

BANKA KOVANICA d.d.

**Financial statements as at
31 December 2014 together with the
Independent Auditor's Report**

Contents

	<i>Page</i>
Responsibility of the Management Board	1
Independent Auditor's Report	2-3
Financial statements:	
Statement of comprehensive income	4
Statement of financial position	5
Statement of changes in equity	6
Cash flow statement	7
Notes to the financial statements	8-58

Responsibility of the Management Board

Pursuant to the Croatian Accounting Act (Official Gazette 109/07, 54/13 and 121/14), the Management Board is responsible for ensuring that the financial statements are prepared for each financial year in accordance with statutory accounting regulations applicable to banks in Croatia, which give a true and fair view of the financial position and results of the Bank for that period.

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

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

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

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Act (Official Gazette 190/07, 54/13 and 121/14). The Management Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Management Board:

Nicola Ceccaroli

President of the Management Board

Darko Kosovec

Member of the Management Board

Banka Kovanica d.d.

Preradovićeve 29

Varaždin

21 April 2015



Independent Auditor's Report

To the Shareholders and Management of Banka Kovanica d.d.

We have audited the accompanying financial statements of Banka Kovanica d.d. (the "Bank"), which comprise the balance sheet as at 31 December 2014 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting regulations applicable to banks in Croatia as set out in Note 2.1 - 'Accounting framework' to the financial statements and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

PricewaterhouseCoopers d.o.o., Ulica kneza Ljudevita Posavskog 31, 10000 Zagreb, Croatia
T: +385 (1) 6328 888, F: +385 (1) 6111 556, www.pwc.hr

Commercial Court in Zagreb, Tt-99/7257-2, Reg. No.: 080238978; Company ID No.: 81744835353; Founding capital: HRK 1,810,000.00, paid in full; Management Board: Hrvoje Zgombić, President; J. M. Gasparac, Member; S. Dušić, Member; T. Mačašović, Member; Giro-Account: Raiffeisenbank Austria d.d., Petrinjska 59, Zagreb, IBAN: HR8124840081105514875.



Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2014, its financial performance and cash flows for the year then ended in accordance with accounting regulations applicable to banks in Croatia as set out in Note 2.1 - 'Accounting framework' to the financial statements.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 29 which states that the Bank is involved in a legal dispute relating to the issuance of the Bank's guarantee in the amount of EUR 710 thousand, which is contested by the Bank. In the first-instance verdict the claim was entirely rejected, i.e. the court ruled in favour of the Bank and the Bank's Management believes that the final ruling will be positive for the Bank.

We also draw attention to Note 33 which sets out the capital requirements of the Croatian National Bank that the Bank must meet during 2015, and the plan for the Bank's compliance with the above requirements.

PricewaterhouseCoopers d.o.o.
Zagreb, 21 April 2015

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

Statement of comprehensive income

for the year from 1 January to 31 December 2014

	Note	2014 HRK'000	2013 HRK'000
Interest income		78,470	82,055
Interest expense		(36,361)	(42,249)
Net interest income	4	42,109	39,806
Fee and commission income		5,923	5,571
Fee and commission expense		(1,279)	(1,000)
Net fee and commission income	5	4,644	4,571
Foreign exchange differences – net	6	1,695	3,769
Result of assets available for sale – net	17	2,178	662
Other operating income	7	3,193	2,593
Impairment charge for credit losses – net	8	(17,818)	(37,828)
Administrative expenses	9	(44,874)	(50,324)
Other operating expenses	10	(4,611)	(7,068)
Loss before income tax		(13,484)	(43,819)
Income tax	11		-
Loss after taxation		(13,484)	(43,819)
Unrealised (loss)/gains from available-for-sale financial assets		1,802	(1,822)
Other comprehensive (loss)/profit		1,802	(1,822)
Total comprehensive loss		(11,682)	(45,641)
Loss per share	12	(4.15)	(16.72)

The financial statements set out on pages 4 to 59 were approved by the Management Board of the Bank on 21 April 2015.

Nicola Ceccaroli
President of the Management Board

Darko Kosovec
Member of the Management Board

Statement of financial position

as at 31 December 2014

	Note	31/12/2014 HRK'000	31/12/2013 HRK'000
ASSETS			
Cash in hand and balances with banks	13	128,770	207,932
Obligatory reserve with the Croatian National Bank	14	91,548	97,861
Placements with banks	15	39,313	29,857
Loans and advances to customers	16	750,021	730,395
Available-for-sale financial assets	17	72,624	62,915
Held-to-maturity financial assets	18	1,008	2,666
Property and equipment	19	18,390	27,086
Intangible assets	19	1,103	1,415
Reposessed collateral	20	37,519	37,975
Other assets	21	13,092	11,761
Total assets		1,153,388	1,209,863
LIABILITIES			
Deposits from customers	22	973,870	1,030,158
Due to banks	23	54,536	40,415
Hybrid instruments	24	14,925	58,282
Repurchase agreements	25	-	-
Other liabilities	26	9,702	11,720
		1,053,033	1,140,575
SHAREHOLDERS' EQUITY			
Share capital	27	333,834	291,084
Treasury shares		(15)	(15)
Share premium		76,430	76,430
Reserves		1,081	(721)
Accumulated loss		(297,491)	(253,671)
Loss for the year		(13,484)	(43,819)
		100,355	69,288
Total liabilities and shareholders' equity		1,153,388	1,209,863

The financial statements set out on pages 4 to 59 were approved by the Management Board of the Bank on 21 April 2015.

Nicola Ceccaroli
President of the Management Board

Darko Kosovec
Member of the Management Board

Statement of changes in equity

for the year from 1 January to 31 December 2014

	Share capital HRK'000	Treasury shares HRK'000	Share premium HRK'000	Reserves HRK'000	Accumulated loss HRK'000	Total HRK'000
At 31 December 2012	260,764	(15)	76,430	1,101	(253,672)	84,609
Loss for the year	-	-	-	-	(43,819)	(43,819)
Unrealised loss on available-for-sale financial assets	-	-	-	(1,822)	-	(1,822)
Total comprehensive income/(loss)	-	-	-	(1,822)	(43,819)	(45,641)
Increase in share capital	30,320	-	-	-	-	30,320
At 31 December 2013	291,084	(15)	76,430	(721)	(297,491)	69,288
	Share capital HRK'000	Treasury shares HRK'000	Share premium HRK'000	Reserves HRK'000	Accumulated loss HRK'000	Total HRK'000
At 31 December 2013	291,084	(15)	76,430	(721)	(297,491)	69,288
Loss for the year	-	-	-	-	(13,484)	(13,484)
Unrealised gains on available-for-sale financial assets	-	-	-	1,802	-	1,802
Total comprehensive income/(loss)	-	-	-	1,802	(13,484)	(11,682)
Increase in share capital	42,750	-	-	-	-	42,750
At 31 December 2014	333,834	(15)	76,430	1,081	(310,975)	100,355

The notes to the financial statements are an integral part of the Statement of changes in equity.

Cash flow statement

for the year from 1 January to 31 December 2014

	Note	2014 HRK'000	2013 HRK'000
Cash flow from operating activities			
Loss for the year		(13,484)	(43,819)
Depreciation and amortisation	9, 19	3,904	7,278
Write-off and disposals of property and equipment	19	(8,423)	(1,352)
Impairment charge for credit losses - net	8	17,818	37,828
Result of assets available for sale - net		11,887	40,866
Other non-cash items		48,110	(56,368)
Operating result before changes in operating assets		59,812	(15,567)
(Increase)/decrease in assets with the Croatian National Bank		6,313	(14,355)
(Increase)/decrease in loans and advances to customers		(37,210)	(39,307)
(Increase)/decrease in bills of exchange		1,660	5,763
(Increase)/decrease in repossessed and other assets		(2,159)	(2,238)
Increase/(decrease) in deposits from customers		(56,287)	185,610
Increase/(decrease) in hybrid instruments		(43,357)	30,706
Increase/(decrease) in other liabilities		(2,019)	604
Net cash used in operating activities		(73,247)	151,216
Cash flow from investing activities			
Purchase of property and equipment and intangible assets	19	(3,319)	(654)
Purchase of available-for-sale financial assets	17	(113,433)	(60,636)
Disposal of available-for-sale financial assets	17	105,725	20,324
Net cash used in investing activities		(11,027)	(40,966)
Cash flow from financing activities			
Increase in share capital	27	42,750	30,320
Increase/(decrease) of deposits from banks		(21,152)	(38,620)
(Increase) of placements with banks		-	-
Increase/(decrease) in bank borrowings		(7,030)	896
Repayment of borrowings		-	(10,600)
Net cash from financing activities		14,568	(18,004)
Net (decrease)/increase in cash and cash equivalents		(69,706)	92,246
Cash and cash equivalents at beginning of year		237,789	145,543
Cash and cash equivalents at end of year	28	168,083	237,789

The notes to the financial statements are an integral part of the Cash flow statement.

Notes to the financial statements

for the year from 1 January to 31 December 2014

1. General information

Activities

BANKA KOVANICA d.d. Varaždin (the "Bank") was incorporated in 1997 and was registered at the Commercial Court in Varaždin. The address of the Bank's registered office is in Varaždin, Preradovićeve 29.

The Bank's registered activities are as follows:

- accepting cash deposits
- granting loans and other placements in its own name and for its own account
- issuing electronic money
- issuing guarantees and other warrants
- factoring
- finance lease
- credit operations, including consumer credit, mortgage loans and financing of commercial operations (including forfeiting)
- trading in its own name and for its own account or in its own name and for a customer's account: in money market instruments and other transferable securities, foreign currencies including foreign exchange activities
- trading in financial forward contracts and options, currency and interest instruments
- performing local and international payments
- collection of data, conducting analyses and providing information on creditworthiness of legal and natural persons who conduct business activities on their own
- representation in the sale of insurance policies, in accordance with the law regulating insurance, intermediation and representation in insurance activities
- issuing and managing instruments of payment, intermediation in concluding financial deals.

Notes to the financial statements (continued)for the year from 1 January to 31 December 2014

Supervisory Board

Fabiomassimo Mango	President from 15 September 2014
Pier Luigi Martelli	President until 15 September 2014
Ivan Majdak	Vice president
Emanuele Restelli Prandoni Della Fratta	Member
Albani Marino	Member from 2 December 2014
Mladen Vedriš	Member from 2 December 2014
Davor Štern	Member until 1 May 2014
Gian Primo Giardi	Member until 1 May 2014

Management Board

Nicola Ceccaroli	President from 13 March 2014
Emanuele Restelli Prandoni Della Fratta	Vice president from 11 January 2014 until 13 March 2014
Gian Luigi Bonfè	President until 10 January 2014
Darko Kosovec	Member

On 6 June 2007, the Bank's ordinary shares (VSK-R-A) were quoted on the regular listing of shares of joint stock companies on the Zagreb Stock Exchange. On 6 November 2008, such listing was cancelled and the Bank's shares were transferred to the parallel listing on the Zagreb Stock Exchange. The regular listing was cancelled since the Bank had less than a 100 shareholders for a longer period of time, so it does not fulfil the criteria for a joint stock company in accordance with the Securities Market Act.

The Bank is subject to the regulatory requirements of the Croatian National Bank. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off-balance sheet commitments and provisioning to cover credit risk, liquidity, interest rate and foreign currency position.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

2. Basis of presentation of financial statements

The principal accounting policies applied in the preparation of these financial statements are summarised below. Where specific accounting policies are aligned with the accounting principles set out in International Financial Reporting Standards ("IFRS"), reference may be made to certain Standards in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards endorsed for use in the European Union as at 31 December 2014.

2.1. Compliance with Croatian accounting demands and IFRS

The financial statements have been prepared in accordance with statutory accounting requirements for banks in Croatia. The Bank's operations in Croatia are subject to the Credit Institutions Act, in accordance with which the Bank's financial reporting is regulated by the Croatian National Bank ("the CNB") which is the central monitoring institution of the banking system in Croatia. These financial statements have been prepared in accordance with these banking regulations.

The main differences between the requirements of the International Financial Reporting Standards ("IFRS") and the accounting regulations of the CNB relates to the recognition of impairment losses of financial assets calculated on a portfolio basis. In accordance with CNB regulations, banks domiciled in Croatia should recognise impairment on the portfolio basis by the prescribed rates on balance sheet and off-balance sheet exposure to credit risk of counterparties for which impairment on individual basis is not determined, while IFRS requires that the provisions on the portfolio basis should be determined for existing but unidentified losses on the basis of valuation models taking into account individual characteristics of the Bank and the counterparty in the portfolio (e.g. collateral, customers' scoring etc.).

The Bank calculates impairment losses on corporate lending as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate, in accordance with IFRS. The CNB requires the amortisation of the calculated discount to be presented in the income statement within the movement in impairment losses on loans and advances to customers and other assets, rather than as interest income, as required by International Financial Reporting Standards.

Additionally, the CNB prescribes minimum levels of impairment losses against certain specifically identified impaired exposures, which may be different from the impairment loss required to be recognised in accordance with IFRS.

2.2. Basis of preparation

The financial statements are presented in thousands of Croatian kuna (HRK), unless otherwise stated.

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

The financial statements are prepared on the historical or amortised cost basis, except for available-for-sale financial assets, which are recorded at fair value. Other financial assets and liabilities, and non-monetary assets and liabilities, are stated at amortised or historical cost, less impairment, where appropriate.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The accounting policies adopted are consistent with those of the previous financial year unless otherwise stated and disclosed.

The Bank has adopted the following new and amended IFRS and IFRIC interpretations during the year which were endorsed by the EU. When the adoption of the standard or interpretation is deemed to have an impact on the financial statements or performance of the Bank, its impact is described below.

Amendment to IAS 32, 'Financial Instruments: Presentation' on asset and liability offsetting (effective for annual periods beginning on or after 1 January 2014)

These amendments are to the application guidance in IAS 32, 'Financial instruments: Presentation', and clarify some of the requirements for offsetting financial assets and financial liabilities at the balance sheet date. This amendment did not have a significant impact on the Bank's financial statements.

Amendment to IAS 36, 'Impairment of assets' on recoverable amount disclosures (effective for annual periods beginning on or after 1 January 2014)

This amendment addresses the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal. This amendment did not have a significant impact on the Bank's financial statements.

IFRS 10 Consolidated Financial Statements (effective for annual periods beginning on or after 1 January 2014)

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities to present consolidated financial statements. It defines the principle of control, and establishes controls as the basis for consolidation and sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. It sets out the accounting requirements for the preparation of consolidated financial statements. This amendment did not have an impact on the Bank's financial position or performance.

IFRS 11 Joint Arrangements (effective for annual periods beginning on or after 1 January 2014)

IFRS 11 is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangements: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and therefore accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and therefore equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. This amendment did not have an impact on the Bank's financial position or performance.

IFRS 12 Disclosures of Interests in Other Entities (effective for annual periods beginning on or after 1 January 2014)

IFRS 12 includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special-purpose vehicles and other off-balance sheet vehicles. This amendment did not have an impact on the Bank's financial position or performance.

Other standards, amendments and interpretations that are effective for the financial year beginning on 1 January 2014 are not relevant to the Bank's financial statements.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

Standards and interpretations issued but not yet effective:

A number of new standards and amendments to IFRS standards and IFRIC interpretations are effective for annual periods after 1 January 2014, and have not been applied in preparing these financial statements.

IFRIC 21, 'Levies' (effective for annual periods beginning on or after 1 January 2015)

This is an interpretation of IAS 37 'Provisions, contingent liabilities and contingent assets'. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The interpretation addresses what the obligating event is that gives rise to the payment of a levy and when a liability should be recognised. This amendment will not have a significant impact on the Bank's financial statements.

IFRS 15, 'Revenue from contracts with customers' (effective for annual periods beginning on or after 1 January 2017)

This is the converged standard on revenue recognition. It replaces IAS 11, 'Construction contracts,' IAS 18, 'Revenue' and related interpretations. Revenue is recognised when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity recognises revenue in accordance with that core principle by applying the following steps:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

IFRS 15 also includes a cohesive set of disclosure requirements that will result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

The Bank is currently assessing the impact of the amendments on their financial statements, but do not expect any impact. The Bank plans to adopt this amendment on its effective date.

IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2018)

The complete version of IFRS 9 replaces most of the guidance in IAS 39. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through OCI and fair value through P&L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in OCI. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value, through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the 'hedged ratio' to be the same as the one management actually use for risk management purposes. Adequate documentation is still

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

required but is different to that currently prepared under IAS 39. The Bank plans to adopt this new standard on the effective date as of and when endorsed by EU. The Bank is still assessing the impact of this standard.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a significant impact on the Bank's financial statements.

2.3. Critical accounting judgements and key sources of estimation uncertainty

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

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

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

While it is possible that in particular periods the Bank may sustain losses, which are substantially relative to the allowance for impairment losses, it is the judgement of Management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

There are several legal actions against the Bank, which have arisen from the regular course of its operations. The Bank's Management believes that the probable outcome will have no significant negative effects on the Banks' financial position or its results.

Economic crisis

The ongoing economic crisis has resulted, among other things, in a lower level of capital market funding, lower liquidity levels across the banking sector, and occasionally, higher interbank lending rates and very high volatility in stock markets, especially in the peripheral countries of the Eurozone.

Management believes that all the necessary measures to support the sustainability and growth of the Bank's business in the current circumstances have been taken. In 2014, the Bank had an adequate level of liquidity.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

3. Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

3.1. Interest income and expense

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

Interest income includes coupons earned on fixed income investments and securities and accrued discount and premium on treasury bills and other discounted instruments.

When loans become impaired, they are written down to their recoverable amounts and interest income thereafter is recognized based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

3.2. Fee and commission income and expense

Fees and commissions consist mainly of fees on domestic and foreign payments, fees for issuing guarantees and letters of credit, fees and commissions on card operations and other credit instruments issued by the Bank. Fees and commissions are generally recognized as income when service is provided. Loan origination fees for loans which are probable of being drawn down are deferred (together with the related direct issue costs) and recognized as an adjustment to the effective yield of the loan, and thus adjust the interest income.

3.3. Taxation

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

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

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised. Deferred tax is recognised as an expense or income in profit or loss, except when they relate to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Bank has the ability and intention to settle its current tax asset and liability on a net basis.

3.4. Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns different from those of segments operating in other economic environments.

3.5. Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which the Company operates ('the functional currency'). The Bank's financial statements are presented in Croatian kuna (HRK), which is the Bank's functional currency and presentation currency.

(b) Transactions and balances

Transactions denominated in foreign currencies are translated into HRK at the prevailing exchange rates on the date of the transaction.

Monetary items denominated in foreign currencies are retranslated into HRK at the appropriate spot rates of exchange prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in 'Foreign exchange differences - net' for the period. Exchange differences arising on the retranslation of non-monetary assets carried at fair value are included in profit or loss for the period except for exchange differences arising on the retranslation of non-monetary assets available-for-sale in respect of which gains and losses are recognized directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognized directly in equity.

The Bank has assets and liabilities originated in HRK, which are linked to foreign currency clause. Due to this clause the Bank has to revalue both the asset and related liability by higher of: foreign exchange rate valid as of the date of maturity, or foreign exchange rate valid as of the date of origination of the financial instrument. In case of liability linked to this clause the counterparty has this option. As such the Bank values its assets and liabilities related to this clause by middle rate of CNB valid at the date of balance sheet or foreign exchange rate agreed by the option (rate valid at origination), whichever is higher.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The principal rates of exchange set forth by the CNB and used in the preparation of the Bank's balance sheet at the reporting dates were as follows:

31 December 2014	EUR 1 = HRK 7.661471	USD 1 = HRK 6.302107
31 December 2013	EUR 1 = HRK 7.637643	USD 1 = HRK 5.549000

3.6. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand, balances with the CNB, balances with banks on giro accounts and term deposits with other banks with remaining maturities of three months or less.

Cash and cash equivalents exclude the obligatory reserves with the CNB as these funds are not available for the Bank's day to day operations. The obligatory reserve with the CNB is a required reserve to be held by all commercial banks licensed in Croatia.

3.7. Financial assets

Financial assets held by the Bank are categorized into portfolios in accordance with the Bank's intent on the acquisition and pursuant to the Bank's investment strategy. Financial assets and liabilities are classified as 'At fair value through profit or loss', 'Held to maturity', 'Assets available for sale' or as 'Loans and receivables'. The principal difference among the portfolios relates to the measurement of financial assets and the recognition of their fair values in the financial statements.

All financial assets and liabilities are recognized and derecognized on a settlement date basis, where the purchase or sale of financial asset or liability is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned.

When a financial asset or financial liability is recognized initially, the Bank measures it at its fair value plus, in the case of a financial assets or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

(a) Financial assets at fair value through profit or loss

Financial assets are classified at fair value through profit or loss where the financial assets are held for trading.

A financial asset is classified as held for trading if:

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

Measurement:

Financial assets at fair value through profit or loss are initially accounted at fair value and related transaction costs are recorded as an expense. Subsequent to the initial recognition financial assets at fair value through profit or loss are accounted for and stated at fair value which approximates the price quoted on recognised stock exchanges or acceptable valuation models. The Bank includes unrealised gains and losses in 'Result of trading assets - net'. Interest earned on assets at fair value through profit or loss representing coupons on debt securities is accrued on a daily basis and reported as 'Interest income' in the income statement.

Dividends on trading securities are recorded when declared and included as a receivable in the balance sheet line 'Other assets' and in 'Other operating income' in the income statement.

All purchases and sales of securities held for trading that require delivery within the time frame established by regulation or market convention ('regular way' purchases and sales) are recognized as spot transactions. Transactions that do not meet the 'regular way' settlement criterion are treated as financial derivatives.

(b) Assets available for sale

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as: (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

This portfolio comprises equity and debt securities. Subsequent to initial recognition, available-for-sale financial assets are re-measured at fair value based on quoted prices or amounts derived from cash flow models.

In circumstances where the quoted market prices are not readily available, the fair value of debt securities is estimated using the present value of future cash flows and the fair value of unquoted equity instruments is estimated using applicable price/earnings or price/cash flow ratios refined to reflect specific circumstances of the issuer.

For available-for-sale assets, gains and losses arising from changes in fair value are recognised directly in equity under the caption 'Reserves', until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the profit or loss for the period.

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement.

Impairment losses recognized in profit or loss for equity investments classified as available-for-sale are not subsequently reversed through profit or loss. Impairment losses recognised in profit or loss for debt instruments classified as available-for-sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

Interest earned whilst holding available-for-sale securities is accrued on a daily basis using the effective interest rate method and reported as "Interest income" in the income statement.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

Foreign exchange differences related to available-for-sale equity instruments held in foreign currency are reported together with fair value gains and losses in equity until the financial asset is sold. Foreign exchange differences related to available-for-sale debt instruments held in foreign currency are reported in the income statement.

Dividends on securities available for sale are recorded as declared and included as a receivable in the balance sheet line 'Other assets' and in 'Other operating income' in the income statement. Upon payment of the dividend, the receivable is offset against the collected cash.

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank's Management has the positive intention and ability to hold to maturity. Held-to-maturity investments are carried at amortised cost using the effective interest method, less any allowance for impairment.

The Bank assess on a regular basis whether there is an objective evidence that an investment held to maturity may be impaired. A financial assets is impaired if its carrying amount is greater than its recoverable amount which is equal to the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate. The amount of impairment loss for assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of the expected future cash flows discounted at the financial instrument's original effective interest method. When an impairment of assets is identified, the Bank recognises allowances through the income statement.

Impairment losses are reversed in subsequent periods when an increase in the recoverable amount can be related objectively to an event occurring after the impairment was recognised, with the restriction that the carrying amount of the investment at the date the impairment is reversed shall not exceed the amount of the amortised cost that would have been recorded, had the impairment not been recognised.

(d) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than: (a) those that the Bank intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; (b) those that the Bank upon initial recognition designates as available for sale; or (c) those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

This portfolio comprises loans provided to customers.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers. Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. 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.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest;
- Cash flow difficulties experienced by the borrower (for example, equity ratio, net income percentage of sales);
- Breach of loan covenants or conditions;
- Initiation of bankruptcy proceedings;
- Deterioration of the borrower's competitive position;
- Deterioration in the value of collateral; and
- Downgrading below investment grade level.

(e) Financial liabilities

Financial liabilities of the Bank such as 'Due to banks', 'Deposits from customers', are recognised initially at fair value net of transaction cost incurred. Financial liabilities are subsequently measured at amortized cost using the effective interest method. Interest expense arising on the issue of certificated debts is included in the income statement line 'Interest expense'.

3.8. Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking products.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight-line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of Management.

Any increase in the liability relating to guarantees is recognised in the income statement under other operating expenses.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

3.9. Derivative financial instruments

Derivative financial instruments include foreign exchange rate forward contracts and are initially recognised in the balance sheet at fair value and subsequently re-measured at their fair value. Fair values are obtained from quoted market prices or pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Derivative financial instruments include contracts with one-way currency clause. The contracted value is initially recognised in the off-balance sheet records and as a loan given with a one-way currency clause in the balance sheet. They are subsequently measured at amortised cost as for all other placements that carry credit risk in the balance sheet. Increase in exchange rates (fair value of the embedded derivative) above the contracted, is recorded in the balance sheet as an embedded derivative and recognised within profit or loss from embedded derivatives in the income statement.

The Bank's derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement under net trading income. However, the gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in 'net income from financial instruments designated at fair value'.

3.10. Sale and repurchase agreements

If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognized as the Bank retains substantially all the risks and rewards of ownership.

3.11. Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

3.12. Non-current tangible and intangible assets

Non-current tangible and intangible assets are recorded at cost less accumulated depreciation/amortisation. Depreciation/amortisation is calculated on a straight-line basis to write down the cost of such assets to their residual values over their estimated useful lives. Assets under construction are not depreciated.

Depreciation of other assets is calculated using the straight-line method to allocate their cost over their estimated useful lives, as follows:

	2014	2013
	%	%
Property	2.5	2.5
Leasehold improvements	20	20
Electronic equipment	20	20
Other assets	20-25	20-25
Software	20	20
Leasehold improvements	20	20

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. In addition, the carrying amounts of non-current tangible and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts. Where the carrying amount of an asset exceeds its estimated recoverable amount, it is written down immediately to its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. An impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for fixed assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

3.13. Leases

The leases entered into by the Bank are operating leases. The total payments made under operating leases are charged to other operating expenses in the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which the termination takes place.

3.14. Non-current assets held for sale

Non-current assets are classified as assets held for sale and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is recovered principally through a sale transaction rather than through continuing use.

3.15. Provisions

Provisions are recognised when: the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. The Management Board determines the adequacy of the provision based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of the various categories of transactions and other pertinent factors at the balance sheet date. If the effect is material, provisions are discounted to the present value.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

3.16. Employee benefits

The Bank has no post-retirement benefit plans for its employees or management. The Bank makes contributions on behalf of its employees to mandatory state pension plans, which are charged as expense in the period to which they relate. Any future payments to employees are the responsibility of the Republic of Croatia.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

3.17. Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities, unless the Bank has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

3.18. Fiduciary activities

Assets and income arising thereon, together with related undertakings to return such assets to customers are excluded from these financial statements when the Bank acts in a fiduciary capacity such as nominee, trustee or agent.

3.19. Share capital and treasury shares

External costs directly attributable to the issuance of new shares, except for those resulting from business combinations, are deducted from the equity, net of any related taxes.

When the Bank or its associates purchase or become entitled to purchase its share capital, the consideration paid, including all transaction costs less any taxes, is presented as a deduction from the total equity. Gains and losses on the sale of treasury shares are credited and charged, respectively, to treasury shares within equity. The acquisition of treasury shares is recognised within capital at the trade date.

Notes to the financial statements (continued)
for the year from 1 January to 31 December 2014

4. Net interest income

Interest income

	2014	2013
	HRK`000	HRK`000
Loans and advances:		
- to customers	74,545	79,387
- to banks	2,791	1,212
Securities	1,134	1,455
Other	-	1
	78,470	82,055

Interest expense

	2014	2013
	HRK`000	HRK`000
Customers deposits	34,481	39,639
Hybrid instruments	649	1,103
Other borrowed funds	1,231	1,507
	36,361	42,249

5. Net fee and commission income

Fee and commission income

	2014	2013
	HRK`000	HRK`000
Domestic and foreign currency transactions	3,209	3,152
Guarantees and letter of credits given	3	42
Other	2,711	2,377
	5,923	5,571

Fee and commission expense

	2014	2013
	HRK`000	HRK`000
Domestic and foreign currency transactions	430	433
Other	849	567
	1,279	1,000

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

6. Foreign exchange differences – net

	2014	2013
	HRK'000	HRK'000
Net foreign exchange gains from operations	2,924	3,632
Net foreign exchange gains/(losses) on translation of foreign currency assets and liabilities to mid exchange rate	(1,229)	137
	1,695	3,769

7. Other operating income

	2014	2013
	HRK'000	HRK'000
Income from transfer of corporate loan claims to majority shareholder	9	1
Lease income	0	677
Court costs refund	117	132
Income from provision reversal for legal disputes	-	-
Other	3,067	1,783
	3,193	2,593

8. Impairment charge for credit losses - net

	2014	2013
	HRK'000	HRK'000
Loans and advances to customers (Note 16)	17,584	37,582
Placements with banks (Note 15)	-	-
Collected credit losses written off in previous years	(541)	(803)
Held-to-maturity financial assets (Note 18)	(2)	146
Other assets (Note 21)	828	982
Provision for contingent liabilities and commitments (Note 26)	(51)	(79)
	17,818	37,828

9. Administrative expenses

	2014	2013
	HRK'000	HRK'000
Staff costs		
Net salaries	12,353	12,237
Pension insurance contributions	3,516	3,622
Health insurance contributions	3,211	2,844
Other contributions and taxes on salaries	3,380	2,850
Other staff costs	924	799
	23,384	22,352
Other administrative expenses	17,586	21,740
Depreciation and amortisation (Note 19)	3,904	6,232
	44,874	50,324

At 31 December 2014, the Bank had 117 employees (2013: 133 employees).

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

10. Other operating expenses

	2014	2013
	HRK`000	HRK`000
Rental costs	1,973	4,481
Saving deposits insurance charge	3,041	2,738
Provisions for legal disputes	(198)	(308)
Accrued unused vacation	(246)	182
Other	41	(25)
	4,611	7,068

11. Income tax

	2014	2013
	HRK`000	HRK`000
Accounting loss before tax	(13,484)	(43,819)
Effect of items increasing tax base	9,360	5,632
Effect of items decreasing tax base	(7,053)	(5,100)
Tax loss	(11,177)	(43,287)
Tax losses carried forward from the previous period	(242,353)	(223,425)
Expiration of tax losses carried forward	39,776	24,360
Tax loss available for carry forward in future periods	(213,754)	(242,352)
Recognized deferred tax assets (IAS 12)	5,463	5,463
Unrecognised deferred tax assets (statutory tax rate 20%)	37,288	43,007

In the financial statements for the year 2012, the Bank recognised deferred tax assets for the carryforward of unused tax losses in the amount of HRK 5,463 thousand, which according to the Bank's estimate represents tax savings to be achieved in the following 5-year period. The Bank has not recognised deferred tax assets in the further amount of HRK 37,288 thousand in the progress of adopting the new 5-year plan.

The Bank may utilise the recorded tax loss in the amount of HRK 213,754 thousand not later than in a period of 5 years:

- tax loss for 2010 in the amount of HRK 76,778 thousand not later than (including) 2016
- tax loss for 2011 in the amount of HRK 19,276 thousand not later than (including) 2017
- tax loss for 2012 in the amount of HRK 63,235 thousand not later than (including) 2018
- tax loss for 2013 in the amount of HRK 43,287 thousand not later than (including) 2019
- tax loss for 2014 in the amount of HRK 11,177 thousand not later than (including) 2020

In accordance with local regulations, the Tax Authority may at any time inspect the Bank's books and records within 3 years following the year in which the tax liability is reported and may impose additional tax assessments and penalties. The Bank's Management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

12. Loss per share**Basic**

Basic earnings per share are calculated by dividing the loss for the year by the weighted average number of existing shares (ordinary) for the period, excluding own shares.

	<u>2014</u>	<u>2013</u>
Loss for the year (in HRK'000)	(13,484)	(43,819)
Weighted average number of shares in issue excluding own shares	<u>3,249,339</u>	<u>2,620,924</u>
Basic loss per share – ordinary (in HRK)	<u>(4.15)</u>	<u>(16.72)</u>

On 17 March 2014, the Bank's share capital increased (Note 27) by issuing 427,500 ordinary shares each with a nominal value of HRK 100.

Diluted

Diluted loss per share for 2014 and 2013 is equal to basic loss per share, since the Bank did not have any convertible instruments or share options outstanding during either period.

13. Cash in hand and balances with banks

	<u>31/12/2014</u> <u>HRK'000</u>	<u>31/12/2013</u> <u>HRK'000</u>
Cash in hand	15,677	17,977
Cash on the clearing account	41,452	78,416
Foreign currency account	<u>71,641</u>	<u>111,539</u>
	<u>128,770</u>	<u>207,932</u>

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

14. Obligatory reserve with the Croatian National Bank

	31/12/2014	31/12/2013
	HRK'000	HRK'000
Earmarked obligatory reserve		
- in HRK	67,228	71,932
- in foreign currency	13,461	15,588
CNB treasury notes	10,859	10,341
	91,548	97,861

The obligatory reserve rate as at 31 December 2014 was 12% of HRK and foreign currency deposits, loans taken and debt securities issued (31 December 2013: 12%). The Banks were committed to enrol treasury bills with a three-year maturity in the exempt amount of released obligatory reserves. No interest is calculated on these treasury bills and they are non-transferable. The above mentioned investments can be repurchased by the Croatian National Bank at the end of each month in the amount of 50% of previous month growth rate of certain investments to domestic non-financial companies. If the gains on certain investments are negative, banks are obliged to repurchase previously purchased treasury bills in the amount of 50% reduction of the afore mentioned investments, not exceeding the net cumulative amount of previously repurchased Croatian National Bank's treasury bills.

15. Placements with banks

	31/12/2014	31/12/2013
	HRK'000	HRK'000
Loans	5,138	5,138
Deposits	39,313	29,857
	44,451	34,995
Provision for identified losses	(5,138)	(5,138)
	39,313	29,857

Movement in the provision for identified losses:

	31/12/2014	31/12/2013
	HRK'000	HRK'000
As at 1 January	5,138	5,138
Additional provisions (Note 8)	-	-
Collected amounts (Note 8)	-	-
At 31 December	5,138	5,138

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

16. Loans and advances to customers

	31/12/2014 HRK'000	31/12/2013 HRK'000
Retail customers	597,363	539,341
Corporate customers	360,748	389,376
Gross loans and advances	958,111	928,717
Less: Provision for impairment	(208,090)	(198,322)
Net loans and advances	750,021	730,395
Current portion	136,060	154,679
Non-current portion	613,961	575,716

The reconciliation of the provision for impairment on loans and advances to customers is as follows:

2014	Retail customers HRK'000	Corporate customers HRK'000	Total HRK'000
As at 1 January	31,967	166,355	198,322
Additional provisions (Note 8)	25,936	45,895	71,831
Collected amounts (Note 8)	(22,068)	(32,179)	(54,247)
Write-off	(166)	(8,013)	(8,179)
Foreign exchange differences	112	251	363
At 31 December	35,781	172,309	208,090

2013	Retail customers HRK'000	Corporate customers HRK'000	Total HRK'000
As at 1 January	21,750	151,750	173,500
Additional provisions (Note 8)	44,812	79,191	124,003
Collected amounts (Note 8)	(30,493)	(55,928)	(86,421)
Write-off	(4,350)	(9,234)	(13,584)
Foreign exchange differences	248	576	824
At 31 December	31,967	166,355	198,322

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

17. Available-for-sale financial assets

	31/12/2014	31/12/2013
	HRK'000	HRK'000
Bonds and treasury bills	69,755	60,439
Corporate bonds	2,179	2,031
Equity securities – listed	549	304
Equity securities – unlisted	141	141
Units in investment funds	-	-
	72,624	62,915

Movements in available-for-sale financial assets may be summarised as follows:

	31/12/2014	31/12/2013
	HRK'000	HRK'000
As at 1 January	62,915	22,712
Additions	113,433	60,636
Disposals	(105,725)	(20,324)
Unrealised (loss)/gain	1,802	(1,822)
Result of assets available for sale – net	2,178	662
Interest payment	2,292	967
Foreign exchange differences	(4,271)	84
At 31 December	72,624	62,915

Bonds and treasury bills as at 31 December 2014:

Name	Maturity	Nominal amount (in thousands)	Currency	Carrying amount	Unrealised gains/ (losses)
				HRK'000	HRK'000
XS0757376610	21/03/2022	500	EUR	4,379	33
US857524AC63	22/01/2024	500	USD	3,397	6
XS0982708926	18/02/2019	200	USD	1,339	(10)
IT0005042806	27/02/2015	5,000	EUR	38,297	-
HRRHMFT507X9	12/02/2015	2,000	EUR	15,321	-
HRRHMFT514B1	02/04/2015	5,000	HRK	4,975	-
HRHP00O155A5	31/05/2015	2,000	HRK	2,047	-
				69,755	29

As at 31 December 2014, there were no bonds pledged as collateral in repurchase agreements.

Notes to the financial statements (continued)
for the year from 1 January to 31 December 2014

Corporate bonds as at 31 December 2014:

Name	Maturity	Nominal amount (in thousands)	Currency	Carrying amount	Unrealised gains/(losses)
				HRK'000	HRK'000
ATGR-O-169A	20/9/2016	2,000	HRK	2,179	145
				2,179	145

18. Held-to-maturity financial assets

	31/12/2014 HRK'000	31/12/2013 HRK'000
Bills of exchange	2,773	4,433
	2,773	4,433
Provision for identified losses	(1,765)	(1,767)
	1,008	2,666

Movement in the provision for identified losses:

	31/12/2014 HRK'000	31/12/2013 HRK'000
As at 1 January	1,767	6,934
Additional provisions (Note 8)	-	146
Collected amounts (Note 8)	(2)	-
Write-off	-	(5,313)
At 31 December	1,765	1,767

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

19. Property and equipment and intangible assets

	Land and buildings	Leasehold improvements	Electronic equipment	Other assets	Total property and equipment	Software	Assets under construction	Total intangible assets
Cost	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000
At 1 January 2013	25,138	22,011	9,435	12,542	69,126	8,401	268	8,669
Additions	-	211	126	170	507	146	-	146
Disposals	-	(9,260)	(281)	(448)	(9,989)	-	(268)	(268)
At 31 December 2013	25,138	12,962	9,280	12,264	59,644	8,547	-	8,547
Additions	2,570	18	116	328	3,032	287	-	287
Disposals	(10,474)	-	(62)	(222)	(10,758)	-	-	-
At 31 December 2014	17,234	12,980	9,334	12,370	51,918	8,834	0	8,834
Accumulated depreciation and amortisation								
At 1 January 2013	3,750	12,767	8,619	10,739	35,875	6,488	-	6,488
Charge for the year	463	3,940	461	724	5,588	644	-	644
Disposals	-	(8,246)	(281)	(378)	(8,905)	-	-	-
At 31 December 2013	4,213	8,461	8,799	11,085	32,558	7,132	-	7,132
Charge for the year	437	2,009	272	587	3,305	599	-	599
Disposals	(2,050)	-	(62)	(223)	(2,335)	-	-	-
At 31 December 2014	2,600	10,470	9,009	11,449	33,528	7,731	0	7,731
Net book amount								
At 31 December 2013	20,925	4,501	481	1,179	27,086	1,415	-	1,415
At 31 December 2014	14,634	2,510	325	921	18,390	1,103	-	1,103

20. Repossessed collateral

Movements in repossessed collateral during the year:

	31/12/2014	31/12/2013
	HRK'000	HRK'000
As at 1 January	37,975	26,961
Additions	4,064	12,439
Disposals	(4,520)	(1,425)
Write-off	-	-
At 31 December	37,519	37,975

The Bank's repossessed collateral as at 31 December 2014 included property in the total amount of HRK 6,390 thousand (2013: HRK 30,543 thousand) which was not in the Bank's possession. The Bank took over formal ownership over the property in exchange for outstanding receivables in the process of obtaining physical possession.

21. Other assets

	31/12/2014	31/12/2013
	HRK'000	HRK'000
Deferred tax assets	5,463	5,463
Receivables for court costs refunds	4,094	3,632
Trade receivables	9,303	4,334
Other prepayments	307	2,719
Prepaid expenses	954	518
Prepayments of pensions to customers	-	5
Derivative financial assets	325	280
Other	1,228	2,573
	21,674	19,524
Provision for identified losses	(8,582)	(7,763)
	13,092	11,761

Movement in the provision for identified losses during the year:

	31/12/2014	31/12/2013
	HRK'000	HRK'000
At 1 January	7,763	7,409
Additional provisions (Note 8)	2,483	3,098
Collected amounts (Note 8)	(1,655)	(2,118)
Write-off	(9)	(626)
At 31 December	8,582	7,763

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

22. Deposits from customers

Deposits comprise demand deposits and time deposits:

	31/12/2014	31/12/2013
	HRK`000	HRK`000
Demand deposits		
Corporate customers	9,990	8,684
Retail customers	88,749	90,406
	98,739	99,090
Term deposits		
Corporate customers	6,315	6,654
Retail customers	868,816	924,414
	875,131	931,068
Deposits from customers	973,870	1,030,158
Current portion	844,655	879,766
Non-current portion	129,215	150,392

23. Due to banks

	31/12/2014	31/12/2013
	HRK`000	HRK`000
Borrowings:		
- Croatian Bank for Reconstruction and Development	31,352	38,383
- other	-	-
Deposits	23,184	2,032
	54,536	40,415
Current portion	23,184	2,032
Non-current portion	31,352	38,383

As at 31 December 2014 and 2013, all deposits from banks are current.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

24. Hybrid instruments

Hybrid financial instruments represent special term deposits from citizens and legal entities with no option of cancellation prior to maturity, except for the purpose of purchasing shares of the Bank, and which are under certain conditions, prescribed by the Croatian National Bank, calculated within the Bank's regulatory capital.

	31/12/2014	31/12/2013
	HRK'000	HRK'000
Legal entities	14,802	58,160
Citizens	123	122
	14,925	58,282

25. Repurchase agreements

As at 31 December 2014 and 31 December 2013, the Bank did not have any repurchase agreements.

26. Other liabilities

	31/12/2014	31/12/2013
	HRK'000	HRK'000
Provisions for legal disputes	799	1,019
Provision for contingent liabilities and commitments	368	419
Payables in the course of settlement	2,483	3,095
Trade payables	1,697	2,069
Employee payables – salaries and contributions	1,861	2,001
Liabilities for savings deposits insurance charge	747	765
Accrued unused vacation (Note 10)	192	438
Other liabilities	1,555	1,914
	9,702	11,720

Movement in provisions for legal disputes:

	31/12/2014	31/12/2013
	HRK'000	HRK'000
At 1 January	1,019	1,314
Additional provisions	282	321
Release of provisions	(492)	(628)
Payments made per court verdicts	(10)	12
At 31 December	799	1,019

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

Movement in provisions for contingent liabilities and commitments:

	31/12/2014 HRK'000	31/12/2013 HRK'000
At 1 January	419	498
Additional provisions	2,350	479
Release of provisions	(2,401)	(558)
At 31 December	368	419

27. Shareholders' equity**Share capital**

At the General Assembly meeting held on 17 March 2014, a Decision was made to increase the share capital by contributing rights - a hybrid instrument in the Bank. The share capital in the amount of HRK 291,084 thousand increased by HRK 42,750 thousand to the amount of HRK 333,834 thousand by issuing 427,500 ordinary shares, with a nominal value of HRK 100,00 by partial contribution of hybrid instruments into the Bank from Cassa di Risparmio della Repubblica di San Marino S.p.A.

At 31 December 2014, the Bank's share capital amounted to HRK 333,834 thousand (31 December 2013: HRK 291,084 thousand), and it is divided among 3,338,344 ordinary shares (31 December 2013: 2,910,844) (VSK-R-A) with a nominal value of HRK 100 per share.

The Bank's main shareholders as at 31 December were as follows:

Shareholder	31/12/2014		31/12/2013	
	Number of shares	% in share capital	Number of shares	% in share capital
Cassa di Risparmio della Repubblica di San Marino	3,327,461	99.67	2,899,961	99.63
Treasury shares	153	0.01	153	0.01
Other	10,730	0.32	10,730	0.36
Total	3,338,344	100.00	2,910,844	100.00

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

28. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than 90 days maturity:

	Note	31/12/2014	31/12/2013
		HRK'000	HRK'000
Cash in hand and balances with banks	13	128,770	207,932
Placements with banks	15	39,313	29,857
		168,083	237,789

29. Contingencies and commitments**Legal disputes**

The Bank is currently subject to several legal proceedings. As at 31 December 2014, provisions for legal disputes for which the Bank anticipates outflow of economic benefits amount to HRK 799 thousand (2013: HRK 1,019 thousand) and the provision for contingent liabilities amounts to HRK 368 thousand (2013: HRK 419 thousand). Total contingent liabilities arising from the dispute with the company Prvi Faktor d.o.o. per the instituted enforcement proceedings against the Bank in the amount of EUR 710 thousand at 31 December 2014 amounted to HRK 9,427 thousand, and the total provisions for contingent liabilities arising from the dispute amounted to HRK 94 thousand. It is a guarantee issued by the Bank in favour of the company Prvi faktor d.o.o. for the loan payment to the company Glas Istre d.o.o. The first-instance court ruling was issued in the Bank's favour, rejecting the plaintiff's claim.

Capital commitments

At 31 December 2014 and 31 December 2013, the Bank had no capital commitments in respect of purchases of buildings and equipment.

Loan commitments, guarantees and other financial instruments

The following table indicates the contractual amounts of the Bank's off-balance sheet financial instruments:

	31/12/2014	31/12/2013
	HRK'000	HRK'000
Guarantees	7,678	9,010
Letters of credit	5,079	6,251
Loan commitments and other	24,004	26,620
Less: Provision for contingent liabilities and commitments (Note 26)	-	-
Total	36,761	41,881

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurance that the Bank will make payments in the event that customer cannot meet its obligations to third parties, carry the same credit risks as loans given.

Commitments to lend represent unused portions of authorisations to lend in the form of loans or guarantees. With respect to credit risk on commitments to lend, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to lend are contingent upon customers maintaining specific credit standards.

Guarantees and undrawn loan commitments are subject to similar credit risk monitoring and credit policies as utilised in the approval of loans. The Management of the Bank believes the market risk associated with guarantees and undrawn loan commitments is minimal.

Operating lease commitments where the Bank is the lessee.

The future minimum lease payments receivable from operating leases are as follows:

	31/12/2014	31/12/2013
	HRK`000	HRK`000
Up to 1 year	2,457	2,298
From 2 to 5 years	7,051	4,910
Over 5 years	5,219	2,815
Total	14,727	10,023

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

30. Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. Related-party transactions are part of the normal course of business.

The Bank considers itself to be an immediately related person to its major shareholders, their subsidiaries, Supervisory and Management Board members and their close family members.

In 2014 and 2013, transactions with related parties were as follows:

	Supervisory Board, Management Board and their related parties	
	2014	2013
	HRK'000	HRK'000
Interest income	61	52
Interest expense	6	121
Loans		
At 1 January	1,531	1,204
Increase	-	394
Decrease	(99)	(67)
At 31 December	1,432	1,531
Deposits received		
At 1 January	2,343	3,166
Increase	855	2,197
Decrease	(2,193)	(3,020)
At 31 December	1,005	2,343
Hybrid instruments		
At 1 January	-	-
Increase	-	-
Decrease	-	-
At 31 December	-	-

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

	Cassa di Risparmio della Repubblica di San Marino	
	2014	2013
	HRK'000	HRK'000
Interest income	142	115
Other operating income	126	40
Impairment charge for credit losses - net	-	-
Interest expense	(667)	(1,135)
Given deposits and cash		
At 1 January	29,053	24,190
Increase	19,173	29,027
Decrease	(29,027)	(24,164)
At 31 December	19,199	29,053
Deposits received		
At 1 January	1,936	40,587
Increase	21,220	-
Decrease	(2)	(38,651)
At 31 December	23,154	1,936
Hybrid instruments		
At 1 January	58,160	26,498
Increase	14,802	31,662
Decrease	(58,160)	-
At 31 December	14,802	58,160

As at 31 December 2014, the exposure towards the majority shareholder amounts to HRK 19,199 thousand, which represents 18.66% of the Bank's regulatory capital (2013: 23.58%, 2012: 23.81%). The regulatory limit exposure to one person or Group of related persons is a maximum of 25% of the regulatory capital.

Key management and Supervisory Board compensation

	31/12/2014	31/12/2013
	HRK 000	HRK 000
Gross salaries and other short-term benefits	3,569	2,151

31. Financial risk management

The Bank's activities are exposed to a variety of financial and operational risks, the management of which includes the analysis, evaluation, acceptance and management to some degree of risk or combination of risks. Risk management and risk acceptance represents the basic merit of financial operations. The Bank's aim is therefore to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance.

The Bank's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The Bank regularly reviews its risk management policies and systems to reflect changes in market, products and emerging best practise.

Risk management is the responsibility of the Management Board and the Assets and Liabilities Committee (ALCO) and the Committee for credit risk management (RICO). Management identifies, evaluates and hedges financial risks in close co-operation with the Bank's operating units. Management provides written principles for overall risk management, as well as written policies covering specific areas, such as currency risk, interest rate risk, credit risk, liquidity risk, price risk, operational risk and use of derivative and non-derivative financial instruments. In addition, Internal audit Department is responsible for the independent review of risk management and the control environment.

The most important types of risk are credit risk, liquidity risk, market risk and other operational risks. Market risk includes currency risk, interest rate and other price risks.

31.1. Credit risk

The Bank is exposed to credit risk, which is the risk that a counterparty will be unable to settle its obligations in full when due. Significant changes in the economy, or in the particular industry segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the balance sheet date. Management therefore carefully manages its exposure to credit risk. Credit exposures arise principally in loans and advances, debt and other securities. There is also credit risk in off-balance sheet financial arrangements such as loan commitments and other issued guarantees. The credit risk management and control are centralised within the Risk Management Sector.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

31.1.1. Credit risk measurement

(a) Loans and advances

When granting loans and advances to customers and loans to banks according the contract, the Bank estimates and measures credit risk based on:

1. assessment of counterparty's credit worthiness,
2. assessment of counterparty's regularity in obligations settlement and
3. quality of collateral.

The Bank assesses the counterparty's credit worthiness using the external rating tools. The tools combine statistical analysis with financial advisor judgment and are validated, where appropriate, by comparison with externally available data. Financial analyst exposures for all groups over EUR 150 thousand based on the collected data and indicators must make an opinion on the financial position of the client, and give their opinion regarding the approval. The Bank's placements to customers are segmented into three rating classes; fully recoverable placements, partially recoverable and unrecoverable placements.

Settlement of obligations means the payment of all liabilities within contractual maturity terms, without establishing new receivables in that respect.

The quality of collateral is established based on market effectiveness, the existence of documentation and the possibility of forced collection.

(b) Debt securities and other bills

For debt securities and other bills, external rating such as Standard & Poor's, Moody's, Fitch/BCA rating or their equivalents are used by the Treasury Sector, if available. The investments in those securities and bills are viewed as a way to gain a better credit quality mapping and maintain a readily available source to meet the funding requirement at the same time.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

31.1.2. Risk limit control and mitigation policies

The Bank manages, limits and controls concentrations of credit risk wherever they are identified – in particular, with respect to individual counterparties and groups, and to industries and countries.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, his related parties and industry segments. Limits on the level of credit risk by industry sector are subject to an annual or more frequent review, when considered necessary.

Exposure to credit risk is also managed through regular analysis of the ability of borrowers and potential borrowers to meet all obligations towards the Bank, and by changing these lending limits where appropriate.

Some other specific control and mitigation measures are outlined below:

(a) Collateral

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for certain types of placements. The Bank has internal regulations in place on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types are:

- Mortgages over residential properties;
- Mortgages over business assets such as premises, inventory and receivables, equipment;
- Mortgages over financial instruments such as debt and equity securities.

Debt securities, treasury and other eligible bills are generally unsecured.

(b) Commitments related to loans

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit carry the same credit risk as loans. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans or guarantees. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

31.1.3. Impairment and provisioning policies

Impairment provisions are recognised for financial reporting purposes only for losses that have been incurred at the balance sheet date based on objective evidence of impairment.

The impairment provision shown in the balance sheet at year-end is derived from each of the three internal rating grades. However, the majority of the impairment provision comes from the bottom two grades. The table below shows the percentage of balance items of the Bank's on-balance sheet items relating to loans and advances to customers, and the associated impairment provision for each of the Bank's internal rating categories:

Bank's rating

	2014		2013	
	Loans and advances	Provision for impairment	Loans and advances	Provision for impairment
	HRK'000	HRK'000	HRK'000	HRK'000
1. Fully recoverable placements	656,300	9,076	621,743	9,474
2. Partially recoverable placements	182,820	80,024	200,086	81,960
3. Unrecoverable placements	118,991	118,991	106,888	106,888
	958,111	208,091	928,717	198,322

Bank's rating

	2014		2013	
	Loans and advances (%)	Provision for impairment (%)	Loans and advances (%)	Provision for impairment (%)
	HRK'000	HRK'000	HRK'000	HRK'000
1. Fully recoverable placements	68.50	4.36	66.95	4.78
2. Partially recoverable placements	19.08	38.46	21.54	41.32
3. Unrecoverable placements	12.42	57.18	11.51	53.90
	100.00	100.00	100.00	100.00

The internal rating tool assists Management to determine whether objective evidence of impairment exists, based on the following criteria set out by the Bank:

- Delinquency in contractual payments of principal, interest or fee;
- Cash flow difficulties users placement experienced by the borrower (e.g. equity ratio, net income percentage of sales);
- Breach of loan covenants or conditions approved loans;
- Initiation of bankruptcy proceedings;
- Deterioration in the value of collateral.

The Bank's policy requires the review of individual financial assets that are above materiality thresholds at least annually or more regularly when individual circumstances require. Impairment allowances on individually assessed accounts are determined by an evaluation of the incurred loss at balance-sheet date on a case-by-case basis, and are applied to all individually significant accounts. The assessment normally encompasses collateral held (including re-confirmation of its enforceability) and the anticipated receipts for that individual account.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

31.1.4. Maximum exposure to credit risk before collateral held or other credit enhancements

	31/12/2014 HRK'000	31/12/2013 HRK'000
Credit risk exposure relating to on-balance sheet assets is as follows:		
Cash in hand and balances with banks	128,770	207,932
Obligatory reserve with the Croatian National Bank	91,548	97,861
Placements with banks	39,313	29,857
Loans and advances to customers	750,021	730,395
Available-for-sale financial assets	72,624	62,915
Held-to-maturity financial assets	1,008	2,666
Other assets	13,092	11,761
	1,096,376	1,143,387
Exposure to credit risk which relating to off-balance sheet assets is as follows:		
Financial guarantees	7,678	9,010
Letters of credit	5,079	6,251
Loan commitments and other credit related liabilities	24,004	26,620
	1,133,137	1,185,268

The above table represents Bank's maximum exposure to credit risk as at 31 December 2014 and 2013, without taking into account any collateral held or other credit enhancements attached. For on-balance sheet items, exposures set out above are based on net carrying amounts as reported in the balance sheet. As indicated above, 71.99% of the total maximum exposure is derived from loans and advances to banks and customers (2013: 66.49%).

31.1.5. Loans and advances

Loans and advances are summarised as follows:

	31/12/2014		31/12/2013	
	Loans and advances to customers HRK'000	Loans and advances to banks HRK'000	Loans and advances to customers HRK'000	Loans and advances to banks HRK'000
Neither past due nor impaired	639,156	39,313	599,525	29,857
Past due but not impaired	17,144	-	22,218	-
Individually impaired	301,811	5,138	306,974	5,138
Gross	958,111	44,451	928,717	34,995
Less: provision for impairment	(208,090)	(5,138)	(198,322)	(5,138)
Net	750,021	39,313	730,395	29,857

The total impairment provision for loans and advances is HRK 208,090 thousand (2013: HRK 198,322 thousand) of which HRK 199,014 thousand (2013: HRK 188,848 thousand) represents the individually impaired loans and the remaining amount of HRK 9,076 thousand (2013: HRK 9,474 thousand) represents the portfolio provision. Further information of the impairment provision for loans and advances to banks and to customers is provided in Notes 15 and 16

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The breakdown of the gross amount of loans and advances by class held by the Bank are as follows:

	Retail customers HRK'000	Corporate customers HRK'000	Total loans and advances to customers HRK'000	Loans and advances to banks HRK'000
31 December 2014				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	538,762	100,394	639,156	39,313
<i>Past due but not impaired</i>				
Past due up to 30 days	2,010	645	2,655	-
Past due from 30 to 90 days	4,686	9,803	14,489	-
<i>Individually impaired</i>				
Individually impaired loans	51,905	249,906	301,811	5,138
Total	597,363	360,748	958,111	44,451
	Retail customers HRK'000	Corporate customers HRK'000	Total loans and advances to customers HRK'000	Loans and advances to banks HRK'000
31 December 2013				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	481,128	118,397	599,525	29,857
<i>Past due but not impaired</i>				
Past due up to 30 days	1,898	1,508	3,406	-
Past due from 30 to 90 days	7,771	11,041	18,812	-
<i>Individually impaired</i>				
Individually impaired loans	48,544	258,430	306,974	5,138
Total	539,341	389,376	928,717	34,995

Loans and advances less than 90 days past due are not considered impaired, unless other information is available to indicate the contrary. Upon initial recognition of loans and advances, the fair value of collateral is based on valuation techniques commonly used for the corresponding assets. In subsequent periods, the fair value is updated on the basis of market prices or indexes of similar assets.

31.1.6. Repossessed collateral

Reposessed collateral is sold as soon as practicable with the proceeds used to reduce the outstanding indebtedness.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

31.1.7. Concentration of risks of financial assets with credit risk exposure*(a) Geographical sectors*

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorised by geographical region as at 31 December 2014. For this table, the Bank has allocated exposures to regions based on the country of domicile of its counterparties.

	Croatia	European Union	Other countries	Total
	HRK'000	HRK'000	HRK'000	HRK'000
Cash in hand and balances with banks	75,547	43,314	9,909	128,770
Obligatory reserve with the Croatian National Bank	91,548	-	-	91,548
Placements with banks	986	-	38,327	39,313
Loans and advances to customers	750,021	-	-	750,021
Available-for-sale assets	25,212	47,412	-	72,624
Held-to-maturity financial assets	1,008	-	-	1,008
Other assets	13,092	-	-	13,092
At 31 December 2014	957,414	90,726	48,236	1,096,376
At 31 December 2013	965,305	140,933	37,149	1,143,387

(b) Industry sectors

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorised by the industry sectors of our counterparties.

	Financial institutions	Manu- facturing	Properties	Wholesale and retail trade	Public sector	Other industries	Individuals	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Placements with banks	39,313	-	-	-	-	-	-	39,313
Loans and advances to customers	2,474	62,127	38,233	41,298	3,307	45,822	556,760	750,021
Available-for-sale assets	47,656	5	199	2,274	20,296	2,194	-	72,624
Held-to-maturity financial assets	-	-	-	-	-	495	513	1,008
Other assets	12,403	34	15	52	60	279	249	13,092
At 31 December 2014	101,846	62,166	38,447	43,624	23,663	48,790	557,522	876,058
At 31 December 2013	122,209	62,227	43,589	46,079	2,025	58,723	502,743	837,595

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

32. Market risk

The Bank is exposed to market risks, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rate or prices such as interest rates, credit spreads, foreign exchange rate and equity prices. The Bank separates exposures to market risk into either trading or non-trading portfolios.

The market risks arising from trading and non-trading activities are concentrated in the Treasury Division. Regular reports are submitted to the Management Board and heads of each business unit.

Trading portfolios include those positions arising from market-making transactions where the Bank acts as principal with clients or with the market.

Non-trading portfolios primarily arise from the interest rate management of the entity's retail and commercial banking assets and liabilities. Non-trading portfolios also consist of foreign exchange and equity risks arising from the Bank's available-for-sale investments.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

Liquidity requirements to support guarantee payments and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit at the balance sheet date does not necessarily represent future cash flows, since many of these commitments will expire or be terminated without being funded.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

32.1. Foreign exchange risk

The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank manages its currency risk by setting principles and limits for foreign currency exposures and by monitoring exposure with respect to limits. The Bank directs its business activities trying to minimise the gap between assets and liabilities denominated in or linked to foreign currency, and maintaining the daily business activities within daily potential loss limits. The parameters are regularly reviewed in accordance with fluctuations in foreign currency rates and correlations between currencies.

The table below summarises the Bank's exposure to currency risk at 31 December. Included in the table are the Bank's financial instruments at carrying amounts, categorised by currency.

Concentrations of currency risk – on- and off-balance sheet financial instruments

	HRK	EUR	USD	Other currencies	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
At 31 December 2014					
Assets					
Cash in hand and balances with banks	50,065	75,210	2,747	748	128,770
Obligatory reserve with the CNB	78,088	13,460	-	-	91,548
Placements with banks	-	39,313	-	-	39,313
Loans and advances to customers	145,886	600,322	-	3,813	750,021
Available-for-sale financial assets	9,891	57,997	4,736	-	72,624
Held-to-maturity financial assets	1,008	-	-	-	1,008
Other assets	13,029	63	-	-	13,092
Total financial assets	297,967	786,365	7,483	4,561	1,096,376
Liabilities					
Deposits from customers	223,341	738,594	7,481	4,454	973,870
Due to banks	13,623	40,913	-	-	54,536
Hybrid instruments	-	14,925	-	-	14,925
Repurchase agreements	-	-	-	-	-
Other liabilities	8,118	1,520	64	-	9,702
Total financial liabilities	245,082	795,952	7,545	4,454	1,053,033
Net on-balance sheet financial position	52,885	(9,587)	(62)	107	43,343
Loan commitments	9,005	11,325	3,674	-	24,004
Nominal value of FX forward	-	14,210	-	-	14,210
At 31 December 2013					
Total financial assets	284,098	845,361	8,890	5,038	1,143,387
Total financial liabilities	257,405	871,006	9,034	3,131	1,140,576
Net on-balance sheet financial position	26,693	(25,645)	(144)	1,907	2,811
Loan commitments	9,194	15,887	1,539	-	26,620

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

32.2. Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of financial instruments will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of the financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest spreads may increase as a result of such changes, but may also reduce losses in the event that unexpected movements arise. The Management Board sets limits on the level of mismatch of interest rates repricing that may be undertaken, which is monitored daily by the Bank's Treasury and Financial Markets Division.

The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non- interest bearing	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
At 31 December 2014							
Assets							
Cash in hand and balances with banks	-	-	-	-	-	128,770	128,770
Obligatory reserve with the CNB	-	-	-	-	-	91,548	91,548
Placements with banks	39,313	-	-	-	-	-	39,313
Loans and advances to customers	125,146	28,024	59,480	136,278	398,587	2,506	750,021
Available-for-sale financial assets	66	-	58,721	2,033	11,114	690	72,624
Held-to-maturity financial assets	112	444	452	-	-	-	1,008
Other assets	-	-	-	-	-	13,092	13,092
Total financial assets	164,637	28,468	118,653	138,311	409,701	236,606	1,096,376
Liabilities							
Deposits from customers	196,709	124,360	584,785	40,247	26,950	819	973,870
Due to banks	19,608	1,613	5,908	10,811	12,567	4,029	54,536
Hybrid instruments	560	-	-	-	14,365	-	14,925
Repurchase agreements	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	9,702	9,702
Total financial liabilities	216,877	125,973	590,693	51,058	53,882	14,550	1,053,033
Net on-balance sheet financial position	(52,240)	(97,505)	(472,040)	87,253	355,819	222,056	43,343
At 31 December 2013							
Total financial assets	180,496	26,550	71,481	136,598	410,160	318,102	1,143,387
Total financial liabilities	186,046	137,973	609,324	87,698	103,484	16,051	1,140,576
Net on-balance sheet financial position	(5,550)	(111,423)	(537,843)	48,900	306,676	302,051	2,811

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

32.3. Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations associated with its financial liabilities when they fall due and to replace funds when they are withdrawn. The consequence may be the failure to meet obligations to repay depositors and fulfil commitments to lend.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs and other calls on cash. The Bank does not maintain cash resources to meet all of these needs as experience shows that the minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank manages liquidity reserves daily, ensuring also meeting all customer needs.

32.3.1. Funding approach

Sources of liquidity are regularly reviewed by the Bank's Treasury to maintain a wide diversification by currency, geography, provider, product and term.

32.3.2. Non-derivative cash flows

The table below presents the cash flows payable by the Bank under non-derivative financial liabilities by remaining contractual maturities at the balance sheet date.

At 31 December 2014	Up to 1 month HRK'000	1 - 3 months HRK'000	3 - 12 months HRK'000	1 - 3 years HRK'000	Over 3 years HRK'000	Total HRK'000
Deposits from customers	196,767	124,366	584,819	40,596	27,322	973,870
Due to banks	23,636	1,613	5,909	10,811	12,567	54,536
Hybrid instruments	560	-	-	-	14,365	14,925
Repurchase agreements	-	-	-	-	-	-
Other liabilities	7,643	776	1,280	2	-	9,702
Total liabilities (contractual maturity dates)	228,606	126,755	592,008	51,409	54,254	1,053,033
Total liabilities on unused loans (expected maturity dates)	5,460	77	18,229	238	-	24,004

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

At 31 December 2013	Up to 1 month HRK'000	1 - 3 months HRK'000	3 - 12 months HRK'000	1 - 3 years HRK'000	Over 3 years HRK'000	Total HRK'000
Deposits from customers	185,124	136,421	603,470	74,580	30,563	1,030,158
Due to banks	2,474	1,579	6,080	13,674	16,608	40,415
Hybrid instruments	878	-	-	122	57,282	58,282
Repurchase agreements	-	-	-	-	-	-
Other liabilities	9,459	234	2,002	26	-	11,721
Total liabilities (contractual maturity dates)	197,935	138,234	611,552	88,402	104,453	1,140,576
Total liabilities on unused loans (expected maturity dates)	5,436	52	20,817	315	-	26,620

Assets available to meet all of the liabilities and to cover outstanding loan commitments include cash, central bank balances, items in the course of collection and treasury and other eligible bills; loans and advances to banks; and loans and advances to customers. In the normal course of business, a proportion of customer loans contractually repayable within one year will be extended. The Bank would also be able to meet unexpected net cash outflows by selling securities and approaching other funding sources.

32.3.2. Off-balance sheet items

(a) Loan commitments

The dates of the contractual amounts of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers and other financial instruments (Note 29) are summarised in the table below.

(b) Other financial instruments

Other financial instruments (Note 29), are also included below based on the earliest contractual maturity date.

	No later than 1 year HRK'000	1 to 3 years HRK'000	Over 3 years HRK'000	Total HRK'000
At 31 December 2014				
Loan commitments	23,766	238	-	24,004
Guarantees, letters of credit and other	12,757	-	-	12,757
Total	36,523	238	-	36,761
At 31 December 2013				
Loan commitments	26,305	315	-	26,620
Guarantees, letters of credit and other	12,970	2,291	-	15,261
Total	39,275	2,606	-	41,881

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the Management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

Liquidity requirements to support guarantee payments and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit at the balance sheet date does not necessarily represent future cash flows, since many of these commitments will expire or be terminated without being funded.

32.4. Fair value of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is based on quoted market prices, where available. However, no readily available market prices exist for a significant portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing techniques as appropriate. Changes in assumptions on which the estimates are based, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates may not be realisable in a current sale of the financial instrument.

The Bank uses the following hierarchy for determining the fair value of financial instruments by using valuation techniques:

- level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- level 2: other techniques for which all inputs which have significant effect on the recorded fair value are observable, either directly or indirectly
- level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

	31/12/2014			31/12/2013		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Bonds	71,934	-	71,934	62,470	-	62,470
Investment funds	-	-	-	-	-	-
Shares	549	141	690	304	141	445
	72,483	141	72,624	62,774	141	62,915

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The table below summarises the carrying amounts and fair values of financial assets and liabilities not presented on the Bank's balance sheet at their fair value.

	Carrying amount		Fair value	
	2014	2013	2014	2013
	HRK'000	HRK'000	HRK'000	HRK'000
Financial assets				
Placements with banks	39,313	29,857	39,313	29,857
Loans and advances to customers	750,021	730,395	750,021	730,395
Held-to-maturity financial assets	1,008	2,666	1,008	2,666
Other assets	13,092	11,761	13,092	11,761
Total financial assets	803,434	774,679	803,434	774,676
Financial liabilities				
Deposits from customers	973,870	1,030,158	973,870	1,030,158
Due to banks	54,536	40,415	54,536	40,415
Hybrid instruments	14,925	58,282	14,925	58,282
Repurchase agreements	-	-	-	-
Other liabilities	9,702	11,721	9,702	11,721
Total financial liabilities	1,053,033	1,140,576	1,053,033	1,140,576

For the purpose of the fair value assessment of the Bank's financial instruments the following methods and assumptions have been used:

(a) Cash and funds with Central bank

The carrying amount of cash and amounts due from banks, obligatory reserve with the Croatian National Bank, and placements with banks, deposits from banks and deposits from companies and similar entities are deemed to reflect their fair value due to the short-term maturity of these financial instruments.

(b) Held-to-maturity financial assets

The fair value of securities held-to-maturity is calculated based on quoted market prices.

(c) Due from other banks

The estimated fair values of amounts due from other banks, which mature within a maximum of 180 days approximate their carrying amounts. The fair values of other amounts due from banks is estimated based on discounted cash flow analyses using prevailing interest rates for investments under similar terms (market rates adjusted by credit risk). The fair value of non-performing amounts due from banks is estimated using a discounted cash flow analysis. Allowances are not taken into consideration when calculating fair values.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

(d) Loans to and receivables from customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality. The fair value of non-performing loans to customers is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral, where available. Loans at fixed interest rates represent only a fraction of the total carrying value and hence the fair value of total loans to and receivables from customers approximates the carrying values as at the balance sheet date. Allowances are not taken into consideration when calculating fair values.

(e) Due to other banks and customers

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

32.5. Capital risk management

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

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

In accordance with the regulations governing this area of monitoring of the Bank's operations, the Bank is obliged to submit to the Croatian National Bank reports on capital adequacy and coverage of capital requirements on a quarterly basis.

Based on the capital requirements from Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and the amending Regulation (EU) No. 648/2012, the minimum rate of regulatory capital that the Bank must maintain is 8%, while maintaining a level of capital sufficient to cover the capital requirements of additional tier for capital protection (2.5%) and the additional tier for structural systemic risk (1.5%).

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

The table below summarises the composition of regulatory capital and the ratios of the Bank for the year ended 31 December 2014.

	31/12/2014
	HRK'000
Regulatory capital	
Common equity tier I capital	409,478
Additional tier I capital	11,826
Deductions from regulatory capital	(318,437)
Regulatory capital	102,867
Structure of risk exposure	
Exposure amount weighted by credit risk	729,889
Market risk exposure	529
Operating risk exposure	89,392
Total risk exposure	819,810
Structure of capital requirements	
Capital requirements for total capital ratio (8%)	65,585
Capital conservation buffer (2.5%)	20,495
Systemic risk buffer (1.5%)	12,297
Total capital requirements	98,377
Capital adequacy	12.55%

It is not practicable for the Bank to provide comparative information for 2013 due to different rules and requirements that were legally prescribed during 2013. As at 31 December 2013, under the then applicable rules the Bank had a capital adequacy ratio of 13.93%.

In February 2015, the Bank received a decision of the regulator based on which, as of 31 March 2015, the Bank is required to maintain regulatory capital by at least 2.96 percentage points higher than as prescribed in Article 92 paragraph 1 item c) of Regulation (EU) no. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and Chapter VII of the Credit Institutions Act, i.e. to maintain the rate of 14.96%.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2014

33. Events after the balance sheet date

As stated in Note 32, in February 2015 the Bank received a decision of the regulator based on which, as of 31 March 2015, the Bank is required to maintain regulatory capital by at least 2.96 percentage points higher than as prescribed in Article 92 paragraph 1 item c) of Regulation (EU) no. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and Chapter VII of the Credit Institutions Act. Without disputing the amount of the required regulatory capital, in March 2015 the Bank initiated a procedure for extending the implementation term until 31 December 2015, which would enable the Bank to take action in a timely manner to meet regulatory requirements. Up to the date of these financial statements, the procedure has not been completed.

As at 31 March 2015, an extraordinary meeting of the Bank's General Assembly was held at which the requirements of maintaining the regulatory capital were discussed and at which the Management Board was granted approval to reprogram a hybrid instrument. This would extend the maturity of the said instrument by 2 years and the supplementary share capital as at 31 March 2015 would be increased by HRK 3,242 thousand.

Also, at the meeting a plan was adopted based on which the Bank would comply with regulatory capital requirements as at 31 December 2015.

34. Approval of the financial statements

The financial statements set out on pages 4 to 56 were approved by the Management Board of the Bank on 21 April 2015.

Nicola Ceccaroli
President of the Management Board

Darko Kosovec
Member of the Management Board