ProCredit Bank
Serbia


Annual Report 2011

Key Figures

	EUR '000 2011	EUR '000 2010	RSD '000 2011	RSD '000 2010	Change RSD
Balance Sheet Data					
Total Assets	578,644	672,080	60,549,850	70,903,253	-14.6%
Gross Loan Portfolio	475,137	460,794	49,718,806	48,612,889	2.3%
Business Loan Portfolio	281,189	263,376	29,423,900	27,785,657	5.9%
EUR < 10,000	63,368	68,383	6,630,916	7,214,247	-8.1%
EUR > 10,000 < 30,000	94,217	63,127	9,858,964	6,659,830	48.0%
EUR > 30,000 < 150,000	51,360	72,192	5,374,358	7,616,109	-29.4%
EUR > 150,000	72,244	59,674	7,559,662	6,295,472	20.1%
Agricultural Loan Portfolio	121,839	113,646	12,749,373	11,989,482	6.3%
Housing Improvement Loan Portfolio	19,055	39,138	1,993,925	4,129,017	-51.7%
Other	53,054	44,633	5,551,607	4,708,733	17.9%
Loan Loss Provisions	-19,923	-15,512	-2,084,798	-1,636,533	27.4%
Net Loan Portfolio	455,214	445,281	47,634,008	46,976,356	1.4%
Customer Deposits	278,409	351,975	29,132,940	37,132,726	-21.5%
Liabilities to Banks and Financial Institutions (excluding PCH)	190,430	231,593	19,926,725	24,432,607	-18.4%
Total Equity	94,035	82,192	9,839,888	8,671,088	13.5%
Income Statement					
Operating Income	51,538	46,173	5,392,940	4,871,149	10.7%
Operating Expenses	35,288	41,374	3,692,602	4,364,887	-15.4%
Operating Profit Before Tax	16,249	4,799	1,700,338	506,261	235.9%
Net Profit	14,734	4,220	1,541,763	445,172	246.3%
Key Ratios					
Cost/Income Ratio	62.2%	74.4%			
Return on Equity	16.7%	5.2%			
Capital Ratio	18.3%	17.3%			
Operational Statistics					
Number of Clients	200,990	227,263			-11.6%
of which Business Clients	81,911	91,404			-10.4%
Number of Loans Outstanding	79,212	85,889			-7.8%
Number of Deposit Accounts	282,248	329,216			-14.3%
Number of Staff	1,315	1,299			1.2%
Number of Branches and Outlets	62	57			8.8%

Exchange rate as of December 31:
2011: EUR 1 = RSD 104.6409
2010: EUR 1 = RSD 105.4982

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Mission Statement

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

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

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

Letter from the Board of Directors

The year 2011 marked the completion of ProCredit Bank's first decade of operations in Serbia, and its steadfast and unremitting support to the country's very small, small and medium enterprises, its entrepreneurs and its agricultural sector. This continuous effort is clearly appreciated by our customers, who – according to surveys conducted early in the year – see the bank as a professional, stable and reliable partner. The initiatives launched in 2010 to shape a solid base for the future continued in 2011, yielding financial and operational results well above the sector averages in terms of return on equity and portfolio at risk in a market hampered by the spill-over effects of the economic crisis.

ProCredit Bank maintained its market share in its key segments, with a moderate rise in lending to business clients. The gross loan portfolio grew by 2% to RSD 54.8 billion (EUR 523.8 million) including leasing and cross-border loans, while sound risk policies assured very high portfolio quality, with average PAR>90 days standing at 3.13%, compared to a sector average of 14.8%. A net profit of RSD 1.5 billion (EUR 14.7 million), up from RSD 445.2 million (EUR 4.2 million) in 2010, translated into a 16.66% return on equity, which was among the sector's highest in 2011. Capital adequacy remained high at 18.31%, well above the local requirement of 12%.

The previous years' efforts to enhance business processes have raised efficiency in all areas and led to greater client satisfaction. In addition to improving the mix and range of services, a special focus was placed on developing and improving our electronic banking services and encouraging people to use them. The bank continued to develop its range of loans for improving energy efficiency, for both businesses and private clients. The loan portfolio is subject to continuous assessment according to environmental criteria, and the bank has designated an Environmental Co-ordinator to be responsible for monitoring environmental performance, and co-ordinating efforts to improve it.

The bank maintained its policy of promoting savings and building long-term relationships with its customers, focusing on ordinary depositors who value service quality, transparency and stability.

To ensure that this culture of responsible banking will continue to thrive in years to come, ProCredit Bank has established the Young Bankers Programme. This six-month course offers a unique opportunity for people embarking on a career in banking to discover whether the ProCredit way of doing business is right for them. Two generations completed the course in 2011, and most of them are already fully integrated into teams in branches and the head office.

ProCredit Bank now accounts for nearly a quarter of all loans disbursed to entrepreneurs in Serbia, and close to half the total number and volume of loans to agricultural producers. Having created a sound base in its core client groups, the bank has become an integral part of their everyday operations.

While maintaining our role as the "house bank" for companies, entrepreneurs and agricultural producers, we will respond to the financial needs of private households by continuing to develop services that help improve their living conditions, and by promoting the importance of saving. We will also focus on maximising the efficiency and convenience of our transaction services, especially through the appropriate use of innovative technology. The changes implemented in response to organisational needs, as well as to Basel II and local regulations, put the bank in a favourable position to achieve these goals.

On behalf of the Board of Directors, I would like to thank our shareholders for their unfailing support. My sincere gratitude also goes to the bank's employees and managers for the commitment they have shown to our mission, and the efforts they have made to achieve it. Without their dedication we would not have been able to present such an encouraging report.

Borislav Kostadinov
Chairman of the Board of Directors
ProCredit Bank a.d.

Members of the Board of Directors as of December 31, 2011:
Borislav Kostadinov (chairman)
Goran Živkov
Stephan Boven
Dr. Klaus Glaubitt
Rainer Ottenstein

Members of the Executive Board as of December 31, 2011:
Svetlana Tolmacheva
Dejan Janjatović
Dragana Tanasić
Igor Anić

The Bank and its Shareholders

ProCredit Bank Serbia is a member of the ProCredit group, which is led by its Frankfurt-based parent company, ProCredit Holding. ProCredit Holding is the majority owner of ProCredit Bank Serbia and holds 83.3% of the shares.

ProCredit Bank Serbia was founded in April 2001 as Micro Finance Bank by an alliance of international development-oriented investors, many of which are shareholders in ProCredit Holding today. Their goal was to establish a new kind of financial institution that would meet the demand of small and very small businesses in a socially responsible way. The primary aim was not short-term profit maximisation but rather to deepen the financial sector and contribute to long-term economic development while also achieving a sustainable return on investment.

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

Today's shareholder structure of ProCredit Bank Serbia is outlined below. Its current share capital is EUR 61.5 million.

		PCH	CoBa
Share		83.33%	16.67%
Subscribed capital EUR	35,005,547.54	29,171,289.62	5,834,257.92
Capital reserve EUR	26,535,945.36	22,114,519.10	4,421,426.26
Total EUR	**61,541,492.90**	**51,285,808.72**	**10,255,684.19**

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

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

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

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

The legal form of ProCredit Holding is a so-called KGaA (Kommanditgesellschaft auf Aktien, or in English a partnership limited by shares). This is a legal form not uncommonly used in Germany which can basically be regarded as a joint stock company in which the role of the management board is assumed by a General Partner, and in which the General Partner has consent rights over certain key shareholder decisions. In the case of ProCredit Holding, the General Partner is

a small separate company which is owned by the core shareholders of ProCredit Holding AG & Co. KGaA: IPC, IPC Invest, DOEN, KfW and IFC. The KGaA structure will allow ProCredit Holding to raise capital in the future without unduly diluting the influence of core shareholders in ensuring the group maintains dual goals: development impact and commercial success.

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

COMMERZBANK

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

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

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

Special Feature

Young Bankers Programme

Because strong employees are the key to enabling clients to gain the full benefit from the bank's services, ProCredit Bank pays particular attention to staff development. To further strengthen its employees and groom potential newcomers to the bank, ProCredit Bank Serbia launched the "Young Bankers Programme" in the second half of 2010. This ambitious six-month course initiated by ProCredit Holding is geared towards individuals with recent university degrees in appropriate subjects or with relevant professional qualifications, as well as towards currently employed professionals who share the bank's values and principles of responsible finance. The programme is a prime example of the ProCredit group's commitment to social responsibility with respect to education and professional development in the Serbian market.

Programme participants attend lectures and receive practical training in economics, banking, maths, accounting, communications as well as analytical and creative thinking skills. These topics are reinforced with numerous projects and tasks that allow the "young bankers" to develop their skills both as individuals and as team members. Through debates on various topics, some of which are not directly related to banking, participants develop their ability to recognise, understand and defend different views and values. These exercises provide valuable opportunities to cultivate openness to new ideas as well as to think critically.

Upon completion of the first half of the programme, participants receive practical training in various positions in ProCredit Bank branches throughout

Serbia. Working directly with bank staff and clients, programme members apply the knowledge and skills they acquired in the classroom.

During the course, all accommodations and meals are provided, so that participants can devote their full attention to learning and developing skills. While programme graduates are not obligated to become ProCredit employees, outstanding individuals who demonstrate the willingness and ability to apply our values in everyday practice are generally offered the possibility of permanent employment.

By the end of 2011, two generations of Young Bankers had completed the programme in Serbia, and 27 of them are now employed in the bank's branches and head office. Mirjana Mitrovic, who was among the first crop of graduates, today works in the marketing department at ProCredit Holding.

"Employment itself is not the final goal of the Young Bankers Programme; it is only the beginning of a continuous learning and development process, which is implemented consistently within ProCredit Bank. It enables employees to fully develop their business skills and knowledge, as well as to recognise the bank's social role, and to accept, adopt and enrich it,"
Mirjana says.

In that context, the Young Bankers Programme represents a truly unique avenue of professional development for individuals who embrace and wish to put into practice ProCredit's responsible approach to banking.

Management Business Review

Management
from left to right:

Igor Anić
Member of the Executive Board

Svetlana Tolmačeva
Chairperson of the Executive Board

Dejan Janjatović
Member of the Executive Board

Dragana Tanasić
Member of the Executive Board

Political and Economic Environment

Major progress towards EU accession was made in 2011, and in October the European Commission recommended Serbia for formal candidate status; however, in December, Serbia's candidacy was delayed until March 2012, by which time the dialogue with Pristina is expected to have moved forward. The Council noted[1] that "Serbia has considerably progressed towards fulfilling the political criteria related to the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, as well as that Serbia has a comprehensive constitutional, legislative and institutional framework which overall corresponds to European standards". The Stabilisation and Association Agreement between the EU and Serbia was ratified by 23 of the EU's 27 member countries[2].

In 2011 Serbia took important steps towards a functional market economy and macroeconomic stability, despite the global economic and financial crisis. In September the IMF approved[3] an 18-month Stand-By Arrangement for an amount equivalent to EUR 1.1 billion, and Serbia successfully issued USD 1 billion of 10-year Eurobonds with a 7.25% coupon. The biggest challenge remains the current account deficit, which reflects the lack of external competitiveness. In response to this problem the Serbian government has been developing a new export-oriented economic model, resulting in an improvement in the export-import ratio[4] by 1.9% compared to last year.

According to a flash estimate by the National Bank of Serbia (NBS), GDP grew by 2%[5] in 2011, driven by rising investment, while the contribution of net exports and final consumption was negative. From January to November 2011 compared to the same period in the previous year, industrial production[6] increased by 2.1% and FDI[7] doubled to USD 1.75 billion. In 2011 inflationary pressure increased due to higher food and energy prices and exchange rate depreciation. Annual inflation was running at 14.7% in April but had declined to 7% by December, approaching the central bank's target band of 4% +/-2%. In the first half of 2011, the NBS raised the REPO rate[8] by 0.5% to 12.5% in order to mitigate inflationary pressures; later, as these pressures diminished, the REPO was decreased to 9.75% in stages between June and December.

After rising 5.4% against the euro in the first half of 2011, mainly due to capital inflows from portfolio investment, the dinar was relatively stable between July and October, when daily fluctuations of up to 1% occurred, reflecting increased uncertainty caused by the eurozone crisis. Although fluctuations in the inflow of FDI and the seasonal increase in corporate demand for foreign currencies led to a decline of 3.4% in the last quarter, the dinar finished the year 0.8%[9] stronger.

Financial Sector Developments

In 2011, the number of banks in the Serbian banking sector remained stable at 33; however, many signs of continued optimisation in the sector were observed, including reductions in the size of branch networks and the associated 2.2% decrease in employee numbers.

The sector's total assets increased slightly, by about 0.2% (in real terms by 4.6%) compared to the end of 2010. This stability is due to the release of previously mandatory reserve funds made possible by regulatory easing. Concentration in the sector is still high, as more than 30% of total assets are held by the top three banks.

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1 http://ec.europa.eu/enlargement/pdf/key_documents/2011/package/sr_conclusions_2011_en.pdf
2 http://www.b92.net/eng/news/politics-article.php?yyyy=2011&mm=11&dd=24&nav_id=77470
3 http://www.imf.org/external/np/sec/pr/2011/pr11353.htm
4 http://webrzs.stat.gov.rs/WebSite/public/PublicationView.aspx?pKey=41&pLevel=1&pubType=2&pubKey=915
5 http://www.nbs.rs/internet/english/15/konferencije_guvernera/attachment/20120123_DS_presentation.pdf
6 http://webrzs.stat.gov.rs/WebSite/public/PublicationView.aspx?pKey=41&pLevel=1&pubType=2&pubKey=918
7 http://www.emportal.rs/en/news/serbia/170516.html
8 http://www.nbs.rs/export/sites/default/internet/english/30/30_4/30_4_5/historical_data.pdf
9 http://www.nbs.rs/internet/english/15/konferencije_guvernera/attachment/20111212_DS_presentation.pdf

Total net loans amounted to RSD 1.672 billion (EUR 16.0 billion) which represents a rise of EUR 1,5 billion or 8.93% compared to the end of the previous year. However, the lending structure has not changed significantly with business loans making up 51.3% of the total (EUR 8.2 billion), and household loans with a share of 31% (EUR 5.0 billion). The currency composition of loans was still in favour of euro-dominated loans, which made up more than 57% of the total.

Customer deposits remained the most important funding source for the bank's activities, contributing 58%. Household deposits rose by 7.51% and with a volume of RSD 837.8 billion (EUR 8.0 billion) made up more than 50% of the total; corporate deposits had a share of 27.2%. The majority (more than 70%) of deposits were short-term and denominated in foreign currencies.

The negative trend in loan portfolio quality continued and non-performing loans (NPLs) reached 19.0% of the total portfolio, or RSD 342 billion (EUR 3.3 billion), compared to 16.9% or RSD 273 billion (EUR 2.6 billion) in the previous year. The increase in NPLs to businesses was the key driver for the deterioration of this indicator; these accounted for 65.2% of total NPLs or RSD 223.3 billion (EUR 2.1 billion), followed by private household NPLs (RSD 42.2 billion / EUR 0.4 billion) with 12.3%.

Sector capitalisation was still high, with a capital adequacy ratio above 19.1%; however, full implementation of Basel II forced some banks to bolster their capital base. The sector's liquidity was satisfactory, with a loan to deposit ratio of 127%.

In 2011, the final pre-tax profit for the Serbian banking sector as a whole was RSD 1.3 billion (EUR 12.4 million), only 5% of the total profit achieved in the previous year. Although profitable banks posted significantly improved results, with an increase of approximately 60%, primarily due to the steady growth in net interest income, one bank reported a loss of RSD 29.7 billion (EUR 284 million), and this was the main factor behind the sector's lower overall profitability.

ProCredit Performance

In the year under review, in spite of spill over effects from the financial crisis such as insolvency, reduced turnovers and stagnating economic activity, ProCredit Bank maintained its market share in its key segments.

By satisfying clients' needs for liquidity and acknowledging their long-term development potential, the bank achieved a moderate rise in lending volume to very small, small and medium-sized enterprises. A number of ProCredit Bank's business clients were also selected to participate in the European Investment Bank's Apex Programme, which is primarily intended for financing SME projects in the fields of energy, environmental protection, industry, health and education, and services. Our leading position as a provider of financial support to agricultural producers was reaffirmed in 2011, and the range of services offered to this customer category was expanded, helping to simplify their day-to-day banking transactions and thus enable us to strengthen our relationships with them.

Recognising the most important financial needs of private households, the bank improved its comprehensive mix of services, including short- and long-term investments that help improve living conditions – with a focus on energy-efficiency loans, but also offering various other services combined into account packages.

Although during the year some of the most expensive and most price-sensitive deposits were withdrawn, savings still represent one of the most important funding sources for the bank, which demonstrates that the majority of clients recognise ProCredit Bank's stability and appreciate the quality of customer service and the professionalism of our staff.

All improvements and efforts made in previous years to enhance business processes have resulted in efficiency increases in all areas and led to greater client satisfaction. We have a special focus on developing, improving and encouraging the use of internet banking under the "eBankar" brand – a range of services with various functionalities now available to all customers around the clock. In addition, the improvement of online connections with POS terminals and the implementation of the

highest payment card security standards, certified by Visa and MasterCard, mean not only a much better service quality for our customers, but also significantly lower card-payment risks. Additional benefits, both for customers and the bank, are expected to be achieved through further advances in new technologies and the development of new service channels.

The bank is well capitalised and it is in compliance with all local regulatory and Basel II requirements; moreover, strong shareholder support is available at any time if necessary.

Our focus on providing high-quality service, maintaining an optimal mix of investments accompanied by efficiency enhancements and successfully keeping abreast of changes in market conditions, resulted in our return on equity being among the sector's highest in 2011.

Lending

Despite the difficulties experienced by the Serbian economy in maintaining the planned pace of GDP growth, many of our customers successfully adjusted to the new market conditions. To do so, they needed short and medium-term loan facilities for liquidity and working capital. Liquidity pressure during 2011 was also the main reason for increased demand for the restructuring of loans.

There was some demand for long-term investments, but most projects were postponed in the hope that market conditions will improve.

ProCredit Bank succeeded in strengthening relationships with existing customers, and also established productive relationships with new customers identified as stable businesses with development potential. While overall credit placements to companies and entrepreneurs in Serbia declined by 1.58%[10] between January and November 2011, ProCredit Bank's loan portfolio grew by 3.2% to RSD 53.3[11] billion (EUR 509.1 million), spread across nearly 83,000 loans. The bank disbursed over 40,040 new loans with a combined volume of roughly RSD 38.5 billion (EUR 368.3 million), while the average loan amount grew from RSD 762,623 (EUR 7,288) in 2010 to RSD 962,487 (EUR 9,198) in 2011. ProCredit Bank's market share increased slightly from 1.62% to 1.67% in the same period.

Loans to business clients accounted for 75.6% of all loans in 2011, representing 65.5% of the year-end portfolio, amounting to RSD 29.2 billion (EUR 279.3 million). Very small loans, for amounts up to EUR 30,000, made up 33.2% of all disbursed business loans, totalling RSD 9.7 billion (EUR 92.7 million). Small loans, EUR 30,001 to EUR 150,000, constituted 30% of disbursements, with a total amount of RSD 8.8 billion (EUR 83.9 million). Medium-sized loans, above EUR 150,000, accounted for 36.8% or RSD 10.7 billion (EUR 102.7 million). The bank remained active in the Ministry of the Economy's subsidised lending programme. During the peak of the 2011 programme between February and May, ProCredit Bank disbursed 2,603 of these loans with a total volume of RSD 8.2 billion (EUR 78.1 million).

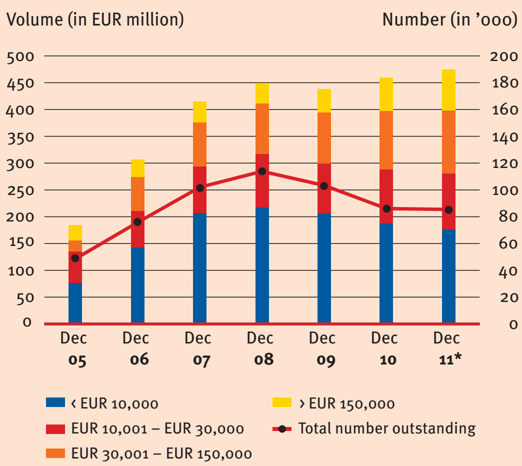
Agriculture remains a vital sector of the Serbian economy, accounting for 10.6% of GDP in 2011.[12] To support it, in 2011 the bank disbursed approximately 10,600 loans worth a total of RSD 7.0 billion (EUR 66.9 million). The agricultural side of the bank's portfolio grew by 4.6% to RSD 12.3 billion (EUR 117.5 million), strengthening the bank's position as market leader with 48.9% of the aggregate outstanding volume of agricultural loans.

In 2011, the bank disbursed 1,012 home improvement loans to private clients; with RSD 5 billion (EUR 47.8 million) still outstanding, this represents 9.3% of the overall portfolio.

During the year a total of 114 energy-efficiency loans amounting to RSD 605 million (EUR 5.8 million) were disbursed across all loan categories.

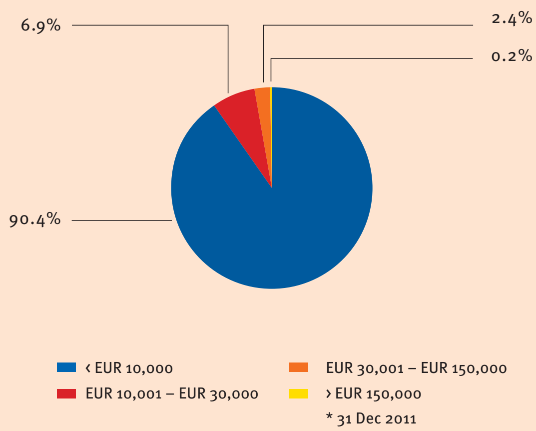
[10] National Bank of Serbia and Credit bureau
[11] 1 EUR = 104.6409 RSD on 31.12.2011
[12] Chamber of Commerce of the Republic of Serbia

Loan Portfolio Development



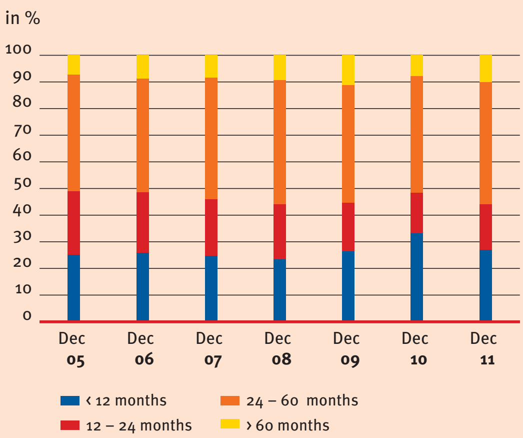
* Starting from 2011 the method of calculation for size categories has been changed

Number of Loans Outstanding – Breakdown by Loan Size*

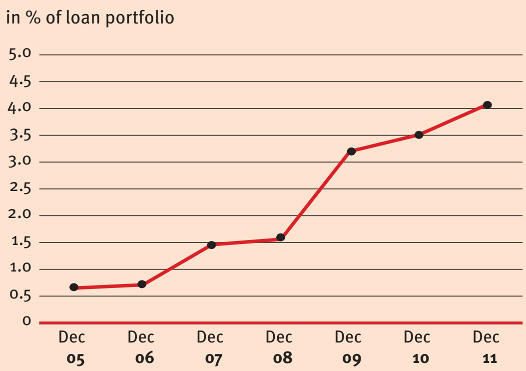


Starting from 2011 the method of calculation for size categories has been changed: breakdown by initial loan amount

Business Loan Portfolio – Breakdown by Maturity



Loan Portfolio Quality (arrears ›30 days)



Net write-offs: in 2007: EUR 2,169,502; in 2008: EUR 4,812,045; in 2009: EUR 2,674,104; in 2010: EUR 9,572,553; in 2011: EUR 848,968

To meet clients' needs for additional support, ProCredit Bank issued 1,865 financial documents (letters of guarantee, letters of credit, etc.) in 2011 amounting to RSD 5,8 billion (EUR 55.7 million).

During 2011 loan portfolio quality remained very good, with average PAR › 90 standing at 2.94%, compared to thesector average of 15.06%[13].

Deposits and Other Banking Services

ProCredit Bank's policy of promoting savings and building long-term relationships with its customers yielded results in 2011 which confirmed that it is not essential to offer high interest rates and conduct aggressive marketing campaigns in order to attract deposits. Our focus has remained on ordinary people, who value service quality, transparency, trust and confidence.

The best evidence of this was the traditional "Savings Month" with most of the banks in the market giving special offers to attract savers. During November, ProCredit Bank succeeded in keeping private customers' deposits completely stable, despite the other banks' aggressive marketing tactics and the increased interest rates available in the market.

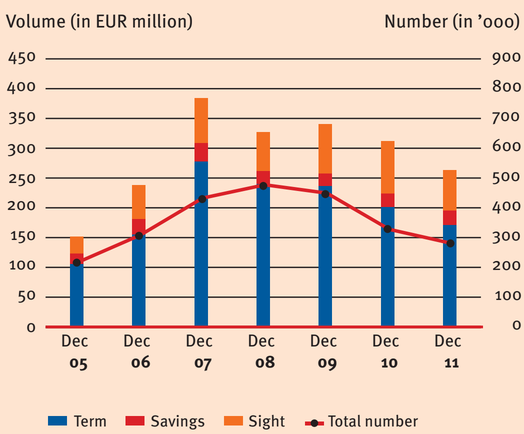
Over the year our total deposits decreased by 21.5% to RSD 29.1 billion (EUR 278 million), mostly due to the release of large institutional deposits. Business clients' deposits decreased by 28.2% to RSD 10.6 billion (EUR 101 million) while private clients' deposits decreased by 6.03% to RSD 16.9 billion (EUR 161 million). The total number of accounts remained stable with a decrease of only 2.0% (400,000); however, the average account balance was affected by withdrawals of very large price-sensitive deposits, and decreased from RSD 80,000 (EUR 762) to RSD 69,000 (EUR 656).

With regard to our other banking services, 2011 was the year of "eBankar", a range of electronic banking services available 24/7. With completely new e-Banking applications for both business and private clients, and the introduction of mobile banking and text message (SMS) notifications, we became one of the market leaders in providing efficient, fast and easy-to-use banking services. The installation of nine new ATMs increased our network to 160.

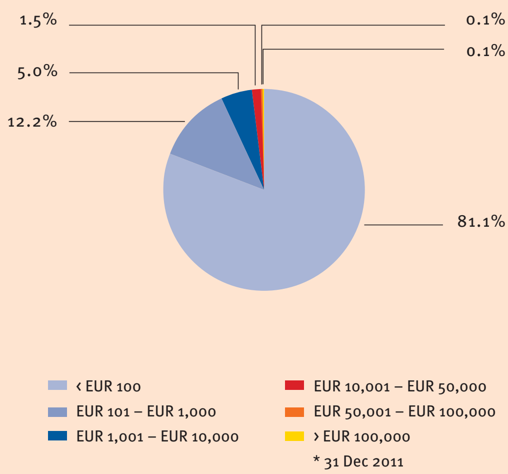
In 2011, we continued our policy of terminating inactive payment cards, which resulted in closing the year with 46,000 cards (a decrease by 20.7% year-on-year), 57.2% of which were being used at least once a month.

[13] National Bank of Serbia and Credit bureau

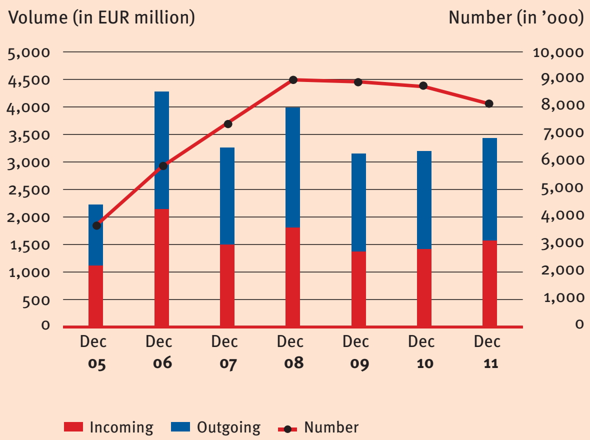
Customer Deposits



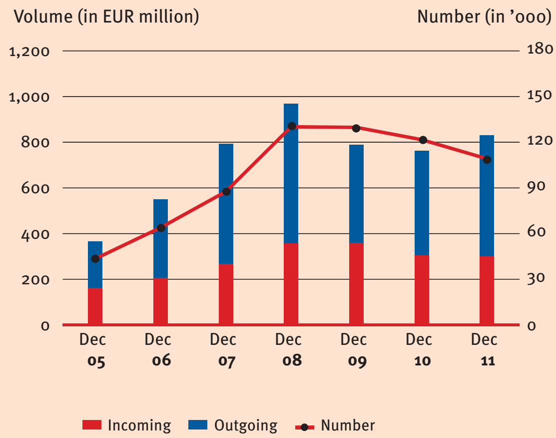
Number of Customer Deposits – Breakdown by Size*



Domestic Money Transfers



International Money Transfers



On the money transfer side, the bank performed domestic transfers totalling RSD 409 billion (EUR 3.9 billion), an decrease of 3.76%. The volume of international transfers increased by 15.4%, reaching RSD 55.6 billion (EUR 531 million).

Financial Results

The year 2011 brought many important changes, starting with a substantial decrease in the mandatory reserve requirements. This caused ProCredit Bank's total assets to decrease by 14.6% to RSD 60.6 billion (EUR 578.6 million), and also decreased the proportion of liquid assets to total assets (from 30.7% to 17.5%) meaning that more funds could be channelled into our core business. The gross loan portfolio, including cross-border loans, grew to RSD 54.8 billion (EUR 523.8 million) at year-end, an increase of 2% compared to 2010. The bank maintained its conservative provisioning policy. Thus, although portfolio quality remained stable, loan-loss provisions increased by 27.4% during 2011 to RSD 2.1 billion (EUR 19.9 million).

With regard to liabilities, the bank continued the optimisation of its funding structure and focused on attracting depositors who place particular value on long-term banking relationships. Total customer deposits at year-end stood at RSD 29.1 billion (EUR 278.4 million). The deposit base accounted for 57.5% of total liabilities and was equivalent to 53.2% of the gross loan portfolio at year-end.

The bank's external funding amounted to RSD 19.6 billion (EUR 187.7 million) which represents a decrease compared to last year, mainly due to the release of previously mandatory reserves and higher utilisation of funds already drawn. The bank drew down one new KfW credit line for energy efficiency and signed new loan agreements with EBRD, EIB and NBS, as an agent for EIB funds

through the APEX programme. Moreover, the bank signed an agreement with ProCredit Holding and drew down additional subordinated debt in order to strengthen its capital base.

Total operating income for the year was RSD 5.6 billion (EUR 53.6 million), 85.9% of which came from net interest income. Compared to the previous year, interest income remained stable at RSD 7.3 billion (EUR 69.6 million). Interest expenses decreased by 10.1%, reflecting the success of the bank's efforts to access less expensive funding sources and the freeing up of formerly mandatory reserves.

Net fee and commission income, including the trading result, increased slightly to RSD 1.2 billion (EUR 11.9 million). The operating result before tax amounted to RSD 1.7 billion (EUR 16.2 million), a respectable 235.9% increase over the 2010 figure.

Operating expenses decreased by 10.5% to RSD 39 billion (EUR 37.3 million) compared to the previous year. This was the expected consequence of efforts put into increasing cost awareness among staff and various reorganisation measures. The cost-income ratio improved from 74.4% in 2010 to 62.2%.

The bank ended 2011 with a net profit of RSD 1.5 billion (EUR 14.7 million), an excellent achievement which was 246% higher than the previous year's result, producing a return on equity of 16.7%. Shareholders' equity remains the strong foundation on which the bank's stability rests and its capital adequacy remained high at 18.31%, well above the local requirement of 12%.

Outlook 2012

The expected slowdown in the global economy and especially in the eurozone, reduced FDI and decreased external and internal demand are likely to be the main challenges for the Serbian economy in 2012. This might adversely impact industrial production and investments making GDP growth harder to predict; however, it is expected to range between 0.5% and 1.5%. Inflation is expected to stay within its targeted range of 4.5% +/- 1.5% until the end of 2012, partly due to central bank measures taken in 2010 and 2011, but also as a result of low inflationary pressure and the strong fiscal discipline imposed by the government and the conditions for the IMF standby arrangement.

The 4% budget deficit projected for 2012 indicates a positive fiscal outlook; however, since Serbia is holding elections this year it is possible that fiscal discipline might be strained. Structural reforms in all segments, primarily targeting the problems of unemployment and the structure of exports and industrial production in general, are expected to continue in 2012.

The Serbian banking sector is well capitalised, giving it a solid buffer against any further deterioration in asset quality. Many banks have tightened up their processes to comply with Basel II regulations, introducing stricter capital management, new procedures and more comprehensive risk management.

As ProCredit Bank has already implemented organisational and operational changes, it will be in a strong position to exploit market opportunities, within predefined risk limits. The strategy for 2012 is to increase our market share in the Small Business category by offering a wider range of services. The objective is to reaffirm our position as the leading bank for sustainable, environmentally-friendly, growing enterprises which contribute to the development of the Serbian economy. Moreover, we will continue to promote the importance of saving, emphasising the transparency, simplicity and security of our deposit services, while on the transaction side, our focus will be on efficiency, convenience and the appropriate use of innovative technology.

Risk Management

While ultimate responsibility for establishing and supervising the bank's risk management system lies with the Board of Directors, the Executive Board is responsible for identifying and measuring risks to which the bank is exposed in its business activities. The Risk Management Department and the organisational units that make up the Risk Division develop and implement mechanisms to identify, assess, and mitigate the bank's exposure to risk. Furthermore, these bodies report to the risk management committees, which are led by Executive Board members. The Credit Risk Committee closely monitors current and future exposure to credit risk; the Assets and Liabilities Committee (ALCO) manages the short-term and long-term liquidity position and also issues decisions on counterparty risk, country risk, interest rate risk, currency risk and the bank's risk-bearing capacity. The Operational Risk Committee manages exposures to operational risk and proposes measures to mitigate them, while information security issues are handled by a separate committee.

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

Risk management throughout the ProCredit group is based on the concept of "risk-bearing capacity", i.e. the principle that each bank's aggregated risk exposures must not exceed its capacity to bear risk, and that the resources available to cover risk are sufficient to absorb any losses that may arise and protect creditors' investments. Statistical models and other procedures are used to quantify the risks incurred, and targets are set for each risk category and a limit for the aggregate exposure. Starting from February 2011, the level of risk bearing capacity usage started to decrease, dropping in the second half of the year to below 30%, whereas the upper limit is 60%. The main factors that contributed to this positive development were a decrease in the level of arrears and the release of part of the mandatory reserve held with the National Bank of Serbia. The level of risk remained well within the predefined targets in every category.

ProCredit Bank's culture of internal and external transparency is crucial to our risk management efforts. Thanks to our clearly defined procedures

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

Credit Risk Management

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

ProCredit Bank Serbia has adopted credit risk policies based on the ProCredit Group Credit Risk Management Policy and the Group Collateral Valuation Policy, which together reflect the experience gained in more than two decades of successful lending operations in developing and transition economies and are in full compliance with Serbian regulations. For every single customer of the bank a credit exposure limit is set and credit decision-making authority is clearly defined; all decisions to issue a loan, or change its terms, are taken by a credit committee, and all credit risk assessments are carefully documented. Above all, the bank seeks to build and maintain long-term relationships with its customers, thus ensuring that it is fully aware of their financial situation, and great care is taken to avoid over-indebting them.

Credit risk is also mitigated by the fact that our portfolio is highly diversified. The businesses we serve operate in a wide range of sectors, and their exposure to global market fluctuations is limited. Moreover, the majority of our credit exposures are relatively small. As of end-2011, loans under EUR 30,000 accounted for 44.6% of the total outstanding portfolio, and the average amount outstanding was EUR 5530, while the ten largest exposures accounted for only 6.54% of the portfolio.

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

In 2011 the bank's overall PAR>30 rose from 3.44% at the start of the year to 4.11% at year-end which was in line with our expectations for arrears development in 2011. It should be noted that ProCredit Bank's PAR is much better than the average for the Serbian banking sector as a whole, where according to figures published by the Serbian Credit Bureau 14.8% of loans were non-performing at the end of October 2011, compared with the 3.13% share of non-performing loans in the portfolio of ProCredit Bank Serbia.

One of the ways in which ProCredit Bank has met the challenge to portfolio quality posed by the financial crisis is to offer loan restructuring to those clients that are judged to have the potential to regain stability. Restructurings follow a thorough analysis of each client's changed payment capacity. The decision to restructure a credit exposure is always taken by a credit committee and aims at full recovery. As of end-2011, the total volume of restructured loans in the "watch" category came to EUR 10.6 million.

ProCredit Bank Serbia takes a conservative approach to loan loss provisioning. Allowances for individually significant exposures with signs of impairment are set aside based on the results of an individual assessment of impairment, while provisioning for impaired loans that are not individually significant is calculated according to historical default rates. For all unimpaired credit exposures, portfolio-based allowances for impairment are made. At the end of the year the coverage ratio (loan loss provisions as a percentage of PAR>30) stood at 99.6%, and as a percentage of the total loan portfolio, provisions amounted to 4.19%.

Loans considered to be irrecoverable are consistently written off. Nonetheless, recovery efforts continue even after a loan has been written off, and collateral collection is rigorously enforced. In 2011 net write-offs totalled EUR 849 thousand, or 0.18% of the gross loan portfolio.

Counterparty and Issuer Risk Management

Counterparty and issuer risks evolve especially from the bank's need to invest its liquidity reserve, to conclude foreign exchange transactions, or to buy protection on specific risk positions. The risk of incurring losses caused by the unwillingness or inability of a counterparty or issuer to fulfil its obligations is managed according to the ProCredit Group Counterparty Risk Management Policy (incl. Issuer Risk), which defines the counterparty selection and limit setting process, as well as according to the Group Treasury Policy, which specifies the set of permissible transactions and the rules for their processing. These policies are fully in line with Serbian regulations. As a matter of principle, only large international banks and local banks with a good reputation and financial standing are eligible counterparties. Limits above certain thresholds are conditional on approval by the Group ALCO. In 2011, in response to the latest sovereign debt crisis, counterparty limits were reviewed and in some cases adjusted.

Country Risk Management

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

Liquidity Risk Management

Several factors inherent to the bank's business model offset liquidity risk. Firstly, the bank's diversified, high quality portfolio of loans means that incoming cash flows are highly predictable. Secondly, our customer deposits are spread across a large number of depositors each holding relatively small amounts. As of December 2011 the average balance in deposit accounts of all types came to EUR 927, and the ten largest depositors made up only 9% of total deposit volume.

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

Currency Risk Management

ProCredit Bank Serbia has a low level of exposure to currency risk because it does not enter into speculative open currency positions, nor does it engage in derivative transactions except for hedging and liquidity purposes. Currency risk is managed in accordance with the Group Foreign Currency Risk Management Policy and local regulations. The bank continuously monitors exchange rate movements and foreign currency markets, and manages its currency positions on a daily basis. Any exceptions to the group policy or violations of group limits are subject to approval by the Group ALCO. Stress tests are regularly carried out to assess the impact of exchange rate movements on open currency positions (OCP) in each operating currency.

The Group Foreign Currency Risk Management Policy allows ProCredit banks to hold strategic open currency positions for the purpose of hedging equity, in which case these positions are closely monitored at both local and group level. As of end-2011, the bank had an overall OCP of EUR 2,328,053.

Unlike 2010, when the local currency depreciated by 10%, during 2011 the Serbian dinar gained a total of 0.81% against the EUR, ending the year at an exchange rate of RSD 104.64 to the EUR. However, this overall rise disguises a certain degree of instability, with dips in June and November as a consequence of both domestic and international factors, including the sovereign debt crisis in the eurozone.

Interest Rate Risk Management

During 2011 interest rates generally exhibited an upward trend. Local currency REPO rates peaked in April at 12.5%, but then dropped to 9.75% by year-end. 6-month Euribor increased significantly during 2011, rising from 1.24% to 1.82% in July, but the troubles in the eurozone and the lowering of the ECB's reference rate brought it down to 1.62% at the end of the year, with analysts predicting further decreases in 2012.

Maturity gap analysis and stress testing are used to measure and analyse the impact of interest rate shifts on the economic value and interest income. As a policy measure to mitigate interest rate risk, ProCredit Bank attracts long-term fixed rate funding and offers loans with variable interest rates, allowing the bank to raise (or lower) the rates it charges in line with shifts in the market interest rates.

Operational Risk Management

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

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

As part of their initial training, all new staff members are taught how to recognise and avoid operational and fraud risk and how to maintain information security. In 2011, ProCredit Bank Serbia reported 143 risk events representing a total net risk amount of EUR 407,402. The main types of reported events included lawsuits against the bank, non-compliance with procedural guidelines, internal and external fraud cases, card-related fraud, and damage due to natural or human causes.

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

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

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

Anti-Money Laundering

ProCredit Bank Serbia fully endorses the fight against money laundering and terrorist financing, and has implemented the Group Anti-Money Laundering Policy, which meets the requirements of German and EU legislation as well as the stipulations of the Serbian authorities. No customer is accepted and no transaction is executed unless the bank understands and agrees to the underlying purpose of the business relationship. The Group Anti-Money Laundering Department (Group AML) conducts an annual risk assessment of all ProCredit banks and updates the policy accordingly. In addition, all ProCredit banks submit quarterly reports on their AML activities to Group AML.

At ProCredit Bank Serbia, responsibility for AML activities is exercised by the Compliance and AML Unit. The Compliance and AML Unit is staffed by two AML specialists and one Compliance Officer who are supported by Unit Supervisor. According to local regulations, any cash transaction exceeding EUR 15,000 must be reported to the local authorities. In addition, any attempt to execute a transaction that arouses suspicion of money laundering, terrorist financing or some other criminal activity must be reported. Front-office staff receive intensive training in how to recognise suspicious transactions. An additional automated safeguard is provided by the use of internal system checks of payments against the UN sanction list, and by checks of all non-residents against the Dow Jones database, which prevents business relationships being established with persons on the sanction list. Monitoring of client account activities is still performed manually, but will be automated when the SIRON AML, SIRON PEP and SIRON EMBARGO systems are implemented in 2012. In cases of doubt, Group AML takes the final decision on how to handle the suspicious transactions and suspicious customers reported by the bank.

Capital Adequacy

The bank's capital adequacy is calculated on a monthly basis and reported both to the management and to the Group Risk Management Committee, together with rolling forecasts to ensure future compliance with capital adequacy requirements. Strong support from our shareholders once again enabled the bank to maintain a comfortable capital cushion. In November 2011 the bank concluded a contract with ProCredit Holding for a 10-year subordinated loan in the amount of EUR 10 million. At year-end 2011 the capital adequacy ratio (tier 1 and tier 2 capital / risk-weighted assets) stood at 18.31% in accordance to IFRS standards and 17.75% in accordance to local regulation, above the group-wide minimum standard of 12%, which is also the locally required minimum. ProCredit Bank's overall risk rating, issued by FitchRatings, remained unchanged in 2011 at BB-. Among other factors, this year's rating report emphasised that despite operating in a challenging environment, ProCredit Bank could, on the strength of its overall business practices, qualify for a higher rating in the future if and when Serbia's country ceiling is increased from its current level of BB-.

Branch Network

At the end of 2011, ProCredit Bank Serbia had a total of 62 offices located in 38 different towns and cities, thus providing country-wide coverage. Belgrade, Novi Sad, Kragujevac and Niš are Serbia's four regional centres in terms of business, cultural and social activity, and the bank has more than two offices in each of these major cities. The region with the largest number of offices (26) is the Belgrade region, where over 30% of the country's total population live and over 50% of Serbia's total turnover is generated.[1] The bank also has a presence in most important cities and towns, and additionally in strategically significant areas, such as the North Region, the main source of the country's agricultural output, where we maintain 15 offices. During 2011 one new service point was opened in Belgrade city, when an existing service point was divided into two smaller ones. This helped to lower total rental expenses, while at the same time providing more convenient access for clients based in a strategically important area near the city centre.

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

[1] http://webrzs.stat.gov.rs/WebSite/repository/documents/00/00/47/54/08_Structural_business_statistics.pdf, p. 182.

payments. Alongside the full-scale branches, the bank has a number of *service centres*, which offer the same services but with fewer staff, focusing more on very small businesses and agricultural enterprises.

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

At the other end of the scale, the bank operates a small number of *business centres,* which are specifically oriented towards serving the more complex needs of our larger-scale business clients, i.e. up to medium-sized enterprises. These specialised branches are located in the capital, Belgrade, and in the regional centres Novi Sad, Kragujevac and Niš.

The interior design of the branches is geared to maximising customer convenience. Signposting directs business clients to physically separate areas staffed by experts in serving enterprises, and rooms for confidential negotiations have been created wherever space has allowed. At the same time, we have introduced a “one-stop” system that allows customers to perform cash and non-cash transactions at a single front office desk. This streamlined service is available at all 62 of our branches and service points. Remodelling and renovation work was carried out in 20 of our business units, and in line with our long-term strategic plans, new business premises were purchased in four towns. Five branches were relocated in 2011 in the interests of improved cost management and in order to meet the needs of the local market more effectively.

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

Among our most popular technology-based services are the VISA debit cards, which both business clients and private individuals can use to withdraw cash at any of our 160 ATMs, or to make cashless purchases using POS terminals operated by local merchants, many of whom are themselves customers of ProCredit Bank Serbia.

In 2012 we plan to focus our efforts on reorganising and modifying some of the offices in the branch network and opening several new service points, mainly in Belgrade, as we consider it necessary to have a more visible presence in the capital, not only from the point of view of our own strategy, but also in response to the strategies of our competitors.

Organisation, Staff and Staff Development

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

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

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

Given the importance of human resources for the future of the bank, highly qualified people have been chosen to serve as the head of the HR department and as managers of its three sub-units – Recruitment, Training and Development, and Administration. Aside from the Young Bankers Programme, the Training and Development unit organises ongoing training to advance the professional and personal development of the staff. During the year, our employees participated in a total of 1375 internal; training days, not including attendance at the international ProCredit Academies.

Continuing the group-wide initiative to raise the level of mathematical knowledge among its staff, in 2011 ProCredit Bank's training activities focused on advanced financial mathematics and accounting. During the year, 642 of the bank's employees reached the ProCredit group's "Maths 2" standard, while another 245 successfully completed the group-wide Basic Accounting course. Other noteworthy training measures have included specialised courses for client-facing positions, as well as a number of individual trainings aimed at developing special skills and knowledge.

A large proportion of the training provided to current and potential middle managers takes place outside Serbia at the international ProCredit Academies. In 2011, 11 colleagues from ProCredit Bank Serbia graduated from the ProCredit Regional Academy for Eastern Europe in Veles, Macedonia. Two of the bank's staff earned their "ProCredit Banker" diploma, marking the successful completion of the highly intensive three-year programme offered at the central ProCredit Academy in Fürth, Germany.

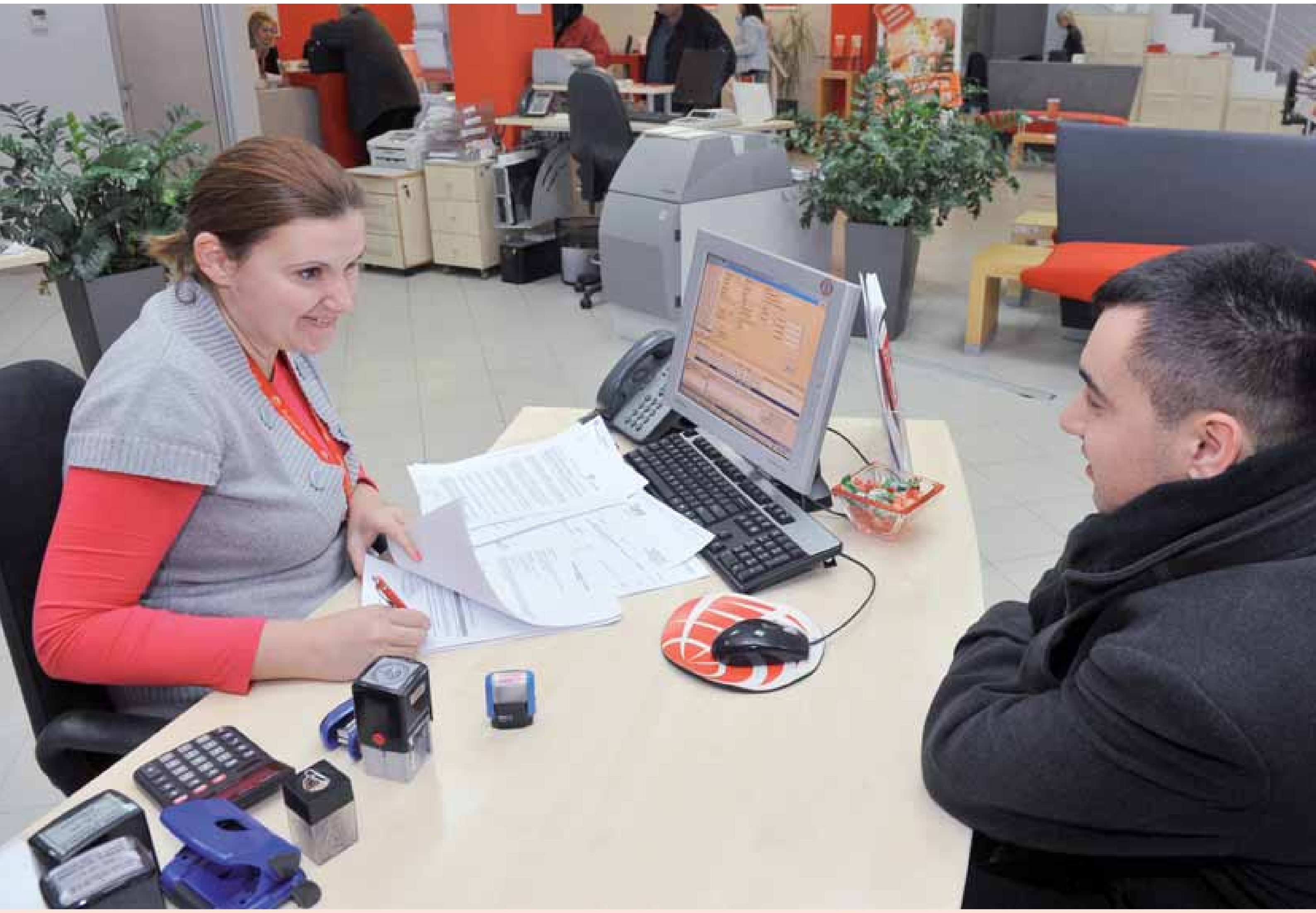
The bank's organisational structure is designed to support the building of long-term customer relationships. At head office level, the Legal Entities Sector is devoted to handling all of the banking needs specific to business customers, while the Private Individuals Sector focuses on serving non-business clients.

The internal organisation of the branches reflects this customer orientation, with separate front office areas for business clients and private individuals, respectively. Business Client Advisers at the branches are responsible for advising Small and Very Small enterprises on all of the bank's services and for acquiring new customers, while the function of Credit Analysts is to evaluate applications for credit services submitted by comparatively large, complex business clients.

Given the bank's continued focus on consolidation and quality in 2011, recruitment of new personnel took place on a relatively limited scale. Nonetheless, 62 people joined the bank in 2011, bringing the total at year-end to 1,315 (including support staff and employees of the bank's leasing company).

ProCredit Bank Serbia understands that the key to providing high quality service lies in building a team of motivated, professionally competent staff who are jointly committed to the bank's mission and objectives, and who work well together on the basis of mutual trust and respect. In addition to its substantial investment in training, the bank provides for regular team building events in smaller groups and hosts an annual sports weekend which is attended by the entire staff of ProCredit Bank Serbia.

Business Ethics and Environmental Standards



Business Ethics

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

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

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

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

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

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

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

Environmental Standards

All of the banks belonging to the ProCredit group set high standards regarding the impact of their operations on the environment. In 2011, ProCredit Bank Serbia established a dedicated Environmental Committee, chaired by a Management Board member, whose main functions are to approve the bank's Environmental Policy and key activities derived from it, and to oversee their implementation on a bank-wide level. In line with ProCredit group standards, the bank has also designated an Environmental Co-ordinator to be responsible for monitoring our environmental performance, and co-ordinating efforts to improve it.

ProCredit banks take a three-pronged approach to environmental challenges:

Pillar 1: Internal environmental management system

ProCredit Bank Serbia is putting in place an approach to better understand and improve the sustainability of its own energy use and environmental impact. For example, the bank has invested in a state-of-the-art "Green Branch" in Nis to highlight what can be done to reduce resource use.

Environmental issues are an essential component of the training provided to ProCredit Bank staff at the local, regional and international level. In addition, there have been special green initiatives to raise environmental awareness among staff, such as a series of educational articles on our internal web portal, depicting successful clients' energy efficiency improvements achieved through financing from the bank. Also, in the context of a project which involves "branding" specific areas in the Head Office, one whole floor was dedicated to energy efficiency. The main corridor of that floor was renamed "Energy Efficiency Boulevard" and connects offices representing different renewable energy sources: Hydro room, Windmill room, Geo room and Solar room. Photo panels with brief explanatory texts, combined with the articles and banners on the bank's Intranet portal, are a daily reminder of the importance of energy efficiency and renewable energy.

Bearing in mind the adverse impact of motorised vehicles on the environment, the bank decided to purchase bicycles for the employees to use. This pilot project has been implemented at several branches, which each received two bicycles, complete with maintenance equipment, and four bikes are also available at the Head Office. The bicycles have been ProCredit-branded to publicise the bank's commitment to environmental protection. Employees can use the bikes for on-site visits to clients, or commuting to work, and our long-term goal is to turn cycling into a healthy habit and a regular means of transportation. For journeys that

still have to be made by car, the bank decided to add to its fleet of hybrid cars, the Toyota Prius, as a further contribution towards global CO_2 reduction.

Pillar 2: Management of environmental risk in lending

ProCredit Bank Serbia has implemented an environmental management system based on continuous assessment of the loan portfolio according to environmental criteria, an in-depth analysis of all economic activities which potentially involve environmental risks, and the rejection of loan applications from enterprises engaged in activities which are deemed environmentally hazardous and appear on our institution's exclusion list. By incorporating environmental issues into the loan approval process, ProCredit Bank Serbia is also able to raise its clients' overall level of environmental awareness.

Pillar 3: Promotion of "green finance"

ProCredit Bank Serbia aims to promote economic development that is as environmentally sustainable as possible. In 2011, we broadened our programme of green finance products consisting of energy efficiency loans and leasing services for private individuals as well as for businesses. This initiative has also involved broadening our base of suppliers of environmentally friendly equipment and services, and encouraging them to offer products bearing the EU standard energy efficiency labels. Since the start of this programme, the bank has disbursed 44 home improvement energy efficiency loans and 506 (436 Leasing and 70 Bank) loans to businesses to finance investments in energy efficient fixed assets. At the end of 2011 the home improvement loan portfolio amounted to approximately EUR 264,252, while outstanding business energy efficiency loans including leasing totalled EUR 13,413,412. The bank continuously monitors the overall impact of these measures in terms of reduced energy consumption and CO_2 emissions. With the financing provided during 2011, our borrowers have achieved annualised savings of 14,999,007 kWh and 7,300 tonnes of CO_2 equivalent.

The bank aims to use its green finance products and approach to increase public awareness and understanding. With the same goal in mind,

ProCredit Bank was also involved in a number of local environmental projects in 2011. For example, on World Habitat Day, 6 October, ProCredit Bank and BiS Recycling Center jointly launched a campaign "For a Healthier Neighbourhood Environment", promoting the recycling of electronic waste and raising public awareness of the significance of responsible e-waste management. For 10 days, a special-purpose container was placed in front of ProCredit Bank's Head Office in New Belgrade where individuals and companies could leave their old or damaged electronic devices, including computer equipment and other disused electronic gadgets. Additionally, to promote environment-friendly fuel systems and appropriate financing models, at the beginning of December the bank organised a special "eco-driving" training course for a number of clients and journalists at the National Driving Academy (NAVAK) facility near Belgrade, using hybrid Toyotas. During 2011 the bank also took part in numerous public debates, conferences and forums dedicated to the financing of energy improvements, taking the opportunity to spread the message that these efforts can have an important beneficial impact on our mutual asset, the environment we live and work in.

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

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

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

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

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

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

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

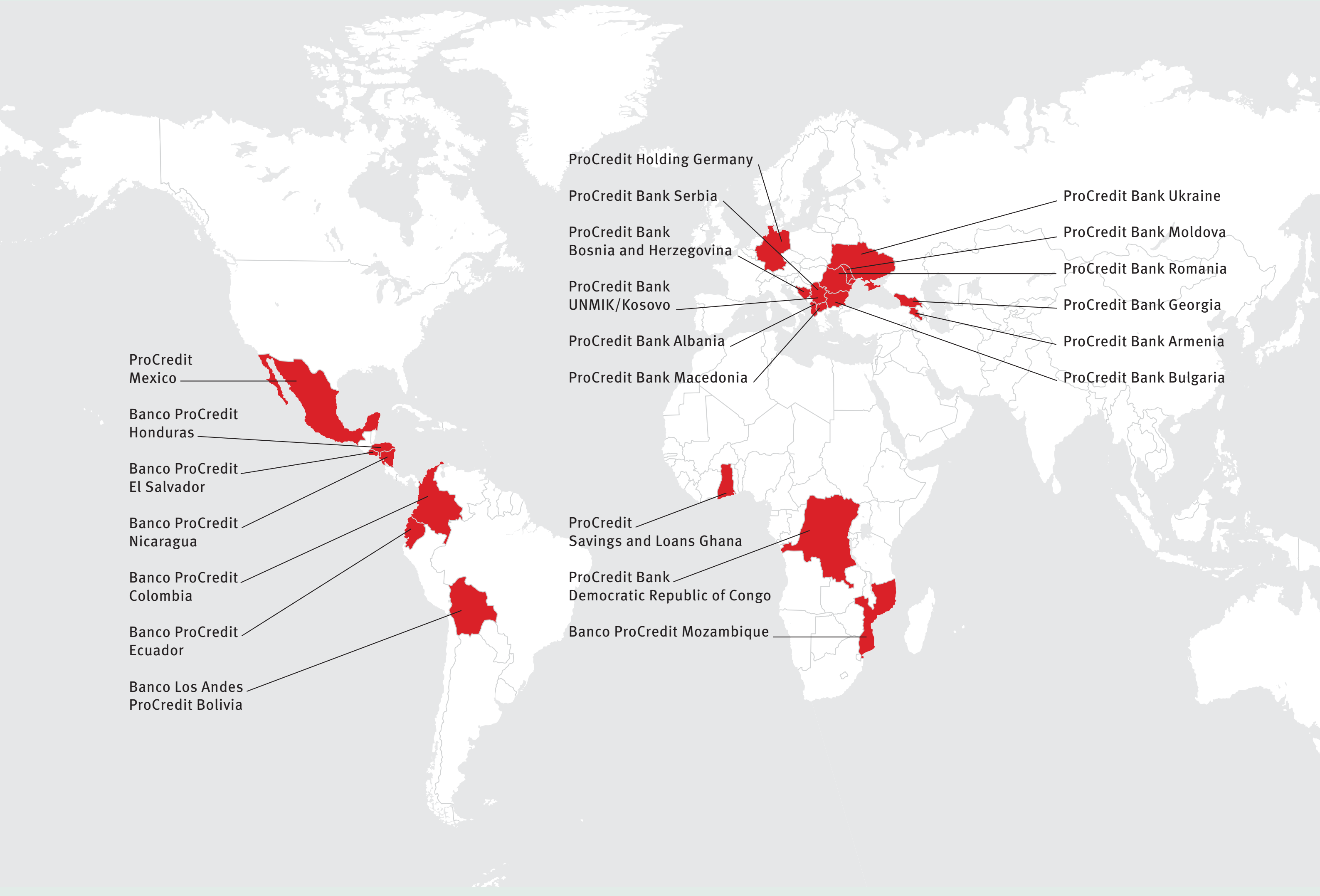
We not only extend loans, but also offer our enterprise clients a broad range of other banking services such as cash management, domestic and international money transfers, payroll services, POS terminals and payment and credit cards. Using our rigorous approach to financial analysis, we promote, in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

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

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

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

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



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

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

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

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

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

ProCredit Holding and the ProCredit group place a strong emphasis on human resource management. Our "ethical neighbourhood bank" concept is not limited to our target customers and how we reach them; it above all concerns the way in which we work with our staff and how we encourage them to work with their customers. The strength of our relationships with our customers will continue to be central to working with them effectively in 2012 and achieving steady business results. In 2011 there was a strong focus on staff quality, recruitment and training. The 6-month Young Banker stipend programme, which all ProCredit banks offer to all potential new recruits, continues to develop. This symbolises our commitment to skill development in all our countries of operation.

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

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

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

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

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

ProCredit in Eastern Europe

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

** Not including finance company ProCredit Moldova.

Our Clients

Janos Koso, 48, started his career in a machine factory in the northern city of Subotica. When the economic crisis hit the former Yugoslavia in the 1990s, however, he saw an opportunity to start his own flower-growing business, Gerbaflor, with his brother and a friend. They began by raising the plants in a hothouse on their own 500 m^2 plot, gradually expanding their production facility to 1.2 hectares.

"My bank at the time didn't really seem to understand my business or try to meet my needs. However, a lot of farmers in the region were talking about ProCredit Bank's professionalism and support for agricultural producers. That motivated me to approach ProCredit for a loan to purchase a tractor in 2007, and later I applied for a working capital loan. The bank came up with the ideal repayment schedule for me, and from then on, our business relationship grew steadily."

Janos, his wife, two children and brother as well as his twelve employees all are private individual customers at ProCredit Bank. In addition, all transactions related to the company are conducted through the bank, and a variety of services, including overdrafts, leasing and loans help the business to thrive.

Thanks to the support received from ProCredit Bank, Gerbaflor has managed to significantly cut costs, improve its production capacity and diversify its product line. The company is now also in the process of investing in its production facilities with a loan for energy efficient heating equipment for the hothouse.

Gerbaflor operates in a predominantly agricultural region where biomass, a fuel suitable for heating purposes, is widely available. According to calculations made by a ProCredit client adviser, the company could reduce its energy costs from EUR 55,000 to EUR 15,000, i.e. by more than 70%, if it were to switch from coal to biomass. On this basis, the investment would pay for itself within less than a year.

"On my path to becoming one of the leading flower producers in the country, I relied on ProCredit Bank for advice and support," says Janos. "The staff understand my business and care about me as a person. I already have investment plans for next year and I hope that I can pass my profitable, sustainable business on to my son one day."

Dragoljub Simonovic, Postal Worker

Dragoljub Simonovic, 53, is a postman and homeowner living on the outskirts of Belgrade. He first heard about ProCredit from his uncle, who has a salary account at the bank's branch in Despota Stefana Boulevard in the capital. He decided to check it out for himself and paid a visit to ProCredit Bank.

"One day, my uncle and I were discussing our experiences with banks in Serbia. I mentioned that I had come up against hidden costs, commissions and non-transparent processes in general. He told me that ProCredit was a different story – transparent, professional and with really good customer service,"
says Dragoljub.

Impressed by the friendly staff and no-nonsense services, Dragoljub opened a current account at ProCredit Bank in which to receive his salary. As his trust grew in ProCredit, he applied for an overdraft and entrusted his savings to the bank. A few years after that, he took out two housing improvement loans. The first loan was for the purchase of energy efficient building materials – insulation and flooring – for his family home in Rakovica.

Today, Dragoljub is repaying the second loan that he took out to improve the energy efficiency of his home's heating system, doors and windows. In addition, having learned about the benefits of the various services packages offered by ProCredit, he has signed up for a package that enables him to access his current account via the internet and his mobile phone.

"What I like most about ProCredit Bank is that they stick to what they say, and they tell you everything; it is a very transparent relationship. There are no hidden elements, and if there is anything that I need to know, I can count on the friendly, helpful staff to inform me ahead of time."

The fact that Dragoljub is one of the few postmen in Serbia who uses banking services other than those offered by the national postal system is testimony to his positive experience with ProCredit. In the meantime, he has also paid the bank the greatest compliment of all: he has referred his son as a customer.

Milan Ristic, Producer of Healthful Foods

Inspired by his mother's healthful cooking, Milan Ristic, 34, decided to start a small family business producing nutritious snacks and foods. In 2001, he registered the business under the name of Bioland, and is now the general manager as well as the owner of the company.

He first came into contact with ProCredit Bank in 2002, when one of his business partners asked him to act as a guarantor for a loan. The bank made a positive impression on him and he applied for his own loan to finance the building of his production premises. He has been a satisfied client ever since.

"I appreciate ProCredit Bank's readiness to listen to me and then give me sound, realistic business advice. It is dramatically different from other banks, where one can encounter difficulties with basic communication. ProCredit also offers a far superior level of customer service."

Other loans followed, and after nine years of doing business with ProCredit, Milan has used a variety of services. At the moment, he is repaying an investment loan and a working capital loan.

"ProCredit truly helped my business to grow and provided me with full support exactly when I needed it. I am especially impressed by the bank's business strategy, which is precisely tailored to the local market – from reaching out to clients to continually improving the products and services it offers to small businesses in Serbia. ProCredit also has a unique ability to assess its clients' businesses – I sometimes wish I had that kind of skill and expertise to apply to my own operations!"

Today, Bioland has a stable base of clients, ranging from small local retailers to some of the country's major chains. In the years to come, Milan will count on ProCredit Bank's support as he transforms his business from a small company into a more industrialised operation.

Miroslav Zoric, Glass Cutter

After years of working with glass as an employee in a glass production factory, Miroslav Zoric, 59, started his own glass cutting and conditioning business with his son Mirko in 1999.

The business began as a very small workshop, but by 2002, the Zorics were ready to expand. They had heard positive things about ProCredit Bank from other small business owners and decided to apply for their first loan there.

Father and son later took out two additional loans for working capital and for purchasing new equipment for the workshop. Production levels grew accordingly, enabling the Zorics to upgrade their business as a limited liability company called Staklo Zoric d.o.o. Based on their successful dealings with the bank, they gradually transferred most of their banking operations to ProCredit, which has effectively been their "house bank" for the past five years.

Both Miroslav and Mirko live in the same building that houses their business, in the reconstructed and adapted former office space. The previously small workshop has grown into a production facility of 380 m² and an attached retail outlet of 70 m². In addition, Miroslav recently opened another retail outlet close to the production facility in the Belgrade suburb of Zemun. Staklo Zoric d.o.o. has ten employees; seven work in the production facility while the other three take care of the administrative and retail areas of the business.

"Above all, I value that ProCredit Bank understands the need for precise and thorough information. Having all of the facts gives me confidence in analysing the possibilities and making good business decisions. In addition, we were recently assigned to a business client adviser, which makes our interaction with the bank more direct and complete."

Today, the Zorics are paying off two loans and a lease and they make use of an overdraft to keep things running smoothly. Their future plans include investing in new production and storage premises, which will cover a total area of more than 4,000 m²; they also wish to purchase new machinery for glass hardening. As they have done all along, they will count on ProCredit Bank's support to take Staklo Zoric d.o.o. to the next level.

Financial Statements

For the year ended 31 December 2011.
Prepared in accordance with International Financial Reporting Standards.

INDEPENDENT AUDITORS REPORT

To the Shareholders of ProCredit Bank a.d. Belgrade

We have audited the accompanying consolidated financial statements of ProCredit Bank a.d. Belgrade and its subsidiary (together the "Group"), which comprise the consolidated balance sheet as at 31 December 2011 and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion

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

Pricewaterhouse Coopers d.o.o. Belgrade

PricewaterhouseCoopers d.o.o. Belgrade

Belgrade, 4 May 2012

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Consolidated income statement

For the year ended 31 December 2011

in thousands of Dinars	Note	Year ended 31 Dec 2011	Year ended 31 Dec 2010
Interest and similar income		7,281,105	7,308,677
Interest expense and similar charges		(2,463,047)	(2,740,493)
Net interest income	4	**4,818,058**	**4,568,184**
Allowance for impairment losses on loans and advances	5	(505,413)	(994,356)
Net interest income after allowances		**4,312,645**	**3,573,828**
Fee and commission income		1,225,910	1,196,778
Fee and commission expense		(194,339)	(160,339)
Net fee and commission income	6	**1,031,571**	**1,036,439**
Net trading income	7	197,681	172,406
Net result from financial assets at fair value through profit or loss	8	11,924	11,909
Operating income	10	45,050	76,567
Gains and losses from available for sale asset	9	9,056	–
Operating income		**263,711**	**260,882**
Personnel expenses		(2,139,766)	(2,493,498)
Other administrative expenses		(1,767,823)	(1,871,389)
Operating expenses	11	**(3,907,589)**	**(4,364,887)**
Operating result		1,700,338	506,261
Income tax	12	(158,575)	(61,089)
Profit for the year		**1,541,763**	**445,172**

Consolidated statement of comprehensive income

	2011	2010
Profit for the year	1,541,763	445,172
Change in revaluation reserve from available-for-sale financial assets	5,254	(2,825)
Change in deferred tax on revaluation reserve from available for sale assets	(525)	283
Total other recognised income and expense	4,729	(2,542)
Total recognised income and expense	**1,546,492**	**442,630**

The accompanying notes on pages 52 to 85 form an integral part of these consolidated financial statements.

ProCredit Bank a.d. Belgrade
Consolidated Financial Statements for the year ended 31 December 2011
(All amounts expressed in thousand of Dinars unless otherwise stated)

Consolidated balance sheet

	Note	As of 31 December 2011	As of 31 December 2010
ASSETS			
Cash and balances with the Central Bank	13	10,010,051	21,025,345
Loans and advances to banks	14	570,527	713,645
Loans and advances to customers	15	47,634,008	46,976,356
Derivative financial assets	16	2,223	105
Available-for-sale financial assets	17	19,090	13,618
Other financial investments	18	-	7,924
Intangible assets	19	210,778	220,676
Property and equipment	20	1,292,509	1,316,447
Deferred tax assets	21	183,751	251,489
Current Tax assets		-	1,855
Other assets	22	626,914	375,794
Total assets		**60,549,851**	**70,903,254**
LIABILITIES			
Deposits from banks	23	1,335,659	2,195,180
Derivative financial liabilities	24	3,463	5,649
Due to customers	25	29,132,940	37,132,726
Other borrowed funds	26	15,717,477	19,350,784
Subordinated debt	27	3,922,292	2,886,643
Tax liabilities	28	51,889	-
Provisions	29	165,402	92,232
Other liabilities	30	380,841	568,952
Total liabilities		**50,709,963**	**62,232,166**
EQUITY			
Share capital	31	3,663,012	3,663,012
Share premium		2,776,745	2,776,745
Retained earnings		1,748,695	584,625
Revaluation reserve on property and equipment		7,571	2,842
Special banking risk reserves	32	1,643,864	1,643,864
Total equity		**9,839,888**	**8,671,088**
Total equity and liabilities		**60,549,851**	**70,903,254**

The accompanying notes on pages 8 to 72 form an integral part of these consolidated financial statements.

These consolidated financial statements were approved by the Executive Board on 4 May 2012 and signed on their behalf by:

Svetlana Tolmacheva
Chairperson of the Executive Board

Dragana Tanasič
Member of the Executive Board

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The accompanying notes on pages 52 to 85 form an integral part of these consolidated financial statements.

Consolidated statement of changes in equity

For the year ended 31 December 2011

in thousands of Dinars	Notes	Share Capital	Share Premium	Retained earnings	Revaluation reserve on available for sale	Special banking risk reserves	Total
At 1 January 2010		**3,663,012**	**2,776,745**	**773,336**	**5,384**	**1,345,592**	**8,564,069**
Total comprehensive income		–	–	445,172	(2,542)	–	442,630
Transfer to special banking risk reserves	32	–	–	(298,272)	–	298,272	–
Distributed dividends		–	–	(335,611)	–	–	(335,611)
At 31 December 2010		**3,663,012**	**2,776,745**	**584,625**	**2,842**	**1,643,864**	**8,671,088**
Total comprehensive income		–	–	1,541,763	4,729	–	1,546,492
Distributed dividends		–	–	(377,692)	–	–	(377,692)
At 31 December 2011		**3,663,012**	**2,776,745**	**1,748,696**	**7,571**	**1,643,864**	**9,839,888**

The accompanying notes on pages 52 to 85 form an integral part of these consolidated financial statements.

Consolidated statement of cash flows

For the year ended 31 December 2011

in thousands of Dinars	Year ended 2011	Year ended 2010
Cash flows from operating activities:		
Profit before tax	1,700,338	506,261
Adjustments for non-cash items:		
Impairment loss	547,002	994,356
Depreciation and amortisation	275,377	304,629
Unrealised (gains) / loss on foreign currency revaluation	(38,724)	9,495
Provisions	73,170	8,084
Increase in Tax liabilities	51,889	–
Net cash flow from operating activities before changes in operating assets and liabilities	**2,609,052**	**1,822,825**
Changes in operating assets:		
(Increase) in derivative financial assets	(4,304)	(101)
(Increase) in loans and advances to customers	(1,151,746)	(6,398,669)
(Increase)/decrease in other assets	(320,713)	163,621
	(1,476,763)	**(6,235,149)**
Changes in operating liabilities:		
(Decrease)/ increase in deposits from banks	(859,521)	1,845,483
(Decrease) in due to customers	(7,999,786)	(512,414)
(Decrease)/ increase in other liabilities	(188,111)	7,320
(Decrease)/Tax liabilities	–	(10,814)
	(9,047,418)	**1,329,575**
Net cash used in operating activities	**(7,915,129)**	**(3,082,749)**
Cash flow from investing activities:		
Proceeds from disposal of property and equipment	3,871	3,393
Purchase of property and equipment and intangible assets	(255,204)	(151,608)
Net cash (used in) investment activity	**(251,333)**	**(148,215)**
Cash flow from financing activities:		
Increase in other borrowed funds	7,031,790	12,522,895
Repayments of other borrowed funds	(9,629,448)	(10,364,441)
Paid dividends	(394,292)	(335,611)
Net cash (used in)/from financing activities	**(2,991,950)**	**1,822,843**
Net (decrease) in cash and cash equivalent	**(11,158,412)**	**(1,408,121)**
Cash and cash equivalents as at 1 January	**21,738,990**	**23,147,111**
Cash and cash equivalents as at 31 December (Note 33)	**10,580,578**	**21,738,990**

The accompanying notes on pages 52 to 85 form an integral part of these consolidated financial statements.

Notes to the Financial Statements

For the year ended 31 December 2011

All amounts expressed in thousands of Dinars unless otherwise stated

1. General information

ProCredit Bank a.d. Beograd (the "Bank") was established in 2001 as a Joint Stock Company and was issued with a banking licence by the National Bank of Yugoslavia (the "Central Bank") on 5 April 2001.

In 2003, the Bank changed its name from Micro Finance Bank a.d. Beograd to ProCredit Bank a.d., Beograd.

The Bank is licensed in the Republic of Serbia to perform payment transfers, credit and deposit activities in the country and abroad, and in accordance with Republic of Serbia law, is to operate on principles of liquidity, security of placements and profitability.

The Bank established ProCredit Leasing d.o.o. as a limited liability company and registered it with the Agency for Legal Entities in Belgrade under register number 1973/2005 on 17 February 2005. The Bank is the 100% owner of ProCredit Leasing.

The group consists of the Bank and its subsidiary ProCredit Leasing d.o.o.

The group is controlled by ProCredit Holding AG & Co. KGaA Frankfurt am Main ("ProCredit Holding", "PCH"), which owns 83.33% of shares. The remaining 16.67% is owned by Commerzbank AG Frankfurt am Main. The ultimate parent of the group is ProCredit Holding.

As at 31 December 2011, the group's head office is located in Belgrade, Milutina Milankovica 17, and has 58 branches throughout Serbia.

These consolidated financial statements were approved for issue by the Executive Board on 15 April 2012.

2. Summary of significant accounting policies

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

A) Basis of preparation

The group's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The consolidated financial statements have been prepared under the historical cost convention except for available for sale financial assets and all derivative financial instruments, which have been measured at fair value. The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. Areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the consolidated financial statements are disclosed in Note 2X.

The consolidated financial statements are presented in RSD, which is the group's presentational currency. The figures shown in the consolidated financial statements are stated in RSD thousands.

(a) Standards effective for annual periods beginning on or after 1 January 2011

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

Amendment to IAS 24, Related Party Disclosures (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities. As a result of the revised standard, the Group now also discloses contractual commitments to purchase and sell services to its related parties.

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

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

Other revised standards and interpretations effective for the current period. IFRIC 19 "Extinguishing financial liabilities with equity instruments", amendments to IAS 32 on classification of rights issues, clarifications in IFRIC 14 "IAS 19 - The limit on a defined benefit asset, minimum funding requirements and their interaction" relating to prepayments of minimum funding requirements and amendments to IFRS 1 "First-time adoption of IFRS", did not have any impact on these financial statements.

(b) Standards, amendments and interpretations issued but not yet effective

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2012 or later, and which the Group has not early adopted.

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

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.
- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.
- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.
- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Group is considering the implications of the standard, the impact on the Group and the timing of its adoption by the Group.

IFRS 10, Consolidated Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities". IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. The Group is currently assessing the impact of the amended standard on its financial statements.

IFRS 11, Joint Arrangements, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces IAS 31 "Interests in Joint Ventures" and SIC-13 "Jointly Controlled Entities—Non-Monetary Contributions by Venturers". Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures.

IFRS 12, Disclosure of Interests in Other Entities, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in group activities and cash flows, summarised financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities.

IFRS 13, Fair Value Measurement, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs.

IAS 27, Separate Financial Statements, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013), was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10, Consolidated Financial Statements.

IAS 28, Investments in Associates and Joint Ventures, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged.

Disclosures—Transfers of Financial Assets – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011.). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood.

Amendments to IAS 1, Presentation of Financial Statements (issued in June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Group expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances.

Amended IAS 19, Employee Benefits (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income.

Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement.

Other revised standards and interpretations: The amendments to IFRS 1 "First-time adoption of IFRS", relating to severe hyperinflation and eliminating references to fixed dates for certain exceptions and exemptions, will not have any impact on these financial statements. The amendment to IAS 12 "Income taxes", which introduces a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale, will not have any impact on these financial statements. IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine, considers when and how to account for the benefits arising from the stripping activity in mining industry.

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

B) Consolidation

Subsidiaries

Subsidiaries are all entities over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights.
The Bank has only one 100% owned subsidiary – ProCredit Leasing d.o.o.
Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. The accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group.

C) Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Serbian Dinars (RSD), which is the functional and presentation currency of the group entities.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains 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.

D) Financial assets

The group classifies its financial assets in the following categories: loans and receivables and available-for-sale financial assets. Management determines the classification of its investments at initial recognition.

Classes of financial assets

The group classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table below:

Category of financial assets per IAS 39	Class determined by the Bank	Subclass
Financial assets at fair value through profit and loss	Derivative financial assets	Derivatives – non-hedging
Loans and receivables	Loans and advances to banks	Banks within the Group
Loans and receivables	Loans and advances to banks	OECD banks
Loans and receivables	Loans and advances to banks	Domestic and non-OECD banks
Loans and receivables	Loans and advances to customers	Business
Loans and receivables	Loans and advances to customers	Agricultural
Loans and receivables	Loans and advances to customers	Housing
Loans and receivables	Loans and advances to customers	Finance leases
Loans and receivables	Loans and advances to customers	Consumer
Loans and receivables	Loans and advances to customers	Other
Available for sale financial assets	Available for sale financial assets	Listed
Available for sale financial assets	Other financial instruments	Unlisted

(a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception.
A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated as hedging instruments.
Financial assets and financial liabilities are designated at fair value through profit or loss when:

- doing so significantly reduces measurement inconsistencies that would arise if the related derivatives were treated as held for trading and the underlying financial instruments were carried at amortised cost for loans and advances to customers or banks and debt securities in issue'
- Certain investments, such as equity investments, are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis are designated at fair value through profit or loss

Gains and losses arising from changes in fair value are included directly in the consolidated income statement and are reported as 'Net trading income'. Interest income and expense and dividend income and expenses on financial assets held for trading are included in 'Net interest income' or 'Dividend income', respectively.
Gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in "Net result from financial assets through profit or loss".

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. All loans and advances are initially recognised at fair value. All loans and advances are recognised when cash is advanced to borrowers. After initial recognition, these are subsequently measured at amortised costs using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs and any discount or premium on settlement.

(c) Available-for-sale financial assets

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.
Regular-way purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on trade-date – i.e. the date on which the group commits to purchase or sell the asset.
Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.
Gains and losses arising from changes in the fair value of the "financial assets at fair value through profit or loss" category are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in "other comprehensive income" until the financial asset is derecognised or impaired. At this time, the cumulative gain or loss previously recognised in "other comprehensive income" is recognised in profit or loss. However, interest calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available for sale is recognised in the income statement.
The fair value of investments quoted in an active market is based on current supply (financial assets) or demand (financial liabilities). If the market for a financial asset is inactive, the Bank shall determine fair value by using valuation techniques. This includes application of recent transactions among independent parties, analysis of discounted cash flows and other valuation techniques used by market participants. The valuation models reflect current market conditions on the date of valuation, whereby such conditions are not necessarily applicable for the period before or after the valuation date.

On the balance sheet date, the management of the Bank revises those models to make sure they faithfully represent current market conditions, including relative market liquidity and interest margins.
Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost.

E) Financial Liabilities

Financial liabilities that are not classified as at fair value through profit or loss fall into category “other liabilities” and are measured at amortised cost. Financial liabilities measured at amortised cost are deposits from banks or customers, convertible bonds, other borrowed funds and subordinated debts.
The group classifies the financial instruments into classes that reflect the nature of information and take into account the characteristics of those financial instruments. The classification made can be seen in the table below:

Category per IAS39		Class determined by the Bank
Financial liabilities	Financial liabilities at fair value through profit and loss	Derivative financial liabilities
Financial liabilities	Financial liabilities at amortized cost	Deposits from banks
Financial liabilities	Financial liabilities at amortized cost	Due to customers
Financial liabilities	Financial liabilities at amortized cost	Other borrowed funds
Financial liabilities	Financial liabilities at amortized cost	Subordinated debt
Off-balance sheet exposure	Loan commitments	Loan commitments
Off-balance sheet exposure	Guarantees, acceptances and other financial liabilities	Guarantees, acceptances and other financial liabilities

F) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

G) Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Gains and losses arising from changes in fair value of derivatives are included in “net trading income”. However, the gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with financial assets or financial liabilities designated at fair value are included in “net result from financial assets at fair value through profit or loss”.
The group had only economic hedging transactions during the reporting period.

H) Interest income and expense

Interest income and expense for all interest-bearing financial instruments are recognised within “interest income” and “interest expense” in the income statement using the effective interest method.
The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the group estimates cash flows and considers all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.
Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

I) Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan.

J) Impairment of financial assets carried at amortised cost

The group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event”) and that a loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.
The criteria that the group uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower (for example, equity ratio, net income percentage of sales);
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower’s competitive position;
- Deterioration in the value of collateral; and
- Downgrading below investment grade level.

The group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the group determines that no objective evidence of impairment exists for an individually assessed

financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.
The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows (excluding future credit losses that have not been incurred) discounted at the original effective interest rate. 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.
The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.
For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). These characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.
Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.
Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the group to reduce any differences between loss estimates and actual loss experience.
When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined.
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 the reversal is recognised in the income statement in impairment charge for credit losses.

K) Impairment of financial assets classified as available for sale

The group assesses at each date of the consolidated statement of financial position whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available-for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the consolidated income statement. Impairment losses recognised in the consolidated income statement on equity instruments are not reversed through the consolidated income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the consolidated income statement.

L) Intangible assets

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives and the period licenses are issued for. Software has a maximum expected useful life of 5 years. Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred.

M) Property and equipment

Premises and equipment are stated at historical cost less accumulated depreciation and provision for impairment, where required.
Historical cost includes expenditure that is directly attributable to acquisition of the items.
Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to other operating expenses during the financial period in which they are incurred.
Depreciation of fixed assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

- Buildings – 40 years
- Leasehold improvements – shortest of 10 years or leasehold contract duration,
- Motor vehicles – 5 years,
- Furniture – 10 years,
- Computers – 5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.
Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in other operating expenses in the income statement.

N) Impairment of non-financial assets

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

O) Leases

(a) A group company is the lessee

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases.
The leases entered into by the group are primarily operating leases. The total payments made under operating leases are charged to other operating expenses in the income statement on a straight-line basis over the period of the lease.
When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

(b) A group company is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return.

P) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than a three-month maturity from the date of acquisition, including cash and non-restricted balances with the Central Bank, treasury bills and other eligible bills, loans and advances to banks, amounts due from other banks and short-term government securities.

Q) Provisions

Provisions for legal claims are recognised when: the group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.
Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any item included in the same class of obligations may be small.
Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is recognised as interest expense.

R) Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.
Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of the management.
Any increase in the liability relating to guarantees is included in the income statement under "other operating expenses".

S) Employee benefits

(a) Pension obligations

The group operates a defined contribution pension plan. The group companies pay contributions to publicly administered pension insurance plans on a mandatory basis. The group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

(b) Other employee benefits

The group companies provide termination benefits, as required by labour laws in Serbia. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and/or the completion of a minimum service period and is calculated as three monthly average salaries in Serbia in the month before employee retirement. The expected costs of these benefits are accrued over the period of employment. The defined benefit obligation is valued annually by independent qualified actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

The assumptions used by the actuary to calculate the retirement benefits are as follows:

– Three average salaries in December 2011 for the Serbian economy as a whole;
– Estimated annual increase in salaries of 3%; and
– Discounting rate of 8%.

T) Current and deferred income tax

a) Current income tax

Income tax represents the amount calculated and paid to the tax authorities, based on legislation in the Republic of Serbia. Estimated monthly instalments are calculated by the tax authority and paid in advance on a monthly basis.
Income tax at the rate of 10% is payable based on the profit disclosed in the tax return. In order to arrive at the taxable profit, the accounting profit is adjusted for certain permanent differences and reduced for certain investments made during the year. The tax return is submitted to the tax authorities 10 days after submission of the financial statements, i.e. on 10 March of the following year.
According to Serbian tax law, the group is entitled to tax credits, based on the amounts invested in property and equipment and the number of new employees hired, and to use these credits to reduce the current income tax liability. Tax credits for new employees hired

can be used by the group only in the year when declared. Tax credits for new investments in property and equipment can be carried forward for a period of 10 years. In order to be eligible to use these investment tax credits, the group should not dispose of the relevant property and equipment items for a period of at least three years from the year in which the tax credit was declared. The tax credit calculation is open to tax audit by the tax authorities for a period of 5 years from the year in which the tax becomes due for payment.

b) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.
Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.
The principal temporary differences arise from depreciation of property and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits and tax losses carried forward. The rates enacted or substantively enacted at the balance sheet date are used to determine deferred income tax.
Deferred tax assets are recognised for all deductible temporary differences, unused tax assets and unused tax losses, to the extent that it is probable that future taxable profits will be sufficient to enable realisation (utilisation) of deductible temporary differences, unused tax assets and unused tax liabilities.
Deferred tax related to fair value re-measurement of available-for-sale investments, which are charged or credited directly to “other comprehensive income” is also credited or charged directly to “other comprehensive income” and subsequently recognised in the income statement together with the deferred gain or loss.

U) Borrowings

Borrowings are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

V) Share capital

(a) Share issue costs
Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction, net of tax, from the proceeds.

(b) Dividends on ordinary shares
Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank’s shareholders.
Dividends for the year that are declared after the balance sheet date are dealt with in the subsequent events note.

W) Repossessed property

In certain circumstances, property is repossessed following the foreclosure of loans that are in default. Repossessed properties are measured at the lower of the carrying amount and fair value less costs to sell and are reported in “other assets”.

X) Critical accounting estimates and judgments

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

(a) Impairment losses on loans and advances

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

(b) Provisions

Provisions in general are highly judgmental, especially in the cases of legal disputes. The group assesses the probability of an adverse event as a result of a past event to happen and if the probability is evaluated to be more than fifty percent, the group fully provides for the total amount of the liability. The group is rather prudent in these assessments, but due to the high level of uncertainty, in some cases the evaluation may not prove to be in line with the eventual outcome of the case.

3. Financial risk management

The group’s activities are exposed to a variety of financial risks. This exposure demands organised activities related to analysis, evaluation, acceptance and management of some degree of risk or combination of risks. Taking risk is core to the financial business, and the operational risks are an inevitable consequence of being in business. The group’s aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects of risks on the group’s financial performance.
The group’s risk management procedures are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The group regularly reviews its risk management procedures and systems to reflect changes in markets, products, legislature and emerging best practice.
Risk management is carried out by the group’s Risk Department and specialised risk committees under risk strategy and policies approved by the Board of Directors. The Risk Department and the Portfolio Management Department identify, evaluate financial risks and makes proposals to the risk committees to hedge those risks in close co-operation with the group’s business units. The Board of Directors provides principles for overall risk management, as well as written policies covering specific areas, such as foreign

exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments. In addition, internal audit is responsible for the independent review of risk management and the control environment. The most important types of risk are:

- Credit risk,
- Liquidity and funding risk,
- Market risks (including currency risk, interest rate and other market price related risks),
- Operational and other risks.

Impact of the Crisis on Operations of the Group

During 2010 and in the second half of 2011, several EU countries were faced with huge public debts and were forced to introduce austerity measures, which had a corresponding negative impact on their GDPs. The main problems are the record high unemployment rates and further economic slowdown. The IMF also notes that at the same time, European banks have reduced lending in order to strengthen their capital reserves – which will probably cause further negative impacts in 2012 on Central and Eastern European economies that rely on support in the form of lending from European banks.
After growing by 5% in 2010, the world economy grew by 2.7% in 2011. However, this is a result of the forecasted 9.1% growth in China, whereas the eurozone showed economic growth of just 1.6%. Projections for 2012 indicate that due to the effects of the debt crisis in Europe, the expected growth in the global economy will be at a level even lower than 2011.
For the 17 EU counties where the euro is the official currency, the World Bank has predicted an overall economic shrinkage of 0.3% for 2012. For Serbia, the 1.5% GDP growth in 2011 followed the growth of 3.0% achieved in 2010. The IMF forecast for 2012 again projects an increase of 1.5% in Serbian GDP.
Due to this macroeconomic climate in the EU, the NBS has taken measures in order to encourage bank lending activity.
In December 2011 the NBS adopted changes in the way assets and off-balance sheet items are classified. The primary aim of the change is to reduce expected risk costs, which should make it easier to provide loans in the real economy at more favourable interest rates.
During 2011, the Government of the Republic of Serbia continued to provide initiatives through various programmes and mechanisms, including subsidised loans. The government's primary goal for 2012 is to protect jobs, which is reflected in the subsidies given to support those sectors of the economy with large workforces.
The Bank's clients – borrowers – were faced with liquidity shortages in both 2010 and 2011; this is also expected to be the case in 2012 and will have implications on their capacity to service loan liabilities. Likewise, the deterioration of the borrowers' business environment may have an adverse impact on the cash flows projected by the Bank's management, as well as on our impairment estimates for financial and non-financial assets. According to available information, however, the management accurately projected future cash flows in terms of impairment assessments.
Lack of liquidity in the Serbian market has also had an unfavourable impact on the fair value of property pledged to the Bank as collateral for loans and other placements. Such an adverse effect is reflected in the marketability and real market value of most collateral items, including residential and commercial real estate, as well as various kinds of movable property. This fall in the fair value of collateral items may lead to an increase in the assumed credit risk, and could trigger losses in the future.
Taking into account the above-mentioned situation and its potential effects, the Bank took supplementary measures to keep the adverse effects of the crisis under control during 2010 and 2011. To that end, the Bank strove to minimise the effects of the crisis on the Bank's exposure to market risk, financial risk and credit risk, as well as the general economic downturn. This involved a range of measures intended to enhance many processes and activities, including the monitoring of borrowers and receivable collections, amendments to loan conditions and pledges required, as well as the training and recruitment of employees in the domain of financial analysis and outstanding debt recovery. The Bank is paying particular attention to its exposure to particular client categories, i.e. those with business activities significantly influenced by the crisis.

A) Management of the Overall Risk Profile

The group is not allowed to take on more risk than it is capable of bearing. This rule is put into operation using specified limits for all types of risks and a risk bearing capacity model which stipulates that at all times the predefined economic Tier I + II capital has to be available to cover potential losses. This model was developed further in the course of 2009, 2010 and 2011. Results are presented below.

The capital management of the group has the following objectives:
- Full compliance with external capital requirements set by the regulators of the banking sectors in the jurisdictions where the group entities operate.
- Meeting the internally defined minimum capital adequacy requirements.
- Enabling the group to implement its plans for continued growth while following its business strategy as a "neighbourhood bank".

The capital management of the ProCredit Bank is governed by the Group Policy on Capital Management and the Group Policy on Risk Bearing Capacity. To ensure that the above stated objectives are met at all times, the Bank uses four indicators. Aside from regulatory and Basel II capital ratios, the leverage ratio and risk bearing capacity are monitored on a monthly basis by the Assets and Liabilities Committee (ALCO).

A.1. Capital Adequacy
External minimum capital requirements are imposed and monitored by the local banking supervision authorities – the National Bank of Serbia. Local supervision is based on stand-alone financial statements according to local accounting rules.
The group's objectives when managing capital can be set down as follows:
- To comply with the capital requirements set by the National Bank of Serbia
- To comply with the capital requirements set by International Financial Institutions according to long term loan contracts
- To ensure expected growth stability and development and strong basis for further progress of the group's business

Capital adequacy is addressed in detail during the process of business planning. The National Bank of Serbia is kept informed of the Bank's capital adequacy ratio on a quarterly basis.
The National Bank of Serbia requires that every bank, at any moment, has a minimum nominal amount of EUR 10 million in share capital and a capital adequacy ratio of minimum 12%.

The Bank's capital consists of 3 parts:
- Tier 1 capital, consists of share capital, share premium, reserves, retained earnings, excluding current year profit;
- Tier 2 capital, consists of subordinated loan capital and reserves from profit for general banking risks up to 1.25% of risk weighted assets, preferential shares, emission premium based on preferential shares, revalorisation reserves based on investments in fixed assets and subordinated liabilities of the Bank up to 50% of core capital;

- Deductable items, consists of collective impairment allowances, share in capital of banks or other financial institutions exceeding 10% of capital of the organisation that is invested into, and 10% of the investing bank capital and the amount of the tier 2 capital of the Bank which exceeds its tier 1 capital.

Table below shows the capital elements and calculation of the capital adequacy ratio as per IFRS standards for the years ended on 31 December.

	31.12.2011	31.12.2010
Tier 1 capital		
Share capital	3,663,012	3,663,012
Share premium	2,776,745	2,776,745
Legal reserves	1,643,864	1,345,592
Retained earnings	584,625	773,336
Intangible assets	(210,778)	(214,157)
Total qualifying Tier 1 capital	**8,457,469**	**8,344,528**
Tier 2 capital	**2,791,921**	**2,276,198**
Deductions from equity	**(337,692)**	**(335,611)**
Total regulatory capital	**10,871,697**	**10,285,115**
Risk weighted assets		
Assets weighted by credit risk	50,143,889	62,547,387
Open currency position	255,558	985,118
Assets weighted by operational risk	8,968,665	–
Total risk weighted assets	**59,368,112**	**63,532,505**
Capital adequacy ratio	**18.31%**	**16.19%**

During the year 2011 there were no additional increases in share capital compared to the end of 2010.

A.2. Risk Bearing Capacity

In addition to regulatory capital ratios, the group assesses its capital adequacy by using the concept of risk bearing capacity to reflect the specific risk profile of the group, i.e. comparing the potential losses arising from operations with the its risk bearing capacity.
The risk taking potential of the group is defined as the equity (net of intangibles) plus subordinated debt, which amounted to RSD 13,500,824 thousand as at the end of December 2011. The Resources Available to Cover Risk ("RAtCR") were set at 60% of the risk-taking potential, i.e RSD 8,100,494 thousand. The table below shows the risk bearing capacity limit and the level of utilisation as at the end of December 2011 and 2010.

	Limit (in%)	Actual (in%)	Risk Taking potential	Actual
2011	60.0	23	13,500,824	3,099,611
2010	60.0	36.7	11,298,414	4,146,018

As the above table indicates, the group showed a modest level of utilisation of its RAtCR as at end of December 2011. All risks combined, as quantified by the methods established in the group's policies, are considerably below the 60% of the group's total risk-bearing potential as defined.

B) Credit risk

The group is exposed to credit risk, which is the risk that a counterparty will be unable or unwilling to pay the debt amounts in full when due. The group's primary exposure to credit risk arises through its loans to customers.

In order to keep the credit risks at an acceptable level the group:

- Evaluates the creditworthiness of each client individually including his/her exposure to loans and off-balance sheet liabilities;
- Analyses risks arising from the investment which is the purpose of the loan;
- Determines limits for credit exposure to its clients;
- Approves loans only to creditworthy clients and secures appropriate collateral;
- Separates the process of maintaining client relationships from the process of assessing client's credit worthiness; this applies to all loans to medium clients;
- Takes mandatory down-payments of 20% to 30% from clients for each finance leasing contract as a cushion against depreciation in the value of the leased object.

B.1. Loan approval policy

To control the credit risk exposure, the Bank has defined a prudent lending policy. The clients that are subjects of the lending process are carefully analysed. Loan approval decisions are based on of the client's loan repayment capability and appropriate means of collateral as loan coverage. All clients must fulfil the following criteria:

- Have a stable and profitable business (in case of legal entities, entrepreneurs and agricultural producers),
- Be capable of meeting future loan repayments (applies to all clients),
- Should the Bank identify maturity mismatches between certain types of assets and liabilities on the client's balance sheet, this mismatch has to be justifiable (in case of legal entities, entrepreneurs and agricultural producers),
- Cash flow does not indicate potential problems (in case of legal entities, entrepreneurs and agricultural producers),
- Good credit record and repayment history with ProCredit Bank and/or other banks (applies to all clients),
- Provide adequate collateral (applies to all clients),
- Have adequate business management and organisation (in case of legal entities, entrepreneurs and agricultural producers).

In the light of the impact of the global financial crisis on the liquidity and financial position of the group's borrowers, the group has tightened the creditworthiness rules for clients. The maximum exposure, which includes all loan instalments versus client's monthly profitability (net cash flow), has been changed and now stands at a level of 50 to 70%.

B.2. Loan Loss Classification

The group has developed procedures for the classification of its loans and off-balance sheet exposures, regarding the degree of credit risk associated with clients. In addition, two methodologies for loan loss classification standards have been developed to satisfy the requirements of:

1. Laws and regulations enacted by the National Bank of Serbia (NBS); and
2. Internal loan loss provisioning policies.

Calculation of allowances for impairment provisions against potential losses for ProCredit Bank
The Bank calculates allowances for loan impairment monthly for the portfolio of loans subject to automatic processing of group provisioning, and for individual impairments –i.e. those determined at individual client level.

In case of group provisioning (at portfolio level) a general weighting, calculated for each risk class, is applied automatically; whereas individual impairment is calculated and determined at client level in accordance with the Bank's specific risk exposure.
Total impairment of balance sheet assets is the sum of impairments calculated by risk class weighting for accounts receivable (calculated provisions) and the amount determined for individual impairments.
For off-balance sheet exposures, the Bank determines provisions based on an internal methodology which defines the provision level based on the particular type of off-balance sheet exposure.
At the time of loan approval, the loan will be allocated (in line with PCB classification) to class I (loan is not in arrears at the time of approval). Credit rules and credit risk management policy allow lending only to clients with good business results and who satisfy strict eligibility criteria defined by the Bank and its shareholders; thus ensuring that rigid and prudent credit risk assessments are performed ex-ante for all clients.

B.2. Loan Loss Classification
Balance sheet items, which according to general rules should change risk class due to the number of days in arrears, will not be reclassified if the amount in arrears in less than EUR 2.00 (31 December 2011: 1 EUR = 104.6409 RSD).

Group /individual provisioning
Group provisions are calculated by applying the general weighting determined for each internal risk class, for both the client and related parties, in line with the contamination principle for outstanding amounts, while individual provisions are determined per client in line with prescribed criteria.
On a group basis, loans are classified into specific internal risk classes for each party, according to the number of days in arrears, and the provisions are determined by applying a general weighting to each risk class based on the definitions below. General weighting is defined according to an internal methodology based on the migration analysis which takes into account historical developments in the portfolio. The weighting indicates the present likelihood that a certain party's risk status (risk of non-settlement) will change and is defined in compliance with internal policy. General provisioning weighting over the preceding period and the equivalent of the Bank's average historical losses is the weighting applied for a large number of parties, i.e. it is defined at portfolio level as an average volume.

Rules for calculation of the provisioning basis

In line with internal policy, provisions for losses allocated to loans, credit cards and authorised current account overdrafts, bill of exchange protests, private client account fees, account transaction fees, i.e. those of the Bank's balance sheet assets which are exposed to credit risk, and off-balance sheet exposures, which could potentially be at risk.

The provisioning basis includes:
- Principal amount not yet due
- Due principal and interest, booked penalty interest
- Authorised current account overdrafts – utilised portion of the approved limit (receivables on the balance sheet), as well as unauthorised overdraft amounts
- Credit cards – utilised portion of the approved limit (receivables on the balance sheet), as well as unauthorised overdraft amounts
- Receivables on the balance sheet originating from off-balance sheet assets, bill of exchange protests and paid letters of credit
- Account transaction fees, and private individual account fees

Receivables as the basis for calculation of provisions against loan losses are reduced by the deposit amount.

Rules for classification

The risk classification of the party/client relies on the following principles:

- The principle of the number of days in arrears per client's party
- Contamination principle, i.e. the party/client and all related parties are monitored, and accordingly all parties are allocated to the lowest risk class a related party has. If the client can be located in more than one group of related parties, the client will be allocated to the lowest class which a party in any one the groups of related parties has, but will not transfer this class to another party which is not located in the group best owing the lower risk class on this client.
- The portfolio of restructured loans is classified differently from the rest of the portfolio. The breakdown of restructured loans includes following categories: standard, watch and impaired, based on criteria defined in a special document "rules for restructured credit exposures". A restructured loan in the category "watch" (arrears over 30 days at the time of restructuring) will have a different risk class compared to the class defined as standard for the rest of the portfolio.
- Credit cards and fees for transaction accounts and private client accounts will not affect the reclassification of other clients' parties from the view point of the rule for related parties if the card/overdraft/fee claim is less than or equal to EUR 1,000 (31 December 2011: EUR 1= 104.6409 RSD), because of their material insignificance for the total portfolio. These parties will be classified according to the number of days in arrears on the classification date. Therefore, if a legal entity has borrowed from the Bank and the owner (as a related party) has credit-card debts of up to EUR 1,000, credit card default will not trigger the reclassification of loans disbursed to the legal entity.

Provisioning weights:

General/group classification	Party class	Provisioning weight 2011	Provisioning weight 2010
No repayment arrears or arrears up to 30 days	I	1.00%	1.00%
Restructured loan – standard, arrears up to 30 days	Standard	4.00%	3.50%
Restructured loan – watch, arrears up to 30 days	Watch	13.00%	12.00%
Restructured loan – impaired, arrears up to 30 days	Impaired	16%	25%
Arrears between 31 and 90 days	II	55%	55%
Arrears between 91 and 180 days	III	70%	70%
Arrears between 181 and 360 days and terminated agreements	IV	100%	100%
Individual provisioning	Impairment	Individually determined	Individually determined

Individual provisioning assessment (impairment)

Individual provisioning is calculated for clients whose total debt amount to the Bank exceeds EUR 30,000 (31 December 2011: 1 EUR = 104.6409 RSD) at the time of classification (including all related parties), and whose arrears exceed 30 days at the end of the month (refers to both standard and reprogrammed loans).
Likewise, individual impairment can be calculated even if a client is less than 30 days in arrears (over EUR 30,000 of total outstanding debt per group of related parties) if there are indicators of changes in the client's business, i.e. if the client is facing certain business problems and if the indicators show that the loan will exceed 30-day arrears. The frequency of monitoring of a borrower's financial position is determined by the credit committee in accordance with the Bank's policies, the credit committee assesses the credit risk pursuant to the criteria defined by the Bank's rules and regulations.
When monitoring any borrower, all factors are taken into account which may aggravate a client's eligibility or cause the pledge quality to deteriorate, thus leading to problems in loan collection. These factors are:

- Information from borrowers' financial reports indicating financial problems or potential aggravation of the financial situation
- Possibility of business cessation due to financial problems, owner's death or illness, changes in management structure, changes in buyer or supplier structure, changes in competition that may have a material adverse effect on the client's business
- Deterioration in pledge value or liquidity
- Historical trend in loan instalment payments, implying it is not likely that the total loan amount will be repaid by the borrower
- Other factors, such as general economic conditions, regional risk, industry risk, regulatory risk, dependence on buyers and suppliers, and the like.

The Credit Analysis Department, in cooperation with the responsible credit staff, is in charge of preparing the impairment analyses for such loans, on the basis of which the weighting for individual provisioning is determined, also taking into consideration the possibility of collection through the sale of the pledged collateral item. Based on this analysis, the Bank will make its final decision on individual provisioning for the respective client.

Basis
In case of individual impairments, the basis represents the total amount of balance sheet receivables (due and undue principal, due interest).

Analysis of discounted cash flows (impairment analysis) – defining individual impairment weights

The individual impairment of the book value of the exposure is determined on the basis of net present value of future inflows.
Impairment analyses are performed at the level of the group of related parties for all balance sheet receivables of the Bank from that borrower. Impairment analyses should be performed annually for each client for whom the decision to have individually weighted provisions has been reached. If material changes occur in the quarter during which an individual weighting has previously been determined, it is necessary to do a new analysis and determine a new weighting. The risk weight used in this case for the calculation of provisioning represents the potential loss for the Bank expressed as a percentage.
Impairment analyses are prepared taking into account both qualitative and quantitative criteria:

- Client's (group of related parties) total debt with respect to all credit (balance sheet) products in the Bank, including bill of exchange protests, but excluding potential liabilities (documentary products) or ProCredit Leasing placements.
- Claimed amounts monitored in the course of the analyses are the total due liabilities of the group of related parties (principal, due interest and due booked penalty interest).
- Anticipated problems with loan collection, and problems faced by client
- Data on the pledge type and value, as well as the possibility of pledge activation
- Expected loan amount to be recovered through borrower's payments or through enforced sale of loan collateral over the next 3 years, including costs of sale

For the purpose of determining the weighting for individual exposure provisioning for a particular borrower, it is necessary to:

- Prepare cash flow projections that will include data on the loan instalment maturity, as well as data about the expected loan amount recovered through borrower's payments and from sale of collateral items
- Future cash flows of the expected collection are discounted by the weighted effective interest rate of all the borrower's loans
- The projected loss is calculated, at the date of the impairment analysis, as the difference between receivables from the borrower and the present value of the projected collection arising from those receivables

The individual provisioning weight is related to the total exposure towards the client, calculated as a percentage of the potential loss. Irrespective of the number of days in arrears, an individual loan will be immediately reclassified as class V ("terminated" status), in accordance with the credit committee decision, if the loan agreement is terminated.

Write-off policy
As a rule of thumb, ProCredit Bank writes off all loans with repayment arrears exceeding 360 days with an outstanding debt of over EUR 10,000, and loans with arrears exceeding 180 days with an outstanding debt less than EUR 10,000. Exceptions are loans with an outstanding debt in excess of EUR 30,000, with acceptable collateral, over 360 days in arrears, and with expected collection; in this situation the claim is not written off.
As a general rule, claim write-off is possible only if the claim already has 100% provisioning.

Necessary documentation
All branches / business centres are required, according to credit procedures, to create a credit file for each client regardless of the nature of the client's exposure (be it a loan, credit card, overdraft or documentary business). The necessary credit file documentation is defined by an internal Bank document "CFO" (credit file order).

Calculation of allowances for impairment – provisions against potential losses for ProCredit Leasing
Loan-loss classification and the creation of provisions with regard to credit risk for financial leases is conducted in accordance with the number of days in arrears, the amount of the receivable from the client and the status of the leasing contract. Loan-loss classification is conducted on the level of the client and not the level of individual financial leasing contracts.
Status "Leased" means that the financial leasing contract with the client is active. Within this status allowances are created in line with number of days in arrears, estimated losses on the portfolio level and the probability of these losses for group (portfolio) level allowances, while on the level on individual clients this is conducted for significant receivables on an individual basis using the analysis of discounted cash flow.

Status “Terminated” means that the financial lease contract with the client has been terminated. It has two more sub-statuses – “In Possession” when the leased asset is in the possession of ProCredit Leasing and “Out of Possession” when the leased asset is not in the possession of ProCredit Leasing.
Calculation of the risk classes and allowances is conducted quarterly except for the sub-status “In Possession” for which it is calculated upon allocation to this status.
The basis for calculating allowances is the outstanding debt of the client at the time of determining loan-loss classification, which includes outstanding principle, principle overdue, interest and penalties.
Loan-loss classifications and impairment provisions at 31 December 2011 are shown in the table below.

Status	Number of Days in arrears / sub-status	Up to EUR 50,000	Over EUR 50,000
Leased	0	–	–
Leased	1 to 30 Days	–	–
Leased	31 to 60 Days	–	–
Leased	61 to 90 Days	Portfolio level 24%	Client level
Leased	91 to 180 Days	Portfolio level 30%	Client level
Leased	Over 180 Days	Portfolio level 43%	Client level
Leased	Over 360 days	Portfolio level 100%	Client level
Leased	In possession	Client level	Client level
Leased	All due(w/o leased assets)	Portfolio level 43% until 6 months after contract termination, after this 100%	Client level

Leasing internal loan loss classification rating for 2010 is shown below.

Status	Number of Days in arrears / sub-status	Up to EUR 50,000	Over EUR 50,000
Leased	0	–	–
Leased	1 to 30 Days	–	–
Leased	31 to 60 Days	–	–
Leased	61 to 90 Days	Portfolio level 20%	Client level
Leased	91 to 180 Days	Portfolio level 30%	Client level
Leased	Over 180 days	Client level	Client level
Leased	In possession	Client level	Client level
Terminated	Out of possession	Portfolio level 42% until 6 months after contract termination, after this 100%	Client level

The impairment provision shown in the balance sheet at year-end is derived from each of the five internal rating classes. However, the majority of the impairment provision comes from the bottom two classes. The table below shows the percentage of the group’s balance sheet items relating to loans and advances and the associated impairment provision according to the rules governed by the group’s internal methodology.

		31.12.2011		31.12.2010
	Impairment provision (%)	Loans and advances (%)	Impairment provision (%)	Loans and advances (%)
I	1.2	94.8	1.1	95.9
II	49.0	0.5	50.2	0.5
III	62.4	0.3	65.3	0.5
IV	99.6	1.9	98.3	0.9
Impairment	36.6	2.5	23.5	2.2
	4.2	**100.0**	**3.0**	**100.0**

Associated impairment provision percentages in this case represent the relationship between the extracted impairment provision and the gross amount of loans and advances to customers without taking into consideration deductible items, which can lower the basis for calculating impairment provisions. Financial lease receivables are, for the purpose of this analysis, shown in risk class I if their status is “Leased” with arrears up to 30 days. Financial lease receivables are shown in risk class II if their status is “Leased” with arrears between 31 and 90 days. Financial lease receivables are shown in risk class III if their status is “Leased” with arrears between 91 and 180 days. Financial lease receivables are shown in risk class IV if their status is “Leased” with arrears of over 180 days or if their status is “Terminated”.

B.3. Quality of the Loan Portfolio and the Maximum Exposure to Risk before Collateral Held

The quality of the loan portfolio is high, which is reflected in the low level of portfolio at risk (defined as the unpaid part of loan portfolio with at least one instalment overdue 30 days or more). The general rule of the Bank is that a loan is written off after it has been in arrears for 360 days. However, in special cases a write-off is possible before this.

The following table shows exposure to credit risk at 31 December 2011 and 2010 indicating total exposure to credit risk without taking into consideration means of collateral. The table also includes off-balance sheet items which might lead to credit risk.

Maximum Exposure Before Collateral		
	2011	**2010**
Balance Sheet Exposure		
Balances with Central Bank other than mandatory reserve deposits	18,145	10,788
Loans and advances to banks		
Loans to banks within a group	13,124	16,443
Loans to OECD banks	449,591	271,562
Loans to domestic and non-OECD banks	107,812	425,641
Total loans and advances to banks and balances with Central Bank	**588,672**	**724,433**
Loans and advances to customers (net):		
Business	27,876,813	25,562,625
Agricultural	12,047,057	11,264,906
Housing	1,887,634	4,002,508
Finance leases	1,969,585	2,233,984
Consumer	2,322,159	2,262,784
Other	1,530,760	1,649,549
Total loans and advances to customers	**47,634,008**	**46,976,356**
Other financial assets (Note 22)	352,802	37,951
Off balance sheet credit risk exposure (Note 34)	9,067,588	8,099,743
At 31 December	**57,054,398**	**55,838,482**

In the above table the position of housing loans for 2011 includes only loans disbursed to private individuals – salary receivers, whereas the position for 2010 includes all loans for housing purposes including loans disbursed to business and agricultural clients. Housing loans disbursed to private individuals – salary receivers at the end of 2010 amounted to RSD 2,128,754 thousand.

The table above represents the scenario of the maximum credit risk exposure of the group at 31 December 2011 and 2010, without taking account of any collateral held or other credit enhancements attached. For on-balance sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet.

- 83.5% of the total exposure is related to loans to customers and financial leases thus reflecting the major business activity of the group (31 December 2010: 84.1%);
- 94.8% of the total of loans and advances is classified in the most favourable impairment class according to the group’s internal methodology (31 December 2010: 95.9%);
- 28.8% of loans and advances to customers are covered by mortgages or customer deposits (31 December 2010:29.1%)

The table below shows quality structure of the loan portfolio (gross amounts):

		31.12.2011		**31.12.2010**
	Loans to clients	**Loans to banks**	**Loans to clients**	**Loans to banks**
Neither past due nor impaired	43,392,509	588,672	44,893,077	724,432
Past due but not impaired	4,072,105	–	1,885,468	–
Impaired	2,254,192	–	1,834,344	–
Total	**49,718,806**	**588,672**	**48,612,889**	**724,432**

The total allowance for impairment is RSD 2,084,798 thousand (31 December 2010: RSD 1,636,533 thousand). Out of this amount, individually impaired loans make up RSD 454,536 thousand (31 December 2010: RSD 399,373 thousand) and the remaining amount of RSD 1,630,262 thousand (31 December 2010: RSD 1,237,160 thousand) represents the group allowance.

(a) Loans and advances neither past due or impaired

The credit quality of the portfolio of loans and advances that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by the group. All loans and advances to customers that are neither past due nor impaired are mostly classified in risk class I according to group's internal methodology.

		31.12.2011		31.12.2010
Business loans	24,736,335	57.01%	24,445,522	54.45%
Agriculture loans	11,513,007	26.53%	10,930,451	24.35%
Consumer loans	2,269,532	5.23%	2,041,545	4.55%
Housing improvement loans and housing loans	1,834,275	4.23%	3,833,864	8.54%
Other	1,396,734	3.22%	1,640,270	3.65%
Finance leases	1,642,626	3.79%	2,001,425	4.46%
Total loans to customers	**43,392,509**	**100.00%**	**44,893,077**	**100.00%**

Loans and advances to banks are exposures to banks with the following Standard and Poor's credit ratings:

		31.12.2011		31.12.2010
AA- to AA+ rated	–	0,00%	13,671	1.92%
A- to A+ rated	462,715	81,10%	364,207	51.03%
BB-	107,812	18,90%	319,451	44.76%
Not rated	–	0.0%	16,316	2.29%
Total loans and advances to banks	**570,527**	**100.0%**	**713,645**	**100.0%**

The following table indicates the quality of loans and advances to customers and banks which are neither past due nor impaired for 2011 and 2010:

		31.12.2011		31.12.2010
	Loans to clients	Loans to banks	Loans to clients	Loans to banks
I	43,332,069	588,672	44,802,428	724,432
II	19,551	–	38,634	–
III	4,823	–	23,201	–
IV	26,270	–	28,814	–
Total	**43,392,509**	**588,672**	**44,893,077**	**724,432**

(b) Loans and advances past due but not impaired

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Gross amounts of loans and advances by class to customers that were past due but not impaired were as follows:

31 December 2011	Business loans	Agriculture loans	Consumer loans	Housing improvement and housing loans	Other	Finance leases	Total
Past due up to 30 days	2,674,384	565,395	110,429	59,179	148,118	232,802	3,790,307
Past due 31 to 90 days	144,230	59,679	22,155	24,509	2,244	28,981	281,798
Total	**2,818,614**	**625,074**	**132,584**	**83,688**	**150,362**	**261,783**	**4,072,105**

31 December 2010	Business loans	Agriculture loans	Consumer loans	Housing improvement and housing loans	Other	Finance leases	Total
Past due up to 30 days	747,581	313,063	213,835	151,482	1,220	152,005	1,579,186
Past due 31 to 90 days	149,552	42,853	22,446	47,380	1,306	42,745	306,282
Total	**897,133**	**355,916**	**236,281**	**198,862**	**2,526**	**194,750**	**1,885,468**

c) Loans and advances to customers individually impaired

Loans that are overdue by more than 90 days are considered to be impaired. This also includes individually impaired loans.
As at 31 December 2011, individually impaired loans amounted to RSD 1,243,362 thousand (31 December 2010: RSD 1,053,380 thousand).
The following table gives a composition of collectively impaired loans and allowances:

	Business loans	Agriculture loans	Consumer loans	Housing improvement and housing loans	Finance leases	Total
31 December 2011						
Gross exposure	502,003	140,335	179,233	62,038	127,221	1,010,830
Allowance	433,485	97,882	173,527	52,091	66,093	823,078
Net exposure	68,518	42,453	5,706	9,947	61,128	187,752
31 December 2010						
Gross exposure	434,820	89,303	115,782	64,073	76,985	780,963
Allowance	376,864	74,901	113,353	48,439	39,995	653,552
Net exposure	57,956	14,402	2,429	15,364	36,990	127,411

The following table shows the composition of individually impaired loans and allowances.

	Business loans	Agriculture loans	Consumer loans	Housing improvement and housing loans	Finance leases	Total
31 December 2011						
Gross exposure	1,035,276	139,024	165	14,717	54,180	1,243,362
Allowance	355,730	53,857	58	7,137	37,754	454,536
Net exposure	679,546	85,167	107	107	16,426	788,826
31 December 2010						
Gross exposure	699,077	153,881	793	83,710	115,919	1,053,380
Allowance	273,403	69,681	231	15,200	40,858	399,373
Net exposure	425,674	84,200	562	68,510	111,550	609,342

The table below indicates the allowance level which the Group would incur if collateral was not recognised in the allowance calculation for individually impaired loans. Inclusion of future cash inflows from the sale of collateral in the calculation for individually impaired loans reduces the allowances, which would otherwise be included. Future cash inflows from the sale of collateral are based on estimated market prices at the time of expected sale, adjusted for haircut effects.

31 December 2011	Gross exposure	Allowance
Business:	1,035,276	524,215
Agricultural:	139,024	70,395
Housing:	14,717	7,452
Finance leases:	54,180	54,180
Consumer:	165	84
Total:	**1,243,362**	**656,326**

31 December 2011	Gross exposure	Allowance
Business:	699,077	466,420
Agricultural:	153,881	66,023
Housing:	83,710	13,853
Finance leases:	115,919	115,919
Consumer:	793	219
Total:	**1,053,380**	**662,434**

(d) Repossessed collateral

The following table below indicates the balances and types of repossessed collateral held by the group at 31 December 2011 and 2010.

	31 .12.2011	31.12.2010
Real-estate bank:	2,172	–
Movable - bank:	2,148	8,213
Movable - financial leases:	38,243	65,499
Total:	**42,563**	**73,712**

B.4. Collateral Policy

As a general rule, collateral or an external guarantor (or a combination of those two types of security) is required for all disbursed loans. For housing loans, real-estate is required as collateral. The same rule applies for housing improvement loans exceeding EUR 10,000.

For all loans to be approved for amounts over EUR 100,000, or smaller loans that require collateral in the professional opinion of the Bank's lawyer, is necessary to screen any legal risks related to the client's business and to the collateral itself.

For all loans over EUR 30,000 with mortgages as collateral, it is necessary to have an official mortgage estimate made by a court accredited expert.

When financing the purchase of new cars or taxis, fully-comprehensive insurance assigned to the Bank is a necessary means of collateral. In addition when using mortgages as collateral the Bank reserves the right to demand buildings insurance against common risks. Also the Bank can ask for an endowment life insurance policy for the client (only in case of a private person) if deemed necessary.

B.5. Structure and Diversification of the Loan Portfolio

Concentration of exposure risk to various industries and sectors is under constant observation. The sector diversification achieved is at a high level, thus diminishing the credit exposure risk arising from risk concentrations.

For analysis of the portfolio diversification/concentration HHI index was used (Hirschman-Herfindahl Index), representing the sum of squares of relative participation of every sector/industry in the Bank's portfolio. If the result is closer to 1, the portfolio is over concentrated. If the result is closer to the ideal proportion it indicates a low level of portfolio concentration. For the group the ideal proportion would be 1/40, or HHI ratio of 0.025 meaning that the loan portfolio is spread over 40 different sectors/industries. The following table shows the values of HHI ratio for 2011 and 2010:

	2011		2010
HHI ratio by number of loans	**HHI ratio by volume of loans**	**HHI ratio by number of loans**	**HHI ratio by volume of loans**
0.2207	0.1305	0.2176	0.1329

B.5. Structure and Diversification of the Loan Portfolio

The following table sets out the basis for interpretation of the degree of concentration of the group's loan portfolio according to the Hirschman-Herfindahl Index:

Concentration level	HHI
Low	0.025 – 0.26875
Medium	0.26876 – 0.5125
High	0.5126 – 0.75625
Critical	0.75626 – 1

The table below gives a breakdown of the group's loan portfolio by industry, including loans to financial institutions, loans to business clients and agricultural loans on 31 December 2011 and 31 December 2010.

		31.12.2011		31.12.2010
	Placements to clients	**(%)**	**Placements to clients**	**(%)**
Financial institutions	588,672	1.34%	724,432	1.83%
Trade	11,422,419	26.40%	10,891,059	27.45%
Industry and other production	7,759,991	17.93%	6,951,638	17.52%
Construction	938,267	2.17%	921,274	2.32%
Transport	3,193,736	7.38%	2,754,183	6.94%
Tourism	1,433,296	3.31%	1,140,574	2.87%
Other services	5,458,020	12.61%	3,601,872	9.08%
Mixed	1,991,474	4.60%	902,375	2.27%
Agricultural loans	11,074,295	25.59%	11,787,339	29.71%
Total	**43,860,170**	**100.00%**	**39,674,746**	**100.00%**

B.6. Credit related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Guarantees or letters of credit are subjected to the same approval mechanism as regular loans. This also implies that the same collateral requirements apply for off-balance sheet commitments as for loans. Moreover, the Bank measures total client exposure and creditworthiness by also adding off-balance sheet commitments to him/her and by taking into consideration any related parties and their exposure and creditworthiness.

C) Market risk

The policy of the group is not to speculate and to keep all forms of risk at an acceptable level. Market risks arise from open positions in interest rate, 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 group complies with the limits on the value of risk that may be accepted as prescribed by the Central Bank as well as with limits set by internal risk committees.

C.1. Foreign currency risk

Foreign currency risk exposure is monitored regularly through compliance with the regulatory limits prescribed by the Central Bank. The group maintains its foreign currency position by granting loans with foreign currency clauses. Furthermore, the group takes an active approach to currency risk management, and prudently assesses and manages open foreign currency position with foreign currency swaps and by keeping open currency risk exposure within the limits set by the Central Bank, as well as adhering to internal rules and limits prescribed by the Bank's management and risk committees.

The table below summarises the group's exposure to foreign currency exchange risk at 31 December. The table includes the group's assets and liabilities at the relevant carrying amounts, categorised by currency.

31 December 2011	EUR	USD	Other currencies	Total foreign currencies	Local Currency	Total
Assets						
Cash and balances with the Central Bank	6,186,486	526,910	87,553	6,800,949	3,209,102	10,010,051
Loans and advances to banks	336,244	69,277	57,194	462,715	107,812	570,527
Loans and advances to customers	34,760,482	–	–	34,760,482	12,873,526	47,634,008
Derivative Financial Assets	–	–	–	–	2,223	2,223
Available-for-sale financial assets	1,963	17,127	–	19,090	–	19,090
Intangible assets	–	–	–	–	210,778	210,778
Property, plant and equipment	–	–	–	–	1,292,509	1,292,509
Deferred and current tax assets	–	–	–	–	183,751	183,751
Other assets	277,453	25	–	277,478	349,436	626,914
Total assets	**41,562,628**	**613,339**	**144,747**	**42,320,714**	**18,229,137**	**60,549,851**
Liabilities						
Deposits from banks	1,330,643	5,012	4	1,335,659	–	1,335,659
Derivative financial liabilities	3,421	–	–	3,421	42	3,463
Due to customers	19,793,474	889,252	282,988	20,965,714	8,167,226	29,132,940
Other borrowed funds	15,777,007	–	–	15,777,007	(59,530)	15,717,477
Subordinated debt	3,922,781	–	–	3,922,781	(489)	3,922,292
Tax liabilities	–	–	–	–	51,889	51,889
Provisions	48,410	–	–	48,410	116,992	165,402
Other liabilities	12,811	331	–	13,142	367,699	380,841
Equity	–	–	–	–	9,839,888	9,839,888
Total liabilities and equity	**40,888,547**	**894,595**	**282,992**	**42,066,134**	**18,483,717**	**60,549,851**
Net on-balance sheet position	**674,081**	**(281,256)**	**(138,245)**	**254,580**	**(254,580)**	
Credit commitments (Note 34)	**–**	**–**	**–**	**–**	**3,442,746**	**3,442,746**
31 December 2010						
Total assets	**52,699,339**	**644,274**	**125,300**	**53,468,913**	**17,434,341**	**70,903,254**
Total liabilities and equity	**51,064,120**	**1,121,259**	**141,087**	**52,326,466**	**18,576,788**	**70,903,254**
Net on–balance sheet position	**1,635,219**	**(476,985)**	**(15,787)**	**1,142,447**	**(1,142,447)**	**–**
Credit commitments (Note 34)	**–**	**–**	**–**	**–**	**1,961,441**	**1,961,441**

The following table provides an overview of the sensitivity analysis of the exposure to currency risk assuming a change in the local currency exchange rate of 15%:

	Open Currency Position based on balance sheet data on 31 December		Effect of 15% Depreciation of RSD to Open Currency Position		Effect of 15% Appreciation of RSD to Open Currency Position	
	2011	**2010**	**2011**	**2010**	**2011**	**2010**
USD	(281,256)	(476,985)	(42,188)	(71,548)	42,188	71,548
EUR	674,081	1,635,219	101,112	245,283	(101,112)	(245,283)
Other Currencies	(138,245)	(15,787)	(20,737)	(2,368)	20,737	2,368

Bearing in mind the currency structure of the balance sheet, an appreciation of 15% in the value of the local currency would negatively affect profit by RSD 38,187 thousand (2010: negative effect 171,367 thousand). In case of a depreciation of 15% in the value of local currency the positive effect on profit would be RSD 38,187 thousand (2010: positive effect 171,367 thousand).

C.2. Interest rate risk

The group is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rates may increase or decrease as a result of such changes and may create negative effects to the group's capital and/or income. Interest rates are based on market rates which the group reprises and reassesses regularly.

Risk management activities are aimed at optimising net interest income, assuming market interest rate levels consistent with the group's business strategies. In managing the maturity structure, senior management considers i.a.:

- Macro- and microeconomic forecasts,
- Forecasts in liquidity conditions and
- Anticipated trends in interest rates.

Interest rate risk arising from gaps between varying maturities of assets and liabilities with fixed interest rates is managed by balancing the structure of loans and advances to customers with amounts due to customers and other types of short- and long-term borrowings. Interest rate risk arising from maturity gaps between the repricing of long-term loans taken at floating rates, and the repricing of loans disbursed at floating interest rates, is prudently hedged with fixed-for-floating interest rate swaps. As of 31 December 2011 the group had outstanding interest rate swaps worth a notional amount of EUR 1.550 million (31 December 2010: EUR 1.938 million).

The table below summarises the group's exposure to interest rate risks. The table includes the group's assets and liabilities at carrying amounts, categorised by the earlier of either contractual repricing or maturity date.

	Up to 1 month	1 – 3 months	3 – 12 months	1 – 2 years	2 – 5 years	over 5 years	Non–Interest Sensitive	Total
Assets								
Cash and balances with the Central Bank	802,383	–	–	–	–	–	9,207,668	10,010,051
Loans and advances to banks	–	–	–	–	–	–	570,527	570,527
Loans and advances to customers	22,338,172	2,730,588	11,017,336	6,776,177	4,546,245	126,807	98,683	47,634,008
Derivative financial assets	–	–	–	–	–	–	2,223	2,223
Available-for-sale financial assets	–	–	–	–	–	–	19,090	19,090
Other assets	–	–	–	–	–	–	2,313,952	2,313,952
Total assets	**23,140,555**	**2,730,588**	**11,017,336**	**6,776,177**	**4,546,245**	**126,807**	**12,212,143**	**60,549,851**
Liabilities								
Liabilities to banks	1,335,583	–	–	–	–	–	76	1,335,659
Derivative financial liabilities	–	–	–	–	–	–	3,463	3,463
Due to customers	9,850,504	4,105,894	8,464,494	392,188	349,194	81,676	5,888,990	29,132,940
Other borrowed funds	1,935,795	5,833,634	6,209,503	563,880	921,856	93,012	159,797	15,717,477
Subordinated debt	–	2,825,304	–	–	–	1,046,409	50,579	3,922,292
Other liabilities	–	–	–	–	–	–	10,438,020	10,438,020
Total liabilities and equity	**13,121,882**	**12,764,832**	**14,673,997**	**956,068**	**1,271,050**	**1,221,097**	**16,540,925**	**60,549,851**
Interest sensitivity gap	**10,018,673**	**(10,034,244)**	**(3,656,661)**	**5,820,109**	**3,275,195**	**(1,094,290)**	**(4,328,782)**	**–**
As 31 December 2010								
Total assets	**20,195,363**	**2,615,628**	**10,136,201**	**6,573,369**	**6,597,423**	**367,418**	**22,627,386**	**69,112,788**
Total liabilities	**17,828,423**	**9,789,925**	**15,723,611**	**815,993**	**8,132,808**	**76,256**	**9,772,918**	**62,139,934**
Interest sensitivity gap	**2,366,940**	**(7,174,297)**	**(5,587,410)**	**5,757,376**	**(1,535,385)**	**291,162**	**12,854,468**	**6,972,854**

Negative gaps in time brackets in the table above are a consequence of the significant volume of assets tied up in minimum reserves. The proportion of the minimum reserves held in foreign currency is not interest rate sensitive.

At 31 December 2011, if interest rates had been 200 basis points lower but all other variables were constant, the group's profit for the year would have been approximately RSD 43,845 thousand lower (2010: RSD 58,640 thousand higher). The following table indicates the influence of potential interest rate movements on profit/loss for 2011 and 2010 respectively.

Income statement sensitivity to changes in interest rates						
	2% increase in interest rates			2% decrease in interest rates		
	TOTAL	EUR	RSD	TOTAL	EUR	RSD
31 December 2011	43,845	28,358	16,533	(43,845)	(28,358)	(16,533)

Income statement sensitivity to changes in interest rates						
	2% increase in interest rates			2% decrease in interest rates		
	TOTAL	EUR	RSD	TOTAL	EUR	RSD
31 December 2010	(58,640)	(71,852)	17,342	58,640	71,852	(17,342)

At 31 December 2011, if interest rates had been 200 basis points lower but all other variables were constant, the economic value of the group's capital would have been approximately RSD 60,796 thousand higher (2010: RSD 270,825 thousand higher). The following table indicates the influence of interest rate movements on the economic value of the group's capital for 31 December 2011 and 2010 respectively.

Influence on the economic value of capital						
	2% increase in interest rates			2% decrease in interest rates		
	TOTAL	EUR	RSD	TOTAL	EUR	RSD
31 December 2011	(60,796)	28,986	(100,978)	60,796	(28,986)	100,978

Influence on the economic value of capital						
	2% increase in interest rates			2% decrease in interest rates		
	TOTAL	EUR	RSD	TOTAL	EUR	RSD
31 December 2010	(270,825)	(186,510)	(90,109)	270,825	186,510	90,109

Bearing in mind the extent of the potential impact of the changes in interest rates on the economic capital value and profit/loss, the group considers its interest rate risk profile to be adequate.

D) Liquidity risk

Liquidity risk arises in the general funding of the group's activities and in the management of its liquidity position. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The group has diversified its funding base. The funding base includes:

- customer deposits with wide ranges of maturity
- money market deposits
- loans from foreign banks and financial institutions
- subordinated debt
- share capital

The group continually assesses the liquidity risk by identifying and monitoring changes in the funding required to achieve business goals and targets, in line with the group's overall strategy.
The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the group and its exposure to changes in interest rates and exchange rates.
Monitoring and reporting take the form of cash flow measurement and projections for the next day, week and month respectively, as these are key periods for liquidity management. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets.
Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the group does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represents future cash requirements, since many of these commitments will expire or terminate without being funded.

D.1 Non derivatives cash flow

The table below presents the cash flows payable by the group under non-derivative financial liabilities by remaining contractual maturities at the balance sheet date. The amounts presented in the table are the contractual undiscounted cash flows, whereas the group manages the inherent liquidity risk based on expected undiscounted cash inflows.

As at 31 December 2011	Up to 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 – 4 years	Over 4 years	Total
Financial Liabilities							
Liabilities to banks	1,336,083	–	–	–	–	–	1,336,083
Due to customers	15,773,049	4,136,483	3,895,035	4,715,594	724,424	192,530	29,437,115
Other borrowed funds	619,458	3,465,357	1,705,711	1,611,639	8,274,262	1,262,776	16,939,203
Provisions	5,109	10,218	15,327	30,653	57,377	46,719	165,402
Subordinated debt	–	–	–	–	3,402,237	1,138,158	4,540,395
Other liabilities	143,920	12,289	18,434	46,258	60,940	150,889	432,730
Total Financial Liabilities (by contractual due dates)	**17,877,619**	**7,624,347**	**5,634,507**	**6,404,144**	**12,519,241**	**2,791,072**	**52,850,929**
Total Financial Assets (by expected due dates)	**14,051,430**	**4,590,522**	**5,725,308**	**11,167,179**	**27,743,367**	**5,745,573**	**69,023,379**

31 December 2010	Up to 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1 – 4 years	Over 4 years	Total
Financial Liabilities							
Liabilities to banks	2,215,022	–	–	–	–	–	2,215,022
Due to customers	8,423,786	11,384,001	8,249,774	7,516,066	1,421,301	251,890	37,246,818
Other borrowed funds	1,279,205	587,495	574,464	2,366,592	15,001,577	1,820,481	21,629,813
Provisions	4,964	9,927	14,891	29,781	–	32,670	92,233
Subordinated debt	6,578	134,246	13,131	129,557	1,420,736	1,815,600	3,519,848
Other liabilities	77,425	–	1,916	–	–	–	79,341
Total Financial Liabilities (by contractual due dates)	**12,006,980**	**12,115,669**	**8,854,176**	**9,104,222**	**18,546,865**	**4,155,163**	**64,783,075**
Total Financial Assets (by expected due dates)	**23,540,235**	**4,549,756**	**6,266,205**	**10,400,006**	**26,383,870**	**6,513,465**	**77,653,537**

Assessments of the expected inflows from financial assets were made on the basis of contractual cash flows, diminished in accordance with historical write-off data and premature loan repayments by clients.

D.2 Derivatives settled on a gross basis

The group's derivatives that are settled on a gross basis include foreign currency swaps.

The table below breaks down the group's derivative financial instruments that are settled on a gross basis into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Less than one month	From 1 – 3 months	From 3 – 12 months	Over one Year	Total
At 31 December 2011					
Foreign currency swaps:					
– Outflow	429,028	–	–	–	429,028
– Inflow	431,174	–	–	–	431,174
At 31 December 2010					
Foreign currency swaps					
– Outflow	–	–	490,567	–	490,567
– Inflow	–	–	495,706	–	495,706

D.3 Derivatives settled on a net basis

The group's derivatives that are settled on a net basis include interest rate swaps.

The table below breaks down the group's derivative financial instruments that are settled on a net basis into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual or settlement maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Less than one month	From 1 – 3 months	From 3 – 12 months	Over one Year	Total
At 31 December 2011					
Interest rate swaps:					
– Outflow	–	–	3,422	–	3,422
At 31 December 2010					
Interest rate swaps					
– Outflow	–	–	4,460	–	4,460

D.4 Contingent Liabilities and Credit Commitments

The table below provides an analysis of the maturity structure of contingent liabilities and credit commitments on the basis of remaining maturity. The entire stock of credit commitments is related to local currency potential loan placements to clients, maturing mostly within 24 months.

31 December 2011	No later than 1 year	1 – 4 years	Over 4 years	Total
Approved but unused overdraft limits for consumer clients	146,190	–	–	146,190
Approved but unused overdraft limits for business clients	2,835,751	–	–	2,835,751
Approved but unused credit card limits	385,495	75,310	–	460,805
Payments and guarantees	2,292,869	1,239,876	1,078,139	4,610,883
Letters of credit	100,339	–	–	100,339
Performance guarantees	540,619	224,088	139,981	904,688
Total	**6,301,263**	**1,539,274**	**1,218,119**	**9,058,656**

31 December 2010	No later than 1 year	1 – 4 years	Over 4 years	Total
Approved but unused overdraft limits for consumer clients	140,284	–	–	140,284
Approved but unused overdraft limits for business clients	1,264,716	–	–	1,264,716
Approved but unused credit card limits	207,430	349,011	–	556,441
Payments and guarantees	2,039,677	850,465	2,377,222	5,267,364
Letters of credit	97,538	–	–	97,538
Performance guarantees	374,526	323,197	122,678	820,401
Total	**4,124,171**	**1,522,673**	**2,499,900**	**8,146,744**

E) Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the group's balance sheet at their fair value.

	Carrying value, December		Fair value, December	
	2011	2010	2011	2010
Financial assets				
Loans and advances to customers	**47,634,008**	**47,033,829**	**47,146,740**	**47,718,580**
Business	27,877,296	25,617,817	27,777,341	26,252,557
Agro	12,047,057	11,264,906	12,196,239	12,223,785
Housing Loans	1,887,634	4,002,508	1,864,255	4,190,888
Consumer	2,321,916	2,265,065	2,297,245	821,988
Leasing	1,969,585	2,233,984	1,773,365	3,475,172
Other	1,530,519	1,649,549	1,238,294	754,190
Loans and advances to banks	**570,527**	**713,645**	**562,096**	**689,512**
Total Financial Assets	**48,204,535**	**47,747,474**	**47,708,835**	**48,408,092**
Financial liabilities				
Deposits from banks	**1,335,659**	**2,195,180**	**1,315,920**	**2,120,947**
Due to customers	**29,132,940**	**37,132,726**	**29,174,319**	**37,265,840**
Legal entities	12,058,651	18,980,200	12,083,550	18,986,267
Private individuals	17,074,289	18,152,526	17,090,770	18,279,573
Due to IFI's and other borrowings	**15,717,477**	**19,350,784**	**15,259,571**	**18,290,624**
Subordinated debt	**3,922,292**	**2,886,643**	**3,922,292**	**2,886,643**
Total Financial Liabilities	**50,108,368**	**61,565,333**	**49,672,102**	**60,564,054**

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist, to measure the financial instrument.
The estimated fair values of financial instruments have been determined by the group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the estimated fair value.
The carrying amounts of other financial assets and other financial liabilities represent a reasonable approximation of the fair value due to their short-term maturity.

Loans and advances to banks
The fair value of placements with and loans to other banks approximately equals the carrying amount since they all have less than a six-month maturity.
The estimated fair value of fixed-interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers
The fair value of loans and advances to customers is their expected cash flow discounted at current market rates. Current market rates are interest rates we would charge at the moment (year-end). Loans and advances to customers are stated net of provisions for impairment.

Deposits from banks
The fair value of liabilities to banks approximately equals the carrying amount since they all have less than a six-month maturity.

Due to customers
The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand.

The estimated fair value of term deposits is calculated by discounting the cash flows at agreed dates with current market rates on deposit that have more than a six-month maturity and where actual interest rate is not the same as the agreed for these deposits.

Other borrowed funds
Fair value of liabilities to international financial institutions shows that the group – based on its current position in the market, strong shareholders and results achieved – was able to contract very good conditions for long term loans. Fair value is smaller than the carrying amount, discounted by the interest rate normally demanded by ProCredit Holding.

Subordinated debts
Subordinated debts are subject to variable rates and the carrying value is not materially different from their fair value.

Fair value hierarchy
IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the group's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities (from New York Stock Exchange).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes the majority of the OTC derivative contracts. The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

This hierarchy requires the use of observable market data when available. The group considers relevant and observable market prices in its valuations where possible.

Assets and liabilities measured at fair value as at 31 December 2011:

	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	–	2,223	–	2,223
Available for sale financial assets	821,473	–	–	821,473
Total Financial Assets	**821,473**	**2,223**	**–**	**823,696**
Financial liabilities				
Derivative financial liabilities	–	3,463	–	3,463
Total Financial Liabilities	**–**	**3,463**	**–**	**3,463**

Assets and liabilities measured at fair value as at 31 December 2010:

	Level 1	Level 2	Level 3	Total
Financial assets				
Derivative financial assets	–	105	–	105
Available for sale financial assets	13,618	–	–	13,618
Total Financial Assets	**13,618**	**105**	**–**	**13,723**
Financial liabilities				
Derivative financial liabilities	–	5,649	–	5,649
Total Financial Liabilities	**–**	**5,649**	**–**	**5,649**

In 2011 there was no transfer between level 1 and level 2 of the fair value hierarchy. There were no Level 3 items as at 31 December 2011 or 2010.

F) Operational Risk

In line with the Basel II Accord, we define operational risks as the risk of loss resulting from inadequate or failed internal processes, people and systems and/or external events. This category includes all "risk events" in the areas of personnel, processes, and information technology.

To further expand the processes for managing operational risks, a new operational risk policy was implemented in the Bank in 2009 and a policy update was implemented in 2011. The principles outlined in this document have been designed to effectively manage the operational risk exposure, and they are in compliance with the Basel II requirements for the "standard approach". Furthermore, a fraud prevention policy was implemented in 2011.

The overall framework for managing operational risks is a complementary and balanced system with key components of Corporate Culture, Governance Framework, Policies and Procedures, Risk Assessments, New Risk Approvals (NRAs) and the Risk Event Database. While of the Corporate Culture, the Governance Framework, and Policies and Procedures have been put in place to set basic organisational requirements, Risk Assessments, New Risk Approvals (NRAs) and the Risk Event Database are the key instruments used to execute the risk management process.

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

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

To achieve these goals the following tools and processes have been implemented within the framework outlined above. They are presented in the sequence in which they are used within the operational risk management process. This process is subdivided into the following phases: identification, evaluation, treatment, monitoring, documentation & communication, and follow up. All details have been implemented in the Bank in line with the Group Operational Risk Policy.

Identification

- Annual operational risk assessments
- Detailed process reviews as appropriate
- New risk approval (NRA) process
- Risk identification and documentation in Risk Event Database (RED)
- Ad hoc identification of potential risks

Evaluation / Quantification

- Agreed standards to quantify risks (impact, likelihood, scenario analysis, stress testing, risk bearing capacity)

Mitigation and Treatment

- Implementation of measures to avoid, reduce or mitigate the risks depending on priorities, efficiency considerations and regulations
- Transfer of risk to an insurance or other party

Monitoring & Control

- Process owners' responsibility to monitor risks
- Operational risk reports as a form of MIS, risk bearing capacity calculation and monitoring

Communication, Escalation, Documentation

- Escalation levels to management bodies, regular reporting, risk committees
- RED, management summary documents for risk events

Issue Tracking / Follow up tables for material action plans

- Follow up tools used in banks

The following categories of operational risk are looked at specifically:

People Risks

- the Bank seeks to avoid key person dependencies and enforces a two weeks' consecutive leave policy
- staff training has a very high priority in the Bank and ensures continuous development of staff members' personal attitude and commitment and their professional skills

IT Risks:

- business continuity plans are in place
- Information Security standards are in place

Legal Risks:

- suitable legal resources are employed to deal with legal matters (internal legal staff and / or external legal counsel)
- the legal function is involved whenever required and appropriate (e.g. NRA process, all legal issues)

Compliance and Regulatory Risk

- The Bank ensures the identification of new regulations or updates on the interpretation of regulations and covenants agreed with financing institutions in a timely manner. This function is hosted in legal/compliance department.

Fraud Risk and AML Risk

- a new Group AML Policy and a Group Fraud Prevention Policy have been implemented in the Bank and corresponding risk assessments have been executed for these areas, based on the German standards.
- A new group wide IT solution to manage unusual transactions has been acquired and is being rolled out to the Bank of the group.

Reputation Risk

- Any extraordinary mentions (whether positive or negative) are reported to the management board and to the risk management department to decide on possible responses.

External Risk Factors

- external risk events such as a natural disaster that damages a firm's physical assets as well as electrical or telecommunications failures that disrupt business are analysed by risk managers.

As at December 2011, there were 89 legal cases (19 cases are related to parking tickets for leased vehicles for small amounts) in which the group was prosecuted (2010: 56). Consequently, based on standard procedures, the group set aside reserves of RSD 34,273 thousand (2010: RSD 25,691 thousand) for estimated potential losses arising from court cases.

4. Net interest income

	Year ended 31 December	
Interest and similar income	**2011**	**2010**
Interest income from loans and advances to banks	226,365	109,292
Interest income from available-for-sale assets	3,022	59,627
Interest income from loans and advances to customers	7,024,439	7,139,758
Unwinding cash flow calculation	7,827	–
Income from early closure of term deposit accounts	19,452	–
Total interest income	**7,281,105**	**7,308,677**

Interest and similar expenses	**2011**	**2010**
Interest expenses on liabilities to banks	66,009	118,892
Interest expenses on liabilities to customers	1,296,229	1,541,041
Interest expenses on subordinated debt	164,642	138,438
Interest expenses on debt securities	936,167	942,122
Total interest expenses	**2,463,047**	**2,740,493**
Net interest income	**4,818,058**	**4,568,184**

5. Allowance for impairment losses on loans and advances

	Year ended 31 December	
	2011	**2010**
Charge for the year loans to customers	3,400,712	2,701,679
Expenses derived from write-offs	6,209	6,628
Release of provision loans to customers	(2,750.406)	(1,593,180)
Recovery of written-off loans	(151,102)	(120,771)
Total impairment provision	**505,413**	**994,356**

6. Net fee and commission income

	Year ended 31 December	
	2011	**2010**
Fee and commission income		
Payment transfers and transactions	611,128	567,782
Account maintenance fee	258,020	263,625
Letters of credit and guarantees	123,458	117,688
Debit/credit cards	116,708	126,876
E-banking fees	98,906	98,520
Other fees and commission income	17,690	22,287
Total fee and commission income	**1,225,910**	**1,196,778**
Fee and commission expense		
Payment transfers and transactions	132,585	144,196
Fee exp. processing centre	44,101	–
Other fees and commission expenses	17,653	16,142
Total fee and commission expenses	**194,339**	**160,339**
Net fee and commission income	**1,031,571**	**1,036,439**

Other fee income include fees and commissions from banks amounting to RSD 3,950 thousand (2010: 4,772 thousand), fees on travellers' cheques of RSD 696 thousand (2010: RSD 859 thousand) and other fees from customers of RSD 13,044 thousand (2010: RSD 16,656 thousand).
Other fees and commission expenses include fee expenses to banks amounting to RSD 17,513 thousand (2010: RSD 15,964 thousand) and fees to other parties amounting to RSD 140 thousand (2010: RSD 178 thousand).

7. Net trading income

	Year ended 31 December	
	2011	**2010**
Currency translation (losses)/ gains	26,800	(9,495)
Transaction losses from forex trading operations with other banks	(15,086)	(5,520)
Transaction gains from forex trading operations with customers	185,967	187,421
Total net trading income	**197,681**	**172,406**

8. Net result from financial assets at fair value through profit or loss

	Year ended 31 December	
	2011	**2010**
Losses from fair value changes for financial assets at fair value through profit or loss	(215,613)	(164,435)
Gains from fair value changes for financial assets at fair value through profit or loss	227,537	176,344
Net result from financial assets at fair value through profit or loss	**11,924**	**11,909**

9. Operating income

	Year ended 31 December	
	2011	**2010**
Insurance indemnity	1,723	3,979
Reimbursement of expenses for bills of exchange and safe bags for money	9,951	11,689
Net gains from the disposal of property and equipment	8,713	3,394
Income from litigation settlements	3,479	6,674
Release of provision on retirement benefit obligations	1,647	4,912
Income from amortisation of grants	119	–
Income from reversals of other provisions not related to lending	6,466	33,731
Income surplus from sale of repossessed property	11,851	6,217
Other	1,101	5,971
Total operating income	**45,050**	**76,567**

10. Gains and losses from available-for-sale financial assets

	Year ended 31 December	
	2011	**2010**
Dividends from available-for-sale financial assets	64	–
Gains from disposal of available-for-sale securities	8,992	–
Gains and losses available-for-sale financial assets	**9,056**	–

11. Operating expenses

	Year ended 31 December	
	2011	**2010**
Staff costs :		
Wages and salaries	1,233,516	1,468,980
State pension contributions	611,628	646,379
Taxes and contributions on salaries	204,876	266,312
Fringe benefits	89,746	111,827
Total staff costs	**2,139,766**	**2,493,498**
Office rent	308,150	403,262
Depreciation and amortisation	275,377	304,629
Marketing and representation	206,637	163,862
Office supplies and other office utilities	129,244	129,086
Other service expenses	80,422	122,875
Communication expenses	70,297	74,068
Expenses for consulting services	115,706	128,965
Transport expenses	61,391	61,624
Legal and advisory expenses	52,950	57,577
Security	40,814	45,337
Other taxes	84,318	78,051
Training expenses	49,031	10,217
Expenses for royalties on software	9,304	3,341
Expenses for repairs and maintenance	38,040	42,097
Insurance expenses	14,253	19,049
One-time working contracts	7,519	3,756
Other administrative expenses	2,482	732
Expenses for deposit insurance fund	114,187	144,306
Expenses for litigation settlements	12,774	23,125
Expenses for disposal of property and equipment	13,587	44,478
Expenses for stipends	8,556	0
Expenses for provisions on off-balance sheet	38,799	0
Expenses for impairment of repossessed properties	22,974	483
Others	11,011	4,469
	1,767,823	**1,871,389**
Total Other operating expenses	**3,907,589**	**4,364,887**

12. Income taxes

	Year ended 31 December	
	2011	**2010**
Current income tax expenses	(186.289)	(82,806)
Deferred income tax credit	27,714	21,717
Total income tax expenses	**(158,575)**	**(61,089)**

The tax on the group's profit before tax differs from the theoretical amount that would arise using the official rate as follows:

	Year ended 31 December	
	2011	**2010**
Profit before tax	1,700,338	506,261
Tax calculated at a tax rate of 10% (2010: 10%)	(170,034)	(50,626)
Fines and penalties	(6,520)	(695)
Accounting depreciation above tax depreciation	(46,174)	(8,350)
Other non-deductible expenses	(62,314)	(41,487)
Utilised tax credits	88,366	18,352
Unutilised tax credits brought forward	–	21,717
Income not subject to tax	34,999	–
Provisions not subject to tax	3,102	–
Current tax expenses	**(158,575)**	**(61,089)**

According to Serbian tax law, the group is entitled to tax credits, based on the amounts invested in property and equipment and the number of new employees hired, and to use these credits to reduce the current income tax liability. Tax credits for new employees hired can be used by the group only in the year when declared. Tax credits on new investments in property and equipment can be carried forward for a period of 10 years. In order to be eligible to use these investment tax credits, the group should not dispose of the relevant property and equipment for a period of at least three years from the year in which the tax credit was declared. Tax credit calculation is open to tax audit by the tax authorities for a period of 5 years from the year in which the tax becomes due for payment.

13. Cash and balances with the Central Bank

	At 31 December	
	2011	**2010**
Cash on hand	1,213,350	1,221,927
Mandatory reserve	7,976,173	19,792,630
Other balances with the Central Bank	18,145	10,788
Treasury bills	802,383	–
Total included in Cash and cash equivalents (Note 33)	**10,010,051**	**21,025,345**

The National Bank of Serbia (NBS) regulations related to mandatory reserve were changed at the beginning of 2011.
The mandatory reserve in local currency is calculated by applying the following ratios:
– 5% – on the average daily amount deposits in local currency maturing in less than two years
– 0% – on the average daily amount deposits in local currency maturing in over two years

The mandatory reserve in foreign currency is calculated by applying the following ratios:
– 30% – on borrowings from abroad and deposits in foreign currency maturing in less than two years
– 25% – on borrowings from abroad and deposits in foreign currency maturing in over two years

The required reserves in local currency are allocated as follows: required reserves in local currency calculated plus 15% of the accrued foreign currency reserve up to 2 years maturity plus 10% of the accrued foreign currency reserve for over 2 years maturity.
The required reserves in foreign currency are allocated as follows: 85% of the accrued foreign currency reserve up to 2 years maturity plus 90% of the accrued foreign currency reserve for over 2 years maturity.
The mandatory reserves on subordinated debt are calculated by applying a rate of 0% on the average daily liabilities for subordinated debt in preceding month.
The Bank does not calculate required reserves as liabilities in local and foreign currency in respect of funds received by banks from international financial institutions, governments and financial institutions founded by foreign states, through the intermediation of the government as the main debtor and/or owner of these funds or received directly, provided that the agreed principles of setting interest spreads are complied with on reinvestment of those funds. Mandatory reserves can be used by the group in its day-to-day operations. The NBS pays interest of 2.5% on mandatory reserves held in RSD but does not pay any interest on mandatory reserves held in foreign currency.

14. Loans and advances to banks

	At 31 December	
	2011	**2010**
Nostro accounts	103,994	234,593
Money market placements	466,533	479,052
Total loans and advances to banks	**570,527**	**713,645**

Nostro accounts represent the account balances with Commerzbank AG, ProCredit Bank Bulgaria, Standard Chartered Bank GMBH, Standard Chartered Bank New York and Deutsche Bank AG.
All loans and advances to banks are current assets.

15. Loans and advances to customers

	At 31 December	
	2011	**2010**
Legal entities	19,919,291	19,090,498
Small and medium-sized enterprises	9,690,324	9,744,979
Agricultural	11,462,787	9.404,800
Private individuals	9,129,396	11,091,168
Total loans and advances to customers	**50,201,798**	**49,331,445**
Unearned future finance income on finance leases	(2,382)	(307,407)
Deferred fee income	(480,610)	(411,149)
Allowance for impairment	(2,084,798)	(1,636,533)
Net loans to customers	**47,634,008**	**46,976,356**
Current	16,762,369	24,055,672
Non-current	33,439,429	25,275,773
	50,201,798	**49,331,445**

Accrued interest amounts to RSD 494,563 thousand (2010: RSD 450,834 thousand).
Movements in the allowance for losses on loans and advances are as follows:

	2011	2010
Balance at 1 January	**1,636,533**	**1,582,920**
Provision charge for impairment of loans and advances	650,306	1,022,379
Loans written off	(194.863)	(1,031,702)
Unwinding effect	(7,827)	–
Exchange rate differences	649	62,936
Balance at 31 December	**2,084,798**	**1,636,533**

Loans and advances to customers include finance lease receivables:

	At 31 December	
	2011	**2010**
Gross investment in finance leases :		
No later than 1 year	998,843	1,234,602
Later than 1 year and no later than 5 years	1,177,012	1,394,359
Later than 5 years	2,204	2,169
	2,178,059	**2,631,130**
Unearned future finance income on finance leases	(249,305)	(307,406)
Net investment in finance leases	**1,928,754**	**2,323,724**
Net investment in finance lease is broken down as follows:		
No later than 1 year	861,375	1,063,833
Later than 1 year and no later than 5 years	1,065,220	1,257,870
Later than 5 years	2,159	2,021
	1,928,754	**2,323,724**

16. Derivative financial assets

Derivative financial assets amounting to RSD 2,223 thousand (31 December 2010: RSD 105 thousand) include currency swaps with Barclays Bank for EUR 1,500 thousand and with Commerzbank AG for EUR 1,400 thousand. Currency swaps are commitments to exchange one set of cash flows for another. The risk is monitored on an ongoing base with reference to the current fair value, and the liquidity of the market.
During 2011 the group entered into foreign currency swap agreements in order to hedge its open currency position. The foreign currency swaps were economic hedges only and hedge accounting was not applied.

17. Financial assets available for sale

Financial assets available for sale include Visa International shares worth RSD 17,127 thousand and SWIFT shares worth RSD 1,963 thousand.

	At 31 December	
	2011	**2010**
Shares in companies situated in OECD countries	19,090	13,618
Total available-for-sale financial assets	**19,090**	**13,618**

The revaluation of available for sale financial assets in "other comprehensive income" shows the following changes:

Movements in revaluation reserve (AFS)

	2011	2010
As at January 1	2,841	5,384
Fair value remeasurement	5,255	(2,825)
Deferred taxes	(525)	282
As at December 31	**7,571**	**2,841**

18. Other financial investments

	At 31 December	
	2011	**2010**
Shares in equity- PC Academy Eastern Europe	–	7,924
Total financial investments	**–**	**7,924**

The Bank sold its investment in the capital of PC Academy Eastern Europe in 2011.

19. Intangible assets

Movements in intangible assets for the years 2011 and 2010 are presented in the table below:

Software	
Cost	
Balance, 1 January 2010	300,801
Disposals	23,618
Additions	(87)
Balance, 31 December 2010	**324,332**
Accumulated amortisation	
Balance, 1 January 2010	49,791
Charge for the year	53,943
Disposals	(78)
Balance, 31 December 2010	**103,656**
Net book value at 31 December 2010	**220,676**
Cost	
Balance, 1 January 2011	324,332
Additions	50,827
Disposals	–
Balance, 31 December 2011	**375,159**
Accumulated amortisation	
Balance, 1 January 2011	103,656
Charge for the year	60,725
Disposals	–
Balance, 31 December 2011	**164,381**
Net book value at 31 December 2011	**210,778**

20. Property and equipment

Movements in property and equipment for 2011 and 2010 are presented in the table below:

	Building	Leasehold improvements	IT and other equipment	Furniture and fixtures	Total
Cost					
Balance, 1 January 2010	704,246	344,941	1,309,479	207,481	2,566,147
Additions	23,761	3,534	99,306	1,389	127,990
Disposals	–	(52,110)	(61,488)	(12,231)	(125,829)
Balance, 31 December 2010	**728,007**	**296,365**	**1,347,297**	**196,639**	**2,568,308**
Accumulated Depreciation					
Balance, 1 January 2010	17,427	169,141	790,315	105,686	1,082,569
Disposals	–	(15,718)	(57,292)	(8,385)	(81,395)
Charge for the year	17,626	46,617	167,519	18,925	250,687
Balance, 31 December 2010	**35,053**	**200,040**	**900,542**	**116,226**	**1,251,861**
Net book value at 31 December 2010	**692,954**	**96,325**	**446,755**	**80,413**	**1,316,447**
Cost					
Balance, 1 January 2011	728,007	296,365	1,347,297	196,639	2,568,308
Additions	63,197	3,617	132,288	5,275	204,377
Disposals	–	(32,735)	(112,165)	(25,538)	(170,438)
Balance, 31 December 2011	**791,204**	**267,247**	**1,367,420**	**176,376**	**2,602,247**
Accumulated Depreciation					
Balance, 1 January 2011	35,053	200,040	900,542	116,226	1,251,861
Disposals	–	(28,078)	(108,587)	(20,110)	(156,775)
Charge for the year	18,738	22,246	157,408	16,260	214,652
Balance, 31 December 2011	**53,791**	**194,208**	**949,363**	**112,376**	**1,309,738**
Net book value at 31 December 2011	**737,413**	**73,039**	**418,057**	**64,000**	**1,292,509**

21. Deferred tax assets

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 10% (2010: 10%).

Deferred tax assets are attributable to the following items:

	At 31 December	
	2011	**2010**
Tax credit carried forward (expiring in the period over 5 years)	155,537	223,210
Accelerated tax depreciation	25,953	28,279
Other provision	3,102	–
Temporary differences, equity reserve	(841)	–
As at 31 December	**183,751**	**251,489**

Movements in the deferred income tax account areas follows:

	2011	**2010**
As of 1 January	251,488	270,891
Income statement charge	21,155	22,283
Fair value measurement of available for sale securities	(525)	(282)
Deferred tax on tax credit	(88,365)	(41,403)
As at 31 December	**183,751**	**251,489**

The deferred tax charge in the consolidated income statement comprises the following temporary differences:

	At 31 December	
	2011	**2010**
Tax credit on investment in property and equipment	24,447	17,880
Other provisions	3,267	3,837
As at 31 December	**27,714**	**21,717**

All deferred tax assets are to be recovered after more than 12 months.

22. Other assets

a)

	At 31 December	
	2011	**2010**
Accounts receivables	352,802	37,951
Pre-payments	131,654	194,115
Repossessed properties	42,563	54,745
Deferred items	87,527	76,353
Claims on insurances	–	100
Claims from customs and taxes	385	1.554
Inventory items	5,776	10,103
Others	6,207	873
	626,914	**375,794**

Prepayments mostly related to claims for maternity pay amounting to RSD 28,206 thousand and interest expenses paid in advance to clients using Pro Advance deposit accounts amounting to RSD 17,978 thousand (31 December 2010: RSD 64,407 thousand).

Deferred items consist of the following:

- Deferred expenses that are related to rent amounting to RSD 3,306 thousand (31 December 2010: RSD 3,721 thousand)
- Deferred advance payments to creditors amounting to RSD 17,910 thousand (31 December 2010: RSD 26,673 thousand)
- Other deferred expenses amounting to RSD 66,311 thousand (31 December 2010: RSD 22,783 thousand)

Others represent trade receivables amounting to RSD 6,001 thousand and losses in cash box and litigated receivables amounting to RSD 205 thousand (31 December 2010: RSD 873 thousand).

b) Financial and non-financial assets

	At 31 December	
	2011	**2010**
Financial	469,172	124,111
Non-financial	157,742	251,683
	626,914	**375,794**

c) All other assets are current assets

23. Deposits from banks

	At 31 December	
	2011	**2010**
Liabilities for spot transactions	104,641	424,570
Liabilities for term transactions	1,230,933	1,770,007
Other banks deposits	9	9
Accrued interest on deposits	76	594
	1,335,659	**2,195,180**

Liabilities for term transactions as at 31 December 2011 consist of fx deals amounting to RSD 27,562 thousand (2010: RSD 53,272 thousand) and other short term deposits amounting to RSD 1,203,371 thousand (2010: RSD 1,716,735 thousand).
Other bank deposits as at 31 December 2010 consist of deposits from banks in the process of bankruptcy amounting to RSD 5 thousand (2010: RSD 5 thousand) and loro accounts with OECD banks amounting to RSD 4 thousand (2010: 4 thousand).
All deposits from banks are current liabilities.

24. Derivative financial liabilities

Derivative financial liabilities amounting to RSD 3,463 thousand (2010: RSD 5,649 thousand) consist of interest rate swaps amounting to RSD 3,422 thousand (2010: RSD 4,460 thousand) and interest rate currency swaps amounting to RSD 41 thousand (2010: RSD 1,189 thousand). Interest rate swaps are used to exchange commitments with floating interest rates for commitments with fixed interest rates.
As of 31 December 2010 the group had fixed-for-floating interest rate swaps with Commerzbank AG of EUR 10,625 thousand. The group entered into swap agreements in order to hedge its open maturity gap between the repricing of long-term loans taken at floating rates and the repricing of loans disbursed at floating interest rates (Note 3.C.2 Interest rate risk).

The fair value of interest rate swaps is presented in the income statement in the position “net result from financial assets at fair value through profit or loss” (Note 8).

25. Due to customers

	At 31 December	
	2011	**2010**
Current accounts		
private clients	2,008,082	1,988,940
business clients	6,003,111	7,831,902
other customers	–	357,761
Savings accounts		
private clients	2,552,322	2,464,072
Term deposit accounts		
private clients	11,198,971	12,279,001
business clients	5,061,854	7,107,727
ProCredit Holding	–	2,637,455
other customers	–	128,308
Deposit as collateral for credit commitment	8,932	23,863
Deposit as collateral on balance exposure	1,618,350	1,667,496
Other liabilities	455,883	300,392
	28,907,505	**36,786,917**
Accrued interest on deposits	225,435	345,809
Total deposits	**29,132,940**	**37,132,726**
Current	28,386,707	35,058,950
Non-current	746,233	2,073,776
	29,132,940	**37,132,726**

Other liabilities as at 31 December consist of pending client transfers amounting to RSD 455,186 thousand (31 December 2010: RSD 300,120 thousand) and other liabilities amounting to RSD 697 thousand (31 December 2010: RSD 272 thousand).

26. Other borrowed funds

Other borrowed funds include long term borrowed funds from international financial institutions and foreign banks. The table below summarises other borrowed funds as of 31 December 2011:

	Initial loan in EUR	Carrying value in EUR	Maturity	Interest rate	RSD thousand	RSD thousand
		2011			2011	2010
European Bank for Reconstruction and Development (EBRD)	10,000,000	10,000,000	2010-2015	Euribor + 4.00%	1,046,409	1,054,982
Kreditanstalt für Wiederaufbau (KfW)	65,000,000	46,191,143	2007-2017	1.75%- Euribor +4.90%	4,833,484	4,596,707
International Finance Corporation	30,000,000	26,250,000	2010-2015	Euribor +2.65%-3%	2,746,824	3,560,564
Instituto de Credito Oficial	15,000,000	11,000,000	2004-2015	Euribor + 2.34% - 2.50%	1,151,050	1,476,975
Financierings - Maatschappij voor Ontwikkelingslanden (FMO)	58,000,000	7,500,000	2006-2013	Euribor + 2.65% - 6.68%	784,806	2,252,387
EFSE	26,183,333	15,485,714	2006-2016	Euribor +2.3%- 3.10%	1,620,438	2,072,285
Dexia Micro credit fund	7,000,000	5,250,000	2009-2012	6m Euribor + 3.50%	549,365	738,487
PC Finance B.V.	125,000,000	27,000,000	2007-2012	6%	2,825,304	3,465,615
	346,183,333	**148,676,857**			**15,557,680**	**19,218,002**
Accrued interest					219,217	276,175
Deferred fees					(59,420)	(143,393)
Total					**15,717,477**	**19,350,784**

	2011	2010
Current	7,095,261	2,944,605
Non-current	8,622,216	16,406,179
	15,717,477	**19,350,784**

The group is obliged to comply with a number of debt covenants set in the borrowing contracts, such as risk weighted capital adequacy, single client exposure ratio, aggregate large exposure ratio, group exposure ratio, related party exposure ratio, maturity gap to available capital ratio, open credit exposure ratio, unhedged open foreign currency positions in any currency and in aggregate.
One of the most significant debt covenants is risk weighted capital adequacy ratio, which as at 31 December 2011 was as follows:

Required (higher than)		Actual
International Finance Corporation	12%	21.68%
FMO (loan to ProCredit Bank)	12%	20.21%
FMO (loan to ProCredit Leasing)	10%	20.21%
European Bank for Reconstruction and Development	13%	21.68

The methodology of calculation of the risk weighted capital adequacy ratio varies, depending on specific requirements in the loan agreements.
As of 31 December 2011 and 2010 the group was not in breach of any debt covenants in respect of its borrowed funds, except for the ratios in the KfW loan agreement regarding the proportion of non-performing leases in the total lease portfolio of ProCredit Leasing and the coverage of non-performing leases with lease-loss provisions, and also the liquidity ratio in the EBRD loan agreement. ProCredit Leasing (borrower) has been granted waivers by KfW (lender) for 2011 and 2012, under which the lender has declared that they do not intend to exercise their rights to demand additional securities, or to terminate the loan agreement as of 31 December 2011 or 31 December 2012 respectfully, provided that the borrower shall at no time be in breach of any other obligation under the loan agreement. The breach of the EBRD liquidity ratio is due to a change in Central Bank regulations and the borrowing is classified as a current liability.

27. Subordinated debt

	Initial loan in EUR	Carrying value in EUR	Maturity	RSD thousand	RSD thousand
		2010		2011	2010
ProCredit Holding	10,000,000	10,000,000	2011-2021	1,046,409	–
EFSE-subordinated debt	27,000,000	27,000,000	2007-2015	2,825,304	2,848,451
Accrued interest				51,068	39,607
Deferred fees				(489)	(1,415)
Total				**3,922,292**	**2,886,643**

	2011	2010
Current	50,579	38,192
Non-current	3,871,713	2,848,451
	3,922,292	**2,886,643**

28. Tax liabilities

Tax liabilities as at 31 December 2011 amounted to RSD 51,889 (31 December 2010: RSD 0).

29. Provisions

	At 31 December	
	2011	2010
Company pension provision	31,022	32,670
Provisions for lawsuits and recourse claims	34,273	25,692
Provision for untaken annual leave	61,307	33,870
Provision for off-balance sheet items	38,799	–
Total provisions	**165,402**	**92,232**

Retirement benefit obligations are paid upon the regular retirement of the employee. The right to this benefit is conditional on retaining the employee until the regular retirement age. Expected costs for this allowance are accumulated during the employee's working years. The defined retirement obligation is estimated on a yearly basis by an independent, certified actuary by applying a projected credit sample. The net present value of this liability is determined by discounting future net cash outflows and applying interest rates on long-term bonds issued in the same currency and with similar maturity terms as the retirement benefit obligations.
Retirement benefit obligations which mature more than 12 months after the balance sheet date are discounted to net present value.

Movement in provisions is as follows:

	2011	2010
Balance at 1 January	**92,232**	**84,148**
Charge for the year	79,138	49,140
Releases	(5,795)	(42,030)
Other	(173)	974
Balance at 31 December	**165,402**	**92,232**

Movement in provisions for retirement benefit obligations:

	2011	2010
Balance at 1 January	**32,670**	**37,581**
Release	(1,648)	(4,911)
Balance at 31 December	**31,022**	**32,670**

30. Other liabilities

	At 31 December	
	2011	2010
Liabilities to employees	38	71
Taxes, contributions and other charges	9,426	14,154
Liabilities to suppliers	58,632	75,313
Prepayments received for loan instalments	31,168	251,638
Liabilities to Credit Bureau	18,371	11,869
Deferred income from subsidies	130,574	194,784
Prepayments received	129,030	15,766
Other liabilities	3,602	5,357
	380,841	**568,922**

	2011	2010
Financial	210,668	112,265
Non-financial	170,172	456,687
	380,841	**568,952**

	2010	2010
Current	280,698	374,168
Non-current	100,143	194,784
	380,841	**568,952**

31. Share Capital

The ownership structure of ProCredit Bank a.d. Belgrade as at 31 December 2011 and 2010 was as follows:

	Number of shares		Share in %	
	2011	2010	2011	2010
ProCredit Holding	3,052,510	3,052,510	83,33	83,33
Commerzbank AG	610,502	610,502	16,67	16,67
	3,663,012	**3,663,012**	**100,00**	**100,00**

The group is controlled by ProCredit Holding, Germany, which owns 83.33% of the shares. The remaining 16.67% is owned by Commerzbank AG, Germany. The ultimate parent of the group is ProCredit Holding.
The total number of shares at the end of the year was 3,663,012 (2010: 3,663,012) with nominal value of 1,000 RSD per share (2010: 1,000 RSD per share). In 2011 there was no issue of new shares.

32. Special banking risks reserves

According to the Central Bank decision on the classification of banks' balance sheet assets and off-balance sheet items, effective 30 June 2006, the group is obliged to allocate an equity reserve from retained earnings, equal to the difference between the amount of loan allowances and advances to banks and customers, to be deposited in a special reserve account; the calculation is based on the group's internal rules and Central Bank provisioning regulations, respectively. Amounts allocated to special account reserves are not distributable to shareholders.
As at 31 December 2011, the special banking risk reserves under Central Bank regulations amounted to RSD 1,643,864 thousand (31 December 2010: RSD 1,643,864 thousand).
During 2011 there was no additional allocation to special account reserves.

33. Cash and cash equivalents

	At 31 December	
	2011	**2010**
Cash and balances with the Central Bank (Note 13)	10,010,051	21,025,345
Nostro accounts with other banks (Note 14)	103,994	234,593
Money market placements (Note 14)	466,533	479,052
	10,580,578	**21,738,990**

34. Contingent liabilities and commitments

The following table indicates the contractual amounts of the group's off-balance sheet financial instruments that commit it to extend credit to customers:

	At 31 December	
	2011	**2010**
Payments and guarantees	4,619,815	5,266,211
Acceptances and endorsements	–	4,862
Loan commitments	3,442,746	1,961,441
Letters of credit	100,339	97,538
Credit related commitments	8,162,900	7,330,052
Performance guarantees	904,688	769,691
Balance as at 31 December	**9,067,588**	**8,099,743**

The following table shows the operating lease commitments for business premises rental:

	At 31 December	
	2011	**2010**
No later than 1 year	8,140	8,119
Later than 1 year and no later than 5 years	346,553	91,597
Later than 5 years	718,533	1,202,351
	1,073,226	**1,302,067**

35. Related party transactions

In the normal course of business, the group enters into transactions with its shareholders and other ProCredit institutions in Central and Eastern Europe.
A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and foreign currency transactions. There were related-party transactions with the ultimate parent company ProCredit Holding, in addition to the payment of dividends on ordinary shares.

	At 31 December	
	2011	**2010**
Nostro accounts		
Commerzbank AG	22,121	69,356
ProCredit Bank Bulgaria	13,123	16,443
Share in equity		
ProCredit Academy Eastern Europe	–	7,923
Other receivables		
ProCredit Holding	–	340
PC Finance II	1,867	5,007
ProCredit Academy Eastern Europe	1	3,853
Banco ProCredit Honduras	–	2,755
ProCredit Bank Kosovo	229	230
Liabilities to group co,		
PC Finance II	968,954	922,260
ProCredit Holding	–	2,637,455
Deposits from related parties		
ProCredit Financial	2,825,304	3,465,616
ProCredit Holding	1,046,409	–
Other liabilities to group co		
ProCredit Holding	9,813	29,213
PC Finance II	1,857	1,392
ProCredit Bank Kosovo	467	549
ProCredit Academy Germany	523	75
Off balance sheet items		
Guarantees issued to PC Finance II	351,593	354,474

The volumes of related party transactions and related expenses for the year are as follows:

	2011	2010
Deposits from banks		
Outstanding at 1 January	2,637,455	–
Deposits collected during year	3,254,276	14,820,162
Deposits returned during the year	(5,781,858)	(12,182,707)
Outstanding at 31 December	109,873	2,637,455
Other borrowed funds		
Loans outstanding at 1 January	3,465,616	4,506,774
Loans borrowed during the year	1,915,341	1,154,780
Loans repayments during the year	(1,509,244)	(2,195,938)
Loans outstanding at 31 December	3,871,713	3,465,616

Paid salaries and other short-term employee benefits to the members of Executive Board as of 31 December 2011 amounted RSD 22,372 thousand (2010: RSD 17,657 thousand). No other benefits were paid to key management staff.

36. Events after balance sheet date

For the period up to and including 15 March 2012, no post-balance sheet events have occurred which have any substantial impact on the consolidated financial statements for the year ending 31 December 2011.

37. Exchange rates

The official exchange rates as at 31 December 2011 and 2010 were as follows:

	2011	2010
USD	80.8662	79.2802
EUR	104.6409	105.4982
CHF	85.9121	84.4458

Svetlana Tolmacheva
Chairperson of the Executive Board

Dragana Tanasić
Member of the Executive Board

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