UNICREDIT BANK A.D., BANJA LUKA

Financial statements for the year ended 31 December 2010

This version of our report is a translation from the original, which was prepared in Serbian 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.

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Director's report

To the Supervisory Board and shareholders of UniCredit Bank a.d., Banja Luka

Dear shareholders and business partners,

It is my great pleasure to present, on behalf of the Bank's Management Board, the results achieved by UniCredit Bank a.d., Banja Luka in 2010.

Within the unstable economy in Bosnia and Herzegovina as a whole, the Bank preserved stability of operations as a result of being a member of the strong UniCredit Group, the confidence of its business partners, and continuously offering its clients high quality conditions for business.

In the past year, the Bank realized profit before tax in the amount of BAM 1.1 million, income tax amounted to BAM 0.7 million, and net profit BAM 0.4 million. Net interest income was realized in the amount of BAM 25.8 million, which is 3.5% more than in the previous year and net non-interest income (fees and commission) was realized in the amount of BAM 8.3 million, which is 1.2% more than the previous year.

Total net loans to customers at the end of last year amounted to BAM 424.3 million, 7.5% higher compared to the previous year, of which loans to legal entities amounted to BAM 185.6 million, which is 3% less than in the previous year, and loans to individuals amounted to BAM 238.7 million, which is 17% more than in the previous year. In terms of structure, 44% of total loans relate to legal entities and 56% to individuals.

The bank's deposits at the end of 2010 amounted to BAM 51.1 million, or 29.6% less compared to the previous year, while customers' deposits amounted to BAM 366.7 million, or 8.6% less compared to the previous year. Deposits from customers comprise deposits from legal entities amounting to BAM 187.6 million and deposits from individuals amounting to BAM 179.1 million. In terms of structure, 51% of total deposits relate to legal entities and 49% to individuals.

At the year end, apart from the Head Office, the Bank had a total of 44 business units with a total of 482 employees, which is 5 business units and 24 employees lower compared to the previous year.

Retail

During the last year, in order to optimize and improve business network management, reorganization of the business network was performed such that five regions have been formed in place of three, and activities for the measurement and evaluation of efficiency of the branches have been initiated within a business network optimization project. Also, changes have been made in certain managerial positions within the segment.
In the market in which it operates, the Bank is improving its products and services on a daily basis, focusing on clients and their needs. The established service quality system is regularly monitored and continuously improved. In 2010, the results of client satisfaction research which is carried out every year indicate a significant improvement compared to the previous period and the result is above the market average.
In 2010 we continued to expand the ATM and POS network, so that at the end of the year the Bank had 49 installed ATMs and 45 POS devices.

Corporate banking

From an internal perspective, the previous year was a year of establishment of the organizational structure in accordance with organizational acts, staffing of departments and staff training and personnel changes in managerial positions.
Under demanding market conditions, we managed to maintain our existing client base, with the targeted acquisition of a smaller number of good quality clients.
The total loan volume increased compared to the previous year by 3%, while total revenues are 18% higher.

The economic crisis caused serious difficulties in the operations of a portion of clients, hindering their capability to meet their loan obligations, so the net result did not follow the positive income trend due to an increase in provisioning costs.

In the forthcoming year the focus will be on the acquisition of the best quality clients on the market, increasing the amount of cooperation with the public sector and significant growth of placements in the domain of energy and infrastructure.

Financial markets

The previous year was marked by a significant impact of the financial crisis which can be seen in the decreased volume of regular turnover on the capital market, low rates in the money market, and a decrease of inflow of foreign currency from abroad. Even under such conditions, in 2010 the capital markets realized their highest result in the last three years, which was significantly above planned amounts, thanks to, above all, increased activities in trade and sale. We plan to maintain this trend in 2011.

By adjusting our range of products and services in line with market expectations, it is our intention to be the leader in this segment of operations.

Risk management

Consequences of the global economic crisis were strongly present in the local market in the previous year as well, which was even more challenging for the Bank than the previous year in terms of protection and maintenance of loan portfolio quality and the Bank's equity. Exposure of the Bank to clients in industries which were strongly impacted by disturbances in the market, is the result of the characteristics and structure of the local economy. Serious difficulties in the operations of clients in these industries influenced their ability to settle loan liabilities. The growth of risk of failure to pay was especially present in the segment of corporate and small business clients. With the aim of protection of portfolio quality, the Bank intensified monitoring activities and a proactive approach to clients with a demonstrated need for rescheduling of their loan liabilities.

In spite of the decline in the standard of living and purchasing power of the population, and growth of unemployment and salary reductions, the quality of the retail loan portfolio for retail operations was stable. Significant efforts were made to collect due liabilities and to realize various options for loan rescheduling in accordance with decisions of the regulator and programs of the Group.

Significant recovery of the market is not expected in 2011, and the management of loan portfolio quality, constant monitoring and collection will continue to be the most significant activities in credit risk management.

Given the relative underdevelopment of the capital market, the Bank is not significantly exposed to market risks due to which world finances suffered serious losses during the crisis. The management of market risk, mainly the risk of changes in foreign exchange rates and interest rate risk, liquidity risk, capital and capital requirements for coverage of market risks is continuously being improved and developed in accordance with the requirements of the local regulator and Group standards. In the area of operational risk, losses which occur due to operational risks are continuously monitored and recorded, causes are analysed and activities undertaken to remove the causes, to decrease losses or indemnity for damages that can occur due to operational risks. The bank regularly calculates capital requirements and sets aside capital needed for the coverage of operational risks, applying valid regulations and standards of the Group. Given the significance and attention given by the Group to reputation risks, activities have been initiated to establish a system of management for this risk as well.

Expectations for 2011

In 2011, the Bank will again invest maximum effort to support the recovery and development of the local economy and to remain dedicated to the needs of its clients, the creation of new value for its shareholders and the entire community.
Finally, I would like to express my most sincere gratitude to all of our clients and business partners, as well as our shareholders for the confidence they have demonstrated. I direct particular thanks to all of the Bank's employees for their conscientious and professional approach to their work.

I believe that our cooperation will continue and that in the forthcoming period it will be even better and more successful.

Director

Ivan Vlaho

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

The Management Board 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 its operations and cash flows, in accordance with the statutory accounting requirements for banks in the Republic of Srpska, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. The Management Board has a general responsibility to take 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 applying 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, following which the Supervisory Board is required to approve the annual financial statements for submission to the General Assembly of Shareholders for adoption.

The financial statements set out on pages 13 to 84 were approved by the Management Board on 17 February 2011 for submission to the Supervisory Board, and are signed below to signify this:

For and on behalf of the Management Board

Ivan Vlaho
Director

Ljubica Tešić
Chief Financial Officer

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Independent auditor's report to the shareholders of UniCredit Bank a.d., Banja Luka

We have audited the accompanying financial statements of UniCredit Bank a.d. Banja Luka ("the Bank"), which comprise the statement of financial position as at 31 December 2010, the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The financial statements as of and for the year ended 31 December 2009 were audited by another auditor whose report dated 10 March 2010 expressed an unqualified opinion on those financial statements with an emphasis of matter paragraph relating to the incompliance with regulatory requirements in respect of a deposit concentration where one depositor exceeded the regulatory maximum as at 31 December 2009.

Management's Responsibility for the financial statements

Management Board is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, 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 relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 our 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, we consider 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 principles 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 opinion.

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Opinion

In our opinion, the financial statements give a true and fair view of the financial position of UniCredit Bank a.d. Banja Luka as of 31 December 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG B-H d.o.o. za reviziju
Registered auditors
Fra Anđela Zvizdovića 1
71000 Sarajevo
Bosnia and Herzegovina

17 February 2011

On behalf of KPMG BiH d.o.o za reviziju:

D.O.O. ZA REVIZIJU KPMG B-H SARAJEVO

Manal Bećirbegović
Executive director

Senad Pekmez
FBiH registered auditor

Licence number: 3090044102

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Statement of comprehensive income
For the year

	Note	2010 BAM '000	Restated 2009 BAM '000
Interest income	*5*	37,828	39,217
Interest expenses	*6*	(12,016)	(14,284)
Net interest income		**25,812**	**24,933**
Fee and commission income	*7*	9,457	9,420
Fee and commission expenses	8	(1,206)	(1,268)
Net fee and commission income		**8,251**	**8,152**
Foreign exchange gains, net	*9*	2,272	1,724
Other operating income	*10*	549	387
Net profit from financial assets available for sale	*11*	114	46
Other operating income		**2,935**	**2,157**
Total operating income		**36,998**	**35,242**
Net impairment losses and provisions	*12*	(7,189)	(5,251)
Personnel expenses	*13*	(10,269)	(10,960)
Depreciation and amortization		(5,300)	(4,692)
Other expenses	*14*	(13,139)	(11,977)
Profit before tax		**1,101**	**2,362**
Income tax	*15*	(723)	(605)
Net profit for the year		**378**	**1,757**
Other comprehensive income			
Net change in fair value reserves		(85)	120
Other comprehensive income/ (expense)		**(85)**	**120**
Total comprehensive income for the year		**293**	**1,877**
Earnings per share (in BAM)	*31*	4.26	19.82

Statement of financial position
As at 31 December

	Note	2010 BAM '000	Restated 2009 BAM '000	Restated 2008 '000 BAM
ASSETS				
Cash reserves	*16*	42,513	102,752	81,253
Obligatory reserve with the Central Bank	*17*	47,974	45,966	70,161
Placements with and loans to banks	*18*	28,445	38,353	47,661
Loans to customers	*19*	424,294	394,762	395,652
Financial assets available for sale	*20*	462	785	803
Property and equipment	*21*	22,485	24,373	25,914
Intangible assets	*22*	6,178	8,657	8,886
Accrued interest and other assets	*23*	6,292	4,830	4,280
TOTAL ASSETS		**578,643**	**620,478**	**634,610**
LIABILITIES				
Transaction accounts and deposits from banks	*24*	51,127	72,611	139,055
Transaction accounts and deposits from customers	*25*	366,695	401,023	368,718
Borrowings	*26*	78,511	67,485	49,585
Accrued interest and other liabilities	*27*	8,520	7,189	6,110
Provisions for liabilities and charges	*28*	2,390	1,226	2,071
Current tax liability		191	37	146
Net deferred tax liability	*29*	353	344	239
TOTAL LIABILITIES		**507,787**	**549,915**	**565,924**
EQUITY				
Share capital	*30*	62,054	62,054	62,054
Share premium		373	373	373
Regulatory reserves for credit losses		3,496	3,496	1,778
Statutory reserves		2,374	2,335	1,010
Revaluation reserves		2,195	2,195	2,196
Fair value reserves		(14)	71	(49)
Retained earnings		378	39	1,324
TOTAL EQUITY		**70,856**	**70,563**	**68,686**
TOTAL LIABILITIES AND EQUITY		**578,643**	**620,478**	**634,610**

Statement of changes in equity
As at 31 December

	Share capital	Share premium	Regulatory reserves for credit losses	Statutory reserves	Revaluation reserves	Fair value reserves	Retained earnings	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Balance as at 1 January 2010 *(restated)*	**62,054**	**373**	**3,496**	**2,335**	**2,195**	**71**	**39**	**70,563**
Total comprehensive income for the year								
Net profit for the year	-	-	-	-	-	-	378	**378**
Other comprehensive income								
Net gain from change in fair value of financial assets available for sale	-	-	-	-	-	16	-	**16**
Realised financial assets available for sale transferred to profit or loss (note 11)	-	-	-	-	-	(114)	-	**(114)**
Foreign exchange difference on non-monetary financial assets available for sale	-	-	-	-	-	3	-	**3**
Deferred tax	-	-	-	-	-	10	-	**10**
Total other comprehensive income/(expense)	-	-	-	-	-	*(85)*	-	***(85)***
Total comprehensive income	-	-	-	-	-	(85)	378	**293**
Transfer of profit into statutory reserves	-	-	-	39	-	-	(39)	**-**
Balance as at 31 December 2010	**62,054**	**373**	**3,496**	**2,374**	**2,195**	**(14)**	**378**	**70,856**

As explained in Note 30, as at 31 December 2010 the cumulative amount of regulatory reserves for credit losses amounted to BAM 5,861 thousand (2009: BAM 3,496 thousand), while the amount of insufficient reserves required by the regulator as at 31 December 2010 was BAM 2,365 thousand. The difference will be covered from current year profit and previously created reserves based on the decision of the Bank's General Assembly.

Statement of changes in equity (continued)
As at 31 December

	Share capital	Share premium	Regulatory reserves for credit losses	Statutory reserves	Revaluation reserves	Fair value reserves	Retained earnings	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Balance as at 1 January 2009	**62,054**	**373**	**-**	**1,010**	**2,440**	**-**	**1,324**	**67,201**
Changes in fair value of fianancial assets available for sale	-	-	-	-	-	(54)	-	**(54)**
Deferred tax	-	-	-	-	(244)	5	-	**(239)**
Impairment loss on loans and other assets	-	-	-	-	-	-	1,778	**1,778**
Transfer from retained earnings to regulatory reserves for credit losses	-	-	1,778	-	-	-	(1,778)	-
Balance as at 1 January 2009 (restated)	**62,054**	**373**	**1,778**	**1,010**	**2,196**	**(49)**	**1,324**	**68,686**
Total comprehensive income for the year								
Net profit for the year *(restated)*	-	-	-	-	-	-	1,757	**1,757**
Other comprehensive income								
Net gain from change in fair value of financial assets available for sale	-	-	-	-	-	175	-	**175**
Realised financial assets available for sale transferred to profit or loss (note 11)	-	-	-	-	-	(46)	-	**(46)**
Foreign exchange difference on non-monetary financial assets available for sale	-	-	-	-	-	4	-	**4**
Deferred tax	-	-	-	-	-	(13)	-	**(13)**
Total other comprehensive income	-	-	-	-	-	*120*	-	***120***
Total comprehensive income	-	-	-	-	-	120	1,757	**1,877**
Other	-	-	-	1	(1)	-	-	-
Transfer of profit into statutory reserves	-	-	-	1,324	-	-	(1,324)	**-**
Transfer from retained earnings to regulatory reserves for credit losses	-	-	1,718	-	-	-	(1,718)	**-**
Balance as at 31 December 2009 *(restated)*	**62,054**	**373**	**3,496**	**2,335**	**2,195**	**71**	**39**	**70,563**

The notes set out on pages 13 to 84 form an integral part of these financial statements

Statement of cash flows
For the year

	Note	2010 BAM '000	Restated 2009 BAM '000
Cash flow from operating activities			
Profit before tax		**1,101**	**2,362**
Adjustments:			
- depreciation and amortization	*21,22*	5,300	4,692
- impairment losses on loans to customers and other assets	*12*	7,189	5,251
- provisions for liabilities and charges	*14,10*	1,178	(105)
- net foreign exchange gain	*10*	(166)	(47)
- losses on disposal and write-off of property and equipment		120	2
Changes in operating assets and liabilities			
Decrease in placements with and loans to other banks		9,908	9,308
Increase in loans and advances to customers		(36,335)	(4,384)
Increase in accrued interest and other assets		(1,746)	(1,133)
(Increase)/decrease in obligatory reserve with the Central Bank		(2,008)	24,195
Decrease in deposits from banks		(21,484)	(66,444)
(Decrease)/increase in deposits from customers		(34,187)	32,335
Increase in other liabilities		1,215	945
Net cash inflow/(outflow) from operating activities before tax		**(69,915)**	**6,977**
Income tax outflow		(550)	(622)
Net cash inflow/(outflow) from operating activities		**(70,465)**	**6,355**
Cash flow from investing activities			
Purchase of property, equipment and intangible assets		(1,053)	(2,924)
Decrease in financial assets available for sale		228	151
Net cash outflow from investment activities		**(825)**	**(2,773)**
Cash flow from financing activities			
Increase in borrowings		11,026	17,900
Net cash inflow from financing activities		**11,026**	**17,900**
Effect of foreign exchange rate changes on cash and cash equivalents		25	17
Net (decrease)/increase in cash and cash equivalents		**(60,239)**	**21,499**
Cash and cash equivalents at the beginning of the year	***16***	**102,752**	**81,253**
Cash and cash equivalents at the end of the year	***16***	**42,513**	**102,752**

Notes to the financial statements (continued)

1. Reporting entity

UniCredit Bank a.d. Banja Luka (the "Bank") is a joint stock company registered and domiciled in the Republic of Srpska for conducting payment transactions, domestic and foreign credit and deposit transactions, and, in accordance with legislation of the Republic of Srpska, it is obliged to operate according to principles of liquidity, security of placements and profitability.

As at 31 December 2010, the Bank was headquartered in Banja Luka with the registered seat at Marije Bursac Street, No. 7, and operated 37 branch offices and 7 agencies (31 December 2009: the Headquarters, 40 branch offices and 9 agencies).

As at 31 December 2010, the Bank had 482 employees (2009: 506 employees).

The Bank's tax identification number is 4400958880009, and the VAT number is 400958880009.

2. Basis for preparation of the financial statements

2.1. Statement of compliance

In 2009, the National Assembly of the Republic of Srpska adopted the new Accounting and Auditing Act (the "Act") of the Republic of Srpska, regulating the preparation and auditing of financial statements for legal entities in the Republic of Srpska, which is in force as of 1 January 2010.

According to the new Act, legal entities with a registered seat in the Republic of Srpska must prepare their financial statements, for the periods starting as of 1 January 2010, in full compliance with International Financial Reporting Standards ("IFRS") and International Accounting Standards ("IAS").

In accordance with the above-mentioned amendments to regulations in the Republic of Srpska, the Bank has prepared financial statements in accordance with IFRS for the first time. Previous financial statements were prepared in accordance with accounting regulations of the Banking Agency of the Republic of Srpska (hereinafter referred to as: the "BARS"), which is the central supervisory institution for the banking system in the Republic of Srpska. The Bank is a new user of IFRS and, in accordance with this, IFRS 1: *First-time Adoption of International Financial Reporting Standards* was applied.

An explanation of the effects of the transfer to IFRS and its influence on the Bank's financial position and its results is set out in Note 2.5. – First time adoption of IFRS.

The financial statements were approved for issue by the Management Board on 17 February 2011 and submitted to the Bank's bodies for adoption.

2.2. Basis of preparation

These financial statements are prepared on a historical or amortized cost basis with the exception of the financial assets available for sale which are stated at fair value and buildings which are stated at revalued amortised cost.

2.3 Use of estimates and judgements

The preparation of financial statements in accordance with the accounting regulations requires the use of certain critical accounting judgements. It also requires Management to make judgements, estimates and assumptions that affect the application of accounting policies of the Bank. Areas that require significant judgement or complexity and areas where estimates and judgements have a significant impact on the financial statements are discussed in Note 3.

2.4. Functional and presentation currency

The financial statements are presented in Convertible Marks (hereinafter referred to as: BAM), which is also the functional currency. Amounts are rounded to the nearest thousand (unless otherwise stated).

The Central Bank of Bosnia and Herzegovina (hereinafter referred to as: the "Central Bank") has implemented a currency board arrangement aligning BAM to EUR at an exchange rate of EUR 1: BAM 1.955830, which prevailed through 2010 and 2009.

Notes to the financial statements (continued)

2. Basis for preparation of the financial statements (continued)

2.5. First-time adoption of IFRS

As previously mentioned in the Statement on compliance, these are the first statements of the Bank prepared in accordance with IFRS.

In previous periods, the Bank prepared financial statements in accordance with the accounting regulations of the Banking Agency of the Republic of Srpska. In addition, in accordance with the Accounting Act, the Bank applied IFRS which were translated in the Republic of Srpska, and also applied the Banking Act and the Accounting and Auditing Act as well as other relevant legislation. The basic differences between IFRS and the previous accounting framework relate to the following:

- The assesment of specific impairment allowances for financial instruments, in particular regarding loans and receivables, in accordance with relevant regulations of the BARS, is not in line with the requirements of IAS 39 *Financial instruments: Recognition and measurement* which requires impairment allowances on loan losses and provisions to be estimated based on discounted expected future cash flows by using the original effective interest rate.
- The BARS requires banks to recognise impairment losses in the income statement for assets not individually identified for impairment by using the prescribed rate of 2%. Such a policy results in deviation from the methodology for measurement of the total impairment allowance on a portfolio basis, which is based on IFRS, and which assumes recognition only of losses which have occured but have not yet been reported ("IBNR"). IBNR represents a situation where the losses have been inccured but it is not yet evident which financial asset are impaired and is calculated by applying an estimated loss rate for an estimated emergence period to the balance of unimpaired loans.
- Suspended interest represents the accrued but uncollected interest payments on assets which are classified as impaired assets (assets classified as substandard assets, doubtful assets and losses). Upon reclassification from interest earning to impaired assets, the Bank reverses the full amount of the accrued uncollected interest in the income statement, and ceases to accrue any further interest in the balance sheet (suspended interest is recorded off balance sheet) until collected in cash from the borrower. The only exception to this rule may occur where an impaired asset is covered by first class or good quality collateral and at the same time is in the process of collection. This policy is not in accordance with IAS 18 *"Revenue"* or IAS 39 *"Financial Instruments: Recognition and Measurement"* which require interest income on impaired financial assets to be calculated using the effective interest rate method.
- In accordance with the reporting for the BARS, the Bank did not comply with the formats for principal financial statements prescribed by IAS 1 (Revised) *"Presentation of financial statements"*, effective for IFRS financial statements for annual periods beginning from 1 January 2009. In previous periods the Bank continued to present the balance sheet (did not apply the statement of financial position), income statement and statement of changes in equity (did not apply the statement of comprehensive income nor the new format of the statement of changes in equity).

The accounting policies stated in this report have been applied in preparing the financial statements for the year ended 31 December 2010, the comparative information presented in these financial statements for the year ended 31 December 2009, and in the preparation of an opening IFRS statement of financial position as at 1 January 2009 (the Bank's date of transition).

In preparating its opening IFRS statement of financial position, the Bank has adjusted amounts reported previously in financial statements prepared in accordance with the previous accounting framework.

Where necessary, comparative data has been reclassified in order to achieve consistence in the presentation of data with data from the current financial year and other data.

An explanation of how the transition from the previous basis of accounting to IFRS has affected the Bank's financial position and its financial results is set out below.

Notes to the financial statements (continued)

2. Basis for preparation of the financial statements (continued)

2.5. First-time adoption of IFRS (continued)

2.5.1. Reconciliation of the Bank's equity

	Note	31 December 2009 Previous accounting framework BAM '000	31 December 2009 Effect of transition to IFRS BAM '000	31 December 2009 IFRS BAM '000	1 January 2009 Previous accounting framework BAM '0000	1 January 2009 Effect of transition to IFRS BAM '000	1 January 2009 IFRS BAM '000
ASSETS							
Cash reserves		102,752	-	102,752	81,253	-	81,253
Obligatory reserve with the Central Bank		45,966	-	45,966	70,161	-	70,161
Placements with and loans to banks		38,353	-	38,353	47,661	-	47,661
Loans to customers	*a)*	392,537	2,225	394,762	395,005	647	395,652
Financial assets available for sale	*b)*	837	(52)	785	857	(54)	803
Property and equipment		24,373	-	24,373	25,914	-	25,914
Intangible assets		8,657	-	8,657	8,886	-	8,886
Accrued interest and other assets	*a)*	4,330	500	4,830	4,004	276	4,280
Total assets		**617,805**	**2,673**	**620,478**	**633,741**	**869**	**634,610**
LIABILITIES							
Transaction accounts and deposits from banks		72,611	-	72,611	139,055	-	139,055
Transaction accounts and deposits from customers		401,023	-	401,023	368,718	-	368,718
Borrowings		67,485	-	67,485	49,585	-	49,585
Accrued interest and other liabilities		7,189	-	7,189	6,110	-	6,110
Provisions for liabilities and charges	*d)*	1,997	(771)	1,226	2,926	(855)	2,071
Current tax liabilities		37	-	37	146	-	146
Net deferred tax liabilities	*c)*	92	252	344	-	239	239
Total liabilities		**550,434**	**(519)**	**549,915**	**566,540**	**(616)**	**565,924**
EQUITY							
Share capital		62,054	-	62,054	62,054	-	62,054
Share premium		373	-	373	373	-	373
Regulatory reserves for credit losses		-	3,496	3,496	-	1,778	1,778
Statutory reserves		2,335	-	2,335	1,010	-	1,010
Revaluation reserves	*c)*	2,439	(244)	2,195	2,440	(244)	2,196
Fair value reserves	*b)*	131	(60)	71	-	(49)	(49)
Retained earnings		39	-	39	1,324	-	1,324
Total equity	*e)*	**67,371**	**3,192**	**70,563**	**67,201**	**1,485**	**68,686**
Total liabilities and equity		**617,805**	**2,673**	**620,478**	**633,741**	**869**	**634,610**

Notes to the financial statements (continued)

2. Basis for preparation of the financial statements (continued)

2.5 First-time adoption of IFRS (continued)

2.5.1. Reconciliation of the Bank's equity (continued)

The effects of the above stated adjustements on equity are as follows:

	Note	**31 December 2009** **BAM '000**	**1 January 2009** **BAM '000**
Impairment allowance on loans to customers	*a)*	2,225	647
Fair value reserves of financial assets available for sale	*b)*	(52)	(54)
Deferred tax on fair value reserves in equity	*b)*	(8)	5
Deferred tax liabilities on revaluation reserves	*c)*	(244)	(244)
Impairment allowance on accrued interest and other assets	*a)*	500	276
Provisions for off-balance potential liabilities	*d)*	771	855
Total adjustments to equity		**3,192**	**1,485**

Note a)

As explanied in Notes 2.5 and 3.6, the Bank calculated impairment allowance on loans and receivables in accordance with the relevant regulations of the BARS which was not alligned with the requirements of the relevant standards.

Calculation of impairment allowance for loans in compliance with relevant standards resulted in a decrease of previously reported impairment allowance for the loan portfolio in the amount of BAM 2,225 thousand as at 31 December 2009 (2008: BAM 647 thousand). In addition, calculation of impairment allowance for other assets in compliance with relevant standards resulted in a decrease of previously reported impairment allowance for other assets in the amount of BAM 500 thousand as at 31 December 2009 (2008: BAM 276 thousand).

Note b)

In accordance with the previous accounting framework the Bank carried financial assets available for sale at cost which was not in compliance with IAS 39 which requires that available for sale financial assets are measured at fair value.

Measurement of financial assets at fair value resulted in a decraese in fair value of the respective assets by BAM 54 thousand as at 1 January 2009 (prior to deduction of deffered tax) and by BAM 52 thousand (prior to deduction of deffered tax) as at 31 December 2009, which was recorded through the fair value reserves in equity.

Note c)

The application of IAS 12 resulted in an adjustment in revaluation reserves (recognised based on the market valuation of Bank's property) by the amount of deferred tax liabilities in the amount of BAM 244 thousand at 1 January 2009. Given that there were no disposals of real estate during 2009, there were no changes in the amount of deferred tax liability.

Notes to the financial statements (continued)

2. Basis for preparation of the financial statements (continued)

2.5. First-time adoption of IFRS (continued)

2.5.1. Reconciliation of the Bank’s equity (continued)

Note d)

Calculation of the impairment allowance for off-balance sheet exposure in accordance with IFRS resulted in a decrease in previously reported impairment allowance in the amount of BAM 771 thousand as at 31 December 2009 and a decrease of BAM 855 thousand as at 31 December 2008.

Note e)

The total impact of the transition to IFRS for the Bank was an increase in opening equity in the amount of BAM 1,485 thousand as at 1 January 2009 and an increase of BAM 3,192 thousand as at 31 December 2009. At the same time, the effect on the net profit in 2009 amounted to BAM 1,718 thousand, or BAM 1.838 thousand on total comprehensive income.

Notes to the financial statements (continued)

2. Basis for preparation of the financial statements (continued)

2.5. First-time adoption of IFRS (continued)

2.5.2. Reconciliation of the profit for 2009

	Note	**Previous accounting framework** BAM '000	**Effects of transition to IFRS** BAM '000	**IFRS** BAM '000
Interest income		39,217	-	39,217
Interest expenses		(14,284)	-	(14,284)
Net interest income		**24,933**	-	**24,933**
Fee and commission income		9,420	-	9,420
Fee and commission expenses		(1,268)	-	(1,268)
Net fee and commission income		**8,152**	-	**8,152**
Foreign exchange differences, net		1,724	-	1,724
Other operating income		387	-	387
Net profit from financial assets available for sale		46	-	46
Other operating income		**2,157**	-	**2,157**
Total operating income		**35,242**	-	**35,242**
Net impairment losses and provisions	e)	(6,969)	1,718	(5,251)
Personnel expenses		(10,960)	-	(10,960)
Depreciation and amortisation		(4,692)	-	(4,692)
Other expenses		(11,977)	-	(11,977)
Profit before tax		**644**	**1,718**	**2,362**
Income tax		(605)	-	(605)
Net profit for the year		**39**	**1,718**	**1,757**
Total comprehensive income				
Net change in fair value reserves		-	120	120
Other comprehensive income		**-**	**120**	**120**
Total comprehensive income for the year		**-**	**1,838**	**1,877**

Notes to the financial statements (continued)

3. Specific accounting policies

The accounting policies adopted in the preparation of these financial statement are set out below. These policies have been consistently applied for all the years presented, except as stated in Note 2.5. First time adoption of IFRS.

3.1. Interest income and expenses

Interest income and expenses are recognized in the income statement (the statement of comprehensive income) for all interest yielding/bearing instruments on the accrued basis by the application of the effective interest rate method, i.e. according to the rate that discounts the estimated cash flows to the net present value during the term of the agreement. Such income and expenses are presented as interest and similar income and interest and similar expenses in the income statement (the statement of comprehensive income). Interest income and expenses also include income and expenses from loan fees and commissions and receivables from customers, or borrowings from banks, recognized on the basis of the effective interest rate.

The effective interest rate method is the method of calculation of amortized cost of the financial assets or financial liabilities and distribution of interest income or expenses in the appropriate time period. The effective interest rate is the rate that precisely discounts the estimated future cash disbursement or payment through the expected duration of the financial instrument or, where appropriate, a shorter period, on the net carrying value of financial assets or financial liabilities. When calculating the effective interest rate, the Bank performs an assessment of cash flows, taking into consideration all conditions of the agreement related to the financial instrument, but not considering the future loan losses. The calculation includes all fees and commission that the contractual sides have paid and received, and which are a constituent part of the effective interest rate, transaction costs and all other premiums and discounts.

3.2. Fee and commission income and expenses

Fee and commission income and expenses mainly comprise fees related to credit card transactions, the issue of guarantees and letters of credit, domestic and foreign payment transations, stock brokering services, depository activities and other services and are recognized in the statement of comprehensive income upon performance of the relevant service.

3.3. Net gains and losses from the purchase and sale of foreign currencies, foreign exchange differences from translation of monetary assets and liabilities and available for sale financial assets

Net gains and losses from the purchase and sale of foreign currencies include non-realized and realized gains and losses on the basis of the purchase and sale of currencies and derivative financial instruments.

Net gains and losses from foreign exchange differences incurred from the translation of monetary assets and liabilities denominated in foreign currency, are classified as other operating income and expense.

Net gains and losses from available for sale financial assets include realized net gains and losses from the sale of available for sale financial assets.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.4. Foreign currency

Transactions in foreign currency are translated into BAM at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into BAM at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income, except in the case of differences arising on non-monetary available for sale financial assets, which are recognized in equity. Non-monetary assets and liabilities denominated in foreign currency measured at historical cost are translated into BAM using the exchange rate at the date of the transaction and are not retranslated at the reporting date.

3.5. Income tax expenses

Current tax

Current tax is the amount calculated according to the prescribed tax rate of 10% on the tax base determined in the tax return, which represents the amount of the profit before tax adjusted for the effect of reconciling income and expenses, in accordance with tax legislation of the Republic of Srpska.

Income tax is based on taxable profit for the year and comprises current and deferred tax.

Deferred taxes

Deferred tax items are calculated using the balance sheet liability method, for all temporary differences arising between the tax base of assets and liabilities and their carring value for financial reporting purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which realization or settlement of the carrying value of the assets or liabilities is expected, and on the basis of the tax rate applicable at the balance sheet date.
The measurement of deferred tax liabilities and 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 book value of these assets and liabilities.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the statement of financial position. 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 reporting date, the Bank reassesses unrecognised potential deferred tax assets and tests the carrying value of recognised deferred tax assets on impaired values.

3.6. Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: loans and receivables, available for sale financial assets and other financial liabilities. Management determines the classification of financial instruments after initial recognition and revaluates initital classification at each reporting date.

Loans and receivables are non-derivative financial assets with fixed or determined payment that are not quoted on an active market. Loans and receivables arises when the Bank provides money to a debtor with no intention of trading with the receivable. Loans and receivables include placements with and loans to banks and loans to customers.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

Classification (continued)

Available for sale financial assets are non-derivative financial assets classified as available for sale or which are not classified in any other category. Financial assets classified as available for sale are intended to be held for an indefinite period of time, but may be sold in response to a need for liquidity or a change in interest rates, foreign exchange rates or equity prices. Assets available for sale include debt and equity securities.

Other financial liabilities comprise all financial liabilities not classified at fair value through profit and loss and include current accounts, deposits and borrowings.

Recognition

Loans and receivables and other financial liabilities are recognized when advanced to borrowers or received from landers.
The Bank recognizes available for sale financial assets at the trade date.

Measurement

(a) Loans and receivables

Loans and receivables are initially recognized at fair value. After initial recognition, loans and receivables are measured at amortized cost using the effective interest rate method, less any impairment.

(b) Available for sale financial assets

Available for sale financial assets are initially measured at fair value, plus transaction costs that are directly attributable to the acquisition or issue of the financial asset.

Subsequent to initial recognition all available for sale financial assets are measured at fair value, except for equity securities that do not have a quoted market price in an active market, or whose fair value cannot be reliably measured, which are stated at cost, including transaction costs, less impairment.

(c) Other financial liabilities

Other financial liabilities are initially measured at fair value. Subsequent to initial recognition, other financial liabilities are measured at amortised cost using the effective interest rate method.

Recognition of gains and losses on subsequent measurement of financial instruments

Gains and losses from a change in the fair value of available-for-sale financial assets are recognised directly in the fair value reserve within equity until derecognition or impairment, when the cumulative amount previously recognised in equity is transferred to the statement of comprehensive income. Interest income calculated using the effective interest rate method is recognised in the statement of comprehensive income.

Foreign exchange gains and losses on available for sale equity securities represent a part of the fair value of these instruments and are recognized in equity. Dividend income on available for sale equity securities is recognized in the statement of comprehensive income when the right to receive payment has been established.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

Impairment of financial assets

The Bank reviews financial assets at each reporting date to determine whether there is objective evidence of impairment. The impairment of financial assets or a group of financial assets is recognized if there is objective evidence of impairment as the result of one or more events occurring after initial recognition, which has an influence on estimated future cash flows from the financial assets or the group of financial assets, which can be reliably estimated ("an event that causes the impairment").

1) Loans and receivables

The Bank regularly reviews and monitors loans and receivables as well as other financial assets at each reporting date to determine whether there is objective evidence of impairment.

If there is objective evidence of impairment of loans and receivables on an individual basis, the impairment loss is determined as the difference between the carrying value of the assets and the present value of the expected future cash flows discounted by the original effective interest rate of the financial assets. The carrying value of the assets is decreased by the amount of impairment allowance, and the amount of the loss is recognized in the statement of comprehensive income. If loans and receivables have a variable interest rate, the discount rate for determining impairment allowance represents the current effective interest rate determined by an agreement at the moment when impairment has occured.

Financial assets for which no impairment was recognised on an individual basis, is grouped with other financial assets with similar characteristics, which are then reviewed for impairment on a group basis. Group impairment also includes impairment on a portfolio basis (IBNR) in cases where the Bank (on an individual or group basis) determines that there is no objective evidence of impairment.

If the loan cannot be collected and all legal procedures have been completed and the final amount of the loss is known, the loan is directly written off. If, in the subsequent period, the amount of impairment loss decreases and the decrease can be directly linked to an event that has occured after the write-off, the amount written-off or the impairment allowance is then shown as income in the statement of comprehensive income. Write-off of uncollectible receivables is performed based on the decision of the Credit Committee, and in accordance with court decisions, agreements between the interested parties and the Bank's assessments.

In accordance with local regulations, the Bank also calculates impairment allowance according to BARS regulations. Loans, placements and other financial assets of the Bank are classified into categories prescribed by the BARS according to the expected recoverability determined on the basis of the number of days overdue, an assessment of the debtor's financial position and the quality of the collateral. The assessed amount of the reserve for potential losses is calculated by applying percentages prescribed by the BARS.

If the specific provision for potential losses calculated in accordance with BARS regulations is higher than the impairment allowance calculated in accordance with IFRS requirements, this difference is presented as a regulatory reserve for credit losses within equity based on a decision of the Bank's General Assembly and in accordance with accounting regulations of the Republic of Srpska.

2) Available for sale financial assets

At each reporting date, the Bank reviewes whether there is objective evidence of impairment of individual financial assets or groups of financial assets.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

Impairment of financial assets (continued)

2) Available for sale financial assets (continued)

In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exist 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 other comprehensive income and recognised in profit or loss.

Impairment losses recognised in the statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income at any point thereafter. 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 statement of comprehensive income.

Derecognition

A financial asset is derecognised (in full or in part) when the Bank loses control over the contractual rights on the asset. This occurs when the rights are realised, expire or are surrendered.

Available for sale financial assets are derecognized on the trade date.

Loans and receivables and other financial liabilities are derecognized at the date that they are transfered by the Bank or when the liability ceases to exist.

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 that liability and will instantaneously recognise a new financial liability, with new terms and conditions.

Fair value measurement principles

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

Specific instruments

a) Financial derivatives

Financial derivatives include foreign exchange forward and swap contracts. Financial derivatives are initially recognized and subsequently measured at their fair value in the statement of financial position. Fair values are obtained by application of various assessment techniques, including discounted cash flow models. All derivatives are presented as financial assets at fair value through profit or loss when their fair value is positive and as financial liabilities at fair value through profit or loss when it is negative. Changes in the fair value of financial derivatives are recorded as gains or losses.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.6. Financial instruments (continued)

Specific instruments (continued)

b) Cash and cash equivalents

Cash and cash equivalents include: cash, cheques sent for collection, current accounts with other banks and cash deposited with the Central Bank (not including the amount of the obligatory reserve).

c) Placements with and loans to banks

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

d) Loans to customers

Loans to customers are presented net of impairment allowance to reflect the estimated recoverable amounts.

e) Equity securities

Equity securities are classified as assets available for sale and are carried at fair value, unless there is no reliable measure of the fair value, in which case they are stated at acquisition cost, less any impairment.

f) Debt securities

Debt securities are classified as available for sale financial assets and carried at fair value.

g) Transaction accounts and deposits from banks and customers

Transaction accounts and deposits are classified as other liabilities and are initially recognized at fair value less transaction costs, and subsequently stated at their amortised cost using the effective interest rate method.

h) Borrowings

Interest bearing borrowings are classified as other financial liabilities and are initially measured at fair value less transaction costs, and subsequently stated at their amortised cost using the effective interest rate method.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.7. Property and equipment

(a) *Recognition and measurement*

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

Property, including land and buildings, is measured at market value less accumulated depreciation. Periodic valuations of the Bank's property are performed for the purpose of minimizing the differences between its carrying and market value. This policy has been applied since 2000. Revaluation was carried out in accordance with the valuation performed by an independent appraiser.

Any surplus arising from revaluation is recognized directly as revaluation reserves within equity, except when the surplus cancels out a previous revaluation deficit for the same asset recognized in the statement of comprehensive income, in which case an amount up to this amount is recognized in the statement of comprehensive income. Any deficit arising from revalution is recognized in the statement of comprehensive income, except when the deficit cancels out a previous revaluation surplus for the same asset, in which case it is recognized directly in revaluation reserves.

Equipment is measured at cost less accumulated depreciation and impairment.

Subsequent costs

Cost includes the invoice value of purchased assets increased by all costs incurred until the moment of putting the new assets into use. Subsequent costs are included in the book value of the asset or recognized as a separate asset, as appropriate, only when it is probable that the Bank will have future economic benefits from this asset and the value of this asset can be reliably measured. All other repairs and maintenance are charged to the statement of comprehensive income during the period in which they incur.

(b) *Depreciation*

Depreciation is calculated for all assets, except land and assets not yet put into use, on a straight line basis in order to write off the aquisition cost through their estimated useful life. Exceptionally, passenger vehicles are depreciated by the declining-balance method over a period of six years, whereas a depreciation rate of 30% applies in the first year, and a rate of 14% in the five subsequent years.

The remaining value of assets and estimated useful life are reviewed at each reporting date.

Profit and loss on disposals of assets are determined as the difference between cash inflow and net book value and are recorded within other income or other expenses.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.7. Property and equipment (continued)

Depreciation rates for tangible assets are set out below:

	2010	**2009**
Buildings	1.25% - 4%	1.25% - 4%
Computer equipment	20%	20%
Furniture and other equipment	5% - 20%	5% - 20%
Motor vehicles	10% - 30%	10% - 30%
Other	10% - 20%	10% - 20%

3.8. Intangible assets

Intangible assets are measured at cost less accumulated amortisation and impairment.

Intangible assets, with the exception of assets not yet put into use, are amortised on a straight line basis over their estimated useful economic life.

Useful life is reviewed and adjusted, if necessary, at each reporting date.

Amortisation rates for intangible assets are set out below:

	2010	**2009**
Intangible investment – software and licences	10% - 25%	10% - 25%

3.9. Impairment of non-financial assets

Carrying amount of intangible assets not yet brought into use and intangible assets that have an indefinite useful life, are tested for impairment and their recoverable amount estimated whenever events or changes in circumstances indicate that their carrying amount may not be recoverable, or at least annually.

Other non-financial assets (other than deferred tax) are tested on impairment at each balance sheet date. Whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, the recoverable amount is estimated. An impairment loss is recognised in the statement of comprehensive income whenever the carrying amount of an asset exceeds its recoverable amount.

The recoverable amount of non-financial 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.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.10. Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, 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 law in the case of provisions for unidentified losses on of off-balance-sheet credit risk exposures.

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as 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.

3.11. Employee benefits

a) Employee's salaries

On behalf of its employees, the Bank pays manditory contributions (pension and health insurance, unemployment contributions and child welfare contributions), which are calculated on the gross salary, as well as tax that is calculated on income (gross salary less contributions). The Bank pays the above-mentioned contributions into the public revenue account at the statutory rates prescribed by the entities of the Republic of Srpska, the Federation of BiH, as well as the Brcko District throughout the year for each salary payment. In addition, employees' expenses for travel to and from the office as well as holiday pay are paid in accordance with local legislation. These expenses are recorded in the statement of comprehensive income in the period in which they incur.

b) Jubilee awards

The Bank pays out jubilee awards to its employees. The liabilities and expenses from these outlays are estimated using the projected monetary unit method. The projected monetary units method takes into consideration each year of employment with the Bank, where the sum of all the particular units is the final liability which is measured individually for each unit. Liabilities are measured at present values of estimated future cash flows discounted at an econometrically modeled interest rate, which is more adequate in existing market conditions than the interest rate on state long-term debt securities. Jubilee awards are paid out in the amount of one average salary of the Bank accrued in the month preceding the payment for the completion of 20 years of employment, or two average salaries of the Bank for the completion of 30 years of employment with the Bank.

c) Severance pay

In accordance with internal regulations on salaries, the Bank pays out severance pay to employees upon their entry into retirement in the amount of two average monthly salaries for the employee.

Calculation of long-term provisions for employee severance pay is performed annually by a certified actuary using the projected monetary unit method. The projected monetary units method takes into consideration each year of employment with the Bank, where the sum of all the particular units is the final liability which is measured individually for each unit. Liabilities are measured at present values of estimated future cash flows discounted at an econometrically modeled interest rate, which is more adequate in existing market conditions than the interest rate on state long-term debt securities.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.12. Equity

Share capital

Share capital includes ordinary (common) shares and is denominated in BAM at nominal value.

Statutory reserves

Statutory reserves are derived from the distribution of net profit from previous years.

According to the Companies Act, for the distribution of profit by annual calculation, joint stock companies in the Republic of Srpska are obligated to allocate a minimum of 5% of their profit to statutory reserves, until the amount of reserves reaches a level of 10% of the joint stock company's share capital. The law does not prescribe the deadline by which joint stock companies should have a statutory reserves of at least 10% of share capital.

Share premium

Share premium relates to the accumulated positive difference between the nominal value and the selling price for the issued share.

Regulatory reserves for credit losses

As explained in Note 3.6. 1) regulatory reserves for credit losses represents the difference between impairment allowance calculated in accordance with the requirements of IFRS and the impairment allowance calculated in accordance with the regulations of the BARS, if the latter is higher.

3.13. Dividends

Dividend income is recognized in the statement of comprehensive income when the right to receive dividends has been established.

3.14. Earnings per share

The Bank presents basic earnings per share (EPS). The basic earnings per share is calculated by dividing the profit or loss in the current period attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares in circulation during the year.

3.15. Leases

Leases in which the Bank as the lease holder assumes all risks and rewards related to ownership, are classified as finance leases. At the reporting date, the Bank did not have any such leases. All other leases are operating leases. The leasing costs based on operating leases burden the statement of comprehensive income by the linear method through the duration of the lease agreement.

3.16. Off-balance-sheet commitments and contingent liabilities

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

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.17. Funds managed for and on behalf of third parties

The Bank manages funds for and on behalf of third parties. These amounts do not constitute part of the Bank's assets, and, therefore, they are excluded from the statement of financial position. The Bank receives fee income for providing these services and does not bear any risk.

3.18. Standards, interpretations and amendments to published Standards that are not yet effective and have not been applied in preparing these financial statements

A significant number of new standards and interpretations have still not been applied for the year ended 31 December 2010 and have not been applied in the preparation of these financial statements. With the exception of IFRS 9 which is explained below, the Bank does not expect other standards to have a significant effect on the Bank.

- Additions to IFRS 9 *Financial Instruments* (issued in 2010) (effective for annual periods beginning on or after 1 January 2013, early application is permitted).

  The 2010 additions to IFRS 9 replace the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*, about classification and measurement of financial liabilities and the derecognition of financial assets and financial liabilities.

  The Standard retains almost all of the existing requirements from IAS 39 on the classification and measurement of financial liabilities and for derecognition of financial assets and financial liabilities.

  The Standard requires that the amount of change in fair value attributable to changes in the credit risk of a financial liability designated at initial recognition as fair value through profit or loss, be presented in other comprehensive income (OCI), with only the remaining amount of the total gain or loss included in profit or loss. However, if this requirement creates or enlarges an accounting mismatch in profit or loss, then the whole fair value change is presented in profit or loss.

  Amounts presented in OCI are not subsequently reclassified to profit or loss but may be transferred within equity.

  Derivative financial liabilities that are linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, are required to be measured at fair value under IFRS 9.

  It is not expected that IFRS 9 issued in 2010 will have a material impact on the financial statements. The classification and measurement of the Bank's financial liabilities under IFRS 9 are not expected to significantly change because of the nature of the Bank's operations and the types of financial assets that it holds.

- IFRS 9 Financial Instruments (issued in 2009) (effective for annual periods beginning on or after 1 January 2013, earlier application is permitted).

  This Standard replaces the guidance in IAS 39, *Financial Instruments: Recognition and Measurement*, about classification and measurement of financial assets. The Standard eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivable. Financial assets will be classified into one of two categories on initial recognition: financial assets measured at amortized cost; or financial assets measured at fair value.

Notes to the financial statements (continued)

3. Specific accounting policies (continued)

3.18. Standards, interpretations and amendments to published Standards that are not yet effective and have not been applied in preparing these financial statements (continued)

A financial asset is measured at amortized cost if the following two conditions are met: the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and, its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets are measured at fair value.

Gains and losses on remeasurement of financial assets measured at fair value are recognised in profit or loss, except that for an investment in an equity instrument which is not held for trading, IFRS 9 provides, on initial recognition, an irrevocable election to present all fair value changes from the investment in other comprehensive income (OCI). The election is available on an individual share-by-share basis. No amount recognised in OCI is ever reclassified to profit or loss at a later date.

It is not expected that IFRS 9 issued in 2010 will have a material impact on the Bank's financial statements as the classification and measurement of the Bank's financial assets under IFRS 9 are not expected to significantly change because of the nature of the Bank's operations and the types of financial assets that it holds.

Notes to the financial statements (continued)

4. Significant accounting estimates and judgements

The Bank makes estimates and assumptions about certain events, including estimates and judgements about the future. Such accounting assumptions and estimates are regularly evaluated and based on historical experience and other factors such as: expected flow of future events that can be realistically assumed in the existing circumstances, but in spite of this, necessarily represent sources of uncertainty.

The estimation of impairment losses of the Bank's loan portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

a) Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. The need for impairment of the Bank's on and off-balance sheet exposure to credit risk is assessed on a monthly basis. Impairment losses are made mainly against the carrying value of loans to legal entities and individuals (as disclosed in Note 19) and as provisions for liabilities and charges arising from off-balance exposure to customers, mainly in the form of guarantees and letters of credit (as disclosed in Note 28). Impairment losses are also considered for credit risk exposures to banks and for other assets not carried at fair value, where the primary risk of impairment is not credit risk.

	Note	2010 BAM '000	Restated 2009 BAM '000
Summary of impairment allowance			
Impairment allowance for loans to customers	19	39,735	36,411
Provisions for off-balance sheet contingent liabilities	28	570	469
Total		**40,305**	**36,880**
Impairment allowance of other assets	23	4,938	5,595
Total loans and receivables		**45,243**	**42,475**

In addition to impairment calculated in accordance with IFRS, the Bank also calculates impairment in accordance with the regulations of the BARS, where the difference between the two is recognised as regulatory reserves for credit losses within equity.

Notes to the financial statements (continued)

4. Significant accounting estimates and judgements (continued)

a) Impairment losses on loans and receivables (continued)

The following table summarizes the impairment allowance calculated in accordance with BARS regulations:

	2010 BAM'000	Restated 2009 BAM'000
Summary of impairment allowance		
Impairment allowance for loans to customers	44,636	38,636
Provisions for off-balance sheet contingent liabilities	1,354	1,240
Total loans	**45,990**	**39,876**
Impairment allowance of other assets	5,114	6,095
Total loans and receivables	**51,104**	**45,971**

As explained in Note 30, insufficient reserves for credit losses required by the regulator for 2010 amounts to BAM 2.365 thousand which will be covered from the current year profit and previously created reserves based on the decision of the General Assembly of the Bank after the reporting date.

Notes to the financial statements (continued)

4. Significant accounting estimates and judgements (continued)

a) Impairment losses on loans and receivables (continued)

The Bank takes into considereation the combined effect of several events when assessing impairment and uses its experience in making judgements in cases where the observable data required to estimate impairement is limited.

At year end, the gross value of specifically impaired loans and receivables (non-performing loans – NPL) and the rate of impairment loss recognized, were as follows:

	2010 BAM '000			2009 BAM '000		
	Legal persons	**Individuals**	**Total**	**Legal persons**	**Individuals**	**Total**
Gross exposure	55,245	15,621	**70.866**	41,637	15,082	56,719
Impairment rate	35.6%	84.3%	**46.3%**	41.6%	86.6%	53.6%

Each additional increase in the impairment rate by one percentage point of the gross non-performing exposure presented above as at 31 December 2010, would lead to the recognition of an additional impairment loss of BAM 709 thousand (2009: BAM 567 thousand).

In addition to separately identified losses for NPLs on an individual and group basis, as explained above, the Bank also recognizes impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified (IBNR, portfolio impairement allowance).

The amount of impairment allowance as at 31 December 2010 assessed on a portfolio basis amounted to BAM 7,468 thousand (2009: BAM 6,478 thousand) of the relevant on and off-balance sheet exposure. Total impairment on a portfolio basis amounted to 1.8% (2009: 1.6%) of net loans to customers and 1.6% (2009: 1.5%) of the total net on and off-balance sheet credit risk exposure.

Financial assets carried at amortised cost

The Bank assesses impairment on an individual basis for all exposures where there is objective evidence of impairment. Assets which are not significant are assessed on a group (portfolio) basis for impairment.

The Bank estimates impairment losses in cases where 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. Evidence includes irregular repayment or other indications of financial difficulties of borrowers, unfavourable changes in economic conditions in which the borrowers operate, changes in the value or collectibility of collateral instruments when these changes can be linked to the above-mentioned breach of terms.

b) Taxation

The Bank provides for tax liabilities in accordance with the tax law of the Republic of Srpska and Bosnia and Herzegovina. Tax returns are subject to the approval of the tax authorities who are entitled to carry out subsequent inspection of taxpayers' records.

c) Regulatory requirements

The Banking Agency of the Republic of Srpska is authorized to perform regulatory inspection of the Bank's operations and to request adjustments to the carrying value of assets and liabilities, in accordance with the underlying regulations.

Notes to the financial statements (continued)

4. Significant accounting estimates and judgements (continued)

d) Litigation and claims

The Bank performs an individual assessment of all court cases and creates provisions in accordance with the assessment. Assessment is carried out by a special Commission of three members, two of whom are employed in Legal Affairs, and one in the Workout department. Proposals on provisions after the assessment are verified by the managers of Legal Affairs and Risk Management, and the decision on creating the provisions is made by the Bank's Management Board.

As stated in Note 28, the Bank provided BAM 1,205 thousand (2009: BAM 238 thousand), which the management estimates as sufficient.

Notes to the financial statements (continued)

5. Interest income

a) Analysis by source:

	2010 BAM '000	Restated 2009 BAM '000
Individuals	23,822	22,671
Companies and entrepreneurs	12,421	15,197
Banks and banking institutions	559	1,221
Public sector	1,026	128
	37,828	**39,217**

Banks and other banking institutions also include income on obligatory reserve with the Central Bank.

b) Analysis by product:

	2010 BAM '000	Restated 2009 BAM '000
Loans to customers	37,261	37,982
Placements with and loans to banks	162	560
Obligatory reserve with the Central Bank	397	661
Financial assets available for sale	8	14
	37,828	**39,217**

Notes to the financial statements (continued)

6. Interest expense

a) Analysis by recipient:

	2010 BAM '000	Restated 2009 BAM '000
Individuals	3,816	2,486
Companies and entrepreneurs	2,037	2,913
Banks and banking institutions	3,224	4,796
Public sector	1,831	3,895
Other organizations	1,108	194
	12,016	**14,284**

b) Analysis by product:

	2010 BAM '000	Restated 2009 BAM '000
Current accounts and deposits from individuals	3,816	2,486
Borrowings	1,915	1,359
Current accounts and deposits from companies	3,868	6,808
Current accounts and deposits from banks	1,309	3,437
Other	1,108	194
	12,016	**14,284**

Notes to the financial statements (continued)

7. Fee and commission income

	2010 BAM '000	Restated 2009 BAM '000
Domestic payment transaction fees	4,077	4,357
Foreign payment transaction fees	1,284	1,127
Fees based on payments of foreign currency pensions	1,465	1,433
Fee income from guarantees and letters of credit	902	1,081
Debit card fees	632	553
Loan fees	517	546
Fees based on operations with cash	131	101
Other fee and commission income	449	222
	9,457	**9,420**

8. Fee and commission expense

	2010 BAM '000	Restated 2009 BAM '000
Domestic payment transaction fees	148	184
Foreign payment transaction fees	56	82
Fee income from guarantees and letters of credit	148	139
Credit card fees	423	642
Fees based on operations with cash	240	186
Loan fees	165	35
Other fee and commission expenses	26	-
	1,206	**1,268**

9. Foreign exchange gains, net

	2010 BAM '000	Restated 2009 BAM '000
Positive realized foreign exchange differences	3,759	1,973
Negative realized foreign exchange differences	(1,487)	(249)
	2,272	**1,724**

Notes to the financial statements (continued)

10. Other operating income

	2010 BAM '000	Restated 2009 BAM '000
Rental income	40	60
Net income from release of provisions	-	105
Net foreign exchange gain from translation of monetary assets and liabilities	166	47
Dividend income	-	1
Other income	343	174
	549	**387**

11. Net profit from financial assets available for sale

	2010 BAM '000	Restated 2009 BAM '000
Realized gains based on the sale of financial assets available for sale	114	46
	114	**46**

12. Net impairment losses and provisions

	2010 BAM '000	Restated 2009 BAM '000
Loans to customers (Note 19)	6,803	5,274
Other assets (Note 23)	284	628
Off-balance sheet assets (Note 28)	102	(651)
	7,189	**5,251**

Notes to the financial statements (continued)

13. Personnel expenses

	2010 BAM '000	Restated 2009 BAM '000
Net salary expenses	6,571	7,185
Taxes and employee contributions	3,239	3,319
Personal income taxes	459	456
	10,269	**10,960**

Personnel expenses include contributions for pension and disability insurance paid in 2010 in the amount of BAM 2,025 thousand (2009: BAM 1,889 thousand).

Remuneration to key management

- Total remuneration paid for the Management Board members for 2010 amounts to BAM 862 thousand gross. The above-mentioned remuneration includes the bonus paid to the members of the Management Board in the gross amount of BAM 112 thousand, and severance pay for director in the gross amount of BAM 169 thousand.

- Total remuneration paid for the Management Board members for 2009 amounts to BAM 638 thousand gross. There was no bonus payment in 2009.

Amount of paid bonuses and award salaries for employees

- Total amount of gross bonuses paid to other key management personnel of the Bank amounted to BAM 188 thousand for 2010. There was no bonus payment in 2009.

14. Other expenses

	2010 BAM '000	Restated 2009 BAM '000
Net losses on provisions for liabilities and charges	1,178	-
Other personnel expenses	828	564
Materials expenses	971	1,005
Production services expenses	3,070	3,197
Operating expenses	6,008	6,212
Other tax and contributions expenses	638	767
Other expenses	446	232
	13,139	**11,977**

Notes to the financial statements (continued)

15. Income tax

	2010 BAM '000	Restated 2009 BAM '000
Current tax	704	513
Deferred tax (Note 29)	19	92
Total	**723**	**605**

Reconciliation of the income tax expense

	2010, BAM '000	Restated 2009, BAM '000
Profit before tax	1,101	2,362
Income tax at rate of 10%	110	236
Tax deduction for excluded income	(73)	(114)
Impairment losses on loans and other assets not deductible for tax purposes and other expenses	827	586
Impairment losses on loans and other assets deductible for tax purposes (20% of the adjusted tax base)	(141)	(103)
Income tax expense	**723**	**605**
Average effective income tax rate	**65.6%**	**25.6%**

Tax regulations stipulate that for the purpose of calculation of the tax base, a maximum of 20% of the adjusted (result for the period) tax base (which respresents the difference between adjusted income and expenses before impairment of loans and other assets) may be taken as a taxable expense of impairment of loans and other assets.

The Bank's tax liabilities are stated in tax return prepared by the Bank and might be a matter of subsequent inspection and consequent adjustment by tax authorities in a five year period after recognition. The Bank's Management Board is not aware of any circumstances, which may give rise to a potential material liability in this respect.

Notes to the financial statements (continued)

16. Cash reserves

	2010 BAM '000	Restated 2009 BAM '000
Cash in domestic currency	7,452	7,694
Funds with the Central Bank – gyro account	28,910	84,678
Cash and current accounts with other banks in foreign currency	6,151	10,380
	42,513	**102,752**

The amount of cash reserves also represents cash and cash equivalents for the purpose of preparing the statement of cash flows.

17. Obligatory reserve with the Central Bank

	2010 BAM '000	Restated 2009 BAM '000
Obligatory reserve with the Central Bank in domestic currency	**47,974**	**45,966**

The Central Bank of Bosnia and Herzegovina (the "Central bank") has prescribed, for the banks in BiH, a method for calculating and holding obligatory reserve, as well as the amount and manner of payment of fees on the amount of obligatory reserve and on the amount of funds held on the account with the Central Bank above the obligatory reserve.

The basis for the calculation of the obligatory reserve is the average amount of deposit and borrowed funds in BAM and foreign currencies (denominated in BAM, calculated according to the exchange rate of the Central Bank valid at the time of the calculation period).

The basis for calculation of obligatory reserve excludes:

- borrowed funds which banks, based on a written contract, borrows from non-residents, starting from 1 November 2008,

- as well as deposits and loans from government and entities (residents) intended for development projects starting from 1 May 2009.

The Bank is obliged to hold on the reserves account with the Central Bank, at least 14% on deposits and borrowed funds with an agreed maturity date up to one year, and 7% on the deposits and borrowed funds with an agreed maturity date over one year.

The Central Bank calculates interest on the funds as follows:

- for obligatory reserves, the interest rate of 0.5% until July 1, 2010, and after this the interest rate which is equal to the rate set based on average interest rate earned by the Central Bank at the same period on its "overnight" deposits.

- for the deposited funds exceeding the minimum requirements the interest which is determined based on the average interest rates earned by Central Bank at the same period on funds invested up to one month.

Notes to the financial statements (continued)

18. Placements with and loans to banks

	2010 BAM '000	Restated 2009 BAM '000
Placements with and loans to banks up to 30 days		
- Placements with and loans to other foreign banks	17,473	24,662
- Placements with and loans to related foreign banks	9,779	13,691
	27,252	**38,353**
Placements with and loans to banks with maturity over 30 days		
- Placements with and loans to related domestic banks	1,193	-
	28,445	**38,353**

19. Loans to customers

a) Analysis by product

	2010 BAM '000	Restated 2009 BAM '000
Legal entities		
- in domestic currency	64,188	47,429
- in foreign currency	132,814	154,164
- with foreign currency clause	9,240	7,599
Total gross	**206,242**	**209,192**
Impairment allowance	(20,596)	(18,242)
Total net legal entities	**185,646**	**190,950**
Individuals		
- in domestic currency	43,865	35,333
- in foreign currency	118	56
- with foreign currency clause	213,804	186,592
Total gross	**257,787**	**221,981**
Impairment allowance	(19,139)	(18,169)
Total net individuals	**238,648**	**203,812**
Net loans	**424,294**	**394,762**

Notes to the financial statements (continued)

19. Loans to customers (continued)

b) Movement in impairment allowance of loans and liabilities

	Loans to legal entities BAM '000	Loans to individuals BAM '000	Total loans BAM '000
Balance as at 1 January 2009	20,826	12,900	**33,726**
Net loss in the statement of comprehensive income *(Note 12)*	3	5,271	**5,274**
Write-offs	(2,587)	(2)	**(2,589)**
Balance as at 31 December 2009	**18,242**	**18,169**	**36,411**
Net loss in the statement of comprehensive income *(Note 12)*	5,259	1,544	**6,803**
Write-offs	(2,905)	(574)	**(3,479)**
Balance as at 31 December 2010	**20,596**	**19,139**	**39,735**

c) Concentration of credit risk by industry

The Bank's loan portfolio as at 31 December 2010 is analyzed by industry in the table below:

	2010 BAM '000	Restated 2009 BAM '000
Legal entities		
Mining and energy	12,092	11,690
Agriculture	14,013	16,452
Civil Engineering	12,009	13,415
Industry	45,263	43,427
Trade	87,159	88,553
Services	9,076	8,975
Transport	8,524	7,318
Finance	2,730	1
Other	15,376	19,361
	206,242	**209,192**
Individuals	257,787	221,981
Total gross loans	**464,029**	**431,173**
Impairment allowance	(39,735)	(36,411)
Total net loans	**424,294**	**394,762**

Notes to the financial statements (continued)

19. Loans to customers (continued)

d) Geographic concentration of credit risk

The geographic concentration of credit portfolio risk refers mostly to the region of Bosnia and Herzegovina. Geographic concentration in gross amounts of balance sheet exposure is as follows:

	Bosnia and Herzegovina	OECD countries	Non-OECD countries	Total
31 December 2010				
Loans to individuals	257,633	154	-	257,787
Loans to legal entities	206,242	-	-	206,242
Total	**463,875**	**154**	**-**	**464,029**
31 December 2009				
Loans to individuals	221,948	33	-	221,981
Loans to legal entities	209,192	-	-	209,192
Total	**431,140**	**33**	**-**	**431,173**

The structure of the credit portfolio is regularly monitored by the Risk Management sector in order to recognize potential events that could have a significant impact on the credit portfolio (usual risk factors) and, if needed, mitigate the Bank's exposure to certain sectors of the economy.

20. Financial assets available for sale

	2010 BAM '000	Restated 2009 BAM '000
Quoted		
Equity securities		
Dunav osiguranje a.d. Banja Luka	19	34
Krajina Osiguranje d.d. Banja Luka	28	25
Debt securities		
Bonds of the City of Banja Luka	100	200
Bonds of the Municipality of Šamac	10	10
	157	**269**
Unquoted		
"BLB export-import" d.o.o., Banja Luka	84	76
Banjalučka berza a.d., Banja Luka	167	152
VISA International	-	240
Other	54	48
	305	**516**
	462	**785**

As at 31 December 2010, fair value reserves of financial assets available for sale was negative and amounted to BAM 16 thousand or BAM 14 thousand net of deferred tax (31 December 2009: positive reserve in the amount of BAM 79 thousand, or BAM 71 thousand, net of deferred tax) and was recorded within equity.

Notes to the financial statements (continued)

21. Property and equipment

	Land and buildings	Equipment and other assets	Leasehold improvements	Assets under construction	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Cost					
Balance as at 1 January 2010	26,604	15,318	1,931	1,069	44,922
Additions	-	-	-	604	604
Brought into use	124	1,164	28	(1,316)	-
Disposals and write-offs	(75)	(448)	(321)	-	(844)
Balance as at 31 December 2010	**26,653**	**16,034**	**1,638**	**357**	**44,682**
Depreciation					
Balance as at 1 January 2010	9,982	9,777	790	-	20,549
Depreciation	389	1,732	188	-	2,309
Disposals and write-offs	(4)	(411)	(246)	-	(661)
Balance as at 31 December 2010	**10,367**	**11,098**	**732**	**-**	**22,197**
Net carrying amount					
Balance as at 1 January 2010	**16,622**	**5,541**	**1,141**	**1,069**	**24,373**
Balance as at 31 December 2010	**16,286**	**4,936**	**906**	**357**	**22,485**

At 31 December 2010, the Bank did not have real estate under mortgage as security for loan repayment (2009: nil).

Assets under construction relate to real estate, equipment and ATM machines not yet put into use.

Notes to the financial statements (continued)

21. Property and equipment (continued)

	Land and buildings	Equipment and other assets	Leasehold improvements	Assets under construction	Total
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
Cost					
Balance as at 1 January 2009	26,604	15,224	2,137	522	44,487
Additions	-	-	-	1,000	1,000
Brought into use	-	453	-	(453)	-
Disposals and write-offs	-	(359)	(206)	-	(565)
Balance as at 31 December 2009	**26,604**	**15,318**	**1,931**	**1,069**	**44,922**
Depreciation					
Balance as at 1 January 2009	9,593	8,284	696	-	18,573
Depreciation	389	1,765	201	-	2,355
Disposals and write-offs		(272)	(107)	-	(379)
Balance as at 31 December 2009	**9,982**	**9,777**	**790**	**-**	**20,549**
Net carrying amount					
Balance as at 1 January 2009	**17,011**	**6,940**	**1,441**	**522**	**25,914**
Balance as at 31 December 2009	**16,622**	**5,541**	**1,141**	**1,069**	**24,373**

Notes to the financial statements (continued)

22. Intangible assets

	Software	Assets under construction	Other	Total
	BAM '000	BAM '000	BAM '000	BAM '000
Cost				
Balance as at 1 January 2010	12,605	-	2,868	15,473
Additions	-	512	-	512
Brought into use	230	(310)	80	-
Disposals and write-offs	-	-	-	-
Balance as at 31 December 2010	**12,835**	**202**	**2,948**	**15,985**
Amortisation				
Balance as at 1 January 2010	4,946	-	1,870	6,816
Amortisation	2,577	-	414	2,991
Disposals and write-offs	-	-	-	-
Balance as at 31 December 2010	**7,523**	**-**	**2,284**	**9,807**
Net carrying amount				
Balance as at 1 January 2010	**7,659**	**-**	**998**	**8,657**
Balance as at 31 December 2010	**5,312**	**202**	**664**	**6,178**

Notes to the financial statements (continued)

22. Intangible assets (continued)

	Software	Assets under construction	Other	Total
	BAM '000	BAM '000	BAM '000	BAM '000
Cost				
Balance as at 1 January 2009	9,031	1,525	2,809	13,365
Additions	-	2,108	-	2,108
Brought into use	3,574	(3,633)	59	-
Disposals and write-offs	-	-	-	-
Balance as at 31 December 2009	**12,605**	**-**	**2,868**	**15,473**
Amortisation				
Balance as at 1 January 2009	3,053	-	1,426	4,479
Amortisation	1,893	-	444	2,337
Disposals and write-offs	-	-	-	-
Balance as at 31 December 2009	**4,946**	**-**	**1,870**	**6,816**
Net carrying amount				
Balance as at 1 January 2009	**5,978**	**1,525**	**1,383**	**8,886**
Balance as at 31 December 2009	**7,659**	**-**	**998**	**8,657**

Notes to the financial statements (continued)

23. Accrued interest and other assets

	2010 BAM '000	Restated 2009 BAM '000
Due interest	5,209	5,905
Accrued interest	195	171
Receivables for fees in local currency	139	158
Other receivables	5,687	4,191
Impairment allowance	(4,938)	(5,595)
	6,292	**4,830**

Movement in impairment allowance for other assets:

	Total BAM '000
Balance as at 1 January 2009	5,496
Net loss in the statement of comprehensive income *(Note 12)*	628
Write-offs	(529)
Balance as at 31 December 2009	**5,595**
Net loss in the statement of comprehensive income *(Note 12)*	284
Write-offs	(941)
Balance as at 31 December 2010	**4,938**

Notes to the financial statements (continued)

24. Transaction accounts and deposits from banks

	2010 BAM ‘000	Restated 2009 BAM ‘000
Demand deposits		
- in local currency	171	144
- with foreign exchange clause	-	-
- in foreign currency	14	1
	185	**145**
Term deposits		
- in local currency	90	-
- with foreign exchange clause	-	100
- in foreign currency	50,852	72,366
	50,942	**72,466**
	51,127	**72,611**

Notes to the financial statements (continued)

25. Transaction accounts and deposits from customers

	2010 BAM '000	Restated 2009 BAM '000
Legal entities		
Demand deposits		
- in local currency	98,073	99,985
- with foreign exchange clause	-	-
- in foreign currency	17,351	16,105
	115,424	**116,090**
Term deposits		
- in local currency	844	411
- with foreign exchange clause	30,996	33,042
- in foreign currency	40,310	103,938
	72,150	**137,391**
	187,574	**253,481**
Individuals		
Demand deposits		
- in local currency	60,344	53,042
- with foreign exchange clause	-	-
- in foreign currency	34,439	31,435
	94,783	**84,477**
Term deposits		
- in local currency	8,134	7,124
- with foreign exchange clause	602	825
- in foreign currency	75,602	55,116
	84,338	**63,065**
	179,121	**147,542**
	366,695	**401,023**

Notes to the financial statements (continued)

26. Borrowings

	2010 BAM '000	Restated 2009 BAM '000
Borrowings		
- with foreign exchange clause	57,191	43,883
- in foreign currency	21,320	23,602
	78,511	**67,485**

Structure of borrowings is presented below:

	2010 BAM '000	Restated 2009 BAM '000
Domestic funds and ministries		
- Housing Fund of the Republic of Srpska	28,900	23,218
- Fund for development of the Eastern part of the Republic of Srpska	5,464	6,516
- Fund for development and employment of the Republic of Srpska	22,845	14,612
- Fund for Italian Participation in the Stabilization, Reconstruction and Development of the Balkans - "MCI Fund")	912	1,033
- Ministry of Finance of Republika Srpska – financing of cattle and village entrepreneurship - IFAD II	-	1,968
Foreign banks		
- European Investment Bank	20,390	20,138
	78.511	**67.485**

27. Accrued interest and other liabilities

	2010 BAM '000	Restated 2009 BAM '000
Accrued interest	2,876	2,011
Deferred loan origination fee	2,514	2,548
Liabilities to employees	234	348
Liabilities to suppliers	516	795
Other liabilities	2,380	1,487
	8,520	**7,189**

Notes to the financial statements (continued)

28. Provisions for liabilities and charges

	2010 BAM '000	Restated 2009 BAM '000
Provisions for severance pay	472	436
Provisions for jubilee awards	143	83
Provisions for court cases	1,205	238
Provisions for off-balance sheet contingent liabilities	570	469
	2,390	**1,226**

Movement in provisions for liabilities and charges:

	Off-balance sheet BAM '000	Court cases BAM '000	Jubilee awards BAM '000	Severance pay BAM '000	Total BAM '000
Balance as at 1 January 2009	1,120	444	70	437	2,071
Net loss/(gain) in the statement of comprehensive income	(651)	(118)	13	-	(756)
Provisions used during the period	-	(88)	-	(1)	(89)
Write-offs	-	-	-	-	-
Balance as at 31 December 2009	**469**	**238**	**83**	**436**	**1,226**
Net loss in the statement of comprehensive income	102	1,082	60	36	1,280
Provisions used during the period	-	(115)	-	-	(115)
Write-offs	(1)	-	-	-	(1)
Balance as at 31 December 2010	**570**	**1,205**	**143**	**472**	**2,390**

Impairment losses for off-balance sheet exposure are recognized through net impairment losses and provisions in the statement of comprehensive income (note 12). Loss and gain from other provisions is recognized through other expenses (note 14), or other income (note 10).

Notes to the financial statements (continued)

29. Net deferred tax liability

Deferred taxes are calculated on all temporary differences under the balance sheet method using the effective tax rate of 10 % (2009: 10%). Movements in temporary differences and components of deferred tax liabilities, recognised in equity or in the statement of comprehensive income are as follows:

	2010 BAM '000	Restated 2009 BAM '000
Deferred tax assets		
Fair value reserves	2	-
Deferred tax liabilities		
Fair value reserves	-	(8)
Revaluation of reserves	(244)	(244)
Deferred tax liabilities on the basis of differences in depreciation rates	(111)	(92)
Net deferred tax liabilities	**(353)**	**(344)**

Movement in deferred tax liabilities is as follows:

	Deferred tax assets BAM '000	Deferred tax liabilities BAM '000	Net deferred tax liabilities BAM '000
Balance as at 1 January 2009	50	(289)	(239)
Increase/decrease recognised to the statement of comprehensive income *(Note 15)*	(45)	(47)	(92)
Changes in fair value of financial assets available for sale recognized in equity	(18)	-	(18)
Sale of financial assets available for sale	5	-	5
Balance as at 31 December 2009	**(8)**	**(336)**	**(344)**
Balance as at 1 January 2010	**(8)**	**(336)**	**(344)**
Increase/decrease recognised to the statement of comprehensive income *(Note 15)*	-	(19)	(19)
Changes in fair value of financial assets available for sale recognized in equity	(2)	-	(2)
Sale of financial assets available for sale	12	-	12
Balance as at 31 December 2010	**2**	**(355)**	**(353)**

Notes to the financial statements (continued)

30. Share capital

	Ordinary shares BAM '000
Balance as at 1 January 2010	62,054
Balance as at 31 December 2010	62,054
Nominal value (BAM)	700
Number of shares	88,649

The share capital of the Bank was created by the initial investment of the shareholders and from subsequent issues of new shares. The shareholders are entitled on the Bank's governance, as well as on profit sharing.

The shareholders of the Bank as at 31 December 2010 were 107 domestic and foreign legal entities and individuals. The following shareholders hold over 1% shares:

	share (%)
Bank Austria Creditanstalt AG, Vienna	**90.92%**
Share Fund of the Republic of Srpska	1.94%
ZIF Kristal invest fond a.d. Banja Luka	1.42%
Hypo Alpe Adria Bank d.d. Mostar (Custody operations)	1.09%
	95.37%
Others	4.63%
	100%

The ultimate owner of the Bank is Unicredit S.p.A., an Italian bank with its headquarters in Milan.

As at 31 December 2010, the Bank calculated impairment allowance in accordance with the requirements of the BARS. The cumulative difference as at 31 December 2010 between impairment allowance calculated in accordance with IFRS and impairment allowance calculated in accordance with the requirements of the BARS amounted to BAM 5,861 thousand and represents regulatory reserves for credit loss. BAM 3,496 thousand, of the stated amount, relates to reserves for credit losses created in the period before 1 January 2010 and are covered from retained earnings according to BARS regulations, while the difference in the amount of BAM 2,365 thousand represents the amount of insufficient regulatory reserves for current period which will be covered from current year profit and previously created reserves, based on the decision of the Bank's General Assembly after the reporting date.

31. Earnings per share

	2010 BAM '000	Restated 2009 BAM '000
Weighted average number of shares	88,649	88,649
Net profit in BAM '000	378	1,757
Earnings per share in BAM	**4.26**	**19.82**

Notes to the financial statements (continued)

32. Commitments and contingent liabilities

	2010 BAM '000	Restated 2009 BAM '000
Guarantees		
- in BAM	8,173	7,297
- in foreign currency	2,293	3,192
Performance guarantees:		
- in BAM	14,491	17,571
- in foreign currency	450	2,380
Contingent liabilities based on unused loans and guarantees:		
- in BAM	33,861	26,920
- in foreign currency	3,721	551
Letters of credit in foreign currency	1,785	277
	64,774	**58,188**

As at 31 December 2010 provisions for potential loss for commitments and contingent liabilities amounted to BAM 570 thousand (2009: BAM 469 thousand). Movement in provision is shown in Note 28.

33. Financial assets and liabilities at fair value through profit and loss

	2010		2009	
	BAM '000	BAM '000	BAM '000	BAM '000
	Nominal amount	Fair value	Nominal amount	Fair value
Currency swaps	18,580	-	11,735	-

The currency swap relates to a BAM transaction whose fair value in relation to the fixed exchange rate is nil.

Notes to the financial statements (continued)

34. Transactions with related parties

The Bank is a member of the UniCredit Group. The key shareholder of the Bank is UniCredit Bank Austria AG Vienna with 90.92% (2009: 90.92%). None of the minority shareholders has a share in the Bank's equity exceeding 5%.

The Bank considers that it has an immediate related party relationship with its key shareholders and their subsidiaries, its associates, members of the Supervisory Board, members of the Management Board and other upper management of the Bank (together, "key management"), close family members of the key management and legal entities where key management and/or their close family members have control or significant influence.

Transactions with related parties are part of the Bank's regular operations.

Assets and liabilities with related entities are as follows:

	2010 BAM '000	2009 BAM '000
Assets:		
Foreign current accounts:		
- UniCredit Bank Austria AG Vienna	792	632
- UniCredit Bank Srbija A.D. Beograd	27	13
- Zagrebačka banka d.d., Zagreb	194	234
- Hypo Vereinsbank AG – (HVB)	23	41
- Unicredito Italiano SPA Milano	59	23
- UniCredit Bank d.d. Mostar	2	-
	1,097	**943**
Short-term deposits:		
- UniCredit Bank Austria AG Vienna	9,779	-
- UniCredit CAIB AG Vienna	-	13,691
- UniCredit Bank d.d. Mostar	1,193	-
	10,972	**13,691**
TOTAL ASSETS	**12,069**	**14,634**
Liabilities:		
Short-term deposits:		
-UniCredit Bank Austria AG Vienna	50,856	72,366
Trade payables:		
-UGIS -Wawe, Vienna	-	3
-Bank Austria Global Information – BAGIS, Vienna	60	47
-IT, Vienna	-	13
TOTAL LIABILITIES	**50,916**	**72,429**
Net liabilities:	**(38,847)**	**(57,795)**

Notes to the financial statements (continued)

34. Transactions with related entities (continued)

Income and expenses with related entities are as follows:

	2010 BAM '000	2009 BAM '000
Items included in the statement of comprehensive income:		
Interest income:		
-UniCredit Bank Austria AG Vienna	85	56
-UniCredit CAIB AG Vienna	-	68
-Hypo Vereinsbank AG – (HVB)	-	14
-UniCredit bank d.d., Mostar	6	19
Total interest income	**91**	**157**
Fee and commissions income:		
-UniCredit Bank Austria AG Vienna	16	1
-Zagrebačka banka d.d., Zagreb	1	1
Total fee and commission income	**17**	**2**
Interest expenses:		
-UniCredit Bank Austria AG Vienna	1,310	2,170
-UniCredit CAIB AG Vienna	-	1,254
Total interest expenses	**1,310**	**3,424**
Fee and commission expenses:		
-UniCredit Bank Austria AG Vienna	128	126
-Unicredito Italiano SPA Milano	2	2
-Zagrebačka banka d.d., Zagreb	3	3
-UniCredit bank d.d. Mostar	82	-
Total fee and commission expenses	**215**	**131**
Software maintenance costs:		
-BTS – Banking Transaction services s.r.o., Prague	84	253
-UGIS-Wawe, Vienna	627	702
-IT, Vienna	57	156
-Bank Austria Global Information – BAGIS, Vienna	647	602
Total software maintenance costs	**1,415**	**1,713**
Net expenses:	**(2,832)**	**(5,109)**

Notes to the financial statements (continued)

35. Risk management

The Bank's risk management is conducted through a system of policies, programs, procedures and approved limits, which are continuously upgraded in accordance with changes in legislation, changes in business activities based on market trends and development of new products, as well as through the adoption of risk management standards of UniCredit Group ("the Group"). The Group has a comprehensive risk management system based on policies and procedures and set limits acceptable at the Group level.

The Supervisory Board and Management Board of the Bank prescribe risk management principles and adopt risk management official policies and procedures. In accordance with the Group requirements, the Bank has implemented a standard approach to the international Basel II standard, through an IT platform, that is aligned with the requirements of this standard.

The most significant types of risk to which the Bank is exposed are credit risk, market risk and operational risk.

35.1. Credit risk

The Bank is exposed to credit risk that can be defined as the possibility that a debtor may default on (some of) the obligations defined in their loan agreements, which may result in financial loss for the Bank. The exposure to credit risk is managed in accordance the Bank's programs and policies currently in force, as well as other internal regulations prescribed by the Supervisory Board and the Management Board. The exposure to credit risk is managed very carefully, such that the credit exposure for portfolios and individual clients/group exposures is reviewed on a regular basis, taking into account set limits. The limits to credit risk are determined in relation to the Bank's tier 1 guarantee capital.

Credit Risk Management is organized through 4 organizational units, which are under the direction of the Chief Risk Officer:

1 Credit Risk Underwriting
2 Credit Risk Monitoring
3 Workout, and
4 Credit Risk Controlling

The function of the Chief Risk Officer is performed by a member of the team for support to management in the risk management area.

a) Measurement of credit risk

The following factors are taken into account in credit risk measurement: risk of loss related to insolvency of the debtor and risk of loss related to a change in client risk rating, then credit exposure including balance sheet and off-balance sheet positions of the Bank and value of collateral.

Within the Risk Management Department, the Credit Risk Underwriting function approves loan applications, or issues opinions on these in accordance with relevant assumptions, conditions and internal procedures. The purpose of this function is to manage credit risk with the aim of minimising credit risk expenses at the Bank level, through assessment of credit risk at the underwriting stage.

Management of exposure to credit risk is performed through analysis of the capability of credit customers and potential credit customers to fulfil their obligations to pay the interest and principal. Management of credit risk exposure is also partially performed by obtaining pledges and guarantees from the company and personal guarantees.

The Credit Risk Monitoring function is focused on monitoring of the loan portfolio, in order to reduce credit risk and improve the quality of the Bank's portfolio, through timely identification of potentially risky clients, and structural, targeted management of business relationships with such clients.

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

a) Measurement of credit risk (continued)

The Workout function contributes to the efficient management of non-performing loans through:

- overcoming the current / structural weaknesses of a customer through negotiations, development and implementation of a restructuring strategy;
- maximizing successful collection of bad debt from the Bank's debtors;
- quality support of the legal function in respect of court-processing of customer cases and cost effective management of foreclosed assets;
- efficient management of the Bank's NPL portfolio.

Key activities and measures are also implemented through:

- Annual review of clients, where the Bank continues its regular review of each individual client – legal entity, at least once a year, during which, based on its financial statements it evaluates the creditworthiness of the client, awards an internal rating, and analyses the current status of approved transactions;
- The NPL centralization project, in which specially trained staff pays special attention to and monitors non-performing loans;
- The “Watch List” system, which assumes a regular monitoring process which, *inter alia,* includes careful monitoring of the loan portfolio of corporate clients with early warning signs in their business;
- The “Fraud Project”, the establishment of a new function for the prevention of credit fraud, implementation of business processes for prevention and recognition of fraud, development of application support for recording information on fraud in the IT system of the Bank, establishment of a system for monitoring cases of fraud, all in order to decrease the share of the non-performing portfolio in the Retail segment;
- The Soft Collection project, performed through focused activities to achieve higher efficiency in the monitoring of performing loans and better collection of due debts as well as better cost control within the retail portfolio;
- The “Retail Monitoring” project, through a regular monitoring process which, *inter alia,* includes control of the credit portfolio of individuals and small businesses which indicate early signs of the existence of discriminatory events;
- The “Renegotiation Program”, through which the Bank intends to minimize the impact of the current crisis on the portfolio of individuals by immediately identifying overdue clients in order to mitigate potential worsening of that portfolio in the short term. The characteristics of this program are overall renegotiation with selected targeted clients in advance and a proactive approach to the targeted group through predefined and previously approved options.

b) Risk control policies

The Bank manages, limits and controls credit risk concentrations, wherever such risk concentrations exist, particularly with regard to specific clients and/or groups, and industry sectors.

The Bank sets different levels of credit risk, which are based on restricting the amount of risk assumed in relation to one borrower or group of borrowers, or industry segment. Such risks are monitored on a regular basis (once a month) through a report on usage of limits, which are presented to the Credit Committee of the Bank.

The Credit Committee, the Management Board and the Supervisory Board of the Bank are regularly informed of all significant changes in the value and quality of the portfolio.

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

b) Risk control policies (continued)

Exposure to credit risk is also managed by conducting regular solvency analyses of current and potential clients, their repayment potential regarding interest and principal as well as through changes in credit limits, where needed.

In order to minimize the risks from lending activities, the Bank uses the applicable Collateral Policy which establishes rules for the treatment of certain types of collateral in the process of credit risk underwriting. The Bank uses acceptable collateral to ensure collection of its receivables. Acceptable collateral is a pledge which has a known active market and stable price, whose value is satisfactory compared to the Bank's receivables and which is sufficient to protect the Bank from possible loss of principal, interest, fees and costs of collection.

In order to decrease the risk regarding marketability of collateral, the Bank conducts both formal and substantial analysis, as well as an assessment of each item of collateral separately. Special attention is paid to the existence of a proper deed of title for the collateral, and an assessment performed of actual marketability of collateral as well as its value.

Persons in charge of maintaining business relationships with clients are required to obtain the opinion of Legal Affairs on the potential for realization of the planned transaction and legal risks for the Bank when preparing loan applications for revolving loans.

The Bank is also exposed to credit risk through its off-balance sheet items – unused loan commitments, letters of credit and guarantees.

The primary goal is to ensure availability of funds in accordance with clients' needs. Guarantees and letters of credit carry the same exposure to credit risk as loans. Collateral for guarantees and letters of credit are also subject to the Collateral Policy of the Bank.

Notes to the financial statements (continued)

37. Risk management (continued)

35.1. Credit risk (continued)

c) Provisioning policies

Through internal regulations, the Bank prescribes procedures and rules in setting impairment allowance for receivables with which the Bank assumes credit risk:

- legal entities (corporate and business clients)
- banks and financial institutions
- public sector, government agencies, cantons, municipalities and local administration
- central government and funds
- individuals.

When identifying a client, the Bank applies related party aggregation principles, in accordance with current internal regulations of the Bank on related parties and consolidated credit risk. Total credit risk exposure is the total amount of all receivables to all related members.

35.1.1. Maximum exposure to credit risk for on and off-balance sheet items before taking collateral or other increase in loans prior to provisioning is as follows:

	2010 BAM '000	Restated 2009 BAM '000
Balance sheet		
Cash reserves (note 16)	30,947	87,031
Obligatory reserve with the Central Bank (note 17)	47,974	45,966
Placements with and loans to banks (note 18)	28,445	38,353
Loans to customers – legal entities (note 19)	185,646	190,950
Loans to customers – individuals (note 19)	238,648	203,812
Financial assets available for sale (note 20)	110	210
Accrued interest (note 23)	1,525	1,572
Other assets (note 23)	4,767	3,258
Total balance sheet items exposed to credit risk	**538,062**	**571,152**
Off-balance sheet items (note 32)		
Guarantees and other securities	27,192	30,717
Approved overdrafts, undrawn loan commitments and guarantees	37,582	27,471
Total off-balance sheet assets exposed to credit risk	**64,774**	**58,188**
	602,836	**629,340**

The table shows the maximum exposure to credit risk of the Bank as at 31 December 2010 and 31 December 2009, without taking into consideration pledges or other loan collateral. For balance sheet assets, the presented exposure is based on net carrying values. As shown in the table above, 70.4% of total maximum exposure originates from loans to customers (2009: 62.7%), and 4.7% originates from placements with and loans to other banks (2009: 6.1%). The Management Board is confident in the Bank's ability to continue controlling and maintaining exposure to credit risk.

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

The Bank accepts collateral for loans and receivables in the form of mortgage on real estate and other insurance over assets and guarantees. Initial assessments of the value of collateral, or real estate, are performed when approving a loan application, and are an integral part of the process of approval of a customer's loan application. Reassessments are performed in accordance with the Bank's policies in scope and conditions defined by principles and rules of the collateral management system. Collateral is not used for placements with and loans to other banks or financial assets available for sale.

In light of the impact of the general financial and economic crisis, there is considerable uncertainty in respect of the fair market value of such collateral, as well as of the time needed to realize sale.

35.1.2. Credit risk management and policies for impairment and provisions

Impairment losses and impairment loss policies

The Bank performs an assessment of the existence of objective evidence of impairment of financial assets at each reporting date, as previously explained in note 3.6.1).

For the purpose of credit monitoring and the management of credit risk, the Bank divides its credit portfolio into the following groups:

- Performing loans to customers – loans that are neither due nor impaired
- Past due but not impaired
- Non-performing loans (impaired loans).

An analysis of the loan portfolio according to the above-mentioned categories is presented below.

For the purpose of determining impairment allowance for loans and receivables, the Bank distinguishes between three approaches:

- Loans assessed on an individual basis
- Loans assessed on a group basis
- Loans assessed on a portfolio basis (IBNR).

Loans assessed on an individual basis

Loans assessed on an individual basis are all loans for which there exists objective evidence of an impairment. Objective evidence of an impairment, i.e. factors that can influence the ability and willingness of debtors to fulfil their obligations toward the Bank, are as follows:

- delinquencies in contractual payments of interest or principal
- breach of covenants or conditions
- initiation of bankruptcy proceedings
- any specific information on the customer's business (e.g. reflected by cash flow difficulties experienced by the client)
- changes in the customer's market environment
- the general economic situation.

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

35.1.2. Credit risk management and policies for impairment and provisions (continued)

Loans assessed on a group basis

For assessing the impairment of loans which are not individualy significant, loans are grouped on the basis of similar characteristics of credit risk, i.e. days of delay in repayment, collateral structure, purpose and other similar characteristics, based on which the Bank creates impairment allowance.

Loans assessed on a portfolio basis (IBNR)

The Bank also recognises impairment for losses which are incurred but are not reported (IBNR). IBNR is calculated for a group of financial assets with similar characteristics of credit risk and is considered on a portfolio basis applying parameters (such as probability of default, loss given default, amount that the Bank requires in terms of non-fulfillment of liabilities) determined by Basel II and reconciled to IFRS requirements through emergence period of recognition of the losses.

Restructured loans and receivables

During the year the Bank has rescheduled certain loans to clients aiming at improvement of their final recoverability. Rescheduling is mainly performed in response to deterioration of the clients' financial position or for the prevention of further deterioration of the clients' financial position based on an analysis of the likelihood of successful rescheduling in order to remove difficulties in the client's operations within a defined deadline and return of the client to the "performing" portfolio. In all cases of rescheduled loans with negative influence on the net current value, the Bank recognised an impairment of the loans.

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

35.1.2. Credit risk management and policies for impairment and provisions (continued)

The table below shows the amounts of impairment for each predefined loan risk category:

	2010 BAM '000			2009 BAM '000		
	Loans to customers	Impairment allowance	%	Loans to customers	Impairment allowance	%
Performing loans						
- loans to legal entities	150,997	954	0.6%	167,555	907	0.5%
- loans to individuals	242,166	5,972	2.5%	206,899	5,102	2.5%
Non-performing loans						
- loans to legal entities	55,245	19,642	35.6%	41,637	17,335	41.6%
- loans to individuals	15,621	13,167	84.3%	15,082	13,067	86.6%
Total loans	**464,029**	**39,735**	**8.6%**	**431,173**	**36,411**	**8.4%**

Provision coverage of non-performing portfolio is 46.3% (2009: 53.6%)

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

35.1.2. Credit risk management and policies for impairment and provisions (continued)

The table below presents an analysis of gross and net (decreased by impairment allowance) loans and advances to customers:

	2010 BAM '000	2009 BAM '000
Legal entities		
Loans to customers that are neither due nor impaired	148,400	164,971
Past due but not impaired loans	2,597	2,584
Non-performing loans (impaired loans)	55,245	41,637
Gross exposure	**206,242**	**209,192**
Decreased by impairment allowance:		
Portfolio (IBNR), individual and group impairment allowance	(20,596)	(18,242)
Net exposure	**185,646**	**190,950**

	2010 BAM '000	2009 BAM '000
Individuals		
Loans to customers that are neither due nor impaired	242,142	206,881
Past due but not impaired loans	24	18
Non-performing loans (impaired loans)	15,621	15,082
Gross exposure	**257,787**	**221,981**
Decreased by impairment allowance:		
Portfolio (IBNR), individual and group impairment allowance	(19,139)	(18,169)
Net exposure	**238,648**	**203,812**
Total gross exposure	**464,029**	**431,173**
Portfolio impairment allowance (IBNR)	(6,926)	(6,009)
Individual and group impairment allowance	(32,809)	(30,402)
Net exposure	**424,294**	**394,762**

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

35.1.2. Credit risk management and policies for impairment and provisions (continued)

a) Loans to customers that are neither due nor impaired

The quality of the portfolio of loans to customers that are neither due nor impaired can be assessed through the internal standard monitoring system. All loans to customers that are neither due nor impaired are regularly monitored and systematically reviewed in order to identify any irregularities or warning signals. These loans are subject to constant monitoring with the aim of taking timely action based on improvement/deterioration of clients' risk profile.

An analysis of gross exposure of loans to customers that are neither due nor impaired according to type of client is as follows:

	Loans to individuals				Loans to legal entities			
	Custumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2010	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM'000**	**BAM '000**	**BAM '000**	**BAM '000**
Standard monitoring	176,394	49,733	16,015	**242,142**	28,847	82,715	36,838	**148,400**
2009								
Standard monitoring	147,917	44,275	14,689	**206,881**	60,979	58,616	45,376	**164,971**

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

35.1.2. Credit risk management and policies for impairment and provisions (continued)

b) Past due but not impaired loans

Loans to customers less than 90 days due are not considered impaired, unless other information is available to indicate the contrary. The gross amount of loans and advances to customers that were past due but not impaired for the Bank were as follows:

	Loans to individuals				Loans to legal entities			
	Custumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2010	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**
Past due up to 30 days	13	-	-	**13**	-	100	5	**105**
Past due 30 – 60 days	6	-	-	**6**	1,000	-	7	**1,007**
Past due 60 – 90 days	5	-	-	**5**	1,450	-	3	**1,453**
Past due over 90 days	-	-	-	**-**	-	-	32	**32**
Total	**24**	**-**	**-**	**24**	**2,450**	**100**	**47**	**2,597**
Value of collateral	1	-	-	**1**	1,787	100	26	**1,913**
2009								
Past due up to 30 days	12	-	-	**12**	-	171	207	**378**
Past due 30 – 60 days	3	-	-	**3**	-	-	12	**12**
Past due 60 – 90 days	3	-	-	**3**	-	-	191	**191**
Past due over 90 days	-	-	-	**-**	1,976	-	27	**2,003**
Total	**18**	**-**	**-**	**18**	**1,976**	**171**	**437**	**2,584**
Value of collateral	-	-	-	**-**	1,250	113	202	**1,565**

Notes to the financial statements (continued)

35. Risk management (continued)

35.1. Credit risk (continued)

35.1.2. Credit risk management and policies for impairment and provisions (continued)

c) Non-performing loans (impaired loans)

The classification of loans to customers that are impaired, together with the assessed value of associated collateral, is as follows:

	Loans to individuals				**Loans to legal entities**			
	Custumer loans	Housing loans	Credit card loans and overdrafts	**Total**	Large	Medium	Small	**Total**
2010	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**	**BAM '000**
Non-performing loans	12,283	1,678	1,660	15,621	9,632	23,672	21,941	55,245
Value of collateral	366	1,476	-	1,842	9,632	22,633	12,830	45,095
2009								
Non-performing loans	11,666	2,120	1,296	15,082	5,018	16,363	20,256	41,637
Value of collateral	234	1,869	-	2,103	4.457	13,364	8,423	26,244

The data shown in the table above is presented in gross amounts.

As at 31 December 2010, foreclosed assets amounted to BAM 282 thousand (2009: BAM 416 thousand), which is recorded off-balance.

d) Rescheduled loans and receivables

Rescheduled loans that would otherwise be past due or impaired as at 31 December 2010 amounted to a total of BAM 12,734 thousand (2009: BAM 9,545 thousand).

	2010	**2009**
Loan portfolio (BAM'000)	464,029	431,173
Rescheduled loans (BAM'000)	12,734	9,545
Rescheduled loans recorded as % of loan portfolio	2.7%	2.2%

Notes to the financial statements (continued)

35. Risk management (continued)

35.2. Liquidity risk

Liquidity risk arises in the general funding of the Bank’s activities and in the management of positions. The Bank consolidates its operations in respect of liquidity risk in accordance with applicable regulations and internal policies aimed at the maintenance of liquidity reserves, matching of assets and liabilities in accordance with defined policies and limits of the UniCredit Group.

Through its decision on minimum standards for liquidity risk management for banks, the BARS prescribes minimum standards for the creation and implementation of liquidity policy.

Under this Act the Bank shall:

1. maintain alignment of remaining maturity to the contracted maturity date for financial assets and financial liabilities so that it:

– engages at least 75% of funding sources with maturities of up to 180 days in placements with maturity of up to 180 days;

– engages at least 80% of funding sources with maturities of up to 90 days in placements with maturity of up to 90 days;

– engages at least 85% of funding sources with maturity of up to 30 days in placements with maturities of up to 30 days.

2. The Bank is required to maintain an average ten-day solvency minimum in its short-term portfolio of assets (cash, placements with the Central bank and short-term placements up to 7 days at domestic and foreign banks) in all currencies, amounting to at least 10% of short-term funding sources according to the carrying value on the last day of previous month, provided that the amount of funds shall not be less than 5% on any given day.

The Department for Assets and Liabilities Management manages solvency reserves on a daily basis, ensuring that all clients’ requirements are met and maintaining balance between the continuity of funding and flexibility through the use of sources with different maturities. In addition, it ensures the matching of liquidity with the above-mentioned legislation and the internal regulations of the Group. Daily control of short-term liquidity calculations in accordance with the guidelines of the Group pursuant to the defined rules, is the responsibility of the Market Risk Department.

Requirements for short-term liquidity are planned each month for a period of six months, and are monitored and restated on a daily basis.

The Bank has access to various funding sources that include various types of deposits of individuals, legal entities, banks, borrowings, subordinated debt, issued bonds, and share capital. These sources enable flexibility of funding sources, reduce dependence on one source of funding and facilitate better management of funding costs.

The liquidity management process includes development of annual plans and the development of liquidity back-up plans.

Notes to the financial statements (continued)

35. Risk management (continued)

35.2. Liquidity risk (continued)

Tables below analyse the assets and liabilities of the Bank into relevant maturity groupings based on the remaining period from the reporting date to the contractual maturity date. The maturity of assets and liabilities and the possibility of reprogramming of interest-bearing liabilities on their maturity date, at an affordable cost, are important factors in assessing the liquidity of the Bank and its exposure to risks due to changes in interest rates and exchange rates. The remaining maturity of assets and liabilities as at 31 December 2010 and 31 December 2009 is as follows:

	Up to 1 month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
31 December 2010						
ASSETS						
Cash and cash equivalents	42,513	-	-	-	-	42,513
Obligatory reserve with the Central bank	47,974	-	-	-	-	47,974
Placements with and loans to banks	27,252	-	1,193	-	-	28,445
Loans to customers	25,847	40,349	87,678	180,201	90,219	424,294
Financial assets available for sale	50	-	50	352	10	462
Property and equipment	-	-	-	-	22,485	22,485
Intangible assets	-	-	-	-	6,178	6,178
Accrued interest and other assets	4,461	504	1,300	10	17	6,292
TOTAL ASSETS	**148,097**	**40,853**	**90,221**	**180,563**	**118,909**	**578,643**
LIABILITIES AND EQUITY						
Transaction accounts and bank deposits	275	17,603	33,249	-	-	51,127
Transaction accounts and deposits	155,693	36,144	93,953	80,582	323	366,695
Borrowings	457	1,355	7,828	34,130	34,741	78,511
Accrued interest and other liabilities	3,455	250	2,050	2,765	-	8,520
Provisions for liabilities and charges	781	142	163	1,304	-	2,390
Current tax liability		191				191
Net deferred tax liability	-	-	-	353	-	353
Equity	-	-	-	-	70,856	70,856
TOTAL LIABILITIES AND EQUITY	**160,661**	**55,685**	**137,243**	**119,134**	**105,920**	**578,643**
Maturity Gap	**(12,564)**	**(14,832)**	**(47,022)**	**61,429**	**12,989**	**-**

Notes to the financial statements (continued)

35. Risk management (continued)

35.2. Liquidity risk (continued)

31 December 2009	Up to 1 month BAM '000	From 1 to 3 months BAM '000	From 3 to 12 months BAM '000	From 1 to 5 years BAM '000	Over 5 years BAM '000	Total BAM '000
ASSETS						
Cash and cash equivalents	102,752	-	-	-	-	102,752
Obligatory reserve with the Central bank	45,966	-	-	-	-	45,966
Placements with and loans to banks	34,441	3,912	-	-	-	38,353
Loans to customers	39,280	19,335	85,379	173,852	76,916	394,762
Financial assets available for sale	50	-	50	675	10	785
Property and equipment	-	-	-	-	24,373	24,373
Intangible assets	-	-	-	-	8,657	8,657
Accrued interest and other assets	4,486	313	-	8	23	4,830
TOTAL ASSETS	**226,975**	**23,560**	**85,429**	**174,535**	**109,979**	**620,478**
LIABILITIES AND EQUITY						
Transaction accounts and bank deposits	245	29,338	43,028	-	-	72,611
Transaction accounts and su deposits	153,762	58,650	96,392	91,894	325	401,023
Borrowings	265	986	6.115	28.628	31.491	67.485
Accrued interest and other liabilities	3,990	213	750	2,236	-	7,189
Provisions for liabilities and charges	548	112	262	304	-	1,226
Current tax liability		37				37
Net deferred tax liability	-	-	-	344	-	344
Equity	-	-	-	-	70,563	70,563
TOTAL LIABILITIES AND EQUITY	**158,810**	**89,336**	**146,547**	**123,406**	**102,379**	**620,478**
Maturity Gap	**68,165**	**(65,776)**	**(61,118)**	**51,129**	**7,600**	**-**

Notes to the financial statements (continued)

35. Risk management (continued)

35.3. Currency risk

Exposure to currency risk arises from credit, deposit and trading activities and is controlled on a daily basis in accordance with legal and internal limits set by the UniCredit Group for each currency and in total amount for assets and liabilities denominated in or linked to foreign currency.

Daily monitoring of foreign exchange risk calculations in accordance with Group instructions is in compliance with defined regulations for monitoring of movements in the conversion accounts for each currency and is in the domain of market risk.

Exposure to this risk is monitored on a daily basis in accordance with legally and internally determined limits for each currency, and the total amount for assets and liabilities denominated in foreign currency or linked to a foreign currency clause. The Bank currently measures the risk of exposure to changes in foreign exchange rates through the openess of the position in foreign currencies in relation to set limits.

A majority of the Bank's activities exposes the Bank to risk in respect of fluctuations in the EUR exchange rate. Due to the Currency Board policy according to which the ratio of the local currency to the EUR is fixed, the exposure of the Bank to foreign exchange rate risk can be considered to be not materially significant.

The Bank protects itself from risk in respect of exposure to open positions in foreign currencies other that the EUR through derivative financial instruments for the purpose of managing assets and liabilities (currency swap, curreny clause agreements).

The Bank is in the process of defining the daily maximum allowable loss due to open positions in foreign currencies, and will also monitor the exposure risk through application of daily VaR (Value at Risk) in the forthcoming period.

Notes to the financial statements (continued)

35. Risk management (continued)

35.3. Currency risk (continued)

An analysis of assets and liabilities shown in foreign currency as at 31 December 2010 is presented in the table below:

	EUR	EUR linked	USD	Other foreign currency	Total foreign currency	BAM	Total
	BAM'000	BAM'000	BAM'000	BAM'000	BAM'000	BAM'000	BAM'000
31 December 2010							
ASSETS							
Cash reserves	3,683	-	467	2,008	6,158	36,355	42,513
Obligatory reserve with the Central Bank	-	-	-	-	-	47,974	47,974
Placements with and loans to banks	20,223	-	4,050	2,979	27,252	1,193	28,445
Loans to customers	122,194	211,600	-	-	333,794	90,500	424,294
Financial assets available for sale	-	110	-	-	110	352	462
Property and equipment	-		-	-	-	22,485	22,485
Intangible assets	-		-	-	-	6,178	6,178
Accrued interest and other assets	1,034	586	50	-	1,670	4,622	6,292
TOTAL ASSETS	**147,134**	**212,296**	**4,567**	**4,987**	**368,984**	**209,659**	**578,643**
LIABILITIES AND EQUITY							
Current accounts and deposits from banks	50,856	90	10	-	50,956	171	51,127
Current accounts and deposits from customers	158,519	31,598	4,493	4,689	199,299	167,396	366,695
Borrowings	21,320	57,191	-	-	78,511	-	78,511
Accrued interest and other liabilities	2,718	273	20	26	3,037	5,483	8,520
Provisions for liabilities and charges	29		-	-	29	2,361	2,390
Current tax liabilities	-	-	-	-	-	191	191
Net deferred tax liability	-	-	-	-	-	353	353
Equity	-	-	-	-	-	70,856	70,856
TOTAL LIABILITIES AND EQUITY	**233,442**	**89,152**	**4,523**	**4,715**	**331,832**	**246,811**	**578,643**
Net foreign exchange position	**(86,308)**	**123,144**	**44**	**272**	**37,152**	**(37,152)**	**-**

A 10% fall in currencies (other than EUR) against BAM, if all other variables remain constant, would result in a decrease in profit after tax for 2010 of BAM 32 thousand (2009: BAM 58 thousand).

A 10% rise for these currencies would result in an increase in profit after tax for 2010 of BAM 32 thousand (2009: BAM 58 thousand).

Notes to the financial statements (continued)

35. Risk management (continued)

35.3. Currency risk (continued)

	EUR BAM'000	EUR linked BAM'000	USD BAM'000	Other foreign currency BAM'000	Total foreign currency BAM'000	BAM BAM'000	Total BAM'000
31 December 2009							
ASSETS							
Cash reserves	8,201	-	790	1,388	10,379	92,373	102,752
Obligatory reserve with the Central Bank	-	-	-	-	-	45,966	45,966
Placements with and loans to banks	30,509	-	6,004	1,840	38,353	-	38,353
Loans to customers	147,822	183,632	-	-	331,454	63,308	394,762
Financial assets available for sale	-	210	240	-	450	335	785
Property and equipment	-	-	-	-	-	24,373	24,373
Intangible assets	-	-	-	-	-	8,657	8,657
Accrued interest and other assets	188	588	27	-	803	4,027	4,830
TOTAL ASSETS	**186,720**	**184,430**	**7,061**	**3,228**	**381,439**	**239,039**	**620,478**
LIABILITIES AND EQUITY							
Current accounts and deposits from banks	72,367	100	-	-	72,467	144	72,611
Current accounts and deposits from customers	197,063	33,866	6,941	2,739	240,609	160,414	401,023
Borrowings	23,601	43,884	-	-	67,485	-	67,485
Accrued interest and other liabilities	1,971	234	9	22	2,236	4,953	7,189
Provisions for liabilities and charges	-	-	-	-	-	1,226	1,226
Current tax liabilities	-	-	-	-	-	37	37
Net deferred tax liability	-	-	-	-	-	344	344
Equity	-	-	-	-	-	70,563	70,563
TOTAL LIABILITIES AND EQUITY	**295,002**	**78,084**	**6,950**	**2,761**	**382,797**	**237,681**	**620,478**
Net foreign exchange position	**(108,282)**	**106,346**	**111**	**467**	**(1,358)**	**1,358**	**-**

Foreign exchange rate

The official exchange rates applied for recalculation of the balance sheet positions as at 31 December 2010 and 2009 for the following more significant currencies was:

	31 December 2010	31 December 2009
USD	1.472764	1.364088
CHF	1.567800	1.314579
EUR	1.955830	1.955830

Notes to the financial statements (continued)

35. Risk management (continued)

35.4. Interest rate risk

The Bank's activities are under the influence of interest rate fluctuations, to the extent that interest bearing assets and liabilities mature or their interest rates change at different times or in different amounts.

Exposure to interest rate risk is monitored within the Risk Management Department through specified reports and guidelines of the Group and is in the domain of market risk.

The Bank assesses exposure to interest rate risk on the basis of the influence of changes in interest rates by 1pp on net interest income for a period of 12 months. A simulation is performed based on simultaneous growth or decline in interest rate items in the balance sheet of the Bank sensitive to changes in interest rates, whereas changes in net interest income due to changes in interest rates should not exceed 10% of planned net interest income.

Sensitivity analysis

Taking into consideration discrepancies between assets and liabilities in the observed periods: up to one month, 1-3 months and 3-12 months, an assessment of the impact of interest rate change was performed +/-1pp on the net interest income of the Bank for 2010 and for 2009. From the above-mentioned assumptions it was estimated that a decrease in the interest rate of 1pp would cause a decrease in net interest income for 2010 in the amount of BAM 1,045 thousand, or 3%. A simulation of the influence of changes in interest rates on the net interest income in the previous year resulted in almost the same effect as in 2010. The effects are presented in the following table:

	2010	**2009**
Potential decrease in net interest income (BAM '000)	(1,045)	(1,017)
% of decrease in planned net interest income	(3%)	(3%)

A view of the Bank's exposure to interest rate risk as at 31 December 2010 and 31 December 2009 is shown on the following pages.

The Bank is in the process of establishing stress testing in accordance with methodology and models developed by the Group, and will also measure exposure to interest rate risk in relation to the economic value of equity in the future.

Notes to the financial statements (continued)

35. Risk management (continued)

35.4. Interest rate risk (continued)

a) Interest rate repricing, gap analysis and amounts subject to fixed interest rates

The Bank is exposed to various risks which associated with the effects of fluctuations in the prevailing levels of market interest rates have an impact on its financial position and cash flows. The following table presents the estimate of the interest rate risk for the Bank as at 31 December 2010 and 2009, as well as sensitivities of the Bank's earnings to movements in interest rates, which is not necessarily indicative for forthcoming periods. Earnings will also be affected by the maturity structure of the Bank's assets and liabilities.

	Up to 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Non-interest bearing	Total	Amounts subject to fixed rates
	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000	BAM '000
31 December 2010								
ASSETS								
Cash reserves	30,590	-	-	-	-	11,923	**42,513**	-
Obligatory reserve with the Central Bank	47,974	-	-	-	-	-	**47,974**	-
Placements with and loans to banks	27,252	-	1,193	-	-	-	**28,445**	-
Loans to customers	297,187	82,295	32,261	6,134	6,417	-	**424,294**	14,064
Financial assets available for sale	50	-	50	-	10	352	**462**	110
Property and equipment	-	-	-	-	-	22,485	**22,485**	-
Intangible assets	-	-	-	-	-	6,178	**6,178**	-
Accrued interest and other assets	-	-	-	-	-	6,292	**6,292**	-
TOTAL ASSETS	**403,053**	**82,295**	**33,504**	**6,134**	**6,427**	**47,230**	**578,643**	**14,174**
LIABILITIES AND EQUITY								
Transaction accounts and deposits from banks	90	17,603	33,249	-	-	185	**51,127**	-
Transaction accounts and deposits from customers	289,035	7,581	23,118	25,754	-	21,207	**366,695**	61,629
Borrowings	456	42,106	21,697	6,484	6,856	912	**78,511**	15,094
Accrued interest and other liabilities	-	-	-	-	-	8,520	**8,520**	-
Provisions for liabilities and charges	-	-	-	-	-	2,390	**2,390**	-
Current tax liabilities	-	-	-	-	-	191	**191**	-
Net deferred tax liability	-	-	-	-	-	353	**353**	-
Equity	-	-	-	-	-	70,856	**70,856**	-
TOTAL LIABILITIES AND EQUITY	**289,581**	**67,290**	**78,064**	**32,238**	**6,856**	**104,614**	**578,643**	**76,723**
Interest rate gap	**113,472**	**15,005**	**(44,560)**	**(26,104)**	**(429)**	**(57,384)**	**-**	**(62,549)**

Notes to the financial statements (continued)

35. Risk management (continued)

35.4. Interest rate risk (continued)

a) Interest rate repricing, gap analysis and amounts subject to fixed interest rates (continued)

	Up to 1 month BAM '000	1 – 3 months BAM '000	3 months to 1 year BAM '000	1 – 5 years BAM '000	Over 5 years BAM '000	Non-interest bearing BAM '000	Total BAM '000	Amounts subject to fixed rates BAM '000
31 December 2009								
ASSETS								
Cash reserves	86,410	-	-	-	-	16,342	**102,752**	-
Obligatory reserve with the Central Bank	45,966	-	-	-	-	-	**45,966**	45,966
Placements with and loans to banks	34,441	3,912	-	-	-	-	**38,353**	-
Loans to customers	240,776	103,172	36,667	6,140	8,007	-	**394,762**	15,559
Financial assets available for sale	50	-	50	100	10	575	**785**	210
Property and equipment	-	-	-	-	-	24,373	**24,373**	-
Intangible assets	-	-	-	-	-	8,657	**8,657**	-
Accrued interest and other assets	-	-	-	-	-	4,830	**4,830**	-
TOTAL ASSETS	**407,643**	**107,084**	**36,717**	**6,240**	**8,017**	**54,777**	**620,478**	**61,735**
LIABILITIES AND EQUITY								
Transaction accounts and deposits from banks	53,052	-	19,559	-	-	-	**72,611**	19,559
Transaction accounts and deposits from customers	284,665	10,138	57,136	28,798	-	20,286	**401,023**	129,075
Borrowings	265	27,304	21,711	6,598	10,574	1,033	**67,485**	19,335
Accrued interest and other liabilities	-	-	-	-	-	7,189	**7,189**	-
Provisions for liabilities and charges	-	-	-	-	-	1,226	**1,226**	-
Current tax liabilities	-	-	-	-	-	37	**37**	-
Net deferred tax liability	-	-	-	-	-	344	**344**	-
Equity	-	-	-	-	-	70,563	**70,563**	-
TOTAL LIABILITIES AND EQUITY	**337,982**	**37,442**	**98,406**	**35,396**	**10,574**	**100,678**	**620,478**	**167,969**
Interest rate gap	**69,661**	**69,642**	**(61,689)**	**(29,156)**	**(2,557)**	**(45,901)**	**-**	**(106,234)**

Notes to the financial statements (continued)

35. Risk management (continued)

35.4. Interest rate risk (continued)

a) Interest rate repricing, gap analysis and amounts subject to fixed interest rates (continued)

The estimated future cash flows for the Bank's interest bearing liabilities as at 31 December 2010 and 31 December 2009 are shown in the following table:

	Up to 1 month	1 – 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total
	BAM'000	BAM'000	BAM'000	BAM'000	BAM'000	BAM'000
31 December 2010						
LIABILITIES						
Transaction accounts and deposits from banks	275	17,603	34,049	-	-	**51,927**
Transaction accounts and deposits from customers	155,800	36,267	95,766	83,687	323	**371,843**
Borrowings	537	1.601	8,913	37,690	36,982	**85,723**
Other liabilities	2,022	250	2,050	1,513	-	**5,835**
Total liabilities	**158,634**	**55,721**	**140,778**	**122,890**	**37,305**	**515,328**
31 December 2009						
LIABILITIES						
Transaction accounts and deposits from banks	392	29.338	43.443	-	-	**73,173**
Transaction accounts and deposits from customers	154,131	59,032	98,590	94,029	325	**406,107**
Borrowings	310	1,182	7,111	32,753	34,416	**75,772**
Other liabilities	2,845	250	750	1,370	-	**5,215**
Total liabilities	**157,678**	**89,802**	**149,894**	**128,152**	**34,741**	**560,267**

b) Effective interest rates

The following table presents the effective interest rates calculated as the weighted average for the reporting period for financial instruments:

	2010	2009
	%	%
Cash reserves	0.32	0.50
Obligatory reserve with the Central Bank	0.41	0.66
Placements with and loans to banks	0.42	0.98
Loans to customers	9.10	9.31
Debt securities available for sale	5.75	5.75
Transaction accounts and deposits from banks	2.55	3.46
Transaction accounts and deposits from customers	2.29	2.48
Borrowings	2.72	2.27

Notes to the financial statements (continued)

35. Risk management (continued)

35.5. Operational risk

Operational risk is the risk of loss for the bank or negative effects on the bank's equity due to inadequate or poor internal processes, systems and procedures, as well as due to errors made by employees during their work or the result of externally caused events.

Operational risk events are events resulting from inadequate or failed internal processes, people and systems or from systemic or other external events: internal or external fraud, relations with employees and safety at the workplace, customer complaints, distribution of products, fines and penalties for violations of regulations, damage to tangible assets of the Bank, work disruptions and errors in the system and management processes.

Based on rules and methodology of the Group as well as local regulations, the Bank has established the basic elements for an operational risk management system.

The operational risk management system includes tools and mechanisms for continuous monitoring of damages incurred by the Bank through operational risk and the Bank's exposure to operational risk, assessment of operational risk within processes and products, defining ways to avoid, control or transfer operational risk to third parties, as well as a reporting system.

The Bank's management and the Group are regularly informed and receive reports in respect of the aforementioned processes and indicators included in the operational risk management system. In addition, the operational risk management system is regularly aligned with the standards of the UniCredit Group and local and international regulations.

35.6. Capital management

The Bank's objectives in capital management are:

- compliance with capital requirements set by regulators of banking markets where the Bank's units are operating,
- to safeguard the Bank's ability to continue as a going concern basis so that it can continue to provide returns for shareholders and benefits for other stakeholders, and
- maintenance of a strong capital position to support the development of its business activities.

The Bank monitors capital adequacy using techniques based on the regulatory requirements of the BARS. Minimum equity standards prescribed by law and other regulations are: maintenance of minimum levels of net capital, maintenance of the ratio of total net capital and risk weighted assets at the prescribed minimum of 12%.

Net capital of the Bank, which is the amount used for calculating the Bank's capital adequacy ratio, represents the sum of core and supplementary capital, decreased by deductible items consisting of, *inter alia,* the amount of insufficient impairment allowance for loans and other assets in accordance with regulations of the BARS.

Notes to the financial statements (continued)

35. Risk management (continued)

35.6. Capital management (continued)

The core capital (tier 1) of the Bank consists of: share capital (ordinary shares), share premium, revaluation reserves, statutory reserves and retained profit from previous years, less intangible assets.

Supplementary capital (tier 2) of the Bank consists of general loan loss provision calculated by BARS methodology on assets of the Bank classified in Category A (performing assets) and current year profit, verified by an external auditor.

Core, supplementary, net capital and capital adequacy calculated pursuant to the BARS' regulations, are presented in the following table:

	2010 BAM '000	**2009 BAM '000**
Tier 1 capital		
Ordinary shares	62,054	62,054
Share premium	373	373
Reserves	4,555	4,905
Intangible assets	(6,178)	(9,799)
Total tier 1 capital	**60,804**	**57,533**
Tier 2 capital		
General provision	8,684	8,009
Audited profit for the year	378	39
Total tier 2 capital	**9,062**	**8,048**
Insufficient reserves per regulatory requirement	**(2,365)**	-
Net capital	**67,501**	**65,581**
Risk weighted assets		
Credit risk weighted assets	448,748	419,868
Weighted operational risk	47,095	604
Total weighted risk	**495,843**	**420,472**
Capital adequacy (%)	**13.6**	**15.6**

Data for 2010 and 2009 are shown according to regulations valid in the respective year. Due to changes in IAS and IFRS in 2010, the BARS changed regulations relating to the calculation of capital adequacy.

Notes to the financial statements (continued)

36. Funds managed for and on behalf of third parties

The Bank manages funds for and on behalf of third parties, it maintains these funds off-balance sheet separated from its assets. The Bank charges a fee for managing funds for and on behalf of third parties. Income and expenses for these funds are posted as income or expense of the owner, i.e. user.

Placements under activities for and on behalf of third parties are presented in the table below:

	2010 BAM '000	2009 BAM '000
Commission deals - Telekom RS	3,387	3,137
Commission deals - IFAD I	13,797	13,808
Commission placements - MCI	600	499
Total	**17,784**	**17,444**

Total fees earned for managing funds for and on behalf of third parties amounted to BAM 38 thousand in 2010 (2009: BAM 24 thousand).

37. Operating lease commitments

The Bank has 29 operating lease contracts. The contracts relate to rental premises for branches of the Bank and for installed ATMs.

The future minimum lease payments under the above-mentioned operating leases are summarised in the table below:

	2010 BAM '000	2009 BAM '000
Up to 1 year	749	812
From 1 to 5 years	3,747	3,747
Over 5 years	117	191
	4,613	**4,750**

38. Fair value of financial assets and liabilities

Fair value represents the amount for which a certain asset can be replaced or liability settled between knowledgeable parties on an arm's length basis. It can be defined as the value under which assets/liabilities can be disposed of, or the estimated value of neutralization of market risk which is incurred from these assets/liabilities in the corresponding time period.

Assumptions used in the estimation of fair value of certain financial instruments are stated below.

Loans to customers

The fair value of loans is calculated based on discounted expected future principal and interest cash flows. Expected future cash flows are estimated taking into consideration credit risks and all indicators of impairment, that are determined in accordance with relevant standards.

Notes to the financial statements (continued)

38. Fair value of financial assets and liabilities (continued)

Loans to customers (continued)

The estimated fair values of loans reflect changes in loan status from the moment the loans were approved and changes in interest rates for loans with a fixed interest rate. In 2010 the Bank has corporate loans with a fixed interest rate in the amount of BAM 45 thousand, and some BAM 82 thousand in loans with a fixed interest rate in 2009. Under the assumption that the corporate market interest rate is 8.4% p.a. for long-term foreign currency loans (2009: corporate market interest rate was 7.69% p.a. for long-term foreign currency loans), expected future cash flows from loans with fixed interest rates are discounted to present value.

The Management Board estimated fair value in accordance with assumptions for the above-mentioned loans of legal entities and it was determined that there was no significant difference between the carrying and fair value of these instruments.

In dealing with individuals, the Bank grants loans with a contracted clause on variability of the interest rate in accordance with a Bank decision. An exception is loans given to individuals from the credit line of the Housing Fund of the Republic of Srpska which have a fixed interest rate. Given that these loans are aligned with the source of funding in terms of maturity, currency and interest structure, the Bank does not perform an estimate of fair value either of that financial asset or corresponding liabilities.

Placements with and loans to banks

Fair value of placements with and loans to other banks do not deviate significantly from their carrying value given these are mostly short-term deposits.

Transaction accounts and deposits from banks and customers

The estimated fair value of deposits with fixed maturity is based on discounted cash flows according to currently valid interest rates for deposits with similar remaining maturity.

For sight deposits which have no defined maturity, fair value is the amount paid at sight on the balance sheet date.

The value of short-term relations with depositors is not take into consideration in the estimate of fair value.

Under the assumption that the average market interest rate in local currency on long-term deposits of legal entities amounts to 3.5% and (2009: legal entities – long-term, 4.5%) and considering the events in the market, expected future cash flows on long-term deposits of legal entities with a fixed interest rate was discounted to present value.

Based on the above assumption, the Management Board has estimated the fair value of deposits from legal entities in the amount of BAM 186,544 thousand, which is BAM 1,030 thousand less than the carrying value (2009: BAM 252,701 thousand which was BAM 780 thousand less than the carrying value).

The fair value of deposits from individuals was estimated under the assumption that the average market interest rate in foreign currency on long-term deposits of individuals amounts to 3.7% and (2009: individuals long-term, 4.2%) and considering the events in the market, expected future cash flows on long-term deposits of individuals with a fixed interest rate was discounted to present value.

Based on the above assumption, the Management Board has estimated the fair value of deposits of individuals in the amount of BAM 179,112 thousand, which is BAM 9 thousand less than the carrying value (2009: BAM 147,596 thousand which is BAM 54 thousand more than the carrying value).

Notes to the financial statements (continued)

38. Fair value of financial assets and liabilities (continued)

Borrowings

The majority of the Bank's long-term debt was agreed with a variable interest rate and its fair value is estimated as the present value of future cash flows, discounted at the interest rate available at the balance sheet date for new debt of similar type and remaining maturity. Management has estimated that the carrying value of borrowings is not significantly different from their fair value.

An exception is the credit line from the Housing Fund of the Republic of Srpska, which was contracted with a fixed interest rate, but taking into considerations that the loans funded from this credit line were also placed with a fixed interest rate, it is considered that there is complete alignment and no influence of changes in interest rates, and thus the Bank did not perform a calculation of fair value of these liabilities.