

**CENTRAL BANK OF MONTENEGRO
PODGORICA**

**Financial Statements
Year Ended December 31, 2011
and Independent Auditors' Report**

CENTRAL BANK OF MONTENEGRO, PODGORICA

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Translation of the Auditors' Report issued in the Montenegrin language

INDEPENDENT AUDITORS' REPORT

To the Council of the Central Bank of Montenegro, Podgorica

We have audited the accompanying financial statements of the Central Bank of Montenegro, Podgorica (the "Bank" or "CBM"), which comprise the statement of financial position as of December 31, 2011 and the related statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, accompanied financial statements give true and fair view of the financial position of Central Bank of Montenegro, Podgorica as at December 31, 2011 and it's financial performance and it's cash flows for the year then ended, in accordance with the International Financial Reporting Standards

(Continued)

Translation of the Auditors' Report issued in the Montenegrin language

INDEPENDENT AUDITORS' REPORT

To the Council of the Central Bank of Montenegro, Podgorica (Continued)

Emphasis of Matter

We draw attention to Note 29 to the financial statements where it is disclosed that Article 11 of the Central Bank of Montenegro Law (Official Gazette of Montenegro No. 40/10 and 46/10) prescribes that the capital of CBM be comprised of the initial capital and reserves. Article 12 of the aforesaid law defines the CBM initial capital in the amount of EUR 50,000 thousand and that the increase in the initial capital of the Central Bank shall be provided from the general reserve funds. In case the general reserve funds are not sufficient to cover the determined increase in the initial capital, the shortfalls may be provided from the budget of Montenegro. At December 31, 2011, the CBM initial capital amounted to EUR 35,003 thousand and is entirely comprised of monetary assets. The additional required amount of the initial capital totaled EUR 14,997 thousand at December 31, 2011. Our opinion is not modified in respect to this matter.

Other Matter

The financial statements of the Central Bank of Montenegro, Podgorica as of and for the year ended December 31, 2010 were audited by another auditor whose report dated March 25, 2011 expressed an unmodified opinion.



Deloitte d.o.o
Podgorica
March 15, 2012

Žarko Mionić, Certified Auditor
(License no. 062 issued on March 10, 2011)

CENTRAL BANK OF MONTENEGRO, PODGORICA

INCOME STATEMENT
Year ended December 31, 2011
(thousands of EUR)

	Notes	2011	2010
Interest income	6a	3,887	1,830
Interest expense	6b	(1,310)	(754)
Net interest income		<u>2,577</u>	<u>1,076</u>
Fee income	7a	6,604	6,379
Fee expense	7b	(112)	(71)
Net fee income		<u>6,492</u>	<u>6,308</u>
INTERST AND FEE INCOME, NET		9,069	7,384
Other income	8	5,118	845
Gains on reversal of provisions		-	2,246
Net foreign exchange (losses)/ gains	9	(125)	186
Net (losses)/gains on financial assets available for sale	10	(428)	60
Staff costs	11	(5,946)	(6,296)
Other operating expenses	12	(2,872)	(3,389)
NET PROFIT		<u>4,816</u>	<u>1,036</u>
Other comprehensive income/(expense)		<u>8,637</u>	<u>(281)</u>
TOTAL COMPREHENSIVE INCOME		<u><u>13,453</u></u>	<u><u>755</u></u>

The accompanying notes form an integral part
of these financial statements

Signed on behalf of the Central Bank of Montenegro, Podgorica, on March 16, 2012 by:


Valentina Ivanović, MSc.
Control, Finance and Accounting Director
of the Central Bank of Montenegro


Dr. Radoje Žugić
Governor of the Central Bank of Montenegro

STATEMENT OF FINANCIAL POSITION
As of December 31, 2011
(thousands of EUR)

	<u>Notes</u>	<u>2011</u>	<u>2010</u>
ASSETS			
Cash and demand deposits	13	87,109	172,092
Time placements with foreign banks	14	100,564	176,427
Financial assets available for sale	15	76,914	29,941
Assets held with International Monetary Fund	16	63,586	62,126
Loans and advances to customers	17	1,072	1,091
Accounts receivable	18	2,160	1,880
Investment property	19	2,378	1,654
Intangible assets	20	273	386
Property, plant and equipment	21	27,203	20,239
Long-term receivables from employees	22	1,880	2,059
Inventories	23	620	631
Other assets	24	329	319
Total assets		<u>364,088</u>	<u>468,845</u>
LIABILITIES			
Banks and other financial institutions' accounts	25	227,825	294,773
Government and other state organizations' accounts	26	10,858	63,348
Liabilities to the International Monetary Fund	27	63,670	62,215
Other liabilities	28	1,052	1,279
Total liabilities		<u>303,405</u>	<u>421,615</u>
EQUITY			
Initial capital	29	35,003	33,842
General reserves		326	-
Special reserves		165	-
Revaluation reserves for property, plant and equipment		19,895	11,918
Revaluation reserves for financial assets available for sale		372	(188)
Retained earnings		4,922	1,658
Total equity		<u>60,683</u>	<u>47,230</u>
Total liabilities and equity		<u>364,088</u>	<u>468,845</u>
OFF-BALANCE-SHEET ITEMS		<u>55,726</u>	<u>48,715</u>

The accompanying notes form an integral part
of these financial statements

STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2011
(thousands of EUR)

	Initial capital	General reserves	Special reserves	Revaluation reserves for property, plant and equipment	Revaluation reserves for financial assets available for sale	Retained earnings	Total
Balance at January 1, 2010	2,556	30,746	-	11,905	154	1,114	46,475
Capital increase from general reserves and retained earnings	31,286	(30,746)	-	-	-	(540)	-
Effects of valuation of property, plant and equipment	-	-	-	(48)	-	48	-
Fair value adjustment of securities available for sale	-	-	-	-	(342)	-	(342)
Effects of valuation of other assets	-	-	-	61	-	-	61
Profit for the year	-	-	-	-	-	1,036	1,036
Balance at December 31, 2010	33,842	-	-	11,918	(188)	1,658	47,230
Balance at January 1, 2011	33,842	-	-	11,918	(188)	1,658	47,230
Transfer from retained earnings (Note 29)	661	826	165	-	-	(1,652)	-
Transfer from general reserves (Note 29)	500	(500)	-	-	-	-	-
Effects of valuation of property, plant and equipment (Note 21)	-	-	-	8,080	-	-	8,080
Decrease of revaluation reserves according to inventory	-	-	-	(101)	-	101	-
Fair value adjustment of securities available for sale	-	-	-	-	560	-	560
Effects of valuation of other assets	-	-	-	(2)	-	-	(2)
Profit for the year	-	-	-	-	-	4,816	4,816
Other	-	-	-	-	-	(1)	(1)
Balance at December 31, 2011	35,003	326	165	19,895	372	4,922	60,683

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of these financial statements

STATEMENT OF CASH FLOWS
Year Ended December 31, 2011
(thousands of EUR)

	<u>Notes</u>	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		3,509	2,045
Fee and commission receipts		6,226	5,968
Receipts of other operating income		5,483	840
Interest paid		(1,308)	(756)
Fees and commissions paid		(113)	(71)
Realized fair value adjustments of assets available for sale		(428)	60
Payments to, and on behalf of employees		(5,650)	(6,238)
Accounts payable		(2,476)	(2,294)
<i>Net cash inflows/(outflows) before value adjustment of assets and liabilities</i>		<u>5,243</u>	<u>(446)</u>
Value adjustment of assets and liabilities			
Decrease/(increase) of loans and advances to customers		81	(442)
Increase of financial assets available for sale		(46,237)	(4,822)
Decrease of other assets		-	3
(Decrease)/increase in other banks and financial institutions' accounts		(66,948)	43,598
Decrease in Government and other organizations' accounts		(52,489)	(25,847)
<i>Net cash (used in)/provided by operating activities</i>		<u>(160,350)</u>	<u>12,044</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of fixed assets		(369)	(431)
Purchase of intangible assets		(2)	(5)
<i>Net cash used in investing activities</i>		<u>(371)</u>	<u>(436)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
<i>Net cash provided by/(used in) financing activities</i>		-	-
Foreign exchange (losses)/gains		(125)	185
Net (decrease)/ increase in cash and cash equivalents		(160,846)	11,793
Cash and cash equivalents, beginning of year		<u>348,519</u>	<u>336,726</u>
Cash and cash equivalents, end of year	31	<u><u>187,673</u></u>	<u><u>348,519</u></u>

The accompanying notes form an integral part
of these financial statements

STATEMENT OF COMPREHENSIVE INCOME
Year Ended December 31, 2011
(thousands of EUR)

	<u>Notes</u>	<u>2011</u>	<u>2010</u>
Net profit		4,816	1,036
Gains on fair value adjustment of financial assets available for sale	15	560	(342)
Property, plant and equipment revaluation effect	21	8,080	-
Revaluation of other assets		-	61
Other		(3)	-
Other comprehensive income/(expense) for the year		<u>8,637</u>	<u>(281)</u>
Total comprehensive income for the year		<u>13,453</u>	<u>755</u>

The accompanying notes form an integral part
of these financial statements

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

1. FOUNDATION AND ACTIVITY

The Central Bank of Montenegro (hereinafter: the "Bank" or "CBM") was founded under the Law on the Central Bank of Montenegro (Official Gazette of RM, no. 52/00, 53/00, 47/01 and 4/05), adopted by the Parliament of Montenegro in November 2000.

The Parliament of Montenegro enacted a new Central Bank of Montenegro Law (Official Gazette of Montenegro, no. 40/10 and 46/10) in July 2010 (hereinafter: "the new CBM Law"). This law defines that CBM continues to operate thereunder.

The status, objectives, functions, performance and organization of the CBM are regulated by the Constitution of Montenegro and the CBM Law.

Pursuant to Article 143 of the Constitution of Montenegro, the CBM is an independent organization, responsible for monetary and financial stability and banking system, governed by the Council of the Central Bank and managed by the Governor of the CBM.

The new CBM Law created legal preconditions for adjustment of the status, objectives, functions and organization of the CBM to Article 143 of the Constitution of Montenegro in the manner that at the same time optimizes governing and managing the Central Bank and preserves its independence.

The new law also enabled compliance of the CBM functions and operations with the general principles relating to the operations of national central banks as defined by the relevant European Union regulations, primarily the provisions of the Treaty on the Functioning of the European Union (Articles 119, 123 and 127 to 133) and provisions of the Protocol No. 4 on the Statute of the European System of Central Banks and of the European Central Bank.

The new CBM Law defines that CBM shall perform the following functions:

- 1) oversee the maintenance of stability of the financial system as a whole and pass the pertinent regulations and measures;
- 2) issue licenses and approvals to banks and financial institutions and supervise banks and financial institutions;
- 3) carry out bankruptcy and liquidation proceedings against banks and financial institutions in line with the law;
- 4) regulate and oversee the national and international payment systems;
- 5) may be a payment system owner and operator and a participant in other payment systems;
- 6) license payment systems other than the one it operates and oversee these payment systems;
- 7) manage the foreign reserves;
- 8) act as payment and/or fiscal agent towards international financial institutions and may be a representative of Montenegro in international financial institutions;;
- 9) perform macroeconomic analyses, including monetary, fiscal, financial and the balance of payments analyses, and tender economic policy recommendations to the Government;
- 10) identify, analyses and assess the impact of certain factors on the financial system stability as a whole, which are in accordance with this law and law governing statistics and statistical system;
- 11) collect and statistically process data and information of importance for the achievement of objectives and the exercising of functions of the Central Bank;
- 12) set up the information system required for undisturbed exercising of its functions;
- 13) perform transfers in the national and international financial markets;
- 14) accept deposits of banks, state bodies and organizations and financial institutions and other parties in accordance with the regulations;
- 15) open accounts for banks and financial institutions, state bodies and organizations, foreign banks, central banks, international financial institutions, organizations donating funds to state bodies and organizations, and other entities in accordance with the law and other regulations, and provide financial services for those accounts;
- 16) pass regulations and measures pursuant to its authority granted under this and other law;
- 17) perform other activities in accordance with this and other law.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**1. FOUNDATION AND ACTIVITY (Continued)**

The new CBM Law regulates the performance of the Central Bank's functions and operations in detail, particularly pertaining to the following:

- monetary and other instruments;
- foreign reserves of Montenegro;
- provision and protection of banknotes and coins and redemption of rare and original currency;
- responsibility for the functioning of the banking system;
- payment transactions and payment systems;
- collection, processing and dissemination of data and information, including statistical data and information;
- relationships between the CBM and other state bodies and organizations;
- governance and management of the CBM;
- capital, assets, income and expenses of the CBM;
- internal audit of the CBM.

Pursuant to the new CBM Law, the Parliament of Montenegro appointed the first Governor of the CBM in mid-October 2010. Two vice-governors and four "external" CBM Council members were appointed by the end of October 2010 so that the newly appointed CBM Council commenced work early in November 2010.

With regard to the CBM capital and reserves, Articles 11, 12 and 13 of the new CBM Law define the following:

- The Bank's capital shall comprise of the initial capital and reserves;
- The Bank's initial capital shall amount to EUR 50 million;
- The Bank's initial capital shall be the state property;
- The initial capital may be increased by amounts suggested by the CBM and approved by the Government from the Montenegro Budget;
- The CBM reserves shall comprise general, special and revaluation reserves, where general reserves shall be used for absorption of losses incurred by the Bank;
- The Bank may, after consultation with the Government, establish special reserves in order to cover specific operating expenses.

The amount of the initial capital of EUR 50 million is determined by the Constitution of Montenegro for the purpose of creating adequate material preconditions for performance of the defined CBM functions. The amount of the initial capital was determined based on the Bank's responsibility for maintaining financial and monetary stability by using monetary and other instruments available in the circumstances (approval of loans to banks, open market operations, lender of last resort actions, etc.), and with the view to creation of conditions for performance of other CBM functions.

With regard to the CBM initial capital in the amount of EUR 50,000 thousand, Article 90 of the new CBM Law defines the manner of providing the prescribed amount as follows: it shall be provided from the founding capital set in the Law on the Central bank of Montenegro (Official Gazette of the Republic of Montenegro, no. 52/00 and 47/01) and from general reserves which shall be at the CBM's disposal as at the date of entry into force of the new CBM Law. If the aforescribed funds are insufficient to provide the initial capital of the Bank, any shortfall in the funds shall be provided from the Budget of Montenegro.

The registered Head Office of the Central bank of Montenegro is located in Podgorica, at the following street address: Bulevar Svetog Petra Cetinjskog 7, 81000 Podgorica.

As of December 31, 2011, the Bank had 301 employees (December 31, 2010: 313 employees).

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION****2.1. Basis of Preparation and Presentation of Financial Statements**

The accompanying financial statements have been prepared for the general usage and in accordance with the International Financial Reporting Standards (IFRS).

(a) Statement on Financial Statements' Compliance with IFRS

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

The presentation of the financial statements in accordance with IFRS requires the Bank's management to use certain critical accounting estimates and assumptions in the process of implementing the Bank's accounting policies. The areas demanding higher-level or higher-complexity estimates, or the areas where the estimates and assumptions are materially significant for the financial statements are disclosed in Note 2.1.(d).

The Bank consistently adhered to the accounting policies in line with IFRS that are disclosed in the following passages for all the accounting periods presented in the accompanying financial statements.

(b) Basis of Preparation of the Financial Statements

The Bank's financial statements were prepared at historical cost principle, as modified by applying revaluation of financial assets available for sale, property, equipment and other financial assets and liabilities (including derivative financial instruments) at fair value through profit and loss statement, and under going concern assumption.

(c) Functional and Reporting Currency

The Bank's financial statements are stated in thousands of EUR, which is the Bank's functional currency. All the financial data are stated in thousands of EUR and rounded off to the nearest thousand.

(d) Use of Accounting Estimates and Assumptions

The preparation of financial statements in conformity with IFRS requires the usage of certain critical accounting estimates and assumptions that influence the effects of policies applied, and amounts of assets and liabilities, i.e. income and expense amounts stated over the reporting period. Estimates and assumptions are made based on historical experience and other factors, including expectations referring to the future events that are deemed reasonable in the circumstances where the results present a solid basis for appraisal of the carrying value of assets and liabilities and where other sources result in uncertainties. Actual future results may vary from these estimates.

Estimates and assumptions are subject to constant review. Changes to the accounting estimates are recognized in the current period if they relate to that period only or, both in the current period and the ensuing periods if the change affects both the current and the ensuing periods.

The areas demanding higher-level or higher-complexity estimates, or the areas where the estimates and assumptions are materially significant for the financial statements are disclosed in Note 5 to the financial statements.

In the preparation of the accompanying financial statements in line with the IFRS the Bank adhered to the accounting policies described in Note 3.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(e) Standards and Interpretations in Effect in the Current Period

At the date of issuance of these financial statements the following standards, revisions and interpretations were in issue and in effect:

- “Conceptual Framework for Financial Reporting 2010” being an amendments to “Framework for the Preparation and Presentation of Financial Statements” (effective for transfer of assets from customers received on or after September 2010);
- Amendments to IFRS 1 “First-time Adoption of International Financial Reporting Standards” – Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (effective for annual periods beginning on or after July 1, 2010);
- Amendments to IAS 24 “Related Party Disclosures” – Simplifying the disclosure requirements for government-related entities and clarifying the definition of a related party (effective for annual periods beginning on or after January 1, 2011);
- Amendments to IAS 32 “Financial Instruments: Presentation” – Accounting for rights issues (effective for annual periods beginning on or after February 1, 2010);
- Amendments to various standards and interpretations “Improvements to IFRSs (2010)” resulting from the Annual quality improvement project of IFRS published on May 6, 2010 (IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34, IFRIC 13) primarily with a view to removing inconsistencies and clarifying wording, (most amendments are to be applied for annual periods beginning on or after January 1, 2011);
- Amendments to IFRIC 14 “IAS 19 – The Limit on a defined benefit Asset, Minimum Funding Requirements and their Interaction” – Prepayments of a Minimum Funding Requirement (effective for annual periods beginning on or after January 1, 2011);
- IFRIC 19 “Extinguishing Financial Liabilities with Equity Instruments” (effective for annual periods beginning on or after July 1, 2010).

Adoption of these standards and interpretations did not result in changes to the Bank's accounting policies.

(f) Standards and Interpretations in Issue not yet in Effect

At the date of issuance of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- IFRS 9 “Financial Instruments” (effective for annual periods beginning on or after January 1, 2013);
- IFRS 10 “Consolidated Financial Statements” (effective for annual periods beginning on or after January 1, 2013);
- IFRS 11 “Joint Arrangements” (effective for annual periods beginning on or after January 1, 2013);
- IFRS 12 “Disclosures of Involvement with Other Entities” (effective for annual periods beginning on or after January 1, 2013);
- IFRS 13 “Fair Value Measurement” (effective for annual periods beginning on or after January 1, 2013);

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.1. Basis of Preparation and Presentation of Financial Statements (Continued)

(f) Standards and Interpretations in Issue not yet in Effect (Continued)

- IAS 27 (revised in 2011) "Separate Financial Statements" (effective for annual periods beginning on or after January 1, 2013);
- IAS 28 (revised in 2011) "Investments in Associates and Joint Ventures" (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 1 "First-time Adoption of IFRS" – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Transfers of Financial Assets (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 9 "Financial Instruments" and IFRS 7 "Financial Instruments: Disclosures" – Mandatory Effective Date and Transition Disclosures;
- Amendments to IAS 1 "Presentation of Financial Statements" – Presentation of Items of Other Comprehensive Income (effective for annual periods beginning on or after July 1, 2012);
- Amendments to IAS 12 "Income Taxes" – Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after January 1, 2012);
- Amendments to IAS 19 "Employee Benefits" – Improvements to the Accounting for Post-employment Benefits (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IAS 32 "Financial Instruments: Presentation" – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after January 1, 2014);
- IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine" (effective for annual periods beginning on or after January 1, 2013).

The CBM management considers the impact of the aforesaid standards and interpretations on the financial statements, as well as their effective dates, and holds that their adoption will not have materially significant effects on the Bank's financial statements in the period of their initial adoption.

2.2. Use of Accounting Estimates

The presentation of the financial statements requires the Company's management to make best estimates and reasonable assumptions that influence the assets and liabilities amounts, as well as the disclosure of contingent liabilities and receivables as of the financial statements' preparation date, and income and expenses arising during the accounting period. These estimations and assumptions are based on information available to us at the financial statements' preparation date and mostly relate to the estimated amounts of the provisions for loans and interest payables, provisions for deposits held with other banks, permanent investments and off-balance sheet items. However, actual results may depart from these estimates.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****3.1 Interest and fee Income and Expenses**

Interest income and expenses arising from all interest-bearing financial instruments are recognized in the income statement within "interest income" and "interest expenses" applying the effective interest rate method.

The effective interest rate method is a method of calculating repayment costs of a financial asset or liability and of allocating interest income or interest expenses over the relevant period. The effective interest rate is the rate that accurately discounts estimated future cash payments or receipts over the expected life of the financial asset, or when appropriate, over a shorter time period, to the net present value of the financial asset or liability. When calculating interest rate, CBM estimates cash flows considering all the contractual terms of a financial instrument but does not consider future credit losses.

Once a financial asset or a group of related financial assets are written off as a result of an impairment loss, interest income is recognized based on the interest rate applied for discounting future cash flows for the purpose of impairment loss measurement.

Fee income and expenses from banking services rendered or used, are recognized on the accrual basis when such services are invoiced and rendered. Fees primarily comprise bank charges for domestic payment transactions, fiscal agency services and other services CBM renders in accordance with the relevant law. In the accounting period under review, CBM did not have fee income and expenses.

3.2. Operating Lease

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases.

Assets leased out under operating lease are included in investment property in the statement of financial position. They are depreciated over their expected useful lives in the manner consistent with the one applied to the similar assets owned by the Bank. Rental income (net of any incentives granted to lessees) is recognized as income in the income statement on a straight-line basis over the lease term.

3.3. Foreign Currency Translation***Functional and Reporting Currency***

Items included in the financial statements of CBM are measured using the currency of the primary economic environment the Bank operates in ("the functional currency"). The amounts in the financial statements are presented in thousands of EUR, the EUR being the functional and reporting currency of the Bank.

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 arising from settlement of such transactions and from translation of monetary assets and liabilities denominated in foreign currencies at the end of the year are recognized in the income statement.

3.4. Taxes and Contributions**Income Taxes**

In accordance with the Central Bank of Montenegro Law, CBM is exempt from income tax payment.

Indirect Taxes and Contributions

Indirect taxes and contributions are included in other operating costs. Tax amounts the Bank is obligated to pay are included in other liabilities as tax payables.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.5. Cash and Cash Equivalents**

For the purposes of the statement of cash flows preparation, cash and cash equivalents comprise balances with less than a three-month maturity from the date of acquisition, including vault cash, demand deposits and short-term placements with foreign banks.

3.6. Financial Instruments***Financial Assets***

CBM classifies its financial assets in the following categories: loans and receivables and available-for-sale financial assets. The Bank's management classifies financial assets at initial recognition.

(a) Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. All loans and advances are initially recognized at fair value. All loans and advances are recognized when cash is advanced to borrowing customers. After initial recognition, loans and receivables are subsequently measured at amortized cost using the effective interest rate method.

(b) Financial Assets Available-for-Sale

Financial assets available for sale represent financial instruments which are intended to be held over an indefinite time period and which may be sold for liquidity purposes due to the movements in interest rates, exchange rates or prices of capital.

Regular purchase and sale of investments are recognized at the date of transaction, which is the date when the Bank has committed to purchase or sell the asset.

Financial assets are initially recognized at fair value increased by the transaction costs.

Financial assets available for sale are subsequently carried at fair value.

Gains and losses arising from changes in fair value of available-for-sale financial assets are recognized within equity until the moment of disposal or impairment. At this time, cumulative gains or losses previously recognized within equity, are recognized in profit and loss account. However, interest calculated using the effective interest method and foreign currency gains and losses on value adjustments of monetary assets classified as available for sale are recognized in the income statement.

The fair value of financial assets quoted in an active market is based on current bid and demand prices. If there is no active market for a financial asset, CBM determines its fair value using valuation techniques. These include using recent arm's length transactions, experience with similar instruments, discounted cash flow analysis and other valuation techniques commonly used by participants in the market.

(c) Offsetting Financial Instruments

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legal right to offset the recognized amounts as well as if there is an intention to reconcile them on net basis or realize the asset and settle the liability at the same time.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Financial Instruments (Continued)

Financial Assets (Continued)

(d) Impairment of Financial Assets Carried at Amortized Cost

CBM assesses at each balance date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. 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 (an incurred "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The indicators that the Bank uses to determine whether there is objective evidence of an impairment loss include the following:

- defaults in contractual payments of principal or interest;
- cash flow problems on the part of the borrower (e.g. decrease in capital adequacy ratios or decrease in profitability);
- breach of contractual covenants or conditions;
- initiation of the bankruptcy procedure;
- deterioration of the borrower's competitive position;
- decrease in the value of collateral.

The estimated period between the inception of the loss and its identification is determined by the Bank's for each financial asset portfolio. In general, the periods may vary from 3 to 12 months; in exceptional cases, longer periods are warranted.

The Bank assesses whether objective evidence of impairment exists individually for financial assets.

The amount of the loss is measured as the difference between the asset's carrying amount and its recoverable value, being the present value of estimated future cash flows (excluding future credit losses not yet incurred), discounted at the original effective interest rate for that particular financial asset. The carrying value is decreased in the account of allowance for impairment and the impairment loss is recognized in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from realization of the collateral, netted of the collateral acquisition and sale costs, regardless of the likelihood of such realization.

Uncollectible loans are written off in the account of allowance for impairment of loans after completion of all the necessary procedures and establishment of the loss amount.

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

Financial Liabilities

Financial liabilities are initially recognized at fair value, which is usually the value of inflows netted of the transaction costs incurred. Financial liabilities are subsequently measured at amortized cost, using the effective interest rate method.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Intangible Assets

Acquired computer software licenses are capitalized in the amount of expenditure incurred upon purchase and bringing the software into use. Expenses relating to new computer software development are recognized when incurred. Expenditure directly attributable to the development of the existing software applications under CBM control are capitalized only when it is likely that future economic benefits associated with investments into such software will flow to the Bank and when the expenses can be reliably measured. Directly attributable expenses include staff costs of the software development team.

Costs of improving computer program performances so that they extend beyond their original specifications are recognized as increase in value of the computer software in usage. Computer software is amortized on a straight-line basis, over its estimated useful life, but no longer than five years.

Other expenditure arising from development and/or maintenance of computer software programs is recognized as expense when incurred.

Intangible assets are reviewed for impairment whenever events or changes in the circumstances indicate that their carrying amounts may not be recoverable. An impairment loss is recognized in the amount whereby an asset's carrying amount is higher than its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and the value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

3.8. Property, Plant and Equipment

CBM's property, plant and equipment are stated at fair value, as described below, less accumulated depreciation.

Land is stated at cost and is not depreciated.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to income statement of the reporting period in which they are incurred.

Depreciation is calculated on a straight-line basis to the cost of property and equipment by applying the following annual rates in order to write them off over their useful lives.

Depreciation of major categories of property, plant and equipment is calculated by applying the following depreciation rates determined based on their estimated useful lives:

<u>Major categories of property, plant and equipment</u>	<u>Depreciation rate before revaluation(%)</u>	<u>Depreciation rate after revaluation(%)</u>
Buildings	1.30	1.47 – 2.63
Ancillary premises	8.00	1.30 – 33.33
Power stations and generators	4.00 – 5.00	6.67 – 20.00
Money handling equipment	15.50	100.00
Computer equipment	33.33	25.00 – 50.00
Mobile phones	33.33	33.33 – 50.00
Telecommunication equipment	7.00 – 10.00	8.33 – 50.00
Furniture and other equipment	10.00 – 20.00	10.00 – 50.00
Motor vehicles	15.50	12.50 – 25.00

Gains and losses on disposals of property, plant and equipment are determined as a difference between the cash receipt and the carrying value and are recognized in the income statement as other operating expenses.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.8. Property, Plant and Equipment (Continued)**

Residual values and useful lives of the assets are reviewed and adjusted as appropriate, at each statement of financial position date.

Fixed assets are reviewed for impairment whenever events or changes in the circumstances indicate that their carrying amounts may not be recoverable. An impairment loss is recognized in the amount whereby an asset's carrying amount is higher than its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and the value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

Property, plant and equipment are subject to revaluation on a regular basis. The frequency of revaluation depends upon the changes in fair values of the assets being revalued. When an asset is revalued, its accumulated revaluation is restated proportionately to the changes in its gross carrying amount up to the date of new revaluation, so that the carrying amount of the asset after revaluation equals its revalued amount.

Increase in the carrying amount of the property, plant and equipment arising on revaluation is credited to revaluation reserves, within equity. Decrease that offsets previous increase in the value of the same asset is charged against revaluation reserves directly; all other decreases are charged to the income statement. The revaluation reserve is transferred directly to retained earnings/(accumulated losses) upon the asset's disposal or sale.

3.9. Investment Property

Investment property comprises business premises not occupied by CBM but rented out mainly to commercial banks. Investment property is stated at cost less accumulated depreciation.

Depreciation of investment property is calculated using the straight-line method to allocate its residual value over its estimated useful life, ranging from 50 to 75 years.

3.10. Numismatic Coins

Numismatic coins are stated at the lower of cost and its net realizable value.

3.11. Provisions

Provisions for litigation claims are recognized when: CBM has a present legal or contractual liability resulting from past events; it is more likely than not that the settlement of the liability will require an outflow of assets; when the amount of the liability can be reliably estimated.

Where there are a number of similar liabilities, the likelihood that an outflow of assets will be required for settlement is determined by considering the class of liabilities as a whole. A provision is recognized even if the likelihood of an outflow of assets in respect of any item included in the same class of liabilities is minor.

Provisions are measured at the present value of the expenditures expected to arise from the settlement of the liability using a pre-tax rate that reflects current market estimate of the time value of money and specific risks associated with the liability. Increase in provisions due to passage of time is recognized as interest expense.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.12. Employee Benefits

a) Taxes and Contributions Made to the Employee Social Security and Insurance Funds

CBM pays the following mandatory contributions for all employees to the state funds: pension and disability insurance contribution, healthcare insurance contribution and unemployment insurance contribution. Contributions paid by the employee are aggregately calculated at the rate of 15% applied to the gross salary. Contributions paid by the employer are aggregately calculated at the rate of 5.5% applied to the gross salary. Contributions paid are recognized as expenses when incurred and are stated in the income statement within staff costs. CBM is under no obligation to pay any contributions other than the aforescribed contributions.

b) Severance/Redundancy Payments

Severance or redundancy payments are paid upon employment termination by CBM before retirement or when an employee accepts consensual employment termination in exchange for severance or redundancy payment. CBM recognizes severance or redundancy payments when it is evidently committed to either terminate employment according to a detailed official plan without any possibility of withdrawal; or providing redundancy benefits in order to encourage voluntary redundancy and reduce the number of employees. Benefits falling due within periods exceeding 12 months after the statement of financial position are discounted to the present value.

c) Residential Housing Loans

In accordance with the Employee Housing Rules of Procedure and the Decision of the Employee Housing Commission, CBM approves housing loans to the employees. Housing loans are initially recognized at fair value and subsequently measured at amortized cost based on the effective interest rate. The difference between the initial fair value of the loans and the cash disbursed to the beneficiary employees is recognized as prepaid employee benefits within long-term receivables from employees. The prepaid employee benefits are amortized over the benefit period. The benefit period is the expected service life of the employee that cannot exceed the term of the loan.

d) Bonuses

CBM recognizes the liability and expense for bonuses disbursed to employees in accordance with the Rules on the evaluation of staff performance in CBM.

3.13. Initial Capital and Reserves

The new Central Bank of Montenegro Law defines that the Bank's capital shall comprise of the initial capital and reserves and that the minimum initial capital amount shall total EUR 50,000 thousand.

In accordance with the new CBM Law, the capital was transformed whereby the founding capital and general reserves were converted into the initial capital. The new law introduced new categories of reserves: general, special and revaluation reserves.

As of December 31, 2011, the initial capital of the Bank amounted to EUR 35,003 thousand.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.14. Fair Value**

IAS 32 - "Financial Instruments: Presentation" envisages disclosing fair value of financial assets and financial liabilities in the notes to the financial statements. For this purpose, fair value is defined as an amount an asset can be exchanged for or a liability settled with in a transaction between well informed and willing counterparties. The Bank is under obligation to disclose all information about the fair value of assets and liabilities whereof there is available market information and whereof a materially significant difference between their carrying values and fair values is identified.

In Montenegro, sufficient market experience, stability and liquidity do not exist for the purchase and sale of financial assets and liabilities as well as of other financial instruments for which published market prices are presently not readily available. As a result, fair value cannot readily or reliably be determined in the absence of an active market, as required by IAS IFRS. In management's opinion, the amounts stated in these financial statements reflect the values most truthful in the given circumstances and most appropriate for the purpose of financial reporting. The Bank assesses its overall risk exposure and in instances in which it estimates that the value of assets stated in its books may not be realized, it recognizes allowance for impairment, based on the management's decision.

4. FINANCIAL INSTRUMENTS**4.1. Risk Management**

Owing to the nature of its activities, the Bank is exposed to the following major risks:

- Credit risk,
- Market risk (which includes the interest risk, currency risk and other market risks),
- Liquidity risk and
- Operational risk.

Risk exposure is inherent in the Bank's business operations, and operational risks are their inevitable consequences. It is therefore CBM's objective to achieve appropriate balance between the risks taken and return aimed at and to minimize the potential adverse effects on its financial performance. CBM's adequate response to risks includes risk analysis, estimates and management of certain degree of risk.

CBM's risk management policies are designed to identify and analyze these risks, to set appropriate risk limits and controls and to monitor the risks and adherence to the limits set by means of reliable and up-to-date information system.

Risk management is conducted within the Financial and Banking Operations Sector under policies approved by the CBM Council. the Financial and Banking Operations Sector identifies and assesses financial risks in collaboration with other CBM departments. The Council defines and provides written procedures for overall risk management as well as written procedures to cover specific areas, such as foreign exchange rate risk, interest rate risk, liquidity risk and credit risk.

4.2. Credit Risk

CBM is exposed to credit risk, which represents the risk of negative effects on the Bank's financial result arising from the transaction counterparty's inability to settle its committed liability.

Significant changes in the economies where the Bank's portfolio is concentrated might result in losses different from those stated at the statement of financial position date. Therefore, the management prudently manages the Bank's credit risk exposure. Credit risk exposure is mainly associated with placements with foreign banks and debt securities.

Credit risk management and risk exposure control are centralized within the Financial and Banking Operations Sector, and regularly reported on to the CBM Council.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.1. Credit Risk Measurement and Set Limit Control

(a) *Placements with Foreign Banks*

During the last quarter of 2008, in the light of significant changes having occurred in the international financial market, the Bank had transferred deposits from foreign commercial banks into foreign central banks in order to improve the placement safety and risk protection.

(b) *Debt Securities and Other Bonds*

Debt securities where foreign reserves are invested comprise German Government and Dutch Government bonds with maturities from 1 to 3 years and AAA rating (Standard&Poor). These debt securities are held at the securities account with Deutsche Bundesbank, Frankfurt.

The entire debt securities portfolio is denominated in EUR.

4.2.2. Impairment and Allowance for Impairment Policy

The internal and external rating systems focus on credit-quality mapping based on the lending and investing activities. In contrast, allowance for impairment is recognized for financial reporting purposes only for losses incurred as of the statement of financial position based on the objective evidence of impairment.

	December 31, 2011		December 31, 2010	
	Loans and advances, gross	Allowance for Impairment (%)	Loans and advances, gross	Allowance for Impairment (%)
Loans to employees – short-term portion (Note 17)	1,072	-	1,088	-
Loans to employees – long-term portion (Note 22)	1,880	-	2,059	-
Loans to the Government	-	-	3	-
Total, gross	2,952	-	3,150	-

4.2.3. Maximum Exposure to Credit Risk Without Collateral

The table below presents the worst case scenario of credit risk exposure as of December 31, 2011 and 2010. The statement of financial position items exposure is based on the net carrying amounts as stated in the statement of financial position:

	December 31, 2011	December 31, 2010
Cash, cash equivalents and demand deposits (Note 13)	87,109	172,092
Placements with foreign banks (Note 14)	100,564	176,427
Financial assets available for sale (Note 15)	76,914	29,941
Assets held with IMF (Note 16)	63,586	62,126
Loans and advances approved to the Government prior to commencement of CBM operations	-	3
Housing loans approved to employees (Notes 17 and 22)	2,952	3,147
Receivables (Note 18)	1,997	1,710
Total	333,122	445,446

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk Without Collateral (Continued)

As shown in the table above, as of December 31, 2011, 26% of the total maximum exposure relates to the demand deposits held with foreign banks (December 31, 2010: 39%) and 30% to fixed-term deposits held with foreign banks (December 31, 2010: 40%).

Credit risk is managed by selecting a financial institution – a central bank or a debt securities issuer based on the criteria adopted by the CBM Council. The table below presents the analysis of CBM placements with foreign banks and debt securities issuers as of December 31, 2011 and 2010:

Credit rating	December 31, 2011			December 31, 2010		
	Placements with foreign banks	Debt securities	Total	Placements with foreign banks	Debt securities	Total
AAA	-	76,914	76,914	-	29,941	29,941
Central banks	100,564	-	100,564	176,427	-	176,427
Total	100,564	76,914	177,478	176,427	29,941	206,368

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.4. Financial Placements

Financial placements were classified as follows:

	December 31, 2011						
	Time placements foreign banks (Note 14)	Loans and advances approved to the Government	Financial assets available for sale (Note 15)	Assets held with the IMF (Note 16)	Receivables (Note 18)	Housing loans approved to employees (Notes 17 and 22)	Total
Not matured	100,564	-	76,914	63,586	-	2,952	244,016
Matured, not written off	-	-	-	-	1,997	-	1,997
Individually written off	-	-	-	-	-	-	-
Gross	100,564	-	76,914	63,586	1,997	2,952	246,013
Less:							
Allowance for impairment	-	-	-	-	-	-	-
Net	<u>100,564</u>	<u>-</u>	<u>76,914</u>	<u>63,586</u>	<u>1,997</u>	<u>2,952</u>	<u>246,013</u>
	December 31, 2010						
	Time placements foreign banks (Note 14)	Loans and advances approved to the Government	Financial assets available for sale (Note 15)	Assets held with the IMF (Note 16)	Receivables (Note 18)	Housing loans approved to employees (Notes 17 and 22)	Total
Not matured	176,427	-	29,941	62,126	-	3,147	271,641
Matured, not written off	-	3	-	-	1,806	-	1,809
Individually written off	-	-	-	-	-	-	-
Gross	176,427	3	29,941	62,126	1,806	3,147	273,450
Less:							
Allowance for impairment	-	-	-	-	96	-	96
Net	<u>176,427</u>	<u>3</u>	<u>29,941</u>	<u>62,126</u>	<u>1,710</u>	<u>3,147</u>	<u>273,354</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.4. Financial Placements (Continued)

Placements to foreign banks and loans approved to the Government and domestic commercial banks are not collateralized. That is why CBM did not disclose fair value of collateralized accepted for the loans approved.

4.2.5. Risk Concentration of the Financial Assets with Credit Risk Exposure

Geographical Regions

The following table breaks down the CBM's main credit risk exposures at the assets' carrying amounts per geographical regions as of December 31, 2011. In this table credit risk exposure is based on the country of domicile of the CBM's counterparty banks and institutions.

	<u>EU countries</u>	<u>USA</u>	<u>Montenegro</u>	<u>Total</u>
Cash and cash equivalents	-	-	22,708	22,708
Demand deposits held with foreign banks	64,167	234	-	64,401
Placements with foreign banks	100,100	464	-	100,564
Financial assets available for sale	76,914	-	-	76,914
Assets held with the IMF	-	63,586	-	63,586
Loans and advances	-	-	2,952	2,952
Other financial assets	-	-	1,997	1,997
Balance at December 31, 2011	<u>241,181</u>	<u>64,284</u>	<u>27,657</u>	<u>333,122</u>
Balance at December 31, 2010	<u>362,051</u>	<u>64,656</u>	<u>18,739</u>	<u>445,446</u>

4.3. Market Risk

CBM is exposed to market risks which refer to the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market prices. Market risks arise from outstanding balances due to changes in interest rates, foreign currency exchange rates and prices of securities. CBM manages only non-trading portfolios.

Market risks arising from the CBM portfolio are managed by the Financial and Banking Operations Sector and regularly reported on to the CBM Council.

The CBM portfolio is mostly comprised of securities available for sale.

4.3.1. Market Risk Measurement Techniques

Major measurement techniques used to measure and control market risks are outlined in the following passages.

CBM applies "Value at Risk" methodology (VAR) to estimate the market risk exposures and the maximum losses expected based on a number of assumptions for various changes of market conditions. The CBM Council sets limits on the value of risk acceptable for CBM, which is monitored on a monthly basis and according to the reports submitted by the Financial and Banking Operations Sector.

VAR represents a statistical methodology for assessing the maximum change in foreign reserve value arising from changes in the financial instrument prices and in foreign exchange rates together with certain level of confidence for particular time frame. The 1998 Basel Agreement recommends that the bank apply a 99% level of confidence within a 10-day interval when calculating VAR.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.3. Market Risk (Continued)

4.3.1. Market Risk Measurement Techniques (Continued)

The VAR methodology estimates how much the foreign reserves will decrease as a result of the price fluctuations and changes in foreign reserves of the currencies comprising the foreign reserves with a 99% confidence for a 30-day interval. Fluctuations of instrument prices and foreign exchange rates are determined according to the historical changes in prices, instruments and currencies comprising the foreign reserves at the end of the month. The value of VAR resulting in 99% confidence level denotes the maximum change in the foreign reserves in the environment of common market changes with probability of 99%.

The use of this approach does not prevent losses outside these limits in the circumstances of more significant market movements.

As VAR constitutes an integral part of CBM's market risk control regime, VAR limits are established and by the Council annually for investments in securities. Actual exposure against limits is reviewed by the Financial and banking Operations Sector on a monthly basis.

As of December 31, 2011, the maximum VAR was -0.52%, whereas the minimum VAR was -0.47% of the entire portfolio market value.

4.3.2. Foreign Currency Risk

CBM is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on the statement of financial position items and cash flows. The CBM Council sets the limits on the level of exposure per currencies and aggregately, both for overnight and intra-day positions, which is monitored on a monthly basis.

The table below summarizes the CBM's exposure to foreign currency exchange rate risk as of December 31, 2011. Included in the table are the CBM's financial assets and liabilities at their carrying amounts and classified by currency.

	<u>EUR</u>	<u>USD</u>	<u>SDR</u>	<u>Total</u>
Balance at December 31, 2011				
Assets				
Cash, cash equivalents and demand deposits	86,875	234	-	87,109
Fixed-term deposits with foreign banks	100,100	464	-	100,564
Assets held with the IMF	-	-	63,586	63,586
Financial assets available for sale	76,914	-	-	76,914
Loans and advances	2,952	-	-	2,952
Other financial assets	1,997	-	-	1,997
Total financial assets	<u>268,838</u>	<u>698</u>	<u>63,586</u>	<u>333,122</u>
Liabilities				
Payables arising from the accounts of other banks and financial institutions	227,825	-	-	227,825
Payables arising from the Government's accounts	10,858	-	-	10,858
Liabilities to the IMF	-	-	63,670	63,670
Other financial liabilities	88	-	-	88
Total financial liabilities	<u>238,771</u>	<u>-</u>	<u>63,670</u>	<u>302,441</u>
Net statement of financial position position	<u>30,067</u>	<u>698</u>	<u>(84)</u>	<u>30,681</u>
Balance at December 31, 2010				
Total financial assets	380,822	2,498	62,126	445,446
Total financial liabilities	358,315	-	62,215	420,530
Net statement of financial position position	<u>22,507</u>	<u>2,498</u>	<u>(89)</u>	<u>24,916</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.3. Market Risk (Continued)

4.3.2. Foreign Currency Risk (Continued)

As of December 31, 2011, had the USD strengthened/weakened by 5% against EUR and all other variables remained unchanged, net profit for the year would have been EUR 25 thousand lower/higher (December 31, 2010: EUR 125 thousand), as a result foreign exchange losses/gains.

4.3.3. Interest Rate Risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on both their fair value and cash flow risks. Interest margins may increase as a result of such changes, but they may also reduce losses in the event when unexpected movements arise. The Council sets limits on the level of mismatch of interest rate repricing, which may be undertaken and which is monitored monthly by the Financial and Banking Operations sector.

The following table summarizes the Bank's exposure to the interest rate risk. It presents financial instruments of the CBM carried at carrying values, categorized by the earlier of contractual repricing or maturity dates.

	Up to 1 month	From 1 to 12 months	From 1 to 5 years	Over 5 years	Non-interest bearing	Total
Balance at December 31, 2011						
Assets						
Cash, cash equivalents and demand deposits	64,401	-	-	-	22,708	87,109
Fixed-term deposits with foreign banks	100,564	-	-	-	-	100,564
Assets held with the IMF	63,586	-	-	-	-	63,586
Financial assets available for sale	76,914	-	-	-	-	76,914
Loans and advances	-	-	-	-	2,952	2,952
Other financial assets	-	-	-	-	1,997	1,997
Total financial assets	<u>305,465</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>27,657</u>	<u>333,122</u>
Liabilities						
Payables arising from the accounts of other banks and financial institutions	195,483	-	-	-	32,342	227,825
Payables arising from the Government's accounts	10,744	-	-	-	114	10,858
Liabilities to the IMF	63,670	-	-	-	-	63,670
Other financial liabilities	-	-	-	-	88	88
Total financial liabilities	<u>269,897</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>32,544</u>	<u>302,441</u>
Net exposure to change in interest rate risk	<u>35,568</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4,887)</u>	<u>30,681</u>
Balance at December 31, 2010						
Net exposure to change in interest rate risk	<u>311,350</u>	<u>3</u>	<u>-</u>	<u>-</u>	<u>(286,437)</u>	<u>24,916</u>

The interest rate sensitivity analysis is determined based on the exposure to interest rate risk as of the reporting date. As of December 31, 2011, had the interest rate been 100 basis points higher/lower and all other variables remained unchanged, the Bank's net profit for the 12-month period ended December 31, 2011 would have respectively increased/decreased by approximately EUR 280 thousand (December 31, 2010: approximately EUR 2,492 thousand).

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.4. Liquidity Risk

Liquidity risk is the risk that the Bank will not be able to settle its financial liabilities when due and to replace the funds withdrawn. The consequences thereof may be default and breach of contractual obligations.

4.4.1. Liquidity Risk Management Process

The CBM's liquidity risk management process, as conducted within CBM and monitored by an expert team of the CBM Treasury, includes the following:

- day-to-day funding managed by monitoring future cash flows in order to fulfill the expected requirements. This involves replenishment of funds as they mature or as they are borrowed;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruptions to cash flows;
- monitoring statement of financial position liquidity ratios according to internal and regulatory requirements; and
- managing the risk concentration and the maturities of debt securities.

Monitoring and reporting entail cash flow measurement and projections for the following day, week and month as these are the key periods to liquidity management. The starting point for such projections is an analysis of the contractual maturity of the financial liabilities and the expected date of collection of the financial assets.

4.4.2. Funding Approach

Sources of liquidity are regularly reviewed by CBM's Financial and Banking Operations Sector s as to maintain wide diversification by currency, region, supplier, etc.

4.4.3. Non-Derivative Cash Flows

The table below presents the non-derivative cash flows for CBM financial assets and liabilities. The amounts presented in the table represent contractual non-discounted cash flows.

	Up to 1 month	From 1 to 12 months	From 1 to 5 years	Over 5 years	Non-interest bearing
Balance at December 31, 2011					
Assets					
Cash, cash equivalents and demand deposits	87,109	-	-	-	87,109
Fixed-term deposits with foreign banks	-	100,564	-	-	100,564
Assets held with the IMF	63,586	-	-	-	63,586
Financial assets available for sale	-	-	76,914	-	76,914
Loans and advances	-	-	-	2,952	2,952
Other financial assets	-	1,997	-	-	1,997
Total financial assets	<u>150,695</u>	<u>102,561</u>	<u>76,914</u>	<u>2,952</u>	<u>333,122</u>
Liabilities					
Payables arising from the accounts of other banks and financial institutions	227,825	-	-	-	227,825
Payables arising from the Government's accounts	10,858	-	-	-	10,858
Liabilities to the IMF	63,670	-	-	-	63,670
Other financial liabilities	88	-	-	-	88
Total financial liabilities	<u>302,441</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>302,441</u>
Liquidity GAP	<u>(151,746)</u>	<u>102,561</u>	<u>76,914</u>	<u>2,952</u>	<u>30,681</u>
Balance at December 31, 2010					
Total assets	410,645	1,713	29,941	3,147	445,446
Total liabilities	420,530	-	-	-	420,530
Liquidity GAP	<u>(9,885)</u>	<u>1,713</u>	<u>29,941</u>	<u>3,147</u>	<u>24,916</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

4. FINANCIAL INSTRUMENTS (Continued)

4.4. Liquidity Risk (Continued)

4.4.3. Non-Derivative Cash Flows (Continued)

Assets available for settlement of all liabilities include cash and demand deposits, placements held with foreign banks and loans and advances. CBM can also respond to the unexpected cash outflows by selling available-for-sale assets.

4.5. Fair value of Financial Assets and Liabilities

Available-for-sale financial assets are presented at fair value. All other financial assets and liabilities are presented at amortized cost. Due to the fact that the largest portion of the CBM's financial assets and liabilities carried at amortized cost have a maturity less than a month, the management believes that their carrying value is not materially different from their fair value.

Fair Value Hierarchy

Financial assets and liabilities carried at fair value as per levels:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Financial assets available-for-sale	76,914			76,914
Total	<u>76,914</u>	<u>-</u>	<u>-</u>	<u>76,914</u>

Level 1 – Quoted prices in active markets for identical instruments.

Level 2 – Inputs other than quoted market for those assets or liabilities are directly observable.

Level 3 – Inputs for an asset or a liability that are not based on observable market data (unobservable inputs).

4.6. Capital Management

The bank's objectives when managing capital, which is a broader concept than equity stated in the statement of financial position, are the following:

- To comply with the capital requirements defined by the CBM Law;
- To preserve the Bank's ability to continue as a going concern in the foreseeable future and fulfill all its functions defined by the CBM Law; and
- To maintain sufficient capital level to support further development of its activities.

The CBM Law defines the following:

- (a) the CBM capital shall comprise the initial capital and reserves;
- (b) the initial capital shall amount to EUR 50,000 thousand.

Pursuant to the CBM Law, in the year 2010 the capital was transformed in such a manner that the founding capital and general reserves were transformed into the initial capital.

As of December 31, 2011, the initial capital amounted to EUR 35,003 thousand. The additional required capital amount of EUR 14,997 thousand is to be obtained from the Budget of Montenegro (Article 90., paragraph 2 of the CBM Law, Official Gazette of Montenegro no. 40/10 and 46/10).

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**5. REVIEW OF SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS
IN APPLYING ACCOUNTING POLICIES**

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

a) Impairment of Securities Available for Sale

The Bank establishes whether the securities available for sale have been impaired when there is a significant or prolonged decrease in their fair value below their cost. Determining what is significant or prolonged decrease requires judgment. Impairment is justified when there is evidence of deterioration of the financial standing of the entity invested into, or industry, industrial sector or cash flows from operating and financing activities.

b) Provisions

Provisions are highly judgmental, particularly in the cases of litigations. CBM assesses the probability of an adverse outcome as a result of the past events and if the probability is higher than 50%, CBM fully provides for the liability. The Bank's management is prudent in such assessments, but due to a high level of uncertainty, in some cases the estimated outcome may deviate from the actual outcome of an event.

c) Retirement and Other Long-Term Employee Benefits

In accordance with the Labor Law, the Bank has an obligation to disburse an employment retirement benefit to a retiree. The Bank's obligation is incurred at the time of termination of employment of an employee who has fulfilled the legal requirements for retirement. Present value of retirement pension obligation depends on many factors - the salary growth rate, discount rates, labor turnover rates, etc. The Bank's management has assessed the present value of provisions for retirement benefits and considers that the amount assessed has no material impact on the financial statements of the Bank. Given the above, the amount concerned has not been recorded in the financial statements as at December 31, 2011.

d) Financial Crisis

The ongoing global financial and economic crisis that emerged in the second half of 2008, among other things, has resulted in a lower level of capital market funding, lower liquidity levels across the banking sector and, at times, higher interbank interest rates and high volatility in security markets. Uncertainties in the global financial markets have also led to failures of banks and to the bank rescues organized in the United States, Western Europe, Russia and elsewhere. The full extent of the impact of the financial crisis is proving to be difficult to anticipate or completely guard against.

Besides the global financial market turmoil, the Montenegrin banking system remained sound and stable, which can be explained by low financial integration and lack of significant exposure of domestic financial sector to risk-bearing securities abroad. However, deepening of the financial and economic crisis has affected the domestic economic activity more intensely, resulting in a reduced external demand for export products and goods from Montenegro, as well as in a further pressure exerted on the country's economic growth rate. Further indirect impact is expected on the level and terms of domestic crediting activity, deposit growth rate and more restricted external financing terms.

The CBM management is unable to reliably estimate the effects of any further liquidity deterioration of the financial markets and the increased volatility in the currency and capital markets on the CBM's future financial position. The management holds that it is taking all the necessary measures to support sustainability and development of the bank's operations in the current circumstances.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

6. INTEREST INCOME AND EXPENSES

a) Interest Income

	Year Ended December 31,	
	2011	2010
Fixed-term deposits held with foreign banks	2,472	1,005
Financial assets available-for-sale	1,415	822
Loans and advances to the Government and banks prior to commencement of CBM operations	-	3
	<u>3,887</u>	<u>1,830</u>

b) Income Expenses

	Year Ended December 31,	
	2011	2010
Mandatory special reserves of commercial banks	419	417
Public sector deposits	731	280
Other financial institutions	160	57
	<u>1,310</u>	<u>754</u>

7. FEE INCOME AND EXPENSES

a) Fee Income

	Year Ended December 31,	
	2011	2010
Participation in RTGS	203	231
Order processing in RTGS	1,138	1,150
Order processing in DNS	408	397
State Treasury order processing	1,581	1,586
Processing orders for public duties payables	327	448
Cash payments and disbursements through customers' accounts	155	156
Forced collection order issuance and realization	534	600
Registration of state commercial papers	430	346
Servicing foreign debt	240	136
Income on inspection of microcredit financial institutions	1,028	1,072
Credit regulatory body services	305	94
Transfers via the CBM accounts held abroad	240	148
Other fee income	15	15
	<u>6,604</u>	<u>6,379</u>

For the services rendered the Bank charges fees in the amount and manner determined by the Decision on Determination of Tariffs for Calculation of Fees for Services Rendered by CBM (Official Gazette of Montenegro, no. 29/11).

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

7. FEE INCOME AND EXPENSES (Continued)

b) Fee Expenses

	Year Ended December 31,	
	2011	2010
Import and export of foreign money	84	52
Registration of the state commercial papers	18	8
Payment transactions	9	11
Money transport services	1	-
	<u>112</u>	<u>71</u>

8. OTHER INCOME

	Year Ended December 31,	
	2011	2010
Operating lease of premises - rental	221	214
Sales of bills of exchange forms	361	298
Sale of precious metals	15	14
Sale of property, plant and equipment	10	-
Collection of receivables previously written off	107	142
Compensation for contribution in the Bank for International Settlements, Basel	4,258	-
Reversal of provisions for potential litigation losses	10	-
Other income	136	177
	<u>5,118</u>	<u>845</u>

In 2011 CBM realized income in the amount of EUR 4,258 thousand from the right to contribution in the Bank for International Settlements in Basel (BIS). Since the National Bank of Serbia (NBS) became the legal successor of the National Bank of Yugoslavia (NBY) in 2007, NBS inherited NBY stock in BIS and CBM received cash payment as compensation.

After a series of negotiations considering the possibility to retain the BIS member status, the CBM took over assets from BIS based on the CBM entitlement to 5.88% of stock (172 shares) of the former NBY. The BIS Board of Directors enacted a decision on continuation of BIS membership for the NBS as the only successor of the NBY, whereas the CBM ought to apply for acceptance into BIS membership, as an institution of a newly formed state. The BIS Board of Directors determined the obligation for the NBS to effect a payment to CBM an amount of SDR 3,213,476 to a "special purpose account" opened in the BIS books, which amount corresponds to the proportion of CBM interest in the BIS share issued for the former Federal Republic of Yugoslavia. According to BIS, this amount represented the current net assets value (NAV) of the BIS shares as decreased by 30%, applying the formula adopted for previous BIS share transactions. Following this payment, CBM was also made available additional amounts of SDR 203,986 and CHF 419,367, relating to dividends on the shares accrued in the period from 2007 to 2009, with interest.

During 2010 and in the first half of 2011, there were bilateral discussions with NBS and BIS General Manager in order to find a solution for adequate treatment of the CBM BIS membership issue (which would finally complete the acceptance of all SFRY successor states), i.e. a solution for the takeover of the financial compensation for the NBY stock.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

8. OTHER INCOME (Continued)

With regard to the CBM requests to be accepted as a BIS member submitted several times during 2005, 2006, 2007 and 2008, despite argumentation repeatedly presented, The BIS Board of Directors stated that CBM did not qualify for BIS membership in view of their membership policies, appropriate international law succession principles and the practice of other international organizations in similar situations.

Upon reception of this communication, the CBM Council adopted a conclusion whereby it authorized the CBM Governor to enact a Decision on Takeover of 5.88% NBY from BIS, based on the central bank status entitlement. The Governor enacted the Decision on July 20, 2011.

9. FOREIGN EXCHANGE GAINS AND LOSSES, NET

	Year Ended December 31,	
	2011	2010
<i>Foreign exchange gains:</i>		
- CBM accounts abroad	1,071	1,926
- Vault cash	23	21
- IMF accounts in the country	18	18
	<u>1,112</u>	<u>1,965</u>
<i>Foreign exchange losses:</i>		
- CBM accounts abroad	(1,201)	(1,759)
- Vault cash	(22)	(7)
- IMF accounts in the country	(14)	(13)
	<u>(1,237)</u>	<u>(1,779)</u>
	<u>(125)</u>	<u>186</u>

10. (LOSSES)/GAINS ON FINANCIAL ASSETS AVAILABLE FOR SALE, NET

	Year Ended December 31,	
	2011	2010
Gains on sales of securities available for sale	89	209
Losses on sales of securities available for sale	(517)	(149)
	<u>(428)</u>	<u>60</u>

11. STAFF COSTS

	Year Ended December 31,	
	2011	2010
Gross salaries	4,096	4,157
Contributions paid by the employer	1,191	503
Other employee benefits	659	1,636
	<u>5,946</u>	<u>6,296</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

12. OTHER OPERATING EXPENSES

	Year Ended December 31,	
	2011.	2010.
Costs of material	127	130
Fuel and energy costs	176	265
Marketing and advertising	32	27
Authors' fees and other service contracts	148	347
Remunerations to the Council members, Audit Committee members and the Governor	108	123
Other fee payables to individuals	58	20
Allowance for impairment of housing loans (Note 22)	153	16
Professional services	48	88
Property maintenance	350	343
Property insurance	63	76
Telecommunications and mailing services	313	355
Taxes and contributions	10	7
Depreciation and amortization	811	918
Humanitarian actions	130	151
Entertainment	44	52
Employee professional training	90	29
Provisions for potential litigation losses (Note 33)	109	-
Other operating expenses	102	442
	<u>2,872</u>	<u>3,389</u>

13. CASH AND DEMAND DEPOSITS

	December 31,	December 31,
	2011	2010
Vault cash and cash on hand:		
- in EUR	20,666	13,772
- in foreign currency	42	107
	<u>20,708</u>	<u>13,879</u>
Cash in transport	2,000	-
Interest-bearing demand deposits	64,139	157,989
Non-interest bearing fixed-term deposits	262	224
	<u>87,109</u>	<u>172,092</u>

As of December 31, 2011, CBM had interest-bearing demand and short-term deposits placed in the accounts with foreign central and commercial banks in the amount of EUR 64,139 thousand. The Bank had interest income on these assets at the annual level of Eonia minus 10 basis points.

14. FIXED-TERM DEPOSITS HELD WITH FOREIGN BANKS

	December 31,	December 31,
	2011	2010
Short-term time deposits held with central banks	100,464	176,378
Interest receivables from short-term time deposits	100	49
	<u>100,564</u>	<u>176,427</u>

In order to reduce risks in regular operations and improve the safety of its placements, CBM transferred its placements from commercial banks to central banks in 2008. These placements have maturities ranging from 1 to 3 months.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

15. FINANCIAL ASSETS AVAILABLE FOR SALE

As of December 31, 2011, financial assets available for sale in the amount of EUR 76,914 thousand comprise debt securities issued by the German Government and the Dutch Government, with maturities from 1 to 3 years.

16. ASSETS HELD WITH THE INTERNATIONAL MONETARY FUND

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Reserves with IMF (Note 27)	7,831	7,654
Promissory note on IMF membership (Note 27)	24,715	24,155
SDR allocation (Note 27)	30,639	29,853
Accrued interest receivable (Note 27)	235	109
Asset holding fee (Note 27)	166	355
	<u>63,586</u>	<u>62,126</u>

In 2007 the IMF Board established the membership quota for Montenegro in the amount of SDR 27,500 (SDR – Special Drawing Rights). Montenegro made 24% of its quota in cash and the remaining amount was settled through a promissory note on membership issued by the Ministry of Finance of Montenegro.

As of December 31, 2011, the amount of cash contribution totaled EUR 7,831 thousand, whereas the value of the promissory note was EUR 24,715 thousand.

In 2009 the IMF performed the third general allocation whereby Montenegro received SDR 25,822 thousand, which as of December 31, 2011 amounted to EUR 30,639 thousand.

17. LOANS AND ADVANCES

As of December 31, 2011, loans and advances in the amount of EUR 1,072 thousand relate to the housing loans approved to CBM employees (December 31, 2010: EUR 1,088 thousand related to housing loans approved to CBM employees and EUR 3 thousand related to loans and advances to domestic banks by the prior central bank).

Housing loans were approved to employees in accordance with the Employee Housing Rules of Procedure and the Decision of the Employee Housing Commission, under the following terms:

- housing loans approved to employees are non-interest bearing, with 1 to 2-year grace period and 30 to 35-year maturity;
- for the purpose of credit risk protection, the borrowing employees are under obligation to sign mortgage agreements for the account of CBM during the grace period at the latest and verify the agreements with the competent court; the mortgages are assigned until the date of full loan repayment.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

18. RECEIVABLES

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Interest received on the required special reserves	206	276
Payment transaction charges	219	203
Receivables from forced collection order issuance and realization	340	190
Receivables from inspection of banks and microcredit financial institutions	290	320
Fiscal agency services receivables	430	346
Prepaid expenses	163	170
Receivables from entitlement to apartments not entered in the Land Registry	126	128
Receivables from employees	125	125
Other receivables	261	122
	<u>2,160</u>	<u>1,880</u>

19. INVESTMENT PROPERTY

	<u>Investment property</u>
Cost	
Balance at January 1, 2010	2,408
Balance at December 31, 2010	2,408
Balance at January 1, 2011	2,408
Revaluation effects	(21)
Balance at December 31, 2011	2,387
Accumulated depreciation	
Balance at January 1, 2010	723
Charge for the year	31
Balance at December 31, 2010	754
Balance at January 1, 2011	754
Charge for the year	32
Revaluation effects	(777)
Balance at December 31, 2011	9
Net Book Value:	
- at December 31, 2011	2,378
- at December 31, 2010	1,654

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

20. INTANGIBLE ASSETS

	Intangible assets
Cost	
Balance at January 1, 2010	1,569
Additions	6
Balance at December 31, 2010	<u>1,575</u>
Balance at January 1, 2011	1,575
Additions	-
Balance at December 31, 2011	<u>1,575</u>
Accumulated amortization	
Balance at January 1, 2010	1,040
Charge for the year	149
Balance at December 31, 2010	<u>1,189</u>
Balance at January 1, 2011	1,189
Charge for the year	113
Balance at December 31, 2011	<u>1,302</u>
Net Book Value:	
- at December 31, 2011	<u>273</u>
- at December 31, 2010	<u>386</u>

21. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings	Equipment	Fixed assets under Construction	Total
Cost					
Balance at January 1, 2010	2,100	22,470	4,889	1,322	30,781
Additions	-	-	-	385	385
Transfers	-	294	382	(676)	-
Disposals	-	-	(384)	-	(384)
Balance at December 31, 2010	<u>2,100</u>	<u>22,764</u>	<u>4,887</u>	<u>1,031</u>	<u>30,782</u>
Balance at January 1, 2011	2,100	22,764	4,887	1,031	30,782
Additions	-	-	-	317	317
Transfers	-	274	136	(410)	-
Disposals	-	-	(3)	-	(3)
Write-off	-	-	(8)	-	(8)
Revaluation effects	1,603	(1,555)	(3,793)	-	(3,745)
Balance at December 31, 2011	<u>3,703</u>	<u>21,483</u>	<u>1,219</u>	<u>938</u>	<u>27,343</u>
Accumulated depreciation					
Balance at January 1, 2010	-	6,695	3,478	-	10,173
Charge for the year	-	297	441	-	738
Disposals	-	-	(368)	-	(368)
Balance at December 31, 2010	<u>-</u>	<u>6,992</u>	<u>3,551</u>	<u>-</u>	<u>10,543</u>
Balance at January 1, 2011	-	6,992	3,551	-	10,543
Charge for the year	-	314	352	-	666
Revaluation effects	-	(7,216)	(3,853)	-	(11,069)
Balance at December 31, 2011	<u>-</u>	<u>90</u>	<u>50</u>	<u>-</u>	<u>140</u>
Net Book Value:					
- December 31, 2011	<u>3,703</u>	<u>21,393</u>	<u>1,169</u>	<u>938</u>	<u>27,203</u>
- December 31, 2010	<u>2,100</u>	<u>15,772</u>	<u>1,336</u>	<u>1,031</u>	<u>20,239</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

21. PROPERTY, PLANT AND EQUIPMENT (Continued)

As of September 30, 2011, the CBM's property, plant and equipment and investment property were evaluated by the independent assessor DOO Reviko, Podgorica. The positive revaluation effect in the amount of EUR 8,080 thousand is credited to revaluation reserves within equity for the year 2011, whereas the negative effects are recognized in the income statement in the amount of EUR 9 thousand.

22. LONG-TERM RECEIVABLES FROM EMPLOYEES

Long-term receivables from employees in the amount of EUR 1,880 thousand represent prepaid employee benefits calculated as a difference between the outstanding nominal value of non-interest bearing housing loans approved to employees and amortized (fair) value of loans at the statement of financial position date (Note 17). The loan amount is amortized through loan repayment from the employees during their years of service with the Bank.

For all the employees that left the Bank and terminated employment during the year, the Bank has calculated allowance for impairment of prepaid employee benefits and charged to staff costs. In 2011, two employees terminated employment with the Bank. The Bank recognized allowance for impairment of housing loans in respect thereof, in the amount of EUR 153 thousand (Note 12).

23. INVENTORIES

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Materials and fixtures	24	32
Bill of exchange forms	12	2
Inventories of silver readily convertible into cash	21	22
Jubilee gold and silver coins	7	7
Montenegrin coins	556	568
	<u>620</u>	<u>631</u>

24. OTHER ASSETS

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Library	215	205
Equity investments	114	114
	<u>329</u>	<u>319</u>

As of December 31, 2011, equity investments refer to the investments in Central Depository Agency, a.d.d, Podgorica in the amount of EUR 89 thousand and the Mediation Center of Montenegro, Podgorica in the amount of EUR 25 thousand. These investments are recognized at cost.

25. ACCOUNTS OF BANKS AND OTHER FINANCIAL INSTITUTIONS

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Demand deposits	77,316	142,166
Mandatory reserves in the country	111,052	122,073
Mandatory reserves abroad	18,083	12,041
Fixed-term deposits	21,374	18,493
	<u>227,825</u>	<u>294,773</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

25. ACCOUNTS OF BANKS AND OTHER FINANCIAL INSTITUTIONS (Continued)

As of December 31, 2011, the mandatory required reserve of the commercial banks represents the minimum of deposits set aside in accordance with the CBM regulations and the Decision on the Mandatory Reserves of Banks Held with CBM (Official gazette of Montenegro no. 35/2011). In accordance with the aforesaid, commercial banks calculate mandatory reserve on both demand deposits and fixed-term deposits.

The banks calculate the mandatory reserve by applying the rate of:

- 9.5% to the portion of the principal comprised of demand deposits and deposits with maturity of up to 1 year, i.e. up to 365 days;
- 8.5% to the portion of the principal comprised of deposits with maturity of over 1 year, i.e. over 365 days.

A rate of 9.5% is applied to fixed-term deposits with maturities over 365 days and with a pre-term withdrawal clause within periods of less than 365 days.

Commercial banks may set aside and hold up to 25% of the mandatory reserve in the form of commercial papers issued by Montenegro.

The calculated mandatory reserve is deposited on the mandatory reserve account in the country and/or to the accounts of the CBM held abroad. CBM accrues interest on the 25% of the total amount of the mandatory reserve at an annual interest rate of 1% and disburses it in monthly payments up to the 8th day of each month for the preceding month. The mandatory reserve is held in EUR.

Banks may use up to 50% of the mandatory reserve set aside to maintain daily liquidity. CBM does not charge any fee to commercial banks if the amount of the mandatory reserve used for liquidity purposes is returned to the reserve account within the same day. Commercial banks are under obligation to pay fees for the amounts of the mandatory reserve used and not returned to the reserve account within the same day. The fee is paid on a monthly basis, at a rate determined by CBM regulation.

26. ACCOUNTS OF THE GOVERNMENT AND OTHER STATE ENTITIES

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Government's accounts	10,743	63,253
Other state entities' accounts	115	95
	<u>10,858</u>	<u>63,348</u>

The Government, state agencies and other organizations hold their current accounts with CBM for the purpose of participation in domestic payment operations. .

27. LIABILITIES TO THE INTERNATIONAL MONETARY FUND

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Deposits with IMF (Note 16)	38,871	37,971
Account no.1	83	88
Account no.2	1	1
Promissory note – account no. 3 (Note 16)	24,715	24,155
	<u>63,670</u>	<u>62,215</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

27. LIABILITIES TO THE INTERNATIONAL MONETARY FUND (Continued)

Deposits held with the IMF in the amount of EUR 38,871 thousand as of December 31, 2011 are comprised of:

- reserves held with the IMF in the amount of EUR 7,831 thousand (Note 16), which represents the cash contribution of 24% of the quota in the amount of SDR 27,500 thousand translated at the exchange rate prevailing as of the statement of financial position date;
- SDR allocation by the IMF to Montenegro as a member state in the amount of SDR 25,822 thousand, which at December 31, 2011 totaled EUR 30,639 thousand (Note 16);
- interest accrued in the amount of EUR 235 thousand (Note 16) and
- consideration for funds deposited in the amount of EUR 166 thousand (Note 16).

Account no. 1 is used for IMF operation transactions, whereas account no. 2 is used for payment of IMF operating expenses in the currency of the member state.

28. OTHER LIABILITIES

	December 31, 2011	December 31, 2010
Interest payable on the mandatory reserve of the banks	37	35
Advances received	317	328
Liabilities paid to and on behalf of employees	-	65
Provisions for potential litigation losses (Note 33)	483	478
Accruals	141	162
Other liabilities	74	211
	<u>1,052</u>	<u>1,279</u>

29. CAPITAL

Article 11 of the CBM Law (Official Gazette of Montenegro no. 40/10 and 41/10) defines the CBM capital as comprising of the initial capital and reserves. Article 12 of the same Law sets the initial capital in the amount of EUR 50,000 thousand.

Transitional and closing provisions of the Law (Article 90) stipulate that the initial capital shall be provided from the founding capital determined by the CBM Law (Official Gazette of the Republic of Montenegro no. 52/00, 53/00, 47/01 and 4/05) and from general reserves made available to CBM at the date of entry into force of the new CBM Law, while the additional amount is to be provided from the Montenegro Budget.

The CBM initial capital as of December 31, 2011 totaled EUR 35,003 thousand and was entirely in the form of monetary assets. The lacking amount of the initial capital was EUR 14,997 thousand as of December 31, 2011.

The CBM reserves are comprised of general reserves, special reserves and revaluation reserves.

The total CBM capital as of December 31, 2011 totaled EUR 60,683 thousand.

The structure of the CBM capital is presented in the table below:

	December 31, 2011	December 31, 2010
Initial capital	35,003	33,842
General reserves	326	-
Special reserves	165	-
Revaluation reserves	20,267	11,730
Retained earnings	106	622
Net profit for the year	4,816	1,036
Total capital	<u>60,683</u>	<u>47,230</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011**29. CAPITAL (Continued)**

Net profit or loss of the Bank is determined for each fiscal year in accordance with the International Financial reporting Standards. Pursuant to Article 68 of the CBM Law, profit available for distribution is determined by subtracting unrealized revaluation gains from the net profit and adding to it unrealized revaluation gains subtracted from the net profit in prior years and realized in the current year.

Profit available for distribution allocated to general reserves in the amount of 50% of the realized profit, until the level of general reserves reaches 10% of the total CBM financial liabilities. A portion of profit available for distribution may be allocated to special reserves in the amount defined by the CBM Council but not exceeding 10% of the determined profit available for distribution. The remaining amount of the profit available for distribution comprises income of the Montenegro Budget, as stipulated by the CBM Law.

At April 8, 2011 the Protocol on Provision of the Lacking Amount of the Initial CBM Capital was signed between the Ministry of Finance on one side and CBM on the other side. The Protocol established that the CBM initial capital amounted EUR 2,556 thousand as of December 31, 2010 and that general reserves amounted to EUR 31,286 thousand at the same date, as well as that the lacking amount of the initial capital to be provided from the Budget of Montenegro totaled EUR 16,158 thousand. The parties agreed that, due to the significant lacking amount to be provided from the Budget of Montenegro, the amount could not be provided as a single payment and consented to forwarding a portion of the CBM profit, which would comprise income of the Montenegro Budget under Article 69 of the CBM Law, to the CBM initial capital until the prescribed amount is reached.

At April 11, 2011, the CBM Council enacted the Decision on the distribution of CBM profit for the year 2010. The net profit of the CBM for the year 2010 amounted to EUR 1,036 thousand. Profit available for distribution totaled EUR 1,652 thousand and shall be distributed in the following manner:

- 50% to general reserves – in the amount of EUR 826 thousand
- 10% to special reserves – in the amount of EUR 165 thousand
- 40% as income to the Budget of Montenegro – in the amount of EUR 661 thousand.

At April 11, 2011, the CBM Council enacted the Decision on the CBM Initial Capital Increase by the amount of EUR 500 thousand from the general reserves.

At April 12, 2011, the CBM Council enacted the Decision on Forwarding a Portion of Profit into the CBM Initial Capital, in the amount of EUR 661 thousand, in accordance with the aforesaid Protocol, which stipulates that the portion of profit available for distribution for the year 2010 comprising income of the Budget of Montenegro, shall be distributed not to the Budget, but to the CBM initial capital instead.

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

30. RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. CBM has a related party relationship with the Government of Montenegro, including all public institutions.

The review of receivables and payables, as well as income and expenses and off-statement of financial position items from the related party transactions as of December 31, 2011 is presented in the following table:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Receivables and payables		
<i>Receivables</i>		
Loans and advances to the Government	-	3
Fee and other receivables from the Government	617	494
	<u>617</u>	<u>497</u>
<i>Payables</i>		
Payables on the accounts of the Government and other state institutions	10,858	63,348
	<u>10,858</u>	<u>63,348</u>
Payables, net	<u>(10,241)</u>	<u>(62,851)</u>
Income and expenses		
<i>Income</i>		
Fee income from the Government	2,578	2,516
	<u>2,578</u>	<u>2,516</u>
<i>Expenses</i>		
Interest paid to the Government	(891)	(337)
	<u>(891)</u>	<u>(337)</u>
Income, net	<u>1,687</u>	<u>2,179</u>
Off-balance sheet items		
Assets of the Montenegro Deposit Protection Fund	2,500	2,500
	<u>2,500</u>	<u>2,500</u>

In 2011 the gross remunerations disbursed to the key management totaled EUR 283 thousand (2010: EUR 216 thousand).

In addition, during 2011, CBM disbursed gross remunerations in the amount of EUR 101 thousand (2010: EUR 66 thousand) to the Council members who are not CBM's employees.

31. CASH AND CASH EQUIVALENTS (for the purpose of Statement of Cash Flows preparation)

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Cash, cash equivalents and demand deposits	87,109	172,092
Short-term time deposits with foreign banks	100,564	176,427
	<u>187,673</u>	<u>348,519</u>

NOTES TO THE FINANCIAL STATEMENTS
Year Ended December 31, 2011

32. SUBSEQUENT EVENTS

As of December 31, 2011, the Bank had lawsuit filed against Prva banka Crne Gore – osnovana 1901. a.d., Podgorica (hereinafter: "Prva banka"), for the claim amount of EUR 206 thousand, arising from interest receivables Prva banka failed to settle. The interest had accrued on the grounds of usage of the mandatory reserve assets on the part of Prva banka during the year 2008. At December 15, 2010, the court verdict was passed ordering Prva banka to effect the payment of the amount of EUR 206 thousand, whereupon Prva banka submitted an appeal. At November 21, 2011, the Appellate Court of Montenegro passed a decision to reject the appeal of Prva banka, after which Prva banka settled the entire amount claimed.

33. LITIGATION

As of December 31, 2011 there are a number of lawsuits filed against the bank by legal entities and individuals. As per estimate of the Legal Affairs Directorate of the CBM, the total value of the litigations amounted to EUR 2,368 thousand. This amount does not include penalties that may be assigned to CBM upon the completion of the lawsuits, given that the management was unable to determine potential effects of the penalties arising from these litigations until the date of issuance of these financial statements.

At times, in the regular course of operations, CBM receives damage claims. Based on its own and assessment of internal professional counsel, the Bank's management deems that there may be losses resulting from such lawsuits. Accordingly, provision thereof is included in all financial statements in the amount of EUR 483 thousand, as of December 31, 2011 (Note 28). Out of the total sum, the amount of EUR 256 thousand relates to housing issue lawsuits, whereas the amount of EUR 227 thousand relates to other property rights disputes.

As per estimate of the Legal Affairs Directorate of the CBM that there is a risk of losing lawsuits, CBM stated expenses for provision for contingent litigation liabilities in the amount of EUR 109 thousand (Note 12).

34. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of statement of financial position components denominated in foreign currencies into EUR as of December 31, 2011 and 2010, were as follows:

	<u>December 31,</u> <u>2011</u>	<u>December 31,</u> <u>2010</u>
USD	0.7729	0.7484
CHF	0.8226	0.7997
GBP	1.1972	1.1618
SDR	1.1865	1.1597