

BANKA KOVANICA d.d.

**Financial statements as at
31 December 2013 together with
Independent Auditor's Report**

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Responsibility of the Management Board

Pursuant to the Croatian Accounting Law (Official Gazette 109/07 and 54/13), 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 those 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 Law (Official Gazette 109/07 and 54/13). The 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 the behalf of the Management Board:

Nicola Ceccaroli
President of the Management board



Banka Kovanica d.d.,
Preradovićeve 29
Varaždin



Darko Kosovec
Member of the Management Board



31 March 2014

Independent Auditor's Report

To the Management Board and shareholders of Banka Kovanica d.d.

We have audited the accompanying financial statements of Banka Kovanica d.d. (hereinafter: "the Bank") which comprise of statement of financial position as at 31 December 2013, the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as presented on pages 4 to 58.

Management's Responsibility

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting regulations applicable to banks in Croatia. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 whether the financial statements are free from material misstatement.

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

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

Basis for Qualified Opinion


As presented in the Note 11, the Bank recognises deferred tax asset in the amount of HRK 5,463 thousand for the carryforward of unused tax losses for the following 5 years. Considering the utilization of unused tax losses in the future depends on the realization of the 5-year plan, which includes significant uncertainty, we are not able to confirm the recoverability of the reported deferred tax asset.

Qualified Opinion


In our opinion, except for the effects on the financial statements of the matters described in preceding paragraph, the financial statements presented on pages 4 to 58 give a true and fair view of the financial position of the Bank as at 31 December 2013 and the results of its operations and cash flows for the year then ended in accordance with statutory accounting regulations applicable to banks in Croatia.

Emphasis of matter

As explained in the Note 29, the Bank has legal proceeding with regards to a Bank's guarantee in the amount of EUR 710 thousand which issuance is denied by the Bank. First instance court ruling was made in the Bank's favour, rejecting the plaintiff's claim and therefore, the Management of the Bank is of opinion that final court decision will be favourable for the Bank.


Grant Thornton revizija d.o.o.
Ivana Lučića 2a, Zagreb

GRANT THORNTON
revizija d.o.o.
ZAGREB

Ivica Smiljan, 
Certified auditor, Director

Zagreb, 31 March 2014

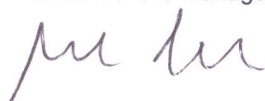
Statement of comprehensive income

for the year ended 31 December 2013

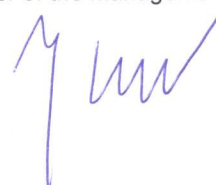
	Notes	2013 HRK'000	2012 HRK'000
Interest income		82,055	76,629
Interest expense		(42,249)	(41,211)
Net interest income	4	39,806	35,418
Fee and commission income		5,571	5,648
Fee and commission expense		(1,000)	(873)
Net fee and commission income	5	4,571	4,775
Foreign exchange differences - net	6	3,769	7,212
Result of assets available for sale - net	17	662	1,755
Other operating income	7	2,593	6,294
Impairment charge for credit losses - net	8	(37,828)	(61,842)
Administrative expenses	9	(50,324)	(49,139)
Other operating expenses	10	(7,068)	(7,630)
Loss before income tax		(43,819)	(63,157)
Income tax expense	11	-	5,463
Loss after taxation		(43,819)	(57,694)
Unrealized (loss) / gains on financial assets available for sale		(1,822)	1,151
Other comprehensive (loss) / income		(1,822)	1,151
Total comprehensive loss		(45,641)	(56,543)
Loss per share	12	(16.72)	(22.51)

Financial statements set out on pages 4 to 58 were approved by the Management Board on 31 march 2014.

Nicola Ceccaroli
President of the Management Board




Darko Kosovec
Member of the Management Board



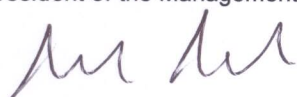
Statement of financial position

as at 31 December 2013

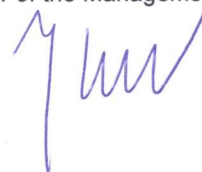
	Notes	31/12/2013 HRK'000	31/12/2012 HRK'000
ASSETS			
Cash in hand and balances with banks	13	207,932	115,838
Obligatory reserve with the Croatian National Bank	14	97,861	83,506
Placements with banks	15	29,857	29,703
Loans and advances to customers	16	730,395	728,670
Available for sale financial assets	17	62,915	22,712
Held to maturity financial assets	18	2,666	3,262
Property and equipment	19	27,086	33,251
Intangible assets	19	1,415	2,181
Repossessed assets	20	37,975	26,961
Other assets	21	11,761	10,505
Total assets		1,209,863	1,056,589
LIABILITIES			
Deposits from customers	22	1,030,158	844,548
Due to banks	23	40,415	78,139
Hybrid instruments	24	58,282	27,576
Repurchase agreements	25	-	10,600
Other liabilities	26	11,720	11,117
		1,140,575	971,980
SHAREHOLDERS' EQUITY			
Share capital	27	291,084	260,764
Treasury shares		(15)	(15)
Share premium		76,430	76,430
Reserves		(721)	1,101
Loss brought forward		(253,671)	(195,977)
Loss for the year		(43,819)	(57,694)
		69,288	84,609
Total liabilities and shareholders' equity		1,209,863	1,056,589

Financial statements set out on pages 4 to 58 were approved by the Management Board on 31 march 2014.

Nicola Ceccaroli
President of the Management Board



Darko Kosovec
Member of the Management Board




The notes to the financial statements are an integral part of the Statement of financial position.

Statement of changes in equity

for the year ended 31 December 2013

	Share capital	Treasury shares	Share premium	Reserves	Loss brought forward	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
As at 31 December 2011	208,964	(15)	76,430	(50)	(195,977)	89,352
Loss for the year	-	-	-	-	(57,694)	(57,694)
Unrealized gains on assets available for sale	-	-	-	1,151	-	1,151
Other comprehensive income / (loss)	-	-	-	1,151	(57,694)	(56,543)
Increase of capital	51,800	-	-	-	-	51,800
As at 31 December 2012	260,764	(15)	76,430	1,101	(253,671)	84,609
Loss for the year	-	-	-	-	(43,819)	(43,819)
Unrealized loss on assets available for sale	-	-	-	(1,822)	-	(1,822)
Other comprehensive loss	-	-	-	(1,822)	(43,819)	(45,641)
Increase of capital	30,320	-	-	-	-	30,320
As at 31 December 2013	291,084	(15)	76,430	(721)	(297,490)	69,288

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

Statement of cash flows

for the year ended 31 December 2013

	Notes	2013 HRK'000	2012 HRK'000
Cash flows from operating activities			
Loss before taxation		(43,819)	(57,694)
Depreciation and amortisation	9, 19	7,278	6,588
Write off and disposals of property and equipment	19	(1,352)	(500)
Impairment charge for credit losses - net	8	37,828	61,842
Result of financial assets available for sale		40,866	(9,312)
Other non-cash items		(56,368)	1,155
Operating result before changes in operating assets		(15,567)	2,079
(Increase) / decrease in assets with the Croatian National Bank		(14,355)	(31,938)
(Increase) / decrease in loans and advances to customers		(39,307)	8,925
(Increase) / decrease in bills of exchange		5,763	358
(Increase) / decrease in repossessed and other assets		(2,238)	(6,979)
Increase / (decrease) in deposits from customers		185,610	5,530
Increase / (decrease) in hybrid instruments		30,706	(63,613)
Increase / (decrease) in other liabilities		604	(842)
Net cash used in operating activities		151,216	(86,480)
Cash flows from investing activities			
Purchase of property and equipment and intangible assets	19	(654)	(1,098)
Purchase of financial assets available for sale	17	(60,636)	(34,578)
Proceeds on sale of financial assets available for sale	17	20,324	49,252
Net cash used for investing activities		(40,966)	13,576
Cash flows from financing activities			
Capital increase	27	30,320	51,800
Increase / (decrease) of deposits from banks		(38,620)	27,786
(Increase) of placements with banks		-	-
Increase / (decrease) of loans due to banks		896	(3,927)
Repayment of loans received		(10,600)	(15,600)
Net cash from financing activities		(18,004)	60,059
Net (decrease) / increase in cash and cash equivalents		92,246	(12,845)
Cash and cash equivalents at beginning of year		145,543	158,388
Cash and cash equivalents at end of year	28	237,789	145,543

The notes to the financial statements are an integral part of the Statement of cash flows.

Notes to the financial statements

for the year ended 31 December 2013

1. General information

Activities

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

Registered activities of the Bank are as follows:

- accepting cash deposits
- granting loans and other placements in own name and for own account
- issuing electronic money
- issuing guarantees or other security
- Factoring
- finance lease
- credit operations, including consumer credit, mortgage loans and financing of commercial operations (including forfeiting)
- trading in own name and for own account or in own name and for a customer's account: in instruments of money market 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
- gathering, analysing and providing information on credit ratings of legal and natural persons who perform activities individually
- 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 ended 31 December 2013

Supervisory Board

Pier Luigi Martelli	President
Ivan Majdak	Vice president
Emanuele Restelli Prandoni Della Fratta	Member
Davor Štern	Member
Gian Primo Giardi	Member

Management Board

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

The shareholders of the Bank as at 31 December 2013 and 31 December 2012 are disclosed in Note 27.

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 fulfill 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.

2. Basis of presentation of financial statements

The principal accounting policies applied in preparation of these financial statements are summarized below. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards ("IFRS"), reference may be made to certain Standards endorsed for use in the European Union as at 31 December 2013.

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 Banks 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 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 portfolio basis. In accordance with CNB regulations, banks with headquarters in Croatia should recognize 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 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 (e.g. collateral, customers' scoring and alike).

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 minimal levels of impairment losses for certain specifically identified impaired exposures, which may be different from the impairment loss required to be recognized in accordance with IFRS.

Notes to the financial statements (continued)

for the year ended 31 December 2013

2.2. Basis of preparation

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

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

Standards, Amendments and Interpretations issued by IASB, adopted by the Croatian Board for financial reporting standards and made effective

For the year ended 31 December 2013 the Bank has adopted the following amendments which are or have become effective during the year, and in accordance with the requirements, presented comparative data. The application of new standards had no effect on the equity as at 1 January 2013:

- Changes in IAS 1 – Presentation of Financial statements – amendments effective for annual periods beginning on or after 1 July 2012 and amendments effective for annual periods beginning on or after 1 January 2013. As a result of „Presentation of other comprehensive income items“ as part of amendments of IAS 1, certain points have been amended, revised or deleted for the following standards: IAS 1, 12, 20, 21, 32, 33, 34 and IFRS 1, 5 and 7;
- IFRS 1 First time adoption of IFRS – replacement of fixed dates for certain exceptions – effective for annual periods beginning on or after 1 January 2013;
- IFRS 1 First time adoption of IFRS – additional exemptions for entities ceasing to suffer from severe hyperinflation – effective for annual periods beginning on or after 1 January 2013;
- IAS 12 Income taxes (revised) – limited scope amendments effective for annual periods beginning on or after 1 January 2013;
- IFRS 13 – Fair value measurement - new standard effective for annual periods beginning on or after 1 January 2013;
- IAS 19 Employee benefits (revised) – amendments effective for annual periods beginning on or after 1 January 2013. As a result of revised IAS 19 the following standards have been also amended: IAS 24, IFRS 1, IFRS 8, IFRS 13 and IFRIC 14;
- IFRS 7 Financial instruments: Disclosures – offsetting Financial Asset and Financial Liabilities – amendments effective for annual periods beginning on or after 1 January 2013;
- Amendments to IFRS 1 - Government Loans – effective for annual periods beginning on or after 1 January 2013;
- Annual Improvements to IFRSs 2009 - 2011 Cycle (IFRS 1, IAS 1, IAS 16, IAS 32 and IAS 34) – effective for annual periods beginning on or after 1 January 2013;
- IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine - effective for annual periods beginning on or after 1 January 2013.

Notes to the financial statements (continued)

for the year ended 31 December 2013

Standards, amendments and interpretations to existing standards which are not yet effective

At the approval date of these financial statements, certain new standards, amendments and interpretations to existing standards have been published but are not yet effective for the year ended 31 December 2013:

- IFRS 10 Consolidated financial statements – new standard effective for annual periods beginning on or after 1 January 2014;
- IFRS 11 Joint arrangements – new standard effective for annual periods beginning on or after 1 January 2014;
- IFRS 12 Disclosure of interests in other entities – new standard effective for annual periods beginning on or after 1 January 2014;
- Amendments to IFRS 10, IFRS 11 and IFRS 12 – Transition Guidance effective for the annual periods beginning on or after 1 January 2014;
- Amendments to IFRS 10, IFRS 12 and IAS 27 – Investment entities effective for the annual periods beginning on or after 1 January 2014;
- IAS 27 and IAS 28 – consequential amendments due to above mentioned new consolidation standards - effective for annual periods beginning on or after 1 January 2014;
- IAS 32 – Financial instruments: Presentation – amendments to application guidance on the offsetting of financial assets and financial liabilities – effective for annual periods beginning on or after 1 January 2014;
- IFRS 7 Financial instruments: Disclosures – amendments requiring disclosures about the initial application of IFRS 9 for which mandatory effective date is deferred;
- IFRS 9 Financial Instruments – new standard for which mandatory effective date is deferred;
- Amendments to IAS 36 – Impairment of assets – amendments arising from recoverable amount disclosures for non-financial assets - effective for annual periods beginning on or after 1 January 2014;
- Amendments to IAS 39 – Financial instruments: Recognition and Measurement – amendments for novations of derivatives - effective for annual periods beginning on or after 1 January 2014;
- Annual Improvements to IFRSs 2010 - 2012 Cycle (IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38) – effective for annual periods beginning on or after 1 July 2014 by IASB, not endorsed for use by EU yet;
- Annual Improvements to IFRSs 2011 - 2013 Cycle (IFRS 1, IFRS 3, IFRS 13 and IAS 40) – effective for annual periods beginning on or after 1 July 2014 by IASB, not endorsed for use by EU yet.

Management anticipates that all of the relevant pronouncements will be adopted in the Bank's financial statements for the first period beginning after the effective date of the pronouncement and its application should not have a material impact on the Bank's financial statements.

Notes to the financial statements (continued)

for the year ended 31 December 2013

2.3. Critical accounting judgments and key sources of estimation uncertainty

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

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

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 judgment of management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

There are few legal actions against the Bank, which have arisen from the regular course of its operations. The management estimates that the probable outcome will have no significant negative effects on the Bank's 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. During the year 2013 the Bank had an adequate level of liquidity, enhanced by capital increases by the owner in the prior periods.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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

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

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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

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 Bank operates ('the functional currency'). The financial statements are presented in Croatian kuna's (HRK), which is the Bank's functional 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.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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.

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 2013	EUR 1 = HRK 7.637643	USD 1 = HRK 5.549000
31 December 2012	EUR 1 = HRK 7.545624	USD 1 = HRK 5.726794

3.6. Cash and cash equivalents

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

Cash and cash equivalents excludes 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.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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

Financial assets are classified at fair value through profit or loss where the financial asset 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 together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

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 recognized stock exchanges or acceptable valuation models. The Bank includes unrealized 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 profit and loss account.

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.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 recognized 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.

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 income statements.

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 profit and loss account. Upon payment of the dividend, the receivable is offset against the collected cash.

(c) Held-to-maturity financial assets

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

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 recognizes allowances through profit and loss statement.

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

(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 Banks 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.

Loans and receivables are measured at initial recognition at fair value, and are subsequently measured at amortized cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers. 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 group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred 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.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 like 'Due to banks', 'Deposit from customers', are recognised initially at fair value net of transaction cost incurred. Financial liabilities are subsequently stated at amortized costs using the effective interest rate 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 facilities.

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 judgment of Management.

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

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 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. Property and equipment and intangible assets

Property and equipment and intangible assets are started at cost less accumulated depreciation/amortization. Depreciation 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 in the course of construction are not depreciated.

Notes to the financial statements (continued)for the year ended 31 December 2013

Depreciation is calculated using the straight-line method to allocate the cost over their estimate useful lives as follows:

	2013	2012
	%	%
Property	2.5	2.5
Leasehold improvements	20	20
Electronic equipment	20	20
Other assets	20-25	20-25
Leasehold improvements	20	20
Software	20	20

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. In addition, the carrying amounts of fixed and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount. The recoverable amount is the higher of the 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 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. 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.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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.

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. Acquisition of treasury shares is recognised within capital at the trade date.

Notes to the financial statements (continued)

for the year ended 31 December 2013

4. Net interest income**Interest income**

	2013	2012
	HRK`000	HRK`000
Loans and advances:		
- to customers	79,387	73,627
- to banks	1,212	1,991
Securities	1,455	1,011
Other	1	-
	82,055	76,629

Interest expense

	2013	2012
	HRK`000	HRK`000
Customers deposits	39,639	37,434
Hybrid instruments	1,103	1,098
Other borrowed funds	1,507	2,679
	42,249	41,211

5. Net fee and commission income**Fee and commission income**

	2013	2012
	HRK`000	HRK`000
Domestic and foreign currency transactions	3,152	3,153
Guarantees and letter of credits given	42	40
Other	2,377	2,455
	5,571	5,648

Fee and commission expense

	2013	2012
	HRK`000	HRK`000
Domestic and foreign currency transactions	433	358
Other	567	515
	1,000	873

Notes to the financial statements (continued)

for the year ended 31 December 2013

6. Foreign exchange differences - net

	2013	2012
	HRK`000	HRK`000
Net foreign exchange gains from operations	3,632	4,405
Net foreign exchange gains / (losses) on translation of foreign currency assets and liabilities to mid exchange rate	137	2,807
	3,769	7,212

7. Other operating income

	2013	2012
	HRK`000	HRK`000
Income from transfer of corporate loan claims to majority shareholder (Note 30)	1	3,577
Income from lease	677	393
Court costs refund	132	289
Income from provision reversal for legal cases	-	1,061
Other	1,783	974
	2,593	6,294

8. Impairment charge for credit losses - net

	2013	2012
	HRK`000	HRK`000
Loans and advances to customer (Note 16)	37,582	55,726
Placements with banks (Note 15)	-	2,533
Collected credit losses written off in previous years	(803)	(363)
Held to maturity financial assets (Note 18)	146	(351)
Other assets (Note 21)	982	4,433
Provision for contingent liabilities and commitments (Note 26)	(79)	(136)
	37,828	61,842

9. Administrative expenses

	2013	2012
	HRK`000	HRK`000
Staff costs		
Net salaries	12,237	12,511
Pension contributions	3,622	3,749
Health security contributions	2,844	3,034
Other contributions and taxes on salaries	2,850	3,013
Other staff costs	799	935
	22,352	23,242
Other administrative expenses	21,740	19,309
Depreciation and amortisation (Note 19)	6,232	6,588
	50,324	49,139

As at 31 December 2013, the Bank had 133 employees (2012: 131 employees).

Notes to the financial statements (continued)

for the year ended 31 December 2013

10. Other operating expenses

	2013	2012
	HRK'000	HRK'000
Rental costs	4,481	4,804
Saving deposits insurance charge	2,738	2,399
Provisions for legal cases (Note 26)	(308)	652
Vacation accruals (Note 26)	182	(304)
Other	(25)	79
	7,068	7,630

11. Income tax expense

	2013	2012
	HRK'000	HRK'000
Accounting loss before tax	(43,819)	(63,157)
Effect of items increasing tax base	5,632	7,067
Effect of items decreasing tax base	(5,220)	(7,144)
Tax loss for the period	(43,407)	(63,234)
Tax losses brought forward	(223,425)	(170,994)
Expiration of tax losses carried forward	24,360	10,803
Tax losses carried forward	(242,472)	(223,425)
Recognized deferred tax assets (IAS 12)	5,463	5,463
Unrecognized deferred tax assets (statutory tax rate 20%)	(43,031)	(39,222)

In the financial statements for the year 2012, the Bank has recognised deferred tax assets for the carryforward of unused tax losses in the amount of HRK 5,463 thousand, for which it estimated 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 43,031 thousand in the progress of adopting the new 5-year plan.

The Bank may utilise the recorded tax loss in the amount of HRK 242,472 thousand as a deduction item of recorded base for the calculation of tax liability, not later than in a period of 5 years:

- tax loss for 2009 in the amount of HRK 39,777 thousand not later than (including) 2014
- tax loss for 2010 in the amount of HRK 76,778 thousand not later than (including) 2015
- tax loss for 2011 in the amount of HRK 19,276 thousand not later than (including) 2016
- tax loss for 2012 in the amount of HRK 63,235 thousand not later than (including) 2017
- tax loss for 2013 in the amount of HRK 43,406 thousand not later than (including) 2018

In accordance with the regulations of the Republic of Croatia, the Tax Authority may at any time inspect books and records of the Bank 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 ended 31 December 2013

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>2013</u>	<u>2012</u>
Loss for the year (in HRK'000)	(43,819)	(57,694)
Weighted average number of shares excluding own shares	<u>2,620,924</u>	<u>2,563,476</u>
Basic loss per share – ordinary (in HRK)	<u>(16.72)</u>	<u>(22.51)</u>

On 16 December 2013 the Bank's share capital increased (Note 27) by issuing 303,200 ordinary shares each in nominal value of HRK 100.

Diluted

Diluted loss per share for the year 2013 and 2012 is equal to basic loss per share, since the Bank did not have any convertible instruments and share options during both years.

13. Cash in hand and balances with banks

	<u>31/12/2013</u>	<u>31/12/2012</u>
	<u>HRK'000</u>	<u>HRK'000</u>
Cash in hand	17,977	14,979
Cash on the clearing account	78,416	31,807
Foreign currency account	<u>111,539</u>	<u>69,052</u>
	<u>207,932</u>	<u>115,838</u>

Notes to the financial statements (continued)

for the year ended 31 December 2013

14. Obligatory reserve with the Croatian National Bank

	31/12/2013	31/12/2012
	HRK`000	HRK`000
Earmarked obligatory reserve		
- in HRK	71,932	68,465
- in foreign currency	15,588	15,041
CNB treasury notes	10,341	-
	97,861	83,506

Obligatory reserve rate as at 31 December 2013 was 12% (2012: 13.5%) of Croatian and foreign currency deposits, loans taken and debt securities issued. As at 11 December 2013 the Croatian National Bank issued regulation on reducing the rate of obligatory reserve (from 13.5% to 12%) pursuant to the bank's commitments to enroll treasury bills with a three year maturity in the exempt amount of released obligatory reserves. 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

	31/12/2013	31/12/2012
	HRK`000	HRK`000
Loans	5,138	9,870
Deposits	29,857	24,971
	34,995	34,841
Allowance for identified losses	(5,138)	(5,138)
	29,857	29,703

Movement in allowance for identified losses:

	31/12/2013	31/12/2012
	HRK`000	HRK`000
As at 1 January	5,138	2,605
Increase in provisions (Note 8)	-	2,533
Collection (Note 8)	-	-
As at 31 December	5,138	5,138

Notes to the financial statements (continued)

for the year ended 31 December 2013

16. Loans and advances to customers

	31/12/2013 HRK`000	31/12/2012 HRK`000
Retail customers	539,341	466,123
Corporate customers	389,376	436,047
Gross loans and advances	928,717	902,170
Less: Allowance for impairment	(198,322)	(173,500)
Net loans and advances	730,395	728,670
Current	154,679	182,538
Non – current	575,716	546,132

Reconciliation of allowance for impairment on loans and advances to customers:

2013	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
As at 1 January	21,750	151,750	173,500
Increase in provisions (Note 8)	44,812	79,191	124,003
Reversal (Note 8)	(30,493)	(55,927)	(86,420)
Write off	(4,350)	(9,234)	(13,585)
Foreign exchange differences	248	576	824
As at 31 December	31,967	166,356	198,323
2012	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
As at 1 January	18,015	98,261	116,276
Increase in provisions (Note 8)	20,919	116,492	137,411
Reversal (Note 8)	(17,509)	(64,176)	(81,685)
Write off	-	-	-
Foreign exchange differences	325	1,173	1,498
As at 31 December	21,750	151,750	173,500

Notes to the financial statements (continued)

for the year ended 31 December 2013

17. Available for sale financial assets

	31/12/2013	31/12/2012
	HRK'000	HRK'000
Foreign Government bonds	60,439	19,615
Corporate bonds	2,031	2,029
Equity securities – listed	304	463
Equity securities – unlisted	141	141
Investment funds	-	464
	62,915	22,712

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

	31/12/2013	31/12/2012
	HRK'000	HRK'000
As at 1 January	22,712	33,778
Additions	60,636	34,578
Disposals	(20,324)	(49,252)
Unrealised (loss) / gain	(1,822)	1,151
Result of assets available for sale - net	662	1,755
Interest payment	967	1,015
Foreign exchange difference	84	(313)
As at 31 December	62,915	22,712

Foreign Governments' bonds as at 31 December 2013:

Name	Maturity	Interest %	Nominal amount	Currency	Book value	Unrealized gains / (loses)
					HRK'000	HRK'000
FR0011337880	25/10/2022	2.25	2,000	EUR	15,364	(246)
XS0757376610	21/03/2022	2.25	500	EUR	3,975	(128)
LU0905090048	09/03/2028	2.242	1,000	EUR	7,390	(382)
BE0000328378	22/06/2023	2.25	2,000	EUR	15,077	(341)
NL0010418810	15/07/2023	1.75	1,000	EUR	7,389	(308)
AT0000A105W3	20/10/2023	1.75	1,000	EUR	7,393	(315)
SK4120009234	28/11/2018	1.592	500	EUR	3,851	43
					60,439	(1,677)

As at 31 December 2013, there were no bonds pledged as collateral in repurchase agreements (as at 31 December 2012: fair value of bonds in the amount HRK 26,102 thousand)

Notes to the financial statements (continued)

for the year ended 31 December 2013

Corporate bonds as at 31 December 2013:

Name	Maturity	Interest %	Nominal amount	Currency	Book value HRK'000	Unrealized gains / (loses) HRK'000
ATGR-O-169A	20/9/2016	6.75	2,000	HRK	2,031	2
					2,031	2

18. Held to maturity financial assets

	31/12/2013 HRK'000	31/12/2012 HRK'000
Bills of exchange	4,433	10,196
	4,433	10,196
Allowance for identified losses	(1,767)	(6,934)
	2,666	3,262

Movement in allowance for identified losses:

	31/12/2013 HRK'000	31/12/2012 HRK'000
As at 1 January	6,934	7,285
Increase in provisions (Note 8)	146	209
Collection (Note 8)	-	(560)
Write off	(5,313)	-
As at 31 December	1,767	6,934

Notes to the financial statements (continued)

for the year ended 31 December 2013

19. Property and equipment and intangible assets

	Land and buildings	Leasehold improvements	Electronic equipment	Other assets	Total property and equipment	Software	Intangible assets under construction	Total intangible assets
	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000
Cost								
As at 1 January 2012	25,686	21,441	9,342	13,046	69,515	8,094	279	8,373
Additions	-	570	95	127	792	307	-	307
Disposals	(548)	-	(2)	(631)	(1,181)	-	(11)	(11)
As at 31 December 2012	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)
As at 31 December 2013	25,138	12,962	9,280	12,264	59,644	8,547	-	8,547
Accumulated depreciation								
As at 1 January 2012	3,359	8,910	7,955	10,398	30,622	5,844	-	5,844
Charge for the year	466	3,857	666	955	5,944	644	-	644
Disposals	(75)	-	(2)	(614)	(691)	-	-	-
As at 31 December 2012	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)	-	-	-
As at 31 December 2013	4,213	8,461	8,799	11,085	32,558	7,132	-	7,132
Net book value								
As at 31 December 2012	21,388	9,244	816	1,803	33,251	1,913	268	2,181
As at 31 December 2013	20,925	4,501	481	1,179	27,086	1,415	-	1,415

Notes to the financial statements (continued)

for the year ended 31 December 2013

20. Repossessed assets

Movements in repossessed assets during the year:

	31/12/2013	31/12/2012
	HRK'000	HRK'000
As at 1 January	26,961	12,356
Increase	12,439	14,846
Decrease	(1,425)	(241)
Written off	-	-
As at 31 December	37,975	26,961

Repossessed assets as at 31 December 2013 included real estates in the amount of HRK 30,543 thousand which was not in the Bank's possession (in 2012, in amount of HRK 26,533 thousand). The Bank took over formal ownership over the real estate and is undertaking legal proceedings to get into its possession. As at 31 March 2014 real estates not in the Bank's possession were reduced to HRK 19,019 thousand.

21. Other assets

	31/12/2013	31/12/2012
	HRK'000	HRK'000
Deferred tax assets	5,463	5,463
Receivables for court costs refunds	3,632	3,474
Receivables from customers	4,334	4,361
Other pre-payments	2,719	2,402
Prepaid expenses	518	165
Pre-payments of pensions to customers	5	5
Derivative financial asset	280	105
Other	2,573	1,939
	19,524	17,914
Allowance for identified losses	(7,763)	(7,409)
	11,761	10,505

Movement in allowance for identified losses:

	31/12/2013	31/12/2012
	HRK'000	HRK'000
As at 1 January	7,409	2,977
Increase in provisions (Note 8)	3,098	6,098
Collection (Note 8)	(2,118)	(1,666)
Write off	(626)	-
As at 31 December	7,763	7,409

Notes to the financial statements (continued)

for the year ended 31 December 2013

22. Deposits from customers

Deposits comprise demand deposits and time deposits:

	31/12/2013	31/12/2012
	HRK`000	HRK`000
Demand deposits		
Corporate customers	8,684	8,142
Retail customers	90,405	49,294
	99,089	57,436
Time deposits		
Corporate customers	6,654	3,460
Retail customers	924,414	783,652
	931,068	787,112
Deposits from customers	1,030,157	844,548
Current	879,766	719,199
Non – current	150,392	125,349

23. Due to banks

	31/12/2013	31/12/2012
	HRK`000	HRK`000
Borrowings:		
- Croatian Bank for Reconstruction and Development	38,383	37,487
- other	-	-
Deposits	2,032	40,652
	40,415	78,139
Current	2,032	40,652
Non-current	38,383	37,487

As at 31 December 2013 and 31 December 2012, all deposits from banks are current.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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.

	31/12/2013 HRK'000	31/12/2012 HRK'000
Legal entities	58,160	26,498
Citizens	122	1,078
	58,282	27,576

25. Repurchase agreements

As at 31 December 2013 the Bank did not have any repurchase agreements (31 December 2012: HRK 10,600 thousand).

26. Other liabilities

	31/12/2013 HRK'000	31/12/2012 HRK'000
Provisions for legal cases	1,019	1,314
Provisions for contingent liabilities and commitments	419	498
Payables in the course of settlement	3,095	3,278
Liabilities to suppliers	2,069	1,932
Employee payables – salaries and contributions	2,001	1,821
Liabilities for savings deposits insurance charge	765	612
Vacation accruals (Note 10)	438	256
Other	1,915	1,406
	11,721	11,117

Movement in provisions for legal cases:

	31/12/2013 HRK'000	31/12/2012 HRK'000
As at 1 January	1,314	790
Increase in provision (Note 10)	321	971
Reversal (Note 10)	(628)	(319)
Payments made per court verdicts	12	(128)
As at 31 December	1,019	1,314

Notes to the financial statements (continued)

for the year ended 31 December 2013

Movement in provisions for contingent liabilities and commitments:

	31/12/2013 HRK' 000	31/12/2012 HRK' 000
As at 1 January	498	1,695
Increase in provision	479	848
Reversal of provision	(558)	(2,045)
As at 31 December	419	498

27. Shareholder's equity**Share capital**

At the General Assembly meeting held on 30 January 2012, a Decision was made to increase the share capital by inputting rights - a hybrid instrument in the Bank. The share capital in the amount of HRK 208,964 thousand increased by HRK 51,800 thousand to HRK 260,764 thousand, issuing 518,000 ordinary shares with nominal value of HRK 100.00 through hybrid instrument from Cassa di Risparmio della Repubblica di San Marino S.p.A.

At the General Assembly meeting held on 16 January 2013, a Decision was made to increase the share capital by payment in cash. The share capital in the amount of HRK 260,764 thousand increased by HRK 30,320 thousand to HRK 291,084 thousand, issuing 303,200 ordinary shares with nominal value of HRK 100.00 through the payment in cash from Cassa di Risparmio della Repubblica di San Marino S.p.A.

As at 31 December 2013, the share capital amounts to HRK 291,084 thousand (31 December 2012: 260,764 thousand), and comprises 2,910,844 ordinary shares (31 December 2012: 2,607,644) (VSK-R-A) with a nominal value of HRK 100 per share.

Bank's main shareholders as at 31 December are as follows:

Shareholder	31/12/2013		31/12/2012	
	Number of shares	% in share capital	Number of shares	% in share capital
Cassa di Risparmio della Repubblica di San Marino	2,899,961	99.63	2,596,761	99.58
Treasury shares	153	0.01	153	0.01
Other	10,730	0.36	10,730	0.41
Total	2,910,844	100.00	2,607,644	100.00

The ultimate owner of the Bank is Cassa di Risparmio della Repubblica di San Marino – S.U.M.S Foundation.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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:

	Notes	31/12/2013 HRK`000	31/12/2012 HRK`000
Cash in hand and balances with banks	13	207,932	115,838
Placements with banks	15	29,857	29,703
		237,789	145,541

29. Contingent liabilities and commitments**Legal Proceedings**

The Bank is currently subject to few legal proceedings. As at 31 December 2013 provisions for legal proceeding for which the Bank anticipates outflow of economic benefits amounts to HRK 1,019 thousand (2012: HRK 1,314 thousand) and provision for contingent liabilities amounting to HRK 419 thousand (2012: HRK 498 thousand). Legal (initiated enforcement) proceeding of the company Prvi Faktor d.o.o. in the amount of EUR 710 thousand relates to the guarantee issued by the Bank in favour of the company Prvi Faktor d.o.o. for the loan payment toward the company Glas Istre d.o.o. Total contingent liabilities for the legal proceeding of the company Prvi Faktor d.o.o. as at 31 December 2013 amounts to HRK 8,625 thousand and provision for contingent liabilities amounts to HRK 86 thousand. First instance court ruling was made in the Bank's favour, rejecting the plaintiff's claim.

Capital commitments

As at 31 December 2013 and 31 December 2012, the Bank had no capital commitments in respect of buildings and equipment purchases.

Loan commitments, guarantees and other financial instruments

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

	31/12/2013 HRK`000	31/12/2012 HRK`000
Guarantees	9,010	11,874
Letters of credit	6,251	3,684
Loan commitments and other	26,620	31,926
Less: Provision for contingent liabilities and commitments (Note 26)	-	(498)
Total	41,881	46,986

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

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 since 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 extension 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 under operating leases are as follows:

	31/12/2013 HRK'000	31/12/2012 HRK'000
Up to 1 year	2,298	4,396
From 2 to 5 years	4,910	6,770
Over 5 years	2,815	4,580
Total	10,023	15,746

Notes to the financial statements (continued)

for the year ended 31 December 2013

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, procurator, and their close family members.

In the year 2013 and 2012, transactions with related parties were as follows:

	Supervisory board, Management board and their related parties	
	2013	2012
	HRK`000	HRK`000
Interest income	52	50
Interest expense	121	150
Loans		
As at 1 January	1,204	1,563
Increase	394	151
Decrease	(67)	(510)
As at 31 December	1,531	1,204
Received deposits		
As at 1 January	3,166	2,934
Increase	2,197	3,100
Decrease	(3,020)	(2,868)
As at 31 December	2,343	3,166
Hybrid instruments		
As at 1 January	-	500
Increase	-	-
Decrease	-	(500)
As at 31 December	-	-

Notes to the financial statements (continued)

for the year ended 31 December 2013

	Cassa di Risparmio della Repubblica si San Marino	
	31/12/2013	31/12/2012
	HRK`000	HRK`000
Interest income	115	681
Other income	40	47
Impairment charge for credit losses - net	-	-
Interest expense	(1,135)	(1,310)
Given deposits and cash		
As at 1 January	24,190	38,409
Increase	29,027	24,219
Decrease	(24,164)	(38,438)
As at 31 December	29,053	24,190
Received deposits		
As at 1 January	40,587	12,811
Increase	-	39,096
Decrease	(38,651)	(11,320)
As at 31 December	1,936	40,587
Hybrid instruments		
As at 1 January	26,498	79,276
Increase	31,662	-
Decrease	-	(52,778)
As at 31 December	58,160	26,498

As at 31 December 2013 exposure towards majority shareholder amounts to 29,053 thousand kuna, which represents 23.58% of regulatory capital (2012: 23.81%). The regulatory limit exposure to one person or Group of related persons is 25% maximum of regulatory capital.

Key management and Supervisory Board compensation

	31/12/2013	31/12/2012
	HRK`000	HRK`000
Gross salaries and other short-term benefits	2,151	1,546

31. Financial risk management

Notes to the financial statements (continued)

for the year ended 31 December 2013

The Bank's activities are exposed to a variety of financial and operational risks, management of which includes analysis, evaluation, acceptance and management to some degree of risk or combination of risks. Risk management and risk acceptance represents 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 markets, products and emerging best practice.

Risk management is responsibility of the Management Board and Assets and Liabilities Committee and Committee for the management of credit risk. 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 ended 31 December 2013

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 in that respect new receivables.

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, FitchIBCA 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.

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, to individual counterparties and groups, and to industries and countries.

The Bank structures the levels 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) Credit-related commitments

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 remaining period 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 ended 31 December 2013

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 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

	2013		2012	
	Loans and advances	Allowance for impairment	Loans and advances	Allowance for impairment
	HRK`000	HRK`000	HRK`000	HRK`000
1. Fully recoverable placements	621,743	9,474	576,374	8,057
2. Partially recoverable placements	200,086	81,961	230,999	70,683
3. Unrecoverable placements	106,888	106,888	94,797	94,760
	928,717	198,323	902,170	173,500

Bank's rating

	2013		2012	
	Loans and advances	Allowance for impairment	Loans and advances	Allowance for impairment
	(%)	(%)	(%)	(%)
1. Fully recoverable placements	66.95	4.78	63.89	4.64
2. Partially recoverable placements	21.54	41.32	25.60	40.74
3. Unrecoverable placements	11.51	53.90	10.51	54.62
	100.00	100.00	100.00	100.00

Notes to the financial statements (continued)

for the year ended 31 December 2013

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.

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

	31/12/2013	31/12/2012
	HRK'000	HRK'000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash in hand and balances with banks	207,932	115,838
Obligatory reserve with the Croatian National Bank	97,861	83,506
Placements with banks	29,857	29,703
Loans and advances to customers	730,395	728,670
Available for sale financial assets	62,915	22,711
Held to maturity financial assets	2,666	3,262
Other assets	11,761	10,505
	1,143,387	994,195
Credit risk exposures relating to off-balance sheet items are as follows:		
Financial guarantees	9,010	11,874
Letters of credit	6,251	3,684
Loan commitments and other	26,620	31,926
	1,185,265	1,041,679

The above table represents the maximum exposure of the Bank to credit risk at 31 December 2013 and 2012, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet. As shown above, 66.49% of the total maximum exposure is derived from loans and advances to banks and customers (2012: 76.28%).

Notes to the financial statements (continued)

for the year ended 31 December 2013

31.1.5. Loans and advances

Loans and advances are summarised as follows:

	31/12/2013		31/12/2012	
	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks
	HRK`000	HRK`000	HRK`000	HRK`000
Neither past due nor impaired	599,525	29,857	547,160	29,703
Past due but not impaired	22,218	-	29,214	
Individually impaired	306,974	5,138	325,796	5,138
Gross	928,717	34,995	902,170	34,841
Less: allowance for impairment	(198,322)	(5,138)	(173,500)	(5,138)
Net	730,395	29,857	728,670	29,703

The total impairment provision for loans and advances is HRK 198,322 thousand (2012: HRK 173,500 thousand) of which HRK 188,848 thousand (2012: HRK 165,442 thousand) represents the individually impaired loans and the remaining amount of HRK 9,474 thousand (2012: HRK 8,058 thousand) represents the portfolio provision. Further information of the impairment allowance 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 ended 31 December 2013

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
As at 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>				
Due less than 30 days	1,898	1,508	3,406	-
Due 30 – 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
As at 31 December 2012				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	407,620	139,540	547,160	29,703
<i>Past due but not impaired</i>				
Due less than 30 days	2,534	2,939	5,473	-
Due 30 – 90 days	13,386	10,355	23,741	-
<i>Individually impaired</i>				
Individually impaired loans	42,584	283,213	325,796	5,138
Total	466,124	436,047	902,170	34,841

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 by reference to the market prices or indexes of similar assets.

31.1.6. Repossessed assets

Reposessed assets are sold as soon as practicable with the proceeds used to reduce the outstanding indebtedness.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 2013. 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	119,316	80,494	8,122	207,932
Obligatory reserve with the CNB	97,861	-	-	97,861
Placements with banks	830	-	29,027	29,857
Loans and advances to customers	730,395	-	-	730,395
Available for sale financial assets	2,476	60,439	-	62,915
Held to maturity financial assets	2,666	-	-	2,666
Other assets	11,761	-	-	11,761
As at 31 December 2013	965,305	140,933	37,149	1,143,387
As at 31 December 2012	883,295	85,434	25,466	994,195

(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	Real estate	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	29,857	-	-	-	-	-	-	29,857
Loans and advances to customers	20,743	62,198	43,354	42,356	1,970	57,930	501,844	730,395
Available for sale financial assets	60,462	5	221	2,104	-	123	-	62,915
Held to maturity financial assets	-	-	-	1,566	-	450	650	2,666
Other assets	11,147	24	14	53	55	220	249	11,761
As at 31 December 2013	122,209	62,227	43,589	46,079	2,025	58,723	502,743	837,594
As at 31 December 2012	70,377	80,246	47,755	62,303	2,341	86,151	445,677	794,851

32. Market risk

The Bank is exposed to market risk, 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 rates or prices such as interest rates, credit spreads, foreign exchange rates 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 calls under guarantees 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 does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

Notes to the financial statements (continued)

for the year ended 31 December 2013

32.1. Foreign currency 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 a 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
As at 31 December 2013					
Assets					
Cash and balances with banks	86,585	111,702	8,890	755	207,932
Obligatory reserve with the CNB	82,273	15,588	-	-	97,861
Placement with banks	-	29,857	-	-	29,857
Loans and advances to customers	98,354	627,758	-	4,283	730,395
Available for sale financial assets	2,476	60,439	-	-	62,915
Held to maturity financial assets	2,666	-	-	-	2,666
Other assets	11,744	17	-	-	11,761
Total financial assets	284,098	845,361	8,890	5,038	1,143,387
Liabilities					
Deposits from customers	229,437	788,612	8,978	3,131	1,030,158
Due to banks	17,233	23,182	-	-	40,415
Hybrid instruments	-	58,282	-	-	58,282
Repurchase agreements	-	-	-	-	-
Other liabilities	10,735	930	56	-	11,721
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
Nominal value of FX Forward	-	14,210	-	-	14,210
As at 31 December 2012					
Total financial assets	241,403	739,125	7,852	5,815	994,195
Total financial liabilities	222,619	737,863	7,291	4,207	971,980
Net on-balance sheet financial position	18,784	1,262	561	1,608	22,215
Loan commitments	13,158	13,862	4,905	-	31,925

Notes to the financial statements (continued)

for the year ended 31 December 2013

32.2. Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a 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 margins may increase as a result of such changes but may reduce losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest rate 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
As at 31 December 2013							
Assets							
Cash and balances with banks	-	-	-	-	-	207,932	207,932
Obligatory reserve with CNB	-	-	-	-	-	97,861	97,861
Placements with banks	29,857	-	-	-	-	-	29,857
Loans and advances to customers	149,583	25,254	70,521	136,598	348,336	102	730,394
Available for sale financial assets	646	-	-	-	61,824	445	62,915
Held to maturity financial assets	410	1,296	960	-	-	-	2,666
Other assets	-	-	-	-	-	11,761	11,761
Total financial assets	180,496	26,550	71,481	136,598	410,160	318,102	1,143,387
Liabilities							
Deposits from customers	184,726	136,394	603,244	73,902	29,594	2,298	1,030,158
Due to banks	442	1,579	6,080	13,674	16,608	2,032	40,415
Hybrid instruments	878	-	-	122	57,282	-	58,282
Repurchase agreements	-	-	-	-	-	-	-
Other liabilities	-	-	-	-	-	11,721	11,721
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
As at 31 December 2012							
Total financial assets	221,799	31,993	85,388	133,274	307,325	214,416	994,195
Total financial liabilities	199,038	136,635	478,102	81,312	65,776	11,117	971,980
Net on-balance sheet financial position	22,761	(104,642)	(392,714)	51,962	241,549	203,299	22,215

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 settled derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Bank manages liquidity reserves daily, ensuring also accomplishment of 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.

As at 31 December 2013	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	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

Notes to the financial statements (continued)

for the year ended 31 December 2013

As at 31 December 2012	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Deposits from customers	146,678	135,149	472,499	66,527	23,695	844,548
Due to banks	40,835	1,486	5,482	14,665	15,671	78,139
Hybrid instruments	925	-	121	120	26,410	27,576
Repurchase agreements	10,600	-	-	-	-	10,600
Other liabilities	8,162	1,028	1,731	195	1	11,117
Total liabilities (contractual maturity dates)	207,200	137,663	479,833	81,507	65,777	971,980
Total liabilities on unused loans (expected maturity dates)	6,060	1,232	6,310	18,235	88	31,925

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 others 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 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	1-3 years	Over 3 years	Total
	HRK'000	HRK'000	HRK'000	HRK'000
As at 31 December 2013				
Loan commitments	26,305	315	-	26,620
Guarantees, letters of credit and other	12,970	2,291	-	15,261
Nominal value of FX Forward	-	-	-	14,210
Total	39,275	2,606	-	56,091
As at 31 December 2012				
Loan commitments	13,602	18,235	88	31,925
Guarantees, letters of credit and other	15,193	365	-	15,558
Nominal value of FX Forward	-	-	-	14,210
Total	28,795	18,600	88	61,693

Notes to the financial statements (continued)

for the year ended 31 December 2013

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 transactions are 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 calls under guarantees 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 requirements, since many of these commitments will expire or terminate without being funded.

32.4. Fair values of financial assets and liabilities

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arm's length basis. Where available, fair value is based on quoted market prices. 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 underlying assumptions, 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.

Bank uses following hierarchy for determining fair value of financial instruments by valuation technique:

- level 1: quoted (unadjusted) prices 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

	31/12/2013			31/12/2012		
	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000
Bonds	62,470	-	62,470	21,644	-	21,644
Investments funds	-	-	-	464	-	464
Equity securities	304	141	445	463	141	604
	62,774	141	62,915	22,571	141	22,712

Notes to the financial statements (continued)

for the year ended 31 December 2013

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

	Carrying value		Fair value	
	2013	2012	2013	2012
	HRK`000	HRK`000	HRK`000	HRK`000
Financial assets				
Placements with banks	29,857	29,703	29,857	29,703
Loans and advances to customers	730,395	728,670	730,395	728,670
Held to maturity financial assets	2,666	3,262	2,666	3,262
Other assets	11,761	10,505	11,761	10,505
Total financial assets	774,679	772,140	774,676	772,140
Financial liabilities				
Deposits from customers	1,030,158	844,548	1,030,158	844,548
Due to banks	40,415	78,139	40,415	78,139
Hybrid instruments	58,282	27,576	58,282	27,576
Repurchase agreements	-	10,600	-	10,600
Other liabilities	11,721	11,117	11,721	11,117
Total financial liabilities	1,140,576	971,980	1,140,576	971,980

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) Financial assets held-to-maturity

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 ended 31 December 2013

(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 management

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

- to comply with the capital requirements set by the 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.

Capital adequacy and the use of regulatory capital are monitored by the Bank employing techniques based on the guidelines developed by the Basel Committee and the European Community Directives, as implemented by the Croatian National Bank (the Authority), for supervisory purposes. The required information is filed with the Authority on a quarterly basis.

In year 2012 the Central bank required each bank or banking group to: (a) hold the minimum level of the regulatory capital in the amount of HRK 40 million and (b) maintain a ratio of total regulatory capital to the risk-weighted asset (the 'Basel ratio') at the minimum of 12%, which is above the internationally agreed minimum of 8%.

Notes to the financial statements (continued)

for the year ended 31 December 2013

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

- Tier 1 capital: share capital (net of any book values of the treasury shares), and reserves created by appropriations of profit after tax, share premium and provisions for treasury shares.
- Tier 2 capital: qualifying capital and collective impairment allowances.

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

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

	2013	2012
	HRK'000	HRK'000
Tier 1 capital		
Share capital (less treasury shares)	366,728	336,408
Reserves from profit after taxation	1,013	1,013
Share premium	772	772
Reserves for treasury shares	476	476
Less: Accumulated loss and other deductions	(304,269)	(263,523)
Total qualifying Tier 1 capital	64,720	75,146
Tier 2 capital		
Hybrid instruments	57,282	26,531
Total qualifying Tier 2 capital	57,282	26,531
Total regulatory capital	122,002	101,677
Risk-weighted assets:		
Credit risk exposure	781,954	909,441
Operating risk exposure	82,640	75,202
Currency risk exposure	10,965	10,249
Total risk-weighted assets	875,559	994,892
Capital adequacy ratio	13.93	10.22

From 31 March 2010, ratio of total regulatory capital is set at the minimum of 12%.

Approval of financial statements

for the year ended 31 December 2012

33. Post balance sheet events

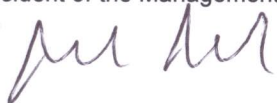
At the General Assembly meeting held on 17 March 2014, a decision was made to increase the share capital from the amount of HRK 291,084 thousand, by the amount of HRK 42,750 thousand, to the amount of HRK 333,834 thousand. Share capital has been increased by issuing 427,500 ordinary shares, each in nominal value of HRK 100, through hybrid deposits from its majority owner Cassa di Risparmio della Repubblica di San Marino S.p.A.

34. Approval of financial statements

Financial statements set out on pages 4 to 58 were approved by the Management Board on 31 March 2014.

Nicola Ceccaroli

President of the Management Board



Darko Kosovec

Member of the Management Board

