VABA d.d. banka Varaždin

Annual report for the year
ended 31 December 2010

This version of the report is a translation from the original, which was prepared in the Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Contents

Introduction

The annual report comprises a summary of operation and key financial indicators, a description of operation and the audited financial statements including Independent auditor's report for the year ended 31 December 2010.

Legal status

The Annual Report includes the Bank's financial statements prepared in accordance with accounting regulations applicable to banks in the Republic of Croatia and audited in accordance with International Standards on Auditing.

The Annual report was prepared by the Management of the Bank in compliance with the Accounting Law and the Companies Act, which prescribe reporting to shareholders at the General Assembly meeting.

Abbreviations

In the Annual Report of Vaba d.d. banka Varaždin is referred to as the "Bank" or "Vaba", Croatian National Bank is referred to as the "CNB", the Republic of Croatia as the "Government" and the Croatian Bank for Reconstruction and Development, is referred to as "CBRD".

Exchange Rate

The following CNB exchange rates were used for translation of foreign currencies into Croatian kuna:

31 December 2010	1 EUR = HRK 7.385	1 USD = HRK 5.568
31 December 2009	1 EUR = HRK 7.306	1 USD = HRK 5.089

Summary of operation and key financial indicators

	Restated 2009 (HRK '000)	2010 (HRK '000)
Net interest income	41,903	47,927
Net fee and commission income	5,003	4,188
Operating income	60,994	62,602
Profit before impairment losses	7,786	9,622
Profit/(loss) for the year	3,791	(3,042)
Total assets	1,208,201	1,427,014
Loans and advances to customers	818,217	885,163
Deposits from customers	934,076	1,080,476
Total equity	151,007	146,896
Regulatory capital (as reported to the CNB)	144,579	146,504

Report of the President of the Supervisory Board

Dear Sirs,

In accordance with its development strategy, Vaba d.d. banka Varaždin has used the elapsed year for further increase in volume of its operations and increase in efficiency despite negative economic environment.

Confirmation of the chosen strategy, adopted by the Management Board and the Supervisory Board, and its successful implementation is best reflected through the increase of the profits before impairment losses and taxes by 23.6%.

We are extremely proud of the Bank's contribution to the development of the region it operates in through development projects of the local communities. In that respect, the Bank took part in projects with the Varaždin County (Local development projects – micro lending for 2007, 2008 and 2009, Local projects for development of small enterprises for 2009, Programme for stimulation of small enterprises of Varaždin County), with the City of Varaždin (Lending to small enterprises and entrepreneurs in the City of Varaždin), with the City of Ivanec (Micro lending to small enterprises and entrepreneurs in the City of Ivanec, lending for investments in the business zone, lending to small enterprises and entrepreneurs in the City of Ivanec), with the City of Ludbreg ("Entrepreneur 3" programme) and the City of Lepoglava ("Entrepreneur").

Improvement in the business processes was certainly helped by further intensive work on IT system, which is mostly done despite many challenges put in front of us by the changes in the regulatory environment.

On behalf of the Supervisory Board of Vaba d.d. banka Varaždin, I would like to express my satisfaction with the successful results of the Bank over the past year, which demonstrated how to successfully examine and capture the needs of the Croatian economy.

I thank all members of the Supervisory Board and Management Board for their cooperation and I believe that Vaba d.d. banka Varaždin will continue with achieving favourable results in the future as it has in the past.

Vladimir Košćec

President of the Supervisory Board

Vaba d.d. banka Varaždin

Report of the President of the Management Board

Dear Sirs,

It is my pleasure to present the results of Vaba d.d. banka Varaždin for 2010.

Despite the negative economic trends, which started in 2008, have marked the past year, the Bank has operated stabile, with increase in the volume of business and the contribution to development of the region's economy.

Total assets increased to HRK 1,427.0 million with increase in lending activity (increase in loans given by 8.2%). Also, we are pleased with the increase in retail term deposits by 24.8% (HRK 151.1 million) despite big competition in the market, clearly showing the trust and satisfaction of the customers.

With interest income at the previous year's levels and the decrease of the interest expense, net interest income increased by 14.4% and are main generator of the increase in total revenue (by 2.6%). Operating expenses were kept in line with the previous year as a result of continuous efforts for improvement of business processes and efficiency. In accordance with previously stated, profit before impairment losses increased by 23.6%, amounting to HRK 9.6 million. Considering further deterioration in macroeconomic conditions, impairment losses for the loan portfolio increased from 6.1 million in 2009 to 13.1 million in 2010, resulting in net loss for the year in the amount of HRK 3.0 million.

We are especially happy with the European Investment Fund (EIF) recognition of the Bank as its partner in the project of financing of micro entrepreneurs. At the year's end a contract between EIF and the Bank for long term credit line for financing of micro entrepreneurs in the amount of EUR 5 million was signed. Besides EIF funds, the Bank will supply additional EUR 5 million if its own funds for the project.

The programme is a continuation of numerous projects for development of the region's economy the Bank undertook so far. Particularly, the Bank was already involved in development projects with the Varaždin County, City of Varaždin, City of Ivanec, City of Ludbreg and City of Lepoglava, also establishing extremely successful cooperation with the Guarantee agency of the Varaždin County and the Development agency "Sjever-Dan" and using subsidised credit lines from the Croatian Bank for Reconstruction and Development for the development of small and medium enterprises.

We would like to take the opportunity to thank all the employees of Vaba d.d. banka Varaždin on their hard work and dedication in achieving good business results and the Supervisory Board for their support which we will, surely, justify in the years before us.

Igor Čičak

President of the Management Board

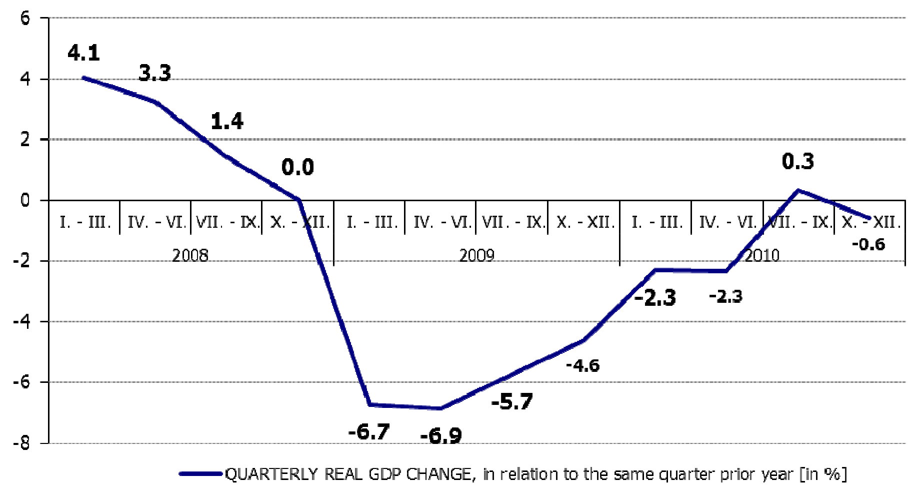
Vaba d.d. banka Varaždin

Macroeconomic developments in the Republic of Croatia for the year ended 31 December 2010

After slowing down of gross domestic product (GDP) growth in 2008 and negative growth in 2009, negative trends prevailed in 2010 as well, with minimal GDP growth in the third quarter after six consecutive negative quarters.

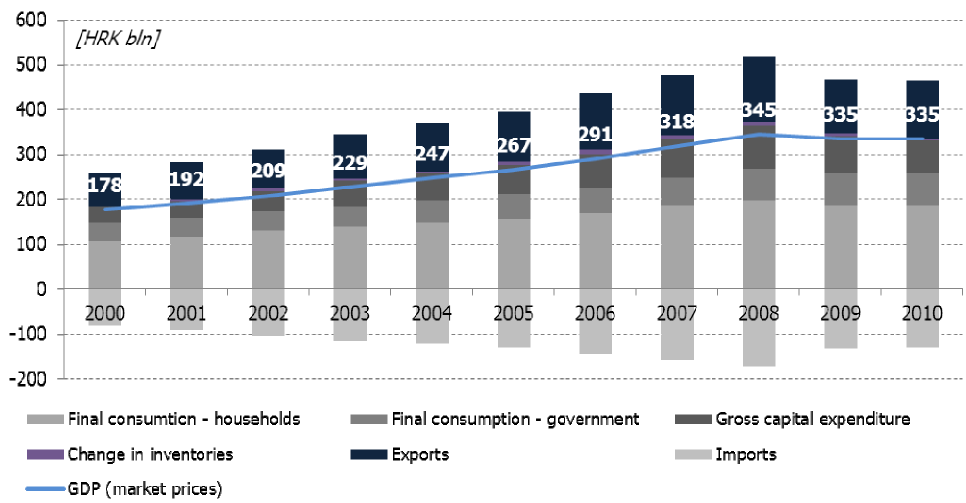
According to the estimate by the Central Bureau of Statistics (CBS), real GDP growth in 2010 was negative 1.2% compared to 2009 (-5.8%), which is the second annual decrease in real GDP since 1999 (-1.5%).

Rate of change in GDP



Source: Central Bureau of Statistics

Movements in real GDP

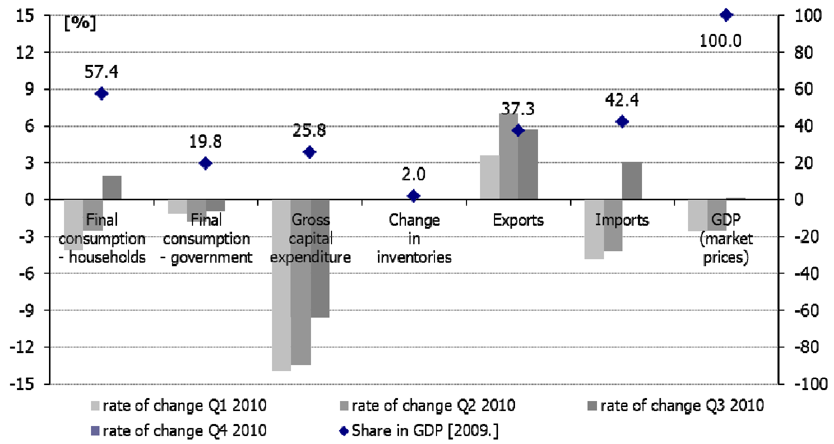


Source: Central Bureau of Statistics

Modest increase in GDP growth in the third quarter was mainly influenced by an increase in household consumption (the most significant GDP component with 55.6% share) amidst positive influence of seasonal employment increase, reasonably good tourist season (although annual increase in revenue was not in line with increase in physical indicators) and the abolishment of special tax on salaries, pensions and other income. Strong negative trends are still visible in decrease in investments.

After significant decrease in household consumption in 2009 (decrease by HRK 12.3 billion on yearly basis), in 2010 it was held almost to 2009 levels (decrease by HRK 0.4 billion). Gross capital expenditure continue to decrease significantly on yearly basis (HRK 12.2 billion in 2009 with additional HRK 11.0 billion in 2010), while exports were increased in 2010 by HRK 9.5 billion, after declining by HRK 25.0 billion in 2009. In accordance with stoppage of the household consumption decline, decline in exports was also stopped (decrease by HRK 40.4 billion in 2009, HRK 2.0 billion in 2010).

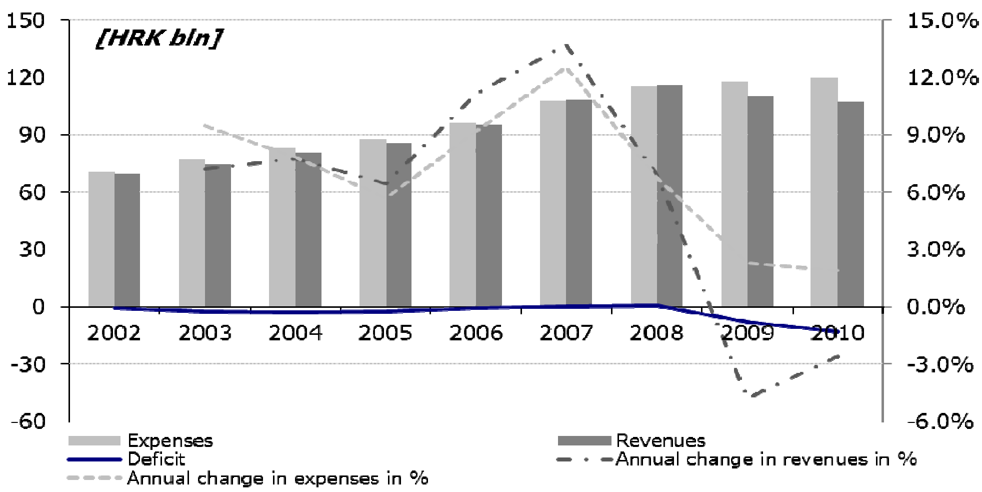
The structure of GDP and the rate of change of its components



Source: Central Bureau of Statistics

Contraction of the economy resulted in reduced budgetary revenue, which, along with the real growth of public consumption generated an increase in the budget deficit in the amount of HRK 12.8 billion in 2010 (preliminary data from the Ministry of Finance), which is 3.8% of GDP (per CBS estimate of GDP for 2010).

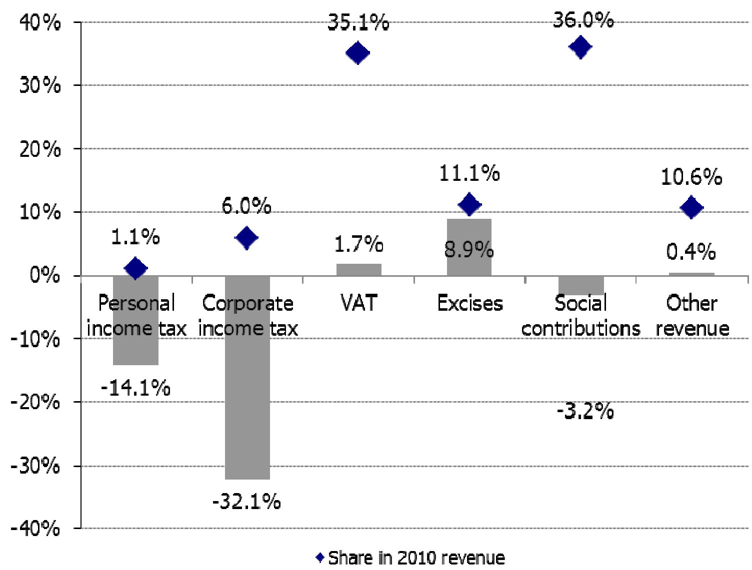
Movement in budget revenue and expenses from 2002 to 2010



Source: Ministry of Finance

Biggest influence on the budget revenue decrease was due to decrease in corporate income tax (decrease by HRK 3.0 billion), while value-added tax (VAT) revenue increased by HRK 0.6 billion mainly as a result of the increase in basic VAT rate from 22% to 23% in August 2009.

Structure and changes in budget revenue for 2010

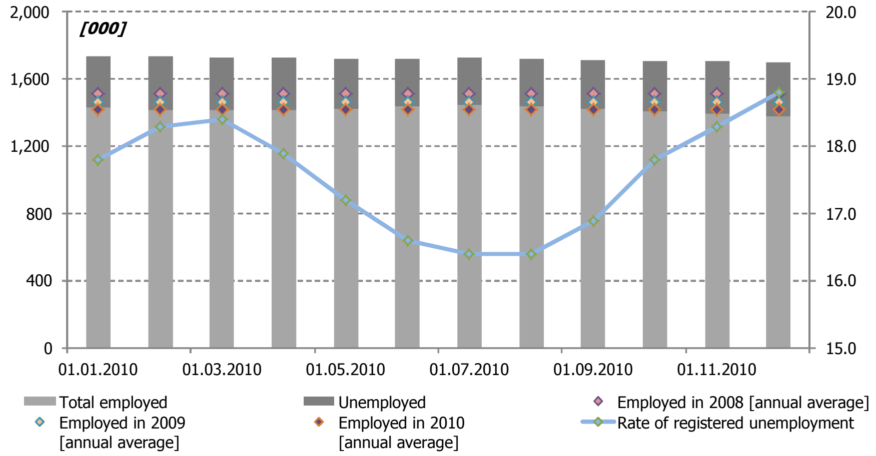


Source: Ministry of Finance

The Government tried to stop negative trends by abolishing special tax on salaries, pensions and other income (2% or 4% on net income, depending on the amount of monthly income, introduced in August 2009) before the legal deadline (the lower rate abolished in July, the higher in November 2010, while the legal deadline was set for the end of 2010) and by the changes in the personal income tax structure (in July 2010 changes were made to tax classes and rates, but also tax reliefs were abolished). However, due to negative movements in the labour market and uncertainty, decrease in household consumption wasn't stopped until 2010 Q3, after 7 consecutive quarterly decreases.

At the annual level the average number of employees is still falling, with the number of unemployed persons reaching 319.8 thousand at the end of 2010 and the registered unemployment increasing from 17.8% (January 2010) to 18.8% (December 2010) with a decrease to 16.4% (July 2010) amidst seasonal demand for workers during the tourist season.

Movements in the number of employees, unemployed and the rate of registered unemployment



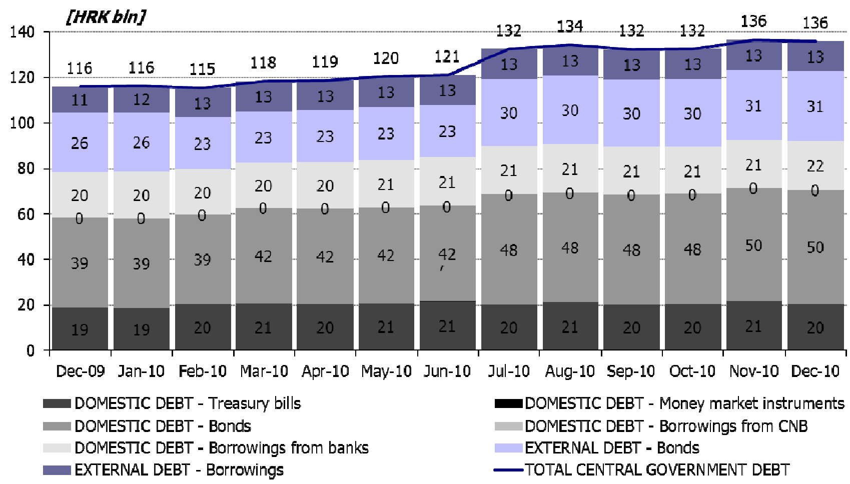
Source: Central Bureau of Statistics

Worsening of Croatia's fiscal position and its significant dependence on foreign financing resulted in lowering of its Standard & Poor's rating to BBB- (bottom line above speculative rating) with negative outlook (possibility of further rating lowering). Standard & Poor's also notes that Croatia's competitiveness is burdened by big public sector, high taxation, bad business climate and relative low rate of labour force activity.

The Government mainly financed its budget deficit and repayments of debt on domestic market by issuing of bonds (10-year HRK 5 billion with the interest rate of 6.75% and 10-year EUR 1 billion with the interest rate of 6.5%, 7-year HRK 4 billion with the interest rate of 6.25% issued in November 2010) and issuing of dollar bonds on external markets (10-year USD 1.25 billion with 6.625% coupon, i.e. 381.3 basis points above 10-year US T-Notes in July 2010).

Amidst everything above the central government debt increased by HRK 13.8 billion from the end of 2009 to the end of 2010 (increase by HRK 10.3 billion during 2009), while the external debt increased by HRK 6.2 billion in the dame period (HRK 7.2 billion during 2009).

The structure of central government debt

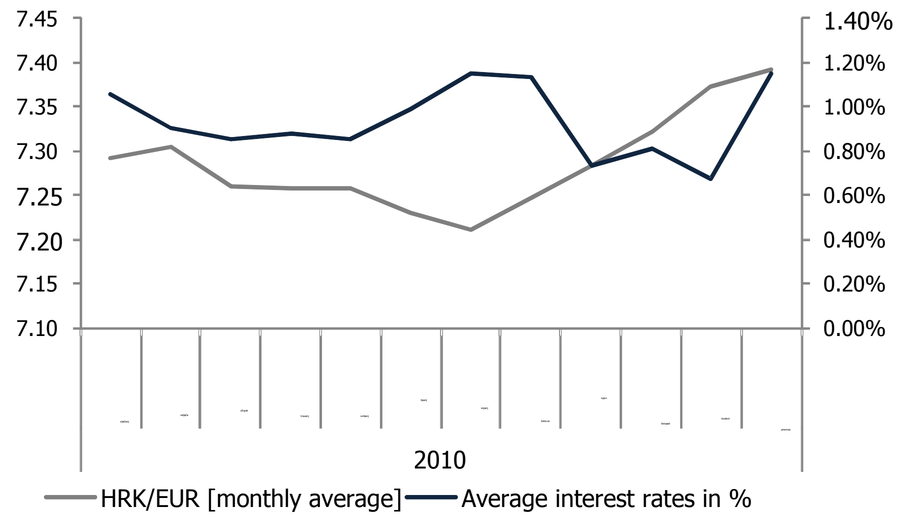


Source: Croatian National Bank

Interest rates on the money market were held at their historic lows during the last year with sporadic rises reflecting investors caution and unbalanced liquidity within the system.

After appreciation pressure on kuna in the first three quarters, the last quarter of 2010 was marked by strong depreciation pressure, forcing CNB to intervene twice during November by selling total of HRK 350 million worth of euro to banks.

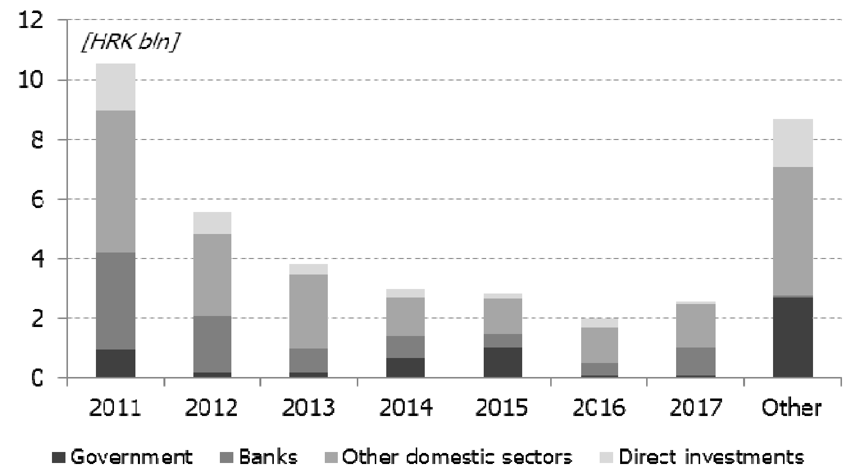
Fluctuations in interest rates on the Zagreb Money Market and changes of Euro



Source: Money Market Zagreb, the Croatian National Bank

According to CNB external debt repayment projections for 2011, total repayments will reach HRK 10.6 billion, HRK 0.9 billion of which relates to the government.

Gross external debt repayment projection

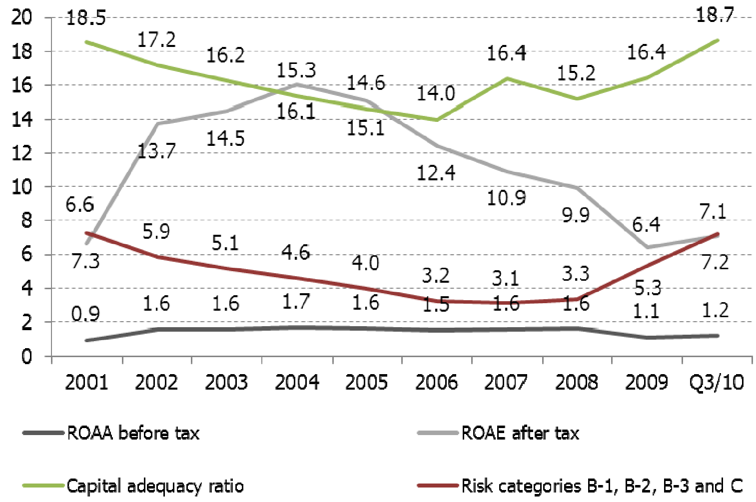


Source: Croatian National Bank

THE BANKING SYSTEM IN 2010

Croatian banking system has high level of capital adequacy and liquidity reserves, ensuring stability of the system, but effect of the crisis are visible through lower rates of profitability and increase in non-performing placements.

Capital adequacy, share of non-performing placements and profitability indicators



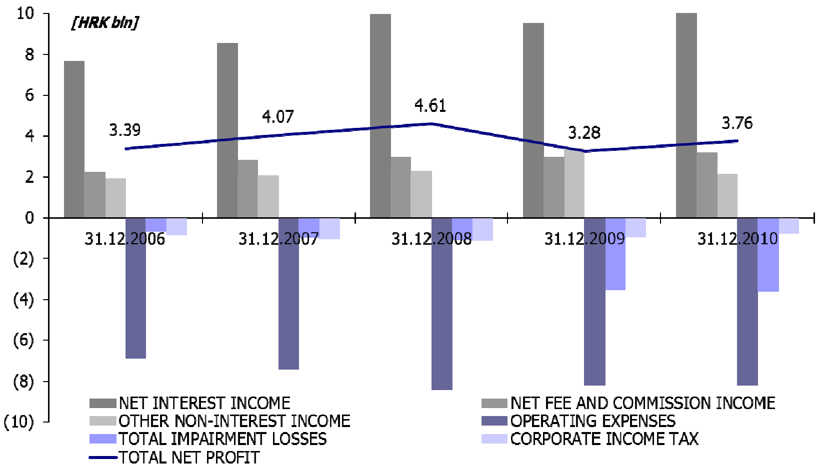
Source: Croatian National Bank

Based on unaudited aggregate data of banks published by the CNB, net interest income in 2010 increased by 14.8% (decrease by 4.1% in 2009) as a result of a decrease by 22.8% of interest expense (increase by 12.4% in 2009).

Net interest and fee income also increased (7.6% in 2010, 0.1% in 2009) as a result of lower fee and commission expenses (annual decrease rate of 7.2% in 2010, 3.1% in 2009) while other non-interest income, after strong growth in 2009 (47.9%), fell by 37.0%, returning to 2007 and 2008 levels.

As a result of all of the above, operative income increased by 2.4% (4.5% in 2009). With operating expenses and impairment losses remaining at 2009 levels, profits before impairment losses and taxes increased by 4.9% (13.1% growth in 2009), pre-tax profits increased by 7.3% and net income increased by 14.7%.

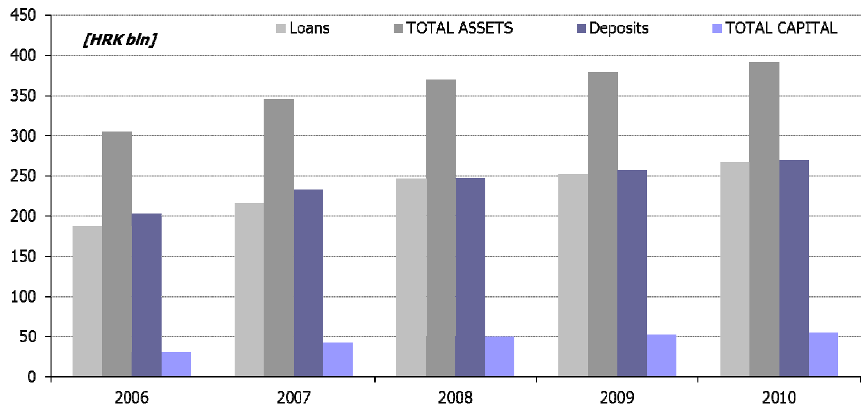
Aggregate income statement of banks in the Republic of Croatia



Source: Croatian National Bank

In 2010, based on unaudited data published by the CNB, gross loan portfolio increased by 6.9% (3.3% in 2009), impairment allowances increased by 36.5% (43.3% in 2009) and consequently, net loan portfolio increased by 5.9% annually (2.4% in 2009). The banks' capital increased by 3.9% annually and the share of capital in total assets increased from 13.9% to 14.0%.

Aggregate total assets of banks in the Republic of Croatia



Source: Croatian National Bank

Description of the Bank's operation

Vaba d.d. banka Varaždin is registered as a limited company with the Commercial Court in Varaždin, headquartered in Varaždin, Alana kralja Zvonimira 1, for the following purposes:

- Receipt of all types of deposits or other redeemable funds and lending from those funds, for its own account,
- Receipt of all types of deposits or other redeemable funds,
- Providing all types of loans, including consumer loans and mortgage loans if allowed by separate laws, financing of commercial business, including export financing based on forfeighting,
- Factoring,
- Finance lease,
- Issuing of bank guarantees or other guarantees,
- Trading for its own account or on behalf of its customers of:
    - money market instruments,
    - transferrable securities,
    - foreign currencies, including money exchange,
    - financial futures and options,
    - currency and interest instruments,
- Payment operations within the country (in accordance with the Law on payment operations)
- Services tied with lending, such as gathering of data, analysis and issuing information on credit ability of sole traders and enterprises,
- Issuing of other payment instruments and managing them in accordance with separate laws, if these services are not considered to be payment operations in accordance with separate laws,
- Safe rentals,
- Mediation in financial affairs,
- Investments and other services and activities in accordance with separate laws regulating capital markets, as follows:
    - trading for its own account,
    - services of offerings, i.e. sale of financial instruments without purchase obligation,
    - safekeeping and administration of financial instruments on behalf of clients, including custodian and similar services, such as money and securities management,
- Representation in the sale of insurance policies in accordance with legislation regulating insurance.

As of 31 December 2010, the Bank operates through two financial centres (Varaždin and Zagreb), and 11 branches (Varaždin, Ludbreg, Ivanec, Novi Marof, Čakovec, Zagreb, Slavonski Brod, Nova Gradiška, Pula).

MISSION

An individual approach to each client and our high quality and professional services, based on the competence of our employees, we create value added for our customers. This contributes to the growth of our organization and improves the quality of the life of our community. We appreciate the personal contribution of each of our employees, whose creativity and knowledge are our greatest value.

VISION

Our vision is to continuously exceed expectations and be the first to innovate and create new values. We want to be a leader in creating high quality financial solutions for our customers and be the best in the area of development and prosperity for all of our employees.

Retail operation

Retail banking is carried out through 11 branches (Varaždin, Ludbreg, Ivanec, Novi Marof, Čakovec, Zagreb, Slavonski Brod, Nova Gradiška, Pula) and 11 ATMs.

Despite strong competition, the Bank, through different services and offers of attractive interest rates on savings, was able to attract new customers, due to which savings in 2010 increased by 24.4% with decrease of average passive interest rates.

With the cooperation of the Varaždin County, the Bank began with lending to students from the Varaždin County, where a great interest of students and their parents was noted. Municipality of Radoboj from the Krapinsko zagorska County also joined the project.

As a partner bank, Vaba participated in numerous exhibitions and events in the areas where it conducts its operation, such as the Međimurje's "MESAP", the "Catherine Fair" in Slavonski Brod, Small "MEF" in Čakovec and Business fair in Ivanec.

Business operations with soletraders and small entrepreneurs

Business operations with soletraders and entrepreneurs represent a significant segment of the Bank's operations.

Considering that supporting small and medium enterprises is one of main strategic goals of the Bank, European Investment Fund (EIF) has recognised Vaba d.d. banka Varaždin as its partner in achieving common mission. At 17 December 2010 Vaba d.d. banka Varaždin and EIF signed Loan agreement with the objective of easier access of funds to Croatian micro entrepreneurs. By signing this agreement, EIF will provide 50% of each microloan and Vaba d.d. banka Varaždin will provide the remaining part from its own funds. Within the programme, mid-term loans will be approved with the expectation that the entire programme of 10 million euro will be allocated to micro entrepreneurs in the next two years.

To date, cooperation of the Bank and local government has created a strong lever for the development of regional and local banking industry and has led to an active involvement of the Bank in development projects of local communities in which it operates. In that sense, the Bank participated in the projects with the Varaždin County (local development projects-micro lending for the years 2007, 2008 and 2009), with the City of Varaždin (lending to soletraders and small entrepreneurs of the City of Varaždin), the City of Ivanec (micro lending to soletraders and small entrepreneurs of the City of Ivanec, lending of investments in the business zone, lending to soletraders and small entrepreneurs that invest in the area of the City of Ivanec) and the the City of Ludbreg ("Entrepreneur 3" programme) and the City of Lepoglava ("Entrepreneur").

Through already successful realisation of the projects mentioned above, extremely successful cooperation with the Guarantee agency of the Varaždin County and the Development agency "Sjever-Dan" was established.

Corporate banking

Credit policy in corporate banking in 2010 was focused on further strengthening of primary business activities and creation of quality client base, targeting mainly clients in the region, primarily from Varaždin and Međimurje Counties, mid-size, production and export oriented.

In the north-western region as the main operating market segment, gradual recovery of economic activity is expected, with gradual recovery from the crisis, further foreign investments and new business zones, which are target segments of the Corporate banking division.

One of important objectives for 2010 was orientation to usage of subsidised, specialised lines by the Croatian Bank for Reconstruction and Development for development of small and medium enterprises, inclusion in measures for economic recovery through programmes and models of the Government (model A), involvement in auctions and inclusion of the local and national guarantee agencies, usage of the Fund for development funds and subsidised loans from different ministries. This especially relates to support of export activities of the region as a help with the recovery from the crisis and to quality lending and growth support to the clients primarily operating in production activities. Through its role in this process, the Bank joined the creation of new values, support of employment creation in small and medium enterprises in the segment of production activities of its clients, development of tourism and new technologies.

The Bank was actively involved in production processes of its clients and was engaged in supporting faster cash flows and liquidity maintenance, especially through maintaining of orientation of activities towards supporting development and technical plans of exporting and production based companies. In accordance with the difficult economic environment, special consideration was given to maintenance of the loan portfolio quality and to helping quality clients whose operations were endangered by the recession and high level of illiquidity of the system.

Strategy was also oriented to maximum increase in service quality, above all combining comprehensive supply, speed and availability and maximum dedication to the client.

In 2010 further development was made in restructuring of the existing loan portfolio in the Corporate banking division domain, replacing certain big exposures with larger number of smaller quality placements with sustainable cash flows and adequate collaterals with the objective of minimising all types of risks. For the objective to be reached it is important to constantly follow market conditions, market movements and early recognition of disruptions, with implementations of new technologies into development of new products and distribution channels.

Business management as a continuing strategy of the Corporate banking division has been developing during 2010 and it will continue to be developed in the segment of business relations with the clients through improvement of credit policies toward optimal acceptable credit risk in difficult business environment, i.e. in the environment of recession and general worsening of liquidity.

With the objective of creation of quality base of clients, target lists of the clients acceptable to the Bank were made, together with new products and acquisition costs. This is a process which will be worked on in the following years and which will have effects on the structure and the quality of the existing portfolio. Special segment to which more attention was given includes payment operations and tracking of clients' contribution through account operations with the objective of quality financing sources. Positive effects are evident in the increase of payment operations fee income, but it still lags behind the planned income so the work will continue using all available actions, from contracting to adjusting the fees to market conditions to stimulating clients to conduct higher volumes of their transactions through their accounts in the Bank.

We can conclude that the operations with small and medium enterprises in the region intensified in every segment during 2010, in accordance with strategic orientation of the Bank. Also, cooperation with cities, municipalities and counties was continued in areas of cash pooling (at the end of 2010 it had 106 members), creation of quality and stabile deposit base and cross selling.

Basic objectives of the Corporate banking division remain expanding of the client base, portfolio diversification and quality monitoring of the clients in all aspects of their operations.

Segment of small and medium entrepreneurship and craftsmanship from SME portfolio of FC Zagreb and Varaždin was merged into the Corporate banking division resulting in change in employees and clients numbers and increase in volume.

Following market conditions and opportunities, the Bank, through the Corporate banking division, joined the EU funds programmes, primarily IPARD measures, further opening possibilities for SME segment to join the measures for which tenders will be held during 2011.

Treasury activities

2010 operations were marked by significantly different business environment then it was the case in turbulent 2009. Effects of the global economic crisis wind down reflected on the market conditions in Croatia as well.

We can say that the year went by without any bigger shocks on foreign exchange and money markets. Stock market prices measured by CROBEX index, with volatility during the year, remained almost the same. Despite that, the Bank achieved positive results from the sale of stock portfolio. Depreciation pressures on the domestic currency were significantly lower than those from 2009, enabling the central bank to maintain low levels of interest rates and high banking system liquidity. Regarding the bond markets, the trend of the reduction in the perception of risk of Croatian debt continued in the first quarter of the year, but failed to hold to the end of the year. In fact, the crises highlighted problems of PIGS countries, with negative impact on Croatia's risk, resulting in lowering of credit rating of Croatia at the year's end. This was the main reason of stoppage of the trend of the decrease in bond yields which started in 2009 as a result of calming down of the financial crisis. Drastic yield movements were absent so yields, measured from the beginning of the year, remained mainly at the same levels.

We continue to improve and simplify our services to the clients so during 2010 the project of the migration of the foreign payment operations was started. We expect faster and simplified transaction operations in the corporate segment as a result of the project. Treasury department actively monitors the portfolio and business needs of the existing clients, trying to expand the volume of foreign exchange transactions. Considering the reduction in volatility of the exchange rate, foreign exchange market margins decreased, having negative impact on the profitability of the transactions.

Continuing activities in improvement of existing business processes and the reduction in operating and market risks are present through improvement in existing and writing new procedures in the Division's operations.

System of internal control and internal audit

The internal control system is a set of processes and procedures set up to adequately control risks, monitor the effectiveness and efficiency of the Bank's operations, to monitor reliability of its financial and other information and compliance with regulations, internal acts, standards and codes, in order to ensure stability of the Bank's operations.

The Bank has set up internal controls system comprising:

1. adequate organisational structure,
2. organisational culture,
3. adequate control activities and segregation of duties,
4. adequate internal controls integrated in business processes and activities of the credit institution,
5. adequate administrative and accounting procedures,
6. operations in the scope of the control function of the credit institution.

The Bank has regulated and implemented adequate control activities and the segregation of duties, adequate internal controls and adequate administrative and accounting procedures undertaken in the regular course of the Bank's operations.

Based on the Decision on the internal controls system, the Bank has established and organised three control functions, independent of the processes and activities in which risks occur, i.e. independent of the processes and activities they monitor and oversee. These functions are:

1. risk control function,
2. compliance monitoring function,
3. internal audit function.

Risk control function ensures compliance of the credit institutions with strategies and policies of risk management, through risk monitoring and analysis, risk reporting and involvement in setting up, implementation and monitoring of methods and models of risk management.

Compliance monitoring function ensures the credit institution to operate in accordance with relevant legislation and codes and internal acts through compliance risk identification and assessment, counselling of the Management Board and other responsible persons on the methods of implementation of the relevant legislation, standards and rules, assessment of the effects of the changes in legislation on the credit institution's operations, testing of new products' and procedures' compliance with relevant legislation and acts as well as with changes in legislation and counselling in preparation of compliance education.

Internal audit function, as a part of internal controls, analyses and evaluates the adequacy and effectiveness of the internal control system, evaluates adequacy and effectiveness of the risk management procedures and risk assessment methodology, evaluates management reporting system, evaluates adequacy and reliability of the accounting evidence and financial reporting system, evaluates strategies and procedures of internal capital adequacy assessment, audits the information system, tests reliability of the reporting system and timeliness and correctness of the reports defined by the Credit Institutions Act, evaluates and correctness of the reports defined by the Credit Institutions Act, evaluates safeguarding of assets, evaluates the system of publicly reported information gathering and validity and performs all other operations necessary to achieving internal audit objectives.

Each control function reports on its work in accordance with operational plans and with the Credit Institutions Act and the legislation based on the Act.

Development plan

In accordance with the mission and vision of the Bank, during 2011 operations will be focused on further development of the quality of products and services, functionality improvement of business processes and compliance with new regulatory requirements.

The above should contribute to increased quality of the Bank's business operations to the satisfaction of customers, regulator, employees and shareholders of the Bank.

Statement on the application of the Code of Corporate Governance

During December 2009, the Bank's Management and Supervisory Board have adopted the Code of Corporate Governance of Vaba d.d. banka Varaždin, which established high standards and methods of quality corporate governance (further: the Code). The Code is published on the Bank's official web site (www.vaba.hr).

In every matter that is not regulated by the Code, the Bank applies the Code of Corporate Governance adopted by the Croatian Financial Services Supervisory Agency and Zagreb's Stock Exchange, to the extent applicable to the Bank.

In accordance with the Companies Act, Article 272p, the Management Board announces that the Bank has voluntarily applied the recommendations of both Codes during 2010, with exception to certain sections (as explained in details within annual questionnaire in the Code delivered along with the annual report to the Zagreb Stock Exchange for the publication).

The Management Board governs the Bank and its assets. Accordingly, the Board is obliged and authorised to take any necessary actions and decisions required for successful management of the Bank, all within the valid framework of the Companies Act and the Credit Institutions Act.

In accordance with the Bank's Articles of Association, the Management Board consists of three members at most, and the Supervisory Board decides on the number of members of the Management Board. Currently, the Management Board consists of three members.

The Supervisory Board appoints members and the president of the Management Board for the period of a maximum of 5 years, with the possibility of reappointment, upon CNB's approval.

The Supervisory Board can recall its decision on appointment in the case of existence of relevant reason in accordance with effective regulation.

Members of the Management Board who have preformed their duty during 2010 were as follows:

- Igor Čičak, Chairman,
- Denis Čivgin, Member (until 18 May 2010),
- Natalija Jambrečić, Member.

The Supervisory Board is composed of seven members on a 4 year mandate, and can be re-elected. In accordance with the Companies Act, Article 256, Section 2, a right to appoint 2 (two) members of the Supervisory Board has a shareholder Validus, as long as it owns at least 24% of the Bank's shares.

A member of the Supervisory Board can be appointed only if an individual has knowledge and experience in banking or economics or scientific research, which would guarantee proper and duly performance of his duties. In addition, a member of the Supervisory Board cannot be an individual in contrary to the conditions specified by the Law.

The privileges of the Supervisory Board are set out in the Bank's Articles of Association in accordance with the applicable regulations within Companies Act and Credit Institutions Act.

Members of the Supervisory board of the Bank for 2010 were as follows:

- Vladimir Košćec, President,
- Anisur Rehman Khan,
- Balz Thomas Merkli,
- Ankica Mamić,
- Marina Bača,
- Slavko Kulić (until 22 April 2010),
- Mensur jašarević (until 9 June 2010)

Information on the composition and activities of the Management and the Supervisory Board and their sub-committees is provided within the Annual Questionnaire within the Code of Corporate Governance.

The procedure for making amendments to the Articles of Association is defined in Article 65 of the Articles of Association. In accordance with law and this Articles of Association, amendments to Articles of Association can be processed at the General Assembly, whereas Supervisory Board is entitled to amend Articles of Association in order to adapt or to refine content of the Articles of Association.

Proposals for amendments and additions to the Articles of Association can be made by the Supervisory Board, the Management Board and the Bank's shareholders.

The Management Board is entitled to issue new shares of the Bank as a part of the section on so called approved issued capital. Issue of new shares is subject to approval by the Bank's Supervisory Board, and can be made during the period of 5 years, commencing from the date of entry of amendments into the Court register, in accordance with the Decision of the General Assembly of 6 March 2009. The Management Board can make decisions to increase Bank's share capital by making cash contribution and by issuing new shares, but total increase of share capital cannot exceed half of the nominal amount of the Bank's share capital at the date of decision on amendment of the Articles of Association. Management Board, upon approval of the Supervisory Board, is entitled to exclude shareholders' priority. Furthermore, management Board upon approval of the Supervisory Board decides on rights arising from ownership of shares and condition of their issue.

In accordance to the Articles of Association, the Bank can acquire its own shares in following circumstances:

1. if share acquisition is needed to prevent potential damage to the Bank,
2. if shares acquisition is offered to the Bank's employees or related parties of the Bank,
3. if the shares are acquired in order to be given to shareholders as severance in accordance with the law,
4. if acquisition is free of charge and if Bank acquires shares on behalf of its customer,
5. on the basis of legal succession,
6. if based on an Assembly's decision to withdraw shares in accordance with regulations for reduction of share capital,
7. under the authority of the General Assembly of the Bank for the acquisition of shares in accordance with legal provisions.

Shares acquired for the purposes mentioned under 1-3 and 7, cannot exceed more than ten percent of the Bank's share capital. Such acquisition would only be allowed if the Bank recorded reserves for those shares in a way not to reduce share capital, nor reserves prescribed by law. Management Board makes decision about acquisition of its own shares, and it's required to notify General Assembly at the next General Meeting. Main shareholders of the Bank with a share capital exceeding 2% of total share capital as at 31 December 2010 were as follows:

	Ownership share %	**Number of shares**
VALIDUS D.D.	29.09	513,477
BALKAN FINANCIAL SECTOR EQUITY FUND C.V.	16.54	292,000
PLURIS D.D.	8.99	158,694
GARA SECUNDUS D.O.O.	4.31	76,000
FINESA CONTEPTUS D.O.O.	3.53	62,276
INTERFINANCE D.O.O.	3.53	62,226
KALEM JOZO	3.53	62,226
CROATIA OSIGURANJE D.D.	2.86	50,470
NIKOMAT D.O.O.	2.46	43,346
PODVEZANEC ĐURO	2.26	39,935
CITY OF VARAŽDIN	2.18	38,501

Politics of risk management are described in detail within the Notes to the financial statements for 2010.

The duties of the established internal audit function, through the independent organizational unit. Division of internal audit, is the implementation of controls for compliance and conformity of the Bank's business activities with legislations, maintenance of accounting records, recording of business transactions, application of accounting standards and procedures, accuracy of the financial and other reports in accordance with the Credit Institutions Act and subordinated provisions, the adequacy of internal controls, accounting, financial and other operational controls and assessment of management system which covers all the risks arising from operating activities.

In December 2009, the Supervisory Board founded the Audit Committee which consisted of three members of Supervisory Board (with at least one independent member), and of one member which is not a member of the Supervisory Board, neither employee of the Bank, but has experience in accounting and audit.

The Audit Committee, which consists of the members of Bank's Supervisory Board, represented by Marina Bača (president of the Audit Committee), Vladimir Košćec (member of the Audit Committee), Marija Maltar (member of the Audit Committee) and Balz Merkli (member of the Audit Committee), assists the Supervisory Board performing the function of business supervision, and especially of the following tasks:

- Monitors the reliability (credibility) of the financial information and reports (examines the relevance and consistence of the accounting methods),
- at least once a year revises the internal control system and the risk management system,
- provides the efficiency of the internal audit by suggesting the selection, appointment, removal or re-appointment of the Head of the Internal Audit, concerning also available budget and by assessing actions taken by the Management following the findings and recommendations of the internal audit
- makes recommendations to the Supervisory Board regarding the selection, appointment, re-appointment or replacement of external auditors and concerning also the terms of external auditors' engagement,
- oversees the independence and objectivity of external auditors, particularly regarding the rotation of auditors and fees paid by the Bank for audit services and takes care of other regulatory requirements (assessment of the extent and the level of other fees paid by the Bank to the auditor),
- considers the efficiency of external audit process and the actions undertaken by the senior management following the external auditor's recommendations following the audit.

At least twice a year the Audit Committee reports to the Supervisory Board about its work, which is at least on the issuance of the half year and the Annual report of the Bank.

Beside the Audit Committee, the Supervisory Board in the performing function of supervision, follows and assess the work of the internal audit and makes recommendations to improve the quality of it's work, and makes the recommendations for the use of available resources, with the purpose of establishing the quality system of internal controls which will timely identify the risks that the Bank is exposed to, with the aim of effective risk management.

Igor Čičak, President of the Management Board

Vaba d.d. banka Varaždin 1

Natalija Jambrečić, Member of the Management Board

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

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

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

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements for acceptance. If the Supervisory Board approves the annual financial statements they are deemed confirmed by the Management Board and Supervisory Board.

The financial statements set out on pages 22 to 79 were authorised by the Management Board on 18 March 2011 for issue to the Supervisory Board and are signed below to signify this.

For and on behalf of Vaba d.d. banka Varaždin:

Igor Čičak
President of the Management Board

Vaba d.d. banka Varaždin 1

Natalija Jambrečić
Member of the Management Board

This version of the report is a translation from the original, which was prepared in the Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Grant Thornton

Independent Auditors' Report

To the Management Board and Shareholders of VABA d.d. banka Varaždin

We have audited the accompanying financial statements of VABA d.d. banka Varaždin (herein below the Bank), which comprise of the balance sheet as at 31 December 2010, the income statement, 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 22 to 79.

The financial statements for the year ended on 31 December 2009 were audited by another auditor who, on 28 April 2010, issued a qualified opinion on the financial statements regarding the adequacy of the amount of recognized impairment losses on loans and advances to customers.

Management's Responsibility for the financial statements

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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with 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.

Opinion

In our opinion the financial statements on pages 22 to 79 give a true and fair view of the financial position of the Bank as at 31 December 2010, and the results of its operations, cash flows and changes in equity for the year then ended in accordance with statutory accounting regulations applicable to banks in Croatia.

Grant Thornton revizija d.o.o.
Koranska 16, Zagreb
Zagreb, 18 March 2011

Siniša Dušić
Certified auditor

GRANT THORNTON
revizija d.o.o.
ZAGREB

This version of our report is a translation from the original, which was prepared in the Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

ZGOMBIĆ & PARTNERI GRUPA

Grant Thornton revizija d.o.o. Koranska 16, Zagreb, Trgovački sud u Zagrebu; MBS: 080642448; Žiro-račun 2500009-1101268790 kod Hypo Alpe-Adria-Bank d.d., Zagreb;
Temeljni kapital: 20.000,00 kuna uplaćen u cijelosti; članovi uprave: M. Butković, S. Dušić, I. Smiljan
Član mreže Grant Thornton International Ltd

Balance sheet as at 31 December

	Notes	Restated 31 December 2009 (HRK '000)	31 December 2010 (HRK '000)
ASSETS			
Cash and amounts due from banks	4	56,365	98,150
Obligatory reserve with Croatian National Bank	5	88,150	102,594
Placements with and loans to other banks	6	1,086	13,792
Financial assets available for sale	7	187,648	248,041
Financial assets held to maturity	8	4,094	17,515
Loans and advances to customers	9	818,217	885,163
Property and equipment	10	28,291	28,292
Intangible assets	11	18,501	18,024
Other assets	12	5,849	15,444
TOTAL ASSETS		**1,208,201**	**1,427,014**
LIABILITIES			
Deposits from banks	13	38,280	17,741
Deposits from customers	14	934,076	1,080,476
Borrowings	15	69,111	154,680
Hybrid instruments	16	2,922	2,954
Provisions for liabilities and charges	17	3,601	2,164
Other liabilities	18	9,202	22,103
TOTAL LIABILITIES		**1,057,194**	**1,280,118**
EQUITY			
Share capital	19.1	176,523	176,523
Share premium	19.2	27,464	27,464
Other reserves	19.3	2,611	2,611
Fair value reserve	19.4	395	(674)
Accumulated losses	19.5	(55,986)	(59,028)
TOTAL EQUITY		**151,007**	**146,896**
TOTAL LIABILITIES AND EQUITY		**1,208,201**	**1,427,014**

The significant accounting policies and other notes on pages 27 to 79 form an integral part of these financial statements.

Income statement for the year ended 31 December

	Notes	Restated 2009 (HRK '000)	2010 (HRK '000)
Interest and similar income	20	101,710	101,562
Interest expense and similar charges	21	(59,807)	(53,635)
Net interest income		**41,903**	**47,927**
Fee and commission income	22	7,251	6,594
Fee and commission expense	23	(2,248)	(2,405)
Net fee and commission income		**5,003**	**4,188**
Gains less losses from financial assets through P/L	24	2,549	-
Gains less losses from financial assets available for sale	25	1,956	2,427
Gains less losses arising from dealing in foreign currencies	26	7,381	5,793
Other operating income	27	2,201	2,267
Dealing and other income/(expense)		**14,088**	**10,487**
OPERATING INCOME		**60,994**	**62,602**
General and administrative expenses	28	(47,534)	(47,994)
Depreciation and amortisation		(5,533)	(5,607)
Provisions for liabilities and charges		(141)	621
Operating expenses		**(53,208)**	**(52,980)**
OPERATING RESULT BEFORE IMPAIRMENT OF ASSETS		**7,786**	**9,622**
Identified impairment losses		(6,093)	(13,081)
Identified impairment losses on group basis		2,098	417
Impairment losses	29	**(3,995)**	**(12,664)**
PROFIT/(LOSS) BEFORE TAX		**3,791**	**(3,042)**
Income tax expense	30	-	-
PROFIT/(LOSS) FOR THE YEAR		**3,791**	**(3,042)**
Basic and diluted earnings/(loss) per share in HRK		**2.21**	**(1.72)**

The significant accounting policies and other notes on pages 27 to 79 form an integral part of these financial statements.

Statement of comprehensive income for the year ended 31 December

	Notes	Restated 2009 (HRK '000)	2010 (HRK '000)
PROFIT/(LOSS) FOR THE YEAR		**3,791**	**(3,042)**
Net unrealised losses from financial assets available for sale		(826)	(1,070)
Other comprehensive income		**(826)**	**(1,070)**
Total comprehensive income		**2,965**	**(4,111)**

The significant accounting policies and other notes on pages 27 to 79 form an integral part of these financial statements.

Statement of changes in equity

HRK '000	Share capital	Share premium	Other reserves	Fair value reserve	Accumulated losses	Total
Balance at 1 January 2009	**153,355**	**27,423**	**2,652**	**1,221**	**(64,018)**	**120,634**
Profit for the year (restated)	-	-	-	-	3,791	3,791
Net unrealised losses from financial assets available for sale	-	-	-	(826)	-	(826)
Total comprehensive income	***-***	***-***	***-***	***(826)***	***3,791***	***(2,965)***
Property acquisition costs recognised in equity	-	-	-	-	4,240	4,240
Transfer	-	41	(41)	-	-	-
Increase in share capital	23,168	-	-	-	-	23,168
Balance at 31 December 2009 (restated)	**176,523**	**27,464**	**2,611**	**395**	**(55,986)**	**151,007**
Loss for the year	-	-	-	-	(3,042)	(3,042)
Net unrealised losses from financial assets available for sale	-	-	-	(1,070)	-	(1,070)
Total comprehensive income	***-***	***-***	***-***	***(1,070)***	***(3,042)***	***(4,111)***
Balance at 31 December 2010	**176,523**	**27,464**	**2,611**	**(674)**	**(59,028)**	**146,896**

The restatement of amounts originally reported as of and for the year ended 31 December 2009 has no effect on the opening balance of equity as at 1 January 2009.

The significant accounting policies and other notes on pages 27 to 79 form an integral part of these financial statements.

Statement of cash flows for the year ended 31 December

	Notes	Restated 2009 (HRK '000)	2010 (HRK '000)
Cash flow from operating activities			
Profit/(loss) before tax		3,791	(3,042)
Adjustments:			
- depreciation and amortisation		5,533	5,607
- net foreign exchange losses		1,209	1,028
- impairment losses on loans and advances to customers and other assets		3,995	12,661
- provisions for liabilities and charges		141	28
- losses on disposal and write off of property and equipment		1,241	-
Changes in operating assets and liabilities			
Decrease/(increase) in placements with and loans to other banks		29	(8,206)
Increase in loans and advances to customers		(3,841)	(73,305)
Decrease in other assets		589	(9,363)
(Decrease)/increase in deposits from banks		(4,867)	(20,539)
(Increase)/decrease in obligatory reserve with the CNB		(1,059)	(13,186)
(Decrease)/increase in deposits from customers		(49,342)	137,182
(Decrease)/increase in other liabilities		(8,949)	11,458
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES		**(51,530)**	**40,324**
Cash flow from investing activities			
Purchase of property and equipment and intangible assets		(5,504)	(5,131)
Increase in financial assets available for sale		(41,202)	(59,288)
Maturity/(acquisition) of financial assets held to maturity		48,448	(13,565)
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES		**1,742**	**(77,984)**
Cash flow from financing activities			
Increase in hybrid instrument		2,915	-
(Decrease)/increase in borrowings		(150,241)	82,839
Increase/(decrease) in share capital		23,168	-
NET CASH (OUTFLOW)/INFLOW FROM FINANCING ACTIVITIES		**(124,158)**	**82,839**
Effect of foreign exchange rate changes on cash and cash equivalents		477	1,106
NET (DECREASE)/INCREASE CASH AND CASH EQUIVALETNS		**(173,469)**	**46,285**
Cash and cash equivalents at the beginning of the year		**229,834**	**56,365**
Cash and cash equivalents at the end of the year		**56,365**	**102,650**

The significant accounting policies and other notes on pages 27 to 79 form an integral part of these financial statements.

1. SIGNIFICANT ACCOUNTING POLICIES

General data

Vaba d.d. Bank Varaždin (the "Bank") was established as Brodsko - posavska banka d.d., Slavonski Brod in 1994. On 27 December 2004 the Bank was renamed Vaba d.d. Banka Varaždin, and its headquarters were relocated from Slavonski Brod to Varaždin, Anina 2. This change was a result of the changes in the ownership structure of the Bank, whose shareholder became Validus d.d. from Varaždin, with the consent of the Croatian National Bank.

On the General Assembly dated 14 December 2006, the Bank issued a decision to increase the share capital by issuing 292 thousand of new shares, with a nominal value of HRK 100 per share through a private offer at a price of HRK 140 per share. On the General Assembly held on 18 April 2007, a decision was made to increase share capital by issuing a further 619 thousand of new shares, with a nominal value of HRK 100 per share, through a private offer to the Bank's existing shareholders at a price of HRK 140 per share. In 2007, the share capital of the Bank was increased, and the capital increased from HRK 62,226,400 to HRK 153,355,000 which was registered at the Commercial Court in Varaždin by the Court decision dated 17 August 2007.

By Decision of the General Assembly dated 18 April 2007, the Bank's headquarters were changed to Aleja kralja Zvonimira 1, Varaždin.

On 6 March 2009, the General Assembly authorised an increase in share capital by the maximum amount of HRK 31,113,200 up to a total of HRK 184,468,200. Share capital was increased by certain shareholders during March 2009 by the amount of HRK 23,167,800 to HRK 176,522,800 and registered in court on 25 March 2009. Share capital is divided into 1,765,228 ordinary shares, each with a nominal value of HRK 100.

These financial statements were approved by the Bank's Management Board on 28 April 2010 for submission to the Supervisory board.

I. Basis of presentation

(a) Statement of compliance

The financial statements have been prepared in accordance with statutory accounting requirements for banks in Croatia. This version represents an unofficial translation into English of the statutory financial statements originally presented in Croatian. The Bank's operations are subject to the Banking Act, in accordance with which the Bank's financial reporting is regulated by Croatian National Bank ("the CNB") which is the central monitoring institution of the banking system in Croatia.

The principal accounting policies applied in the preparation of these financial statements are summarised 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 in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards applicable at 31 December 2010.

The accounting regulations which are the basis for the preparation of these financial statements differ from IFRS, in respect of presentation, recognition and measurement. The principal differences between the accounting regulations of the CNB and recognition and measurement requirements of IFRS are as follows:

- The CNB requires banks to recognise impairment losses, in the income statement, on assets not identified as impaired (including sovereign risk assets) at prescribed rates (excluding assets carried at fair value through profit or loss). In accordance with these requirements, as of 31 December 2010 the Bank has recognised portfolio-based provisions of HRK 9,356 thousand (2009: HRK 9,802 thousand) in the balance sheet and has recognised income for the year ending 31 December 2010 in the amount of HRK 445 thousand (2009: expense of HRK 2,521 thousand) within the movement in impairment loss on loans and advances to customers and other assets. Although, in accordance with IFRS, such provisions are more properly presented as an appropriation within equity, the Bank continues to recognise such provisions in the income statement as a substitute for unidentified impairment losses calculated in accordance with the requirements of IFRS.

Notes to the financial statements (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(a) Statement of compliance (continued)

- Although the Bank calculates impairment losses on corporate lending as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate, in accordance with IFRS, the CNB requires the amortisation of the calculated discount to be presented in the income statement within the movement in impairment losses on loans and advances to customers and other assets, rather than as interest income, as required by International Financial Reporting Standards.
- Additionally the CNB prescribes minimum levels of impairment losses against certain specifically identified impaired exposures, which may be different from the impairment loss required to be recognised in accordance with IFRS.

(b) Basis of measurement

The financial statements are prepared on a fair value basis for derivative financial instruments, financial assets and liabilities at fair value through profit or loss and available for sale assets, except those for which there is no reliable measure of fair value. Other financial assets and liabilities are carried at amortized cost or historical cost.

The financial statements are prepared in a format that is commonly used and internationally recognized by banks.

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosures of contingent liabilities on the balance sheet date, as well as the amounts of income and expenditure for the period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be realistic in the circumstances and information available on the date of preparation of financial statements, the results of which form the basis for judgments about carrying values of assets and liabilities that are not directly visible from other sources. Actual results could differ from these estimates.

The estimates and underlying assumptions are reviewed on a regular basis. Revisions to accounting estimates are recognized in the period in which they are incurred if affecting only that period or the period in which they are incurred and future periods if they impact current and future periods.

Judgements made by management in applying the appropriate standards that have a significant impact on the financial statements and estimates with a risk of material adjustment in the coming year, are described in Note 3.

These financial statements have been prepared based on going concern basis.

(c) Functional and presentation currency

The Bank's financial statements are presented in the currency of the primary economic environment in which the Bank operates ("the functional currency"), Croatian kuna (HRK), rounded to the nearest thousand.

As at 31 December 2010 the exchange rates used for translation of Bank's assets and liabilities were HRK 7.385 to EUR 1 (2009: HRK 7.306 to EUR 1) and HRK 5.568 to USD 1 (2009: HRK 5.089 to USD 1).

the quality of the existing portfolio of clients for the purpose of timely identification of credit risk.

(d) Changes in presentation or classification of items within the financial statements

Where necessary, comparative information has been reclassified to achieve consistency with amounts presented in the current financial year and other disclosures. As indicated in Note 1 e), the Bank restated prior period balances in respect of the identified impairment losses on loans and advances to customers.

Notes to the financial statements (continued)

(e) Restatement of previously reported data

The table below shows balance sheet figures for the year ended 31 December 2009, restated for the amount of impairment losses on loans and advances to customers. The column "Previously reported" presents the originally reported amounts reclassified for consistency with the classification in the current reporting period.

Balance sheet as at 31 December 2009	**Previously reported 2009 (HRK '000)**	**Restatements (HRK '000)**	**Restated 2009 (HRK '000)**
ASSETS			
Cash and amounts due from banks	56,365	-	56,365
Obligatory reserve with Croatian National Bank	88,150	-	88,150
Placements with and loans to other banks	1,086	-	1,086
Financial assets available for sale	187,648	-	187,648
Financial assets held to maturity	4,094	-	4,094
Loans and advances to customers	819,531	(1,314)	818,217
Property and equipment	28,291	-	28,291
Intangible assets	18,501	-	18,501
Other assets	5,849	-	5,849
TOTAL ASSETS	**1,209,515**	**(1,314)**	**1,208,201**
LIABILITIES			
Deposits from banks	3,684	-	3,684
Deposits from customers	968,729	-	968,729
Borrowings	69,112	-	69,112
Hybrid instruments	2,923	-	2,923
Provisions for liabilities and charges	3,601	-	3,601
Other liabilities	9,145	-	9,145
TOTAL LIABILITIES	**1,057,194**	**-**	**1,057,194**
EQUITY			
Share capital	176,523	-	176,523
Share premium	27,464	-	27,464
Other reserves	2,611	-	2,611
Fair value reserve	395	-	395
Accumulated losses	(54,672)	(1,314)	(55,986)
TOTAL EQUITY	**152,321**	**(1,314)**	**151,007**
TOTAL LIABILITIES AND EQUITY	**1,209,515**	**(1,314)**	**1,208,201**

Notes to the financial statements (continued)

Income statement for the period ended 31 December 2009	Previously reported 2009 (HRK '000)	Restatements (HRK '000)	Restated 2009 (HRK '000)
Interest and similar income	101,710	-	101,710
Interest expense and similar charges	(59,807)	-	(59,807)
Net interest income	**41,903**	**-**	**41,903**
Fee and commission income	7,251	-	7,251
Fee and commission expense	(2,248)	-	(2,248)
Net fee and commission income	**5,003**	**-**	**5,003**
General and administrative expenses	(48,743)	-	(48,743)
Depreciation and amortisation	(5,533)	-	(5,533)
Provisions for liabilities and charges	(141)	-	(141)
Dealing and other income/(expense)	**(53,208)**	**-**	**(53,208)**
OPERATING INCOME	**60,994**	**-**	**60,994**
General and administrative expenses	(47,534)	-	(47,534)
Depreciation and amortisation	(5,533)	-	(5,533)
Provisions for liabilities and charges	(141)	-	(141)
OPERATING EXPENSES	**(53,208)**	**-**	**(53,208)**
OPERATING RESULT BEFORE IMPAIRMENT OF ASSETS	**7,786**	**-**	**7,786**
Identified impairment losses	(4,779)	(1,314)	(6,093)
Identified impairment losses on group basis	2,098	-	2,098
Impairment losses	**(2,681)**	**(1,314)**	**(3,995)**
LOSS BEFORE TAX	**5,105**	**(1,314)**	**3,791**
Income tax expense	-	-	-
LOSS FOR THE YEAR	**5,105**	**(1,314)**	**3,791**

Increase in identified impairment losses

As at 31 December 2009 the Bank had loans and advances to customers which included loans with the value of the financial assets which served as collateral being lower than the carrying value of loans by the amount of 1,314 thousand kuna. In 2010 the Bank has restated the comparative numbers for 2009 by correcting the carrying amounts of loans and advances to customers and the current year profit by the amount of 1,314 thousand kuna.

Notes to the financial statements (continued)

II. Specific accounting policies

(a) Interest income and expense

Interest income and expense are recognised in the income statement as they accrue for all interest earning financial instruments, including those measured at amortised cost, at fair value through profit or loss and available for sale, using the effective interest rate method. Such income and expense is presented as interest and similar income or interest expense and similar charges in the income statement. Interest income and expense also includes fee and commission income and expense in respect of loans provided to customers or borrowings from other banks, premium or discount amortisation, and other differences between the initial carrying amount of an interest-earning financial instrument and its value at maturity.

(b) Fee and commission income and expense

Fee and commission income and expense arise on financial services provided by the Bank and received by the Bank, and mainly comprise fees related to domestic and foreign payments, the issue of guarantees and letters of credit, credit card business and other services provided by the Bank. Fee and commission income and expense are recognised in the income statement when the related service is performed.

Loan commitment fees for loans that are likely to be drawn down are deferred linearly (together with related direct costs) and recognised as an adjustment to the interest rate on the loan. Commitment fees in relation to facilities where draw down is not probable are recognised over the term of the commitment. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank has retained no part for itself, or has retained a part at the same interest rate as the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts upon completion of the service.

Asset management fees related to investment fund management are recognised on an accrual basis over the period in which the service is provided. The same principle is applied for custody services that are continuously provided over an extended period of time.

(c) Dividend income

Dividend income from equity securities is recognised in the income statement when the rights to receive the dividend are established.

(d) Gains less losses from dealing and investment securities

Gains less losses from financial instruments at fair value through profit or loss include unrealised and realised gains and losses arising from trading with debt securities and other financial instruments designated at fair value through profit or loss.

Gains less losses arising from investment securities comprise realised gains and losses from financial instruments available for sale.

(e) Gains less losses arising from dealing in foreign currencies

Gains less losses from dealing in foreign currencies include unrealised and realised gains and losses arising from spot and forward dealings in foreign currencies.

(f) Foreign currencies

Transactions in foreign currencies are translated into HRK at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into HRK at the foreign exchange rate ruling at that date.

Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currency that are stated at fair value are translated in HRK at the foreign exchange rates ruling at the dates when the fair values were determined.

Notes to the financial statements (continued)

Non-monetary assets and items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at the balance sheet date.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security, and other changes in the carrying amount of the securities. The translation differences are recognised in the income statement as part of the foreign exchange gains or losses on the revaluation of monetary assets and liabilities presented within general and administrative expenses in the income statement or other operating income. Translation differences on non-monetary financial assets, such as equity instruments classified as available for sale, are included in the fair value reserve in equity.

(g) Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: at fair value through profit or loss, loans and receivables, available for sale, held to maturity or financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. The management determines the classification of financial instruments upon initial recognition.

Financial assets and financial liabilities at fair value through profit or loss

This category comprises two subcategories: financial instruments held for trading (including derivatives), and those designated by management as at fair value through profit or loss at inception. The Bank designates financial assets and liabilities at fair value through profit or loss when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis,
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

As of 31 December 2010 the Bank had no financial assets and financial liabilities at fair value through profit and loss (2009: nil).

Loans and receivables

This category comprises of non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money to a debtor with no intention of trading with the receivable and include loans and receivables from banks, loans and receivables from customers, and the obligatory reserve with the Croatian National Bank.

Held-to-maturity investments

This category comprises non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has the positive intention and ability to hold to maturity. These include corporate bills of exchange.

Available for sale financial assets

This category comprises non-derivative financial assets which are defined as available for sale or are not included in loans and receivables or held-to-maturity investments, or classified as financial assets at fair value through profit or loss. Available for sale financial assets are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates, or equity prices.

Notes to the financial statements (continued)

Available-for-sale financial assets include debt and equity securities, units in investment funds and units in a private equity fund.

Other financial liabilities

Other financial liabilities comprise of all financial liabilities which are not held for trading or designated at fair value through profit or loss.

Recognition and derecognition

Purchases and sales of financial assets and financial liabilities at fair value through profit or loss, and financial assets held to maturity and available for sale, are recognised on the settlement date which is the date when the financial instrument is delivered to or transferred from the Bank. Loans and receivables and financial liabilities at amortised cost are recognised when advanced to borrowers or received from lenders.

The Bank derecognises financial instruments (in full or part) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights over the financial instrument. It occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realised, surrendered or have expired. The Bank derecognises financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognising of the liability and will instantaneously recognise a new financial liability, with new terms and conditions.

Realised gains and losses from the disposal of financial instruments are calculated by using the weighted average cost method.

Initial and subsequent measurement

Financial assets and liabilities are recognised initially at fair value plus, in the case of a financial asset 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.

After initial recognition, the Bank measures financial instruments at fair value through profit or loss and financial assets available for sale at their fair value, without any deduction for costs of sale. Instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less impairment.

Loans and receivables and held-to-maturity investments and financial liabilities not designated at fair value through profit or loss are measured at amortised cost.

Gains and losses

Gains or losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognised in the income statement.

Gains or losses arising from a change in the fair value of available-for-sale monetary assets are recognised directly in a fair value reserve within equity and are disclosed in the statement of changes in equity. Impairment losses, foreign exchange gains and losses, interest income and amortisation of premium or discount on available-for-sale monetary assets are recognised in the income statement. Foreign exchange differences on equity instruments are part of the fair value of these instruments and are recognised in equity.

Upon disposal or other derecognition of financial assets available for sale all cumulative gains and losses from the financial instrument are transferred to the income statement.

Gains or losses arising from financial assets and financial liabilities carried at amortised cost are recognised as interest in the income statement over the period of amortisation.

Gains or losses may also be recognised in the income statement when a financial instrument is derecognised or when its value is impaired.

Notes to the financial statements (continued)

Determination of fair value of financial instruments

The fair values of quoted available-for-sale financial assets are based on closing prices at the reporting date. If there is no active market for the financial instrument, or if, due to any other reason, the fair value cannot be reliably measured by the market price, the Bank uses an internal evaluation model for fair value estimation.

The fair value of non-exchange-traded derivatives is estimated at the amount that the Bank would receive or pay to terminate the contract on the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

Impairment of financial assets

Impairment of assets identified as impaired

Financial assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The Bank estimates and performs impairment of all financial assets, except financial assets at fair value through profit or loss.

If any evidence of impairment 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. Significant or prolonged decline in fair value of instruments in equity securities and investments in investment funds is considered as impairment. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

The recoverable amount of financial assets measured at amortised cost is calculated as the present value of the expected future cash flows, discounted at the instrument's original interest rate. Short-term balances are not discounted. Provisions for uncollectibility are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts (or lower amount if required by applicable CNB regulations). The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties. An increase in impairment losses is recognised in the income statement. When a loan is known to be uncollectable, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly. If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-off, the write-off or impairment loss is reversed through the income statement.

Notes to the financial statements (continued)

Impairment of assets not identified as impaired

In addition to the above described impairment losses on assets identified as impaired, the Bank recognises impairment losses, in income, in on and off-balance-sheet credit risk exposures not identified as impaired at rates from 0.85 - 1.20%, in accordance with the accounting regulations of the CNB (the Bank uses the rate of 0.85%).

Debt securities carried at fair value and classified as available for sale were excluded from the basis of such calculation at the reporting date.

(h) Specific financial instruments

Cash and cash equivalents

Cash and cash equivalents comprise of cash balances on hand, cash deposited with Croatian National Bank, placements with other banks with original maturities of three months or less, and items in course of collection.

Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to currency risk and interest rate risk arising from operating, financing and investing activities. In accordance with its investment policies, the Bank does not hold or issue derivative financial instruments for the purpose of speculative trading. Hedge accounting has not been applied and consequently, all derivative agreements are classified as financial instruments at fair value through profit or loss.

Derivative financial instruments include foreign currency forward agreements and swaps and are initially recognised at fair value which is the value of consideration paid to acquire the instrument less transaction costs. Subsequent to initial recognition, derivatives are measured at fair value. The fair value is determined based on the quoted market price or, if more appropriate, based on the discounted cash flow. All derivative instruments are presented as assets if their fair value is positive and as liabilities if their fair value is negative.

Hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is considered to represent an embedded derivative. Except as required to the contrary by the CNB, when the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract and when the hybrid contract is not itself carried at fair value through profit or loss, the embedded derivative is treated as a separate derivative and classified at fair value through profit or loss with all unrealised gains and losses recognised in the income statement, unless there is no reliable measure of their fair value.

Changes in the fair value of derivatives instruments are included in gains less losses arising from dealing with foreign currencies.

Treasury bills and debt securities

Treasury bills and debt securities that the Bank holds for the liquidity purposes are classified as available-for-sale assets, and are carried at fair value.

Equity securities and investments in open-ended investment funds

Equity securities and investments in open-ended and close-ended investment funds are classified as available-for-sale assets.

Notes to the financial statements (continued)

Placements with banks

Placements with banks are classified as loans and receivables and are carried at amortised cost less impairment losses.

Loans and advances to customers

Loans and advances to customers are classified as loans and receivables and are presented net of impairment allowances to reflect the estimated recoverable amounts.

Borrowings

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

Repurchase agreements and linked transactions

The Bank enters into purchases/(sales) of investments under agreements to resell (repurchase) substantially identical investments or in a series of linked sales and buy-back transactions at a certain date in the future at a fixed price. The amounts paid are recognised in loans and advances to either banks or customers. The receivables are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the balance sheet and are measured in accordance with the accounting policy for the relevant financial asset at amortised cost or at fair value as appropriate. The proceeds from the sale of the investments are reported as liabilities to either banks or customers.

The difference between the sale and repurchase consideration is recognised on an accrual basis over the period of the transaction and is included in interest income or expense.

Offsetting of 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.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

(i) Income tax

The income tax charge is based on taxable profit for the year and comprises of current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred taxes are calculated by using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted at the balance sheet date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

Notes to the financial statements (continued)

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the balance sheet. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. At each balance sheet date, the Bank reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets.

(j) Property and equipment

Property and equipment are tangible assets that are held for use in the supply of services or other administrative purposes.

Recognition and measurement

Property and equipment are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

Land and assets under development are not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost over their estimated useful lives as follows:

	2010	2009
Buildings	33 years	33 years
Computers	5 years	5 years
Furniture and equipment	7-15 years	7-15 years
Motor vehicles	4 years	4 years
Other assets	10 years	10 years

Residual values are not taken into account. Depreciation methods and estimated useful lives are reassessed at the each reporting date. Gains and losses on disposals are determined by comparing proceeds with carrying amount, and are included in the income statement.

(k) Intangible assets

Intangible assets are stated at cost less accumulated amortization and impairment losses. Expenditure on development activities are capitalised if all of the features required by IAS 38 "Intangible Assets" are satisfied. Amortisation is provided on a straight-line basis over the estimated useful lives of intangible assets. Costs associated with maintaining intangible assets are recognised as an expense as incurred.

Intangible assets are amortised on a straight-line basis over their estimated useful economic lives as follows:

	2010	2009
Leasehold improvements	5 years	5 years
Software	5 years	5 years
Licences	5 years	5 years

Notes to the financial statements (continued)

(l) Impairment of non-financial assets

The recoverable amount of property and equipment and intangible assets is the higher of the asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit.

Non-financial assets that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognised.

(m) Provisions for liabilities and charges

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

Provision for liabilities and charges are maintained at a level which management believes is adequate to absorb probable future losses. The management 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 relevant factors. Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

(n) Operating leases

Leases where the Bank as a lessor retains substantially all the risks and rewards incidental to ownership are classified as financial leases. The Bank did not have any financial leases on the balance sheet date, neither as a lessee or lessor. All leases are operating leases. Rental income under operating leases is recognised in the income statement on a straight-line basis over the term of the lease. The Bank leases office space for conducting its business activities. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.

(o) Employee benefits

Pension obligations

The Bank pays contributions to state-owned institutions and obligatory pension funds managed by privately owned management companies, in accordance with legal requirements or individual choice. The Bank has no further payment obligations once the contributions have been paid. The pension contributions are recognised as employee benefits in the income statement as they accrue.

Other employee benefits

Liabilities based on other long-term employee benefits, such as jubilee awards and statutory termination benefits, are recorded as the net present value of the liability for defined benefits at the balance sheet date. The projected discounted present value unit method is used for the calculation of the present value of the liability, using discount rates that, in opinion of the Bank's management, best represent the time value of money.

Notes to the financial statements (continued)

(p) Share capital and reserves

Issued share capital represents the nominal value of paid-in ordinary shares classified as equity and is denominated in HRK.

Reserve for general banking risks

The Bank recognises a reserve for general banking risks, which represents a reserve for potential losses in excess of those expected and provided for through recognised impairment losses. The reserve is calculated in accordance with applicable regulations which require that a certain percentage of net profit for the year be set aside as a reserve within equity if the growth of risk assets on an annual basis exceeds a specific level. The reserve for general banking risk cannot be transferred to retained earnings or be otherwise distributed until the expiry of a consecutive three year period in which the Bank has recorded annual growth not exceeding 15%. Given that the stated excess has not occurred, the Bank has not created a reserve for general banking risk.

Accumulated losses

Profit for the year is transferred to accumulated loss. Accumulated losses include losses from previous periods, the profit for the year and expenditures related to acquisition of property in the prior period.

Earnings per share

The Bank presents earnings per share (EPS) data for its ordinary shares. EPS is calculated by dividing the net profit attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period.

(r) Off-balance-sheet commitments and contingent liabilities

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

(s) Funds management for and on behalf of third parties

The Bank manages funds for and on behalf of corporate and retail customers. These amounts do not represent the Bank's assets and therefore are excluded from the balance sheet. For the services rendered, the Bank charges a fee which is recognised in the income statement on an accruals basis.

Notes to the financial statements (continued)

2. RISK MANAGEMENT

2.1 Internal assessment of risk of the Bank's operations

This section provides details of the Bank's exposure to risk and describes the methods used by management to identify, measure and manage risk in order to safeguard capital. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk.

2.1.1 Credit risk

The Bank is subject to credit risk through its lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties. Credit risk can be defined as a risk of financial loss of the Bank by a counterparty failing to discharge its obligation.

To manage the level of credit risk, the Bank evaluates debtors' creditworthiness, and in order to minimise credit risk, obtains appropriate collateral. Also, the risk that counterparties to financial instruments might default on their obligations is monitored on an ongoing basis.

The Bank's primary exposure to credit risk arises from loans to and receivables from customers. The amount of credit exposure in this regard, and in respect of held-to-maturity securities recognised at amortised cost, is represented by the carrying amounts of the assets on the balance sheet. In addition, the Bank is exposed to the credit risk in respect of the off-balance-sheet items, through commitments arising from unused facilities and guarantees issued.

The Bank manages its credit risk exposure in accordance with the legislative requirements and regulations of the Croatian National Bank, as well as in accordance with its internal procedures.

Assessment of credit risk of the placements

Process of credit risk rating of placements comprises the following:

- debtors' creditworthiness,
- debtors' timeliness in meeting their obligations and
- collateral quality.

Assessment of creditworthiness is preformed on each loan application, that is, minimum once a year subsequent to the delivery of the annual financial reports by the clients to which the Bank is exposed and who have not filed a loan request for a new risky product.

Creditworthiness implies the ability of a client to comply with credit terms or potential obligations and to ensure fulfilment of accepted obligation towards the Bank with its own funds, in the manner and within period determined by the contract and that client's operations comply with laws and regulations.

Assessment of creditworthiness of a corporate customer is preformed at least by following criteria:

1. the nature of the debtor
2. the debtor's capital
3. creditworthiness of the debtor
4. liquidity and profitability
5. cash flow of the debtor
6. the general business terms and conditions and the outlook of the debtor
7. the debtor's exposure to currency indicated credit risk.

Monitoring of placements and contingent obligations includes continuous assessment whether elements exist which would indicate a deterioration of the customer's financial position, the customer's exposure to currency risk or an increase in risk due to the decrease of collateral value.

Notes to the financial statements (continued)

Classification of placements into risk categories

The process and criteria for the classification of placements into risk categories and calculation of impairment losses is defined by the By-law on classification of placements and contingent liabilities of Vaba d.d. banka, in accordance with the CNB's Decision on Classification of Placements and Contingent Liabilities of Banks.

The Bank assesses quality of placements and contingent liabilities continuously and classifies them based on the following general criteria:

a) creditworthiness of the debtor,

b) debtors' timeliness in meeting their obligations and

c) collateral quality.

The Bank uses all of the criteria in the process of classification of placements, in line with general practice of credit risk management.

Exceptionally, in accordance with the CNB's Decision on Classification of Placements and Contingent Liabilities of Banks, the Bank classifies placements from the "small loan portfolio" into risk categories based on the debtors' timeliness in meeting their obligations and/or their collateral quality with individually significant placements being classified based on the collateral quality if the key criteria for the approval of the placement was not the creditworthiness of the debtor, but the collateral quality (with obligatory assessments of fair value and marketability of the collateral).

Based on the criteria and the classification of the placements and contingent liabilities which are defined separately for the "small loan portfolio" (total exposure toward one counterparty or a group of related counterparties less than 200,000 kuna at the assessment date) and for the individually significant exposures (total exposure toward one counterparty or a group of related counterparties more than 200,000 kuna at the assessment date), the Bank classifies all its placements into risk categories with impairment losses as follows:

1. **Risk category A** – newly approved placements upon initial approval and placements that the Bank estimates are fully recoverable – with no impairment losses on individual basis (impairment losses for risk category A placements are calculated on the group basis).
2. **Risk category B –** partly recoverable placements – **risk category B,** which are classified into three subcategories, depending on the percentage of the impairment losses in relation to the initial amount of placements:

    B1 – losses ranging from 1% to 29,99%,

    B2 – losses ranging from 30,00% to 69,99%,

    B3 – losses ranging from 70,00% to 99,99%.
3. **Risk category C** – non-recoverable placements with impairment losses of 100%.

Classification into risk categories is done at least on quarterly basis. Risk categories for "small loan portfolio" are applied systematically with control of Sector for risk management. Assessment of recoverability of placements which are not part of "small loan portfolio" is done continuously and risk categories are updated at least on quarterly basis on suggestion of Sector for risk management.

Assets exposed to credit risk

Based on the applicable acts, the Bank uses the usual instruments as collaterals: bank guarantees, fiduciary right on real estate and movable assets, insurance policies, fiduciary rights on securities and shares in open-ended investment funds, cessions of receivables from companies and governments, bills of exchanges and pledges of accounts. Fair value appraisals of real estate and movable assets are done by certified appraisers form the Bank's list of certified appraisers. Fair value of collateral is revised based on usual business practice and market movements.

Notes to the financial statements (continued)

The table presented below discloses the maximum exposure of the Bank to credit risk as at 31 December 2010 and 31 December 2009, where by existing collateral is not taken into account. The exposure disclosed in the table below represents the exposure net of impairment losses.

Assets	Notes	Restated 31.12.2009 (HRK '000)	2010 (HRK '000)
Amounts due from banks	4	39,555	79,365
Obligatory reserve with Croatian National Bank	5	88,150	102,594
Placements with and loans to other banks	6	1,086	13,792
Financial assets available for sale	7	187,648	248,041
Financial assets held to maturity	8	4,094	17,515
Loans and advances to customers	9	818,217	885,163
Other assets	12	5,848	15,444
Total assets exposed to credit risk		**1,144,598**	**1,361,914**
Unused loan commitments	34	39,649	42,837
Guarantees	34	27,774	24,655
Other contingent liabilities	34	1,986	1,247
Total off balance sheet exposure to credit risk		**69,409**	**68,739**
Total credit exposure		**1,214,006**	**1,430,653**

Uncollected due receivables

Uncollected due receivables include gross receivables based on maturity of both due and not due principal, on individual basis, including due but uncollected interest. Total amount of individual placement is allocated to the maturity class of the oldest uncollected receivable, relating to either principal or the interest.

Restructured loans and advances to customers

Widespread economic situation and longer collection time periods heavily influenced restructuring of loans, mostly applied to loans with expected difficulties of regular servicing of debt due to disparity of collection of their trade receivables and maturity of their trade payables. With decrease of business activities, resulting from the global recession, restructuring of loans enable the clients to be able to service their debt in accordance with current market conditions. The Bank approves restructuring of a loan only after the client delivers a credible business plan showing ability of future repayments and usually additional collateral is required as well.

The Bank approves restructuring for overcoming liquidity problems of the clients with objective of decreasing their instalments by increasing maturities of the loans, resulting in more regular dynamic of repayments, improvement of liquidity and long term sustainability.

Notes to the financial statements (continued)

31 December 2010	Gross	%	Impairment loss for identified losses	Impairment loss for unidentified losses	Total impairment loss	*Total impairment loss /gross*	Net	Collateral value	*Collateral value / net*
	(HRK '000)								
	1	2	3	4	5 = 3 + 4	6 = 5 / 1	7 = 1 - 5	8	9 = 8 / 7
Amounts due from banks	79,365	*100.00%*	-	-	-	-	79,365	-	-
A	79,365	*100.00%*	-	-	-	-	79,365	-	-
Obligatory reserve with the CNB	102,594	*100.00%*	-	-	-	-	102,594	-	-
A	102,594	*100.00%*	-	-	-	-	102,594	-	-
Placements with and loans to other banks	13,792	*100.00%*	-	-	-	-	13,792	-	-
A	13,792	*100.00%*	-	-	-	-	13,792	-	-
Available for sale financial assets	248,041	*100.00%*	-	-	-	-	248,041	-	-
A	248,041	*100.00%*	-	-	-	-	248,041	-	-
B, C	-	-	-	-	-	-	-	-	-
Held to maturity investments	17,515	*100.00%*	-	-	-	-	17,515	-	-
A	17,515	*100.00%*	-	-	-	-	17,515	-	-
B, C	-	-	-	-	-	-	-	-	-
Loans and advances to customers	934,338	100.00%	40,547	8,628	49,175	5.26%	885,163	347,414	39.25%
A	-	-	-	-	-	-	-	-	-
B, C	-	-	-	-	-	-	-	-	-
Government entities	13,979	100.00%	-	-	-	-	13,979	-	-
A	*13,979*	*100.00%*	-	-	-	-	13,979	-	-
B, C	-	-	-	-	-	-	-	-	-
Corporate	673,932	100.00%	21,766	7,897	29,663	4.40%	644,269	286,011	44.39%
A	*570,398*	*84.64%*	-	*7,897*	*7,897*	*1.38%*	*562,501*	*221,116*	*39.31%*
B, C	*103,534*	*15.36%*	*21,766*	-	*21,766*	*21.02%*	*81,768*	*64,895*	*79.36%*
Retail	212,273	100.00%	18,781	708	19,489	9.18%	192,784	61,403	31.85%
A	*183,878*	*86.62%*	-	*708*	*708*	*0.39%*	*183,170*	*57,823*	*31.57%*
B, C	*28,395*	*13.38%*	*18,781*	-	*18,781*	*66.14%*	*9,614*	*3,580*	*37.24%*
Other loans and advances	34,154	*100.00%*	-	23	23	0.07%	34,131	-	-
A	*34,154*	*100.00%*	-	*23*	*23*	*0.07%*	*34,131*	-	-
B, C	-	-	-	-	-	-	-	-	-
Other assets	18,261	*100.00%*	2,817	-	2,817	*15.43%*	15,444	-	-
A	15,247	*83.49%*	-	-	-	-	15,247	-	-
B, C	3,014	*16.51%*	2,817	-	2,817	*93.46%*	197	-	-
TOTAL ASSETS	**1,413,906**		**43,364**	**8,628**	**51,992**		**1,361,914**	**347,414**	

Notes to the financial statements (continued)

31 December 2009 (HRK '000)	Gross	*%*	Impairment loss for identified losses	Impairment loss for unidentified losses	Total impairment loss	*Total impairment loss /gross*	Net	Collateral value	*Collateral value / net*
	1	2	3	4	5 = 3 + 4	6 = 5 / 1	7 = 1 - 5	8	9 = 8 / 7
Amounts due from banks	39,555	*100.00%*	-	-	-	-	39,555	-	-
A	39,555	*100.00%*	-	-	-	-	39,555	-	-
Obligatory reserve with the CNB	88,150	*100.00%*	-	-	-	-	88,150	-	-
A	88,150	*100.00%*	-	-	-	-	88,150	-	-
Placements with and loans to other banks	1,086	*100.00%*	-	-	-	-	1,086	-	-
A	1,086	*100.00%*	-	-	-	-	1,086	-	-
Available for sale financial assets	188,213	*100.00%*	-	565	565	*0.30%*	187,648	-	-
A	188,213	*100.00%*	-	565	565	*0.30%*	187,648	-	-
B, C	-	-	-	-	-	-	-	-	-
Held to maturity investments	4,094	*100.00%*	-	-	-	-	4,094	-	-
A	4,094	*100.00%*	-	-	-	-	4,094	-	-
B, C	-	-	-	-	-	-	-	-	-
Loans and advances to customers	853,601	*100.00%*	25,445	8,625	34,070	*3.99%*	819,531	312,257	*38.10%*
A	762,393	*89.31%*	-	8,625	8,625	*1.13%*	753,768	261,267	*34.66%*
B, C	91,208	*10.69%*	25,445	-	25,445	*27.90%*	65,763	50,990	*77.54%*
Government entities	*7,735*	*100.00%*	-	-	-	-	*7,735*	-	-
A	*7,735*	*100.00%*	-	-	-	-	*7,735*	-	-
B, C	-	-	-	-	-	-	-	-	-
Corporate	*567,846*	*100.00%*	*7,162*	*7,020*	*14,182*	*2.50%*	*553,664*	*247,739*	*44.75%*
A	*498,537*	*87.79%*	-	*7,020*	*7,020*	*1.41%*	*491,517*	*197,650*	*40.21%*
B, C	*69,309*	*12.21%*	*7,162*	-	*7,162*	*10.33%*	*62,147*	*50,089*	*80.60%*
Retail	*240,545*	*100.00%*	*18,283*	*1,579*	*19,862*	*8.26%*	*220,683*	*64,518*	*29.24%*
A	*218,646*	*90.90%*	-	*1,579*	*1,579*	*0.72%*	*217,067*	*63,617*	*29.31%*
B, C	*21,899*	*9.10%*	*18,283*	-	*18,283*	*83.49%*	*3,616*	*901*	*24.92%*
Other loans and advances	*37,475*	*100.00%*	-	*26*	*26*	*0.07%*	*37,449*	-	-
A	*37,475*	*100.00%*	-	*26*	*26*	*0.07%*	*37,449*	-	-
B, C	-	-	-	-	-	-	-	-	-
Other assets	4,908	*100.00%*	2,902	-	2,902	*59.13%*	2,006	-	-
A	1,950	*39.73%*	-	-	-	-	1,950	-	-
B, C	2,958	*60.27%*	2,902	-	2,902	*98.11%*	56	-	-
TOTAL ASSETS	**1,179,607**		**28,347**	**9,190**	**37,537**		**1,142,070**	**312,257**	

Notes to the financial statements (continued)

2.1.2 Market risks

The exposure to market risk occurs in respect of positions recognised at fair value and refers to securities and other financial instruments held for trading, securities and other financial instruments available for sale and positions denominated in foreign currency.

2.1.2.1 Foreign exchange risk

Foreign exchange operations of the Bank are subject to risks due to changes in intercurrency relationships, as well as changes in foreign currency rates in relation to the domestic currency. The Bank monitors changes in the foreign currency sub ledger on a daily basis by monitoring the relationship between the foreign currency receivables and liabilities, in accordance with the regulations of the CNB on the open foreign exchange position.

The Bank uses the open foreign exchange position (gap analysis) to measure and report exposure to currency risk in accordance with the methodology prescribed by the Croatian National Bank. Operational management of foreign currency position, within the prescribed limits is responsibility of the Treasury Department, which has the ability to propose measures to eliminate currency gap through a reduction or increase in loans and deposits with a currency clause, selling or buying the currency, or through arbitration - selling one currency for another.

The Risk Management Division controls the compliance with limits on a daily basis, and monthly reports to Asset and Liability Management Committee on foreign exchange risk exposure.

Notes to the financial statements (continued)

Foreign exchange risk

Balance sheet as at 31 December 2010	HRK	HRK with foreign currency clause	EUR	Other foreign currencies	Total
ASSETS					
Cash and amounts due from banks	64,164	-	30,379	3,607	**98,150**
Obligatory reserves with Croatian National Bank	85,304	-	-	17,289	**102,593**
Placements with and loans to other banks	11,000	-	-	2,792	**13,792**
Financial assets available for sale	85,578	27,698	119,329	15,436	**248,041**
Financial assets held to maturity	17,515	-	-	-	**17,515**
Loans and advances to customers	269,632	504,594	110,937	-	**885,163**
Property and equipment	28,292	-	-	-	**28,292**
Intangible assets	18,024	-	-	-	**18,024**
Other assets	15,444	-	-	-	15,444
TOTAL ASSETS	**594,953**	**532,292**	**260,645**	**39,124**	**1,427,014**
LIABILITIES					
Deposits from banks	-	-	17,741	-	**17,741**
Deposits from customers	371,877	10,760	668,107	29,732	**1,080,476**
Borrowings	29,101	8,859	-	116,720	**154,680**
Hybrid instruments	-	-	-	2,954	**2,954**
Provisions for liabilities and charges	2,164	-	-	-	**2,164**
Other liabilities	18,976	-	-	3,127	**22,103**
TOTAL LIABILITIES	**422,118**	**19,619**	**685,848**	**152,533**	**1,280,118**
EQUITY					
Share capital	176,523	-	-	-	**176,523**
Share premium	27,464	-	-	-	**27,464**
Other reserves	2,611	-	-	-	**2,611**
Fair value reserve	(674)	-	-	-	**(674)**
Accumulated losses	(59,028)	-	-	-	**(59,028)**
TOTAL EQUITY	**146,896**	**-**	**-**	**-**	**146,896**
TOTAL LIABILITIES AND EQUITY	**569,014**	**19,619**	**685,848**	**152,533**	**1,427,014**
NET FOREIGN EXCHANGE POSITION	**25,939**	**512,673**	**(425,203)**	**(113,409)**	**-**

Notes to the financial statements (continued)

Restated Balance sheet as at 31 December 2009	HRK	HRK with foreign currency clause	EUR	Other foreign currencies	Total
ASSETS					
Cash and amounts due from banks	26,457	-	20,203	9,705	56,365
Obligatory reserves with Croatian National Bank	75,534	-	-	12,616	88,150
Placements with and loans to other banks	-	-	365	721	1,086
Financial assets available for sale	28,251	78,138	81,259	-	187,648
Financial assets held to maturity	4,094	-	-	-	4,094
Loans and advances to customers	234,687	401,600	181,930	-	818,217
Property and equipment	28,291	-	-	-	28,291
Intangible assets	18,501	-	-	-	18,501
Other assets	4,883	104	862	-	5,849
TOTAL ASSETS	**420,698**	**479,842**	**284,619**	**23,042**	**1,208,201**
LIABILITIES					
Deposits from banks	3,684	-	-	-	3,684
Deposits from customers	330,631	7,414	608,996	21,691	968,729
Borrowings	15,088	4,617	49,407	-	69,112
Hybrid instruments	-	-	2,923	-	2,923
Provisions for liabilities and charges	3,601	-	-	-	3,601
Other liabilities	9,072	73	-	-	9,145
TOTAL LIABILITIES	**362,076**	**12,104**	**661,326**	**21,691**	**1,057,194**
EQUITY					
Share capital	176,523	-	-	-	176,523
Share premium	27,464	-	-	-	27,464
Other reserves	2,611	-	-	-	2,611
Fair value reserve	395	-	-	-	395
Accumulated losses	(55,986)	-	-	-	(55,986)
TOTAL EQUITY	**151,007**	**-**	**-**	**-**	**151,007**
TOTAL LIABILITIES AND EQUITY	**513,083**	**12,104**	**661,326**	**21,691**	**1,208,201**
NET FOREIGN EXCHANGE POSITION	**(92,385)**	**467,738**	**(376,707)**	**1,351**	**-**

2.1.2.2 Position risk

The exposure to position risk relates to risk arising from changes in value of a financial instrument or changes in underlying variable of derivatives.

Financial instruments held for trading are exposed to general position risk, which is the risk of loss due to price change of financial instruments which can occur due to interest rate changes, or more significant changes on capital markets not related to any specific characteristics of financial instruments. Related instruments are also exposed to specific position risk which arises from price changes of individual financial instruments due to factors related to its issuer.

Asset and Liability Management Committee of the Bank establishes limits to exposures to financial assets available for sale. Decision on purchase/sale of a financial instrument and its classification into a category is made by the Management Board. Treasury Division does the transaction while the Risk Management Division

Notes to the financial statements (continued)

controls the compliance with the internal acts and monitors fair values of the financial instruments on daily basis, if available.

The Risk Management Division calculates: market risk exposure, usage of exposure to market risk limits and capital requirements for exposure to market risks.

In the measurement of the market risk exposure, the Bank relies on regulations set out by the Croatian National Bank and monitors the following:

- Capital requirements calculated by the standard method calculated in accordance with the Croatian National Bank's Decision on capital adequacy;
- Internal models of monitoring exposure to interest rate risk in the Bank's records.

The Risk Management Division reports daily to the Treasury Division on the usage of market risk exposure limits and reports to the Asset and Liability Management Committee monthly.

2.1.2.3 Interest rate risk

The Bank's operations are subject to the risk of loss which arises from potential interest rate fluctuations which affects positions in the Bank's records.

In line with cautious interest rate risk management, the Bank defines responsibilities in accordance with generally accepted standards and defined limits for maintaining an acceptable level of economic capital and achieving satisfactory financial results.

The majority of placements and deposits are initially contracted at variable interest rate in accordance with the Bank's Decision, except when, for competitive reasons, fixed interest rates are contracted.

The Bank utilises the following measures for measurement of interest rate risk exposure:

1. repricing gap analysis;
2. standard interest shock on net interest income;
3. "what if" simulation; and
4. economic value of capital simulation (duration analysis).

Since 31 March 2010, based on the Decision on interest rate management, Risk Management Division reports on interest rate exposure on quarterly basis. For each reporting period in 2010, economic value of capital in relation to capital adequacy was in line with the regulatory requirements.

Measuring exposure to interest rate risk

The Bank measures the exposure to interest rate risk from two perspectives; profit perspective and the perspective of economic value of capital.

Profit perspective

When calculating the effect of interest rate change on net interest income, the Bank uses standard interest shock on net interest income for a 12 month period. The simulation is based on parallel movements in all interest rates, increase/decrease by 2 percentage points for HRK and increase/decrease by 1 percentage point for EUR and all other currencies.

u 000 HRK

	2010.	2009.
Potential decrease in net interest income (000 kn)	-111	-307
% of budgeted net interest income	-0.23%	-0.60%

Perspective of economic value of capital

The perspective of economic value of capital (duration analysis) represents a long term measure of interest rate risk exposure in the balance sheet. The effect of interest rate changes on economic value of capital is measured by economic value of capital simulation. This model is based on duration analysis and the hypothesis is that economic value of capital is expressed as the difference between the present value of assets and the present value of liabilities. The calculation is based on balance sheet positions which are distributed according to repricing criteria.

Notes to the financial statements (continued)

The Bank calculates the market value of capital by discounting the balance sheet positions using a rate of 5%. The economic value of capital is expressed as the difference between the present value of assets and the present value of liabilities. The simulation of change in economic value of capital is based on a simultaneous parallel increase of interest rates by 1%.

Risk Management Division reports the results of the interest rate risk exposure to the Asset and Liability Management Committee.

	2010	**2009**
Net book value of capital (HRK '000)	146,896	151,007
Economic value of capital (HRK '000)	131,255	127,564
Change in economic value of capital (%)	-2.03%	-3.18%
Limit of change in market value of capital (%)	10.00%	10.00%

Interest rate risk stress test

Interest rate risk stress test is performed at least on yearly basis. It represents sensitivity analysis of net interest income and net interest margin on changes in interest rates based on repricing of sensitive positions. Risk Management Division selects at least two scenarios, informing the Asset and Liability Committee on the results.

Notes to the financial statements (continued)

Interest rate gap analysis

Balance sheet as at 31 December 2010	2010 (HRK' 000)							
	up to 1 month	1 month to 3 months	3 months to 1 year	1 to 3 years	over 3 years	Interest free	Total	Fixed interest rate
ASSET								
Cash and amounts due from banks	79,365	-	-	-	-	18,785	**98,150**	54,002
Obligatory reserves with Croatian National Bank	102,593	-	-	-	-	-	**102,593**	-
Placements with and loans to other banks	13,790	-	-	-	-	2	**13,792**	-
Financial assets available for sale	-	51,661	177,198	-	2,106	17,076	**248,041**	228,859
Financial assets held to maturity	11,575	5,216	-	-	-	724	**17,515**	16,791
Loans and advances to customers	597	1,035	810,126	5,942	2,119	65,344	**885,163**	14,559
Property and equipment	-	-	-	-	-	28,292	**28,292**	-
Intangible assets	-	-	-	-	-	18,024	**18,024**	-
Other assets	-	-	-	-	-	15,444	**15,444**	-
TOTAL ASSETS	**207,920**	**57,912**	**987,324**	**5,942**	**4,225**	**163,691**	**1,427,014**	**314,211**
LIABILITIES								
Deposits from banks	17,724	-	-	-	-	17	**17,741**	-
Deposits from customers	15,751	48,021	961,008	30,303	3,867	21,526	**1,080,476**	358,517
Borrowings	98,155	51,997	-	70	4,274	184	**154,680**	149,982
Hybrid instruments	-	-	-	-	-	2,954	**2,954**	-
Provisions from liabilities and charges	-	-	-	-	-	2,164	**2,164**	-
Other liabilities	-	-	-	-	-	22,103	**22,103**	-
TOTAL LIABILITIES	**131,630**	**100,018**	**961,008**	**30,373**	**8,141**	**48,948**	**1,280,118**	**508,499**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**146,896**	**146,896**	**-**
TOTAL LIABILITIES AND EQUITY	**131,630**	**100,018**	**961,008**	**30,373**	**8,141**	**195,844**	**1,427,014**	**508,499**
INTEREST GAP	**76,290**	**(42,106)**	**26,316**	**(24,431)**	**(3,916)**	**(32,153)**	**-**	**(194,288)**

As at 31 March 2010 the Decision on interest rate management became effective. Based on the Decision the Bank adjusted its internal acts, defining balance sheet items it considers interest risk sensitive. Based on the Management Board decision, all loans with variable interest rates fall under time slot in which changes in interest rates are expected. Considering that significant part of the loan portfolio relates to loans with variable interest rates, the biggest section was allocated to the time slot of 3 months to 1 year (which was defined as the time period in which next change in the interest rates is expected). In comparison to 2009, interest free category includes C category placements, overdue A placements, deposit – secured loans and interest receivables, while in 2009 only interest receivables were included into the category.

Notes to the financial statements (continued)

Balance sheet as at 31 December 2009	Restated 2009 (HRK' 000)							
	up to 1 month	1 month to 3 months	3 months to 1 year	1 to 3 years	over 3 years	Interest free	Total	Fixed interest rate
ASSET								
Cash and amounts due from banks	39,555	-	-	-	-	16,810	56,365	-
Obligatory reserves with Croatian National Bank	88,102	-	-	-	-	48	88,150	-
Placements with and loans to other banks	1,078	-	-	-	-	8	1,086	-
Financial assets available for sale	27,760	46,173	83,272	-	2,078	28,365	187,648	159,283
Financial assets held to maturity	2,782	674	286	-	-	352	4,094	3,742
Loans and advances to customers	105,909	147,017	553,603	2,528	330	8,830	818,217	4,578
Property and equipment	-	-	-	-	-	28,291	28,291	-
Intangible assets	-	-	-	-	-	18,501	18,501	-
Other assets	-	-	-	-	-	5,849	5,849	-
TOTAL ASSETS	**265,186**	**193,864**	**637,161**	**2,528**	**2,408**	**107,054**	**1,208,201**	**167,603**
LIABILITIES								
Deposits from banks	37,940	-	-	-	-	340	3,684	-
Deposits from customers	229,959	137,243	518,832	23,974	6,383	17,685	968,729	449,553
Borrowings	69,007	-	-	-	-	105	69,112	-
Hybrid instruments	-	-	-	-	-	2,923	2,923	-
Provisions from liabilities and charges	-	-	-	-	-	3,601	3,601	-
Other liabilities	-	-	-	-	-	9,145	9,145	-
TOTAL LIABILITIES	**336,906**	**137,243**	**518,832**	**23,974**	**6,383**	**33,856**	**1,057,194**	**449,553**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**151,007**	**152,321**	**-**
TOTAL LIABILITIES AND EQUITY	**336,906**	**137,243**	**518,832**	**23,974**	**6,383**	**184,863**	**1,208,201**	**449,553**
INTEREST GAP	**(71,720)**	**56,621**	**118,329**	**(21,446)**	**(3,975)**	**(77,809)**	**-**	**(281,950)**

Notes to the financial statements (continued)

2.1.2.4 Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of its positions. The main categories of liquidity risk to which the Bank is exposed are:

- inability to settle liabilities as a result of the maturity gap between cash inflow and outflow - structural liquidity risk, and
- risk of being unable to sell or acquire liquid asset at market in an appropriate timeframe and at a reasonable price - liquidity risk of financial instruments.

The liquidity risk management is conducted in compliance with regulatory requirements, and is also defined with the following internal acts:

- liquidity risk management policy,
- liquidity stress test procedure,
- procedure for the Bank's liquidity management,
- liquidity risk (crisis) plan.

Internal acts are proposed by the Risk Management Division and approved by the Bank's Management Board. In accordance with changes proposed by the Risk Management Division, a revision of internal acts is made.

The liquidity monitoring system is aimed at assessing the Bank's short-term liquidity and its ability to comply with future financing requirements. The Bank continuously aims its activities on improving the quality of the model and the entire process of liquidity management by upgrading the monitoring system, its related assumptions and by enhancing technical support in the procedural process.

The key purpose of the liquidity policy is to ensure that the Bank operates in a way to achieve an optimal balance between the Bank's safety and shareholders return on investment. Framework for a appropriate liquidity risk management comprises of: liquidity management strategy approved by the Management Board within budget and strategic plans, efficient supervision by Asset and Liability Management Committee and the Management Board, clearly defined responsibilities and conducts operations in line with agreed limits, management of assets and liabilities by matching their maturities, an established evaluation system of all current and future inflows and outflows, liabilities structure management, specifically in monitoring concentration of large deposits, sustained development of liquidity stress tests, assessment of access to financial markets and available funds under usual and stressed conditions and a crisis plan.

As part of it's business activities the Bank monitors liquidity risk and complies with regulations, following measures are part of liquidity risk management:

- prescribed ratio of short-term foreign currency receivables in relation to payables, which are monitored on a daily basis;
- reserve requirements - HRK;
- reserve requirements - foreign currency; and
- minimum liquidity ratio.

The purpose of management liquidity funds is compliance with regulatory minimum in a method to maintain minimum cost of liquidity funds.

The following liquidity risk indicators are monitored by the Bank:

- financial and structural indicators;
- deposit concentration;
- cash flow notice and projection system; and
- liquidity stress tests.

Notes to the financial statements (continued)

The Bank raises funds using a broad range of instruments including deposits, borrowings, subordinated loans and share capital. The Bank continuously assesses its liquidity risk by identifying and monitoring changes in the level of funding required to achieve business goals and strategic targets. Diverse funds enable flexibility, decrease dependence on a single source of funding and enable straightforward management of financing costs.

Liquidity stress test

Liquidity stress tests are done based on analysis of different scenarios, i.e. assessment of effects of simultaneous changes in several different factors of risk for the financial position of the Bank in clearly defined stress circumstances. The Bank performs liquidity stress tests adapted to business size and characteristics, strategic goals and plans, internal Bank's organization and its environment, to ensure sufficient liquidity funding. The aim of the liquidity stress test is to recognise a situation and to prepare relevant function of the Bank for prompt reaction in the case of a liquidity crisis. The development of the liquidity stress test represents the Bank's internal policy and is good practice for liquidity management. Management of the long term liquidity is accomplished by position maintenance with regards to liquidity risk exposure limits.

Stress scenario is arbitrarily selected, approved by the Risk Management Division. Two scenarios are selected, at minimum, one including Bank specific factors, the other including market factors. Different combinations of the factors are possible as well.

Selection of scenarios is usually affected by:

- current market movements;
- other movements historically significant for the Bank's liquidity;
- future predictions based on available information significant for the Bank's liquidity.

Upon selection of stress scenario, Treasury Division analyses the scenario or does the sensitivity analysis, depending on whether one or more factors on the financial position of the Bank are analysed. Risk Management Division and the Treasury Division report the results of the stress tests to the Asset and Liability Management Committee.

Notes to the financial statements (continued)

Maturity analysis

Balance sheet as at 31 December 2010	2010 (HRK '000)					
	up to 1 month	1 month to 3 months	3 months to 1 year	1 to 3 years	over 3 years	Total
ASSETS						
Cash and amounts due from banks	98,150	-	-	-	-	**98,150**
Obligatory reserves with Croatian National Bank	102,593	-	-	-	-	**102,593**
Placements with and loans to other banks	4,705	34	2,553	-	6,500	**13,792**
Financial assets available for sale	119,329	11,688	-	15,436	101,588	**248,041**
Financial assets held to maturity	-	17,515	-	-	-	**17,515**
Loans and advances to customers	201,297	77,641	266,240	149,033	190,952	**885,163**
Property and equipment	-	-	-	-	28,292	**28,292**
Intangible assets	-	-	-	-	18,024	**18,024**
Other assets	7,773	908	-	-	6,763	**15,444**
TOTAL ASSETS	**533,847**	**107,786**	**268,793**	**164,469**	**352,119**	**1,427,014**
LIABILITIES						
Deposits from banks	17,741	-	-	-	-	**17,741**
Deposits from customers	273,738	146,177	561,860	91,139	7,562	**1,080,476**
Borrowings	106,826	38,996	-	-	8,858	**154,680**
Hybrid instruments	-	-	-	-	2,954	**2,954**
Provisions for liabilities and charges	-	-	2,164	-	-	**2,164**
Other liabilities	17,873	1,273	2,957	-	-	**22,103**
TOTAL LIABILITIES	**416,178**	**186,446**	**566,981**	**91,139**	**19,374**	**1,280,118**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**146,896**	**146,896**
TOTAL LIABILITIES AND EQUITY	**416,178**	**186,446**	**566,981**	**91,139**	**166,270**	**1,427,014**
MATURITY GAP	**117,669**	**(78,660)**	**(298,188)**	**73,330**	**185,849**	**-**
CUMULATIVE MATURITY GAP	**117,669**	**39,009**	**(259,179)**	**(185,849)**	**-**	**-**

Notes to the financial statements (continued)

Balance sheet as at 31 December 2009	2009 (HRK '000)					
	up to 1 month	1 month to 3 months	3 months to 1 year	1 to 3 years	over 3 years	Total
ASSETS						
Cash and amounts due from banks	56,365	-	-	-	-	56,365
Obligatory reserves with Croatian National Bank	88,150	-	-	-	-	88,150
Placements with and loans to other banks	373	-	713	-	-	1,086
Financial assets available for sale	56,144	46,751	82,675	-	2,078	187,648
Financial assets held to maturity	3,134	674	286	-	-	4,094
Loans and advances to customers	114,739	145,703	232,549	122,663	202,563	818,217
Property and equipment	-	-	-	-	28,291	28,291
Intangible assets	-	-	-	-	18,501	18,501
Other assets	3,321	-	-	2,528	-	5,849
TOTAL ASSETS	**322,226**	**193,128**	**316,223**	**125,191**	**251,433**	**1,208,201**
LIABILITIES						
Deposits from banks	840	-	2,844	-	-	3,684
Deposits from customers	282,355	137,243	470,844	67,470	10,817	968,729
Borrowings	51,495	13,000	-	-	4,617	69,112
Hybrid instruments	-	-	-	-	2,923	2,923
Provisions for liabilities and charges	-	-	3,601	-	-	3,601
Other liabilities	3,721	870	2,627	727	1,200	9,145
TOTAL LIABILITIES	**338,411**	**151,113**	**479,916**	**68,197**	**19,557**	**1,057,194**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**151,007**	**151,007**
TOTAL LIABILITIES AND EQUITY	**338,411**	**151,113**	**479,916**	**68,197**	**170,564**	**1,208,201**
MATURITY GAP	**(16,185)**	**42,015**	**(163,693)**	**56,994**	**80,869**	**-**
CUMULATIVE MATURITY GAP	**(16,185)**	**25,830**	**(137,863)**	**(80,869)**	**-**	**-**

Notes to the financial statements (continued)

2.1.3 Operational risks

Operational risk is defined as the risk of loss due to inadequate or incorrect internal processes, human or system errors or events caused by external factors (natural disasters, fire, flood, attack, changes of legislation, embezzlement). Operational risk exists in every segment of the Bank's operations, requiring knowledge and continuous monitoring of all business processes. Organisational model of operational risk management is set up on centralised and decentralised levels of operational risk management.

Operational risk is managed in accordance with applicable legislation and is defined by the following internal acts:

- policy on operational risk management
- procedure on operational risk management
- methodology for operational risk management
- directive od reporting of operational losses and operational risks

When measuring exposure to the operational risk, The Bank, based on the consequences of a risk event, differs the following:
Loss from operational risk, which represents operational losses affecting the balance sheet and assumes known amount of losses in the Bank's records.
Significant operational risk, which is present in business processes and has not resulted in operational losses, but there is a possibility of future operational losses resulting from it.

Self Risk Assessment is performed for every Bank's business process. Self Risk Assessment is done on yearly basis based on questionnaires prepared in accordance with Basel guidelines. Based on the collected data, each reported event which could result in operational risk is quantified and classified into a risk category. For events for which risks are high and very high, business processes owners, in coordination with the Risk Management Division, propose action for reducing exposure to an operational risk using methods for reduction of effects, i.e. damages and probability of occurrence or transferring the risk to a counterparty. Risk Management Division reports the results of the Self Risk Assessment to the Management Board once a year.

Risk Management Division reports the Management Board quarterly on recorded operational losses, i.e. events which resulted in losses recorded in the Bank's records due to exposure to operational risk. Report on operational losses contains, at minimum, data on amounts of losses, recovered amounts, unrecovered amounts, operational losses per type of event and cause and share of different organisational parts of the Bank in operational losses.

For operational risk management, The Bank has secured the following:

- adequate IT system management by using the following internal acts: Safety policy and Bylaw on adequate use of IT systems
- adequate risk management related to externalisation by using the following internal acts: Bylaw on externalisation and Procedure for externalisation
- adequate compliance risk management by using the following internal acts: Bylaw on compliance monitoring and implementation and Methodology for controls of organisational compliance of processes with internal and external processes
- adequate business continuity management by using the following internal acts: Business continuity policy and Business continuity procedure
- adequate system for prevention of money laundry and financing of terrorism by using the following internal acts: Policies and procedures for prevention of money laundry and financing of terrorism.

Notes to the financial statements (continued)

2.1.4 Concentration risks

Risk of concentration is every individual, direct or indirect exposure toward one counterparty or group of related parties or group of exposures connected by common risk factors such as industry, geographical area, operations or goods, i.e. application of techniques for credit risk reduction, which can cause such losses which could put the Bank's operations in question.

The Bank analyses and reports on concentration risk present both on the asset side of the balance sheet, i.e. loan portfolio, as well as on the capital and liability side of the balance sheet.

The Bank analyses concentration risk on the basis of each individual, direct or indirect exposure toward one counterparty or group of related parties and has regulated identification of related parties by internal acts, determining:

1) control, i.e. relationship between the parent company and its subsidiary or similar relationship between any entity or individual and
2) economical and financial ties.

Relationship is established mainly on the basis of information/data received from the client, but also by checking other available sources. Groups of related parties are entered into Registry of related parties, comprehensive database.
Identification and measurement of concentration relates to group of exposures connected by common risk factors such as common industry, geographical area or similar operations.
In order to maintain diversified and stable base of financing and to avoid overdependence on only certain sources, concentration is monitored for the following:

- clients or groups of related parties whose deposits make more than 2% of the Bank's total liabilities on both individual and group basis
- deposits from companies and other financial institutions: individual deposit and 10 biggest deponents in relation to the total deposits from companies and financial institutions and relating to the total deposits
- retail deposits: 10 and 100 biggest deponents from retail sector as a percentage
- total retail deposits as a percentage of total deposits.

Risk Management Division reports the concentration risk to the Asset and Liability Management Committee on monthly basis.

2.1.5 Business continuity management

The Bank has adopted internal acts regulating the plan for business continuity management for the main business processes. The plan contains data on key personnel contacts, alternative locations in case of operations discontinuity, descriptions of key processes and strategies for their emergency recovery and documentation to be prepared in the case of operations discontinuity.

2.2 The Bank's general acts

2.2.1 General acts regulating credit policy

General acts regulating credit policy and asset and liability management are given as follows.

2.2.1.1 Credit policy objective

Credit policy objective includes the following:

- establishment of adequate credit risk management environment
- operations in accordance with generally accepted procedure for loan approval
- maintenance of adequate procedures for administration, measurement and monitoring of loans
- maintenance of adequate controls over credit risk
- maintenance of adequate assessment of the quality of assets
- recognition of adequate impairment allowances for identified and unidentified losses.

Notes to the financial statements (continued)

2.2.1.2 General articles of credit policy

The Bank's credit policy is based on applicable legislation and mission, vision and business policy of the Bank. It includes all important factors needed for ensuring development and reputation of the Bank, realisation of profit and maintenance of real value of capital based on safety, liquidity and profitability principles.

2.2.1.3 Definitions, principles and standards

Intention of the credit policy is establishment of basic principles for approving loans and other placements, relating to implementation of segregation of responsibilities for execution and for controls of activities into processes and procedures.

Basic principles of the credit policy are:

- safety of placements through realistic insight into the client’s operations, assessment of its business capacity and its capability of servicing liabilities to the Bank,
- stable liquidity through assessment of repayments of placements in scheduled timeframe, expected inclusion of the debtor’s funds into the Bank’s deposit system as well as usage of the Bank’s other services,
- profitability, i.e. satisfying the investors interests and enhancing self-financing of sales activities,
- quality service and satisfied customer,
- cross selling and enhancing deposit bases through private and corporate banking,
- capital adequacy maintenance through adequate rating of primary credit risk and reduction of the need for capital coverage through collaterals for loans.

2.2.1.4 Approval of placements

The Bank has established formal procedure for rating and approval of placements with the objective of maintenance of quality loan portfolio. Approvals are given in accordance with internal acts and are given by an appropriate organisational level. Each placement’s approval procedure and the level of approval is properly documented. Segregation of duties of recommendations, approval and execution of a risk product ensures the adequacy of the approval process.

2.2.1.5 Monitoring of placements

Monitoring of placements process includes assessment of creditworthiness of a debtor, the group of its related parties and the quality of collateral during the lifespan of the legal relationship representing the exposure. Adequate system for placement monitoring includes measures:

- ensuring Bank’s understanding of the current financial position of the debtor
- for assessment of the current collateral coverage in relation to the debtor’s current position
- for identification of overdue payments

Internal acts define organisational units and responsible personnel ensuring all necessary information for undertaking of corrective actions as well as deadlines in which to act, considering potential conflicts of interest.

Notes to the financial statements (continued)

2.2.1.6 Loan portfolio analysis and process of monitoring of credit risk

The Bank has established the system for monitoring of entire structure and quality of the loan portfolio. Credit Committee, Supervisory Board and Audit Committee are regularly informed on the quality of the portfolio. Analysis of the loan portfolio includes, at minimum, analysis of risk categories, overdue days and the total exposure. Loan portfolio report is prepared by the Risk Management Division / Credit Risk Management Division. Based on the analysis results, decisions are made on the Bank's strategy toward the counterparty, group of related parties, certain industry or economic sector, geographical region, certain type of collateral etc.

2.2.1.7 Non-performing loans

Continuous monitoring of collection is an integral part of the loan process. If the borrower does not pay its liabilities before due date, overdue liability exists. The Bank has internally defined actions and procedures for collection of overdue receivables. Primary goal is swift action and the objective is maximum collection with optimal solution for the Bank. Within the process of non-performing loans management, the Bank's objectives are improvement of its loan portfolio, timely reaction to identified collection issues, limitation of impairment losses to minimum and loan portfolio management.

2.2.1.8 Credit risk control and stress test

Credit risk control is one of the Bank's functions organised as a separate organisational part, functionally and organisationally separated from other organisational parts of the Bank and is directly responsible to the Bank's Management Board.

The objective of establishment of the credit risk control is maintenance of the Bank's exposure to the credit risk within the parameters established by the Management Board. Credit risk control assists in ensuring the credit risk stays within the limits acceptable to the Bank.

Credit risk control ensures independent, continuous check of the application and effectiveness of the methods and procedures for the credit risk management. Also, credit risk control includes establishment of measurement and assessment of credit risk which the Bank is or could be exposed to, and making recommendations for adequate credit risk management.

In order to function effectively, the credit risk control has the authorization for unlimited and permanent access to all documents, evidences and personnel of the Bank, with strict confidentiality.

Credit risk control function keeps evidence on performed work and reports the results of each separate review to the Management Board.

Stress test

Risk Management Division / Credit Risk Management Division tests the effects of two different factors, at minimum. Stress situation simulated in a test is usually determined by indicators on the market or within the Bank which point to a possibility of occurrence of significant changes in the loan portfolio, resulting in changes to the financial results of the Bank and to the regulatory indicators.

Risk Management Division reports the results of the stress tests to the Credit Committee and recommends the risk management strategy to be maintained or changed, depending on the stress test results.

Notes to the financial statements (continued)

3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated, and are based on historical experience and other factors. Key sources of estimation of uncertainty are described below.

Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. In accordance with the CNB regulations, the need for impairment of the Bank's on and off-balance-sheet credit risk exposure is assessed at least quarterly. Impairment losses are made mainly against the carrying value of loans and advances to corporate and retail customers as described in Note 2.1.1. "Credit risk", while provisions for liabilities and charges arise from off-balance-sheet risk exposure to customers, mainly in the form of guarantees, documentary credits and undrawn loan commitments as described in Note 34.

Financial assets carried at amortized cost

Financial assets carried at amortised cost include financial investments held to maturity and loans and advances to customers.

The Bank initially assesses whether objective evidence of impairment exists. Assets for which impairment is not individually assessed are included in group of assets with similar credit risk characteristics. These portfolios are then assessed collectively for impairment.

The Bank estimates impairment losses when it estimates that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets.

The Bank also seeks to recognise impairment losses which are known to exist at the balance sheet date, but which have not yet been specifically identified. In estimating unidentified impairment losses existing in collectively assessed portfolios, and in the absence of reliable data on historical loss rates and the emergence period for the identification of these impairment losses, the Bank considers the range of impairment loss rates from 0.85% to 1.20% prescribed by the CNB to be calculated on all credit risk exposures except those carried at fair value, including off-balance-sheet amounts and Croatian sovereign risk. Amounts assessed as impaired on an individual basis are excluded from this calculation.

Fair value of the financial instruments quoted in an active market

In estimating the fair value of quoted financial instruments, the Bank uses closing prices at the date of estimation. If the market for a financial asset is not active (and for unlisted securities), or if, for any other reason, the fair value cannot be reliably measured by market prices, the Bank establishes fair value by using valuation techniques.

Provisions for court cases

The Bank performs individual assessment of outcome of court cases. Initial assessment is made by the Legal department of the Bank. The Bank is defendant in a several court cases and approximately ten violations arising from the daily operations of the Bank. According to the Management's estimate, except for the Bank's violations raised by the CNB for which the Bank created a provision, the final outcome of other claims are expected to be in favour of the Bank, and accordingly, no additional provision is recognised.

Regulatory requirements

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

Notes to the financial statements (continued)

4. CASH AND AMOUNTS DUE FROM BANKS

	31 December 2009 (HRK '000)			31 December 2010 (HRK '000)		
	HRK	foreign currency	total	HRK	foreign currency	total
Cash at hand	**8,802**	**8,008**	**16,810**	**10,161**	**8,624**	**18,785**
Amounts due from banks						
Current accounts with domestic banks	-	966	966	-	792	792
Current accounts with foreign banks	-	20,934	20,934	-	24,570	24,570
Giro account with the CNB	17,655	-	17,655	54,003	-	54,003
	17,655	**21,900**	**39,555**	**54,003**	**25,362**	**79,365**
TOTAL	**26,457**	**29,908**	**56,365**	**64,164**	**33,986**	**98,150**

5. OBLIGATORY RESERVE WITH CROATIAN NATIONAL BANK

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Obligatory reserve		
In HRK	75,486	85,251
In foreign currency	12,616	17,289
	88,102	**102,540**
Accrued interest		
Accrued interest – due	48	54
Accrued interest – not due	-	-
	48	**54**
Total	**88,150**	**102,594**

The CNB determines the requirement for banks to hold obligatory reserves, both in the form of amounts required to be deposited with the CNB and held in the form of other liquid receivables. The obligatory reserve with the CNB represents the amount required to be deposited with the CNB.

The rate of the obligatory reserve at 31 December 2010 amounted to 13% (2009: 14%; CNB changed the rate of the obligatory reserve from 14% to 13% in February 2010) of HRK and foreign currency deposits, borrowings and issued debt securities.

At 31 December 2010 the required minimum rate of maintenance of the obligatory reserve in the Croatian kuna with the CNB amounted to 70% (2009: 70%), while the remaining 30% (2009: 30%) could be held in the form of other liquid receivables. This includes the part of foreign currency obligatory reserve required to be held in HRK. During 2010, the annual interest rate on the kuna obligatory reserve payable by the CNB was 0.75% up until 29 December 2010, when it fell to 0.25% (2009: 0.75%). On 9 March 2011 the CNB made a decision not to pay any interest on the obligatory reserve in the future.

Notes to the financial statements (continued)

60% of the foreign currency obligatory reserve (2009: 60%) is maintained with the CNB, while the remaining 40% (2009: 40%) must be held in the form of other liquid receivables, after adjusting for the obligatory reserve requirement arising from foreign currency funds from non-residents and related parties (which is required to be held in full with the CNB). 75% of the foreign currency obligatory reserve (2009: 75%) is included in the HRK obligatory reserve and is required to be held in HRK.

In accordance with CNB decision in force from 11 November 2009, the CNB pays no interest on foreign currency obligatory reserve (prior to the decision, an interest for maintaining the reserve in the USD amounted to 75% of U.S. Federal Funds Target Rate and for EUR amounted to 75% ECB Minimum Bid Refinance Rate.)

6. PLACEMENTS WITH AND LOANS TO OTHER BANKS

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Short-term placements		
With foreign banks	-	4,660
With domestic banks	-	-
	-	**4,660**
Long-term placements		
With foreign banks	713	2,261
With domestic banks	365	6,869
	1,078	**9,130**
Accrued interest		
Accrued interest – due	-	2
Accrued interest – not due	8	-
	8	**2**
TOTAL	**1,086**	**13,792**

Notes to the financial statements (continued)

7. FINANCIAL ASSETS AVAILABLE FOR SALE

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Debt securities		
Bonds issued by the Ministry of Finance	-	109,531
Treasury bills issued by the Ministry of Finance	75,946	-
Foreign treasury bills	81,823	119,328
Corporate bonds	2,078	2,106
	159,847	**230,965**
Shares in investment funds		
Units in investment funds	19,196	11,689
	19,196	**11,689**
Equity securities		
Corporate entity	9,055	3,990
	9,055	**3,990**
Accrued interest		
Accrued interest – due	-	-
Accrued interest – not due	115	1,397
	115	**1,397**
Impairment allowance	**(565)**	**-**
TOTAL	**187,648**	**248,041**

The Bank recognises available-for-sale financial assets at fair value with changes in fair value recognised in a fair value reserve in equity, i.e. in the other comprehensive income.

Based on Article 3 of the Decision on Classification of Placements and Contingent Liabilities of Banks (Official Gazette (1/2009, 75/2009 and 2/2010) which became effective on 31 March 2010, the Bank classifies its "loans and receivables" and "held to maturity" placements in accordance with IAS 39 under the scope of the Decision. Based on the Article 4 of the Decision, financial assets classified as "at fair value through profit and loss" and "financial assets available for sale" in accordance with IAS 39 do not fall under the scope of the Decision. In accordance with the Decision, no impairment losses on group basis are calculated for financial assets classified as "available for sale".

8. FINANCIAL ASSETS HELD TO MATURITY

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Debt securities		
Bills of exchange	3,742	16,935
TOTAL	**3,742**	**16,935**
Accrued interest		
Accrued interest – due	352	520
Accrued interest – not due	-	204
TOTAL	**352**	**724**
Impairment allowance		
Identified losses	-	-
Identified losses on group basis	-	(144)
TOTAL	**-**	**(144)**
TOTAL	**4,094**	**17,515**

Notes to the financial statements (continued)

9. LOANS AND ADVANCES TO CUSTOMERS

	Restated 31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Total gross loans		
Retail	238,138	210,064
Corporate	606,625	704,665
TOTAL	**844,763**	**914,729**
Derivatives		
Derivatives	9	-
TOTAL	**9**	**-**
Accrued interest		
Accrued interest – due	7,234	14,606
Accrued interest – not due	1,596	5,003
TOTAL	**8,830**	**19,609**
Impairment allowance		
Identified losses – gross	(26,729)	(37,251)
Identified losses – accrued interest	(53)	(3,297)
Identified losses on group basis	(8,624)	(8,628)
TOTAL	**(35,398)**	**(49,176)**
TOTAL	**818,217**	**885,163**

	Restated 2009 (HRK' 000)			2010 (HRK' 000)		
	identified losses	identified losses on group basis	total	identified losses	identified losses on group basis	total
Movement in impairment allowances						
Balance at 1 January	23,001	10,800	33,801	26,759	8,625	35,384
Increase/(decrease) in impairment losses	5,982	(2,175)	3,807	13,077	3	13,080
Write-offs	(1,073)	-	(1,073)	-	-	-
Net gain on foreign exchange differences	(213)	-	(213)	860	-	860
Usage	(938)	-	(938)	(148)	-	(148)
Balance at 31 December	**26,759**	**8,625**	**35,384**	**40,548**	**8,628**	**49,176**

The Bank applies the rate of 0.85% on balance sheet and off balance sheet exposures which are subject to the credit risk and for which no identified impairment losses have been recognised.

Notes to the financial statements (continued)

10. PROPERTY AND EQUIPMENT

2010 (HRK '000)	Land and buildings	IT equipment	Office furniture and equipment	Motor vehicles and others	Assets in the course of construction	Total
Cost						
Balance as at 1 January 2010	20,231	6,140	10,809	1,757	-	38,937
Property acquisition costs recognized in equity	-	-	-	-	-	-
Additions	-	-	-	-	3,014	3,014
Transfers	905	201	348	15	(1,478)	-
Write offs	-	-	(14)	(6)	-	(20)
Balance as at 31 December 2010	**21,136**	**6,350**	**11,143**	**1,766**	**1,536**	**41,931**
Accumulated depreciation						
Balance as at 1 January 2010	1,630	3,353	4,576	1,087	-	10,646
Charge for the year	624	1,068	1,065	252	-	3,009
Disposal and write offs	-	-	(14)	(2)	-	(16)
Balance as at 31 December 2010	**2,254**	**4,421**	**5,627**	**1,337**	**-**	**13,639**
Carrying value						
Balance as at 1 January 2010	18,601	2,787	6,233	670	-	28,291
Balance as at 31 December 2010	**18,882**	**1,929**	**5,516**	**429**	**1,536**	**28,292**

2009 (HRK '000)	Land and buildings	IT equipment	Office furniture and equipment	Motor vehicles and others	Assets in the course of construction	Total
Cost						
Balance as at 1 January 2009	15,515	5,361	11,209	1,799	787	34,671
Property acquisition costs recognized in equity	4,240	-	-	-	-	4,240
Additions	726	-	-	-	3,430	4,156
Transfers	2,008	852	1,297	60	(4,217)	-
Write offs	(2,258)	(73)	(1,697)	(102)	-	(4,130)
Balance as at 31 December 2009	**20,231**	**6,140**	**10,809**	**1,757**	**-**	**38,937**
Accumulated depreciation						
Balance as at 1 January 2009	1,634	2,299	4,350	819	-	9,102
Charge for the year	623	1,091	1,059	303	-	3,076
Disposal and write offs	(627)	(37)	(833)	(35)	-	(1,532)
Balance as at 31 December 2009	**1,630**	**3,353**	**4,576**	**1,087**	**-**	**10,646**
Carrying value						
Balance as at 1 January 2009	13,881	3,062	6,859	980	787	25,569
Balance as at 31 December 2009	**18,601**	**2,787**	**6,233**	**670**	**-**	**28,291**

Notes to the financial statements (continued)

11. INTANGIBLE ASSETS

2010 (HRK '000)	Software	Goodwill	Leasehold improvements	Licences	Assets in the course of construction	Total
Cost						
Balance as at 1 January 2010	1,304	2,300	9,025	4,373	9,104	26,106
Additions	-	-	-	-	2,107	2,107
Transfers	3	-	68	451	(522)	-
Write off	-	-	-	-	-	-
Balance as at 31 December 2010	**1,307**	**2,300**	**9,093**	**4,824**	**10,689**	**28,213**
Accumulated depreciation						
Balance as at 1 January 2010	929	-	4,896	1,780	-	7,605
Charge for the year	154	-	1,566	864	-	2,584
Write off	-	-	-	-	-	-
Balance as at 31 December 2010	**1,083**	**-**	**6,462**	**2,644**	**-**	**10,189**
Carrying value						
Balance as at 1 January 2010	374	2,300	4,129	2,594	9,104	18,501
Balance as at 31 December 2010	**224**	**2,300**	**2,631**	**2,180**	**10,689**	**18,024**

2009 (HRK '000)	Software	Goodwill	Leasehold improvements	Licences	Assets in the course of construction	Total
Cost						
Balance as at 1 January 2009	1,246	2,300	9,421	2,549	8,433	23,949
Additions	-	-	-	-	3,161	3,161
Transfers	57	-	595	1,838	(2,490)	-
Write off	-	-	(992)	(13)	-	(1,005)
Balance as at 31 December 2009	**1,303**	**2,300**	**9,024**	**4,374**	**9,104**	**26,105**
Accumulated depreciation	-	-	-	-	-	-
Balance as at 1 January 2009	773	-	3,901	1,023	-	5,697
Charge for the year	156	-	1,543	758	-	2,457
Write off		-	(549)	(1)	-	(550)
Balance as at 31 December 2009	**929**	**-**	**4,895**	**1,780**	**-**	**7,604**
Carrying value						
Balance as at 1 January 2009	473	2,300	5,520	1,526	8,433	18,252
Balance as at 31 December 2009	**374**	**2,300**	**4,129**	**2,594**	**9,104**	**18,501**

Notes to the financial statements (continued)

12. OTHER ASSETS

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Other assets		
Fees receivable	1,714	969
Prepaid expenses	471	1,092
Foreclosed assets	1,776	6,555
Inventories	653	638
Syndicated loans	-	3,747
Other receivables	4,136	5,260
Total	**8,751**	**18,261**
Impairment allowance	**(2,902)**	**(2,817)**
TOTAL	**5,849**	**15,444**

The movement in the impairment allowance of Other assets is presented below:

	2009. (HRK' 000)	2010. (HRK' 000)
Movement in impairment allowance		
Balance as at 1 January	2,792	2,902
Increase/(decrease) in impairment loss	110	(85)
Write offs	-	-
Balance as at 31 December	**2,902**	**2,817**

Notes to the financial statements (continued)

13. DEPOSITS FROM BANKS

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Term deposits		
In HRK	37,992	17,724
In foreign currency	-	-
Total	**37,992**	**17,724**
Interest payable		
Interest – not due	288	17
Total	**288**	**17**
TOTAL	**38,280**	**17,741**

14. DEPOSITS FROM CUSTOMERS

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Demand deposits		
Retail	17,174	19,255
in HRK	*8,887*	*9,894*
in foreign currency	*8,287*	*9,361*
Corporate	58,757	74,612
in HRK	*54,665*	*69,132*
in foreign currency	*4,092*	*5,480*
Total	**75,931**	**93,868**
Restricted deposits		
Restricted deposits	4,191	3,735
Total	**4,191**	**3,735**
Term deposits		
Retail	610,388	761,512
in HRK	*137,416*	*161,219*
in foreign currency	*472,972*	*600,293*
Corporate	225,829	203,587
in HRK	*132,104*	*137,799*
in foreign currency	*93,726*	*65,788*
Total	**836,218**	**965,099**
Interest payable		
Interest – due	250	144
Interest – not due	17,486	17,630
Total	**17,736**	**17,774**
TOTAL	**934,076**	**1,080,476**

Notes to the financial statements (continued)

15. BORROWINGS

	31 December 2009 (HRK' 000)	31 December 2010 (HRK' 000)
Short term		
From Banks	51,390	117,637
in HRK	*2,000*	*1,000*
in foreign currency	*49,390*	*116,637*
From CBRD	13,000	28,000
in HRK	*13,000*	*28,000*
in foreign currency	-	-
Total	**64,390**	**145,637**
Long term		
From CBRD	4,617	8,859
in HRK	*4,617*	*8,859*
in foreign currency	-	-
Total	**4,617**	**8,859**
Interest payable		
Interest – due	105	184
Interest – not due	-	-
Total	**105**	**184**
TOTAL	**69,111**	**154,680**

Borrowings include repurchase agreements in the total amount of 131,637 thousand kuna (2009: 49,390 thousand kuna). Out of the total amount of the repurchase agreements, 116,637 thousand kuna relate to borrowings denominated in euro (2009: 49,390 thousand kuna) while 15,000 thousand kuna relate to borrowings denominated in kuna (2009: nil).

16. HYBRID INSTRUMENTS

	31 December 2009 (HRK '000)	31 December 2010 (HRK' 000)
Hybrid instruments in HRK	2,922	2,954
TOTAL	**2,922**	**2,954**

In September 2009 the Bank received a hybrid instrument with maturity of 5.5 years and fixed interest rate of 7.75%. The hybrid instrument is included in to the Bank's additional capital. These amounts may be used for covering the losses from current operations, in bankruptcy or liquidation, and if the Bank's capital adequacy falls below ¾ of the capital adequacy ratio prescribed by law (or some other ratio prescribed by the CNB) and if shareholders of the Bank do not acquire of additional shares within 90 days, the Bank will convert hybrid instruments into shares, which, in accordance with Decision on capital adequacy, are to be included in share capital.

Notes to the financial statements (continued)

17. PROVISIONS FOR LIABILITIES AND CHARGES

	31 December 2009 (HRK '000)	31 December 2010 (HRK '000)
Provisions for court cases	2,413	1,490
Provisions for pensions and other liabilities to employees	576	90
Provisions for contingent and other liabilities	612	584
TOTAL	**3,601**	**2,164**

The movement in provisions for liabilities and charges is presented below:

	2009 (HRK '000)	2010 (HRK '000)
Movement in provision		
Balance at 1 January	3,664	3,601
Increase in provision	141	(666)
Provisions used during the year	(204)	(771)
Balance at 31 December	**3,601**	**2,164**

18. OTHER LIABILITIES

	31 December 2009 (HRK '000)	31 December 2010 (HRK '000)
Trade payables	535	2,059
Liabilities for salaries, deductions from salaries, taxes and contributions	1,944	2,098
Items in the course of settlement	257	137
Deferred income from sale of shares	-	-
Deferred fee income	4,855	4,187
Syndicated loans	-	3,747
Other liabilities	1,611	9,875
TOTAL	**9,202**	**22,103**

19. EQUITY

19.1 Share capital

31 December 2010	Paid in capital (HRK '000)	Ownership share (%)
VALIDUS D.D.	51,348	29.09
BALKAN FINANCIAL SECTOR EQUITY FUND C.V.	29,200	16.54
PLURIS D.D.	15,869	8.99
Small shareholders	80,106	45.38
	176,523	**100.00**

Notes to the financial statements (continued)

31 December 2009	Paid in capital (HRK '000)	Ownership share (%)
VALIDUS D.D.	51,348	29.09
BALKAN FINANCIAL SECTOR EQUITY FUND C.V.	29,200	16.54
PLURIS D.D.	18,369	10.41
Small shareholders	77,606	43.96
	176,523	**100.00**

19.2 Share premium

Share premium relates to capital gain incurred on issuance of new shares at a price higher than the nominal value during the recapitalization process in 2006 and 2007.

19.3 Other reserves

Other reserves as at 31 December 2010 amount to HRK 2,611 thousand (2009: HRK 2,611 thousand) and are created in accordance with the General Assembly decision.

19.4 Fair value reserve

The fair value reserve includes unrealised gains and losses on changes in the fair value of financial assets available for sale.

19.5 Accumulated losses

Accumulated loss comprise previous year accumulated losses and property acquisition cost related to capitalised costs incurred during sale and repurchase transactions of property owned by the Bank in prior years.

19.6 Statutory reserve

The Bank is required to create a statutory reserve by allocating 5% of its net profit for the year, until the reserve reaches 5% of share capital. The legal reserve can be used to cover losses from previous years if the losses are not covered by current year profits or if other reserves are not available.

19.7 Reserves for general banking risks

Reserve for general banking risks represents a reserve for potential losses in excess of planned and already established allowances for identified losses.

In accordance with the regulations of the Croatian National Bank, the Bank is required to create provision for general banking risks, if the growth in the Bank's balance-sheet and off-balance-sheet exposure exceeds 15% of balance sheet and off-balance-sheet exposure at the previous year end.

The Bank did not recognised provision for general banking risks.

19.8 Proposed dividends

Dividends payable are not recognized until they are approved at the General Assembly. The Management will not propose a dividend payment for 2010 (2009: nil).

Notes to the financial statements (continued)

20. INTEREST AND SIMILAR INCOME

	2009 (HRK '000)	2010 (HRK '000)
Analysis by product		
Loans and advances to customers	93,738	94,303
- corporate	*65,181*	*22,189*
- retail	*28,557*	*72,114*
Deposits	1,153	650
Debt securities	6,783	6,465
Other	36	144
TOTAL	**101,710**	**101,562**
Analysis by source		
Corporate	65,179	69,530
Retail	28,557	22,189
State and public sector	4,564	5,115
Financial institutions	2,335	739
Other	1,075	3,989
TOTAL	**101,710**	**101,562**

21. INTEREST EXPENSE AND SIMILAR CHARGES

	2009 (HRK '000)	2010 (HRK '000)
Analysis by product		
Deposits from customers	53,453	50,738
- retail	*30,760*	*39,820*
- financial institutions	*11,386*	*4,919*
- corporate and other	*11,307*	*5,999*
Borrowings	6,296	2,656
Hybrid instruments	55	218
Other	3	23
Total	**59,807**	**53,635**
Analysis by recipient		
Retail	30,815	40,039
Corporate	10,351	4,221
State and public sector	185	120
Financial institutions	17,682	7,575
Other	775	1,681
Total	**59,807**	**53,635**

Notes to the financial statements (continued)

22. FEE AND COMMISSION INCOME

	2009 (HRK '000)	2010 (HRK '000)
Payment transaction fees	4,276	4,515
Letter of credit and guarantee fees	1,268	716
Impairment losses	(13)	103
Other fee and commission income	1,720	1,260
TOTAL	**7,251**	**6,594**

23. FEE AND COMMISSION EXPENSE

	2009 (HRK '000)	2010 (HRK '000)
Payment transaction fees	1,631	1,861
Other fee and commission expense	617	544
TOTAL	**2,248**	**2,405**

24. GAINS LESS LOSSES FROM FINANCIAL ASSETS THROUGH P/L

	2009 (HRK '000)	2010 (HRK '000)
Realised gains/(losses)		
Equity securities	2,549	-
TOTAL	**2,549**	**-**

25. GAINS LESS LOSSES FROM FINANCIAL ASSETS AVAILABLE FOR SALE

	2009 (HRK '000)	2010 (HRK '000)
Realised gains/(losses)		
Equity securities	-	736
Bonds	685	262
Treasury bills	547	842
Investment funds	724	587
TOTAL	**1,956**	**2,427**

Notes to the financial statements (continued)

26. OTHER OPERATING INCOME

	2009 (HRK '000)	2010 (HRK '000)
Net gains / (losses) from translation of monetary assets and liabilities	(1,209)	(1,160)
Net gains / (losses) from foreign currency trading	8,590	6,953
TOTAL	**7,381**	**5,793**

27. OTHER OPERATING INCOME

	2009 (HRK '000)	2010 (HRK '000)
Dividend income	331	389
Other income	1,870	1,878
TOTAL	**2,201**	**2,267**

28. GENERAL AND ADMINISTRATIVE EXPENSES

	2009 (HRK '000)	2010 (HRK '000)
Personnel expenses	23,777	25,300
Savings deposit insurance expense	1,719	1,781
Other general and administrative expenses	22,038	20,913
TOTAL	**47,534**	**47,994**

At 31 December 2010 the bank had 179 employees (2009: 175).

29. IMPAIRMENT LOSSES

	2009 (HRK ‘000)	2010 (HRK ‘000)
Identified losses		
Loans and advances to customers	5,042	10,679
Deposits	10	-
Interest receivables	938	2,400
Other receivables	102	2
TOTAL	**6,093**	**13,081**
Identified losses on group basis		
Other assets	(2,098)	(417)
TOTAL	**(2,098)**	**(417)**
TOTAL	**3,995**	**12,664**

Notes to the financial statements (continued)

30. INCOME TAX EXPENSE

Income tax expense recognised in the income statement:

	Restated 2009 (HRK '000)	2010 (HRK '000)
Profit/(loss) before income tax	3,791	(3,042)
Income tax at 20% rate	758	(608)
Expenses not deductible for tax purposes	1,090	2,561
Income not subject to tax	(66)	(3,413)
(Tax losses)/tax benefit	(1,782)	1,461
Income tax expense	-	-
Effective income tax rate	n/a	n/a

In previous years the Bank incurred tax losses. Such tax losses can be carried forward over the following five years in which are incurred. Tax losses and their expiry dates at 31 December 2010 are as follows:

		2009 (HRK '000)		2010 (HRK '000)	
Incurred	**Year of expiry**	**Gross tax losses**	**Tax losses to be carried forward (20%)**	**Gross tax losses**	**Tax losses to be carried forward (20%)**
2008	2013	26,433	5,287	26,430	5,286
2010	2015	-	-	7,303	1,461
		26,433	**5,287**	**33,733**	**6,747**

31. BASIC AND DILUTED EARNINGS/(LOSS) PER SHARE

For the purposes of calculating earnings per share, earnings are calculated as the profit for the period attributable to share holders of the Bank. The number of ordinary shares is the weighted average number of ordinary shares circulating during the year after deducting the number of ordinary treasury shares (none during 2009 or 2008).

Given that there is no effect of options, convertible bonds or similar effect, the weighted average number of ordinary shares used for diluted earnings per share was the same as used to calculate basic earnings per share. The Bank has no preference shares.

	Restated 2009	2010
Gains/(losses) for the year (HRK '000)	3,791	(3,042)
Weighted average number of ordinary shares	1,711,910	1,765,228
Basic and diluted earnings/(loss) per share (HRK)	**2.21**	**(1.72)**

Notes to the financial statements (continued)

32. CONCENTRATION OF ASSETS AND LIABILITIES

	2009 (HRK '000)	2010 (HRK '000)
Giro account with the CNB	17,655	54,003
Obligatory reserves with Croatian National Bank	88,150	102,594
Bonds issued by the Ministry of Finance	-	109,531
Treasury bills issued by the Ministry of Finance	75,946	-
Borrowings (CBRD)	(17,617)	(36,858)
TOTAL	**164,134**	**229,270**

The Bank's exposure towards local government and state institutions not directly funded from the State Budget (excluding companies owned by state) is presented below:

	31 December 2009 (HRK '000)	31 December 2010 (HRK '000)
Loans	4,101	3,766
Deposits	(6,915)	(7,842)
TOTAL	**(2,814)**	**(4,076)**

33. CASH AND CASH EQUIVALENTS

	31 December 2009 (HRK '000)	31 December 2010 (HRK '000)
Cash and amounts due from banks	56,365	98,150
Placements to banks with original maturity up to 90 days	-	4,500
TOTAL	**56,365**	**102,650**

34. COMMITMENTS AND CONTINGENCIES

	31 December 2009 (HRK '000)	31 December 2010 (HRK '000)
Guarantees in HRK	25,782	20,449
Guarantees in foreign currency	1,992	4,206
Unused loan commitments	39,649	42,837
Other contingent liabilities	1,986	1,247
TOTAL	**69,409**	**68,739**

At 31 December 2010, the Bank recognised unidentified impairment losses for off-balance-sheet risks arising from the issue of guarantees, letters of credit and undrawn lending commitments in the amount of HRK 584 thousand (2009: HRK 612 thousand).

Notes to the financial statements (continued)

35. RELATED PARTY TRANSACTIONS

The key shareholders of the Bank are Validus d.d. and Balkan Financial Sector Equity Fund which together owned 54.62 % (2009: 56.04 %) of the Bank's shares at year end. The remaining 45.38% (2008: 43.96%) of the shares are publicly traded. The Bank considers that it has an immediate related party relationship with its key shareholders; the Supervisory and Management Board members and other executive management (together "key management personnel"); close family members of key management personnel; and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members, in accordance with the definitions contained in International Accounting Standard 24 "Related Party Disclosures" ("IAS 24").

35.1. Key transactions with immediate related parties

At 31 December 2010 the Bank has no high risk product exposure towards its key shareholders (2009: nil). All transactions with key shareholders during the year are generated from deposit activities, while transactions with key management personnel were generated from deposit, lending activities and given benefits. Gross exposure to key shareholders at 31 December 2010 amounted HRK 97 thousand (2009: HRK 2 thousand).

Liabilities towards the Bank's key shareholders at 31 December 2010 amounted to HRK 1 thousand and relate to demand deposits held with the Bank (2009: HRK 114 thousand).

	2009 (HRK '000)				2010 (HRK '000)			
	Exposure	Liabilities	Revenue	Expenses	Exposure	Liabilities	Revenue	Expenses
Key shareholders	**2**	**114**	**18**	**22**	**97**	**1**	**99**	**23**
Key management								
Paid benefits	-	835	-	2,538	-	51	-	2,621
Loans granted	3,625	-	76	18	3,118	-	138	10
TOTAL	**3,627**	**949**	**94**	**2,578**	**3,215**	**52**	**237**	**2,654**

Notes to the financial statements (continued)

36. MANAGED FUNDS FOR AND ON BEHALF OF CORPORATE AND RETAIL CUSTOMERS

The Bank manages funds for and on behalf of corporate and retail customers, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. The Bank receives fee income for providing these services. These assets are not assets of the Bank and are not recognised in the balance sheet of the Bank. The Bank is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

Further, the Bank manages credit exposure of third parties as follows:

	31 December 2009 (HRK '000)	31 December 2010 (HRK '000)
Assets		
Corporate	41,340	54,060
Retail	24,106	35,841
Giro accounts	2,600	2,587
TOTAL	**68,046**	**92,488**
Liabilities		
Corporate	34,803	45,846
Republic of Croatia	9,126	10,818
HBOR	24,073	35,742
Local governments	44	82
TOTAL	**68,046**	**92,488**

37. AVERAGE INTEREST RATES

Average interest rates calculated based on the average monthly balances for each category of interest-earning assets and interest-bearing liabilities, are presented below:

	2009 (%)	2010 (%)
Assets		
Obligatory reserve with Croatian National Bank	0.69	0.63
Placements with and loans to other banks	6.68	1.71
Available for sale financial assets	3.23	2.49
Held to maturity investments	15.64	10.23
Loans and advances to customers	11.09	10.57
Liabilities		
Deposits	5.40	5.01
Borrowings	6.73	1.71
Hybrid instruments	7.49	7.49

Notes to the financial statements (continued)

38. OPERATING LEASE LIABILITIES

	2009 (HRK '000)	2010 (HRK '000)
Up to 1 year	5,212	5,273
From 1 to 5 years	20,064	19,596
Over 5 years	3,460	525
TOTAL	**28,736**	**25,394**

39. FAIR VALUE OF FINANCIAL ASSETS

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arm's length basis.

The Management Board believes that the fair value of financial assets and liabilities are not significantly different from their carrying values at 31 December 2010.

The following methods were used to estimate the fair value of financial instruments of the Bank:

Cash and amounts due from banks, amounts held with the CNB

Carrying values of cash, amounts due from banks, amounts held with the CNB generally approximate their fair values.

Placements and loans other banks

Estimated fair value of placements and loans to other banks represents a discounted value of future cash flows.

Financial assets available for sale

Fair value of financial assets available for sale is based on their market prices. Financial instruments non quoted on active markets are evaluated through discounted cash flows method or by an alternative method used for fair value estimation.

Loans and advances to customers

Fair value of loans and advances to customers is based on analysis of discounted cash flows of loans by applying current interest rates for loans with similar conditions or characteristics. Fair value of non-performing loans is estimated based on analysis of discounted cash flow or the appraised value of the collateral. Considering that insignificant part of loans and advances to customers is contracted with fixed interest rate or the one which deviates from market rates, The Bank considers the fair value of loans and advances to customers to approximate their carrying value.

Deposits from banks and customers

Fair value of deposits maturing on demand is the carrying amount of obligation payable at the balance sheet date. Fair value of term deposits with variable interest rates approximates their carrying amount at the balance sheet date. Fair value of deposits with fixed interest rate is estimated by discounting future cash flows using interest rates currently used for deposits of similar remaining maturities. The Bank estimates that the fair value of bank and customer deposits do not significantly deviate from their carrying value.