

**SRPSKA BANKA A.D., BEOGRAD**

**Financial Statements  
For the Year Ended December 31, 2010  
and Independent Auditors' Report**

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***Translation of the Independent Auditors' Report Issued in the Serbian language***

**INDEPENDENT AUDITORS' REPORT**

**To the Shareholders of  
Srpska banka a.d., Beograd**

We have audited the accompanying financial statements of Srpska banka a.d., Beograd (the "Bank"), which comprise the balance sheet as of December 31, 2010 and the related income statement, statement of changes in equity and cash flow statement for the year than 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 the accounting regulations of the Republic of Serbia and regulations of the National Bank of Serbia governing financial reporting of banks, as well as for internal control relevant to 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 and the Law on Accounting and Auditing of the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 of Srpska banka a.d., Beograd for the year ended December 31, 2010 have been prepared, in all material respects, in accordance with the accounting regulations of the Republic of Serbia and regulations of the National Bank of Serbia governing financial reporting of banks.

*Other Matter*

The financial statements of Srpska banka a.d., Beograd as of and for the year ended December 31, 2009 were audited by another auditor whose report dated March 9, 2010 expressed an unqualified opinion with an emphasis of matter paragraph describing the fact that at December 31, 2009, the Bank's ratio of exposure to a group of related parties exceeded the prescribed maximum which the Bank reconciled with the National Bank of Serbia requirements by January 25, 2010 through collection of receivables due from a group of related parties.

Belgrade, March 31, 2011

Nada Sudić  
Certified Auditor

**INCOME STATEMENT**  
**Year Ended December 31, 2010**  
**(Thousands of RSD)**

	<u>Note</u>	<u>2010</u>	<u>2009</u>
<b>INCOME AND EXPENSES FROM OPERATIONS</b>			
Interest income	5	1,489,006	1,008,987
Interest expense	5	<u>(409,056)</u>	<u>(274,465)</u>
<b>Net interest income</b>		1,079,950	734,522
Fee and commission income	6	201,142	153,944
Fee and commission expense	6	<u>(24,487)</u>	<u>(29,119)</u>
<b>Net fee and commission income</b>		176,655	124,825
Net foreign exchange losses	7	(116,657)	(75,445)
Dividend and other income from equity investments		688	1,890
Other operating income	8	27,903	18,272
Net impairment losses and provisions	9	(423,486)	(268,290)
Staff costs	10	(475,129)	(455,453)
Depreciation and amortization	11	(53,282)	(62,453)
Operating and other expenses	12	(437,251)	(406,817)
Net gains on the valuation of assets and liabilities	13	<u>222,048</u>	<u>107,506</u>
<b>Profit/(Loss) from operations</b>		<u>1,439</u>	<u>(281,443)</u>
<b>Income taxes</b>			
Deferred tax benefits	14	<u>11</u>	<u>1,055</u>
<b>Profit/(Loss) before taxation</b>		<u>1,450</u>	<u>(280,388)</u>
<b>Earnings per share</b>		<u>9</u>	<u>-</u>

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

These financial statements were approved by management of Srpska banka a.d., Beograd and submitted with the Serbian Business Registers Agency on February 25, 2011.

Signed on behalf of Srpska banka a.d., Beograd by:

Chairman of the Executive Board  
Ivan Maričić

Member of the Executive Board  
Ivan Ristić

Head of Accounting  
Snežana Savić

**BALANCE SHEET**  
**As of December 31, 2010**  
**(Thousands of RSD)**

	<b>Notes</b>	<b>December 31, 2010</b>	<b>December 31, 2009</b>
<b>ASSETS</b>			
Cash and cash equivalents	15	2,983,747	1,891,526
Revocable loans and deposits	16	2,429,958	1,834,092
Receivables arising from interest, fee and commission, trade, fair value adjustments of derivatives and other receivables	17	128,620	66,463
Loans and deposits to customers	18	7,759,392	6,947,962
Securities (excluding repurchased own shares)	19	356,861	300,737
Other placements	20	271,000	26,327
Intangible assets	21	17,900	25,553
Property, equipment and investment property	21	733,204	745,831
Other assets	22	31,445	27,320
<b>Total assets</b>		<b>14,712,127</b>	<b>11,865,811</b>
<b>LIABILITIES</b>			
Transaction deposits	23	2,533,446	2,467,956
Other deposits	24	8,853,465	6,167,957
Borrowings	25	23,049	5,321
Interest, fee and commission payables and fair value adjustments of derivatives	26	2,040	4,165
Provisions	27	38,775	33,885
Tax liabilities		3,935	230
Deferred tax liabilities	14	31,096	31,107
Other liabilities	28	241,184	172,089
<b>Total liabilities</b>		<b>11,726,990</b>	<b>8,882,710</b>
Share capital	29	1,617,520	1,617,520
Reserves		933,112	1,175,427
Revaluation reserves		433,055	432,860
Unrealized losses on securities available for sale		-	(391)
Retained earnings/(Accumulated loss)		1,450	(242,315)
<b>Total Equity</b>		<b>2,985,137</b>	<b>2,983,101</b>
<b>Total Liabilities and Equity</b>		<b>14,712,127</b>	<b>11,865,811</b>
<b>OFF-BALANCE-SHEET ITEMS</b>	30	<b>32,746,989</b>	<b>23,691,142</b>

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

**STATEMENT OF CHANGES IN EQUITY**  
**Year Ended December 31, 2010**  
**(Thousands of RSD)**

	<b>Share Capital</b>	<b>Reserves</b>	<b>Revaluation Reserves</b>	<b>Unrealized Losses on AFS Securities</b>	<b>Retained Earnings/ (Accumulated Losses)</b>	<b>Total</b>
Balance at January 1, 2009	1,617,520	1,168,420	470,933	(115)	7,007	3,263,765
Transfer from reserves	-	7,007	-	-	(7,007)	-
Realization of property and equipment revaluation reserves	-	-	(38,073)	-	38,073	-
Decrease in the fair value of AFS securities	-	-	-	(276)	-	(276)
Loss for the year	-	-	-	-	(280,388)	(280,388)
Balance at December 31, 2009	<u>1,617,520</u>	<u>1,175,427</u>	<u>432,860</u>	<u>(391)</u>	<u>(242,315)</u>	<u>2,983,101</u>
Loss absorption	-	(242,315)	-	-	242,315	-
Equity investment valuation effects	-	-	195	-	-	195
Increase in the fair value of AFS securities	-	-	-	391	-	391
Profit for the year	-	-	-	-	1,450	1,450
Balance at December 31, 2010	<u>1,617,520</u>	<u>933,112</u>	<u>433,055</u>	<u>-</u>	<u>1,450</u>	<u>2,985,137</u>

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

**CASH FLOW STATEMENT**  
**Year Ended December 31, 2010**  
**(Thousands of RSD)**

	<u>2010</u>	<u>2009</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
<b>Cash inflows from operating activities</b>	<u>1,633,970</u>	<u>1,159,224</u>
Interest receipts	1,394,589	971,689
Fee and commission receipts	200,054	153,009
Receipts from other operating income	38,639	32,636
Receipts from dividends and profit distribution	688	1,890
<b>Cash outflows from operating activities</b>	<u>(1,314,699)</u>	<u>(1,163,877)</u>
Interest payments	(411,191)	(273,181)
Fee and commission payments	(24,477)	(29,127)
Payments to, and on behalf of, employees	(448,035)	(472,805)
Taxes, contributions and other duties paid	(117,106)	(114,022)
Payments of other operating expenses	(313,890)	(274,742)
<b>Net cash provided by/(used in) operating activities prior to increases or decreases in placements and deposits</b>	319,271	(4,653)
Decrease in placements made and increase in deposits received	<u>2,912,352</u>	<u>2,063,670</u>
Decrease in FVTPL securities, trading placements and short-term securities held to maturity	143,626	101,217
Increase in banks and customer deposits	2,768,726	1,962,453
Increase in placements made and decrease in deposits received	<u>(2,240,945)</u>	<u>(2,666,719)</u>
Increase in loans and advances to banks and customers	(2,240,945)	(2,666,719)
<b>Net cash provided by/(used in) operating activities before income taxes</b>	990,678	(607,702)
Income taxes paid	<u>(2,075)</u>	<u>(2,900)</u>
<b>Net cash provided by/(used in) operating activities</b>	988,603	(610,602)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of intangible assets, property and equipment	<u>(37,320)</u>	<u>(40,966)</u>
<b>Net cash used in investing activities</b>	(37,320)	(40,966)
<b>Total net inflows</b>	4,546,322	3,222,894
<b>Total net outflows</b>	<u>(3,595,039)</u>	<u>(3,874,462)</u>
<b>Cash provided by/(used in) financing activities, net</b>	951,283	(651,568)
<b>Cash and cash equivalents, beginning of year</b>	1,891,526	2,499,158
Foreign exchange gains	4,398,722	3,161,242
Foreign exchange losses	<u>(4,257,784)</u>	<u>(3,117,306)</u>
<b>Cash and cash equivalents, end of year</b>	<u><u>2,983,747</u></u>	<u><u>1,891,526</u></u>

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

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***1. BANK'S ESTABLISHMENT AND ACTIVITY**

Srpska banka a.d. Beograd (hereinafter the "Bank") was established through the transformation of a specialized organization within the National Bank of Yugoslavia (NBY) – Military Service no. 920 as of November 1996. The Bank is inscribed in the Register maintained by the Commercial Court of Belgrade pursuant to the Decision number VI/Fi-19015/96 as of November 14, 1996.

Pursuant to the Bank's Establishment Agreement dated September 17, 1996, it was decided that the Bank should commence its operations on January 1, 1997. Until September 1, 2003, the Bank operated as JU GARANT BANKA a.d., Beograd. On November 5, 2004, the Bank inscribed the legal successor of the Federal Republic of Yugoslavia in the Decision numbered XI Fi 11391/04.

The founder and majority owner of the Bank is the Republic of Serbia whose participation in share capital as of December 31, 2010 totaled 96.52%.

The Bank is registered in the Republic of Serbia to provide banking services associated with payment transfers performed domestically and abroad, credit and deposit operations performed domestically, card payment operations, security trading and dealer operations as stipulated in the Law on Banks. The Bank operates based on principles of liquidity, solvency and profitability and is an open shareholding company.

The Bank's headquarters are in Belgrade, Savska Street number 25. It is comprised of 14 branch offices. At December 31, 2010, the Bank had 369 employees (December 31, 2009: 394 employees).

The Bank's registration number 07092288, and its Tax Identification Number is 100000387.

The Bank's Management Board adopted these financial statements on February 25, 2011.

**2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION****2.1. Basis of Preparation and Presentation of Financial Statements**

Pursuant to the Law on Accounting and Auditing (Official Gazette of the Republic of Serbia no. 46 of June 2, 2006 and no. 111 as of December 29, 2009), legal entities and entrepreneurs incorporated in Serbia are required to maintain their books of account, to recognize and value assets and liabilities, income and expenses, and to present, submit and disclose financial statements in conformity with the prevailing legislation and professional rules which include: the Framework for the Preparation and Presentation of Financial Statements (the "Framework"), International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), as well as the related interpretations representing an integral part of these standards which were in effect as at December 31, 2002.

The amendments to IAS, as well as the newly-issued IFRS and the related interpretations issued by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC"), in the period between December 31, 2002 and January 1, 2009, were officially adopted pursuant to a Decision enacted by the Ministry of Finance of the Republic of Serbia ("Ministry") and published in the Official Gazette of the Republic of Serbia number 77 of October 25, 2010.

However, until the preparation date of the accompanying financial statements, not all amendments to IAS/IFRS and IFRIC in effect for annual periods beginning on or after January 1, 2009 had been translated. In addition, the accompanying financial statements are presented in the format prescribed under the "Guidelines on the Prescribed Form and Content of the Financial Statements of Banks and Other Financial Institutions" (Official Gazette of the Republic of Serbia nos. 74/2008, 3/2009 and 5/2010). Such statements represent the complete set of financial statements as defined under the law, which differ from those defined under the provisions of IAS 1, "Presentation of Financial Statements," and differ in some respects, from the presentation of certain amounts as required under the aforementioned standard. Standards and interpretations in issue, but not yet officially translated and adopted and standards and interpretations in issue but not yet in effect are disclosed in Notes 2.2 and 2.3.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)****2.1. Basis of Preparation and Presentation of Financial Statements (Continued)**

In accordance with the aforescribed, and given the potentially material effects which the departures of accounting regulations of the Republic of Serbia from IAS and IFRS may have on the fairness presentations made in the financial statements, the accompanying financial statements cannot be treated as a set of financial statements prepared in accordance with IAS and IFRS.

The Bank's management estimates the effect of the aforementioned standards, interpretations and revisions of the existing standards and does anticipate any materially significant effect to arise thereof on the Bank's financial statements in the period of first time application.

In the preparation of the accompanying financial statements, the Bank adhered to the accounting policies described in Note 3.

The Bank's financial statements are stated in thousands of dinars (RSD). The dinar is the official reporting currency in the Republic of Serbia

**2.2. Standards and Interpretations in Issue, but not yet Translated and Adopted**

As of the financial statements issuance date, the following standards, amendments were issued by the International Accounting Standards Board and Interpretations issued by the International Financial Reporting Interpretations Committee but were not officially adopted and translated in the Republic of Serbia for the annual accounting periods commencing on or after January 1, 2010:

- Amendments to IFRS 7 "Financial Instruments: Disclosures" – Amendments improving fair value and liquidity risk disclosures (revised in March 2009, effective for annual periods beginning on or after January 1, 2009);
- Amendments to IFRS 1 "First-time Adoption of IFRS" – Additional Exemptions for First-time Adopters. The amendments relate to assets in oil and gas industry and determining whether an arrangement contains a lease (revised in July 2009, effective for annual periods beginning on or after January 1, 2010);
- Amendments to various standards and interpretations resulting from the Annual quality improvement project of IFRS published on April 16, 2009 (IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36, IAS 39, IFRIC 16) primarily with a view to removing inconsistencies and clarifying wording, (amendments are to be applied for annual periods beginning on or after 1 January 2010, while the amendment to IFRIC is to become effective as of July 1, 2009);
- Amendments to IAS 38 "Intangible Assets" (revised in July 2009, effective for annual periods beginning on or after July 1, 2009);
- Amendments to IFRS 2 "Share-based Payment": Amendments resulting from the Annual quality improvement project of IFRS (revised in April 2009, effective for annual periods beginning on or after July 1, 2009) and amendments relating to group cash-settled share-based payment transactions (revised in June 2009, effective for annual periods beginning on or after January 1, 2010);
- Amendments IFRIC 9 "Reassessment of Embedded Derivatives" effective for annual periods beginning on or after July 1, 2009 and IAS 39 "Financial Instruments: Recognition and Measurement" – Embedded Derivatives (effective for annual periods ending on or after June 30, 2009);
- IFRIC 18 "Transfers of Assets from Customers" (effective for annual periods ending on or after July 1, 2009).

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)****2.3. Standards and Interpretations in Issue not yet in Effect**

At the date of issuance of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- “Conceptual Framework for Financial Reporting 2010” being an amendments to “Framework for the Preparation and Presentation of Financial Statements” (effective for transfer of assets from customers received on or after September 2010);
- IFRS 9 “Financial Instruments” (effective for annual periods beginning on or after January 1, 2013);
- Amendments to IFRS 1 “First-time Adoption of International Financial Reporting Standards” – Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters (effective for annual periods beginning on or after July 1, 2010);
- Amendments to IFRS 1 “First-time Adoption of IFRS”- Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IFRS 7 “Financial Instruments: Disclosures” – Transfer of Financial Assets (effective for annual periods beginning on or after July 1, 2011);
- Amendments to IAS 12 “Income Taxes” – Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after January 1, 2012);
- Amendments to IAS 24 “Related Party Disclosures” – Simplifying the disclosure requirements for government-related entities and clarifying the definition of a related party (effective for annual periods beginning on or after January 1, 2011);
- Amendments to IAS 32 “Financial Instruments: Presentation” – Accounting for rights issues (effective for annual periods beginning on or after February 1, 2010);
- Amendments to various standards and interpretations “Improvements to IFRSs” resulting from the Annual quality improvement project of IFRS published on May 6, 2010 (IFRS 1, IFRS 3, IFRS 7, IAS 1, IAS 27, IAS 34, IFRIC 13) primarily with a view to removing inconsistencies and clarifying wording, (most amendments are to be applied for annual periods beginning on or after January 1, 2011);
- Amendments to IFRIC 14 “IAS 19 – The Limit on a defined benefit Asset, Minimum Funding Requirements and their Interaction” - Prepayments of a Minimum Funding Requirement (effective for annual periods beginning on or after January 1, 2011);
- IFRIC 19 “Extinguishing Financial Liabilities with Equity Instruments” (effective for annual periods beginning on or after July 1, 2010).

**2.4. Comparative Information**

The comparative data comprise the Bank’s audited financial statements for the year 2009.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****3.1. Interest Income and Expenses**

Interest income and interest expenses, including penalty interest and other income and expenses arising on interest-bearing assets and/or interest-bearing liabilities, are recorded in the income statement on an accrual basis in accordance with the agreement signed between the Bank and the customer.

For all financial instruments measured at amortized cost and interest-bearing financial instruments classified as available-for-sale, interest income and expenses are stated using the effective interest rate which precisely discounts the estimated future payments or receipts throughout the estimated life of an instrument or, where necessary, within the shorter period, to the net book value of financial assets or liabilities.

Loan origination fees, that are an integral part of interest income, are calculated and collected one-off and in advance, are deferred and recognized as income on a proportionate basis throughout the loan repayment period (Note 29). Proportionate deferral of fees is not materially different from effective interest approach.

**3.2. Fee and Commission Income and Expenses**

Fee and commission income and expenses arising on banking services are recognized in full when earned and are calculated on an accrual basis and are determined for the period when they are realized i.e. when the service is rendered.

The Bank earns fee and commission income from a wide range of services it renders to its customers. Fee and commission income can be classified into two categories.

Loan origination fees and other fees relating to loans that are deferred (together with all additional expenses) and presented within accruals, transferred to the income statement and presented within interest income over the maturity period of a financial instrument.

Fees and commissions and fee and commission components that are related to the execution of a certain business are recognized once certain criteria have been fulfilled.

**3.3. Foreign Exchange Translation**

Items included in Bank's financial statements are presented in the functional currency, i.e., the currency of the primary economic environment in which the Bank operates. As disclosed in Note 2.1, financial statements are stated in thousands of Dinars (RSD), which is the Bank's functional currency.

Transactions denominated in foreign currencies are translated into dinars at official exchange rates at the date of each transaction. Monetary assets and liabilities stated in the foreign currency as of the balance sheet date are recalculated into Dinars by applying the middle exchange rates as determined on the Interbank Exchange Market effective at that date (Note 36).

Foreign exchange gains or losses arising upon the translation of transactions, and the assets and liabilities denominated in foreign currencies are credited or charged to the income statement as foreign exchange gains and losses (Note 7).

Gains and losses arising from translation of financial assets and liabilities indexed to a currency are carried through profit or loss of the respective period, i.e., recorded as gains and losses on the valuation of assets and liabilities (Note 13).

Commitments and contingent liabilities denominated in foreign currencies are translated into dinars by applying the middle exchange rates of the National Bank of Serbia that are prevailing at the balance sheet date.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Financial Instruments**

When a financial asset or financial liability is recognized initially, the Bank measures it at its fair value, (except in the case of a financial asset or financial liability that are measured at fair value through profit or loss), as increased by transaction costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on a trade date basis (or on a settlement date accounting basis) i.e. at the date when the Bank commits to purchase or sell the asset (the date when the Bank receives the asset purchased or transfers the asset sold).

Financial assets and financial liabilities are recognized in the Bank's balance sheet on the date upon which the Bank becomes a counterparty to the contractual provisions of a specific financial instrument. Regular purchase or sale of financial assets is recognized by applying the computation as of the settlement date, or the date when the Bank has delivered the specific financial instrument to the other party.

***Derecognition of Financial Assets and Liabilities***

Financial assets cease to be recognized when the Bank loses control of the contractual rights governing such instruments, which occurs when the rights of use of such instruments have been realized, expired, abandoned, and/or ceded. When the contractual rights to the cash flows from the asset have been transferred or the Bank contractually agrees to transfer the asset but it neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the Bank recognizes the financial asset to the extent of its continuing involvement in the financial asset. Continuing involvement taking the form of guaranteeing the transferred asset is recognized as the lower of the amount of the asset and the maximum amount of the consideration received that the Bank could be required to repay ('the guarantee amount').

Financial liabilities cease to be recognized when the Bank fulfills the obligations, or when the contractual repayment obligation has either been cancelled or has expired. Where an existing financial liability is substituted by another liability towards the same lender with substantially different terms or under a substantial modification of the terms of an existing financial liability, such substitute is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability while the difference between the original and new value of liability is carried through profit and loss.

***Classification of Financial Instruments***

The Bank's management classifies financial instruments upon their initial recognition. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

The Bank classified the financial assets into the following categories: financial assets at fair value to profit or loss, securities held-to-maturity, loans and receivables and securities held-for-sale.

Subsequent measuring of financial assets depends on their classification being as follows:

**3.4.1. Financial Assets at Fair Value to Profit and Loss**

This category includes two subcategories of financial assets: trading financial assets and those carried at fair value to profit and loss.

Upon initial recognition, no financial assets have been included within assets carried at fair value through profit and loss.

Financial assets are classified as trading instruments if the Bank acquired or incurred them principally for the purpose of selling or repurchasing them in the near term in order to derive profit from the short-term price fluctuations or as derivatives. The aforementioned assets are recorded at fair value in the Bank's balance sheet.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Financial Instruments (Continued)****3.4.1. Financial Assets at Fair Value through Profit and Loss (Continued)**

Trading securities comprise shares of enterprises, other banks and insurance companies.

Gains and losses on the valuation and sale of financial assets at fair value are stated in the income statement.

**3.4.2. Securities Held-to-Maturity**

Held-to-maturity investments are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity.

Upon initial recognition, securities held-to-maturity are recorded at amortized cost by applying the effective interest method less any allowance for impairment, i.e., accumulated impairment losses. The amortized cost is calculated by taking into account all discounts or premiums realized in the purchase, in the maturity period.

The Bank performs individual assessment so as to determine objective evidence of impairment of investments in securities held to maturity.

If there is objective evidence of impairment, the amount of loss arising from impairment of securities held to maturity is calculated as the difference between the carrying value of investments and the present value of expected cash flows discounted by applying the original interest rate, and stated in the income statement through the allowance account (Note 9).

If in the following year the amount of estimated impairment loss decreases owing to an event that ensued after the impairment was recognized, each amount of impairment previously recognized is decreased and the effects thereof are credited to the income statement.

Interest income from these instruments is calculated by applying the method of effective interest rate and is stated within interest income. Fees and commission being an integral part of effective interest income to these instruments are deferred and credited to income statement over the instrument's maturity period.

**3.4.3. Loans and Receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not listed on an active market. Loans and advances to banks and customers are recorded on the balance sheet from the moment these are disbursed to the borrower. All loans and advances are initially recognized at fair value.

After initial measuring, loans and advances to banks and customers are stated in the amount of principal outstanding, taking into account all discounts and premiums upon acquisition, less allowance for impairment. Income and receivables arising from interest accrued on these instruments are recorded within interest income/interest receivables. Interest which is a part of effective interest on these instruments is deferred and stated as accruals and credited to profit within interest income over the instrument's maturity period.

The loans disbursed in dinars and index linked to EUR or USD exchange rate, are revalued in accordance with the agreement pertaining to each individual loan. The difference between the principal outstanding and the amount calculated by applying currency clause is stated within loans and deposits. Gains and losses arising from the application of a currency clause are carried through profit and loss as gains and losses on the valuation of assets and liabilities.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Financial Instruments (Continued)****3.4.3. Loans and Receivables (Continued)*****Allowances for Impairment and Provisions for Contingent Liabilities***

In accordance with the Bank's internal policies, at each reporting date the Bank assesses whether there are any indications of the impairment of a financial asset or group of financial assets. Impairment losses are calculated only if there is objective evidence of impairment which resulted from one or several events that occurred after the initial recognition of an asset and when these events influence the estimated future cash flows from financial assets of a group of financial assets and effects can be reliably measured.

The objective evidence of impairment may include significant financial difficulties of debtors and groups of debtors, or defaults or delinquency in interest or principal repayment, or possibility that a bankruptcy proceeding or financial reorganization process may be initiated by the debtor, and when available information indicate that there is a measurable decrease in future cash flows such as changes in unsettled liabilities or economic conditions coinciding with departures from the agreed terms.

When determining the impairment of loans and advances to banks and customers measured at amortized cost, the Bank first makes individual assessment in order to determine whether there is objective evidence of impairment for each individually significant financial asset and performs collective assessment of impairment in financial assets that are not individually significant. If the Bank determines that there is no objective evidence of impairment in financial assets individually assessed for impairment, such assets are included into a group of financial assets with similar credit risk exposure and are assessed for impairment collectively. The assets assessed individually for impairment and for which the impairment loss is recognized or continues to be recognized, are not encompassed in the assessment of impairment on portfolio basis.

In case there is objective evidence of impairment, the amount of loss is determined as a difference between the loan carrying amount and its recoverable amount, which is considered to be the net present value of the estimated future cash flows, discounted at the initial interest rate contracted for that particular financial asset. If a loan is indexed to a floating interest rate current effective interest rate is used.

The calculation of the present value of the estimated future cash flows arising from a collateralized financial asset, reflects the cash flows contingent on the realization of the instrument's securitization. In case a loan or a placement held to maturity bears a variable interest rate, the discount rate for measuring any impairment loss is the current interest rate stated in the respective agreement.

For the purposes of assessing the impairment loss on portfolio basis, financial assets are aggregated based on their similar exposure to credit risk and internal classification system applied in the Bank according to the assets' nature, branch of industry, geographical location, type of collaterals, the status of matured, but uncollected loans and the like. The future cash flows for the group of financial assets collectively classified are estimated for impairment based on contractual cash flows and the Bank's historical experience with losses on assets with similar characteristics of credit risk.

Historical data on incurring loss for the purposes of assessing impairment on portfolio basis are adjusted based on the currently available data reflecting the effects of past circumstances which influenced the period from which the forgoing experience with losses dates, with the aim to remove the effects which are non-existent in the current period. The Bank regularly verifies and reconsiders the methodology and assumptions used to decrease the differences between the estimated losses and actual losses incurred.

The carrying value of assets is decreased using the allowance account and losses on impairment of loans and receivables as well as other financial assets carried at amortized cost, are recorded in the income statement within allowance for impairment (Note 9).

**NOTES TO THE FINANCIAL STATEMENTS**

December 31, 2010

*All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Financial Instruments (Continued)****3.4.3. Loans and Receivables (Continued)*****Allowances for Impairment and Provisions for Contingent Liabilities (Continued)***

In case the amount of impairment loss on loans in the forthcoming period reverses due to the event which took place after the initial allowance for the impairment was made, such allowance is adjusted by the amount of reversal and the amount of adjustment is credited to the income statement as reversal of the allowance for impairment (Note 9).

The write-off of bad debts is performed based on a court decision, decisions enacted by the Bank's Assembly, President of the Executive Board when there is no real possibility to collect the receivable and when all collaterals have been exhausted.

***Rescheduled Loans***

Whenever possible, the Bank is more inclined to reschedule loans than to foreclose on collaterals. The reschedule may take the form of repayment deadline extension or of different terms of crediting. Once terms have been changed, the loan is not considered to be matured. Management controls rescheduled loans on an ongoing basis so as to ensure that all criteria are met and future payments discharged. The Bank continues to perform individual assessment for impairment applying the effective interest rate.

**3.4.4. Securities Available-for-Sale**

Securities for which there is intention to hold them for an indefinite time period, and which can be sold to meet liquidity needs or due to fluctuation in the interest rates, foreign exchange rates or prices of capital, are classified as "available-for-sale securities." Securities available for sale are comprised of equity instruments of other legal entities, as well as debt securities.

Upon initial recognition, securities available-for-sale, are stated at fair value. The fair value of securities quoted in the market is based on the current bid prices. Unrealized gains and losses arising from securities available-for-sale are credited or charged to revaluation reserves, until the security is sold, collected or in any other way realized, or until such security is impaired. When securities available-for-sale are disposed or their value is impaired, the accumulated fair value adjustments are recognized within equity in the income statement.

Equity investments in other legal entities which do not have quoted price in an active market and cannot be assessed by applying other reasonable methods, are not measured at fair value and are stated at cost less any allowance for impairment.

Dividends from financial assets available for sale are included in dividend and other income from equity investments when the right to inflows from dividends has been established.

In respect to equity investments and other securities available for sale, at the balance sheet date, the Bank assesses whether there is objective evidence that one or more investments have suffered impairment. In case equity investments in other legal entities classified as available for sale, objective evidence of impairment includes significant or prolonged decline in fair value below cost. When there is evidence of impairment, cumulative loss measured as the difference between cost and current value, as decreased for any amount of impairment loss on that investment, previously recognized on the income statement is removed from equity and charged to the income statement.

For debt instruments classified as available for sale, impairment is assessed using the same criteria as for financial assets initially stated at amortized cost. If in the ensuing year the fair value of a debt instrument increases or the increase may objectively be linked to an event that occurred after the impairment was charged to the income statement, the impairment loss is reversed and the related amount is credited to the income statement.

**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2010**

*All amounts expressed in thousands of RSD, unless otherwise stated.*

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**3.4. Financial Instruments (Continued)**

**3.4.5. *Financial Instruments Issued and Other Financial Liabilities***

Financial instruments or their components are classified as liabilities when the substance of contracts governing such instruments indicates that the Bank is liable to make cash payments or deliver some other financial asset to the holder or to settle the liability otherwise than through cash payment or exchange of another financial instrument for a fixed number of own shares.

The subsequent measuring of financial liabilities depends on their classifications as follows:

***Amounts Owed to Banks and Customers***

Amounts owed to banks and customers, as all other interest-bearing liabilities, are initially recognized at fair value, as reduced by all transaction costs except for the financial liabilities carried at fair value through profit and loss. Subsequent to initial recognition, interest bearing deposits and borrowings are stated at amortized cost.

***Borrowings***

The liabilities arising from borrowings are initially stated at fair value net of any transaction costs. Borrowings are subsequently measured at amortized cost. Borrowings are classified within current liabilities unless the Bank is not unconditionally liable to discharge the liability within 12 months from the date of issuing the Report.

***Accounts Payable***

Accounts payable and other current liabilities are stated at their nominal value.

**3.4.6. *Offset of Financial Assets and Financial Liabilities***

The Bank offsets its assets and liabilities and the difference between their aggregates is recognized within the balance sheet, if, and only if, it has a legally enforceable right to set off the recognized amounts and intends either to settle them on a net basis, or to sell the asset and settle the liability simultaneously.

**3.4.7. *Special Reserve for Potential Losses on Balance Sheet and Off-Balance Sheet Exposures***

Special reserve for potential losses is estimated in accordance with the requirements of the relevant NBS Decision on the Classification of Balance Sheet and Off-Balance Sheet Exposures ("RS Official Gazette," No. 129/2007, 63/2008, 104/2009 and 30/2010).

Total receivables from a single debtor (balance sheet and off-balance exposures) are classified into the categories from A to D, in accordance with the evaluation of their collectability. The collectability of receivables from one debtor is estimated based on the debtor's diligence in servicing its debt, as well as based on its financial position, number of days in default against interest and principal liabilities, as well as the quality of the collateral provided for the debt.

Pursuant to the classification of receivables, and in accordance with the Decision issued by the National Bank of Serbia, the amount of special reserve for potential losses is calculated by applying the following percentages to the categories: A (0%), B (5%-10%), V (20%-35%), G (40%-75%) and D (100%).

In its internal acts the Bank determined the criteria and methodology for determining the special reserves for potential losses with the percentages prescribed by the Decision issued by the National Bank, based on days in default of liabilities, financial position, and analyses of the debtor's financial performance, cash flow adequacy and collaterals.

Calculated special reserve for potential losses as decreased by the allowance for impairment of balance sheet assets and provisions for losses on off-balance sheet items which is in accordance with the accounting policy of the Bank disclosed in Note 29 (a) and charged to the income statement (Note 9).

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.4. Financial Instruments (Continued)****3.4.7. Special Reserve for Potential Losses on Balance Sheet and Off-Balance Sheet Exposures (Continued)**

The amount of special reserve for potential losses after allowance or impairment of balance sheet assets and provisions for losses on off-balance sheet items are allocated from retained earnings based on the Decision of the Bank's Assembly and recorded within the reserves from profit for estimated losses on placements.

If current year profit and retained earnings from prior years are insufficient to cover estimated amount of special reserve, the difference is disclosed as an additionally required provision (Note 29a).

**3.5. Cash and Cash Equivalents**

For the purposes of the cash flow statement, "Cash and cash equivalents" include cash held on the Bank's account and cash on hand (in dinars or in foreign currency), cheques, foreign currency assets held on the accounts with domestic and foreign banks (Note 15).

**3.6. Repurchase Transactions**

Repurchase transactions relate to securities purchased under agreements to resell determining the exact date when these securities will be sold again, are recognized in the balance sheet.

Cash used for the purposes above described, including matured interest, is recognized in the balance sheet. The difference between the purchase price and the price realized in resale is treated as interest income and matures during the respective agreement.

**3.7. Intangible Assets**

Intangible assets comprise of software and licenses. Intangible assets are stated at cost net of accumulated amortization and impairment losses, if any.

The useful life of intangible assets is estimated as finite. Intangible assets with a finite useful life are amortized over their useful life. The period and method of amortization applied to intangible assets with finite useful life are reexamined once a year at the end of financial year.

The changes in the expected useful life or expected patterns of consumption of future economic benefits comprised in the asset are encompassed by changing the period or amortization method and are treated as changes in accounting estimates.

Amortization is provided for on a straight-line basis to the cost or revalued amount of intangible assets in order to write them off over their useful lives as follows using the following useful lives:

Software licenses	3 years
Other intangible assets	5 years

Amortization of intangible assets is charged to the income statement (Note 11).

Expenditures arising from the development or administration of computer software are expensed in the period in which these are incurred.

**3.8. Property and Equipment**

The Bank's fixed assets comprise buildings, equipment and other assets. Such assets are initially recognized at cost as increased by any acquisition related expenses, net of any trade discounts and rebates.

Subsequently, buildings are measured at revalued amount being their fair value at the revaluation date net of allowance for impairment and accumulated impairment losses.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.8. Property and Equipment (Continued)**

Buildings are stated at the appraised value as determined by an independent certified appraiser as of August 27, 2008, less accumulated depreciation. The appraisal surplus is credited to the Bank's revaluation reserves. The frequency of revaluations depends on the volatility of the fair values of the buildings being revalued.

The Bank's equipment is stated at cost net of allowance for impairment.

Subsequent expenditure is recognized as an increase in the cost of respective assets, when it is probable that future economic benefits, in excess of the originally assessed standard of performance, will flow to the Bank, and when the cost can reliably be measured. Repairs and maintenance are expensed as incurred and are stated under operating expenses.

The depreciation of property and equipment is provided for on a straight-line basis in order to fully write-off the cost of such assets over their estimated useful lives as follows:

Buildings	up to 77 years
Computer equipment	up to 5 years
Equipment	from 6 to 14 years

Changes in the expected useful life are treated as changes in accounting estimates. Depreciation of buildings and equipment commences in the month following the month when such assets are placed in use. Depreciation is not accrued for assets under construction. Accrued amortization expense is recognized as an expense of the period in which it is incurred.

Gains and losses on the disposal or sale of property and equipment are credited or charged to the income statement, within other operating income or expenses.

The calculation of depreciation and amortization for tax purposes is performed in accordance with the Corporate Income Tax Law of the Republic of Serbia and the Rules on Classification of Fixed Assets into Groups and the Manner of Determining Depreciation for Tax Purposes, which gives rise to deferred taxes (Note 14c).

**3.9. Leases**

Considering whether or not a particular agreement comprises leases or contains lease elements is based on the substance of the agreement and requires the assessment whether the fulfillment of conditions is dependent on the use of a certain asset or group of assets and whether the agreement transfers rights of use over the assets.

*a) Finance Lease – the Bank as a Lessee*

A finance lease transferring substantially all the risks and rewards incidental to ownership of an asset to the Bank is capitalized at the lease inception at the lower of the fair value of leased item or the present value of minimum lease payment and is recognized within property and equipment along with the related liability towards the lessor, stated within other liabilities. Capitalized assets taken under lease are depreciated over the lease term. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability so as to produce a constant periodic rate of interest on the remaining balance of the liability. Such finance expenses are charged to the income statement within interest expense.

*b) Operating Lease – the Bank as a Lessee*

A lease that does not transfer substantially all the risks and rewards incidental to ownership of an asset is classified as an operating lease.

Lease payments under an operating lease are recognized as an expense on a straight-line basis at their inception over the lease term (Note 12).

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.10. Impairment of Non-Financial Assets**

Pursuant to the adopted accounting policy, at the reporting date, the Bank's management reviews the carrying amounts of the Bank's tangible and intangible assets in order to determine the indications of impairment loss. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount, being the higher of net selling price and value in use. Impairment loss is recognized in the amount of the difference charged to expenses in accordance with IAS "Impairment of Assets."

Non-financial assets that have suffered impairment are revised in each reporting period for potential reversal of impairment loss.

**3.11. Provisions, Contingent Liabilities and Contingent Assets**

A provision is recognized when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. So as to reflect the best possible estimates, provisions are considered, determined and revised at each reporting date. Provisions are measured at the present value of expected outflows required to settle the present obligation applying the discount rate reflecting the current market estimate of time value of money.

If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed. Provisions are monitored per types and can be used for purposes for which it was initially recognized. Provisions are not recognized for future operating losses.

Contingent liabilities are not recognized in the financial statements of the Bank. Contingent liabilities are disclosed in the notes to the financial statements (Note 34), unless the possibility of an outflow of resources embodying economic benefits is remote.

Contingent assets are not recognized in the financial statements of the Bank. They are disclosed in the notes to the financial statements where an inflow of economic benefits is probable.

**3.12. Employee Benefits***a) Employee Taxes and Contributions for Social Security – Defined Contribution Plans*

In accordance with regulatory requirements in the Republic of Serbia, the Bank is obligated to pay contributions to state social care funds. These obligations involve the payment of taxes and contributions on behalf of the employee, by the employer, in an amount computed by applying the specific, legally-prescribed rates. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to the applicable government funds. The Bank is not obligated to pay benefits that represent the obligation of the Republic of Serbia Pension Fund. These taxes and contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

*b) Other Benefits Payable – Retirement Benefits and Jubilee Awards*

Pursuant the Collective Bargaining Agreement, the Bank is under obligation to pay retirement benefits in the amount of 3 average gross salaries in the Republic of Serbia in the month preceding the month the retirement benefit is paid out, according to the most recent information published by the Republic Statistical Office.

The costs and liabilities arising in connection with these plans are not secured through funds. Provisions for these benefits and related expenses are recognized in the amount of the present value of expected future cash flows applying the actuarial Projected Credit Unit Method. The actuarial gains and losses and expenses of previously rendered services are recognized in the income statement when they occur.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.12. Employee Benefits (Continued)***c) Short-Term paid Absences*

Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. The expected costs of paid benefits are recognized in the amount of accumulated unused entitlements as of the balance sheet date expected to be used in the ensuing period.

**3.13. Equity**

Equity is comprised of share capital (common shares) and other capital, revaluation reserves and retained earnings of the current and prior years (Note 29a).

Revaluation surplus from buildings is recorded within revaluation reserves.

Gains and losses arising from the change in the market value of securities available for sale are also recorded within revaluation reserves

**3.14. Financial Guarantees**

In the regular course of business, the Bank issues financial guarantees encompassing payment guarantees and performance bonds, letters of credit, bill acceptances and other sureties. Financial guarantees are contracts whereby a guarantee issuer is committed to make payments or compensate for a loss incurred by a guarantee holder caused when a debtor does not meet its liabilities in accordance with the terms defined in the agreement.

Financial guarantees are initially recognized in the financial statements at their fair value at the date of guarantee issuance, after receiving guarantee issuance fees. Following the initial recognition, the Bank's liabilities arising from financial guarantees measured at the higher of the amount of amortized fees or the best estimate of outflows that may be required to discharge a financial liability incurred as a result of a guarantee.

An increase in liabilities arising from financial guarantees is recognized in the income statement. Fees received are credited in the income statement within fee and commission income on a straight-line basis over the guarantee period.

**3.15. Taxes and Contributions****a) Income Taxes***Current Income Taxes*

Income taxes relate to the amounts calculated and payable in accordance with the provisions of the Corporate Income Tax Law of the Republic of Serbia. Throughout the year, the Bank pays taxes in the form of monthly advances, the amount of which is determined based on the corporate tax return filed in the previous year. The final tax basis, to which the prescribed tax rate of 10% is applied, is determined based on the Bank's tax return. In order to calculate taxable profit, accounting profit is adjusted for permanent differences and reduced by certain investments made during the year, as shown in the annual tax return submitted within ten days from the deadline for the filing financial statements, i.e. on March 10 of the following year.

The Corporate Income Tax Law of the Republic of Serbia allows 20% tax credit for the capital expenditures, whereas such tax credits cannot exceed 50% of the assessed tax in the year in which the expenditures occurred. The unused portion of tax credit is available for carryforward and used against future accounting periods but only for the duration of no longer than five years in succession.

The tax regulations in the Republic of Serbia do not envisage that any tax losses of the current period be used to recover taxes paid within a specific carryback period. However, any current year losses may be used to reduce or eliminate taxes to be paid in future periods, but only for duration of no longer than five years in succession.

**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2010**

*All amounts expressed in thousands of RSD, unless otherwise stated.*

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**3.15. Taxes and Contributions (Continued)**

**a) Income Taxes (Continued)**

*Deferred Income Taxes*

Deferred income taxes are provided using the balance sheet liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying values in the financial statements. The currently-enacted tax rates or the substantively-enacted rates at the balance sheet date are used to determine the deferred income tax amount.

Deferred tax liabilities are recognized for all temporary differences. Deferred tax assets are recognized for all deductible temporary differences, and the tax effects of income tax losses and credits are available for carryforward, to the extent that it is probable that taxable profit will be available, against which the deductible temporary differences and the tax loss/credits of the carryforwards can be utilized.

A deferred tax asset is recognized for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilized. The carrying value of deferred tax assets is reexamined at each reporting date and adjusted to its revised estimate to the extent that it is probable that taxable profit will be available against which the deferred tax assets can be utilized in part or in full.

At each reporting date, the Bank reexamines unrecognized deferred tax assets and recognizes them to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are calculated using the tax rate expected to be effective in the year when tax credits are earned i.e. when deferred tax liabilities are settled based on the currently-enacted tax rates or the substantively-enacted rates as of the balance sheet date.

*Deferred Taxes*

Current and deferred taxes are recognized as income and expenses are included in net profit/(loss) for the period. Deferred income tax relating to the items directly credited or charged to equity is also credited or charged to equity.

The amendments and supplements to the Enterprise Profit Tax Law (Official Gazette of RS number 18/2010) set forth that the changes that apply in determining income taxes for the year 2010 for the first time. As stipulated therein, deferred tax assets are determined based on the following:

- long-term provisions for employee retirement benefits;
- long-term provisions for guarantees issued,
- impairment of inventories of goods and material,
- impairment of investment property,
- impairment of trading securities and
- calculation of public duties outstanding in the current tax period.

**b) Indirect Taxes and Contributions**

Indirect taxes and contributions include property taxes, value added taxes, contributions to salaries charged to employer and various other taxes and contributions paid, pursuant to effective republic and local tax regulations. These taxes and contributions are included within operating and other operating expenses (Note 12).

**3.16. Earnings per Share**

Basic earnings per share are calculated by dividing net profit/(loss) attributable to shareholders, holders of common shares of the Bank, weighted by the average number of common shares issued in the reporting period.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****3.17. Managed Funds**

Funds managed by the Bank on behalf of, and for the account third persons for a fee, are included in the Bank's off-balance sheet items (Note 30a). The Bank is not exposed to any risk based on the aforementioned placements.

**3.18. Segment Reporting**

A business segment is the Bank's component involved in business activities earning income and incurring expenses (including income and expenses arising from transactions with the Bank's other components) whose business results are regularly examined by the Bank's managing body in order to decide on the resources allocated to this segment and determine the segment's performance, and for which separate financial information is available.

The patterns applied in the allocation of jointly incurred expenses are defined based on the Bank's management best estimates.

Business segments being reported are based on the manner of organizing business activities in the Bank and are presented in Note 34.

**4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES AND ASSUMPTIONS**

The preparation and presentation of the financial statements requires the Bank's management to make best estimates and reasonable assumptions that influence the assets and liabilities amounts, as well as the disclosure of contingent liabilities and receivables as of the date of preparation of the financial statements, and the income and expenses arising during the accounting period.

These estimations and assumptions are based on information available, as of the date of preparation of the financial statements. Actual results may vary from these estimates. Estimates and assumptions are subject to constant review and when adjustments become necessary they are stated within the income statement for periods in which they became known.

**a) Impairment of Financial Assets**

The Bank assesses at each reporting date whether there is objective evidence that the value of a financial assets or group of financial assets has suffered impairment. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated (see Note 3.4).

With regards to the assessment of impairment losses on loans, the Bank reviews the credit portfolio at least quarterly for the purpose of calculating the impairment in their value.

In the process of determining whether an impairment loss needs to be accounted for within the income statement, the Bank assesses whether there is reliable evidence showing a measurable decrease in the estimated future cash flows from the credit portfolio before the impairment, which can be identified within individual loans comprised in the portfolio. Such evidence may include available data indicative of unfavorable changes in debtor's settling its liabilities towards the Bank or in the national or local circumstances having adverse influences on the Bank's assets.

The Bank's management makes assessment based on its experience with losses incurred on loans from prior periods for all assets susceptible to credit risk and showing evidence of impairment similar to the one that existed in the credit portfolio at the time of planning future cash flows. The methodology and assumptions used in the assessment of amounts and time of future cash flows are subject to regular reviews with the aim to decrease differences between the estimated and realized losses.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES AND ASSUMPTIONS (Continued)*****b) Determining the Fair Value of Financial Instruments***

The fair value of financial instruments traded on an active market at the balance sheet date are based on the quoted market bid and ask prices, before the decrease by transaction costs. The fair value of financial instruments which are not listed on an active market are determined using adequate measurement techniques including techniques of net present value, comparison with similar instruments for which there are market prices and other relevant models.

When market inputs are unavailable, these are determined through assessments that include a certain degree of judgments in the fair value assessment. Models of estimates reflect the current market situation at the date of assessment and do not have to correspond to the market terms before or after the date of measuring. Hence, measurement techniques are revised periodically so they would best reflect current market terms.

***c) Useful Life of Intangible Assets, Property and Equipment***

Determining the useful life of intangible assets, property and equipment is based on historical experience with similar assets, as well as the anticipated technical development and changes affected by numerous economic and industrial factors. Adequacy of useful life is reexamined annually or whenever there are indications of significant changes in factors underlying the estimate of useful lives.

The impact of any changes in the aforementioned assumptions may significantly influence the financial position of the Bank, as well as the results of its operations. For instance: should the Bank decrease the useful life of intangible assets, property and equipment by 1% depreciation and amortization charge would additionally increase on annual basis by the amount of RSD 583 thousand.

***d) Impairment of Non-Financial Assets***

At each balance sheet date, the Bank's management reviews the carrying amounts of the Bank's intangible assets, property and equipment. If there is any indication that such assets have been impaired, the recoverable amount of an asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount.

Impairment assessment requires management to make subjective judgments in respect to cash flows, growth rates and discounting rates for units generating cash subject to assessment.

***e) Provisions for Litigations***

The Bank is involved in a number of lawsuits arising in the everyday business operations in respect to commercial and contractual issues, as well as labor issues, which are resolved or considered in the regular course of business. The Bank estimates the probability of negative outcome of these issues, as well as amounts of likely or reasonable loss assessments.

Reasonable assessment encompass judgments made by management upon consideration of information provided in reports, settlements, assessment made by legal department, facts available, identification of potentially responsible parties and their ability to contribute to the resolution of the matter, as well as historical experience.

Provisions for litigation are recognized when the Bank has an obligation whose reliable estimate can be made by way of a careful analysis. The amount of provisions is subject to changes contingent on new events or new information coming to light.

The matters that either constitute a contingent liability or do not meet the criteria for provisioning are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

***f) Deferred Tax Assets***

Deferred tax assets are recognized for all unused tax losses and/or tax credits to the extent that it is probable that taxable profit will be available, against which the deductible temporary differences and the tax loss/credits of the carryforwards can be utilized.

**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2010**

*All amounts expressed in thousands of RSD, unless otherwise stated.*

**4. SUMMARY OF SIGNIFICANT ACCOUNTING ESTIMATES AND ASSUMPTIONS (Continued)**

**f) Deferred Tax Assets (Continued)**

The Bank's management needs to make prudent assessments of deferred tax assets that should be recognized, based on the period when these arise and the amount of future taxable income and tax policy planning strategy.

**g) Retirement Benefits and Other Post-Employment Benefits**

The cost of defined post employment benefits to employees and/or retirement benefits are determined in an actuarial assessment. An actuarial assessment includes the assessment of a discount rate, future movements in salaries, mortality rates and employee turnover. Due to a long-term nature of these plans, significant uncertainties influence these assessments. Additional information is disclosed in Note 27 to the financial statements.

Had a discount rate been 1% higher, provisions for retirement benefits would have been RSD 720 thousand and if a discount rate had been 1% lower than the one assessed by management, provisions for retirement benefits would have been RSD 798 thousand higher compared to the aforementioned provisions stated in the Bank's business books as of December 31, 2010.

**5. INTEREST INCOME AND EXPENSE**

	<b>Year Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Interest income:</b>		
- National Bank of Serbia	25,525	88,968
- banks	29,194	64,665
- enterprises	1,128,353	595,112
- entrepreneurs	1,023	4,467
- public sector	26,019	3,389
- citizens	211,738	217,123
- foreign entities	410	1,076
- securities	66,744	34,187
	<u>1,489,006</u>	<u>1,008,987</u>
<b>Interest expense:</b>		
- banks	(145,290)	(79,966)
- public companies	(84,798)	(28,809)
- other enterprises	(72,972)	(16,453)
- entrepreneurs	(60)	(43)
- public sector	(21,316)	(93,895)
- citizens	(80,972)	(53,858)
- foreign entities	(203)	(251)
- other customers	(3,445)	(1,190)
	<u>(409,056)</u>	<u>(274,465)</u>
<b>Profit from interest</b>	<u>1,079,950</u>	<u>734,522</u>

For financial assets that have suffered impairment accrued interest is suspended from income and recognized within income once collected.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

All amounts expressed in thousands of RSD, unless otherwise stated.

## 6. FEE AND COMMISSION INCOME AND EXPENSE

	Year Ended December 31,	
	2010	2009
<b>Fee and commission income:</b>		
Fee and commission income from domestic payment transfers	50,164	42,083
Fee and commission income from foreign payment transfers	8,751	6,055
Fee and commission income from current account banking services	16,502	14,958
Fee and commission income from operations with retail customers	48,023	40,363
Fee and commission income from payment card operations	32,853	32,979
Fee and commission income from issued guarantees and other sureties issued	43,122	15,595
Managed funds	795	1,132
Other fee and commission income	932	779
	<u>201,142</u>	<u>153,944</u>
<b>Fee and Commission Expense:</b>		
Fee and commission expense arising from domestic payment transfers	(17,572)	(21,733)
Fee and commission expense arising from international payment transfers	(2,363)	(2,535)
Foreign exchange purchase and sale operations	(3,743)	(2,923)
Fees and commissions on payment cards	(236)	(182)
Fees and commissions on broker-dealer operations	(36)	(360)
Other fee and commission expense	(537)	(1,386)
	<u>(24,487)</u>	<u>(29,119)</u>
<b>Profit from fees and commissions</b>	<u>176,655</u>	<u>124,825</u>

## 7. NET FOREIGN EXCHANGE LOSSES

	Year Ended December 31,	
	2010	2009
Foreign exchange gains	3,762,423	2,705,798
Foreign exchange losses	<u>(3,879,080)</u>	<u>(2,781,243)</u>
<b>Net foreign exchange losses</b>	<u>(116,657)</u>	<u>(75,445)</u>

## 8. OTHER OPERATING INCOME

	Year Ended December 31,	
	2010	2009
Gains on disposal of property and equipment	585	4
Collection of receivables previously written off	138	28
Receipts from arbitration	14,241	9,526
Write-off of liabilities	9,332	7,048
Other	3,607	1,666
	<u>27,903</u>	<u>18,272</u>

The decrease in liabilities is associated with the write-off of liabilities arising from unused annual leaves.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

All amounts expressed in thousands of RSD, unless otherwise stated.

## 9. LOSSES ON IMPAIRMENT AND PROVISIONS

	Year Ended December 31,	
	2010	2009
<b>Losses on impairment and provisions</b>		
Impairment of placements included in the balance sheet:		
- interest, fees and commission and trade receivables (Note 17)	(38,109)	(37,248)
- loans and advances to customers (Note 18c)	(729,534)	(559,992)
- securities (Note 19)	-	(177,068)
- other placements (Note 20)	(362)	(7,619)
- other assets (Note 22)	(29,905)	(1,500)
	<u>(797,910)</u>	<u>(783,427)</u>
Provisions against off-balance sheet items (Note 27)	(50,389)	(20,518)
Provisions for retirement benefits (Note 27)	(11,063)	(1,012)
Cost of unused annual leaves	(16,934)	(10,885)
	<u>(78,386)</u>	<u>(32,415)</u>
	<u>(876,296)</u>	<u>(815,842)</u>
<b>Reversal of impairment loss on placements and provisions</b>		
Reversal of impairment of placements included in the balance sheet:		
- interest, fees and commission and trade receivables (Note 17)	6,957	9,015
- loans and advances to customers (Note 18c)	261,507	368,457
- securities (Note 19)	129,616	151,770
- other placements (Note 20)	9,253	-
- other assets (Note 22)	1,057	596
	<u>408,390</u>	<u>529,838</u>
Reversal of provisions against off-balance sheet items (Note 27)	44,420	17,714
	<u>452,810</u>	<u>547,552</u>
<b>Net impairment losses and provisions</b>	<u>(423,486)</u>	<u>(268,290)</u>

## 10. STAFF COSTS

	Year Ended December 31,	
	2010	2009
Net salaries and benefits	332,786	306,499
Taxes and contributions to salaries charged to employee	132,798	128,051
Other staff costs	9,545	20,903
	<u>475,129</u>	<u>455,453</u>

## 11. DEPRECIATION AND AMORTIZATION

	Year Ended December 31,	
	2010	2009
Depreciation and amortization charge:		
- property and equipment (Note 21)	43,190	47,348
- intangible assets (Note 21)	10,092	15,105
	<u>53,282</u>	<u>62,453</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

All amounts expressed in thousands of RSD, unless otherwise stated.

## 12. OPERATING AND OTHER EXPENSES

	Year Ended December 31,	
	2010	2009
Contributions charged to employer	85,410	81,640
Non-material services	81,242	85,958
Rental of business premises	61,060	53,071
Maintenance of property and equipment	59,273	54,588
Telecommunications	34,762	35,178
City development land fee	24,340	20,916
Marketing and advertizing	10,196	6,037
Insurance premiums	12,881	9,773
Donations and sponsorships	5,140	2,126
Write-off of bad debts	1,885	3,913
Losses on the sale and disposal of property, equipment and intangible assets	145	104
Other	60,917	53,513
	<u>437,251</u>	<u>406,817</u>

## 13. GAINS AND LOSSES ON THE VALUATION OF ASSETS AND LIABILITIES

	Year Ended December 31,	
	2010	2009
<b>Gains on the valuation of assets and liabilities:</b>		
- placements and receivables – currency clause	647,905	465,853
- securities	10,735	21,405
- liabilities – currency clause	58,829	22,523
	<u>717,469</u>	<u>509,781</u>
<b>Losses on the valuation of assets and liabilities:</b>		
- placements and receivables – currency clause	(399,740)	(352,575)
- securities	(8,518)	(17,921)
- liabilities – currency clause	(87,163)	(31,779)
	<u>(495,421)</u>	<u>(402,275)</u>
<b>Net gains</b>	<u>222,048</u>	<u>107,506</u>

## 14. INCOME TAXES

## a) Income tax components

Income taxes in 2010 totaling RSD 11 thousand, as well as income taxes in 2009 of RSD 1,055 thousand relate to deferred tax benefit.

## b) Numerical reconciliation between tax expense and the product of the accounting results multiplied by the applicable tax rate

	Year Ended December 31,	
	2010	2009
Profit /(Loss) before tax	1,439	(281,443)
Income taxes at the statutory tax rate of 10%	144	(28,144)
Tax effects of expenses not recognized for tax purposes	1,326	2,929
Tax credits for capital expenditures	(1,470)	(3,847)
Unrecognized tax losses	-	26,674
Other	(11)	1,333
<b>Total tax benefit</b>	<u>(11)</u>	<u>(1,055)</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

*All amounts expressed in thousands of RSD, unless otherwise stated.*

## 14. INCOME TAXES (Continued)

*c) Deferred tax liabilities*

Deferred tax liabilities relate to temporary differences between the carrying value of property, equipment and intangible assets and their tax basis.

The movements in deferred tax liabilities during the year are shown in the following table:

	<u>2010</u>	<u>2009</u>
Balance at January 1	31,107	32,162
Effect of temporary differences arising from depreciation/ amortization recorded within the income statement	<u>(11)</u>	<u>(1,055)</u>
Balance at December 31	<u><u>31,096</u></u>	<u><u>31,107</u></u>

At December 31, 2010, the Bank did not recognize deferred tax assets in the amount of RSD 1,470 thousand (December 31, 2009: RSD 3,847 thousand), based on unused tax credits available for carryforward. The entitlement to carry forward unused tax credits expires within one to five years. In addition, at December 31, 2010, the Bank did not recognize deferred tax assets of RSD 26,674 thousand, arising from losses brought forward from 2009.

The Bank did not recognize deferred tax assets due to the uncertainty over the availability of sufficient amounts of future taxable income against which deferred tax assets could be used.

## 15. CASH AND CASH EQUIVALENTS

	<u>December 31, 2010</u>	<u>December 31, 2009</u>
<b>In dinars:</b>		
Gyro account	257,770	536,175
Cash on hand	114,128	99,032
Cash equivalents	<u>-</u>	<u>100,000</u>
	371,898	735,207
<b>In foreign currency:</b>		
Foreign currency accounts with foreign banks	2,554,850	1,053,002
Cash on hand	<u>56,999</u>	<u>103,317</u>
	<u><u>2,611,849</u></u>	<u><u>1,156,319</u></u>
	<u><u>2,983,747</u></u>	<u><u>1,891,526</u></u>

As in accordance with the National Bank of Serbia "Decision on Required Reserves of Banks with the National Bank of Serbia," the Bank is obligated to calculate and allocate dinar required reserve at the rate of 5% (2009: 10%) to the amount of average daily book balance of dinar funds during the previous calendar month onto its gyro account held with the National Bank of Serbia.

At December 31, 2010, required reserves in dinars totaled RSD 257,045 thousand (December 31, 2009: RSD 525,670 thousand).

The interest rate applied to the amount of required reserve in dinars set aside, in 2010 totaled 2.5% annually.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

All amounts expressed in thousands of RSD, unless otherwise stated.

## 16. REVOCABLE DEPOSITS AND LOANS

	<u>December 31, 2010</u>	<u>December 31, 2009</u>
<b>In dinars:</b>		
Liquidity surpluses deposited with the National Bank of Serbia	756,000	90,000
Receivables from the National Bank of Serbia arising from repurchase transactions	-	551,138
	<u>756,000</u>	<u>641,138</u>
<b>In foreign currency:</b>		
Required reserve with the National Bank of Serbia	<u>1,673,958</u>	<u>1,192,954</u>
	<u><u>2,429,958</u></u>	<u><u>1,834,092</u></u>

As in accordance with the "Decision on Required Reserves of Banks with the National Bank of Serbia," the Bank is obligated to calculate and allocate foreign currency required reserve onto the account held with the National Bank of Serbia at the rate of 25% (2009: 45%) to the amount of average daily book balance of foreign currency funds registered during the previous calendar month.

At December 31, 2010, the Bank's required foreign currency reserve was in compliance with the aforementioned Decision of the National Bank of Serbia. The average daily balance of allocated required foreign currency reserve does not accrue interest.

An interest rate applied to liquidity surpluses which the Bank deposited with the National Bank of Serbia totals 9% annually.

## 17. RECEIVABLES ARISING FROM INTEREST, FEES AND COMMISSIONS, TRADE, FAIR VALUE ADJUSTMENTS OF DERIVATIVES AND OTHER RECEIVABLES

	<u>December 31, 2010</u>	<u>December 31, 2009</u>
<b>In dinars:</b>		
<i>Fee and commission receivables:</i>		
- Other banks	980	1,438
- National Bank of Serbia	439	529
- Enterprises	190,327	97,558
- Public sector	1,764	1,069
- Citizens	11,708	10,580
- Other customers	906	31
	<u>206,124</u>	<u>111,205</u>
<b>In foreign currency:</b>		
<i>Fee and commission receivables:</i>		
- Enterprises	<u>677</u>	<u>92</u>
<b>Gross receivables</b>	206,801	111,297
Less: Allowance for impairment	<u>(78,181)</u>	<u>(44,834)</u>
	<u><u>128,620</u></u>	<u><u>66,463</u></u>

Interest, fee and commission receivables as of December 31, 2010 include interest of RSD 44,361 thousand arising from loans index linked to currency clause (December 31, 2009: RSD 25,716 thousand).

**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2010**

All amounts expressed in thousands of RSD, unless otherwise stated.

**17. RECEIVABLES ARISING FROM INTEREST, FEES AND COMMISSIONS, TRADE, FAIR VALUE ADJUSTMENTS OF DERIVATIVES AND OTHER RECEIVABLES (Continued)**

The movements on the accounts of allowance for impairment are presented in the following table:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Balance at January 1	44,834	15,980
Charge for the year (Note 9)	38,109	37,248
Reversal (Note 9)	(6,957)	(9,015)
Foreign exchange gains	2,195	621
<b>Balance at December 31</b>	<b>78,181</b>	<b>44,834</b>

**18. LOANS AND DEPOSITS TO CUSTOMERS**

**a) Review of loans and deposits per different groups of customers**

	<b>2010</b>			<b>2009</b>		
	<b>Short-Term</b>	<b>Long-Term</b>	<b>Total</b>	<b>Short-Term</b>	<b>Long-Term</b>	<b>Total</b>
<b>In dinars</b>						
<i>Loans and deposits to customers:</i>						
- Banks	1,168	-	1,168	461,168	-	461,168
- Enterprises	6,445,670	741,222	7,186,892	3,950,130	767,241	4,717,371
- Public sector	20,000	-	20,000	23,750	-	23,750
- Citizens	531,168	598,084	1,129,252	555,832	608,837	1,164,669
	<u>6,998,006</u>	<u>1,339,306</u>	<u>8,337,312</u>	<u>4,990,880</u>	<u>1,376,078</u>	<u>6,366,958</u>
<b>In foreign currency</b>						
<i>Loans and deposits to customers:</i>						
- National Bank of Serbia	399,626	-	399,626	336,357	-	336,357
- Other banks	-	-	-	779,382	-	779,382
- Enterprises	78,069	-	78,069	23,013	1,271	24,284
	<u>477,695</u>	<u>-</u>	<u>477,695</u>	<u>1,138,752</u>	<u>1,271</u>	<u>1,140,023</u>
<b>Gross loans and deposits to customers</b>	<b>7,475,701</b>	<b>1,339,306</b>	<b>8,815,007</b>	<b>6,129,632</b>	<b>1,377,349</b>	<b>7,506,981</b>
<i>Less: Allowance for impairment</i>	<u>(996,748)</u>	<u>(58,867)</u>	<u>(1,055,615)</u>	<u>(523,027)</u>	<u>(35,992)</u>	<u>(559,019)</u>
	<u><b>6,478,953</b></u>	<u><b>1,280,439</b></u>	<u><b>7,759,392</b></u>	<u><b>5,606,605</b></u>	<u><b>1,341,357</b></u>	<u><b>6,947,962</b></u>

Short-term and long-term dinar denominated loans as of December 31, 2010 include loans approved with a currency clause totaling RSD 2,680,820 thousand (December 31, 2009: RSD 1,749,210 thousand) out of which an amount of RSD 464,335 thousand relates to loans extended to citizens and RSD 2,216,485 thousand relates to loans to enterprises.

Short-term loans to enterprises for financing business activities in the field of trade, processing industry, construction, services and tourism, energy industry, agriculture and food products, as well as for other purposes at interest rates ranging from 0.7% to 2.2% monthly.

The Bank's most significant receivables arising from loans are due from the following customers: "Koncern Farmakom MB" d.o.o., Šabac; "Res trade" d.o.o., Novi Sad; "GP Auto-šop" d.o.o., Lazarevac; "Simpo" a.d., Vranje and "HK Krušik" d.o.o., Valjevo, accounting for 20.71% of gross placements with customers at December 31, 2010.

Loans and advances to citizens including consumer and cash loans (short-term and long-term) were approved at an interest rate ranging from 0.9% to 2.3% monthly.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***18. LOANS AND DEPOSITS TO CUSTOMERS (Continued)****a) Review of loans and deposits per different groups of customers (Continued)**

The interest rate applied to overdraft facilities on current accounts of citizens amounted to 2.5% monthly while the rate of 3.5% applies to unauthorized overdrafts on current accounts of citizens. The interest rate to credit cards to citizens ranges from 2% to 2.4% monthly.

Long-term loans to citizens were approved for the purchase of durable goods and mature over the period from 2 to 7 years at an interest rate from 0.9% to 2.3% monthly, depending on the loan purpose and currency in which loans are approved.

Placements with the National Bank of Serbia of RSD 399,626 thousand (December 31, 2009: RSD 336,357 thousand) are associated with funds of USD 5,041 thousand which the National Bank of Serbia retained as collateral for the payment made in 1998 to "JP Jugoimport SDPR" for the technical support provided to the Kuwait associate.

**b) Concentration of Loans and Deposits**

The concentration of loans and deposits to customers presented in the gross amount at December 31, 2010 and 2009 is significant in the following industries:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Trade	2,713,703	2,063,532
Processing industry	3,078,545	2,095,352
Civil engineering	415,734	267,370
Services and tourism	178,696	76,853
Agriculture and food processing industry	458,055	126,325
Other	440,228	135,973
Retail	1,129,252	1,164,669
Domestic and foreign banks	400,794	1,576,907
	<u>8,815,007</u>	<u>7,506,981</u>

**c) Movements on the allowance for impairment of loans and deposits**

The movements on the allowance for impairment accounts of loans and deposits to customers are provided in the following table:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Balance at January 1	559,019	356,904
Charge for the year (Note 9)	729,534	559,992
Reversal (Note 9)	(261,507)	(368,457)
Foreign exchange gains	28,569	10,580
Balance at December 31	<u>1,055,615</u>	<u>559,019</u>

## NOTES TO THE FINANCIAL STATEMENTS

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All amounts expressed in thousands of RSD, unless otherwise stated.

## 19. SECURITIES (EXCLUDING TREASURY SHARES)

	December 31, 2010	December 31, 2009
<b>In dinars</b>		
Trading securities	26,817	28,307
Securities available for sale	5,534	280,232
Securities held to maturity:		
- cheques from citizens	7,363	7,363
- discounted bills of exchange	352,393	149,697
	<u>392,107</u>	<u>465,599</u>
<b>In foreign currency</b>		
Securities available for sale	18,090	18,090
	<u>410,197</u>	<u>483,689</u>
<b>Total securities</b>		
Less: Allowance for impairment		
- Securities available for sale	(4,180)	(139,637)
- Securities held to maturity	(49,156)	(43,315)
	<u>(53,336)</u>	<u>(182,952)</u>
	<u>356,861</u>	<u>300,737</u>

Securities available for sale in dinars encompass the shares of "Kompanija Fidelinka," Subotica of RSD 4,180 thousand and shares of the Postal Savings Bank of RSD 1,354 thousand. Shares available for sale denominated in foreign currency include the shares issued by "Euroaxis bank" Moscow of RSD 12,526 thousand and shares of "Visa" system of RSD 5,564 thousand.

The effect of measuring the aforementioned securities at market value as of the balance sheet date totaling RSD 195 thousand was recorded within revaluation reserves.

The interest rate of receivables from corporate bills of exchange received to be discounted maturing within 1 to 12 months, amounts to 1.8 % to 2% monthly.

The movements on the allowance for impairment accounts of securities during the year are presented in the following table:

	December 31, 2010	December 31, 2009
Balance at January 1	182,952	157,654
Charge for the year (Note 9)	-	177,068
Reversal (Note 9)	(129,616)	(151,770)
Balance at December 31	<u>53,336</u>	<u>182,952</u>

## 20. OTHER PLACEMENTS

	December 31, 2010	December 31, 2009
<b>Other placements:</b>		
- in dinars	82,344	91,340
- in foreign currency	331,458	81,233
	<u>413,802</u>	<u>172,573</u>
Less: Allowance for impairment	(142,802)	(146,246)
	<u>271,000</u>	<u>26,327</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

All amounts expressed in thousands of RSD, unless otherwise stated.

## 20. OTHER PLACEMENTS (Continued)

Other dinar denominated placements at December 31, 2010 totaled RSD 82,344 thousand, mostly associated with placements with "Ineks ukus" from Belgrade in bankruptcy, and were fully provided for.

Other foreign currency placements totaling RSD 331,458 thousand as of December 31, 2010 mostly relate to nostro covered guarantees of RSD 255,765 thousand, foreign currency sureties of RSD 8,906 thousand, as well as placements with banks in bankruptcy of RSD 60,458 thousand fully provided for.

The movements on the allowance for impairment account of other placements during the year were as shown below:

	2010	2009
Balance at January 1	146,246	134,461
Charge for the year (Note 9)	362	7,619
Reversal (Note 9)	(9,253)	-
Foreign exchange gains and losses	5,447	4,166
Balance at December 31	<u>142,802</u>	<u>146,246</u>

## 21. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS

	Land and Buildings	Equipment	Construction in Progress	Total P&E	Intangible Assets
<b>Cost or revaluation at January 1, 2009</b>	686,469	356,889	111	1,043,469	118,359
Additions	-	-	50,448	50,448	11,346
Transfers	12,093	38,466	(50,559)	-	-
Sale and disposal	-	(17,190)	-	(17,190)	-
<b>Balance, December 31, 2009</b>	<u>698,562</u>	<u>378,165</u>	<u>-</u>	<u>1,076,727</u>	<u>129,705</u>
Additions	-	-	30,708	30,708	2,438
Transfers	-	30,708	(30,708)	-	-
Sale and disposal	-	(24,179)	-	(24,179)	(5,029)
<b>Balance, December 31, 2010</b>	<u>698,562</u>	<u>384,694</u>	<u>-</u>	<u>1,083,256</u>	<u>127,114</u>
<b>Accumulated depreciation and amortization</b>					
<b>Balance, January 1, 2010</b>	66,683	233,950	-	300,633	89,047
Charge for the year (Note 11)	8,715	38,633	-	47,348	15,105
Sale and disposal	-	(17,085)	-	(17,085)	-
<b>Balance, December 31, 2009</b>	<u>75,398</u>	<u>255,498</u>	<u>-</u>	<u>330,896</u>	<u>104,152</u>
Charge for the year (Note 11)	8,808	34,382	-	43,190	10,092
Sale and disposal	-	(24,034)	-	(24,034)	(5,030)
<b>Balance, December 31, 2010</b>	<u>84,206</u>	<u>265,846</u>	<u>-</u>	<u>350,052</u>	<u>109,214</u>
<b>Net Book Value:</b>					
<b>- December 31, 2010</b>	<u>614,356</u>	<u>118,848</u>	<u>-</u>	<u>733,204</u>	<u>17,900</u>
<b>- December 31, 2009</b>	<u>623,164</u>	<u>122,667</u>	<u>-</u>	<u>745,831</u>	<u>25,553</u>

At December 31, 2010, the Bank had no buildings assigned under mortgage as collateral for the repayment of borrowings.

The net book value of land and buildings as of December 31, 2010 is comprised of land (RSD 20,792 thousand), building at number 25 Skadarska Street and a building at number 63 Narodnih heroja Street. The Bank holds complete ownership documentation.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

All amounts expressed in thousands of RSD, unless otherwise stated.

## 21. PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS (Continued)

The net book value of equipment at December 31, 2010 mostly relates to computer and telecommunication equipment, office supplies and motor vehicles.

The net book value of intangible assets as of December 31, 2010 principally comprises investments in software and software licenses used by the Bank.

## 22. OTHER ASSETS

	December 31, 2010	December 31, 2009
<b>In dinars</b>		
<i>Other receivables:</i>		
- Advances to customers	6,452	2,380
- Receivables from employees	476	128
- Inventories	1,471	2,207
- Receivables based on prepaid income taxes	9,920	8,657
- Other receivables	89,428	59,318
<i>Prepayments:</i>		
- deferred interest receivables	4,657	4,179
- Other deferrals	3,334	4,416
	<u>115,738</u>	<u>81,285</u>
<b>In foreign currency</b>		
<i>Other receivables:</i>		
- Other receivables	1,159	2,610
<i>Prepayments:</i>		
- Deferred interest receivables	-	23
	<u>1,159</u>	<u>2,633</u>
<b>Gross other assets</b>	<u>116,897</u>	<u>83,918</u>
Less: Allowance for impairment	<u>(85,452)</u>	<u>(56,598)</u>
	<u>31,445</u>	<u>27,320</u>

The movements on the allowance for impairment account of other assets during the year were as shown below:

	December 31, 2010	December 31, 2009
Balance at January 1	56,598	55,694
Charge for the year (Note 9)	29,905	1,500
Reversal (Note 9)	(1,057)	(596)
Other movements	6	-
<b>Balance at December 31</b>	<u>85,452</u>	<u>56,598</u>

## 23. TRANSACTION DEPOSITS

	December 31, 2010			December 31, 2009		
	In Dinars	In Foreign Currency	Total	In Dinars	In Foreign Currency	Total
Other banks	-	-	-	116	-	116
Enterprises	1,013,364	806,294	1,819,658	893,030	708,382	1,601,412
Public sector	38	-	38	-	237,435	237,435
Citizens	303,556	264,297	567,853	344,108	211,278	555,386
Foreign entities	2,714	7,428	10,142	2,445	11,304	13,749
Other customers	118,120	17,635	135,755	58,992	866	59,858
	<u>1,437,792</u>	<u>1,095,654</u>	<u>2,533,446</u>	<u>1,298,691</u>	<u>1,169,265</u>	<u>2,467,956</u>

## NOTES TO THE FINANCIAL STATEMENTS

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## 23. TRANSACTION DEPOSITS (Continued)

Dinar denominated transaction deposits of legal entities accrue interest ranging from 0% to 11.5% annually.

Dinar denominated demand deposits of citizens accrue interest at the rate of 2% annually. Foreign currency denominated transaction deposits of citizens accrue interest at the rate of 2% annually for deposits in EUR and 1.3% for deposits in other currencies.

The most significant deposits of the Bank at December 31, 2010 include those placed by "JP Jugoimport SDPR" from Belgrade, Electric Power Industry of Serbia, "PD Elektrodistribucija" from Belgrade, "Ateks" d.o.o., from Belgrade, "Elektrotehnički institut Nikola Tesla" from Belgrade, "HK Krušik" from Valjevo and "Informatika" from Belgrade, accounting for 37% of total transaction deposits at the balance sheet date.

## 24. OTHER DEPOSITS

	December 31, 2010			December 31, 2009		
	Short-Term	Long-Term	Total	Short-Term	Long-Term	Total
<b>In dinars:</b>						
Savings deposits:						
- Citizens	149,511	-	149,511	147,649	-	147,649
- Foreign entities	94	-	94	85	-	85
Special purpose deposits	102,797	105,633	208,430	-	30,296	30,296
Other deposits	2,923,691	-	2,923,691	2,828,674	-	2,828,674
	<u>3,176,093</u>	<u>105,633</u>	<u>3,281,726</u>	<u>2,976,408</u>	<u>30,296</u>	<u>3,006,704</u>
<b>In foreign currency:</b>						
Savings deposits:						
- Citizens	1,045,029	69,803	1,114,832	717,533	26,921	744,454
- Foreign entities	1,638	-	1,638	4,919	-	4,919
Special purpose deposits	2,486,819	429,624	2,916,443	2,286,776	120,635	2,407,411
Other deposits	1,538,241	585	1,538,826	3,885	584	4,469
	<u>5,071,727</u>	<u>500,012</u>	<u>5,571,739</u>	<u>3,013,113</u>	<u>148,140</u>	<u>3,161,253</u>
	<u>8,247,820</u>	<u>605,645</u>	<u>8,853,465</u>	<u>5,989,521</u>	<u>178,436</u>	<u>6,167,957</u>

The Bank pays interest to time deposits in dinars and in foreign currency at the rate ranging from 0% to 18% annually for dinar funds, and from 0% to 3.5% annually for foreign currency funds depending on the depositing period and currency.

Special purpose deposits of customers and citizens are non-interest bearing. Short-term dinar denominated deposits placed by citizens bear interest ranging between 11% and 15.5% annually, depending on the period and amount of funds deposited.

The interest rate applied to short-term deposits of citizens in foreign currency ranges between 1% and 8.5% annually, depending on the depositing period, amount of funds deposited and their maturity. Long-term deposits of citizens denominated in foreign currency were deposited at interest rates from 4% to 8.5% annually for EUR, and from 1.5% to 5.6% annually for other currencies depending on the period and amount of funds deposited.

The most significant depositors of the Bank at December 31, 2010 include those placed by "JP Jugoimport SDPR" from Belgrade, "Dunav osiguranje" from Belgrade, "Utva avioindustrija" from Pančevo, "Beogradska banka" in bankruptcy from Belgrade, "Beobanka" in bankruptcy from Belgrade, "KMG Trudbenik" in restructuring from Belgrade, "JP PTT saobraćaj Srbije" from Belgrade, accounting for 63% of total amounts owed to customers based on other deposits at the balance sheet.

**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2010**

All amounts expressed in thousands of RSD, unless otherwise stated.

**24. OTHER DEPOSITS (Continued)**

The structure of other deposits with customers is presented in the following table:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Enterprises	4,919,510	3,639,436
Public sector	269,390	693,544
Citizens	1,274,303	904,809
Banks	1,462,803	660,486
Foreign entities	3,228	3,124
Other customers	924,231	266,558
	<u>8,853,465</u>	<u>6,167,957</u>

**25. BORROWINGS**

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
- in dinars	6,998	4,721
- in foreign currency	16,051	600
	<u>23,049</u>	<u>5,321</u>

**26. INTEREST, FEE AND COMMISSION PAYABLES AND CHANGE IN THE VALUE OF DERIVATIVES**

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
<i>Interest, fee and commission payable:</i>		
<b>In dinars</b>		
- Public sector	1,431	3,228
- Citizens	126	240
- Other customers	10	-
	<u>1,567</u>	<u>3,468</u>
<b>In foreign currency</b>		
- Enterprises	8	8
- Citizens	465	689
	<u>473</u>	<u>697</u>
	<u>2,040</u>	<u>4,165</u>

**27. PROVISIONS**

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Provisions for losses on off-balance sheet items (a)	24,731	17,204
Provisions for retirement benefits (b)	14,044	16,681
	<u>38,775</u>	<u>33,885</u>

- a) According to the adopted internal policy, the Bank estimates provisions for risk weighted off-balance sheet items on a case basis for off-balance sheet exposures. Provisions for off-balance sheet exposures (payment guarantees, performance bonds, acceptances, letters of credit, other irrevocable commitments) are assessed on a customer level applying the average weighted rate of impairment for balance sheet receivables from the subject customer.

The estimated receivables for off-balance sheet contracts executed with customers in respect to which allowance for impairment was formed for balance sheet receivables, but where the estimated percentage is below 0.5%, the amount of provisions is determined based on the minimum percentage of 0.5%. In case of guarantees collateralized by cash deposits, such deposits are excluded from the basis used to calculate provisions.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

*All amounts expressed in thousands of RSD, unless otherwise stated.*

## 27. PROVISIONS (Continued)

- b) Provisions for retirement benefits of employees were formed based on a report compiled by a certified actuary as of the balance sheet date and are stated at the present value of expected future payments. On determining the present value of expected outflow of resources a discount rate of 8% was used. Provisions are determined in conformity with the Collective Bargaining Agreement which came in effect on January 16, 2008 and assumptions of average salary increase in accordance with long-term projection of inflation rate.

The movements on the accounts of provisions during the year are shown in the following table:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
<b>Provisions for losses on off-balance sheet items</b>		
Balance, beginning of year	17,204	13,652
Charge for the year (Note 9)	50,389	20,518
Reversal of unused provisions (Note 9)	(44,420)	(17,714)
Other movements (foreign exchange differences)	1,558	748
	<u>24,731</u>	<u>17,204</u>
<b>Provisions for retirement benefits</b>		
Balance, beginning of year	16,681	19,199
Charge for the year (Note 9)	11,063	1,012
Payment of retirement benefits	(13,700)	(3,530)
	<u>14,044</u>	<u>16,681</u>
	<u>38,775</u>	<u>33,885</u>

## 28. OTHER LIABILITIES

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
<b>In dinars</b>		
Accounts payable	106,230	71,393
Net salaries and benefits	15,037	1,208
Taxes, contributions and other duties payable	5,865	-
Accruals:		
- deferred interest accruals	53,574	66,311
- deferred loan origination fees	14,537	4,178
- other deferrals	12,731	8,094
Other liabilities	26,325	19,251
	<u>234,299</u>	<u>170,435</u>
<b>In foreign currency</b>		
Accruals:		
- Deferred interest accruals	6,880	1,654
Other liabilities	5	-
	<u>6,885</u>	<u>1,654</u>
	<u>241,184</u>	<u>172,089</u>

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

*All amounts expressed in thousands of RSD, unless otherwise stated.*

## 29. EQUITY

**a) Bank's Equity Structure**

The Bank's equity structure is presented as follows:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Share capital – common shares	1,617,060	1,617,060
Other capital	460	460
Reserves from profit	933,112	1,175,427
Revaluation reserves	433,055	432,860
Unrealized losses on securities	-	(391)
Retained earnings/(Accumulated losses)	1,450	(242,315)
<b>Balance at December 31</b>	<b>2,985,137</b>	<b>2,983,101</b>

**Share Capital**

As of December 31, 2010, subscribed and paid in capital of the Bank comprised of 161,706 common shares with the individual par value of RSD 10 thousand (December 31, 2009: 161,706 common shares with the par individual value of RSD 10 thousand). In 2010 and 2009, there were no changes on share capital. The Bank is an open shareholding company whose shares are listed on the Belgrade Stock Exchange.

The Bank's majority shareholder is the Republic of Serbia with 96.52% interest in the Bank's share capital, holding 156,082 shares at December 31, 2010 and 2009.

Common shareholders are liable for and bear risk inherent in the Bank's business operations in proportion to the number of shares in their possession. Shares are transferable to other persons pursuant to the Articles of Incorporation. Common shareholders are entitled to dividend before the additional provision for potential losses is set aside as an appropriation of retained earnings.

**Reserves from Profit**

Reserves from profit include special reserve for potential losses, reserves used to cover general banking risks and other reserves from profit distribution, formed in accordance with the relevant regulations of the National Bank of Serbia, Articles of Association and the Bank's other enactments.

Special reserve for potential losses from credit risk exposure in the Bank's loan portfolio is calculated pursuant to the Decision of the National Bank of Serbia on the Classification of Balance Sheet Assets and Off-Balance Sheet Items (RS Official Gazette number 129/2007, 63/2008, 104/2009 and 30/2010).

As of December 31, 2010, the required special reserve for potential losses contingent on balance sheet assets and off-balance sheet items, net of allowance for impairment of balance sheet assets and provisions for losses on off-balance sheet items, calculated in accordance with the aforementioned NBS Decision (Note 3.4.7.), totaled RSD 1,002,661 thousand (December 31, 2009: RSD 961,386 thousand).

The balance of allocated special reserve for potential losses totaled RSD 424,291 thousand as of December 31, 2010, so the outstanding portion of reserves from profit for estimated losses on placements as of December 31, 2010 totaled RSD 578,370 thousand (December 31, 2009: RSD 537,095 thousand).

**Revaluation Reserves**

At December 31, 2010, revaluation reserves totaling RSD 433,055 thousand (2009: RSD 432,860 thousand) were created by recording positive effects of buildings and remeasurement of AFS securities to their fair market value.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

All amounts expressed in thousands of RSD, unless otherwise stated.

## 29. EQUITY (Continued)

## c) Bank's Business Ratios – Compliance with Legally Prescribed Ratios

The Bank is required to maintain the scope and structure of its business operations and risk-weighted placements in compliance with the ratios prescribed by the Law on Banks and relevant decisions enacted by the National Bank of Serbia based on the aforementioned Law.

At December 31, 2010, according to the Bank's calculation, the Bank reconciled all operating ratios with the prescribed values. The realized business ratios of the Bank as of December 31, 2010 were as follows:

Operating ratios	Prescribed	Realized
	Minimum	
Capital	EUR 10 million	22,625,580
Capital adequacy	Minimum 12%	21.01%
Bank's investments	Maximum 60%	30.72 %
Exposure to related parties	Maximum 20%	0.19%
Large and most significant loans in comparison with the capital	Maximum 400%	217.61%
Average monthly liquidity ratio:		
– in the first month of reporting period	Minimum 1	2.12
– in the second month of reporting period	Minimum 1	2.09
– in the third month of reporting period	Minimum 1	2.35
Currency risk ratios	Maximum 20%	6.36%
Exposure to a group of related parties	Maximum 25%	22.34%
Exposure to a related party	Maximum 5%	0.03%
Investments in entities outside the financial sector	Maximum 10%	0.23%

At December 31, 2010, the Bank had the following large loans in excess of 10% of capital, extended to a single entity or a group of related parties: "Delta maks" d.o.o., Beograd, "Koncern Farmakom" d.o.o., Šabac "HK Krušik" from Valjevo, "Informatika" from Belgrade, "Milan Blagojević" from Lučani, "Interkomerc" d.o.o. Beograd, "MVM Motors" d.o.o., Novi Sad, "IMK Trgovina" in restructuring from Kruševac, "JP Jugoiimport-SDPR" from Belgrade, "Beohemija" from Belgrade, "Res Trade" from Novi Sad, "GP Autoshop" from Lazarevac, "Simp" from Vranje, "Interkop" from Mišar, "Banini" d.o.o., Kikinda, and "Unihemkom" d.o.o., Novi Sad.

## 30. OFF-BALANCE SHEET ITEMS

	December 31, 2010	December 31, 2009
Managed funds (a)	5,264,953	4,907,564
Guarantees and other irrevocable commitments (b)	5,001,740	2,951,591
Other off-balance sheet position (c)	22,480,296	15,831,987
	32,746,989	23,691,142

## a) Managed Funds

	December 31, 2010	December 31, 2009
Dinar placements from managed funds:		
- housing loans to the members of the Serbian Armed Forces	591,432	631,985
- loans for installment purchase of apartments	4,658,090	4,258,108
- loans for installment purchase of garages	1,107	1,135
- other	14,324	16,336
	5,264,953	4,907,564

**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2010**

All amounts expressed in thousands of RSD, unless otherwise stated.

**30. OFF-BALANCE SHEET ITEMS (Continued)**

**b) Guarantees and Other Irrevocable Commitments**

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
<b>In dinars</b>		
Payment guarantees	797,988	97,961
Performance bonds	885,582	445,879
Irrevocable commitments for undrawn loans and placements	363,891	554,292
	<u>2,047,461</u>	<u>1,098,132</u>
<b>In foreign currency</b>		
Payment guarantees	88,738	56,483
Performance bonds	2,865,541	1,796,976
	<u>2,954,279</u>	<u>1,853,459</u>
	<u>5,001,740</u>	<u>2,951,591</u>

Irrevocable commitments relate to unused loans approved that cannot be cancelled unilaterally as follows: overdrafts against current accounts, revolving loans to enterprises, multi-purpose framework loans and other irrevocable commitments. Irrevocable commitments are usually indexed to fixed dates when they expire or other provisions related to expiry.

Since irrevocable commitments may expire before loans are drawn by customers total amount agreed upon does not represent definite future cash outflows. The Bank monitors the maturity of irrevocable commitments arising from approved loans as long-term commitments carry a higher level of credit risk from short-term commitments.

As of December 31, 2010, foreign currency denominated performance bonds mainly relate to guarantees on behalf of the Public Company "Jugoimport SDPR" of RSD 2,731,226 thousand.

The Bank forms provisions for potential losses on guarantees and other risk weighted off-balance sheet items as in accordance with accounting policy disclosed in Note 3.11. As of December 31, 2010, reserves for potential losses on guarantees and on other commitments were formed in the amount of RSD 24,731 thousand (December 31, 2009: RSD 17,204 thousand).

**(c) Other off-balance sheet items**

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Loro letters of credit records	7,339,090	8,330,548
Letters of credit with coverage	139,166	445,337
Performance bonds until coming into force	41,355	930,489
Guarantees received from foreign banks and other financial organizations	485,765	619,161
Records of repurchase securities	-	550,000
Mortgages collateralizing placements	13,734,777	4,759,060
Other	740,143	197,392
	<u>22,480,296</u>	<u>15,831,987</u>

Within loro letters of credit stated as of December 31, 2010, the most significant amount of RSD 7,166,920 thousand is associated with the goods delivery agreements closed by the Public Company "Jugoimport SDPR" from Belgrade with foreign associates (December 31, 2009: RSD 7,901,969 thousand).

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***31. RELATED PARTY TRANSACTIONS**

In the regular course of business, the Bank enters into business transactions with its shareholders, employees and other entities.

The forgoing balances of receivables and payables, as well as amounts of income and expenses arise on the regular course of the Bank's business. The Bank collects and pays interest accrued applying regular market interest rates.

- (a) The Bank enters into business transactions and arrangements with the members of the Executive Board and other key managing staff and their related parties in the regular course of business based on general market terms. Balances of receivables and payables as well as effects of these transactions during the year are presented in the following table.

	<b>Balance at December 31, 2010</b>	<b>Income/ (Expenses) in 2010</b>	<b>Balance at December 31, 2009</b>	<b>Income/ (Expenses) in 2009</b>
Overdrafts against current accounts, credit cards and cash and consumer loans	2,458	665	3,399	834
Total allowance for impairment of loans and placements	(188)	-	(34)	-
Deposits	25,826	(1,709)	9,261	(290)
Commitments	1,136	-	3,019	-

- (b) In addition to the abovementioned related parties, the Bank enters into business transactions with entities exercising significant influence on the Bank (shareholders), and parties that are significantly influenced by the Bank, such as "Jugoimport SDPR" from Belgrade, "HK Krušik" from Valjevo, "IMK 14. oktobar" from Kruševac and others. The balances of receivables and payables at the year end, as well as the effects of transactions with entities having significant influence on the Bank are presented as follows:

	<b>Receivables</b>	<b>Payables</b>	<b>Financial Guarantees</b>	<b>Interest Income</b>	<b>Interest Expense</b>
<b>2010</b>	1,313,539	3,707,188	2,797,930	142,894	5,363
<b>2009</b>	1,400,060	3,588,028	1,806,182	132,868	3,999

- (c) Remunerations to the members of the Executive Board and the Management Board (in their gross amount) in 2010 and 2009 are presented in the following table:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Salaries of the members of the Executive Board	15,392	15,019
Remunerations to the members of the Management Board	7,970	5,867
	<u>23,362</u>	<u>20,886</u>

**32. RISK MANAGEMENT****32.1. Introduction**

Risk is inherent in banking activities which is managed through the continuous process of identifying, measuring and monitoring, establishing exposure limits and by applying other controls.

In its nature, the Bank is exposed to the following most significant risk types: credit risk, liquidity risk and market risk (comprising risk inherent in the interest rate movements, foreign exchange risk and other market risks). The Bank is also exposed to operational risk, counterparty risk, risk of exposure to a group of related parties, risk of investing in other legal entities and capital expenditure risk, as well as country risk, all of which are monitored on an ongoing basis.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.1. Introduction (Continued)**

Risk management in the Bank is an all comprising process entailing identification, analysis, ranking and control of all forms of business risks.

The Bank has adopted policies and procedures ensuring the control and application of all internal enactments of the Bank in respect to risk management. The risk management processes are of key importance for continued business dealings of the Bank and each individual working in the Bank shares the responsibility within the field of his/her competencies.

The independent process of risk management includes business risks encompassing changes in the environment, technology and industry. The Bank monitors these risks through the process of strategic planning.

**Risk Management Structure**

The Management Board and the Executive Board are responsible for risk identification and control. However, the Bank has established a special organizational unit – Risk Management Sector charged with the organization and implementation of risk management activities. In addition, the competencies of these Boards, being separate and mutually independent bodies, also include risk management and monitoring.

**Management Board and Executive Board**

The Management Board and the Executive Board are responsible for the overall risk management approach, risk strategy and principle approval, as well as for the implementation of principles, frameworks, policies and limits. They are in charge of the adoption of the relevant risk management decisions and monitoring thereof.

**Committee for Monitoring Business Activities**

The Committee for Monitoring Business Activities oversees the comprehensive risk management process in the Bank. The aforementioned Committee analyzes and adopts the proposals of policies and procedures in respect to risk management and analyzes and supervises the application and adequate implementation of the adopted policies and procedures.

**Risk Management Sector**

The Risk Management Sector identified measures, assesses and manages risks to which the Bank is exposed in its operations. This Sector is responsible for the implementation and maintenance of risk related procedures, ensuring an independent control process. It ensures comprehensive risk measuring and reporting in the system.

**Regulatory Compliance Sector**

The Regulatory Compliance Sector in the Bank is responsible for monitoring the compliance with the principles and policies defined in the Bank or external regulations. The Sector is responsible for the independent risk control and monitors the risk arising from the introduction of new products and complex transactions.

**Asset and Liability Management Committee**

The Asset and Liability Management Committee monitors the Bank's risk exposure arising from the structure of its balance sheet receivables and payables and off-balance sheet items and proposes measures for interest rate risk management and in particular liquidity risk management. In addition, this Committee is mainly responsible for financing the Bank's liquidity.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.1. Introduction (Continued)****Internal Audit**

The process of risk management in the Bank is controlled by the Internal Audit examining the adequacy of procedures, as well as the compliance of the Bank with the adopted procedures. The Internal Audit discusses the results of its operations with the Bank's management and reports to the Committee for Monitoring Business Activities with reference to its findings and recommendations.

**Risk Management and Reporting Systems**

The Bank's risks are measured using methods that reflect losses that may be incurred in the regular course of business and anticipated losses reflecting the estimate of ultimate losses based on probability of events. The models use the probability derived from available current and historical data adjusted so as to reflect current economic environment.

Risk monitoring and control is primarily based on the establishment of procedures and limits. These limits reflect the Bank's business strategy and environment, as well as the risk level acceptable to the Bank. The Bank continually monitors and measures the capacity of acceptable level of risk exposure taking into account the total exposure to all types of risks and activities.

Information collected from all business activities are reexamined and processed so as to identify, analyze and control these risks. Such information is presented and explained to the Management Board, Executive Board, Committee for Monitoring Business Activities and managers of all business units. Reports encompass total credit risk exposure, placement forecast, departures from limits prescribed, market risk measurement, liquidity ratios and changes in risk profile. Based on these reports, the Executive Board and the Management Board of the Bank consider the adequacy of allowances for impairment of placement value. The Asset and Liability Management Committee is also provided with an extensive risk report comprising all necessary information for assessing and drawing of the conclusion on risks present in the Bank.

Daily reports are submitted to the members of the Bank's Management Board and to the concerned directors containing data on the realization of market limits, liquidity and foreign currency risk, as well as all other information.

**32.2. Credit Risk**

Credit risk is the risk that the Bank will suffer a loss due to the fact that its customers and contractual parties will be unable to fully or partially settle their liabilities to the Bank when and as due.

Based on the risk management policy, the Bank sets the rules and procedures defining the process of credit risk management in individual placements and risks on a portfolio level, i.e. delineating the procedures for identifying, measuring and tracking (controlling) placements, particularly those with increased risk exposure.

The Bank controls and manages credit risk by setting limits that define the level of risk acceptable to the Bank in respect to individual customers and type of business, as well as by monitoring these risks.

The Bank has established the process of monitoring the quality of loans so as to ensure timely identification of potential changes in customer creditworthiness, including regular control of collaterals. The limits for different clients are determining using the credit risk classification system classifying each customer into a proper credit rating group. The customer classification is subject to regular reviews.

The Risk Management Sector identifies, measures and assesses credit risk according to debtor's creditworthiness and regularity in settling liabilities towards the Bank, and based on the quality of collaterals securing the Bank's receivables. The process of monitoring the quality of loans makes it possible for the Bank to assess potential losses that may arise from the risks to which the Bank is exposed and helps to determine corrective measures that are to be taken with this respect.

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2010

*All amounts expressed in thousands of RSD, unless otherwise stated.*

## 32. RISK MANAGEMENT (Continued)

## 32.2. Credit Risk (Continued)

**Exposures Similar to Credit Risk**

The Bank issues guarantees and letters of credit to its customers based on which the Bank has contingent liabilities to make payments in favor of third parties. In this manner, the Bank is exposed to risks that are of similar nature as credit risk and can be overcome using the same control processes and procedures as those used for credit risk.

**Excessive Concentration Risk**

Concentration risk is the risk from loss due to an excessive volume of placements with a certain group of debtors. The concentration occurs in the situation where a significant number of customers belongs to the same or similar industry, same geographical area or have similar economic characteristics which may influence the settlement of contractual liabilities in case of a change in economic, political or some other circumstances which influence them in a like fashion. The concentration is indicative of a relative sensitivity of the Bank's operations to the changes that affect a certain industry or a geographical area.

In order to avoid excessive risk concentration, the Bank's policies and procedures comprise specific guidelines for the development and preservation of diversity of its portfolio. Hence, the Bank controls and manages identified credit risk concentrations. The risk concentration is managed by setting limits in respect to individual customers.

**(a) Maximum Credit Risk Exposure in Balance Sheet and Off-Balance Sheet Items**

The review of maximum credit risk exposures is presented in the gross amounts without taking into account collaterals as at December 31, 2010 and 2009 is provided in the following table:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
<b>Credit risk exposure in balance sheet assets:</b>		
Cash and cash equivalents, assets with foreign banks	59,280	42,611
Interest, fee and commission receivables	206,801	111,297
Loans and deposits to customers	8,395,382	7,147,404
Securities (excluding treasury shares)	383,380	455,381
Other placements	407,473	166,290
Other assets	92,219	64,439
	<u>9,544,535</u>	<u>7,987,422</u>
<b>Credit risk exposure in off-balance sheet items:</b>		
Payment guarantees	886,726	154,444
Performance bonds	3,751,123	2,242,855
Letters of credit with coverage	139,166	445,337
Irrevocable commitments	363,891	554,292
	<u>5,140,906</u>	<u>3,396,928</u>
<b>Total credit risk exposure</b>	<u>14,685,441</u>	<u>11,384,350</u>

In case of financial instruments measured at fair value, amounts presented reflect their current exposure to credit risk, but not the maximum risk exposure that may arise in the future as the result of changes in fair values.

At December 31, 2010, the maximum credit risk exposure in the Bank towards a single customer or a group of related customers totaled RSD 547,174 thousand (December 31, 2009: RSD 671,001 thousand) without taking into account deductibles (collaterals securing the collection of receivables and other assets used as a hedge against credit risk), i.e. RSD 533,342 thousand (2009: RSD 652,875 thousand) net, taking into account collaterals.

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**32. RISK MANAGEMENT (Continued)**
**32.2. Credit Risk (Continued)**
**(a) Maximum Credit Risk Exposure in Balance Sheet and Off-Balance Sheet Items (Continued)**

The Bank's maximum credit risk exposure (gross risk-weighted balance sheet assets and off-balance sheet items are classified as of December 31, 2010 and 2009, not taking into account collaterals and other hedges against credit risk, can be broken down to the following geographical areas:

	December 31, 2010					
	Placements with Banks	Loans and Advances to Customers	Securities	Cash, Interest, Fees and Commissions, Other Placements and Other Assets	Guarantees and Other Commitments	Total
Serbia:						
- Belgrade	-	3,252,013	257,595	309,591	4,290,130	8,109,329
- Vojvodina	-	1,609,791	104,695	68,759	460,034	2,243,279
- the rest of Serbia	-	3,533,398	3,000	68,193	390,742	3,995,333
	-	8,395,202	365,290	446,543	5,140,906	14,347,941
European Union	-	-	5,564	130,933	-	136,497
Rest of Serbia	-	180	12,526	3,348	-	16,054
Rest of the world	-	-	-	184,949	-	184,949
	-	8,395,382	383,380	765,773	5,140,906	14,685,441

  

	December 31, 2009					
	Placements with Banks	Loans and Advances to Customers	Securities	Cash, Interest, Fees and Commissions, Other Placements and Other Assets	Guarantees and Other Commitments	Total
Serbia:						
- Belgrade	729,441	2,817,381	157,747	276,705	3,031,895	7,013,169
- Vojvodina	511,109	682,818	279,544	14,466	8,562	1,496,499
- the rest of Serbia	-	2,405,900	-	30,755	356,259	2,792,914
	1,240,550	5,906,099	437,291	321,926	3,396,716	11,302,582
European Union	529	-	5,564	22,371	-	28,464
Rest of Serbia	-	226	12,526	39,237	212	52,201
Rest of the world	-	-	-	1,103	-	1,103
	1,241,079	5,906,325	455,381	384,637	3,396,928	11,384,350

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## 32. RISK MANAGEMENT (Continued)

## 32.2. Credit Risk (Continued)

## (a) Maximum Credit Risk Exposure in Balance Sheet and Off-Balance Sheet Items (Continued)

The analysis of the Bank's credit risk exposure according to industrial sectors as of December 31, 2010 and 2009 is presented in the following table:

	December 31, 2010		December 31, 2009	
	Gross Maximum Exposure	Net Maximum Exposure	Gross Maximum Exposure	Net Maximum Exposure
Retail customers	1,440,648	1,213,031	1,512,350	1,304,447
Processing industry	4,084,658	3,694,065	2,722,417	2,374,792
Trade	6,189,708	6,023,365	4,512,623	4,367,628
Mining and energy	592,441	585,813	20,232	19,765
Agriculture, hunting, fishing and forestry	638,029	205,051	441,019	272,556
Civil engineering	484,411	411,203	449,295	393,401
Traffic and communication Services, tourism and accommodation industry	275,893	269,555	79,432	77,845
Other	404,266	397,924	169,546	165,668
Banks and financial sector	21,000	19,271	23,160	21,401
	554,387	426,799	1,454,276	1,360,626
	<u>14,685,441</u>	<u>13,246,077</u>	<u>11,384,350</u>	<u>10,358,129</u>

## b) Portfolio Quality

The quality of the Bank's financial assets is managed using internal placement classification. The following table shows the portfolio quality (gross placements and off-balance sheet exposures) per types of placements based on the Bank's system of classification as of December 31, 2010:

	2010				Total
	Not Matured and Unimpaired			Matured and Impairment	
	High Quality	Standard Quality	Substandard		
Placements with banks and customers:					
- Placements with banks	-	-	-	1,168	1,168
- Loans to large enterprises	1,362,380	3,071,047	610,086	609,802	5,653,315
- SME loans	218,934	1,156,426	57,943	198,305	1,631,608
- Retail loans	770,758	41,513	90,232	205,619	1,108,122
- Other	387,646	60,379	318,917	-	766,942
Securities	29,055	280,884	73,441	-	383,380
Guarantees and other commitments	4,346,937	553,309	240,660	-	5,140,906
	<u>7,115,710</u>	<u>5,163,558</u>	<u>1,391,278</u>	<u>1,014,894</u>	<u>14,685,441</u>

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**32. RISK MANAGEMENT (Continued)**

**32.2. Credit Risk (Continued)**

**b) Portfolio Quality (Continued)**

The portfolio quality (gross placements and off-balance sheet exposures) per types of placements based on the Bank's classification system as at December 31, 2009 is presented in the following table:

	2009				Total
	Not Matured and Impaired			Matured and Impairment	
	High Quality	Standard Quality	Substandard		
Placements with banks and customers:					
- Placements with banks	1,239,911	-	-	1,168	1,241,079
- Loans to large enterprises	716,198	2,713,586	304,976	227,266	3,962,026
- SME loans	422,297	306,105	20,357	40,844	789,603
- Retail loans	801,717	43,485	119,660	189,304	1,154,166
- Other	108,207	34,418	540,863	-	683,488
Securities	120,000	-	37,060	-	157,060
Guarantees and other commitments	3,088,004	245,572	63,352	-	3,396,928
	<u>6,496,334</u>	<u>3,343,166</u>	<u>1,086,268</u>	<u>458,582</u>	<u>11,384,350</u>

**Age Analysis of Matured Loans and Advances to Customers**

The age analysis of impaired loans to customers in their net amount, as decreased by the amount of allowance for impairment, as of December 31, 2010 and 2009 is presented in the following table:

	December 31, 2010			
	Within 30 Days	From 31 to 90 Days	Over 91 Days	Total
Advances to customers:				
- Loans to large enterprises	-	4,830	-	4,830
- SME loans	17,592	109,085	26,197	152,874
- Retail loans	7,868	3,602	6,070	17,540
	<u>25,460</u>	<u>117,517</u>	<u>32,267</u>	<u>175,244</u>
	December 31, 2009			
	Within 30 Days	From 31 to 90 Days	Over 91 Days	Total
Advances to customers:				
- Loans to large enterprises	2,504	-	20,072	22,576
- SME loans	-	-	1,987	1,987
- Retail loans	8,838	3,610	8,792	21,240
	<u>11,342</u>	<u>3,610</u>	<u>30,851</u>	<u>45,803</u>

As of December 31, 2010, the fair value of collaterals securing the repayment of the abovementioned matured loans totaled RSD 130,851 thousand. The Bank had no collaterals for matured but unimpaired placements as of December 31, 2009.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.2. Credit Risk (Continued)****b) Portfolio Quality (Continued)*****Collaterals and Other Hedges against Credit Risk***

The amount and the type of required collateral depends on credit risk rating estimated for each customer. The terms that apply to securitizing are determined separately upon determining the creditworthiness individually for each customer, type of credit risk exposure, placement maturity, as well as the amount itself. By way of its internal methodology, the Bank determines the types of collateral and parameters used in their measuring.

The basic types of collateral are the following:

- For commercial loans: mortgage on property, cash deposits, sureties provided by other persons, pledges on securities, and
- For placements with retail customers: placement insurance with specialized insurance agencies.

The Bank also accepts guarantees (co-sureties) from parent companies when issuing loans to subsidiaries.

Management keeps track of the market value of collaterals and seeks additional collaterals pursuant to the relevant agreements. Also, management takes into account the market value of collaterals when reconsidering the adequacy of the placement's allowance for impairment.

As in accordance with the Bank's policies, foreclosed collaterals are held for sale in the regular course of business. In this way the amounts of outstanding receivables from a customer are settled. It is unusual for the Bank to use for business purposes the assets acquired in lieu of receivables.

Gross loans that are assessed as impaired at December 31, 2010 totaled RSD 8,415,381 thousand (December 31, 2009: RSD 5,969,429 thousand). The fair value of collaterals securitizing the loans that are individually assessed as impaired totaled RSD 4,226,797 thousand (December 31, 2009: RSD 2,104,382 thousand). The aforementioned collaterals securitizing the collection of receivables comprise deposits, guarantees and mortgages on property.

***Impairment Assessment in Financial Asses***

The most significant factors taken into account in determining the impairment in placements involve the servicing principal and interest amounts with more than 15 days in default for retail customers and more than 30 days of default for corporate entities, weaknesses identified in the customer's cash flows, deterioration in customer credit rating, as well as departures from contractually defined terms.

The Bank determines the amount of allowance for impairment for each individual loan or placement. In determining the amount of allowance for impairment, the Bank takes into account the customer's ability to realize its business plans, customer's ability to improve results of operations in case of financial difficulties, the value at which collaterals may be realized and timelines in realizing collaterals, availability of the alternative financial support to customers, possibility of collecting receivables, as well as the time dimension of expected cash flows. Impairment is assessed at each balance sheet date, except in case of non-performing placements, when unforeseen circumstances call for higher attention and more frequent assessments. The impairment of financial guarantees and letters of credit is assessed and provisions are allocated in a similar way as in case of loans.

Pursuant to the regulations of the National Bank of Serbia, the Bank also calculates the special reserve for estimates losses that may arise from balance sheet assets and off-balance sheet items as in accordance with the internal methodology based on the Decision on the Classification of Balance Sheet and Off-Balance Sheet Exposures.

**NOTES TO THE FINANCIAL STATEMENTS**  
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*All amounts expressed in thousands of RSD, unless otherwise stated.*

**32. RISK MANAGEMENT (Continued)**

**32.2. Credit Risk (Continued)**

**c) Restructured Loans**

The loan restructuring program that was effective as of December 31, 2009 has been cancelled and so at December 31, 2010, the Bank had no restructured loans in its accounts.

The carrying value of rescheduled loans and advances to customers are presented in the following table:

	<u>December 31, 2010</u>	<u>December 31, 2009</u>
Loans to large enterprises	-	127,378
	<u>-</u>	<u>127,378</u>

**d) Receivables in Default**

The Bank pays special attention to the supervision over receivables having the status of being in default by monitoring the total balance and trend in the amounts of these receivables. Receivables in default are monitored per sectors and most significant industries (enterprises and entrepreneurs), whereas the structure of placements with retail customers is monitored per basic products (cash, consumer and housing loans, credit cards and the like).

Pursuant to the regulations, receivables in default from enterprises and entrepreneurs are monitored on the individual loan basis and in case of retail customers, total receivables from a particular customer are taken into account.

The balance sheet assets having the status of receivables in default totaled RSD 1,666,529 thousand and the allowance for impairment of the aforementioned balance sheet assets being in default totaled RSD 1,228,941 thousand at December 31, 2010.

The off-balance sheet items being in default totaled RSD 23,021 thousand as of December 31, 2010 whereas the provisions for losses on the aforementioned off-balance sheet items totaled RSD 521 thousand.

**32.3. Liquidity Risk and Financial Asset Management**

Liquidity risk is the risk that the Bank will be unable to discharge its liabilities when due. So as to decrease or curb its risk exposure, the Bank strives to diversify its sources of financing, to manage assets taking heed of their liquidity, to monitor future cash flows and the Bank's daily liquidity. This includes the estimate of future cash flows and existence of highly rated collaterals that may be used to provide additional financial assets, should the need arise.

The Bank maintains the portfolio comprised of highly liquid securities and diversified assets that may easily be converted into cash in case of unforeseen and adverse oscillations in the Bank's cash flows. The Bank also maintains the mandatory level of required reserves in dinars and in foreign currency as stipulated in the regulations of the National Bank of Serbia.

The Asset and Liability Management Committee is responsible for liquidity risk monitoring, liquidity risk management and proposal of measures to the Executive Board of measures and activities aiming to maintain liquidity, match maturities of assets and liabilities, plans reserves and finance other measures of significance for the Bank's financial stability.

The Asset and Liability Management Committee keeps track of basic liquidity parameters striving to balance inflows and outflows of resources so that daily liquidity ratios move within the limits prescribed by the National Bank of Serbia. The basis for high quality management and ensuring the necessary liquidity level is the matching between maturities of placements and the maturity of their sources. Deciding on the placement maturity is based on the data on deposit maturities and particularly on the information on movements in deposits placed by significant depositors, as well as their needs on short notice. When making such decisions, the Bank takes special care whether the resources from short-term sources are used for long-term placements.

## NOTES TO THE FINANCIAL STATEMENTS

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## 32. RISK MANAGEMENT (Continued)

## 32.3. Liquidity Risk and Financial Asset Management (Continued)

The liquidity level is shown by the liquidity ratio being the ratio between the sum of liquid assets of first and second rank (cash, funds on accounts with other banks, deposits with the National Bank of Serbia, receivables in the process of settlement, financial instruments quoted on the market and other receivables of the Bank maturing within a month) and the sum of liabilities at sight that do not have defined maturity date and liabilities with a defined maturity date falling within a month.

The liquidity risk ratio during 2010 and 2009 was as follows:

	December 31, 2010	December 31, 2009
Period's average	2.24	2.81
Maximum	2.79	3.79
Minimum	1.88	1.89
As of December 31	2.34	2.38

**Analysis of Financial Liabilities According to Maturity**

The table below shows the most significant financial liabilities of the Bank according to the remaining maturity date as of December 31, 2010 and 2009 based on contractually agreed undiscounted repayment amounts. The Bank expects that most depositors will not withdraw their deposits at the maturity date determined in the relevant contract.

	December 31, 2010					
	Within 1 Month	From 1 to 3 Months	From 3 to 12 Months	From 1 to 5 Years	Over 5 Years	Total
Transaction deposits	2,533,446	-	-	-	-	2,533,446
Other deposits	2,022,698	2,334,070	3,891,052	605,620	25	8,853,465
Borrowings	23,049	-	-	-	-	23,049
Interest, fee and commission payable	2,040	-	-	-	-	2,040
Taxes payable	3,935	-	-	-	-	3,935
Other liabilities	153,462	-	87,722	-	-	241,184
	<u>4,738,630</u>	<u>2,334,070</u>	<u>3,978,774</u>	<u>605,620</u>	<u>25</u>	<u>11,657,119</u>
	December 31, 2009					
	Within 1 Month	From 1 to 3 Months	From 3 to 12 Months	From 1 to 5 Years	Over 5 Years	Total
Transaction deposits	2,467,956	-	-	-	-	2,467,956
Other deposits	1,885,835	1,815,356	2,039,111	427,655	-	6,167,957
Borrowings	5,321	-	-	-	-	5,321
Interest, fee and commission payable	4,165	-	-	-	-	4,165
Taxes payable	230	-	-	-	-	230
Other liabilities	91,853	-	80,236	-	-	172,089
	<u>4,455,360</u>	<u>1,815,356</u>	<u>2,119,347</u>	<u>427,655</u>	<u>-</u>	<u>8,817,718</u>

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.3. Liquidity Risk and Financial Asset Management (Continued)*****Analysis of Financial Liabilities According to Maturity (Continued)***

The maturities of undrawn loans and limits, i.e. assumed irrevocable liabilities, guarantees and letters of credit as of December 31, 2010 and 2009 are presented as follows:

	<b>December 31, 2009</b>				
	<b>At Sight</b>	<b>Within 3 Months</b>	<b>From 3 to 12 Months</b>	<b>From 1 to 5 Years</b>	<b>Total</b>
Guarantees	60,102	239,290	3,528,154	810,303	4,637,849
Letters of credit	-	40,513	98,653	-	139,166
Irrevocable commitments	-	22,792	225,614	115,485	363,891
	<u>60,102</u>	<u>302,595</u>	<u>3,852,421</u>	<u>925,788</u>	<u>5,140,906</u>

	<b>December 31, 2009</b>				
	<b>At Sight</b>	<b>Within 3 Months</b>	<b>From 3 to 12 Months</b>	<b>From 1 to 5 Years</b>	<b>Total</b>
Guarantees	58,150	351,174	1,850,676	137,299	2,397,299
Letters of credit	-	445,337	-	-	445,337
Irrevocable commitments	-	36,518	290,711	227,063	554,292
	<u>58,150</u>	<u>833,029</u>	<u>2,141,387</u>	<u>364,362</u>	<u>3,396,928</u>

The Bank expects that not all contingent liabilities and commitments will be drawn before their maturity date.

***Liquidity Gap Analysis***

The Bank's liquidity as its ability to discharge its liabilities when due depends on the balance sheet structure, on one side, and on the matching between inflows and outflows of assets.

The structure of assets and liabilities according to their maturity as of December 31, 2010 is indicative of a maturity mismatch for assets and liabilities due within 1 to 3 months and within 3 to 12 months. The main cause for the aforementioned mismatch is the fact that short-term sources of funds have been placed over different, partly longer time periods, but still within short-term business operations. Also, the Bank has a surplus of liquidity assets in the first time spread (within 30 days) which enables it to address the mismatch by planning future placements (positive cumulative gap).

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**32. RISK MANAGEMENT (Continued)**

**32.3. Liquidity Risk and Financial Asset Management (Continued)**

**Analysis of Financial Liabilities According to Maturity (Continued)**

The following table represents the analysis of maturities of assets and liabilities of the Bank based on contractually agreed terms of payment. The agreed due dates of assets and liabilities have been determined based on the maturity period outstanding as of the balance sheet date. The maturity structure of assets and liabilities as of December 31, 2010 is shown as follows:

	<b>Within 1 Month</b>	<b>From 1 to 3 Months</b>	<b>From 3 to 12 Months</b>	<b>From 1 to 5 Years</b>	<b>Over 5 Years</b>	<b>Total 2010</b>
<b>ASSETS</b>						
Cash and cash equivalents	2,983,747	-	-	-	-	2,983,747
Revocable loans and deposits	2,429,958	-	-	-	-	2,429,958
Receivables arising from interest, fee and commission, trade, fair value adjustments of derivatives and other receivables	128,620	-	-	-	-	128,620
Loans and deposits to customers	1,461,322	1,940,115	3,481,697	870,047	6,211	7,759,392
Securities	149,485	105,470	82,462	-	19,444	356,861
Other placements	10,137	43,972	169,465	38,520	8,906	271,000
Intangible assets	-	-	-	-	17,900	17,900
Property, equipment and investment property	-	-	-	-	733,204	733,204
Other assets	31,445	-	-	-	-	31,445
<b>Total assets</b>	<b>7,194,714</b>	<b>2,089,557</b>	<b>3,733,624</b>	<b>908,567</b>	<b>785,665</b>	<b>14,712,127</b>
<b>LIABILITIES</b>						
Transaction deposits	2,533,446	-	-	-	-	2,533,446
Other deposits	2,022,698	2,334,070	3,891,052	605,620	25	8,853,465
Borrowings	23,049	-	-	-	-	23,049
Interest, fee and commission payables and fair value adjustments of derivatives	2,040	-	-	-	-	2,040
Provisions	-	38,775	-	-	-	38,775
Tax liabilities	3,935	-	-	-	-	3,935
Deferred tax liabilities	-	31,096	-	-	-	31,096
Other liabilities	153,462	-	87,722	-	-	241,184
<b>Total liabilities</b>	<b>4,738,630</b>	<b>2,403,941</b>	<b>3,978,774</b>	<b>605,620</b>	<b>25</b>	<b>11,726,990</b>
<b>Total Equity</b>	<b>-</b>	<b>-</b>	<b>424,291</b>	<b>-</b>	<b>2,560,846</b>	<b>2,985,137</b>
<b>Total Liabilities and Equity</b>	<b>4,738,630</b>	<b>2,403,951</b>	<b>4,403,065</b>	<b>605,620</b>	<b>2,560,871</b>	<b>14,712,127</b>
<b>Liquidity gap as of:</b>						
<b>- December 31, 2010</b>	<b>2,456,084</b>	<b>(314,384)</b>	<b>(669,441)</b>	<b>302,947</b>	<b>(1,775,206)</b>	<b>-</b>
<b>- December 31, 2009</b>	<b>1,055,048</b>	<b>(691,998)</b>	<b>363,487</b>	<b>840,778</b>	<b>(1,567,315)</b>	<b>-</b>

**32.4. Market Risk**

Market risk relates to the risk that the fair value or expected future cash flows of financial instruments may fluctuate, due to changes in market variables such as interest rates and exchange rates. The Bank is not exposed to the risk inherent in the change of prices of equity instruments and prices of goods. Except for the concentration of foreign exchange market risk, the Bank does not have a significant market risk concentration in other positions.

**32.4.1. Interest Rate Risk**

Interest rate risk is the risk from negative effects on the Bank's financial result and equity contingent on the changes in interest rates. Interest rate risk is contingent on interest rate fluctuations that may affect future cash flows and the fair value of financial instruments.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.4. Market Risk (Continued)****32.4.1. Interest Rate Risk (Continued)**

The Bank's Management Board set the limits for the amount of interest rates for defined time periods. The balance sheet positions are monitored on monthly basis so as to insure that the balance sheet positions are in accordance with the set policies and plans. The basis for establishing interest rates is market interest rates whose movements are used as reference values in adjusting the Bank's interest rates. The movements in interest rates may result in the increase or decrease in interest margins. The activity of interest rate risk management aims to optimize the proportion of these influences on the net interest income on one side and economic value of capital on the other side.

The Asset and Liability Management Committee manages the matching between assets and liabilities based on macroeconomic analysis and forecasts, forecasts how to achieve a matched liquidity structure, forecasts of terms for achieving liquidity, analysis and forecast of trends in market interest rates for different segments of assets and liabilities.

The table below shows the sensitivity of the Bank's income statement to the reasonably expected changes in interest rates with all other variables remaining at the same level. The sensitivity of the income statement is the effect of expected changes in interest rates on the net interest income in a year, on financial assets and liabilities that are based on interest rates at December 31, 2010 and 2009.

<u>Currency</u>	<u>Change in Percentage Point</u>	<u>Income Statement Sensitivity</u>
<b>2010</b>		
EUR	+1%	7,231
USD	+1%	(3,141)
RSD	+1.5%	29,822
<b>2009</b>		
EUR	+1%	6,980
USD	+1%	9,015
RSD	+1.5%	32,547

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**32. RISK MANAGEMENT (Continued)**

**32.4. Market Risk (Continued)**

**32.4.1. Interest Rate Risk (Continued)**

The following table provides the Bank's exposure to the changes in interest rates as of December 31, 2010. Assets and liabilities are shown according to the earlier of the date of reconsidering interest or the maturity date.

	<b>Within 1 Month</b>	<b>From 1 to 6 Months</b>	<b>From 6 to 12 Months</b>	<b>Over 1 Year</b>	<b>Non- Interest Bearing</b>	<b>Total</b>
<b>ASSETS</b>						
Cash and cash equivalents	2,165,906	-	-	-	817,841	2,983,747
Revocable loans and deposits	756,000	-	-	-	1,673,958	2,429,958
Receivables arising from interest, fee and commission, trade, fair value adjustments of derivatives and other receivables	-	-	-	-	128,620	128,620
Loans and deposits to customers	2,199,614	3,308,251	1,420,929	430,972	399,626	7,759,392
Securities	118,858	182,093	-	-	55,910	356,861
Other placements	10,137	49,406	22,101	25,981	163,375	271,000
Intangible assets	-	-	-	-	17,900	17,900
Property, equipment and investment property	-	-	-	-	733,204	733,204
Other assets	-	-	-	-	31,445	31,445
<b>Total assets</b>	<b>5,250,515</b>	<b>3,539,750</b>	<b>1,443,030</b>	<b>456,953</b>	<b>4,021,879</b>	<b>14,712,127</b>
<b>LIABILITIES</b>						
Transaction deposits	717,792	-	-	-	1,815,654	2,533,446
Other deposits	1,964,299	2,360,524	1,433,556	178,897	2,916,189	8,853,465
Borrowings	-	-	-	-	23,049	23,049
Interest, fee and commission payables and fair value adjustments of derivatives	-	-	-	-	2,040	2,040
Provisions	-	-	-	-	38,775	38,775
Tax liabilities	-	-	-	-	3,935	3,935
Deferred tax liabilities	-	-	-	-	31,096	31,096
Other liabilities	-	-	-	-	241,184	241,184
<b>Total Liabilities</b>	<b>2,682,091</b>	<b>2,360,524</b>	<b>1,433,556</b>	<b>178,897</b>	<b>5,071,922</b>	<b>11,726,990</b>
<b>Total Equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,985,137</b>	<b>2,985,137</b>
<b>Total Liabilities and Equity</b>	<b>2,682,091</b>	<b>2,360,524</b>	<b>1,433,556</b>	<b>178,897</b>	<b>8,057,049</b>	<b>14,712,127</b>
<b>Net interest rate risk exposure as of:</b>						
- December 31, 2010	2,568,424	1,179,226	9,474	278,056	(4,035,170)	-
- December 31, 2009	183,318	867,191	1,522,389	922,705	(3,495,170)	-

**32.4.2. Foreign Exchange Risk**

Foreign exchange risk is the risk from changes in the value of financial instruments and negative effects on the Bank's result and equity due to changes in exchange rates. Banking operations in various currencies conditions exposures to oscillations in the exchange rates of several currencies.

The Bank manages foreign exchange risk striving to prevent adverse effects of the fluctuations in exchange rates of foreign currencies and dinar to foreign currency exchange rates (foreign exchange losses) as on the Bank's financial result, so on the debtor's ability to repay loans denominated in the same currency.

As a hedge against foreign exchange risk, the Bank monitors daily movements in exchange rates on the financial market, implements the policy of low foreign exchange exposure and indexes its placements to a currency clause.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.4. Market Risk (Continued)****32.4.2. Foreign Exchange Risk (Continued)**

The Asset and Liability Management Committee monitors open foreign currency positions per currencies significant for the Bank so as to minimize the negative effects of changes in exchange rates on the Bank.

As in accordance with the regulatory requirements of the National Bank of Serbia, the Bank continually maintains its currency position – the ratio of its foreign exchange risk is within the legally set maximum compared with the equity, where the Bank is liable to ensure that its total net open foreign currency position does not exceed 20% of its equity. During 2010, the Bank took good care that the foreign currency ratio be within the prescribed value.

The following table shows the currencies in which the Bank has significant exposures at December 31, 2010 and 2009 of its monetary assets and liabilities not being traded.

The analysis accounts for the result of reasonably expected fluctuations in exchange rates compared to RSD with all other variables remaining at the same level. Negative amounts provided in the table represent potential decrease in operating results or in equity, whereas positive amounts refer to possible increases.

<u>Currency</u>	<u>Exchange rate Fluctuations (%) 2010</u>	<u>Effect on the Operating Result before Taxation 2010</u>	<u>Effect on Equity 2010</u>
EUR	10%	40,152	-0.68
USD	10%	32,395	
<u>Currency</u>	<u>2009</u>	<u>2009</u>	<u>2009</u>
EUR	10%	16,863	-1.26
USD	10%	12,521	

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**December 31, 2010**

All amounts expressed in thousands of RSD, unless otherwise stated.

**32. RISK MANAGEMENT (Continued)**

**32.4. Market Risk (Continued)**

**32.4.2. Foreign Exchange Risk (Continued)**

The following table shows the Bank's exposure to currency risk at December 31, 2010. The table includes assets and liabilities at their carrying values.

	<u>EUR</u>	<u>USD</u>	<u>CHF</u>	<u>Other Currencies</u>	<u>Total FX Balance</u>	<u>Total in RSD</u>	<u>Total</u>
<b>ASSETS</b>							
Cash and cash equivalents	1,104,301	1,445,570	19,001	42,977	2,611,849	371,898	2,983,747
Revocable loans and deposits	32,124	1,641,834	-	-	1,673,958	756,000	2,429,958
Receivables arising from interest, fee and commission, trade, fair value adjustments of derivatives and other receivables	14,605	4,685	-	-	19,290	109,330	128,620
Loans and deposits to customers	1,804,566	1,045,160	-	-	2,849,726	4,909,666	7,759,392
Securities	-	18,090	-	-	18,090	338,771	356,861
Other placements	49,057	221,943	-	-	271,000	-	271,000
Intangible assets	-	-	-	-	-	17,900	17,900
Property, equipment and investment property	-	-	-	-	-	733,204	733,204
Other assets	3,450	-	-	-	3,450	27,995	31,445
<b>Total assets</b>	<u>3,008,103</u>	<u>4,377,282</u>	<u>19,001</u>	<u>42,977</u>	<u>7,447,363</u>	<u>7,264,764</u>	<u>14,712,127</u>
<b>LIABILITIES</b>							
Transaction deposits	874,856	187,297	9,354	24,147	1,095,654	1,437,792	2,533,446
Other deposits	1,700,492	3,861,202	9,458	587	5,571,739	3,281,726	8,853,465
Borrowings	13,687	2,173	-	191	16,051	6,998	23,049
Interest, fee and commission payables and fair value adjustments of derivatives	459	14	-	-	473	1,567	2,040
Provisions	10,270	2,594	-	-	12,864	25,911	38,775
Tax liabilities	-	-	-	-	-	3,935	3,935
Deferred tax liabilities	-	-	-	-	-	31,096	31,096
Other liabilities	6,820	54	11	-	6,885	234,299	241,184
<b>Total Liabilities</b>	<u>2,606,584</u>	<u>4,053,334</u>	<u>18,823</u>	<u>24,925</u>	<u>6,703,666</u>	<u>5,023,324</u>	<u>11,726,990</u>
<b>Total Equity</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,985,137</u>	<u>2,985,137</u>
<b>Total Liabilities and Equity</b>	<u>2,606,584</u>	<u>4,053,334</u>	<u>18,823</u>	<u>24,925</u>	<u>6,703,666</u>	<u>8,008,461</u>	<u>14,712,127</u>
<b>Net foreign currency position at:</b>							
- December 31, 2010	<u>401,519</u>	<u>323,948</u>	<u>178</u>	<u>18,052</u>	<u>743,697</u>	<u>(743,697)</u>	<u>-</u>
- December 31, 2009	<u>522,884</u>	<u>214,150</u>	<u>(16,184)</u>	<u>5,067</u>	<u>725,917</u>	<u>(725,917)</u>	<u>-</u>

**32.5. Bank's Counterparty Risks**

The Bank's counterparty risks relate to the Bank's exposure to a single entity or towards a group of related parties, as well as the Bank's exposure to its related party.

Monitoring the Bank's exposure to a single entity or a group of related parties, as well as parties related to the Bank is under jurisdiction of the organizational part responsible for the approval of product engagement. Monitoring the Bank's exposure to this risk is the obligatory part of the process of approving engagements within the meaning that the body – the board approving the engagement, handles data on the total Bank's exposure to a customer or a group of related parties and the proportion of such exposure and the Bank's equity.

In 2010, the Bank took care of the counterparty risk ratio compliance and implemented adequate activities envisaged by the relevant procedures and decisions on loan approval. Also, it ensured that its placements and investments be in conformity with business ratios prescribed by the National Bank of Serbia (see Note 29b).

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.5. Bank's Counterparty Risks (Continued)**

The Risk Management Sector determines the ratio of large counterparty exposures to one entity or a group of related entities that exceed 10% of capital as the proportion of total exposure to these parties and the Bank's capital, comparing it with the review of large exposures per customers and their compliance with the previously approved limits set by the Management Board. The Sector determines counterparty risk exposure to the Bank's related parties on quarterly basis as a proportion of total net exposure to these entities and the Bank's equity, comparing it to the prescribed 5% limit.

The Management Board needs to give its consent to exposure of the Bank towards customers or groups of related customers in cases where these aggregate to over 10% equity i.e. for any increase in this exposure that exceeds 20% of the Bank's capital. The Bank's Executive Board decides on placements made and debts incurred towards customers or a group of related customers that constitute large exposure to the Bank up to the amount determined in the risk management policy (over 20% of the Bank's capital).

**32.6. Bank's Investment Risks**

The Bank's investment risks include the risk of capital investments in other legal entities and capital expenditures. As in accordance with the regulations prescribed by the National Bank of Serbia, the capital adequacy must constantly be monitored and it is necessary to ensure that the Bank's investment in a single entity operating outside the financial sector does not exceed 10% of the Bank's capital, and that the Bank's total investments in entities outside the financial sector and capital expenditures do not exceed 60% of the Bank's capital.

The Bank's risk exposure arising from investments in other legal entities and capital expenditures is monitored by keeping the Bank's organizational part or the unit tasked with the acquisition of fixed assets and investments in legal entities informed of the current exposure and amount of capital so that timely steps could be taken to ensure compliance with the prescribed limits.

The Bank's assembly sets the amount of capital expenditures and investments in intangible assets at the beginning of the year, based on the plan of capital expenditures and investments in intangible assets ranging within the limits prescribed by the National Bank of Serbia.

The Bank's assembly also sets the limit for the amounts invested in other legal entities operating outside the financial sector within the limits prescribed by the NBS (as in accordance with the Decision on Risk Management in Banks, this limit is set at 10% of a bank's capital).

The Accounts Department monitors the compliance of acquisition with the approved plan of capital expenditures for the current year.

In 2010, the Bank ensured the compliance of investment risk ratios and implemented measures so as to comply with the ratios prescribed by the National Bank of Serbia.

**32.7. Country Risk**

Risks that relate to the country of origin of the counterparty to which the Bank is exposed (country risk) include risks from adverse effects on the financial result and capital of the Bank arising in connection with the Bank's inability to collect receivables from such counterparty for political, economic or social circumstances in the country of origin of such entity.

The Bank determines country risk limits for each country separately and in case there are significant concentrations of exposures to certain geographical regions – these limits are determined for regions as well.

For measuring country risk, the Bank uses long-term credit rating of a debtor's country set by the internationally recognized credit rating agencies. Risk monitoring by analyzing the balance, changes and trends as the basis for country risk monitoring comprises changes on the Country Risk Ratings. The Treasury Department takes the country risk rating list available on the sites of authorized Agencies. The changes and updates of the list of country risk ratings are performed by employees in the Treasury Department whenever such changes are identified.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.7. Country Risk (Continued)**

The Bank minimizes country risk by observing its foreign investment policies, through short-term deposits of assets with first rate foreign banks. As in accordance with the internal procedures and depending on the assessed country risk, the Asset and Liability Management Committee approves to the organizational part investing the Bank's assets in foreign bank overdrafts, unlimited short-term depositing, keeping funds on a foreign bank account in accordance with the minimum amount necessary for the Bank's operations, or up to the limit set in a special decision adopted by the Executive Board.

The Credit Committee approves placements with corporate customers domiciled abroad as in accordance with the special decision of the Executive Board taking into account the impact of country risk on the classification of receivables determined by the Risk Management Sector.

The Asset and Liability Management Committee and the Executive Board review and monitor country risk, keeping it at a level acceptable for the Bank's risk profile. The Management Board may define limits for placement of assets with corporate entities and banks in certain countries and regions, including the suspension of placements in the circumstances of significant political and economic events.

The Bank performs most of its activities on the territory of the Republic of Serbia, so the major part of the Bank's credit portfolio relates to domestic customers and citizens.

**32.8. Operatinal Risk**

Operational risk is the risk of loss arising from system failure, human errors, frauds or unforeseen external events. When controls cease to be effective, operational risk may impair the Bank's reputation, give rise to legal issues or cause financial losses.

The Bank cannot eliminate all operational risks; however, through the introduction of a rigorous chart of accounts and by supervising and responding to potential risks, the Bank is able to manage these risks. The role of the operational risk management process is to identify, assess, control and reduce the operational risk probability and their impact, as well as losses contingent thereupon. Control includes effective duty segregation, access rights, authorizations and reconciliation of procedures, staff training and supervision process, including internal audit.

In the course of the Bank's operational risk management, the Bank implements quantitative and qualitative measures that are based on data gathered on losses incurred as a consequence of operational risk, as per categories determined pursuant to sources of loss.

The Bank manages operational risk so as to minimize the influence of negative and failed internal processes, people and systems or external events on the Bank's financial result. The events that give rise to operational risks are classified and monitored by the Bank according to lines of business according to the type of event and the like) and according to the type of loss (loss, averted loss and the like). The Bank developed a database as a starting point for recording and monitoring risk events, which is updated by authorized employees on an ongoing basis.

In compliance with the prescribed requirements and stipulations of good business practice the Bank compiled a Business Continuity Plan to be used in case of unforeseen events.

**32.9. Capital Management**

The objectives of the Bank in respect to capital management, being the notion wider than the capital included in the balance sheet, are as follows:

- to comply with the requirements of the National Bank of Serbia;
- to ensure the business continuity, return to the shareholders and benefits to other parties interest; and
- to provide an adequate capital base as a support to the further business development in the Bank.

The Bank's management regularly monitors capital adequacy ratios of the Bank and other business ratios prescribed by the National Bank of Serbia and submits quarterly reports to the National Bank of Serbia on the ratio values realized.

**NOTES TO THE FINANCIAL STATEMENTS**  
**December 31, 2010**

*All amounts expressed in thousands of RSD, unless otherwise stated.*

**32. RISK MANAGEMENT (Continued)**

**32.9. Capital Management (Continued)**

The Law on Banks and relevant decisions of the National Bank of Serbia stipulate that banks must maintain the minimum amount of capital in the dinar value of EUR 10 million calculated by applying the official middle exchange rate; its capital adequacy ratio must at all times be above 12%, and the scope and structure of its business activities must be in accordance with the regulatory Decision on Risk Management in Banks (RS Official Gazette number 129/2007, 63/2008 and 112/2008) and the Decision on Capital Adequacy (RS Official Gazette number 129/2007 and 63/2008).

The Bank manages its equity structure and makes reconciliations in accordance with the changes in economic terms and risks inherent in the Bank's activities.

The aforementioned Decision of the National Bank of Serbia on Capital Adequacy delineates the manner of calculating the Bank's capital and its capital adequacy ratio. The Bank's total capital is comprised of core capital and supplementary capital, and deductibles defined, while risk-weighted balance sheet and off-balance sheet assets are determined in accordance with the prescribed risk weights for all types of assets. The Bank's core capital is defined in the decision and must amount to no less than 50% of the Bank's capital. Pursuant to the regulations of the National Bank of Serbia, when calculating the capital adequacy ratio, total risk weighted balance sheet assets and off-balance sheet items are increased by the amount of open foreign currency position.

The following table shows the structure of total regulatory capital of the Bank as of December 31, 2010 and 2009, as well as the capital adequacy ratio:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
<b>Regulatory capital</b>		
Core capital	2,532,273	2,524,618
Supplementary capital	433,055	432,469
<b>Total core and supplementary capital</b>	<b>2,965,328</b>	<b>2,957,087</b>
<i>Capital deductibles:</i>		
Outstanding portion of reserves for special losses	(578,370)	(537,095)
	<u>2,386,958</u>	<u>2,419,992</u>
<b>Risk-weighted balance sheet and off-balance sheet items</b>		
Balance sheet assets	9,445,498	7,735,253
Off-balance sheet items	1,736,980	642,066
Open foreign currency position	176,977	313,976
	<u>11,359,455</u>	<u>8,691,295</u>
<b>Capital adequacy (1/2 x 100)</b>	<u>21.01%</u>	<u>27.84%</u>

**32.10. Estimates of the World Financial Crisis Effects**

The current world financial crises commenced in mid 2007, whereas the actual effects on the banking and corporate sector in the world became apparent in 2008 and 2009 with further aggravation of the crisis effects. The effects of crisis reflected mostly on the investments made into the capital market, decrease of liquidity in banking sector, increase in interbank interest rates and caused an excessive fluctuation on the securities market.

The crisis effects in Serbia started showing in the last quarter of 2008 and first impacted the banking sector through significant withdrawal of retail deposits which further impacted the overall liquidity crisis. The crisis effects in Serbia manifested in the significant fluctuations in dinar exchange rate compared to other currencies, mainly EUR, as well as in the decrease in economic activity which resulted in diminished credit rating of both retail and corporate customers.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.10. Estimates of the World Financial Crisis Effects (Continued)**

The National Bank of Serbia and the Government of the Republic of Serbia assumed a range of measures of short-term and long-term nature for the purpose of relieving the effects of financial crisis, preservation of the stability of the banking system in Serbia, as well as for creating the terms for the rehabilitation of economic activities through more favorable crediting terms.

The measures undertaken by the National Bank of Serbia for the purpose of preserving stability in the situation of financial crisis contained in the following documents:

- Decision on Temporary Measures for Preserving Financial Stability in the Republic of Serbia;
- Decision on Special Facilities Supporting the Country's Financial Stability;
- Monetary Policy Program of the National Bank of Serbia in 2009; and
- Monetary Policy Program of the National Bank of Serbia in 2010.

The purpose of these measures is to ensure that in case there are liquidity issues, commercial banks may obtain borrowings from the National Bank of Serbia in order to bridge temporary difficulties in connection with liquidity; to increase liquidity of the banking sector jeopardized by decreased confidence in the banking sector and money market, through amendments in regulations with respect to required reserves for foreign sources and other debts incurred by mid 2010; to overcome difficulties in repayment of loans by banks' customers; measures for stimulating credit activity and increase in the insured deposit amount from EUR 3,000 to EUR 50,000. The aforementioned measures in 2010 impacted the stability of the banking sector and restored the citizens' trust in the banking system which principally manifested in re-depositing of deposits withdrawn from the accounts and increase in retail savings. Towards the end of 2010, the National Bank of Serbia amended special facilities supporting financial stability of the banking sector, opening new channels of credit activity towards commercial banks for the purpose of maintaining a required level of liquidity of certain banks and sector on the whole.

Pursuant to the regulatory requirements and measures of the National Bank of Serbia, as well as the interim risk management policies, the Bank implements proper activities aiming to maintain the quality of credit portfolio and ensure adequate sources of finances in the ensuing period. These activities encompass a prudent policy of loan origination, analysis of debtor creditworthiness, acquisition of proper collaterals securitizing receivables, loan rescheduling, as well as adequate provisioning against credit losses. The Bank's management assesses that the collection of receivables, liquidity risk management and ensuring of adequate sources of finances will be key choice of management and managing bodies in the Bank in the ensuing period.

In 2009 and 2010, the Bank stabilized and widened depository base and on that basis credit activity grew in the corporate sector.

The Bank's management is of the opinion that it undertakes all the necessary activities under given circumstances to ensure sustainable growth and development in the Bank. Also, the Bank's management is unable to assess further effects and extent of crises on the economic environment of Serbia or the effect on the financial position and operating results of the Bank, but assesses that the crisis will not jeopardize the continuity of its business operations.

**32.11. Fair Value of Financial Assets and Liabilities**

It is a policy of the Bank to disclose the fair value information of those components of assets and liabilities for which published or quoted market prices are readily available, and of those for which the fair value may be materially different than their recorded amounts. In the Republic of Serbia, sufficient market experience, stability and liquidity do not exist for the purchase and sale of receivables and other financial assets or liabilities, for which published market prices are presently not readily available. As a result of this, fair value cannot readily or reliably be determined in the absence of an active market. The Bank's management assesses its overall risk exposure, and in instances in which it estimates that the value of assets stated in its books may not have been realized, it recognizes a provision.

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***32. RISK MANAGEMENT (Continued)****32.11. Fair Value of Financial Assets and Liabilities (Continued)**

The fair value of cash and cash equivalents, short-term deposits, other placements and other assets, transaction deposits, accounts payable and other short-term liabilities corresponds to their carrying value principally due to their short-term maturities. The Bank's financial instruments are stated at amortized cost mostly have short-term maturities and carry a floating interest rate that reflects current market terms. Accordingly, the Bank assesses that the value at which the aforementioned financial instruments are stated corresponds to their market value. The fair value of loans and advances to customers equals their carrying value net of accumulated allowance for impairment.

In the opinion of the Bank's management, the reported carrying amounts are the most valid and useful reporting values under the present market conditions.

***Financial Instrument whose Fair Value Approximates Their Carrying Value***

For financial assets and financial liabilities that are liquid or have short-term maturities (within 3 months) it is assumed that the carrying values approximate their fair value. This assumption also applies to demand deposits, savings deposits without definite maturities and financial instruments indexed to floating interest rates.

***Financial Instruments with Fixed Interest Rates***

The fair value of financial assets and liabilities with the fixed interest rates, that are recorded at amortized value, are assessed by comparison with the market interest rates upon initial recognition with the current market rates that apply to similar financial instruments. The estimated fair value of deposits indexed to a fixed interest rate is based on discounted cash flows using the prevalent interest rates on the money market for contracts with similar interest rate risk exposure and maturities. For quoted debt instruments, fair values are calculated based on prices listed on the market.

***Financial Instruments at Fair Value***

Financial instruments are measured at fair value based on information available on the market i.e. the use of quoted market prices at the reporting date.

**33. COMMITMENTS AND CONTINGENT LIABILITIES****a) Operating Lease Liabilities**

Operating lease liabilities relate to the rental of business premises based on agreements entered.

The future minimum non-cancellable operating lease payments were as follows:

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Within a year	61,060	55,084
From 1 to 5 years	244,240	220,334
	<u>305,300</u>	<u>275,418</u>

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***33. COMMITMENTS AND CONTINGENT LIABILITIES (Continued)****b) Litigations**

As of December 31, 2010, the Bank is involved in a lawsuit against the Commercial Bank of Kuwait as a defendant based on the activated counter guarantee for the amount of USD 6,000 thousand. The aforementioned lawsuit was terminated in 2005. During 2010, the litigants agreed with the Commercial Bank of Kuwait that the liability arising from the guarantee be written off (the Commercial Bank of Kuwait provided the Certificate on Receivable Write-off) so the Bank petitioned with the court requesting that the litigation be terminated by adjudicating in favor of liability write-off. The Bank expects to win this lawsuit in full.

If the Bank's contingent liability would be established, pursuant to Decision number 25 on the Resolution of the Issue of Contingent Liabilities Arising from Valid Guarantees Issued by the National Bank of the Former SFRY (as of July 7, 2005), it could not exceed the amount of USD 509,421, i.e. it could not exceed the amount which the Bank's customers (JP Jugoimport SDPR and Centropjekt from Belgrade) from the territory of Serbia and Montenegro, received as advances for which the guarantee had been issued.

The total value of lawsuits filed against the Bank as of December 31, 2010 totaled RSD 50,462 thousand (RSD 10,108 thousand and USD 509 thousand). The Bank's management does not anticipate materially significant losses to arise from litigations in the ensuing period and accordingly, the accompanying financial statements do not include provisions for potential losses thereof.

The Bank was involved in lawsuits as a plaintiff for the purpose of collecting its receivables, seeking an amount of RSD 1,231,987 thousand (RSD 1,092,835 thousand and EUR 1,319 thousand). The Bank fully provided for all receivables from legal and retail customers subject to litigation have been charged to net profit of the prior and current year.

**c) Taxation Risks**

The Republic of Serbia taxation system is subject to revisions and amendments. The fiscal periods remain open for review by the tax authorities with regard to the tax-paying entity's tax liabilities for a period of five years. In various circumstances, the views of the taxation authorities may not concur with that of the Bank's management and the Bank may be assessed additional taxes, penalties and interest. The Bank's management is of the opinion that tax liabilities recorded in the financial statements have been fairly stated.

**NOTES TO THE FINANCIAL STATEMENTS**  
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**34. SEGMENT REPORTING**

**a) Information on Profit and Loss, Assets and Liabilities per Segments**

At December 31, 2010, for managing purposes, the Bank's business activities were organized in two main reporting segments:

- Corporate activities;
- Retail activities.

Given the Bank does not have a complex structure of various banking activities, the Bank's management concluded that the business segments determined in accordance with IFRS 8 "Operating Segments" are the same as the business segments that were previously identified in accordance with IAS 14.

Other Bank's activities, such as broker-dealer operations, do not constitute a separate reporting segment.

The segment results for the period from January 1 through December 31, 2010 were as shown below:

	<b>Corporate Activities</b>	<b>Retail Activities</b>	<b>Other Segments</b>	<b>2010 Total</b>
Interest income	1,217,589	210,494	60,923	1,489,006
Fee and commission income	33,786	101,452	65,904	201,142
Dividend and other income from equity investments	405	-	283	688
Net gains on the valuation of assets and liabilities	202,438	42,365	(22,755)	222,048
Foreign exchange gains	1,912,279	176,966	1,673,178	3,762,423
Other operating income	155	739	27,009	27,903
<b>Profit from operations</b>	<b>3,366,652</b>	<b>532,016</b>	<b>1,804,542</b>	<b>5,703,210</b>
Interest expense	(329,895)	(79,161)	-	(409,056)
Fee and commission expense	-	(16,090)	(8,397)	(24,487)
Net impairment losses and provisions	(381,636)	(11,011)	(30,839)	(423,486)
Staff costs	(37,825)	(214,214)	(223,090)	(475,129)
Depreciation and amortization	-	-	(53,282)	(53,282)
Other operating expenses	(4,036)	(100,182)	(333,033)	(437,251)
Foreign exchange losses	(2,237,173)	(286,539)	(1,355,368)	(3,879,080)
<b>Loss from operations</b>	<b>(2,990,565)</b>	<b>(707,197)</b>	<b>(2,004,009)</b>	<b>(5,701,771)</b>
<b>Profit/(Loss) from operations before taxation</b>	<b>376,087</b>	<b>(175,181)</b>	<b>(199,467)</b>	<b>1,439</b>
Gains on the decrease in deferred tax liabilities	-	-	11	11
<b>Net profit/(loss)</b>	<b>376,087</b>	<b>(175,181)</b>	<b>(199,456)</b>	<b>1,450</b>

**NOTES TO THE FINANCIAL STATEMENTS**  
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**34. SEGMENT REPORTING (Continued)**

**a) Information on Profit and Loss, Assets and Liabilities per Segments (Continued)**

The segment results for the period from January 1 through December 31, 2009 were as shown below:

				<b>2009</b>
	<b>Corporate Activities</b>	<b>Retail Activities</b>	<b>Other Segments</b>	<b>Total</b>
Interest income	648,020	214,768	146,199	1,008,987
Fee and commission income	66,436	49,448	38,060	153,944
Dividend and other income from equity investments	172	-	1,718	1,890
Net gains on the valuation of assets and liabilities	73,586	30,227	3,693	107,506
Foreign exchange gains	1,201,293	169,871	1,334,634	2,705,798
Interest income	86	300	17,886	18,272
<b>Profit from operations</b>	<b>1,989,593</b>	<b>464,614</b>	<b>1,542,190</b>	<b>3,996,397</b>
Interest expense	(220,021)	(54,244)	(200)	(274,465)
Fee and commission expense	(7,342)	(21,644)	(133)	(29,119)
Net impairment losses and provisions	(301,831)	45,439	(11,898)	(268,290)
Staff costs	(109,924)	(210,493)	(135,036)	(455,453)
Depreciation and amortization	(11,242)	(26,230)	(24,981)	(62,453)
Other operating expenses	(2,513)	(1,400)	(402,904)	(406,817)
Foreign exchange losses	(1,331,588)	(216,801)	(1,232,854)	(2,781,243)
<b>Loss from operations</b>	<b>(1,984,461)</b>	<b>(485,373)</b>	<b>(1,808,006)</b>	<b>(4,277,840)</b>
<b>(Loss)/Profit from operations before taxation</b>	<b>5,132</b>	<b>(20,759)</b>	<b>(265,816)</b>	<b>(281,443)</b>
Gains on the decrease in deferred tax liabilities	-	-	1,055	1,055
<b>Net (loss)/profit</b>	<b>5,132</b>	<b>(20,759)</b>	<b>(264,761)</b>	<b>(280,388)</b>

Assets of business segments at December 31, 2010 did not encompass cash and cash equivalents (RSD 2,726,702 thousand), required reserve in dinars and in foreign currency (RSD 1,931,003 thousand), intangible assets, property and equipment (RSD 751,104 thousand), since these assets are managed on the Bank level.

Liabilities of business segments at December 31, 2010 did not encompass borrowings (RSD 23,049 thousand), taxes payable (RSD 3,935 thousand), and deferred tax liabilities (RSD 31,096 thousand), since these liabilities are managed on the Bank level.

Segment assets and liabilities as of December 31, 2010 are presented as follows:

				<b>2010</b>
	<b>Corporate Activities</b>	<b>Retail Activities</b>	<b>Other Segments</b>	<b>Total</b>
Assets	7,046,912	1,048,323	1,208,083	9,303,318
Liabilities	6,692,644	1,842,857	3,133,409	11,668,910

**NOTES TO THE FINANCIAL STATEMENTS****December 31, 2010***All amounts expressed in thousands of RSD, unless otherwise stated.***34. SEGMENT REPORTING (Continued)****a) Information on Profit and Loss, Assets and Liabilities per Segments (Continued)**

Segment assets and liabilities as of December 31, 2009 are presented as follows:

	<u>Corporate Activities</u>	<u>Retail Activities</u>	<u>Other Segments</u>	<u>2009 Total</u>
Assets	4,699,031	976,119	2,334,797	8,009,947
Liabilities	5,397,996	1,464,723	1,983,333	8,846,052

Assets of business segments at December 31, 2009 did not encompass cash and cash equivalents (RSD 1,365,856 thousand), required reserve in dinars and in foreign currency (RSD 1,718,624 thousand), intangible assets, property and equipment (RSD 771,384 thousand), since these assets are managed on the Bank level.

Liabilities of business segments at December 31, 2009 did not encompass borrowings (RSD 5,321 thousand), taxes payable (RSD 230 thousand), and deferred tax liabilities (RSD 31,107 thousand), since these liabilities are managed on the Bank level.

**b) Geographical Segment Reporting**

The Bank's country of origin and the country where its operations are headquartered is the Republic of Serbia. The allocation of income was performed according to the country where the customer, i.e. the user of the Bank's products and services, is domiciled. The Bank earns its entire income on the territory of the Republic of Serbia. All loans and placements, as well as other financial assets of the Bank are placed on the territory of the Republic of Serbia. The total assets are allocated as per their location. The Bank's total non-current assets are located on the Republic of Serbia territory.

**c) Information on Main Customers**

The Bank has numerous unrelated customers with individually small amounts of loans issued and income earned, none of which accounts for more than 10% of interest, fee and commission income.

**35. RECONCILIATION OF MUTUAL RECEIVABLES AND PAYABLES**

As in accordance with Article 20 of the Law on Accounting and Auditing, the Bank reconciled its payables and receivables with its debtors and creditors, which is substantiated with valid documentation.

The Bank provided to its customers open item statements as of November 30, 2010. Based on the exchange of open item statements with customers, only 8% of receivables and liabilities remain unreconciled.

The main reason for disputing open item statements is the manner of recording and posting receivables from customers that posted receivables under a different date.

Open item statements returned due to wrong addresses account for 1% of total open item statements.

**36. EXCHANGE RATES**

The official middle exchange rates of the National Bank of Serbia have been determined at the Interbank Exchange Market assembly used to recalculate foreign currency denominated balance sheet line items as of December 31, 2010 and 2009 into the functional currency for particular currencies were as follows:

	<u>2010</u>	<u>In RSD 2009</u>
EUR	105.4982	95.8888
USD	79.2802	66.7285
CHF	84.4458	64.4631