, Valuation Policy, Guideline for the Management of Corporate Special Credit Clients, Rules on the IAS/IFRS provision calculation and other regulations. The goal is to manage and optimize exposure to risks, by defining adequate procedures and responsibilities in the risk management process.

In order to define a consistent policy for the credit activity and a general framework for risk management, the Bank has made Credit risk strategies for Retail (Credit Risk Retail Strategy) and Corporate (Industry Credit Risk Strategy) segments, which include general guidelines for the basic parameters of risk management, principles of analysis of the creditworthiness of each customer segment, and the determination of the direction of development of individual products, as well as detailed strategy direction of portfolio development by individual industries and the largest groups of related persons. In this way, the Bank ensures that approved business policies are implemented, resulting in an acceptable level of exposure to credit risk at the level of individual placement, as well as adequate diversification and general quality of the loan portfolio.

Competences, responsibilities and authorities of persons involved in risk management system are defined in Rules on Competences for Credit Business. In credit process four eyes principle has to be followed in order to ensure that each side in credit process is checked – the one who propose credit decision, and the other who approves application.

Credit risk reporting

Timely identification, measuring, monitoring and managing of credit risk on portfolio level of the Bank is supported by Risk Management Information System (hereinafter: RMIS). By reporting at total portfolio level or particular client level, RMIS provides complete, accurate and timely information about the quality and changes of the loan portfolio.

RMIS has to fulfil 4 main functions:
1. Collecting and processing of data and indicators of credit risk
2. Analysis of movements and changes of total loan portfolio and it's structural characteristics
3. Continuous monitoring of credit risk
4. Providing basis for credit risk management decisioning process.

The scope of monitoring, management and reporting on credit risk on portfolio level includes monitoring of loan loss provisions, as well as special reserves for loan losses, calculated in accordance with Decision on classification and relevant internal regulations of the Bank.

Credit Risk Parameters

Quantification of credit risk is done by measuring of expected loss. Main indicators that are used to monitor credit risk and to calculate expected loss and loan loss provisions are:
- Exposure of the Bank at default moment (EaD)
- Probability of default (PD)
- Loss given default (LGD)
- Loss confirmation period (LCP).

The Bank is using internal credit rating models. Rating models define specific rating for clients with similar credit risk level. Each rating grade is related to certain PD parameter. The Bank also internally calculates others parameters of credit risk.

Rating models, credit risk parameters and collaterals are used for LLP calculation in line with International Financial Reporting Standards (hereinafter: IFRS), as defined by the special internal regulation of the Bank.

In order to fulfill above mentioned functions, RMIS is using IT systems of the Group and internally generated databases with figures about portfolio by types of placement. Group systems provide rating and overdue days data, as important parameters of credit risk of client.

Limits

The Bank manages credit risk concentration in portfolio by determining limits. Limits are defined by internal regulations and/or NBS regulations; they are constantly monitored and reported.

In accordance with NBS regulation, total exposure limit toward one client or group of related entities should not be over 25% of total capital of the Bank, after applying all prescribed deducted positions. Sum of all exposures that exceed 10% of capital of the Bank, cannot be higher than 400% of capital of the Bank. Total exposure limit toward one client or group of related entities that exceed 10% of capital of the Bank have to be approved by Supervisory Board.

Exposure of the Bank towards entity related with the Bank cannot exceed 5% of capital of the Bank. Total exposure of the Bank towards related entities cannot exceed 20% of capital of the Bank.

Reports

In monitoring of credit risk on portfolio level, the following reports are used:
- Risk Report (RR)
- Credit Risk Monitoring Report (CRM).

RR is prepared monthly and quarterly, and quarterly report is more detailed and with wider scope.

Standard monthly RR, among other, includes:
- Structure and development of portfolio by risk classes
- Amounts and changes of provisions in accordance with IFRS
- Collateral coverage of portfolio
- Main indicators of credit risk and their development
- Comment on main changes and credit risk tendency
- Overview of largest clients with default status.

Quarterly RR includes data shown on monthly level but dispersed by segments as well as additional information related to:
- Collateral structure
- Off balance sheet structure
- Overview of portfolio by type and currency of placement
- Overview of portfolio by industrial sectors
- Structure of portfolio depending on loan tenor
- Overview of large exposures toward one client or group of related entities.

CRM is prepared on monthly level. Data are shown in sub segment level (large companies, mid companies, financing real estate, business clients and freelancers and retail), with comparable data from previous month and end of previous year. Report contains, among other, the following information:
- Structure of placement (type and currency)
- Portfolio collateral coverage and collateral structure
- Maturity structure of portfolio
- Amounts and changes of provisions in accordance with IFRS
- Structure of portfolio by rating categories
- Structure of portfolio by criteria of (non)-default status.

Beside standardized reports, there are many activities in order to provide accurate parameters used in monitoring of credit risk: ad hoc analysis and reporting and other activities that contribute to the accuracy of parameters of credit risk.

Ad hoc analysis and reporting are applied in case of higher risk exposure, especially if the credit risk level is changing drastically and promptly and when timely reaction is expected. For example: deterioration of internally defined rating grades, significant need for additional provisions, mismatching signs in organization, implemented system or procedures, change of any of credit risk parameters and provisions calculation.

Others activities include: control of data quality that are used in monitoring, managing and reporting of credit risk, improving of existing systems and procedures, annual process of budgeting and additional controlling and correcting of budget parameters.

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

Exposure to credit risk

The table below shows gross loans and advances to customers and banks, but also classification for group portfolio and classification on a case-by-case basis.

In thousands of RSD

	Loans and advances to banks		Loans and advances to customers		Investment securities		Non - pledged trading assets		Other assets		Off - balance sheet items	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Individually impaired												
Legal entities, Rating 10	1,659	1,557	13,467,711	7,257,672	55,316	56,252	-	-	72,610	22,249	1,396	15,503
Legal entities, Rating 9	-	-	3,401,917	3,061,211	12,061	12,061	-	-	4,206	1,169	33,304	61,615
Legal entities, restructured loans*	-	840	107,844	648,487	-	-	-	-	3,878	3,587	301	2,004
Citizens, > 90 overdue	-	-	2,674,706	2,285,562	-	-	-	-	58,523	24,026	24,079	25,681
Gross placements	1,659	2,397	19,652,178	13,252,932	67,377	68,313	-	-	139,217	51,031	59,080	104,803
Impairment	1,659	1,724	9,778,627	6,245,439	67,222	68,313	-	-	81,928	40,071	16,311	14,443
Book value	-	673	9,873,551	7,007,493	155	-	-	-	57,289	10,960	42,769	90,360
Portfolio impairment												
Legal entities, Rating 1-6	16,951,363	6,758,628	96,937,053	85,334,790	4,006,027	1,749,122	575,241	32,492	885,705	1,168,709	55,309,505	60,880,431
Legal entities, Rating 7	-	-	11,264,991	10,405,080	69,280	278,970	-	-	45,039	292	3,607,076	3,494,682
Legal entities, Rating 8	-	-	3,810,667	227,351	-	-	-	-	15,158	65	3,240,791	58,999
Citizens, < 90 overdue	-	-	30,681,987	28,561,018	-	-	-	-	208,050	12	1,718,595	1,661,550
Gross placements	16,951,363	6,758,628	142,694,698	124,528,239	4,075,307	2,028,092	575,241	32,492	1,153,952	1,169,078	63,875,967	66,095,662
Impairment	30	872	478,672	378,702	1,277	5,392	-	-	3,747	144	49,435	64,269
Book value	16,951,333	6,757,756	142,216,026	124,149,537	4,074,030	2,022,700	575,241	32,492	1,150,205	1,168,934	63,826,532	66,031,393
Book value of rated assets	16,951,333	6,758,429	152,089,577	131,157,030	4,074,185	2,022,700	575,241	32,492	1,207,494	1,179,894	63,869,301	66,121,753
Book value of non-rated assets	27,642,420	33,573,997	-	-	26,392,886	14,046,259	3,365,577	3,861,050	1,906	5,181	284,281,874	221,402,561
Total book value	**44,593,753**	**40,332,426**	**152,089,577**	**131,157,030**	**30,467,071**	**16,068,959**	**3,940,818**	**3,893,542**	**1,209,400**	**1,185,075**	**348,151,175**	**287,524,314**

*Category Legal entities, restructured loans include debtors with rating 8- for which provision for impairment has been made on portfolio bases

Implementation of Basel II standards for the Group reporting purposes

In the area of Basel II standards implementation the focus of activities was placed mainly on implementation of locally refined corporate rating model and Income Producing Real Estate rating model. Also, for Retail scoring, a comprehensive validation in line with UniCredit Group standards was performed. Regarding LGD and EaD parameters, activities were focused on validation of LGD model and enhancement of EaD model. Full Pillar 2 / ICAAP implementation, according to Group and NBS regulations, has been achieved during 2012, including Economic Capital calculation and Stress Testing processes. Preliminary activities started on A-IRB RWA calculation, including process and systems set-up.

Internal Rating System (internal rating scale)

The ranking rules for customers are established at the level of the UniCredit Group and as such are unique for each member of the group. The Bank's rating system is developed and in use since 2004 at Group level for clients classified in the corporate clients group. For retail clients and entrepreneurs, the rating system is internally developed and in use as of 2010. The Master Scale is used as a unique rating assignment method which ensures that customers with the same rating have the same credit characteristics and the same probability that they will not settle their obligations, in part or in full, within the period of 1 year.

The Master Scale is divided into 10 rating classes that are further broken down into a total of 26 rating subgroups.

The internal master scale is compliant with Basel II standards, meaning that each rating subgroup has a PD parameter associated with it, with probability that a customer with particular characteristics will be unable to settle liabilities toward the Bank and will be in default. For the first 24 subgroups the probability of default ranges between 0.02% and 20.00%, where those clients are rated between 1+ and 8. Their probability of default is based on statistical analysis based on historical data.

Ratings from 1+ to 6: These rating notches are reserved for customers determined in an internal credit assessment to have a credit standing of very good to just acceptable. For customers with this rating periodic review of credit rating is performed annually.

Ratings 7+ to 7-: Covers three subgroups for transactions with low credit rating. Customers assigned these rating notches have substantially greater risk factors and must be constantly monitored.

Ratings 8+ and 8- cover those companies without individual provisioning which are subject to special workout or credit-reduction measures.

Rating 8- relates to customers in default according to the Basel II criteria.

Rating 9 comprises customers who are individually provisioned or for which a part of the claim has been written off.

Rating 10 contains customers who are in a state of liquidation or bankruptcy.

Ratings 8-, 9 and 10 are by definition assigned to customers in default in accordance with Basel II measures, with loan loss provisioning.

Impairment methodology

The procedure which is based on the Rule Book for IAS/IFRS provision calculation and adopted rules is conducted in two steps:

- assigning of individual / specific provision (at group or individual level) for clients where impairment of value already occurred, and
- assigning of provision on a portfolio level for loans where impairment in value does not exist or exists but it has not yet been identified.

Special provisioning rules and principles

A financial asset is impaired and impairment has occurred if there is objective evidence of impairment resulting from one or more events after initial recognition which impact future cash flows associated with such financial asset. The Bank reviews at least once in three months whether there is objective evidence of impairment of a financial assets or group of assets. If there is such evidence, the Bank is required to calculate the amount of impairment for the purpose of deciding whether to recognize an impairment loss. In other words, if there is any such evidence of impairment, the Bank should estimate the recoverable amount for such assets or group of assets and recognize an impairment loss.

In determining the adequate amount of provision a distinction is made between the need for calculating a special provision on an individual basis and a special provision on a group basis for clients grouped in categories with similar risk characteristics, including segments to which the client belongs and total amount of exposure at client level. Total exposure of clients consists of the balance of receivable and off-balance balance of receivables, including undrawn amounts of placements.

The process of calculating a special provision on an individual basis is intended to measure impairment at client level. Individual provisions are measured as the difference between the book value of a receivable and present value of expected future cash flows (excluding future impairments not recognized as already occurred) discounted using the effective interest rate for the particular financial asset (e.g. effective interest rate specified in the contract).

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

In other words, the provision is set in the amount of the individual receivable for which collection is doubtful. In the event that the effective interest rate is not available, in calculating the provision an alternative interest rate is used which is compliant with rules specified in the Bank`s internal regulations. In determining the present value of a receivable, first the discounted cash flow from repayment of principal, interest and any other cash flows associated with the placement is determined. After that, the discounted cash flow from the net realizable value of impaired assets is determined for the given placement. Finally, the net present value of future cash flows is compared to the carrying amount of the particular asset and the amount of the provision for impairment of the given placement is calculated and reported in the income statement.

Calculation of provisions for exposures that are impaired and which are not classified as individually significant is performed on a group basis by grouping clients with a default status into homogenous categories with similar risk characteristics. In defining homogenous categories, the Bank uses segmentation criteria in developing the model for computing the loss rate upon occurrence of loss given default (LGD model).

General provisioning rules and principles

In determining provisions for exposures for which there are no objective evidence of impairment the Bank uses the general provisioning method (IBNR). According to this method, provisions are calculated not just for exposures for which an event has been identified which leads to impairment, but also for exposures for which an event that leads to impairment has occurred, but has not been identified yet by the Bank. Even though for such placements no indications of impairment exist, nor any credit risk losses as at balance sheet date, historical information suggest that over time, for a portion of these placements, contractual obligations toward the Bank will not be performed.

The method of general provisioning is based on the concept of expected loss according to Basel II standards. Expected loss represents the average loss for a credit portfolio in the period of one year and depends on credit risk parameters. A parameter which links the concept of expected losses with the method of general provisioning is the period of identification of an occurred loss (Liquidity Contingency Plan – LCP). LCP represents a time period expressed as the number of months between the moment of occurrence or potential occurrence of an event that results in placement impairment and the moment when an event has been identified by the Bank. Identification of the event itself is linked to the fulfilment of criteria for default status.

In order for an occurred (but still not identified) loss to be covered for a part of the credit portfolio without the existence of objective evidence of placement impairment, a general provision is calculated as the product of the expected loss for the period of one year and the LCP parameter expressed for parts of the year.

The value of the LCP parameter is six months, in accordance with the range recommended by the UniCredit Group, and ranges between four to twelve months.

For receivables from transactions with other banks a provision will be calculated and assigned only if there is actual impairment of value with respect to such transactions.

The table below shows gross and net loans and advances to banks and customers for non-performing loans. Non-performing loans are loans which have at least one instalment overdue for more than 90 days. For these types of loans, impairment is calculated at 100% after considering the value of collaterals expected to be recovered.

In thousands of RSD

	Loans and advances to banks		Loans and advances to customers		Investment securities		Non-pledged trading assets		Other assets		Off-balance sheet items	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
As at 31 December 2012												
Legal entities, Rating 10	1,659	-	13,467,711	6,583,467	55,316	155	-	-	72,610	41,395	1,396	389
Legal entities, Rating 9	-	-	3,401,917	2,331,003	12,061	-	-	-	4,206	2,613	33,304	22,679
Legal entities, Restructured loans	-	-	107,844	59,547	-	-	-	-	3,878	1,503	301	222
Citizens, > 90 overdue	-	-	2,674,706	899,534	-	-	-	-	58,523	11,778	24,079	19,479
Total	**1,659**	**-**	**19,652,178**	**9,873,551**	**67,377**	**155**	**-**	**-**	**139,217**	**57,289**	**59,080**	**42,769**
As at 31 December 2011												
Legal entities, Rating 10	1,557	-	7,257,672	3,576,125	56,252	-	-	-	22,249	747	15,503	15,406
Legal entities, Rating 9	-	-	3,061,211	1,979,848	12,061	-	-	-	1,169	-	61,615	47,274
Legal entities, Restructured loans	840	673	648,487	576,805	-	-	-	-	3,587	2,870	2,004	1,999
Citizens, > 90 overdue	-	-	2,285,562	874,715	-	-	-	-	24,026	7,343	25,681	25,681
Total	**2,397**	**673**	**13,252,932**	**7,007,493**	**68,313**	**-**	-	-	**51,031**	**10,960**	**104,803**	**90,360**

Collateral

Mitigation of credit risk is done with adequate collateral requirements. The purpose of acquiring all available collaterals, proper booking, assessment and monitoring is to minimize risk as much as possible. Therefore the Bank is especially dedicated to the management of collaterals, maintaining the acceptable relationship between the undertaken risk and real rate of the collateral recovery, control and mitigation of risks related to quality, concentration, or insurance of the receivables, maturity, currency, etc. Aiming at further enhancement of processes and systems with regards to credit risk mitigation, Bank set-up a special unit within Strategic Risk Management and Control department – Collateral Management unit (CMU).

The Bank uses relevant policies for Collateral management. Collaterals accepted and used by the Bank for minimizing credit risk comprise:

- Cash deposits can be recognized at full value,
- Cash convertible guarantees of top rated banks and states, can be recognized at full value,
- Mortgages on residential or commercial property, recognized up to 70% or 60% of appraised value of property,
- Pledged receivables, recognized up to 70%,
- Pledged movable assets, recognized up to 50%,
- Bonds issued by governments, central banks or institutions with adequate credit ratings.

In the event that the currency of a security instrument differs from the currency of the loan for which it provides security, the value of the security instrument must be further reduced using a factor defined for every currency combination, as specified by the mentioned Policy.

4) Financial risk management (continued)

An estimation of the fair value of collateral held against financial assets taken as loan security by the Bank as at 31 December 2012 is shown below:

In thousands of RSD

	Loans and advances to banks		Loans and advances to customers		Investment securities		Non-pledged trading assets		Other assets		Off-balance sheet items	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Legal entities, Rating 10	**-**	**-**	**1,739,790**	**2,563,465**	**-**	**-**	**-**	**-**	**3,845**	**2,502**	**-**	**5,340**
Real estate	-	-	1,721,230	2,509,857	-	-	-	-	3,845	2,447	-	5,223
Other	-	-	18,560	53,608	-	-	-	-	-	55	-	117
Legal entities, Rating 9	**-**	**-**	**1,297,621**	**1,288,478**	**-**	**-**	**-**	**-**	**541**	**493**	**14,392**	**25,943**
Real estate	-	-	1,245,026	1,276,074	-	-	-	-	403	488	14,392	25,692
Other	-	-	52,595	12,404	-	-	-	-	138	5	-	251
Legal entities, restructured loans	**-**	**-**	**44,726**	**285,984**	**-**	**-**	**-**	**-**	**1,095**	**1,263**	**-**	**705**
Real estate	-	-	42,456	284,624	-	-	-	-	1,078	1,253	-	700
Other	-	-	2,270	1,360	-	-	-	-	17	10	-	5
Citizens, > 90 days overdue	**-**	**-**	**504,190**	**434,351**	**-**	**-**	**-**	**-**	**4,720**	**-**	**-**	**-**
Real estate	-	-	484,581	404,732	-	-	-	-	3,171	-	-	-
Other	-	-	19,609	29,619	-	-	-	-	1,549	-	-	-
Collateral used to evaluate collective allowance for impairment	**-**	**-**	**58,640,897**	**56,465,647**	**-**	**-**	**-**	**-**	**224,064**	**1,395,775**	**15,222,797**	**21,156,924**
Real estate	-	-	33,614,906	32,144,120	-	-	-	-	120,758	825,587	4,719,571	12,575,594
Other	-	-	25,025,991	24,321,527	-	-	-	-	103,306	570,188	10,503,226	8,581,330
Total	**-**	**-**	**62,227,224**	**61,037,925**	**-**	**-**	**-**	**-**	**234,265**	**1,400,033**	**15,237,189**	**21,188,912**

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial assets.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash settled derivatives. The Bank does not maintain cash resources to meet all of these needs since historical experience demonstrates that a minimum level of reinvestment of maturing funds can be predicted with a high degree of certainty.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is not unusual for banks never to cover their balances, given that business transactions are often carried out for indefinite periods and are of different types. Open positions potentially increase profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, the interest bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

The Bank's management judges that the diversification of deposits by the type of deposit placed and the number of customers, as well as the historical experience of the Bank, provide adequate assurance that its deposits represent a stable and reliable source of finance.

The Bank's liquidity is expressed through the liquidity ratio. The Bank is under obligation to maintain the ratio between the sum of liquid receivables of first order and liquid receivables of second order, on the one hand, and the sum of the Bank's call deposit liabilities and deposits without contractual maturity and deposits with contracted maturity, as follows:

- at least 1.0 – when calculated as an average of all working days in the month,
- at least 0.8 – when calculated for the working day,
- not below 0.9 for longer than three consecutive days.

The Bank is under obligation to report to the National Bank of Serbia if the liquidity ratio is not within prescribed parameters for two working days, and must do so on the next working day. If the Bank determines a critically low liquidity ratio, it must report this to the National Bank of Serbia at the latest by the next working day. Such report should contain information on the amount of liquid assets that are not available, on the reasons for the lack of liquidity and on planned activities for resolving the cause of illiquidity. The Market and Operating Risk Department prepares a report on daily liquidity for the National Bank of Serbia at daily and monthly levels.

The Bank's liquidity management is the responsibility of the head of Assets and Liabilities Management ("ALM"). The Liquidity Centre of the UniCredit Group monitors the liquidity of its subsidiaries, maintains liquidity policy in the region and, when needed, orders corrective measures that are to be carried out by a subsidiary. Short term liquidity management in responsibility of Markets department.

In the event that the liquidity crisis is limited to the local market, the local CEO, CFO and CRO hold general responsibility for crisis management in line with effective liquidity management policy. They identify and assess necessary measures and manage the internal/external communications process. Also, they ensure timely flow of information within the subsidiary entity and to/from the Liquidity Centre and facilitate timely decision making.

	2012	2011
Liquidity ratio (I grade)		
as at 31 December	1.99	2.43
average for the period – month of December	1.92	2.36
maximum for the period – month of December	2.04	2.60
minimum for the period – month of December	1.78	2.22

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant maturity groupings for 2012:

(In thousands of RSD)

	Less than 1 month	1 to 3 months	3 months to 1 year	1-5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	9,063,823	-	-	-	-	9,063,823
Non-pledged trading assets	3,940,818	-	-	-	-	3,940,818
Loans and advances to banks	44,543,411	-	-	50,342	-	44,593,753
Loans and advances to customers	15,039,434	1,868,301	20,506,980	71,873,134	42,801,728	152,089,577
Investment securities	1,980,419	2,897,600	11,295,581	10,767,430	3,526,041	30,467,071
Property and equipment	-	-	-	-	1,151,981	1,151,981
Intangible assets	-	-	-	999,854	-	999,854
Deferred tax assets	-	-	37,507	-	-	37,507
Other assets	1,207,872	-	-	-	1,528	1,209,400
Total assets	**75,775,777**	**4,765,901**	**31,840,068**	**83,690,760**	**47,481,278**	**243,553,784**
Liabilities						
Trading liabilities	597,286	-	-	-	-	597,286
Derivative liabilities held for risk management	259,718	-	-	-	-	259,718
Deposits from banks	9,540,253	235,400	323,234	66,739,138	10,281,735	87,119,760
Deposits from customers	63,271,485	8,576,316	21,806,515	5,140,841	5,777,236	104,572,393
Subordinated liabilities				909,746	2,527,177	3,436,923
Provisions	-	65,746	48,570	-	37,294	151,610
Deferred tax liabilities	-	-	322	-	-	322
Other liabilities	1,608,270	-	-	-	-	1,608,270
Equity	-	-	-	-	45,807,502	45,807,502
Total liabilities	**75,277,012**	**8,877,462**	**22,178,641**	**72,789,725**	**64,430,944**	**243,553,784**
Net liquidity gap as of 31 December 2012	**498,765**	**(4,111,561)**	**9,661,427**	**10,901,035**	**(16,949,666)**	**-**

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant maturity groupings for 2011:

(In thousands of RSD)

	Less than 1 month	1 to 3 months	3 months to 1 year	1-5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	3,912,139	-	-	-	-	3,912,139
Non-pledged trading assets	3,893,542	-	-	-	-	3,893,542
Loans and advances to banks	40,232,358	39,485	3,601	56,982	-	40,332,426
Loans and advances to customers	11,962,531	3,146,237	25,835,130	48,107,125	42,106,007	131,157,030
Investment securities	1,216,491	2,253,219	6,317,156	4,725,331	1,556,762	16,068,959
Property and equipment	-	-	-	-	1,235,542	1,235,542
Intangible assets	-	-	-	750,368	-	750,368
Deferred tax assets	-	-	32,961	-	-	32,961
Other assets	1,183,514	-	-	-	1,561	1,185,075
Total assets	**62,400,575**	**5,438,941**	**32,188,848**	**53,639,806**	**44,899,872**	**198,568,042**
Liabilities						
Trading liabilities	37,347	-	-	-	-	37,347
Derivative liabilities held for risk management	63,418	-	-	-	-	63,418
Deposits from banks	3,548,359	796,693	652,896	54,254,176	12,514,642	71,766,766
Deposits from customers	49,261,893	6,619,597	18,585,795	2,789,880	2,318,976	79,576,141
Subordinated liabilities	-	-	-	837,127	2,305,022	3,142,149
Provisions	-	78,713	20,069	-	35,955	134,737
Other liabilities	1,526,425	-	-	-	-	1,526,425
Equity	-	-	-	-	42,321,059	42,321,059
Total liabilities	**54,437,442**	**7,495,003**	**19,258,760**	**57,881,183**	**59,495,654**	**198,568,042**
Net liquidity gap as of 31 December 2011	**7,963,133**	**(2,056,062)**	**12,930,088**	**(4,241,377)**	**(14,595,782)**	**-**

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

(d) Market risks

The Bank takes on exposure to market risks. Market risk arise from open positions in interest rate, currency and securities, all of which are exposed to general and specific market movements. The Bank applies a "value at risk" methodology to estimate the market risk of positions held and the maximum losses expected, based upon a number of assumptions for various changes in market conditions. The Board sets limits on the value of risk that may be accepted, which is monitored on a daily basis.

(i) Interest rate risk

The Bank is exposed to various risks that due to market interest rate fluctuations affect its financial position and cash flows. Interest rate margins can increase as the result of these fluctuations, but at the same time they can be reduced or cause losses in the event of unexpected fluctuations. Review of risk of fluctuation in interest rates is made using reports of acceptable interest rates based on which monetary assets and liabilities can be revaluated very quickly, with all risk of interest rate fluctuation becoming materially insignificant. The Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily.

The Bank is focused on interest rate spreads. The Bank is aware that volatility of Interest Rate Risk (IRR) spread is potential interest rate risk indicator. This spread is managed by loan pricing, deposit pricing, and investing.

The methodology used to assess the Investment book interest rate risk is the Gap/Duration analysis. The difference between the interest bearing assets and liabilities within the separate time "baskets" shows how two balance sheet sides react differently to interest rate changes:

- in case of positive GAP the bank is exposed to the risk of loss if interest rates of the certain maturity of the observed currency fall,
- in case of negative GAP, bank is exposed to the risk of loss if interest rates of the certain maturity of the observed currency rise.

The number and the "baskets" schedule are defined on the ALCO and level of UniCredit Group.

Gap Limit is placed according to the currency (Limits per currency).

Resulting short and long positions are weighted by factors designed to reflect the sensitivity of the positions in the different time baskets to an assumed change in interest rates, based on an assumed parallel shift of 200 basis points throughout the time spectrum, and on proxies of modified duration.

	31 December 2012		31 December 2011	
	Nominal Gap Duration	Effect of Interest Rate Parallel Shift 200 bp	Nominal Gap Duration	Effect of Interest Rate Parallel Shift 200 bp
RSD	-	(352,047)	-	(152,577)
EUR	-	-	-	(62,679)
USD	-	(30,919)	-	(17,431)
GBP	-	-	-	-
CHF	-	(348,663)	-	(828,311)
JPY	-	-	-	-
CAD	-	-	-	-
AUD	-	-	-	-
DKK	-	-	-	-
NOK	-	-	-	-
SEK	-	-	-	-
Total effect	**-**	**(731,629)**	**-**	**(1,060,998)**

The Bank prepares reports for measuring interest rate risk for all positions of assets, liability and off-balance items, as well as for all other compensations or expenditures that are exposed to interest rate risk. These reports are used to measure risk to Net Interest Income ("NII") arising from the re-pricing of assets and liabilities over time. The risk is measured upon the size and duration potential movements in interest rates.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard and non-standard interest rate scenarios. Standard scenarios that are considered on a daily basis include a 200 basis point ("bp") parallel fall or rise in all yield curves in Serbia. UniCredit Group's risk model (NORISK) calculates the Value at Risk for trading book ("VaR") for a one-day holding period and a confidence level of 99% based on a Monte Carlo ("MC")/ Historical Simulation approach. In the foreign exchange/interest rate sector a declustered historical simulation is used. Declustering means that historical scenarios are adapted to the current volatility level. Correlations between historical and MC simulations are taken into consideration through a linear regression. Exempt from this regression are all residual risks (including price-determining correlations) as well as price determining volatilities. The former are simulated as uncorrelated, for the latter, the VaR is calculated separately and added to the VaR from the remaining risk factors.

One of the objective targets of ALM is managing of the interest rate risk of the Bank through acting on financial market (through Interbanktrading) in order to hedge the risk return profile desired by the Bank and providing sufficient earnings by managing the Bank's investment portfolio. Approved instruments for ALM to take an interest related strategic position to improve the profitability of the banking book.

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates, for the both banking and trading book, assuming no asymmetrical movement in yield curves and a constant financial position, is as follows:

In thousand of RSD

	200bp parallel increase	200bp parallel decrease
2012		
As at 31 December	224,621	(224,621)
Average for the year	206,048	(206,048)
Maximum for the year	266,415	(266,415)
Minimum for the year	131,672	(131,672)
2011		
As at 31 December	241,344	(241,344)
Average for the year	99,459	(99,459)
Maximum for the year	285,159	(285,159)
Minimum for the year	42,974	(42,974)

A summary of the VaR position of the Bank's trading portfolio:

In thousand of RSD

	As at 31 December	Average	Maximum	Minimum
2012				
Foreign currency risk	9,903	7,203	29,620	236
Interest rate risk	6,378	17,870	59,269	3,568
Credit spread risk	-	-	-	-
Other price risk	-	-	-	-
Covariance	(5,066)	-	-	-
Overall	11,215	19,805	59,254	4,428
2011				
Foreign currency risk	6,107	6,635	35,048	434
Interest rate risk	14,913	75,699	184,956	353
Credit spread risk	-	-	-	-
Other price risk	-	-	-	-
Covariance	(1,477)	-	-	-
Overall	19,543	76,725	188,514	516

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

Exposure to interest rate movements as at 31 December 2012

(In thousands of RSD)

	Carrying amount	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest bearing
Assets							
Cash and cash equivalents	9,063,823	7,748,642	-	-	-	-	1,315,181
Non-pledged trading assets	3,940,818	3,365,577	-	-	-	-	575,241
Loans and advances to banks	44,593,753	27,036,258	-	-	16,376	-	17,541,119
Loans and advances to customers	152,089,577	12,053,493	3,616,649	14,427,268	51,844,938	68,662,349	1,484,880
Investment securities	30,467,071	350	125,406	2,401,090	22,519,528	5,230,667	190,030
Total assets	**240,155,042**	**50,204,320**	**3,742,055**	**16,828,358**	**74,380,842**	**73,893,016**	**21,106,451**
Liabilities							
Trading liabilities	597,286	-	-	-	-	-	597,286
Derivative liabilities held for risk management	259,718	-	-	-	-	-	259,718
Deposits from banks	87,119,760	7,985,923	65,567,176	7,134,891	5,685,915	-	745,855
Deposits from customers	104,572,393	36,600,988	28,160,679	28,981,925	2,748,309	-	8,080,492
Subordinated liabilities	3,436,923	-	-	3,436,923	-	-	-
Total liabilities	**195,986,080**	**44,586,911**	**93,727,855**	**39,553,739**	**8,434,224**	**-**	**9,683,351**
Interest sensitivity gap as of 31 December 2012	**44,168,962**	**5,617,409**	**(89,985,800)**	**(22,725,381)**	**65,946,618**	**73,893,016**	**11,423,100**

Exposure to interest rate movements as at 31 December 2011

(In thousands of RSD)

	Carrying amount	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest bearing
Assets							
Cash and cash equivalents	3,912,139	3,025,289	-	-	-	-	886,850
Non-pledged trading assets	3,893,542	3,861,050	-	-	-	-	32,492
Loans and advances to banks	40,332,426	21,860,983	25,114	120,773	-	-	18,325,556
Loans and advances to customers	131,157,030	13,426,018	59,158,099	51,272,204	5,027,538	1,059,046	1,214,125
Investment securities	16,068,959	1,005	56,675	9,460,971	4,725,331	1,556,762	268,215
Total assets	**195,364,096**	**42,174,345**	**59,239,888**	**60,853,948**	**9,752,869**	**2,615,808**	**20,727,238**
Liabilities							
Trading liabilities	37,347	-	-	-	-	-	37,347
Derivative liabilities held for risk management	63,418	-	-	-	-	-	63,418
Deposits from banks	71,766,766	3,156,383	56,576,590	11,991,388	-	-	42,405
Deposits from customers	79,576,141	17,216,218	35,535,015	19,504,433	760,787	-	6,559,688
Subordinated liabilities	3,142,149	-	-	3,142,149	-	-	-
Total liabilities	**154,585,821**	**20,372,601**	**92,111,605**	**34,637,970**	**760,787**	**-**	**6,702,858**
Interest sensitivity gap as of 31 December 2011	**40,778,275**	**21,801,744**	**(32,871,717)**	**26,215,978**	**8,992,082**	**2,615,808**	**14,024,380**

(ii) Currency risk

Foreign currency risk is the risk of potential negative effects on the Bank's financial result and equity due to fluctuations in the foreign currency exchange rate.

The foreign currency risk ratio is the relation between total foreign currency balance and the Bank's risk based capital, calculated in accordance with the decision that regulates the adequacy of the Bank's risk based capital. The Bank is under obligation to maintain the relation between assets and liabilities in such a way that its foreign currency balance at the end of a working day must not exceed 20% of its equity capital. The Market and Operational Risk Department prepares a report on daily liquidity for the NBS at daily and monthly levels.

The Bank is exposed to the effects of exchange rate fluctuations of the most important foreign currencies on its financial position and cash flows. Bank management sets limits for risk of exposure to particular foreign currencies and constantly monitors whether balances of various foreign currencies are within prescribed limits. Limits are effective for all relevant foreign currency products within the Financial Markets Trading Sector (Markets). They comprise trade balances as well as selected strategic foreign currency ALM balances. These limits are defined in the General section of the MIB Manual. All sensitivities that result from foreign currency balances are limited by the general VaR limit set for Unicredit Bank Serbia, both for the Bank in the aggregate and for the Markets and ALCO departments individually.

For the purpose of protecting itself against the risk of fluctuations in the foreign currency exchange rate the Bank concludes derivative contracts and concludes loan and investment contracts linked to foreign currency.

Foreign currency risk management at the operating level of a bank that is a member of the Unicredit Group is the responsibility of the Financial Markets Trading Directorate.

Foreign exchange risk ratio relates to the ratio between total open foreign currency position and capital, calculated in accordance with the decision governing capital adequacy. The Bank should maintain this ratio so as to ensure its total open foreign currency position at the end of any business day does not exceed 20% of its capital.

	2012	2011
Foreign exchange risk ratio:		
as at 31 December	1.73%	4.83%
maximum for the period – month of December	13.28%	8.17%
minimum for the period – month of December	1.28%	0.69%

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

Currency positions as at 31 December 2012

(In thousands of RSD)

	USD	EUR	CHF	Other	RSD	Total
Assets						
Cash and cash equivalents	71,414	370,659	76,269	80,126	8,465,355	9,063,823
Non-pledged trading assets	-	3,343,193	-	-	597,625	3,940,818
Loans and advances to banks	8,838,226	23,147,589	22,613	286,997	12,298,328	44,593,753
Loans and advances to customers	6,273,242	105,082,096	8,480,861	5	32,253,373	152,089,577
Investment securities	-	11,169,019	-	-	19,298,052	30,467,071
Property and equipment	-	-	-	-	1,151,981	1,151,981
Intangible assets	-	-	-	-	999,854	999,854
Deferred tax assets	-	-	-	-	37,507	37,507
Other assets	4,840	500,340	6,908	274	697,038	1,209,400
Total assets	**15,187,722**	**143,612,896**	**8,586,651**	**367,402**	**75,799,113**	**243,553,784**
Liabilities						
Trading liabilities	-	572,645	-	-	24,641	597,286
Derivative liabilities held for risk management	-	259,718	-	-	-	259,718
Deposits from banks	5,182,860	72,029,271	4,021,166	2,411	5,884,052	87,119,760
Deposits from customers	5,312,887	65,174,408	2,112,577	349,411	31,623,110	104,572,393
Subordinated liabilities	-	909,746	2,527,177	-	-	3,436,923
Provisions	-	-	-	-	151,610	151,610
Deferred tax liabilities	-	-	-	-	322	322
Other liabilities	33,710	827,620	44,787	1,083	701,070	1,608,270
Equity	-	-	-	-	45,807,502	45,807,502
Total liabilities	**10,529,457**	**139,773,408**	**8,705,707**	**352,905**	**84,192,307**	**243,553,784**
Net currency gap as of 31 December 2012	**4,658,265**	**3,839,488**	**(119,056)**	**14,497**	**(8,393,194)**	**-**

Currency positions as at 31 December 2011

(In thousands of RSD)

	USD	EUR	CHF	Other	RSD	Total
Assets						
Cash and cash equivalents	67,117	263,084	93,533	34,020	3,454,385	3,912,139
Non-pledged trading assets	-	388,883	-	-	3,504,659	3,893,542
Loans and advances to banks	4,197,007	19,279,561	44,098	184,179	16,627,581	40,332,426
Loans and advances to customers	5,835,931	88,713,620	9,078,246	5	27,529,228	131,157,030
Investment securities	-	5,156,632	-	-	10,912,327	16,068,959
Property and equipment	-	-	-	-	1,235,542	1,235,542
Intangible assets	-	-	-	-	750,368	750,368
Deferred tax assets	-	-	-	-	32,961	32,961
Other assets	2,571	694,373	5,672	40	482,419	1,185,075
Total assets	**10,102,626**	**114,496,153**	**9,221,549**	**218,244**	**64,529,470**	**198,568,042**
Liabilities						
Trading liabilities	-		-	-	37,347	37,347
Derivative liabilities held for risk management	-	63,418	-	-	-	63,418
Deposits from banks	4,833,325	61,156,766	1,887,771	234	3,888,670	71,766,766
Deposits from customers	3,570,981	52,644,227	2,263,506	201,069	20,896,358	79,576,141
Subordinated liabilities	-	837,127	2,305,022	-	-	3,142,149
Provisions	-	-	-	-	134,737	134,737
Other liabilities	16,719	546,176	99	1,832	961,599	1,526,425
Equity	-	-	-	-	42,321,059	42,321,059
Total liabilities	**8,421,025**	**115,247,714**	**6,456,398**	**203,135**	**68,239,770**	**198,568,042**
Net currency gap as of 31 December 2011	**1,681,601**	**(751,561)**	**2,765,151**	**15,109**	**(3,710,300)**	**-**

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

(e) Country risk

Country risk is the risk of occurrence of negative effects on the Bank's financial result and equity, arising from the Bank's inability to collect receivables from borrowers from other countries, for reasons that are associated with political, economic or social conditions in the borrower's country of origin. Country risk comprises:

- political-economic risk which consists of the probability that losses will be incurred due to the impossibility of collecting the Bank's receivables due to limitations stipulated by state and other institutions of the borrower's country of origin, as well as general and systemic conditions in that country;
- transfer risk which comprises the probability that losses will be incurred due to the impossibility of collecting receivables denominated in a currency that is not the official currency of the borrower's country of origin, due to limitations on payments of liabilities to creditors from other countries in specific currencies, as prescribed by regulations issued by state and other institutions of the borrower's country of origin.

The Bank sets country risks individually per borrower's country of origin, per risk concentration at regional level and, when needed, it sets country risks per specific geographic regions.

Periodic monitoring of country risk is established at UniCredit Group level, with reporting of identified risks which permits for monitoring of established limits for all individual countries, as well as monitoring of each country risk based on ratings issued by external agencies. Country risk is part of the Group's watch list for continuous risk monitoring. Country ratings are reviewed at least monthly, with reports being available to all members of the Group. Ratings for territories and micro-states are reviewed at least once annually. A country risk covers a period of five years and is intended to express the Loss Given Default value. This risk covers twelve months and assesses the possibility of loss given default of a country. Information is available to all members of the UniCredit Group, and in that sense the Group uses analyses available at Group level – General Credit Guide for determining limits and risks per country of origin of individual exposures (country risk) in analyzing a loan request, where it is important to determine the country risk of an entity filing for loan approval.

(f) Operational risks

Operational risk is the risk of loss resulting from error, breach, interruption, damage caused by internal processes, employees or systems or external events. Operational risk is defined as an event occurring as the result of inappropriate or unsuccessful internal processes, actions of employees and systems or systemic and other external events: internal or external embezzlement, employment practice and safety at work, receivables from clients, distribution of products, fines and penalties for injury, damage to property, disruption in operation and system errors, process management.

Strategic risks, business risks and reputation risks differ from operational risks, while legal risks and compliance risk are included in the definition of operational risk.

The Market and Operational Risk Department is responsible for recording, monitoring and managing the Group's operating risk and directly answers to the Chief Risk Officer (CRO).This Department's basic task is to coordinate and cooperate with operating risk managers and to communicate with colleagues at the Operational Risk Department in Vienna and Milano, with the purpose of securing information for the efficient monitoring of operating risk at all levels. On a daily basis the department monitors changes in specially defined accounts and on a weekly basis it reports to members of the Executive Board regarding all changes in operational risks. For the purpose of efficient monitoring of operational risks the Bank appoints operational risk managers and their deputies from various organizational units that are responsible for the accuracy and timeliness of data relating to all damaging events in their organizational unit, as well as for recording all damaging events into a database. The Bank uses ARGO application for the operational risk evidence.

The Operating Risk Monitoring Committee meets quarterly for more efficient internal control and process improvement for minimising risks arising from operating risk. The Directorate is also responsible for the calculation of capital requirements for operating risks that are calculated using the Standardised Approach, as well as reporting for local management and at Group level.

(g) Capital management

The Bank's regulator, the National Bank of Serbia ("NBS"), sets and monitors capital requirements for the Bank. The capital requirements of the regulator are based on the Basel II framework. The Bank monitors on the monthly basis its capital adequacy in compliance with the Standardized approach.

The capital adequacy ratio is equal to the ratio between capital and risk assets. In accordance with the NBS Decision on Capital Adequacy ("Decision") the Bank is required to maintain its capital adequacy ratio at a level that cannot be lower than 12%. If the capital adequacy ratio specified in Decision, due to profit distribution, is greater by less than 2.5%, profit distribution can only be carried out from elements of basic capital.

The Bank is required to maintain basic capital in the dinar equivalent amount of 10,000,000 EUR, using the official exchange rate. The Bank is required to maintain at all times its capital at a level required for covering all risks to which it is exposed or could be exposed in its operations, and at least in the aggregate sum of the following capital requirements:

- Capital requirements for credit risk and for counterparty risk for all of the Bank's banking activities and capital requirements for settlement/supply risk for its trading activities;
- Capital requirements for price risk for trading activities;
- Capital requirements for foreign currency risk and commodity risk for all banking activities;
- Capital requirements for operations risks for all banking activities.

The Bank's regulatory capital as managed by its Central Bank Treasury is divided into two tiers:

- Tier 1 capital and
- Tier 2 capital.

Tier 1 capital consists of:

- Paid in share capital, except for cumulative preference shares;
- Profit reserves – all types of reserves of the Bank formed based on a decision by the Bank's shareholders' assembly from profits, after taxes;
- Retained earnings for previous as well as for the current year.

When calculating Tier 1 capital, the Bank is obliged to reduce sum of Tier 1 capital elements for the following categories:

- Previous years' losses;
- Current year loss;
- Intangible assets;
- Purchased common and preference shares, except for cumulative preference shares, in the amount of the book value (nominal value increased for share issue premium);
- Common and preference shares, except for cumulative preference shares, that the Bank received as collateral in the lower amount of receivables secured with pledged shares and nominal value of shares received as collateral increased for related share issue premium;
- Regulatory adjustments in value in compliance with International Financial Reporting Standards and International Accounting Standards (IFRS/IAS), which comprise:
  - Unrealised losses on available-for-sale securities;
  - Other revaluation reserves in the negative net amount which relate to deductible items of basic equity or elements which are included in additional equity;
  - Profit based on the Bank's liabilities measured at fair value which are reduced because of change in the Bank's credit rating;
  - Amount of required reserve for estimated losses on balance sheet assets and off-balance sheet items of the Bank.

Tier 2 capital consists of:

- Paid in share capital for cumulative preference shares – the nominal value of paid in cumulative preference shares and associated share issue premium;
- Part of positive revaluation reserves – the Bank includes the part of positive revaluation reserves (90%) occurred from effects of changes in the fair value of fixed assets, securities and other assets that, in accordance with IFRS/IAS, are reported under these reserves, and that are reduced for tax liabilities;
- Hybrid capital instruments;
- Subordinated liabilities (with the following characteristics: fully paid in; with date of maturity of at least 5 years from date of payment; repayment to or purchase from creditors is not possible before contractual date of maturity, except in the case of conversion of these liabilities into the Banks' shares which are not cumulative preference shares; in the event of bankruptcy or liquidation of the Bank, they can be settled only after settlement of all other liabilities which are not subordinated, and before the Bank's shareholders and owners of hybrid instruments issued by the bank; they are not the subject of collateral issued by the Bank or any of its related parties; the Bank's creditor is not at the same time its debtor in respect of subordinated receivables). The amount of subordinated liabilities of the Bank included in additional equity, in the last 5 years before the date of maturity of such liabilities, is reduced by 20% per annum, so that in the last year before the date of maturity of such subordinated liability they are not included in additional equity;
- Surplus provisions, reserves and required reserves in respect of expected losses – if the Bank receives NBS approval for use of IRB approach.

When calculating Tier 2 capital, the Bank is obliged to reduce sum of Tier 2 capital elements for the following categories:

- Purchased cumulative preference shares for the amount of their book value;
- The Bank's cumulative preference shares that the Bank accepted as collateral in the lower amount of the receivable secured with a pledge over such shares and of the nominal value of shares accepted as collateral, increased for related share issue premium;
- Receivables for balance sheet assets and off-balance sheet items of the Bank which are secured with hybrid instruments or subordinated liabilities, up to the amount for which such instruments/liabilities are included in additional equity.

The capital of the Bank shall be the sum total of its Tier 1 and Tier 2 minus following deductions:

- Direct and indirect investment in banks and other financial sector entities that exceed 10% of the capital of such banks and/or other financial sector entities;
- Investment in hybrid instruments and subordinated obligation of other banks and entities in financial sector in which Bank has direct and indirect investment that exceed 10% of the capital of such banks and/or other financial sector entities;
- Total of direct and indirect investment in banks and other financial sector entities up to exceed 10% of the capital of such banks and /or other financial sector entities and investment in hybrid instruments and subordinated obligation that exceed 10% of tier 1 and tier 2 capital of such banks;
- Amount that exceed qualified investment in entities in other sectors;
- Amount of exposure to free delivery if other party has not fulfilled its obligation within four working days;

Notes to the Financial statements (CONTINUED)

4) Financial risk management (continued)

- All claims and potential liabilities of entities related to the Bank or employees of the Bank that were contracted on more favourable terms and conditions than those contracted with entities that are not related with the Bank.

The Bank may treat part of required reserve for estimated losses on balance sheet assets and off-balance sheet items as deductable item from capital of the Bank, instead as deductable item from Tier 1 capital, as follows:

- Till 31 December 2011 – 100% of total amount;
- Till 31 December 2012 – 75% of total amount;
- Till 31 December 2013 – 50% of total amount

The Policy of the Bank is to maintain strong base of capital in order to maintain confidence of the market, investors and creditors and for future development.

The following table shows the capital as at 31 December 2012:

In thousands of RSD

	2012	2011
Tier 1 capital		
Share capital	23,607,620	23,607,620
Share premium	562,156	562,156
Retained earnings	17,062,649	17,062,649
Less:		
Intangible assets	(999,854)	(750,368)
Unrealised losses on available for sale securities	(25,637)	(46,460)
Required profit reserves for estimated losses	(3,736,638)	-
Total qualifying Tier 1 capital	36,470,296	40,435,597
Tier 2 capital		
Qualifying subordinated loans	2,709,126	2,639,873
Revaluation reserves	185,044	85
Total qualifying Tier 2 capital	2,894,170	2,639,958
Deductable items		
Receivables and liabilities to related parties with better conditions comparing to conditions for non-related parties	(8,161)	(8,317)
Reserve for potential losses	(11,209,913)	(13,085,135)
Total deductable items	(11,218,074)	(13,093,452)
Reduction in Tier 1 capital	(8,323,904)	(10,453,494)
Reduction in Tier 2 capital	(2,894,170)	(2,639,958)
Total Tier 1 capital	28,146,392	29,982,103
Total Tier 2 capital	-	-
Total regulatory capital	**28,146,392**	**29,982,103**
Credit risk	135,899,346	126,945,064
Market risk	4,604,916	3,213,045
Price risk	3,240,933	1,130,282
Foreign currency risk	1,363,983	2,082,763
Operational risk	11,558,608	9,587,933
Total risk weighted assets	**152,062,870**	**139,746,042**
Capital adequacy ratio	**18.51%**	**21.45%**

All prescribed statutory requirements as at 31 December 2012 are fulfilled, as presented in the table below:

		Achieved by the Bank	
	Prescribed ratios by NBS	2012	2011
Capital adequacy ratio	min 12%	18.51%	21.45%
Capital asset ratio	max 60%	4.10%	4.13%
Indicator of exposure to related parties	max 20%	10.98%	10.00%
Indicator of large and the largest individual exposures in relation to capital	max 400%	156.27%	78%
Liquidity ratio - for December	min 1.00	1.92	2.36
Foreign currency risk	max 20%	4.85%	6.95%

5) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under circumstances. Revision to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

These disclosures supplement the commentary on financial risk management (Note 4).

Key sources of estimation uncertainty

Allowances for credit losses

Assets accounted at amortized cost are evaluated for impairment on a basis described in accounting policy 3(i)(v).

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about counterparty's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and advances and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowances, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the allowances depends on the estimates of future cash flows for specific counterparty allowances and the model assumptions and parameters used in determining collective allowances.

Determining fair values

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy 3(i)(vi). For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgement depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

Critical accounting judgements in applying the Bank's accounting policies

Critical accounting judgements made in applying the Bank's accounting policies include:

Valuation of financial instruments

The Bank accounting policy on fair value measurement is disclosed in accounting policy 3(i) (vi).

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs other than quoted prices, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using valuation techniques.

Notes to the Financial statements (CONTINUED)

5) Use of estimates and judgements (continued)

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable price exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, which would have been determined by market participants acting at arm's length.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the future markets.

The table below analyses financial instruments measured at fair value at the end of the reporting period, by the level in the fair value hierarchy into which the fair value measurement is categorised:

(In thousands of RSD)

	Note	Level 1	Level 2	Level 3	Total
2012					
Trading assets	15	-	703,729	3,237,089	3,940,818
Investment securities	18	-	117,642	30,349,429	30,467,071
		-	821,371	33,586,518	34,407,889
Trading liabilities	15	-	572,645	24,641	597,286
Derivative liabilities held for risk management	23	-	259,718	-	259,718
		-	**1,653,734**	**33,611,159**	**35,264,893**
2011					
Trading assets	15	-	153,508	3,740,034	3,893,542
Investment securities	18	-	155,575	15,913,384	16,068,959
		-	309,083	19,653,418	19,962,501
Trading liabilities	15	-	-	37,347	37,347
Derivative liabilities held for risk management	23	-	63,418	-	63,418
		-	**372,501**	**19,690,765**	**20,063,266**

6) Financial assets and liabilities - Accounting classification and fair values

The table bellow sets out the Bank's classification of each class of financial assets and liabilities, and their fair values as at 31 December 2012:

(In thousands of RSD)

	Note	Trading	Designated at fair values	Held-to-maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
31 December 2012									
Cash and cash equivalents	14	-	-	-	9,063,823	-	-	9,063,823	9,063,823
Non-pledged trading assets	15	3,940,818	-	-	-	-	-	3,940,818	3,940,818
Loans and advances to banks	16	-	-	-	44,593,753	-	-	44,593,753	44,593,753
Loans and advances to customers:	17								
Measured at fair value		-	-	-	-	-	-	-	-
Measured at amortised cost		-	-	-	152,089,577	-	-	152,089,577	131,069,220
Investment securities:	18								
Measured at fair value		-	-	-	-	30,165,542	-	30,165,542	30,165,542
Measured at amortised cost		-	-	301,529	-	-	-	301,529	301,529
Other assets	22	-	-	-	1,209,400	-	-	1,209,400	1,209,400
Total assets		**3,940,818**	**-**	**301,529**	**206,956,553**	**30,165,542**	**-**	**241,364,442**	**220,344,085**
Trading liabilities	15	597,286	-	-	-	-	-	597,286	597,286
Derivative liabilities held for risk management	23	-	259,718	-	-	-	-	259,718	259,718
Deposits from banks	24	-	-	-	-	-	87,119,760	87,119,760	87,119,760
Deposits from customers	25	-	-	-	-	-	104,572,393	104,572,393	103,974,863
Subordinated liabilities	26	-	-	-	-	-	3,436,923	3,436,923	3,436,923
Other liabilities	28	-	-	-	-	-	1,608,270	1,608,270	1,608,270
Total liabilities		**597,286**	**259,718**	**-**	**-**	**-**	**196,737,346**	**197,594,350**	**196,996,820**

The table bellow sets out the Bank's classification of each class of financial assets and liabilities, and their fair values as at 31 December 2011:

(In thousands of RSD)

	Note	Trading	Designated at fair values	Held-to-maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
31 December 2011									
Cash and cash equivalents	14	-	-	-	3,912,139	-	-	3,912,139	3,912,139
Non-pledged trading assets	15	3,893,542	-	-	-	-	-	3,893,542	3,893,542
Loans and advances to banks	16	-	-	-	40,332,426	-	-	40,332,426	40,332,426
Loans and advances to customers:	17								
Measured at fair value		-	-	-	-	-	-	-	-
Measured at amortised cost		-	-	-	131,157,030	-	-	131,157,030	131,157,030
Investment securities:	18								
Measured at fair value		-	-	-	-	15,541,377	-	15,541,377	15,541,377
Measured at amortised cost		-	-	527,582	-	-	-	527,582	527,582
Other assets	22	-	-	-	1,185,075	-	-	1,185,075	1,185,075
Total assets		**3,893,542**	**-**	**527,582**	**176,586,670**	**15,541,377**	**-**	**196,549,171**	**196,549,171**
Trading liabilities	15	37,347	-	-	-	-	-	37,347	37,347
Derivative liabilities held for risk management	23	-	63,418	-	-	-	-	63,418	63,418
Deposits from banks	24	-	-	-	-	-	71,766,766	71,766,766	71,766,766
Deposits from customers	25	-	-	-	-	-	79,576,141	79,576,141	78,897,824
Subordinated liabilities	26	-	-	-	-	-	3,142,149	3,142,149	3,142,149
Other liabilities	28	-	-	-	-	-	1,526,425	1,526,425	1,526,425
Total liabilities		**37,347**	**63,418**	**-**	**-**	**-**	**156,011,481**	**156,112,246**	**155,433,929**

Notes to the Financial statements (CONTINUED)

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the financial statements.

(ii) Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term original maturity (less than one year) it is assumed that the carrying amount approximate to their fair value. This assumption is also applied to demand deposits, saving accounts without a specific maturity and variable rate financial instruments.

(iii) Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortized cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing financial instruments are based on discounted cash flows using prevailing money-market interest rates for financial instruments with similar credit risk and maturity.

7) Net interest income

Net interest income includes:

In thousands of RSD

	2012	2011
Interest income		
Cash and cash equivalents	399,719	98,184
Derivative and financial assets held for risk management	342,993	33,608
Loans and advances to banks	579,290	755,115
Loans and advances to customers	11,171,663	10,466,263
Swaps	1,034,119	686,441
Investment securities	2,837,183	2,088,622
Total interest income	**16,364,967**	**14,128,233**
Interest expense		
Derivative liabilities held for risk management	(232,983)	(63,418)
Deposits from banks	(2,745,042)	(2,067,935)
Deposits from customers	(3,404,732)	(2,681,619)
Subordinated liabilities	(134,972)	(99,456)
Swaps	(474,635)	(552,245)
Total interest expense	(6,992,364)	(5,464,673)
Net interest income	**9,372,603**	**8,663,560**

Notes to the Financial statements (CONTINUED)

8) Net fee and commission income

Net fee and commission income includes:

In thousands of RSD

	2012	2011
Fee and commission income		
Payment transfer business	198,794	124,486
Fees on issued guarantees and other contingent liabilities	417,495	369,296
Brokerage fee	48,273	56,403
Custody fee	303,483	249,822
Fees arising from card operations	339,674	248,450
Other banking services	1,080,241	990,871
Total fee and commission income	**2,387,960**	**2,039,328**
Fee and commission expense		
Payment transfer business	(38,523)	(34,224)
Commission expenses arising on guarantees	(54,071)	(29,724)
Fees arising from card operations	(334,374)	(246,469)
Other banking services	(53,563)	(69,770)
Total fee and commission expense	(480,531)	(380,187)
Net fee and commission income	**1,907,429**	**1,659,141**

9) Net trading income

Net trading income includes:

In thousands of RSD

	2012	2011
Foreign exchange gains	1,143,161	1,065,617
Net result from derivative financial instruments held for trading	82,257	(18,642)
Net result from changes in fair value of securities held for trading	27,264	291
Net trading income	**1,252,682**	**1,047,266**

Notes to the Financial statements (CONTINUED)

10) Net impairment loss on financial assets

Net impairment loss on financial assets includes:

In thousands of RSD

	2012	2011
Loans and advances to customers		
Net addition of specific loan impairment	3,202,533	2,561,246
Net release of collective based impairment	28,656	(41,997)
Total	3,231,189	2,519,249
Contingent liabilities		
Release of specific loan impairment (Note 27)	1,868	(25,323)
Release/addition of collective loan impairment (Note 27)	(14,834)	17,733
Total	(12,966)	(7,590)
Direct write-off	351	6,952
Income from collection of written-off claims	(36)	(48)
Total	**3,218,538**	**2,518,563**

11) Personnel expenses

Personnel expenses include:

In thousands of RSD

	2012	2011
Wages and salaries	1,194,802	1,055,568
Social security costs and staff related taxes	468,542	412,982
Staff training expenses	3,662	3,030
Provision for retirement benefits	2,739	185
Other personal expenses	296,800	220,390
Total	**1,966,545**	**1,692,155**

Notes to the Financial statements (CONTINUED)

12) Other expenses

Other expenses include:

In thousands of RSD

	2012	2011
Other administrative expenses		
Building and office space expenses	74,074	67,192
IT expenses	325,714	265,282
Legal and advisory expenses	67,608	59,118
Advertising, public, relation and representation expenses	77,169	85,404
Communication expenses	84,641	63,982
Office supplies	20,945	23,133
Insurance premium	265,585	215,242
	915,736	779,353
Other expenses		
Other taxes and contributions	376,237	334,812
Loss from disposal of property, equipment and intangible assets	968	2,899
Provision for court cases	28,500	-
Other	417,992	339,928
	823,697	677,639
Total	**1,739,433**	**1,456,992**

13) Income tax expense

13.1 Major components of income tax expense as at 31 December are as follows:

In thousands of RSD

	2012	2011
Current tax expense	(531,096)	(505,878)
Deferred tax income/(expense) (Note 21.2)	9,183	(607)
Total	**(521,913)**	**(506,485)**

13.2 Reconciliation of the effective tax rate is presented as follows:

In thousands of RSD

	2012	2012	2011	2011
Profit for the year before tax		4,921,660		5,046,618
Income tax using the domestic corporation tax rate	10.00%	492,166	10.00%	504,662
Non-deductable expenses and tax effect of income reconciliation	1.09%	53,601	0.45%	22,880
Other	-0.24%	(12,042)	0.06%	3,114
Tax credit for capital expenditures	-0.24%	(11,812)	-0.48%	(24,171)
Total income tax expense	**10.60%**	**521,913**	**10.04%**	**506,485**

13.3 Income tax recognized in other comprehensive income is presented as follows:

In thousands of RSD

	Before tax	Tax expense	Net of tax	Before tax	Tax expense	Net of tax
Available-for-sale investment securities	180,289	(322)	179,967	(46,366)	4,637	(41,729)
Balance as at 31 December	**180,289**	**(322)**	**179,967**	**(46,366)**	**4,637**	**(41,729)**

Notes to the Financial statements (CONTINUED)

14) Cash and cash equivalents

Cash and cash equivalents include:

In thousands of RSD

	2012	2011
Cash on hand	1,311,769	879,193
Giro account	7,748,642	3,025,288
Cheques	3,412	7,658
Balance as at 31 December	**9,063,823**	**3,912,139**

Giro account includes obligatory reserves in dinars, which represent the minimum deposits set aside in accordance with the NBS Regulation on the "Obligatory Reserves of Banks to be Held with the NBS". Pursuant to the relevant decisions the obligatory reserve is to be calculated on the basis of the average amount of dinar deposits, borrowings and other related liabilities in effect during a period of one month to which a range from 0% to 5% is applied, depending on maturity and the source of funding, and subsequently maintained on the Bank's gyro account. In 2012, the annual interest rate earned on the Bank's obligatory reserve in dinars was 2.5% p.a.

15) Trading assets and liabilities

15.1 Trading assets consist of:

In thousands of RSD

	2012		2011	
	Non-pledged trading assets	Total trading assets	Non-pledged trading assets	Total trading assets
Government bonds	703,729	703,729	153,508	153,508
Treasury bills	2,661,848	2,661,848	3,707,542	3,707,542
Total	3,365,577	3,365,577	3,861,050	3,861,050
Derivative assets				
Interest rate - swaps	572,645	572,645	-	-
Foreign exchange - swaps	2,596	2,596	32,492	32,492
Total	575,241	575,241	32,492	32,492
Balance as at 31 December	**3,940,818**	**3,940,818**	**3,893,542**	**3,893,542**

15.2 Trading liabilities consist of:

In thousands of RSD

	2012	2011
Derivative liabilities		
Interest rate – swaps	572,645	-
Foreign exchange – swaps	24,641	37,347
Balance as at 31 December	**597,286**	**37,347**

Notes to the Financial statements (CONTINUED)

16) Loans and advances to banks

16.1 Loans and advances to banks include:

In thousands of RSD

	2012	2011
Current/clearing business		
Domestic banks	27,597	30,968
Foreign banks	1,788,451	1,191,259
Money market business		
Short-term deposits with central bank	-	4,800,000
Short-term deposits with domestic banks	878	2,722
Short-term deposits with foreign banks	15,071,330	5,244,453
Loans and placements to banks		
Repo transactions with Central Bank	12,019,230	11,717,604
Domestic banks	16,413	128,766
Foreign banks	-	121,627
Obligatory reserve in foreign currency held with Central Bank	15,631,375	17,060,013
Guarantee deposits for sale/purchase of bonds	4,549	4,186
Other placements	35,619	33,424
Less allowances for impairment	(1,689)	(2,596)
Balance as at 31 December	**44,593,753**	**40,332,426**

The obligatory reserves in foreign currencies represent the minimum deposits set aside in accordance with the NBS Regulation on the "Obligatory Reserves of Banks to be Held with the NBS". The obligatory reserve is to be calculated on the basis of the average amount of deposits, borrowings and other related liability balances in foreign currencies, or that have been index linked to the dinar-euro exchange rate existing during a period of one calendar month, to which a rate ranging from 22% to 29% is applied, depending on type and maturity of related liabilities.

The Bank is required to maintain an average daily balance on its foreign currency accounts held with the NBS, in an amount not lower than the calculated amounts of the obligatory reserves. Deposits placed in foreign currencies with the National Bank of Serbia are non-interest bearing ones.

As at 31 December 2012 the securities purchased under resell agreements with NBS totalling RSD 12,019,230 thousand are associated with the bonds purchased from the NBS, having 8 day maturities, issued at annual interest of 9.49% to 9.74%. These transactions are governed by the NBS Agreement on the Sale of Securities with an Obligation to Repurchase.

16.2 Movement in balance of impairment for loans and advances to banks is presented in the table below:

In thousands of RSD

	Specific		Collective	
	2012	2011	2012	2011
Balance as at 1 January	(1,724)	(1,555)	(872)	(23)
Impairment loss for the year:				
Charge for the year	-	(154)	1,024	(835)
Effect of foreign currency movements	65	(29)	(182)	(14)
Releases	-	-	-	-
Write offs	-	14	-	-
Total for the year	65	(169)	842	(849)
Balance as at 31 December	**(1,659)**	**(1,724)**	**(30)**	**(872)**

17) Loans and advances to customers

17.1 Loans and advances to customers consist of:

In thousands of RSD

	2012			2011		
	Gross amount	Impairment allowance	Carrying amount	Gross amount	Impairment allowance	Carrying amount
Public sector	6,530,506	(22,238)	6,508,268	7,379,250	(27,491)	7,351,759
Corporate customers	121,044,290	(8,222,232)	112,822,058	98,749,502	(5,004,933)	93,744,569
Retail customers	34,772,080	(2,012,829)	32,759,251	31,652,419	(1,591,717)	30,060,702
Balance as at 31 December	**162,346,876**	**(10,257,299)**	**152,089,577**	**137,781,171**	**(6,624,141)**	**131,157,030**

17.2 Movements in balance of impairment for loans and advances to customers, during the year, were as follows:

In thousands of RSD

	Specific		Collective	
	2012	2011	2012	2011
Balance as at 1 January	(6,245,439)	(3,596,572)	(378,702)	(409,844)
Impairment loss for the year:				
Charge for the year	(3,160,677)	(2,537,476)	(30,192)	36,630
Effect of foreign currency movements	(368,499)	(55,487)	(69,778)	(5,488)
Interest income correction	(145,512)	(184,513)	-	-
Sales of portfolio	-	99,327	-	-
Releases	-	-	-	-
Used for write offs	141,500	29,282	-	-
Total for the year	(3,533,188)	(2,648,867)	(99,970)	31,142
Balance as at 31 December	**(9,778,627)**	**(6,245,439)**	**(478,672)**	**(378,702)**

17.3 Loans are extended to enterprises for the purposes of daily liquidity (current account overdrafts), working capital and import financing, as well as to finance new investments. Loans up to one year have primarily been extended at thirty day to one-year maturity periods, whereas long-term loans have been extended with 2 to 10-year maturities. These loans were issued at interest rates equal to the one-month, quarterly or semi-annual EURIBOR rate and LIBOR increased on the average 5.93% per annum, in accordance with other expenses and the Bank's interest rate policy.

During 2012 long-term loans to retail customers were mainly granted for financing residential property purchases, with 5 to 25-year maturities (for subsidies loans up to 30 years). Interest rates ranged from 3M EURIBOR increased for 4.59% to 5.79% for loans indexed in EUR, or for 4.09% to 4.50% for subsidised housing loans. Long-term retail loans were granted in dinars with repayment periods of up to 7 years, and up to 10 years for insured loans (insurance provides coverage for the following: unemployment, temporary incapacity for work and insolvency of legal successors). During 2012 the Bank also offered cash loans with fixed interest over the entire loan period, with repayment periods of 6-60 months, with and without insurance, at interest rates ranging from 20% to 25%.

In November 2012 the Bank expanded its offering of cash loans for pensioners with life insurance up to age 75 at the time of maturity of last instalment, with fixed interest of 20% or interest rate of three month EURIBOR plus 5.7%.

In 2012 interest rates for financing investments for small companies and entrepreneurs ranged between 8.5% to 18% for loans indexed in EUR. For the same client segment interest rates for short-term financing up to 12 months ranged between 8.5 to 18% for loans indexed in EUR, and 20% to 25% for dinar loans.

Also during 2012 interest rates on subsidies loans for indexed loans amounted to 3.5%, and for dinar loans the interest rate was equal to the NBS key policy rate. The state subsidy amounted to 5% for both types of loans.

17.4 All impaired loans and advances have been written down to their recoverable amount. The allowance is apportioned as a reduction of loans and advances to customers.

17.5 The concentration of total short- and long-term loans approved by the Bank is as follows:

In thousands of RSD

	2012	2011
Corporate customers		
Mining industry and energy	907,057	2,059,490
Agriculture	1,818,313	1,958,556
Architecture	11,520,978	14,233,221
Industry	38,725,349	24,035,794
Trade	18,097,237	13,340,369
Services	12,900,462	13,300,675
Transportation and logistics	22,249,964	18,689,522
Other	14,824,930	11,131,875
	121,044,290	98,749,502
Public sector	6,530,506	7,379,250
Retail customers		
Private individuals	33,715,113	30,842,711
Entrepreneurs	1,056,967	809,708
	34,772,080	31,652,419
Total	**162,346,876**	**137,781,171**
Allowance for impairment	(10,257,299)	(6,624,141)
Balance as at 31 December	**152,089,577**	**131,157,030**

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 the geographical and industry segments. Such risks are monitored on a revolving basis and are subject to an annual or more frequent review. Exposure to credit risk is managed by the 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.

18) Investment securities

18.1 Investment securities consist of:

In thousands of RSD

	2012	2011
Financial assets at fair value through profit or loss		
Commercial bills	-	-
Held-to-maturity investment securities		
Bills of exchange	301,529	527,582
Available-for-sale investment securities		
Equity investments	12,061	12,061
Other available-for-sale investment securities		
Treasury bills	26,533,997	13,890,684
Foreign currency savings bonds	-	155,575
Bonds issued by other banks	117,642	-
Municipality bonds	3,570,341	1,556,762
Less allowances for impairment	(68,499)	(73,705)
Balance as at 31 December	**30,467,071**	**16,068,959**

As at 31 December 2012 receivables for discounted bills in the amount of RSD 301,529 thousand relate to investments that mature within one year at a discount rate ranging from 0.97% to 1.50% per month.

As at 31 December 2012 available-for-sale securities of RSD 3,570,341 thousand represent a portfolio of local municipality bonds – hedging item, with maturities occurring up to 2023, the amount of RSD 26,533,997 thousand relates to treasury bonds of the Republic of Serbia with maturities up to 2017, while the amount of 117,642 thousand dinars relate to investments in bonds issued by the finance and insurance sectors with maturities up to 2014.

For hedging interest rate risks related to local municipality bonds, with long-term maturity and fixed interest rate, the Bank implemented micro fair value hedging relationship, i.e. it reported investments in local self-government bonds in the amount of EUR 29 million as a hedged item, while a hedged instrument is reported as an interest rate swap, also in the amount of EUR 29 million. As at 31 December 2012 a hedging effectiveness test was performed which showed that the hedge is very effective.

18.2 Allowances for impairment consist of:

In thousands of RSD

	Specific		Collective	
	2012	2011	2012	2011
Balance as at 1 January	(68,313)	(63,886)	(5,392)	(11,713)
Impairment loss for the year:				
Charge for the year	1,091	(5,489)	4,115	6,321
Releases	-	-	-	-
Write offs	-	1,062	-	-
Total for the year	1,091	(4,427)	4,115	6,321
Balance as at 31 December	**(67,222)**	**(68,313)**	**(1,277)**	**(5,392)**

Notes to the Financial statements (CONTINUED)

19) Property and equipment

19.1 Property and equipment includes:

In thousands of RSD

	2012	2011
Buildings	631,868	645,243
Fixtures and fittings	366,477	401,582
Leasehold investments	150,009	185,117
Assets under development	3,627	3,600
Balance as at 31 December	**1,151,981**	**1,235,542**

19.2 The movements in property and equipment for the year 2012 were as follows:

In thousands of RSD

	Land and buildings	Leasehold investment	Fixtures and fittings	Assets under development	Total
Cost					
Balance as at 1 January 2012	668,752	371,800	1,010,956	3,600	2,055,108
Acquisitions	-	-	-	84,791	84,791
Transfer from investment in progress	-	12,172	72,592	(84,764)	-
Disposals	-	(5,700)	(19,671)	-	(25,371)
Other	-	-	-	-	-
Balance as at 31 December 2012	668,752	378,272	1,063,877	3,627	2,114,528
Accumulated depreciation and impairment losses					
Balance as at 1 January 2012	23,509	186,683	609,374	-	819,566
Depreciation for the period	13,375	44,310	106,717	-	164,402
Impairment losses	-	-	-	-	-
Disposals	-	(2,730)	(18,691)	-	(21,421)
Other	-	-	-	-	-
Balance as at 31 December 2012	36,884	228,263	697,400	-	962,547
Carrying amount as at 31 December 2012	**631,868**	**150,009**	**366,477**	**3,627**	**1,151,981**
Carrying amount as at 1 January 2012	**645,243**	**185,117**	**401,582**	**3,600**	**1,235,542**

The movements in property and equipment for the year 2011 were as follows:

In thousands of RSD

	Land and buildings	Leasehold investment	Fixtures and fittings	Assets under development	Total
Cost					
Balance as at 1 January 2011	668,752	346,699	945,700	7	1,961,158
Acquisitions	-	-	-	200,792	200,792
Transfer from investment in progress	-	33,092	164,107	(197,199)	-
Disposals	-	(7,991)	(90,061)	-	(98,052)
Other	-	-	(8,790)	-	(8,790)
Balance as at 31 December 2011	668,752	371,800	1,010,956	3,600	2,055,108
Accumulated depreciation and impairment losses					
Balance as at 1 January 2011	10,134	150,181	605,316	-	765,631
Depreciation for the period	13,375	40,629	98,035	-	152,039
Disposals	-	(4,127)	(87,172)	-	(91,299)
Other	-	-	(6,805)	-	(6,805)
Balance as at 31 December 2011	23,509	186,683	609,374	-	819,566
Carrying amount as at 31 December 2011	645,243	185,117	401,582	3,600	1,235,542
Carrying amount as at 1 January 2011	658,618	196,518	340,384	7	1,195,527

20) Intangible assets

20.1 Intangible assets, net include:

In thousands of RSD

	2012	2011
Intangible assets	949,854	624,835
Intangible assets in progress	50,000	125,533
Balance as at 31 December	**999,854**	**750,368**

20.2 The movements in intangible assets for the year 2012 were as follows:

In thousands of RSD

	Intangible assets	Intangible assets in progress	Total
Cost			
Balance as at 1 January 2012	1,628,485	125,533	1,754,018
Acquisitions	552,361	(75,533)	476,828
Other	-	-	-
Balance as at 31 December 2012	2,180,846	50,000	2,230,846
Amortization and impairment losses			
Balance as at 1 January 2012	1,003,650	-	1,003,650
Amortization for the period	227,342	-	227,342
Balance as at 31 December 2012	1,230,992	-	1,230,992
Carrying amount as at 31 December 2012	**949,854**	**50,000**	**999,854**
Carrying amount as at 1 January 2012	**624,835**	**125,533**	**750,368**

The movements in intangible assets for the year 2011 were as follows:

In thousands of RSD

	Intangible assets	Intangible assets in progress	Total
Cost			
Balance as at 1 January 2011	1,241,895	250,400	1,492,295
Acquisitions	388,082	(124,867)	263,215
Other	(1,492)	-	(1,492)
Balance as at 31 December 2011	1,628,485	125,533	1,754,018
Amortization and impairment losses			
Balance as at 1 January 2011	804,669	-	804,669
Amortization for the period	198,981	-	198,981
Balance as at 31 December 2011	1,003,650	-	1,003,650
Carrying amount as at 31 December 2011	**624,835**	**125,533**	**750,368**
Carrying amount as at 1 January 2011	**437,226**	**250,400**	**687,626**

Notes to the Financial statements (CONTINUED)

21) Deferred tax assets and liabilities

21.1 Deferred tax assets and liabilities relate to:

In thousands of RSD

	2012			2011		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Difference in net carrying amount of tangible assets for tax and financial reporting purpose	23,887	-	23,887	22,140	-	22,140
Deferred tax assets associated with unrecognised expenses	13,620	-	13,620	6,184	-	6,184
Valuation of available-for-sale securities	-	(322)	(322)	4,637	-	4,637
Total	**37,507**	**(322)**	**37,185**	**32,961**	**-**	**32,961**

21.2 Movements in temporary differences during the year 2012 are presented as follows:

In thousands of RSD

	Balance at 1 Jan	Recognised in profit or loss	Recognised in other comprehensive income	Balance at 31 Dec
Property and equipment	22,140	1,747	-	23,887
Deferred tax assets associated with unrecognised expenses	6,184	7,436	-	13,620
Available-for-sale securities	4,637	-	(4,959)	(322)
Total	**32,961**	**9,183**	**(4,959)**	**37,185**

22) Other assets

Other assets relate to:

In thousands of RSD

	2012	2011
Assets held for sale	378	982
Accounts receivables	315,733	251,484
Accrued income	253,939	240,028
Assets received in exchange for collection of receivables	4,927	4,927
Prepayments	184,548	163,047
Investment property	1,528	1,561
Other deferred expenses	534,022	563,261
Less allowances for impairment	(85,675)	(40,215)
Balance as at 31 December	**1,209,400**	**1,185,075**

Movements in balance of impairment of other assets and accrued income, during the year, were as follows:

In thousands of RSD

	Specific		Collective	
	2012	2011	2012	2011
Balance as at 1 January	(40,071)	(23,202)	(144)	(25)
Impairment loss for the year:				
Charge for the year	(42,947)	(18,127)	(3,603)	(119)
Effect of foreign currency movements	(913)	(123)	-	-
Releases	-	-	-	-
Write offs	2,003	1,381	-	-
Balance as at 31 December	**(81,928)**	**(40,071)**	**(3,747)**	**(144)**

Notes to the Financial statements (CONTINUED)

23) Derivative liabilities held for risk management

23.1 Derivative liabilities held for risk management include:

In thousands of RSD

	2012	2011
Instrument type:		
Interest rate swaps	259,718	63,418
Balance as at 31 December	**259,718**	**63,418**

The Bank uses interest rate swaps to hedge its exposure to changes in the fair values of its fixed rate euro bonds. Interest rate swaps are matched to specific issuances of fixed rate bonds (Notes 18.1 and 7).

24) Deposits and loans from banks

24.1 Deposits and loans from banks include:

In thousands of RSD

	2012	2011
Demand deposits	12,231,868	2,796,566
Short-term deposits	3,306,006	3,735,338
Long-term deposits	57,371	31,392
Long-term loans	71,334,957	65,189,985
Other	189,558	13,485
Balance as at 31 December	**87,119,760**	**71,766,766**

Demand deposits in dinars from banks are deposited at 4% interest rate per annum.

Short-term term deposits in dinars from banks are deposited with maturities of up to one year at interest rates ranging from 7.3% to 12.7% per annum.

Short-term foreign currency deposits from banks are deposited with maturities of up to one year at interest rates ranging from 0.0444% to 2.0555% per annum.

24.2 The structure of long-term loans is presented as follows:

In thousands of RSD

	2012	2011
European Bank for Reconstruction and Development (EBRD)	12,254,280	11,870,966
Kreditanstalt fur Wiederaufbau Frankfurt am Main („KfW“)	4,662,450	4,290,277
European Investment Bank, Luxembourg	8,368,710	5,808,697
Deutsche Invertitions und Entwicklungs GmbH, Germany	1,137,183	1,395,212
UniCredit Bank Austria AG, Vienna	44,863,966	41,815,729
National Bank of Serbia	48,368	9,104
Balance as at 31 December	**71,334,957**	**65,189,985**

Presented long term loans are granted with maturities from 5 to 17 years at interest rates from 1% to 4.21% per annum.

Notes to the Financial statements (CONTINUED)

25) Deposits and loans from customers

25.1 Deposits and loans from customers include:

In thousands of RSD

	2012	2011
Public sector	1,651,693	275,235
Corporate customers	58,562,725	44,281,796
Retail customers	36,244,602	29,740,675
Long-term loans	8,113,373	5,278,435
Balance as at 31 December	**104,572,393**	**79,576,141**

Demand deposits in dinars from companies are deposited at average interest rate of 1.47% per annum in euro, while interest rate on term deposits is up to 10.75% per annum. Demand deposits in foreign currencies from companies are deposited at annual interest rate ranging from 0.5% to 4.14% per annum depending on deposited currency.

Short-term deposits in foreign currencies from companies are deposited at annual interest rate ranging from 3.03% to 4.78% per annum depending from deposited currency.

Demand deposits in dinars from retail clients are deposited at annual interest rates up to 1%.

Demand deposits in foreign currency from retail clients are deposited at annual interest rate of 0.9% per annum, while interest on funds on current accounts amounts to 0.3% per annum.

Short-term term deposits from retail customers in foreign currencies are deposited at annual interest rates ranging from 2% to 5.1% depending on term of deposit and currency presumably.

Dinar deposits indexed in EUR from small companies and entrepreneurs are deposited at annual interest rates up to 2.3%.

25.2 The structure of long-term loans is presented as follows:

In thousands of RSD

	2012	2011
International Finance Corporation, Washington	7,345,298	4,614,441
Government of the Republic of Italy	83,841	16,647
BA CA Leasing GmbH, Bad Hamburg	684,234	647,347
Balance as at 31 December	**8,113,373**	**5,278,435**

Maturity of the presented long term loans ranges between 2016 to 2021, with interest rates from 1 to 3.42 % per annum.

26) Subordinated liabilities

Subordinated liabilities relate to:

In thousands of RSD

	2012	2011
UniCredit Bank Czech Republic	852,887	784,807
UniCredit Bank Austria AG, Vienna	2,584,036	2,357,342
Balance as at 31 December	**3,436,923**	**3,142,149**

As at 31 December 2012 subordinated liabilities in foreign currencies in the amount of RSD 3,436,923 thousand relate to the subordinated long-term loans originated by UniCredit Bank Czech Republic in the amount of EUR 7,500,000 (equivalent of RSD 852,887 thousand) and by UniCredit Bank Austria AG, Vienna in the amount of EUR 500,000 (equivalent of RSD 56,859 thousand) and CHF 26,830,000 (equivalent of RSD 2,527,177 thousand). These loans were extended with 7-year and 12-year maturities, at an interest rate equal to the three-month EURIBOR rate as increased by 0.75 percent per annum, and at the six-month EURIBOR interest rate as increased by 0.65 percent per annum and three-month CHF LIBOR rate as increased by 2.93% respectively. These loans are unsecured and all claims arising, explicitly in the event of bankruptcy or liquidation, from this agreement are subordinated to all other debt instruments (obligations toward ordinary creditors).

The Bank has not had any defaults of interest or other breaches with respect to its subordinated liabilities during 2012 and 2011.

Notes to the Financial statements (CONTINUED)

27) Provisions

Provisions include:

In thousands of RSD

	2012	2011
Individual loan loss provision for contingent liabilities	16,311	14,443
Portfolio based loan loss provision for contingent liabilities	49,435	64,269
Retirement benefit obligations	37,294	35,955
Other	48,570	20,070
Balance as at 31 December	**151,610**	**134,737**

Movements in provisions during the year were as follows:

In thousands of RSD

	Individual loan loss provision for contingent liabilities	Portfolio based loan loss provision for contingent liabilities	Retirement benefit obligations	Other	Total
Balance as at 1 January 2012	14,443	64,269	35,955	20,070	134,737
Provision made during the year	1,868	-	2,739	28,500	33,107
Provision used during the year	-	(14,834)	(1,400)	-	(16,234)
Provision reversed during the year	-	-	-	-	-
Balance as at 31 December	**16,311**	**49,435**	**37,294**	**48,570**	**151,610**

28) Other liabilities

Other liabilities include:

In thousands of RSD

	2012	2011
Accrued interest	87,635	10,012
Prepayments	522,550	472,646
Liabilities to suppliers	219,553	211,152
Liabilities for corporate income tax	45,453	120,728
Liabilities for other taxes and contributions	8,724	26,443
Liabilities for received advances, deposits and bonds	5,393	85,915
Other accrued income	101,912	126,796
Other accrued expenses	137,774	98,480
Other	479,276	374,253
Balance as at 31 December	**1,608,270**	**1,526,425**

Notes to the Financial statements (CONTINUED)

29) Equity

29.1 Equity comprises:

In thousands of RSD

	2012	2011
Share capital	23,607,620	23,607,620
Share premium	562,156	562,156
Retained earnings	21,457,759	18,193,012
Fair value reserves	179,967	(41,729)
Balance as at 31 December	**45,807,502**	**42,321,059**

As of 31 December 2012 the authorised share capital amounts to RSD 23,607,620 thousand and consists of 2,360,762 ordinary shares, with nominal value of RSD 10,000.00 per share. All shares are ordinary shares.

Holders of ordinary shares are entitled to receive dividends as declared by the Board of the Bank and are entitled to one vote per share at the General assembly meetings of the Bank.

UniCredit Bank Austria AG, Vienna holds 100% of the Bank's equity.

The fair value reserves include the cumulative net change in the fair value of available for sale investments.

In 2012 the Bank has paid dividends for year ended 31 December 2011, in the amount of RSD 1,135,000 thousand.

After 31 December 2012 the Bank didn't propose dividends in respect of 2012.

29.2 Analysis of other comprehensive income, net of tax, is presented in the following table:

In thousands of RSD

	Fair value reserve	Total
2012		
Fair value reserve:		
Net change in fair value on available for sale financial assets	221,696	221,696
Total other comprehensive income, net of tax	**221,696**	**221,696**
2011		
Fair value reserve:		
Net change in fair value on available for sale financial assets	(42,105)	(42,105)
Total other comprehensive income, net of tax	**(42,105)**	**(42,105)**

30) Contingent liabilities and commitments

30.1 Legal proceedings

As at 31 December 2012 the Bank is defendant in 25 court cases (including 9 labour disputes) whose total value amounts to RSD 40,435 thousand, excluding the labour disputes. In 4 cases the claimants are companies, and in 21 cases the claimants are private individuals.

The Bank made provisions in the amount of RSD 48,570 thousand for court cases that have been filed against it. This amount includes labour disputes involving the Bank. No provisions have been made for other court cases, primarily because of the assessment that the outcome of those cases will be positive for the Bank and that the Bank will not have any outflows as a result, or that they are less significant potential liabilities that do not need to be provisioned.

The Bank has filed a number of claims against third parties, mainly for the collection of its receivables.

30.2 Commitments for operating leases of business premises:

In thousands of RSD

	2012	2011
Commitments due within one year	356,167	347,491
Commitments due in the period from one to five years	927,912	1,079,362
Commitments due in the period longer than five years	90,295	192,269
Total	**1,374,374**	**1,619,122**

30.3 Contingent liabilities are presented in the table below:

In thousands of RSD

	2012	2011
Contingent liabilities		
Payment guarantees		
in local currency	8,109,189	8,024,435
in foreign currency	9,427,355	8,758,463
Performance guarantees		
in local currency	14,633,617	11,356,361
in foreign currency	2,358,767	2,232,678
Letters of credit		
in local currency	557,633	-
in foreign currency	4,368,461	3,361,195
Other acceptance and endorsements	-	-
Balance as at 31 December	**39,455,022**	**33,733,132**

30.4 Breakdown of commitments is presented in the table below:

In thousands of RSD

	2012	2011
Commitments		
Current account overdrafts	2,474,749	3,021,083
Unused credit limits on credit cards	1,526,957	1,477,809
Unused framework loans	3,982,765	17,604,267
Letters of intention	510,051	910,537
Balance as at 31 December	**8,494,522**	**23,013,696**

30.5 Undrawn foreign loan facilities as at 31 December 2012 amount to RSD 4,529,411 thousand (2011: RSD 4,174,136 thousand).

Notes to the Financial statements (CONTINUED)

31) Related parties

31.1 The Bank is controlled by the UniCredit Bank Austria AG, Vienna incorporated in Austria, which owns 100% of its ordinary shares. A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits, equity investments and derivative instruments. Transactions with related parties are made at arm's length market prices.

Outstanding balances with related parties at the end of a year are as follows:

In thousands of RSD

	2012	2011
Balance sheet		
Loans and advances to banks		
UniCredit Bank Austria AG, Vienna	15,384,606	6,157,871
UniCredit Bank AG, Munich	14,336	25,401
UniCredit Bulbank, Sofia	21	2,950
UniCredit S.P.A. Milano	50,560	54,673
UniCredit Banka Slovenija, Ljubljana	107	5,791
Zagrebacka banka d.d. Zagreb	1,619	2,059
UniCredit Bank Hungary Z.r.t., Hungary	18,500	4,772
UniCredit Leasing Srbija d.o.o. Beograd	0	40
UniCredit Bank ZAO Moscow	6	-
	15,469,755	**6,253,557**
Loans and advances to customers		
Management Board of Bank	28,475	16,154
UniCredit Rent d.o.o.	190,000	-
	218,475	**16,154**
Other assets		
UniCredit S.P.A. Milano	567	547
UniCredit Bank Austria AG, Vienna	22,611	14,986
UniCredit Bank AG, Munich	0	-
UniCredit Bulbank, Sofia	0	-
ATF Bank, Kazahstan	6,281	8,413
UniCredit Bank Slovakia a.s., Bratislava	14,398	17,668
Unicredit CAIB Serbia	0	51
UniCredit Leasing d.o.o. Beograd	43	40
UniCredit Bank Hungary Z.r.t., Hungary	7	-
UniCredit Business Partner S.C.P.A., Milano	1,514	-
	45,421	**41,705**
Deposits and loans from banks		
UniCredit Bank Austria AG, Vienna	53,674,679	44,256,923
UniCredit Leasing Srbija d.o.o. Beograd	1,098,747	396,013
UniCredit Partner d.o.o. Beograd	109,793	83,753
UniCredit Bank AD Banja Luka	1,087	88
Zagrebacka banka d.d. Zagreb	7,825	43,056
UniCredit Bank AG, London	48	47
UniCredit Banka Slovenija, Ljubljana	2,384	9,356
UniCredit CAIB AG, Vienna	60	57
UniCredit Bank AG, Munich	5,186	1,003
UniCredit Bank BiH	7	6
UniCredit Bank Hungary Z.r.t., Hungary	216	104
UniCredit S.P.A. Milano	2,044	5,415
UniCredit Bank Czech Republic	868,201	787,901
UniCredit Bank ZAO Moscow	10,664	-
	55,780,941	**45,583,722**

31) Related parties (continued)

In thousands of RSD

	2012	2011
Deposits and loans from customers		
Management Board of Bank	13,224	6,951
UniCredit Rent d.o.o. Beograd	752,428	54,314
UniCredit CAIB Srbija d.o.o.	28,037	8,882
BA CA Leasing Deutschland Gmbh, Germany	685,262	648,319
UCTAM D.O.O.	96,541	-
	1,575,492	**718,466**
Other liabilities		
UGIS, Vienna	94	17,582
UniCredit Business Partner GMBH Wien	-	86
UniCredit Business Partner s.r.o., Czech Republic	1,499	1,578
UniCredit Bank Slovenia	8,805	2,158
UniManagement, Torino	-	105
UniCredit Bank Austria AG, Vienna	-	146
UniCredit Rent d.o.o. Beograd	492	302
Unicredit S.P.A. Milano	121,176	97,853
	132,066	**119,810**
Net Liabilities as at 31 December	**41,754,848**	**40,110,582**

The table below presents total revenues and expenses from related party transactions:

In thousands of RSD

	2012	2011
Income statement		
Interest income	20,849	15,413
Interest expenses	(2,152,011)	(1,547,607)
Fees and other incomes	173,095	122,948
Fees and other expenses	(341,092)	(276,007)
Net expenses as at 31 December	**(2,299,159)**	**(1,685,253)**

31.2 Total gross salaries and other remuneration of the Executive Board in 2012 amount to RSD 27,065 thousand (2011: RSD 19,861 thousand).

Notes to the Financial statements (CONTINUED)

32) Subsequent events

Up to the day of issuance of these financial statements there were no subsequent events that would require correction of these financial statements (corrective events).

PROTECTION

Supporting communities in critical times

“After one of our town’s largest employers closed its doors, our local communities went through a very tough time. UniCredit worked closely with government officials on an innovative initiative that helped those who had lost their jobs, like me, gain prompt access to unemployment benefits. The bank quickly facilitated funding for entitlements, protecting families from collapse.”

Franco F., customer of UniCredit in Italy

Boards

Supervisory Board[1]

Erich Hampel	Chairman
Heinz Tschiltsch	Vice Chairman
Martin Klauzer	Member
Simone Marcicci	Member
Boris Begović	Member
Svetlana Kisić Zajčenko	Member

Management Board of the Bank[1]

Claudio Cesario	Chairman
Branislav Radovanović	Deputy Chairman
Alen Dobrić	Member

[1] on December 31st, 2012

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