# J&T banka d.d.

# Annual report for the year 2018

J&T banka d.d.
J&T Finance Group
T: + 385 42 659 400
F: + 385 42 659 401
www.jtbanka.hr
E-mail: banka@jt.hr

## Contents

# Introduction

The annual report comprises a summary of operation and key financial indicators, a description of operation and the audited financial statements for the year ended 31 December 2018 together with the Independent Auditor's Report.

## Legal status

The Annual Report includes annual financial statements prepared in accordance with accounting legislation applicable to banks in the Republic of Croatia and audited in accordance with International Standards on Auditing.

The Annual Report has been prepared in accordance with the Accounting Act and Companies Act which requires the Management Board of an entity to report to shareholders at their annual General Assembly.

## Abbreviations

In the Annual Report, J&T banka d.d. is referred to as 'the Bank' or 'J&T', the Croatian National Bank as 'CNB', the Republic of Croatia as 'the Government' and the Croatian Bank for Reconstruction and Development as 'CBRD'. Other abbreviations may be used in report are:

F/Ss - financial statements
SFP - statement of financial position
SPL - statement of profit and loss
OCI - other comprehensive income
CC – currency clause
GDP – gross domestic product
IAS – International accounting standards
IFRS - International Financial Reporting Standards

In this report, the abbreviations "HRK thousand", "HRK million" or "EUR thousand" and "EUR million" represent thousands and millions of Croatian kunas and euros.

## Exchange rates

The following CNB middle exchange rates were used for translation of foreign currencies into Croatian kuna:

| | | |
|---|---|---|
| 31 December 2018 | EUR 1 = HRK 7.417575 | USD 1 = HRK 6.469192 |
| 31 December 2017 | EUR 1 = HRK 7.513648 | USD 1 = HRK 6.269733 |

# Macroeconomic environment and banking sector in the Republic of Croatia in 2018

## Changes in global environment

After a dynamic growth in the second half of 2017, global economic growth began to slow down during 2018. This slowdown became more visible during the current year with the rise of uncertainty on the global level due to intensified economic tensions and political risks.

That is particularly visible in the Euro-area, which had the slowest growth in the last few years in the third quarter of 2018. The slowdown of economic activities and the lack of a significant rise in raw material prices kept inflation on a relatively low level.

Due to accommodative monetary policies s, which still prevail in the majority of big global economies, the terms of financing remained relatively favourable, with the exception of some highly unstable emerging markets. Contrary to global trends, economic activity in the US became even stronger in 2018. The biggest contribution to the growth of American economy came from personal and government consumption, alongside capital investments. On the other hand, negative contribution to foreign trade also grew. A strong labour market continued to support personal consumption. The tax reform and the transfer of profits from previous periods from overseas to the US motivated by tax changes stimulated the growth in domestic demand.

After a mild slowdown in the second quarter, the economic growth in the Euro-area became even more slower by the end of 2018. The slowdown of growth was widely spread among member states (Germany, Italy, the Netherlands), while in a small number of states the growth accelerated. Increased global uncertainty and fluctuations in financial markets serve neither to economies of developing countries nor to emerging markets. For that reason, the economic crisis in Latin America continued to deepen. Despite intensified relations with the US, relatively favourable trends continued in big Asian emerging markets. Russia also continued to recover, and the higher prices of oil in relation to previous years favoured other oil exporting countries.

## Changes in Croatia

## Economic activity

According to the announcements and forecasts of the European Commission, the economic activity in Croatia slowed down, but also kept a positive direction in 2018.

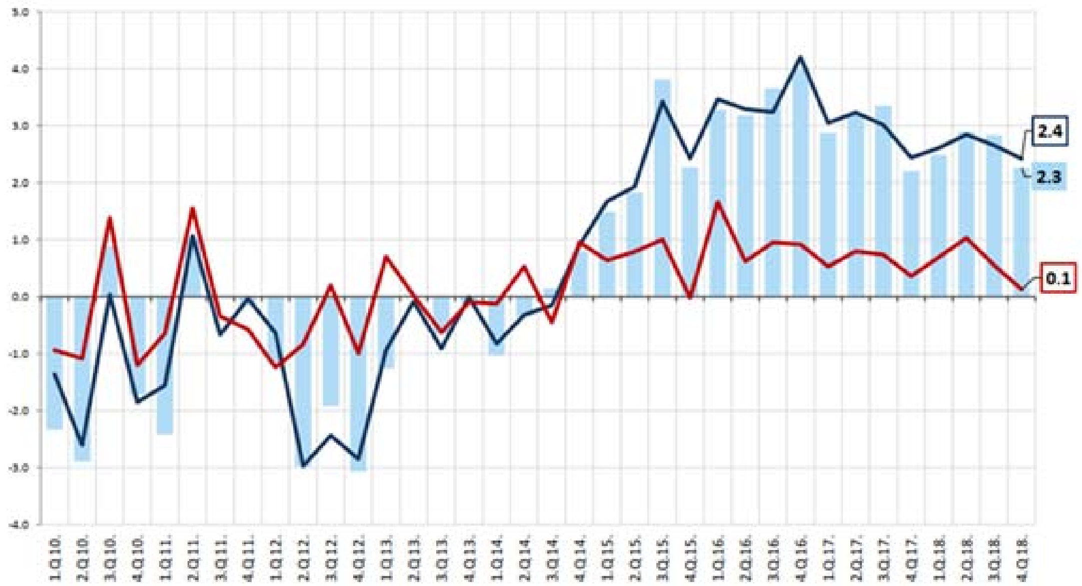
Considering that in all quarters of 2018, apart from the fourth, the annual growth rates were somewhat lower than in the same quarters of the previous year, a slight slowdown in GDP growth occurred in 2018, from 2.9% in 2017 to 2.6%.

The year was marked by a mild slowdown in growth on the global level and a somewhat more visible slowdown in growth on the EU level, which is the most important market for exports of goods and services from Croatia. According to the preliminary data, EU growth slowed down from 2.4% to 1.9% in 2017, with the growth of the most important export markets, those of Italy and Germany, slowing down from 1.6% and 2.2% to 0.8% and 1.5 %.. This led to a significant slowdown in the dynamics of growth of exports of goods and services from 6.4% in 2017 to just 2.5%, and this slowdown has led to this slowdown dynamics of GDP growth.

Personal consumption remains the main driver of growth. Private investments still have relatively favourable terms of financing, but recover more slowly. This slower recovery of investments is partly caused by the crisis in Agrokor, which took place during 2017 and partly in 2018.

Public investments are still falling behind due to slower withdrawal of funds from the EU funds. The unemployment rate is declining, but that must be taken with a grain of salt because the trend of emigration of the working-age population can affect the employment/unemployment statistics significantly.

Graph 1: Quarterly and annual rate of GDP growth from original and seasonally adjusted series




*Source: DZS*

**Labour market**

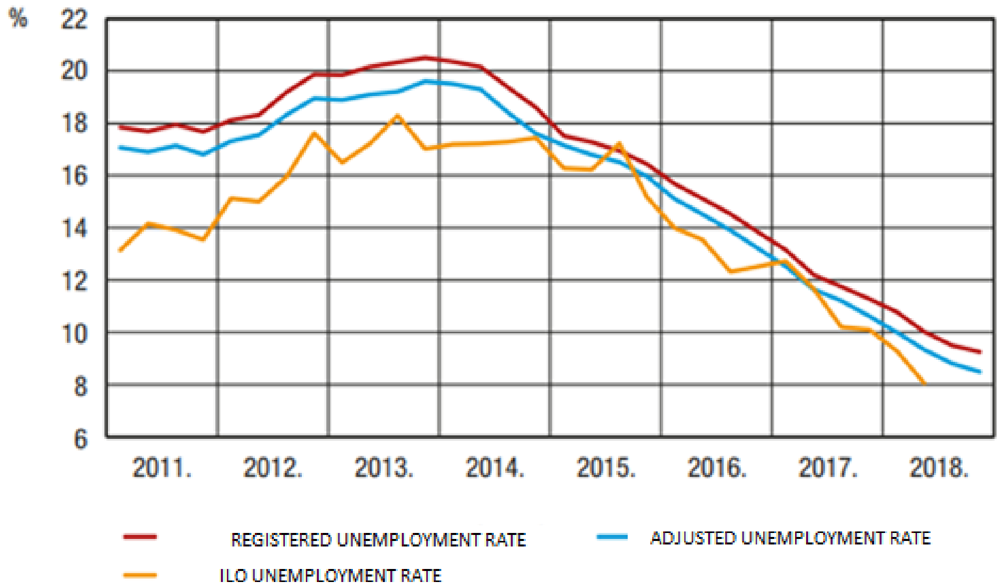
Favourable labour market trends continued during 2018. The number of employed people went up, with the biggest growth recorded in construction and other service industries. The employment growth was realized in all activities of the NCEA, except for financial and insurance activities, where there was a slight decrease in the number of employed people. On the other hand, the public sector was the strongest contributor to the growth in the number of employees.

The number of unemployed continued to decrease strongly during 2018. That decrease is a result of both new hires from the Croatian Employment Office records, as well as the deletion from records for other reasons related to non-compliance with statutory provisions and deletion due to not getting in touch with the Office.

Data from the Labour Force Survey is available only for the first six months of 2018, and it confirms the favourable movements on the labour market recorded in that period. It shows the unemployment rate decreasing from 9.3% in the first quarter to 8.0% in the second quarter of 2018.

When it comes to salaries, the data available shows a growth in nominal gross earnings in 2018. The data from national accounts suggests a rise of fees per employee, with labour productivity slightly decreasing, as the number of employees was slightly stronger than GDP growth. Such movements led to an increase in unit labour cost.

Graph 2: Unemployment rate



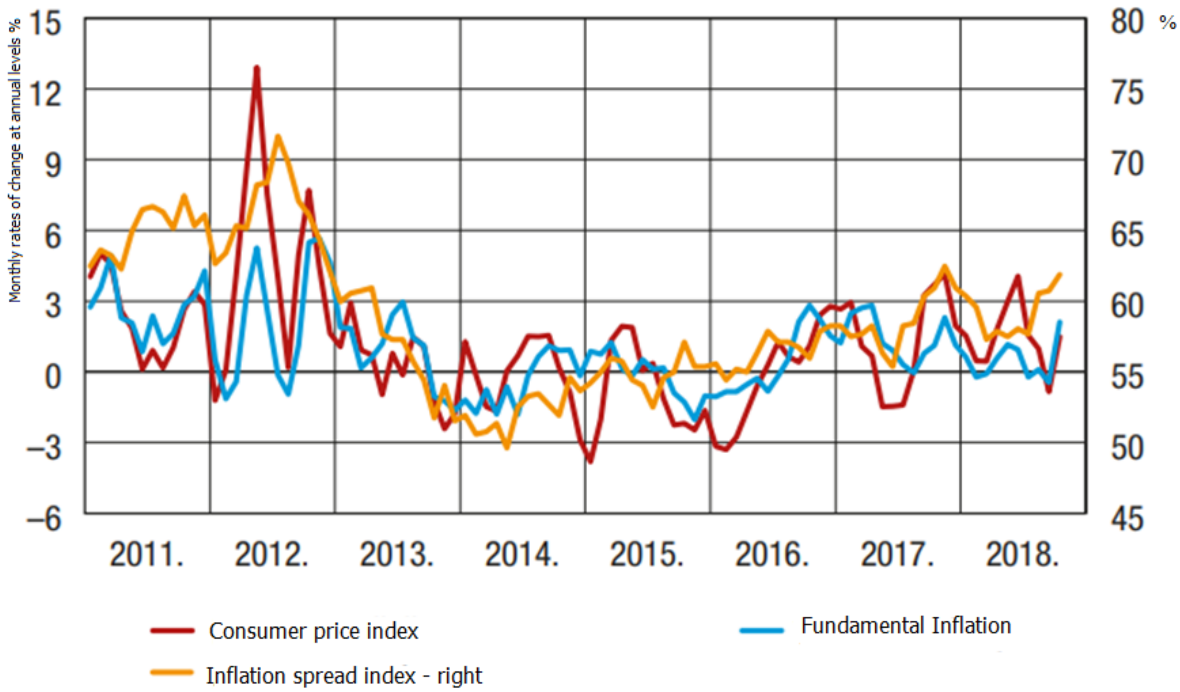

*Source: DZS*

**Inflation**

After the total inflation of consumer prices accelerated in the first half of the year, mainly due to annual growth rate of energy prices, the inflation decreased in the second half of the year. This was mostly contributed by the reduction in the annual rate of growth in energy prices and unprocessed food products.

At the level of the entire 2018, when compared to the previous year, all categories except Clothing and footwear (-1.3%) and Communication (-0.2%) recorded an average increase in prices. The year 2018 was marked by the continued strong import pressures from crude oil prices on the world market compared to the previous year. Energy is still the component that gives the highest contribution to inflation (1.0 percentage points), of which the predominant part refers to oil derivatives. The contribution of service prices to total inflation increased slightly in the last four months, which is a continuation of the trend present since mid-2017.
In the last four months the annual growth in communication, air transport, hospitality services and insurance prices has accelerated. Industrial products without food and energy are a component that has, for a long time, little contributed to inflation.

Graph 3: Fluctuation indicators of inflation



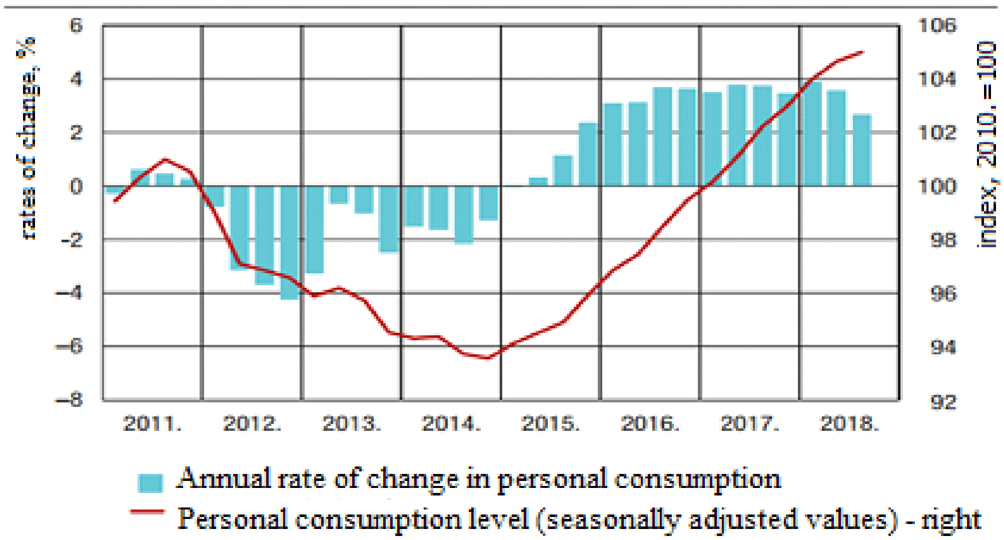

*Source: DZS, CNB calculations*

**Personal consumption**

Strong personal consumption and investments remain the main supporters of the Croatian economy. The biggest support to the growth of economy still comes from personal consumption, which is the largest GDP component at almost 60% and the largest share in the total consumption at approximately 40%. This is evidenced by retail trade turnover, which has been increasing annually for 52 months in a row.

The personal consumption growth slowed down in the third quarter of 2018 to 0.3%. This slowing down might be connected with the slowdown in payroll grow, while consumer optimism remained on high level. Household consumption grew for 2.7% on an annual level.

Graph 4: Personal consumption - real value




*Source: CNB Bulletin*

**Terms of financing and banking sector**

The banking system remains stable and highly capitalized, and the majority of its vulnerabilities arise from high levels of currency and currency-induced credit risk, high banking system concentration and concentration of credit institutions exposure to the state sector and groups of related persons from the non-financial sector.

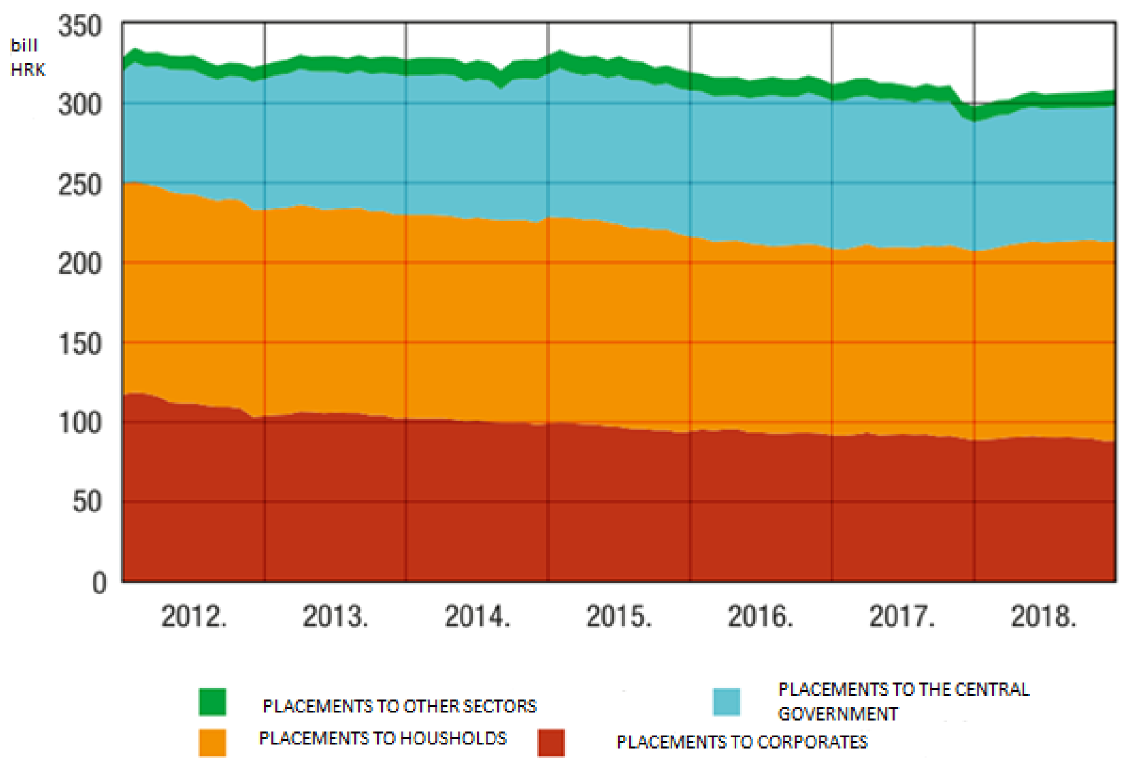
The growth of non-purpose loans in the last two years has made the largest contribution to the strengthening of household borrowing by credit institutions, accounting for approximately two-thirds of its total increase. Non-purpose loans grew by HRK 5.4 billion in 2018, which with the growth of HRK 2.9 billion recorded in 2017 and HRK 1.7 billion recorded the previous year clearly indicates a significant intensification of this form of lending. Thus, at the end of 2018, non-purpose loans accounted for almost 40% of total household loans, compared with 33% two years earlier.

During 2018, the credit activity of banks towards the private sector was more dynamic than in the previous year, as can be seen in data on the value of new jobs, which was higher in households (3.2%) and in nonfinancial institutions (19%). The balance of credit indebtedness of these two sectors shows different trends. The credit standing of households is growing nominally, while the sector of nonfinancial corporations is still deleveraging. This is affected by the dynamics of the sale of hardly performing and non-performing loans (risk groups B and C), which is much more visible in the non-financial corporation sector. In the first three quarters, banks sold B & C loans in the gross value of HRK 3.3 billion from the nonfinancial sector and 849 million from the household sector.
The year 2018 was marked by record high liquidity as a consequence of continued strong deposit growth, moderate credit activity and the pronounced appreciation pressures the central bank sought to curb by buying foreign currency from banks, creating an additional HRK 13.4 billion. The average liquidity surplus rose to HRK 25 billion, exceeding HRK 30 billion in the last month of the year, as a result of which there was no interest in regular reverse repurchase operations of the CNB and the demand on the interbank market was weak.

Interest rates recorded a slight decline. Zibor at overnight loans and dropped by 1 and 3 months on average by 10 b.b. on an annual basis at 0.3 and 0.4, or 0.5 percent, and 12M Zibor for 30 b.b. to 0.5 percent. Interest rates on treasury bills followed the trend, achieving a decline of 19 b.b. on six-month kuna (0.06 percent), 5 b.b. on one-year kuna (at 0.09 percent) and by 1 b.b. on one-year foreign currency-denominated currency bonds (at 0.00 percent).

Due to significant liquidity surpluses, the central bank maintained only one structural operation, with a HRK 1.4 billion kuna interest rate of 1.2 percent and a maturity of five years. Low interest rates on the domestic money market and the eurozone market, as well as an improved rating of the state, have led to falling yields and government bonds. The yield on the 10-year kuna bond dropped by an average of 60 bps, to 2.1 percent, and the spread to the German state bond was narrowed by 70 b.b. to 170 b.b.

Graph 5: Structure of credit institution placement




*Source: CNB Bulletin*

**Monetary policy**

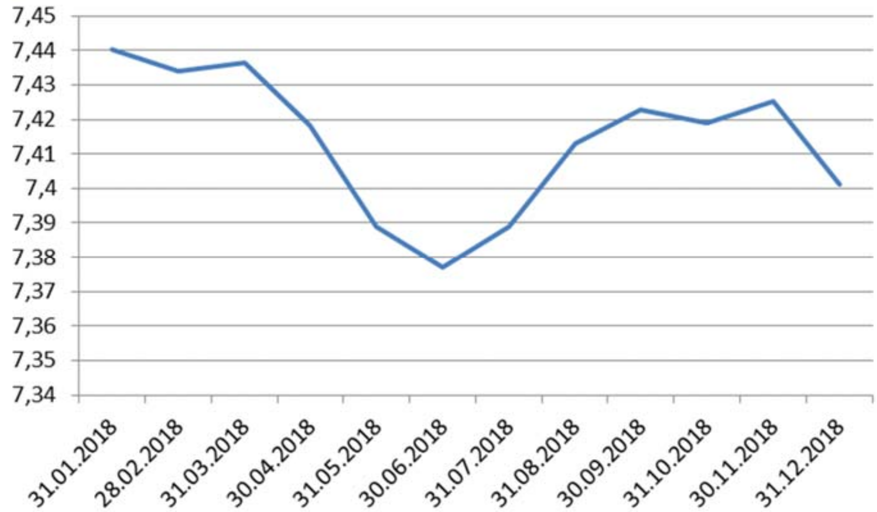
During 2018 CNB continued to lead expansive monetary policy. During January and May, due to appreciation pressures on the kuna exchange rate against the euro, the CNB intervened and redeemed EUR 1.2 billion from commercial banks (from the beginning of the year to the beginning of December a total of EUR 27.9 million was redeemed from the Ministry of Finance) and so the CNB created HRK 9.3 billion with all foreign exchange transactions.

When it comes to the kuna, the CNB continued to hold regular weekly repo auctions with a fixed repo rate of 0.3% (weak interest of banks for the excess of kuna liquidity in the monetary system).
In the first eleven months of 2018, the average surplus of kuna liquidity reached HRK 24.6 billion (which is HRK 9.4 billion higher than in 2017).

The average weighted interest rate on the overnight interbank market was 0.11%.
The exchange rate of the kuna against the euro at the end of November 2018 was 7.42 EUR / HRK, which is by 1.7% lower than in the same period last year, while the average exchange rate in the first eleven months of 2018 was lower by 0.5% when compared to the same period last year.

Monetary policy will remain an expansive character with the continued maintenance of a stable kuna-euro exchange rate.

Graph 6: Average FX rate EUR/HRK in 2018




*Source: Reuters*

# Management report

J&T banka d.d. is registered as joint-stock company at the Commercial Court in Varaždin under registration number (MBS): 50000185, with its registered office in Varaždin, Aleja kralja Zvonimira 1, for the performance of the following activities:

- accepting deposits or other repayable funds from people and approving credits from those funds, for own account;
- accepting deposits and other repayable funds;
- approval of loans and credits, including consumer credits and loans, and mortgage credits and loans, if it is allowed by a special law, and financing commercial activities, including export financing based on discount repurchase and without reimbursement of long-term unmatured claims ensured by financial instruments (forfeiting);
- purchase of receivables with or without recourse (factoring);
- finance lease;
- issuing guarantees and other warrants;
- trading for own account or for the client's account:
  - money market instruments,
  - transferable securities,
  - foreign currencies, including exchange transactions,
  - financial futures and options,
  - currency and interest rate instruments,
- payment services in line with special laws;
- services related to crediting, e.g. collection of data, conducting analyses and providing information on creditworthiness of legal and natural persons who conduct business activities on their own;
- issuing other payment instruments and managing them, in line with a special law, unless provision of these services is not considered provision of payment services in line with special laws;
- renting safe boxes;
- mediation in money market transactions;
- investments and other services and activities in accordance with separate laws regulating capital markets, as follows:
  - trading for own account,

As at 31 December 2018, the Bank operates through 2 branches (Varaždin, Zagreb).

The Bank performs most of its business activities in the territory of the Republic of Croatia while only a small part of its business is carried out with non-residents.

Total revenue for the Bank in 2018 amounted to HRK 65,780 thousand.

The Bank employs 71 full- time workers.

Profit in 2018 amounted to HRK 830 thousand and the Bank did not have any obligation to pay taxes on profits.

In 2018, the Bank did not receive public subsidies.

## MISSION

Our individual approach to each client and our top quality and professional services, based on the competencies of our employees, creates added value for our clients. This contributes to the growth of our organization and the improvement of the quality of life of our community. We appreciate the personal contribution of all of our employees whose creativity and knowledge are our greatest values.

## VISION

Our vision is to continuously exceed expectations and be the first to innovate and create new values. We want to be a leader in creating world-class financial solutions for our customers and be the best in providing growth and development opportunities to all our employees.

## Financial performance

Bank operations in 2018 were marked by changing business strategies and putting the focus on larger corporate clients. Total share capital amounts to 307,085,400.00 HRK and the ownership share of J&T Bank a.s. Prague 82.55%.

In 2018 Bank generated HRK 45.3 million of interest income, while interest expenses amounted to HRK 16.9 million. Net interest income amounted to HRK 28.4 million, which is a decrease compared to 2017 by HRK 11.8 million. Part of the reason for this reduction lies in the fact that there has been slight reduction on interest rates on both loans and deposits in 2018, and there was also a decrease in the volume of the Bank's credit portfolio for the collection and repayment from customers outside the Bank's strategy. Portfolio of loans and advances to customers on 31.12.2018 and 31.12.2017. amounted to HRK 504.1 million and HRK 642.7 million, respectively.

Securities portfolio at 31.12.2018 amounted to HRK 244.7 million and was HRK 21.2 million lower than the end of the previous year.

By the beginning of 2018, the Bank implemented IFRS 9 (Financial Instruments) and established impairment allowance in accordance with the Standard and internal methodology. The initial effect of the Standard introduction amounted to HRK 7.7 million and was stated at the accumulated losses.

Net fee and commission income in 2018 amounted to HRK 8.3 million and was HRK 3 million higher than in the previous year (2017 HRK 5.3 million) mainly due to the increased share of fees charged for mediating loan approvals from foreign credit institution.

Administrative costs and depreciation amounted to HRK 20.5 million, HRK 1.7 million lower compared with the previous year as a result of the active management of the Bank's expenses.

Impairment losses of loans to customers of the Bank records value adjustments in the net amount of HRK 8.2 million, while last year amounted to HRK 51.9 million. The depreciation of property, plant and equipment in 2018 was carried out in the amount of HRK 0.8 million. Profit for the current year after the value adjustment amounts to HRK 0.8 million (the same period last year was a loss of HRK 29.1 million).

The most significant share of the funding structure of the Bank comprise term deposits which amounted to HRK 766.5 million at 31 December 2018 and comprise 70.9% of total sources of funding, while the share capital and reserves of the Bank as at 31.12.2018. amounts to HRK 129 million and comprise 11.9% of total sources of funding.

As at 31.12.2018. the Bank's total assets amounted to HRK 1,080.5 million (HRK 1,274.5 million at 31 December 2017).

## Retail sector

In 2018. Retail banking was performed through 2 branches on domestic market (Varaždin and Zagreb) and on German market, where the Bank has been permitted by regulator BaFin (Die Bundesanstalt für Finanzdienstleistungsaufsicht) to provide services of collecting deposits from customers abroad in cooperation with Deposit Solutions (before: Savedo Gmbh).

In line with its strategic focus, Bank has completely stopped providing consumer loans from the beginning of 2018., following changes in the relevant regulatory/legislative framework, which had made terms and approval processes for (housing) consumer loans more stricter. Accordingly, Retail/consumer loan portfolio decreased by HRK 42.6 million or 40% in 2018.

Variable interest rates on existing retail loans has followed decrease of NRS (National Reference Rate - 6M NRS1) in 2018., all in-line with the Bank's Principles for Determining Variable Interest Rates on Retail Loans. In 2018 value of 6M NRS1 has decreased by 0.16 pp for HRK loans and 0.22 pp for EUR loans.

The average interest rate on retail deposits in 2018 dropped for 0.21 pp for deposits in HRK and 0.04 pp for deposits in EUR, as a result of a continuous decrease of interest rates on retail term deposits in order to aligning with market trends. Despite, Retail deposit portfolio increased by HRK 12.2 million, or 2%.

Average interest rate, on term deposits which Bank collects in cooperation with partner Deposit Solutions, was increased for 0,16 pp, due to gradual abandoning of this financing resource channel, whilst deposits with shorter maturity and having/carrying lower interest rate have been regularly withdrawn. As a result, the volume of deposits, in cooperation with Deposit Solutions, was decreased by HRK 49.5 million in 2018. or 57.5%.

During the year Bank has implemented EBA Guidelines on product oversight and governance arrangements for retail banking products (further: EBA Guidelines), meaning that Bank has developed a system and processes for fulfilling requirements which are arising from the EBA Guidelines and supervision of the entire system.

## Corporate sector

Despite the ongoing outflow of existing clients that are not part of the Bank's strategy, the first five months of 2018 were marked by a gradual increase in portfolio (over 15% in that period). Due to the disposal and sale of part of the NPL portfolio, and due to the regular outflow of clients which are out of the Strategy, the portfolio was reduced in the second half of 2018. Although such a significant decrease in portfolio was not fully compensate with new placements, compared to the previous year, the portfolio quality was significantly increased with resolving NPL clients.

With the goal of increasing the placements and achieving the planned volume of the portfolio, intensively are working and preparing more projects of a significant amount. Due to regulatory restrictions, in some planned loans will be included other members of the J&T Group in financing. Partial contribution to revenue growth is expected through approvals of syndicated loans. Consequently, in 2019 is expected growth in interest income, but also growth of income from services provided by syndicated and participated loans.

The growth strategy of the portfolio in the Corporate Banking Department continues in the planned volume, and the first significant results are expected in the first half of 2019.

## Treasury activities

Trends in Croatian money markets continued in 2018. The country GDP after growth in 2017, continued to grow in 2018. Monetary policy of Croatian central bank with incentive of negative inflation rates, stayed expansive. Central bank continued to increase HRK liquidity announcing the structural and regular repo auction showing that it will support credit activity in domestic currency. Adding to that was aggressively loose ECB monetary policy so it is clear that money markets interest rates where under strong deflationary influences both in Eurozone and Croatia.

Liquidity in Croatian and Eurozone banking system stayed elevated in 2018, although the benchmark interest rates slightly increased. For example 6 month EURIBOR rate rose from -0.271% at the beginning of the year all the way to negative -0.237% at the year end. Slow decreasing trend in banking financing costs also continued in HRK and other currencies as well so the Croatian banking association 12-month national benchmark banking sector average financing rate (NRS) for Kuna and Euro fell in third quarter to 0.46% and 0.63% for EUR respectively.

Although spread between Croatian and benchmark German bonds grew a bit, widespread reduction in European yields led to further decline in Croatian sovereign bond yield so the yield on longest domestic bond indexed to EUR ended the year at around 1.45%. Yield on domestic bonds in HRK decreased a bit, only and yield on longest domestic bond in HRK increased and ended the year around 3.06%.

In 2018 the trend of the decreasing exchange rate of the euro against the HRK continued. After a streak of yearly drop in value of HRK against the common European currency, in last two years there has been a slight increase. In 2018 the average annual rate was about 7.414 which is lower than 2017 when it was about 7.455.

Having macro environment in mind all through the year the Bank held high portion of liquid assets in its balance sheet at the same time with decrease of liabilities constantly reducing its financing cost.

In 2018 the Bank had HRK 3.8 million of securities trading income, and in 2017 this income was HRK 5.6 million. FX gains amounted to HRK 1.8 million in 2018, which is HRK 0.5 million less than in 2017, due to lower volume on FX Market.

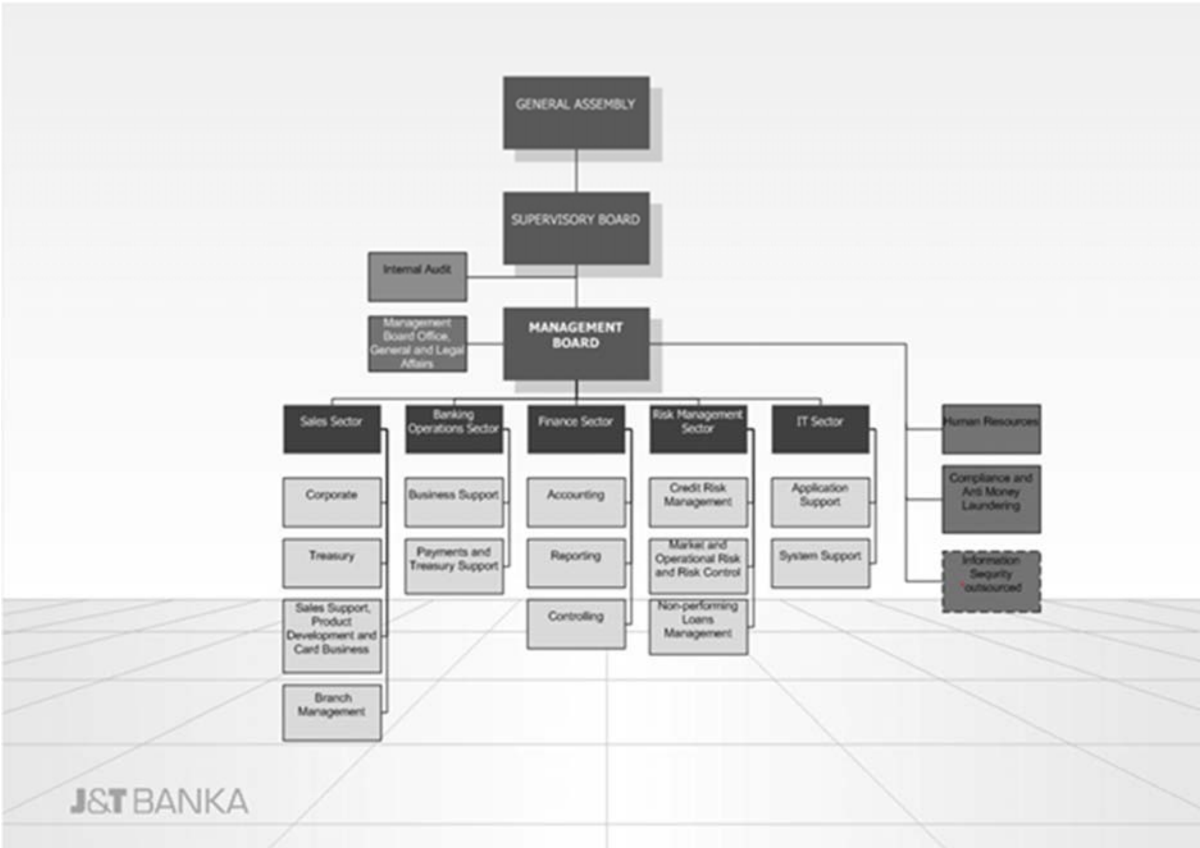
## Employees and organizational structure

During 2018, Bank's business took place in Bank's headquarter in Varaždin, branches in Zagreb and Varaždin and office in Zagreb.

In 2018, the Bank made the final decision and carried out activities following decisions made at the end of 2017 concerning the collective surplus of employees. The Bank analysed and complied all acts which defining the organizational structure and job descriptions and removed certain unnecessary positions from the Catalogue of job descriptions. Marketing activities were abolished and taken over directly by the Management Board. The organizational scheme itself has been minimally changed.

On December 31, 2018 Bank had 71 employees (92 employees on December 31, 2017). Even though the number of employees has decreased, the Bank continued with investments in education and specialization of employees.

## Organizational scheme




## IT development

Most activities in application development during 2018 were focused on adaptation of OLBIS system (especially Internet banking) as well as fulfilling legislative and regulatory demands and reports. OLBIS (Online Bank Information System) is an integral bank information system, which now consolidates all application modules of 'core' system, as well as full regulatory reporting.

During 2018 several significant modules were implemented or processed:

- IFRS 9 - new Risk Calculation Methodology and Standard Implementation
- GDPR - system analysis and refinement according to project requirements
- Securities - a new method of accrual
- Syndicated loans – enhancement
- Euro NKS - change XSD scheme
- PSD2 - analysis and preparation of the PSD2 project
- SPN - enhancement
- CNB reporting - changes by COP, DOP, FATCA, CRS and TSSP reports according to regulatory requirements
- PAD Directive - Reporting on Representative Services

Regarding infrastructural segment, the most significant was the upgrade of server operating systems and system support in the area of information security and GDPR requirements. Other activities were aimed at supporting organizational changes in the Bank and the physical transfer of employees at the central location.

During the second part of the year preparations for replacing the central firewall were carried out, analysis of system requirements for the PSD2 project were carried out and support was provided to develop a new Business Impact Analysis (BIA) and a new Business Continuity Plan (BC plan).

## Internal controls system and internal audit

The internal controls system is a set of processes and procedures set up to adequately control risks, monitor efficiency and performance of the Bank's operations, the reliability of its financial and other information, and compliance with regulations, internal acts, standards and codes in order to ensure the stability of the Bank's operations.

In accordance with the Credit Institutions Act and the Decision on the internal controls system, the Bank established an internal controls system comprising the following:

1. appropriate organisational structure;
2. organisational culture;
3. adequate control activities and segregation of duties;
4. appropriate internal controls integrated into business processes and activities of the credit institution;
5. appropriate administrative and accounting procedures;
6. activities within the scope of the control functions of the credit institution.

The Bank prescribed and established adequate control activities and segregation of duties, adequate internal controls and appropriate administrative and accounting procedures carried out in course of the Bank's regular operations.

In accordance with provisions of laws and by-laws, the Bank established three control functions independent of the business processes and activities in which risk occurs, i.e. which the functions monitor and supervise. These are:

1. the risk control function;
2. the compliance monitoring function;
3. the internal audit function.

The risk control function ensures the Bank's compliance with risk management strategies and policies by performing risk analysis, monitoring risk, reporting risk-related information to the Management Board and other persons, and participating in the preparation, application and monitoring of the functionality of risk management methods and models. It also carries out the evaluation of the Bank's internal capital adequacy and controls the preparation of the Bank's recovery plan.

The compliance monitoring function ensures the compliance of the Bank's operations with relevant regulations, standards and codes and internal acts. The compliance monitoring function is responsible for: determining and assess compliance risks to which the Company is or might be exposed; advising the Management Board and other responsible persons on the application of relevant legislation, standards and rules; assessing the effects that changes to relevant regulation will have on the Bank's operations; verifying the compliance of new products and procedure with relevant legislations and regulations as well as with related amendments; serving as advisor in the preparation of compliance-related training programs.

The internal audit function, as part of the internal controls system, assesses and evaluates the following: adequacy and efficiency of the internal controls system; adequacy and efficiency of risk management and risk assessment methodologies; efficiency and reliability of the compliance monitoring function; system for informing the Management Board and key management; adequacy and reliability of the accounting records system and financial statements; strategies and procedures for assessing internal capital adequacy; reliability of the reporting system and the timeliness and accuracy of reports set out in the Credit Institutions Act; asset safeguarding; collection system and validity of information that is made public. It also reviews the IT system and performs all other tasks needed to achieve the objectives of internal audit.

Each control function prepares reports in line with their tasks and established operational work plans, in accordance with provisions of the Credit Institutions Act and regulations and decisions issued based thereon.

## Financial reporting control system

The Bank has ensured the internal control systems of the accounting system and financial reporting, risk management system and the reliability of the information system covering all the major Bank's activities. In addition, the Bank hired an external auditor and has applied previous, current and subsequent financial supervision of the financial reporting and decision-making process.

The accounting system, based on the International Accounting Standards and the International Financial Reporting Standards prescribed by the Accounting Policies of the Bank, is regulated by the Accounting Rules that define rights, obligations and responsibilities of all the participants, including the obligation of ongoing monitoring, while the functioning of the other systems is governed by special standard regulations.

The Bank's internal control system includes efficient direct monitoring through integrated procedures and processes set for monitoring the efficiency of the Bank's operations, reliability of financial reports and compliance with the laws and by-laws. The Bank's internal control system is established through parallel operating of three mutually independent functions: (a) risk control function, (b) compliance monitoring function, and (c) internal audit function.

## Research and development

The Bank capitalizes intangible assets. Intangible assets include internally developed software of total capitalised value of HRK 18.5 million. The Bank uses software in its business, and it is transferred to use according to the stage of completion.

Expenditure related to the development of software is capitalised when it meets the criteria outlined in IAS 38 Intangible Assets.

## Information relating to treasury shares repurchase

The Bank has 590,338 treasury shares as at 31 December 2018.

## Subsidiaries information

The Bank has no subsidiaries.

## Development plan

The Bank plans to create a prerequisite to continue its positive business after an exceptionally negative series has been interrupted in the past years, with the introduction of additional tools and criteria when approving placements, to ensure adequate quality and portfolio growth diversification. The focus of the business is the corporate market segment, primarily the financing of real estate, project financing, financing from the domain of investment banking, financing of renewable energy sources and financing of client restructuring, as well as financing of other activities in which the J&T  has previous experience, at the sole level of J&T banka dd , or J&T Finance Group in its entirety. The targeted level of funding is at least EUR 1 million at client / group level. The basis of business is individual access to clients and the creation of banking products according to their needs, with adequate risk management associated with certain segments of financing.

In the forthcoming period, the Bank plans to further improve the credit risk management process within the Bank, ie to establish stronger risk control measures, related to asset growth and concentration risk. It is planned to set up a more transparent system for approving and tracking financing items in accordance with the type of financing, as well as additional alignment of the concentration limits with the planned credit focus of the Bank. Further improvement of the process of charging problematic placements through The prevention (improvement of early warning signs of increasing credit risk and concentration on early payments), and further reduction of the volume of bad placements, both through regular collection of restructured exposures and through the sale of part of the portfolio where the Bank has exhausted all billing options from the cash flow. Control of optimized operating costs and keeping these costs roughly at the 2018 level.

The mission is to build a strong and stable bank in the Croatian market aimed at prosperous clients who are able to provide their own resources as well as the contribution of external bodies when financing the realization of certain projects. In the domain of legal entities, there are clients who do not rely solely on financing the Bank during the realization of projects or investments but participate in the investment and with adequate own engagement in the form of financing and risk taking. Through its customer intimacy, the Bank will focus its focus on well-known and reputable unquestionable clients with a long-term perspective, striving to offer them a complete solution in solving their financial needs. Given the limiting factor of the overwhelming amount of funding, the Bank has realized further plans to cooperate with the matrix for syndicated loans, with which it is possible to lend clients with the need for a larger amount of funds than it allows the Bank's capital.

## Risk management

The most significant types of financial risk to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk. Market risk include foreign exchange risk, interest rate risk and risk of changes in market prices of equity and debt securities.

An integrated risk management system is being developed and constantly upgraded on the Bank level by introducing policies and procedures for risk assessment, measurement, control and management, and for determining the risk exposure limits compliant with the legal framework and the Bank's risk profile.

## Credit risk

The Bank is exposed to credit risk through its trading, lending and investing activities and in cases where it acts as an intermediary on behalf of a client or third party or when issuing guarantees. The risk of default which occurs in financial instrument transactions with certain parties is constantly monitored. To manage credit risk, the Bank deals with clients of good credit standing and obtains security instruments in order to, as a rule, secure the repayment of placement by two independent instruments (cash flow and collateral).

Credit risk is managed in line with the Bank's policies. Credit exposure toward a portfolio or specific groups is regularly reviewed in accordance with established limits. The competent bodies of the Bank responsible for approving limits are regularly informed of limit utilization. The Credit Committee approves all material increases in credit exposure and issues all decisions related to credit risk.

## Liquidity risk

Liquidity risk arises in the funding of the Bank's activities and in the management of its positions.

The Bank has access to different sources of funding. Funds are collected through a variety of instruments, including different type of deposit, borrowings, dependent liabilities, including deposits, borrowings and equity. The Bank is systematically working on defining the procedures and business processes that efficiently monitor liquidity risk by detecting and monitoring changes in funding in order to achieve business objectives set in accordance with the overall business strategy of the Bank.

The Bank adapts its business activities related to liquidity risk in accordance with legal provisions and internal policies for maintaining liquidity reserves, matching assets and liabilities and limit control, and with targeted liquidity ratios and contingency plans. The Treasury manages liquidity reserves on a daily basis and ensure that all of the client's needs are successfully met.

## Market risk

Market risk management entails position and foreign exchange risk management. In order to manage position risk defined as the risk of loss arising from the change in the price of a financial instrument, a limit system has been established according to the type of financial instrument and issuer. Limit utilization is monitored on a daily basis.

Foreign exchange risk, defined as loss arising from the change in exchange rates of a relevant foreign currency due to the currency gap in the balance sheet, is managed by the Bank on a daily basis in accordance with legal provisions related to the open foreign exchange position.

Interest rate risk represents the sensitivity of the Bank's financial position to movements in interest rates. The Bank's operations are influenced by interest rate risk to the extent that interest-bearing assets and liabilities mature, or their interest rates change at different points in time or in different amounts.

## Operational risk

Operational risk exists in every segment of the Bank's operations, requiring knowledge and continuous monitoring of all business processes. The organizational model of the operational risk management process is conceived at the level of centralized and decentralized functions of operational risk management. It is carried out in accordance with legal provisions, Basel guidelines and internal acts (policies, procedures and methodologies for operational risk management).

In the context of managing operational risk of the information system, IS security management entails a series of periodic activities whose aim is to reduce operational risk of the Bank's information system, or more precisely, to implement control mechanisms, improve business processes and harmonize with legislation in order to reduce damages that vulnerabilities can cause in the Bank's information system.

In order to manage operational risk, the Bank has provided appropriate risk management for risk management, information system risk, risk model, risk to project management, risk management related to outsourcing, risk management compliance, business changes, including business risks, new products, activities, processes and systems, significant inherent risks in existing products, activities, processes and systems, and business continuity management. The Bank has provided an appropriate system for preventing money laundering and financing of terrorism.

Policies for managing financial risk are described in detail in Notes to the Annual Report for the year 2018.

For and on behalf of J&T banka d.d. Varaždin:

Hrvoje Draksler, President of the Management Board

J&T BANKA d.d.

1

Petar Rajković, Member of the Management Board

# Responsibilities of the Management Board and Supervisory Board for the preparation and approval of the annual report

The Management Board is responsible for preparation of financial statements for each financial year which fairly present, in all material respect, of the financial position of J&T banka d.d. ("the Bank") and of its operation and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for a taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting appropriate accounting policies to conform with the applicable accounting standards and then apply them consistently; make judgements and estimates that are reasonable and prudent; and preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business

The Management Board is responsible for submission to the Supervisory Board of its annual financial statements, following which the Supervisory Board is required to approve the annual financial statements for submission to the General Assembly of Shareholders for adoption.

The Management Board is also responsible for the preparation and fair presentation of the supplementary information prepared in accordance with the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of credit institutions (Official Gazette 42/2018).

The financial statements set out on pages 28 to 110 as well as supplementary schedules for the Croatian National Bank, set out on pages 111 to 118 and reconciliation, set out on pages 119 to 127 were authorised by the Management Board on 30 April 2019 for issue to the Supervisory Board and are signed bellow to signify this.

The Management Board is also responsible for the preparation and content of the Management Report as required by the Croatian Accounting Law, and for other information comprises of the Introduction, the Macroeconomic Environment and Banking Sector in the Republic of Croatia in 2018 set out on pages 3 to 10 and the Management Report presented on pages 11 to 19 were approved by the Management Board on 30 April 2019, and are signed bellow.

For and on behalf of J&T banka d.d.:

Hrvoje Draksler, President of the Management Board

J&T BANKA d.d.

1

Petar Rajković, Member of the Management Board

# Independent Auditors' report to the shareholders of J&T banka d.d.

## Report on the Audit of the Financial Statements

### *Opinion*

We have audited the financial statements of J&T banka d.d. ("the Bank"), which comprise the statement of financial position of the Bank as at 31 December 2018, and the statements of comprehensive income, cash flows and changes in equity of the Bank for the year then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as "the financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2018 and of its financial performance and its cash flows for the year then ended in accordance with statutory accounting requirements for credit institutions in Croatia.

### *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in Croatia and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Key Audit Matters*

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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

# Independent Auditors' report to the shareholders of J&T banka d.d. (continued)

## Report on the Audit of the Financial Statements (continued)

### Impairment of loans and advances to customers

As at 31 December 2018, gross loans and advances to customers in the financial statements amount to HRK 563,691 thousand, impairment allowance amounts to HRK 56,597 thousand and impairment loss recognised in the income statement amounts to HRK 8,166 thousand (31 December 2017: gross loans and advances to customers: HRK 842,887 thousand, impairment allowance: HRK 195,855 thousand and impairment loss recognised in the income statement for the year then ended: HRK 51,852 thousand).

Refer to pages 35 to 38 (Basis of preparation), pages 45 to 50 (Significant accounting policies), pages 83 to 84 (Significant accounting estimates and judgements), pages 57 to 67 (credit risk section) and page 89 (note 11 Loans and advances to customers).

| Key audit matter | How our audit addressed the matter |
|---|---|
| Impairment allowances on loans to customers represent Management Board's best estimate of the expected credit losses on the loan portfolios at the reporting date. This area is determined to be a key audit matter as the determination of the appropriate amount of impairment losses requires from Management Board the application of significant judgement and use of subjective assumptions over both the timing of recognition and the amounts of any such impairment.<br><br>Additionally, as at 1 January 2018, the Bank applied the new Croatian National Bank (the CNB) provisioning regulations, which partially incorporate the requirements of new financial instruments standard, IFRS 9 Financial Instruments (dual-measurement approach, under which the impairment allowance is measured as either 12-months expected credit losses or lifetime expected credit losses, depending on whether there has been a significant increase in credit risk since initial recognition), whose impairment requirements are based on the expected credit loss (ECL) model rather than the incurred loss model, as previously used. New CNB provisioning regulations also prescribe minimum provisioning percentages in certain cases as well as the minimum haircuts to be applied on the estimated value of collateral and minimum period of realisation of collateral.<br><br>Following the initial application of the provisioning regulation, impairment allowances for performing exposures (Stage 1 and Stage 2 in the IFRS 9 hierarchy) and non-performing exposures (Stage 3) below HRK 200 thousand individually (together "collective impairment allowance") are determined by modelling techniques, except for performing exposures LGD parameter for exposures above HRK 1 million which is calculated individually based on different scenario assumptions. | Our audit procedures in this area included, among others:<br><br>• Inspecting the Bank's new ECL impairment provisioning methodology and assessing its compliance with the relevant requirements of the CNB.<br>• Assessing and testing the design, implementation and operating effectiveness of selected key controls over the approval, recording and monitoring of loans, including, but not limited to, the controls relating to the identification of loss events and default, appropriateness of the classification of exposures into performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the impairment allowances;<br><br>• With respect to the impairment accounting under the new regulations:<br>- Understanding the overall transition process activities and controls, including the process and controls over determining the impact as well as the underlying process activities that generated the related disclosures;<br>- Assessing whether the definition of significant increase in credit risk and default are appropriate and whether the new CNB's staging criteria were consistently applied;<br>- Obtaining the relevant forward-looking information and macroeconomic projections used in the Bank's ECL assessment. Independently assessing the information by means of corroborating inquiries of the Management Board and inspecting publicly available information;<br>- Performing an analysis of the ECL-based impairment allowances as at the new regulation's initial application date, to those calculated at that same date in accordance with the previous standard, and assessing their reasonableness based on inquiries of the credit risk management personnel;<br>- Challenging LGD and PD parameters used by the Bank, by performing back-testing of historical default and by reference to historical realized losses on defaults;<br>- Assessing whether the minimum impairment allowance requirements as prescribed by the CNB have been met. |

## Independent Auditors' report to the shareholders of J&T banka d.d. (continued)

### Report on the Audit of the Financial Statements (continued)

**Impairment of loans and advances to customers (continued)**

| Key audit matter | How our audit addressed the matter |
| --- | --- |
| Historical experience, identification of exposures with a significant deterioration in credit quality since origination, forward-looking information and management judgment are incorporated into the model assumptions.<br><br>Expected credit losses for individually significant non-performing exposures (those in excess of HRK 200 thousand, individually) from Stage 3 are determined on an individual basis by means of a discounted cash flows analysis. The process involves a certain level of subjectivity and reliance on a number of significant assumptions, including those in respect of the probable sale proceeds from the related collateral and minimum period for collateral disposal. These are based on the Bank's own historical experience, also considering specific guidance of the Croatian National Bank (CNB) regarding minimum haircuts to be applied on the estimated value of collateral. | • For impairment allowances that are calculated individually, selecting a sample of loans and advances, based on their magnitude and risk criteria, such as watchlisted, restructured or rescheduled exposures and non-performing loans with low provision coverage. For the items selected:<br>- assessing the existence of any triggers for classification to Stage 2 or Stage 3 as at 31 December 2018 by reference to the loan files and through discussions with the risk management personnel;<br>- for those loans where triggers for classification in Stage 3 were identified, challenging key assumptions applied in the Management Board's estimates of future cash flows used in the impairment calculation such as discount rates, collateral values and realization period, and performing respective independent recalculations and assessment, where relevant.<br><br>• For non-performing unsecured exposures, testing whether the Bank applied internally prescribed loss rates based on days in arrears and whether those are in line with the CNB requirements;<br><br>• We assessed the financial statement disclosures arising on implementation of new classification, measurement and impairment for expected credit losses methodology. |

## Report on the Audit of the Financial Statements (continued)

### *Key audit matter (continued)*

**Going concern basis of accounting**

Refer to page 38 (Basis of preparation – Going concern) and page 80 (Capital adequacy)

| Key audit matter | How our audit addressed the matter |
|---|---|
| The Bank's financial statements are prepared on a going concern basis. In 2018, the Bank reported a net profit in the amount of HRK 830 thousand (2017: net loss of HRK 29,073 thousand), and as at 31 December 2018 had accumulated losses of HRK 203,917 thousand (31 December 2017: accumulated losses of HRK 197,235 thousand). As at 31 December 2018 accumulated losses include HRK 7,689 thousand of first-time adoption effect of new regulation related to ECL. The effect of new impairment regulations for the purposes of calculation of regulatory capital will be recognised during the 5-year period.<br><br>Due to the losses reported in previous periods, since 2014, the Bank has received several capital injections from the majority shareholder in order to maintain its capital adequacy ratio at least at the minimum level required by the CNB. As disclosed in Note 4.1.5, the Bank's capital Tier 1 adequacy ratio as at 31 December 2018 amounted to 17.11%. Although the ratio is above the CNB's minimum prescribed level, potential future losses without adequate capital support may erode the capital base. The above factors were identified by the Bank as events and conditions that may cast significant doubt on its ability to continue as a going concern.<br><br>The Bank's going concern assessment was based on profit and loss forecasts, as well as liquidity plans. The preparation of these forecasts and projections incorporated a number of complex assumptions and required the Management Board to apply significant judgment. The Bank's going concern assessment is also based on the expected continued support from the majority shareholder in a form of further capital injections or subordinated loans which may be used in order to strengthen the capital base.<br><br>The above, in the Management Board's view, supports the assertion that the Bank will have sufficient resources and adequate capital to continue as a going concern for a period of at least 12 months from the reporting date. The Management Board concluded that the range of possible outcomes considered at arriving at this judgment does not give rise to material uncertainties related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. Note 2 g) to the financial statements further explains how the judgment was formed by the Management Board.<br><br>The Bank's use of the going concern basis of accounting is a key audit matter due to the associated extent of uncertainty, and consequently, high level of judgment required in evaluating the Bank's plans for future actions and their financial impact. | Our audit procedures in this area included, among others:<br><br>• discussing with the Management Board members their plans for future actions in relation to the going concern assessment, whether the outcome of these plans is likely to improve the Bank's liquidity and capital situation and whether the plans are feasible in the circumstances;<br><br>• analysing the Bank's capital adequacy position (in particular, the minimum capital requirement), inquiring of the Management Board regarding their expectations on the continuation of the financial support from the parent company, as well as their alternative plans for future actions in relation to the going concern assessment;<br><br>• comparing the Bank's profit and loss forecast for the current and previous years to the current year's outcomes to assess the quality of the Management Board's forecasting process;<br><br>• evaluating the Bank's financial performance forecasts provided to us in support of the management's use of the going concern basis of accounting, by assessing the planned measures to be implemented by the Bank; specifically challenging the key assumptions and judgements with most significant impact on these forecasts, including, among others:<br>- forecast of interest and similar income;<br>- expected loan impairment losses;<br>- capital adequacy position.<br><br>• obtaining a letter of financial support provided to the Bank by its majority shareholder, J&T Bank A.S., and also assessing the majority shareholder's capacity to provide such further support by inspecting the majority shareholder's latest financial statements and making related inquiries of the group auditor;<br><br>• considering whether any additional facts or information have become available since the date on which the Bank made its assessment;<br><br>• evaluating whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about the events or conditions that had been identified that may cast significant doubt on the entity's ability to continue as a going concern. |

## Independent Auditors' report to the shareholders of J&T banka d.d. (continued)

### Report on the Audit of the Financial Statements (continued)

#### *Other Information*

Management is responsible for the other information. The other information comprises of the Introduction, the Macroeconomic environment and banking sector in the Republic of Croatia in 2018, and the Management Report included in the Annual Report of the Bank, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the Management Report, we also performed procedures required by the Accounting Act in Croatia ("Accounting Act"). Those procedures include considering whether the Management Report has been prepared in accordance with the requirements of Article 21 of the Accounting Act.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and procedures above, in our opinion:

- the information given in the Management Report for the financial year for which the financial statements are prepared, is consistent, in all material respects, with the financial statements;
- the Management Report has been prepared, in all material respects, in accordance with the requirements of Article 21 of the Accounting Act.

In addition, in light of the knowledge and understanding of the entity and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the Introduction, the Macroeconomic environment and banking sector in the Republic of Croatia in 2018, and the Management Report. We have nothing to report in this respect.

#### *Responsibilities of Management and Those Charged with Governance for the Financial Statements*

Management is responsible for the preparation of the financial statements which are presented fairly, in all material respects in accordance with statutory accounting requirements for credit institutions in Croatia, and for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

## Independent Auditors’ report to the shareholders of J&T banka d.d. (continued)

### Report on the Audit of the Financial Statements *(continued)*

***Auditors’ Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors’ report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with International Standards on Auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit 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 controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors’ report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors’ report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

# Independent Auditors' report to the shareholders of J&T banka d.d. (continued)

## Report on the Audit of the Financial Statements *(continued)*

***Auditors' Responsibilities for the Audit of the Financial Statements (continued)***

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## Report on Other Legal and Regulatory Requirements

Pursuant to the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of credit institutions dated 9 May 2018 (Official Gazette 42/18), the Management Board of the Bank has prepared the schedules ("the Schedules"), which comprise an alternative presentation of the statement of financial position as of 31 December 2018, and of the income statement, statement of changes in equity and statement of cash flows for the year then ended, and a reconciliation ("the Reconciliation") of the Schedules with the financial statements. The Schedules are set out on pages 111 to 118, and the Reconciliation on pages 119 to 127. The Management Board of the Bank is responsible for the Schedules and the Reconciliation. The financial information in the Schedules is derived from the financial statements set out on pages 28 to 110 on which we have expressed an opinion as set out above.

We were appointed by those charged with governance on 15 June 2018 to audit the financial statements of J&T banka d.d. for the year ended 31 December 2018. Our total uninterrupted period of engagement is 3 years, covering the periods from 1 January 2016 to 31 December 2018.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Company dated 30 April 2019;
- for the period to which our statutory audit relates, we have not provided any non-audit services (NASs), hence we have not provided any prohibited non-audit services referred to in Article 44 of the Audit Act. We also remained independent of the audited entity in conducting the audit.

***KPMG Croatia d.o.o. za reviziju***
Croatian Certified Auditors
Eurotower, 17th floor
Ivana Lučića 2a
10000 Zagreb
Croatia

KPMG Croatia
d.o.o. za reviziju
Eurotower, 17. kat
Ivana Lučića 2a, 10000 Zagreb
7

30 April 2019

Katarina Kecko
*Director, Croatian Certified Auditor*

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

# Statement of financial position as at 31 December 2018

| [HRK'000] | Notes | 31 December 2017 | 31 December 2018 |
|---|---|---|---|
| **ASSETS** | | | |
| Amounts with the Croatian National Bank | 6 | 168,257 | 159,650 |
| Cash and accounts with banks | 7 | 141,712 | 124,460 |
| Placements with other banks | 8 | 476 | 466 |
| Financial assets- securities | 9 | 265,979 | 244,690 |
| Held-to-maturity financial assets | 10 | - | - |
| Loans and advances to customers | 11 | 642,728 | 504,102 |
| Property and equipment | 12 | 17,387 | 14,832 |
| Intangible assets | 13 | 13,523 | 11,905 |
| Other assets | 14 | 24,462 | 20,416 |
| **TOTAL ASSETS** | | **1,274,524** | **1,080,521** |
| **LIABILITIES** | | | |
| Deposits from customers | 15 | 939,618 | 887,277 |
| Borrowings | 16 | 143,286 | 10,624 |
| Subordinated debt | 17 | 47,021 | 46,673 |
| Provisions for liabilities and charges | 18 | 832 | 1,560 |
| Other liabilities | 19 | 4,981 | 5,052 |
| Deferred tax liability | 31 c) | 720 | 321 |
| **TOTAL LIABILITIES** | | **1,136,458** | **951,507** |
| **EQUITY** | | | |
| Share capital | 20.1 | 307,085 | 307,085 |
| Share premium | 20.2 | 21,435 | 21,435 |
| Treasury shares | 20.4 | (287) | (2,202) |
| Other reserves | 20.3 | 3,792 | 3,792 |
| Fair value reserve | 20.5 | 3,276 | 2,821 |
| Accumulated loss | 20.6 | (197,235) | (203,917) |
| **TOTAL EQUITY** | | **138,066** | **129,014** |
| **TOTAL LIABILITIES AND EQUITY** | | **1,274,524** | **1,080,521** |

The significant accounting policies and other notes on pages 33 to 110 form an integral part of these financial statements.

# Income statement for 2018

| [HRK'000] | Notes | 2017 | 2018 |
|---|---|---|---|
| Interest and similar income | 21 | 60,805 | 45,286 |
| Interest and similar charges | 22 | (20,624) | (16,915) |
| **Net interest income** | | **40,181** | **28,371** |
| Fee and commission income | 23 | 7,038 | 9,268 |
| Fee and commission expense | 24 | (1,773) | (940) |
| **Net fee and commission income** | | **5,265** | **8,328** |
| Net realised gains from financial assets available for sale | 25 | 5,600 | - |
| Net gains and losses from financial assets at fair value through profit or loss and financial assets at fair value through OCI | 26 | - | 3,841 |
| Net foreign exchange gains | 27 | 2,309 | 1,873 |
| Other income | 28 | 10,081 | 5,512 |
| **Trading and other income** | | **17,990** | **11,226** |
| Personnel expenses | 29a | (18,619) | (17,953) |
| Depreciation, amortisation and impairment of goodwill | 12, 13 | (3,558) | (4,724) |
| Other administrative expenses | 29b | (18,082) | (14,805) |
| Impairment losses and provisions | 30 | (52,250) | (9,613) |
| **(LOSS)/PROFIT BEFORE TAX** | | **(29,073)** | **830** |
| Income tax expense | 31 | - | - |
| **(LOSS)/PROFIT FOR THE YEAR** | | **(29,073)** | **830** |
| **(LOSS)/PROFIT PER SHARE (in HRK)** | **32** | **(0.95)** | **0.03** |

The significant accounting policies and other notes on pages 33 to 110 form an integral part of these financial statements.

# Statement of comprehensive income for 2018

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **(Loss)/profit for the year** | **(29,073)** | **830** |
| Unrealised gains/(losses) on financial assets at fair value through other comprehensive income (2017: available-for-sale) | 1,560 | (2,552) |
| Deferred tax on financial assets at fair value thorugh OCI (2017: available-for-sale) | 5 | 399 |
| **Other comprehensive income /(loss) net of tax** | **1,565** | **(2,153)** |
| **TOTAL COMPREHENSIVE (LOSS)/PROFIT** | **(27,508)** | **(1,323)** |

The significant accounting policies and other notes on pages 33 to 110 form an integral part of these financial statements.

## Statement of changes in equity

| [HRK'000] | Notes | Share capital | Share Premium | Treasury shares | Other reserves | Fair value reserve | Accumulated loss | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2017** | | **307,085** | **21,435** | **-** | **3,792** | **1,711** | **(168,162)** | **165,861** |
| Loss for the year | | - | - | - | - | - | (29,073) | (29,073) |
| Change in fair value on financial assets available for sale, net of realized amounts and deferred tax | | - | - | - | - | 1,565 | - | 1,565 |
| ***Total comprehensive loss*** | | - | - | - | - | **1,565** | **(29,073)** | **(27,508)** |
| ***Transactions with owners, recorded directly in equity:*** | | | | | | | | |
| Purchase of treasury shares | 20.1 | - | - | (287) | - | - | - | (287) |
| **Balance at 31 December 2017** | | **307,085** | **21,435** | **(287)** | **3,792** | **3,276** | **(197,235)** | **138,066** |
| **Balance at 1 January 2018** | | **307,085** | **21,435** | **(287)** | **3,792** | **3,276** | **(197,235)** | **138,066** |
| First time adoption effect of IFRS 9 | | - | - | - | - | 1,698 | (7,689) | (5,991) |
| **Balance at 1 January 2018** | | **307,085** | **21,435** | **(287)** | **3,792** | **4,974** | **(204,924)** | **132,075** |
| Profit for the year | | - | - | - | - | - | 830 | 830 |
| Change in fair value of financial assets that are valued at FV through OCI, net of realized amounts and taxes | | - | - | - | - | (2,153) | - | (2,153) |
| ***Total comprehensive loss*** | | - | - | - | - | **(2,153)** | **830** | **(1,323)** |
| Transfer of realised gain on financial assets at FV through OCI to accumulated loss | | - | - | - | - | - | 177 | 177 |
| ***Transactions with owners, recorded directly in equity:*** | | | | | | | | |
| Purchase of treasury shares | 20.1 | - | - | (1,915) | - | - | - | (1,915) |
| **Balance at 31 December 2018** | | **307,085** | **21,435** | **(2,202)** | **3,792** | **2,821** | **(203,917)** | **129,014** |

The significant accounting policies and other notes on pages 33 to 110 form an integral part of these financial statements.

# Statement of cash flows for 2018

| [HRK'000] | Notes | 2017 | 2018 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| (Loss)/profit for the year | | (29,073) | 830 |
| Adjustments: | | | |
| Depreciation, amortization of property and equipment and intangible assets and impairment of goodwill | 12, 13 | 3,558 | 4,724 |
| Impairment losses and provisions | 30 | 52,250 | 9,613 |
| Net interest income | | (40,181) | (28,371) |
| Realised gains less losses from securities available for sale | 25 | (5,600) | - |
| Net gains on financial assets at fair value through profit or loss and financial assets at fair value through OCI | 26 | - | (3,841) |
| | | **(19,046)** | **(17,045)** |
| **Changes in operating assets and liabilities** | | | |
| Net (increase)/decrease in loans and advances to customers | | 109,464 | 113,411 |
| Net decrease in placements with other banks | | 2 | 10 |
| Decrease in obligatory reserves | | 14,047 | 15,113 |
| Net decrease in other assets | | 37,435 | 3,188 |
| Net (decrease) in deposits from customers | | (294,400) | (49,780) |
| Net (decrease) in other liabilities and provisions | | (9,847) | (395) |
| **Movements in operating assets and liabilities** | | **(143,299)** | **81,547** |
| Interest received | | 60,814 | 60,647 |
| Interest paid | | (26,266) | (20,074) |
| **Net cash outflow/inflow from operating activities** | | **(127,797)** | **105,075** |
| Receipts from investment funds | | 11,878 | 15,353 |
| Purchase of debt securities | | (238,280) | (304,679) |
| Proceeds from debt securities | | 222,554 | 310,336 |
| Net Income of/redemption of held-to-maturity financial investments | | 15,339 | - |
| Acquisition of property and equipment and intangible assets | | (1,147) | (551) |
| **Net cash inflow from investing activities** | | **10,344** | **20,459** |
| Receipts from borrowings | | 298,829 | 149,298 |
| Repayment of borrowings | | (217,184) | (283,116) |
| (Decrease) in subordinated debt | | (159) | - |
| Acquisition of own shares | | (287) | (1,915) |
| **Net cash inflow/outflow from financing activities** | | **81,199** | **(135,733)** |
| Net (decrease) in cash and cash equivalents | | (36,254) | (10,199) |
| Cash and cash equivalents at the beginning of the year | | 266,036 | 229,782 |
| **Cash and cash equivalents at the end of the year** | **34** | **229,782** | **219,583** |

The significant accounting policies and other notes on pages 33 to 110 form an integral part of these financial statements.

# Notes to the financial statements

## 1. General information

J&T banka d.d. ("the Bank") Member of the J&T Finance Group, dated back to 1994, when the Brodsko-posavska banka d.d. was incorporated in Slavonski brod, to build upon the tradition of the former Varaždinska banka, it changed its name on December 27, 2004 to Vaba d.d. banka Varaždin and relocated to Varaždin.

The Czech bank J&T a.s. recapitalised the bank with HRK 75 million in June 2014 and increased the Bank's capital to HRK 128.6 million. During 2015, J&T has further invested in the Bank's capital and the share capital was increased to HRK 231.1 million. During 2016, another increase of the share capital of the Bank was conducted in the amount of HRK 76 million by the majority shareholder of the Bank - J&T Bank a.s. so the new share capital amounts to HRK 307,1 million, and J&T Banka a.s. holds a total of 25,350,000 shares tags BPBA-R-B or equity of 82.55%.

From 1 January 2017 the Bank started operating under the name J&T banka d.d.

These financial statements were approved by the Board on 30 April 2019 for submission to the Supervisory Board.

## 2. Basis of presentation

## (a) Statement of compliance

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

The principal accounting policies applied in the preparation of these financial statements are summarized below. In addition to the changes presented in Note 2 (f), the Bank has consistently applied the accounting policies presented below for all periods reported in these consolidated financial statements. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards, reference may be made to certain Standards in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards as adopted in the European Union as at 31 December 2018. From 2018 the Bank applies, for the first time in the financial statements, new CNB regulations regarding credit loss impairment, which partially incorporated the requirements of the new standard IFRS 9 Financial Instruments.

The accounting regulations based on which these financial statements have been prepared differ from IFRS both in terms of presentation as well as in terms of recognition and measurement. We draw attention to the following differences between the accounting regulations of the CNB and the recognition and measurement requirements of IFRS:

- CNB requires banks to recognize impairment losses in profit or loss for all performing financial assets measured at amortized cost and off-balance exposures of at least 0.80% of the corresponding financial assets
- In accordance with CNB regulations, interest income on non-performing exposures is recognized when charged, which is contrary to IFRS 15 requirements, which prescribes recognition of interest income from exposures that are impaired through discount amortisation.

# Notes to the financial statements (continued)

## 2. Basis of presentation (continued)

### (a) Statement of compliance (continued)

- In accordance with the CNB's Decision on provisions for court proceedings against credit institutions, the Bank recognizes provisions for court cases incorporating the likelihood of the loss into measurement of the provision (the provision is made in the amount of estimated cash outflow in case the dispute is lost and for certain disputes of greater value a minimum provision of 1% of the total value of the dispute is made independent of the Bank's estimate that it will not lose the dispute) which is not in accordance with International Financial Reporting Standards, which prescribe that, if it is certain that a court dispute will not be lost, no provision for the court dispute should be created.
- Although the Bank calculates the impairment of individually significant exposures as the present value of expected cash flows discounted at the original effective interest rate instrument in accordance with International Financial Reporting Standards, the CNB requires that the depreciation of the calculated discount be presented in the income statement as a change in impairment losses of loans and advances rather than interest income, as prescribed by the International Financial Reporting Standards.
- For certain exposures the CNB prescribes some specific requirements for impairment of loans and receivables such as: prescribed minimum hair-cuts and minimum realization period in calculating specific impairment allowances where the collection is expected from collateral, minimum loss rates on unsecured exposures based on the number of overdue days, minimum loss rates for non-performing exposures that are overdue more than 2 years, independent of collateral value. This may result in different rates of loss than those that would have been calculated in accordance with IFRSs.

### (b) Basis of preparation

The financial statements are prepared on a fair value basis for financial assets at fair value through profit and loss and for financial assets at fair value through other comprehensive income (during 2017: for financial assets available for sale) as well as in the loans and advances portfolio. Other financial assets and liabilities, and non-financial assets and liabilities, are stated at amortized or historical cost.

### (c) Use of estimates and judgments

In preparing the financial statements, the Management Board has made judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities and disclosure of potential liabilities at the reporting date, as well as on the amounts of income, expense and other comprehensive income of the period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances and information available at the date of the preparation of the financial statements, the result of which form the basis for making judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

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

Judgements made by the management in application of applicable standards that have significant effects on the financial statements and estimates with a significant risk of a possible material adjustment in future periods are discussed in Note 5.

### (d) Functional and presentation currency

The Bank's financial statements are presented using the currency of the primary economic environment in which the Bank operates (the functional currency), Croatian kuna (HRK). Amounts are rounded to the nearest thousand.

The exchange rates of currencies, in which the majority of the Bank's assets and liabilities are denominated, are used for the translation of the Bank's assets and liabilities and as at 31 December 2018 they were as follows: EUR 1 = HRK 7.418 (2017: EUR 1 = HRK 7.514) and USD 1 = HRK 6.469 (2017: USD 1 = HRK 6.270).

# Notes to the financial statements (continued)

## 2. Basis of presentation (continued)

### (e) Changes in presentation or classification of items within the financial statements

Where necessary, comparative information has been reclassified to achieve consistency with amounts presented in the current financial year amounts and other disclosures.

### (f) Application of new CNB regulations related to IFRS 9 Financial Instruments

From January 1, 2018, the Bank has applied new CNB regulations that partially incorporate the requirements of the new International Financial Reporting Standard (IFRS) 9 Financial Instruments and has not revised the comparative data for 2017 as allowed by the standard.

Accordingly, financial information for 2018 is based on the new CNB regulations related to IFRS 9, while the results for 2017 are based on previous CNB Decisions related to Recognition and Measurement of financial instruments, and comparative information for 2017 are not comparable with information presented in 2018.

The adoption effects of IFRS 9 and CNB's *Decision on Classification of Exposure to Risk Groups and the Method of Determining Credit Losses* (Official Gazette 114/2017) are recognized in capital and amounted to HRK 5.953 million at 1 January 2018.

The following table shows the original measurement categories in accordance with previous decisions and the new categories of measurements in accordance with new decisions for the financial assets and liabilities of the Bank as of January 1, 2018.

| Financial assets | Original classification as at 31 December 2017 | New classification as at 1 January 2018 | Carrying amount as at 31 December 2017 | Carrying amount as at 1 January 2018 |
|---|---|---|---|---|
| Amounts with the Croatian National Bank | Loans and receivables | Amortised cost | 168,257 | 166,911 |
| Cash and cash equivalents | Loans and receivables | Amortised cost | 141,712 | 140,653 |
| Loans and advances to Banks | Loans and receivables | Amortised cost | 476 | 472 |
| Loans and advances to customers | Loans and receivables | Amortised cost | 582,892 | 579,392 |
| Loans and advances to customers | Loans and receivables | Fair value through profit and loss - obligatory | 59,836 | 59,836 |
| Debt securities | Available for sale | Fair value through other comprehensive income | 240,342 | 240,319 |
| Equity securities | Available for sale | Fair value through profit and loss | 24,696 | 24,696 |
| Equity securities | Available for sale | Fair value through other comprehensive income | 941 | 941 |
| Other assets - limited deposits with the central bank | Loans and receivables | Amortised cost | 3,265 | 3,243 |
| **Total financial assets** | | | **1,222,417** | **1,216,463** |

# Notes to the financial statements (continued)

## 2. Basis of presentation (continued)

### (f) Application of new CNB regulations related to IFRS 9 Financial Instruments (continued)

| Financial liabilities and provisions | Original classification at 31 December 2017 | New classification at 1 January 2018 | Carrying amount at 31 December 2017 | Carrying amount at 1 January 2018 |
|---|---|---|---|---|
| Borrowings | Amortised cost | Amortised cost | 143,286 | 143,286 |
| Deposits from customers | Amortised cost | Amortised cost | 939,618 | 939,618 |
| Subordinated debt | Amortised cost | Amortised cost | 47,021 | 47,021 |
| Provisions | | | 832 | 869 |
| **Total financial liabilities** | | | **1,130,757** | **1,130,794** |

The following table shows the reconciliation of the carrying amounts as at 31 December 2017 with the carrying amounts as at 1 January 2018 pursuant to the new CNB's decision regarding recognition and measurement of financial instruments, as well as measurement categories and business models for financial instruments:

| | Carrying amount as at 31 December 2017 | Reclassification | Remeasurement | Carrying amount as at 1 January 2018 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| **Amortised cost** | | | | |
| Amounts with the Croatian National Bank | | | | |
| Opening balance | 168,257 | - | - | **168,257** |
| Remeasurement | - | - | (1,346) | **(1,346)** |
| Closing balance | **168,257** | **-** | **(1,346)** | **166,911** |
| Cash and cash equivalents | | | | |
| Opening balance | 141,712 | - | - | **141,712** |
| Remeasurement | - | - | (1,059) | **(1,059)** |
| Closing balance | **141,712** | **-** | **(1,059)** | **140,653** |
| Loans and advances to Banks: | | | | |
| Opening balance | 476 | - | - | **476** |
| Remeasurement | - | - | (4) | **(4)** |
| Closing balance | **476** | **-** | **(4)** | **472** |
| Loans and advances to customers: | | | | |
| Opening balance | 642,728 | - | - | **642,728** |
| Reclassified to loans and advances at fair value portfolio | - | (59,836) | - | **(59,836)** |
| Reclassified from financial assets held to maturity | - | - | - | **-** |
| Remeasurement | - | - | (3,500) | **(3,500)** |
| Closing balance | **642,728** | **(59,836)** | **(3,500)** | **579,392** |
| Financial assets held to maturity | | | | |
| Opening balance | - | - | - | **-** |
| Reclassified to loans and advances to customers at amortised cost | - | - | - | **-** |
| Closing balance | - | - | - | **-** |
| Other assets | **3,265** | **-** | **(22)** | **3,243** |
| **Total amortised cost** | **956,437** | **(59,836)** | **(5,931)** | **890,671** |

# Notes to the financial statements (continued)

## 2. Basis of presentation (continued)

## (f) Application of new CNB regulations related to IFRS 9 Financial Instruments (continued)

| | Carrying amount as at 31 December 2017 | Reclassification | Remeasurement | Carrying amount as at 1 January 2018 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| **Available for sale** | | | | |
| Securities: | | | | |
| Opening balance | 265,979 | - | - | 265,979 |
| To fair value through other comprehensive income - equity securities | - | (941) | - | (941) |
| To fair value through other comprehensive income – debt securities | - | (240,342) | - | (240,342) |
| To fair value through profit and loss account | - | (24,696) | - | (24,696) |
| Closing balance | **265,979** | **(265,979)** | **-** | **-** |
| **Fair value through other comprehensive income – debt securities** | | | | |
| Opening balance | - | - | - | - |
| From available for sale | - | 240,342 | - | **240,342** |
| Remeasurement | - | - | (23) | **(23)** |
| Closing balance | **-** | **240,342** | **(23)** | **240,319** |
| **Fair value through other comprehensive income – equity securities** | | | | |
| Opening balance | **-** | - | - | **-** |
| From available for sale | **-** | 941 | - | 941 |
| Closing balance | **-** | **941** | **-** | **941** |
| **Total securities through other comprehensive income** | **-** | **241,283** | **(23)** | **241,260** |
| **Financial assets** | | | | |
| **Fair value through profit and loss account** | | | | |
| Loans and advances to customers | - | 59,836 | - | **59,836** |
| Securities: | | | | |
| Opening balance | **-** | - | - | **-** |
| From available for sale | - | 24,696 | - | **24,696** |
| **Total fair value through profit and loss account** | **-** | **84,532** | **-** | **84,532** |

The following table analyses the impact of adopting the CNB's "*Decisions on the Classification of Exposure to Risk Groups and the Method of Determining Credit Losses*" on reserves and accumulated losses, net of taxes. It has no impact on other capital items.

| **Fair value reserve** | |
|---|---|
| Closing balance (31 December 2017) | 3,276 |
| Recognition of expected credit losses for debt financial assets at fair value through OCI | 1,698 |
| **Opening balance (1 January 2018)** | **4,974** |

| **Accumulated losses** | |
|---|---|
| Closing balance (31 December 2017) | (197,235) |
| Recognition of expected credit losses (including credit liabilities and issued financial guarantees) | (7,689) |
| **Opening balance (1 January 2018)** | **(204,924)** |

# Notes to the financial statements (continued)

## 2. Basis of presentation (continued)

### (f) Application of new CNB regulations related to IFRS 9 Financial Instruments (continued)

The following table reconciles provisions for impairment of financial assets and provisions for credit lines and guarantees closing balance as at 31 December 2017 with the opening balance of the expected credit losses determined in accordance with the CNB's "*Decision on Classification of Exposure to Risk Groups and the Method of Determining Credit Losses* " as of 1 January 2018.

| | Carrying amount as at 31 December 2017 | Reclassification | Remeasurement | Carrying amount as at 1 January 2018 |
|---|---|---|---|---|
| Loans and receivables and securities held to maturity / financial assets at amortized cost (including cash and cash equivalents, loans and advances to banks and loans and advances to customers) | 198,752 | - | 5,954 | 204,706 |
| | **198,752** | **-** | **5,954** | **204,706** |
| Debt securities available for sale under IAS 39 / FVOCI Debt securities under IFRS 9 | - | - | 1,698 | 1,698 |
| Credit lines and guarantees | 194 | - | 37 | 231 |
| **TOTAL** | **198,946** | **-** | **7,689** | **206,635** |

### (g) Going concern

In 2018, the Bank realized a net profit of HRK 0.8 million (2017: loss of HRK 29 million) and at 31 December 2018 had accumulated losses of HRK 203,9 million (31 December 2017: 197 million million). Due to significant losses in the past, the Bank has had several recapitalisations by the majority owner since 2014 in order to maintain capital adequacy prescribed by the CNB. In the case of further operational losses, there is a risk of capital inadequacy and non-compliance with other regulatory limits, in which case the unlimited business time of the Bank would depend on financial support and capital increase by the parent company.

As disclosed in Note 4.1.5, the Tier 1 ratio at 31 December 2018 amounts to 17.11% and is above the minimum rate prescribed by the CNB as well as the 23.02% total capital adequacy ratio. Furthermore, the Bank has the support of a majority owner who is willing to further recapitalize the Bank or approve a subordinated debt if required.

# Notes to the financial statements (continued)

## 3. Significant accounting policies

The accounting policies set out below have been consistently applied to all periods presented in these financial statements.

### (a) Interest income and expense

*Policy applicable from 1 January 2018*

Interest income and expense is recognized in profit or loss as it arises for all interest-bearing financial instruments, including those measured at amortized cost and FVOCI debt securities, taking into account the effective rate of return of the asset / liability or the applicable variable rate. Interest income and expense includes amortization of the discount or premium, as well as other differences between the initial carrying amount of the interest-bearing financial instrument and the amount by maturity, which is calculated using the effective interest rate.

An effective interest rate is the rate at which the expected future cash outflows or receipts are discounted over the expected lifetime of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

Interest income is recognized depending on the degree of credit risk of a financial instrument and for financial assets classified in Stage 1 and Stage 2 (performing) - when calculating interest income, the EIR is applied to the gross carrying amount of financial assets, and for financial assets allocated to Stage 3 the interest is suspended. Suspended interest represents an already charged interest on an asset for which an individual impairment has been recognized (non-performing). At the time of reclassification into uncollectable receivables, the Bank writes off the full amount of accrued uncovered interest at the expense of the income statement and suspends further calculation in the balance sheet and keeps the suspended interest off-balance until the debtor makes a cash payment.

For purchased or created financial assets decreased for credit losses - POCIs, the EIR adjusted for credit risk at the amortized cost of the POCI assets is applied in the calculation of interest income.

In calculating the effective interest rate, the Bank does not take into account future credit losses. The calculation includes all fees and percentage points paid or received between the contracting parties which are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Loans and advances that have been impaired are written off to recoverable amounts, and interest income is subsequently recognized on the basis of the interest rate used to discount future cash flows for the purpose of measuring the recoverable amount. Other fees are recognized when earned.

Interest income on debt securities at fair value through profit or loss is recognized at the nominal coupon interest rate and is included in interest income.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

### (a) Interest income and expense (continued)

*Policy applicable before 1 January 2018*

Interest income and expense are recognised in the income statement as they accrue for all interest-bearing financial instruments, including those measured at amortised cost, at fair value through profit or loss and available for sale, using the effective interest rate method. Such income and expense are presented as interest and similar income or interest expense and similar charges in the income statement. Interest income and expense also includes fee and commission income and expense in respect of loans provided to customers or borrowings from other banks, premium or discount amortisation, and other differences between the initial carrying amount of an interest-bearing financial instrument and its value at maturity, recognised by the effective interest rate method. Income and expense on all assets and liabilities held for trading is recognised as interest income and expense.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank does not consider future credit losses.

### (b) Fee and commission income and expense

Fee and commission income and expense arise on financial services provided by the Bank and received by the Bank, and mainly comprise fees related to domestic and foreign payments, the issue of guarantees and letters of credit, credit card business and other services provided by the Bank. Fee and commission income and expense are recognised in the income statement when the related service is performed.

Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank has retained no part for itself or has retained a part at the same effective interest rate as other participants. Portfolio and other management service fees are recognised based on the applicable service contracts upon completion of the service.

Investment management fees related to investment services are recognised on an accrual basis over the period in which the service is provided. The same principle is applied for custody services that are continuously provided over an extended period of time.

### (c) Dividend income

Dividend income from equity securities is recognised in the income statement when the rights to receive the dividend are established.

### (d) Net realised gains and losses from financial assets at fair value through profit or loss and financial assets at fair value through OCI

*Policy applicable from 1 January 2018*

The category includes realised and unrealised gains and losses on debt and equity securities held for trading and other financial instruments at fair value through profit or loss.

Net gains and losses on derecognition of financial assets at fair value through other comprehensive income refer to gains and losses from sale of debt securities classified as FV OCI.

### (e) Net realised gains from financial assets available for sale

*Policy applicable before 1 January 2018*

Net realized gains on available-for-sale securities include realized gains and losses on financial instruments available for sale.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

### (f) Net foreign exchange gains

Net gains from foreign exchange include unrealised and realised gains and losses arising from spot dealings in foreign currencies.

### (g) Foreign currencies

Foreign currency transactions are translated into HRK using exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into HRK at the foreign exchange rate prevailing at that date.

Foreign currency differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies and measured at fair value are translated into HRK at the foreign exchange rate prevailing at the date on which their fair value was determined.

Non-monetary assets and items that are carried at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not re-translated.

Changes in the fair value of monetary securities denominated in foreign currency classified as fair value through OCI (2017: available for sale) are separated between exchange rate differences arising from changes in the amortized cost of securities and other changes in the net book value of the security. Foreign exchange differences are recognized in the income statement as part of exchange gains or losses on the sale of monetary assets and liabilities. Foreign exchange differences on non-monetary financial assets, as equity securities classified as available for sale, are included within other comprehensive income.

### (h) Financial instruments

i) <u>Classification</u>

*Policy applicable from 1 January 2018*

After initial recognition, financial assets are classified as assets at amortized cost, assets at fair value through other comprehensive income (FVOCI) and assets at fair value through profit and loss (FVTPL).

Financial assets are measured at amortized cost if they meet both of the following conditions and if they are not valued at fair value through profit and loss (FVTPL):

- The purpose of a business model is to hold assets in order to collect contractual cash flows;
- The contractual terms of a financial asset presuppose cash flows that are solely principal and interest payments (SPPI), at specific dates.

A debt instrument is measured at fair value through other comprehensive income (FVOCI) if it meets both of the following conditions and if it is not valued at fair value through profit and loss account (FVTPL):

- The purpose of the business model is the holding of assets for the purpose of collecting contractual cash flows and the sale of financial assets; and
- contractual terms of financial assets presuppose cash flows that are solely principal and interest repayment (SPPI), at specific dates.

In the initial recognition of an investment in equity instruments that are not held for trading, the Bank may irrevocably decide to display subsequent changes in fair value through other comprehensive income. This choice is made on the basis of a particular investment.

All other financial assets are classified as measured at fair value through profit or loss (FVTPL).

In addition, at initial recognition, the Company may irrevocably evaluate financial assets at fair value through profit or loss (FVTPL), although it meets the measurement requirements at amortized cost or at fair value through other comprehensive income (FVOCI), if this eliminates or substantially reduces the accounting mismatch that would arise if contrary.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

### (g) Financial instruments (continued)

i) Classification (continued)

*Policy applicable from 1 January 2018 (continued)*

*Business Model Assessment*

The Bank determines the goal of the asset's business model because it best represents the way in which assets are managed and the Bank's management is reported. Information considered includes:

- management policies and portfolio objectives and implementation of these policies in practice;
- assessing the performance of the portfolio and reporting to the management of the Bank;
- risks affecting the performance of the business model (and financial assets within that business model) and the risk management strategy; and
- frequency, volume and time of sales in previous periods, reasons for the sale and expectations of future sales activities.

Financial assets held for trading and whose performance is assessed on the basis of fair value are measured at fair value through profit and loss account, as it is not held for the purpose of collecting the contracted cash flows nor for collecting contractual cash flows and for sale.

*Estimate whether contractual cash flows are solely principal and interest payments*

In order to assess whether contractual cash flows are solely payments of principal and interest, the principal is defined as the fair value of financial assets at initial recognition. Interest is defined as compensation for the time value of money and credit risk associated with the outstanding principal amount over a specified period of time and for other basic risks and costs of lending (eg liquidity risk and administrative costs) and as a profit margin.

When assessing whether the contractual cash flows are solely principal and interest payments (SPPI), the Bank considers the contractual terms of the instrument. This includes assessing whether a financial asset contains a contractual term that could change the time or amount of contractual cash flows so that it would not meet the SPPI requirement. When assessing, the Bank considers:

- potential events that would change the amount and time of cash flows;
- terms of prepayment and extension; and
- features that alter the consideration of the time value of money (e.g. periodic interest rate reset).

*Reclassification*

Financial assets are not reclassified after initial recognition, except in the period after the change in the financial model for the financial asset management.

*Loans and advances to customers*

The "Loans and advances to customers" caption in the statement of financial position includes:

- loans and advances measured at amortised cost; initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method; and
- loans and advances mandatorily measured at fair value through profit and loss account (FVTPL) or designated as at fair value through profit and loss account (FVTPL); these are measured at fair value with changes recognised immediately in profit or loss.

When the Bank purchases a financial asset and simultaneously enters into an agreement to resell the asset (or a substantially similar asset) at a fixed price on a future date (reverse repo or stock borrowing), the arrangement is accounted for as a loan or advance, and the underlying asset is not recognised in the Bank's financial statements.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

i) Classification (continued)

*Financial assets - investment securities*

The 'financial assets - investment securities' caption in the statement of financial position includes:

- debt investment securities measured at amortised cost; these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method;
- debt and equity investment securities mandatorily measured at fair value through profit and loss account (FVTPL) or designated as at fair value through profit and loss account (FVTPL); these are at fair value with changes recognised immediately in profit or loss;
- debt securities measured at fair value through other comprehensive income (FVOCI); and
- equity investment securities designated as at fair value through other comprehensive income (FVOCI).

For debt securities measured at fair value through other comprehensive income (FVOCI), gains and losses are recognised in other comprehensive income (OCI), except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest income;
- calculation of Expected credit loss (ECL) and reversals; and
- foreign exchange gains and losses.

When debt security measured at fair value through other comprehensive income is derecognised, the cumulative gain or loss previously recognised in other comprehensive income (OCI) is reclassified from equity to profit or loss.

The Bank decides to present in other comprehensive income (OCI) changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in other comprehensive income (OCI). Cumulative gains and losses recognised in other comprehensive income (OCI) are transferred to retained earnings on disposal of an investment.

*Policy applicable before 1 January 2018*

The Bank classifies its financial instruments into the following categories: fair value through profit and loss, loans and receivables, available for sale, held to maturity or financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. The Management Board determines the classification of financial instruments at initial recognition.

*Financial assets and financial liabilities at fair value through profit or loss*

This category comprises two subcategories: financial instruments held for trading, and those designated by the Management Board as at fair value through profit or loss at inception. The Bank designates financial assets and liabilities at fair value through profit or loss when:

- the assets and liabilities are managed, evaluated and reported internally on a fair value basis,
- the designation eliminates or significantly reduces an accounting inconsistency which would otherwise arise, or
- the asset and liability contain an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

i) Classification (continued)

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money to a debtor with no intention of trading with the receivable and include loans and receivables from banks, loans and receivables from customers, obligatory reserve with CNB and various other receivables.

*Held-to-maturity financial instruments*

Held-to-maturity financial instruments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank's Management Board has the positive intention and ability to hold to maturity. Mentioned category includes corporate bills of exchange.

*Available-for-sale financial assets*

This category comprises non-derivative financial assets which are defined as available for sale or not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Available-for-sale financial assets are intended to be held for an indefinite period of time but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates, or prices of equity securities.

Securities include debt and equity securities and investment funds and a venture capital fund with a private offer.

Other financial liabilities comprise all financial liabilities which are not designated at fair value through profit or loss. Other financial liabilities include demand deposits and deposits from financial institutions and clients and other liabilities.

ii) Recognition and derecognition

Loans and receivables and financial liabilities at amortised cost are recognised when advanced to borrowers or received from lenders. Regular purchases of financial assets available-for-sale and held-to-maturity financial assets are recognised on the settlement date.

The Bank derecognises financial instruments (in full or in part) when the contractual rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights to such financial instruments. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realised, surrendered or have expired. The Bank derecognises financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognising that liability and will instantaneously recognise a new financial liability, with new terms and conditions.

Realised gains and losses from the disposal of financial instruments are calculated by using the weighted average cost method.

iii) Initial and subsequent measurement

Financial assets and liabilities are recognised initially at their fair value plus, in the case of a financial asset 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.

After initial recognition, the Bank measures financial instruments at fair value through profit or loss and available-for-sale financial assets at their fair value, without any deduction for selling costs. Instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less impairment.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

### (g) Financial instruments (continued)

iii) Initial and subsequent measurement (continued)

Loans and receivables and held-to-maturity investments and financial liabilities not designated at fair value through profit or loss are measured at amortised cost.

iv) Gains and losses

Gains or losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognised in the income statement.

Gains or losses arising from a change in the fair value of FVOCI monetary assets are recognised directly in the other comprehensive income. Impairment losses, foreign exchange gains and losses, interest income and amortisation of premium or discount on FVOCI monetary assets are recognised in the income statement. Foreign exchange differences on equity instruments are part of the fair value of these instruments and are recognised in other comprehensive income.

Upon sale or other derecognition of FVOCI financial assets, any cumulative gains or losses on the instrument are transferred to the income statement. Gains or losses may also be recognised in the income statement when a financial instrument is derecognised or when its value is impaired. Dividend income is recognised in the income statement.

v) Determination of fair value of financial instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability also reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The Bank recognises the transfer between levels of the fair value hierarchy at the end of the reporting period during which the change occurred.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is entirely supported by observable market data.

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

vi) Impairment of financial assets

*Policy applicable from 1 January 2018*

The Bank recognises loss allowances for "expected credit losses" (hereinafter: ECL) on the following financial instruments that are not measured at fair value through profit or loss (FVTPL):

- debt instruments;
- issued guarantees; and
- loans and advances to customers.

No impairment loss is recognised on equity investments and financial assets at fair value through profit or loss (FVTPL).

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

vi) Impairment of financial assets (continued)

*Policy applicable from 1 January 2018 (continued)*

The Bank measures impairment losses at an amount equal to lifetime expected credit losses (ECL), except for the following, for which they are measured as 12-month expected credit loss (ECL):

- debt securities for which it was determined to have a low credit risk at the reporting date; and
- other financial instruments for which credit risk has not significantly increased since their initial recognition.

12-month expected credit losses (ECL) are the portion of expected credit loss (ECL) that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month expected credit loss (ECL) is recognised are referred to as "Stage 1 financial instruments", or A-1 risk category by CNB.

Life-time expected credit losses (ECL) are the expected credit losses (ECL) that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime expected credit loss (ECL) is recognised but which are not credit-impaired are referred to as "Stage 2 financial instruments", or A-2 risk category by CNB.

Total impairment of exposures classified in risk categories A-1 and A-2 during the period until 31 December 2018 may not be less than 0.8% of the gross book value except for financial assets measured at fair value through other comprehensive income.

*Expected Credit Loss Measurement (ECL)*

For the purpose of assessing the expected credit losses, the Bank prescribes processes and control mechanisms for the development and application of estimation methods of expected credit losses with a goal to ensure their integrity and timely inclusion of relevant data.

Probability of default (PD) provides an estimate of the probability that the borrower will not be able to fulfil his obligations. For PD calculations loans and advances are divided into corporate and retail. Corporate loans are divided into homogeneous groups by type of product, while retail is a separate homogeneous group. For each type of product, the default rate is calculated based on available historical data. In order to incorporate future information adequately into macroeconomic scenarios, the Bank uses adjustments of the calculated PD to macroeconomic expectations. The macroeconomic scenario is determined on the basis of customised publicly available information.

To determine the PD (probability of default) for exposures to countries or exposures rated by an external credit rating institution, the Bank uses the data available on the Moody's Investor Service website (Annual One-Year Alphanumeric Rating Migration Rates). For unsecured exposures for which an external credit rating agency estimates, the Bank uses the basic approach prescribed by the BIS (Bank for international settlement): LGD of 45% (Basel Committee on Banking Supervision Discussion Paper Regulatory treatment of accounting provisions, October 2016).

For securities under the model Financial assets through other comprehensive income, primarily related to corporate bonds, the Bank uses the Parent Company's internal rating (J&T bank a.s.) to calculate the ECL ("Expected credit loss") per ISIN.

For exposures to credit institutions and the CNB that are classified to risk subgroups A-1 and A-2, the Bank uses a single rate of 0.8% of the gross book value of exposure.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

vi) Impairment of financial assets (continued)

*Policy applicable from 1 January 2018 (continued)*

*Restructuring of financial assets*

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

*Credit-impaired financial assets*

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets at fair value through other comprehensive income (FVOCI) are credit-impaired (hereinafter referred to as "Stage 3 financial assets"). A financial asset is “credit-impaired” when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulties of the debtor;
- breach of contract such as failure to complete or due to maturity;
- restructuring of a loan or an advance by the Company under conditions that the Company would not consider in the normal circumstances;
- it is probable that the borrower will enter bankruptcy or another type of financial reorganisation.

A loan that has been renegotiated due to a deterioration in the borrower’s condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment.

*Presentation of impairment allowance for expected credit loss (ECL) in the statement of financial position*

Loss allowances for expected credit loss (ECL) are presented in the statement of financial position as follows:

- financial assets measured at amortized cost: as a deduction from the gross carrying amount of the asset;
- credit lines and issued guarantees: in general, as provisions;
- when the financial instrument includes a drawn and an undrawn component, and the Bank can not identify the expected credit loss (ECL) separately: The Bank shows a loss for both as a deduction from the gross carrying amount of the used component;
- Debt instruments measured at fair value through other comprehensive income (FVOCI): no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

vi) Impairment of financial assets (continued)

*Policy applicable from 1 January 2018 (continued)*

*Presentation of allowance for expected credit loss (ECL) in the statement of financial position*

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision,
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the expected credit loss (ECL) on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component.
- debt instruments measured at fair value through other comprehensive income (FVOCI): no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

*Write-off*

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

vi) Impairment of financial assets (continued)

*Policy applicable to 1 January 2018*

*Specific impairment of assets identified as impaired*

*a) Financial assets carried at amortised cost*

The Bank assesses at each reporting date whether there is objective evidence for impairment of an individual financial asset or group of financial assets that are not stated at fair value through profit or loss. A financial asset or a group of financial assets is impaired and impairment losses are incurred 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. Objective evidence that a financial asset or group of assets is impaired includes observable data, which comes to the attention of the Bank, about the following loss events:

i) significant financial difficulty of the borrower;
ii) a breach of contract, such as a default or delinquency in interest or principal payments;
iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that it would not otherwise consider;
iv) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
v) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified for the individual financial assets in the group.

All individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively. Financial assets which are not identified as impaired are subsequently included in the basis for collective impairment assessment. Loans and advances to customers and investments held to maturity that are not individually significant are collectively tested for impairment.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (including amounts recoverable from collaterals) discounted at the financial asset's original effective interest rate. If a loan and receivable or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract at the time when the asset becomes initially impaired. The loss is recognised in the income statement.

For the purposes of a collective evaluation of impairment of individually non-significant exposures, the amount of the loss is measured in line with the relevant CNB regulations.

If in a subsequent period, the amount of the impairment loss decreases, and the decrease can be related objectively to an event occurring after the impairment was recognized in the income statement, the amount of the reversal is recognised in the income statement.

When a loan is uncollectible, it is written off against the related impairment allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised as a reversal of impairment losses in the income statement.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

vi) Impairment of financial assets (continued)

*Policy applicable to 1 January 2018 (continued)*

*Specific impairment of assets identified as impaired (continued)*

*a) Financial assets carried at amortised cost (continued)*

When possible, the Bank implements loan restructuring rather than initiate enforcement action. This may include the extension of repayment period and other changes in credit conditions. After changing conditions, any further impairment calculation is made with the original effective interest rate applicable prior to changing conditions. The management continuously monitors restructured loans with regards to the fulfilment of the new conditions and security of future payments. These loans are subject to further regular testing of impairment on an individual or group basis using the original effective interest rate.

*b) Financial assets carried at fair value*

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 investment 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 the income statement, is removed from other comprehensive income and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is subsequently recognised in other comprehensive income.

*c) Impairment of assets not identified as impaired*

In addition to the impairment losses of the asset for which impairment is recognized, the Bank recognizes impairment losses in the income statement, balance sheet and off-balance sheet exposures subject to credit risk, for which impairment losses have not yet been recognized at a rate of 0.80% in accordance with the accounting regulations of the CNB.

Debt securities carried at fair value and classified as available for sale were excluded from the basis of such calculation at the reporting date.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (g) Financial instruments (continued)

vii) Offsetting of financial instruments

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

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

## (h) Specific financial instruments

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, on bank accounts, placements with other banks with original maturities of three months or less, and items in the course of collection.

Derivative financial instruments

In accordance with its investment policy, the Bank does not hold or issue derivative financial instruments for the purpose of speculative trading. Hedge accounting has not been applied.

Derivative financial instruments are initially recognised at fair value which is the value of the consideration paid to acquire the instrument less transaction costs. Subsequent to initial recognition, derivatives are measured at fair value. The fair value is determined based on the quoted market price or, if more appropriate, based on the discounted cash flow. All derivatives are carried as assets if their fair value is positive and as liabilities if their fair value is negative.

Hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is considered to represent an embedded derivative. Unless it is inconsistent with the requirements of the CNB, when the economic characteristics and risks of embedded derivatives are not closely related to those of the primary contract and when the hybrid contract is not itself carried at fair value through profit or loss, the embedded derivative is treated as a separate derivative and classified at fair value through profit or loss with all unrealised gains and losses recognised in the income statement, unless there is no reliable measure of their fair value.

Treasury bills and debt securities

Treasury bills and debt securities that the Bank holds for short-term gain purposes are carried at fair value. The Bank uses treasury bills for liquidity purposes.

Equity securities and investments in investment and other funds

Equity securities and investments in open-ended and close-ended investment funds are classified as asset measured at fair value through profit or loss or asset measured through other comprehensive income.

Placements with banks

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

Current accounts and deposits from banks

Current accounts and deposits from banks are classified as other liabilities and stated at amortised cost.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (h) Specific financial instruments (continued)

Deposits from customers

Deposits are classified as other liabilities and initially measured at fair value plus transaction costs, and subsequently stated at the amortised costs using the effective interest method.

Loans and advances to customers

Loans and advances to customers are presented net of impairment losses to reflect the estimated recoverable amounts or at fair value for loans and advances that are measured at fair value.

Borrowings

Interest-bearing borrowings are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings as interest expense.

Sale and repurchase agreements

The Bank enters into purchases and sales of investments under agreements to resell or repurchase substantially identical investments at a certain date in the future at a fixed price. Investments purchased subject to such commitments to resell them at future dates are not recognised in the statement of financial position. The amounts paid are recognised as loans to either banks or customers, collateralised by the underlying security from the repurchase agreement. Securities sold under repurchase agreements continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy for the relevant financial asset at amortised cost or at fair value as appropriate. The proceeds from the sale of investments are reported as collateralised liabilities to either banks or customers.

The difference between the sale and repurchase consideration is recognised on an accrual basis over the period of the transaction and is included in interest income or expense.

Financial guarantee

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

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss incurred because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, being the premium received, and the initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment (when a payment under the guarantee becomes probable), depending on which amount is higher. Financial guarantees are included within other liabilities.

## (i) Income tax

Income tax is based on taxable income for the year and comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

## (i) Income tax (continued)

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which the carrying value of assets and liabilities is expected to be recovered or settled based on tax rates enacted at the reporting date.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would arise from the manner in which the Bank expects, at the reporting date, to recover or settle the net carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the balance sheet. Deferred tax assets are recognised only to the extent that it is probable that they could be utilised as a tax benefit. At each balance sheet date, the Bank reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets.

## (j) Property and equipment

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

Recognition and measurement

Property and equipment are stated at historical cost less accumulated depreciation and impairment. Historical cost includes the cost that is directly attributable to the acquisition of assets.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.
Land and assets under construction are not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost over their estimated useful lives as follows:

| | |
|---|---|
| **Buildings** | 33 years |
| **IT equipment** | 5 years |
| **Furniture and equipment** | 7-15 years |
| **Motor vehicles** | 4 years |
| **Other assets** | 10 years |

Residual values are not considered. Depreciation methods and estimated useful lives are reassessed at each reporting date. Gains and losses on disposals are determined by comparing proceeds with the carrying amount and are included in the income statement.

## (k) Intangible assets

Intangible assets are recorded at cost less accumulated amortisation and impairment. Expenditure on development activities is recognised as intangible assets if all of the requirements of IAS 38 "*Intangible Assets*" are met. Amortisation is provided on the straight-line basis over the estimated useful lives of intangible assets. Costs associated with maintaining intangible assets are recognised as an expense as incurred.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

### (k) Intangible assets (continued)

Intangible assets are amortised on a straight-line basis over their estimated useful lives as follows:

| | |
|---|---|
| **Leasehold improvements** | 5 years |
| **Software** | 5 years |
| **Applicative software developed by the Bank** | 10 years |
| **Licences** | 5 years |

### (l) Impairment of non-financial assets

The recoverable amount of property and equipment and intangible assets is the higher of the asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit.

All non-financial assets previously impaired, are reviewed for possible reversal of the impairment at each reporting date. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of amortisation/depreciation, if no impairment had been recognised.

### (m) Provisions for liabilities and charges

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made, or as required by law in the case of provisions for unidentified impairment of off-balance-sheet credit risk exposures, as previously referred to in Note 3 (g) 'Financial Instruments'.

Provisions for liabilities and charges are maintained at a level which the Bank's Management Board believes is adequate to absorb probable future losses. The Management Board determines the adequacy of the provision based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of various categories of transactions and other relevant factors. Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If an outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

### (n) Operating lease

Leases where the Bank has substantially all the risks and rewards of ownership, are classified as finance leases. At the reporting date, the Bank did not have any financial leases neither as a lessee nor lessor. Other leases are operating leases. Bank leases office space for conducting its business activities. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

### (o) Employee benefits

Pension obligations

The Bank pays contributions to state-owned institutions and obligatory pension funds managed by privately owned management companies, in accordance with legal requirements or by individual choice. The Bank has no further payment obligations once the contributions have been paid. Pension contributions are recognised as staff costs in the income statement as they accrue.

Other employee benefits

Liabilities based on other long-term employee benefits, such as jubilee awards and statutory termination benefits, are recorded as the net present value of the liability for defined benefits at the reporting date. The projected discounted present value unit method is used for the calculation of the present value of the liability, using discount rates that, in the opinion of the Bank's Management Board, best represent the time value of money.

Termination benefits

Termination benefits are recognised as an expense when the Bank is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan either to terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised if the Bank has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting date, then they are discounted to their present value.

### (p) Equity

Issued share capital represents the nominal value of paid-up ordinary shares classified as equity and is denominated in HRK. The premium on the issued shares presents the surplus of the fair value above the nominal value of the issued shares.

Accumulated losses

Accumulated losses include losses from previous periods and loss for the year.

Loss per share

The Bank presents basic loss per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period.

Treasury shares

Acquisition of treasury shares is carried out in the cases provided by the Companies Act, primarily in order to eliminate possible damage. Purchased treasury shares are stated at cost of purchase. The difference realized through the sale of treasury shares at the cost above the cost of acquisition is shown in favour of the capital gains account, and the difference realized below the cost of acquisition represents a capital loss.

### (q) Off-balance-sheet commitments and contingent liabilities

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

# Notes to the financial statements (continued)

## 3. Significant accounting policies (continued)

### (r) Repurchased assets in exchange for uncollected receivables

Foreclosed assets are stated at lower of the net recoverable value of property and the value of the related receivables. The Management Board has estimated that the carrying value of these assets approximates their market value.

The Bank occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the cost of the related loans and advances and the current fair value of such assets. The Bank's intention is mainly to sell such assets, which, however, in certain limited cases may end up being used by the Bank.

Gains or losses on disposal are recognised in the income statement.

### (s) Standards and Interpretations that are not yet valid

A number of new standards, amendments to standards and interpretations have been issued by the International Accounting Standards Board and IFRS Interpretations Committee but are effective for the accounting period ending 31 December 2018 and / or were not adopted by the European Union a and have not been applied in preparation of these financial statements. The Bank considers that other new standards and additions to standards will not affect the financial statements.

IFRS-16 of 01 January 2019 is replaced by IAS 17 Leases and Related Interpretations. The Standard requires that most leases are shown in the balance sheet by a single model, eliminating the difference between operating and finance leases.

According to IFRS 16, the contract is, or contains, a lease if it transfers the right to use a particular asset over a specified period of time in exchange for a fee. For such contracts, the new model requires the lessee to recognize the right to use property and the obligation to lease. The right to use assets is amortized until the interest is accrued on the liability. This will result in a higher rental cost recognized in the initial period for most leases, even when the fee is payable unchanged.

The new standard introduces several limited lease exclusions which include:

- Leases with a lease term of up to 12 months without a purchase option
- Leases in which the asset in question is of small value.

The accounting model of the lessor remains largely unaltered and the difference between operating and financial lease remains.

The Bank will recognize new assets and liabilities for operating leases (business premises, motor vehicles and equipment) in the balance sheet in the estimated amount of HRK 6 million. The costs associated with these leases will not have a significant impact because the Bank will recognize the cost of depreciation for the right to use property and the cost of interest on lease payments.

The Bank will use the option to keep the definition of lease when moving to a new standard. This means that IFRS 16 will apply to contracts concluded prior to 1 January 2019 identified as leases in accordance with IAS 17.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT

### 4.1 Internal assessment of risk of the Bank's operations

This section provides details regarding the Bank's exposure to risk and describes the methods used by the management to identify, measure and manage risks in order to safeguard capital. The most significant types of financial risk to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk.

For the most significant risks, the Bank adopted strategies and policies which include objectives and basic principles of risk assumption and management, define its risk profile and risk appetite and the compliance of the Bank's risk profile and the level of capital.

The Bank has established a risk management system appropriate to the nature, scope and complexity of the business, and the risk profile of the Bank, which includes an adequate strategy, policy and other internal regulations for risk management, organisational structure with defined authorities and responsibilities for risk management, risk management process and system of internal controls. The Bank regularly monitors and checks the risk management system and identifies and assesses the risks to which it is or expects to be exposed in its operations.

#### 4.1.1 Credit risk

The Bank is subject to credit risk through its lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties. Credit risk can be defined as a risk of financial loss of the Bank by a counterparty failing to discharge its obligation.

The Bank manages its credit risk exposure in accordance with the legislative requirements and regulations of the Croatian National Bank, as well as in accordance with its internal procedures. The Bank has established a system for monitoring its entire loan portfolio. The Credit Committee, the Supervisory Board and the Audit Committee are regularly informed of the quality of the portfolio. The analysis of the loan portfolio includes, at a minimum, an analysis of risk categories, overdue days and total exposure. The loan portfolio report is prepared by the Risk Management Sector. Based on the analysis results, decisions are made on the Bank's strategy toward the counterparty, group of related parties, certain industry or economic sector, geographical region, risk product type, certain type of collateral, etc.

The credit risk management policy and strategy is an umbrella document, i.e. a framework for managing credit risk, which is complemented with procedures, instructions and other documents that define the following in more detail:

- credit risk appetite,
- clear lines of authority and responsibility,
- way of assumption, overcoming and management of credit risk,
- defining the credit process and establishing a system of control and reporting of credit risk exposure,
- methodology for determining credit worthiness, measurement and assessment of credit risk for the duration of the repayment / validity of risky products,
- procedures for controlling and monitoring credit risk, including the establishment of exposure limits,
- maximum exposure limits regarding risk products with common risk factors,
- procedures and measures for approval of deviations from the application of existing policies, in case such deviations should occur and
- stress testing as a preparation of the Bank for possible crisis situations.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank’s operations (continued)

### 4.1.1 Credit risk (continued)

### Credit risk assessment

The process of credit risk assessment of placements comprises the following:

- debtors' creditworthiness,
- timely settlement of due instalments and
- collateral quality.

Creditworthiness is assessed for each loan application, and thereafter, as a minimum once a year subsequent to the delivery of the annual financial statements by the clients to which the Bank is exposed.

Monitoring of placements and contingent liabilities includes continuous assessment as to whether elements exist which would indicate a deterioration of the customer’s financial position or an increase in risk due to the decrease of collateral value.

The Bank’s effort, whenever possible, is to reconcile the customers' ability to pay in accordance with prevailing market conditions by way of overall restructuring of the debtors' operations or financial position. This should ultimately lead to a better settlement of liabilities to the Bank and improve the liquidity of customers in order to ensure business stability and sustainability over the long term.

### Classification of placements into risk categories

The risk classification process and classification criteria into risk categories and impairment for expected credit losses is defined by the CNB’s Decision on the Classification of Exposure to Risk Groups and the Method of Determining Credit Losses.

The Bank classifies its loan exposures into two groups: small loan portfolio (group of related exposures below HRK 200 thousand) and individually significant exposures (group of related exposures exceeding HRK 200 thousand). Impairment of small loan portfolio exclusively depends on the ageing of overdue amounts, while impairment of individually significant exposures is individually assessed for impairment, as it was earlier described in Note 3 g) vi).

After calculating the required impairment, the Bank allocates exposures to risk categories depending on the level of the calculated loss (in accordance with the CNB Regulations).

1. **Risk category A**

   **A1** - newly approved exposures at the beginning of the contractual relationship and exposures where no significant increase in credit risk was identified since approval (calculation of expected credit losses over a twelve-month period)

   **A2** - exposures where a significant increase in credit risk was recognized since initial recognition (calculation of expected credit losses over the lifetime of the financial asset)

2. **Risk category B** – partly recoverable exposure which are classified into three subcategories, depending on the percentage of the impairment losses recognized in relation to the nominal carrying amount:

   **B1** – when the level of impairment and provisions does not exceed 30% of the exposure amount;

   **B2** – when the level of impairment and provisions amounts to more than 30% (minimum 30.01%) and not more than 70% of the exposure amount;

   **B3** – when the level of impairment and provisions is more than 70% (minimum 70.01%) and less than 100% of the exposure amount.

3. **Risk category C** - non-recoverable placements with impairment at the amount of 100% exposure.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

## 4.1.1 Credit risk (continued)

### Assets exposed to credit risk

The Bank's primary exposure to credit risk arises from loans and advances to customers, debt securities amounts with the CNB, accounts with banks and receivables. In addition, the Bank is exposed to credit risk arising from off-balance-sheet items, through commitments arising from unused facilities and guarantees issued. Exposures to banks and other assets that are not presented at fair value are also considered a credit risk where the credit risk is not the primary risk of impairment. The table below presents the maximum exposure to credit risk for the components of the statement of financial position. The maximum exposure is presented net of impairment for expected credit losses (2017: impairment allowance) before the effect of mitigation through collateral agreements.

| [HRK'000] | Notes | 31 December 2017 | 31 December 2018 |
|---|---|---|---|
| Amounts with the Croatian National Bank | 6 | 168,257 | 159,650 |
| Placements with other banks | 8 | 476 | 466 |
| Giro accounts with banks | 7 | 132,316 | 112,097 |
| Financial assets available for sale | | 240,342 | - |
| Financial assets at fair value through OCI | 9 | - | 234,406 |
| Financial assets at fair value through profit and loss account | | 25,637 | 10,284 |
| Loans and advances to customers | 11 | 642,728 | 504,102 |
| Other assets | 14 | 3,264 | 1,521 |
| **Total assets exposed to credit risk** | | **1,213,020** | **1,022,526** |
| Guarantees | | 8,032 | 8,920 |
| Credit lines | | 11,366 | 23,164 |
| **Total off-balance sheet exposure to credit risk** | 35 | **19,398** | **32,084** |
| **Total credit risk exposure** | | **1,232,418** | **1,054,610** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

**Collateral and other credit enhancements held**

In terms of credit risk mitigation, the Bank's policy is to require suitable collateral to be provided by customers prior to the disbursement of approved loans. As a rule, the Bank approves a facility if there are two independent and viable repayment sources – cash flows generated by the borrower's activity and security instruments/collateral.

In general, a quality security instrument is an instrument with characteristics that provide a reasonable estimate of the Bank's ability to recover its receivables secured by that instrument (in case of its activation), through market or court mechanisms, within a reasonable period. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its regular review of the adequacy of the allowance for impairment losses.

Based on the applicable acts, Bank's standard collateral instruments are, in addition to promissory notes and bills of exchange: bank guarantees, real estate and movable asset pledges/fiduciary rights, fiduciary/pledge rights on shares and shares in open-ended investment funds, fiduciary/pledge rights on equity interests in a company, assignment of receivables from companies and government, guarantees of guarantee agencies and cash deposits.

A significant part of the corporate portfolio is secured by mortgages over different types of property. The liquidity of the real-estate market has an effect on the recoverability of assets and its timing in cases where, due to borrowers' financial difficulties, the Bank relies on collateral for collection.

The valuation of property and movable assets is performed by certified assessors included in the list of the Bank's certified assessors. The collateral value is revised based on common business practices and market movements.

### Restructuring of loan exposures

Restructuring of an exposure resulting with a decrease of initially contracted Debtor's liabilities, is considered to be an evidence of loss. The Bank has set up a system for identifying and subsequent monitoring of restructured exposures. Restructured exposures which were classified in risk category A before restructuring, are at least classified to risk category B1. Restructured exposures which was classified in one of the sub-categories of the risk category B before restructuring are classified in that same risk category or lower after restructuring. Reclassifying a restructured exposure into a different risk category is performed immediately during the restructuring:

Restructured exposures may be classified into risk category A after a period of at least 12 months if, after the credit assessment, it is evident that the exposure meets the following conditions:

a) financial position of the client is based on reliable cash flows
b) regular repayment has been established in a period of minimum 12 months and during that period significant payments have been made (regular repayment means no debt due over 30 days)
c) there are no overdue outstanding claims in in accordance with the repayment plan that is applied in accordance with the restructuring plan.

The minimum period of 12 months specified in the previous paragraph begins with the last of the following events:

a) moment of introducing measures for the restructuring of exposure
b) the end of the period of interest included in the exposure restraint arrangement

In case of a classification of the restructured exposure to risk category A, and when required terms are fulfilled, a new 24-month period is activated during which the borrower may not be overdue for more than 30 days with a materially significant amount (> 1,750.00 HRK). Otherwise such exposure is again classified into the risk group B1 or worse.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

### Credit Quality Analysis

The following table presents information on credit quality of financial assets measured at amortized cost, debt instruments at fair value through other comprehensive income (2017: debt assets available-for-sale) and other assets. Unless otherwise indicated, for financial assets shown in the table, values are represented as gross book value. For credit lines and guarantees, the amounts in the table are obligatory or guaranteed amounts.

| [HRK'000] | 2018 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL net of impairment | Lifetime ECL with impairment | Purchased or created financial assets less credit losses | Total | Total |
| **Amounts with the CNB** | | | | | | |
| Low risk | 160,937 | - | - | - | **160,937** | **168,257** |
| Impairment | (1,287) | - | - | - | **(1,287)** | **-** |
| **Carrying value** | **159,650** | **-** | **-** | **-** | **159,650** | **168,257** |
| **Cash and accounts with banks** | | | | | | |
| Low risk | 125,364 | - | - | - | **125,364** | **141,712** |
| Impairment | (904) | - | - | - | **(904)** | **-** |
| **Carrying value** | **124,460** | **-** | **-** | **-** | **124,460** | **141,712** |
| **Placements with other banks** | | | | | | |
| Low risk | 470 | - | - | - | **470** | **476** |
| Impairment | (4) | - | - | - | **(4)** | **-** |
| **Carrying value** | **466** | **-** | **-** | **-** | **466** | **476** |
| **Loans and advances to customers at amortised cost** | | | | | | |
| Low risk | 353,363 | 28,942 | - | - | **382,305** | **395,655** |
| Watch list | - | 7,857 | - | - | **7,857** | **70,437** |
| Past due impaired | - | - | 145,212 | 6,904 | **152,116** | **372,491** |
| Impairment | (7,349) | (1,331) | (45,110) | (2,807) | **(56,597)** | **(195,855)** |
| **Carrying value** | **346,014** | **35,468** | **100,102** | **4,097** | **485,681** | **642,728** |
| **Other assets at amortised cost** | | | | | | |
| Low risk | 1,521 | - | - | - | 1,521 | **3,264** |
| Past due impaired | - | - | 2,824 | - | 2,824 | **2,824** |
| Impairment | - | - | (2,824) | - | (2,824) | **(2,824)** |
| **Carrying value** | **1,521** | **-** | **-** | **-** | **1,521** | **3,264** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

### Credit Quality Analysis (continued)

| [HRK'000] | 2018 | | | | 2017 |
|---|---|---|---|---|---|
| | 12- month ECL | Lifetime ECL net of impairment | Lifetime ECL with impairment | Total | Total |
| **Financial assets at fair value through other comprehensive income (2017: available for sale)** | | | | | |
| Low risk | 234,406 | - | - | **234,406** | **265,979** |
| Impairment | (1,361) | - | - | **(1,361)** | **-** |
| **Carrying value** | **233,045** | **-** | **-** | **233,045** | **265,979** |
| **Credit lines** | | | | | |
| Low risk | 23,162 | 1 | 1 | **23,164** | **11,366** |
| Impairment | (515) | - | (1) | **(516)** | **(191)** |
| **Carrying value** | **22,647** | **1** | **-** | **22,648** | **11,175** |
| **Guarantees** | | | | | |
| Low risk | 8,620 | - | 300 | **8,920** | **8,032** |
| Impairment | (69) | - | (6) | **(75)** | **(3)** |
| **Carrying value** | **8,551** | **-** | **294** | **8,845** | **8,029** |

The credit risk of financial assets and credit lines and guarantees is presented through the internal credit risk classification.

Internally, the Bank classifies exposures to the following risk categories:

Low risk: the client is timely in servicing its liabilities and this exposure is not classified as exposure less credit losses;
Watch list: The Bank includes clients on the Monitoring List with the first early signs of increased credit risk using previously defined quantitative and qualitative criteria that are appropriate to the internal methodology. For the purpose of monitoring the increased credit risk, the Bank created 3 different Watch Lists:

1. Legal entities and tradesmen WL - clients with a maturity of 60 or more days whose total exposure exceeds 100,000 HRK from the basis of approved loans

2. Natural persons WL - clients with a maturity of 60 or more days whose total exposure exceeds 100,000 HRK from the basis of approved loans

3. Purchase of receivables and bills of exchange WL – overdue exposures based on purchased receivables and bills of exchange are listed regardless of the amount of due debt. As an additional criterion, a criterion of 10 days past due applies for purchased receivables, while overdue receivables on bills of exchange are listed regardless of days past due.

Stage 3 - Past due impaired: exposures that are past due for more than 90 days on a continuous basis above the established threshold.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

### Credit Quality Analysis – presentation of comparative data

| [HRK'000] | Neither past due nor impaired | | | 31 December 2017 |
|---|---|---|---|---|
| | Standard and sub-standard grades | Past due but not impaired | Individually impaired | Total |
| **ASSETS** | | | | |
| Amounts with the Croatian National Bank | 168,257 | - | - | 168,257 |
| Placements with other banks | 476 | - | - | 476 |
| Cash and accounts with banks | 132,316 | - | - | 132,316 |
| Financial assets available for sale | 240,342 | - | - | 240,342 |
| Loans and advances to customers | 362,959 | 95,509 | 184,260 | 642,728 |
| Other assets | 3,265 | - | - | 3,265 |
| Off-balance-sheet exposures | 19,139 | - | 259 | 19,398 |
| **TOTAL** | **926,754** | **95,509** | **184,519** | **1,206,782** |

*Past due but not impaired exposures*

An ageing analysis of loans and advances to customers past due but not impaired is shown below. The amounts in the table below include gross receivables based on maturity of both past due and not past due principal, on an individual basis, including past due but uncollected interests. The total amount of individual placements is allocated to the maturity class of the oldest uncollected receivable, relating to either principal or interest.

| | | | | | | | 31 December 2017 |
|---|---|---|---|---|---|---|---|
| | **Overdue up to 30 days** | **Overdue 31-90 days** | **Overdue 91-180 days** | **Overdue 181-365 days** | **Overdue 1-2 years** | **Overdue more than 2 years** | **Total** |
| Loans to and receivables to customers -retail | 23,332 | 3,212 | - | - | - | - | **26,544** |
| Loans to and receivables to customers - corporate | 32,980 | 35,985 | - | - | - | - | **68,965** |
| Off-balance-sheet exposures | - | - | - | - | - | - | **-** |
| **Total** | **56,312** | **39,197** | **-** | **-** | **-** | **-** | **95,509** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

### Credit Quality Analysis - presentation of comparative data (continued)

*Individually impaired*

The Bank determines the impairment of loans and advances to customers if there is objective evidence that the event that caused the impairment has occurred since the moment of initial recognition and that the event has an impact on future cash flows from the asset. The age structure of impaired loans and advances to customers is shown in the table below:

| | | | | | | | | 31 December 2017 |
|---|---|---|---|---|---|---|---|---|
| *in HRK 000* | Not due | Overdue up to 30 days | Overdue 31-90 days | Overdue 91-180 days | Overdue 181-365 days | Overdue 1-2 years | Overdue more than 2 years | Restated Total |
| Loans to and receivables to customers -retail | 6,344 | 539 | 312 | 1,212 | 2,432 | 823 | 1,748 | **13,410** |
| Loans to and receivables to customers - corporate | 48,630 | 8,449 | 14,773 | 22,329 | 15,750 | 33,931 | 26,988 | **170,850** |
| Held to maturity financial assets | - | - | - | - | - | - | - | **-** |
| Off-balance-sheet exposures | - | - | - | - | 259 | - | - | **259** |
| **Total** | **54,974** | **8,988** | **15,085** | **23,541** | **18,441** | **34,754** | **28,736** | **184,519** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

### Input data, assumptions and techniques used to estimate impairment

When determining whether the risk of default on a financial instrument has increased significantly from the initial recognition, the Bank takes into account both quantitative and qualitative information and expert credit assessments. The criteria for determining a significant increase in credit risk are set for the purpose of a proper allocation of exposure to Stage 1 or Stage 2. Throughout the contractual relationship, the Bank assesses credit exposure quality and classifies those exposures into appropriate risk groups on the basis of the general classification criteria:

- creditworthiness of the debtor,
- the timeliness in settling liabilities towards the credit institution and other creditors represents the debtor's ability to fully settle its liabilities towards the Bank including principal, interest, commissions and other liabilities within the agreed terms and does not meet the conditions from Article 178 of the Regulation (EU) No. 575/2013 defining the non-performing status,
- the quality of the collateral instruments determined on the basis of marketability, documentation and the possibility of exercising control by the bank, the possibility of enforcement and value in relation to exposure / off-balance sheet liabilities.

Credit risk is considered to have increased considerably from the initial recognition if any of the following occurs:

- at the reporting date the debtor is past due for more than 30 days, but is still within a period not exceeding 90 days and
- at the reporting date the borrower is timely in settling its liabilities. Days past due do not exceed 30 days but exposure has been past due for more than 30 days in the last 3 months, not exceeding 90 days.

Except for days past due, the Bank uses qualitative indicators to determine the increased credit risk pursuant to the internal credit risk monitoring system for the purpose of transitioning between "stages".

**Macroeconomic adjustment**

Measurement of financial assets reflects the best estimate of the effects of future conditions, and in particular the economic conditions affecting forward-looking probabilities of the non-performance of liabilities and losses due to the non-fulfilment of obligations. In order for future information to be adequately included in macroeconomic scenarios, the Bank prescribed the manner and the conditions of adjustments of the calculated PD to macroeconomic expectations. The macroeconomic scenario is determined on the basis of adjusted publicly available information.

**Modification of financial assets**

In some situations, change in conditions or modifications in the contracted cash flow may result in termination of the recognition of an existing financial asset.

When a modification of a financial asset results in cessation of recognition of an existing financial asset and subsequent recognition of a modified financial assets, the modified financial asset is viewed as a "new" financial asset.

Modification or change in contractual cash flows of financial assets occurs when re-contracting or as another change in contractual cash flows between the first recognition and maturity of the financial asset. Changes to the contractually agreed terms must be legally binding and enforceable.

When re-contracting or any other changes in contractual cash flows occur, during the period between initial recognition and maturity of the financial asset, the Risk Management Division / Credit Risk Management Department is obligated to determine whether there are any modifications and whether the modifications are so significant that the existing financial asset is derecognised, and a new financial asset is recognised.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

**Expected Credit Loss Measurement (ECL)**

Key figures for measuring expected credit loss are the following variables: probability of default (PD); loss given default (LGD).

Expected Credit Losses (ECL) in Stage 1 are calculated by multiplying the 12-month PD with LGD and the value of the exposure to credit risk at the reporting date. The ECL for the entire lifetime is calculated by multiplying the PD for its entire lifetime with LGD and the carrying amount of exposure to credit risk at the reporting date. Lifetime ECL is calculated by multiplying the lifetime PD with LGD and the gross book value of exposure at the reporting date.
The following definitions apply to PD and LGD:
- PD (likelihood of a non-fulfilment of obligations): the probability of a transition from performing status to non-performing status over a one-year period,
- LGD (loss due to the non-fulfilment of obligations): percentage of loss in case of non-performing of obligations.

The table below shows the movement of expected credit losses for Loans and advances to customers valued at amortized cost:

| [HRK'000] | 12- month ECL | Lifetime ECL net of impairment | Lifetime ECL with impairment | POCI assets | Total |
|---|---|---|---|---|---|
| **Loans and advances to customers at amortised cost** | | | | | |
| **As at 1 January 2018** | **6,461** | **3,804** | **169,970** | **19,193** | **199,428** |
| Transfer to expected credit losses in 12 months | 849 | (791) | (58) | - | - |
| Transfer to expected credit losses during lifetime | (258) | 285 | (27) | - | - |
| Transfer to non-performing status | (29) | (43) | 72 | - | - |
| Net impairment allowance during the year | 326 | (1,924) | 10,218 | 971 | **9,591** |
| Collected impaired interest | - | - | (1,475) | - | **(1,475)** |
| Write-offs and other movements | - | - | (133,590) | (17,357) | **(150,947)** |
| **As at 31 December 2018** | **7,349** | **1,331** | **45,110** | **2,807** | **56,597** |

The table below shows comparative movement in impairment allowance for 2017:

| [HRK'000] | Identified losses | Provisions on collective basis | TOTAL |
|---|---|---|---|
| **Changes in provisions** | | | |
| Balance at 1 January | **191,407** | **9,787** | **201,194** |
| Increase/(decrease) in impairment allowance | 54,793 | (2,090) | 52,703 |
| Collected impaired interest | (851) | - | (851) |
| Impairment losses recognized in the income statement (Note 29) | 53,942 | (2,090) | 51,852 |
| Write-offs and other movements | (57,191) | - | (57,191) |
| **At 31 December 2017** | **188,158** | **7,697** | **195,855** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

### 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.1 Credit risk (continued)

**Expected Credit Loss Measurement (ECL) (continued)**

The table below shows the movement of expected credit losses of financial assets at fair value through other comprehensive income recognized in equity:

| [HRK'000] | 2018 | | | |
|---|---|---|---|---|
| | 12- month ECL | Lifetime ECL net of impairment | Lifetime ECL with impairment | Total |
| **Financial assets at fair value through other comprehensive income** | | | | |
| **As at 1 January 2018** | **1,698** | **-** | **-** | **1,698** |
| New impairment during the year | 82 | - | - | 82 |
| Financial assets derecognised | (419) | - | - | (419) |
| **As at 31 December 2018** | **1,361** | **-** | **-** | **1,361** |

**Financial assets at fair value through other comprehensive income (2017: available for sale) by external risk classification**

The table below provides information on the credit quality of a financial asset at fair value through other comprehensive income, using the external ratings - Fitch Ratings.

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **Government bonds and treasury bills** | **137,515** | **155,016** |
| AAA | 12,509 | 6,426 |
| BBB+ and lower | 125,006 | 148,590 |
| **Corporate bonds** | **102,827** | **79,390** |
| Without rating | 102,827 | 79,390 |
| **Total** | **240,342** | **234,406** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

### 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.2 Market risk

Market risk is defined as the risk that the fair value or future cashflows of a financial instrument will fluctuate as a result of changes in market prices. It includes: interest rate risk, foreign exchange risk and positional risk.

The Risk Management Sector calculates: market risk exposure, market risk limits and capital requirements for exposure to market risks.

The Risk Management Sector reports daily to the Treasury Department on the usage of market risk exposure limits and reports to the Asset and Liability Management Committee monthly.

#### 4.1.2.1 Foreign exchange risk

Foreign exchange operations of the Bank are subject to risks due to changes in inter-currency relationships, as well as changes in foreign currency rates in relation to the domestic currency. The Bank monitors changes in the foreign currency sub-ledger on a daily basis by monitoring the relationship between the financial assets and liabilities in foreign currency, in accordance with CNB regulations on the open foreign exchange position.

The Bank uses the open foreign exchange position (gap analysis) to measure and report exposure to currency risk in accordance with the methodology prescribed by the Croatian National Bank. The operational management of the foreign currency position within the prescribed limits is the responsibility of the Treasury Department, which has the ability to propose measures to eliminate the currency gap through a reduction or increase in placements and deposits with a currency clause, selling or buying currency or through arbitration - selling one currency for another.

The Risk Management Sector controls the compliance with limits on a daily basis, and monthly reports to the Asset and Liability Management Committee on foreign exchange risk exposure.

The exposure in currencies other than EUR and HRK is below 5% of assets per single currency. Banks assets in other currencies include cash and deposits with other banks. In addition, the Bank has exposure to the USD through US treasury bills in the financial assets at fair value through other comprehensive income portfolio (2017: available for sale portfolio). Regarding other currencies, most of them refer to deposits in US dollar and swiss francs.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

## 4.1.2 Market risk (continued)

## 4.1.2.1 Foreign exchange risk (continued)

### Foreign exchange risk analysis

The Bank manages currency risk through a range of measures, including a currency clause, which has the same effect as denominating assets in HRK in other currencies.

| [HRK'000] | 31.12.2018 | | | | |
|---|---|---|---|---|---|
| | HRK | EURO linked | Euro | Other foreign currencies | Total |
| **ASSETS** | | | | | |
| Amounts with the Croatian National Bank | 159,650 | - | - | - | 159,650 |
| Cash and accounts with banks | 7,173 | - | 103,290 | 13,997 | 124,460 |
| Placements with other banks | - | - | 466 | - | 466 |
| Financial assets at fair value through OCI | 98,680 | 8,112 | 131,472 | 6,426 | 244,690 |
| Loans and advances to customers | 134,753 | 156,977 | 212,372 | - | 504,102 |
| Property and equipment | 14,832 | - | - | - | 14,832 |
| Intangible assets | 11,905 | - | - | - | 11,905 |
| Other assets | 20,387 | - | 29 | - | 20,416 |
| **TOTAL ASSETS** | **447,380** | **165,089** | **447,629** | **20,423** | **1,080,521** |
| **LIABILITIES** | | | | | |
| Deposits from customers | 288,820 | 1,512 | 576,442 | 20,503 | 887,277 |
| Borrowings | 1,715 | 8,900 | 9 | - | 10,624 |
| Subordinated debt | 20,000 | - | 26,673 | - | 46,673 |
| Provisions for liabilities and charges | 1,183 | 12 | 365 | - | 1,560 |
| Other liabilities | 4,077 | 967 | 8 | - | 5,052 |
| Deferred tax liability | 321 | - | - | - | 321 |
| **TOTAL LIABILITIES** | **316,116** | **11,391** | **603,497** | **20,503** | **951,507** |
| | | | | | |
| **CURRENCY GAP** | **131,264** | **153,698** | **(155,868)** | **(80)** | **129,014** |

| [000 HRK] | 31.12.2017 | | | | |
|---|---|---|---|---|---|
| | HRK | EURO linked | Euro | Other foreign currencies | Total |
| **ASSETS** | | | | | |
| Amounts with the Croatian National Bank | 168,257 | - | - | - | 168,257 |
| Cash and accounts with banks | 6,224 | - | 121,771 | 13,717 | 141,712 |
| Placements with other banks | - | - | 476 | - | 476 |
| Financial assets available for sale | 88,912 | 8,585 | 155,973 | 12,509 | 265,979 |
| Loans and advances to customers | 186,812 | 329,239 | 126,677 | - | 642,728 |
| Property and equipment | 17,387 | - | - | - | 17,387 |
| Intangible assets | 13,523 | - | - | - | 13,523 |
| Other assets | 19,570 | - | 4,892 | - | 24,462 |
| **TOTAL ASSETS** | **500,685** | **337,824** | **409,789** | **26,226** | **1,274,524** |
| **LIABILITIES** | | | | | |
| Deposits from customers | 301,795 | 1,513 | 610,277 | 26,033 | 939,618 |
| Borrowings | 11,116 | 11,820 | 120,350 | - | 143,286 |
| Subordinated debt | 20,000 | - | 27,021 | - | 47,021 |
| Provisions for liabilities and charges | 830 | 2 | - | - | 832 |
| Other liabilities | 3,883 | 1,043 | 55 | - | 4,981 |
| Deferred tax liability | 720 | - | - | - | 720 |
| **TOTAL LIABILITIES** | **338,344** | **14,378** | **757,703** | **26,033** | **1,136,458** |
| | | | | | |
| **CURRENCY GAP** | **162,342** | **323,446** | **(347,915)** | **193** | **138,066** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.2 Market risk (continued)

### 4.1.2.1 Foreign exchange risk (continued)

**Sensitivity of profit and loss to exchange rate fluctuations**

The tables below show the open position in EUR, the currency in which the Bank had the most significant exposures on 31 December 2018 and 31 December 2017. Open positions in foreign currency represent net exposure in foreign currency for balance sheet positions. The analysis shows the impact of reasonably possible foreign currency exchange rates on the profit and loss account, while all other variables remain the same. The negative amounts shown in the table reflect the possible net decrease in profit, while the positive amounts reflect the possible net increase in profit.

The Bank's analysis of the 10% lower exchange rate of the HRK against the EUR was made on 31st of December 2018. The table below shows the currency position at the end of 2018 and the net effect on the income statement. The positive figure shows a decrease in loss in case of depreciation of the HRK against the EUR by 10%. In case of a 10% appreciation of the HRK against the EUR, the impact on the profit and loss account would be negative.

| 2018. | | HRK'000 |
|---|---|---|
| | EUR | Other currencies |
| Open currency position | (212) | (206) |
| % change | 10% | 10% |
| Net P/L effect | (21) | (21) |

| 2017. | | HRK'000 |
|---|---|---|
| | EUR | Other currencies |
| Open currency position | (37,941) | 193 |
| % change | 10% | 10% |
| Net P/L effect | (3,794) | 19 |

### 4.1.2.2 Price risk

Price risk is the risk of loss arising from changes in the price of a financial instrument. Primary exposure to positional risk comes from shares in investment funds and debt securities at fair value through other comprehensive income (2017: available for sale). Shares in investment funds mainly relate to cash funds where no significant fluctuations in value. The Bank has minor investment to one alternative fund which is not significant. The Bank manages the risks arising from the change in their fair value by continuously following changes in share price and investment returns and reports to the Management Board. At least once a year The Market and Operational Risk department and Risk Control department conducts stress testing on fixed income securities portfolio. Stress testing includes at least the sensitivity analysis and relates to the impact of significant changes in interest rates on portfolio value and profit / loss.

### 4.1.2.3 Interest rate risk

The Bank's operations are subject to the risk of loss which arises from potential interest rate fluctuations which affect positions in the Bank's records.

In line with prudential interest rate risk management, the Bank defines responsibilities in accordance with generally accepted standards and defined limits for maintaining an acceptable level of economic capital and achieving satisfactory financial results.

For placements with corporate clients, the majority of placements and deposits are initially contracted at variable interest rate in accordance with the Bank's policies, except when, for competitive reasons, fixed interest rates are contracted.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.2 Market risk (continued)

### 4.1.2.3 Interest rate risk

The Bank uses the following internal models for the measurement of interest rate risk exposure:

1. repricing gap analysis,
2. standard interest shock method.

According to the Decision on interest rate management in the Bank's records, the Risk Management Sector reports on interest rate exposure on a quarterly basis in accordance with regulatory requirements.

The Bank manages with interest rate risk by using the following measures:

- whenever possible contracting loans and advances with variable interest rate, except when it comes to competitiveness than fixed interest rate are contracted
- ensuring the maturity matching of fixed and variable interest rates
- using internal limits for timely detecting excessive exposure to interest rate risk
- regular revision of interest rates on loans and advances and funding sources

**Measuring exposure to interest rate risk**

The Bank measures the exposure to interest rate risk both from the profit perspective and the perspective of the economic value of capital.

When calculating the effect of interest rate change on net interest income, the Bank uses the standard interest shock on net interest income for a 12-month period. The simulation is based on parallel movements in all interest rates, an increase by 2 percentage points for HRK and an increase by 1 percentage point for EUR and all other currencies. Parallel increase of all interest rates would affect the increase of net interest income by HRK 2,215 thousand (2017: decrease of HRK 705 thousand) which is 7.81% (2017: 1.76%) of net realised interest income.

**Interest rate risk stress test**

The Market and Operational Risk Department performs stress test at least once a year. Given that changes in interest rate can have adverse effects on earnings and their economic value, the Bank performs stress tests taking into account the earnings perspective, i.e. the effect of stress events on the net interest income, and the economic value perspective, i.e. the effect of stress events on the Bank's economic value. The results of stress tests are presented at the meeting of the Banks' Asset and Liability Management Committee.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

## 4.1.2 Market risk (continued)

### Interest rate gap analysis

The following tables present the Bank's financial assets and financial liabilities analysed according to repricing periods determined as the earlier of the remaining contractual maturity and the contractual repricing.

| [HRK'000] | 31 December 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Up to 1 month | From 1 to 3 months | From 3 months to 1 year | From 1 to 3 years | Over 3 years | Non-interest bearing | Total | Fixed interest rate |
| **FINANCIAL ASSETS** | | | | | | | | |
| Amounts with the Croatian National Bank | - | - | - | - | - | 159,650 | **159,650** | - |
| Placements with other banks | 466 | - | - | - | - | - | **466** | 470 |
| Cash and accounts with banks | 124,460 | - | - | - | - | - | **124,460** | - |
| Securities | - | 18,544 | 119,247 | 65,275 | 29,670 | 11,954 | **244,690** | 232,736 |
| Loans and advances to customers | 123,983 | 68,661 | 239,493 | 23,619 | 54,435 | (6,089)* | **504,102** | 112,865 |
| Other assets | - | - | - | - | - | 20,416 | **20,416** | - |
| **TOTAL FINANCIAL ASSETS** | **248,909** | **87,205** | **358,740** | **88,894** | **84,105** | **185,931** | **1,053,784** | **346,071** |
| **FINANCIAL LIABILITIES** | | | | | | | | |
| Deposits from customers | 182,236 | 77,115 | 497,908 | 67,637 | 54,522 | 7,859 | **887,277** | 603,200 |
| Borrowings | 88 | 305 | 2,092 | 3,029 | 5,094 | 16 | **10,624** | 10,608 |
| Subordinated debt | - | - | 22,253 | 4,336 | 20,000 | 84 | **46,673** | 46,589 |
| Other liabilities | - | - | - | - | - | 5,052 | **5,052** | - |
| Deferred tax liability | - | - | - | - | - | 321 | **321** | - |
| **TOTAL FINANCIAL LIABILITIES** | **182,324** | **77,420** | **522,253** | **75,002** | **79,616** | **13,332** | **949,947** | **660,397** |
| **INTEREST GAP** | **66,585** | **9,785** | **(163,513)** | **13,892** | **4,489** | **172,599** | **103,837** | **(314,326)** |

*includes impairment of performing loans, past due principal of performing loans, accrued interest and impairment of interest

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.2 Market risk (continued)

**Interest rate gap analysis**

| [HRK'000] | 31 December 2017 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Up to 1 month | From 1 to 3 months | From 3 months to 1 year | From 1 to 3 years | Over 3 years | Non-interest bearing | Total | Fixed interest rate |
| **FINANCIAL ASSETS** | | | | | | | | |
| Amounts with the Croatian National Bank | - | - | - | - | - | 168,257 | **168,257** | - |
| Placements with other banks | 476 | - | - | - | - | - | **476** | 476 |
| Cash and accounts with banks | 132,316 | - | - | - | - | 9,396 | **141,712** | - |
| Financial assets available for sale | - | 6,270 | 131,191 | 75,136 | 38,320 | 15,062 | **265,979** | 250,916 |
| Held-to-maturity financial assets | - | - | - | - | - | - | **-** | - |
| Loans and advances to customers | 154,547 | 36,548 | 382,288 | 35,888 | 32,777 | 680 | **642,728** | 101,240 |
| Other assets | - | - | - | - | - | 3,264 | **3,264** | - |
| **TOTAL FINANCIAL ASSETS** | **287,339** | **42,818** | **513,479** | **111,024** | **71,097** | **196,659** | **1,222,416** | **352,632** |
| **FINANCIAL LIABILITIES** | | | | | | | | |
| Deposits from customers | 227,241 | 119,204 | 444,960 | 64,612 | 71,358 | 12,243 | **939,618** | 649,039 |
| Borrowings | 125,693 | 474 | 6,499 | 3,662 | 6,693 | 265 | **143,286** | 22,802 |
| Subordinated debt | - | - | 22,541 | - | 24,392 | 88 | **47,021** | 24,392 |
| Other liabilities | - | - | - | - | - | 4,981 | **4,981** | - |
| Deferred tax liability | - | - | - | - | - | 720 | **720** | - |
| **TOTAL FINANCIAL LIABILITIES** | **352,934** | **119,678** | **474,000** | **68,274** | **102,443** | **18,297** | **1,135,626** | **696,233** |
| **INTEREST GAP** | **(65,595)** | **(76,860)** | **39,479** | **42,750** | **(31,346)** | **178,362** | **86,790** | **(343,601)** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.3 Liquidity risk

Liquidity risk arises through the general funding of the Bank's activities and in the management of its positions. The main categories of liquidity risk to which the Bank is exposed are:

- inability to settle liabilities as a result of the maturity gap between cash inflow and outflow - structural liquidity risk, and
- risk of being unable to sell or acquire liquid instruments on the market in an appropriate time frame and at a reasonable price - financial instruments liquidity risk.

Liquidity risk management is conducted in compliance with regulatory requirements and is defined by the following internal acts:

- liquidity risk management policy,
- liquidity stress test procedure,
- procedure for the Bank's liquidity management,
- liquidity risk (crisis) plan.

Internal acts are proposed by the Risk Management Sector and approved by the Bank's Management Board. In accordance with changes, the Risk Management Sector proposes revisions of internal acts.

The key purpose of the liquidity policy is to ensure that the Bank operates in a way to achieve an optimal balance between the Bank's safety and shareholders return on investment. The framework for appropriate liquidity risk management comprises the following: liquidity management strategy approved by the Management Board within budget and strategic plans; efficient supervision by the Asset and Liability Management Committee and the Management Board; clearly defined responsibilities and operations in line with agreed limits; management of assets and liabilities by matching their maturities; an established evaluation system of all current and future inflows and outflows; liabilities structure management, specifically in monitoring the concentration of large deposits; sustained development of liquidity stress tests; assessment of access to financial markets and available funds under usual and stressed conditions; and a crisis plan.

As part of its business activities the Bank monitors liquidity risk and complies with relevant regulations, the following measures are part of liquidity risk management:

- monitoring that minimum 17% of foreign currency liabilities is held as short-term foreign currency assets,
- monitoring liquidity reserve requirements in HRK,
- monitoring liquidity reserve requirements in foreign currency,
- LCR.

The purpose of managing liquidity funds is the compliance with the regulatory minimum by maintaining the minimum cost of liquidity funds.

The Bank uses the following models for liquidity risk measurement:

- financial and structural indicators,
- deposit concentration,
- cash flow notice and projection system, and
- liquidity stress tests.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.3 Liquidity risk (continued)

The Bank raises funds using a broad range of instruments including deposits, borrowings, subordinated debt and share capital. The Bank continuously assesses its liquidity risk by identifying and monitoring changes in the level of funding required to achieve business goals and strategic targets. Diverse funds enable flexibility, decrease dependence on a single source of funding and enable straightforward management of financing costs.

**Liquidity stress test**

Liquidity stress tests are performed based on the analysis of different scenarios, i.e. the assessment of effects of simultaneous changes in several different factors of risk on the financial position of the Bank in clearly defined stress circumstances. In order to prepare for a possible impact on liquidity, the Bank performs liquidity stress tests adapted to business size and characteristics, strategic goals and plans, the internal Bank's organization and its environment, to ensure sufficient liquidity funding. The aim of the liquidity stress test is to recognise a situation and to prepare the Bank's relevant functions for a prompt reaction in the case of a liquidity crisis. The development of the liquidity stress test represents the Bank's internal policy and good practice for liquidity management. The stress test relates to the change in value of certain parameters that have an impact on the financial and liquidity position of the Bank and determining the effects of said impact of these parameters on the entire business.

The stress scenario is arbitrarily selected and approved by the Risk Management Sector. Two scenarios are selected, at a minimum, one including the Bank's specific factors and the other including market factors. Different combinations of the factors are possible as well.

The selection of scenarios is usually affected by:

- current market movements;
- other movements historically significant for the Bank's liquidity;
- future predictions based on available information significant for the Bank's liquidity.

Upon selection of the stress scenario, the Treasury Department analyses the scenario or performs the sensitivity analysis, depending on whether one or more factors on the financial position of the Bank are analysed. The Risk Management Sector and the Treasury Sector report the results of the stress tests to the Asset and Liability Management Committee.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

## 4.1.3 Liquidity risk (continued)

### Maturity analysis

The tables below present the assets and liabilities of the Bank based on the remaining contractual maturity as of 31st December 2018 and 31st December 2017. Despite the maturity mismatch of assets and liabilities, the expected cash flows on a particular financial asset and liability differ significantly from the contractual cash flows. The Bank expects that demand deposits will not significantly oscillate and will not be withdrawn immediately. Assets and liabilities presented below are based on the Bank's carrying values.

| [HRK'000] | 31. December 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Up to 1 month | From 1 to 3 months | From 3 months to 1 year | From 1 to 3 years | Over 3 years | Total |
| **FINANCIAL ASSETS** | | | | | | |
| Amounts with the Croatian National Bank | 159,650 | - | - | - | - | **159,650** |
| Placements with other banks | 466 | - | - | - | - | **466** |
| Cash and accounts with banks | 124,460 | - | - | - | - | **124,460** |
| Financial assets at fair value through OCI | 10,843 | 20,387 | 25,776 | 98,843 | 88,841 | **244,690** |
| Loans and advances to customers | 42,423 | 35,813 | 94,711 | 86,598 | 244,557 | **504,102** |
| Other assets | 660 | 364 | 305 | - | 19,087 | **20,416** |
| **TOTAL FINANCIAL ASSETS** | **338,502** | **56,564** | **120,792** | **185,441** | **352,485** | **1,053,784** |
| | | | | | | |
| **FINANCIAL LIABILITIES** | | | | | | |
| Deposits from customers | 182,323 | 78,604 | 411,477 | 158,340 | 56,533 | **887,277** |
| Borrowings | 921 | 9 | - | 338 | 9,356 | **10,624** |
| Subordinated debt | - | - | - | 4,420 | 42,253 | **46,673** |
| Other liabilities | 4,435 | 537 | 80 | - | - | **5,052** |
| Deferred tax liability | - | 321 | - | - | - | **321** |
| **TOTAL FINANCIAL LIABILITIES** | **187,679** | **79,471** | **411,557** | **163,098** | **108,142** | **949,947** |
| | | | | | | |
| **MATURITY GAP** | **150,823** | **(22,907)** | **(290,765)** | **22,343** | **244,343** | **103,837** |
| | | | | | | |
| **OFF- BALANCE SHEET** | | | | | | |
| | | | | | | |
| Guarantees | 776 | 8 | 7,959 | 177 | - | 8,920 |
| Overdrafts | 8,537 | - | 19 | 14,484 | 123 | 23,164 |
| **TOTAL OFF-BALANCE SHEET** | **9,313** | **8** | **7,978** | **14,661** | **123** | **32,084** |

# Notes to the financial statements (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1.3 Liquidity risk (continued)

| [HRK'000] | 31. December 2017<br>Up to 1 month | From 1 to 3 months | From 3 months to 1 year | From 1 to 3 years | Over 3 years | Total |
|---|---|---|---|---|---|---|
| **FINANCIAL ASSETS** | | | | | | |
| Amounts with the Croatian National Bank | 168,257 | - | - | - | - | **168,257** |
| Placements with other banks | 476 | - | - | - | - | **476** |
| Cash and accounts with banks | 141,712 | - | - | - | - | **141,712** |
| Financial assets available for sale | 26,125 | 8,443 | 14,650 | 88,393 | 128,368 | **265,979** |
| Held-to-maturity financial assets | - | - | - | - | - | **-** |
| Loans and advances to customers | 110,693 | 41,575 | 82,942 | 168,062 | 239,456 | **642,728** |
| Other assets | 807 | 25 | 1,941 | - | 491 | **3,264** |
| **TOTAL FINANCIAL ASSETS** | **448,070** | **50,043** | **99,533** | **256,455** | **368,315** | **1,222,416** |
| **FINANCIAL LIABILITIES** | | | | | | |
| Deposits from customers | 231,411 | 121,575 | 377,852 | 136,525 | 72,255 | **939,618** |
| Borrowings | 5,936 | 120,351 | 5,382 | 3,290 | 8,327 | **143,286** |
| Subordinated debt | - | - | - | - | 47,021 | **47,021** |
| Other liabilities | 3,525 | 1,416 | 40 | - | - | **4,981** |
| Deferred tax liabilities | - | - | 720 | - | - | **720** |
| **TOTAL FINANCIAL LIABILITIES** | **240,872** | **243,342** | **383,994** | **139,815** | **127,603** | **1,135,626** |
| **MATURITY GAP** | **207,198** | **(193,299)** | **(284,461)** | **116,640** | **240,712** | **86,790** |
| **OFF- BALANCE SHEET** | | | | | | |
| Guarantees | 385 | 96 | 6,055 | 1,496 | - | 8,032 |
| Overdrafts | 10,775 | 104 | 102 | 20 | 365 | 11,366 |
| **TOTAL OFF-BALANCE SHEET** | **11,160** | **200** | **6,157** | **1,516** | **365** | **19,398** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.3 Liquidity risk (continued)

Analysis of undiscounted cash flows of financial liabilities by remaining contracted amounts.

| 31. December 2018 | Less than 1 month | 1 – 3 months | 3 – 12 months | 1 – 3 years | Over 3 years | Total | Carrying value |
|---|---|---|---|---|---|---|---|
| Deposits to costumers | 182,331 | 78,641 | 412,937 | 162,073 | 60,015 | 895,997 | 887,277 |
| Borrowings | 921 | 9 | - | 344 | 10,128 | 11,402 | 10,624 |
| Subordinated debt | - | - | - | 4,862 | 58,750 | 63,612 | 46,673 |
| Provisions for liabilities and charges | 159 | 365 | 639 | 397 | - | 1,560 | 1,560 |
| Other liabilities | 4,435 | 537 | 80 | - | - | 5,052 | 5,052 |
| Differed tax liabilities | - | 321 | - | - | - | 321 | 321 |
| **Total undiscounted financial liabilities** | **187,846** | **79,873** | **413,656** | **167,676** | **128,893** | **977,944** | **951,507** |
| **Off Balance-sheet** | **9,314** | **8** | **7,978** | **14,661** | **123** | **32,084** | **32,084** |

| 31. December 2017 | Less than 1 month | 1 – 3 months | 3 – 12 months | 1 – 3 years | Over 3 years | Total | Carrying value |
|---|---|---|---|---|---|---|---|
| Deposits to costumers | 231,419 | 121,630 | 379,237 | 138,729 | 75,089 | 946,104 | 939,618 |
| Borrowings | 5,941 | 120,491 | 5,441 | 3,488 | 8,881 | 144,242 | 143,286 |
| Subordinated debt | - | - | - | - | 64,935 | 64,935 | 47,021 |
| Provisions for liabilities and charges | - | 413 | 194 | - | 225 | 832 | 832 |
| Other liabilities | 3,525 | 1,416 | 40 | - | - | 4,981 | 4,981 |
| Differed tax liabilities | 720 | - | - | - | - | 720 | 720 |
| **Total undiscounted financial liabilities** | **241,605** | **243,950** | **384,912** | **142,217** | **149,130** | **1,161,814** | **1,136,458** |
| **Off Balance-sheet** | **11,160** | **199** | **6,158** | **1,516** | **365** | **19,398** | **19,398** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.4 Operational risk

Operational risk is defined as the risk of loss due to inadequate or incorrect processes, human or internal system errors or events caused by external factors (natural disasters, fire, flood, attack, changes of legislation, embezzlement).

Operational risk management is conducted in compliance with regulatory requirements and is defined by the following internal acts:

- Policy on operational risk management
- Procedure on operational risk management
- Methodology for operational risk management
- Directive on reporting of operational losses and operational risks

When measuring operational risk exposure, based on the consequences of a risk event, the Bank distinguishes the following:
*Loss from operational risk*, which represents operational losses affecting the balance sheet and assuming the known amount of losses in the Bank's records.
*Significant operational risk,* which is present in business processes and has not resulted in operational losses, but there is a possibility of future operational losses resulting from it.

Operational risk assessment is performed through Self Risk Assessment for every business process of the Bank. Self-Risk Assessment is performed on a yearly basis for every business process of the Bank using event-based questionnaires prepared in accordance with Basel guidelines. Based on collected data, each reported event which could result in operational risk is quantified and classified into a risk category. For events for which risks are high and very high, the business processes owners, in coordination with the Risk Management Sector, propose actions for reducing exposure to operational risk by using methods for reduction of effects, i.e. damages and the probability of occurrence or by transferring the risk to a counterparty. The Risk Management Sector reports the results of the Self Risk Assessment to the Management Board once a year.

The Risk Management Sector reports to the Management Board quarterly on recorded operational losses, i.e. events which resulted in losses recorded in the Bank's records due to exposure to operational risk. The report on operational losses contains, at a minimum, data on amounts of losses, recovered amounts, unrecovered amounts, operational losses per type of event and cause, and share of different organisational units of the Bank in operational losses.

### 4.1.5 Capital adequacy

The basic parameters of the capital management policy are given by the Credit Institutions Act and the Regulation (EU) no. 575/2013.

The basic objectives of capital management mean ensuring the following:

- the going concern assumption and
- meeting the regulatory and capital adequacy requirements

The total capital ratio as at 31 December 2018 was set at a minimum of 8%, while based on CNB's Decision for the Bank this amount was increased by an additional 2.5%, while keeping a protective layer for the preservation of ordinary capital in the amount of 2.5% and a protective layer for structural system risk of 1.5%.
Total capital is determined as a category of capital that is managed by the Bank and must be at least at a level that ensures the adequacy of capital sufficient to cover the capital requirements and to ensure minimum prescribed capital adequacy ratio. Total capital is calculated in accordance with the prescribed subordinate acts of CNB and Regulation (EU) no. 575/2013.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.5 Capital adequacy (continued)

For the purpose of calculating capital adequacy, the Bank has decided to adopt a "static approach" that allows the Bank to gradually incorporate IFRS 9 effect on the calculation of regulatory capital by 5% in 2018, 15% in 2019, 30% in 2020, 50% in 2021 and 75% in 2020.

| (HRK 000) CAPITAL ADEQUACY | 31.December 2017 | 31. December 2018 |
|---|---|---|
| **TIER 1 CAPITAL** | **120,951** | **121,130** |
| **TIER 1 CAPITAL – COMMON EQUITY** | **120,951** | **121,130** |
| Capital instruments eligible as CET1 Capital | 306,798 | 304,883 |
| Accumulated loss | (197,235) | (204,094) |
| Accumulated other comprehensive losses | (55) | (22) |
| Other reserves | 25,227 | 25,227 |
| (-) Goodwill | - | - |
| (-) Other intangible assets | (13,523) | (11,905) |
| Other transitional adjustments to CET 1 Capital | (262) | 7,041 |
| **TIER 1 CAPITAL - ADDITIONAL** | **-** | **-** |
| **TIER 2 CAPITAL** | 45,440 | 41,828 |
| **TOTAL REGULATORY CAPITAL** | **166,391** | **162,958** |
| **Risk weighted assets** | | |
| Credit risk weighted assets | 757,862 | 609,824 |
| Exposure for operational risk | 92,584 | 98,112 |
| Exposure for FX risk | 19,197 | - |
| **TOTAL RISK WEIGHTED ASSETS** | **869,643** | **707,936** |
| **COMMON EQUITY TIER 1 CAPITAL RATIO** | **13.91%** | **17.11%** |
| **TIER 1 CAPITAL** | **13.91%** | **17.11%** |
| **TOTAL CAPITAL RATIO** | **19.13%** | **23.02%** |

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.6 Concentration risk

*Concentration risk* is every individual, direct or indirect exposure toward one counterparty or group of related parties or group of exposures connected by common risk factors such as industry, geographical area, operations or goods, i.e. application of techniques for credit risk reduction, which can cause such losses which could jeopardize the Bank's going concern.
The Bank analyses and reports on concentration risk present both on the asset side of the balance sheet, i.e. loan portfolio, as well as on the equity and liabilities side of the balance sheet, i.e. source of funds.

The Bank analyses concentration risk on the basis of each individual, direct or indirect exposure toward one counterparty or group of related parties and has regulated the identification of related parties by internal acts, determining the following:

1) control, i.e. relationship between the parent company and its subsidiary or similar relationship between any legal or natural person and the company, and
2) economical and financial ties.

This relationship is established mainly on the basis of information/data received from the client, but also by checking other available sources. Groups of related parties are formed and reported by the Credit Risk Management Department within the Risk Management Sector. Groups of related parties are entered into the Registry of Related Parties as the comprehensive database for related parties.

The Bank actively manages the diversification of the loan portfolio and limits the concentration limits, thus adjusting the structure and quality of the loan portfolio or reducing the credit risk.

For the purpose of defining the Bank's exposure to risk, limits for certain types of exposure are determined, depending on the geographical location of the debtor, the activity, the type of placements and the method of repayment of the placements.

In order to maintain a diversified and stable base of financing and to avoid becoming overly dependent on only certain sources, concentration is monitored for the following:

- deposits from companies and other financial institutions: 10 biggest deponents with term deposits in relation to total deposits from legal persons and financial institutions; 10 biggest deponents in relation to total deposits
- retail deposits: 10 biggest deponents from the retail sector in relation to total retail deposits and 100 biggest deponents from the retail sector in relation to total deposits.

The Risk Management Sector reports the concentration risk to Management Board, Credit Committee and the Asset and Liability Management Committee on a monthly basis.

# Notes to the financial statements (continued)

## 4. RISK MANAGEMENT (continued)

## 4.1 Internal assessment of risk of the Bank's operations (continued)

### 4.1.6 Concentration risk (continued)

Concentration risk is also monitored on a sector basis, as shown in the following table where the numbers are presented on a gross basis:

| GROSS EXPOSURE (HRK) | 2018 | % | 2017 | % |
|---|---|---|---|---|
| ADMINISTRATIVE AND SUPPORT SERVICE ACTIVITIES | 7,446 | 1.34% | 9,550 | 1.16% |
| ACCOMMODATION AND FOOD SERVICE ACTIVITIES | 72,250 | 12.99% | 131,632 | 16.05% |
| HUMAN HEALTH AND SOCIAL WORK ACTIVITIES | 789 | 0.14% | 1,033 | 0.13% |
| FINANCIAL AND INSURANCE ACTIVITIES | 73,374 | 13.19% | 39,286 | 4.79% |
| CONSTRUCTION | 28,281 | 5.08% | 52,373 | 6.38% |
| INFORMATION AND COMMUNICATION | 23,069 | 4.15% | 25,070 | 3.06% |
| PUBLIC ADMINISTRATION | - | 0.00% | 7,032 | 0.86% |
| EDUCATION | - | 0.00% | - | 0.00% |
| ELECTRICITY SUPPLY, GAS AND CLIMATIZATION | - | 0.00% | - | 0.00% |
| WATER SUPPLY; SEWERAGE, WASTE MANAGEMENT AND REMEDIATION ACTIVITIES | - | 0.00% | 22,356 | 2.73% |
| OTHER SERVICE ACTIVITIES | 6,979 | 1.25% | 7,381 | 0.90% |
| AGRICULTURE, FORESTRY AND FISHING | 6,992 | 1.26% | 23,004 | 2.80% |
| REAL ESTATE ACTIVITIES | 49,675 | 8.93% | 21,028 | 2.56% |
| MANUFACTURING | 37,564 | 6.75% | 140,557 | 17.13% |
| TRANSPORTATION AND STORAGE | 83 | 0.01% | 2,761 | 0.34% |
| MINING AND QUARRYING | 196 | 0.04% | 267 | 0.03% |
| PROFESSIONAL, SCIENTIFIC AND TECHNICAL ACTIVITIES | 66,925 | 12.03% | 66,849 | 8.15% |
| WHOLESALE AND RETAIL TRADE; REPAIR OF MOTOR VEHICLES AND MOTORCYCLES | 108,633 | 19.53% | 143,988 | 17.55% |
| ARTS, ENTERTAINMENT AND RECREATION | - | 0.00% | - | 0.00% |
| RETAIL | 74,027 | 13.31% | 126,212 | 15.38% |
| **TOTAL** | **556,283** | **100.00%** | **820,379** | **100.00%** |

# Notes to the financial statements (continued)

## 5. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. The estimation of impairment losses in the Bank's credit risk portfolio represents the major source of estimation uncertainty. Significant judgments made in determining the most appropriate methodology for estimating the fair value of foreclosed assets and financial instruments carried at fair value are also described below. This and other key sources of estimation uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

### Classification of financial assets after 1 January 2018

#### *Business Model Assessment*

The Bank determines its business models based on the objective under which its portfolios of financial assets are managed. In determining its business models, the Bank considers the following:

- Management's intent and strategic objectives and the operation of the stated policies in practice;
- The primary risks that affect the performance of the business model and how these risks are managed;
- How the performance of the portfolio is evaluated and reported to management; and
- The frequency and significance of financial asset sales in prior periods, the reasons for such sales and the expected future sales activities.

#### *Solely Payments of Principal and Interest Test (SPPI test)*

In assessing whether contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that they would not be consistent with a basic lending arrangement. In making the assessment, the Bank considers the primary terms as follows and assess if the contractual cash flows of the instruments continue to meet the SPPI test:

- Performance-linked features;
- Terms that limit the Bank's claim to cash flows from specified assets (non-recourse terms);
- Prepayment and extension terms;
- Leverage features; and
- Features that modify elements of the time value of money.

### Impairment of financial assets after 1 January 2018

#### *Significant Increase in Credit Risk*

The basic criteria for assessing significant increases in credit risk are days past due. The Bank considers that the credit risk has increased considerably after the initial recognition if any of the following occurs:

- at the reporting date the borrower is more than 30 days past due, but is still within a period not exceeding 90 days;
- In the last 3 months the borrower was past due for more than 30 days but did not exceed 90 days past due;
- at the reporting date the borrower is timely in settling its liabilities. Days past due do not exceed 30 days but exposure has been past due for more than 30 days in the last 3 months, not exceeding 90 days.

In addition to days past due, the Bank uses qualitative indicators to determine a significant increase in credit risk such as a breach in contractual financial covenants, additional borrowing or third-party liability, loss of license, concession and similar permits, which may negatively affect client business etc.

# Notes to the financial statements (continued)

## 5. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

### Impairment of financial assets after 1 January 2018 (continued)

#### *Measurement of Expected Credit Loss*

Expected credit losses are calculated as the product of PD (probability of default), loss given default (LGD), and exposure at default (EAD) over the remaining expected life of the financial asset and discounted to the reporting date at the effective interest rate for exposures with significant increase in credit risk (i.e. stage 2 contracts). For exposures classified as stage 1, expected credit loss is calculated as the product of 12-month PD multiplied with LGD and the amount of exposure to credit risk on the reporting date. Lifetime ECL is calculated as a product of the lifetime PD and LGD and the amount of exposure to credit risk at the reporting date. Lifetime ECL is calculated by multiplying the Lifetime PD with LGD and the gross book value of exposure at the reporting date.

Impairment allowance on assets individually assessed as credit-impaired (2017: impaired) is based on the management’s best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor’s financial situation and net realizable value of any underlying collateral. Each impaired asset is assessed separately, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Impairment allowance on assets individually assessed as credit-impaired (2017: impaired) is based on the management’s best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor’s financial situation and net realizable value of any underlying collateral. Each impaired asset is assessed separately, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

The Bank's management believes that the recognised expected credit losses and provisions are sufficient.

### Impairment losses on loans and receivables before 1 January 2018

The Bank monitors the creditworthiness of its customers on an ongoing basis. In accordance with CNB regulations, the need for impairment of the Bank’s on and off-balance-sheet credit risk exposure is assessed at least quarterly. Impairment losses are made mainly against the carrying value of loans and advances to corporate and retail customers. The Bank also recognises provisions arising from off-balance-sheet exposure to credit risk to customers, mainly in the form of credit lines and guarantees.

The Bank first assesses whether objective evidence of impairment exists individually for assets that are individually significant (mainly corporate exposures) and collectively for assets that are not individually significant (mainly retail exposures).

The Bank estimates impairment losses in cases where it judges that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets. Such evidence includes delinquency in payments or other indications of financial difficulty of borrowers; and adverse changes in the economic conditions in which borrowers operate or in the value or enforceability of security, where these changes can be correlated with defaults.

Impairment allowance on assets individually assessed for impairment is based on the management’s best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor’s financial situation and net realisable value of any underlying collateral.

Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.
Collective impairment for the group of homogenous assets that are not individually significant is established taking into account ageing analysis and loss rates prescribed by the CNB.

The Bank also seeks to recognize impairment losses that are known to exist on the reporting date and which have not been individually identified. When assessing unidentified impairment losses that exist in commonly assessed portfolios, and in the absence of reliable historical data on loss rates and the identification period of those impairment losses, the Bank uses a rate of 1.00% prescribed by the CNB on all credit exposures other than those that are carried at fair value, including off-balance-sheet exposure to credit risk and central government risk.

# Notes to the financial statements (continued)

## 5. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

### Valuation of foreclosed assets

The Bank occasionally acquires land and properties in settlement of certain loans and advances. Real estate is stated at the lower of the carrying value of the related loans and advances at the date of settlement and the net realisable value of such assets. When assessing the valuation of foreclosed assets, the Bank engages chartered surveyors, and subsequently reviews them and compares them with the carrying amount. Gains or losses on disposal are recognised in the income statement.

### Taxation

The Bank provides for tax liabilities in accordance with the tax laws of the Republic of Croatia. Tax returns are subject to the approval of the tax authorities which are entitled to carry out subsequent inspections of a taxpayer's records.

The Bank did not recognise deferred tax asset on tax losses carried forward due to history of recurring past losses.

### Legal disputes

Management Board believes that court settlement provisions are sufficient at the reporting date. The Bank conducts an individual assessment of all legal disputes against the Bank. The initial assessment is carried out by the Department of Legal Affairs of the Bank, and the final decision on the risk group and the amount of the provision is made by the Management Board

At 31 December 2018 a total of 7 court proceedings against the Bank were conducted, of which 6 are litigation and one is a misdemeanour procedure.

In the 3 civil cases there is a first-instance verdict issued in favour of the Bank, whereas in one case and the second-instance court confirmed the first-instance verdict passed to the Bank's benefit and is undergoing a revision procedure.

There are 5 disputes in the risk group A, while the two slots are classified into the risk group C.

### Regulatory requirements

The CNB is entitled to carry out regulatory inspections of the Bank's operations and to request changes to the carrying values of assets and liabilities, in accordance with the underlying regulations.

### Internally developed software-determination of capitalisation criteria and estimated useful life

Intangible assets include internally developed software of total capitalized value of HRK 18.5 million. The Bank uses software in its business, and it is transferred to use according to the completion of individual modules.

Software development costs are capitalized when the criteria in IAS 38 are met *Intangible assets*. Such assets are then amortized linearly over a useful life of 10 years. Management Board re-evaluates the remaining useful life of the software at each reporting date.

There is judgement involved in determining an appropriate framework to consider which expenditure requires capitalisation and which should be expensed. Note 13 of the financial statements provides details of the amounts capitalised.

# Notes to the financial statements (continued)

## 6. AMOUNTS WITH THE CROATIAN NATIONAL BANK

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Giro accounts with CNB** | **88,070** | **94,362** |
| in HRK | 88,070 | 95,123 |
| in foreign currency | - | - |
| impairment | | (761) |
| **Obligatory reserve with CNB** | **80,187** | **65,288** |
| in HRK | 80,187 | 65,814 |
| in foreign currency | - | - |
| impairment | - | (526) |
| **TOTAL** | **168,257** | **159,650** |

Movements in impairment of amounts with the CNB are presented below:

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **As at 1 January** | **-** | **1,346** |
| Net (decrease) in impairment | - | (59) |
| **As at 31 December** | **-** | **1,287** |

Banks are obliged to calculate compulsory reserve in HRK and foreign exchange at the rate of 12% of kuna and foreign exchange funds (31 December 2017: 12%) as of December 31, 2018.

The kuna part of the compulsory reserve thus calculated is increased by 75% (December 31, 2017: 75%) computed reserve requirements on foreign currencies. A special account with the Croatian National Bank is allocated 70% of the Kuna part of the reserve requirement, while the rest can be maintained in appropriate liquid assets.

The portion of accrued foreign currency reserves is reduced by 75% (31 December 2017: 75%), which is accounted for by the calculated portion in kunas while the remaining 25% is held in foreign currencies. The percentage of the part of the reserve requirement in foreign currencies calculated on the basis of the funds of non-residents and funds received from legal entities in a special relationship with the bank in foreign currencies is 100% (31 December 2017: 100%) and is maintained in appropriate liquid assets.

The Croatian National Bank does not pay any interest on the obligatory reserve funds.

# Notes to the financial statements (continued)

## 7. CASH AND ACCOUNTS WITH OTHER BANKS

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Cash in hand** | **9,396** | **12,363** |
| in HRK | 6,224 | 7,174 |
| in foreign currency | 3,172 | 5,189 |
| **Giro accounts with other banks** | **132,316** | **112,097** |
| with foreign banks | 80,582 | 35,461 |
| impairment | - | (284) |
| with domestic banks | 51,734 | 77,540 |
| impairment | - | (620) |
| **TOTAL** | **141,712** | **124,460** |

Movements in impairment of Giro accounts with other banks are presented below:

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **As at 1 January** | **-** | **1,059** |
| Net (decrease) in impairment | - | (155) |
| **As at 31 December** | **-** | **904** |

## 8. PLACEMENTS WITH OTHER BANKS

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Short-term** | **476** | **466** |
| with domestic banks | 476 | 470 |
| impairment | - | (4) |
| **TOTAL** | **476** | **466** |

# Notes to the financial statements (continued)

## 9. FINANCIAL ASSETS -SECURITIES

| [HRK'000] SECURITIES AT FAIR VALUE THROUGH OCI (2017: AVAILABLE FOR SALE) | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Financial assets at fair value through OCI** | **236,828** | **231,172** |
| Bonds of the Croatian Ministry of Finance | 104,622 | 128,484 |
| Treasury bills of the Croatian Ministry of Finance | 18,826 | 18,550 |
| Foreign government treasury bills | 12,509 | 6,426 |
| Foreign corporate bonds | 100,871 | 77,712 |
| **Of which**: | | |
| - listed | 205,494 | 206,196 |
| - not listed | 31,334 | 24,976 |
| **Accrued interest** | **3,514** | **3,234** |
| not past due | 3,514 | 3,253 |
| impairment | - | (19) |
| **TOTAL** | **240,342** | **234,406** |

| [HRK'000] SECURITIES AT FAIR VALUE THROUGH PL (2017: AVAILABLE FOR SALE) | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **PORTFOLIO measured at FV through profit or loss - FOB** | **25,637** | **10,284** |
| **TOTAL** | **25,637** | **10,284** |

## 10. HELD-TO-MATURITY FINANCIAL ASSETS

| [HRK'000] | 31 December 2017 |
|---|---|
| **Debt securities** | **69** |
| Bills of exchange | 69 |
| **Accrued interest** | **4** |
| past due | 4 |
| **Allowance for impairment** | **(73)** |
| identified losses - bills of exchange | (69) |
| identified losses - accrued interest | (4) |
| **TOTAL** | **-** |

| [HRK'000] Movement in impairment allowance of financial assets held to maturity | 2017 |
|---|---|
| **Balance at 1 January** | **1,642** |
| (Release of impairment allowance) recognized in the income statement - unidentified losses (Note 30) | (151) |
| Write off and reversal | (1,418) |
| **Balance at 31 December** | **73** |

In 2018 exposure from the of held-to-maturity financial asset portfolio is reclassified to the Loans and advances portfolio at amortized cost.

# Notes to the financial statements (continued)

## 11. LOANS AND ADVANCES TO CUSTOMERS

### Loans and advances to customers at amortised cost

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Gross loans** | **820,379** | **537,862** |
| retail | 124,180 | 74,588 |
| corporate | 696,199 | 463,274 |
| **Interest receivables** | **22,508** | **7,408** |
| **Allowance for impairment** | **(195,855)** | **(56,597)** |
| identified losses - gross loans | (177,075) | (52,756) |
| identified losses - past due interest receivables | (18,780) | (3,841) |
| **Deferred income from fees** | **(4,304)** | **(2,992)** |
| **TOTAL** | **642,728** | **485,681** |

### Loans and advances to customers at fair value through profit and loss

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| Corporate | - | 18,421 |
| **TOTAL** | | **18,421** |
| **Total loans and advances to customers** | **642,728** | **504,102** |

# Notes to the financial statements (continued)

## 12. PROPERTY AND EQUIPMENT

| 2018<br>[HRK'000] | Land and buildings | IT equipment | Office furniture and equipment | Motor vehicles and other | Assets under construction | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **At 1 January 2018** | **20,662** | **8,222** | **9,839** | **1,396** | **62** | **40,181** |
| Additions | 15 | 38 | 97 | - | 40 | 190 |
| Transfer from Leasehold improvements | - | - | 219 | - | - | 219 |
| Write-offs and disposals | - | - | (517) | (41) | - | (558) |
| Transfers | - | - | - | - | - | - |
| Wantage | - | - | (19) | - | - | (19) |
| **At 31 December 2018** | **20,677** | **8,260** | **9,619** | **1,355** | **102** | **40,013** |
| | | | | | | |
| **Accumulated depreciation** | | | | | | |
| At 1 January 2018 | **5,955** | **6,825** | **9,088** | **926** | **-** | **22,794** |
| Depreciation expense | 2,026 | 425 | 163 | 131 | - | 2,745 |
| Sales / Write-offs | - | - | (517) | (41) | - | (558) |
| Wantage | - | - | (19) | - | - | (19) |
| Transfer from Leasehold improvements | - | - | 219 | - | - | 219 |
| **At 31 December 2018** | **7,981** | **7,250** | **8,934** | **1,016** | **-** | **25,181** |
| | | | | | | |
| **Net carrying value** | **12,696** | **1,010** | **685** | **339** | **102** | **14,832** |

| 2017<br>[HRK'000] | Land and buildings | IT equipment | Office furniture and equipment | Motor vehicles and other | Assets under constru ction | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **At 1 January 2017** | **20,724** | **8,279** | **9,890** | **1,391** | **23** | **40,307** |
| Additions | - | 59 | 185 | 131 | 48 | 423 |
| Transfer from and to foreclosed assets | - | - | - | - | - | - |
| Write-offs and disposals | (62) | (125) | (236) | (126) | - | (549) |
| Transfers | - | 9 | - | | (9) | - |
| **At 31 December 2017** | **20,662** | **8,222** | **9,839** | **1,396** | **62** | **40,181** |
| | | | | | | |
| **Accumulated depreciation** | | | | | | |
| At 1 January 2017 | **5,375** | **6,445** | **9,045** | **877** | **-** | **21,742** |
| Charge for the year | 598 | 506 | 266 | 175 | - | 1,545 |
| Write-offs and disposals | (18) | (126) | (223) | (126) | - | (493) |
| **At 31 December 2017** | **5,955** | **6,825** | **9,088** | **926** | **-** | **22,794** |
| | | | | | | |
| **Net carrying value** | **14,707** | **1,397** | **751** | **470** | **62** | **17,387** |

Decrease in the value of buildings and land during 2018 was due to regular depreciation in the amount of HRK 2,026 thousand.

# Notes to the financial statements (continued)

## 13. INTANGIBLE ASSETS

| 2018 [HRK'000] | Internally generated software | Leasehold improvements | Licenses | Assets under construction | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 January 2018 | **17,766** | **5,951** | **6,118** | **1,031** | **33,166** |
| Additions | 6 | - | - | 355 | 361 |
| Transfer to equipment | - | (219) | - | - | (219) |
| Transfer into use | 749 | - | - | (749) | - |
| Write-offs | - | (626) | - | - | (626) |
| **At 31 December 2018** | **18,521** | **5,106** | **6,118** | **637** | **32,682** |
| | | | | | |
| **Accumulated amortisation** | | | | | |
| At 1 January 2018 | **5,836** | **5,893** | **5,614** | **-** | **19,643** |
| Depreciation cost | 1,722 | 58 | 199 | - | 1.979 |
| Write-offs | - | (626) | - | - | (626) |
| Transfer to equipment | - | (219) | - | - | (219) |
| **At 31 December 2018** | **7,558** | **5,106** | **5,813** | **-** | **20,777** |
| | | | | | |
| **Net carrying value** | **10,963** | **-** | **305** | **637** | **11,905** |

| 2017 [HRK'000] | Internally generated software | Leasehold improvements | Licenses | Assets under construction | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 January 2017 | **16,650** | **5,951** | **5,985** | **1,500** | **32,386** |
| Additions | - | - | 17 | 763 | 780 |
| Transfer into use | 1,116 | - | 116 | (1,232) | - |
| **At 31 December 2017** | **17,766** | **5,951** | **6,118** | **1,031** | **33,166** |
| | | | | | |
| **Accumulated amortisation** | | | | | |
| At 1 January 2017, | **4,189** | **5,746** | **5,395** | **-** | **17,630** |
| Charge for the year | 1,647 | 147 | 219 | - | 2,013 |
| **At 31 December 2017** | **5,836** | **5,893** | **5,614** | **-** | **19,643** |
| | | | | | |
| **Net carrying value** | **11,930** | **58** | **504** | **1,031** | **13,523** |

The most significant movement in the bank's intangible asset refers to internally generated software. In 2018, the Bank transferred HRK 749 thousand in internally developed application software to use (2017: HRK 1,116 thousand).

# Notes to the financial statements (continued)

## 14. OTHER ASSETS

| [HRK'000] OTHER ASSETS | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Other assets** | **27,286** | **23,240** |
| Fees receivable | 484 | 368 |
| Prepaid expenses | 299 | 279 |
| Other receivables | 5,604 | 3,977 |
| Collateral repossessed | 20,899 | 18,616 |
| **Impairment allowance** | **(2,824)** | **(2,824)** |
| **TOTAL** | **24,462** | **20,416** |

a) *Impairment of foreclosed assets*

Foreclosed assets refer to land and real estate acquired through pledge for non-performing loans to customers. They are measured at a lower of loans and advances balance and their realisable value.

During the year, the Bank carried out impairment of the value of the foreclosed assets in the amount of HRK 858 thousand as presented in Note 30 (2017: HRK 620 thousand).

b) *Movements in impairment allowance for other assets*

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **At 1 January** | **29,150** | **2,824** |
| Increase/decrease (Note 30) | - | - |
| Write-offs | (26,326) | - |
| **At 31 December** | **2,824** | **2,824** |

# Notes to the financial statements (continued)

## 15. DEPOSITS FROM CUSTOMERS

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Demand deposits** | **121,889** | **113,402** |
| retail | 35,326 | 35,710 |
| *in HRK* | *22,340* | *23,705* |
| *in foreign currency* | *12,986* | *12,005* |
| corporate | 86,563 | 77,692 |
| *in HRK* | *56,568* | *48,898* |
| *in foreign currency* | *29,995* | *28,794* |
| **Term deposits** | **807,760** | **766,467** |
| retail | 586,863 | 580,406 |
| *in HRK* | *150,260* | *137,330* |
| *in foreign currency* | *436,603* | *443,076* |
| corporate | 220,897 | 186,061 |
| *in HRK* | *73,322* | *79,088* |
| *in foreign currency* | *147,575* | *106,973* |
| **Accrued interest** | **9,969** | **7,408** |
| **TOTAL** | **939,618** | **887,277** |

## 16. BORROWINGS

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Short-term** | **130,218** | **914** |
| from banks | 10,000 | 914 |
| *in HRK* | *10,000* | *914* |
| *in foreign currency* | - | - |
| from other financial institutions | 120,218 | - |
| *in foreign currency* | *120,218* | - |
| **Long-term** | **12,802** | **9,694** |
| from banks | 12,802 | 9,694 |
| *in HRK* | *1,022* | *794* |
| *in foreign currency* | *11,780* | *8,900* |
| **Accrued interest** | **266** | **16** |
| **TOTAL** | **143,286** | **10,624** |

Borrowings contain repurchase agreements in the amount of HRK 3,500 thousand (2017: HRK 10,000 thousand) as presented in note 39.

# Notes to the financial statements (continued)

## 17. SUBORDINATED DEBT

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Subordinated debt** | **46,933** | **46,589** |
| in HRK | 20,000 | 20,000 |
| in foreign currency | 26,933 | 26,589 |
| **Accrued interest** | **88** | **84** |
| **TOTAL** | **47,021** | **46,673** |

In July 2014 subordinated debt contract was signed, based on which J&T Banka, Prague, has made payment in the amount of EUR 3 million, or equivalent of HRK 22.9 million, at an interest rate of Euribor 12M + 7% per annum for a period of 10 year. During 2016, a new subordinated debt contract was signed, based on which J&T Bank Prague injected additional new funds of HRK 20 million at an interest rate of 8.8% for a period of seven years.

The subordinated debt was also collected from retail customers in the total amount of EUR 584 thousand equivalent in HRK 4.4 million with a fixed interest rate of 5% and a term of 5 years.

Subordinated debt is included in the additional capital of the Bank and is amortized for the purposes of calculating capital adequacy.

Subordination of subordinated debt obligations is subordinated to all other liabilities of the Bank.

## 18. PROVISIONS FOR LIABILITIES AND CHARGES

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| Provisions for legal disputes | 125 | 267 |
| Provisions for termination benefits and similar liabilities to employees | 413 | 596 |
| Provisions for contingent liabilities from credit risk | 194 | 591 |
| Provisions for contingent liabilities from other sources to individuals | 100 | 106 |
| **TOTAL** | **832** | **1,560** |

The movement in provisions for liabilities and charges is presented below:

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **As at 1 January, including the first-time adoption effect of IFRS 9** | **1,601** | **869** |
| Increase/decrease in the income statement | | |
| - Increase in provisions for legal disputes (Note 30) | 3 | 242 |
| - Provisions for termination benefits and similar liabilities to employees (note 30) | 404 | 592 |
| - (Release)/increase in provisions for contingent liabilities (Note 30) | (478) | 360 |
| - Increase in provisions from other sources to individuals (Note 29b) | 28 | 6 |
| Provisions used during the year (towards employees) | (726) | (409) |
| Provisions used during the year (for legal disputes) | - | (100) |
| **At 31 December** | **832** | **1,560** |

# Notes to the financial statements (continued)

## 19. OTHER LIABILITIES

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| Trade payables | 523 | 665 |
| Liabilities for salaries, deductions from salaries, taxes and benefits | 1,529 | 1,408 |
| Deferred income | - | - |
| Other liabilities | 2,929 | 2,979 |
| **TOTAL** | **4,981** | **5,052** |

In other liabilities, the most significant single liability amounts to a liability of HRK 0.5 million (31 December 2017: HRK 0.6 million) on the deposit insurance premium.

## 20. EQUITY

### 20.1. Share capital

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| Share capital | 307,085 | 307,085 |
| **TOTAL** | **307,085** | **307,085** |

| 31 December 2018 | Number of shares | Ownership share (%) |
|---|---|---|
| J&T BANKA A.S. | 25,350,000 | 82.55 |
| ALTERNATIVE UPRAVLJANJE D.O.O. | 3,571,429 | 11.63 |
| Other shareholders | 1,787,111 | 5.82 |
| **TOTAL** | **30,708,540** | **100.00** |

| 31 December 2017 | Number of shares | Ownership share (%) |
|---|---|---|
| J&T BANKA A.S. | 25,350,000 | 82.55 |
| Nexus FGS II | 3,571,429 | 11.63 |
| Other shareholders | 1,787,111 | 5.82 |
| **TOTAL** | **30,708,540** | **100.00** |

The Bank’s shares are not listed on the Zagreb Stock Exchange. On May 10, 2017 the Bank filed a request to delist its shares off the regulated market and the last trading day was on November 03, 2017.

During 2018 there was no capital increase. Last capital increase was in July 2016 when there was an increase in share capital by the amount of HRK 76,000,000.00 by the majority shareholder of the Bank - J&T Bank a.s., through the issuance of 7,600,000 new shares so that the new share capital amounts to HRK 307,085,400.00 and no capital gain or loss has been realized.

During February 2015, an increase of the Bank's share capital was made under the provisions of the Statute of the so-called authorized capital by the amount of HRK 37,500,000.00 approved by the majority shareholder of the Bank - J & T banka., and by September, another capital increase of the Bank was carried out, also based on the provisions of the Statute of the so-called authorized capital with the payment of an amount of HRK 65,000,000.00 by the same shareholder, so that the share capital on 31 December 2015 amounted to HRK 231,085,400.00.

Ordinary shares carry voting rights at shareholders’ meetings, subject to a minimum shareholding of one share. The Bank does not have preference shares.

# Notes to the financial statements (continued)

## 20. EQUITY (continued)

### 20.2 Premium on issued shares

The premium on the issued shares was formed in previous periods as a result of the recapitalization of the Bank above the nominal value of the subscribed capital.

### 20.3 Other reserves

| [HRK'000] | 31 December 2017 | 31 December2018 |
|---|---|---|
| Reserves for treasury shares | 2,557 | 2,557 |
| Legal reserves | 1,235 | 1,235 |
| | **3,792** | **3,792** |

Other reserves comprise of legal reserves and treasury shares reserves.

*Legal reserve*

The bank is obliged to form a legal reserve by allocating 5% of net profit for the year, until reserves reach 5% of the share capital. The legal reserve may be used to cover losses of previous years if the losses are not covered by current profit for the year or if no other reserves are available.

*Treasury share reserve*

The reserve for treasury shares is the result of the divestments based on the previous ownership of its own shares, and subsequently sold with the net gain and re-purchase during 2018 and 2017.

### 20.4 Treasury shares

When the Bank purchases the share capital of the Bank (treasury shares), the paid amount represents a deductible item from the capital and reserves belonging to the Bank's shareholders until such shares are rescinded, issued or sold.

On December 31, 2018, the Bank had a total of 590,338 treasury shares worth HRK 2,202 thousand. During the bankruptcy proceedings for the debtor Validus d.d. the Commercial Court in Varaždin granted the Bank 513,477 shares registered as debtor’s bankruptcy property. Ownership rights of the property were transferred after its validation in 2018.

During 2017, the Bank purchased 76,861 treasury shares. The total value of 76,861 treasury shares at December 31, 2017 is HRK 287 thousand.

### 20.5 Fair value reserve

The Fair value reserve includes unrealized gains and losses from changes in fair value and impairment of financial assets - securities classified by other comprehensive income.

### 20.6 Accumulated loss

The transferred loss includes accrued losses from previous years.

# Notes to the financial statements (continued)

## 21. INTEREST AND SIMILAR INCOME

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **Analysis by product** | **60,805** | **45,286** |
| Loans and advances to customers | 53,263 | 39,261 |
| Deposits | 1 | 1 |
| Debt securities | 7,541 | 6,020 |
| Other | - | 4 |
| **Analysis by source** | **60,805** | **45,286** |
| Retail | 9,310 | 7,789 |
| Corporate | 41,496 | 26,853 |
| State and public sector | 5,924 | 2,515 |
| Financial institutions | 79 | 10 |
| Other | 3,996 | 8,119 |

## 22. INTEREST AND SIMILAR CHARGES

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **Analysis by product** | **20,624** | **16,915** |
| Deposits from customers | 15,400 | 11,538 |
| Borrowings | 1,659 | 1,841 |
| Subordinated debt | 3,565 | 3,536 |
| **Analysis by source** | **20,624** | **16,915** |
| Retail | 14,559 | 9,773 |
| Corporate | 917 | 908 |
| State and public sector | 6 | 14 |
| Financial institutions | 5,089 | 6,204 |
| Other | 53 | 16 |

## 23. FEE AND COMMISSION INCOME

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| Payment transactions | 2,866 | 2,371 |
| Letters of credit and guarantee fees | 403 | 222 |
| Early repayment fees | 2,137 | 596 |
| Brokerage fees | 795 | 5,142 |
| Other | 837 | 937 |
| **TOTAL** | **7,038** | **9,268** |

# Notes to the financial statements (continued)

## 24. FEE AND COMMISSION EXPENSE

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| Payment transactions | 868 | 622 |
| Credit cards | 237 | 178 |
| Other | 668 | 140 |
| TOTAL | 1,773 | 940 |

## 25. NET REALISED GAINS FROM SECURITIES AVAILABLE FOR SALE

| [HRK'000] | 2017 |
|---|---|
| **Realised gains from securities available for sale** | **5,600** |
| Bonds | 6,120 |
| Investment funds | (520) |
| TOTAL | 5,600 |

## 26. NET REALISED GAINS FROM FINANCIAL ASSETS AT FAIR VALUE THROGUH PROFIT OR LOSS AND FINANCIAL ASSETS AT FAIR VALUE THROUGH OCI

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **Realised from securities through OCI** | - | **3,528** |
| Bonds | - | 3,528 |
| Investment funds | - | - |
| **Unrealised net gains from financial assets at fair value through profit and loss** | - | **313** |
| TOTAL | - | 3,841 |

## 27. NET FOREIGN EXCHANGE GAINS

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| Net (losses) from translation of monetary assets and liabilities | (917) | (1,139) |
| Net gains from trading with foreign currencies | 3,226 | 3,012 |
| TOTAL | 2,309 | 1,873 |

# Notes to the financial statements (continued)

## 28. OTHER INCOME

| [000 HRK] | 2017 | 2018 |
|---|---|---|
| Rental of premises | 1,211 | 1,449 |
| Use of official cars | 60 | 45 |
| Collection of written off and the transfer of receivables | 2,998 | 63 |
| Income from disposal of tangible and intangible assets | 2,135 | 522 |
| Release of accrued provisions from previous years | 431 | 183 |
| Other | 3,246 | 3,250 |
| **TOTAL** | **10,081** | **5,512** |

## 29. OTHER ADMINISTRATIVE EXPENSES

a) Personnel expenses

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **Personnel expenses** | **18,619** | **17,953** |
| - *Net salaries* | *10,013* | *8,972* |
| - *Contributions on and from salaries* | *5,526* | *5,154* |
| - *Taxes and surtaxes* | *2,352* | *2,560* |
| - *Other personnel expenses* | *728* | *1,267* |
| **TOTAL** | **18,619** | **17,953** |

As at 31 December 2018, the Bank had 71 employees (31 December 2017: 92 employees).

b) Other administrative expenses

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| Services | 9,383 | 9,175 |
| Costs of deposit insurance | 2,888 | 2,164 |
| Material and other costs | 1,263 | 1,029 |
| Representation, advertising and sponsorship | 568 | 437 |
| Other administrative expenses | 2,112 | 466 |
| Car and other transportation expenses | 144 | 195 |
| Business trip | 260 | 371 |
| Other expenses | 234 | 152 |
| Taxes, contributions, fees | 1,230 | 816 |
| **TOTAL** | **18,082** | **14,805** |

Other administrative costs include intellectual services, i.e. the cost of auditing. The revised audit fee in 2018 amounted to HRK 433 thousand, plus VAT. (2017: HRK 322 thousand + VAT).

In accordance with the Deposit Insurance Act and the Methodology for calculating the degree of risk of a particular credit institution in Croatia, the deposit insurance premium is calculated as a multiplication of the premium base, the premium rate and the degree of risk.

In other expenses, there is the expense of increase in provisions for contingent liabilities on other bases to physical persons in the amount of HRK 6 thousand (2017: HRK 28 thousand) (note 18).

# Notes to the financial statements (continued)

## 30. IMPAIRMENT LOSSES AND PROVISIONS

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **Specifically identified losses** | **51,223** | **7,921** |
| Impairment of loans and advances to customers (Note 4.1.1) | 51,852 | 8,166 |
| Impairment of Accounts with the CNB and giro accounts with other banks | - | (214) |
| Impairment of securities | - | (341) |
| Impairment of financial assets held to maturity (Note 10) | (151) | - |
| Impairment of off-balance-sheet exposure to credit risk (Note 18) | (478) | 360 |
| **Other provisions** | **1,027** | **1,692** |
| Provisions for court cases (Note 18) | 3 | 242 |
| Provisions for termination benefits (Note 18) | 404 | 592 |
| Impairment of foreclosed assets (Note 14a) | 620 | 858 |
| **TOTAL** | **52,250** | **9,613** |

## 31. INCOME TAX

### *a) Income tax expense recognised in the income statement*

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| Current income tax expense | - | - |
| Deferred income tax | - | - |
| **TOTAL INCOME TAX** | **-** | **-** |

### *b) Reconciliation of accounting profit and current income tax liability*

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| Accounting (loss)/profit before tax | (29,073) | 830 |
| Income tax at a rate of 18% | (5,233) | 149 |
| Tax deductible expenses - tax at a rate of 18% | 4,951 | 6,253 |
| Non-taxable income - tax rate 18% | (5,730) | (5,261) |
| Tax (loss)/profit for the year at a rate of 18% | (6,012) | 1,141 |
| Tax (loss)/profit that is not considered deferred tax asset for transfer in future period | (6,012) | - |
| Utilized transferred tax losses | - | 1,141 |
| Effective tax rate | - | - |

# Notes to the financial statements (continued)

## 31. INCOME TAX (CONTINUED)

The availability of tax losses in future periods, subject to change by the Ministry of Finance, are as follows:

| [HRK'000] | 31 December 2018 |
|---|---|
| No later than 1 year | 1,259 |
| No later than 2 year | 42,420 |
| No later than 3 year | 58,384 |
| No later than 4 year | 20,722 |
| No later than 5 year | - |
| **Total tax losses carried forward not recognised as deferred tax assets** | **122,785** |

On the reporting date the Bank did not recognise any deferred tax asset in respect of tax losses carried forward on the grounds of uncertainty as to whether sufficient future taxable profits will be available to utilise those losses before their expiry.

*c) Deferred tax liability on financial assets - securities classified under other comprehensive income*

The Bank has recognized in its books a deferred tax liability for unrealized gains on securities measured by OCI in the amount of HRK 321 thousand (2017: HRK 720 thousand).

| [HRK '000] CHANGES IN DEFERRED TAX LIABILITIES | 2018 |
|---|---|
| **Balance as at 1 January** | **720** |
| Recognised deferred tax liability in other comprehensive income | (399) |
| **Balance as at 31 December** | **321** |

# Notes to the financial statements (continued)

## 32. BASIC AND DILUTED (LOSS)/PROFIT PER SHARE

For the purpose of calculating (loss)/profit per share, losses are calculated as the (loss)/profit for the period attributable to shareholders of the Bank. The number of ordinary shares is the weighted average number of ordinary shares in circulation during the year after deducting the number of ordinary treasury shares.

Since there is no effect of options, convertible bonds or similar effects, the weighted average number of ordinary shares used to calculate diluted earnings per share was the same as the one used to calculate basic earnings per share. The bank has no preference shares.

| | 2017 | 2018 |
|---|---|---|
| Profit/(Loss) for the year [HRK'000] | (29,073) | 830 |
| Weighted average number of shares | 30,708,540 | 30,708,540 |
| **BASIC AND DILUTED (LOSS)/PROFIT PER SHARE (in HRK)** | **(0,95)** | **0,03** |

| | 2017 | 2018 |
|---|---|---|
| Number of shares as at January 1 | 30,708,540 | 30,708,540 |
| **Weighted average number of shares as at December 31** | **30,708,540** | **30,708,540** |

# Notes to the financial statements (continued)

## 33. CONCENTRATION OF ASSETS AND LIABILITIES

The table below represents the concentration of the Bank's assets and liabilities towards the state and state-owned institutions,

| [HRK'000] | Notes | 31 December 2017 | 31 December 2018 |
|---|---|---|---|
| Giro account with CNB | 6 | 88,070 | 95,123 |
| Obligatory reserve with CNB | 6 | 80,187 | 65,814 |
| Bonds issued by the Ministry of Finance | | 125,006 | 148,594 |
| Borrowings from Croatia Bank for Reconstruction and Development | | (12,802) | (9,694) |
| **TOTAL** | | **280,461** | **299,837** |

## 34. CASH AND CASH EQUIVALENTS

| [HRK'000] | Notes | 31 December 2017 | 31 December 2018 |
|---|---|---|---|
| Cash and giro accounts with banks | 7 | 141,712 | 124,460 |
| Giro account with CNB | 6 | 88,070 | 95,123 |
| **TOTAL** | | **229,782** | **219,583** |

## 35. CONTINGENCIES

| [HRK'000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| **Guarantees** | **8,032** | **8,920** |
| in HRK | 8,032 | 8,920 |
| **Revolving facility** | **11,366** | **23,164** |
| in HRK | 11,344 | 8,695 |
| in foreign currency | 22 | 14,469 |
| **TOTAL** | **19,398** | **32,084** |

As at 31 December 2018, the Bank recognized provisions on off-balance sheet risks arising from the issuance of guarantees, letters of credit and unused loan credits in the amount of HRK 591 thousand (2017: HRK 194 thousand) as presented in note 18.

# Notes to the financial statements (continued)

## 36. RELATED PARTY TRANSACTIONS

The majority owner of the Bank is J&T Banka A,S, based in the Czech Republic and the ultimate parent is J&T Finance Group, The majority owner as at 31 December 2018 owned 82,55% of the Bank's shares (31 December 2017: 82,55%), With the recapitalization in 2015 and 2016 and the subordinated debt, the Bank had other banking transactions with its majority owner during the year which resulted with revenue and expenses for the year, as well as assets and liabilities at year-end.

The second largest shareholder as at 31 December 2018 is Alternative d.o.o. owning 11,63% of the shares, The remaining 5,82% of the shares were traded publicly until 3rd November 2017 and delisting from Zagreb Stock Exchange, The Bank considers its related parties are their key shareholders, their direct or indirect subsidiaries, members of the Supervisory Board and the Management Board and other management (together "key management"), close family members of key management, jointly controlled companies or companies under significant influence of the Management board members and members of their immediate families, in accordance with the definition given in the International Accounting Standard 24 "Related Party Disclosures" ("IAS 24").

As at 31 December 2018, the Bank has liabilities to key shareholders in respect of assets on current accounts, liabilities for services rendered, loans and advances and deposits.

Transactions related to key management in 2018 were related to the payment of regular salaries, received deposits and given loans. The Bank regulates the Proceeds through the Policy and Ordinance on measuring and rewarding the Bank's performance, organizational units and employees.

Key management includes members of the Management Board and directors responsible for areas of strategic importance. The number of key management members at 31 December 2018 is 14 (31 December 2017: 15).

Related party transactions for the year ended 31 December 2018 and 31 December 2017 were as follows:

| | 2017. | | | | 2018. | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Assets | Liability | Revenue | Expenses | Assets | Liability | Revenue | Expenses | Impairment |
| **J&T Banka A.S.** | | | | | | | | | |
| **Other income** | - | - | 974 | - | - | - | 5,251 | - | (78) |
| **Other receivables** | 5 | - | - | - | - | - | - | - | - |
| **Received deposits** | | | | | | | | | |
| Giro accounts | - | 10,029 | - | - | 8,757 | 827 | - | - | (70) |
| Received loans | - | 120,218 | - | 547 | - | - | - | 1,591 | - |
| Subordinated debt | - | 42,541 | - | 3,350 | - | 42,252 | - | 3,324 | - |
| Other liabilities | - | 1 | - | - | - | - | - | - | - |
| **TOTAL** | **5** | **172,789** | **974** | **3,897** | **8,757** | **43,079** | **5,251** | **4,915** | **(148)** |
| **Key management personnel** | | | | | | | | | |
| Loans and advances to customers | 2,572 | - | 118 | - | 2,546 | 28 | 130 | - | (19) |
| Received deposits | - | 3,472 | - | 17 | - | 3,108 | - | - | - |
| Compensation to key management personnel | - | 612 | - | 7,798 | - | 641 | - | 8,299 | - |
| **UKUPNO** | **2,572** | **4,084** | **118** | **7,815** | **2,546** | **3,777** | **130** | **8,299** | **(19)** |

# Notes to the financial statements (continued)

## 37. AVERAGE EFECTIVE INTEREST RATES

Average interest rates calculated based on the weighted average for each category of interest-earning assets and interest-bearing liabilities, are presented below:

| | 2017 | 2018 |
|---|---|---|
| **Assets** | | |
| Amounts with the Croatian National Bank | - | - |
| Placements with banks | 0.12% | 0.22% |
| Investment securities | 2.62% | 2.48% |
| Held-to-maturity financial assets | 8.81% | - |
| Loans and advances to customers | 6.99% | 6.29% |
| **Liabilities** | | |
| Deposits from customers | 1.47% | 1.22% |
| Borrowings | 1.32% | 1.42% |
| Subordinated debt | 7.62% | 7.59% |

## 38. OPERATING LEASE COMMITMENTS

Future minimum lease payments at undiscounted amounts under non-cancellable operating leases where the Bank is the lessee are the following:

| [HRK '000] | 31 December 2017 | 31 December 2018 |
|---|---|---|
| Up to 1 year | 2,994 | 3,001 |
| From 1 to 5 years | 6,513 | 3,487 |
| Over 5 years | - | - |
| **TOTAL** | **9,457** | **6,488** |

# Notes to the financial statements (continued)

## 38. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value represents the amount at which an asset could be exchanged, or a liability settled on normal market conditions, Financial assets through other comprehensive income (2017: available for sale) are carried at fair value.

*Determination of fair value and fair value hierarchy.*

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: These instruments include: liquid debt and equity securities traded on liquid markets and quoted investment in investment funds.
- Level 2: These instruments include: lesser liquid debt and equity securities and derivatives valued by a model that uses input level 1 data.
- Level 3: Instruments where fair value can not be determined directly by referring to available market information and for which different valuation techniques were used to calculate the value. Instruments classified in this category relate to a factor that is not available on the market, which has a significant impact on the fair value of the instrument itself.

There were no transfers between levels in 2017 and 2018.

The tables below present the fair value of financial instruments that are not carried at fair value for the Bank, allocated by the hierarchy of fair value levels with respect to the input data used in the valuation process.

| 2018<br>Financial assets | Level 1<br>HRK '000 | Level 2<br>HRK '000 | Level 3<br>HRK '000 | Total<br>HRK '000 |
|---|---|---|---|---|
| **Financial assets at fair value through other comprehensive income** | | | | |
| Bonds of the Ministry of Finance | 130,042 | - | - | 130,042 |
| Treasury bills of the Ministry of Finance | - | 18,548 | - | 18,548 |
| Foreign corporate bonds | 79,390 | - | - | 79,390 |
| Foreign treasury bills | - | 6,426 | - | 6,426 |
| Closed-end investment funds | - | - | - | - |
| **Financial assets at fair value through profit and loss account** | | | | |
| Cash funds | 10,284 | - | - | 10,284 |
| Loans and advances to customers | - | - | 18,421 | 18,421 |
| **Total financial assets at fair value** | **219,716** | **24,974** | **18,421** | **263,111** |

| 2017<br>Financial assets | Level 1<br>HRK '000 | Level 2<br>HRK '000 | Level 3<br>HRK '000 | Total<br>HRK '000 |
|---|---|---|---|---|
| **Financial assets available for sale** | | | | |
| Bonds of the Ministry of Finance | 106,180 | - | - | 106,180 |
| Treasury bills of the Ministry of Finance | - | 18,826 | - | 18,826 |
| Foreign corporate bonds | 102,827 | - | - | 102,827 |
| Foreign treasury bills | - | 12,509 | - | 12,509 |
| Closed-end investment funds | - | - | 941 | 941 |
| Cash funds | 24,696 | - | - | 24,696 |
| **Total financial assets** | **233,703** | **31,335** | **941** | **265,979** |

# Notes to the financial statements (continued)

## 38. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

### Financial instruments measured at fair value (continued)

The table below shows the reconciliation of initial and final financial instruments at level 3 of the fair value hierarchy.

| | Financial assets available for sale |
|---|---|
| **As at 1 January 2017** | **2,886** |
| Valuation up to the day of sale, through other comprehensive income | *2,702* |
| Receipt from sales | *(4,054)* |
| Loss from sales | (593) |
| **As at 31 December 2017** | **941** |

| | Securities | Loans and advances |
|---|---|---|
| **As at 1 January 2018, after IFRS 9 adoption** | **941** | **59,836** |
| Valuation up to the day of sale, through other comprehensive income | *(341)* | - |
| Receipt from sales | *(600)* | *(41,415)* |
| Loss from sales | - | - |
| **As at 31 December 2018** | **-** | **18,421** |

During 2018 there was no transfer from level 3 or in level 3 fair value hierarchy, except for the reclassification of financial assets due to the first-time adoption of the CNB's new decision on classification and valuation of financial assets.

Financial instruments classified in level 3 refer to investments in alternative investment funds that are valued on the basis of the NAV published in the audited financial statements.

# Notes to the financial statements (continued)

## 38. FAIR VALUE OF FINANCIAL ASSETS (continued)

### Financial instruments measured at fair value (continued)

When discounting cash flows of assets or liabilities, the Bank uses weighted average monthly interest rates on loans and advances, ie deposits.

In assessing fair value, the Bank uses the following methods:

### Cash and accounts with banks, amounts with the Croatian National Bank

The carrying values of accounts with banks and amounts with the central bank approximate to their fair values, given the short maturity of these assets.

### Placements with other banks

The estimated fair value of placements with banks represents the discounted amount of future cash flow receipts, Due to their short-term character, their fair value approximates to their carrying value.

### Loans and advances to customers carried at amortised cost

Fair value is based on a discounted cash flows using currently applicable interest rates on loans for similar terms or similar credit characteristics. Most of the Bank's loan portfolio is approved at a variable interest rate. Using the discounting method of cash flows and interest (assuming that the loan is repayable according to the agreed terms and taking into account the existing losses on specific provisions), there is a difference between the fair value of the loan portfolio and the carrying amount, resulting from higher interest rates of the Bank than those on the market. The fair value of loans to non-repayable customers is estimated on the basis of a discounted cash flow analysis or the estimated value of the underlying security instrument. Estimated fair value of loans and advances to customers represents the discounted amount of expected future cash receipts. Expected future cash inflows are discounted using the market interest rate.

# Notes to the financial statements (continued)

## 38. FAIR VALUE OF FINANCIAL ASSETS (continued)

### Financial instruments not carried at fair value

### Financial investments held to maturity

The fair value of financial investments held to maturity, according to the Management Board, approximates their carrying value, given that these are short – term instruments. They relate to bills of exchange with maturities up to 12 months.

### Deposits from banks and customers

The fair value of term deposits payable on demand represents the carrying value of amounts payable as at the balance sheet date. The fair values of term deposits at variable interest rates approximate 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 applied to deposits of similar remaining maturities. According to the discounted cash flows, it is concluded that the fair value does not differ significantly from carrying value. Most of the customers' deposits with fixed interest rates become due within one year and consequently their fair value does not significantly differ from their carrying value.

### Borrowings

Due to its short-term nature, the carrying value approximates the fair value.

### Subordinated debt

Considering that there are no similar investments on the market, the management believes that the carrying value of subordinated debt approximates its fair value.

Financial instruments not valued at fair value:

| | 31 December 2017 | | 31 December 2018 | |
|---|---|---|---|---|
| | Carrying value | Fair value | Carrying value | Fair value |
| **FINANCIAL ASSETS** | | | | |
| Accounts with the CNB and credit institutions | 309,969 | 309,969 | 284,110 | 284,110 |
| Placements with other banks | 476 | 476 | 466 | 466 |
| Loans and advances to customers | 642,728 | 689,209 | 504,102 | 542,462 |
| Held-to-maturity financial assets (2017) | - | - | - | - |
| **Total financial assets** | **953,173** | **999,654** | **788,678** | **750,737** |
| Deposits from customers | 939,618 | 939,618 | 887,277 | 887,277 |
| Borrowings | 143,286 | 143,286 | 10,624 | 10,624 |
| Subordinated debt | 47,021 | 47,021 | 46,673 | 46,673 |
| **Total financial liabilities** | **1,129,925** | **1,129,925** | **944,574** | **944,574** |

# Notes to the financial statements (continued)

## 39. OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The disclosures set out in the table on the next page include financial assets and financial liabilities that are offset in the Bank's statement of financial position.

*Sale and repurchase agreement, and reverse sale and repurchase transaction*

Sale and repurchase agreements (repo contracts) are transactions in which the Bank sells a security and simultaneously contracts its re-purchase at a fixed price on a specified date in the future. The Bank continues to recognize securities sold on the basis of a sale and repurchase agreement in the statement of financial position as it assumes all the risks and rewards associated with the ownership. Received assets are recognized as financial assets and the financial liability is recognized for the obligation to pay the purchase price classified as an interest-bearing loan.
Reverse sale and repurchase agreements are transactions in which the Bank buys a security and simultaneously arranges for sale at a fixed price on a specific date in the future. The Bank holds a security instrument in the form of marketable securities based on the loans granted.
Sale and repurchase agreements and reverse sale and repurchase agreements give the Bank the ability to net these positions on a net basis in the event of non-payment by either party.

The table below shows the amount of security instruments received for the given loans with a sale and repurchase agreement and reverse the sale and re-purchase agreement and the security instruments issued for the received loans under the re-sale and re-sale contract. Days of insurance instruments include treasury bills and central government bonds.

| [HRK'000] | 2017 | 2018 |
|---|---|---|
| **Receivables from reverse sale and repurchase agreements related to:** | | |
| Loans and advances to banks | - | - |
| Loans and advances to costumers | - | - |
| **Fair value of collateral accepted in respect of the above** | - | - |
| **Payables under sale and repurchase agreements** | | |
| Interest-bearing borrowings | 10,000 | 3,500 |
| **Carrying amount of collateral provided in respect of the above relating to:** | | |
| Available-for-sale financial assets / securities | 9,994 | 4,293 |

# Additional reports for Croatian National Bank

This is the first year of presentation of the supplementary forms in the new format, accordingly amounts related to 2017 are only of a presentational nature.

The content of supplementary forms prepared in accordance with the CNB's Decision on the Structure and Content of the Annual Financial Statements of Credit Institutions (Official Gazette 42/18) does not prescribe separate categories for comparative financial information for financial instruments. Considering that comparative financial information has not been restated related to the first-time adoption of IFRS 9 Financial Instruments, financial instruments have been classified as follows: held-to-maturity financial assets are presented as financial assets at amortised cost and available-for-sale financial assets are presented as financial assets at fair value through other comprehensive income. The related classification has also been followed in income statement and cash flow statement as appropriate.

Supplementary financial statements prepared in accordance with the framework for reporting set out in the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of credit institutions (Official Gazette 42/18) are presented below:

# Additional reports for Croatian National Bank (continued)

# Balance sheet as at 31 December 2018

## Statement of financial position (Balance sheet)

### As at 31 December 2018

| Company: J&T banka d.d. | | | | |
|---|---|---|---|---|
| **Position Name** | **AOP tag** | **note numb.** | **Previous year (net)** | **Current year (net)** |
| 1 | 2 | 3 | 4 | 5 |
| **Imovina** | | | | |
| **1. Cash and deposits with the Croatian National Bank (AOP 002 to 004)** | 1 | | 228,048,059 | 218,821,018 |
| 1.1. Cash in hand | 2 | | 9,395,993 | 12,362,803 |
| 1.2. Deposits with the Croatian National Bank | 3 | | 131,606,242 | 161,224,497 |
| 1.3. Other deposits | 4 | | 87,045,824 | 45,233,718 |
| **2. Financial assets held for trading (AOP 006 do 009)** | 5 | | 0 | 0 |
| 2.1. Derivatives | 6 | | | |
| 2.2. Equity instruments | 7 | | | |
| 2.3. Debt securities | 8 | | | |
| 2.4. Loans and advances | 9 | | | |
| **3. Non-trading financial assets mandatorily at fair value through profit or loss** (AOP 011 to 013) | 10 | | 0 | 28,704,267 |
| 3.1. Equity instruments | 11 | | | 10,283,774 |
| 3.2. Debt securities | 12 | | | |
| 3.3. Loans and advances | 13 | | | 18,420,493 |
| **4. Financial assets designated at fair value through profit or loss** (AOP 015 + 016) | 14 | | 0 | 0 |
| 4.2. Debt securities | 15 | | | |
| 4.3. Loans and advances | 16 | | | |
| **5. Financial assets at fair value through other comprehensive income** (AOP 018 do 020) | 17 | | 265,978,671 | 234,406,137 |
| 5.1. Equity instruments | 18 | | 25,636,831 | |
| 5.1. Debt instruments | 19 | | 240,341,840 | 234,406,137 |
| 5.2. Loans and advances | 20 | | | |
| **6. Financial assets at amortised cost** (AOP 022+023) | 21 | | 727,615,474 | 551,828,098 |
| 6.1. Debt instruments | 22 | | | |
| 6.2. Loans and advances | 23 | | 727,615,474 | 551,828,098 |
| **7. Derivatives – Hedge accounting** | 24 | | | |
| **8. Fair value changes of the hedged items in portfolio hedge of interest rate risk** | 25 | | | |
| **9. Investments in subsidiaries, joint ventures and associates** | 26 | | | |
| **10. Tangible assets** | 27 | | 18,872,520 | 15,785,449 |
| **11. Intangible assets** | 28 | | 13,522,993 | 11,905,830 |
| **12. Tax assets** | 29 | | 285,090 | 296,448 |
| **13. Other assets** | 30 | | 2,462,551 | 1,111,245 |
| **14. Non-current assets and disposal groups classified as held for sale** | 31 | | 19,413,453 | 17,662,977 |
| **15. TOTAL ASSETS** (AOP 001 + 005 + 010 + 014 + 017 + 021 + 024 to 031) | 32 | | 1,276,198,811 | 1,080,521,469 |
| **Obveze** | | | | |
| **16. Financial liabilities held for trading** (AOP 034 do 038) | 33 | | 0 | 0 |
| 16.1. Derivatives | 34 | | | |
| 16.2. Short positions | 35 | | | |

## Additional reports for Croatian National Bank (continued)

## Balance sheet as at 31 December 2018 (continued)

| | | | | |
|---|---|---|---|---|
| 16.3. Deposits | 36 | | | |
| 16.4. Debt securities issued | 37 | | | |
| 16.5. Other financial liabilities | 38 | | | |
| **17. Financial liabilities designated at fair value through profit or loss** (AOP 040 to 042) | 39 | | 1,129,923,948 | 944,574,097 |
| 17.1. Deposits | 40 | | 1,129,923,948 | 944,574,097 |
| 17.2. Debt securities issued | 41 | | | |
| 17.3. Other financial liabilities | 42 | | | |
| **18. Financial liabilities measured at amortised cost** (AOP 044 to 046) | 43 | | 0 | 0 |
| 18.1. Deposits | 44 | | | |
| 18.2. Debt securities issued | 45 | | | |
| 18.3. Other financial liabilities | 46 | | | |
| **19. Derivatives – Hedge accounting** | 47 | | | |
| **20. Fair value changes of the hedged items in portfolio hedge of interest rate risk** | 48 | | | |
| **21. Provisions** | 49 | | 832,119 | 1,560,177 |
| **22. Tax liabilities** | 50 | | 719,637 | 320,518 |
| **23. Share capital repayable on demand** | 51 | | | |
| **24. Other liabilities** | 52 | | 6,657,037 | 5,052,259 |
| **25. Liabilities included in disposal groups classified as held for sale** | 53 | | | |
| **26. TOTAL LIABILITIES** (AOP 033 + 039 + 043 + 047 to 053) | 54 | | 1,138,132,741 | 951,507,051 |
| Equity | | | | |
| **27. Share capital** | 55 | | 307,085,400 | 307,085,400 |
| **28. Share premium** | 56 | | | |
| **29. Equity instruments issued other than capital** | 57 | | | |
| **30. Other equity** | 58 | | | |
| **31. Accumulated other comprehensive income** | 59 | | 3,275,317 | 24,432,190 |
| **32. Retained earnings** | 60 | | -168,161,503 | -204,923,409 |
| **33. Revaluation reserves** | 61 | | | |
| **34. Other reserves** | 62 | | 25,226,834 | 3,792,675 |
| **35. Treasury shares** | 63 | | -286,691 | -2,201,961 |
| **36. Profit or loss attributable to owners of the parent** | 64 | | -29,073,287 | 829,523 |
| **37. Interim dividends** | 65 | | | |
| **38. Minority interests (Non-controlling interests)** | 66 | | | |
| **39. TOTAL EQUITY** (AOP 055 to 066) | 67 | | 138,066,070 | 129,014,418 |
| **40. TOTAL LIABILITIES AND EQUITY** (AOP 054+067) | 68 | | 1,276,198,811 | 1,080,521,469 |

## Additional reports for Croatian National Bank (continued)

## Income statement for the period ended 31 December 2018

### Profit and Loss Account

**for the period from 1 January 2018 to 31 December 2018**

**Company: J&T banka d.d.**

| Position Name | AOP tag | note numb. | Previous year | Current year |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| 1. Interest income | 69 | | 61,271,291 | 45,445,019 |
| 2. Interest expense | 70 | | 20,614,959 | 16,990,603 |
| 3. Expenses on share capital repayable on demand | 71 | | | |
| 4. Dividend income | 72 | | | |
| 5. Fee and commission income | 73 | | 7,038,218 | 9,499,981 |
| 6. Fee and commission expense | 74 | | 1,782,750 | 940,852 |
| 7. Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net | 75 | | 5,600,142 | 3,528,251 |
| 8. Gains or losses on financial assets and liabilities held for trading, net | 76 | | 3,226,415 | 3,011,800 |
| 9. Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss, net | 77 | | | 312,559 |
| 10. Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net | 78 | | | |
| 11. Gains or losses from hedge accounting, net | 79 | | | |
| 12. Exchange differences gain or loss, net | 80 | | -917,280 | -1,192,069 |
| 13. Gains or losses on derecognition of non-financial assets, net | 81 | | 2,054,675 | 78,676 |
| 14. Other operating income | 82 | | 6,573,203 | 4,990,342 |
| 15. Other operating expenses | 83 | | 4,271,790 | 3,143,672 |
| **16. TOTAL OPERATING INCOME, NET** (AOP 069 - 070 - 071 + 072 + 073 - 074 + 075 to 082 - 083) | 84 | | 58,177,165 | 44,599,432 |
| 17. Administrative expenses | 85 | | 32,199,019 | 29,488,232 |
| 18. Depreciation | 86 | | 3,707,708 | 4,863,853 |
| 19. Modification gains or losses, net | 87 | | | |
| 20. Provision or release of provision | 88 | | 405,798 | -438,360 |
| 21. Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | 89 | | 51,688,848 | 9,441,709 |
| 22. Impairment or reversal of impairment of investments in subsidiaries, joint ventures and associates | 90 | | | |
| 23. Impairment or reversal of impairment on non-financial assets | 91 | | 621,713 | 857,646 |
| 24. Negative goodwill recognized in profit or loss | 92 | | | |
| 25. Share of the profit or loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method | 93 | | | |
| 26. Profit or loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations | 94 | | | 443,171 |
| **27. PROFIT OR LOSS BEFORE TAX FROM CONTINUING OPERATIONS** (AOP 084 - 085 - 086 + 087 - 088 do 091+ 092 to 094) | 95 | | -30,445,921 | 829,523 |
| 28. Tax expense or income related to profit or loss from continuing operations | 96 | | | |

## Additional reports for Croatian National Bank (continued)

## Income statement for the period ended 31 December 2018 (continued)

| | | | | |
|---|---|---|---|---|
| **29. PROFIT OR LOSS AFTER TAX FROM CONTINUING OPERATIONS** (AOP 095 - 096) | **97** | | -30,445,921 | 829,523 |
| **30. Profit or loss after tax from discontinued operations** (AOP 099 - 100) | **98** | | 1,372,634 | 0 |
| 30.1. Profit or loss before tax from discontinued operations | **99** | | 1,372,634 | |
| 30.2. Tax expense or income related to discontinued operations | **100** | | | |
| **31. PROFIT OR LOSS FOR THE YEAR** (AOP 097 + 098; 102 + 103) | **101** | | -29,073,287 | 829,523 |
| 32. Attributable to minority interest (non-controlling interests) | **102** | | | |
| 33. Attributable to owners of the parent | **103** | | | |

## Statement of Comprehensive Income for the Year Ended 31 December 2018

| **Statement of other comprehensive income** | | | | |
|---|---|---|---|---|
| **1. Profit or loss for the year** (AOP 101) | **104** | | -29,073,287 | 829,523 |
| **2. Other comprehensive income** (AOP 106 + 118) | **105** | | 1,564,633 | -277,287 |
| **2.1. Items that will not be reclassified to profit or loss** (AOP 107 do 113 + 116 + 117) | **106** | | 0 | 176,945 |
| 2.1.1. Tangible assets | **107** | | | |
| 2.1.2. Intangible assets | **108** | | | |
| 2.1.3. Actuarial gains or losses on defined benefit pensions plans | **109** | | | |
| 2.1.4. Non-current assets and disposal groups classified as held for sale | **110** | | | |
| 2.1.5. Share of other recognized revenues and costs from entities accounted by equity method | **111** | | | |
| 2.1.6. Fair value changes of equity instruments measured at fair value through other comprehensive income | **112** | | | |
| 2.1.7. Gains or losses from hedge accounting of equity instruments at fair value through other comprehensive income, net | **113** | | | 176,945 |
| 2.1.8. Fair value changes of equity instruments measured at fair value through other comprehensive income (hedged item) | **114** | | | |
| 2.1.9. Fair value changes of equity instruments measured at fair value through other comprehensive income (hedging instrument) | **115** | | | |
| 2.1.10. Fair value changes of financial liabilities at fair value through profit or loss attributable to changes in their credit risk | **116** | | | |
| 2.1.11. Income tax relating to items that will not be reclassified | **117** | | | |
| **2.2. Items that are or may be reclassified to profit or loss** (AOP 119 to 126) | **118** | | 1,564,633 | -454,232 |
| 2.2.1 Hedge of net investments in foreign operations (effective portion) | **119** | | | |
| 2.2.2. Foreign currency translation | **120** | | | |
| 2.2.3. Cash flow hedges (effective portion) | **121** | | | |
| 2.2.4. Hedging instruments (not designated elements) | **122** | | | |
| 2.2.5. Debt instruments at fair value through other comprehensive income | **123** | | 1,559,549 | -853,351 |
| 2.2.6. Non-current assets and disposal groups held for sale | **124** | | | |
| 2.2.7. Share of other recognised income and expense of Investments in subsidiaries, joint ventures and associates | **125** | | | |
| 2.2.8. Income tax relating to items that may be reclassified to profit or loss | **126** | | 5,084 | 399,119 |
| **3. Total comprehensive income for the year** (AOP 104 + 105 i AOP 128 + 129) | **127** | | -27,508,654 | 552,236 |
| 4. Attributable to minority interest (non-controlling interests) | **128** | | | |
| 5. Attributable to owners of the parent | **129** | | | |

## Additional reports for Croatian National Bank (continued)

## Statement of cash flows for year ended 31 December 2018

### STATEMENT OF CASH FLOWS - Indirect method

**for the period from 1 January 2018 to 31 December 2018**

| Company: J&T banka d.d. | | | | |
|---|---|---|---|---|
| Position Name | AOP tag | note numb. | Previous year | Current year |
| 1 | 2 | 3 | 4 | 5 |
| **Operating activities and adjustments** | | | | |
| 1. Profit/loss before tax | 1 | | -29,073,287 | 829,523 |
| 2. Impairment losses | 2 | | 51,623,325 | 8,110,104 |
| 3. Depreciation | 3 | | 4,329,421 | 5,721,499 |
| 4. Unrealized (gains)/losses on securities at fair value through profit or loss | 4 | | | |
| 5. Gains/losses from sale of tangible assets | 5 | | | |
| 6. Other gains/losses | 6 | | 932,147 | 370,474 |
| **Changes in assets and liabilities due to operating activities** | | | | |
| 7. Deposits with the Croatian National Bank | 7 | | 14,046,008 | 14,372,989 |
| 8. Deposits with banking institutions and loans to financial institutions | 8 | | 168,475 | 549,985 |
| 9. Loans to other clients | 9 | | 107,378,587 | 81,685,919 |
| 10. Securities and other financial instruments at FVOCI | 10 | | -10,828,873 | 28,981,546 |
| 11. Securities and other financial instruments held for trading | 11 | | | |
| 12. Securities and other financial instruments at fair value through profit or loss which are not actively traded | 12 | | | -10,283,774 |
| 13. Securities and other financial instruments mandatorily at FVTPL | 13 | | | |
| 14. Securities and other financial instruments at amortized cost | 14 | | | |
| 15. Other operating assets | 15 | | 31,860,246 | 3,456,200 |
| **Increase/decrease of operating liabilities** | | | | |
| 16.Financial institutions deposits | 16 | | | |
| 17. Other clients demand deposits | 17 | | -5,719,507 | -4,017,684 |
| 18. Other clients savings deposits | 18 | | -279,366,117 | -20,444,928 |
| 19. Other clients term deposits | 19 | | | -2,834,979 |
| 20. Derivative financial liabilities and other liabilities held for trading | 20 | | | |
| 21. Other liabilities | 21 | | -17,759,728 | -6,111,525 |
| 22. Interest received | 22 | | | 45.256.119 |
| 23. Dividends received | 23 | | | |
| 24. Interest paid | 24 | | | -16.990.603 |
| 25. Income tax paid | 25 | | | |
| **A) Net cash flow from operating activities** (AOP 001 to 025) | 26 | | -132,409,303 | 128,650,865 |
| **Investing activities** | | | | |
| 1. Cash receipts from/(payments to acquire) tangible and intangible assets | 27 | | 4,242,685 | -675,784 |
| 2. Cash receipts from the disposal of/(payments for the investment in) subsidiaries, associates and joint ventures | 28 | | | |

| | | | | |
|---|---|---|---|---|
| 3. Cash receipts from sales of/(cash payments to acquire) securities and other financial instruments held until maturity | **29** | | 15,189,311 | |
| 4. Dividends received | **30** | | | |
| 5. Other receipts from/(payments for) investments | **31** | | | |
| **B) Net cash flow from investing activities (AOP 027 to 031)** | **32** | | 19,431,996 | -675,784 |
| **Financing activities** | | | | |
| 1. Net increase/(decrease) in received loans | **33** | | 79,603,833 | -127,762,056 |
| 2. Net increase/(decrease) in issued debt securities | **34** | | | |
| 3. Net increase/(decrease) in subordinated and hybrid instruments | **35** | | -466 | -15,168 |
| 4. Proceeds from issue of share capital | **36** | | | |
| 5. Dividends paid | **37** | | | |
| 6. Other proceeds/(payments) from financing activities | **38** | | -286,692 | -9,426,943 |
| **C) Net cash flow from financing activities** (AOP 033 to 038) | **39** | | 79,316,675 | -137,204,167 |
| **D) Net increase/(decrease) in cash and cash equivalents** (AOP 026+032+039) | **40** | | -33,660,632 | -9,229,086 |
| **Cash and cash equivalents at the beginning of the year** | **41** | | 266,035,505 | 229,781,012 |
| **Effect of foreign exchange differences on cash and cash equivalents** | **42** | | -2,593,861 | -1,730,908 |
| **Cash and cash equivalents at the end of the year** (AOP 040+041+042) | **43** | | 229,781,012 | 218,821,018 |

# Additional reports for Croatian National Bank (continued)

## Statement of changes in equity for year ended 31 December 2018

**CHANGES IN EQUITY**
**for the period from 1 January 2018 to 31 December 2018**

Company: J&T Banka d.d.

| Position | AOP tag | Note nb. | Distributable to Parent share holders | | | | | | | | | | | Minority share | | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Capital | Share premium | Issued other equity instruments | Other shares in equity | Accumulated other comprehensive income | Retained earnings | Revalorisation reserves | Other reserves | Treasury shares | Profit / loss belonging to the Parent company's share holders | Dividens during the year | Accumulated other comprehensive income | Other | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 (4 to 16) |
| **1. Opening balance (before restatement)** | 01 | | 307,085,400 | | | | 3,275,317 | -168,161,503 | | 25,226,835 | -286,692 | -29,073,287 | | | | 138,066,070 |
| 2. Effects of modification | 02 | | | | | | | | | | | | | | | 0 |
| 3. Effects of changes in accounting policies | 03 | | | | | | | | | | | | | | | 0 |
| **4. Opening balance (current period)** (AOP 01 to 03) | 04 | | 307,085,400 | 0 | 0 | 0 | 3,275,317 | -168,161,503 | 0 | 25,226,835 | -286,692 | -29,073,287 | 0 | 0 | 0 | 138,066,070 |
| 5. Issue of share capital | 05 | | | | | | | | | | | | | | | 0 |
| 6. Issue of preference shares | 06 | | | | | | | | | | | | | | | 0 |
| 7. Issue of other equity instruments | 07 | | | | | | | | | | | | | | | 0 |
| 8. Execution or maturity of other equity instruments | 08 | | | | | | | | | | | | | | | 0 |
| 9. Converting Debt to Equity instruments | 09 | | | | | | | | | | | | | | | 0 |
| 10. Reduction of Capital | 10 | | | | | | | | | | | | | | | 0 |
| 11. Dividends | 11 | | | | | | | | | | | | | | | 0 |
| 12. Purchase of treasury shares | 12 | | | | | | | | | | -1,915,269 | | | | | -1,915,269 |
| 13. Sale or annulment of treasury shares | 13 | | | | | | | | | | | | | | | 0 |
| 14. Reclassification of securities from equity to liabilities | 14 | | | | | | | | | | | | | | | 0 |
| 15. Reclassification of securities from liabilities to equity | 15 | | | | | | | | | | | | | | | 0 |
| 17. Transfer between equity instrument components | 16 | | | | | | | -29,073,287 | | | | 29,073,287 | | | | 0 |
| 17. Increase or decrease in securities as a result of business combinations | 17 | | | | | | | | | | | | | | | 0 |
| 18. Share-based payments | 18 | | | | | | | | | | | | | | | 0 |
| 19. Other increase or decrease in equity | 19 | | | | | | 21,434,160 | -7,688,618 | | -21,434,160 | | | | | | -7,688,618 |
| 20. Total comprehensive income for the year | 20 | | | | | | -277,287 | | | | | 829,523 | | | | 552,236 |
| **21. Closing balance (current period)** (AOP 04 to 20) | 21 | | 307,085,400 | 0 | 0 | 0 | 24,432,190 | -204,923,408 | 0 | 3,792,675 | -2,201,961 | 829,523 | 0 | 0 | 0 | 129,014,419 |

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB

## Reconciliation of balance sheet as at 31 December 2018

in '000 HRK

| TOTAL ASSETS - Statutory financial statements | | Amounts with the Croatian National Bank | Cash and accounts with banks | Placements with other banks | Financial assets-securities | Loans and advances to customers | Property and equipment | Intangible assets | Other assets | TOTAL ASSETS | No. |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **ASSETS Audited financial statements 31 December 2018** | | | | | | | | | | | |
| 1. | Cash and deposits with the Croatian National Bank | | | | | | | | | | |
| 1.1. | Cash in hand | | 12,363 | | | | | | | **12,363** | **1** |
| 1.2. | Deposits with the Croatian National Bank | 94,361 | 66,863 | | | | | | | **161,224** | **2** |
| 1.3. | Other deposits | | 45,234 | | | | | | | **45,234** | **3** |
| 2. | Financial assets held for trading | | | | | | | | | | |
| 2.1. | Derivatives | | | | | | | | | | |
| 2.2. | Equity instruments | | | | | | | | | | |
| 2.3. | Debt securities | | | | | | | | | | |
| 2.4. | Loans and advances | | | | | | | | | | |
| 3. | Non-trading financial assets mandatorily at fair value through profit or loss | | | | | | | | | | |
| 3.1. | Equity instruments | | | | 10,284 | | | | | **10,284** | **4** |
| 3.2. | Debt securities | | | | | | | | | | |
| 3.3. | Loans and advances | | | | | 18,421 | | | | **18,421** | **5** |
| 4. | Financial assets designated at fair value through profit or loss | | | | | | | | | | |
| 4.2. | Debt securities | | | | | | | | | | |
| 4.3. | Loans and advances | | | | | | | | | | |
| 5. | Financial assets at fair value through other comprehensive income | | | | | | | | | | |
| 5.1. | Equity instruments | | | | | | | | | | |
| 5.1. | Debt securities | | | | 234,406 | | | | | **234,406** | **6** |
| 5.2. | Loans and advances | | | | | | | | | | |
| 6. | Financial assets at amortised cost | 65,289 | | 466 | | 485,681 | | | 392 | **551,828** | **7** |
| 6.1. | Debt securities | | | | | | | | | | |
| 6.2. | Loans and advances | | | | | | | | | | |
| 7. | Derivatives – Hedge accounting | | | | | | | | | | |
| 8. | Fair value changes of the hedged items in portfolio hedge of interest rate risk | | | | | | | | | | |
| 9. | Investments in subsidiaries joint ventures and associates | | | | | | | | | | |
| 10. | Tangible assets | | | | | | 14,832 | | 953 | **15,785** | **8** |
| 11. | Intangible assets | | | | | | | 11,905 | | **11,905** | **9** |
| 12. | Tax assets | | | | | | | | 297 | **297** | **10** |
| 13. | Other assets | | | | | | | | 1,111 | **1,111** | **11** |
| 14. | Non-current assets and disposal groups classified as held for sale | | | | | | | | 17,663 | **17,663** | **12** |
| **TOTAL ASSETS** | | **159,650** | **124,460** | **466** | **244,690** | **504,102** | **14,832** | **11,905** | **20,416** | **1,080,521** | |

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Reconciliation of balance sheet as at 31 December 2018

in '000 HRK

| | TOTAL LIABILITIES - Statutory financial statements | Deposits from customers | Borrowings | Subordinated debt | Provisions for liabilities and charges | Other liabilities | Deferred tax liability | TOTAL LIABILITIES | No. |
|---|---|---|---|---|---|---|---|---|---|
| **LIABILITIES Audited financial statements 31 December 2018** | | | | | | | | | |
| 1. | Financial liabilities held for trading | | | | | | | | |
| 1.1. | Derivatives | | | | | | | | |
| 1.2. | Short positions | | | | | | | | |
| 1.3. | Deposits | | | | | | | | |
| 1.4. | Debt securities issued | | | | | | | | |
| 1.5. | Other financial liabilities | | | | | | | | |
| 2. | Financial liabilities designated at fair value through profit or loss | | | | | | | | |
| 2.1. | Deposits | 887,277 | 10,624 | 46,673 | | | | **944,574** | **1** |
| 2.2. | Debt securities issued | | | | | | | | |
| 2.3. | Other financial liabilities | | | | | | | | |
| 3. | Financial liabilities measured at amortised cost | | | | | | | | |
| 3.1. | Deposits | | | | | | | | |
| 3.2. | Debt securities issued | | | | | | | | |
| 3.3. | Other financial liabilities | | | | | | | | |
| 4. | Derivatives – Hedge accounting | | | | | | | | |
| 5. | Fair value changes of the hedged items in portfolio hedge of interest rate risk | | | | | | | | |
| 6. | Provisions | | | | 1,560 | | | **1,560** | **2** |
| 7. | Tax liabilities | | | | | | 321 | **321** | **3** |
| 8. | Share capital repayable on demand | | | | | | | | |
| 9. | Other liabilities | | | | | 5,052 | | **5,052** | **4** |
| 10. | Liabilities included in disposal groups classified as held for sale | | | | | | | | |
| | **TOTAL LIABILITIES** | **887,277** | **10,624** | **46,673** | **1,560** | **5,052** | **321** | **951,507** | |

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Reconciliation of balance sheet as at 31 December 2018

in '000 HRK

| TOTAL EQUITY - Statutory financial statements | | Share capital | Share premium | Treasury shares | Other reserves | Fair value reserve | Accumulated loss | TOTAL EQUITY AND RESERVES | No. |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | |
| 1. | Share capital | 307,085 | | | | | | **307,085** | **1** |
| 2. | Share premium | | | | | | | | |
| 3. | Equity instruments issued other than capital | | | | | | | | |
| 4. | Other equity | | | | | | | | |
| 5. | Accumulated other comprehensive income | | 21,435 | | | 2,821 | 176 | **24,432** | **2** |
| 6. | Retained earnings | | | | | | -204,923 | **-204,923** | **3** |
| 7. | 33. Revaluation reserves | | | | | | | | |
| 8. | 34. Other reserves | | | | 3,792 | | | **3,792** | **4** |
| 9. | 35. Treasury shares | | | -2,202 | | | | **-2,202** | **5** |
| 10. | 36. Profit or loss attributable to owners of the parent | | | | | | 830 | **830** | **6** |
| 11. | 37. Interim dividends | | | | | | | | |
| 12. | 38. Minority interests (Non-controlling interests) | | | | | | | | |
| **TOTAL EQUITY** | | **307,085** | **21,435** | **-2,202** | **3,792** | **2,821** | **-203,917** | **129,014** | |

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Explanations for adjustments to the balance sheet of the Specific Financial Statements and the Core Financial Statements

## ASSETS

1. The amount of cash (HRK 12,363 thousand) from the cash item in the Cashier's Special Financial Statements has been reclassified to cash and accounts with the Bank's Core Financial Statements.

2. The amount of deposits with the CNB (HRK 161,224 thousand) from cash receivables from central banks of the Special Financial Statements was reclassified to cash and deposits with the CNB in the consolidated financial statements in the amount of (HRK 94,361 thousand) and in cash and accounts Banks Fundamental Financial Statements in the amount of (HRK 66,864 thousand).

3. The amount of other sight deposits (HRK 45,234 thousand) from the item other deposits at the end of the Special Financial Statements was reclassified to cash and balances with the banks of the underlying financial statements in the amount of (HRK 45,234 thousand).

4. The amount of non-trading financial assets that are measured by FV through profit or loss (10,284 thousand kuna) from the items of the equity instruments of the Special Financial Statements are reclassified to Financial Assets under the Financial Statements.

5. The amount of non-trading financial assets that are measured at FV through profit or loss (HRK 18,421 thousand) from loans and advances to the Special Financial Statements are reclassified to loans and advances to customers of the Core Financial Statements.

6. The amount of financial assets of the FV through the OSD (234,406 tons of kuna) from the Securities Deposits item of Special Financial Statements was reclassified to Financial Assets-Securities item (234,406 tons of kuna).

7. Amounts of financial assets at amortized cost (HRK 551,828,098 thousand) from loans and advances to the Special Financial Statements were reclassified to cash and deposits with the CNB (HRK 65,289 thousand), as part of placements with other banks (HRK 466 thousand), loans and advances to customers (HRK 485,681 thousand), and other assets (HRK 392 thousand) of the underlying financial statements.

8. The amount of tangible assets (HRK 15,785 thousand) from tangible assets of the separate financial statements is reclassified to the item of property and equipment of the Core Financial Statements in the amount of (HRK 14,832 thousand), and to the item other assets amounting to HRK 963 thousand).

9. The amount of intangible assets (11,906 thousand kuna) from the item intangible assets of the separate financial statements is reclassified to the item intangible assets of the Core Financial Statements.

10. Item 10-12 Tax assets, other assets and fixed assets classified as held for sale in the amount of (HRK 19,071 thousand) of special financial statements are reclassified to item other assets of the underlying financial statements.

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Explanations for adjustments to the balance sheet of the Specific Financial Statements and the Core Financial Statements

### LIABILITIES

11. The amount of financial liabilities at fair value through profit or loss (HRK 944,574 thousand) from the Deposits Item of Special Financial Statements was reclassified in the item received loans (HRK 10,624 thousand), item deposits (HRK 887,227 thousand) and Hybrid Instrument (HRK 46,673 thousand) Basic financial statements.

12. The amount (HRK 1,560 thousand) under the provision of the Special Financial Statements has been reclassified to the provision for liabilities and expenses of the Core Financial Statements.

13. The amount of HRK 321 thousand related to the Deferred tax liability is reclassified from the item Tax liabilities of the Special Financial Statements to the item Deferred tax liabilities of the Core Financial Statements.

14. Amounts on other liabilities (5,052 thousand kuna) are reclassified from other liabilities of the Special Financial Statements to other liabilities of the Core Financial Statements.

### EQUITY

1. The amount of share capital (307,085 tons of kuna) from the share capital of the Special Financial Statements is reclassified to the Share Capital Share Financial Statements item.

2. Accumulated other comprehensive income (HRK 24,432 thousand) of special financial statements has been reclassified to the premium item on issued shares (HRK 21,438 thousand) and the fair value reserve item (HRK 2,821 thousand), and item accumulated losses (HRK 176 thousand) reports.

3. The amount of retained profit / loss (HRK 204,923 thousand) from the retained earnings item of Special Financial Statements has been reclassified to the item accumulated losses of the Core Financial Statements.

4. The amount of reserves (3,792 thousand kuna) from the other reserves of the Special Financial Statements has been reclassified to the other reserves of the Core Financial Statements.

5. The treasury share item (2,202 thousand kuna) of the Special Financial Statements has been reclassified to the Treasury Share of Financial Statements.

6. The amount of gain or loss (830 thousand kuna) from the profit or loss item belonging to the owners of the parent company is reclassified to the accumulated losses / gains of the Core Financial Statements.

# Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Reconciliation of the Income statement as at 31 December 2018

in '000 HRK

| | PROFIT AND LOSS ACCOUNT - Statutory financial statements | Interest and similar income | Interest and similar charges | Fee and commission income | Fee and commission expense | Realised gains on financial assets, net of loss | FX trading income, net | Other income | Personnel expenses | Depreciation, amortisation and impairment of goodwill | Other administrative expenses | Impairment losses and provisions | PROFIT (LOSS) BEFORE TAX | Total | No. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. | Interest income | 45,445 | | | | | | | | | | | | **45,445** | **1** |
| 2. | Interest expense | | -16,991 | | | | | | | | | | | **-16,991** | **2** |
| 3. | Expenses on share capital repayable on demand | | | | | | | | | | | | | | |
| 4. | Dividend income | | | | | | | | | | | | | | |
| 5. | Fee and commission income | | | 9,500 | | | | | | | | | | **9,500** | **3** |
| 6. | Fee and commission expense | | | | -940 | | | | | | | | | **-940** | **4** |
| 7. | Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net | | | | | 3,528 | | | | | | | | **3,528** | **5** |
| 8. | Gains or losses on financial assets and liabilities held for trading, net | | | | | | 3,012 | | | | | | | **3,012** | **6** |
| 9. | Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss, net | | | | | 313 | | | | | | | | **313** | **7** |
| 10. | Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net | | | | | | | | | | | | | | |
| 11. | Gains or losses from hedge accounting, net | | | | | | | | | | | | | | |
| 12. | Exchange differences gain or loss, net | -159 | 76 | | | | -1,139 | | | | | 30 | | **-1,192** | **8** |
| 13. | Gains or losses on derecognition of non-financial assets, net | | | | | | | 79 | | | | | | **79** | **9** |
| 14. | Other operating income | | | | | | | 4,990 | | | | | | **4,990** | **10** |
| 15. | Other operating expenses | | | | | | | | | | -3,143 | | | **-3,143** | **11** |
| 16. | **TOTAL OPERATING INCOME, NET** | | | | | | | | | | | | | | |
| 17. | Administrative expenses | | | | | | | | -17,953 | | -11,534 | | | **-29,487** | **12** |
| 18. | Depreciation | | | | | | | | | -4,724 | -140 | | | **-4,864** | **13** |
| 19. | Modification gains or losses, net | | | | | | | | | | | | | | |
| 20. | Provision or release of provision | | | | | | | | | | | 438 | | **438** | **14** |
| 21. | Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | | | -232 | | | | | | | | -9,211 | | **-9,443** | **15** |
| 22. | Impairment or reversal of impairment of investments in subsidiaries, joint ventures and associates | | | | | | | | | | | | | | |
| 23. | Impairment or reversal of impairment on non-financial assets | | | | | | | | | | | -858 | | **-858** | **16** |
| 24. | Negative goodwill recognized in profit or loss | | | | | | | | | | | | | | |
| 25. | Share of the profit or loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method | | | | | | | | | | | | | | |
| 26. | Profit or loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations | | | | | | | 443 | | | | | | **443** | **17** |
| 27. | **PROFIT OR LOSS BEFORE TAX FROM CONTINUING OPERATIONS** | | | | | | | | | | | | | | |
| 28. | Tax expense or income related to profit or loss from continuing operations | | | | | | | | | | | | | | |
| 29. | PROFIT OR LOSS AFTER TAX FROM CONTINUING OPERATIONS | | | | | | | | | | | | | | |
| 30. | Profit or loss after tax from discontinued operations | | | | | | | | | | | | | | |
| 30.1. | Profit or loss before tax from discontinued operations | | | | | | | | | | | | | | |
| 30.2. | Tax expense or income related to discontinued operations | | | | | | | | | | | | | | |
| **31.** | **PROFIT OR LOSS FOR THE YEAR** | 45,286 | -16,915 | 9,268 | -940 | 3,841 | 1,873 | 5,512 | -17,953 | -4,724 | -14,817 | -9,601 | 830 | | |
| 32. | Attributable to minority interest (non-controlling interests) | | | | | | | | | | | | | | |
| 33. | Attributable to owners of the parent | | | | | | | | | | | | | | |

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Explanations for adjustments of the Income statement for CNB reporting and the Statutory Financial Statements

1. The amount of interest income (HRK 45,445 thousand) from the item interest income and net foreign exchange differences (net profit or loss) in the amount of (-159 thousand kuna) of special financial statements has been reclassified to interest income item (45,286 thousand HRK) Basic financial statements.

2. Amount of interest expense (HRK 16,991 thousand) from interest expense items and foreign exchange differences (net profit or loss) net (HRK 76 thousand) Special financial statements are reclassified to interest expense item (HRK 16,915 thousand) reports.

3. Amount of fee income (HRK 9,500 thousand) from the item Fee and commission income and impairment or write-down of financial assets not measured at fair value through profit or loss (-232 thousand kuna) The separate financial statements have been reclassified in the income statement item (9,268 thousand kuna) Basic financial statements.

4. Fee and commission expense (HRK 940 thousand) The special financial statements have been reclassified to the statement of fees and commissions of the Core Financial Statements.

5. Gains or losses on termination of recognition of financial assets and financial liabilities that are not measured at fair value through profit or loss, net of (3,528 thousand kuna) of special financial statements, are reclassified to income less impairment losses on Securities financial statements.

6. Gains or losses on financial assets and financial liabilities held for trading, net of (3,012 thousand kuna) of special financial statements have been reclassified to the item Gains less losses on exchange rate differences on the underlying financial statements.

7. Gains or losses on financial assets that are not traded at fair value through profit or loss, net of special financial statements, are reclassified to profit or loss for impairment losses on securities of the Core Financial Statements.

8. Foreign exchange differences (profit or loss), net of the (HRK 1,192 thousand) of the Special Financial Statements, reclassified the item Interest income (-159 thousand kuna) to item interest expense (HRK 76 thousand) foreign exchange losses (1,193 thousand kuna) and in the item impairment charges and provisions (30 thousand kuna) of the Core Financial Statements.

9. Gains or losses on discontinuing non-financial assets, net of HRK (79 thousand) of special financial statements, are reclassified to other income of the Core Financial Statements.

10. Other operating income in the amount of (HRK 4,990 thousand) of Special Financial Statements is reclassified to other income of the Core Financial Statements.

11. Other operating expenses in the amount of (3,143 thousand kuna) of the Special Financial Statements are reclassified to other operating expenses of the Core Financial Statements.

12. Administrative expenses in the amount of (HRK 29,487 thousand) of Special Financial Statements have been reclassified as employee expenses in the amount of HRK 17,953 thousand (HRK 17,953 thousand) and other operating expenses in the amount of HRK 11,534 thousand.

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Explanations for adjustments of the Income statement for CNB reporting and the Statutory Financial Statements

13. Amortization in the amount of (4,864 thousand kuna) of the Special Financial Statements was reclassified to the amortization and impairment of goodwill in the amount of HRK 4,724 thousand and to other operating expenses (HRK 140 thousand) of the Core Financial Statements.

14. The provision or termination of provisions in the amount of (HRK 438 thousand) of the Special Financial Statements is reclassified to the item of impairment charges and provisions of the Core Financial Statements.

15. Impairment or amortization of an impairment of financial assets that is not measured at fair value through profit or loss in the amount of (9,443 thousand kuna) of Special Financial Statements, the cost of impairment and provisions in the amount of (HRK 9,211 thousand) and in the Income of Fees and Commissions in the amount of (HRK 232 thousand) of the Core Financial Statements.

16. Impairment of or impairment of impairment of non-financial assets in the amount of (858 thousand kuna) of special financial statements has been reclassified in the item impairment charges and provisions of the Core Financial Statements.

17. Profit or loss on long-term assets and alienation groups classified as intended for sale that are not qualified as a business that will not continue in the amount of (443 thousand kuna) of the Special Financial Statements are reclassified to the item other income of the Core Financial Statements.

## Reconciliation of comprehensive income statement as at 31 December 2018

in '000 HRK

| Statement of other comprehensive income | | (Loss)/profit for the year | Unrealised gains/(losses) on financial assets at fair value through other comprehensive income | Deferred tax on financial assets at fair value thorugh OCI | TOTAL COMPREHENSIVE (LOSS)/PROFIT | No. |
|---|---|---|---|---|---|---|
| **1.** | Profit or loss for the year | 830 | | | **830** | |
| **2.** | Other comprehensive income | | | | | |
| **2.1.** | Items that will not be reclassified to profit or loss | | | | | |
| 2.1.1. | Tangible assets | | | | | |
| 2.1.2. | Intangible assets | | | | | |
| 2.1.3. | Actuarial gains or losses on defined benefit pensions plans | | | | | |
| 2.1.4. | Non-current assets and disposal groups classified as held for sale | | | | | |
| 2.1.5. | Share of other recognized revenues and costs from entities accounted by equity method | | | | | |
| 2.1.6. | Fair value changes of equity instruments measured at fair value through other comprehensive income | | | | | |
| 2.1.7. | Gains or losses from hedge accounting of equity instruments at fair value through other comprehensive income, net | | 177 | | **177** | **1** |
| 2.1.8. | Fair value changes of equity instruments measured at fair value through other comprehensive income (hedged item) | | | | | |
| 2.1.9. | Fair value changes of equity instruments measured at fair value through other comprehensive income (hedging instrument) | | | | | |
| 2.1.10. | Fair value changes of financial liabilities at fair value through profit or loss attributable to changes in their credit risk | | | | | |
| 2.1.11. | Income tax relating to items that will not be reclassified | | | | | |
| **2.2.** | Items that are or may be reclassified to profit or loss | | | | | |
| 2.2.1. | Hedge of net investments in foreign operations (effective portion) | | | | | |
| 2.2.2. | Foreign currency translation | | | | | |
| 2.2.3. | Cash flow hedges (effective portion) | | | | | |
| 2.2.4. | Hedging instruments (not designated elements) | | | | | |
| 2.2.5. | Debt instruments at fair value through other comprehensive income | | -853 | | **-853** | **2** |
| 2.2.6. | Non-current assets and disposal groups held for sale | | | | | |
| 2.2.7. | Share of other recognised income and expense of Investments in subsidiaries, joint ventures and associates | | | | | |
| 2.2.8. | Income tax relating to items that may be reclassified to profit or loss | | | 399 | **399** | **3** |
| **3.** | Total comprehensive income for the year (AOP 104 + 105 i AOP 128 + 129) | 830 | -676 | 399 | **553** | |
| **4.** | Attributable to minority interest (non-controlling interests) | | | | | |
| **5.** | Attributable to owners of the parent | | | | | |

## Additional reports for Croatian National Bank (continued)

## Reconciliation of the statutory financial statements with the supplementary schedules for CNB (continued)

## Reconciliation of comprehensive income statement as at 31 December 2018 (continued)

1. The amount (177 thousand kuna) of the gain or loss on accounting for hedging of equity instruments measured at fair value through other comprehensive income of the separate financial statements is reclassified to the item of unrealized gains on securities, net of the realizations of the Core Financial Statements.

2. The amount of (853 thousand kuna) from the item debt instruments at fair value through other comprehensive income of the separate financial statements is reclassified to the item of unrealized gains on securities, net of the realizations of the Core Financial Statements.

3. Amount (HRK 399 thousand) from the item Income tax relating to items that can be reclassified to the profit or loss of the Special Financial Statements, a deferred tax asset is reclassified to the financial assets of the Securities Financial Statements.

## Reconciliation of the Statement of cash flows in statutory financial statements with the supplementary schedules for CNB

The differences in the cash flow statement published in the annual report and that defined by the CNB's prescribed structure and content are caused by the different methodology of these two reports. Cash flow elaboration on items of operational, investment and financial activities is also different due to different starting points in cash flow presentation.