VABA d.d. banka Varaždin

Annual report for the year
ended 31 December 2011

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 2011.

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 2011	1 EUR = HRK 7.530	1 USD = HRK 5.820
31 December 2010	1 EUR = HRK 7.385	1 USD = HRK 5.568

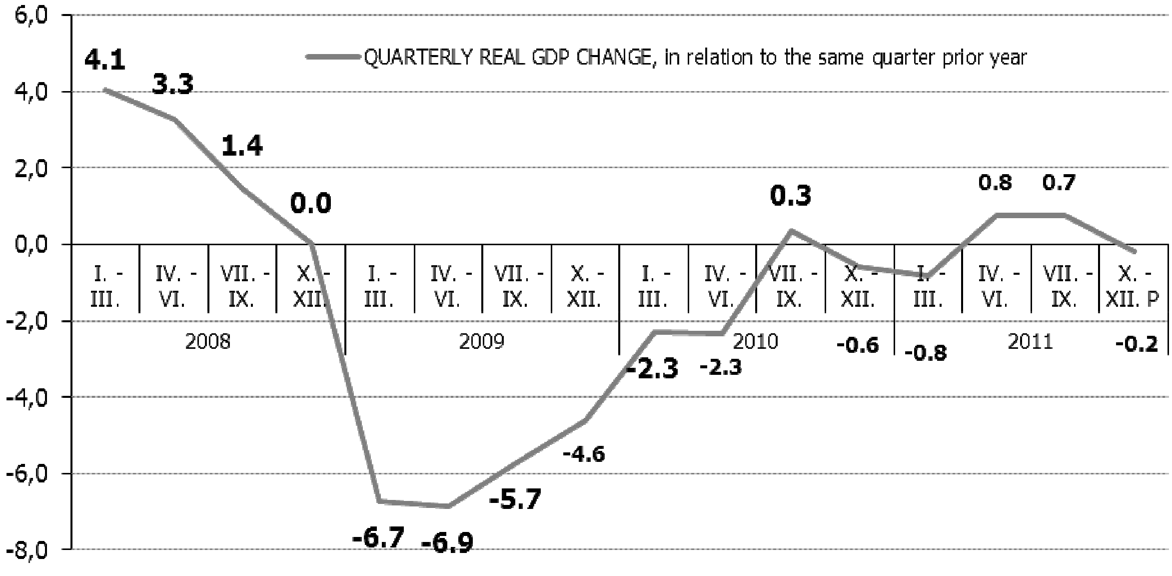
Summary of operation and key financial indicators

	2010 (HRK '000)	2011 (HRK '000)
Net interest income	47,927	48,444
Net fee and commission income	4,188	4,464
Operating income	62,602	9,805
Profit before impairment losses	9,622	9,561
Profit/(loss) for the year	(3,042)	(13,456)
Total assets	1,427,014	1,236,257
Loans and advances to customers	885,163	792,731

Macroeconomic developments in the Republic of Croatia for the year ended 31 December 2011

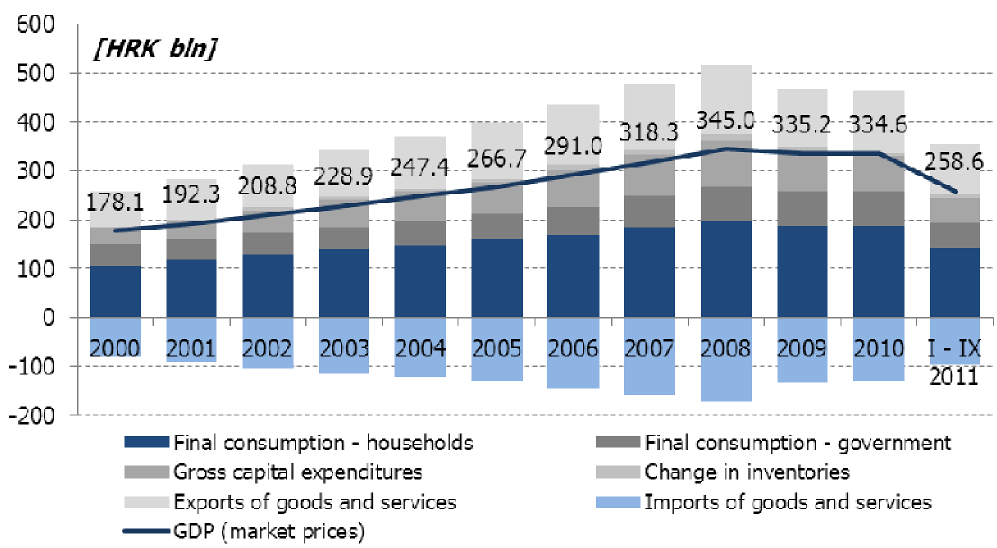
After continuous growth of GDP from 2000 to 2008, the growth slowed down in 2008, 2009 saw the first negative GDP growth since 1999, continuing with the negative trends in 2010, while 2011 was marked by stagnation. Based on the Central Bureau of Statistics (CBS) data, GDP fell by 6.0% in 2009, 1.2% in 2010, while the first estimate for 2011 puts the GDP growth at a minimal 0.2%.

Rate of change in GDP



Source: Central Bureau of Statistics

Movements in real GDP



Source: Central Bureau of Statistics

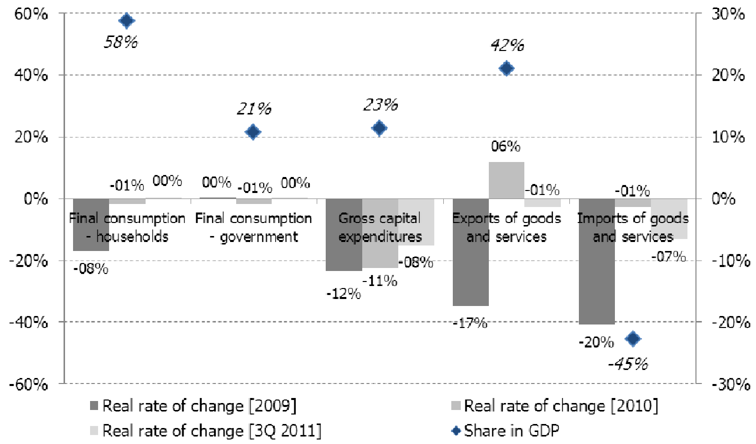
After significant decrease in household consumption in 2009 (real change rate of -8.5%), in 2010 and the first 3 quarters of 2011 it was held almost to 2009 levels (real change rate of 0.9% in 2010, 0.2% in first 3 quarters of 2011). Household consumption is still the most significant GDP component with 57.6% share in the first 3 quarters of 2011.

Gross capital expenditure also decreased significantly (real change rates of -11.8% in 2009, -11.3% in 2010 and -7.5% in first 3 quarters of 2011), while also decreasing its share in GDP from 29.2% in 2008 to 22.8% in the first 3 quarters of 2011.

Exports, after a recovery in 2010 (real change rates of -17.3% in 2009 and 6.0% in 2010), again went into the negative territory (real decrease rate of 1.4% in the first 3 quarters of 2011).

On the other side, government spending has not changed significantly since the start of negative GDP movements (real change rates of 0.2% in 2009, -0.8% in 2010 and 0.1% in the first 3 quarters of 2011).

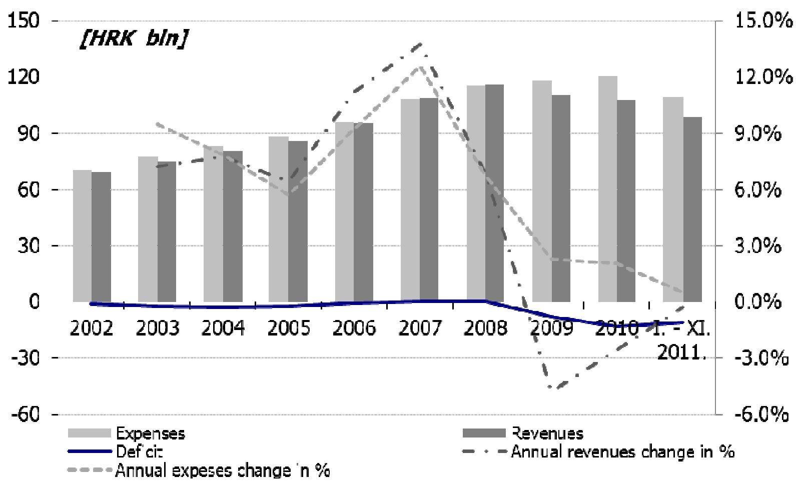
The structure of GDP and the rate of change of its components



Source: Central Bureau of Statistics

Contraction of the economy resulted in reduced budgetary revenue, which, along with the increase of expenditure, resulted in the increase in the budget deficit (HRK 7.7 billion in 2009, 12.9 billion in 2010 and 10.7 billion in the first 11 months of 2011; Ministry of Finance data).

Movement in budget revenue and expenses from 2002 to November 2011

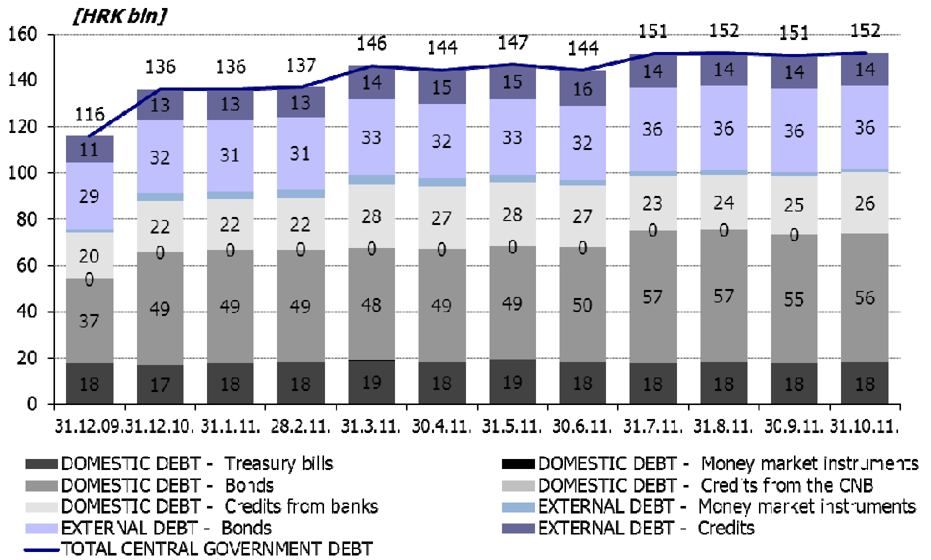


Source: Ministry of Finance

For financing of deficit and the repayment of due debt, the government has several bond issuing on domestic and foreign markets. In the first quarter of the year it repaid due Eurobond in the amount of EUR 750 million while issuing new bond in the US market in the amount of USD 1.5 billion. In June Eurobond was issued in the amount of EUR 750 million with 8 year maturity and 6.13% yield. On the domestic market in July additional EUR 600 million (in HRK with FC clause) was issued with 6.88% yield and HRK 1.5 billion with 5.95% yield. By borrowing on the domestic market the government took advantage of high liquidity of the financial system, but also squeezed out financing of the economic activities by high yields and large amounts of borrowing.

Internal debt of the central government increased by HRK 12.7 billion from the end of 2010 to October 2011 (increase of HRK 13.3 billion during 2010), while foreign debt increased by HRK 3.2 billion during the same period (HRK 6.9 billion during 2010).

The structure of central government debt

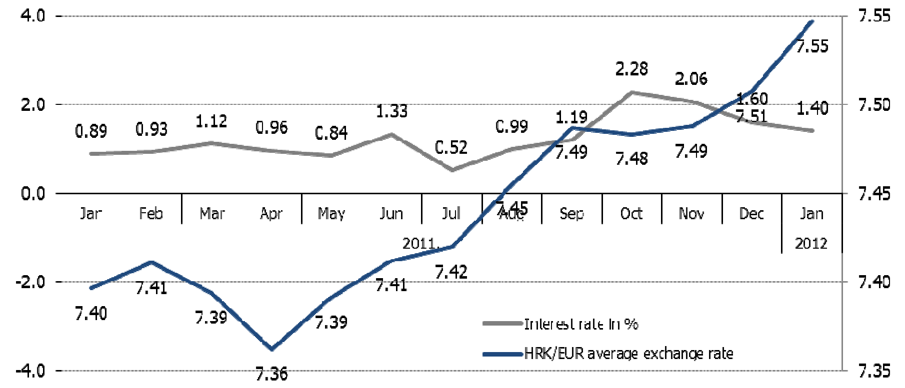


Source: Croatian National Bank

To ensure budget revenue for 2012, the government decided to again raise VAT basic rate, effective from March 2012 (increase from 23% to 25%; the last increase from 22% to 23% was done in August 2009), but also to decrease the rate of contributions for medical insurance (from 15% to 13%), while decrease from the expenditure side should be achieved through savings in the public sector.

The government will probably satisfy its financial needs in the first part of 2012 by short term borrowing on the domestic market, which will further decrease available funds for financing the economy and raising the price of borrowing. Also, in the midst of depreciation pressures on the kuna, CNB raised the rate of obligatory reserve in January 2011 from 14% to 15%, withdrawing HRK 3.1 billion from the circulation, resulting in the increase of the inter-banking interest rates (additional HRK 3.1 billion was already withdrawn from the circulation in October 2011 by increasing the obligatory reserve rate from 13% to 14%). CNB has additionally reacted on depreciation pressures by foreign currency interventions on the market (during 2012 HRK 2.5 billion was withdrawn, HRK 3.1 billion during 2011).

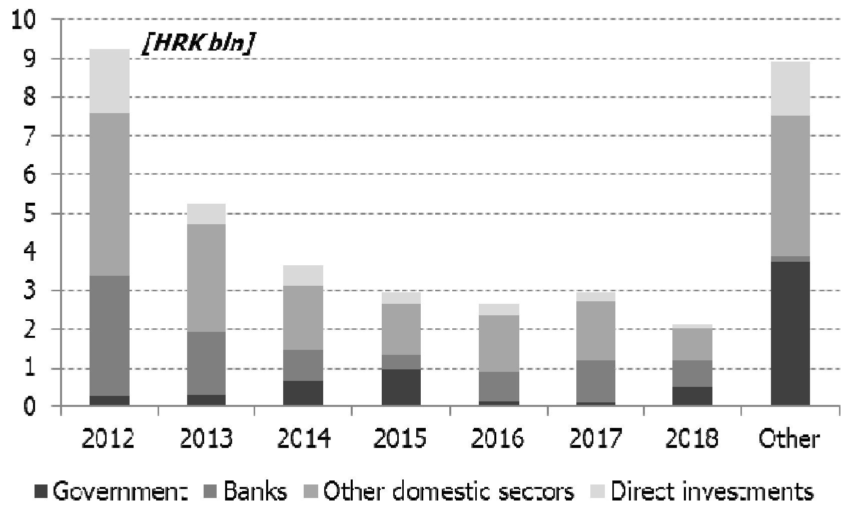
Fluctuations in interest rates on the Zagreb Money Market and changes of Euro



Source: Money Market Zagreb, the Croatian National Bank

Depreciation pressure will probably be increased in 2012 by the repayment of the foreign debt. Based on the CNB projections in 2012, the total repayments will amount to HRK 9.3 billion, of which 0.3 billion relates to the government.

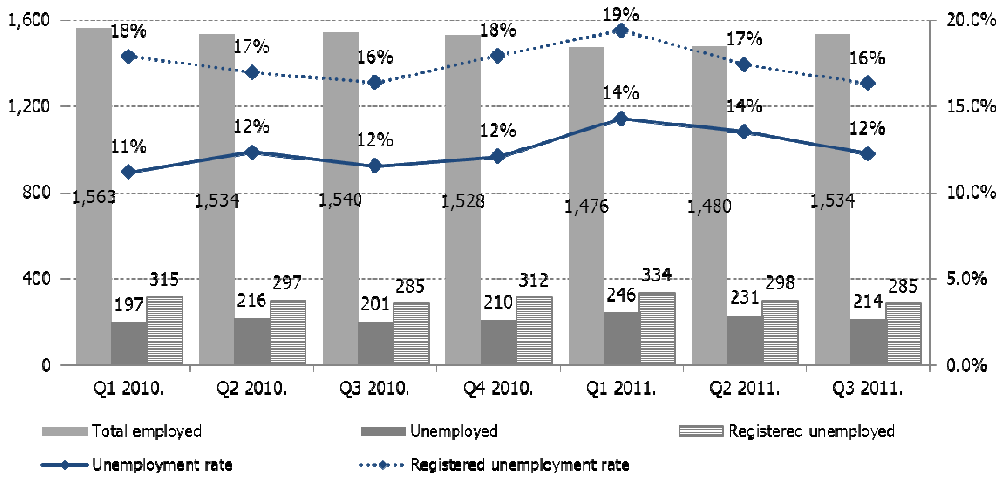
Gross external debt repayment projection



Source: Croatian National Bank

Labour market continues to show negative movement, improving only during the tourist season.

Movement in number of employed, unemployed and the registered unemployment rate



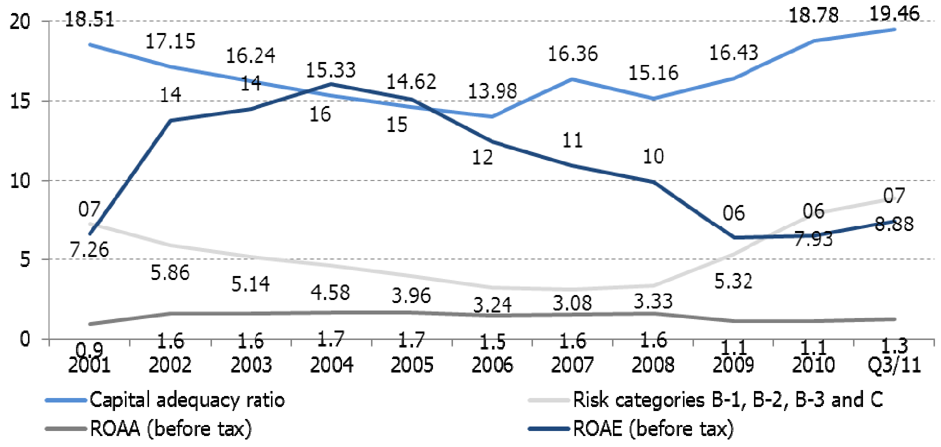
Source: Central Bureau of Statistics

THE BANKING SYSTEM IN 2011

In these unfavourable conditions, the banking system in Croatia notes lower rates of profitability, increase in non-performing loans and increase in impairment allowances. Also, in November 2011, due to significant legal breaches and bad credit risk management resulting in significantly material impairment allowances and negative capital adequacy ratio, CNB revoked banking licence of Credo banka d.d.

Despite this, the banking system is highly capitalised and liquid.

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



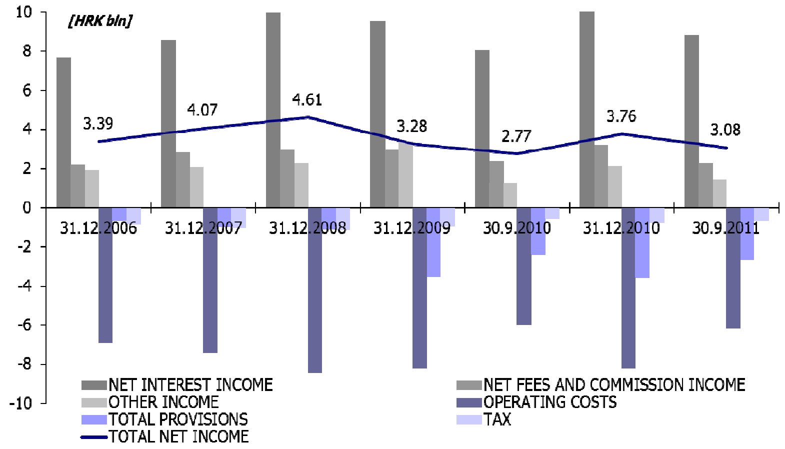
Source: Croatian National Bank

Based on unaudited aggregate data of banks published by the CNB, net interest income in the first 3 quarters of 2011 increased by 9.3%, as a result of the increase of interest revenue by 2.8% and the decrease in interest expenses by 4.0%.

Net interest and fee income decreased by 4.9% as a result of lower income (by 2.1%) and higher expenses (by 5.1%), while other non-interest income increased by 11.9%

As a result of all of the above, operative income increased by 6.7% which, with slight increase in operating expenses (by 3.1%) and 9.3% increase in total impairment allowances, generated increase in pre-tax profits of 11.1% and the increase in net profits by 11.0%.

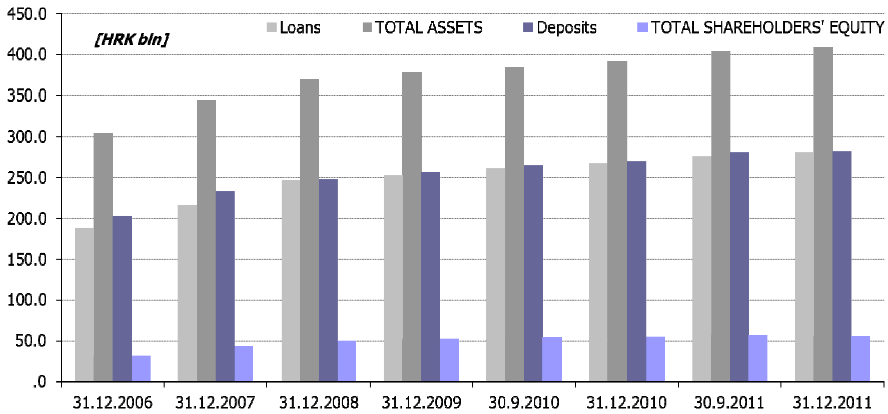
Aggregate income statement of banks in the Republic of Croatia



Source: Croatian National Bank

In 2011, based on unaudited data published by the CNB, gross loan portfolio increased by 5.9% (6.9% in 2010), impairment allowances increased by 28.3% (36.5% in 2010) and consequently, net loan portfolio increased by 4.9% annually (5.9% in 2010). The banks' capital increased by 2.3% annually (3.9% in 2010).

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 2011, 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.

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.

Starting from March, the Bank implemented new IT system for retail support and has started cooperation with HROK, resulting in retail portfolio quality improvement. Due to large interest of the clients for the kuna denominated loans, the Bank introduced a new product in August, long term kuna denominated non-purpose loan, which is well accepted in the market.

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 sole traders and entrepreneurs represent a significant segment of the Bank's operations.

Considering that the European Investment Fund (EIF) at the end of 2010 recognised Vaba d.d. banka Varaždin as its partner in achieving common mission, on 17 December 2010 the Bank and EIF signed Loan agreement with the objective of easier access of funds to Croatian micro entrepreneurs. A new product, Entrepreneur's loan by the Bank in cooperation with the EIF, was offered to new and existing clients.

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.

Due to large interest of the small entrepreneurs and sole traders from the Međimurje County, effective from 1 October the Bank has decided to expand the range of its products and services for those clients. Hence, the Bank's Small entrepreneurship and sole trader division opened an office in the Čakovec branch. With already existing products and services being offered to the clients by the Čakovec branch, all existing and new clients (small entrepreneurs and sole traders) are being offered information on opening of accounts, Internet banking and different short and long term credit lines adapted to individual needs of small entrepreneurs.

Corporate banking

The Bank's strategy in corporate banking in 2011 was focusing 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 2011 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 (models A, A+), involvement in auctions and inclusion of the local and national guarantee agencies. 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.

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.

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.

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 the following few years.

Treasury activities

In its main revenue segment – foreign currency exchange differences and securities trading, the Treasury performed well this year too. Foreign currency differences segment exceeded last year's results, while securities trading noted decrease in realised profits.

Situation in the foreign currency trading segment was quite stable, with no big market shocks. Only the year's end brought a significant weakening of the kuna as well as expectations that the CNB could react not only through foreign currency interventions, but also by using other measures with the objective of defending the FX exchange rate. Looking at the rate's movement, the year's end noted maximum level of the rate for the year (around 7.55). Not even the better tourist season couldn't compensate for lower investments inflow and, as an interesting factor affecting the kuna weakening, during April a negative EUR/HRK forward trading interest differential appeared. Stable trading was marked by still low margin in corporate trading, enhancing the importance of the foreign exchange differences trading realised results.

Market of fixed income securities was interesting, but marked by mainly negative news for the issuers (corporate as well as sovereign). PIGS countries situation escalated in the second half of the year, with general impression being worsened by negative macroeconomic forecasts and numerous rating downgrades, not only in Europe. Even the USA lost its decades undisputed AAA ratings. At the beginning of the year growth outlook and various indicators seemed relatively good so ECB even increased its basic interest rate (April and July). Unfortunately, the last quarter was marked by returning of the interest rate to the levels at the beginning of the year (1%) and by aforementioned ratings downgrades. All this resulted in very bad situation for most securities, including those issued by the Republic of Croatia, with significant yield increase.

Foreign payment transactions migration project resulted in significant improvements in IT support to the Treasury. As a result, transactions processing in the back office and their recording in the Bank's records have become significantly faster while operating risks have been decreased.

System of internal control and internal audit

The internal control system represents processes and procedures established to adequately control and monitor the risks incurred in operations, monitor the effectiveness of the Bank's operations, the reliability of financial reporting, information and compliance with regulations. The Bank has, in accordance with the Credit Instituions Act and the Decision on the internal controls system, established internal controls system comprising:

1. adequate organisational system
2. organisational culture
3. adequate control activities and segregation of duties
4. adequate internal controls integrated in the business processes and activities of the Bank
5. adequate administrative and accounting procedures
6. activities in the area of control function of the Bank

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

Based on the legal requirements, the Bank has established three control functions independent of the business processes and activities in which risks arise, i.e. which it monitors. These are:

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

Risk control function ensures the Bank's compliance with strategies and policies of risk management, through risk analysis, reporting to the Board and others on the risks and involvement in creating, application and monitoring of methods and models for risk management.

Compliance monitoring function ensures the Bank operates in accordance with the relevant legislation, standards and internal acts. Activities of the compliance monitoring function include recognising and assessment of the compliance risk the Bank is, or could be, exposed to, advising the Board and other responsible persons on the application of relevant legislation, standards and rules, assessment of legislative changes to the Bank's operations, checking of compliance of new products and procedures with the applicable legislation and with the legislation changes, and advising on the preparation of the compliance related educational programmes.

Internal audit function, as a part of the internal supervision, tests and values adequacy and effectiveness of the internal controls system, rates adequacy and effectiveness of risk management procedures and risk assessment methodology, rates the effectiveness of compliance monitoring function, rates the reporting system to the Board and the Management, rates the correctness and reliability of the accounting evidence system and of the financial statements, rates strategies and procedures of assessment of internal capital adequacy ratios, audits the IT system, checks reliability of the reporting system and timing and accuracy of reports as required by the Credit Institutions Act, rates the safety of the assets, rates the system of gathering and the accuracy of the information being publicly announced and performs all other activities needed for reaching the objectives of the internal audit.

Each control function prepares reports in accordance with its respective activities and which are based on the operational plans in accordance with the Credit Institutions Act and the Decisions based on the Act.

Development plan

In accordance with the mission and vision of the Bank, during 2012 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.

In every matter that is not regulated by the Code, the Bank applies Code of Corporate Governance made by the Zagreb Stock Exchange and the Croatian Financial Services Supervisory Agency "CFSSA", 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 2011, 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 two 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 2011 were as follows:

- Igor Čičak, Chairman (until 18 October 2011)
- Natalija Jambrečić, Member
- Josip Šeremet, deputy Chairman* (from 19 October 2011)

** Mr Šeremet has been appointed a deputy Chairman in the capacity of the Supervisory Board member, one off, to a 3-month term, until the appointment of the permanent Chairman of the Management Board (Article 43, 13p of the Credit Institutions Act).*

The Supervisory Board is currently composed of six 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 is an owner of 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 the year 2011 were as follows:

- Vladimir Košćec, Chairman
- Anisur Rehman Khan
- Mensur Jašarević (until 23.8.2011),
- Zaltan Kuljiš (from 24.8.2011),
- Zdenko Franić (from 24.8.2011),
- Josip Šeremet (from 3.10.2011),
- Ankica Mamić (until 10.10.2011),
- Marinko Benić (from 10.10.2011),
- Balz Thomas Merkli (until 10.10.2011).

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 2011 were as follows:

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

Policies of risk management are described in detail within the Notes to the financial statements for 2011.

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 on 31 December 2011 consisted of three members, Marinko Benić (president of the Audit Committee), Vladimir Košćec (member of the Audit Committee) and Marija Maltar (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.

____

Stanko Kežman, president of the Management Board

____

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 20 to 73 were authorised by the Management Board on 15 March 2012 for issue to the Supervisory Board and are signed below to signify this.

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

____

Stanko Kežman, president of the Management Board

____

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
An instinct for growth™

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 2011, 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 20 to 73.

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 20 to 73 give a true and fair view of the financial position of the Bank as at 31 December 2011, 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.

Emphasis of matter
Without qualifying our opinion, we draw attention to note 8 explaining a Bank's receivable and the legal case the Bank has raised because of other's side cancellation of the signed agreement on purchase of receivables. At the reporting date the case was still in process, however the Management Board and the Bank's legal counsellors believe the case will have positive outcome for the Bank and that the allowances made for the receivable are adequate at the reporting date.

Grant Thornton revizija d.o.o.
Koranska 16, Zagreb
Zagreb, 15 March 2012

GRANT THORNTON
revizija d.o.o.
ZAGREB

Ivica Smiljan
Certified auditor

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 2011

	Notes	31 December 2010 (HRK '000)	31 December 2011 (HRK '000)
ASSETS			
Cash and deposits with Croatian National Bank	4	175,381	131,491
Placements with and loans to other banks	5	39,154	19,424
Financial assets available for sale	6	248,041	221,734
Financial assets held to maturity	7	17,515	13,430
Loans and advances to customers	8	885,163	792,731
Property and equipment	9	28,292	27,116
Intangible assets	10	18,024	17,100
Other assets	11	11,697	13,232
TOTAL ASSETS		**1,423,266**	**1,236,257**
LIABILITIES			
Deposits from banks	12	17,741	-
Deposits from customers	13	1,080,476	863,431
Borrowings	14	154,680	230,259
Hybrid instruments	15	2,954	3,012
Provisions for liabilities and charges	16	2,164	729
Other liabilities	17	18,356	9,496
TOTAL LIABILITIES		**1,276,371**	**1,106,926**
EQUITY			
Share capital	18.1	176,523	176,464
Share premium	18.2	27,464	27,440
Other reserves	18.3	2,611	2,611
Fair value reserve	18.4	(674)	(4,701)
Accumulated losses	18.5	(59,028)	(72,484)
TOTAL EQUITY		**146,896**	**129,331**
TOTAL LIABILITIES AND EQUITY		**1,423,266**	**1,236,257**

The significant accounting policies and other notes on pages 25 to 73 form an integral part of these financial statements.

Income statement for the year ended 31 December 2011

	Notes	2010 (HRK '000)	2011 (HRK '000)
Interest and similar income	19	101,562	97,833
Interest expense and similar charges	20	(53,635)	(49,389)
Net interest income		**47,927**	**48,444**
Fee and commission income	21	6,594	6,645
Fee and commission expense	22	(2,405)	(2,182)
Net fee and commission income		**4,188**	**4,464**
Gains less losses from financial assets available for sale	23	2,427	1,057
Gains less losses arising from foreign currencies	24	5,893	6,348
Other operating income	25	2,267	2,400
Dealing and other income/(expense)		**10,587**	**9,805**
OPERATING INCOME		**62,702**	**62,713**
General and administrative expenses	26	(47,994)	(47,909)
Depreciation and amortisation		(5,607)	(5,134)
Provisions for liabilities and charges		621	(109)
Operating expenses		**(52,980)**	**(53,152)**
OPERATING RESULT BEFORE IMPAIRMENT OF ASSETS		**9,722**	**9,561**
Identified impairment losses		(13,181)	(24,312)
Identified impairment losses on group basis		417	1,295
Impairment losses	**27**	**(12,764)**	**(23,017)**
PROFIT/(LOSS) BEFORE TAX		**(3,042)**	**(13,456)**
Income tax expense	28	-	-
PROFIT/(LOSS) FOR THE YEAR		**(3,042)**	**(13,456)**

The significant accounting policies and other notes on pages 25 to 73 form an integral part of these financial statements.

Statement of comprehensive income for the year ended 31 December 2011

	2010 (HRK '000)	2011 (HRK '000)
PROFIT/(LOSS) FOR THE YEAR	**(3,042)**	**(13,456)**
Net unrealised losses from financial assets available for sale	(1,070)	(4,026)
Other comprehensive income	**(1,070)**	**(4,026)**
Total comprehensive income	**(4,111)**	**(17,482)**

The significant accounting policies and other notes on pages 25 to 73 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 2010	**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**
Transactions with the owners						
Share capital decrease for own shares	(59)	(24)	-	-	-	(83)
Total transactions with the owners	**(59)**	**(24)**	**-**	**-**	**-**	**(83)**
Loss for the year	-	-	-	-	(13,456)	(13,456)
Net unrealised losses from financial assets available for sale	-	-	-	(4,026)	-	(4,026)
Total comprehensive income	**-**	**-**	**-**	**(4,026)**	**(13,456)**	**(17,482)**
Balance at 31 December 2011	**176,464**	**27,440**	**2,611**	**(4,700)**	**(72,484)**	**129,331**

The significant accounting policies and other notes on pages 25 to 73 form an integral part of these financial statements.

Statement of cash flows for the year ended 31 December 2011

	2010 (HRK '000)	2011 (HRK '000)
Cash flow from operating activities		
Profit/(loss) before tax	**(3,042)**	**(13,456)**
Adjustments:	**19,324**	**27,527**
- depreciation and amortisation	5,607	5,134
- net foreign exchange losses	1,028	(359)
- impairment losses on loans and advances to customers and other assets	12,661	22,752
- provisions for liabilities and charges	28	-
Changes in operating assets and liabilities	**24.401**	**(126,474)**
Decrease/(increase) in placements with and loans to other banks	(8,206)	567
Decrease/(Increase) in loans and advances to customers	(73,305)	80,538
Decrease/(Increase) in other assets	(9,363)	2,421
(Decrease)/increase in deposits from banks	(20,539)	(17,741)
(Increase)/decrease in obligatory reserve with the CNB	(13,186)	50,256
(Decrease)/increase in deposits from customers	137,182	(228,371)
(Decrease)/increase in other liabilities	11,458	(14,144)
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES	**40,324**	**(112,403)**
Cash flow from investing activities		
Purchase of property and equipment and intangible assets	(5,131)	(3,035)
Increase in financial assets available for sale	(59,288)	25,565
Maturity/(acquisition) of financial assets held to maturity	(13,565)	4,011
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES	**(77,984)**	**26,541**
Cash flow from financing activities		
(Decrease)/increase in borrowings	82,839	71,327
Increase/(decrease) in share capital	-	(83)
NET CASH (OUTFLOW)/INFLOW FROM FINANCING ACTIVITIES	**82,839**	**71,244**
Effect of foreign exchange rate changes on cash and cash equivalents	1,106	646
NET (DECREASE)/INCREASE CASH AND CASH EQUIVALETNS	**46,285**	**(13,972)**
Cash and cash equivalents at the beginning of the year	**56,365**	**102,650**
Cash and cash equivalents at the end of the year	**102,650**	**88,678**

The significant accounting policies and other notes on pages 25 to 73 form an integral part of these financial statements.

Notes to the financial statements for the year ended 31 December 2011

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 15 March 2012 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. The Bank's operations are subject to the Credit Institutions 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 endorsed for use in the EU at 31 December 2011.

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 2011 the Bank has recognised portfolio-based provisions of HRK 8,151 thousand (2010: HRK 9,356 thousand) in the balance sheet and has recognised income for the year ending 31 December 2011 in the amount of HRK 1,295 thousand (2010: HRK 417 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)

- 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.

(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 2011 the exchange rates used for translation of Bank's assets and liabilities were HRK 7.530 to EUR 1 (2010: HRK 7.385 to EUR 1) and HRK 5.820 to USD 1 (2010: HRK 5.568 to USD 1).

(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.

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, recognised on a linear basis. Income and expense on all assets and liabilities held for trading is recognised as interest income and expense.

(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 financial assets through profit and loss 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.

Notes to the financial statements (continued)

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.

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 2011 the Bank had no financial assets and financial liabilities at fair value through profit and loss (2010: 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.

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.

Notes to the financial statements (continued)

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 short-term gain purposes are classified as available-for-sale assets, and are carried at fair value. The Bank uses treasury bills for liquidity purposes.

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.

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.

Notes to the financial statements (continued)

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.

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:

	2011	**2010**
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.

Notes to the financial statements (continued)

(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:

	2011	**2010**
Leasehold improvements	5 years	5 years
Software	5 years	5 years
Licences	5 years	5 years

(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.

Notes to the financial statements (continued)

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.

(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%.

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)

Assets	Notes	31.12.2010 (HRK '000)	31.12.2011 (HRK '000)
Deposits with Croatian National Bank	4	156,596	112,218
Placements with and loans to other banks	5	39,154	19,424
Financial assets available for sale	6	248,041	221,734
Financial assets held to maturity	7	17,515	13,430
Loans and advances to customers	8	885,163	792,731
Other assets	11	11,697	13,232
Total assets exposed to credit risk		**1,358,166**	**1,172,768**
Unused loan commitments		39,767	34,196
Guarantees		27,655	32,029
Other contingent liabilities		1,317	1,803
Total off balance sheet exposure to credit risk	**32**	**68,739**	**68,280**
Total credit exposure		**1,426,905**	**1,241,048**

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)

[000 HRK]	31.12.2011								
	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 - 6	8	9 = 8 / 7
ASSETS									
Deposits at CNB	112,218		-	-	-	-	112,218	-	-
A	112,218	*100.00%*	-	-	-	-	112,218	-	-
Placements at and loans to other banks	19,424		-	-	-	-	19,424	-	-
A	19,424	*100.00%*	-	-	-	-	19,424	-	-
Financial assets held to maturity	14,108		558	120	678	*4.80%*	13,430	-	-
A	13,550	*96.05%*	-	120	120	*0.89%*	13,430	-	-
B, C	558	*3.95%*	558	-	558	*100.00%*	-	-	-
Loans and advances to customers	863,174		63,086	7,357	70,443	*8.16%*	792,731	338,171	*42.66%*
A	700,399	*81.14%*	-	7,357	7,357	*1.05%*	693,042	266,065	*38.39%*
B, C	162,775	*18.86%*	63,086	-	63,086	*38.76%*	99,689	72,106	*72.33%*
Retail	201,554		22,777	1,787	24,565	*12.19%*	176,989	56,367	*31.85%*
A	170,148	*84.42%*	-	1,787	1,787	*1.05%*	168,361	53,215	*31.61%*
B, C	31,406	*15.58%*	22,777	-	22,777	*72.53%*	8,628	3,152	*36.53%*
Corporate	661,620		40,309	5,570	45,879	*6.93%*	615,741	281,804	*45.77%*
A	530,251	*80.14%*	-	5,570	5,570	*1.05%*	524,681	212,850	*40.57%*
B, C	131,369	*19.86%*	40,309	-	40,309	*30.68%*	91,060	68,954	*75.72%*
Other assets	14,559		1,327	-	1,327	*9.12%*	13,232	-	-
A	13,216	*90.78%*	-	-	-	-	13,216		-
B, C	1,343	*9.22%*	1,327	-	1,327	*98.82%*	16		-
TOTAL	**1,023,482**		**64,971**	**7,477**	**72,448**	***7.08%***	**951,034**	**338,171**	***35.56%***

Notes to the financial statements (continued)

[000 HRK]	31.12.2010								
	Gross	%	Impairment loss for identified losses	Impairment loss for unidentified losses	Total impairment loss	Total impairment loss / Gross	Net	Collateral value	Collateral value / net
	1	2	3	4	5 = 3 + 4	6 = 5 / 1	7 = 1 - 6	8	9 = 8 / 7
ASSETS									
Deposits at CNB	156,596		-	-	-	-	156,596	-	-
A	156,596	*100.00%*	-	-	-	-	156,596	-	-
Placements at and loans to other banks	39,154		-	-	-	-	39,154	-	-
A	39,154	*100.00%*	-	-	-	-	39,154	-	-
Financial assets held to maturity	17,659		-	144	144	*0.82%*	17,515	-	-
A	17,659	*100.00%*	-	144	144	*0.82%*	17,515	-	-
B, C	-	-	-	-	-	-	-	-	-
Loans and advances to customers	934,338		40,548	8,628	49,176	*5.26%*	885,163	360,548	*40.73%*
A	802,408	*85.88%*	-	8,628	8,628	*1.08%*	793,780	292,073	*36.80%*
B, C	131,930	*14.12%*	40,548	-	40,548	*30.73%*	91,382	68,475	*74.93%*
Retail	213,188		19,696	1,977	21,673	*10.17%*	191,515	61,395	*32.06%*
A	183,878	*86.25%*	-	1,977	1,977	*1.08%*	181,901	57,815	*31.78%*
B, C	29,310	*13.75%*	19,696	-	19,696	*67.20%*	9,614	3,580	*37.24%*
Corporate	721,151		20,852	6,651	27,503	*3.81%*	693,647	299,153	*43.13%*
A	618,530	*85.77%*	-	6,651	6,651	*1.08%*	611,879	234,258	*38.29%*
B, C	102,621	*14.23%*	20,852	-	20,852	*20.32%*	81,768	64,895	*79.36%*
Other assets	14,514		2,817	-	2,817	*19.41%*	11,697	-	-
A	12,639	*87.08%*	-	-	-	-	12,639		-
B, C	1,875	*12.92%*	2,817	-	2,817	*150.22%*	(942)		-
TOTAL	**1,162,262**		**43,365**	**8,772**	**52,137**	***4.49%***	**1,110,126**	**360,548**	***32.48%***

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

[000 HRK]	31.12.2011 HRK	HRK with FC clause	EUR	Other foreign curencies	Total
ASSETS					
Cash and deposits with Croatian National Bank	106,519	-	5,644	19,328	131,491
Placements with and loans to other banks	6,370	-	8,684	4,371	19,424
Financial assets available for sale	59,022	2,271	160,441	-	221,734
Financial assets held to maturity	13,430	-	-	-	13,430
Loans and advances to customers	228,145	494,489	70,098	-	792,731
Property and equipment	27,116	-	-	-	27,116
Intangible assets	17,100	-	-	-	17,100
Other assets	11,321	-	1,908	2	13,232
TOTAL ASSETS	**469,023**	**496,760**	**246,774**	**23,701**	**1,236,258**
LIABILITIES					
Deposits from banks	-	-	-	-	-
Deposits from customers	289,420	4,872	541,219	27,921	863,431
Borrowings	45,901	13,565	170,792	-	230,259
Hybrid instruments	-	-	3,012	-	3,012
Provisions for liabilities and charges	729	-	-	-	729
Other liabilities	8,540	144	241	570	9,496
TOTAL LIABILITIES	**344,590**	**18,581**	**715,264**	**28,492**	**1,106,927**
EQUITY					
Share capital	176,464	-	-	-	176,464
Share premium	27,440	-	-	-	27,440
Other reserves	2,611	-	-	-	2,611
Fair value reserve	(4,701)	-	-	-	(4,701)
Accumulated losses	(72,484)	-	-	-	(72,484)
TOTAL EQUITY	**129,331**	**-**	**-**	**-**	**129,331**
TOTAL LIABILITIES AND EQUITY	**473,921**	**18,581**	**715,264**	**28,492**	**1,236,258**
VALUTNA NEUSKLAĐENOST	**(4,898)**	**478,179**	**(468,490)**	**(4,790)**	**-**

Notes to the financial statements (continued)

[000 HRK]	31.12.2010 HRK	HRK with FC clause	EUR	Other foreign curencies	Total
ASSETS					
Cash and deposits with Croatian National Bank	149,468	-	7,318	18,595	175,381
Placements with and loans to other banks	11,000 -		23,060	5,094	39,154
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	10,713	-	-	984	11,697
TOTAL ASSETS	**590,222**	**532,292**	**260,644**	**40,109**	**1,423,267**
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	18,356				18,356
TOTAL LIABILITIES	**421,498**	**19,619**	**685,848**	**149,406**	**1,276,371**
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	**568,394**	**19,619**	**685,848**	**149,406**	**1,423,267**
NET FOREIGN EXCHANGE POSITION	**21,828**	**512,673**	**(425,204)**	**(109,297)**	**-**

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 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.

Notes to the financial statements (continued)

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 2011, 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.

Notes to the financial statements (continued)

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.

	2010.	**2011.**
Potential decrease in net interest income (000 HRK)	(111)	(1,345)
% of budgeted net interest income	(0.23%)	(2.77%)

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.

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	**2011**
Net book value of capital (HRK '000)	146,896	129,331
Economic value of capital (HRK '000)	131,255	102,379
Change in economic value of capital (%)	(2.03%)	(4.66%)
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

[000 HRK]	31.12.2011							
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest free	**Total**	Fixed interest rate
ASSETS								
Cash and deposits with Croatian National Bank	77,300	-	34,918	-	-	19,273	**131,491**	-
Placements with and loans to other banks	11,645	-	-	-	-	7,779	**19,424**	-
Financial assets available for sale	22,696	7,531	171,997	-	-	19,510	**221,734**	202,224
Financial assets held to maturity	2,150	4,194	6,602	-	-	484	**13,430**	12,946
Loans and advances to customers	59,785	58,453	621,743	11,645	7,226	33,879	**792,731**	45,500
Property and equipment	-	-	-	-	-	27,116	**27,116**	-
Intangible assets	-	-	-	-	-	17,100	**17,100**	-
Other assets	-	-	-	-	-	13,232	**13,232**	-
TOTAL ASSETS	**173,576**	**70,178**	**835,260**	**11,645**	**7,226**	**138,372**	**1,236,258**	**260,670**
LIABILITIES								
Deposits from banks	-	-	-	-	-	-	**-**	-
Deposits from customers	158,287	97,940	566,186	24,838	2,665	13,515	**863,431**	374,399
Borrowings	106,766	109,121	10,662	1,621	1,146	943	**230,259**	200,190
Hybrid instruments	-	-	-	-	3,012	-	**3,012**	3,012
Provisions for liabilities and charges	-	-	-	-	-	729	**729**	-
Other liabilities	-	-	-	-	-	9,496	**9,496**	-
TOTAL LIABILITIES	**265,053**	**207,061**	**576,848**	**26,459**	**6,823**	**24,683**	**1,106,927**	**577,601**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**129,331**	**129,331**	**-**
TOTAL LIABILITIES AND EQUITY	**265,053**	**207,061**	**576,848**	**26,459**	**6,823**	**154,014**	**1,236,258**	**577,601**
INTEREST GAP	**(91,476)**	**(136,884)**	**258,412**	**(14,813)**	**403**	**(15,642)**	**-**	**(316,931)**

Notes to the financial statements (continued)

[000 HRK]	31.12.2010							
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest free	**Total**	Fixed interest rate
ASSETS								
Cash and deposits with Croatian National Bank	156,542	-	-	-	-	18,839	**175,381**	54,003
Placements with and loans to other banks	30,642	-	160	369	6,500	1,483	**39,154**	-
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	810,120	5,948	2,119	65,344	**885,163**	14,559
Property and equipment	-	-	-	-	-	28,292	**28,292**	-
Intangible assets	-	-	-	-	-	18,024	**18,024**	-
Other assets	-	-	-	-	-	11,697	**11,697**	-
TOTAL ASSETS	**199,356**	**57,912**	**987,478**	**6,317**	**10,725**	**161,479**	**1,423,267**	**314,212**
LIABILITIES								
Deposits from banks	17,741	-	-	-	-	-	**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 for liabilities and charges	-	-	-	-	-	2,164	**2,164**	-
Other liabilities	-	-	-	-	-	18,356	**18,356**	-
TOTAL LIABILITIES	**131,647**	**100,018**	**961,008**	**30,373**	**8,141**	**45,184**	**1,276,371**	**508,499**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**146,896**	**146,896**	**-**
TOTAL LIABILITIES AND EQUITY	**131,647**	**100,018**	**961,008**	**30,373**	**8,141**	**192,080**	**1,423,267**	**508,499**
INTEREST GAP	**67,709**	**(42,106)**	**26,470**	**(24,056)**	**2,584**	**(30,601)**	**-**	**(194,287)**

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 largest 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).

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 proposals 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.

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.

Notes to the financial statements (continued)

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

[000 HRK]	31.12.2011						
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest free	Total
ASSETS							
Cash and deposits with Croatian National Bank	131,491	-	-	-	-	-	**131,491**
Placements with and loans to other banks	19,424	-	-	-	-	-	**19,424**
Financial assets available for sale	22,976	22,595	37,585	17,847	120,731	-	**221,734**
Financial assets held to maturity	2,631	4,195	6,605	-	-	-	**13,430**
Loans and advances to customers	70,995	61,357	221,710	249,518	189,151	-	**792,731**
Property and equipment	-	-	-	-	27,116	-	**27,116**
Intangible assets	-	-	-	-	17,100	-	**17,100**
Other assets	5,812	1,620	505	5,295	-	-	**13,232**
TOTAL ASSETS	**253,329**	**89,767**	**266,404**	**272,660**	**354,098**	**-**	**1,236,258**
LIABILITIES							
Deposits from banks	-	-	-	-	-	-	**-**
Deposits from customers	236,811	99,381	437,117	85,160	4,961	-	**863,431**
Borrowings	106,573	90,513	-	6,574	26,599	-	**230,259**
Hybrid instruments	-	-	-	-	3,012	-	**3,012**
Provisions for liabilities and charges	-	-	729	-	-	-	**729**
Other liabilities	9,496	-	-	-	-	-	**9,496**
TOTAL LIABILITIES	**352,880**	**189,894**	**437,846**	**91,734**	**34,572**	**-**	**1,106,927**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**129,331**	**-**	**129,331**
TOTAL LIABILITIES AND EQUITY	**352,880**	**189,894**	**437,846**	**91,734**	**163,903**	**-**	**1,236,258**
MATURITY GAP	**(99,551)**	**(100,127)**	**(171,442)**	**180,926**	**190,195**	**-**	**-**

Notes to the financial statements (continued)

[000 HRK]	31.12.2010						
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest free	**Total**
ASSETS							
Cash and deposits with Croatian National Bank	175,381	-	-	-	-	-	**175,381**
Placements with and loans to other banks	32,123	-	162	369	6,500	-	**39,154**
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	262,165	149,033	195,027	-	**885,163**
Property and equipment	-	-	-	-	28,292	-	**28,292**
Intangible assets	-	-	-	-	18,024	-	**18,024**
Other assets	5,839	1,488	638	3,731	-	-	**11,697**
TOTAL ASSETS	**533,970**	**108,332**	**262,965**	**168,569**	**349,431**	**-**	**1,423,267**
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	37,608	73,123	35,090	-	8,859	-	**154,680**
Hybrid instruments	-	-	-	-	2,954	-	**2,954**
Provisions for liabilities and charges	-	-	2,164	-	-	-	**2,164**
Other liabilities	18,356	-	-	-	-	-	**18,356**
TOTAL LIABILITIES	**347,443**	**219,300**	**599,114**	**91,139**	**19,375**	**-**	**1,276,371**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**146,896**	**146,896**
TOTAL LIABILITIES AND EQUITY	**347,443**	**219,300**	**599,114**	**91,139**	**19,375**	**146,896**	**1,423,267**
MATURITY GAP	**186,527**	**(110,968)**	**(336,149)**	**77,430**	**330,056**	**(146,896)**	**-**

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 32.

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 the total of 14 court cases, 5 of which are litigations and 9 violations arising from the daily operations of the Bank. For litigations provisions have been made in the total amount of HRK 103 thousand. Of the aforementioned 9 violations, 8 have reached statute of limitation and no risk of financial loss exists.

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 DEPOSITS WITH CROATIAN NATIONAL BANK

[000 HRK] CASH AND DEPOSITS AT CNB	31.12.2010	31.12.2011
Cash at hand	**18,785**	**19,273**
in HRK	10,161	12,896
in foreign currency	8,624	6,378
Giro account at CNB	**54,003**	**58,705**
in HRK	54,003	58,705
in foreign currency	-	-
Obligatory reserve with CNB	**102,539**	**53,513**
in HRK	85,250	34,918
in foreign currency	17,289	18,595
Accrued interest	**54**	**-**
due	54	-
not due	-	-
TOTAL	**175,381**	**131,491**

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 2011 amounted to 14% (2010: 13%; CNB changed the rate of the obligatory reserve from 14% to 13% in February 2010, from 13% to 14% in September 2011 and from 14% to 15% in January 2012) of HRK and foreign currency deposits, borrowings and issued debt securities.

At 31 December 2011 the required minimum rate of maintenance of the obligatory reserve in the Croatian kuna with the CNB amounted to 70% (2010: 70%), while the remaining 30% (2010: 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. Based on the Decision made on 9 March 2011 CNB pays no interest on the obligatory reserve funds (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%).

70% of the foreign currency obligatory reserve (2010: 60%) is maintained with the CNB, while the remaining 30% (2010: 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 (2010: 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.

Notes to the financial statements (continued)

5. PLACEMENTS WITH AND LOANS TO OTHER BANKS

[000 HRK] PLACEMENTS WITH OTHER BANKS	31.12.2010	31.12.2011
Short-term	**30,022**	**10,699**
with foreign banks	24,570	9,193
with domestic banks	5,452	1,506
Long-term	**9,130**	**8,721**
with foreign banks	2,261	1,812
with domestic banks	6,869	6,909
Accrued interest	**2**	**4**
due	-	-
not due	2	4
TOTAL	**39,154**	**19,424**

6. FINANCIAL ASSETS AVAILABLE FOR SALE

[HRK 000] FINANCIAL ASSETS AVAILABLE FOR SALE	31.12.2010	31.12.2011
Debt securities	**230,965**	**202,123**
Bonds issued by the Ministry of Finance	109,531	116,709
Treasury bills issued by the Ministry of Finance	-	-
Foreign countries bonds	-	45,603
Foreign countries treasury bills	119,329	37,658
Corporate bonds	2,106	2,153
Shares in investment funds	**11,689**	**11,945**
Equity securities	**3,990**	**3,500**
Accrued interest	**1,397**	**4,166**
due	-	-
not due	1,397	4,166
TOTAL	**248,041**	**221,734**

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".

Notes to the financial statements (continued)

7. FINANCIAL ASSETS HELD TO MATURITY

[000 HRK] FINANCIAL ASSETS HELD TO MATURITY	31.12.2010	31.12.2011
Debt securities	**16,935**	**13,624**
Bills of exchange	16,935	13,624
Accrued interest	**724**	**484**
due	520	484
not due	204	-
Impairment allowances	**(144)**	**(678)**
identified losses - bills of exchange	-	(75)
identified losses - accrued interest	-	(483)
identified losses on group basis	(144)	(120)
TOTAL	**17,515**	**13,430**

8. LOANS AND ADVANCES TO CUSTOMERS

[000 HRK] LOANS AND ADVANCES TO CUSTOMERS	31.12.2010	31.12.2011
Gross loans	**914,729**	**842,318**
retail	210,064	198,455
corporate	704,665	643,863
Accrued interest	**19,609**	**20,856**
due	14,606	16,054
not due	5,003	4,802
Impairment allowances	**(49,176)**	**(70,443)**
identified losses - gross loans	(37,251)	(57,494)
identified losses - accrued interest	(3,297)	(5,592)
identified losses on group basis	(8,628)	(7,357)
UKUPNO	**885,163**	**792,731**

[000 HRK] MOVEMENT IN IMPAIRMENT ALLOWANCES	2011 Identified losses	Identified losses on group basis	TOTAL
Movement in impairment allowances			
As at 1 January	40,548	8,628	**49,176**
(Decrease) / increase in impairment losses	23,974	(1,271)	**22,703**
Write-offs	(927)	-	**(927)**
Collected impaired interest	-	-	**-**
Net gain / (loss) on foreign exchange differences	(509)	-	**(509)**
As at 31 December	**63,086**	**7,357**	**70,443**

Notes to the financial statements (continued)

[000 HRK] MOVEMENT IN IMPAIRMENT ALLOWANCES	2010 Identified losses	Identified losses on group basis	TOTAL
Movement in impairment allowances			
As at 1 January	26,759	8,625	**35,384**
(Decrease) / increase in impairment losses	13,077	3	**13,080**
Collected impaired interest	860	-	**860**
Net gain / (loss) on foreign exchange differences	(148)	-	**(148)**
As at 31 December	**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.

The Bank has recognised a receivable from a client in the net amount of HRK 10,530 thousand (gross receivable of HRK 26,326 thousand, impairment allowance of HRK 15,796 thousand), made based on an agreement on purchase of receivables with the potential buyer of a part of fixed assets of the client. Since the potential buyer subsequently cancelled the signed agreement, the Bank raised a lawsuit against the buyer for non-honouring of the agreement and the damage compensation in the gross amount of the receivable plus the legal penalty interest. The court case is still in process and has not been finished by the financial statements reporting date. The Management Board and the Bank's legal counsellors believe the case will have positive outcome for the Bank and that the allowances made for the receivable are adequate at the reporting date.

9. PROPERTY AND EQUIPMENT

[000 HRK]	2011 Land and buildings	IT equipment	Office furniture and equipment	Motor vehicles and other	Assets under construction	Total
Cost						
At 1 January	21,136	6,350	11,143	1,766	1,536	41,931
Troškovi stjecanja nekretnine priznati izravno u kapitalu i rezervama	746	-	-	-	926	1,672
Additions	-	-	-	-	-	-
Transfers	-	2,209	74	145	(2,428)	-
Write offs	-	(24)	(80)	(9)	-	(113)
Balance at 31 December	**21,882**	**8,535**	**11,137**	**1,902**	**34**	**43,490**
Accumulated depreciation						
At 1 January	2,254	4,421	5,627	1,337	-	13,639
Charge for the year	636	1,017	1,051	138	-	2,842
Write offs	-	(24)	(74)	(9)	-	(107)
Balance at 31 December	**2,890**	**5,414**	**6,604**	**1,466**	**-**	**16,374**
Net book value						
At 1 January	18,882	1,929	5,516	429	1,536	28,292
Balance at 31 December	**18,992**	**3,121**	**4,533**	**436**	**34**	**27,116**

Notes to the financial statements (continued)

[000 HRK]	Land and buildings	IT equipment	Office furniture and	Motor vehicles and	Assets under construction	Total
			2010			
Cost						
At 1 January	20,231	6,140	10,809	1,757	-	38,937
Troškovi stjecanja nekretnine priznati izravno u kapitalu i rezervama	-	-	-	-	-	-
Additions	-	-	-	-	3,014	3,014
Transfers	905	210	348	15	(1,478)	-
Write offs	-	-	(14)	(6)	-	(20)
Balance at 31 December	**21,136**	**6,350**	**11,143**	**1,766**	**1,536**	**41,931**
Accumulated depreciation						
At 1 January	1,630	3,353	4,576	1,087	-	10,646
Charge for the year	624	1,068	1,065	252	-	3,009
Write offs	-	-	(14)	(2)	-	(16)
Balance at 31 December	**2,254**	**4,421**	**5,627**	**1,337**	**-**	**13,639**
Net book value						
At 1 January	18,601	2,787	6,233	670	-	28,291
Balance at 31 December	**18,882**	**1,929**	**5,516**	**429**	**1,536**	**28,292**

10. INTANGIBLE ASSETS

[000 HRK]	Software	Goodwill	Leasehold improvements	Licences	Assets under construction	Total
			2011			
Cost						
Balance at 1 January	1,307	2,300	9,093	4,824	10,689	28,213
Additions	-	-	-	-	1,375	1,375
Transfers	-	-	86	251	(337)	-
Write offs	-	-	(322)	(134)	-	(456)
Balance at 31 December	**1,307**	**2,300**	**8,857**	**4,941**	**11,727**	**29,132**
Accumulated depreciation						
Balance at 1 January	1,083	-	6,462	2,644	-	10,189
Charge for the year	134	-	1,334	836	-	2,304
Write offs	-	-	(327)	(134)	-	(461)
Balance at 31 December	**1,217**	**-**	**7,469**	**3,346**	**-**	**12,032**
Net book value						
Balance at 1 January	224	2,300	2,631	2,180	10,689	18,024
Balance at 31 December	**90**	**2,300**	**1,388**	**1,595**	**11,727**	**17,100**

Notes to the financial statements (continued)

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

11. OTHER ASSETS

[000 HRK] OTHER ASSETS	31.12.2010	31.12.2011
Other assets	**14,513**	**14,559**
Fees receivable	969	864
Prepaid expenses	1,092	627
Forclosed assets	6,555	8,162
Inventories	638	505
Other receivables	5,260	4,401
Impairment allowances	**(2,817)**	**(1,327)**
TOTAL	**11,697**	**13,232**

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

[HRK 000] MOVEMENT IN IMPAIRMENT ALLOWANCES	2010	2011
As at 1 January	**2,902**	**2,817**
Increase / decrease	(85)	(64)
Write offs	-	(1,426)
Balance at 31 December	**2,817**	**1,327**

Notes to the financial statements (continued)

12. DEPOSITS FROM BANKS

[HRK 000] DEPOSITS FROM BANKS	31.12.2010	31.12.2011
Term deposits	**17,724**	**-**
in HRK	-	-
in foreign currency	17,724	-
Accrued interest	**17**	**-**
due	-	-
not due	17	-
Total	**17,741**	**-**

13. DEPOSITS FROM CUSTOMERS

[HRK 000] DEPOSITS FROM CUSTOMERS	31.12.2010	31.12.2011
Demand deposits	**93,868**	**74,034**
retail	19,255	16,427
in HRK	*9,894*	*9,781*
in foreign currency	*9,361*	*6,646*
corporate	74,612	57,607
in HRK	*69,132*	*54,225*
in foreign currency	*5,480*	*3,383*
Restricted deposits	**3,735**	**508**
Term deposits	**965,099**	**775,882**
retail	761,512	629,432
in HRK	*161,219*	*125,770*
in foreign currency	*600,293*	*503,662*
corporate	203,587	146,450
in HRK	*137,799*	*100,044*
in foreign currency	*65,788*	*46,406*
Accrued interest	**17,774**	**13,007**
due	144	157
not due	17,630	12,850
TOTAL	**1,080,476**	**863,431**

Notes to the financial statements (continued)

14. BORROWINGS

[HRK 000] BORROWINGS	31.12.2010	31.12.2011
Short term	**145,637**	**215,237**
from banks	145,637	196,411
in HRK	*29,000*	*44,772*
in foreign currency	*116,637*	*151,639*
from other financial institutions	-	18,826
in HRK	-	-
in foreign currency	-	*18,826*
Long term	**8,859**	**14,078**
from banks	8,859	14,078
in HRK	*8,859*	*14,078*
in foreign currency		
from other financial institutions	-	-
in HRK	-	-
in foreign currency	-	-
Accrued interest	**184**	**943**
due	-	74
not due	184	870
TOTAL	**154,680**	**230,259**

Borrowings include repurchase agreements in the total amount of HRK 193,411 thousand (2010: HRK 131,637 thousand). Out of the total amount of the repurchase agreements, HRK 151,639 thousand relate to borrowings denominated in euro (2010: HRK 116,637 thousand) while HRK 41,772 thousand relate to borrowings denominated in kuna (2010: HRK 15,000 thousand).

15. HYBRID INSTRUMENTS

[000 HRK] HYBRID INSTRUMENTS	31.12.2010	31.12.2011
Hybrid instruments	**2,954**	**3,012**
in HRK	2,954	3,012
TOTAL	**2,954**	**3,012**

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 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)

16. PROVISIONS FOR LIABILITIES AND CHARGES

[000 HRK] PROVISIONS FOR LIABILITIES AND CHARGES	31.12.2010	31.12.2011
Provisions for court cases	1,490	54
Provisions for pensions and other liabilities to employees	90	-
Provisions for contingent and other liabilities	584	674
TOTAL	2,164	729

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

[HRK 000] MOVEMENT IN PROVISIONS FOR LIABILITIES AND CHARGES	2010	2011
As at 1 January	**3,601**	**2,164**
Increase / decrease	(666)	(799)
Utilised during the period	(771)	(636)
Balance at 31 December	2,164	729

17. OTHER LIABILITIES

[000 HRK] OTHER LIABILITIES	31.12.2010	31.12.2011
Trade payables	2,059	190
Liabilities for salaries, deductions from salaries, taxes and contributions	2,098	1,973
Deferred fee income	4,187	4,268
Other liabilities	10,012	3,065
TOTAL	18,356	9,496

18. EQUITY

18.1 Share capital

31.12.2011	Share capital [000 HRK]	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
UKUPNO	176,523	100.00

Notes to the financial statements (continued)

31.12.2010	Share capital [000 HRK]	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
TOTAL	**176,523**	**100.00**

18.2 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.

18.3 Other reserves

Other reserves as at 31 December 2011 amount to HRK 2,611 thousand (2010: HRK 2,611 thousand) and are created in accordance with the General Assembly decision.

18.4 Fair value reserve

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

18.5 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.

18.6 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.

18.7 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.

18.8 Proposed dividends

Dividends payable are not recognized until they are approved at the General Assembly. The Management will not propose a dividend payment for 2011 (2010: nil).

Notes to the financial statements (continued)

19. INTEREST AND SIMILAR INCOME

[000 HRK] INTEREST AND OTHER INCOME	2010	2011
Analysis by products	**101,562**	**97,833**
Loans and advances to customers	94,303	87,149
retail	*22,189*	*17,916*
corporate	*72,114*	*69,233*
Deposits	650	153
Debt securities	6,465	10,327
Other	144	204
Anlysis by source	**101,562**	**97,833**
Retail	22,189	17,916
Corporate	69,530	66,570
Government and public sector	5,115	9,110
Financial institutions	739	311
Other	3,989	3,926

20. INTEREST EXPENSE AND SIMILAR CHARGES

[000 HRK] INTEREST EXPENSE AND OTHER CHARGES	2010	2011
Analysis by products	**53,635**	**49,389**
Deposits from customers	50,738	44,674
retail	*39,820*	*35,498*
financial institutions	*4,919*	*3,457*
corporate	*5,999*	*5,719*
Borrowings	2,656	4,481
Hybrid instruments	218	223
Other	23	11
Anlysis by source	**53,635**	**49,389**
Retail	40,039	35,721
Corporate	4,221	4,182
Government and public sector	120	133
Financial institutions	7,575	7,938
Other	1,681	1,414

Notes to the financial statements (continued)

21. FEE AND COMMISSION INCOME

[000 HRK] FEE AND COMMISSION INCOME	2010	2011
Payment transactions fees	4,515	4,361
Letters of credit and guarantees fees	716	1,128
Impairment losses	103	(29)
Other	1,260	1,186
TOTAL	6,594	6,645

22. FEE AND COMMISSION EXPENSE

[000 HRK] FEE AND COMMISSION EXPENSE	2010	2011
Payment transactions fees	1,861	1,541
Other	544	641
TOTAL	2,405	2,182

23. GAINS LESS LOSSES FROM FINANCIAL ASSETS AVAILABLE FOR SALE

[000 HRK] GAINS LESS LOSSES FROM FINANCIAL ASSETS AVAILABLE FOR SALE	2010	2011
Realised	2,427	1,057
Equity securities	736	-
Bonds	262	1,055
Treasury bills	842	2
Investment funds	587	-
TOTAL	2,427	1,057

24. GAINS LESS LOSSES FROM FOREIGN CURRENCIES

[000 HRK] GAINS LESS LOSSES FROM FOREIGN CURRENCIES	2010	2011
Net gains / (losses) from translation of monetary assets and liabilities	(1,060)	551
Net gains / (losses) from foreign currency trading	6,953	5,797
TOTAL	5,893	6,348

Notes to the financial statements (continued)

25. OTHER OPERATING INCOME

[000 HRK] OTHEROPERATING INCOME	2010	2011
Dividend income	389	2
Other income	1,878	2,398
TOTAL	2,267	2,400

26. GENERAL AND ADMINISTRATIVE EXPENSES

[000 HRK] GENERAL AND ADMINISTRATIVE EXPENSES	2010	2011
Employee expenses	25,300	26,032
Savings deposit insurance premium	1,781	2,088
Other expenses	20,912	19,789
TOTAL	47,994	47,909

At 31 December 2011 the bank had 170 employees (2010: 170).

27. IMPAIRMENT LOSSES

[000 HRK] IMPAIRMENT LOSSES	2010	2011
Identified	**13,181**	**24,312**
Deposits	-	-
Financial assets held to maturity	-	75
Loans and advances to customers	10,779	21,834
Interest receivables	2,400	2,449
Other receivables	2	(46)
Idenntified losses on group basis	**(417)**	**(1,295)**
Assets	(417)	(1,295)
TOTAL	12,764	23,017

28. INCOME TAX EXPENSE

Income tax expense recognised in the income statement:

[000 HRK] INCOME TAX	2010	2011
Pre-tax profit/(loss)	**(3,042)**	**(13,456)**
Income tax at 20% rate	**(608)**	**(2,691)**
Non-deductible expenses	2,561	2,131
Non-taxable income	(3,413)	(1,102)
(Tax losses)/tax benefits	**1,461**	**(1,662)**
TOTAL		

Notes to the financial statements (continued)

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 2011 were as follows:

[000 HRK] TAX LOSSES		2010		2011	
Incurred	Year of expiry	Gross tax losses	Tax losses to be carried forward at 20%	Gross tax losses	Tax losses to be carried forward at 20%
2008	2013	26,430	5,286	26,430	5,286
2010	2015	7,303	1,461	7,303	1,461
2011	2016	-	-	8,312	1,662
TOTAL		33,733	6,747	42,045	8,409

29. 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.

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.

	2010	2011
Loss for the year (HRK '000)	(3,042)	(13,465)
Weighted average number of ordinary shares	1,765,228	1,764,638
Basic and diluted loss per share (HRK)	(1.72)	(7.63)

30. CONCENTRATION OF ASSETS AND LIABILITIES

[HRK 000]	31.12.2010	31.12.2011
Giro account with the CNB	54,003	58,705
Obligatory reserves with Croatian National Bank	102,594	53,513
Bonds issued by the Ministry of Finance	109,531	116,709
Borrowings from CBRD	(36,858)	(16,494)
TOTAL	229,270	212,433

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:

[HRK 000]	31.12.2010	31.12.2011
Loans	3,766	10,533
Deposits	(7,842)	(7,854)
TOTAL	(4,076)	2,679

Notes to the financial statements (continued)

31. CASH AND CASH EQUIVALENTS

[HRK 000]	31.12.2010	31.12.2011
Cash and amounts due from banks	98,150	88,676
Placements to banks with original maturity up to 90 days	4,500	-
TOTAL	**102,650**	**88,676**

32. COMMITMENTS AND CONTINGENCIES

[000 HRK] COMMITMENTS AND CONTINGENCIES	31.12.2010	31.12.2011
Guarantees	**27,655**	**32,029**
in HRK	23,260	28,207
HRK with FC clause	189	183
in foreign currency	4,206	3,638
Letters of credit	**-**	**252**
in HRK	-	-
HRK with FC clause	-	-
in foreign currency	-	252
Unused credit lines	**39,767**	**34,196**
in HRK	36,067	34,190
HRK with FC clause	-	-
in foreign currency	3,701	6
Other off-balance sheet items	**1,317**	**1,803**
in HRK	69	99
HRK with FC clause	-	-
in foreign currency	1,247	1,704
TOTAL	**68,739**	**68,280**

At 31 December 2011, 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 674 thousand (2010: HRK 584 thousand).

Notes to the financial statements (continued)

33. RELATED PARTY TRANSACTIONS

The key shareholders of the Bank are Validus d.d. and Balkan Financial Sector Equity Fund which together owned 54.62 % (2010: 54.62 %) of the Bank's shares at year end. The remaining 45.38% (2010: 45.38%) 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").

33.1. Key transactions with immediate related parties

At 31 December 2011 the Bank has no high risk product exposure towards its key shareholders (2010: nil). All transactions with key shareholders during the year were 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 2011 amounted HRK 131 thousand (2010: HRK 97 thousand).

Liabilities towards the Bank's key shareholders at 31 December 2011 amounted to HRK 1 thousand and relate to demand deposits held with the Bank (2010: HRK 1 thousand).

[000 HRK] RELATED PARTY TRANSACTIONS	2010				2011			
	exposure	liabilites	revenue	expenses	exposure	liabilites	revenue	expenses
Key shareholders	**97**	**1**	**99**	**23**	**131**	**1**	**40**	**10**
Key management	**3,118**	**51**	**138**	**271**	**1,597**	**41**	**93**	**2,782**
Benefits paid	-	51	-	261	-	41	-	2,765
Loans granted	3,118	-	138	10	1,597	-	93	18
TOTAL	**3,215**	**52**	**237**	**294**	**1,729**	**42**	**134**	**2,792**

34. 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:

[000 HRK] MANAGED FUNDS FOR AND ON BEHALF OF CORPORATE AND RETAIL CUSTOMERS	31.12.2010	31.12.2011
Assets	**68,046**	**96,898**
Corporate	41,340	63,796
Retail	24,106	33,097
Giro accounts	2,600	5
Liabilities	**68,046**	**96,898**
Corporate	34,803	57,849
Republic of Croatia	9,126	9,212
HBOR	24,073	29,461
Local authorities	44	376

Notes to the financial statements (continued)

35. AVERAGE INTEREST RATES

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

[HRK 000]	2010	2011
Assets		
Obligatory reserve with Croatian National Bank	0.63%	0.05%
Placements with and loans to other banks	1.71%	0.92%
Available for sale financial assets	2.49%	3.65%
Held to maturity investments	10.23%	11.21%
Loans and advances to customers	10.57%	9.67%
Liabilities		
Deposits	5.01%	4.28%
Borrowings	1.71%	2.21%
Hybrid instruments	7.49%	7.49%

36. OPERATING LEASE COMMITMENTS

[000 HRK] OPERATING LEASE COMMITMENTS	31.12.2010	31.12.2011
Up to 1 year	5,273	4,452
From 1 to 5 years	19,596	16,637
Over 5 years	525	10
	25,394	21,099

37. 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 2011.

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.

Notes to the financial statements (continued)

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.