Development Bank of the

Federation of Bosnia and Herzegovina

Financial statements for the year ended 31 December 2013

This version of the report is a translation from the original, which was prepared in the Bosnian language. In all matters of interpretation of information, views or opinions, the original language version of the report takes precedence over this translation.

Content

Management Board's Report

The Managements Board has pleasure in submitting its report for the year ended 31 December 2013.

Review of operations

The result for the year ended 31 December 2013 of the Bank is set out in the income statement on page 5.

Supervisory Board, Audit Committee and Management Board

During the course of 2013 and up to the date of this report, the Supervisory Board comprised:

Supervisory Board

Petar Jurčić	Chairman
Senad Softić	Member
Samir Ćatović	Member
Ružica Ćurković	Member
Ivica Music	Member
Dženan Đonlagić	Member
Aid Berbić	Member

During the course of 2013 and up to the date of this report, the Audit Committee comprised:

Audit Committee

Dragan Prusina	Chairman
Advija Alihodžić	Vice-Chairman
Fatima Obhodžaš	Member
Dragan Kolobarić	Member
Meliha Bašić	Member

As of 31 December 2013 the Management Board comprised a president of the Management Board, vice-president of the Management Board and 2 executive directors, who served during the year and up to the date of this report as follows:

Management Board

Ramiz Džaferović	President of the Management Board
Borislav Trlin	Vice-president of the Management Board
Dubravka Bošnjak	Executive Director
Belma Izmirlija	Executive Director

On behalf of the Management Board

mr. sc. Ramiz Džaferović
President of the Management Board

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

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

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

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

The financial statements set out on pages 5 to 44 were authorised by the Management Board on 24 February 2014 for issue to the Supervisory Board and are signed below to signify this:

On behalf of the Management Board

mr. sc. Ramiz Džaferović
President of the Management Board

RB FBiH
Sarajevo

Development Bank of the FBiH
Igmanska 1
71000 Sarajevo
Bosnia and Herzegovina

24 February 2014

This version of the report is a translation from the original, which was prepared in the Bosnian language. In all matters of interpretation of information, views or opinions, the original language version of the report takes precedence over this translation.

Independent auditors' report to the owners of the Development Bank of the Federation of Bosnia and Herzegovina

We have audited the accompanying financial statements of the Development Bank of the Federation of Bosnia and Herzegovina ("the Bank"), which comprise the balance sheet as at 31 December 2013, the income statement and statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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Independent auditors' report to the owners of the Development Bank of the Federation of Bosnia and Herzegovina (continued)

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other matter

The financial statements of the Bank as at and for the year ended 31 December 2012 were audited by another auditor who expressed an unqualified audit opinion on those statements in its report dated 25 February 2013.

D.O.O. ZA REVIZIJU
KPMG B-H
SARAJEVO

KPMG B-H d.o.o. za reviziju
Registered Auditors
Zmaja od Bosne 7-7A/III
71 000 Sarajevo
Bosnia and Herzegovina

24 February 2014

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Income statement

For the year ended 31 December

	Note	2013 BAM'000	2012 BAM'000
Interest income	*6*	9,666	11,237
Interest expense	*7*	(114)	(75)
Net interest income		**9,552**	**11,162**
Fee and commission income	*8*	1,690	1,735
Net fee and commission income		**1,690**	**1,735**
Other operating income	*9*	489	165
Operating income		**11,731**	**13,062**
Personnel expenses	*10*	(5,375)	(5,498)
Depreciation and amortisation		(347)	(348)
Administrative and other expenses	*11*	(1,539)	(1,664)
Operating expenses		**(7,261)**	**(7,510)**
Profit before impairment losses and provisions		**4,470**	**5,552**
Impairment losses and provisions	*12*	(1,233)	333
NET PROFIT FOR THE YEAR		**3,237**	**5,885**

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

Statement of comprehensive income

For the year ended 31 December

	Note	2013	2012
		'000 KM	'000 KM
Net profit for the year		3,237	5,885
Other comprehensive income for the year		-	-
Total comprehensive income for the year		3,237	5,885

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

Balance sheet

As at 31 December

	Note	31. December 2013 BAM'000	31. December 2012 BAM'000
Assets			
Cash and cash equivalents	*13*	80,956	46,981
Obligatory reserve with the Central bank	*14*	3,988	4,211
Loans to banks	*15*	270	391
Loans to customers	*16*	174,366	196,095
Other assets		99	292
Property, equipment and intangible assets	*17*	5,377	5,655
Total assets		**265,056**	**253,625**
Liabilities			
Current accounts and deposits from customers	*18*	61,032	51,739
Borrowings	*19*	3,749	4,314
Provisions for liabilities and charges	*20*	745	925
Other liabilities	*21*	24,621	24,975
Total liabilities		**90,147**	**81,953**
Equity			
Owner's capital	*22*	153,000	153,000
Retained earnings		13,852	10,615
Regulatory reserves for credit losses		8,057	8,057
Total equity		**174,909**	**171,672**
Total liabilities and equity		**265,056**	**253,625**

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

Statement of cash flows

For the year ended 31 December

	Note	2013 BAM'000	2012 BAM'000
Cash flow from operating activities			
Profit before tax		**3,237**	5,885
Adjustments for:			
Depreciation and amortization		**347**	348
Impairment losses and provisions		**1,233**	(333)
Write-off of tangible assets		**-**	1
Cash flow form operating activities before changes in operating assets and liabilities		**4,817**	5,901
(Increase)/decrease in operating assets			
Obligatory reserve with the Central bank		**223**	(582)
Loans to banks		**189**	1,500
Loans to customers		**20,332**	8,719
Other assets		**192**	(83)
Increase/(Decrease) in operating liabilities			
Current assets and deposits from customers		**9,293**	(9,293)
Other liabilities		**(437)**	(19,676)
Net cash inflow from operating activities		**34,609**	(13,514)
Investing Activities			
Purchase of property and equipment		**(61)**	(320)
Purchase of intangible assets		**(8)**	(59)
Net cash outflow from operating activities		**(69)**	(379)
Financing activities			
(Repayment)/proceeds from borrowings, net		**(565)**	(506)
Net cash (outflow) from financing activities		**(565)**	(506)
Net increase in cash and cash equivalents		**33,975**	(14,399)
Cash and cash equivalents at the beginning of period	*13*	**46,981**	61,380
Cash and cash equivalents at the beginning of period	*13*	**80,956**	46,981

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

Statement of changes in equity

For the year ended 31 December

	Owner's Capital BAM '000	Regulatory reserves for credit losses BAM '000	Retained Earnings BAM '000	Total BAM '000
Balance as at 1 January 2012	**153,000**	**4,881**	**7,906**	**165,787**
Transfer from retained earnings to regulatory reserves (Note 3m)	-	3,176	(3,176)	-
Net profit for the year	-	-	5,885	5,885
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	**5,885**	**5,885**
Balance as at 31December 2012	**153,000**	**8,057**	**10,615**	**171,672**
Net profit for the year	-	-	3,237	3,237
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	**3,237**	**3,237**
Balance as at 31 December 2013	**153,000**	**8,057**	**13,852**	**174,909**

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

Notes to financial statements

1 General

Development Bank of the Federation of Bosnia and Herzegovina (hereafter "the Bank") was established by the Law on the Development Bank of the Federation of Bosnia and Herzegovina ("Official Gazette of Federation of Bosnia and Herzegovina, No. 37/08). The Bank is headquartered in Igmanska 1, Sarajevo. The Bank is 100%-ownership of the Federation of Bosnia and Herzegovina.

In compliance with the Law on the Development Bank and the Statute of the Bank, bodies of the Bank are: the Assembly (consisting of the Government of the FBiH), the Supervisory Board, the Management Board and the Audit Committee.

As of 31 December 2013 the Bank had branch offices in Mostar, Bihać, Zenica, Orašje, Tuzla and Livno.

The goals of the Bank are encouragement of economic development and overall social development and the encouragement of sustainable growth to the territory of the Federation of Bosnia and Herzegovina, relating to the financial and general social goals defined by the Law.

Corporate loan and guarantee approval are the key activities of the Bank either directly or through other banks, in order to support the local economy, regional development and employment, The Bank performs credit operations in the name and on behalf of the Bank (from capital, collected deposits and borrowings), as well as in the name and on behalf of the Federation BiH, on which behalf it manages its domestic and foreign funds aimed for development projects, as well as receives cash deposits and takes loans, as a function of financing development projects.

2 Basis of preparation

a) Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as

The Bank's financial statements were authorized for issue by the Management Board on 24 February 2014 for submission to the Supervisory Board.

b) Basis of measurement

These financial statements have been prepared on the historical or amortised cost basis.

c) Functional and presentation currency

The financial statements are presented in Convertible Marks ("BAM"), which is the functional currency of the Bank. Amounts are rounded to the nearest thousand (unless otherwise stated).

The Central Bank of Bosnia and Herzegovina ("CB BiH") implemented a currency board arrangement aligning BAM to EURO at an exchange rate of EUR 1: BAM 1.95583 throughout 2013 and 2012. This is expected to continue in the foreseeable future.

d) Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. Actual results may differ from these estimates.

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

Information on areas with significant uncertainty in the estimates and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in these financial statements are disclosed in Note 5.

Notes to financial statements (continued)

3 Significant accounting policies

The accounting policies set out below have been consistently applied for all periods presented in these financial statements.

a) Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange profits and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Non-monetary assets and items that are measured in terms of historical cost in foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at the reporting date.

b) Interest income and expense

Interest income and expense are recognised in the income statement as they accrue using the effective interest rate method. Effective interest rate is the rate that discounts estimated future cash flows of financial assets or liabilities over the life of financial instrument (or, if appropriate, a shorter period) to its net carrying value. In the calculation of effective interest rates the Bank estimates future cash flows considering all contractual terms, but not future credit losses.

Calculation of the effective interest rate includes all paid or received transaction costs, fees and points, which are an integral part of the effective interest rate. Transaction costs include all incremental costs incurred directly in connection with the issuance or acquisition of financial assets or financial liabilities.

Interest income and expense recognised in the income statement include interest on financial assets and financial liabilities that are measured at amortised cost calculated using the effective interest rate method.

c) Fee and commission income and expenses

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

Fee and commission income and expenses, reported as such, comprise mainly fees related to agency activities, the issuance of guarantees and letters of credit and other services and are recognised in the income statement upon performance of the relevant service.

d) Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

e) Income tax

According to Article 32 of the Law on Development Bank of the Federation of Bosnia and Herzegovina Herzegovina ("Official Gazette of Federation of Bosnia and Herzegovina, No. 37/08), the Bank is not subject to corporate profit tax.

f) Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: loans and receivables and other financial liabilities. The classification depends on the purpose for which the financial assets and liabilities were acquired. The Management determines the classification of financial assets and liabilities upon initial recognition and re-evaluates this classification at each reporting date.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

f) Financial instruments (continued)

a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables arise when the Bank provides money to a debtor with no intention of trading with the receivable and include placements with and loans to other banks, loans to customers and balances with the central bank.

b) Other financial liabilities

Other financial liabilities comprise all other financial liabilities, including current and deposit accounts and borrowings.

Recognition

Loans and receivables and other financial liabilities are recognised when advanced to borrowers or received from lenders.

Initial and subsequent measurement

Loans and receivables and other financial liabilities are initially recognized at fair value. Loans and receivables and other financial liabilities are subsequently measured at amortized cost, using the effective interest rate method, less any impairment.

Derecognition

The Bank derecognizes financial assets (in full or part) when the contractual rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realized, surrendered or have expired.

The Bank derecognizes financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognizing that liability and will instantaneously recognize a new financial liability, with new terms and conditions.

Identification and measurement of impairment of financial assets

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has (or have) an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Objective evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group. For financial assets carried at amortised cost, the Bank first assesses whether objective evidence of impairment exists individually or collectively. Those individual assets which are not identified as impaired are subsequently included in the basis for collective impairment assessment. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics.
If there is an objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred) discounted at the original effective interest rate of financial assets valid at the time the asset become impaired. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

f) Financial instruments (continued)

Identification and measurement of impairment of financial assets

For individually significant loans, the need for, and amount of impairment allowance is determined based on an assessment which includes the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, the availability of working capital and other financial support, the realisable value of collateral, and the timing of the expected cash flows.

Allowances are assessed collectively for losses on loans to customers for loans where there is not yet objective evidence of individual impairment. For the purpose of collective evaluation of impairment the Bank uses statistical models and historical data on the probability of occurrences that cause impairment, the time required to recover and the total loss incurred, adjusted for management's judgement as to whether the current economic and credit conditions are such that it is likely that the actual losses with be higher or lower of those calculated by historical modelling. The Bank regularly reviews the loss rates and the expected rates of recovery at each reporting date, to ensure accurate reporting.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognised in the income statement.

When a loan is uncollectible, it is written off against the related impairment allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised as a reversal of impairment losses in the income statement.

The Bank also calculates provisions in accordance with the relevant regulations of the Banking Agency of the Federation of Bosnia and Herzegovina ("the Agency" or "FBA"). In accordance with these regulations, the relevant placements are classified into appropriate risk groups, depending on the past due days, the financial position of the borrower and collateral; and are provided for at prescribed rates. A general provision is also calculated in accordance with these regulations at a rate of 2% on exposure not specifically impaired.

If the FBA provisions are greater than the impairment allowance calculated in accordance with IFRS, the difference is presented as an appropriation by the capital adequacy calculation.

Specific financial instruments

Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defines as cash, balances with the Central bank and current accounts with other banks.

Cash and cash equivalents exclude the compulsory minimum reserve with the Central Bank as these funds are not available for the Bank's day-to-day operations. The compulsory minimum reserve with the Central Bank is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

Loans and advances

Loans and advances to banks and customers are presented at amortised cost net of impairment allowances to reflect the estimated recoverable amounts.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

f) Financial instruments (continued)

Borrowings

Interest-bearing borrowings are classified as other financial liabilities and are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, these are stated at amortised cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings using the effective interest rate method.

Current accounts and deposits from customers

Current accounts and deposits are classified as other liabilities and are initially measured at fair value plus transaction costs and subsequently stated at their amortised cost using the effective interest method.

g) Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and impairment losses. The cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent cost is included in net book value or is accounted for as separate assets only if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day-to-day repairs and maintenance are recognised in the income statement as incurred.

Depreciation is provided on all property and equipment except for land and assets in the course of construction on a straight-line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The depreciation rates used by the Bank are as follows:

Buildings	3%
Furniture and equipment	20%
Motor vehicles	20%
Computers	33%

Depreciation method and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Gains and losses on disposal are determined by comparing proceeds with the carrying amount, and are included in the income statement as other income or operating expense.

h) Intangible assets

Intangible assets are stated at historical cost less accumulated amortisation and impairment losses. The cost includes all expenditure that is directly attributable to the acquisition of the items.

Amortization is provided on all intangible assets except assets in the course of construction on a straight line basis at prescribed rates designed to write off the cost over the estimated useful lives of the assets. The following estimated useful lives are used:

Software	20%

Amortization method and useful lives are reassessed, and adjusted if appropriate, at each reporting date.

i) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount, Impairment losses are recognised in the income statement.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

j) Impairment of non-financial assets (continued)

The recoverable amount of other assets is the greater of their value in use and fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

k) Employee benefits

Short-term benefits

On behalf of its employees, the Bank pays pension and health insurance which is calculated on the gross salary paid, as well as tax on salaries which are calculated on the net salary paid. The Bank pays the above contributions into the state pension and health funds according to statutory rates during the course of the year. In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with local legislation. These expenses are recorded in the income statement in the period in which the salary expense is incurred.

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

Long-term benefits: retirement severance payments

According to the local legislation the Bank pays to its employees retirement severance benefits upon retirement in an amount of six employee's salaries received in the last six months or six average salaries at the Bank's level in last six months, depending on what is more favorable for the employee.

The obligation and costs of these benefits are determined by using a projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. The obligation is measured at the present value of estimated future cash flows using a discount rate that is similar to the estimated interest rate on government bonds.

l) Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made, or as required by law in the case of provisions for unidentified impairment of off-balance-sheet credit risk exposures.

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of incurred losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

Notes to financial statements (continued)

3 Significant accounting policies (continued)

m) Owner's capital

Owner's capital consists of one share of the Federation of BiH and represents the capital of the legal predecessor of the Bank, the Investment bank of the FBiH, taken over by the Bank on its inception, increased for payments of the Government of the Federation during 2011.

In accordance with the provisions of the Law on Development Bank of the Federation of Bosnia and Herzegovina, Article 3, the capital of the Bank should be increased by BAM 400 million from the budget of Government of the FBiH in equal instalments in the next four years, starting from 2008 to 2011.

Up to 31 December 2013 the Government of the FBiH has not made capital injection in the above stated contracted dynamics and amounts.

Regulatory reserve for credit losses

The regulatory reserve for credit losses represents the surplus of impairment allowances calculated in accordance with regulations as prescribed by the Agency over impairment allowances recognised in accordance with IFRS. The reserve is presented directly within equity (as a non-distributable reserve) and until 2012 any increase of the surplus was covered by transfers from retained earnings, after approval by shareholders.

Prior to 2012, the need for transfers from retained earnings to an earmarked reserve within equity (regulatory reserve for credit losses) was calculated for the whole credit-risk portfolio on a net basis, thereby taking into account both instances where application of Agency regulations would have resulted in a higher provision and instances where the application of Agency regulations would have resulted in a lower provision. However, from 2012, banks are required to calculate the requirement for regulatory reserves for credit losses taking into account only instances where higher provisions would have resulted from the application of the Agency rules. Retroactive application of this change in Agency rules is not required.

As of 5 July 2012 the Agency has defined dynamics of allocation to the regulatory reserves as follows:

- as of 30 June 2012 at least one quarter (1/4) of the total amount of identified difference as at the reporting date;

- as of 30 September 2012 at least one-half (1/2) of the total amount of identified difference as at the reporting date;

- as of 31 December 2012 at least three- quarters (3/4) of the total amount of identified difference as at the reporting date;

- as of 31 March 2013 the total amount of identified difference as at the reporting date.

As at 31 December 2011, remaining part of the difference between the impairment of financial assets and provisions in accordance with IFRS impairment of financial assets and provisions that would be determined applying Agency rules amounted KM 3,176 thousand. This amount was transferred from retained earnings to regulatory reserve in 2012.

Based on the Decision issued by the Agency in February 2013 any increase of the surplus of regulatory provisions no longer needs to be presented as a reserve movement within equity but will be exclusively computed as a deduction of regulatory capital for the purpose of capital adequacy calculations. This decision is to be applied retrospectively from 31 December 2012.

n) Off-balance sheet commitments and contingent liabilities

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

Notes to financial statements (continued)

3 Significant accounting policies (continued)

o) Funds managed for and on behalf of third parties

The Bank manages significant funds for and on behalf of the Government of the FBiH (Ministry of Finance, Ministry of Development, Entrepreneurship and Craft, Ministry of Agriculture, Water Management and Forestry, Ministry of Displaced Persons and Refugees, Ministry of Environment and Tourism and Ministry of Energy, Mining and Industry) and the Federal Employment Agency. Income and expenses from such operations are charged to the principal and the Bank does not bear any liabilities and risks. For these services, the Bank charges fees. For details refer to Note 24.

4 Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements

A number of new standards, amendments to standards and interpretations issued by the International Accounting Standards Board ("IASB") and International Financial Reporting Interpretations Committee ("IFRIC")are not yet effective for annual periods ending 31 December 2013, and have not been applied in preparing these financial statements.

- **IFRS 9 (2013), IFRS 9 Financial Instruments (2010) and IFRS 9 Financial Instruments (2009) (together, IFRS 9)**

IFRS 9 (2009) introduces new requirements for the classification and measurement of financial assets. IFRS 9 (2010) introduces additions relating to financial liabilities. IFRS 9 (2013) introduces new requirements for hedge accounting. The IASB currently has an active project to make limited amendments to the classifications and measurement requirements of IFRS 9 and add new requirements to address the impairment of financial assets.

The IFRS 9 (2009) requirements represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. A financial asset would be measured at amortised cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.. All other financial assets would be measured at fair value. The standard eliminates the existing IAS 39 categories of held-to-maturity, available-for-sale and loans and receivables. For an investment in an equity instrument that is not held for trading, the standard permits an irrevocable election, on initial recognition, on an individual share-by-share basis, to present all fair value changes from the investment in Other comprehensive income ("OCI"). No amount recognised in OCI would ever be reclassified to profit or loss at a later date. However, dividends on such investments would be recognised in profit or loss, rather than OCI, unless they clearly represent a partial recovery of the cost of the investment. Investments in equity instruments in respect of which an entity does not elect to present fair value changes in OCI would be measured at fair value with changes in fair value recognised in profit or loss.

The standard requires derivatives embedded in contracts with a host that is a financial asset in the scope of the standard not to be separated; instead, the hybrid financial instrument is assessed in its entirety for whether it should be measured at amortised cost or fair value.

IFRS 9 (2010) introduces a new requirement in respect of financial liabilites designated under the fair value option to present fair value changes that are attributable to the liability's credit risk in OCI rather than in profit or loss. Apart from this change, IFRS 9 (2010) largely carries forward without substantive amendment the guidance on classification and measurement of financial liabilities from IAS 39.

IFRS 9 (2013) introduces new requirements for hedge accounting that align hedge accounting more closely with risk management. The requirements also establish a more principles-based approach to hedge accounting and address inconsistencies and weaknesses in the hedge accounting model in IAS 39.

The mandatory effective date of IFRS 9 is not specified but will be determined when the outstanding phases are finalised. However, early application of IFRS 9 is permitted. The Bank has not yet decided on the date of initial application of the new standard neither it has analysed the effects of its application.

Notes to financial statements (continued)

4 Standards, interpretations and amendments to published standards that are not yet effective and were not used in preparation of these financial statements (continued)

- **Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)**

The amendments to IAS 32 clarify the offsetting criteria in IAS 32 by explaining when an entity currently has a legally enforceable right to set-off and when gross settlement is equivalent to net settlement. The amendments are effective for annual periods beginning on or after 1 January 2014 and interim periods within those annual periods. Early application is permitted. It is not expected that IAS 32 will have significant impact on the Bank's financial statements.

- **IFRIC 21 Levies**

IFRIC 21 defines a levy as an outflow from an entity imposed by a government in accordance with legislation. It confirms that an entity recognises a liability for a levy when and only when the triggering event specified in the legislation occurs. IFRIC 21 is not expected to have a material effect on the Bank's financial statements.

Notes to financial statements (continued)

5 Critical accounting judgements and key sources of estimation uncertainty

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated and are based on historical experience and other factors such as the expected flow of future events that can be reasonably assumed in existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a possible material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

(a) Impairment losses on loans and receivables and provisions for off-balance-sheet exposure

The Bank monitors the creditworthiness of its customers on an ongoing basis. The need for impairment of the Bank's on and off-balance sheet exposure to credit risk is assessed on a monthly basis.

Impairment losses are made mainly against the carrying value of loans to banks and customers (as disclosed in Notes 15 and 16) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 20).

The Bank estimates impairment losses in cases where it judges that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets. Such evidence includes delinquency in payments or other indications of financial difficulty of borrowers and adverse changes in the economic conditions in which borrowers operate or in the value or enforceability of security, where these changes can be correlated with defaults.

Summary of impairment allowances	*Note*	**31 December 2013 BAM '000**	31 December 2012 BAM '000
Impairment allowances for balance sheet exposures, including other assets	*15, 16*	**21,430**	20,105
Provisions for off-balance sheet exposures	*20*	**300**	310
		21,730	20,415

Notes to financial statements (continued)

5 Critical accounting judgements and key sources of estimation uncertainty (continued)

(a) Impairment losses on loans and receivables and provisions for off-balance-sheet exposure (continued)

As at 31 December 2013 and 31 December 2012, the gross value of impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognised were as follows:

	31 December 2013			31 December 2012		
	Loans to banks	**Loans to customers**	**Total**	**Loans to banks**	**Loans to customers**	**Total**
Gross exposure	1,534	35,830	**37,364**	1,607	53,249	**54,855**
Impairment allowance	(1,534)	(14,730)	**(16,264)**	(1,607)	(15,657)	**(17,264)**
Impairment rate	100%	41%	**44%**	100%	29%	**31%**

In addition to identified losses on impaired loans, as described above, the Bank also recognises impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified ("IBNR"). Amounts, for which specific impairment losses have been identified, are excluded from this calculation.

The amount of IBNR as at 31 December 2013 amounted to BAM 5,165 thousand (2012: BAM 2,836 thousand) or 2.79% (2012: 1.31%) of loans and receivables.

(b) Regulatory requirements

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

In addition to impairment allowances calculated and recognised in accordance with IFRS, the Bank also calculates impairment losses in accordance with Agency regulations for capital adequacy calculation purposes and regulatory reserves for credit losses.

Notes to financial statements (continued)

5 Critical accounting judgements and key sources of estimation uncertainty (continued)

(c) Regulatory requirements (continued)

The following table summarises impairment allowances calculated in accordance with the Agency regulations. Regulatory provisions as of 31 December 2013 are calculated in accordance with the new methodology, as explained in Note 3 m):

Summary of impairment allowances	31 December 2013 BAM '000	31 December 2012 BAM '000
Provisions for balance-sheet exposure (Agency)	**33,061**	30,113
Provisions for off-balance-sheet exposure (Agency)	**497**	701
	33,558	30,814
Negative difference between provisions for balance-sheet exposure (Agency) and impairment allowance in accordance with IFRS	**1,453**	1,286
	35,011	*32,100*
Impairment allowances under IFRS	**21,730**	20,415
Excess at period end	**13,281**	11,685

Prior to 2012, any increase in allowance in accordance with the Agency regulations over amounts recognised under IFRS were required to be transferred to regulatory reserves from profit or retained earnings, upon the decision of the General Assembly. However, as explained in Note 3m), based on the new Decision issued by the Agency in February 2013 any further shortfall in regulatory provisions will be adjusted as a deduction of regulatory capital in the capital adequacy calculation without any transfer of this shortfall from retained earnings to regulatory reserves for credit losses within equity. Accordingly, the approval of the owner is no longer necessary.

As presented in the above table, total Agency provisions exceeded provisions recognised under IFRS by BAM 13,281 thousand as at 31 December 2013 (31 December 2012: BAM 11,685 thousand). Out of this amount, BAM 8,057 thousand has been recognised as a regulatory reserve for credit losses within equity as at 31 December 2013 (31 December 2012: BAM 8,057 thousand). The remaining amount of BAM 5,224 thousand, which represents the current year shortfall, in line with the new Agency regulation, as explained above, will not be transferred to the regulatory reserves for credit losses, but will be recorded as a reduction of regulatory capital (31 December 2012: BAM 3,628 thousand, out of which BAM 2,721 thousand or ¾ recorded as a reduction of regulatory capital).

Notes to financial statements (continued)

6 Interest income

	2013 BAM '000	2012 BAM '000
Interest on loans to customers	9,650	11,187
Interest on placements with other banks	-	28
Interest on placements with Central Bank	10	6
Interest on loans to banks	6	16
	9,666	**11,237**

7 Interest expense

	2013 BAM '000	2012 BAM '000
Interest on borrowings and deposits	**114**	**75**

8 Fee and commission income

	2013 BAM '000	2012 BAM '000
Fee income from agency activities	1,271	1,127
Fee income from guarantees and letters of credit	176	305
Fees from other transactions	243	303
	1,690	**1,735**

9 Other operating income

	2013 BAM '000	2012 BAM '000
Donations	132	76
Foreign exchange trading gain, net	80	50
Other	277	39
	489	**165**

Notes to financial statements (continued)

10 Personnel expenses

	2013 BAM '000	2012 BAM '000
Net salaries	2,355	2,407
Taxes and cotributions	1,739	1,767
Other	1,281	1,324
	5,375	**5,498**

Personnel expenses include BAM 964 thousand (2012: BAM 979 thousand) of defined pension contributions paid into the State pension plan, Contributions are calculated as percentage of the gross salary paid. The average number of employees during the year ended 31 December 2013 and 31 December 2012 was 135 and 133 respectively.

11 Administrative expenses

	2013 BAM '000	2012 BAM '000
Advertising, representation and sponsorship	310	311
Membership fees and taxes	205	237
Telecommunication expenses	176	178
Energy costs	155	151
Supervisory and Audit committee fees	124	136
Services	118	138
Maintenace expenses	106	114
Material costs	102	101
Rent	69	90
Insurance	31	50
Bank fees	16	16
Other expenses	127	142
	1,539	**1,664**

Notes to financial statements (continued)

12 Impairment losses and provisions

	2013 BAM '000	2012 BAM '000
Loans to banks (Note 15)	(68)	(3)
Loans to customers (Note 16)	1,417	(508)
Other assets	(4)	2
Provisions for liabilities and charges (Note 20)	(10)	(72)
Other provisions (Note 20)	(102)	248
	1,233	**(333)**

13 Cash and current accounts with other banks

	31 December 2013 BAM '000	31 December 2012 BAM '000
Current accounts with other banks in foreign currencies	50,368	36,485
Giro accounts with the Central Bank	30,551	10,463
Cash in hand	37	33
	80,956	**46,981**

Cash and current accounts with other banks include funds for and on behalf of third parties (Note 24).

14 Obligatory reserve with the Central bank

	31 December 2013 BAM '000	31 December 2012 BAM '000
Obligatory reserve with the Central Bank of Bosnia and Herzegovina	**3,998**	**4,211**

The minimum obligatory reserve is calculated by applying 10% on short-term deposits as at 31 December 2013 (2012: 10%) and 7% (2012: 7%) on the ten-day average balance of the Bank's total long-term deposits and borrowings.

Interest rates earned with the Central bank on the obligatory reserve for the 2013 and 2012 were in range from 0.0040% to 0.1280% and from 0.004% to 0.08% respectively.

Notes to financial statements (continued)

15 Loans to banks

	31 December 2013 '000 KM	31 December 2012 '000 KM
Loans to banks	1,809	1,998
Less: Impairment allowance	(1,539)	(1,607)
Total net loans to banks	**270**	**391**

The movement in impairment allowance was as follows:

	31 December 2013 '000 KM	31 December 2012 '000 KM
Balance at the beginning of the year	1,607	1,610
Net changes in impairment allowance	(68)	(3)
Balance as at the year end	**1,539**	**1,607**

Loans to customers are presented including accrued interest in the amount of BAM 127 thousand (2012: BAM 127 thousand).

Notes to financial statements (continued)

16 Loans to customers

	31 December 2013 BAM '000	31 December 2012 BAM '000
Short-term loans		
Corporate	7,110	9,086
Individuals and crafts	-	11
Current portion of long-term loans	21,070	16,835
	28,180	25,932
Long-term loans (excluding current portion)		
Corporate	163,412	185,762
Individuals and crafts	2,664	2,894
	166,076	188,656
	194,256	**214,588**
Less: Impairment allowance	(19,890)	(18,493)
	174,366	**196,095**

Loans to customers are presented including interest due and accrued interest in the amount of BAM 884 thousand (31 December 2012: BAM 1,049 thousand), and net of deferred fees in the amount of BAM 951 thousand (31 December 2012: BAM 1,049 thousand).

The movement in impairment allowance was as follows:

	31 December 2013 BAM '000	31 December 2012 BAM '000
Balance at the beginning of the year	**18,493**	**19,023**
Net change in impairment allowances (Note 12)	1,417	(508)
Write-offs	(20)	(22)
Balance at the year end	**19,890**	**18,493**

Notes to financial statements (continued)

16 Loans to customers (continued)

Analysis of gross loans by industry is presented as follows:

Corporate loans	31 December 2013 BAM '000	31 December 2012 BAM '000
Manufacturing	82,270	87,148
Trade	26,671	22,971
Public administration and defense	21,725	29,019
Agriculture	21,395	22,556
Construction	14,260	18,875
Transportation, storage and telecommunication	7,376	9,648
Restaurants	3,702	3,638
Real estate and rental businesses	1,343	181
Financial services	-	96
Other	11,951	16,734
	190,693	**210,866**
Individuals and crafts		
General consumption	53	112
Housing loans	428	520
Crafts	3,082	3,090
	3,563	**3,722**
	194,256	**214,588**

Weighted-average interest rates as of 31 December 2013 and 31 December 2012 were as follows:

	31 December 2013 BAM '000	31 December 2012 BAM '000
Corporate	4.70%	4.69%
Individuals and crafts	4.11%	4.12%

Notes to financial statements (continued)

17 Property, equipment and intangible assets

	Buildings BAM '000	Vehicles BAM '000	Office Equipment BAM '000	Software BAM '000	Leasehold improve-ments BAM'000	Total BAM '000
Cost						
As at 31 December 2012	**7,375**	**557**	**1,963**	**622**	**15**	**10,532**
Additions	-	-	57	8	4	69
Disposals and write-offs	-	-	(31)	-	-	(31)
As at 31 December 2013	**7,375**	**557**	**1,989**	**630**	**19**	**10,570**
Accumulated depreciation/amortisation						
As at 31 December 2012	2,041	529	1,765	542	-	4,877
Charge for the year	221	10	88	26	2	347
Disposals and write-offs	-	-	(31)	-	-	(31)
As at 31 December 2013	**2,262**	**539**	**1,822**	**568**	**2**	**5,193**
Carrying Value						
As at 31 December 2012	**5,334**	**28**	**198**	**80**	**15**	**5,655**
As at 31 December 2013	**5,113**	**18**	**167**	**62**	**17**	**5,377**

Notes to financial statements (continued)

18 Current accounts and deposits from customers

Demand deposits	31 December 2013 BAM '000	31 December 2012 BAM '000
Private entities	7,402	3,399
Public entities	3,118	976
Governments	1,660	3,734
Individuals and crafts	52	50
Total demand deposits	**12,232**	**8,159**
Purpose deposits		
Individuals and crafts	1	1
Private entities	-	2
Public entities	423	-
Government of Tuzla Canton	9,819	9,629
Deposit from the Government of FBiH	367	-
Deposit from the Government of FBiH (guarantee deposit)	-	4,200
Federal Ministryof Development, Entrepreneurship and Craft	-	618
Federal Ministryof Environment and Tourism	-	472
Federal Ministry of Displaced persons and refugees	-	900
Total purpose deposits	**10,610**	**15,822**
Term deposits		
In domestic currency		
Federal Employment Agency	25,399	25,254
Deposit from the Government of FBiH (guarantee deposit)	5,500	-
Deposit from the Government of FBiH	5,000	-
Deposit from the Government of FBiH – Saudi fund	1,945	2,150
Private entities	115	123
In foreign currency		
Deposit from the Government of FBiH – EUR	231	231
Total term deposits	**38,190**	**27,758**
Total deposits	**61,032**	**51,739**

The Bank does not pay interest on demand deposits, purpose deposits and term deposits, except for a part of guarantee deposit by the government of FBiH in the amount of BAM 5,000 thousand (1% p.a.).

Notes to financial statements (continued)

19 Borrowings

	31 December 2013 '000 KM	31 December 2012 '000 KM
Government of the Federation of BiH – Saudi Fund loan for development, interest rate 2% p.a. with maturity date 31 August 2021	2,838	3,338
Government of Federation of BiH – Belgian merchandise loan, interest free with maturity date 31 December 2027	911	976
	3,749	**4,314**

In accordance with contracts signed between the Bank and the Government of the FBiH, the Bank has assumed obligation to redeem part of the borrowings as contacted between the Government and the creditors.

20 Provisions for liabilities and charges

	Provisions for off-balance-sheet items BAM '000	Provisions for employee benefits BAM '000	Total BAM '000
As at 1 January 2012	**382**	**422**	**804**
Increase/(decerease) in provisions (Note 12)	(72)	248	176
Reductions resulting from payments	-	(55)	(55)
As at 31 December 2012	**310**	**615**	**925**
Increase/(decerease) in provisions (Note 12)	(10)	(102)	(112)
Reductions resulting from payments	-	(68)	(68)
As at 31 December 2013	**300**	**445**	**745**

Notes to financial statements (continued)

20 Provisions for liabilities and charges (continued)

Commitments and contingencies (Off-balance sheet exposure) as at 31 December 2013 was as follows:

	31 December 2013 BAM '000	31 December 2012 BAM '000
Performance guarantees	16,581	12,968
Advance and payment guarantees	200	3,514
Undrawn lending commitments	711	3,142
	17,492	**19,624**

21 Other liabilities

	31 December 2013 BAM '000	31 December 2012 BAM '000
Agency liabilities (Note 24)	21,495	24,288
Deferred income	296	383
Liabilities toward suppliers	57	97
Accrued expenses	40	52
Funds provided based on decisions by the Government of FBiH	2,620	-
Accrued interest on deposits	19	-
Other liabilities	94	155
	24,621	**24,975**

22 Owner's capital

	%	31 December 2013 BAM '000	%	31 December 2012 BAM '000
Government of the Federation of Bosnia and Herzegovina	100	**153,000**	100	**153,000**

No payments into the capital structure of the Bank occurred throughout 2013.

Notes to financial statements (continued)

23 Related party transactions

Related parties are entities that directly or indirectly through one or more intermediaries control or are controlled by the Bank.

The majority of related parties' transactions are transactions with the Federation of BiH, the 100% owner of the Bank and with other companies and institutions owned by the Federation of BiH (over 51%).

Balances with related parties as at 31 December were as follows:

BAM '000	Type of relation	31 December 2013		31 December 2012	
		Exposure	Liabilities	Exposure	Liabilities
Federation of Bosnia and Herzegovina	Owner	14	27,363	13	35,183
Public institutions	Common owner	-	36,230	-	29,253
Companies in majority ownership of the Government of FBiH	Common owner	28,897	5,515	20,145	975
		28,911	**69,108**	**20,158**	**65,411**

'000 KM	Type of relation	31 December 2013		31 December 2012	
		Income	Expenses	Income	Expenses
Federation of Bosnia and Herzegovina	Owner	1,152	114	1,039	75
Public institutions	Common owner	119	-	88	-
Companies in majority ownership of the Government of FBiH	Common owner	2,089	1,417	1,810	311
		3,360	**1,531**	**2,937**	**386**

Remuneration of the Management and Supervisory Board

The remuneration of the members of the Management and Supervisory Board during the year ended 31 December

	2013	2012
	BAM '000	BAM '000
Gross salaries and other benefits	571	571
Other benefits	1	12
Fees to the members of the Supervisory Board	79	79
	651	**662**

Notes to financial statements (continued)

24 Funds managed for and on behalf of third parties

The Bank manages significant funds for and on behalf of the Government of the FBiH (Ministry of Finance, Ministry of Development, Entrepreneurship and Craft, Ministry of Agriculture, Water Management and Forestry, Ministry of Displaced Persons and Refugees, Ministry of Environment and Tourism and Ministry of Energy, Mining and Industry) with the purpose of financing reconstruction projects and Federal Employment Agency projects aimed at financing employment incentives and upkeep of employment. Those assets are held separately from other Bank assets. The bank calculates and charges a fee for those services in accordance with a contract signed with the provider of assets.

	31 December 2013	31 December 2012
PLACEMENTS	**BAM '000**	**BAM '000**
Funds placed per project:		
Water and gas supply	51,973	54,847
Healthcare and education	39,350	34,074
Agriculture	36,388	36,581
Manufacture and processing	30,527	14,384
Road construction and transport	19,883	20,592
Micro finance	11,962	15,379
Employment incentives	11,874	11,245
Forestry	369	369
Other	2,294	2,806
Total placed by projects:	*204,620*	*190,277*
Accrued interest and fees	11,832	11,639
Total	**216,452**	**201,916**
SOURCE OF FINANCING		
Government of the FBiH	213,192	201,543
Federal Employment Agency	12,830	12,939
Other	93	83
Total sources	*226,115*	*214,565*
Accrued interest and fees	11,832	11,639
Total	**237,947**	**226,204**
Current liabilities from funds managed for and on behalf of recognized in the balance sheet (Note 21)	**21,495**	**24,288**

The Bank does not bear the risk for these placements and charges a fee for its services.

Notes to financial statements (continued)

25 Financial risk management

The Bank's activities expose it to a variety of financial risks; credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate and other price risk.

The Management Board has overall responsibility for the establishment and oversight of the Bank's risk management framework.

Risk management is carried out by the Bank's departments in charge for individual risks under policies suggested by the Management Board, and approved by the Supervisory Board.

Risk steering and risk controlling processes are adjusted in a timely manner to reflect changes in the market environment.

This Note aims to provide information on Bank's exposure to all of the above stated risks, and its goals, policies and procedures aimed to measure and manage the risks, as well as to manage capital of the Bank.

25.1 Credit risk

The Bank is exposed to credit risk which is the risk that a counterparty will be unable to pay amounts in full when due.

The credit risk is the most significant risk which the Bank faces in the course of its operations, which is analyzed and monitored by individual loan and client, as well as in relation to the whole portfolio.

The Bank has adopted a policy on dealing only with creditworthy counterparties and obtaining sufficient collateral, where appropriate, as a means of mitigating the risk of financial loss from default.

The choice of appropriate securities of the credit exposures depends on:

- Creditworthiness of the client
- Risk of the financed project
- Estimated value of collateral.

With a view to minimising credit risk, the Bank applies the Decision on definition, evaluation and treatment of collateral for loan and potential placement security and secures its credit exposures by taking one or more of the following instruments:

- cash,
- bank and corporate guarantees,
- bills of exchange and unconditional guarantees, issued by the responsible authorities as defined in the Decision;
- mortgages over properties;
- pledges over business assets such as equipment, inventory and accounts receivable.

Notes to financial statements (continued)

25 Financial risk management (continued)

25.1 Credit risk (continued)

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

Credit Risk

	Maximum exposure			
	Net exposure	Commitments /guarantees issued	Total	Estimated value of collateral
31 December 2013				
Cash and cash equivalents	80,956	-	80,956	-
Obligatory reserve with the Central Bank	3,988	-	3,988	-
Loans to banks	270	-	270	-
Loans to customers	174,366	17,492	191,858	194,758
	259,580	**17,492**	**277,072**	**194,758**
31 December 2012				
Cash and cash equivalents	46,981	-	46,981	-
Obligatory reserve with the Central Bank	4,211	-	4,211	-
Loans to banks	391	-	391	-
Loans to customers	196,095	19,624	215,719	216,983
	247,678	**19,624**	**267,302**	**216,983**

For on-balance-sheet assets, the exposures set out above are based on gross carrying amounts. The above table represents a worst case scenario of credit risk exposure to the Bank as at 31 December 2013 and 31 December 2012, without taking into account any collateral held or other credit enhancements attached.

Collateral value estimates are based on assessments by chartered court surveyors at the time of loan approval, reduced by a haircut at certain fixed percentages. In order to verify the adequacy of the impairment allowance on a continuous basis, collateral reassessments are performed in accordance with the principles and rules of the collateral management system, taking into proper consideration the volatility of collateral value and the time needed for its realisation, influenced by the local and global economic trend.

Loans with renegotiated terms

During the year the Bank has renegotiated certain loans to customers in financial difficulties to maximise collection opportunities. Rescheduling is mainly performed in response to initial deterioration of the clients' financial position or for the prevention of further deterioration of the clients' financial position. Following the restructuring the loans remain graded as performing loans until there are clear signs of default. When possible the Bank is obtaining additional instruments of collateral.

Notes to financial statements (continued)

25 Financial risk management (continued)

25.1 Credit risk (continued)

The following table gives an overview of credit quality of financial assets and impairment losses of the Bank

BAM '000	Total gross carrying amount	Unimpaired assets	Impaired assets	Individual impairment allowance	Collective impairment allowance	Total net carrying amount
31 December 2013	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**
Cash and cash equivalents	80,956	80,955	1	-	-	80,956
Obligatory reserve with the Central Bank	3,988	3,988	-	-	-	3,988
Loans to banks	1,809	-	1,809	1,534	5	270
Loans to customers	194,256	5,494	188,762	14,730	5,160	174,366
	281,009	**90,437**	**190,572**	**16,264**	**5,165**	**259,580**
31 December 2012						
Cash and cash equivalents	46,981	46,981	-	-	-	46,981
Obligatory reserve with the Central Bank	4,211	4,211	-	-	-	4,211
Loans to banks	1,998	391	1,607	1,607	-	391
Loans to customers	214,588	99,428	115,160	15,657	2,836	196,095
	267,778	**151,011**	**116,767**	**17,264**	**2,836**	**247,678**

Loans by maturity

BAM '000	Total gross loan portfolio (Principal)	Not Due	Up tp 30 days	31 – 90 days	91 – 180 days	181 – 270 days	over 270 days
31 December 2013							
Corporate loans	192,502	170,924	901	637	1,185	2,791	16,064
Individuals and crafts	3,563	2,664	17	92	18	75	697
Total	**196,065**	**173,588**	**918**	**729**	**1,203**	**2,866**	**16,761**
31 December 2012							
Legal entities	212,863	193,778	2,058	445	605	627	15,350
Individuals and crafts	3,722	2,886	38	13	60	147	578
Total	**216,585**	**196,664**	**2,096**	**458**	**665**	**774**	**15,928**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.2 Liquidity risk

Liquidity risk arises in the funding of the Bank's activities and in the management of its positions. The Bank consolidates its operations in respect of liquidity risk in accordance with applicable decrees and internal policies aimed at maintenance of liquidity reserves, harmonisation of assets and liabilities with targeted liquidity indicators and liquidity limits.

The Bank has limited access to funding sources. Funds are raised through a limited number of instruments, including various types of deposits from the Government of the FBiH and Federal Employment Agency, deposits from legal entities as collateral in order to secure collection, borrowings and equity. This decreases the flexibility of funding sources, and increases dependence on payments of deposits and capital by the Government of the FBiH.

The Bank strives to maintain a balance between continuity of funding and flexibility through the use of liabilities with a range of maturities. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets. In addition, the Bank holds a portfolio of liquid assets as part of its liquidity risk management strategy.

The following tables show the remaining contractual maturities of the Bank's assets and liabilities:

Liquidity Risk

31 December 2013	Up to 1 month BAM '000	1 to 3 months BAM '000	3 months to 1 year BAM '000	1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
Assets						
Cash and cash equivalents	80,956	-	-	-	-	**80,956**
Obligatory reserve with the Central Bank	3,988	-	-	-	-	**3,988**
Loans to banks	9	19	84	158	-	**270**
Loans to customers	13,884	6,055	40,409	102,260	11,758	**174,366**
Other assets	99	-	-	-	-	**99**
Property, equipment and intangible assets	-	-	-	-	5,377	**5,377**
Total assets	**98,936**	**6,074**	**40,493**	**102,418**	**17,135**	**265,056**
Liabilities and equity						
Current accounts and deposits from customers	22,841	99	98	753	37,241	**61,032**
Borrowings	-	177	243	1,679	1,650	**3,749**
Provisions for liabilities and charges	311	2	36	99	297	**745**
Other liabilities	22,128	2,493	-	-	-	**24,621**
Owner's capital and reserves	-	-	-	-	174,909	**174,909**
Total liabilities and equity	**45,280**	**2,771**	**377**	**2,531**	**214,097**	**265,056**
Liquidity gap	**53,656**	**3,303**	**40,116**	**99,887**	**(196,962)**	**-**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.2 Liquidity risk (continued)

31 December 2012	Up to 1 month BAM '000	1 to 3 months BAM '000	3 months to 1 year BAM '000	1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
Assets						
Cash and cash equivalents	46,981	-	-	-	-	**46,981**
Obligatory reserve with the Central Bank	4,211	-	-	-	-	**4,211**
Loans to banks	10	20	86	275	-	**391**
Loans to customers	8,312	12,744	42,033	112,667	20,339	**196,095**
Other assets	292	-	-	-	-	**292**
Property, equipment and intangible assets	-	-	-	-	5,655	**5,655**
Total assets	**59,806**	**12,764**	**42,119**	**112,942**	**25,994**	**253,625**
Liabilities and equity						
Current accounts and deposits from customers	19,788	105	4,304	801	26,741	**51,739**
Borrowings	-	185	251	1,679	2,199	**4,314**
Provisions for liabilities and charges	310	1	197	105	312	**925**
Other liabilities	19,815	5,160	-	-	-	**24,975**
Owner's capital and reserves	-	-	-	-	171,672	**171,672**
Total liabilities and equity	**39,913**	**5,451**	**4,752**	**2,585**	**200,924**	**253,625**
Liquidity gap	**19,893**	**7,313**	**37,367**	**110,357**	**(174,930)**	**-**

25.3 Market risk

The Bank is exposed to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, foreign currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

The Management Board sets limits and guidelines for monitoring and mitigating of market risks, which is regularly monitored.

25.3.1 Foreign exchange risk

Exposure to currency risk arises from credit, deposit-taking and trading activities and is controlled on a daily basis in accordance with legal and internal limits for each currency, as well as in total amounts for assets and liabilities denominated in or linked to foreign currencies.

Treasury department is responsible for daily management of the Bank's currency position in accordance with legal and internal regulations.

Notes to financial statements (continued)

25 Financial risk management (continued)

25.3 Market risk (continued)

25.3.1 Foreign exchange risk (continued)

In order to manage foreign exchange rate risk more efficiently, Bank monitors economic and other business changes in the environment in order to predict possible changes in foreign currency activities, exchange rates, currencies and risk.

The following table summarizes the Bank's exposure to foreign currency exchange rate risk at 31 December 2013 and 31 December 2012. The tables include the Bank's assets and liabilities at carrying amounts categorized by currency.

31 December 2013

	BAM	EUR	USD	Other	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Assets					
Cash and cash equivalents	30,579	44,771	5,606	-	80,956
Obligatory reserve with the Central Bank	3,988	-	-	-	3,988
Loans to banks	270	-	-	-	270
Loans to customers	174,366	-	-	-	174,366
Other assets	98	1	-	-	99
Property, equipment and intangible assets	5,377	-	-	-	5,377
Total assets	**214,678**	**44,772**	**5,606**	**-**	**265,056**
Liabilities and equity					
Current accounts and deposits from customers	57,894	232	2,906	-	61,032
Borrowings	-	911	2,838	-	3,749
Provisions for liabilities and charges	745	-	-	-	745
Other liabilities	24,238	383	-	-	24,621
Owner's capital and reserves	174,909	-	-	-	174,909
Total liabilities and equity	**257,786**	**1,526**	**5,744**	**-**	**265,056**
Net foreign exchange position	**(43,108)**	**43,246**	**(138)**	**-**	**-**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.3 Market risk (continued)

25.3.1 Foreign exchange risk (continued)

31 December 2012

	BAM	EUR	USD	Other	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Assets					
Cash and cash equivalents	10,486	33,299	3,196	-	46,981
Obligatory reserve with the Central Bank	4,211	-	-	-	4,211
Loans to banks	391	-	-	-	391
Loans to customers	196,095	-	-	-	196,095
Other assets	291	1	-	-	292
Property, equipment and intangible assets	5,655	-	-	-	5,655
Total assets	**217,129**	**33,300**	**3,196**	**-**	**253,625**
Liabilities and equity					
Current accounts and deposits from customers	51,506	233	-	-	51,739
Borrowings	-	976	3,338	-	4,314
Provisions for liabilities and charges	925	-	-	-	925
Other liabilities	18,615	6,360	-	-	24,975
Owner's capital and reserves	171,672	-	-	-	171,672
Total liabilities and equity	**242,718**	**7,569**	**3,338**	**-**	**253,625**
Net foreign exchange position	**(25,589)**	**25,731**	**(142)**	**-**	**-**

Foreign currency sensitivity analysis

The Bank is mainly exposed to EUR and USD. Since Convertible Mark (BAM) is pegged to EUR, the Bank is not exposed to risk of change in the exchange rate of EUR.

The following table shows the Bank's sensitivity to a 10% increase and decrease in BAM against the USD. 10% is the sensitivity rate used for reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible changes in foreign exchange rates. The analysis includes only outstanding foreign currency denominated monetary items and represent an adjustment to their value at period end for an USD exchange rate movement of 10%. The sensitivity analysis includes external loans that are denominated in a currency other than the currency of the lender or the borrower. A positive number below indicates an increase in profit when BAM strengthens by 10% against the USD. For a 10% weakening of the BAM against the USD, there would be an equal but opposite impact on the profit.

	USD impact	
	31 December 2013	31 December 2012
Gain / (loss)	(14)	(14)

Notes to financial statements (continued)

26 Financial risk management (continued)

25.3 Market risk (continued)

25.3.2. Interest rate risk

The Bank's activities are affected by changes in interest rates in that interest bearing assets and liabilities mature, or their interest rates are changed, at different times or in different amounts.

The majority of loans and receivables to companies and individuals are initially contracted at fixed interest rates. These financial instruments are classified as instruments that bear fixed interest rates while the remaining are classified as financial instruments that bear a variable interest rate. The Bank does not pay any interest on current accounts and deposits from customers, except on a special purpose deposit form Government of the FBiH amounting to BAM 5,000 thousand (1%). The Supervisory Board decides on changes of interest rates upon the Management Board proposal.

Interest sensitivity of assets and liabilities

The tables below summarize the Bank's exposure to interest rate risks at year end. Included in the table are the Bank's assets and liabilities at carrying amounts, determined as the earlier of contractual repricing or maturity dates. Assets and liabilities on which interest rates are not applied are shown within "Non-interest bearing" category.

31 December 2013	Interest free BAM'000	Up to 1 month BAM'000	1 to 3 months BAM'000	3 months to 1 year BAM'000	1 to 5 years BAM'000	Over 5 years BAM'000	Total BAM'000	Amounts subject to fixed rates BAM'000
Assets								
Cash and cash equivalents	36	80,920	-	-	-	-	**80,956**	-
Obligatory reserve with the Central Bank	-	3,988	-	-	-	-	**3,988**	-
Loans to banks	-	9	19	84	158	-	**270**	270
Loans to customers	-	13,884	6,055	40,409	102,260	11,758	**174,366**	172,596
Other assets	99	-	-	-	-	-	**99**	-
Property, equipment and intangible assets	5,377	-	-	-	-	-	**5,377**	-
Total Assets	**5,512**	**98,801**	**6,074**	**40,493**	**102,418**	**11,758**	**266,056**	**172,866**
Liabilities and equity								
Current accounts and deposits from customers	56,032	-	-	-	-	5,000	**61,032**	5,000
Borrowings	911	-	177	178	1,419	1,064	**3,749**	2,838
Other liabilities	745	-	-	-	-	-	**745**	-
Provisions for liabilities and charges	24,621	-	-	-	-	-	**24,621**	-
Owner's capital and reserves	174,909	-	-	-	-	-	**174,909**	-
Total liabilities and equity	**257,218**	-	**177**	**178**	**1,419**	**6,064**	**256,056**	**7,838**
Interest rate gap	-	**98,801**	**5,897**	**40,315**	**100,999**	**5,694**	-	**165,028**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.3 Market risk (continued)

25.3.2. Interest rate risk (continued)

31 December 2012	Interest free BAM'000	Up to 1 month BAM'000	1 to 3 months BAM'000	3 months to 1 year BAM'000	1 to 5 years BAM'000	Over 5 years BAM'000	Total BAM'000	Amounts subject to fixed rates BAM'000
Assets								
Cash and cash equivalents	33	46,948	-	-	-	-	**46,981**	-
Obligatory reserve with the Central Bank	-	4,211	-	-	-	-	**4,211**	-
Loans to banks	-	10	20	86	275	-	**391**	391
Loans to customers	-	8,312	12,744	42,033	112,667	20,339	**196,095**	194,736
Other assets	292	-	-	-	-	-	**292**	-
Property, equipment and intangible assets	5,655	-	-	-	-	-	**5,655**	-
Total Assets	**5,980**	**59,481**	**12,764**	**42,119**	**112,942**	**20,339**	**253,625**	**195,127**
Liabilities and equity								
Current accounts and deposits from customers	51,739	-	-	-	-	-	**51,739**	-
Borrowings	976	-	185	185	1,484	1,484	**4,314**	3,338
Other liabilities	925	-	-	-	-	-	**925**	-
Provisions for liabilities and charges	24,975	-	-	-	-	-	**24,975**	-
Owner's capital and reserves	171,672	-	-	-	-	-	**171,672**	-
Total liabilities and equity	**250,287**	**-**	**185**	**185**	**1,484**	**1,484**	**253,625**	**3,338**
Interest rate gap	**-**	**59,481**	**12,579**	**41,934**	**111,458**	**18,855**	**-**	**191,789**

Notes to financial statements (continued)

25 Financial risk management (continued)

25.5 Fair values of financial assets and liabilities

The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access. Where available, fair value is measured using the quoted price in an active market. However, no readily available market prices exist for a significant portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing techniques as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates may not be realisable in a current sale of the financial instrument, in particular considering in view of the impact of the global financial crisis and lack of liquid market in Bosnia and Herzegovina.

Cash and cash equivalents

The carrying values of cash and balances with banks are generally deemed to approximate their fair value.

Loans to customers

Considering the specificity of the Bank, a large part of its portfolio of loans carries fixed interest rates and longer-term maturity whereby interest rates are below market rates. It is not practicable to calculate fair value of loans to customers.

Customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. It is not practicable to calculate fair value of deposits with fixed maturity.

Borrowings

Borrowings are either non-interest bearing or with fixed interest rate. The fair value of borrowings at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality. It is not practicable to calculate fair value of borrowings.

25.6 Capital management

The Bank's objectives for capital management, which is a broader concept, in the opinion of the Management Board, than the 'equity' shown in the statement of financial position, are as follows:

- to comply with the capital requirements set by the regulators of the banking markets in the local environment;
- to maintain a strong capital position to support the development of its business activities.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management, employing techniques based on the guidelines developed by Banking Agency of Federation of Bosnia and Herzegovina for supervisory purposes.

As of 31 December 2013 the Bank was in compliance with all regulatory capital requirements and according to the local regulations had a capital adequacy ratio of 85.3% (2012: 73.9%).

The Bank's regulatory capital for monitoring adequacy according to the Agency's methodology consists of:

- Tier 1 Capital or Core Capital: share capital (net of the carrying value of treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; unrealised gains/losses arising on the fair valuation of financial assets available for sale;
- Tier 2 Capital or Supplementary Capital: qualifying principal amounts of subordinated loan capital, collective impairment allowances and audited profit for the current period; and
- Deductible items.

Notes to financial statements (continued)

25 Financial risk management (continued)

25.6 Capital management

	2013 BAM '000	2012 BAM '000
Tier 1 capital		
Share capital	**153,000**	153,000
Reserves	**10,615**	4,730
Intangible assets	**(62)**	(80)
Total Tier 1 capital	**163,553**	157,650
Tier 2 capital		
General provision - Agency regulations	**2,094**	2,284
Audited profit for the year	**3,237**	5,885
Total Tier 2 capital	**5,331**	8,169
Adjustment for shortfall in regulatory reserve	**(5,224)**	(2,721)
Net Capital	**163,660**	163,098
Risk Weighted Assets (unaudited)	**174,205**	201,907
Other weighted Assets (unaudited)	**17,651**	18,867
Total weighted risk	**191,856**	220,774
Capital adequacy ratio (%)	**85,3%**	73,9%