

BANKA KOVANICA d.d.

**Financial statements as at
31 December 2011 together with
Independent Auditor's Report**

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Responsibility of the Management Board

Pursuant to the Croatian Accounting Law (Official Gazette 109/07), the Management Board is responsible for ensuring that the financial statements are prepared for each financial year in accordance with statutory accounting regulations applicable to banks in Croatia which give a true and fair view of the financial position and results of the Bank for that period.

The Management Board has a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the financial statements.

In preparing those financial statements, the responsibilities of the Management Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgements and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Law (Official Gazette 109/07). The Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on the behalf of the Management Board:

Gian Luigi Bonfe
President of the Management board



Banka Kovanica d.d.,
Preradovićeve 29
Varaždin



Darko Kosovec
Member of the Management Board



23 March 2012

Independent Auditor's Report

To the Management Board and shareholders of Banka Kovanica d.d.

We have audited the accompanying financial statements of Banka Kovanica d.d. (hereinafter: "the Bank") which comprise of statement of financial position as at 31 December 2011, the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as presented on pages 5 to 61.

Management's Responsibility

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting regulations applicable to banks in Croatia. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

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

Basis for Qualified Opinion

As of 31 December 2011 loans and advances to customers reported in Note 16 include amounts with a carrying value of HRK 32,724 thousand for which specific impairment provision in the amount of 5,576 thousand has been recorded. Although these loans are not performing or the collection of the loans is slow, the Bank's Management expects collection of the net exposure of these loans from collaterals pledged (estimated value of HRK 20,620 thousand) and from cash flows of borrowers' operations. Considering that, the Bank's Management is of the opinion that the impairment provision recorded at 31 December 2011 is adequate, however, it is uncertain whether collaterals and cash flows from borrowers' operations will be sufficient for recovery of the net exposure of these loans.

Within other assets (note 21), the Bank has receivables for prepaid advances in business premises in the amount of HRK 2,587 thousand for which there is an ongoing legal case. Also, within other assets (note 21) the Bank has included receivables for lease in the amount of HRK 1,5 million which is not collected at the balance sheet date. Furthermore under repossessed assets (note 20) the Bank has assets in the amount of HRK 10,380 thousand which is not in the possession of the Bank at the balance sheet date. Considering stated above, there is uncertainty as to the amount and time in which the Bank will recover these assets.

Qualified Opinion


In our opinion, except for the effects on the financial statements of the matters described in preceding paragraph the financial statements presented on pages 5 to 61 give a true and fair view of the financial positions of the Bank as at 31 December 2011 and the results of its operations, changes in equity and cash flows for the year then ended in accordance with statutory accounting regulations applicable to banks in Croatia.

Emphasis of matter

As explained the Note 29, the Bank has legal proceeding with regards to a Bank's guarantee in the amount of HRK 5 million which issuance is denied by the Bank. The Bank has recognised an impairment provision of HRK 1 million with regards to this legal proceeding. At 31 December 2011, the outcome of this legal proceeding is uncertain.

Furthermore, the Bank recorded significant loss in 2011 (following significant losses realised in 2009 and 2010). Generation of such significant losses forced the Bank to strengthen its capital structure by capital increase in 2011 by HRK 66 million (by transferring hybrid instruments to subscribed capital). In 2011 the Bank has also started with the restructuring programme which included swap of a portion of the credit portfolio with the majority owner and decrease of personnel at all levels, which is planned to show the full results in 2012. Furthermore, through out the year ended 31 December 2011, the Bank's lending activity was at a low level due to stretched Bank's liquidity position. In December 2011, the Bank has opted to utilise a portion of the obligatory reserve placed with the Croatian National Bank for maintaining the regular liquidity level.

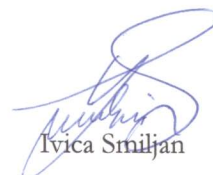
The Bank's operations in the forthcoming period and its going-concern substantially depends on whether the Bank will be able to achieve positive cash flow from operations and maintain required regulatory capital adequacy level. To achieve this a continuous support of the majority shareholder Cassa di Risparmio della Repubblica di San Marino S.p.A is required. Since the Management of the Bank actively works on above noted matters, these financial statements for the year ended 31 December 2011 have been prepared under going-concern principle.



Grant Thornton revizija d.o.o.
Koranska 16, Zagreb

Zagreb, 23 March 2012

GRANT THORNTON
revizija d.o.o.
ZAGREB



Ivica Smiljan
Certified auditor

Statement of comprehensive income
for the year ended 31 December 2011

	Notes	2011 HRK'000	2010 HRK'000
Interest income		84,403	87,909
Interest expense		(51,671)	(56,358)
Net interest income	4	32,732	31,551
Fee and commission income		6,139	6,387
Fee and commission expense		(1,020)	(1,688)
Net fee and commission income	5	5,119	4,699
Foreign exchange differences - net	6	2,017	(1,943)
Result of assets available for sale - net	17	375	(9)
Other operating income	7	4,143	5,783
Impairment charge for credit losses - net	8	(14,007)	(52,580)
Administrative expenses	9	(51,993)	(54,746)
Other operating expenses	10	(7,077)	(10,622)
Loss before income tax		(28,691)	(77,867)
Income tax expense	11	-	-
Loss after taxation		(28,691)	(77,867)
Unrealized (loss) / gains on financial assets available for sale		(1,603)	519
Other comprehensive income		(1,603)	519
Total comprehensive loss		(30,294)	(77,348)
Loss per share	12	(15.79)	(65.29)

Financial statements set out on pages 5 to 61 were approved by the Management Board on 23 March 2012.

Gian Luigi Bonfe
President of the Management Board




Darko Kosovec
Member of the Management Board



Statement of financial position


as at 31 December 2011

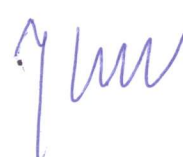
	Notes	31.12.2011 HRK'000	31.12.2010 HRK'000
ASSETS			
Cash in hand and balances with banks	13	78,358	165,941
Obligatory reserve with the Croatian National Bank	14	51,568	100,841
Placements with banks	15	87,432	43,364
Loans and advances to customers	16	795,854	880,472
Available for sale financial assets	17	33,778	20,280
Held to maturity financial assets	18	3,269	5,541
Property and equipment	19	38,893	39,975
Intangible assets	19	2,529	2,730
Reposessed assets	20	12,356	12,261
Other assets	21	7,958	14,224
Total assets		1,111,995	1,285,629
LIABILITIES			
Deposits from customers	22	839,017	995,392
Due to banks	23	54,278	139,577
Hybrid instruments	24	91,189	82,552
Repurchase agreements	25	26,200	-
Other liabilities	26	11,959	14,462
		1,022,643	1,231,983
SHAREHOLDERS' EQUITY			
Share capital	27	208,964	142,964
Treasury shares		(15)	(15)
Share premium		76,430	76,430
Reserves		(50)	1,553
Loss brought forward		(167,286)	(89,419)
Loss for the year		(28,691)	(77,867)
		89,352	53,646
Total liabilities and shareholders' equity		1,111,995	1,285,629

Financial statements set out on pages 5 to 61 were approved by the Management Board on 23 March 2012.

Gian Luigi Bonfe
President of the Management Board

Darko Kosovec
Member of the Management Board





The notes to the financial statements are an integral part of the Statement of financial position.

Statement of changes in equity

for the year ended 31 December 2011

	Share capital	Treasury shares	Share premium	Reserves	Loss brought forward	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
As at 31 December 2009	112,360	(15)	76,430	1,034	(89,419)	100,390
Loss for the year	-	-	-	-	(77,867)	(77,867)
Increase of capital	30,604	-	-	-	-	30,604
Unrealized gains on assets available for sale	-	-	-	519	-	519
Other comprehensive income	-	-	-	519	-	519
As at 31 December 2010	142,964	(15)	76,430	1,553	(167,286)	53,646
Loss for the year	-	-	-	-	(28,691)	(28,691)
Increase of capital	66,000	-	-	-	-	66,000
Unrealized loss on assets available for sale	-	-	-	(1,603)	-	(1,603)
Other comprehensive income	-	-	-	(1,603)	-	(1,603)
As at 31 December 2011	208,964	(15)	76,430	(50)	(195,977)	89,352

The notes to the financial statements are an integral part of the Statement of changes in equity.

Statement of cash flows

for the year ended 31 December 2011

	Notes	2011 HRK'000	2010 HRK'000
Cash flows from operating activities			
Loss before taxation		(28,691)	(77,867)
Depreciation and amortisation	9, 19	6,774	5,937
Write off and disposals of property and equipment	19	(2,648)	234
Impairment charge for credit losses - net	8	14,007	52,580
Result of financial assets available for sale		375	9
Other non-cash items		6,910	6,601
Operating result before changes in operating assets		(3,273)	(12,506)
(Increase) / decrease in assets with the Croatian National Bank		49,273	(6,114)
(Increase) / decrease in loans and advances to customers		67,780	(128,103)
(Increase) / decrease in bills of exchange		1,893	(3,524)
(Increase) / decrease in repossessed and other assets		5,155	(1,473)
Increase / (decrease) in deposits from customers		(156,338)	185,995
Increase / (decrease) in hybrid instruments		74,699	(9,479)
Increase / (decrease) in other liabilities		(2,503)	2,490
Net cash used in operating activities		36,686	27,286
Cash flows from investing activities			
Purchase of property and equipment and intangible assets	19	(6,705)	(6,078)
Purchase of financial assets available for sale	17	(32,673)	(16,517)
Proceeds on sale of financial assets available for sale	17	18,374	1,500
Net cash used for investing activities		(21,004)	(21,095)
Cash flows from financing activities			
Capital contribution	27	-	20,548
Placements with banks		(61,763)	(39,239)
Decrease of placements with banks		(7,400)	-
Increase of loans due to banks		2,566	12,199
Net cash from financing activities		(66,597)	(6,492)
Net (decrease) / increase in cash and cash equivalents		(50,915)	(301)
Cash and cash equivalents at beginning of year		209,305	209,606
Cash and cash equivalents at end of year	28	158,390	209,305

The notes to the financial statements are an integral part of the Statement of cash flows.

Notes to the financial statements

for the year ended 31 December 2011

1. General information

Activities

BANKA KOVANICA d.d., Varaždin (the "Bank") was incorporated in the year 1997 and was registered with the Commercial Court in Varaždin. The address of the Bank's registered office is Preradovićeve 29, Varaždin.

Registered activities of the Bank are as follows:

- accepting cash deposits
- granting loans and other placements in own name and for own account
- issuing electronic money
- issuing guarantees or other security
- Factoring
- finance lease
- credit operations, including consumer credit, mortgage loans and financing of commercial operations (including forfeiting)
- trading in own name and for own account or in own name and for a customer's account: in instruments of money market and other transferable securities, foreign currencies, including foreign exchange activities
- trading in financial forward contracts and options, currency and interest instruments
- performing local and international payments
- gathering, analysing and providing information on credit ratings of legal and natural persons who perform activities individually
- representation in the sale of insurance policies, in accordance with the law regulating insurance, intermediation and representation in insurance activities
- issuing and managing instruments of payment, intermediation in concluding financial deals.

Notes to the financial statements (continued)

for the year ended 31 December 2011

1. General information (continued)

Supervisory Board

Pier Luigi Martelli	President
Ivan Majdak	Vice president
Renzi Vladimiro	Member
Davor Štern	Member
Gian Primo Giardi	Member

Management Board

Gian Luigi Bonfe	President from 11 May 2011
	Member until 10 May 2011
Radojka Olić	President until 28 February 2011
Darko Kosovec	Member

Ms. Radojka Olić has been the president of the Management Board until 28 February 2011. At the meeting held on 11 February 2011, the Supervisory Board reached a Decision to name Mr. Gian Luigi Bonfe to be the president of the Management Board on conditional terms. On 9 June 2011, the Bank has received an approval resolution of the Croatian National Bank (hereinafter: "CNB") for Mr. Gian Luigi Bonfe to be named as president of the Management Board until 19 May 2012.

The shareholders of the Bank as at 31 December 2011 and 31 December 2010 are disclosed in Note 27.

On 6 June 2007, the Bank's ordinary shares (VSK-R-A) were quoted on the regular listing of shares of joint stock companies on the Zagreb Stock Exchange. On 6 November 2008, such listing was cancelled and the Bank's shares were transferred to the parallel listing on the Zagreb Stock Exchange. The regular listing was cancelled since the Bank had less than a 100 shareholders for a longer period of time, so it does not fulfill the criteria for a joint stock company in accordance with the Securities Market Act.

The Bank is subject to the regulatory requirements of the Croatian National Bank. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off-balance sheet commitments and provisioning to cover credit risk, liquidity, interest rate and foreign currency position.

2. Basis of presentation of financial statements

The principal accounting policies applied in preparation of these financial statements are summarized below. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards ("IFRS"), reference may be made to certain Standards applicable in the Republic of Croatia as at 31 December 2011.

2.1. Compliance with Croatian accounting demands and IFRS

The financial statements have been prepared in accordance with statutory accounting requirements for banks in Croatia. The Banks operations in Croatia are subject to the Credit Institutions Act, in accordance with which the Bank's financial reporting is regulated by the Croatian National Bank which is the central monitoring institution of the banking system in Croatia. These financial statements have been prepared in accordance with these banking regulations.

The main differences between the requirements of the International Financial Reporting Standards ("IFRS") and the accounting regulations of the CNB relates to the recognition of impairment losses of financial assets calculated on portfolio basis. In accordance with CNB regulations, banks with headquarters in Croatia should recognize impairment on the portfolio basis by the prescribed rates from 0.85% to 1.20% on balance sheet and off-balance sheet exposure to credit risk of counterparties for which impairment on individual basis is not determined, while IFRS requires that the provisions on portfolio basis should be determined for existing but unidentified losses on the basis of valuation models taking into account individual characteristics of the Bank and the counterparty (e.g. collateral, customers' scoring and alike).

Additionally, the CNB prescribes minimal levels of impairment losses for certain specifically identified impaired exposures, which may be different from the impairment loss required to be recognized in accordance with IFRS.

2.2. Basis of preparation

The financial statements are presented in thousands of Croatian kuna (HRK), unless otherwise stated.

The financial statements are prepared on the accrual basis of accounting, under the going concern assumption.

2. Basis of presentation of financial statements (continued)

2.2. Basis of preparation (continued)

Standards, amendments and interpretations adopted by the European Union and the Croatian Board and effective

The Bank has applied in the year ended 31 December 2011 the following amendments and interpretations issued which are or have become effective during the year and presented, in accordance with the requirements, comparative data. The application of new standards had no effect on the equity as at 1 January 2011:

- 2010 Annual Improvements to IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34 and IFRIC 13 – effective for annual periods beginning on or after 1 January 2011,
- 2010 Annual improvements to IFRSs – amendments of transitional requirements to IAS 21, IAS 28, IAS 31, IAS 32 and IAS 39 – effective for annual periods beginning on or after 1 January 2011,
- IAS 24 Related parties (amended) - effective for annual periods beginning on or after 1 January 2011,
- IFRS 1 First time adoption of IFRS – limited exemption from comparative IFRS 7 disclosures for first-time adopters (amended) – effective for annual periods beginning on or after 1 January 2011,
- IFRIC 14 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction - amendments effective for annual period beginning on or after 1 January 2011,
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments (effective for annual periods beginning on or after 1 January 2011).

Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Bank

On the date of the Financial Statements' approval the following new and revised standards, amendments and interpretations have been issued but were not effective yet for the year ended 31 December 2011:

- IFRS 9 Financial Instruments – new standard effective for annual periods beginning on or after 1 January 2015,
- IFRS 10 Consolidated financial statements – new standard effective for annual periods beginning on or after 1 January 2013,
- IFRS 11 Joint arrangements – new standard effective for annual periods beginning on or after 1 January 2013,
- IFRS 12 Disclosure of interests in other entities – new standard effective for annual periods beginning on or after 1 January 2013,

2. Basis of presentation of financial statements (continued)

2.2. Basis of preparation (continued)

- IAS 27 and IAS 28 – consequential amendments due to above mentioned new consolidation standards - effective for annual periods beginning on or after 1 January 2013,
- IFRS 13 – Fair value measurement - new standard effective for annual periods beginning on or after 1 January 2013,
- IAS 1 Presentation of Financial Statements (revised) - amendments effective for annual periods beginning on or after 1 July 2012,
- IAS 19 Employee benefits (revised) – amendments effective for annual periods beginning on or after 1 January 2013,
- IAS 32 – Financial instruments: Presentation – amendments to application guidance on the offsetting of financial assets and financial liabilities – effective for annual periods beginning on or after 1 January 2014,
- IFRS 1 First time adoption of IFRS – replacement of fixed dates for certain exceptions – effective for annual periods beginning on or after 1 July 2011,
- IFRS 1 First time adoption of IFRS – additional exemptions for entities ceasing to suffer from severe hyperinflation – effective for annual periods beginning on or after 1 July 2011,
- IFRS 7 Financial instruments: Disclosures – amendments effective for annual periods beginning on or after 1 July 2011 or 1 January 2013,
- IFRS 7 Financial instruments: Disclosures – amendments requiring disclosures about the initial application of IFRS 9 effective for annual periods beginning on or after 1 January 2015,
- IAS 12 Income taxes (revised) – limited scope amendment effective for annual periods beginning on or after 1 January 2012.

The Management anticipates that the application of the above mentioned standards and interpretations will be applied in the Bank's Financial Statements for the periods for which they become effective, and that this application will have no material impact on the Bank's Financial Statements in the periods for which they are applied.

2. Basis of presentation of financial statements (continued)

2.3. Critical accounting judgments and key sources of estimation uncertainty

In the application of the Bank's accounting policies, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

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

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

While it is possible that in particular periods the Bank may sustain losses, which are substantially relative to the allowance for impairment losses, it is the judgment of management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

There are several legal actions against the Bank, which have arisen from the regular course of its operations. The managements estimates that the probable outcome will have no significant negative effects on the Banks' financial position or its results.

Economic crisis

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. Indeed the full extent of the impact of the ongoing economic crisis is proving to be impossible to anticipate or completely guard against.

Management is unable to reliably estimate the effects on the Bank's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Bank's business in the current circumstances.

3. Summary of significant accounting policies

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

3.1. Interest income and expense

Interest income is accrued on a time-basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Interest income includes coupons earned on fixed income investments and securities and accrued discount and premium on treasury bills and other discounted instruments.

When loans become impaired, they are written down to their recoverable amounts and interest income thereafter is recognized based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

3.2. Fee and commission income and expense

Fees and commissions consist mainly of fees on domestic and foreign payments, fees for issuing guarantees and letters of credit, fees and commissions on card operations and other credit instruments issued by the Bank. Fees and commissions are generally recognized as income when service is provided. Loan origination fees for loans which are probable of being drawn down are deferred (together with the related direct issue costs) and recognized as an adjustment to the effective yield of the loan, and thus adjust the interest income.

3.3. Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax. The tax expense is based on taxable income for the year. Taxable income differs from net income as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized.

3. Summary of significant accounting policies (continued)

3.3. Taxation (continued)

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Bank has the ability and intention to settle on a net basis.

3.4. Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns different from those of segments operating in other economic environments.

3.5. Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which the Bank operates ('the functional currency'). The financial statements are presented in Croatian kuna's (HRK), which is the Bank's functional and presentation currency.

(b) Transactions and balances

Transactions denominated in foreign currencies are translated into HRK at the prevailing exchange rates on the date of the transaction.

Monetary items denominated in foreign currencies are retranslated into HRK at the appropriate spot rates of exchange prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in 'Foreign exchange differences - net' for the period. Exchange differences arising on the retranslation of non-monetary assets carried at fair value are included in profit or loss for the period except for exchange differences arising on the retranslation of non-monetary assets available-for-sale in respect of which gains and losses are recognized directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognized directly in equity.

3. Summary of significant accounting policies (continued)

3.5. Foreign currency translation (continued)

The Bank has assets and liabilities originated in HRK, which are linked to foreign currency clause. Due to this clause the Bank has to revalue both the asset and related liability by higher of: foreign exchange rate valid as of the date of maturity, or foreign exchange rate valid as of the date of origination of the financial instrument. In case of liability linked to this clause the counterparty has this option. As such the Bank values its assets and liabilities related to this clause by middle rate of CNB valid at the date of balance sheet or foreign exchange rate agreed by the option (rate valid at origination), whichever is higher.

The principal rates of exchange set forth by the CNB and used in the preparation of the Bank's balance sheet at the reporting dates were as follows:

31 December 2011	EUR 1 = HRK 7.530420	USD 1 = HRK 5.819940
31 December 2010	EUR 1 = HRK 7.385173	USD 1 = HRK 5.568252

3.6. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand, balances on the giro accounts with banks and term deposits with other banks with remaining maturities of three months or less.

Cash and cash equivalents excludes the obligatory reserves with the CNB as these funds are not available for the Bank's day to day operations. The obligatory reserve with the CNB is a required reserve to be held by all commercial banks licensed in Croatia.

3.7. Financial assets

Financial assets held by the Bank are categorized into portfolios in accordance with the Bank's intent on the acquisition and pursuant to the Bank's investment strategy. Financial assets and liabilities are classified as 'At fair value through profit or loss', 'Held to maturity', 'Assets available for sale' or as 'Loans and receivables'. The principal difference among the portfolios relates to the measurement of financial assets and the recognition of their fair values in the financial statements.

All financial assets and liabilities are recognized and derecognized on a settlement date basis, where the purchase or sale of financial asset or liability is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned.

When a financial asset or financial liability is recognized initially, the Bank measures it at its fair value plus, in the case of a financial assets or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

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

Financial assets are classified at fair value through profit or loss where the financial asset are held for trading.

A financial asset is classified as held for trading if:

- it has been acquired principally for the purpose of selling in the near future; or
- it is a part of an identified portfolio of financial instruments that the Bank manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

Measurement:

Financial assets at fair value through profit or loss are initially accounted at fair value and related transaction costs are recorded as an expense. Subsequent to the initial recognition financial assets at fair value through profit or loss are accounted for and stated at fair value which approximates the price quoted on recognized stock exchanges or acceptable valuation models. The Bank includes unrealized gains and losses in 'Result of trading assets - net'. Interest earned on assets at fair value through profit or loss representing coupons on debt securities is accrued on a daily basis and reported as 'Interest income' in the income statement.

Dividends on trading securities are recorded when declared and included as a receivable in the balance sheet line 'Other assets' and in 'Other operating income' in the profit and loss account.

All purchases and sales of securities held for trading that require delivery within the time frame established by regulation or market convention ('regular way' purchases and sales) are recognized as spot transactions. Transactions that do not meet the 'regular way' settlement criterion are treated as financial derivatives.

(b) Assets available for sale

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

This portfolio comprises equity and debt securities. Subsequent to initial recognition, available-for-sale financial assets are re-measured at fair value based on quoted prices or amounts derived from cash flow models.

In circumstances where the quoted market prices are not readily available, the fair value of debt securities is estimated using the present value of future cash flows and the fair value of unquoted equity instruments is estimated using applicable price/earnings or price/cash flow ratios refined to reflect specific circumstances of the issuer.

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

For available-for-sale assets, gains and losses arising from changes in fair value are recognised directly in equity under the caption 'Reserves', until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the profit or loss for the period.

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement.

Impairment losses recognized in profit or loss for equity investments classified as available-for-sale are not subsequently reversed through profit or loss. Impairment losses recognized in profit or loss for debt instruments classified as available-for-sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss. Interest earned whilst holding available-for-sale securities is accrued on a daily basis using the effective interest rate method and reported as "Interest income" in the income statement.

Foreign exchange differences related to available-for-sale equity instruments held in foreign currency are reported together with fair value gains and losses in equity until the financial asset is sold. Foreign exchange differences related to available-for-sale debt instruments held in foreign currency are reported in income statements.

Dividends on securities available for sale are recorded as declared and included as a receivable in the balance sheet line 'Other assets' and in 'Other operating income' in the profit and loss account. Upon payment of the dividend, the receivable is offset against the collected cash.

(c) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. Held to maturity investments are carried at amortized cost using the effective interest rate method, less any allowance for impairment.

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

The Bank assess on a regular basis whether there is an objective evidence that an investment held to maturity may be impaired. A financial assets is impaired if its carrying amount is greater than its recoverable amount which is equal to the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate. The amount of impairment loss for assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of the expected future cash flows discounted at the financial instrument's original effective interest method. When an impairment of assets is identified, the Bank recognizes allowances through profit and loss statement.

Impairment losses are reversed in subsequent periods when an increase in the investment's recoverable amount can be related objectively to an event occurring after the impairment was recognized, subject to the restriction that the carrying amount of the investment at the date the impairment is reversed shall not exceed what the amortized cost would have been had the impairment not been recognized.

(d) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Banks intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; (b) those that the Bank upon initial recognition designates as available for sale; or (c) those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

This portfolio comprises loans provided to customers.

Loans and receivables are measured at initial recognition at fair value, and are subsequently measured at amortized cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers. Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that 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.

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

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

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

(e) Financial liabilities

Financial liabilities of the Bank like 'Due to banks', 'Deposit from customers', are recognised initially at fair value net of transaction cost incurred. Financial liabilities are subsequently stated at amortized costs using the effective interest rate method. Interest expense arising on the issue of certificated debts is included in the income statement line 'Interest expense'.

3.8. Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of Management.

Any increase in the liability relating to guarantees is taken to the income statement under other operating expenses.

3. Summary of significant accounting policies (continued)

3.9. Derivative financial instruments

Derivative financial instruments include foreign exchange rate forward contracts and are initially recognised in the balance sheet at fair value and subsequently re-measured at their fair value. Fair values are obtained from quoted market prices or pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Derivative financial instruments include contracts with one-way currency clause. The contracted value is initially recognised in the off-balance sheet records and as a loan given with a one-way currency clause in the balance sheet. They are subsequently measured at amortised cost as for all other placements that carry credit risk in the balance sheet. Increase in exchange rates (fair value of the embedded derivative) above the contracted, is recorded in the balance sheet as an embedded derivative and recognised within profit or loss from embedded derivatives in the income statement.

The Bank's derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement under net trading income. However, the gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in 'net income from financial instruments designated at fair value'.

3.10. Sale and repurchase agreements

If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognized as the Bank retains substantially all the risks and rewards of ownership.

3.11. Offsetting financial instruments

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

3.12. Property and equipment and intangible assets

Property and equipment and intangible assets are started at cost less accumulated depreciation/amortization. Depreciation is calculated on a straight-line basis to write down the cost of such assets to their residual values over their estimated useful lives. Assets in the course of construction are not depreciated.

3. Summary of significant accounting policies (continued)

3.12 Property and equipment and intangible assets (continued)

Depreciation is calculated using the straight-line method to allocate the cost over their estimate useful lives as follows:

	2011	2010
	%	%
Property	2.5	2.5
Leasehold improvements	20	20
Electronic equipment	20	20
Other assets	20-25	20-25
Leasehold improvements	20	20
Software	20	20

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. In addition, the carrying amounts of fixed and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. An impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for fixed assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

3.13. Leases

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

3.14. Non-current assets held for sale

Non-current assets are classified as assets held for sale and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is recovered principally through a sale transaction rather than through continuing use.

3.15. Provisions

Provisions are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Management Board determines the adequacy of the provision based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of the various categories of transactions and other pertinent factors at the balance sheet date.

3. Summary of significant accounting policies (continued)

3.15. Provisions (continued)

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

3.16. Employee benefits

The Bank has no post-retirement benefit plans for its employees or management. The Bank makes contributions on behalf of its employees to mandatory state pension plans, which are charged as expense in the period to which they relate. Any future payments to employees are the responsibility of the Republic of Croatia.

3.17. Borrowings

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

Borrowings are classified as current liabilities unless the Bank has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

3.18. Fiduciary activities

Assets and income arising thereon, together with related undertakings to return such assets to customers are excluded from these financial statements when the Bank acts in a fiduciary capacity such as nominee, trustee or agent.

3.19. Share capital and treasury shares

External costs directly attributable to the issuance of new shares, except for those resulting from business combinations, are deducted from the equity, net of any related taxes.

When the Bank or its associates purchase or become entitled to purchase its share capital, the consideration paid, including all transaction costs less any taxes, is presented as a deduction from the total equity. Gains and losses on the sale of treasury shares are credited and charged, respectively, to treasury shares within equity. Acquisition of treasury shares is recognised within capital at the trade date.

4. Net interest income

Interest income

	2011 HRK`000	2010 HRK`000
Loans and advances:		
- to customers	80,944	85,736
- to banks	2,405	1,522
Securities	1,054	651
	84,403	87,909

Interest expense

	2011 HRK`000	2010 HRK`000
Customers deposits	46,709	50,884
Hybrid instruments	2,838	3,566
Other borrowed funds	2,124	1,908
	51,671	56,358

5. Net fee and commission income

Fee and commission income

	2011 HRK`000	2010 HRK`000
Domestic and foreign currency transactions	3,306	4,063
Guarantees and letter of credits given	107	328
Other	2,726	1,996
	6,139	6,387

Fee and commission expense

	2011 HRK`000	2010 HRK`000
Domestic and foreign currency transactions	433	552
Other	587	1,136
	1,020	1,688

6. Foreign exchange differences - net

	2011 HRK`000	2010 HRK`000
Net foreign exchange gains from operations	2,491	1,821
Net foreign exchange losses on translation of foreign currency assets and liabilities to mid exchange rate	(474)	(3,764)
	2,017	(1,943)

7. Other operating income

	2011 HRK`000	2010 HRK`000
Income from transfer of corporate loan claims to majority shareholder (Note 30)	1,016	-
Income from lease	1,240	31
Court costs refund	498	2,011
Income from payment of insurance	-	2,998
Other	1,389	743
	4,143	5,783

8. Impairment charge for credit losses - net

	2011 HRK`000	2010 HRK`000
Loans and advances to customer (Note 16)	9,395	58,488
Placements with banks (Note 15)	2,605	-
Collected credit losses written off in previous years	(583)	(6,610)
Held to maturity financial assets (Note 18)	380	(313)
Other assets (Note 21)	1,201	870
Provision for contingent liabilities and commitments (Note 26)	1,009	145
	14,007	52,580

9. Administrative expenses

	2011 HRK`000	2010 HRK`000
Staff costs		
Net salaries	13,426	14,251
Pension contributions	4,099	4,469
Health security contributions	3,899	4,408
Other contributions and taxes on salaries	3,555	4,636
Other staff costs	977	1,364
	25,956	29,128
Other administrative expenses	19,263	19,681
Depreciation and amortisation (Note 19)	6,774	5,937
	51,993	54,746

As at 31 December 2011, the Bank had 133 employees (2010: 150 employees).

10. Other operating expenses

	2011 HRK`000	2010 HRK`000
Rental costs	4,875	5,646
Saving deposits insurance charge	2,522	2,177
Provisions for legal cases (Note 26)	129	1,422
Vacation accruals (Note 26)	(592)	1,152
Other	143	225
	7,077	10,622

11. Income tax expense

	2011 HRK`000	2010 HRK`000
Accounting loss before tax	(28,691)	(77,867)
Effect of items increasing tax base	3,574	7,600
Effect of items decreasing tax base	(4,962)	(6,511)
Tax loss for the period	(30,079)	(76,778)
Tax losses brought forward	(151,718)	(74,940)
Expiration of tax losses carried forward	10,803	-
Tax losses carried forward	(170,994)	(151,718)
Unrecognized deferred tax assets (statutory tax rate 20%)	34,199	30,344

In these financial statements, the Bank has not recognised deferred tax assets, in respect of tax loss carry forward, since their future utilisation within a period of 5 years is not certain.

The Bank may utilise the recorded tax loss in the amount of HRK 170,994 thousand as a deduction item of recorded base for the calculation of tax liability, not later than in a period of 5 years:

- tax loss for 2007 in the amount of HRK 24,360 thousand not later than (including) 2012
- tax loss for 2009 in the amount of HRK 39,777 thousand not later than (including) 2014
- tax loss for 2010 in the amount of HRK 76,778 thousand not later than (including) 2015
- tax loss for 2011 in the amount of HRK 30,079 thousand not later than (including) 2016

In accordance with the regulations of the Republic of Croatia, the Tax Authority may at any time inspect books and records of the Bank within 3 years following the year in which the tax liability is reported, and may impose additional tax assessments and penalties. The Bank's management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

12. Loss per share

Basic

Basic earnings per share are calculated by dividing the loss for the year by the weighted average number of existing shares (ordinary) for the period, excluding own shares.

	2011	2010
Loss for the year (in HRK'000)	(28,691)	(77,867)
Weighted average number of shares excluding own shares	1,816,603	1,192,740
Basic loss per share – ordinary (in HRK)	(15.79)	(65.29)

On 30 May 2011 the Bank's share capital increased (Note 27) by issuing 660,000 ordinary shares each in nominal amount of HRK 100.

Diluted

Diluted loss per share for 2011 and 2010 is equal to basic loss per share, since the Bank did not have any convertible instruments and share options during both years.

13. Cash in hand and balances with banks

	31.12.2011	31.12.2010
	HRK'000	HRK'000
Cash in hand	13,289	14,063
Cash on the clearing account	38,345	25,702
Foreign currency account	26,724	126,176
	78,358	165,941

14. Obligatory reserve with the Croatian National Bank

	31.12.2011	31.12.2010
	HRK'000	HRK'000
Earmarked obligatory reserve		
- in HRK	33,794	83,751
- in foreign currency	17,774	17,090
	51,568	100,841

In the period from 10 February 2010 until 12 October 2011 the obligatory reserve in HRK and foreign currencies has been accrued at a unique regulatory rate of 13%. From 12 October 2011 regulatory rate has been increased to 14%.

14. Obligatory reserve with the Croatian National Bank (continued)

According to the Croatian National Bank Resolution, the Bank has opted to utilise a portion of the obligatory reserve placed with the Croatian National Bank for maintaining the regular liquidity level, in the amount of 50,000 thousand kuna from 1 December until 10 January 2012, 40,000 thousand kuna from 11 January until 7 February and 40,000 thousand kuna from 8 February until 13 March 2012.

Earmarked funds of obligatory reserve with the Central National Bank are not intended for financing Bank's current operations.

15. Placements with banks

	31.12.2011 HRK`000	31.12.2010 HRK`000
Loans	10,005	13,015
Deposits	80,032	30,349
	90,037	43,364
Allowance for identified losses	(2,605)	-
	87,432	43,364

16. Loans and advances to customers

	31.12.2011 HRK`000	31.12.2010 HRK`000
Retail customers	425,805	437,120
Corporate customers	486,325	550,552
Gross loans and advances	912,130	987,672
Less: Allowance for impairment	(116,276)	(107,200)
Net loans and advances	795,854	880,472
Current	203,403	242,057
Non – current	592,451	638,415

16. Loans and advances to customers (continued)

Reconciliation of allowance for impairment on loans and advances to customers:

2011	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
As at 1 January	18,876	88,324	107,200
Increase in provisions (Note 8)	12,551	30,779	43,330
Reversal (Note 8)	(13,309)	(20,626)	(33,935)
Write off	(264)	(25)	(289)
Foreign exchange differences	161	(191)	(30)
As at 31 December	18,015	98,261	116,276

2010	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
As at 1 January	15,821	28,993	44,814
Increase in provisions (Note 8)	5,335	56,194	61,529
Reversal (Note 8)	(2,493)	(548)	(3,041)
Transfer of suspended interest	908	3,651	4,559
Write off	(695)	(10)	(705)
Foreign exchange differences	-	44	44
As at 31 December	18,876	88,324	107,200

17. Available for sale financial assets

	31.12.2011 HRK`000	31.12.2010 HRK`000
Croatian Government bonds	28,386	-
Corporate bonds	2,026	-
Equity securities – listed	2,234	2,310
Equity securities – unlisted	141	141
Investment funds	470	17,829
Undue interest	420	-
Claim for interest paid	101	-
	33,778	20,280

17. Available for sale financial assets (continued)

Movements in available for sale financial assets may be summarised as follows:

	31.12.2011 HRK'000	31.12.2010 HRK'000
As at 1 January	20,280	4,744
Additions	32,673	16,517
Disposals	(18,374)	(1,500)
Unrealised (loss) / gain	(1,603)	519
Result of assets available for sale - net	375	-
Interest payment	226	-
Foreign exchange difference	201	-
As at 31 December	33,778	20,280

Croatian Government bonds as at 31 December 2011:

Name	Maturity	Interest %	Nominal amount	Currency	Book value HRK'000	Unrealized gains / (loses) HRK'000
RHMF-O-17BA	25.11.2017	6.25	15,000	HRK	14,515	(553)
XS0645940288	9.7.2018	5.88	2,000	EUR	13,871	(603)
					28,386	(1,156)

As at 31 December 2011, fair value of bonds in the amount of 28,386 thousand kuna has been pledged as a collateral a repurchase agreement (Note 25).

Corporate bonds as at 31 December 2011:

Name	Maturity	Interest %	Nominal amount	Currency	Book value HRK'000	Unrealized gains / (loses) HRK'000
ATGR-O-169A	20.9.2016	6.90	2,000	HRK	2,026	-
					2,026	-

18. Held to maturity financial assets

	31.12.2011	31.12.2010
	HRK`000	HRK`000
Bills of exchange	10,554	12,447
	10,554	12,447
Allowance for identified losses	(7,285)	(6,906)
	3,269	5,541

Movement in allowance for identified losses:

	31.12.2011	31.12.2010
	HRK`000	HRK`000
As at 1 January	6,906	7,219
Increase in provisions (Note 8)	503	388
Collection (Note 8)	(124)	(701)
As at 31 December	7,285	6,906

Notes to the financial statements (continued)

for the year ended 31 December 2011

19. Property and equipment and intangible assets

	Land and buildings	Leasehold improvements	Electronic equipment	Other assets	Total property and equipment	Software	Intangible assets under construction	Total intangible assets
	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000
Cost								
As at 1 January 2010	25,686	12,442	9,696	14,532	62,356	5,881	1,177	7,058
Additions	-	4,097	605	477	5,179	702	197	899
Disposals	-	(259)	(471)	(933)	(1,663)	-	-	-
As at 31 December 2010	25,686	16,280	9,830	14,076	65,872	6,583	1,374	7,957
Additions	-	5,167	20	9	5,196	1,511		1,511
Disposals	-	(6)	(508)	(1,039)	(1,553)	-	(1,095)	(1,095)
As at 31 December 2011	25,686	21,441	9,342	13,046	69,515	8,094	279	8,373
Accumulated depreciation								
As at 1 January 2010	2,413	3,271	7,206	9,017	21,907	4,709	-	4,709
Charge for the year	473	2,306	911	1,729	5,419	518	-	518
Disposals	-	(137)	(471)	(821)	(1,429)	-	-	-
As at 31 December 2010	2,886	5,440	7,646	9,925	25,897	5,227	-	5,227
Charge for the year	473	3,470	815	1,399	6,157	617	-	617
Disposals	-	-	(506)	(926)	(1,432)	-	-	-
As at 31 December 2011	3,359	8,910	7,955	10,398	30,622	5,844	-	5,844
Net book value								
As at 31 December 2010	22,800	10,840	2,184	4,151	39,975	1,356	1,374	2,730
As at 31 December 2011	22,327	12,531	1,387	2,648	38,893	2,250	279	2,529

Notes to the financial statements (continued)

for the year ended 31 December 2011

19. Plant and equipment and intangible assets (continued)

During 2011 the Bank capitalised employee costs in the amount of HRK 3,296 thousand (2010: HRK 2,653 thousand) that relate to the introduction of the new banking application.

20. Repossessed assets

Movements in repossessed assets during the year:

	31.12.2011	31.12.2010
	HRK`000	HRK`000
As at 1 January	12,261	11,717
Increase	132	1,262
Decrease	(37)	(714)
Written off	-	(4)
As at 31 December	12,356	12,261

21. Other assets

	31.12.2011	31.12.2010
	HRK`000	HRK`000
Lease pre-payments	2,587	2,587
Receivables for court costs refunds	2,586	1,899
Receivables from customers	1,371	211
Other pre-payments	1,370	792
Prepaid expenses	229	234
Pre-payments of pensions to customers	118	6,550
Derivative financial asset (Note 30)	77	-
Receivables for insurance	-	2,972
Other	2,597	767
	10,935	16,012
Allowance for identified losses	(2,977)	(1,788)
	7,958	14,224

Movement in allowance for identified losses:

	31.12.2011	31.12.2010
	HRK`000	HRK`000
As at 1 January	1,788	978
Increase in provisions (Note 8)	2,008	962
Collection (Note 8)	(807)	(92)
Write off	(12)	(60)
As at 31 December	2,977	1,788

22. Deposits from customers

Deposits comprise demand deposits and time deposits:

	31.12.2011 HRK`000	31.12.2010 HRK`000
Demand deposits		
Corporate customers	6,220	9,631
Retail customers	37,651	43,002
	43,871	52,633
Time deposits		
Corporate customers	8,489	113,283
Retail customers	786,657	829,476
	795,146	942,759
Deposits from customers	839,017	995,392
Current	705,558	786,325
Non – current	133,459	209,067

23. Due to banks

	31.12.2011 HRK`000	31.12.2010 HRK`000
Borrowings:		
- Croatian Bank for Reconstruction and Development	41,413	59,128
- other	-	6,000
Deposits	12,865	74,449
	54,278	139,577
Current	12,865	98,629
Non-current	41,413	40,948

As at 31 December 2011 and 31 December 2010, all deposits from banks are current.

24. Hybrid instruments

Hybrid financial instruments represent special term deposits from citizens and legal entities with no option of cancellation prior to maturity, except for the purpose of purchasing shares of the Bank, and which are under certain conditions, prescribed by the Croatian National Bank, calculated within the Bank's regulatory capital.

	31.12.2011 HRK'000	31.12.2010 HRK'000
Legal entities	80,232	68,781
Citizens	10,957	13,771
	91,189	82,552

25. Repurchase agreements

At 2 December 2011, the Bank has entered into repurchase agreement with Euroherc Osiguranje d.d. and pledged as collateral bonds classified as available for sale (Note 17). At 31 December 2011 book value of repurchase agreements amounta to 26,200 thousand kuna. Repurchase price is 4.5% with maturity at 4 June 2012.

26. Other liabilities

	31.12.2011 HRK'000	31.12.2010 HRK'000
Provisions for legal cases	790	2,981
Provisions for contingent liabilities and commitments	1,695	686
Payables in the course of settlement	2,267	1,832
Liabilities to suppliers	2,229	2,439
Employee payables – salaries and contributions	1,845	2,692
Liabilities for savings deposits insurance charge	619	611
Vacation accruals (Note 10)	560	1,152
Other	1,954	2,069
	11,959	14,462

Movement in provisions for legal cases:

	31.12.2011 HRK'000	31.12.2010 HRK'000
As at 1 January	2,981	3,067
Increase in provision (Note 10)	318	1,423
Reversal (Note 10)	(189)	(1)
Payments made per court verdicts	(2,320)	(1,508)
As at 31 December	790	2,981

26. Other liabilities (continued)

Movement in provisions for contingent liabilities and commitments:

	31.12.2010 HRK'000	31.12.2009 HRK'000
As at 1 January	686	541
Increase in provision (Note 8 and Note 29)	1,061	145
Reversal of provision	(52)	-
As at 31 December	1,695	686

27. Shareholder's equity

Share capital

At the General Assembly meeting held on 14 September 2010, a Decision was reached to increase the share capital. The share capital in the amount of HRK 112,360 thousand increased by HRK 30,604 thousand to HRK 142,964 thousand, issuing 306,402 ordinary shares with nominal value of HRK 100. The shares were issued by private placement by ceding of receivables in the amount of HRK 10,056 thousand and by cash payment in the amount of HRK 20,548 thousand. All issued shares were subscribed and paid by Cassa di Risparmio della Repubblica di San Marino S.p.A.

At the General Assembly meeting held on 30 May 2011, a Decision was reached to increase the share capital. The share capital in the amount of HRK 142,964 thousand increased by HRK 66,000 thousand to HRK 208,964 thousand, issuing 660,000 ordinary shares with nominal value of HRK 100, through hybrid instrument from Cassa di Risparmio della Repubblica di San Marino S.p.A.

As at 31 December 2011, the share capital amounts to HRK 208,964 thousand (31 December 2010: 142,964 thousand), and comprises 2,089,644 ordinary shares (31 December 2010: 1,429,644) (VSK-R-A) with a nominal value of HRK 100 per share.

Bank's main shareholders as at 31 December are as follows:

Shareholder	31.12.2011		31.12.2010	
	Number of shares	% in share capital	Number of shares	% in share capital
Cassa di Risparmio della Repubblica di San Marino	2,078,761	99.48	1,418,661	99.23
Treasury shares	153	0.01	153	0.01
Other	10,730	0.51	10,830	0.76
Total	2,089,644	100.00	1,429,644	100.00

The ultimate owner of the Bank is Cassa di Risparmio della Repubblica di San Marino – S.U.M.S Foundation.

28. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than 90 days maturity:

	Notes	31.12.2011 HRK`000	31.12.2010 HRK`000
Cash in hand and balances with banks	13	78,358	165,941
Placements with banks	15	80,032	43,364
		158,390	209,305

29. Contingent liabilities and commitments

Legal Proceedings. The Bank is currently subject to several legal proceedings. As at 31 December 2011 provisions for legal proceeding for which the Bank anticipates outflow of economic benefits amounts to HRK 790 thousand (2010: HRK 2,981 thousand) and provision for contingent liabilities amounting to 1,055 thousand (2010: 0 million). Provision for contingent liabilities relates to the legal (initiated enforcement) proceeding of the company Prvi Faktor d.o.o. in the amount of 5,277 thousand (Note 26) that relates to the guarantee issued by the Bank in favour of the company Prvi Faktor d.o.o. for the loan payment toward the company Glas Istre d.o.o.

Capital commitments. As at 31 December 2011 and 31 December 2010, the Bank had no capital commitments in respect of buildings and equipment purchases.

Loan commitments, guarantees and other financial instruments

The following table indicates the contractual amounts of the Bank's off-balance sheet financial instruments:

	31.12.2011 HRK`000	31.12.2010 HRK`000
Guarantees	12,228	17,703
Letters of credit	4,366	6,479
Loan commitments and other	42,435	34,209
Less: Provision for contingent liabilities and commitments (Note 26)	(1,695)	(686)
Total	57,334	57,705

Nominal value of FX Forward agreement (currency futures contracts) as at 31 December 2011 amounts to HRK 14,210 thousand (31 December 2010: HRK 0) (Note 30).

29. Contingent liabilities and commitments (continued)

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

Commitments to lend represent unused portions of authorisations to lend in the form of loans or guarantees. With respect to credit risk on commitments to lend, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to lend are contingent upon customers maintaining specific credit standards.

Guarantees and undrawn loan commitments are subject to similar credit risk monitoring and credit policies as utilised in the extension of loans. The Management of the Bank believes the market risk associated with guarantees and undrawn loan commitments is minimal.

Operating lease commitments where the Bank is the lessee

The future minimum lease payments under operating leases are as follows:

	31.12.2011 HRK`000	31.12.2010 HRK`000
Up to 1 year	2,721	2,819
From 2 to 5 years	9,773	10,566
Over 5 years	4,662	5,409
Total	17,156	18,794

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. Related-party transactions are part of the normal course of business.

The Bank considers itself to be an immediately related person to its major shareholders, their subsidiaries, Supervisory and Management Board members, procurists, and their close family members.

In the year 2011 and 2010, transactions with related parties were as follows:

	Supervisory board, Management board and their related parties	
	31.12.2011	31.12.2010
	HRK`000	HRK`000
Interest income	59	417
Interest expense	122	37
Loans		
As at 1 January	1,755	1,097
Increase	-	683
Decrease	(192)	(25)
As at 31 December	1,563	1,755
Received deposits		
As at 1 January	3,483	3,917
Increase	2,819	5,417
Decrease	(3,368)	(5,851)
As at 31 December	2,934	3,483
Hybrid instruments		
As at 1 January	500	500
Increase	-	-
Decrease	-	-
As at 31 December	500	500

30. Related party transactions (continued)

	Cassa di Risparmio della Repubblica di San Marino	
	31.12.2011	31.12.2010
	HRK'000	HRK'000
Interest income	8,275	304
Other income	1,016	-
Impairment charge for credit losses - net	(4,737)	-
Interest expense	(4,292)	(3,052)
Given deposits and cash		
As at 1 January	15,089	12,202
Increase	38,405	34,935
Decrease	(15,085)	(32,048)
As at 31 December	38,409	15,089
Received deposits		
As at 1 January	54,964	89,758
Increase	12,512	-
Decrease	(54,665)	(34,794)
As at 31 December	12,811	54,964
Hybrid instruments		
As at 1 January	66,628	75,838
Increase	79,535	981
Decrease	(66,887)	(10,191)
As at 31 December	79,276	66,628

In 2011, the Bank has increased exposure towards majority shareholder Cassa di Risparmio della Repubblica di San Marino S.p.A. in the amount of 23,322 thousand kuna. As at 31 December 2011 exposure towards majority shareholder amounts to 38,411 thousand kuna, which represents 23% of regulatory capital. The regulatory limit exposure to one person or Group of related persons is 25% maximum of regulatory capital.

In order to stabilize the activity of the Bank and the intention to improve the quality of Bank loan portfolio, majority shareholder Cassa di Risparmio della Repubblica di San Marino S.p.A. has concluded the Agreement with the Bank on the transfer of the loan claims. By this Agreement the Bank has transferred to the majority shareholder, without right of recourse, a portion of its corporate loan portfolio in total amount of 8,197 thousand euro with all related rights and obligations and collaterals. Instead of fulfilling financial obligations, Bank has received a portion of the majority shareholder's loan portfolio in the amount of 8,196 thousand euro.

This transaction had a positive effect of 13,707 thousand kuna on the Bank's profit, in respect to the income from reversal of credit losses in the amount of 4,737 thousand kuna, interest income in amount of 7,954 thousand kuna and the profit arising from the purchase in amount of 1,016 thousand kuna (Note 7).

30. Related party transactions (continued)

Based on the concluded Agreement with the majority shareholder, for the transferred loan claims in the amount of 14,210 thousand kuna (Note 29), the Bank is committed to bear gain or loss arising from exchange differences on loan payments in kuna in relation to the contracted rate in EUR. At 31 December 2011, the Bank has recognized in the balance sheet changes in the fair value of FX forward in the amount of 77 thousand kuna (Note 21).

In the above stated transferred loans in the amount of 8,196 thousand euro, the Bank has successfully register a lien on the 31 December 2011, except for loan in the amount of 1,241 thousand euro.

Contingent liabilities on transferred loan claims

The Bank has transferred a portion of its corporate loan portfolio in total amount of 8,196 thousand euro to the majority shareholder. For the transferred corporate loans in the amount of 3,638 thousand euro, the Bank has committed to provide a new appraisal of collateral. If the new appraisal would be lower than the value of the transferred corporate loans, the Bank is obliged to reimburse the difference in the cost of transferred corporate claims and the remaining value of the property. Additionally, if the Bank does not provide new appraisal of collaterals, contractual penalty of 30% of the value of transferred credit claims would be charged by the majority shareholder.

Furthermore, if the majority shareholder fails to exercise the right to register the lien in year 2012 for the transferred corporate loan in the amount of 1,077 thousand euro, the Bank has commitment to compensate the difference in the cost of transferred loan claim and the remaining value of the collateral in the amount of 449 thousand euro.

At 31 December 2011, updates in collateral appraisals and potential differences in relation to the contractual values of the transferred corporate claims, are still in progress. The Bank is not aware of circumstances that could lead to significant potential liability.

Based on above transferred corporate loan claims, the majority shareholder has entrusted to the Bank's management, control and collection of assigned transferred corporate loan claims, for which the majority shareholder pay an agreed fixed and variable fee, depending on the collection of assigned corporate claims. Incurred costs related to the management and execution of debt collection services, including those related to employees, costs of procedures, professional personnel fees and costs of attorneys, will be bear solely by the Bank.

Key management and Supervisory Board compensation

	31.12.2011	31.12.2010
	HRK`000	HRK`000
Gross salaries and other short-term benefits	2,097	4,152

31. Financial risk management

The Bank's activities are exposed to a variety of financial and operational risks, management of which includes analysis, evaluation, acceptance and management to some degree of risk or combination of risks. Risk management and risk acceptance represents basic merit of financial operations. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance.

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practice.

Risk management is responsibility of the Management Board and Assets and Liabilities Committee and Committee for the management of credit risk. Management identifies, evaluates and hedges financial risks in close co-operation with the Bank's operating units. Management provides written principles for overall risk management, as well as written policies covering specific areas, such as currency risk, interest rate risk, credit risk, liquidity risk, price risk, operational risk and use of derivative and non-derivative financial instruments. In addition, Internal audit Department is responsible for the independent review of risk management and the control environment.

The most important types of risk are credit risk, liquidity risk, market risk and other operational risks. Market risk includes currency risk, interest rate and other price risks.

31.1. Credit risk

The Bank is exposed to credit risk, which is the risk that a counterparty will be unable to settle its obligations in full when due. Significant changes in the economy, or in the particular industry segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the balance sheet date. Management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in loans and advances, debt and other securities. There is also credit risk in off-balance sheet financial arrangements such as loan commitments and other issued guarantees. The credit risk management and control are centralised within the Risk Management Sector.

31.1.1. Credit risk measurement

(a) Loans and advances

When granting loans and advances to customers and loans to banks according the contract, the Bank estimates and measures credit risk based on:

1. assessment of counterparty's credit worthiness,
2. assessment of counterparty's regularity in obligations settlement and
3. quality of collateral.

The Bank assesses the counterparty's credit worthiness using the internal rating tools. The tools have been developed internally and combine statistical analysis with financial advisor judgment and are validated, where appropriate, by comparison with externally available data. Financial analyst exposures for all groups over EUR 300 thousand based on the collected data and indicators must make an opinion on the financial position of the client, and give their opinion regarding the approval. The Bank's placements to customers are segmented into three rating classes; fully recoverable placements, partially recoverable and unrecoverable placements.

Settlement of obligations means the payment of all liabilities within contractual maturity terms, without establishing in that respect new receivables.

The quality of collateral is established based on market effectiveness, the existence of documentation and the possibility of forced collection.

(b) Debt securities and other bills

For debt securities and other bills, external rating such as Standard & Poor's, Moody's, FitchIBCA rating or their equivalents are used by the Treasury Sector, if available. The investments in those securities and bills are viewed as a way to gain a better credit quality mapping and maintain a readily available source to meet the funding requirement at the same time.

31.1.2. Risk limit control and mitigation policies

The Bank manages, limits and controls concentrations of credit risk wherever they are identified – in particular, to individual counterparties and groups, and to industries and countries.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, his related parties and industry segments. Limits on the level of credit risk by industry sector are subject to an annual or more frequent review, when considered necessary.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet all obligations towards the Bank, and by changing these lending limits where appropriate.

Some other specific control and mitigation measures are outlined below:

(a) Collateral

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for certain types of placements. The Bank has internal regulations in place on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types are:

- Mortgages over residential properties;
- Mortgages over business assets such as premises, inventory and receivables, equipment;
- Mortgages over financial instruments such as debt and equity securities.

Debt securities, treasury and other eligible bills are generally unsecured.

(b) Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans or guarantees. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors remaining period to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

31.1.3. Impairment and provisioning policies

Impairment provisions are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment.

The impairment provision shown in the balance sheet at year-end is derived from each of the three internal rating grades. However, the majority of the impairment provision comes from the bottom two grades. The table below shows the percentage of the Bank's on-balance sheet items relating to loans and advances to customers, and the associated impairment provision for each of the Bank's internal rating categories:

Bank's rating

	2011		2010	
	Loans and advances	Allowance for impairment	Loans and advances	Allowance for impairment
	HRK`000	HRK`000	HRK`000	HRK`000
1. Fully recoverable placements	663,990	9,127	727,437	10,459
2. Partially recoverable placements	194,964	53,973	232,972	69,478
3. Unrecoverable placements	53,176	53,176	27,263	27,263
	912,130	116,276	987,672	107,200

Bank's rating

	2011		2010	
	Loans and advances	Allowance for impairment	Loans and advances	Allowance for impairment
	(%)	(%)	(%)	(%)
1. Fully recoverable placements	72.80	7.85	73.65	9.76
2. Partially recoverable placements	21.37	46.42	23.59	64.81
3. Unrecoverable placements	5.83	45.73	2.76	25.43
	100.00	100.00	100.00	100.00

31.1.3. Impairment and provisioning policies (continued)

The internal rating tool assists Management to determine whether objective evidence of impairment exists, based on the following criteria set out by the Bank:

- Delinquency in contractual payments of principal, interest or fee;
- Cash flow difficulties users placement experienced by the borrower (e.g. equity ratio, net income percentage of sales);
- Breach of loan covenants or conditions approved loans;
- Initiation of bankruptcy proceedings;
- Deterioration in the value of collateral.

The Bank's policy requires the review of individual financial assets that are above materiality thresholds at least annually or more regularly when individual circumstances require. Impairment allowances on individually assessed accounts are determined by an evaluation of the incurred loss at balance-sheet date on a case-by-case basis, and are applied to all individually significant accounts. The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.

31.1.4. Maximum exposure to credit risk before collateral held or other credit enhancements

	31.12.2011 HRK'000	31.12.2010 HRK'000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash in hand and balances with banks	78,358	165,941
Obligatory reserve with the Croatian National Bank	51,568	100,841
Placements with banks	87,432	43,364
Loans and advances to customers	795,854	808,472
Available for sale financial assets	33,778	20,280
Held to maturity financial assets	3,269	5,541
Other assets	7,958	14,224
	1,058,217	1,158,663
Credit risk exposures relating to off-balance sheet items are as follows:		
Financial guarantees	12,228	17,703
Letters of credit	4,366	6,479
Loan commitments and other	42,435	34,209
	1,117,246	1,217,054

The above table represents the maximum exposure of the Bank to credit risk at 31 December 2011 and 2010, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet. As shown above, 79.06% of the total maximum exposure is derived from loans and advances to banks and customers (2010: 69.99%).

31.1.5. Loans and advances

Loans and advances are summarised as follows:

	31.12.2011		31.12.2010	
	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks
	HRK`000	HRK`000	HRK`000	HRK`000
Neither past due nor impaired	598,845	84,932	683,033	43,364
Past due but not impaired	65,145	-	44,404	-
Individually impaired	248,140	5,105	260,235	-
Gross	912,130	90,037	987,672	43,364
Less: allowance for impairment	(116,276)	(2,605)	(107,200)	-
Net	795,854	87,432	880,472	43,364

The total impairment provision for loans and advances is HRK 116,276 thousand (2010: HRK 107,200 thousand) of which HRK 106,955 thousand (2010: HRK 96,398 thousand) represents the individually impaired loans and the remaining amount of HRK 9,321 thousand (2010: HRK 10,802 thousand) represents the portfolio provision. Further information of the impairment allowance for loans and advances to banks and to customers is provided in Notes 15 and 16.

During the year ended 31 December 2011, the Bank's total loans and advances to customers has fallen by 10% as a result of the decreasing of the lending business.

Notes to the financial statements (continued)

for the year ended 31 December 2011

31.1.5. Loans and advances (continued)

The breakdown of the gross amount of loans and advances by class held by the Bank are as follows:

	Retail customers HRK'000	Corporate customers HRK'000	Total loans and advances to customers HRK'000	Loans and advances to banks HRK'000
As at 31 December 2011				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	375,481	223,364	598,845	84,932
<i>Past due but not impaired</i>				
Due less than 30 days	3,551	19,987	23,538	-
Due 30 – 90 days	5,116	36,491	41,607	-
<i>Individually impaired</i>				
Individually impaired loans	41,657	206,483	248,140	5,105
Total	425,805	486,325	912,130	90,037

	Retail customers HRK'000	Corporate customers HRK'000	Total loans and advances to customers HRK'000	Loans and advances to banks HRK'000
As at 31 December 2010				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	387,758	295,275	683,033	43,364
<i>Past due but not impaired</i>				
Due less than 30 days	5,012	24,650	29,662	-
Due 30 – 90 days	191	14,551	14,742	-
<i>Individually impaired</i>				
Individually impaired loans	44,159	216,076	260,235	-
Total	437,120	550,552	987,672	43,364

Notes to the financial statements (continued)

for the year ended 31 December 2011

31.1.5. Loans and advances (continued)

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated by reference to the market prices or indexes of similar assets.

Restructuring activities include extended payment arrangements, modification and deferral of payments. Restructuring policies and practices are based on indicators or criteria which, in the judgment of the Management Board, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to loans for corporate customers financing. Within these loans there were no renegotiated loans that would otherwise be past due or impaired either at 31 December 2011 or 2010.

31.1.6. Repossessed assets

Reposessed assets is sold as soon as practicable with the proceeds used to reduce the outstanding indebtedness.

31.1.7. Concentration of risks of financial assets with credit risk exposure

(a) Geographical sectors

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorised by geographical region as at 31 December 2011. For this table, the Bank has allocated exposures to regions based on the country of domicile of its counterparties.

	Croatia HRK'000	European Union HRK'000	Other countries HRK'000	Total HRK'000
Cash in hand and balances with banks	51,793	26,183	382	78,358
Obligatory reserve with the CNB	51,568	-	-	51,568
Placements with banks	8,226	40,768	38,438	87,432
Loans and advances to customers	795,854	-	-	795,854
Available for sale financial assets	33,778	-	-	33,778
Held to maturity financial assets	3,269	-	-	3,269
Other assets	7,958	-	-	7,958
As at 31 December 2011	952,446	66,951	38,820	1,058,217
As at 31 December 2010	1,075,480	137,974	17,209	1,230,663

(b) Industry sectors

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorised by the industry sectors of our counterparties,

	Financial institutions HRK'000	Manu- facturing HRK'000	Real estate HRK'000	Wholesale and retail trade HRK'000	Public sector HRK'000	Other industries HRK'000	Individuals HRK'000	Total HRK'000
Placements with banks	87,432	-	-	-	-	-	-	87,432
Loans and advances to customers	22,346	108,008	64,262	74,874	2,128	120,678	403,558	795,854
Available for sale financial assets	739	1,322	419	2,106	28,907	285	-	33,778
Held to maturity financial assets	-	144	209	-	-	367	2,549	3,269
Other assets	3	115	43	6,567	38	44	1,148	7,958
As at 31 December 2011	110,520	109,589	64,933	83,547	31,073	121,374	407,255	928,291
As at 31 December 2010	63,753	121,953	91,771	126,379	879	138,633	420,513	963,881

Notes to the financial statements (continued)

for the year ended 31 December 2011

32. Market risk

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

The market risks arising from trading and non-trading activities are concentrated in the Treasury Division. Regular reports are submitted to the Management Board and heads of each business unit.

Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with clients or with the market.

Non-trading portfolios primarily arise from the interest rate management of the entity's retail and commercial banking assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's available-for-sale investments.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

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

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

32.1. Foreign currency risk

The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank manages its currency risk by setting principles and limits for foreign currency exposures and by monitoring exposure with respect to limits. The Bank directs its business activities trying to minimise the gap between assets and liabilities denominated in or linked to a foreign currency, and maintaining the daily business activities within daily potential loss limits. The parameters are regularly reviewed in accordance with fluctuations in foreign currency rates and correlations between currencies.

The table below summarises the Bank's exposure to currency risk at 31 December. Included in the table are the Bank's financial instruments at carrying amounts, categorised by currency.

Concentrations of currency risk – on- and off-balance sheet financial instruments

	HRK	EUR	USD	Other currencies	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
As at 31 December 2011					
Assets					
Cash and balances with banks	45,300	31,919	675	464	78,358
Obligatory reserve with the CNB	33,794	10,580	7,194	-	51,568
Placement with banks	7,400	80,032	-	-	87,432
Loans and advances to customers	116,401	672,971	-	6,482	795,854
Available for sale financial assets	19,478	14,300	-	-	33,778
Held to maturity financial assets	3,269	-	-	-	3,269
Other assets	7,693	265	-	-	7,958
Total financial assets	233,335	810,067	7,869	6,946	1,058,217
Liabilities					
Deposits from customers	199,641	626,895	8,038	4,443	839,017
Due to banks	17,498	36,780	-	-	54,278
Hybrid instruments	6,278	84,911	-	-	91,189
Repurchase agreements	-	26,200	-	-	26,200
Other liabilities	10,047	1,885	-	27	11,959
Total financial liabilities	233,464	776,671	8,038	4,470	1,022,643
Net on-balance sheet financial position	(129)	33,396	(169)	(2,476)	35,574
Loan commitments	9,813	27,786	4,836	-	42,435
Nominal value of FX Forward	-	14,210	-	-	14,210
As at 31 December 2010					
Total financial assets	303,938	902,475	16,805	7,445	1,230,663
Total financial liabilities	326,720	883,757	17,193	4,313	1,231,983
Net on-balance sheet financial position	(22,782)	18,718	(388)	3,132	(1,320)
Loan commitments	31,807	2,402	-	-	34,209

32.2. Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily by the Bank's Treasury and Financial Markets Division.

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	Up to 1 month HRK`000	1-3 months HRK`000	3-12 months HRK`000	1-3 years HRK`000	Over 3 years HRK`00	Non interest HRK`000	Total HRK`000
As at 31 December 2011							
Assets							
Cash and balances with banks	78,358	-	-	-	-	-	78,358
Obligatory reserve with CNB	-	13,313	24,698	7,058	6,499	-	51,568
Placements with banks	64,971	15,061	-	-	4,900	2,500	87,432
Loans and advances to customers	182,554	21,550	138,136	186,409	267,205	-	795,854
Available for sale financial assets	458	-	-	-	30,374	2,946	33,778
Held to maturity financial assets	1,377	857	1,035	-	-	-	3,269
Other assets	-	-	-	-	-	7,958	7,958
Total financial assets	326,900	51,599	163,869	193,467	308,978	13,404	1,058,217
Liabilities							
Deposits from customers	155,031	143,999	455,495	54,106	30,386	-	839,017
Due to banks	13,125	1,447	4,908	14,437	20,361	-	54,278
Hybrid instruments	1,415	1,207	8,428	949	79,190	-	91,189
Repurchase agreements	98	-	26,102	-	-	-	26,200
Other liabilities	-	-	-	-	-	11,959	11,959
Total financial liabilities	169,669	146,653	494,933	69,492	129,937	11,959	1,022,644
Net on-balance sheet financial position	157,232	(95,054)	(331,064)	123,975	179,040	1,445	35,573
As at 31 December 2010							
Total financial assets	366,626	110,045	194,388	209,643	315,457	34,504	1,230,663
Total financial liabilities	247,632	210,250	514,617	91,980	153,042	14,462	1,231,983
Net on-balance sheet financial position	118,994	(100,205)	(320,229)	117,663	162,415	20,042	(1,320)

32.3. Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs and other calls on cash settled derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank manages liquidity reserves daily, ensuring also accomplishment of all customer needs.

32.3.1. Funding approach

Sources of liquidity are regularly reviewed by the Bank's Treasury to maintain a wide diversification by currency, geography, provider, product and term.

32.3.2. Non-derivative cash flows

The table below presents the cash flows payable by the Bank under non-derivative financial liabilities by remaining contractual maturities at the balance sheet date.

As at 31 December 2011	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Deposits from customers	155,031	143,999	455,495	54,106	30,386	839,017
Due to banks	13,125	1,447	4,908	14,437	20,361	54,278
Hybrid instruments	1,415	1,207	8,428	949	79,190	91,189
Repurchase agreements	98	-	26,102	-	-	26,200
Other liabilities	11,959	-	-	-	-	11,959
Total liabilities (contractual maturity dates)	181,628	146,653	494,933	69,492	129,937	1,022,643
Total liabilities on unused loans (expected maturity dates)	28,232	1,655	8,918	2,404	1,226	42,435

32.3.2. Non-derivative cash flows (continued)

As at 31 December 2010	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000
Deposits from customers	179,295	176,566	512,615	81,184	45,732	995,392
Due to banks	65,413	33,216	-	223	40,725	139,577
Hybrid instruments	2,924	468	2,002	10,573	66,585	82,552
Other liabilities	11,271	210	2,981	-	-	14,462
Total liabilities (contractual maturity)	258,903	210,460	517,598	91,980	153,042	1,231,983
Total liabilities on unused loans (expected maturity)	1,607	3,692	22,276	5,043	1,591	34,209

Assets available to meet all of the liabilities and to cover outstanding loan commitments include cash, central bank balances, items in the course of collection and treasury and other eligible bills; loans and advances to banks; and loans and advances to customers. In the normal course of business, a proportion of customer loans contractually repayable within one year will be extended. The Bank would also be able to meet unexpected net cash outflows by selling securities and approaching others funding sources.

32.3.3. Off-balance sheet items

(a) Loan commitments

The dates of the contractual amounts of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers and other instruments (Note 29), are summarised in the table below.

(b) Other financial instruments

Other financial instruments (Note 29), are also included below based on the earliest contractual maturity date.

	No later than 1 year	1-3 years	Over 3 years	Total
	HRK`000	HRK`000	HRK`000	HRK`000
As at 31 December 2011				
Loan commitments	38,805	2,404	1,226	42,435
Guarantees, letters of credit and other	13,903	2,691	-	16,594
Nominal value of FX Forward	-	-	-	14,210
Total	52,708	5,095	1,226	73,239
As at 31 December 2010				
Loan commitments	27,575	5,043	1,591	34,209
Guarantees, letters of credit and other	22,571	1,611	-	24,182
Total	50,146	6,654	1,591	58,391

32.3.3. Off-balance sheet items (continued)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the Management of the Bank. It is unusual for banks ever to be completely matched since business transactions are often of uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

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

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit at the balance sheet date does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

32.4. Fair values of financial assets and liabilities

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arm's length basis. Where available, fair value is based on quoted market prices. However, no readily available market prices exist for a significant portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing techniques as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates may not be realisable in a current sale of the financial instrument.

Bank uses following hierarchy for determining fair value of financial instruments by valuation technique:

- level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
- level 2: other techniques for which all inputs which have significant effect on the recorded fair value are observable, either directly or indirectly
- level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

	31.12.2011			31.12.2010		
	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000
Bonds	30,933	-	30,933	-	-	-
Investments funds	470	-	470	17,829	-	17,829
Equity securities	2,234	141	2,375	2,310	141	2,451
	33,637	141	33,778	20,139	141	20,280

32.4. Fair values of financial assets and liabilities (continued)

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

	Carrying value		Fair value	
	2011 HRK`000	2010 HRK`000	2011 HRK`000	2010 HRK`000
Financial assets				
Placements with banks	87,432	43,364	87,432	43,364
Loans and advances to customers	795,854	880,472	795,854	880,472
Held to maturity financial assets	3,269	5,541	3,269	5,541
Other assets	7,958	14,224	7,958	14,224
Total financial assets	894,513	943,601	894,513	943,601
Financial liabilities				
Deposits from customers	839,017	995,392	839,017	995,392
Due to banks	54,278	139,577	54,278	139,577
Hybrid instruments	91,189	82,552	91,189	82,552
Repurchase agreements	26,200	-	26,200	-
Other liabilities	11,959	14,462	11,959	14,462
Total financial liabilities	1,022,643	1,231,983	1,022,643	1,231,983

For the purpose of the fair value assessment of the Bank's financial instruments the following methods and assumptions have been used:

(a) Cash and funds with Central bank

The carrying amount of cash and amounts due from banks, obligatory reserve with the Croatian National Bank, and placements with banks, deposits from banks and deposits from companies and similar entities are deemed to reflect their fair value due to the short-term maturity of these financial instruments.

(b) Financial assets held-to-maturity

The fair value of securities held-to-maturity is calculated based on quoted market prices.

(c) Due from other banks

The estimated fair values of amounts due from other banks, which mature within a maximum of 180 days approximate their carrying amounts. The fair values of other amounts due from banks is estimated based on discounted cash flow analyses using prevailing interest rates for investments under similar terms (market rates adjusted by credit risk). The fair value of non-performing amounts due from banks is estimated using a discounted cash flow analysis. Allowances are not taken into consideration when calculating fair values.

32.4. Fair values of financial assets and liabilities (continued)

(d) Loans to and receivables from customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality. The fair value of non-performing loans to customers is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral, where available. Loans at fixed interest rates represent only a fraction of the total carrying value and hence the fair value of total loans to and receivables from customers approximates the carrying values as at the balance sheet date. Allowances are not taken into consideration when calculating fair values.

(e) Due to other banks and customers

The fair value of term deposits payable on demand represents the carrying value of amounts payable on demand as at the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as at the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using rates currently offered for deposits of similar remaining maturities.

32.5. Capital management

The Bank's objectives when managing capital, which is a broader concept than the 'equity' on the face of balance sheets, are:

- to comply with the capital requirements set by the central bank;
- to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored by the Bank employing techniques based on the guidelines developed by the Basel Committee and the European Community Directives, as implemented by the Croatian National Bank (the Authority), for supervisory purposes. The required information is filed with the Authority on a quarterly basis.

In year 2011 the Central bank required each bank or banking group to: (a) hold the minimum level of the regulatory capital in the amount of HRK 40 million and (b) maintain a ratio of total regulatory capital to the risk-weighted asset (the 'Basel ratio') at the minimum of 12%, which is above the internationally agreed minimum of 8%.

32.5. Capital management (continued)

The Bank's regulatory capital is divided into two tiers:

- Tier 1 capital: share capital (net of any book values of the treasury shares), and reserves created by appropriations of profit after tax, share premium and provisions for treasury shares .
- Tier 2 capital: qualifying capital and collective impairment allowances.

The risk-weighted assets are measured by means of a hierarchy of six risk weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet exposure, with some adjustments to reflect the more contingent nature of the potential losses.

The table below summarises the composition of regulatory capital and the ratios of the Bank for the years ended 31 December.

	2011	2010
	HRK'000	HRK'000
Tier 1 capital		
Share capital (less treasury shares)	284,608	218,608
Reserves from profit after taxation	1,013	1,489
Share premium	772	772
Reserves for treasury shares	476	476
Less: Accumulated loss and other deductions	(197,784)	(168,409)
Total qualifying Tier 1 capital	89,085	52,936
Tier 2 capital		
Hybrid instruments	80,139	52,936
Total qualifying Tier 2 capital	80,139	52,936
Total regulatory capital	169,224	105,872
Risk-weighted assets:		
Credit risk exposure	1,002,613	1,088,717
Operating risk exposure	60,657	64,531
Currency risk exposure	42,835	29,753
Total risk-weighted assets	1,106,105	1,183,001
Basel ratio	15.30	8.95

From 31 March 2010, ratio of total regulatory capital is set at the minimum of 12%.

According to Decision from 21 July 2011, the Croatian National Bank enforced the Bank to assure the capital adequacy ratio at the level of at least 14% in the period from 30 September 2011 to 30 June 2012, until the revenues realized by the Bank are sufficient to cover all the costs and risks of the Bank's business activities as also support of the regulatory capital increase.

Approval of financial statements

for the year ended 31 December 2011

33. Post balance sheet events

At the General Assembly meeting held on 30 January 2012, a Decision was reached to increase the share capital. The share capital in the amount of HRK 208,964 thousand increased by HRK 51,800 thousand, to HRK 260,764 thousand, issuing 518,000 ordinary shares with nominal value of HRK 100.00. All issued shares were subscribed and paid by Cassa di Risparmio della Repubblica di San Marino S.p.A. Mentioned increase in the share capital will not have effect on the Bank capital adequacy ratio.

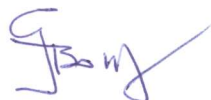
From 27 January 2012, Croatian National Bank has increased the rate of obligatory reserves in HRK and foreign currencies from 14% to 15%. Bank maintains obligatory reserves based on received Decision from Croatian National Bank (Note 14).

34. Approval of financial statements

Financial statements set out on pages 5 to 61 were approved by the Management Board on 23 March 2012.

Gian Luigi Bonfe

President of the Management Board



Darko Kosovec

Member of the Management Board

