Intesa Sanpaolo Banka d.d. Bosna i Hercegovina

Financial statements for the year ended 31 December 2010 and Independent auditors' report

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Pursuant to the Law on Accounting and Audit of Federation of Bosnia and Herzegovina (Official Gazette No. 83/2009), the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia & Herzegovina, which give a true and fair view of the state of affairs and results of the Intesa Sanpaolo Banka Bosna and Hercegovina d.d. for that period.

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

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

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

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Accounting and Auditing Law of Federation of Bosnia and Herzegovina. The Management Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Management Board

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina

Almir Krkalić, Director
Intesa Sanpaolo banka d.d. Bosna i Hercegovina
Obala Kulina bana 9a
71000 Sarajevo
Bosnia and Herzegovina

22 February 2011

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF INTESA SANPAOLO BANKA D.D. BOSNA I HERCEGOVINA

We have audited the accompanying financial statements of Intesa Sanpaolo Banka D.D. Bosna i Hercegovina (hereinafter: the Bank), which comprise the balance sheet as at 31 December 2010, and the income statement, 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.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia & Herzegovina, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity'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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2010, and of its financial performance and its cash flows for the year then ended in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia & Herzegovina.

Sarajevo, 22 February 2011
REVSAR d.o.o. Sarajevo

Alma Malinović
Certified Auditor

DRUŠTVO ZA REVIZIJU »REVSAR« d.o.o. SARAJEVO

Intesa Sanpaolo Banka, d.d. BiH
Statement of income for the year ended 31 December 2010
(all amounts are expressed in thousands of KM)

	Notes	2010	2009
Interest income	5	71,745	66,541
Interest expense	6	(22,563)	(24,612)
Net interest income		**49,182**	**41,929**
Fee and commission income	7	12,293	11,558
Fee and commission expense	8	(2,727)	(2,798)
Net fee and commission income		**9,566**	**8,760**
Net foreign exchange income	9	1,467	878
Other operating income	10	909	894
Operating income		**2,376**	**1,772**
Personnel expenses	11	(18,260)	(17,398)
Administrative expenses	12	(17,253)	(15,908)
Depreciation of fixed assets	23	(4,902)	(4,240)
Operating Expense		**(40,415)**	**(37,546)**
PROFIT BEFORE IMPAIRMENT LOSSES, PROVISIONS AND INCOME TAX		**20,709**	**14,915**
Impairment losses and provisions	13	(18,508)	(14,739)
Recoveries of written off loans	14	4,743	3,842
PROFIT BEFORE INCOME TAX		**6,944**	**4,018**
Income tax	15	(883)	(527)
NET PROFIT FOR THE YEAR		**6,061**	**3,491**
Earnings per share (KM)	16	**13,47**	**7.71**

The accompanying notes form an integral part of these financial statements.

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina
on 22 February 2011:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina

Almir Krkalić
Director

Dario Grassani
Executive Director of Finance

Statement of comprehensive income for the year ended 31 December 2010

(all amounts are expressed in thousands of KM)

	2010	2009
Profit for the year	6,061	3,491
Other comprehensive income for the year		
Net gains/(losses) on financial assets available for sale:		
Gains arising during the year	93	41
Losses during the year	(18)	-
Reclassification adjustments for gains included in the statement of income	(87)	(305)
Income tax relating to items of other comprehensive income	(1)	28
Total comprehensive income for the year, net of tax	**6,048**	**3,255**

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on 22 February 2011:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina

Almir Krkalić
Director

Dario Grassani
Executive Director of Finance

Intesa Sanpaolo Banka, d.d. BiH
Statement of financial position at 31 December 2010
(all amounts are expressed in thousands of KM)

	Notes	31 December 2010	31 December 2009
ASSETS			
Cash and cash equivalents	17	66,364	100,503
Obligatory reserve with the Central Bank	18	97,789	88,772
Placements with other banks	19	190,264	134,678
Loans and receivables	20	890,860	798,795
Assets available for sale	21	979	542
Other assets	22	9,238	7,968
Property, plant and equipment	23	25,604	28,360
TOTAL ASSETS		**1,281,098**	**1,159,618**
LIABILITIES			
Due to banks and other institutions	24	449,297	361,270
Subordinated debt	25	1,244	1,404
Due to customers	26	689,597	662,741
Financial liabilities held for trading	27	-	761
Other liabilities	28	6,826	5,537
Other provisions	29	2,299	2,046
Provisions for contingent liabilities and commitments	30	2,637	2,709
TOTAL LIABILITIES		**1,151,900**	**1,036,468**
SHAREHOLDERS' EQUITY			
Share capital		44,782	45,296
Reserves and retained earnings		84,416	77,854
TOTAL SHAREHOLDER'S EQUITY		**129,198**	**123,150**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**1,281,098**	**1,159,618**
FINANCIAL COMMITMENTS AND CONTINGENCIES	30	127,149	120,332

The accompanying notes form an integral part of these financial statements.

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina
on 22 February 2011:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina

Almir Krkalić
Director

Dario Grassani
Executive Director of Finance

Intesa Sanpaolo Banka, d.d. BiH
Statement of cash flows for the year ended 31 December 2010
(all amounts are expressed in thousands of KM)

	2010	2009
Operating activities		
Net Income	6,061	3,491
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,902	4,240
Impairment losses and provisions	18,508	14,739
Changes in other provisions, net	293	280
(Gain) on sale or disposal of property, plant and equipment	(62)	(343)
Changes in operating assets and liabilities:		
Net (increase)/decrease in due from Central Bank	(9,017)	27,924
Net increase in placements with other banks, before impairment losses	(55,588)	(29,224)
Net increase in loans and receivables, before impairment losses	(109,546)	(85,777)
Net (increase) in other assets, before impairment losses	(1,419)	(2,010)
Net increase due to banks	21,902	4,885
Net increase in demand and term deposits	26,854	128,360
Net (decrease)/increase in other liabilities	(451)	98
NET CASH FROM/(USED IN) OPERATING ACTIVITIES	**(97,563)**	**66,663**
Investing Activities		
Net increase in assets available for sale, before impairment losses	(459)	28
Net purchases of property and equipment	(2,414)	(5,416)
Proceeds from sale of property, plant and equipment	330	841
NET CASH USED IN INVESTING ACTIVITIES	**(2,543)**	**(4,547)**
Financing Activities		
Net proceeds from borrowings	66,125	24,001
Net repayments of subordinated debt	(158)	(9,952)
Increase in share capital	-	-
(Purchase)/sale of treasury shares	-	(2,467)
NET CASH PROVIDED BY FINANCING ACTIVITIES	**65,967**	**11,582**
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	**(34,139)**	**73,698**
CASH AND CASH EQUIVALENTS AT 1 JANUARY	**100,503**	**26,805**
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**66,364**	**100,503**

Operational cash flow from interest and dividends

Interest paid	24,045	25,045
Interest received	67,357	61,669
Dividend received	-	116

The accompanying notes form an integral part of these financial statements.

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina
on 22 February 2011:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina

Almir Krkalić
Director

Dario Grassani
Executive Director of Finance

Statement of changes in shareholders' equity for the year ended 31 December 2010

(all amounts are expressed in thousands of KM)

	Share capital	Treasury shares	Share Premium	Fair Value reserves	Retained earnings and reserves	Total
Balance as at 31 December 2008	45,296	-	59,368	242	17,456	122,362
Total comprehensive income	-	-	-	(236)	3,491	3,255
Purchase/Sale of treasury shares	-	(514)	(1,953)	-	-	(2,467)
Balance as at 31 December 2009	**45,296**	**(514)**	**57,415**	**6**	**20,947**	**123,150**
Balance as at 31 December 2009	45,296	(514)	57,415	6	20,947	123,150
Total comprehensive income	-	-	-	(13)	6,061	6,048
Purchase/Sale of treasury shares	(514)	514	-	-	-	-
Balance as at 31 December 2010	**44,782**	**-**	**57,415**	**(7)**	**27,008**	**129,198**

The accompanying notes form an integral part of these financial statements.

Approved by and signed on behalf of Intesa Sanpaolo Banka d.d. Bosna i Hercegovina on 22 February 2011:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina

Almir Krkalić
Director

Dario Grassani
Executive Director of Finance

(all amounts are expressed in thousands of KM)

1. GENERAL

History and incorporation

Intesa Sanpaolo Banka d.d. Bosna i Hercegovina, former UPI banka d.d. Sarajevo, Obala Kulina Bana 9a (the "Bank") is registered in the Cantonal Court in Sarajevo on 20 October 2000.

The Bank was established in 1972 as an internal bank of the corporate system of the Udružena poljoprivreda, prehrambena industrija i promet (Associated Agriculture and Food Industries and Sales), aimed at supporting the operations of these sectors, which at the time employed more than 35,000 workers. Since 1990, a new phase is coming in the development of the Bank, when it was registered as a shareholding company and it is in a majority state ownership (92 %). The Bank starts with expansion of the network of corporate clients, focusing on the sector of small and medium entrepreneurship. As early as from the year 2000, through the emission of shares, the Bank was fully transferred into the hand of private capital.

In February 2006, Intesa Sanpaolo Holding International S.A. took over the major share package of UPI Banka d.d. Sarajevo, and became the major owner of the Bank's shares.

On 31 July 2007 LT Gospodarska banka d.d. Sarajevo (the "LTG Bank"), also subsidiary of Intesa Sanpaolo Holding, merged into the Bank, with the effect of the LTG Bank cancellation (without initiation of liquidation process), while the Bank became its legal successor.

On 20 August 2008 the Bank changed its name into Intesa Sanpaolo Banka d.d. Bosna i Hercegovina.

Principal activities of the Bank

The Bank's main operations are as follows:

1. Accepting deposits from the public and placing of deposits,
2. Providing current and term deposit accounts,
3. Granting short-term and long-term loans and guarantees to corporate customers, private individuals, local municipalities and other credit institutions dealing with finance lease and foreign exchange transactions,
4. Money market activities,
5. Performing local and international payments,
6. Foreign currency exchange and other banking-related activities,
7. Providing banking services through an extensive branch network in Bosnia and Herzegovina

Supervisory Board

Vojko Čok	Chairman
Massimo Pierdicchi	Vice-Chairman
Beata Kissne Foldi	Member
Nora Kocsis	Member
Massimo Malagoli	Member until April 1, 2010
Finazzi Luca Santo	Member from April 1, 2010

(all amounts are expressed in thousands of KM)

1. GENERAL (continued)

Management Board

Almir Krkalić	Director
Livio Mannoni	Executive Director of Finance until September 30, 2010
Dario Grassani	Executive Director of Finance from November 01, 2010
Igor Bilandžija	Executive Director of Risk Management

Audit Committee

Giovanni Bergamini	Chairman from April 28, 2010
Alberto Gandini	Member from April 28, 2010
Andrea Perucchi	Member from April 28, 2010
Nicoletta Fusetti	Member from April 28, 2010
Damiano Accattoli	Member from April 28, 2010
Giampiero Trevisan	Chairman until April 28, 2010
Gianluca Aliverti	Member until April 28, 2010
Cataldo Quatela	Member until April 28, 2010
Armando Sala	Member until April 28, 2010
Ivanka Petrović	Member until April 28, 2010

Internal Auditor

Muamera Zuko

The shareholding structure is as follows:

	31 December 2010			31 December 2009		
Shareholders	**No. of shares**	**Amount KM '000**	**%**	**No. of shares**	**Amount KM '000**	**%**
Intesa Sanpaolo Holding International S.A.	391,661	39,166	87.46	391,661	39,166	86.47
European Bank for Reconstruction and Development	32,478	3,248	7.17	32,478	3,248	7.17
Other	23,681	2,368	5.29	28,821	2,882	6.36
Total	**447,820**	**44,782**	**100.00**	**452,960**	**45,296**	**100.00**

1. GENERAL (continued)

Nominal value of one share is KM 100.
The Bank's General Assembly of Shareholders, at its meeting held on April 1, 2010, adopted Decision on the capital decrease and withdrawal of personal (treasury) shares. Decision on decrease of treasury shares relates to 5,140 ordinary treasury shares, ES series, of KM 100 nominal value.
In accordance with the Bank's order, the decrease was done by the Securities Register on June 3, 2010.

The Bank has 60 priority (preference) shares with priority right in receipt of dividends. Also the Bank does not have any shares held by the entity or by its subsidiaries and no share reserved for issue under options and contracts for sale.

In the position of Reserves and retained earnings the Bank includes:

- Reserves for undistributed profit from previous years;
- Fair value reserves deriving from the revaluation of the AFS investments;
- Reserve for tax-deductible profit, in the measure of 15% of Bank's profit according to the then valid Income Tax Law (until 2002 year);
- Reserve for tax-deductible profit, in the measure of 75% of Bank's profit reinvested into fixed assets (until 2000 year);
- Reserve for undistributed dividends, following Supervisory Board decisions (until 1999 year);
- Revaluation reserve for fixed assets, according to valid Law (until 2001 year);
- Reserve for treasury shares.

2. ADOPTION OF NEW STANDARDS AND REVISED STANDARDS

2.1 Standards and Interpretations effective in the current period

Amendments resulting from Improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

- IFRS 2 *Share-based payment: Group Cash-settled Share-based Payment Transactions* effective 1 January 2010
- IFRS 3 *Business Combinations (Revised)* and *IAS 27 Consolidated and Separate Financial Statements (Amended)* effective 1 July 2009, including consequential amendments to IFRS 2, IFRS 5, IFRS 7, IAS 7, IAS 21, IAS 28, IAS 31 and IAS 39
- IAS 39 *Financial Instruments: Recognition and Measurement – Eligible* Hedged Items effective 1 July 2009
- IFRIC 17 *Distributions of Non-cash Assets* to Owners effective 1 July 2009

Improvements to IFRSs

Issued in May 2008

- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* effective 1 January 2010

Issued in April 2009

- IFRS 2 *Share-based Payment*
- IAS 1 *Presentation of Financial Statements*
- IAS 17 *Leases*
- IAS 38 *Intangible Assets*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRIC 9 Reassessment of Embedded Derivatives

2. ADOPTION OF NEW STANDARDS AND REVISED STANDARDS (continued)

2.2 Standards and Interpretations in issue not yet adopted

Standards issued but not yet effective up to the date of issuance of the Bank's financial statements are listed below. This listing is of standards and interpretations issued, which the bank reasonably expects to be applicable at a future date. The bank intends to adopt those standards when they become effective.

IAS 24 Related Party Disclosures (Amendment)

The amended standard is effective for annual periods beginning on or after 1 January 2011. It clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The revised standard introduces a partial exemption of disclosure requirements for government-related entities. The bank does not expect any impact on its financial position or performance. Early adoption is permitted for either the partial exemption for government-related entities or for the entire standard.

IAS 32 Financial Instruments: Presentation – Classification of Rights Issues

The amendment to IAS 32 is effective for annual periods beginning on or after 1 February 2010 and amended the definition of a financial liability in order to classify rights issues (and certain options or warrants) as equity instruments in cases where such rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, or to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. This amendment will have no impact on the bank after initial application.

IFRS 9 Financial Instruments: Classification and Measurement

IFRS 9 as issued reflects the first phase of the IASBs work on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after 1 January 2013. In subsequent phases, the Board will address impairment and hedge accounting. The completion of this project is expected in mid 2011. The adoption of the first phase of IFRS 9 will primarily have an effect on the classification and measurement of the bank's financial assets. The Bank is currently assessing the impact of adopting IFRS 9, however, the impact of adoption depends on the assets held by the Bank at the date of adoption, it is not practical to quantify the effect.

IFRIC 14 Prepayments of a minimum funding requirement (Amendment)

The amendment to IFRIC 14 is effective for annual periods beginning on or after 1 January 2011 with retrospective application. The amendment provides guidance on assessing the recoverable amount of a net pension asset. The amendment permits an entity to treat the prepayment of a minimum funding requirement as an asset. The amendment is expected to have no impact on the financial statements of the Bank.

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments

IFRIC 19 is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as consideration paid. The equity instruments issued are measured at their fair value. In case this cannot be reliably measured, they are measured at the fair value of the liability extinguished. Any gain or loss is recognised immediately in profit or loss. The adoption of this interpretation will have no effect on the financial statements of the Bank.

2. ADOPTION OF NEW STANDARDS AND REVISED STANDARDS (continued)

2.2 Standards and Interpretations in issue not yet adopted (continued)

IFRS 7 *Financial Instruments: Disclosures as part of its comprehensive review of off balance sheet activities (amended)*

IFRS 7 is effective for annual periods beginning on or after 1 July 2011. The purpose of this amendment is to allow users of financial statements to improve their understanding of transfer transactions of financial assets (e.g. securitisations), including understanding the possible effects of any risks that may remain with the entity which transferred the assets. The amendment also requires additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period. The amendments broadly align the relevant disclosure requirements of IFRSs and US GAAP.

Improvements to IFRSs (issued in May 2010)

The IASB issued *Improvements to IFRSs*, an omnibus of amendments to its IFRS standards. The amendments have not been adopted as they become effective for annual periods on or after either 1 July 2010 or 1 January 2011. The amendments are as follows:

- IFRS 3 Business Combinations
- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Presentation of Financial Statements
- IAS 27 Consolidated and Separate Financial Statements
- IFRIC 13 Customer Loyalty Programmes

The Bank, however, expects no impact from the adoption of the amendments on its financial position or performance.

In addition, the Federal Banking Agency of Federation Bosnia and Herzegovina adopted Decision on Changes and Amendments to the Decision on minimum standards for credit risk management and classification on bank's assets (FBiH Gazette 86/2010) and Instruction for the changed manner of recording and reporting of loan loss provisions. According to the regulation, banks are obliged to harmonize their reporting of impairment of financial assets and provisions for contingent liabilities and commitments with requirements of IAS 37 and IAS 39 by 31 December 2011. The Bank is currently assessing impact of adoption of the regulation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These financial statements are prepared in accordance with accounting regulations applicable to financial reporting of banks in the Federation of Bosnia and Herzegovina.

As required by local legislation, the Bank prepares financial statements in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board and as modified by the regulatory requirements prescribed by the Banking Agency of Federation of Bosnia and Herzegovina (FBA).

The financial statements have been prepared on the historical cost basis except for certain non-current assets and financial instruments which are reported at fair value. The principal accounting policies are set out below.

The financial statements are presented in thousands of convertible mark (KM '000) which is the functional currency of the Bank.

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

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. These estimates are based on the information available as at the balance sheet date and actual results could differ from those estimates.

The Bank maintains its books of accounts and prepares financial statements for regulatory purposes in accordance with the regulations of the Banking Agency of Federation of Bosnia and Herzegovina (FBA) and Law on Banks of the Federation of Bosnia and Herzegovina.

Interest Income and Expense

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

In accordance with regulations of FBA, the Bank is obligated to remove to off-balance sheet records accrued interest and to suspend recognition of further interest accruals on assets classified as non-performing assets (interest are due and have not been collected for over 90 days after the original maturity date). Such interest accruals are also recorded in off-balance sheet records.

Fee and commission income and expense

Fees and commissions consist mainly of fees earned on domestic and foreign payment transactions, and fees for loans and other credit instruments issued by the Bank.

Fees for payment transactions are recognized in the period when services are rendered.

Loan origination fees, after approval and drawdown of loans, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan over its life.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits

On behalf of its employees, the Bank pays pension and health insurance on and from salaries, which are calculated on the gross salary paid, as well as taxes, which are calculated on the net salary paid. The Bank is paying the above contributions into the Pension and Health Fund of the entities, as per the set legal rates during the course of the year on the gross salary paid. In addition, meal allowances, transport allowances and vacation bonuses are paid in accordance with the local legislation. These expenses are recorded in the income statement in the period in which the salary expense is incurred.

Retirement severance payments

According to the local legislation and internal Rulebook on employment, the Bank makes retirement severance payments of minimum three average monthly salaries of the employee in question or three average salaries of the Federation of Bosnia and Herzegovina paid in the period of the last three months, depending on what is more favourable to the employee.

Provision for retirement benefits is calculated by independent actuary. The liability recognized in the balance sheet is the present value of the obligation, determined by discounting estimated future outflows using the projected unit credit method. Actuarial gains and losses are recognized in income statement in the period in which they arise.

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method.

Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered. Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Bank has the ability and intention to settle on a net basis.

The Bank is subject to various indirect taxes which are included in administrative expenses.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Central Bank ("CBBH") and current accounts with other banks.

Cash and cash equivalents exclude the compulsory minimum reserve with the Central Bank as these funds are not available for the Bank's day to day operations. The compulsory minimum reserve with the CBBH is a required reserve to be held by all commercial banks licensed in Bosnia and Herzegovina.

Financial assets

Financial assets are recognized and derecognized on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the instrument within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value.

Financial assets are classified into the following specified categories: financial assets as 'at fair value through profit or loss' (FVTPL), 'held-to-maturity investments' (HTM), 'available-for-sale' (AFS) financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

Financial assets at FVTPL

Financial assets are classified as at FVTPL where the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset is classified as held-for-trading if:

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

A financial asset other than a financial asset held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- It forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract (asset or liability) to be designated as at FVTPL.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

Financial assets at FVTPL (continued)

Financial assets at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset.

The fair values of financial assets and financial liabilities are determined as follows:

- the fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices (mid price), without any deduction for transaction costs (so called 'first level' of fair value);
- the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions (so called ' second level' of fair value which uses only insignificant adjustments to the market inputs);
- the fair value of derivative instruments, are calculated using quoted prices. Where such prices are not available use is made of discounted cash flow analysis using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives (so called 'second level' of fair value'), and
- Certain financial instruments are recorded at fair value using valuation techniques in which current market transactions or observable market data are not available. Their fair value is determined from input not directly visible on the market or prices of similar assets or deduced from non-active markets that are subject to significant adjustments (so called "third level" of fair value)

Financial liabilities are classified into the following specified categories: financial liabilities 'at fair value through profit or loss' (FVTPL), or "other financial liabilities".

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset or, where appropriate, a shorter period.

AFS financial assets

Available–for–sale investments include equity and debt securities. Equity investments classified as available–for – sale are those which are neither classified as held–for–trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions. The bank has not designated any loans or receivables as available–for–sale. After initial measurement, available–for–sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in equity (other comprehensive income) in the 'Fair value reserves'. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement in 'Other operating income'. Where the bank holds more than one investment in the same security they are deemed to be disposed of on a first–in first–out basis. Interest earned whilst holding available–for–sale financial investments is reported as interest income using the EIR. Dividends earned whilst holding available–for–sale financial investments are recognised in the income statement as 'Other operating income' when the right of the payment has been established.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loan and receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers.

Impairment of financial assets and provisions for contingent liabilities and commitments

According to the Federal Banking Agency requirements, the Bank classifies loans, other receivables, as well as contingent liabilities and commitments into the following categories:

A – Performing assets;
B – Special mention;
C – Substandard;
D – Doubtful loan and
E – Loss.

The classification into one of the above mentioned categories depends from credit standing of the Borrower, timely performance or repayment, type of collaterals obtained and days of default in servicing the loan and other specific criteria of the regulation.

For loans, receivables and off-balance sheet exposures classified as performing, a general allowance/provision equal to 2% of the outstanding exposure is made.

For exposures classified into categories from B to D the following range of provision apply:

B – Special mention	from 5 to 15%
C – Substandard	from 15 to 40%
D – Doubtful	from 41 to 60%
E – Loss	100%

Assets regarded as non-collectable are classified into category "E". These are fully provisioning and recorded off-balance sheet. Subsequent recoveries are credited to “Collected write offs” in income statement.

The process for assessment of impairment of financial assets and provisions for contingent liabilities and commitments differs from relating requirements of IAS 39 and IAS 37.

Derecognition of financial assets

The Bank derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Bank neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Bank recognises its retained interest in the asset and an associated liability for amounts it may have to pay. In addition, the Bank derecognises financial assets when they are classified in the category E in accordance with the Federal Banking Agency requirements as described above.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial liabilities and equity instruments issued by the Bank

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Bank are recorded at the proceeds received, net of direct issue costs.

Compound instruments

The component parts of compound instruments issued by the Bank are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for a similar non-convertible instrument. This amount is recorded as a liability on an amortised cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date. The equity component is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognised and included in equity, net of income tax effects, and is not subsequently remeasured.

Financial liabilities

Financial liabilities are classified as either financial liabilities ''at FVTPL'' or ''other financial liabilities''.

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated as at FVTPL.

A financial liability is classified as held for trading if:

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

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a Bank's portfolio of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the Bank is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 *Financial Instruments: Recognition and Measurement* permits the entire combined contract (asset or liability) to be designated as at FVTPL.

(all amounts are expressed in thousands of KM)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial liabilities and equity instruments issued by the Bank (continued)

Financial liabilities at FVTPL (continued)

Financial liabilities at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability.

Fair value is determined in the manner described in Notes 4 and 33.

Other financial liabilities

Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability or, where appropriate, a shorter period.

Derecognition of financial liabilities

The Bank derecognizes financial liabilities when, and only when, the Bank's obligations are discharged, cancelled or they expire.

Property and equipment

Property and equipment are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Cost includes the purchase price and directly associated cost of bringing the asset to a working condition for its intended use. Maintenance and repairs, replacements and improvements of minor importance are expensed as incurred. Significant improvements and replacement of assets are capitalised. Gains or losses on the retirement or disposal of property and equipment are included in the statement of income in the period in which they occur.

Properties in the course of construction are carried at cost, less impairment loss, if any. Depreciation commences first following month after the assets are ready for their use. Depreciation is calculated on a straight-line basis over the estimated useful life of the applicable assets and based upon the application of the following annual percentages to historical costs:

	31 December 2010	31 December 2009
Buildings	1.30%	1.30%
Furniture and other equipment	10.00% - 20.00%	10.00% - 20.00%
Computers	20.00%	20.00%
Leasehold improvements	20.00%	20.00%
Software	20.00%	20.00%

Property and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in 'Other operating income' in the income statement in the year the asset is derecognised.

(all amounts are expressed in thousands of KM)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currency translation

Transactions in currencies other than Bosnia and Herzegovina KM are initially recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities are translated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Profits and losses arising on translation are included in the statement of income for the period.

The Bank values its assets and liabilities by middle rate of Central Bank of Bosnia and Herzegovina valid at the date of balance sheet. The principal rates of exchange set forth by the Central Bank and used in the preparation of the Bank's balance sheet at the reporting dates were as follows:

31 December 2010	EUR 1= KM 1.95583	USD 1 = KM 1,472764
31 December 2009	EUR 1= KM 1.95583	USD 1 = KM 1.364088

Off-balance sheet commitments

In the ordinary course of business, the Bank enters into credit related commitments which are recorded in off-balance sheet accounts and primarily include guarantees, letters of credit and undrawn loan commitments. Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- the amount of the provision assessed in accordance with the Federal Banking Agency requirements as described above; and
- the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18, *Revenue.*

Provisions

Provisions are recognised when the Bank has a present obligation as a result of a past event, and it is probable that the Bank will be required to settle that obligation. Management Board estimates the provisions based at the best estimate of expenditure to settle the Bank's obligation. Provisions are discounted to present value where the effect is material.

Reclassifications

Certain amounts in the previous year financial statements have been reclassified to conform to the current year presentation:

In 2010 the Bank reclassified income from earlier break of term deposits from Other operating income to Interest expense. For consistency reasons, amount of KM 404 thousand has been reclassified in the 2009 Statement of Income.

In 2010, the Bank also reclassified certain other amounts between various items in the statement of income. For consistency reasons, corresponding reclassifications were made to the 2009 statement of income.

Segment reporting

Management has monitored the operating results of the Bank as a single segment for the purpose of making decisions about resource allocations and performance assessment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Regulatory requirements

The Bank is subject to the regulatory requirements of the Banking Agency of Federation of Bosnia and Herzegovina. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off balance sheet commitments and forming allowances to cover credit risk, liquidity, interest rate and foreign currency position. At year end the Bank was substantially in compliance with all regulatory requirements.

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Bank's accounting policies, which are described in note 3, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

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

Key sources of estimation uncertainty

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

Useful lives of property, plant and equipment

As described above, the Bank reviews the estimated useful lives of property, plant and equipment at the end of each annual reporting period as described in Note 3.

Impairment losses on loans and other placements

The Bank reviews its problem loans and other placements at each reporting date to assess amounts of allowances for impairment and provisions for contingent liabilities and commitments which should be recorded in the income statement. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowances and provisions.

Long-term employee benefits

The cost of the long-term employee benefits is determined using actuarial valuation. The actuarial valuation involves making assumptions about discount rates, future salary increases, and future turnover rates. Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (continued)

Fair value of financial assets and liabilities

The directors use their judgment in selecting an appropriate valuation technique for financial instruments not quoted in an active market. Valuation techniques commonly used by market practitioners are applied. Financial instruments are valued using a discounted cash flow analysis based on assumptions supported, where possible, by observable market prices or rates. The estimation of fair value of unlisted shares includes some assumptions not supported by observable market prices or rates.

It is the opinion of the management of the Bank that the fair value of the Bank's financial assets and liabilities are not materially different from the amounts stated in the balance sheets as at 31 December 2010 and 31 December 2009. In estimating the fair value of the Bank's financial instruments, the following methods and assumptions are used:

Cash balances with the Central bank

The carrying values of cash and balances with the Central bank are generally deemed to approximate their fair value.

Due from banks

The estimated fair value of amounts due from banks that mature in 180 days or less approximates their carrying amounts. The fair value of other amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk).

Loans and advances to customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

Amounts due to banks and customers

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

(all amounts are expressed in thousands of KM)

5. INTEREST INCOME

	2010	2009
Companies	31,745	25,298
Individuals	38,291	38,920
Domestic banks	879	1,074
Foreign banks	638	576
Government	150	673
Assets available for sale	42	-
	71,745	**66,541**

6. INTEREST EXPENSE

	2010	2009
Individuals	7,884	7,669
Banks and other financial institutions	4,880	6,106
Companies	9,496	9,682
Government	303	1,155
	22,563	**24,612**

7. FEE AND COMMISSION INCOME

	2010	2009
Domestic payment transactions	2,857	2,621
Credit card activities	2,734	2,667
Foreign payment transactions	2,106	1,837
FX transactions	1,019	775
Guarantees and letter of credits	1,296	1,300
Agency services	126	185
Other	2,155	2,173
	12,293	**11,558**

8. FEE AND COMMISSION EXPENSE

	2010	2009
Credit card operations	1,948	2,003
Central Bank BiH services	208	191
Domestic payment transactions	450	468
E-banking service	121	136
	2,727	**2,798**

9. NET FOREIGN EXCHANGE INCOME

	2010	2009
Gains on foreign exchange transactions and translations	30,356	29,744
Loss on foreign exchange transactions and translations	(28,889)	(28,866)
	1,467	**878**

(all amounts are expressed in thousands of KM)

10. OTHER OPERATING INCOME

	2010	2009
Rental income	-	1
Dividend income	-	116
Gain on sale of AFS investments	87	355
Gain on sale of property	62	343
Recoveries of claims from legal proceedings	391	-
Other income	369	79
	909	**894**

11. PERSONNEL EXPENSES

	2010	2009
Wages and salaries	12,547	11,809
Social security costs	5,512	5,493
Provisions, net, for retirement and other employee benefits (Note 29)	35	31
Other expenses	166	65
	18,260	**17,398**

The Bank does not have pension arrangements separate from Bosnia and Herzegovina pension system. This system requires that current contributions by the employer should be calculated as a percentage of current gross salary payments and taxes on net salary; these expenses are charged to the profit and loss statement in the period the related compensation is earned by the employee.

The average number of personnel employed by the Bank during the years ended 31 December 2010 and 2009 was 515 and 505 respectively.

12. ADMINISTRATIVE EXPENSES

	2010	2009
Rent and other rent related expense	3,314	2,996
Telecommunication and post expense	2,541	2,263
Saving deposit insurance and other insurance charges	1,472	1,506
Provisions, net, for legal proceedings (Note 29)	258	249
Material expenses	1,125	1,037
Representation and marketing expense	942	963
Consultancy and the Banking Agency of FBiH expenses	1,318	1,434
Energy	771	756
Maintenance expenses	2,508	2,077
Security and transport costs	1,868	1,628
Other expenses	1,136	999
	17,253	**15,908**

(all amounts are expressed in thousands of KM)

13. IMPAIRMENT LOSSES AND PROVISIONS

	2010	2009
Additions on impairment losses on placements with other banks, net (Note 19)	3	5
Additions on impairment losses on loans and advances originated by the Bank, net (Note 20)	17,717	14,128
Additions (Release) of impairment losses on assets available for sale, net (Note 21)	9	(5)
Additions on provision for other assets, net (Note 22)	148	79
Additions on provision for commitments and contingent liabilities, net (Note 30)	631	532
	18,508	**14,739**

Detail of additions on impairment losses on loans and advances to customers (Note 20) are as follows:

	2010	2009
Corporate Lending	11,328	7,540
Retail Lending	4,716	4,294
Credit and debit cards	1,673	2,294
	17,717	**14,128**

14. RECOVERIES OF WRITTEN OFF LOANS

	2010	2009
Suspended Interest	490	666
Principal	4,139	3,111
Other	114	65
	4,743	**3,842**

15. INCOME TAX

	2010	2009
Profit before income tax	6,944	4,018
Non-deductible expenses and taxable income relieves	1,891	1,255
Taxable income	8,835	5,273
Income tax liability at the rate of 10%	**883**	**527**

Tax liability is based on accounting income before restatement taking into the account non-deductible expenses and non-taxable income. Tax income rate for the years ended 31 December 2010 and 2009 was 10%.

(all amounts are expressed in thousands of KM)

16. EARNINGS PER SHARE

	31 December 2010	31 December 2009
Net profit	6,061	3,491
Weighted average number of ordinary shares outstanding	449,886	452,960
Basic earnings per share	**0.01347**	**0.00771**

The Bank does not have dilutive potential ordinary shares.

17. CASH AND CASH EQUIVALENTS

	31 December 2010	31 December 2009
Current account in domestic currency with the Central Bank	40,998	78,238
Cash on hand in domestic currency	14,040	12,984
Cash on hand in foreign currency	7,569	6,676
Correspondent accounts with banks in foreign currency	3,757	2,605
	66,364	**100,503**

18. OBLIGATORY RESERVE WITH THE CENTRAL BANK

	31 December 2010	31 December 2009
Obligatory reserve	97,789	88,772
	97,789	**88,772**

Minimum obligatory reserve as of 31 December 2010 is calculated in amount of 14% for deposits and borrowings with maturity up to one year and 7% for deposits and borrowings with maturity over one year for each working day during 10 calendar days following the period of maintaining the obligatory reserve. Mandatory reserve does not include local inter-bank deposits, short term and long term deposits from non-residents and short term and long term loans from non-residents, with effect from 1 November 2008.

19. PLACEMENTS WITH OTHER BANKS

	31 December 2010	31 December 2009
Short-term placements with banks from OECD countries	190,290	134,701
Less: Provisions for impairment	(26)	(23)
	190,264	**134,678**

The average interest rate for placements in EUR was 0.51 p.a. and 1.33% p.a. and for placements in USD 0.24% p.a. and 0.57% p.a. as of 31 December 2010 and 31 December 2009, respectively.

(all amounts are expressed in thousands of KM)

19. PLACEMENTS WITH OTHER BANKS (continued)

The movements in the provision for impairment of placements with other banks are as follows:

	31 December 2010	31 December 2009
Balance as at 1 January	**23**	**18**
Provisions (Note 13)	605	699
Reversal of provisions (Note 13)	(602)	(694)
Balance as at 31 December	**26**	**23**

20. LOANS AND RECEIVABLES

	31 December 2010	31 December 2009
Short-term loans in domestic currency	294,913	262,222
Short-term loans in foreign currency	21	1,431
Current portion of long-term loans	116,612	117,783
Total short-term loans	411,546	381,436
Long-term loans in domestic currency	629,901	560,783
Long-term loans in foreign currency	9,242	13,648
(Current portion of long-term loans)	(116,612)	(117,783)
Total long-term loans	522,531	456,648
Total loans before provisions	*934,077*	*838,084*
Provision for impairment	(43,217)	(39,289)
	890,860	**798,795**

Short-term and long-term loans in domestic currency include loans disbursed and repayable in domestic currency index-linked to the KM:EUR exchange rate in the amount of KM 16,331 thousand and KM 628,348 thousand, respectively (2009: KM 35,362 thousand and KM 563,765 thousand, respectively).

Short-term loans are granted for periods of up to 365 days. The majority of short-term loans in domestic currency are granted to clients for working capital financing. Long-term loans are mostly granted to individuals for housing and vehicle purchases, and to corporate clients for investment purposes.

The movements in the provision for impairment of loans are summarized as follows:

	31 December 2010	31 December 2009
Balance as at 1 January	**39,289**	**33,612**
Provisions charged (Note 13)	37,843	30,460
Reversal of provision (Note 13)	(20,126)	(16,332)
Reversal of provisions credited to deferred income	(236)	-
Write-offs (Note 34)	(13,553)	(8,451)
Balance as at 31 December	**43,217**	**39,289**

(all amounts are expressed in thousands of KM)

20. LOANS AND RECEIVABLES (continued)

According to the Federal Banking Agency rules, banks should not book reversal of provisions in Income statement relating to foreclosed property, until it is sold. Therefore, the Bank credited reversal of provision in the amount of KM 236 thousand to deferred income.

Total amount of non-performing loans on which interest was suspended as at 31 December 2010 and 2009 was KM 32,828 thousand and KM 31,585 thousand, respectively.

	31 December 2010	31 December 2009
Manufacturing industry	147,551	133,354
Trade	201,859	170,220
Construction industry	42,144	34,222
Services, finance, sport, tourism	21,033	30,540
Administrative and other public institutions	21,037	7,297
Agriculture, forestry, mining and energy	22,202	21,641
Transport and telecommunications	41,275	22,432
Other	36,441	13,211
Citizens	400,535	405,167
	934,077	**838,084**

	31 December 2010	31 December 2009
Corporate Lending	533,542	432,917
Consumer Lending	225,524	241,801
Residential Mortgages	128,974	114,190
Credit and Debit Cards	46,037	49,176
	934,077	**838,084**

Interest rates for granted loans as at 31 December 2010 and 2009 are summarized as follows:

	31 December 2010		31 December 2009	
	KM '000	Annual interest rate	KM '000	Annual interest rate
Domestic currency				
Companies	525,203	2.70% - 12.00%	419,220	2.00% - 15.00%
Citizens	399,612	2.00% - 12.75%	403,786	4.00% - 14.50%
Foreign currency				
Companies	8,340	3.76% - 7.02%	13,697	3.59% - 9.53%
Citizens	923	5.00% - 10.00%	1,381	3.00% - 10.99%
	934,078		**838,084**	

(all amounts are expressed in thousands of KM)

21. ASSETS AVAILABLE FOR SALE

	31 December 2010	31 December 2009
Debt instruments – the Government of Federation of Bosnia and Herzegovina bonds	440	-
Equity instruments	559	553
Total gross value	999	553
Impairment	(20)	(11)
	979	**542**

Assets available for sale include investments of 20,03% in share capital of Bamcard d.d. Sarajevo in the amount of KM 488 thousand (2009: KM 488 thousand).

Also, assets available for sale include investments of less than 1% in various companies in Bosnia and Herzegovina recognized at cost of KM 71 thousand (2009: KM 65 thousand).

The movements in the provision for impairment of financial assets available for sale are summarized as follows:

	31 December 2010	31 December 2009
Balance as at 1 January	**11**	**16**
Provisions (Note 13)	56	1
Reversal of provision (Note 13)	(47)	(6)
Balance as at 31 December	20	**11**

(all amounts are expressed in thousands of KM)

22. OTHER ASSETS

	31 December 2010	31 December 2009
Prepaid income taxes	2,841	3,197
Payment to the Cantonal Privatization Agency for privatization of "Projekt" d.d. Sarajevo	1,200	1,200
Prepaid expenses	2,167	2,026
Fees receivable	442	422
Receivables from card operations	668	336
Assets acquired on foreclosed loans	1,230	40
Other assets	1,182	1,337
Total other assets	**9,730**	**8,558**
Provision for impairment	(492)	(590)
	9,238	**7,968**

The movements in the provision for impairment of other assets are summarized as follows:

	31 December 2010	31 December 2009
Balance as at 1 January	**590**	**649**
Provisions (Note 13)	530	428
Reversal of provision (Note 13)	(382)	(349)
Write-offs (Note 34)	(246)	(138)
Balance as at 31 December	**492**	**590**

(all amounts are expressed in thousands of KM)

23. PROPERTY, PLANT AND EQUIPMENT

	Land and Buildings	Computers and other equipment	Software	Constru-ction in progress	Leasehold improve-ments	Total
Cost value						
31 December 2008	**13,589**	**16,814**	**3,631**	**1,130**	**6,348**	**41,512**
Additions		-		5,416	-	**5,416**
Disposals	(673)	(857)	-	-	(7)	**(1,537)**
Transfers from construction in progress	24	2,563	1,925	(6,322)	1,810	**-**
31 December 2009	**12,940**	**18,520**	**5,556**	**224**	**8,151**	**45,391**
Additions	-	-	-	2,414	-	**2,414**
Disposals	(157)	(413)	-	(56)	-	**(626)**
Transfers from construction in progress	79	1,751	616	(2,522)	76	**-**
31 December 2010	**12,862**	**19,858**	**6,172**	**60**	**8,227**	**47,179**
Accumulated Depreciation						
31 December 2008	**1,321**	**7,434**	**2,406**	**-**	**2,669**	**13,830**
Depreciation for the period	174	2,370	525	-	1,171	**4,240**
Disposals	(246)	(793)	-	-	-	**(1,039)**
31 December 2009	**1,249**	**9,011**	**2,931**	**-**	**3,840**	**17,031**
Depreciation for the period	167	2,518	855	-	1,362	**4,902**
Disposals	(51)	(307)	-	-	-	**(358)**
31 December 2010	**1,365**	**11,222**	**3,786**	**-**	**5,202**	**21,575**
Net book value: 31 December 2010	**11,497**	**8,636**	**2,386**	**60**	**3,025**	**25,604**
Net book value: 31 December 2009	**11,691**	**9,509**	**2,625**	**224**	**4,311**	**28,360**

(all amounts are expressed in thousands of KM)

24. DUE TO BANKS AND OTHER INSTITUTIONS

	31 December 2010	31 December 2009
Current portion of long-term borrowings	53,771	106,521
Total short-term borrowings	53,771	106,521
Long-term borrowings from foreign banks and other institutions	304,258	234,625
Long-term borrowings from domestic banks and other institutions	7,162	10,670
Current portion of long-term borrowings	(53,771)	(106,521)
Total long-term borrowings	257,649	138,774
Current accounts in domestic currency	3	3
Current accounts in foreign currency	4	-
Total current accounts	7	3
Short-term deposit	136,928	112,472
Long-term deposits	942	3,500
	449,297	**361,270**

Long-term borrowings from international banks and other institutions as at 31 December 2010 and 31 December 2009 are as follows:

	31 December 2010	31 December 2009
European Investment Bank	93,645	48,998
Commerzbank Ag Frankfurt, Germany	68,465	68,690
European Fund for Southeast Europe (EFSE), Luxembourg	44,787	44,599
Société Européenne De Banque S.A., Luxembourg	29,500	29,485
European Bank for Reconstruction and Development, London, UK	25,436	-
Vseobecna Uverova Banka A.S. Bratislava	19,640	19,560
Intesa Sanpaolo SPA Milan, Italy	18,595	22,429
KfW Kreditanstalt fur Wiederaufbau	3,936	-
Federalno ministarstvo finansija, Sarajevo	2,446	2,442
Vlada SBH/ŽSB, Travnik	2,134	2,126
Federalni zavod za zapošljavanje, Sarajevo	1,229	3,816
Federalno ministarstvo šumarstva i vodoprivrede, Sarajevo	1,028	1,028
Razvojna banka Federacije Bosne i Hercegovine d.o.o. Sarajevo	295	1,228
OPEC FUND for International Development, Vienna, Austria	255	763
Partners for Development, Sarajevo	-	102
Služba za zapošljavanje SBK / ŽSB	29	29
	311,420	**245,295**

Interest rates for long-term borrowings from banks and other institutions were in the range from 0% to 4.138% per annum and from 0% to 3.73% per annum as of 31 December 2010 and 31 December 2009, respectively.

Interest rate for short term deposits were in the range from 1.14% to 3.72% per annum and from 1% to 2,75% per annum as of 31 December 2010 and 31 December 2009, respectively.

(all amounts are expressed in thousands of KM)

25. SUBORDINATED DEBT

	31 December 2010	31 December 2009
USAID / Ministarstvo finansija trezora BiH	1,244	1,404
	1,244	**1,404**

The subordinated loan from USAID as of 31 December 2009 and 31 December 2010, respectively amounting to KM 1,404 thousand and KM 1,244 thousand was received in August 2003 in the amount of KM 2,408 thousand, and it is repayable in 60 quarterly instalments starting from 1 December 2003 until 1 September 2018. Interest rate is fixed at 2,3163 % p.a.

According to the approval of the Banking Agency of Federation of Bosnia and Herzegovina, the subordinated debt may be used as additional capital for calculation of regulatory capital.

26. DUE TO CUSTOMERS

	31 December 2010	31 December 2009
Demand deposits:		
Citizens:		
In KM	51,785	41,298
In foreign currencies	33,206	23,152
	84,991	64,450
Legal entities:		
In KM	246,007	271,337
In foreign currencies	39,044	54,748
	285,051	326,085
Total demand deposits	**370,042**	**390,535**
Term deposits:		
Citizens:		
In KM	28,833	26,210
In foreign currencies	132,587	128,648
	161,420	154,858
Legal entities:		
In KM	88,631	93,974
In foreign currencies	69,504	23,374
	158,135	117,348
Total term deposits	**319,555**	**272,206**
	689,597	**662,741**

During 2010 interest rates for demand deposits were from 0.00% to 2.50% (during 2009 were from 0,00% to 3,00%).

Short-term deposit interest rates were from 0,00% to 7,20% and from 0,00% to 8,19% during 2010 and 2009 respectively. Long-term deposit interest rates were from 0,00% to 8,00% and from 0,00% to 8,00% during 2010 and 2009 respectively.

(all amounts are expressed in thousands of KM)

26. DUE TO CUSTOMERS (continued)

'Due to Customers' includes deposits held as collateral for loans, guarantee and L/C in the amount of KM 15,729 thousand (2009: KM 17,125 thousand).

	31 December 2010	31 December 2009
Large Corporate customers:	342,198	385,554
Current Accounts	232,438	283,800
Term Deposits	109,760	101,754
Small and medium-sized enterprises:	100,988	57,879
Current Accounts	52,613	42,285
Term Deposits	48,375	15,594
Retail Customers:	246,411	219,308
Current Accounts	84,991	64,450
Term Deposits	161,420	154,858
	689,597	**662,741**

27. FINANCIAL LIABILITIES HELD FOR TRADING

	31 December 2010	31 December 2009
OTC derivatives	-	761
	-	**761**

In 2009 a forward deal was made with Intesa Sanpaolo Milano where the Bank bought USD and sold EUR currency. Value date and maturity date of this transaction were 13 February 2009 and 17 February 2010, respectively. These derivatives were valued using valuation techniques based on observable market data.

28. OTHER LIABILITIES

	31 December 2010	31 December 2009
Loan repayments received before due dates	2,631	2,394
Liabilities to vendors	1,054	1,045
Liabilities for employees bonuses	1,100	550
Managed fund difference (Note 32)	182	-
Credit card liabilities	61	106
Liabilities to shareholders	141	149
Deferred tax liability	1	-
Other liabilities	1,656	1,293
	6,826	**5,537**

Deferred tax liability relates to taxable temporary differences arising on fair value adjustments of financial assets available for sale with respect to which deferred tax liabilities in the amount of KM 1 thousand (2009: KM 0 thousand) were recognized through equity.

(all amounts are expressed in thousands of KM)

29. OTHER PROVISIONS

	31 December 2010	31 December 2009
Provisions for litigations with the Tax authorities and clients	1,838	1,620
Provisions for retirement employee benefits and other short-term employee benefits	461	426
	2,299	**2,046**

Provisions for litigations are made based on the uncertainty in the outcomes of the ongoing court case with the tax authority and other proceedings.

	Provisions for legal proceedings (Note 12)	Provisions for retirement employee benefits and other short term employee benefits (Note 11)	Total
Balance at 31 December 2009	**1,620**	**426**	**2,046**
Additional provision recognised	291	52	343
Release of provision	(33)	(17)	(50)
Reductions arising from payments	(40)	-	(40)
Balance at 31 December 2010	**1,838**	**461**	**2,299**

Calculation of provisions for retirement benefits of KM 215 thousand as of 31 December 2010 (2009: KM 183 thousand) is performed by an independent actuary, applying a discount rate of 6% and 3% expected rate of increase in salaries, to working life and average salary of each employee.

Provisions for unused days of vacation of KM 246 thousand as of 31 December 2010 (2009: KM 243 thousand) are calculated for every employee, taking as a basis his/her salary and unused days of vacation.

In the ordinary course of business, the Bank has been involved in a number of legal proceedings to recover collateral or outstanding credit balances, as well as related interest and expenses from defaulted credit customers and interbank counterparts. The management of the Bank believes that any legal proceedings pending as at 31 December 2010 will not result in material loss to the Bank.

(all amounts are expressed in thousands of KM)

30. FINANCIAL COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Bank enters into credit related commitments which are recorded in off-balance sheet accounts and primarily include guarantees, letters of credit and undrawn loan commitments.

	31 December 2010	31 December 2009
Contingent liabilities		
Payment guarantees	23,833	17,496
Performance guarantees	24,330	27,452
Letters of credit	6,195	4,237
Total contingent liabilities	**54,358**	**49,185**
Commitments		
Unused portion of overdraft loans	72,791	71,147
Total commitments	**72,791**	**71,147**
Total contingent liabilities and commitments	**127,149**	**120,332**

Provisions for contingent liabilities are recognised when the Bank has a present obligation as a result of a past event, and it is probable that the Bank will be required to settle that obligation. Management Board estimates the provisions based at the best estimate of expenditure to settle the Bank's obligation.

Movements in provision for contingent liabilities and commitments are as follows:

	31 December 2010	31 December 2009
Balance as at 1 January	**2,709**	**3,027**
Increase in provisions (Note 13)	5,774	5,272
Reversal of provision (Note 13)	(5,143)	(4,740)
Write offs	(703)	(850)
Balance as at 31 December	**2,637**	**2,709**

31. RELATED-PARTY TRANSACTIONS

Related parties, as defined by IAS 24, are those counter parties that represent:

a. enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries);

b. associates – enterprises in which the Bank has significant influence and which is neither a subsidiary nor a joint venture of the investor;

c. individuals owning, directly or indirectly, an interest in the voting power of the Bank that gives them significant influence over the Bank, and anyone expected to influence, or be influenced by, that person in their dealings with the Bank;

d. key management personnel, that is, those persons who have authority and responsibility for planning, directing and controlling the activities of the Bank, including directors and officers of the Bank and close members of the families of such individuals; and

e. enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (c) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the Bank and enterprises that have a member of key management in common with the Bank.

(all amounts are expressed in thousands of KM)

31. RELATED-PARTY TRANSACTIONS (continued)

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

	31 December 2010	31 December 2009
Receivables		
Key management personnel and close family members	423	249
Bank accounts and loans - Intesa Sanpaolo Group	37,264	16,367
Other receivables - Intesa Sanpaolo Group	110	77
	37,797	**16,693**
Liabilities		
Deposits - Key management personnel and close family members	731	514
Borrowings and term deposits - Intesa Sanpaolo Group	204,356	179,044
Other liabilities - Intesa Sanpaolo Group	1,326	497
Borrowings and other liabilities to European Bank for Reconstruction and Development (EBRD)	25,436	-
	231,849	**180,055**
Financial commitments and contingencies		
Guarantees issued in favour of Intesa Sanpaolo Group	1,883	2,208
Commitments to lend - Key management personnel and close family members	73	73
Commitments to lend - Intesa Sanpaolo Group	-	170
	1,956	**2,451**
Financial liabilities held for trading		
OTC derivates with Intesa Sanpaolo Group	-	761
	-	**761**
Income		
Interest income - Key management personnel and close family members	23	22
Interest income - Intesa Sanpaolo Group	412	626
Other Income - Intesa Sanpaolo Group	120	129
	555	**777**

(all amounts are expressed in thousands of KM)

31. RELATED-PARTY TRANSACTIONS (continued)

Expenses	**31 December 2010**	**31 December 2009**
Interest expense - Key management personnel and close family members	6	7
Interest expense - Intesa Sanpaolo Group	3,340	3,983
Interest expense - European Bank for Reconstruction and Development (EBRD)	1,712	1,843
Other expenses - Intesa Sanpaolo Group	570	75
Other expense - European Bank for Reconstruction and Development (EBRD)	62	21
	5,690	**5,929**

Intesa Sanpaolo Holding International S.A. is the majority shareholder and exercises control over the Bank's operations.

EBRD is one of the Bank's significant shareholders.

No exposure towards related parties has been classified as non-performing.

The remuneration of directors and other members of key management are as follows:

	31 December 2010	**31 December 2009**
Compensation for directors and other key management	481	552
Taxes and contributions on compensation	495	407
Bonuses to the Management Board - accrued expenses	448	336
Compensations for Supervisory Board members	29	22
Other Management benefits	165	314
	1,618	**1,631**

The Bank has:

- neither guarantee with any director or other member of key management,
- nor exposure towards director or key management has been classified as non-performing.

During the period only generic provisions for 2% have been established.

(all amounts are expressed in thousands of KM)

32. MANAGED FUNDS

The Bank manages assets on behalf of third parties. These assets are recorded separately from the Bank's assets. For its services, the Bank charges a fee amounting from 0.0% to 2.5% p.a. (in 2009 from 0.0% to 2.50% p.a.) of the total amount contributed.

	31 December 2010	31 December 2009
Liabilities		
Government organizations	9,105	9,347
Associations and Agencies	4,492	5,187
Banks and Insurance companies	3,555	1,849
Other	920	1,070
Total	**18,072**	**17,453**
Assets		
Loans to companies	16,813	16,071
Loans to citizens	1,077	1,382
Total	**17,890**	**17,453**
Amounts due to original creditors – managed funds (Note 28)	**182**	**-**

The Bank has not issued any guarantees related to manage funds.

33. CAPITAL MANAGEMENT

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

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

The Bank expects to maintain its debt to capital ratio. Solvency indicators are as follows:

	31 December 2010	31 December 2009
Debt (i)	1,138,894	1,024,011
Cash on hand, balances with the Central bank and placements with other banks	(354,417)	(323,953)
Net debt	784,477	700,058
Capital (ii)	130,442	124,554
Net debt to capital ratio	**6,01**	**5,62**

33. CAPITAL MANAGEMENT (continued)

Debt (i) is defined as liabilities to banks and clients presented in detail in Notes and Capital (ii) includes total capital, Bank's reserves, retained earnings and subordinated debt.

Capital adequacy and the use of regulatory capital are monitored daily by the Bank's management and employing techniques based on the guidelines developed by the Banking Agency of Federation of Bosnia and Herzegovina (FBA) for supervisory purposes. The required information is filed with the FBA on a quarterly basis.

The FBA requires each bank to:

(a) hold the minimum level of the regulatory capital of KM 15,000 thousand , and
(b) maintain a ratio of total regulatory capital to the risk-weighted asset at or above the minimum of 12% for 2009. From 31 December 2008 Federal Banking Agency requested banks to include in the calculation of capital adequacy a charge for operational risk.

As of 31 December 2009, the Federal Banking Agency changed the methodology for the calculation of the charge for operational risk, which is based on gross income.

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

- Tier 1 capital or Core Capital: share capital (net of any book values of the treasury shares), share premium, retained earnings and reserves created by appropriations of retained earnings; unrealised gains/losses arising on the fair valuation of equity instruments held as available for sale and
- Tier 2 capital or Supplementary Capital: qualifying principle of subordinated loan capital, collective impairment allowances and profit for the year.

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

(all amounts are expressed in thousands of KM)

33. CAPITAL MANAGEMENT (continued)

The table below summarises the composition of regulatory capital and the ratios of the Bank. The Bank complies with all of the externally imposed capital requirements.

	31 December 2010	31 December 2009
Tier 1 capital		
Share Capital	44,782	45,296
Treasury shares	-	(514)
Share Premium	57,415	57,415
Statutory reserves	614	614
Retained Earnings	14,797	11,306
Other reserves not related to assets valuation	5,536	5,536
Revaluation reserve – available for sale investments	(7)	6
Items to be deducted: Intangible assets	(2,395)	(2,669)
Total qualifying Tier 1 Capital	120,742	116,990
Tier 2 capital		
Qualifying subordinated loan capital	1,244	1,404
Generic provisions for performing assets	19,459	17,291
Profit for the year	6,061	3,491
Total qualifying Tier 2 Capital	26,764	22,186
Total regulatory capital	**147,506**	**139,176**
Risk weighted assets		
On balance sheet	955,585	854,008
Off balance sheet	72,649	67,117
Total	**1,028,234**	**921,125**
Operational risk	**61,559**	**49,605**
Total weighted risk	**1.089.793**	**970.730**
Capital adequacy ratio	**13,53%**	**14,33%**

34. FINANCIAL INSTRUMENTS

Financial risk management objectives

Main purpose of Risk Management Department is to support financial operations, coordinate access to domestic and international financial markets, overlook and manage financial risk trough internal risk reports including analysis by size and level of the risk. Financial risk management includes: market risk (FX risk, interest rate risk, and pricing risk), credit risk, liquidity risk and interest rate cash flow risk.

FX Value-at-Risk is individual, concise, statistic measurement of possible losses in the portfolio. Value-at-Risk is loss measurement in normal movements of risk factors on the market. Losses higher than the Value-at-Risk occur only with a low indicated likelihood.
The main model assumptions are:

- Being based on the Historical methodology,
- 99 percent as a confidence interval for VaR computation,
- One-day held period.

The model covers foreign currency risk – valid for foreign currency transactions and positions denominated on foreign currencies; resulting from foreign currency rate volatility.

The model can compute VaR at different aggregation levels – from a single position to any sub-portfolio level. Therefore, the model allows a detailed analysis of risk profiles of multi-level portfolio hierarchy and diversity effects occurring. Furthermore, VaR measurement can be expounded based on risk source (risk factors). These features of a more detailed risk monitoring allow determining an efficient limit structure which can be compared through different organisational units.

Key data and their sources, necessary for daily VaR computation based on this model are as follows:

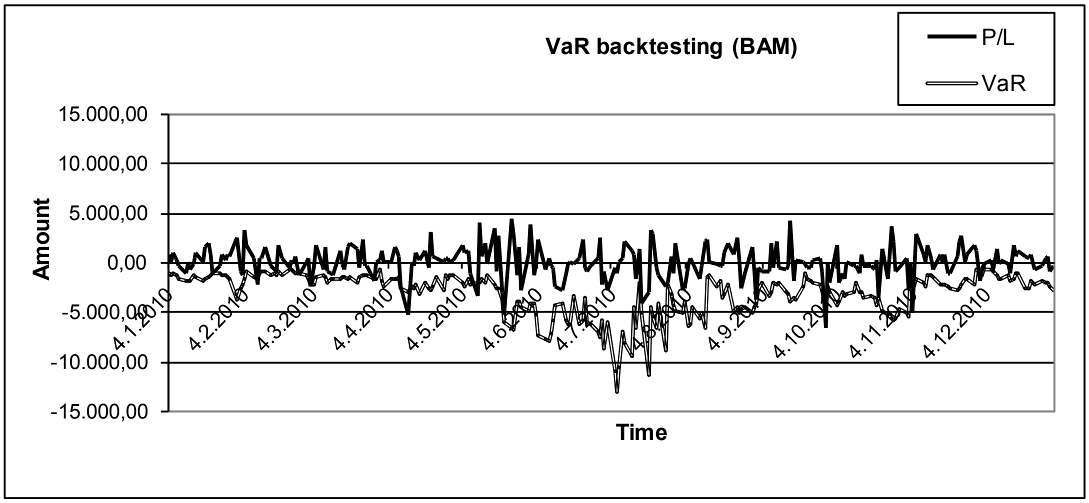
- **Open foreign currency position** – prepared by the Planning and Control Department, checked by the Integrated Risk Management Department, and sent to the Parent Company.
- **Market data:**
- **Local market data –** all local market data unavailable to the Integrated Risk Management Department shall be prepared on a daily basis by the Treasury Division, sent to the Integrated Risk Management Department and to the Parent Company.
- **International market data** – all international market data unavailable to the Integrated Risk Management Department shall be prepared on a daily basis by the Treasury Division, sent to the Integrated Risk Management Department and to the Parent Company.

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Financial risk management objectives (continued)

The quality of the implemented risk measurement model must be constantly assessed. Back testing is way to achieve this goal. The essence of back testing procedure is comparing the computed VaR measure with the P&L for the same period. Based on back testing results opinion on the internal model quality shall be created.



During 2010 the Bank recorded nine back-testing exceptions (2009: three exception), when actual losses exceeded daily Var amount.

The Bank is exposed to foreign currency risk when there is no matching between assets and liabilities due to cash flows denominated in foreign currencies. Portfolio exposure to foreign currency risk arises from portfolio sensitivity to fluctuations in exchange rate values. The degree of foreign currency risk depends on the amount of open positions and the degree of potential change in foreign currency rates.

The carrying amounts of the Bank's foreign currency denominated monetary assets and liabilities at the reporting date are as follows:

	Assets		Liabilities	
	31 December 2010	31 December 2009	31 December 2010	31 December 2009
EUR	820,944	730,959	832,539	758,008
USD	16,658	13,965	16,573	13,832
CHF	2,073	1,241	2,008	1,105
HRK	1,546	1,322	1,478	1,291
GBP	295	186	274	224
Other	866	697	643	623

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Financial risk management objectives (continued)

The Bank is not exposed to foreign currency risk related to EUR due to the fact that Convertible Mark is pegged to EURO (1 EUR = KM 1,955830). Change in the exchange rate would require the amendments of the law and approval by Parliamentary Assembly of Bosnia and Herzegovina. Exposure is more prominent for USD and CHF. The following table details the Bank's sensitivity to a 10% increase or decrease in foreign currency rates against the relevant local currencies. The sensitivity rate of 10% is used when reporting foreign currency risk internally to key management personnel and represents management's assessment of the reasonably possible change in foreign exchange rates.

31 December 2010

Currency	Open position (in KM)	Stress Test	
		10% Move Up	10% Move Down
CHF	65,000	6,500	(6,500)
GBP	21,000	2,1000	(2,100)
USD	85,000	8,500	(8,500)
HRK	68,000	6,800	(6,800)
CAD	10,000	1,000	(1,000)
AUD	17,000	1,700	(1,700)
Other	196,000	19,600	(19,600)
EUR	(11,595,000)	-	-

31 December 2009

Currency	Open position (in KM)	Stress Test	
		10% Move Up	10% Move Down
CHF	136,000	13,600	(13,600)
GBP	(38,000)	(3,800)	3,800
USD	133,000	13,300	(13,300)
HRK	31,000	3,100	(3,100)
CAD	8,000	800	(800)
AUD	2,000	200	(200)
Other	64,000	6,400	(6,400)
EUR	(27,049,000)	-	-

Result of KM thousand profit/loss on USD position at 31 December 2010 is the result of having the Bank open position in USD equal to KM 85 thousand (USD assets KM 16,658 thousand and liabilities KM 16,573 thousand). If we take in consideration foreign currency movements and predict 10% positive or negative change applied to an open position of KM 85 thousand, the Bank is exposed to a FX risk in the amount of KM 8,5 thousand. In case of a long position with a positive market movements the Bank will record a profit and loss in the opposite case.

The analysis outlined above is used on open foreign currency position of the Bank, which includes all asset and liability items.

34. FINANCIAL INSTRUMENTS (continued)

Financial risk management objectives (continued)

If the currency position of a foreign currency is "long" (assets exceeding liabilities) and the exchange rate for this currency increases in relation to the KM, the Bank will experience a foreign exchange gain.

If the currency position of a foreign currency is "long" (assets exceeding liabilities) and the exchange rate for this currency decreases in relation to the KM, the Bank will experience a foreign exchange loss.

If the currency position of a foreign currency is "short" (liabilities exceeding assets) and the exchange rate for this currency increases in relation to KM, the Bank will experience a foreign exchange loss.

If the currency position of a foreign currency is "short" (liabilities exceeding assets) and the exchange rate for this currency decreases in relation to KM, the Bank will experience a foreign exchange gain.

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank monitors its foreign exchange (FX) position for compliance with the regulatory requirements of the Banking Agency of Federation of Bosnia and Herzegovina established in respect of limits on open positions. The Bank seeks to match assets and liabilities denominated in foreign currencies to avoid foreign currency exposures.

34. FINANCIAL INSTRUMENTS (continued)

Interest rate risk management

The Bank is exposed to interest rate risk as the Bank borrows funds at both fixed and floating interest rates. The risk is managed by the Bank by maintaining an appropriate mix between fixed and floating rate borrowings.

The Bank's exposures to interest rates on financial assets and financial liabilities are detailed in the liquidity risk management section of this note.

Interest rate risk reflects the possibility of loss of profit and/or erosion of capital due to a change in interest rates. It relates to all products and balances that are sensitive to changes in interest rates. This risk comprises two components: income component and investment component.

The income component arises from a lack of harmonization between the active and passive interest rates of the Bank (interest on placements is fixed, interest for liabilities is variable and vice versa).

The investment component is a consequence of the inverted relationship between price and interest rate fluctuations of securities.

The Bank strives to protect itself from interest rate risk by harmonizing the type of interest rate (fixed and variable), currency, related interest rate and the date of interest rate change for all products for which it concludes contracts (which are sensitive to interest rate changes). Any incongruity among the abovementioned elements results in exposure of the Bank to interest rate risk.

The sensitivity analyses below have been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the balance sheet date. For floating rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the balance sheet date was outstanding for the whole year. A 200 basis point increases or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If changes in interest rates market moving had been 200 basis points (2.00%) higher/lower and all other variables were held constant, the Bank's profit for the year ended 31 December 2010 with parallel interest rate shock in 200 bps would decrease 3,787 / 3,787 increase (2009: decrease/increase by KM 1,930 thousand). This is mainly attributable to the Bank's exposure to interest rates on its variable rate borrowings.

34. FINANCIAL INSTRUMENTS (continued)

Credit risk management

The Bank takes on exposure to credit risk which is the risk upon credit approval and when counterparty will be unable to pay amounts in full when due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

Making decision on exposure to credit risk is, according to the Bank's policy, centralised and concentrated in the Credit Committee for the retail and business. Decisions of the Credit Committees are made upon consideration of proposal provided by the Risk Management Department. The terms for approval of each corporate loan are determined individually depending on client type, loan's purpose, estimated credit worthiness and current market situation. Terms of security that accompany each loan are also determined according to a client credit worthiness analysis, type of credit risk exposure, term of the placement as well as the placement amount.

Commitments arising from the issuance of letters of credit, documentary letters of credit, which are written irrevocable undertakings by the Bank on behalf of a customer (mandatory) authorising a third party (beneficiary) to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Cash requirements under open letters of credit are considerably less than the commitments under issued guarantees or stand-by letters of credit. However, the Bank records provisions against these instruments on the same basis as is applicable to loans.

Commitments to extend credit, undrawn loan commitments, unutilised overdrafts and approved overdraft loans. The primary purpose of commitments to extend credit is to ensure that funds are available to a customer as required. Commitments to extend credit represent unused portions of authorisations to extend credits in the form of loans, guarantees or stand-by letters of credit. Commitments to extend credit issued by the Bank represent issued loan commitments or guarantees, undrawn portions of and approved overdrafts loans. Commitments to extend credit or guarantees issued by the Bank which are contingent upon customers maintaining specific credit standards (including the condition that a customer’s solvency does not deteriorate) are revocable commitments. Irrevocable commitments represent undrawn portions of authorised loans and approved overdraft facilities because they result from contractual terms and conditions in the credit agreements.

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Credit risk management (continued)

Financial assets

31 December 2010	Total gross carrying amount	Unimpaired assets	Individually impaired assets	Provisions for losses	Total net carrying amount
Cash and balances with other banks	66,364	66,364	-	-	66,364
Obligatory reserve with the Central Bank	97,789	97,789	-	-	97,789
Placements with other banks	190,290	190,290	-	(26)	190,264
Loans and advances to customers	934,077	882,722	51,355	(43,217)	890,860
Assets available for sale	999	999	-	(20)	979
	1,289,519	**1,238,164**	**51,355**	**(43,263)**	**1,246,256**
31 December 2009					
Cash and balances with other banks	100,503	100,503	-	-	100,503
Obligatory reserve with the Central Bank	88,772	88,772	-	-	88,772
Placements with other banks	134,701	134,701	-	(23)	134,678
Loans and advances to customers	838,084	792,562	45,522	(39,289)	798,795
Assets available for sale	553	553	-	(11)	542
	1,162,613	**1,117,091**	**45,522**	**(39,323)**	**1,123,290**

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Credit risk management (continued)

Credit exposure and collateral

31 December 2010		**Credit risk exposure**		
Description	**Loans given**	**Undrawn loan commitments and unutilized overdrafts**	**Commitments / Guarantees issued**	**Fair value of the collateral**
Legal entity	533,542	32,341	54,358	421,309
Retail	400,535	40,450	-	129,200
Total	**934,077**	**72,791**	**54,358**	**550,509**
31 December 2009				
Legal entity	432,917	28,120	49,185	353,452
Retail	405,167	43,027	-	119,149
Total	**838,084**	**71,147**	**49,185**	**472,601**

Fair value of the collateral

	31.12.2010	**31.12.2009**
Property	535,761	460,010
Deposits	14,748	12,591
	550,509	**472,601**

The Collateral Policy of the Bank defines the type of collateral, way of estimating fair value of collaterals and procedure for collection of receivable through collaterals. Type of prescribed collaterals and their respective amount are based on evaluation of every client's credit worthiness. Main categories or accepted collaterals are: cash, real estate, movable property and personal guarantees.

The Bank collateral policy defines also the process of recovery of non-performing loans through collaterals in order to decrease credit risk. The property that the Bank acquired through its collection process (land and buildings in the amount of KM 1,230 thousand; 2009: KM 29 thousand) is not shown among the Bank's property plant and equipment but it is recorded in "Other assets" position.

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Credit risk management (continued)

Delays

			Past due days				
	Gross total loans and advances given to customers	Undue	Until 30 days	31 – 90 days	91 – 180 days	181 – 270 days	Over 270 days
31 December 2010							
Legal entities	533,542	514,703	4,192	874	662	269	12,842
Retail	400,535	393,543	4,313	843	1,037	782	17
Total	**934,077**	**908,246**	**8,505**	**1,717**	**1,699**	**1,051**	**12,859**
31 December 2009							
Legal entities	432,917	413,461	3,396	931	450	1,703	12,976
Retail	405,167	398,507	4,300	782	926	651	1
Total	**838,084**	**811,968**	**7,696**	**1,713**	**1,376**	**2,354**	**12,977**

Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment agreements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to impairment assessment. The amount of renegotiated loans in 2010 was KM 52,737 thousand and in 2009 was KM 42,004 thousand.

Loans and other assets written off and recorded off-balance sheet

Movements in loans and other assets written off and recorded off-balance sheet are as follows:

	Loans and receivables	Assets available for sale	Other assets	Commitments	Total
31 December 2009	**31,886**	**857**	**3,567**	**2,938**	**39,248**
Currency differences and reclassification of beginning balances	2	-	88	-	90
Write-offs in 2010	13,553	-	246	703	14,502
Collections	(4,140)	-	(74)	(488)	(4,702)
Collections of OBS fees	-	-	(41)	-	(41)
Collections – deferred income	(136)	-	-	(137)	(273)
Total write offs	(1,725)	-	(141)	-	(1,866)
31 December 2010	**39,440**	**857**	**3,645**	**3,016**	**46,958**

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management

Liquidity risk is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank maintains its liquidity profiles in accordance with regulations laid down by the Banking Agency of Federation of Bosnia and Herzegovina.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs, guarantees and from margin and other calls on cash-settled derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand,

The following tables present in details the Bank's remaining contractual maturity for its financial assets and non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial assets / liabilities based on the earliest date on which the Bank can be required to receive or pay. The table includes both interest and principal cash flows.

	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	5+ years	Total
31 December 2010						
Cash and balances with Central bank	164,153	-	-	-	-	164,153
Placement with other banks	189,682	-	-	-	1,246	190,928
Loans and receivables	55,783	61,612	292,625	435,996	402,679	1,248,695
Assets available for sale	2	4	19	174	1,557	1,756
Other financial assets	2,465	-	-	-	1,229	3,694
TOTAL ASSETS	**412,085**	**61,616**	**292,644**	**436,170**	**406,711**	**1,609,226**
31 December 2009						
Cash and balances with Central bank	189,293	-	-	-	-	189,293
Placement with other banks	134,092	-	-	-	-	134,092
Loans and receivables	49,200	55,271	268,330	412,982	330,998	1,116,781
Assets available for sale	-	-	498	55	-	553
Other financial assets	7,285	-	-	-	2,352	9,637
TOTAL ASSETS	**379,870**	**55,271**	**268,828**	**413,037**	**333,350**	**1,450,356**

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management (continued)

	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	5+ years	Total
31 December 2010						
Due to banks and other institutions	83,525	28,438	81,383	224,764	66,175	484,285
Subordinated debit	-	40	122	702	561	1,425
Due to customers	380,134	23,266	122,755	171,601	11,944	709,700
Other financial liabilities	2,724	-	-	-	148	2,872
TOTAL LIABILITIES	**466,383**	**51,744**	**204,260**	**397,067**	**78,828**	**1,198,282**
31 December 2009						
Due to banks and other institutions	16,701	68,706	139,732	116,687	46,684	388,510
Subordinated debit	-	40	123	719	813	1,695
Due to customers	392,477	33,492	158,598	81,853	5,773	672,193
Other financial liabilities	7,736	-	-	-	152	7,888
TOTAL LIABILITIES	**416,914**	**102,238**	**298,453**	**199,259**	**53,422**	**1,070,286**

The following tables presents in details the Bank's remaining contractual maturity for its commitments and contingent liabilities:

	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	5+ years	Total
31 December 2010						
Guarantees	2,343	8,195	27,656	9,854	115	48,163
Letter of credit	540	1,517	4,138	-	-	6,195
Unused portion of loans	3,618	8,079	56,935	4,159	-	72,791
	6,501	**17,791**	**88,729**	**14,013**	**115**	**127,149**
31 December 2009						
Guarantees	1,423	7,740	26,420	9,221	144	44,948
Letter of credit	2,783	1,256	198	-	-	4,237
Unused portion of loans	46,607	2,149	17,961	2,321	2,109	71,147
	50,813	**11,145**	**44,579**	**11,542**	**2,253**	**120,332**

(all amounts are expressed in thousands of KM)

34. FINANCIAL INSTRUMENTS (continued)

Liquidity risk management (continued)

The following tables details the Bank's commitments and contingent liabilities allocated according to the earliest date they can be drawn:

	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	5+ years	Total
31.12.2010						
Guarantees	5,550	7,622	25,720	9,164	107	48,163
Letter of credit	936	1,411	3,848	-	-	6,195
Unused portion of loans	8,460	7,513	52,950	3,868	-	72,791
	14,946	**16,546**	**82,518**	**13,032**	**107**	**127,149**
31.12.2009						
Guarantees	3,599	7,353	25,099	8,760	137	44,948
Letter of credit	2,856	1,193	188	-	-	4,237
Unused portion of loans	49,061	1,934	16,165	2,089	1,898	71,147
	55,516	**10,480**	**41,452**	**10,849**	**2,035**	**120,332**

The Bank has access to sources of financing with total unused amount of KM 86,862 thousand (2009: KM 117,426 thousand) at the balance sheet date. The Bank expects to meet its other obligations from operating cash flows and proceeds of maturing financial assets.

35. EVENTS AFTER THE BALANCE SHEET DATE

No events have occurred since the balance sheet date, which significantly affect the state of affairs of the Bank at the balance sheet date or which require additional disclosure.

36. APPROVAL OF THE FINANCIAL STATEMENTS

These financial statements were approved for issue by the Management Board. The Bank's Supervisory Board and the General Assembly have the power to amend these financial statements after issue.

Approved by and signed on behalf of the Management Board:

INTESA SANPAOLO BANKA d.d.
Bosna i Hercegovina

Almir Krkalić,
Director

Dario Grassani
Executive director of Finance