

**BANKA KOVANICA d.d.**

**Financial statements as at  
31 December 2010 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  
Member of the Management board

Banka Kovanica d.d.,  
Preradovićeve 29  
Varaždin

Darko Kosovec  
Member of the Management Board



20 April 2011

# 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 2010, 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 4 to 56.

### **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

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; 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. Also, under intangible assets (note 19), the Bank has receivables for advances that relate to the banking software in the amount of HRK 1,093 thousand for which implementation has been terminated. 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 4 to 56 give a true and fair view of the financial positions of the Bank as at 31 December 2010 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

The Bank's reported capital adequacy at 31 December 2010 was 8.95% (note 32.5) which is below the required regulatory capital adequacy (minimally 12%). The Bank is in the process of capital increase by the majority shareholder in the amount of HRK 66 million which should bring the Bank to the satisfactory capital adequacy level. At the date of issuing these financial statements, this capital increase has not been completed. The Bank's operation in the forthcoming period substantially depends on whether the Bank will attain and maintain required regulatory capital adequacy level.



Grant Thornton revizija d.o.o.

Koranska 16, Zagreb

Zagreb, 20 April 2011

**GRANT THORNTON**  
**revizija d.o.o.**  
**ZAGREB**



Certified auditor

# Statement of comprehensive income

for the year ended 31 December 2010

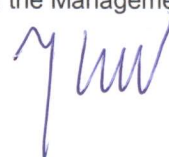
	Notes	2010 HRK'000	2009 HRK'000
Interest income		87,909	79,137
Interest expense		(56,358)	(46,282)
<b>Net interest income</b>	4	<b>31,551</b>	<b>32,855</b>
Fee and commission income		6,387	5,008
Fee and commission expense		(1,688)	(1,217)
<b>Net fee and commission income</b>	5	<b>4,699</b>	<b>3,791</b>
Foreign exchange differences - net	6	(1,943)	14,463
Result of assets available for sale - net		(9)	152
Other operating income	7	5,783	4,320
Impairment (charge) / reversal for credit losses - net	8	(52,580)	(20,259)
Administrative expenses	9	(54,746)	(50,651)
Other operating expenses	10	(10,622)	(6,172)
<b>Loss before income tax</b>		<b>(77,867)</b>	<b>(21,501)</b>
Income tax expense	11	-	-
<b>Loss after taxation</b>		<b>(77,867)</b>	<b>(21,501)</b>
Unrealized gains on financial assets available for sale		519	531
<b>Other comprehensive income</b>		<b>519</b>	<b>531</b>
<b>Total comprehensive loss</b>		<b>(77,348)</b>	<b>(20,970)</b>
Loss per share	12	(65.29)	(19.14)

Financial statements set out on pages 4 to 56 were approved by the Management Board on 20 April 2011.

Gian Luigi Bonfe  
Member of the Management Board




Darko Kosovec  
Member of the Management Board





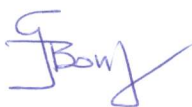
## Statement of financial position

as at 31 December 2010

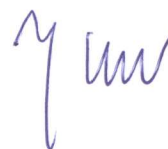
	Notes	31.12.2010 HRK'000	31.12.2009 HRK'000
<b>ASSETS</b>			
Cash in hand and balances with banks	13	165,941	81,966
Obligatory reserve with the Croatian National Bank	14	100,841	94,727
Placements with banks	15	43,364	91,130
Loans and advances to customers	16	880,472	810,857
Available for sale financial assets	17	20,280	4,744
Held to maturity financial assets	18	5,541	38,213
Property and equipment	19	39,975	40,449
Intangible assets	19	2,730	2,349
Reposessed assets	20	12,261	11,717
Other assets	21	14,224	14,072
<b>Total assets</b>		<b>1,285,629</b>	<b>1,190,224</b>
<b>LIABILITIES</b>			
Deposits from customers	22	995,392	809,347
Due to banks	23	139,577	166,617
Hybrid instruments	24	82,552	101,993
Other liabilities	25	14,462	11,877
		<b>1,231,983</b>	<b>1,089,834</b>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	26	142,964	112,360
Treasury shares		(15)	(15)
Share premium		76,430	76,430
Reserves		1,553	1,034
Loss brought forward		(89,419)	(67,918)
Loss for the year		(77,867)	(21,501)
		<b>53,646</b>	<b>100,390</b>
<b>Total liabilities and shareholders' equity</b>		<b>1,285,629</b>	<b>1,190,224</b>

Financial statements set out on pages 4 to 56 were approved by the Management Board on 20 April 2011.

Gian Luigi Bonfe  
Member of the Management Board



Darko Kosovec  
Member of the Management Board




# Statement of changes in equity

for the year ended 31 December 2010

	Share capital	Treasury shares	Share premium	Reserves	Loss brought forward	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
<b>As at 31 December 2008</b>	<b>112,360</b>	<b>(15)</b>	<b>76,430</b>	<b>503</b>	<b>(67,918)</b>	<b>121,360</b>
Loss for the year	-	-	-	-	(21,501)	(21,501)
Unrealized gains on assets available for sale	-	-	-	531	-	531
<b>Other comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>531</b>	<b>-</b>	<b>531</b>
<b>As at 31 December 2009</b>	<b>112,360</b>	<b>(15)</b>	<b>76,430</b>	<b>1,034</b>	<b>(89,419)</b>	<b>100,390</b>
Loss for the year	-	-	-	-	(77,867)	(77,867)
Increase of capital	30,604	-	-	-	-	30,604
Unrealized gains on assets available for sale	-	-	-	519	-	519
<b>Other comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>519</b>	<b>-</b>	<b>519</b>
<b>As at 31 December 2010</b>	<b>142,964</b>	<b>(15)</b>	<b>76,430</b>	<b>1,553</b>	<b>(167,286)</b>	<b>53,646</b>

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 2010

	Notes	2010 HRK'000	2009 HRK'000
<b>Cash flows from operating activities</b>			
Loss before taxation		(77,867)	(21,501)
Depreciation and amortisation	9, 19	5,937	5,093
Write off and disposals of property and equipment	19	234	2,451
Increase / (decrease) in impairment charge for credit losses	8	52,580	20,259
Realized gain / (loss) on financial assets available for sale		9	(152)
Other non-cash items		6,601	4,053
<b>Operating result before changes in operating assets</b>		<b>(12,506)</b>	<b>10,203</b>
(Increase) in assets with the Croatian National Bank		(6,114)	(18,964)
(Increase) in loans and advances to customers		(128,103)	(260,955)
Decrease / (increase) in bills of exchange		(3,524)	65,725
(Increase) in repossessed and other assets		(1,473)	(11,775)
(Decrease) in deposits from customers		185,995	94,491
Increase / (decrease) in hybrid instruments		(9,479)	65,580
Increase / (decrease) in other liabilities		2,490	(7,998)
<b>Net cash used in operating activities</b>		<b>27,286</b>	<b>(63,693)</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment and intangible assets	19	(6,078)	(25,326)
Purchase of financial assets available for sale	17	(16,517)	(22,240)
Proceeds on sale of financial assets available for sale	17	1,500	36,566
<b>Net cash used for investing activities</b>		<b>(21,095)</b>	<b>(11,000)</b>
<b>Cash flows from financing activities</b>			
Capital contribution	26	20,548	-
Decrease of deposits due to banks		(39,239)	(34,835)
Increase of loans due to banks		12,199	50,048
<b>Net cash from financing activities</b>		<b>(6,492)</b>	<b>15,213</b>
<b>Net (decrease) / increase in cash and cash equivalents</b>		<b>(301)</b>	<b>(59,480)</b>
Cash and cash equivalents at beginning of year		209,606	269,086
<b>Cash and cash equivalents at end of year</b>	27	<b>209,305</b>	<b>209,606</b>

*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 2010

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### 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 2010

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### 1. General information (continued)

#### ***Supervisory Board***

Pier Luigi Martelli	President from 1 June 2010 Member from 24 July 2009 until 1 June 2010
Gilberto Ghiotti	President until 31 May 2010 Member from 1 June until 30 June 2010
Ivan Majdak	Vice president
Simoni Luca	Member until 24 March 2010
Renzi Vladimiro	Member
Andrea Albertini	Member until 1 July 2010
Čedomil Cesarec	Member until 1 May 2010
Davor Štern	Member
Aldo Busignani	Member until 1 July 2010
Gian Primo Giardi	Member since 30 June 2010

#### ***Management Board***

Radojka Olič	President until 28 February 2011
Darko Kosovec	Member
Gian Luigi Bonfe	Member

The shareholders of the Bank as at 31 December 2010 and 31 December 2009 are disclosed in Note 26.

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 fulfil 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.

## **Notes to the financial statements (continued)**

for the year ended 31 December 2010

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### **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 2010.

#### **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 (hereinafter: "CNB") 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.

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 2. Basis of presentation of financial statements (continued)

#### 2.2. Basis of preparation (continued)

##### **Standards, amendments and interpretations issued by IASB and adopted by the Croatian Board and effective**

At the date of authorisation of these financial statements the following standards and interpretations adopted by Republic of Croatia were in issue and effective for the reporting periods ending on 31 December 2010:

In the year 2010, the Bank has adopted these revised standards and interpretations and presented the comparable data. Adoption of these revised standards as at 1 January 2010 had no effect on capital.

- *IFRS 1 First-time Adoption of IFRS (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IFRS 2 Share based payment (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IFRS 7 Financial Instruments: Disclosures – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 1 Presentation of Financial Statements (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 16 Property, Plant and Equipment (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 18 Revenue – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 19 Employee Benefits (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 20 Accounting for Government Grants and Disclosure of Government Assistance – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 23 Borrowing costs (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 27 Consolidated and Separate Financial Statements – Cost of an investment at first application – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 28 Investments in Associates (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 29 Financial Reporting in Hyperinflationary Economies (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 31 Interests in Joint Ventures (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 32 Financial Instruments: Presentation and IAS 1 Puttable Financial Instruments and Obligations Arising on Liquidation (revised) – effective for annual periods beginning on or after 1 January 2010,*
- *IAS 36 Impairment of Assets (revised) – effective for annual periods beginning on or after 1 January 2010,*

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 2. Basis of presentation of financial statements (continued)

#### 2.2. Basis of preparation (continued)

- *IAS 38 Intangible Assets (revised)* – effective for annual periods beginning on or after 1 January 2010,
- *IAS 39 Financial Instruments: Recognition and Measurements (revised)* – effective for annual periods beginning on or after 1 January 2010,
- *IAS 40 Investment Property (revised)* – effective for annual periods beginning on or after 1 January 2010,
- *IAS 41 Agriculture (revised)* – effective for annual periods beginning on or after 1 January 2010,
- *IFRIC 15 Agreements for the Construction of Real Estate* – effective for annual periods beginning on or after 1 January 2010,
- *IFRIC 16 Hedges of a Net Investment in a Foreign Operation* – effective for annual periods beginning on or after 1 January 2010,
- *IFRIC 17 Distributions of Non-cash Assets to Owners* – effective for annual periods beginning on or after 1 January 2010,
- *IFRIC 18 Transfers of Assets from Customers* – effective for annual periods beginning on or after 1 January 2010,
- *IFRS 3 Business Combinations (revised)* – effective for annual periods beginning on or after 1 January 2010,
- *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations (revised)* – effective for annual periods beginning on or after 1 January 2010,
- *IAS 27 Consolidated and Separate Financial Statements* – effective for annual periods beginning on or after 1 January 2010,
- *IAS 28 Investments in Associates (revised based on IFRS improvements)* – effective for annual periods beginning on or after 1 January 2010,
- *IAS 31 Interests in Joint Ventures (revised based on IFRS 3 amendment)* – effective for annual periods beginning on or after 1 January 2010,
- *IAS 39 Financial Instruments: Recognition and Measurement: Eligible Hedge items* – effective for annual periods beginning on or after 1 January 2010,

#### Standards, amendments and interpretations to existing standards that are not yet effective

At the date of authorisation of these financial statements, following standards, amendments and interpretations to existing standards have been issued but are not yet effective:

- *Improvements MSFI 2010.* (most of this improvements becomes effective for annual periods beginning on or after 1 July 2010 or 1 January 2011),
- *IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments* – effective for annual periods beginning on or after 1 July 2010
- *IFRS 9 Financial Instruments* – effective for annual periods beginning on or after 1 January 2013,

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 2. Basis of presentation of financial statements (continued)

#### 2.2. Basis of preparation (continued)

Management anticipates that all of the relevant pronouncements will be adopted in the Company's financial statements for the first period beginning after the effective date of the pronouncement and its application should not have a material impact on the Company's financial statements.

#### 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.



## **Notes to the financial statements (continued)**

for the year ended 31 December 2010

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### **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.

## **Notes to the financial statements (continued)**

for the year ended 31 December 2010

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### **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.

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 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 2010	EUR 1 = HRK 7.385173	USD 1 = HRK 5.568252
31 December 2009	EUR 1 = HRK 7.306199	USD 1 = HRK 5.089300

#### 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.

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 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.

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 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.

## **Notes to the financial statements (continued)**

for the year ended 31 December 2010

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### **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.



## **Notes to the financial statements (continued)**

for the year ended 31 December 2010

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### **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.

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

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 3. Summary of significant accounting policies (continued)

#### 3.12 Property and equipment and intangible assets (continued)

	2010	2009
	%	%
Property	2.5	2.5
Leasehold improvements	20	20
Electronic equipment	20	20
Other assets	20-25	20-25
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.

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.

## **Notes to the financial statements (continued)**

for the year ended 31 December 2010

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### **3. Summary of significant accounting policies (continued)**

#### **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.

#### **3.20. Comparatives**

In the financial statements for the year ended 31 December 2009, loan origination fees were disclosed as „Other liabilities“ whereas in this financial statements loan origination fees decrease „Loans and advances to customers“. Comparative amounts have been reclassified so that presented information for both years are comparable.

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**4. Net interest income****Interest income**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Loans and advances:		
- to customers	85,736	68,428
- to banks	1,522	4,284
Securities	651	6,425
	<b>87,909</b>	<b>79,137</b>

**Interest expense**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Customers deposits	50,884	42,458
Hybrid instruments	3,566	2,859
Other borrowed funds	1,908	965
	<b>56,358</b>	<b>46,282</b>

**5. Net fee and commission income****Fee and commission income**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Domestic and foreign currency transactions	4,063	3,826
Guarantees and letter of credits given	328	239
Other	1,996	943
	<b>6,387</b>	<b>5,008</b>

**Fee and commission expense**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Domestic and foreign currency transactions	552	552
Other	1,136	665
	<b>1,688</b>	<b>1,217</b>

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**6. Foreign exchange differences - net**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Net foreign exchange gains from operations	1,821	3,045
Net foreign exchange gains / (losses) on translation of foreign currency assets and liabilities to mid exchange rate	(3,764)	11,418
	<b>(1,943)</b>	<b>14,463</b>

**7. Other operating income**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Refunded costs from the Parent	38	2,239
Court costs refund	2,011	1,467
Income from payment of insurance	2,998	-
Other	736	614
	<b>5,783</b>	<b>4,320</b>

**8. Impairment (charge) / reversal for credit losses - net**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Loans and advances to customer (Note 16)	(58,488)	(15,755)
Collected credit losses written off in previous years	6,610	4,055
Held to maturity financial assets (Note 18)	313	(7,681)
Other assets (Note 21)	(870)	(502)
Provision for contingent liabilities and commitments (Note 25)	(145)	(376)
	<b>(52,580)</b>	<b>(20,259)</b>

**9. Administrative expenses**

	<b>2010</b>	<b>2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
<b>Staff costs</b>		
Net salaries	14,251	14,746
Pension contributions	4,469	4,556
Health security contributions	4,408	3,647
Other contributions and taxes on salaries	4,636	5,684
Other staff costs	1,364	1,572
	<b>29,128</b>	<b>30,205</b>
Other administrative expenses	19,681	15,353
Depreciation and amortisation (Note 19)	5,937	5,093
	<b>54,746</b>	<b>50,651</b>

As at 31 December 2010, the Bank had 150 employees (2009: 150 employees).

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**10. Other operating expenses**

	<b>2010</b>	<b>2009</b>
	<b>HRK'000</b>	<b>HRK'000</b>
Rental costs	5,646	3,626
Saving deposits insurance charge	2,177	2,107
Provisions for legal cases (Note 25)	1,422	(58)
Vacation accruals (Note 25)	1,152	-
Other	225	497
	<b>10,622</b>	<b>6,172</b>

**11. Income tax expense**

	<b>2010</b>	<b>2009</b>
	<b>HRK'000</b>	<b>HRK'000</b>
<b>Accounting loss before tax</b>	<b>(77,867)</b>	<b>(21,501)</b>
Effect of items increasing tax base	7,600	11,078
Effect of items decreasing tax base	(6,511)	(29,354)
<b>Tax loss for the period</b>	<b>(76,778)</b>	<b>(39,777)</b>
Tax losses brought forward	(74,940)	(35,163)
Tax losses carried forward	(151,718)	(74,940)
Unrecognized deferred tax assets (statutory tax rate 20%)	30,344	14,988

As at 31 December 2010, 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 151,718 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 2006 in the amount of HRK 10,803 thousand not later than (including) 2011
- 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

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.

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**12. Losses 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.

	<u>2010</u>	<u>2009</u>
Loss for the year (in HRK'000)	(77,867)	(21,501)
Weighted average number of shares excluding own shares	1,192,740	1,123,449
Basic loss per share – ordinary (in HRK)	<u><b>(65.29)</b></u>	<u><b>(19.14)</b></u>

On 14 September 2010 the Bank's share capital increased (Note 26) which resulted in issuing 306,402 ordinary shares each in nominal amount of HRK 100.

**Diluted**

Diluted loss per share for 2010 and 2009 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**

	<u>31.12.2010</u>	<u>31.12.2009</u>
	<u>HRK'000</u>	<u>HRK'000</u>
Cash in hand	14,063	11,828
Cash on the clearing account	25,702	34,896
Foreign currency account	126,176	35,242
	<u><b>165,941</b></u>	<u><b>81,966</b></u>

**14. Obligatory reserve with the Croatian National Bank**

	<u>31.12.2010</u>	<u>31.12.2009</u>
	<u>HRK'000</u>	<u>HRK'000</u>
Earmarked obligatory reserve		
- in HRK	83,751	78,785
- in foreign currency	17,090	15,942
	<u><b>100,841</b></u>	<u><b>94,727</b></u>

From 10 February 2010 the obligatory reserves in HRK and foreign currencies is accrued at a rate of 13% (2009: 14%), on deposits in HRK and foreign currency and on foreign currency loans.

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



## Notes to the financial statements (continued)

for the year ended 31 December 2010

### 15. Placements with banks

	31.12.2010 HRK`000	31.12.2009 HRK`000
Loans	13,015	25,000
Deposits	30,349	66,979
	<b>43,364</b>	<b>91,979</b>
Allowance for identified losses	-	(849)
	<b>43,364</b>	<b>91,130</b>

In the year 2010 an allowance for identified losses in the amount of HRK 849 thousand has been written-off.

### 16. Loans and advances to customers

	31.12.2010 HRK`000	31.12.2009 HRK`000
Retail customers	437,120	386,096
Corporate customers	550,552	469,575
<b>Gross loans and advances</b>	<b>987,672</b>	<b>855,671</b>
Less: Allowance for impairment	(107,200)	(44,814)
<b>Net loans and advances</b>	<b>880,472</b>	<b>810,857</b>
Current	242,057	305,365
Non – current	638,415	505,492

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

2010.	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
<b>As at 1 January</b>	<b>15,821</b>	<b>28,993</b>	<b>44,814</b>
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
Written off	(695)	(10)	(705)
Foreign exchange differences	-	44	44
<b>As at 31 December</b>	<b>18,876</b>	<b>88,324</b>	<b>107,200</b>
2009.	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
<b>As at 1 January</b>	<b>20,271</b>	<b>34,026</b>	<b>54,297</b>
Increase in provisions (Note 8)	16,440	20,361	36,801
Reversal (Note 8)	(15,731)	(5,315)	(21,046)
Written off	(4,901)	(20,046)	(24,947)
Foreign exchange differences	(258)	(33)	(291)
<b>As at 31 December</b>	<b>15,821</b>	<b>28,993</b>	<b>44,814</b>

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**17. Available for sale financial assets**

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Investment funds	17,829	2,400
Equity securities – listed	2,310	2,203
Equity securities – unlisted	141	141
	<b>20,280</b>	<b>4,744</b>

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

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
<b>As at 1 January</b>	<b>4,744</b>	<b>18,386</b>
Additions	16,517	22,240
Disposals	(1,500)	(36,413)
Unrealized gains	519	531
<b>As at 31 December</b>	<b>20,280</b>	<b>4,744</b>

**18. Held to maturity financial assets**

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Bills of exchange	12,447	8,922
Treasury bills of foreign countries (Note 27)	-	36,510
	<b>12,447</b>	<b>45,432</b>
Allowance for identified losses	(6,906)	(7,219)
	<b>5,541</b>	<b>38,213</b>

Movement in allowance for identified losses:

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
<b>As at 1 January</b>	<b>7,219</b>	<b>156</b>
Increase in provisions (Note 8)	388	7,681
Collection (Note 8)	(701)	-
Write off – expensed in current year	-	(462)
Write off – expensed in previous years	-	(156)
<b>As at 31 December</b>	<b>6,906</b>	<b>7,219</b>

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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
<b>Cost</b>								
<b>As at 1 January 2009</b>	<b>16,924</b>	<b>2,601</b>	<b>8,360</b>	<b>13,189</b>	<b>41,074</b>	<b>5,434</b>	<b>826</b>	<b>6,260</b>
Additions	8.762	9.841	1.347	4.419	24.369	288	510	798
Transfer	-	-	-	-	-	159	-	159
Disposals	-	-	(11)	(3,076)	(3,087)	-	(159)	(159)
<b>As at 31 December 2009</b>	<b>25,686</b>	<b>12,442</b>	<b>9,696</b>	<b>14,532</b>	<b>62,356</b>	<b>5,881</b>	<b>1,177</b>	<b>7,058</b>
Additions	-	4.097	605	477	5.179	702	197	899
Disposals	-	(259)	(471)	(933)	(1,663)	-	-	-
<b>As at 31 December 2010</b>	<b>25,686</b>	<b>16,280</b>	<b>9,830</b>	<b>14,076</b>	<b>65,872</b>	<b>6,583</b>	<b>1,374</b>	<b>7,957</b>
<b>Accumulated depreciation</b>								
<b>As at 1 January 2009</b>	<b>2,001</b>	<b>2,024</b>	<b>6,257</b>	<b>7,783</b>	<b>18,065</b>	<b>4,253</b>	<b>-</b>	<b>4,253</b>
Charge for the year	426	1.247	949	2.015	4.637	456	-	456
Disposals	(14)	-	-	(781)	(795)	-	-	-
<b>As at 31 December 2009</b>	<b>2,413</b>	<b>3,271</b>	<b>7,206</b>	<b>9,017</b>	<b>21,907</b>	<b>4,709</b>	<b>-</b>	<b>4,709</b>
Charge for the year	473	2.306	911	1,729	5,419	518	-	518
Disposals	-	(137)	(471)	(821)	(1,429)	-	-	-
<b>As at 31 December 2010</b>	<b>2,886</b>	<b>5,440</b>	<b>7,646</b>	<b>9,925</b>	<b>25,897</b>	<b>5,227</b>	<b>-</b>	<b>5,227</b>
<b>Net book value</b>								
<b>As at 31 December 2009</b>	<b>23,273</b>	<b>9,171</b>	<b>2,490</b>	<b>5,515</b>	<b>40,449</b>	<b>1,172</b>	<b>1,177</b>	<b>2,349</b>
<b>As at 31 December 2010</b>	<b>22,800</b>	<b>10,840</b>	<b>2,184</b>	<b>4,151</b>	<b>39,975</b>	<b>1,356</b>	<b>1,374</b>	<b>2,730</b>

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**19. Plant and equipment and intangible assets (continued)**

During 2010 the Bank capitalised employee costs in the amount of HRK 2,653 thousand that relate to the introduction of the new banking application.

**20. Repossessed assets**

Movements in repossessed assets during the year:

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK' 000</b>	<b>HRK' 000</b>
<b>As at 1 January</b>	<b>11,717</b>	<b>1,908</b>
Increase	1,262	10,438
Decrease	(714)	(629)
Written off	(4)	-
<b>As at 31 December</b>	<b>12,261</b>	<b>11,717</b>

**21. Other assets**

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK' 000</b>	<b>HRK' 000</b>
Pre-payments of pensions to customers	6,550	6,743
Receivables for insurance	2,972	-
Lease pre-payments	2,587	2,701
Receivables for refunds from the Parent	-	2,205
Receivables for court costs refunds	1,899	1,038
Other pre-payments	792	1,360
Prepaid expenses	234	435
Other	978	568
	<b>16,012</b>	<b>15,050</b>
Allowance for identified losses	(1,788)	(978)
	<b>14,224</b>	<b>14,072</b>

Movement in allowance for identified losses:

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK' 000</b>	<b>HRK' 000</b>
<b>As at 1 January</b>	<b>978</b>	<b>1,480</b>
Increase in provisions (Note 8)	962	825
Collection (Note 8)	(92)	(323)
Write off	(60)	(1,004)
<b>As at 31 December</b>	<b>1,788</b>	<b>978</b>

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**22. Deposits from customers**

Deposits comprise demand deposits and time deposits:

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
<b>Demand deposits</b>		
Corporate customers	9,631	17,532
Retail customers	43,002	38,208
	<b>52,633</b>	<b>55,740</b>
<b>Time deposits</b>		
Corporate customers	113,283	149,538
Retail customers	829,476	604,069
	<b>942,759</b>	<b>753,607</b>
	<b>995,392</b>	<b>809,347</b>
Current	786,325	566,027
Non – current	209,067	243,320

**23. Due to banks**

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Borrowings:		
- Croatian Bank for Reconstruction and Development	59,128	34,929
- other	6,000	18,000
Deposits	74,449	113,688
	<b>139,577</b>	<b>166,617</b>
Current	98,629	134,189
Non-current	40,948	32,428

As at 31 December 2010 and 31 December 2009, all deposits from banks are current.

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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.

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK'000</b>	<b>HRK'000</b>
Legal entities	68,781	79,574
Citizens	13,771	22,419
	<b>82,552</b>	<b>101,993</b>

**25. Other liabilities**

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK'000</b>	<b>HRK'000</b>
Provisions for legal cases	2,981	3,067
Vacation accruals (Note 10)	1,152	-
Provisions for contingent liabilities and commitments	686	541
Employee payables – salaries and contributions	2,692	2,505
Payables in the course of settlement	1,832	2,280
Liabilities to suppliers	2,439	1,169
Liabilities for savings deposits insurance charge	611	445
Other	2,069	1,870
	<b>14,462</b>	<b>11,877</b>

Movement in provisions for legal cases:

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK'000</b>	<b>HRK'000</b>
<b>As at 1 January</b>	<b>3,067</b>	<b>3,125</b>
Increase in provision (Note 10)	1,423	544
Reversal (Note 10)	(1)	(602)
Payments made per court verdicts	(1,508)	-
<b>As at 31 December</b>	<b>2,981</b>	<b>3,067</b>

Movement in provisions for contingences liabilities and commitments:

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK'000</b>	<b>HRK'000</b>
<b>As at 1 January</b>	<b>541</b>	<b>165</b>
Increase in provision (Note 8)	145	376
<b>As at 31 December</b>	<b>686</b>	<b>541</b>

## Notes to the financial statements (continued)

for the year ended 31 December 2010

### 26. 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.

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

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

Shareholder	31.12.2010		31.12.2009	
	Number of shares	% in share capital	Number of shares	% in share capital
Cassa di Risparmio della Repubblica di San Marino	1,418,661	99.23	1,112,619	99.02
Treasury shares	153	0.01	153	0.01
Other	10,830	0.76	10,830	0.97
<b>Total</b>	<b>1,429,644</b>	<b>100.00</b>	<b>1,123,602</b>	<b>100.00</b>

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

### 27. 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	31.12.2010 HRK`000	31.12.2009 HRK`000
Cash in hand and balances with banks	13	165,941	81,966
Placements with banks	15	43,364	91,130
Treasury bills	18	-	36,510
		<b>209,305</b>	<b>209,606</b>

## Notes to the financial statements (continued)

for the year ended 31 December 2010

### 28. Contingent liabilities and commitments

**Legal Proceedings.** The Bank is currently subject to several legal proceedings. As at 31 December 2010 provisions for legal proceeding for which the Bank anticipates outflow of economic benefits amounts to HRK 2,981 thousand (2009: HRK 3,067 thousand).

**Capital commitments.** As at 31 December 2010 and 31 December 2009, 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:

	31.12.2010 HRK`000	31.12.2009 HRK`000
Guarantees	17,703	7,782
Letters of credit	6,479	4,568
Loan commitments and other	34,209	34,609
Less: Provision for contingent liabilities and commitments (Note 25)	(686)	(541)
<b>Total</b>	<b>57,705</b>	<b>46,418</b>

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.



**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**28. Contingent liabilities and commitments (continued)****Operating lease commitments where the Bank is the lessee**

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

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Up to 1 year	2,819	3,411
From 2 to 5 years	10,566	12,353
Over 5 years	5,409	10,062
<b>Total</b>	<b>18,794</b>	<b>25,826</b>

**29. 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.

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**29. Related party transactions (continued)**

In the year 2010 and 2009, transactions with related parties were as follows:

	<b>Supervisory board, Management board and their related parties</b>		<b>Cassa di Risparmio della Repubblica si San Marino</b>	
	<b>31.12.2010</b>	<b>31.12.2009</b>	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>
<b>Loans</b>				
As at 1 January	1,097	420	-	1,080
Increase	683	1,236	-	-
Decrease	(25)	(559)	-	(1,080)
<b>As at 31 December</b>	<b>1,755</b>	<b>1,097</b>	<b>-</b>	<b>-</b>
<b>Given deposits and cash</b>				
As at 1 January	-	-	12,202	-
Increase	-	-	34,935	12,202
Decrease	-	-	(32,048)	-
<b>As at 31 December</b>	<b>-</b>	<b>-</b>	<b>15,089</b>	<b>12,202</b>
Interest income	417	155	304	-
Other income	-	-	-	2,239
<b>Other asset</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,205</b>
<b>Received deposits</b>				
As at 1 January	3,917	4,387	89,758	11,700
Increase	5,417	2,744	-	89,758
Decrease	(5,851)	(3,214)	(34,794)	(11,700)
<b>As at 31 December</b>	<b>3,483</b>	<b>3,917</b>	<b>54,964</b>	<b>89,758</b>
<b>Hybrid instruments</b>				
As at 1 January	500	500	75,838	-
Increase	-	-	981	79,838
Decrease	-	-	(10,191)	-
<b>As at 31 December</b>	<b>500</b>	<b>500</b>	<b>66,628</b>	<b>79,838</b>
Interest expense	37	8	3,052	4,090

Related party transactions include movement arising from exchange rate differences.

**Key management and Supervisory Board compensation**

	<b>31.12.2010</b>	<b>31.12.2009</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Gross salaries and other short-term benefits	4,152	3,866

### **30. 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.

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 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.

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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**

	<b>2010</b>		<b>2009</b>	
	<b>Loans and advances</b>	<b>Allowance for impairment</b>	<b>Loans and advances</b>	<b>Allowance for impairment</b>
	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>
1. Fully recoverable placements	727,437	10,459	771,937	10,899
2. Partially recoverable placements	232,972	69,478	67,261	17,442
3. Unrecoverable placements	27,263	27,263	16,473	16,473
	<b>987,672</b>	<b>107,200</b>	<b>855,671</b>	<b>44,814</b>

**Bank's rating**

	<b>2010</b>		<b>2009</b>	
	<b>Loans and advances</b>	<b>Allowance for impairment</b>	<b>Loans and advances</b>	<b>Allowance for impairment</b>
	<b>(%)</b>	<b>(%)</b>	<b>(%)</b>	<b>(%)</b>
1. Fully recoverable placements	73.65	9.76	90.21	24.32
2. Partially recoverable placements	23.59	64.81	7.86	38.92
3. Unrecoverable placements	2.76	25.43	1.93	36.76
	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

## Notes to the financial statements (continued)

for the year ended 31 December 2010

### 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

	31.12.2010 HRK'000	31.12.2009 HRK'000
<b>Credit risk exposures relating to on-balance sheet assets are as follows:</b>		
Cash in hand and balances with banks	165,941	81,966
Obligatory reserve with the Croatian National Bank	100,841	94,727
Placements with banks	43,364	91,130
Loans and advances to customers	808,472	810,857
Available for sale financial assets	20,280	4,744
Held to maturity financial assets	5,541	38,213
Other assets	14,224	14,072
	<b>1,158,663</b>	<b>1,135,709</b>
<b>Credit risk exposures relating to off-balance sheet items are as follows:</b>		
Financial guarantees	17,703	7,782
Letters of credit	6,479	4,568
Loan commitments and other	34,209	34,609
	<b>1,217,054</b>	<b>1,182,668</b>

The above table represents the maximum exposure of the Bank to credit risk at 31 December 2010 and 2009, 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, 69.99% of the total maximum exposure is derived from loans and advances to banks and customers (2009: 76.27%).

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**31.1.5. Loans and advances**

Loans and advances are summarised as follows:

	<b>31.12.2010</b>		<b>31.12.2009</b>	
	<b>Loans and advances to customers HRK'000</b>	<b>Loans and advances to banks HRK'000</b>	<b>Loans and advances to customers HRK'000</b>	<b>Loans and advances to banks HRK'000</b>
Neither past due nor impaired	683,033	43,364	735,522	91,130
Past due but not impaired	44,404	-	36,415	-
Individually impaired	260,235	-	83,734	849
<b>Gross</b>	<b>987,672</b>	<b>43,364</b>	<b>855,671</b>	<b>91,979</b>
Less: allowance for impairment	(107,200)	-	(44,814)	(849)
<b>Net</b>	<b>880,472</b>	<b>43,364</b>	<b>810,857</b>	<b>91,130</b>

The total impairment provision for loans and advances is HRK 107,200 thousand (2009: HRK 45,663 thousand) of which HRK 96,398 thousand (2009: HRK 34,764 thousand) represents the individually impaired loans and the remaining amount of HRK 10,802 thousand (2009: HRK 10,899 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 2010, the Bank's total loans and advances to customers increased by 9% as a result of the expansion of the lending business.



**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**31.1.5. Loans and advances (continued)**

The breakdown of the gross amount of loans and advances by class, along with the fair value of related collateral held by the Bank as security, are as follows:

	<b>Retail customers</b>	<b>Corporate customers</b>	<b>Total loans and advances to customers</b>	<b>Loans and advances to banks</b>
	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>
<b>As at 31 December 2010</b>				
Neither past due nor impaired				
Fully recoverable placements	387,635	295,398	<b>683,033</b>	43,364
Past due but not impaired				
Due less than 30 days	5,012	24,650	<b>29,662</b>	-
Due 30 – 90 days	191	14,551	<b>14,742</b>	-
Individually impaired				
Individually impaired loans	44,159	216,076	<b>260,235</b>	-
<b>Total</b>	<b>436,997</b>	<b>550,675</b>	<b>987,672</b>	<b>43,364</b>
<b>Fair value of collateral</b>	<b>175,219</b>	<b>539,663</b>	<b>714,882</b>	-

	<b>Retail customers</b>	<b>Corporate customers</b>	<b>Total loans and advances to customers</b>	<b>Loans and advances to banks</b>
	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>
<b>As at 31 December 2010</b>				
Neither past due nor impaired				
Fully recoverable placements	353,303	382,219	<b>735,522</b>	91,130
Past due but not impaired				
Due less than 30 days	1,701	4,642	<b>6,343</b>	-
Due 30 – 90 days	3,726	26,346	<b>30,072</b>	-
Individually impaired				
Individually impaired loans	27,089	56,645	<b>83,734</b>	849
<b>Total</b>	<b>385,819</b>	<b>469,852</b>	<b>855,671</b>	<b>91,979</b>
<b>Fair value of collateral</b>	<b>203,994</b>	<b>574,320</b>	<b>778,314</b>	-

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

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**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.

The total gross amount of individually impaired loans and advances to banks as at 31 December 2010 was HRK 0 thousand (2009: HRK 849 thousand). No collateral is held by the Bank, and a full impairment provision has been made against the gross amount.

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 2010 or 2009.

**31.1.6. Repossessed assets**

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

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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 2010. For this table, the Bank has allocated exposures to regions based on the country of domicile of its counterparties.

	<b>Croatia</b>	<b>European Union</b>	<b>Other countries</b>	<b>Total</b>
	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>
Cash in hand and balances with banks	40,323	123,179	2,439	165,941
Obligatory reserve with the CNB	100,841	-	-	100,841
Placements with banks	13,824	14,770	14,770	43,364
Loans and advances to customers	880,472	-	-	880,472
Available for sale financial assets	20,280	-	-	20,280
Held to maturity financial assets	5,541	-	-	5,541
Other assets	14,199	25	-	14,224
<b>As at 31 December 2010</b>	<b>1,075,480</b>	<b>137,974</b>	<b>17,209</b>	<b>1,230,663</b>
<b>As at 31 December 2009</b>	<b>999,495</b>	<b>121,806</b>	<b>14,408</b>	<b>1,135,709</b>

*(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,

	<b>Financial institutions</b>	<b>Manufacturing</b>	<b>Real estate</b>	<b>Wholesale and retail trade</b>	<b>Public sector</b>	<b>Other industries</b>	<b>Individuals</b>	<b>Total</b>
	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>	<b>HRK'000</b>
Placements with banks	43,364	-	-	-	-	-	-	43,364
Loans and advances to customers	2,275	120,198	90,729	126,201	781	122,044	418,244	880,472
Available for sale financial assets	18,114	1,263	401	91	-	411	-	20,280
Held to maturity financial assets	-	478	628	-	-	2,274	2,161	5,541
Other assets	-	14	13	87	98	13,904	108	14,224
<b>As at 31 December 2010</b>	<b>63,753</b>	<b>121,953</b>	<b>91,771</b>	<b>126,379</b>	<b>879</b>	<b>138,633</b>	<b>420,513</b>	<b>963,881</b>
<b>As at 31 December 2009</b>	<b>91,830</b>	<b>109,585</b>	<b>71,856</b>	<b>154,308</b>	<b>599</b>	<b>145,130</b>	<b>385,708</b>	<b>959,016</b>

## Notes to the financial statements (continued)

for the year ended 31 December 2010

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### 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.

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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
<b>As at 31 December 2010</b>					
<b>Assets</b>					
Cash and balances with banks	34,153	128,628	2,587	573	165,941
Obligatory reserve with the CNB	83,751	12,791	4,299	-	100,841
Placement with banks	13,016	30,348	-	-	43,364
Loans and advances to customers	135,088	728,593	9,919	6,872	880,472
Available for sale financial assets	18,190	2,090	-	-	20,280
Held to maturity financial assets	5,541	-	-	-	5,541
Other assets	14,199	25	-	-	14,224
<b>Total financial assets</b>	<b>303,938</b>	<b>902,475</b>	<b>16,805</b>	<b>7,445</b>	<b>1,230,663</b>
<b>Liabilities</b>					
Deposits from customers	279,787	694,099	17,193	4,313	995,392
Due to banks	25,978	113,599	-	-	139,577
Hybrid instruments	6,503	76,049	-	-	82,552
Other liabilities	14,452	10	-	-	14,462
<b>Total financial liabilities</b>	<b>326,720</b>	<b>883,757</b>	<b>17,193</b>	<b>4,313</b>	<b>1,231,983</b>
<b>Net on-balance sheet financial position</b>	<b>(22,782)</b>	<b>18,718</b>	<b>(388)</b>	<b>3,132</b>	<b>(1,320)</b>
Loan commitments	31,807	2,402	-	-	34,209
<b>As at 31 December 2009</b>					
Total financial assets	314,166	799,348	14,720	7,475	1,135,709
Total financial liabilities	295,741	775,792	14,903	3,398	1,089,834
<b>Net on-balance sheet financial position</b>	<b>18,425</b>	<b>23,556</b>	<b>(183)</b>	<b>4,077</b>	<b>45,875</b>
Loan commitments	17,411	17,198	-	-	34,609

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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
<b>As at 31 December 2010</b>							
<b>Assets</b>							
Cash and balances with banks	165,941	-	-	-	-	-	165,941
Obligatory reserve with CNB	51	36,737	36,938	12,471	14,644	-	100,841
Placements with banks	37,562	5,802	-	-	-	-	43,364
Loans and advances to customers	160,757	66,164	155,566	197,172	300,813	-	880,472
Available for sale financial assets	-	-	-	-	-	20,280	20,280
Held to maturity financial assets	2,315	1,342	1,884	-	-	-	5,541
Other assets	-	-	-	-	-	14,224	14,224
<b>Total financial assets</b>	<b>366,626</b>	<b>110,045</b>	<b>194,388</b>	<b>209,643</b>	<b>315,457</b>	<b>34,504</b>	<b>1,230,663</b>
<b>Liabilities</b>							
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	-	-	-	-	-	14,462	14,462
<b>Total financial liabilities</b>	<b>247,632</b>	<b>210,250</b>	<b>514,617</b>	<b>91,980</b>	<b>153,042</b>	<b>14,462</b>	<b>1,231,983</b>
<b>Net on-balance sheet financial position</b>	<b>118,994</b>	<b>(100,205)</b>	<b>(320,229)</b>	<b>117,663</b>	<b>162,415</b>	<b>20,042</b>	<b>(1,320)</b>
<b>As at 31 December 2009</b>							
Total financial assets	241,803	144,678	254,681	230,397	245,334	18,816	1,135,709
Total financial liabilities	271,274	185,186	346,932	128,492	135,041	22,909	1,089,834
<b>Net on-balance sheet financial position</b>	<b>(29,471)</b>	<b>(40,508)</b>	<b>(92,251)</b>	<b>101,905</b>	<b>110,293</b>	<b>(4,093)</b>	<b>45,875</b>

## Notes to the financial statements (continued)

for the year ended 31 December 2010

### 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 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
<b>Total liabilities</b> (contractual maturity dates)	<b>258,903</b>	<b>210,460</b>	<b>517,598</b>	<b>91,980</b>	<b>153,042</b>	<b>1,231,983</b>
<b>Total liabilities on unused loans</b> (expected maturity dates)	<b>1,607</b>	<b>3,692</b>	<b>22,276</b>	<b>5,043</b>	<b>1,591</b>	<b>34,209</b>

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**32.3.2. Non-derivative cash flows (continued)**

<b>As at 31 December 2009</b>	<b>Up to 1 month</b>	<b>1- 3 months</b>	<b>3-12 months</b>	<b>1-3 years</b>	<b>Over 3 years</b>	<b>Total</b>
	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>
Deposits from customers	147,742	167,097	339,168	105,985	49,355	809,347
Due to banks	134,189	17,955	-	-	14,473	166,617
Hybrid instruments	375	134	7,764	22,507	71,213	101,993
Other liabilities	9,668	1,145	1,064	-	-	11,877
<b>Total liabilities (contractual maturity)</b>	<b>291,974</b>	<b>186,331</b>	<b>347,996</b>	<b>128,492</b>	<b>135,041</b>	<b>1,089,834</b>
<b>Total liabilities on unused loans (expected maturity)</b>	<b>5,739</b>	<b>-</b>	<b>20,710</b>	<b>7,955</b>	<b>205</b>	<b>34,609</b>

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 28), are summarised in the table below.

**(b) Other financial instruments**

Other financial instruments (Note 28), are also included below based on the earliest contractual maturity date.

	<b>No later than 1 HRK`000</b>	<b>1-3 years HRK`000</b>	<b>Over 3 HRK`000</b>	<b>Total HRK`000</b>
<b>As at 31 December 2010</b>				
Loan commitments	27,575	5,043	1,591	34,209
Guarantees, letters of credit and other	22,571	1,611	-	24,182
<b>Total</b>	<b>50,146</b>	<b>6,654</b>	<b>1,591</b>	<b>58,391</b>
<b>As at 31 December 2009</b>				
Loan commitments	17,916	16,693	-	34,609
Guarantees, letters of credit and other	8,119	4,231	-	12,350
<b>Total</b>	<b>26,035</b>	<b>20,924</b>	<b>-</b>	<b>46,959</b>



## Notes to the financial statements (continued)

for the year ended 31 December 2010

### 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

	31.12.2010			31.12.2009		
	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000
Bill of exchange	-	12,447	12,447	-	8,922	8,922
Treasury bills	-	-	-	36,510	-	36,510
Investments funds	17,829	-	17,829	2,400	-	2,400
Equity securities	2,310	141	2,451	2,203	141	2,344
	<b>20,139</b>	<b>12,588</b>	<b>32,727</b>	<b>41,113</b>	<b>9,063</b>	<b>50,176</b>

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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	
	2010	2009	2010	2009
	HRK`000	HRK`000	HRK`000	HRK`000
<b>Financial assets</b>				
Placements with banks	43,364	91,130	43,364	91,130
Loans and advances to customers	880,472	810,857	880,472	810,857
Held to maturity financial assets	5,541	38,213	5,541	38,213
Other assets	14,224	14,072	14,224	14,072
<b>Total financial assets</b>	<b>943,601</b>	<b>954,272</b>	<b>943,601</b>	<b>954,272</b>
<b>Financial liabilities</b>				
Deposits from customers	995,392	809,347	995,392	809,347
Due to banks	139,577	166,617	139,577	166,617
Hybrid instruments	82,552	101,993	82,552	101,993
Other liabilities	14,462	11,877	14,462	11,877
<b>Total financial liabilities</b>	<b>1,231,983</b>	<b>1,089,834</b>	<b>1,231,983</b>	<b>1,089,834</b>

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 2010 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%.

**Notes to the financial statements (continued)**

for the year ended 31 December 2010

**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.

	<b>2010</b>	<b>2009</b>
	<b>HRK'000</b>	<b>HRK'000</b>
<b>Tier 1 capital</b>		
Share capital (less treasury shares)	218,608	188,042
Reserves from profit after taxation	1,489	1,013
Share premium	772	772
Reserves for treasury shares	476	476
Less: Accumulated loss and other deductions	(168,409)	(89,913)
<b>Total qualifying Tier 1 capital</b>	<b>52,936</b>	<b>100,390</b>
<b>Tier 2 capital</b>		
Collective impairment allowance	-	11,440
Hybrid instruments	52,936	89,301
<b>Total qualifying Tier 2 capital</b>	<b>52,936</b>	<b>100,741</b>
Less:	-	11,440
<b>Total regulatory capital</b>	<b>105,872</b>	<b>189,690</b>
<b>Risk-weighted assets:</b>		
Credit risk exposure	1,088,717	1,207,179
Operating risk exposure	64,531	-
Currency risk exposure	29,753	22,501
<b>Total risk-weighted assets</b>	<b>1,183,001</b>	<b>1,229,680</b>
<b>Basel ratio</b>	<b>8.95</b>	<b>15.43</b>

Due to changes in legislation that has been in force since 31 March 2010 there was a change in methodology for calculating capital adequacy ratios. The above data for year 2010 are presented in accordance with the new methodology, while the data given for year 2009 are presented in accordance with the old methodology of calculating capital adequacy ratios.

### Approval of financial statements

for the year ended 31 December 2010

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#### 33. Post balance sheet events

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 president of the Management Board on conditional terms. The Supervisory Board filed a request to the CNB to issue an approval for Mr. Gian Luigi Bonfe to be named president of the Management Board. Until the date of the independent auditor's report, the Bank has not received a resolution of the CNB.

#### 34. Approval of financial statements

Financial statements set out on pages 4 to 56 were approved by the Management Board on 20 April 2011.

Gian Luigi Bonfe

Member of the Management Board

Darko Kosovec

Member of the Management Board

