HIPOTEKARNA BANKA A.D., PODGORICA

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

Translation of the financial statements issued in Montenegrin language

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Translation of the financial statements issued in Montenegrin language

Ernst & Young

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This is an English translation of the Report originally issued in Montenegrin language (for management purposes only)

INDEPENDENT AUDITORS' REPORT
TO THE OWNERS OF HIPOTEKARNA BANKA A.D., PODGORICA

Report on Financial Statements

We have audited the accompanying financial statements of Hipotekarna banka A.D., Podgorica (hereinafter: the Bank), which comprise the balance sheet as at December 31, 2011, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at December 31, 2011, and of its financial performance and its cash flows for the year then ended in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks.

Report on Other Legal and Regulatory Requirements

In accordance with the Law on Accounting and Auditing and the regulations of the Central Bank of Montenegro governing the financial reporting of banks, the Bank's management has prepared analyses to the financial statements which are presented on pages 38 to 50. Information presented in the analyses to the financial statements does not form an integral part of the financial statements of the Bank. This information is the responsibility of the Bank's management. This information has been properly derived from the primary financial statements which were prepared in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks as presented on pages 3-6, and is based on the underlying accounting records of the Bank.

Podgorica, May 15, 2012

Ernst & Young Montenegro d.o.o.
Podgorica, Crna Gora

DRUŠTVO ZA REVIZIJU ERNST & YOUNG MONTENEGRO DOO PODGORICA

Stephen Fish
Partner

Draško Popović
Authorized auditor

STATEMENT OF INCOME FOR THE YEAR ENDED 31 DECEMBER 2011

In thousands of EUR	Notes	2011	2010
Interest income	3.1, 4a	11,405	9,634
Interest expenses	3.1, 4b	(3,873)	(3,433)
Net interest income		7,532	6,201
Provisions for losses	3.6, 5	(2,160)	(1,334)
Net income		5,372	4,867
Fee and commission income	3.1, 6a	3,817	3,105
Fee and commission expenses	3.1, 6b	(645)	(465)
Net fee and commission income		3,172	2,640
NET INTEREST, FEE AND COMMISSION INCOME		8,544	7,507
Other income, net	7	511	399
General expenses	8	(7,379)	(6,827)
NET INCOME BEFORE EXTRAORDINARY ITEMS		1,676	1,079
Extraordinary income		27	263
Extraordinary expenses		(13)	(35)
Net extraordinary income		14	228
PROFIT BEFORE TAXATION	9	1,690	1,307
Income taxes	3.3, 9	(168)	(15)
NET PROFIT FOR THE YEAR		1,522	1,292

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

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Signed on behalf of Hipotekarna banka A.D., Podgorica:

Esad Zaimović
Chief Executive Officer

Mitrović

Aleksandar Mitrović
Executive Director of Finance and Informatics

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STATEMENT OF FINANCIAL POSITION AS OF 31 DECEMBER 2011

In thousands of EUR	Notes	2011	2010
ASSETS			
Cash and deposit accounts held with depository institutions	10	38,500	24,247
Securities available for sale, other than shares		26	42
Loans and leases	11	109,470	98,352
Securities held to maturity	12	2,569	1,093
Factoring and forfeiting		9	-
Receivables in respect of custody operations		39	23
Business premises and other fixed assets	13	1,950	1,742
Acquired assets	14	478	485
Equity investments in other legal entities	15	230	99
Other assets	16	2,641	3,190
Less: Provision for potential losses on other assets	16	(319)	(485)
Total assets		155,593	128,788
LIABILITIES			
Deposits	17	97,853	85,133
Liabilities in respect of custody operations		247	49
Loans and borrowings	18	26,887	15,000
Liabilities to the Government	19	2,889	2,716
Other liabilities	20	3,952	3,773
Provisions for potential losses on off-balance sheet exposures	21	675	494
Total liabilities		132,503	107,165
EQUITY			
Share capital	22	16,006	16,006
Share premium		7,444	7,444
Revaluation reserves		(54)	1
Accumulated loss		(306)	(1,828)
Total equity		23,090	21,623
Total liabilities		155,593	128,788
OFF-BALANCE-SHEET ITEMS	24	388,819	289,488

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Signed on behalf of Hipotekarna banka A.D., Podgorica:

HIPOTEKARNA BANKA AD PODGORICA

Esad Zaimović
Chief Executive Officer

Aleksandar Mitrović
Executive Director of Finance and Informatics

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STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2011

In thousands of EUR	Share Capital	Share premium	Revaluation reserves	Accumulated loss	Total
Balance, January 1, 2010	16,006	7,444	-	(3,120)	20,330
The effect of reducing the market value of securities available for sale	-	-	1	-	1
Profit for the year	-	-	-	1,292	1,292
Balance, December 31, 2010	16,006	7,444	1	(1,828)	21,623
Balance January 1, 2011	16,006	7,444	1	(1,828)	21,623
Revaluation reserves - fair value adjustments of available for sale financial instruments	-	-	(55)	-	(55)
Profit for the year	-	-	-	1,522	1,522
Balance, December 31, 2011	16,006	7,444	(54)	(306)	23,090

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

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

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CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2011

In thousands of EUR	Notes	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest, fees and commissions received		16,406	11,745
Other proceeds		22	88
Interest and commission paid		(4,610)	(2,669)
Cash paid to employees and suppliers		(8,676)	(7,098)
Net cash inflow before changes in operating assets and liabilities		3,142	2,066
Changes in operating assets and liabilities			
Increase in placements to customers, net		(12,112)	(24,226)
Increase/(decrease) in other assets, net		230	335
Increase in deposits from customers		12,720	15,398
Inflow from custody operations		139	26
Decrease in other liabilities		306	(2)
Net cash inflow / (outflow) used in operating activities		4,425	(6,403)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of equipment and intangible assets		(918)	(1,155)
Net cash outflow used in operating activities		(918)	(1,155)
CASH FLOWS FROM FINANCING ACTIVITIES			
(Outflow)/ inflow from loans and borrowings		12,060	11,507
(Outflow)/ inflow from purchase and sale of securities, net		(163)	158
Inflow from equity investments in other legal entities, net		-	-
Outflow from securities held to maturity, net		(1,437)	-
Net cash generated from financing activities		10,460	11,665
Effects of foreign exchange gains and losses		286	223
Net increase in cash and cash equivalents		14,253	4,330
Cash and cash equivalents, beginning of year		24,247	19,917
Cash and cash equivalents, end of year		38,500	24,247
Components of cash and cash equivalents:			
Cash and deposit accounts held with depositary institutions	3.4, 10	38,500	24,247
		38,500	24,247

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

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Signed on behalf of Hipotekarna banka A.D., Podgorica:

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NOTES TO THE FINANCIAL STATEMENTS.

1. FOUNDATION AND BUSINESS ACTIVITY

Hipotekarna banka A.D. Podgorica (hereinafter: the "Bank") was registered in 1995 as a shareholding company. The registration number of the Bank as recorded in the Central Registry of the Commercial Court is 4-0004632. The Bank is included in the Register of Security Issuers maintained by the Securities Commission under the number 3 (Decision number 02/3-1/2-01). The Bank received an operating license from the Central Bank of Montenegro; pursuant to the Decision number 26 dated November 21, 2001.

In accordance with Law on Banks, Founding Agreement, Statute and Decision of the Central Bank of Montenegro, the Bank performs depositary and crediting operations for its own account. In addition to the above, the Bank performs the following activities:

- issuance of guarantees and undertaking other off-balance sheet liabilities,
- purchase, sale and collection of receivables (factoring, forfeiting etc.),
- issuance, processing and recording of payment instruments
- payment transactions, and clearing and settlement transactions services abroad, in accordance with legal requirements regulating payment transfers,
- finance leases,
- operations involving securities, in accordance with the relevant regulations,
- trading on its own behalf and for its own account or for the account of a third party:
  a) foreign currency trade, including exchange operations,
  b) financial derivates,
- depo transactions,
- performing of analysis and advising on creditworthiness of legal entities and entrepreneurs and other issues related to business operations,
- rental of safety deposit boxes,
- other banking activities, additional banking activities and activities directly related to the Bank's operations, in accordance with the Statute.

The Bank's management bodies include: the Shareholders Assembly and the Board of Directors. The Board of Directors has two permanent bodies: Audit Board and Credit Risk Management Board. The members of the Board of Directors are elected by the Bank's Shareholders Assembly. The Board of Directors has 5 (five) members the majority of which are not the Bank's employees.

The Bank is domiciled in the city of Podgorica, at 67 Josipa Broza Tita Street. At December 31, 2011, the Bank had 163 employees (December 31, 2010: 155 employees).

NOTES TO FINANCIAL STATEMENTS

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.1. Basis of Preparation and Presentation of the Financial Statements

The Bank maintains its accounting records and prepares its statutory financial statements in conformity with Accounting and Auditing Law of Montenegro ("Official Gazette of Montenegro," no. 69/2005 ; no. 80/2008 and no. 32/2011) and in accordance with the Decision pertaining to the direct application of International Accounting Standards ("IAS") in Montenegro ("Official Gazette of Montenegro," numbered 69/2002). Consequently, the International Financial Reporting Standards (IFRS) are effective at the date of preparation or the financial statements for the period commencing on January 1, 2003.

The financial statements are presented in the format specified by the Central Bank of Montenegro, which in some parts differ from the presentation of certain amounts as provided in MRS1 "Presentation of Financial Statements."

The accounting policies adopted in the preparation and presentation of the financial statements for the year ended December 31, 2011 differ from the IFRS requirements in respect to the calculation of allowances for the impairment of financial instruments and in respect of disclosures of financial instruments in accordance with IFRS 7 "Financial Instruments: Disclosures." The Bank calculates the amount of allowance for impairment of financial instruments in accordance with the applicable Regulations of the Central Bank of Montenegro (Note 3.7). Such a policy might result in significant departures from the amounts which would be determined, had the allowances for impairment of financial instruments been estimated based on discounted expected future cash flows by applying the original effective interest rate, as required by IAS 39, "Financial Instruments: Recognition and Measurement." In addition, the Bank suspends the calculation of interest on loans classified in category C, D and E ("non-performing assets" in accordance with the Decision of the Central Bank of minimum standards for credit risk management in banks; "Official Gazette of Montenegro," no. 60/08 and no. 41/09), where the decision also regulates the risk assets classified in category E to be written off from the balance sheet and be recorded in off balance sheet as "written off loans". "

Due to the potentially significant effects of the above-described matters on reality and objectiveness of financial statements of the Bank, these financial statements cannot be described as having been prepared in accordance with International Financial Reporting Standards.

In the preparation of the accompanying financial statements, the Bank has adhered to the accounting policies described in Note 3, which are in conformity with the accounting, banking and tax regulations prevailing in Montenegro.

The official currency in Montenegro and the Bank's functional currency is the Euro (EUR).

2.2. Use of Estimates

The presentation of financial statements requires the Bank's management to make the best possible estimates and reasonable assumptions that affect the value of assets and liabilities, as well as the disclosure of contingent liabilities and receivables as of the date of the preparation of the financial statements, and the income and expenses arising during the accounting period. Estimates and judgments relate to historical experience and other factors, including the expectations in respect to future events believed to be reasonable in the given circumstances, where the results provide goods grounds for the estimated carrying value of assets and liabilities that cannot be clearly derived from other sources. These estimations and assumptions are based on information available as of the financial statements' preparation date. However the Bank's operating results may vary from the estimated values. The most significant estimates and assumptions are made on the following balance positions:

- Provisions on loans and interest
- Provisions for deposits with other banks
- Provisions for permanent investments
- Provisions for off balance sheet items
- Provisions for severance payments
- Provisions for litigations
- The fair value of securities available for sale
- The useful life of intangible assets, property and equipment

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest, Fee and Commission Income and Expense Recognition

Interest income and interest expense are recognized in the income statement for all instruments at amortized cost using the effective interest rate method. The effective interest rate method is a method of calculating the amortized cost of a financial asset or financial liability and allocating interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period to the present value of financial assets or financial liabilities. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of financial instrument (e.g. prepayment options) but does not consider future credit losses arising from credit risk. The calculation includes all fees and commissions paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Income from fees and commissions are generally recognized on accrual basis in the period when the services are performed. Compensations for unused lines of credit are deferred (together with related direct costs) and recognized as an adjustment to the effective interest rate on the loan.

3.2. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into EUR at the official exchange rates prevailing on the Interbank Market, at the date of each transaction.

Assets and liabilities denominated in foreign currencies are translated into EUR by applying the official exchange rates, as determined on the Interbank Market that are prevailing at the balance sheet date.

Net foreign exchange gains or losses arising upon the translation of transactions, and the assets and liabilities denominated in foreign currencies are credited or charged to the Income statement, as gains or losses due foreign exchange translation.

Commitments and contingent liabilities denominated in foreign currencies are translated into EUR by applying the official exchange rates prevailing on the Interbank Market, at the balance sheet date.

3.3. Taxes and Contributions

Income Taxes

Current Income Taxes

Income taxes are calculated and paid in conformity with the income tax regulations defined under the Montenegro Tax Law ("Official Gazette of Montenegro," no. 80/2004, 40/2008, 86/2009, 73/2010 and 40/2011) as per the effective proportional tax rate of 9% on taxable income.

A taxpaying entity's taxable income is determined based upon the income stated in its statutory statements of income following certain adjustments to its income and expenses performed in accordance with Montenegro Tax Law (Articles 8 and 9, regarding the adjustment of income and Articles 10 to 20 pertaining to the adjustment of expenses).

Capital losses may be set off against capital gains earned in the same year. In case there are outstanding capital losses even after the set-off of capital losses against capital gains earned in the same year, these outstanding losses are available for carry-forward in the ensuing 5 years.

NOTES TO FINANCIAL STATEMENTS

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3. Taxes and Contributions (continued)

Income Taxes (continued)

Current Income Taxes (continued)

Montenegro tax regulations do not envisage any tax losses of the current period to be used to recover taxes paid within a specific carry back period. However, any current year losses reported in the annual corporate income tax returns may be carried forward and used to reduce or eliminate taxes to be paid in future accounting periods, but only for an ensuing period of a maximum of five years.

Deferred Income Taxes

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

Taxes, Contributions and Other Duties Not Related to Operating Results

Taxes, contributions and other duties that are not related to the Company's operating results, include property taxes, employer contributions on salaries, and various other taxes and contributions paid pursuant to republic and municipal regulations.

3.4. Cash and Cash Equivalents

For purposes of the cash flow statement, "Cash and cash equivalents" include cash and balances on the current accounts held with the Central Bank of Montenegro, including the obligatory reserve, and balances held on the accounts of other banks in the country and abroad.

3.5. Available-for-Sale Securities

Securities available for sale include equity instruments of other entities and debt securities.

When not able to determine market value, equity investments are recognized at cost that management considers closest to fair value.

Subsequent to initial recognition, securities available for sale are stated at fair value. The fair value of securities quoted on the stock exchange is based on their asking prices. Unrealized gains and losses from securities available for sale are recorded within revaluation reserves, until such security is sold, collected or realized in any other way or until such security has suffered permanent impairment. Upon the disposal of securities available for sale are disposed of or when their value has suffered an impairment, the accumulated fair value adjustments are recognized within equity and recorded in the income statement.

Interest income on debt securities is calculated and recognized on a monthly basis.

Dividends from securities available for sale are recognized in the income statement when the right to such receivable has been established.

NOTES TO FINANCIAL STATEMENTS

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6. Loans

Loans originated by the Bank are recorded in the books of account at the moment of the transfer of funds to the loan beneficiary.

Loans originated by the Bank are stated in the balance sheet in the amount of placement originally approved less net of principal repaid and an allowance for impairment which is based on an evaluation using the methodology specified by the Central Bank of Montenegro (Note 3.7).

3.7. Allowances for Impairment and Provisions for Potential Losses

The Decision issued by Central Bank of Montenegro regarding to minimal standards for managing credit risk in banks ("Official Gazette of Montenegro," number 60/2008 and 41/2009) i.e. in accordance with Decision on temporary measures for managing credit risk in banks ("Official Gazette of Montenegro," number 64/2009, 87/2009, 66/2010 and 70/2010) set forth the following: elements of credit risk management, minimum criteria and manner of classifying assets and off-balance sheet items which render the Bank susceptible to interest rate risk, manner of calculation and suspension of unpaid interest, manner of determining the minimum provisions for potential losses contingent on the Bank's exposure to credit risk. The Bank's risk-weighted assets, within the meaning of this Decision, are comprised of loans, interest, fees and commission, lease receivables, deposits with banks, advances and all other items included in the balance sheet exposing the Bank to default risk, as well as guarantees issued, other sureties, effectuated letters of credit and approved, but undrawn loan facilities, as well as all other off-balance sheet items comprising the Bank's contingent liabilities.

Pursuant to the aforementioned Decision, loans and other risk-weighted assets are classified into the following categories:

- A category ("Pass") – including assets assessed as collectible in full and as agreed;
- B category ("Special Mention") – with B1 and B2 subcategories including items for which there is low probability of loss, but which, still the same, require special attention, as potential risk, if not adequately monitored, could diminish collectability;
- C category ("Substandard assets") – with C1, C2, C3 and C4 subcategories for which there is high probability of loss, due to the clearly identified collectability issues;
- D category ("Doubtful assets") – including items the collection of which is, given the creditworthiness of loan beneficiaries, quality of collaterals, highly unlikely;
- E category ("Loss") – including the items which are uncollectible in full, or will be collectible in an insignificant amount

The estimated amount of provision for potential losses is not computed for the Bank's placements classified in the category A. The estimated reserve for potential losses is calculated as 3% of the placements classified in category B, from 15% to 50% to the placements classified into category C, 75% to the placements of category D, and 100% of the placements under category E.

NOTES TO FINANCIAL STATEMENTS

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7. Allowances for Impairment and Provisions for Potential Losses (continued)

Moreover, as in accordance with the provisions of the aforecited regulation, the Bank is to suspend any accrued, uncollected interest and should terminate any further accruals of interest on its non-performing assets, with the exception of the non-performing assets that are secured by quality collateral and are in the process of collection, to the extent that such asset recoveries are anticipated within a reasonable period of time (generally defined as not exceeding three months). Following the suspension of interest accruals on non-performing assets, the Bank remains under an obligation to record the subsequent, matured interest on the same basis, on its off-balance sheet records and upon classification, designates the accrued income into E category. The Decision further prescribes that the risk-weighted assets be classified into E category be written off from the off-balance sheet records under the heading of "Loans written off."

Pursuant to the Decision, provision for potential losses contingent on assets is calculated based on the carrying value net of any deductible items of collaterals based on:

- Monetary deposits,
- Irrevocable guarantees of the Government of Montenegro and
- Irrevocable guarantees of the countries or central banks of the OESD member countries, the banks with credit rating better than A+ pursuant to the ratings of the agency Standard & Poor's, i.e., any equivalent rating of other internationally acclaimed rating agencies and legal entities whose business operations are under the control of Central Bank of Montenegro.

In accordance with amendments to the abovecited decisions on minimum standards for credit risk management in banks, the Bank has applied the following percentages and days of delay by risk categories:

	As at December 31, 2010		As at December 31, 2009	
Risk category	% reserves	Days of delay	% reserves	Days of delay
A	-	<30	-	<30
B	3	31-90	3	31-60
C1	15	91-150	15	91-150
C2	30	151-210	30	151-210
C3	50	211-270	40	211-270
D	75	271-365	75	271-365
E	100	>365	100	>365

3.8. Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. In case the Bank sells a significant amount of held to maturity investments, the entire category is reclassified as available for sale.

After initial recognition, securities held to maturity are recorded at amortized cost using the effective interest method less any allowance or loss on impairment. Amortized value is calculated by taking into account any discount or premium on acquisition, over the period of maturity.

Income from interest expense on these instruments is calculated using the effective interest rate and showing within interest income.

NOTES TO FINANCIAL STATEMENTS

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.9. Business premises, other fixed assets and intangible assets

Business premises and other fixed assets are those assets whose useful life is more than one year. Business premises, other property, equipment and intangible assets at December 31, 2011 are stated at cost of goods sold less accumulated depreciation and/or amortization. Cost of goods sold represents the prices billed by suppliers together with all costs incurred in bringing the respective asset to the location and condition necessary for its intended use.

Additional costs: costs of replacing equipment parts (installation of new spare parts), the cost of repairs and general repair of business premises are recognized as increasing the present value of business premises i.e. equipment, if it is likely that on this basis to get to the inflow of future economic benefits and if those costs could be reliably measured.

The costs arising from maintenance of equipment: replacement and installation of small spare parts and supplies, as well as the costs of everyday repairs are considered expense when incurred.

Losses or gains incurred in the disposal or retirement of business premises and equipment are determined as the difference between the sales and the current value at which the business premises and equipment are lead, and recognized as the benefit or as a part of the income statement over the period in which the disposal occurred or retirements.

Intangible assets consist of software and licenses. Intangible assets acquired are capitalized at cost value of the transaction. After initial recognition, intangible assets are carried at cost value less accumulated depreciation and eventual impairment.

Costs that could be directly linked with certain software and will generate economic benefits for a period longer than one year are recorded as intangible assets. Maintenance and development of computer software are recorded as an expense as incurred.

Depreciation is provided for on a straight-line basis to the cost of business premises and other fixed assets in order to write them off over their expected useful lives. Depreciation is calculated using the following prescribed annual rates:

Items	Depreciation rate (%)	Rate recognized in taxable income (%)
Buildings	2.00	5.00
Motor vehicles	15.00	15.00
Furniture and equipment	15.00 – 20.	20.00
Computers and computer equipment	33.33	30.00
Intangible assets	20	30.00

In accordance with Article 13 of the Income Tax Law ("Official Gazette of Montenegro" nos. 65/01, 12/02 and 80/04, "Official Gazette of Montenegro", nos. 40/08, 86/09 , 73/10 and 40/11) the method of calculating depreciation for tax purposes is different from the method of calculating depreciation for accounting purposes. The depreciation of buildings for tax purposes is calculated using the proportional method, while all other items, amortization of other fixed assets worth more than EUR 300, including the applications software, is calculated using digressive method for the entire year, regardless of the activation date.

The calculation of depreciation of business premises and other fixed assets commences when an asset is placed into use.

NOTES TO FINANCIAL STATEMENTS

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.10. Equity

The Bank's equity includes share capital, share premium, the Bank's reserves, as well as retained earnings (accumulated loss).

The share capital of the Bank is formed from the assets invested by the founders and shareholders of the Bank in the pecuniary or non-pecuniary form. The Law on Securities sets forth that securities are dematerialized and exist in an electronic form in the system of the Central Depositary Agency. The excerpt obtained from the Registry of the Central Depositary Agency is the only and exclusive proof of ownership over securities.

Bank's own funds, in accordance with the Decision on capital adequacy ratio (Official Gazette of Montenegro no. 38/11) are:

1) the basic elements of its own funds, which are included in the calculation of capital;
2) additional elements of its own funds, which are included in the calculation of supplementary capital I, and
3) an additional element of its own funds, which are included in supplementary capital II.

The basic elements of own funds of a bank are:

1) paid up share capital at nominal value, excluding cumulative preferred shares;
2) share premium paid;
3) reserves that are formed at the expense of its profit after tax (legal, statutory and other reserves);
4) Retained earnings from previous years;
5) profit in the current year for which the meeting of shareholders decided to be included in the capital;
6) capital gain on the sale and purchase of own shares.

Additional elements of the bank's own funds which are included in supplementary capital I have:

1) the nominal amount of cumulative preferred stock;
2) the amount of general reserves, up to 1.25% of total risk weighted assets;
3) subordinated debt, for which the conditions provided for are in this Decision;
4) hybrid instruments for which the conditions provided for are in this Decision;
5) the revaluation surplus.

Subordinated debt for which the conditions provided for by this Decision may be treated as an additional element of its own funds to be included in bank's supplementary capital II, if:

1) the debt is fully paid;
2) Bank does not guarantee the repayment of debt in any form;
3) in the event of bankruptcy or liquidation, subordinated debt and other obligations shall be paid only after payment obligations to other creditors;
4) the contract contains a clause prohibiting the payment of principal and interest, even after the maturity of debt, if the payment of the amount of own funds falls below the prescribed level;
5) the maturities of long term pre-determined, is longer than two years and may not be repayable before the agreed maturity date;
6) subordinated debt is a written agreement signed by the conditions in points. 2-5 of this article contains a note that subordinated debt cannot be considered a deposit.

NOTES TO FINANCIAL STATEMENTS

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.11. Employee benefits

Employee taxes and contributions for social security

Pursuant to the regulations effective in Montenegro, the Bank has an obligation to pay contributions to various state social security funds. These obligations involve the payment of contributions on behalf of an employee, by the employer, in an amount calculated by applying the specific, legally-prescribed rates. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on their behalf to transfer the withheld portions directly to the appropriate government funds. These contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

Retirement benefits or other long-term employee benefits

In accordance with the Collective Bargaining Agreement, the Bank is under obligation to pay retirement benefits to an employee upon his/her regular retirement in the amount of 6 net average salaries earned by the Bank's employees in the month in which payment is made. The Bank's financial statements as of and for the year ended December 31, 2011 include provisions calculated by an independent certified actuary, based on the estimated present value of assets to be used for retirement benefits payable to vesting employees.

3.13. Fair Value

In accordance with International Financial Reporting Standards, the fair value of financial assets and liabilities should be disclosed in the Notes to the Financial Statements. For these purposes, the fair value is defined as an amount at which an asset can be exchanged, or a liability settled, between knowledgeable willing parties in an arm's-length transaction. The Bank should disclose the fair value information of those components of assets and liabilities for which published market information is readily available, and for which their fair value is materially different from their recorded amounts.

In Montenegro, sufficient market experience, stability and liquidity do not exist for the purchase and sale of receivables, investments and other financial assets or liabilities, for which published market information is presently not readily available. Fair value cannot readily be determined in the absence of active capital and financial markets, as generally required under the provisions of IFRS/IAS. In the opinion of the Bank's management, the reported carrying amounts are the most valid and useful reporting values under the present market conditions in accordance with the accounting regulations of Montenegro and regulations of the Central Bank of Montenegro governing the financial reporting in banks.

NOTES TO FINANCIAL STATEMENTS

4. INTEREST INCOME AND EXPENSE

a) Interest Income

In thousands of EUR	2011	2010
Deposits with:		
- foreign banks	86	51
- Central bank	13	11
	99	62
Loans to:		
- corporate customers	8,109	6,463
- retail customers	3,195	3,109
	11,304	9,572
Repurchase operations	2	-
	11,405	9,634

b) Interest Expenses

In thousands of EUR	2011	2010
Deposits with:		
- financial institutions	565	885
- state organisation	40	61
- corporate customers	777	837
- retail customers	1,451	1,314
- other	132	86
	2,965	3,183
Loans and other borrowings		
- financial institutions	840	192
- state organisation	68	58
	908	250
	3,873	3,433

5. PROVISIONS FOR LOSSES

a) Charge for the year

In thousands of EUR	2011	2010
Net, provisions / (reversal of provisions):		
- deposits in foreign banks	3	4
- loans and leases	1,846	1,220
- interest receivables	232	147
- country risk	(40)	45
- other receivables of the debtor who has started a process of reorganization	(126)	(112)
- other receivables	(7)	7
- employee benefits (note 20)	9	3
- off-balance sheet items	160	20
- operating risk	83	-
	2,160	1,334

NOTES TO FINANCIAL STATEMENTS

5. PROVISIONS FOR LOSSES (continued)

b) Movements on the accounts of allowance for impairment of bad debts and provisions

In thousands of EUR	Loans and leases (note 11)	Interest (note 16)	Country risk (note 16)	Other receivables from the debtor who has started a process of reorganization (note 16)	Repossessed assets (note 16)	Other receivables (note 16)	Operating risk (note 21)	Off-balance sheet items (note 21)	Total
Balance, January 1, 2010	**2,085**	**6**	**9**	**247**	**-**	**1**	**300**	**195**	**2,843**
Charge for the year	1220	147	45	-	-	7	-	20	1,443
Reversal of provisions	-	-	-	(112)	-	-	-	-	(112)
Provisions used	-	-	-	-	-	-	(21)	-	(21)
Transfer to off-balance sheet items	(648)	(143)	-	-	(268)	10	-	-	(517)
Balance, December 31, 2010	**2,657**	**10**	**54**	**135**	**268**	**18**	**279**	**215**	**3,636**
Charge for the year	1,846	232	-	-	-	3	85	160	2,324
Reversal of provisions	-	-	(40)	(126)	(8)	2	-	-	(172)
Provisions used	-	-	-	-	-	-	(62)	-	(62)
Transfer to/from off-balance sheet items	(492)	(229)	-	-	-	-	-	-	(721)
Balance, December 31, 2011	**4,011**	**13**	**14**	**9**	**260**	**23**	**300**	**376**	**5,005**

6. FEE AND COMMISSION INCOME AND EXPENSE

a) Fee and Commission Income

In thousands of EUR	2011	2010
Loan origination fees	838	707
Fee and commission income from off-balance-sheet operations	511	348
Fee and commission income from payment transfers	1,669	1,530
Fee and commission income from brokerage services	4	4
Fee and commission income from custody services	22	12
Fee and commission income from credit cards	235	181
Other fee and commission income	538	323
	3,817	3,105

b) Fee and Commission Expenses

In thousands of EUR	2011	2010
Fees and commissions payable to the Central Bank	179	159
Fee and commission expense from other banks	73	70
Fee and commission for deposit insurance	313	187
Other fee and commission expense	80	49
	645	465

7. OTHER INCOME, NET

In thousands of EUR	2011	2010
Net gains on unrealized and realized foreign exchange fluctuations	286	223
Collected receivables previously written off	132	83
Income from trading securities	71	88
Gains on acquired assets sold, net	8	5
Miscellaneous income	14	-
	511	399

8. GENERAL EXPENSES

In thousands of EUR	2011	2010
Net salaries	1,941	1,684
Taxes and contributions on salaries	1,309	1,181
Meals and transport	31	47
Remunerations to the members of the Board of Directors and Audit Board	78	91
Severance payments for voluntary leave	18	27
Costs for processing center services	62	60
Business trip expenses	74	75
Entertainment	106	95
Rentals	831	1,010
Maintenance of property and equipment	336	269
Depreciation and amortization charge:		
- property, plant and equipment (note 13)	483	368
- intangible assets (note 16)	287	238
Security services costs	287	223
Insurance premiums	47	63
Taxes	198	67
Advertising	204	250
Professional services costs	267	211
CDA and brokerage services costs	19	30
Telecommunication and postage	207	174
Electricity, fuel and water charges	62	57
Office material	127	83
Temporary engagement compensations	25	47
Sponsorship	148	92
Migration expenses	-	25
Write off bad debt receivables	-	32
Cost reduction - adjustments to fair value	41	-
Bills and checks expenses	31	30
Miscellaneous expenses	161	298
	7,379	6,827

9. INCOME TAXES

a) Components of Income Taxes

In thousands of EUR	2011	2010
Current income tax expenses	177	-
Deferred income tax expenses	(9)	15
	168	15

9. INCOME TAXES (continued)

a) Reconciliation of total amount of income tax stated in the income statement with the amount of profit before tax multiplied by prescribed tax rate is as follows

In thousands of EUR	2011	2010
Net profit before tax	1,690	1,307
Income tax at the statutory tax rate of 9%	152	118
Unrecognized tax assets arising from tax loss carry forwards	-	(121)
Tax effect of expenditures not recognized for tax purposes	21	3
Other	(5)	15
Tax effects on the income statement	168	15
Effective income tax rate	9.94%	1.15%

c) Deferred Tax Liabilities

Deferred tax liabilities as at December 31, 2011 in the amount of EUR 21 thousand (December 31, 2010: EUR 26 thousand) (Note 20) are associated with the taxable temporary differences arising between the tax base at which business premises and other fixed assets are recognized in the tax balance and the carrying value of such assets in Bank's financial statements.

10. CASH AND DEPOSIT ACCOUNTS HELD WITH DEPOSITORY INSTITUTIONS

In thousands of EUR	2011	2010
Cash on hand:		
- in EUR	1,824	1,626
- in foreign currency	297	103
Gyro account	7,145	6,928
Correspondent account with foreign banks	13,817	8,961
Obligatory reserves with the Central Bank of Montenegro	6,684	3,444
Time deposits with foreign banks	8,378	3,015
Deposit for guarantees	36	-
Deposits with domestic banks	319	170
	38,500	24,247

10. CASH AND DEPOSIT ACCOUNTS HELD WITH DEPOSITORY INSTITUTIONS (continued)

Obligatory reserves with the balance as of 31 December 2011. was allocated in accordance with the Decision of the Central Bank of Montenegro on Banks' Required Reserves with the Central Bank of Montenegro (Official Gazette no. 35/2011 of 1 July 2011.).

The obligatory reserve is made by applying a rate of 9.5% of the base which consists of demand deposits and deposits with agreed maturity up to one year, or up to 365 days, and the rate of 8.5% of the base comprised of deposits with agreed maturity over one year, or over 365 days. On deposits with agreed maturity over one year with an option clause termination of the deposit within less than one year, or within less than 365 days, the rate of 9.5% is applied.

Calculated required reserves allocated to the reserve requirement account in the country and / or the accounts of the Central Bank of Montenegro abroad. In accordance with this decision, the Bank may reserve 25% holding in the form of treasury bills issued by Montenegro. In 25% of total allocated funds required reserves, Central Bank of Montenegro pays interest at a rate of 1% per annum and payable until the eighth month for the previous month. Required reserves are held in euro.

Correspondent accounts and deposits with foreign banks as of December 31st December 2011. amount to EUR 22,230 thousand (31 December 2010: EUR 11,973 thousand).

On December 31, 2011, deposits with foreign banks were EUR 8,378 thousand and refer to three deposits placed with Probanka D.D. Maribor, Abanka Vipa D.D. Ljubljana and Banca Monte Dei Pashi di Siena S.p.A., with maturity range period from January 04, 2012 to February 16, 2012 and interest rate range from 0.19% to 1.85%.

11. LOANS AND LEASES

In thousands of EUR	**2011**	**2010**
Matured loans:		
- state-owned corporate entities	206	-
- privately-owned corporate entities	1,318	1,865
- non-profit organizations	11	810
- retail customers	833	851
- other	13	9
Short-term loans:		
- privately-owned corporate entities	29,351	26,358
- non-profit organizations	833	119
- municipalities (public organisations)	34	85
- corporate entities with majority state-ownership	1,464	3,317
- retail customers	3,394	2,065
- other	-	434
Long-term loans, including current portions:		
- privately-owned corporate entities	49,520	39,332
- corporate entities with majority state-ownership	5,111	3,523
- non-profit organizations	5	49
- retail customers	20,883	22,158
- municipalities (public organisations)	505	34
	113,481	101,009
Minus: Allowance for impairment (note 5)	(4,011)	(2,657)
	109,470	98,352

11. LOANS AND LEASES (continued)

Short-term loans to corporate entities with majority state-ownership are approved for current assets and mature over the period from 3 to 12 months, while long-term loans are approved for the period from 12 to 180 months and are mostly relate to corporate entities involved in trade, transport, warehousing, postal services and telecommunications and civil engineering. Short-term loans to corporate entities are mostly approved at an interest rate ranging between 4% and 15% annually (for credit cards rate is up to 20.98%) and the same interest rate is applied to long-term loans. If the customer takes a loan based on 100% of the time deposit, interest rate is a deposit/passive interest of + 2% -4%. The interest rate on loans approved to customers whose guarantees are realized ranged from 19.5% to 23.25% per annum.

Short-term loans to retail customers are approved from one to twelve month maturities. Long-term loans to retail customers encompass loans for the renovation of housing and business premises, loans for the purchase of consumables and other purposes, approved for the period from 13 months to 20 years, at an interest rate ranging from 0.9% to 2% on monthly basis.

The geographic risk concentration within the customer loan portfolio mainly includes customers domiciled in Montenegro and Republic of Croatia.

The concentration of total gross loans to customers per separate fields of industry is as follows:

In thousands of EUR	2011	2010
Agriculture, hunting and fishing	1,300	1,000
Civil engineering	4,897	4,094
Energy and mining	3,514	64
Trade	32,603	28,948
Services, tourism, accommodation industry	5,368	1,967
Transport, warehousing, postal services and communication	14,591	11,347
Administration and other public services	795	3,800
Real estate trade	2,694	3,209
Banks and other financial institutions	1,377	742
Retail customers	25,185	25,491
Other	21,157	20,347
	113,481	101,009

12. SECURITIES HELD-TO-MATURITY

Securities held to maturity as at December 31, 2011 in the amount of EUR 2,569 thousand (December 31, 2009: EUR 1,093 thousand) relate to treasury bills of the Government of Montenegro, whose expiry term is February 28, 2012 and June 27, 2012. Treasury bills earned interest rate of 3.35% per annum. The total nominal value at December 31 2011 amounts to EUR 2,600 thousand.

13. BUSINESS PREMISES AND OTHER FIXED ASSETS

The movements for 2011 and 2010 are shown in the following table:

In thousands of EUR	Buildings	Computer equipment	Other equipment	Construction in progress	Total
Cost					
Balance, January 1, 2010	377	725	1,373	138	2,613
Additions	1	60	-	594	655
Transfers	-	213	492	(705)	-
Sales and disposals	-	(42)	(52)	-	(94)
Balance, December 31, 2010	**378**	**956**	**1,813**	**27**	**3,174**
Additions	-	-	-	719	719
Purchases	-	98	682	-	779
Sales	-	-	(208)	(726)	(934)
Disposals	-	(29)	(40)	-	(68)
Balance, December 31, 2011	**378**	**1,025**	**2,247**	**20**	**3,670**
Accumulated depreciation					
Balance, January 1, 20010	45	621	474	-	1,140
Charge for the year (note 8)	8	106	254	-	368
Sales and disposals	-	(42)	(34)	-	(76)
Balance, December 31, 2010	**53**	**685**	**694**	**-**	**1,432**
Charge for the year (note 8)	8	140	335	-	483
Sales	-	-	(134)	-	(134)
Disposals	-	(29)	(32)	-	(61)
Balance, December 31, 2011	61	796	863	-	1,720
Net book value:					
- December 31, 2011	**317**	**229**	**1,384**	**20**	**1,950**
- December 31, 2010	**325**	**271**	**1,119**	**27**	**1,742**

At December 31, 2011 the Bank has no assets pledged to serve as collateral for timely and regular repayment of loans and other liabilities.

14. ACQUIRED ASSETS

Acquired collaterals as at December 31, 2011 amounted to EUR 478 thousand (December 31, 2010: EUR 485 thousand) and totally relate to acquired collaterals that are expressed in the value of total outstanding receivables. As of December 31, 2011 The Bank has shown impairment of acquired value of these collaterals in the amount of EUR 260 thousand (Notes 5 and 16).

NOTES TO THE FINANCIAL STATEMENTS

15. EQUITY INVESTMENTS IN OTHER LEGAL ENTITIES

In thousands of EUR	2011	2010
Investment in banks and other financial institutions:		
- Tržište novca A.D., Beograd	2	2
- S.W.I.F.T. SRL	6	5
	8	7
Investments in companies abroad:		
- Imlek A.D., Beograd	34	-
- Naftna industrija Srbije („NIS“) A.D., Novi Sad – Republic of Serbia	28	47
	62	47
Investments in domestic companies:		
- Bridgemont D.O.O., Podgorica	2	2
- Jugopetrol A.D. Kotor	14	-
- Crnogorski Telekom A.D, Podgorica	121	32
- Zetatrans A.D , Podgorica	3	3
- Prenos A.D., Podgorica	7	5
- Kontejnerski terminal i generalni tereti A.D., Bar	4	-
- Barska plovidba A.D., Bar	2	-
- Fond zajednickih ulaganja Moneta A.D.	1	-
- Autoremont A.D.	6	-
- Kombinat aluminijuma Podgorica A.D., Podgorica	-	2
- Luka Bar A.D., Bar	-	1
	160	45
	230	99

16. OTHER ASSETS

In thousands of EUR	2011	2010
Interest receivables	803	952
Fee and commission receivables	129	147
Intangible assets	550	705
Accruals	475	566
Advances paid	11	80
Other receivables from the debtor in the process of reorganization	28	449
Receivables for reimbursements of costs	138	89
Receivables from employees	141	135
Other receivables	366	67
	2,641	3,190
Allowance for potential losses contingent on other assets		
- interest (note 5)	13	10
- country risk (note 5)	14	54
- other receivables from the debtor in the process of reorganization (note 5)	9	135
- acquired assets (note 5)	260	268
- other receivables	23	18
	319	485
	2,322	2,705

Translation of the financial statements issued in Montenegrin language

16. OTHER ASSETS (continued)

The movements on intangible assets for 2011 and 2010 were as follows:

In thousands of EUR	2011	2010
Cost of goods sold		
Balance, January 1,	1.345	968
Additions	139	390
Disposals	(76)	(13)
Balance, December 31,	1,408	1,345
Accumulated depreciation		
Balance, January 1,	640	413
Charge for the year (note 8)	287	238
Disposals	(69)	(11)
Balance, December 31,	858	640
Net book value		
- December 31,	550	705

At December 31, 2010, intangible assets in the amount of EUR 550 thousand mainly related to investment in software totaling EUR 233 thousand, the license in the amount of EUR 114 thousand and leasehold improvements in the amount of EUR 204 thousand.

17. DEPOSITS

In thousands of EUR	2011	2010
Sight deposits:		
- government agencies	1,136	1,732
- funds	35	34
- municipalities (public organizations)	85	72
- corporate entities with majority state - ownership	1,572	6,109
- privately-owned companies	22,528	15,511
- banks	198	165
- other financial institutions	294	925
- non-profit organizations	1,305	2,303
- retail customers	12,547	11,111
- other	50	42
Short-term deposits:		
- government agencies	700	1,240
- funds	2,000	800
- corporate entities with majority state - ownership	797	639
- privately-owned companies	10,762	11,518
- banks	-	2,725
- other financial institutions	5,205	6,636
- non-profit organizations	194	682
- retail customers	25,430	19,452
Long-term deposits:		
- government-owned corporate entities	700	-
- privately-owned companies	2,390	781
- non-profit organizations	23	23
- other financial institutions	275	121
- retail customers	9,627	2,512
	97,853	85,133

Sight deposits placed by retail customers denominated in EUR are deposited at the interest rate ranging from 0.1% to 1% annually. Retail sight deposits in foreign currency are deposited at an interest rate ranging from 0.1% to 1% annually, depending on the currency.

Short-term and long-term deposits of retail customers denominated in EUR are placed at an interest rate ranging from 0.2% to 7% annually, depending on the amount of deposit being placed and chosen savings arrangement (up to EUR 5 thousand, from EUR 5 thousand to EUR 50 thousand and over EUR 50 thousand). Short-term and long-term deposits of retail customers in foreign currencies are placed at an interest rate ranging from 1.2% to 3% annually, depending on the currency.

Short-term deposits of corporate entities denominated in EUR are placed at interest rates ranging from 0.2% to 7% annually, depending on the depositing period and the amount of deposit being placed (up to EUR 50 thousand, from EUR 50 thousand to EUR 100 thousand and over EUR 100 thousand). Short-term deposits of corporate entities in foreign currencies are deposited at interest rates ranging from 1% to 2%. Long-term deposits of corporate entities were placed at an interest rate ranging from 0.2% to 7% annually, depending on the depositing period and currency.

Sight deposits of corporate entities, public and other organizations bear interest at the rate ranging from 0% to 2.25% annually.

18. LOANS AND BORROWINGS

In thousands of EUR	Period (Year/Month)	Anally interest rate	December 31, 2011	December 31, 2010
Obligations to foreign creditors				
The European Fund for Southeast Europe ("EFSE") Montenegro B.V.	5y	5.43%	5,000	3,000
European Investment Bank ("EIB")	12y	4.032%	2,499	2,600
EIB	12y	3.923%	1,400	1,400
EIB	12y	3.604%	4,000	4,000
EIB	12y	3.168%	2,010	2,010
EIB	12y	3.019%	1,990	1,990
EIB	12y	3.841%	3,101	-
EIB	12y	3.181%	899	-
Podravska Banka D.D. Koprivnica	6m	4.25%	2,000	-
Probanka D.D. Maribor	3m	3.72%	2,988	-
Banca Monte Dei Paschi Di Siena Sp	10m	4.529%	1,000	-
			26,887	15,000

During 2010 and 2011, EFSE approved to the Bank a loan in the amount of EUR 5,000 thousand with an interest rate of 5.43% for the period of five years, with a grace period of 12 months i.e. till March 22, 2012. In the period until December 31, 2011, the Bank used EUR 5,000 thousand. The loan is repaid in equal semi-annual installments. In accordance with the provisions of the agreement concluded with EFSE, the Bank is obliged to keep its business results within certain financial indicators – debt covenants. At December 31, 2011, the Bank's financial ratios are in line with the terms delineated in the relevant agreements. As at December 31, 2011, the Bank's exposure amounted to EUR 5,000. The loan approved to the Bank is for the purpose of financing sub loans for development of small and medium enterprises (SME), on condition that an individual sub loan does not exceed EUR 100 thousand, or total amount of approved sub loans to the group of related party entities does not exceed EUR 300 thousand.

As at December 31, 2011, the Bank had liabilities towards the EIB based on long-term loans totaling EUR 15,899 thousand (December 31, 2010: EUR 12,000 thousand). EIB approved the Bank a loan in the amount of EUR 16,000 thousand and Bank's commitments arising thereof amounted to EUR 15,899 thousand as of December 31, 2011. Loans are granted to promote the development of SME in Montenegro, with a grace period of maximum 2 years. Loans are repaid in semi-annual annuities. As collateral against these commitments, the Bank provided the guarantee of the Government of Montenegro.

19. LIABILITIES TO THE GOVERNMENT

In thousands of EUR	Period/ Year	Annual interest rate	December 31, 2011	December 31, 2010
Investment and Development Fund of Montenegro	5-10	1.75%-7.5%	2,368	2,195
Directorate for development of small and medium-sized enterprises	4-8	0-1%	521	521
			2,889	2,716

At December 31, 2011, the amount of EUR 2,889 thousand owed to the Government of Montenegro is associated with payables in the amount of EUR 2,368 thousand arising from long-term borrowings from the Investment and Development Fund of Montenegro for financing small and medium enterprises with a grace period from 1 to 2 years, and payables arising from long-term borrowings in the amount of EUR 521 from the Directorate for development of small and medium-sized enterprises with a grace period from 12 to 18 months.

20. OTHER LIABILITIES

In thousands of EUR	2011	2010
Liabilities for accrued interest	1,193	1,263
Deferred loan origination fees	823	732
Accounts payable (suppliers)	247	149
Tax payables	206	53
Deferred tax liabilities (Note 9)	21	26
Liabilities for advance collection of loans	1,065	1,439
Provisions for employee benefits	65	57
Other liabilities	334	54
	3,952	3,773

As of December 31, 2011, provisions for employee benefits in the amount of EUR 66 thousand are calculated as present value of future expected retirement benefits to employees after they fulfill conditions.

The present value of expected future cash payments towards the employees qualified to receive retirement benefits is determined in accordance with actuarial estimation principles of an independent certified actuary as at December 31, 2011. Technical bases applied in calculating the present value of expected future retirement benefits include implementation of the following:

a. cumulative figures, prepared in accordance with the calculated possible age of the population of the Republic of Montenegro included in the population census dating from 1980 to 1982, and
b. annual interest rates of 12% used to discount future retirement payments to employees.

The movements on provisions for employee benefits are as shown in the following table:

In thousands of EUR	2011	2010
Beginning of the year	57	54
Provisions for the period (Note 5)	9	3
End of the year	66	57

21. PROVISIONS FOR POTENTIAL LOSSES CONTINGENT ON OFF-BALANCE SHEET CREDIT EXPOSURES

In thousands of EUR	December 31, 2011	December 31, 2010
Provisions for losses contingent on:		
- off-balance sheet items (Note 5)	375	215
- operational risk	300	279
	675	494

22. SHARE CAPITAL

At December 31, 2011 and 2010, the Bank's share capital was comprised of 31,305 ordinary shares with the par value of EUR 511.29. The Law on Banks ("Official Gazette of Montenegro," no. 17/2008, 44/2010, and no. 40/2011) defines that the minimum cash amount of initial capital may not be less that EUR 5,000 thousand. At December 31, 2011, the Bank's capital complied with the prescribed minimum capital requirements.

The ownership structure of the Bank's share capital as of December 31, 2011 and 2010 was as follows:

	2011			2010		
Shareholder	Number of shares	In thousands of EUR	% share	Number of shares	In thousands of EUR	% share
Allegro S.a.r.l. Luxembourg	5,281	2,700	16.87%	-	-	-
Flandria Participations Financieres	-	-	-	5,000	2,556	15.97%
Cerere s.r.l	4,360	2,229	13.93%	4,360	2,229	13.93%
Gorgoni Antonia	3,131	1,601	10.00%	3,131	1,601	10.00%
Gorgoni Lorenzo	2,591	1,325	8.28%	2,591	1,325	8.28%
Todorović Miljan	2,316	1,184	7.40%	2,316	1,184	7.40%
Others	13,626	6,967	43.53%	13,907	7,111	44.42%
	31,305	16,006	100%	31,305	16,006	100%

23. COMPLIANCE WITH THE REGULATIONS OF THE CENTRAL BANK OF MONTENEGRO

The Bank is required to maintain certain ratios pertaining to the volume of its activities and composition of risk assets in compliance with the Law on Banks and regulations of the Central Bank of Montenegro.

In accordance with the Decision on Capital Adequacy in Banks ("Official Gazette of Montenegro," no. 38/2011), the Bank's capital is comprised of the Bank's core capital and supplementary capital, minus deductions. The Bank's capital as of December 31, 2011 amounted to EUR 22,540 thousand (December 31, 2010: EUR 20,916 thousand).

The Bank's core capital formed in accordance with the Decision on Capital Adequacy in Banks, as of December 31, 2011 amounted to EUR 22,540 thousand (December 31, 2010: EUR 20,916 thousand). The Bank's capital as of December 31, 2011 is comprised of the following components: paid-in share capital at nominal value, collected share premiums and current year retained earnings as decreased by the amount of prior period losses and amount of intangible assets.

As of December 31, 2011 the Bank has supplementary capital in the amount of EUR (54) thousand that refers to revalorization reserve from fair value adjustments of available for sale financial instruments.

Risk-weighted balance sheet assets and off-balance sheet items formed pursuant to the Decision on Capital Adequacy in Banks, as of December 31, 2011 amounted to EUR 106,740 thousand (December 31, 2010: EUR 108,477 thousand). In accordance with the Decision on Capital Adequacy in Banks of the Central Bank of Montenegro, the Bank is under obligation to maintain the minimum capital adequacy ratio of 10%. The solvency ratio calculated by the Bank as of December 31, 2011 amounted to 16.98% (December 31, 2010: 15.54%) and it is greater than statutory minimum.

At December 31, 2011, none of the Bank's ratios departed from the minimum legal requirements set forth by the Central Bank of Montenegro.

24. OFF-BALANCE SHEET ITEMS

In thousands of EUR	2011	2010
Guarantees, sureties and irrevocable commitments::		
Guarantees to corporate entities:		
- payment guarantees	16,327	16,212
- performance bonds	3,721	1,047
- other types of guarantees	8,034	6,338
Commitments arising from undrawn loans	4,342	2,476
Letters of credit	-	96
Other off-balance sheet items:		
- commission banking services	131	131
- custody services	83,584	13,614
- collaterals	269,274	246,954
- written-off loans receivables	2,576	1,819
- current contract for foreign currency transactions / prompt sale of foreign currencies	830	801
	388,819	289,488

25. RELATED PARTY TRANSACTIONS

The Law on Banks ("Official Gazette of Montenegro," no. 17/2008, 44/2010 and no. 40/2011) defines that significant influence on the Bank's operations is by those persons appointing at least one representative in the Board of Directors or some similar board, either through shareholding, through agreement with the owners or otherwise. In accordance with the Law on Banks, related party transactions are presented in the following tables:

In thousands of EUR	December 31, 2011	December 31, 2010
Receivables		
- Miljan Todorovic	1	-
	1	-
Payables		
A vista deposits:		
- Montenegro berza	10	-
- Miljan Todorović	5	-
- Sigilfredo Montinari	1	-
- Gorgoni Lorenzo	15	12
	31	12
Term deposits		
- Miljan Todorovic	360	530
- Montenegro berza	-	59
	360	589
Total payables	391	601

Expenses from transactions with related parties during 2011 amounted to EUR 67 thousands (2010: EUR 95 thousands), while income amounted to EUR 30 thousand.

As at December 31, 2011, receivables from employees amounted to EUR 1,595 thousand (at December 31, 2010: EUR 1,249 thousand), which refer to the approved loans, claims for overdraft on bank accounts and credit cards.

During 2011, total gross remunerations paid to persons with special authorities and responsibilities amounted to EUR 594 thousand (2010: EUR 556 thousand).

26. LIQUIDITY GAP BETWEEN FINANCIAL ASSETS AND LIABILITIES

The Bank is exposed to daily calls on its available cash resources which influence the available cash resources held on the current accounts or from deposits. 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 Bank's liquidity as its ability to settle its outstanding liabilities depends on the balance sheet structures on one side, and compliance between cash inflows and outflows on the other side.
The contractual maturities of the Bank's asset and liability components as of December 31, 2011 were as follows:

In thousands of EUR	Up to one month	From 1 to 3 month	From 3 to 6 month	From 6 to 12 month	From 1 to 5 years	Over 5 years	Total
Financial assets							
Cash and deposit accounts with depository institutions	34,986	3,478	-	36	-	-	38,500
Assets for trade and available for trade, no shares	26	-	-	-	-	-	26
Loans and other receivables	7,892	12,313	13,304	24,249	43,053	12,670	113,481
Securities held to maturity	-	1,094	1,475	-	-	-	2,569
Other financial assets including investments in shares	1,813	-	-	11	483	-	2,307
Total	**44,717**	**16,885**	**14,779**	**24,296**	**43,536**	**12,670**	**156,883**
Financial liabilities							
Deposits	21,351	31,818	11,224	22,346	9,668	1,446	97,853
Obligations based on loans and other borrowings	1,000	5,613	161	957	9,316	9,840	26,887
Obligations to the Government	145	50	76	183	1,869	566	2,889
Other financial liabilities	981	228	361	401	879	286	3,136
Total	**23,477**	**37,709**	**11,822**	**23,887**	**21,732**	**12,138**	**130,765**
Maturity gap:							
- December 31, 2011	**21,240**	**(20,824)**	**2,957**	**409**	**21,804**	**532**	**26,118**
- December 31, 2010	**11,240**	**(10,189)**	**(595)**	**1,556**	**21,140**	**526**	**23,678**
Cumulative GAP:							
- December 31, 2011	**21,240**	**416**	**3,373**	**3,782**	**25,586**	**26,118**	
- December 31, 2010	**11,240**	**1,051**	**456**	**2,012**	**23,152**	**23,678**	
% of total source of funds:							
- December 31, 2011	16.2%	0.3%	2.6%	2.9%	19.6%	20.0%	
- December 31, 2010	10.7%	1.0%	0.4%	1.9%	22.0%	22.5%	

26. LIQUIDITY GAP BETWEEN FINANCIAL ASSETS AND LIABILITIES (continued)

The contractual maturities of the Bank's asset and liability components as of December 31, 2010 were as follows:

In thousands of EUR	Up to one month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	From 1 to 5 years	Over 5 years	Total
Financial assets							
Cash and deposit accounts with depository institutions	22,741	1,506	-	-	-	-	24,247
Assets for trade and available for trade, no shares	42	-	-	-	-	-	42
Loans and other receivables	8,500	15,310	13,703	20,970	32,486	10,040	101,009
Securities held to maturity	-	1,093	-	-	-	-	1,093
Other financial assets including investments in shares	1,962	-	-	74	484	-	2,520
Total	**33,245**	**17,909**	**13,703**	**21,044**	**32,970**	**10,040**	**128,911**
Financial liabilities							
Deposits	21,444	27,830	13,650	18,863	2,928	418	85,133
Obligations based on loans and other borrowings	-	-	-	101	6,692	8,207	15,000
Obligations to the Government	90	31	59	96	1,706	734	2,716
Other financial liabilities	471	237	589	428	504	155	2,384
Total	**22,005**	**28,098**	**14,298**	**19,488**	**11,830**	**9,514**	**105,233**
Maturity gap:							
- December 31, 2011	**11,240**	**(10,189)**	**(595)**	**1,556**	**21,140**	**526**	**23,678**
- December 31, 2010	**8,166**	**(7,664)**	**466**	**(786)**	**20,871**	**801**	**21,854**
Cumulative GAP:							
- December 31, 2011	**11,240**	**1,051**	**456**	**2,012**	**23,152**	**23,678**	
- December 31, 2010	**8,166**	**502**	**968**	**182**	**21,053**	**21,854**	
% of total source of funds:							
- December 31, 2011	**10.7%**	**1.0%**	**0.4%**	**1.9%**	**22.0%**	**22.5%**	
- December 31, 2010	**10.5%**	**0.6%**	**1.2%**	**0.2%**	**27.0%**	**28.0%**	

The Bank's liquidity, as it's ability to settle it's outstanding liabilities is depending of the balance sheet structures on the one side and of compatibility of assets inflows and outflows on the other side.

27. INTEREST RATE RISK

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rate risk requires special treatment under the existing local circumstances of frequent interest rate movements, and irregular capital supply and demand. Interest rate risk is unfavourable when there is fluctuation in the price of a loan in relation to the level of the effective interest rates on deposits, and the potential of a reduction in the optimal difference between the average interest rates applied to loans on one side, and to deposits on the other.

The table below shows the Bank's exposure to interest rate risk as of December 31, 2011.

In thousands of EUR	Less than One Month	From 1 to 3 Months	From 3 to 6 Months	From 6 to 12 Months	Over 1 year	Total
Interest rate sensitive assets						
Interest-bearing deposits in other institutions	6,571	3,478	-	-	-	10,049
Interest bearing securities	-	1,094	1,475	-	-	2,569
Loans and other receivables	7,892	12,313	13,304	24,249	55,723	113,481
Other interest-bearing assets	803	-	-	-	-	803
Total	**15,266**	**16,885**	**14,779**	**24,249**	**55,723**	**126,902**
% of the total interest-bearing assets	12.03%	13.31%	11.65%	19.11%	43.91%	100.00%
Interest rate sensitive liabilities						
Interest-bearing deposits	11,346	11,366	15,070	27,794	24,574	90,150
Interest-bearing borrowings	1,146	5,663	236	1,139	21,592	29,776
Total	**12,492**	**17,029**	**15,306**	**28,933**	**46,166**	**119,926**
% of the total interest-bearing liabilities	10.42%	14.20%	12.76%	24.13%	38.50%	100.00%
Interest rate exposure:						
- December 31, 2011	**2,774**	**(144)**	**(527)**	**(4,684)**	**9,557**	**6,976**
- December 31, 2010	**2,527**	**7,434**	**(3,481)**	**(3,013)**	**9,674**	**13,141**
Cumulative GAP:						
- December 31, 2011	**2,774**	**2,630**	**2,103**	**(2,581)**	**6,976**	
- December 31, 2010	**2,527**	**9,961**	**6,480**	**3,467**	**13,141**	

27. INTEREST RATE RISK (continued)

The table below shows the Bank's exposure to interest rate risk as of December 31, 2010.

In thousands of EUR	Less than One Month	From 1 to 3 Months	From 3 to 6 Months	From 6 to 12 Months	Over 1 year	Total
Interest rate sensitive assets						
Interest-bearing deposits in other institutions	2,367	1,506	-	-	-	3,873
Interest bearing securities	-	1,093	-	-	-	1,093
Loans and other receivables	8,500	15,310	13,703	20,970	42,526	101,009
Other interest-bearing assets	975	-	-	-	-	975
Total	**11,842**	**17,909**	**13,703**	**20,970**	**42,526**	**106,950**
% of the total interest-bearing assets	11.07%	16.75%	12.81%	19.61%	39.76%	100.00%
Interest rate sensitive liabilities						
Interest-bearing deposits	9,226	10,444	17,125	23,787	15,511	76,093
Interest-bearing borrowings	89	31	59	196	17,341	17,716
Total	**9,315**	**10,475**	**17,184**	**23,983**	**32,852**	**93,809**
% of the total interest-bearing liabilities	9.93%	11.17%	18.32%	25.57%	35.02%	100.00%
Interest rate exposure:						
- December 31, 2010	**2,527**	**7,434**	**(3,481)**	**(3,013)**	**9,674**	**13,141**
- December 31, 2009	**6,136**	**2,757**	**(1,539)**	**(3,452)**	**14,330**	**18,232**
Cumulative GAP:						
- December 31, 2010	**2,527**	**9,961**	**6,480**	**3,467**	**13,141**	
- December 31, 2009	**6,136**	**8,893**	**7,354**	**3,902**	**18,232**	

28. CURRENCY RISK

The following table summarizes the net foreign currency position of the Bank as of December 31, 2011. The Bank takes on exposure resulting from fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The management establishes limitations on the exposure levels per currencies and aggregately, and monitors such exposure on regular basis.

28. CURRENCY RISK (continued)

In thousands of EUR	RSD	USD	GBP	CHF	Other	Total
Assets in foreign currencies	-	7,256	69	138	19	7,482
Liabilities in foreign currencies	-	7,450	67	137	3	7,657
Net foreign exchange position:						
- December 31, 2010	-	(194)	2	1	16	
- December 31, 2009	-	(165)	24	3	11	
% of first- tier capital:						
- December 31, 2010	-	(0.83%)	0.01%	0.00%	0.07%	
- December 31, 2009	-	(0.71%)	0.10%	0.02%	0.05%	
Aggregate open position:						
- December 31, 2011	(175)					
- December 31, 2010	(127)					
% of first-tier capital:						
- December 31, 2011	(0.75%)					
- December 31, 2010	(0.54%)					

29. LEGAL PROCEEDINGS

As of December 31, 2011, the Bank is defendant in a certain number of legal proceedings, initiated by retail and corporate clients. Total amount of litigation is EUR 28 thousand. The final outcome of the ongoing legal proceedings is uncertain. However, the Bank's management as well as legal consultant does not expect negative outcome of such litigations as well as material affects on financial statements as of December 31, 2011.

Total amount of litigations in which the Bank acts as prosecutor as of December 31, 2011 is EUR 1,856 thousand.

30. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the annual net gain that is attributable to holders of ordinary shares, divided by the weighted average number of ordinary shares that were outstanding during the period. The Bank is registered as a limited company whose share capital is consisting of 31.305 ordinary shares. Earnings per ordinary share at December 31, 2011 was equal to EUR 0.05 thousand (December 31, 2010: EUR 0.04 thousand).

31. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of balance sheet items denominated in foreign currencies, into EUR as at December 31, 2011 and 2010 were as follows:

	December 31, 2011	December 31, 2010
USD	0.7729	0.7530
CHF	0.8226	0.8016
GBP	1.1972	1.1625

32. EVENTS AFTER THE BALANCE SHEET DATE

There were no significant events after balance sheet date which would require disclosure in the notes to the Bank's financial statements for 2011.

Signed on behalf of Hipotekarna Banka A.D. Podgorica:

Esad Zaimović
Chief Executive Officer

Aleksandar Mitrović
Executive Director of Finance and Informatics

FOR INTERNAL USE OF
CENTRAL BANK OF MONTENEGRO

ANALYSIS TO THE FINANCIAL STATEMENTS FOR THE YEAR 2011

ANALYSIS TO THE FINANCIAL STATEMENTS

A ANALYSIS TO FINANCIAL STATEMENTS

I INTRODUCTION

Financial Statements of Hipotekarna banka A.D., Podgorica (hereinafter the „Bank"), which were subject of audit have been prepared in accordance with Accounting standards and regulations of Montenegro and regulations of Central Bank of Montenegro governing financial reporting of banks. The prescribed forms of financial statements were submitted in due time to the Central Bank of Montenegro.

II INCOME STATEMENT AND BALANCE SHEET ANALYSIS

Detailed analysis of the balance sheet and income statement is provided within Notes from 4 to 31 to the financial statements.

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK

I QUALITY OF THE BANK'S ASSET

Classification of asset and the corresponding balance sheet items, in terms of determining asset quality, was carried out in accordance with the Decision of the classification of bank assets, provisions and reserves for loan losses issued by the Central Bank of Montenegro („Official Gazette of Montenegro", no. 60/2008 and 41/2009) and the Decision of the Central Bank of Montenegro on temporary measures for managing credit risk in banks ("Official Gazette of Montenegro" no. 64/2009, 87/2009, 66/2010 and 70/2010). On the basis of classification performed and in accordance with internal policies, the Bank has made provisions for potential losses as at December 31, 2011 in amount of EUR 5,005 thousand (December 31, 2010: EUR 3,636 thousand).

Based on audit procedures performed on a sample basis and related to risk classification, the auditor has not found any differences related to the risk classification of the clients that is performed in accordance with the relevant Decisions of the Central Bank of Montenegro.

Classification of the Bank is verified by auditors on a sample covering 52.21 % of the total credit risk exposure at December 31, 2011 (excluding loans granted to retail customers).

Available information on indicators of business of the debtor are taken into account when determining the classification of assets and the required reserves for potential losses of the Bank, as well as the quality of debt service, renewal of loans to the same debtors during the year, the quality of the collection instruments and evidence of credit and interest charges in 2011 and up to day of preparing financial statements for 2011.

Summing up the results of a quality of balance sheet and off-balance sheet assets of the Bank from the point of payment collection and the need to create reserves for the provision of the Bank from potential losses in accordance with the stated approach, the following relations and parameters were provided:

ANALYSIS TO THE FINANCIAL STATEMENTS

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

I QUALITY OF THE BANK'S ASSET (continued)

- Risk-weighted balance sheet and off-balance sheet assets of the Bank as of December 31, 2011 and 2010 consists of the following:

	2011			2010		
In thousand of EUR	**Amount**	**In %**	**Formed reserve**	**Amount**	**In %**	**Formed reserve**
Loans	113,481		4,330	101,009		3,142
Less: Loans secured by cash deposit	(9,652)			(5,176)		-
	103,829	72.44	4,330	95,833	76.90	3,142
Accrued interest	803	0.56		950	0.76	
Other asset items	9,118	6.36		3,698	2.97	
Taken over and potential obligations	29,576	20.64	675	24,135	19.37	495
Total exposure to risk	143,326	100.00	5,005	124,616	100.00	3,636

- As at December 31, 2011, the structure of the Bank's investments made by risk categories after decreased for cash deposits is as follows:

In thousand of EUR

Category	Loans	Accrued interest	off-balance sheet records	Total	In %
A	35,995	234	17,145	53,374	39.80
B	57,942	475	11,735	70,152	52.31
C	8,981	-	543	9,524	7.10
D	911	-	153	1,064	0.79
	103,829	709	29,576	134,114	100.00

- As at December 31, 2010, the structure of the Bank's investments made by risk categories after decreased for cash deposits is as follows:

In thousand of EUR

Category	Loans	Accrued interest	off-balance sheet records	Total	In %
A	45,576	482	14,940	60,998	51.34
B	42,945	379	7,151	50,475	42.49
C	6,910	6	10	6,926	5.83
D	402	-	-	402	0.34
	95,833	867	22,101	118,801	100.00

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

Risk-weighted balance sheet and off-balance sheet assets comprising the total sum of assets classified from the point of collection, as at December 31, 2011, represented 53.92% (December 31, 2010: 67,64% total assets (before impairment for loan loss provisions and impairment losses on other assets).

The loan policy of the Bank is in compliance with the Decision of the Central Bank of Montenegro on minimum standards for the management of loans concentration and doing business with related entities.

II EQUITY AND ADEQUACY OF EQUITY

As of December 31, 2011 and 2010 the share capital of the Bank comprises of 31,305 common shares with nominal value of EUR 511.29.

As of December 31, 2011, uncovered loss amounted to EUR 307 thousand (December 31, 2010: 1,828 thousand).

Bank's own funds as at December 31, 2011 amounted to EUR 22,540 thousand (December 31, 2010: EUR 20,916 thousand).

The core equity of the Bank established in accordance with the Decision on Adequacy of equity of the Bank ("Official Gazette of Montenegro" no. 38/2011) as at December 31, 2011 amounted to EUR 22,594 thousand. The core equity of the Bank as at December 31, 2011 constitutes the essential elements of its own funds: share capital paid at nominal value, collected share premium and the amount of net profit from the current year, less the amount of uncovered loss from previous years and the amount of intangible assets.

As at December 31, 2011, the Bank has supplementary capital in the amount of EUR 54 thousand which refers to revalorisation reserves from fair value adjustments of available for sale financial instruments.

Risk-weighted balance sheet and off-balance sheet assets, formed in accordance with the Decision on Adequacy of equity of the Bank at December 31, 2011 amounted to EUR 106,740 thousand (As at December 31, 2010: EUR 108,477 thousand).

Capital required for market risk at 31 December 2011 amounts to EUR 70 thousand, for operational risk EUR 1,380 thousand, for country risk EUR 584 thousand and other risks EUR 567 thousand.

In accordance with the Decision on Adequacy of equity of the banks, the Bank is in obligation to maintain a minimal level of solvency ratio of 10%. The solvency ratio of the Bank, as at December 31, 2011 amounted to 16.98% (as at December 31, 2010: 15.54%) and is higher than prescribed minimum.

As at December 31, 2011 no indicators of Bank's business deviated from prescribed minimum as required by legislation Central bank of Montenegro.

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

III LIQUIDITY OF THE BANK

Liquidity risk management is defined by the Procedure for managing liquidity risk which defines that the responsibilities in managing the Bank's liquidity bear the following authorities of the Bank:

- Management of the Bank
- Asset and liability Committee (ALCO)
- Payments and funds management department, other Bank's departments and services

The Bank maintains its liquidity by constantly monitoring the alignment of resources and placements in order to be able to settle on mature date all its commitments and commitments of its depositors, while at the same time the Bank is trying to meet the needs of the founder and business customers in approving the loans, i.e. to adjust maturities of loans with borrower's needs.

Liquidity of the Bank as at December 31, 2011 and 2010 can be closely looked from the following indicators:

				2011	2010
Loans / Deposits	=	113,481 / 97,853	x 100 =	115.97%	118.65%
Cash and deposit accounts held with depository institutions / Deposits	=	38,500 / 97,853	x 100 =	39.35%	28.48%
Cash and deposit accounts held with depository institutions / Total assets	=	38,500 / 155,593	x 100 =	24.74%	18.83%
Cash and deposit accounts held with depository institutions / Short-term liabilities	=	38,500 / 92,815	x 100 =	41.48%	28.90%

Maturity alignment of financial assets and Bank's liabilities as at December 31, 2011 has been shown in note 26 to the financial statements.

IV INTEREST RATE RISK

Existing interest rates are determined by a Decision on the interest rate. This decision defines the basic goals and guidelines for interest rate policy, principles and methods of determining the interest rates, by which the Bank arranges agreements, calculate and charge interest on loans and other receivables, i.e. pays on deposits and other funds received.

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. As a result of such changes, an interest margin of the Bank could be increased, but also decrease and loss in a case of unexpected interest rate fluctuation can occur.

Interest rate risk as at December 31, 2011 is shown in note 27 to the financial statements.

ANALYSIS TO THE FINANCIAL STATEMENTS

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

IV INTEREST RATE RISK (continued)

In accordance with the policy for managing market risks, the Bank controls the risk of interest rate fluctuations by establishing internal limitations for the ratio of total bank exposure to interest rate changes.

Defining the limits, boundaries are established for the level of exposure to interest rate risk in the following manner, and in accordance with the Policy of managing market risks in Hipotekarna Banka A.D., Podgorica:

- The average interest margin must not fall below 40% of the average lending interest rates.
- The Bank follows and establishes the average lending and deposit interest rates, by putting the ratio of earned interest income for the reference period with an average interest bearing assets for the reference period to determine the average lending interest rates, as well as by putting in relation actual interest expense for the observed period with an average interest bearing liabilities for the reference period in order to establish the average deposit interest rate. The difference got by subtracting the average deposit interest rate from the average lending interest rate, represents the interest margin, which must not fall below 40% of the average lending interest rate, calculated in the aforecited manner.
- The aforecited calculation is done for a particular month, as well as cumulatively for the period from the beginning of the year until the reference period, according to provided data, movement of average lending and deposit interest rates and movement of the interest margin for the reference month and period can be followed.

In a case that an average interest margins fall under 40% of the average lending interest rates, Risk management department, i.e. Risk monitoring and reporting department will inform the ALCO Committee, which is obliged to recommend measures for maintaining operations within the defined limits:

- The total annual cumulative difference for the position in EUR must not exceed 45% of total assets, i.e. 45% of total liabilities,
- The total semi-annual cumulative difference for the position in EUR must not exceed 36% of total assets, i.e. 36% of total liabilities,
- The total annual and semi-annual cumulative difference for the position for particular currencies must not exceed 9% of total assets, i.e. 9% of total liabilities,
- Observed aggregation for the position in all currencies, the total annual cumulative difference must not exceed 54% of total assets, i.e. 54% of total liabilities,
- Observed aggregation for the position in all currencies, the total semi-annual cumulative difference must not exceed 45% of total assets, i.e. 45% of total liabilities.

ANALYSIS TO THE FINANCIAL STATEMENTS

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

IV INTEREST RATE RISK (continued)

Lending interest rates applied to loans granted to corporate entities during 2011 are as follows:

Type of a loan	Interest rate per a year
Overdraft	8.50 – 14.0
Cash loans	4.75 – 15.0
Revolving loans	4.0 - 14.0
Loans for payment obligations to the suppliers	10.5 - 14.0
Factoring loans	11.5 - 15.0
Car loans	11.0 - 14.0
Refinancing loans to other bank liabilities	10.5 - 14.0
Loans based on 100% time deposit	deposit interest rate + 2.0 - 4.0
Loans for financing export receivables	10.0 - 13.5
Loans to financing the purchase of equipment	10.0 - 13.5
Loans to financing and adoption of business premises	10.0 - 13.5
Loans to financing the purchase of fixed assets	10.0 - 13.5
Loans for the preparation of tourist season	13.0
Mortgage loans	12.5 - 15.0

Lending interest rates applied to loans granted to retail customers during 2011 are as follows:

Type of a loan	Interest rate
Cash loans	0.9 – 1.5 p.m.
Mortgage loans	0.95 - 1.5 p.m.
Loans for renovation and construction	1.0 – 1.1 p.m.
Car loans with the deposit of 20%	1.1 – 1.4 p.m.
Loans for tourism development	1.0 - 1.2 p.m.
Loans for marines	1.0 – 1.2 p.m.
Loans for students	1.0.- 1.2 p.m.
Loans for retired	0.95 - 1.2 p.m.
Customer loans	0.9 – 1.4 p.m.
Overdraft	10.5 - 14.6 p.a.
Sprint loans	0.95 – 1.5 p.m.
Agricultural loans	1.1 p.m.
Loans for the purchase of goods	0.9 - 1.2 p.m.
Lombard loans on collateral securities	1.0 – 1.2 p.m.
Lombard loans based on collateral of term deposits of 100%	+2.5 p.m. to deposit interest rate

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

IV INTEREST RATE RISK (continued)

Deposit interest rates which were applicable on corporate entities during 2011 are as follows:

Deposit type	Interest rate per a year
Demand deposits to corporate entities	0.1 – 1.0
Time deposits in dollars - USD	1.2 – 2.0
Time deposits in euros - €	0.2 – 7.0
Time deposits in foreign currencies (AUD,CAD,CHF,GBP)	1.0 – 2.0

Deposit interest rates which were applicable on retail customers during 2011 are as follows:

Deposit type	Interest rate per a year
Children's savings Mravac - term cumulative savings	3.0 – 7.0
Term cumulative savings	3.0 – 7.0
Term savings in $, Term cumulative savings in $, Children's savings Mravac - term cumulative savings in $, Rent savings in $	1.2 – 2.0
Term savings in €	0.2 – 7.0
Term savings, Term cumulative savings, Children's savings Mravac - term cumulative savings, Rent savings – in foreign currencies (AUD, CAD, CHF, GBP)	1.2 – 2.0
Rent savings	3.0 – 7.0
Demand deposits	0.1 – 1.0

V CURRENCY RISK

The Decision issued by the Central Bank of Montenegro regarding minimal standards for management of credit risks in banks establishes the following limits regarding the open foreign currency position:

- Individual open position at the end of the day for the currencies of daily exchange rate on the reference list of the European Central Bank - max 15% of the core capital.
- The aggregate open position at the end of the day for the currencies of daily exchange rate on the reference list of the European Central Bank - max 20% of the core capital
- The net open positions at the end of the day for other currencies, may amount to no more than 5% of the core capital on an individual basis (currencies which are not at the reference exchange rate list of the European Central Bank)
- The net open positions at the end of the day for other currencies, may amount to no more than 10% of the core capital on an aggregate basis.

ANALYSIS TO THE FINANCIAL STATEMENTS

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

V CURRENCY RISK (Continued)

As at December 31, 2011, foreign currency exposure of the Bank was as follows:

In thousands of EUR	RSD	USD	GBP	CHF	Other	Total
Assets in foreign currencies	-	7,256	69	138	19	7,482
Liabilities in foreign currencies	-	7,450	67	137	3	7,657
Net foreign exchange exposure:						
- December 31, 2011	-	(194)	2	1	16	
- December 31, 2010.	-	(166)	24	3	11	
% of first-tier capital:						
- December 31, 2011	-	(0.83%)	0.01%	0.00%	0.07%	
- December 31, 2010.	-	(0.71%)	0.10%	0.02%	0.05%	
Aggregate open position:						
- December 31, 2011	(175)					
- December 31, 2010.	(127)					
% of first-tier capital:						
- December 31, 2011	(0.75%)					
- December 31, 2010	(0.54%)					

VI COUNTRY RISK

In accordance with the Decision of the Central Bank of Montenegro on methodology for measuring country risk in the banks ("Official Gazette of Montenegro" no. 60/2008 and 40/2011), the Bank has adopted a Policy and Procedures of country risk management. Country risk presents a probability of incurring losses to the Bank, due to the inability to collect receivables from entities outside Montenegro because of political, social and economic reasons of the country where the seat of the debtor is.

Country risk as at December 31, 2011 was calculated using the current methodology Rating of debtor countries. Country risk management policy defines the following percentages of reserves in line with the "rating" of land the bank has exposure to (Standard & Poors):

Risk categories	Risk weight
Non-risk countries	0%
Low-risk countries	50-100%
Medium-risk countries	150-250%
High-risk countries	minimum 300%

As at December 31, 2011, the Bank has presented income from cancellation of reserves from the Bank's exposure to country risk in the amount of EUR 14 thousand (December 31, 2010: EUR 54 thousand).

ANALYSIS TO THE FINANCIAL STATEMENTS

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

VII OPERATIONAL RISK

In accordance with the Decision of the Central Bank of Montenegro on minimum standards for operational risk management in banks ("Official Gazette of Montenegro" no. 24/2009), which was adopted at the Council meeting of the Central Bank of Montenegro, held on February 23 and 24, 2009 the Bank has adopted a Policy for managing operational risk.

Operational risk is defined as the risk of loss due to improper or inappropriate conduct and actions of employees, inadequate and / or errors in processes and organization, inadequate and / or errors in systems and infrastructure or due to external factors and influences.

In accordance with the Decision of the Central Bank of Montenegro, the Bank is obliged to inform the Central Bank of losses arising from operational risk exceeding 1% of venture capital, at the latest within eight working days from the date of loss.

As at December 31, 2011, the provisions for operational risk amount to EUR 300 thousand (December 31, 2010: EUR 279 thousand).

VIII INTERNAL CONTROL AND INTENAL AUDIT SYSTEM

Organizational structure of the Bank establishes levels and lines of authority and responsibility with a clear delimitation between the function of management and leadership function. The management bodies are: the Assembly of the Bank and the Board of Directors of the Bank.

Bank is managed by the General Executive Director of the Bank.

The Bank, as a separate organizational unit, organized Internal Audit department. Internal audit department performs its activities in accordance with the internal audit procedures and annual plan of activities.

In accordance with these internal procedures the internal audit activities include but are not limited to:

- Compliance with relevant rules, guidelines, instructions and standards;
- Evaluation of the reliability of rules and division of duties within the banking operations;
- Review and estimation of effectiveness and benefits of financial and administrative controls;
- Monitoring the adequacy, reliability, safety integrity of accounting and other management information systems;
- Review of effectiveness and efficiency of banking operations;
- Testing the validity of measures used to achieve banking operations;
- Test and evaluation of the adequacy and effectiveness of internal control system;
- Review of application and effectiveness of risk management procedures and assessment of the methodology of risk assessment;
- Assessment of information systems, with special emphasis on electronic information systems and banking application;

ANALYSIS TO THE FINANCIAL STATEMENTS

B REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

VIII INTERNAL CONTROL AND INTENAL AUDIT SYSTEM (continued)

- Assessment of the accuracy and reliability of accounting financial statements;
- Assessment of the banking system in the determination of capital in relation to the estimated risk;
- Testing of transactions and functioning of specific internal control procedures;
- Adherence to legal and statutory regulations, code of ethics, implementation of policies and procedures;
- Conducting special investigations.

When reporting to the Bank's management, internal audit operates independently in order to establish and report on the adequacy, reliability and effectiveness of controls used by the Bank's risk management, which has a preventive effect on achievement of the objectives of banking, and reporting whether the banking resources are used efficiently and effectively in achieving the objectives of banking.

C REVIEW OF BANK'S ORGANIZATIONAL STRUCTURE

The Bank performs its activity in central office in Podgorica and branch offices in Podgorica, Bijelo Polje, Budva, Nikšić, Bar, Herceg Novi, Berane, Kotor and Ulcinj, as well as in branches in Podgorica, Tivat, Tuzi and Cetinje.

The Bank carries on business activities through the following bodies and organizational components:

1. Assembly of Shareholders

2. The Board of Directors
2.1 The Audit Committee
2.2 Credit Risk Management Committee
2.3 Internal Audit Department
2.4 Department for monitoring compliance with regulations
2.5 The authorized person for the prevention of money laundering and terrorist financing.
2.6 Head of Information Systems Security

3. Chief Executive Officer
3.1 Administrative and HR Service
3.2 Payments and fund management
3.3 Domestic payments
3.4 International Payments
3.5 Fund management service
3.6 Custody service
3.7 Brokerage service sector

4. Executive Director of Commercial Affairs
4.1 Commercial Sector
4.2 New products development Service and Marketing
4.3 Business Network

5. Risk Management Executive Director
5.1 Risk Management Sector
5.2 Loan Analysis Sector
5.3 Sector for managing risk assets
5.4 Risk monitoring and reporting sector
5.5 Loan portfolio control department

ANALYSIS TO THE FINANCIAL STATEMENTS

C REVIEW OF BANK'S ORGANIZATIONAL STRUCTURE (continued)

6. Executive Director of Finance and Informatics
6.1 Division of Finance and Informatics
6.2 Accounting and Reporting
6.3 Department of General Affairs
6.4 Service Billing
6.5 IT Department

As of December 31, 2011, the Bank had 163 employees (December 31, 2010: 155 employees).

C REVIEW OF BANK'S ORGANIZATIONAL STRUCTURE

Qualification structure of the Bank, as at December 31, 2011 and 2010 were as follows:

	No. of employees	In %	No. of employees	In %
Masters	6	4	4	3
University degree (four years)	78	48	75	48
College degree (two years)	17	10	15	10
Bachelor	12	7	9	6
High school degree	50	31	52	33
Qualified				
	163	100	155	100

The members of Board of Directors as at December 31, 2011 were:

Name	Function
Sigilfredo Montinari	President
Božana Kovačević	Vice president
Snježana Pobi	Member
Renata Vinković	Member
Esad Zaimović	Member

The members of Credit Risk Management Committee, as at December 31, 2011 were:

Name	Function
Renata Vinković	President
Esad Zaimović	Member
Snježana Pobi	Member

The members of the Audit Board, as at December 2011, were:

Name	Function
Marko Žigmund	President
Božana Kovačević	Member
Jovan Papić	Member

As at December 31, 2011 the Chief Executive Officer was Mr. Esad Zaimović.

As at December 31, 2011 Chief Internal Auditor was Mr. Veselin Ivanović.

ANALYSIS TO THE FINANCIAL STATEMENTS

D REPORT IN SHORT FORM

In accordance with the Decision on Reports which banks submit to the Central Bank of Montenegro, the report in a short form consists of Auditor's opinion on financial statements of the bank, Income Statement and Balance Sheet, data on the composition of the Board of Directors, the Committee on Credit Risk Management and Supervisory Committee, information about the Chief Executive Officer and Internal Auditor of the Bank and data on performance indicators.

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This is an English translation of the Report originally issued in Montenegrin language (for management purposes only)

INDEPENDENT AUDITORS' REPORT
TO THE OWNERS OF HIPOTEKARNA BANKA A.D., PODGORICA

Report on Financial Statements

We have audited the accompanying financial statements of Hipotekarna banka A.D., Podgorica (hereinafter: the Bank), which comprise the balance sheet as at December 31, 2011, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at December 31, 2011, and of its financial performance and its cash flows for the year then ended in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks.

Podgorica, May 15, 2012

Ernst & Young Montenegro d.o.o.
Podgorica, Crna Gora

DRUŠTVO ZA REVIZIJU
ERNST & YOUNG MONTENEGRO DOO
PODGORICA

Stephen Fish
Partner

Draško Popović
Authorized auditor

INCOME STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2011

In thousands of EUR	Notes	2011	2010
Interest income	3.1, 4a	11,405	9,634
Interest expenses	3.1, 4b	(3,873)	(3,433)
Net interest income		7,532	6,201
Provisions for losses	3.6, 5	(2,160)	(1,334)
Net income		**5,372**	**4,867**
Fee and commission income	3.1, 6a	3,817	3,105
Fee and commission expenses	3.1, 6b	(645)	(465)
Net fee and commission income		3,172	2,640
NET INTEREST, FEE AND COMMISSION INCOME		**8,544**	**7,507**
Other income, net	7	511	399
General expenses	8	(7,379)	(6,827)
NET INCOME BEFORE EXTRAORDINARY ITEMS		**1,676**	**1,079**
Extraordinary income		27	263
Extraordinary expenses		(13)	(35)
Net extraordinary income		14	228
PROFIT BEFORE TAXATION	9	**1,690**	**1,307**
Income taxes	3.3, 9	(168)	(15)
NET PROFIT FOR THE YEAR		**1,522**	**1,292**

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

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Signed on behalf of Hipotekarna banka A.D., Podgorica:

Esad Zaimović
Chief Executive Officer

Aleksandar Mitrović
Executive Director of Finance and Informatics

Translation of the financial statements issued in Montenegrin language

STATEMENT OF FINANCE POSITION FOR THE DAY OF 31 DECEMBER 2011

In thousands of EUR	Notes	2011	2010
ASSETS			
Cash and deposit accounts held with depository Institutions	10	38,500	24,247
Securities available for sale, other than shares		26	42
Loans and leases	11	109,470	98,352
Securities held to maturity	12	2,569	1,093
Factoring and forfeiting		9	-
Receivables in respect of custody operations		39	23
Business premises and other fixed assets	13	1,950	1,742
Acquired assets	14	478	485
Equity investments in other legal entities	15	230	99
Other assets	16	2,641	3,190
Less: Provision for potential losses on other assets	16	(319)	(485)
Total assets		**155,593**	**128,788**
LIABILITIES			
Deposits	17	97,853	85,133
Liabilities in respect of custody operations		247	49
Obligations based on loans and borrowings	18	26,887	15,000
Obligations to the Government of Montenegro	19	2,889	2,716
Other liabilities	20	3,954	3,773
Provisions for potential losses on off-balance sheet credit exposures	21	675	494
Total liabilities		132,505	107,165
EQUITY			
Share capital	22	16,006	16,006
Share premium		7,444	7,444
Revaluation reserve		(54)	1
Uncovered loss		(307)	(1,828)
Total equity		**23,089**	**21,623**
Total liabilities		**155,593**	**128,788**
OFF-BALANCE-SHEET ITEMS	24	**388,819**	**289,488**

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

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Signed on behalf of Hipotekarna banka A.D., Podgorica:

Esad Zaimović
Chief Executive Officer

Aleksandar Mitrović
Executive Director of Finance and Informatics

Translation of the financial statements issued in Montenegrin language

ANALYSIS TO THE FINANCIAL STATEMENTS

DATA ON COMPOSITION OF BOARD OF DIRECTORS, CREDIT RISK MANAGEMENT COMMITTEE, SUPERVISORY COMMITTEE, CHIEF EXECUTIVE OFFICER AND CHIEF INTERNAL AUDITOR OF THE BANK

As at December 31, 2011 the members of Bank's Board directors were:

Name	Function
Sigilfredo Montinari	President
Božana Kovačević	Vice President
Snježana Pobi	Member
Renata Vinković	Member
Esad Zaimović	Member

As at December 31, 2011 the members of Bank's Board directors were:

Name	Function
Renata Vinković	President
Esad Zaimović	Member
Snježana Pobi	Member

The members of the Audit Board, as at December 31, 2011 were:

Name	Function
Marko Žigmund	President
Božana Kovačević	Member
Jovan Papić	Member

As at December 31, 2011 the Chief Executive Officer was Mr. Esad Zaimović.

As at December 31, 2011 the Chief Internal auditor was Mr. Veselin Ivanović.

BANK'S PERFORMANCE INDICATORS AS AT DECEMBER 31, 2011

Bank's performance indicators as at December 31, 2011 and 2010 were as follows:

Indicators	2011	2010
Core equity	EUR 22,594 thousand	EUR 20,916 thousand
Additional equity	(54) thousand	-
Bank's funds	EUR 22,540 thousand	EUR 20,916 thousand
Weighted balance sheet assets	EUR 106,740 thousand	EUR 108,477 thousand
Solvency ratio	16,98%	15.54%
Return on average assets	1.07%	1.13%
Return on average equity	6.81%	6.16%