VABA d.d. banka Varaždin

Annual report for the year ended 31 December 2013

This version of the 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 matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Contents

Introduction

The annual report comprises a summary of operation and key financial indicators, a description of operation and the audited financial statements including Independent auditor’s report for the year ended 31 December 2013.

Legal status

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

The Annual report was prepared by the Management of the Bank in compliance with the Accounting Law and the Companies Act, which prescribe reporting to shareholders at the General Assembly meeting.

Abbreviations

In the Annual Report of Vaba d.d. banka Varaždin is referred to as the "Bank" or "Vaba", Croatian National Bank is referred to as the "CNB", the Republic of Croatia as the "Government" and the Croatian Bank for Reconstruction and Development, is referred to as "CBRD".

Exchange Rate

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

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

Summary of operation and key financial indicators

	2012 (HRK '000)	2013 (HRK '000)
Net interest income	31,005	30,474
Net fee and commission income	4,511	4,612
Trading and other income	5,419	(2,049)
Operating income	**40,934**	**33,037**
Result before impairment losses	(8,073)	(12,238)
Net profit/(loss) for the year	**(12,699)**	**(109,449)**
Total assets	**1,204,271**	**1,217,629**
Loans and advances to customers	**722,828**	**675,690**

The Bank's operations in 2013 were most significantly influenced by the macroeconomic environment highlighted by long term recessionary movements, further weakening payment abilities of real sector and retail. Furthermore, pre-bankruptcy institute relating to a part of the Bank's portfolio and the change in the regulatory environment relating to recognition of impairment allowances (change of the CNB Decision on classification of placements and off-balance sheet potential liabilities, becoming effective during the 4th quarter of 2013) were the basis for corrections of items of assets and receivables, with reflections in the income statement as one-off value adjustments.

Also, during 2013 the Bank undertook activities on stabilization of the sources of funding (primarily retail deposits) and securing high levels of liquidity. As a result of these activities, liquidity levels of the Bank were high throughout the year, with the biggest growth of the source of funding relating to retail term deposits. Retail term deposits represent primary and stable source of funding and at the same time confirming trust and the Bank's status on the market.

2013 was further highlighted by active management of general and administrative expenses, with the beginning of 2013 being highlighted by programme of outplacement, centralization of back office operations and closing of custodian services. The result of these measures is operating expenses lower by 8% in relation to 2012.

The Bank's activities during 2013 were directed towards capital increase and finding of strategic partner. Up until the issue of these financial statements, the Bank received one obligatory offer and has signed a Memorandum of understanding with the investor. The investment public has been informed on this. Based on the Memorandum, the Management and Supervisory Board are undertaking activities on fulfilling preconditions for the General Assembly meeting and the decisions to be made by the Assembly, enabling increase of the Bank's capital by HRK 75 million. With this capital increase, the Bank will completely fulfil regulatory requirements for the capital adequacy.

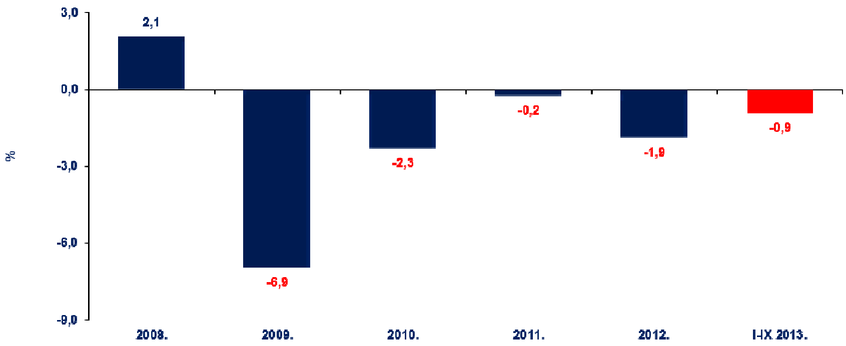
Macroeconomic developments and the banking sector in the Republic of Croatia in 2013

ECONOMIC ACTIVITY

There is still no economic recovery in Croatia, as opposed to most of the Central and Eastern Europe countries and EU as a whole, where a growth of real GDP has occurred. This led to Croatia being singled out as the country with the biggest employment fall.

Real GDP has been in constant fall since 2009, contracting by 0.6% in the fourth quarter of 2013 in comparison to the previous quarter, more than expected.

Graph 1: Real annual GDP growth

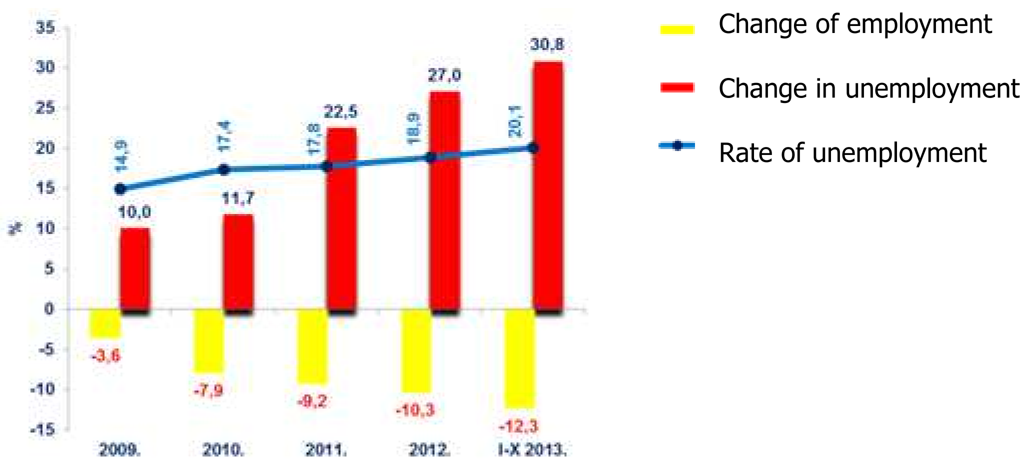


LABOUR MARKET

Last quarter of 2013 has been marked by very unfavourable movements on the labour market, in line with movements of economic activity in the same period.

During the fourth quarter, the biggest quarterly fall of employed persons has been marked since the start of the recession (2.9%) with the average registered unemployment significantly increasing at the end of 2013, to 20.6% at the end of the quarter. In the next two years no significant recovery of the labour market is expected, considering very slow projected economic growth. For 2014 slight increase in employment is expected with further drop in real wages.

Graf 2: Employment, unemployment and registered rate of unemployment



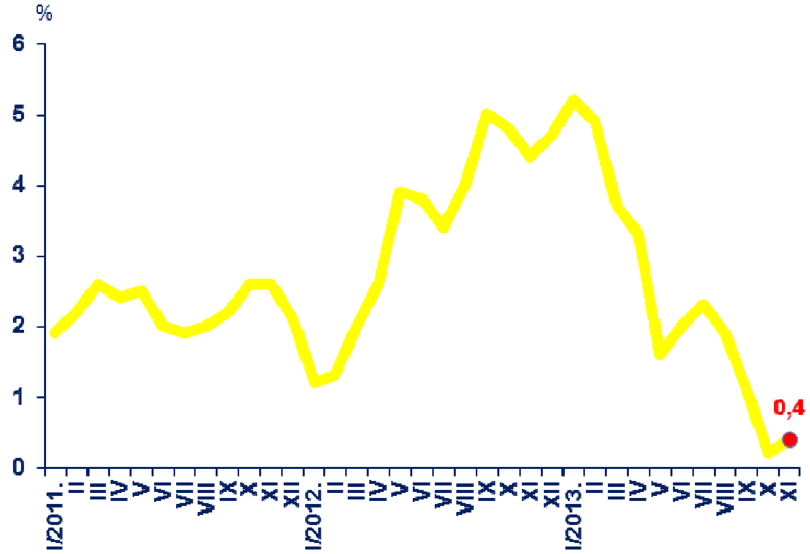
INFLATION

Annual inflation rate in December 2013 amounted to 0.3%, continuing the trend of decreasing inflation rate. In comparison to July 2013, inflation rate decreased by a total of 2.0 percentage points, largely as a result of one-off effects. Share of the food consumer products in the decrease of inflation has been foremost due to decrease in prices of food raw materials in the global markets and stronger competition after abolition of protective customs due to the entrance of Croatia into the European Union.

For 2014 further slowing down of the annual inflation rate is expected in the midst of further decrease of prices of imported goods, the lack of domestic inflationary pressures from demand side and relatively stable exchange rate of kuna versus the euro.

It is estimated that the average annual inflation rate in 2014 will decrease to 1.3%.

Graph 3: Annual change rate of consumer price index



PERSONAL CONSUMPTION

Personal consumption has been decreased due to continuance of unfavourable movements in employment and households deleveraging. Decrease of employed persons has been marked, as well as an increase in the number of unemployed persons, with the simultaneous drop in public sector wages resulting from the decision on decrease in wages and salaries in government and public services by 3% from March 2013.

Lower public sector wages and salaries have also affected the dynamics of wages increase in the overall economy, which has weakened.

More significant recovery of the personal consumption is not expected in 2014 either, considering expected continuance of unfavourable movements in labour markets and the start of excessive deficit procedure for Croatia, requiring fiscal adjustments which could have further unfavourable effects on personal consumption.

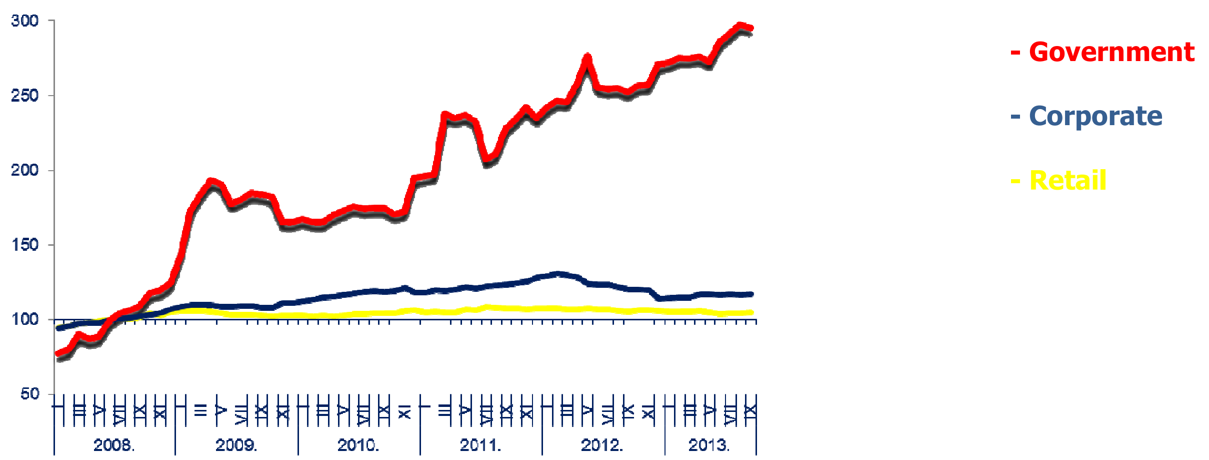
FINANCING CONDITIONS AND THE BANKING SECTOR

During 2013 financing conditions for domestic sectors have not changed significantly. Domestic long term interest rates remained constant while foreign cost of financing remained relatively unfavourable, especially for the government sector.

Additional factors to single out are also the movement in bad loans on domestic banks' balance sheets as well as preferences of their parent banks relating to exposure to Croatia. Corporate sector noted the end of drop of interest rates on overnight loans, while long term corporate and retail cost of financing remained the same, with overall interest rates being lower than in previous years.

Interest rates on banking long term loans to companies remained close to historically lowest levels (around 5.5%).

Graph 4: Banking loans



Total corporate financing in Q3 2013 decreased, resulting in three-month movement of total corporate loans change rate being negative, or -1.1%.

Corporate deleveraging in Q3 nullified around half of the increase in corporate financing in the first half of 2013. At annual level, corporate debt increased by 1.2%.

Deleveraging in Q3 2013 also occurred in retail sector. Lending in the sector continues to be limited due to unchanged financing conditions, depressed demand as a result of unfavourable labour market movements and uncertainties regarding the future movements.

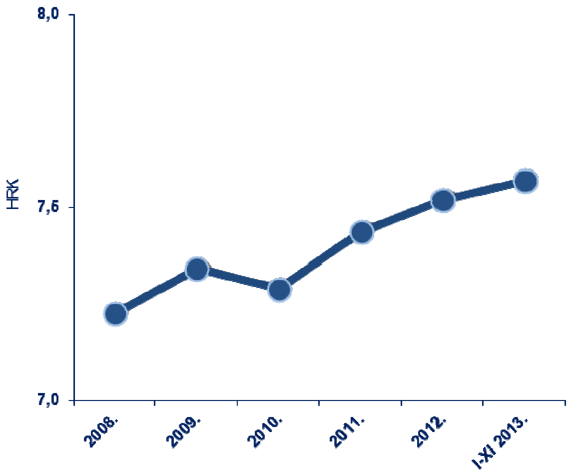
Three-month change rate at the end of September amounted to -0.7% while, at the annual level, the decrease amounted to -1.3%, continuing five-year trend of the sector's deleveraging.

MONETARY POLICY

High levels of liquidity was reflected through very low overnight interest rates on the interbank market and low interest rates at the Ministry of Finance treasury bills auctions. CNB continued to support high liquidity of the banking system, continuing with the expansive orientation of the monetary policy. Average excess of kuna funds on the clearing accounts of the banks during the year amounted to HRK 4.9 billion, which kept overnight interest rate at very low levels.

At the end of 2013 kuna slightly weakened against the euro.

Graph 5: Average middle exchange rate HRK/EUR



Source of data: CNB bulletin – December 2013 and Croatian Chamber of Commerce forecast for 2014.

Description of the Bank's operation

Vaba d.d. banka Varaždin is registered as a limited company with the Commercial Court in Varaždin, headquartered in Varaždin, Alana kralja Zvonimira 1, for the following purposes:

- Receipt of all types of deposits or other redeemable funds and lending from those funds, for its own account,
- Receipt of all types of deposits or other redeemable funds,
- Providing all types of loans, including consumer loans and mortgage loans if allowed by separate laws, financing of commercial business, including export financing based on forfeighting,
- Factoring,
- Finance lease,
- Issuing of bank guarantees or other guarantees,
- Trading for its own account or on behalf of its customers of:
    - money market instruments,
    - transferrable securities,
    - foreign currencies, including money exchange,
    - financial futures and options,
    - currency and interest instruments,
- Payment operations within the country (in accordance with the Law on payment operations)
- Services tied with lending, such as gathering of data, analysis and issuing information on credit ability of sole traders and enterprises,
- Issuing of other payment instruments and managing them in accordance with separate laws, if these services are not considered to be payment operations in accordance with separate laws,
- Safe rentals,
- Mediation in financial affairs,
- Investments and other services and activities in accordance with separate laws regulating capital markets, as follows:
    - trading for its own account,
    - services of offerings, i.e. sale of financial instruments without purchase obligation,
    - safekeeping and administration of financial instruments on behalf of clients, including custodian and similar services, such as money and securities management,
- Representation in the sale of insurance policies in accordance with legislation regulating insurance.

As of 31 December 2013, the Bank operates through two financial centres (Varaždin and Zagreb), and 11 branches (Varaždin, Ludbreg, Ivanec, Novi Marof, Čakovec, Zagreb, Slavonski Brod, Nova Gradiška, Pula).

MISSION

An individual approach to each client and our high quality and professional services, based on the competence of our employees, we create value added for our customers. This contributes to the growth of our organization and improves the quality of the life of our community. We appreciate the personal contribution of each of our employees, whose creativity and knowledge are our greatest value.

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 high quality financial solutions for our customers and be the best in the area of development and prosperity for all of our employees.

Operations with craftsmen and small entrepreneurs and retail operations

Retail banking is carried out through 11 branches (Varaždin, Ludbreg, Ivanec, Novi Marof, Čakovec, Zagreb, Slavonski Brod, Nova Gradiška, Pula) and 11 ATMs. In March 2013 Zagreb branch has been moved to a new location.

During 2013, the Bank continued to improve deposit and loan products for customers, in line with their needs and market trends. In 2013 the Bank introduced e-vaba savings account, enabling internet banking users to independently open and manage funds on the account.

In 2013 significant increase in retail segment was noted: retail term savings increased by 22%, the number of current accounts users increased by 22.98%, number of credit cards increased by 22.22% and the number of internet banking users increased by 15.2%. Craftsmen and small entrepreneurs segment within the Retail sector in 2013 saw a 14.5% increase in placements, while noting 28% increase in the total amount of placements in comparison to 2012.

Strong accent has also been put on additional protection and informing of customers, in accordance with the Credit Institutions Act and the Customer Loans Act, and also on the protection of personal information.

Considering that the European Investment Fund (EIF) at the end of 2010 recognised Vaba d.d. banka Varaždin as its partner in achieving common mission, on 17 December 2010 the Bank and EIF signed Loan agreement with the objective of easier access of funds to Croatian micro entrepreneurs, starting with its implementation at the beginning of 2011. A new product, Entrepreneur's loan by the Bank in cooperation with the EIF, was offered to new and existing clients. At the end of 2012 an annex to the contract was signed, extending the offering to micro entrepreneurs during 2013.

Corporate banking

The Bank's strategy in corporate banking in 2013 was focusing on further strengthening of primary business activities and creation of quality client base, targeting mainly clients in the region, primarily from Varaždin Međimurje, Krapinsko-zagorska and Bjelovarsko-bilogorska Counties, mid-size, production and export oriented.

One of important objectives for 2013 was active involvement in the process of pre-bankruptcy settlement of the Bank's clients and optimization of the Bank's involvement as a creditor in the process. Operations have been, in the conditions of decrease or lack of investment activities, mainly oriented at keeping of the existing, quality part of the portfolio with, if possible, increasing through acquisitions of new clients and increase in exposures to existing targeted clients with maximum possible regular collection and with partially restructuring of the portfolio.

The Bank was actively involved in production processes of its clients and was engaged in supporting faster cash flows and liquidity maintenance, especially through maintaining of orientation of activities towards supporting development and technical plans of exporting and production based companies. In accordance with the difficult economic environment, special consideration was given to maintenance of the loan portfolio quality and to helping quality clients whose operations were endangered by the recession and high level of illiquidity of the system.

In the conditions of the long term difficult macroeconomic environment and the regulatory changes regarding the recognition and forming of the value adjustments in the last quarter of 2013, value adjustments of the part of the portfolio has been made, reflecting on the total assets levels and the results of the operations. Basic objectives of the Corporate banking division remain expanding of quality and stable client base, portfolio diversification and quality monitoring of the clients in all aspects of their operations through development of products and integral client monitoring system, enabling more effective managing of individual clients as well as the client base.

Following market conditions and opportunities, the Bank, through the Corporate banking division, joined the EU funds programmes, further opening possibilities for SME segment to join the measures for which tenders will be held during the following few years and with the joining the EU.

Treasury activities

The Bank's Treasury in 2013 operated in the conditions of lower volatility in all market segments: fx rates, interest rates and government yields.

Average exchange rate of euro versus domestic currency continued with a slow rise at the annual level, average middle exchange rate going from 7.517915 in 2012 to 7.573746 in 2013, with movements in the range from 7.44 to 7.65.

Bad macroeconomic trends and worsening of the fiscal position of the country continued through 2013, resulting in pressure on the rise of the government bond yields during one period of the year. However, yields on domestic and foreign issued bonds haven't risen nowhere near the levels seen in the previous years. Main contribution to this was high liquidity of the domestic financial sector with referent money market and short term treasury bills rates falling to historically low levels. In these conditions long term bond issues of the Ministry of Finance also performed well.

Treasury operations achieved HRK 3.4 million in foreign exchange differences, representing solid results in the conditions of lower activities and trade volumes with the clients. In the available for sale securities portfolio the Bank recorded value adjustments, resulting in the losses in the amount of HRK 6.4 million (2012 profit of HRK 88 thousand), having the biggest impact to the Treasury's results. The Bank continued development of its core banking system in the operations of the Treasury as well, migrating corporate deposit operations to OLBIS system. As a result, processing of the transactions in the back office segment and their recording in the Bank's records are significantly faster with lower operating risks.

System of internal control and internal audit

The internal control system represents processes and procedures established to adequately control and monitor the risks incurred in operations, monitor the effectiveness of the Bank's operations, the reliability of financial reporting, information and compliance with regulations. The Bank has, in accordance with the Credit Instituions Act and the Decision on the internal controls system, established internal controls system comprising:

1. adequate organisational system
2. organisational culture
3. adequate control activities and segregation of duties

4. adequate internal controls integrated in the business processes and activities of the Bank
5. adequate administrative and accounting procedures
6. activities in the area of control function of the Bank

The Bank has regulated and established adequate control activities and the segregation of duties, adequate internal controls and adequate administrative and accounting procedures performed in the course of the Bank's regular activities.

Based on the legal requirements, the Bank has established three control functions independent of the business processes and activities in which risks arise, i.e. which it monitors. These are:

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

Risk control function ensures the Bank's compliance with strategies and policies of risk management, through risk analysis, reporting to the Board and others on the risks and involvement in creating, application and monitoring of methods and models for risk management.

Compliance monitoring function ensures the Bank operates in accordance with the relevant legislation, standards and internal acts. Activities of the compliance monitoring function include recognising and assessment of the compliance risk the Bank is, or could be, exposed to, advising the Board and other responsible persons on the application of relevant legislation, standards and rules, assessment of legislative changes to the Bank's operations, checking of compliance of new products and procedures with the applicable legislation and with the legislation changes, and advising on the preparation of the compliance related educational programmes.

Internal audit function, as a part of the internal supervision, tests and values adequacy and effectiveness of the internal controls system, rates adequacy and effectiveness of risk management procedures and risk assessment methodology, rates the effectiveness of compliance monitoring function, rates the reporting system to the Board and the Management, rates the correctness and reliability of the accounting evidence system and of the financial statements, rates strategies and procedures of assessment of internal capital adequacy ratios, audits the IT system, checks reliability of the reporting system and timing and accuracy of reports as required by the Credit Institutions Act, rates the safety of the assets, rates the system of gathering and the accuracy of the information being publicly announced and performs all other activities needed for reaching the objectives of the internal audit.

Each control function prepares reports in accordance with its respective activities and which are based on the operational plans in accordance with the Credit Institutions Act and the Decisions based on the Act.

Development plan

In accordance with the mission and vision of the Bank, during 2014 operations will be focused on further development of the quality of products and services, functionality improvement of business processes and compliance with new regulatory requirements.

Key concept of the Bank's operations continues to be individual approach to clients and the ability to make fast quality decisions in relation to bigger banks due to stronger regional orientation and good knowledge of the circumstances in which business is done. Furthermore, by positioning itself in the regions of northwestern Croatia, the Bank operates with clients from the most developed part of Croatia with high share of exports, enabling stronger and more quality development of the Bank in relation to its peer group bank operating in less developed parts of Croatia.

STRATEGIC OBJECTIVES

- Become one of the leading banks in operations with small and medium enterprises and with local authorities and public companies in Varaždinska and Međimurska counties,
- Ensure adequate capital in accordance with the business strategy and risks undertaken,
- Ensure stabile finance sources,
- Rationalization of operations and further effectiveness increase,
- Diversification of risks and assets and liabilities management in accordance to best practice,
- Achieve sustainable return on share equity (long term objective).

The Bank's activities during 2013 were pointed towards capital increase and finding of strategic partner. Until the date of this report, the Bank received one binding offer and has signed a Memorandum of Understanding with the investor. This was communicated to the investment public. In accordance with the Memorandum, the Management and Supervisory Board are undertaking activities to meet the preconditions for the General Assembly meeting of the Bank which will enable capital increase in the amount of HRK 75 million. With this capital increase the Bank will fully meet the regulatory requirements on capital adequacy.

Higher capital levels and strategic partner will enable the Bank to further grow and develop business, with the focus remaining on cost management and increase in activities in accordance with adequate levels of risk taking.

Operations in 2013

As at 31 December 2013, the Bank had total assets of HRK 1.22 billion (31.12.2012: HRK 1.20 billion), of which total loans amounted to HRK 676 million (31.12.2012: HRK 723 million).

As at 31 December 2013, total clients' deposits amounted to HRK 988 million (31.12.2012: HRK 863 million).

As at 31 December 2013, the Bank's equity amounted to HRK 62 million (31.12.2012: HRK 127 million).

The Bank generated HRK 73 million interest revenue in 2013, with the interest expenses amounting to HRK 42 million. Consequently, net interest income amounted to HRK 30 million, in line with the previous year.

Net interest and fees income in 2013 amounted to HRK 4.6 million, in line with the previous year. Revenues amounted to HRK 6.4 million and expenses amounted to HRK 1.8 million.

General administrative expenses and depreciation and other expenses are lower than the previous year for HRK 3.7 million (7%) and amount to HRK 45 million.

Operations in 2013 were significantly influenced by macroeconomic situation, foremost reflecting in slowing down of economic activities, investments decrease, worsening of balance of payments and low liquidity of the real sector.

The Bank recorded value adjustments as at 31 December 2013 in accordance with the Decision on classification of placements and off-balance sheet potential liabilities of the credit institutions, which came to force on 1 October 2013.

As a consequence of the aforementioned, net operating loss before impairment allowances amounted to HRK 12.2 million. Impairment allowances amounted to HRK 97.2 million (2012: HRK 4.6 million), resulting in net loss for the year of HRK 109.5 million (2012: HRK 12.7).

The Bank continues to try reducing general administrative expenses, combining with the planned capital increase to create positive effects on the Banks operations.

The Bank continues to try reducing general administrative expenses, combining with the capital increase done at the beginning of 2013 to create positive effects on the Banks operations.

Risk management

The most significant financial risks the Bank is exposed to are credit risk, liquidity risk, market risk and operational risk. Market risk includes foreign exchange risk, interest rate risk and risk of market price changes in value of equity and debt financial instruments.

Integrated system of risk management is built and continuously improved at the Bank's level by introducing policies and procedures for assessment, control and managing of risks and by establishing limits to risks exposures in line with the regulations and the Bank's risk profile.

Credit risk

The Bank is exposed to credit risk through activities including trading, granting of loans, investing and in cases where it acts for and on behalf of clients or third parties or when it issues guarantees. Risk of default present in financial instruments transactions with some counterparties is constantly monitored. With the aim of managing credit risk, the Bank tries to do business with clients with good credit ratings and to obtain good collateral to ensure the recoverability of receivables from two independent sources (cash flow and collateral).

Credit risk is managed in accordance with the Bank's policies. Credit exposure to the portfolio or separate groups is constantly questioned in accordance with the given limits. Usage of limits is communicated to the Bank's bodies responsible for their approval. Credit board approves all significant increases of credit exposures and makes all decisions regarding the credit risk.

Liquidity risk

Liquidity risk occurs in financing activities of the Bank and the management of positions. The bank has access to different financing sources. Funds are collected through large number of instruments including different type of deposits, loans and other liabilities, including deposits, loans and shareholders' equity. The Bank continuously works on defining procedures and business processes for effective monitoring of liquidity risk by establishing and overlooking financing changes, with the aim of achieving business objectives in line with the Bank's overall business strategy. The Bank adjusts its business activities relating to liquidity risk, in line with the regulation and internal policies for maintaining liquidity reserves, balancing of assets and liabilities, controlling limits and liquidity indicators and planning for unforeseen events. Treasury daily manages liquidity reserves and ensures fulfilment of the clients' needs.

Market risk

The Bank manages foreign exchange risk of a foreign currency on the financial position and cash flows. Foreign exchange risk is monitored on the balance sheet level, in accordance to the regulation on open foreign exchange position on a daily basis.

Interest rate risk represents sensitivity of the Bank's financial position on the interest rates movements. The Banks operations are under influence of the interest rate changes to an extent in which interest bearing assets and liabilities mature or their interest rates change in different timing or amounts.

Operational risk

Operational risk is present in all segments of the Bank's operations, requiring quality knowledge over and continuous monitoring of all business processes. Organizational model of the process of managing of operational risk is conceptualized on both centralized and decentralized function of managing operational risk and is performed in accordance with the regulations and Basel guidelines and internal acts (policies, procedures and methodology on managing of operational risk).

IT safety managing in the context of IT operational risk managing includes several periodical activities with the aim of reducing the Bank's IT operational risk, embedding control mechanisms, improving business processes and complying with the regulations with the aim of reducing potential damage to the Bank's IT system arising from the vulnerability.

With the aim of operational risk managing, the Bank has secured adequate IT system management and IT system risk management, externalization risks management, compliance risk management, business continuity management and has secured adequate anti money laundering and financing of terrorism system.

Policies of financial risks management are described in detail in the Notes to the financial statements for 2013.

Statement on the application of the Code of Corporate Governance

During December 2009, the Bank's Management and Supervisory Board have adopted the Code of Corporate Governance of Vaba d.d. banka Varaždin, which established high standards and methods of quality corporate governance (further: the Code). The Code is published on the Bank's official web site.

In every matter that is not regulated by the Code, the Bank applies Code of Corporate Governance made by the Zagreb Stock Exchange and the Croatian Financial Services Supervisory Agency "CFSSA", to the extent applicable to the Bank.

In accordance with the Companies Act, Article 272p, the Management Board announces that the Bank has voluntarily applied the recommendations of both Codes during 2011, with exception to certain sections (as explained in details within annual questionnaire in the Code delivered along with the annual report to the Zagreb Stock Exchange for the publication).

The Management Board governs the Bank and its assets. Accordingly, the Board is obliged and authorised to take any necessary actions and decisions required for successful management of the Bank, all within the valid framework of the Companies Act and the Credit Institutions Act.

In accordance with the Bank's Articles of Association, the Management Board consists of three members at most, and the Supervisory Board decides on the number of members of the Management Board. Currently, the Management Board consists of two members.

The Supervisory Board appoints members and the president of the Management Board for the period of a maximum of 5 years, with the possibility of reappointment, upon CNB's approval. In accordance with new legislation, in mid-2013 Policy on the process of appropriateness of the president and the members of the Board was adopted, which more closely defines criteria and procedures for evaluation of appropriateness of the Bank's Board members during their appointment to the function, as well as during their mandates.

The Supervisory Board can recall its decision on appointment in the case of existence of relevant reason in accordance with effective regulation.

Members of the Management Board who have performed their duty during 2013 were as follows:

- Mr Stanko Kežman, President
- Mrs Natalija Jambrečić, Member

The Supervisory Board on 31 December 2013 composed of seven members on 4-year mandate in accordance with the Statute. Supervisory Board has to have at least one independent member, which during 2013 were Mr Vladimir Košćec (until 10.6.2013) and Mr Željko Filipović (elected on 30.9.2013). Shareholder Validus d.d. Varaždin has, in accordance with the Companies Act, Article 256, Section 2, the right to appoint 2 (two) members of the Supervisory Board as long as it is an owner of at least 24% of the Bank's shares. The right was used at the start of 2013 when it recalled its representatives in the Supervisory Board until then – Mrs Ivana Jagačić and Mr Marinko Benić, and appointed Mr Mario Baburić as a member of the Supervisory Board, but as the share of the shareholder fell below the aforementioned percentage after the capital increase in February 2013, the right was not possible to use further into 2013.

A member of the Supervisory Board can be appointed only if an individual has knowledge and experience in banking or economics or scientific research, which would guarantee proper and duly performance of his duties. In addition, a member of the Supervisory Board cannot be an individual in contrary to the conditions specified by the Law. Furthermore, amidst new legislation, the General Assembly of the Bank voted new Policy on the evaluation of appropriateness of the Supervisory Board members, which more closely defines criteria and procedures for evaluation of appropriateness of the Supervisory Board members during their appointment to the function, as well as during their mandates.

The privileges of the Supervisory Board are set out in the Bank's Articles of Association in accordance with the applicable regulations within Companies Act and Credit Institutions Act.

Members of the Supervisory board of the Bank for the year 2013 were as follows:

- Mr Vladimir Košćec, member (until 10.6.2013, President until 1.3.2013)
- Mr Zlatan Kuljiš (until 27.2.2013)
- Mr Zdenko Franić (until 27.2.2013)
- Mrs Ivana Jagačić (until 31.1.2013)
- Mr Mario Baburić (from 31.1.2013 to 29.7.2013)
- Mr Marinko Benić (until 31.1.2013)
- Mr Tomáš Hlaváč
- Mr Julius Strapek (from 27.2.2013), President from 1.3.2013
- Mr Zoran Zemlić (from 27.2.2013)
- Mr Tomislav Marinac (from 27.2.2013 to 23.1.2014)
- Mrs Irena Adžić-Jagodić (from 27.2.2013)
- Mr Martin Pardupa (from 30.9.2013)
- Mr Željko Filipović (from 30.9.2013)

Information on the composition and activities of the Management and the Supervisory Board and their sub-committees is provided within the Annual Questionnaire within the Code of Corporate Governance.

The procedure for making amendments to the Articles of Association is defined in Article 57 of the Articles of Association. In accordance with law and this Articles of Association, amendments to Articles of Association can be processed at the General Assembly, whereas Supervisory Board is entitled to amend Articles of Association in order to adapt or to refine content of the Articles of Association.

The Management Board is entitled to issue new shares of the Bank as a part of the section on so called approved issued capital. Issue of new shares is subject to approval by the Bank's Supervisory Board, and can be made during the period of 5 years, commencing from the date of entry of amendments into the Court register, in accordance with the Decision of the General Assembly of 6 March 2009. The Management Board can make decisions to increase Bank's share capital by making cash contribution and by issuing new shares, but total increase of share capital cannot exceed half of the nominal amount of the Bank's share capital at the date of decision on amendment of the Articles of Association. Management Board, upon approval of the Supervisory Board, is entitled to exclude shareholders' priority.

Main shareholders of the Bank with a share capital exceeding 2% of total share capital as at 31 December 2013 were as follows:

	Name	**Ownership share**
1	ALTERNATIVE UPRAVLJANJE D.O.O.	66.65%
2	VALIDUS D.D. U STEČAJU	9.58%
3	ATJ INVEST S.R.O.	5.30%
4	PLURIS D.D. U STEČAJU	2.96%

During 2013 the Bank had the Audit Committee comprised of:

- Mr Marinko Benić (until 31.1.2013)
- Mr Vladimir Košćec (until 1.3.2013)
- Mrs Irena Adžić-Jagodić, president (from 1.3.2013)
- Mr Mario Baburić (from 1.3.2013 to 29.7.2013)
- Mr Zoran Zemlić (from 29.4.2013)
- Mr Tomas Hlavač

The Audit Committee assists the Supervisory Board performing the function of business supervision, and especially of the following tasks:

- Monitors the reliability (credibility) of the financial information and reports (examines the relevance and consistence of the accounting methods),
- at least once a year revises the internal control system and the risk management system,
- provides the efficiency of the internal audit by suggesting the selection, appointment, removal or re-appointment of the Head of the Internal Audit, concerning also available budget and by assessing actions taken by the Management following the findings and recommendations of the internal audit
- makes recommendations to the Supervisory Board regarding the selection, appointment, re-appointment or replacement of external auditors and concerning also the terms of external auditors' engagement,
- oversees the independence and objectivity of external auditors, particularly regarding the rotation of auditors and fees paid by the Bank for audit services and takes care of other regulatory requirements (assessment of the extent and the level of other fees paid by the Bank to the auditor),
- considers the efficiency of external audit process and the actions undertaken by the senior management following the external auditor's recommendations following the audit.

At least twice a year the Audit Committee reports to the Supervisory Board about its work, which is at least on the issuance of the half year and the Annual report of the Bank.

Beside the Audit Committee, the Supervisory Board in the performing function of supervision, follows and assess the work of the internal audit and makes recommendations to improve the quality of its work, and makes the recommendations for the use of available resources, with the purpose of establishing the quality system of internal controls which will timely identify the risks that the Bank is exposed to, with the aim of effective risk management.

Stanko Kežman, president of the Management Board

Natalija Jambrečić, member of the Management Board

Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements

The Management Board of the Bank is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Bank and of the results of their operations 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 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 suitable accounting policies to conform with applicable accounting standards and then apply them consistently; making 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 the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements for acceptance. If the Supervisory Board approves the annual financial statements they are deemed confirmed by the Management Board and Supervisory Board.

The financial statements set out on pages 20 to 81 were authorised by the Management Board on 31 March 2014 for issue to the Supervisory Board and are signed below to signify this.

For and on behalf of Vaba d.d. banka Varaždin:

____

Stanko Kežman, president of the Management Board

____

Natalija Jambrečić, member of the Management Board

This version of the 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 matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Independent Auditors' Report

To the Management Board and Shareholders of VABA d.d. banka Varaždin

We have audited the accompanying financial statements of VABA d.d. banka Varaždin (herein below the Bank), which comprise of the balance sheet as at 31 December 2013, the income statement, the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as presented on pages 20 to 81.

Management's Responsibility for the financial statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements presented on pages 20 to 81 give a true and fair view of the financial position of the Bank as at 31 December 2013 and the results of its operations and cash flows for the year then ended in accordance with statutory accounting regulations applicable to banks in Croatia.

Emphasis of matter

Without qualifying our opinion, we draw attention to the note 17.9 and the fact that the Bank's capital adequacy as at 31 December 2013 was below the regulatory limit. Furthermore, the Bank received a resolution by the Croatian National Bank by which it is obliged to fulfil requirements regarding capital adequacy level. During March 2014 the Bank received an investor's binding offer for the capital increase in the amount of HRK 75 million, subject to the General Assembly approval. With this capital increase the Bank would fulfil regulatory requirements on capital adequacy.

Grant Thornton revizija d.o.o.
Ivana Lučića 2A, Zagreb
Zagreb, 31 March 2014

Ivica Smiljan
Certified auditor, Director

GRANT THORNTON
revizija d.o.o.
ZAGREB

This version of our 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 matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Grant Thornton Audit Ltd., Ivana Lučića 2a, Zagreb, Commercial Court in Zagreb; MBS: 080642448; OIB: 43504520878; Bank Account no. 2500009-1101268790 at Hypo Alpe-Adria-Bank d.d., Zagreb;
IBAN HR33 250009 1101268790; Share capital: 20.000,00 HRK fully paid; Directors: Ivica Smiljan, Kristina Dimitrov
Member of Grant Thornton International Ltd.

Balance sheet as at 31 December 2013

	Notes	31 December 2012 (HRK '000)	31 December 2013 (HRK '000)
ASSETS			
Cash and deposits with Croatian National Bank	4	144,353	157,325
Placements with and loans to other banks	5	43,159	50,242
Financial assets available for sale	6	200,146	193,075
Financial assets held to maturity	7	16,248	55,959
Loans and advances to customers	8	722,828	675,690
Property and equipment	9	30,536	30,579
Intangible assets	10	16,971	17,472
Other assets	11	30,029	37,288
TOTAL ASSETS		**1,204,271**	**1,217,629**
LIABILITIES			
Deposits from customers	12	863,182	987,513
Borrowings	13	197,982	151,072
Hybrid instruments	14	3,018	3,055
Provisions for liabilities and charges	15	889	1,039
Other liabilities	16	12,255	12,672
TOTAL LIABILITIES		**1,077,328**	**1,155,351**
EQUITY			
Share capital	17.1	176,523	75,020
Share premium	17.2	27,440	-
Other reserves	17.3	2,552	94,030
Fair value reserve	17.4	5,610	2,677
Accumulated losses	17.5	(85,183)	(109,449)
TOTAL EQUITY		**126,943**	**62,278**
TOTAL LIABILITIES AND EQUITY		**1,204,271**	**1,217,629**

The significant accounting policies and other notes on pages 25 to 81 form an integral part of these financial statements.

Income statement for the year ended 31 December 2013

	Notes	2012 (HRK '000)	2013 (HRK '000)
Interest and similar income	18	73,106	72,550
Interest expense and similar charges	19	(42,101)	(42,076)
Net interest income		**31,005**	**30,474**
Fee and commission income	20	6,215	6,369
Fee and commission expense	21	(1,704)	(1,757)
Net fee and commission income		**4,511**	**4,612**
Gains less losses from financial assets available for sale	22	88	(6,468)
Gains less losses arising from foreign currencies	23	3,415	3,388
Other operating income	24	1,916	1,032
Dealing and other income/(expense)		**5,419**	**(2,049)**
OPERATING INCOME		**40,934**	**33,037**
General and administrative expenses	25	(44,176)	(40,491)
Depreciation and amortisation		(4,670)	(4,068)
Provisions for liabilities and charges		(161)	(716)
Operating expenses		**(49,007)**	**(45,275)**
OPERATING RESULT BEFORE IMPAIRMENT OF ASSETS		**(8,073)**	**(12,238)**
Identified impairment losses		(4,881)	(96,961)
Identified impairment losses on group basis		255	(251)
Impairment losses	**26**	**(4,626)**	**(97,211)**
PROFIT/(LOSS) BEFORE TAX		**(12,699)**	**(109,449)**
Income tax expense	27	-	-
PROFIT/(LOSS) FOR THE YEAR		**(12,699)**	**(109,449)**

The significant accounting policies and other notes on pages 25 to 81 form an integral part of these financial statements.

Statement of comprehensive income for the year ended 31 December 2013

	2012 (HRK '000)	2013 (HRK '000)
PROFIT/(LOSS) FOR THE YEAR	**(12,699)**	**(109,449)**
Net unrealised losses from financial assets available for sale	10,311	(2,932)
Other comprehensive income	**10,311**	**(2,932)**
Total comprehensive income	**(2,388)**	**(112,381)**

The significant accounting policies and other notes on pages 25 to 81 form an integral part of these financial statements.

Statement of changes in equity

HRK '000	Share capital	Share premium	Other reserves	Fair value reserve	Accumulated losses	Total
Balance at 1 January 2012	176,464	27,440	2,611	(4,700)	(72,484)	129,331
Share capital decrease for own shares	59	-	(59)	-	-	-
Profit / (loss for the year)	-	-	-	-	(12,699)	(12,699)
Net unrealised losses from financial assets available for sale	-	-	-	10,311	-	10,311
Total comprehensive income	***59***	***-***	***(59)***	***10,311***	***(12,699)***	***(2,388)***
Balance at 31 December 2012	**176,523**	**27,440**	**2,552**	**5,611**	**(85,182)**	**126,943**
Recapitalization	50,306	-	-	-		50,306
Increase / decrease of share capital	(151,810)	-	-	-		(151,810)
Transfer to reserves	-	(27,440)	91,478	-		64,038
Loss coverage from previous years	-	-	-	-	85,182	85,182
Profit / (loss for the year)	-	-	-	-	(109,449)	(109,449)
Net unrealised gains/losses from financial assets available for sale	-	-	-	(2,934)	-	(2,934)
Total comprehensive income				***(2,934)***	***(109,449)***	***(112,383)***
Balance at 31 December 2013	**75,020**	**-**	**94,030**	**2,677**	**(109,449)**	**62,278**

The significant accounting policies and other notes on pages 25 to 81 form an integral part of these financial statements.

Statement of cash flows for the year ended 31 December 2013

	2012 (HRK '000)	2013 (HRK '000)
Cash flow from operating activities		
Profit/(loss) before tax	**(12.699)**	**(109.449)**
Adjustments:	**9.645**	**80.149**
- depreciation and amortisation	4.670	4.068
- net foreign exchange losses	90	(639)
- impairment losses on loans and advances to customers and other assets	4.724	76.720
- provisions for liabilities and charges	161	-
Changes in operating assets and liabilities	**15.040**	**104.340**
Decrease/(increase) in placements with and loans to other banks	(534)	3.382
Decrease/(Increase) in loans and advances to customers	43.044	(29.772)
Decrease/(Increase) in other assets	6.320	18.888
(Decrease)/increase in deposits from banks	-	(6.546)
(Increase)/decrease in obligatory reserve with the CNB	(35.264)	1.568
(Decrease)/increase in deposits from customers	(1.334)	113.092
(Decrease)/increase in other liabilities	2.808	3.728
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES	**11.986**	**75.040**
Cash flow from investing activities		
Purchase of property and equipment and intangible assets	(7.961)	(20.722)
Increase in financial assets available for sale	32.041	2.158
Maturity/(acquisition) of financial assets held to maturity	(2.788)	(40.252)
NET CASH INFLOW/(OUTFLOW) FROM INVESTING ACTIVITIES	**21.292**	**(58.816)**
Cash flow from financing activities		
(Decrease)/increase in borrowings	(32.025)	(46.876)
Increase/(decrease) in share capital	-	50.306
NET CASH (OUTFLOW)/INFLOW FROM FINANCING ACTIVITIES	**(32.025)**	**3.430**
Effect of foreign exchange rate changes on cash and cash equivalents	(310)	801
NET (DECREASE)/INCREASE CASH AND CASH EQUIVALETNS	**943**	**20.456**
Cash and cash equivalents at the beginning of the year	**88.678**	**89.620**
Cash and cash equivalents at the end of the year	**89.620**	**110.076**

The significant accounting policies and other notes on pages 25 to 81 form an integral part of these financial statements.

Notes to the financial statements for the year ended 31 December 2013

1. SIGNIFICANT ACCOUNTING POLICIES

General data

Vaba d.d. Bank Varaždin (the "Bank") was established as Brodsko - posavska banka d.d., Slavonski Brod in 1994. On 27 December 2004 the Bank was renamed Vaba d.d. Banka Varaždin, and its headquarters were relocated from Slavonski Brod to Varaždin, Anina 2. This change was a result of the changes in the ownership structure of the Bank, whose shareholder became Validus d.d. from Varaždin, with the consent of the Croatian National Bank.

On the General Assembly dated 14 December 2006, the Bank issued a decision to increase the share capital by issuing 292 thousand of new shares, with a nominal value of HRK 100 per share through a private offer at a price of HRK 140 per share. On the General Assembly held on 18 April 2007, a decision was made to increase share capital by issuing a further 619 thousand of new shares, with a nominal value of HRK 100 per share, through a private offer to the Bank's existing shareholders at a price of HRK 140 per share. In 2007, the share capital of the Bank was increased, and the capital increased from HRK 62,226,400 to HRK 153,355,000 which was registered at the Commercial Court in Varaždin by the Court decision dated 17 August 2007.

By Decision of the General Assembly dated 18 April 2007, the Bank’s headquarters were changed to Aleja kralja Zvonimira 1, Varaždin.

On 6 March 2009, the General Assembly authorised an increase in share capital by the maximum amount of HRK 31,113,200 up to a total of HRK 184,468,200. Share capital was increased by certain shareholders during March 2009 by the amount of HRK 23,167,800 to HRK 176,522,800 and registered in court on 25 March 2009. Share capital is divided into 1,765,228 ordinary shares, each with a nominal value of HRK 100.

On 31 January 2013 the General Assembly authorised an simplified reduction of share capital to cover losses and transfer to capital reserves from the amount of HRK 176,522,800.00 to the amount of HRK 24,713,192.00, and at the same general assembly also decided to increase the share capital by the amount of HRK 50,000,006.00 to the amount of HRK 74,713,198.00 by payment in cash, with the issuance of 3,571,429 new ordinary shares in dematerialized form, without par value.

By the Decision of the Management Board from 2 April 2014 adopted in accordance with Article 17 of the Statute, with the prior approval Bank Supervisory Board, it increased the share capital of the Bank from the amount of HRK 74,713,198.00 for the amount of HRK 306,262.00 on to the amount of HRK 75,019,560.00 (approved share capital). The share capital of the Bank was increased by issuing 21,883 ordinary shares in dematerialized form, without par value in cash each with a nominal value of HRK 14.

These financial statements were approved by the Bank's Management Board on 31 March 2014 for submission to the Supervisory board.

Notes to the financial statements

I. 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 are subject to the Credit Institutions Act, in accordance with which the Bank's financial reporting is regulated by Croatian National Bank ("the CNB") which is the central monitoring institution of the banking system in Croatia.

The principal accounting policies applied in the preparation of these financial statements are summarised below. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards ("IFRS"), reference may be made to certain Standards in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards endorsed for use in the EU at 31 December 2013.

The accounting regulations which are the basis for the preparation of these financial statements differ from IFRS, in respect of presentation, recognition and measurement. The principal differences between the accounting regulations of the CNB and recognition and measurement requirements of IFRS are as follows:

- The CNB requires banks to recognise impairment losses, in the income statement, on assets not identified as impaired (including sovereign risk assets) at prescribed rates (excluding assets carried at fair value through profit or loss). In accordance with these requirements, as of 31 December 2013 the Bank has recognised portfolio-based provisions of HRK 8,293 thousand (2012: HRK 7,991 thousand) in the balance sheet and has recognised income for the year ending 31 December 2013 in the amount of HRK 302 thousand (2012: HRK 160 thousand) within the movement in impairment loss on loans and advances to customers and other assets. Although, in accordance with IFRS, such provisions are more properly presented as an appropriation within equity, the Bank continues to recognise such provisions in the income statement as a substitute for unidentified impairment losses calculated in accordance with the requirements of IFRS.
- Although the Bank calculates impairment losses on corporate lending as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate, in accordance with IFRS, the CNB requires the amortisation of the calculated discount to be presented in the income statement within the movement in impairment losses on loans and advances to customers and other assets, rather than as interest income, as required by International Financial Reporting Standards.
- Additionally the CNB prescribes minimum levels of impairment losses against certain specifically identified impaired exposures, which may be different from the impairment loss required to be recognised in accordance with IFRS.

(b) Basis of measurement

The financial statements are prepared on a fair value basis for derivative financial instruments, financial assets and liabilities at fair value through profit or loss and available for sale assets, except those for which there is no reliable measure of fair value. Other financial assets and liabilities are carried at amortized cost or historical cost.

The financial statements are prepared in a format that is commonly used and internationally recognized by banks.

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosures of contingent liabilities on the balance sheet date, as well as the amounts of income and expenditure for the period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be realistic in the circumstances and information available on the date of preparation of financial statements, the results of which form the basis for judgments about carrying values of assets and liabilities that are not directly visible from other sources. Actual results could differ from these estimates.

Notes to the financial statements (continued)

The estimates and underlying assumptions are reviewed on a regular basis. Revisions to accounting estimates are recognized in the period in which they are incurred if affecting only that period or the period in which they are incurred and future periods if they impact current and future periods.

Judgements made by management in applying the appropriate standards that have a significant impact on the financial statements and estimates with a risk of material adjustment in the coming year, are described in Note 3.

(c) Functional and presentation currency

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

As at 31 December 2013 the exchange rates used for translation of Bank's assets and liabilities were HRK 7,638 to EUR 1 (2012: HRK 7,546 to EUR 1) and HRK 5.549 to USD 1 (2012: HRK 5,727 to USD 1).

(d) 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 and other disclosures.

Notes to the financial statements (continued)

II. Specific accounting policies

(a) Interest income and expense

Interest income and expense are recognised in the income statement as they accrue for all interest earning 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 is 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-earning financial instrument and its value at maturity, recognised on a linear basis. Income and expense on all assets and liabilities held for trading is recognised as interest income and expense.

(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 commitment fees for loans that are likely to be drawn down are deferred linearly (together with related direct costs) and recognised as an adjustment to the interest rate on the loan. Commitment fees in relation to facilities where draw down is not probable are recognised over the term of the commitment. 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 interest rate as the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts upon completion of the service.

Asset management fees related to investment fund management 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) Gains less losses from financial assets through profit and loss and investment securities

Gains less losses from financial instruments at fair value through profit or loss include unrealised and realised gains and losses arising from trading with debt securities and other financial instruments designated at fair value through profit or loss.

Gains less losses arising from investment securities comprise realised gains and losses from financial instruments available for sale.

(e) Gains less losses arising from dealing in foreign currencies

Gains less losses from dealing in foreign currencies include unrealised and realised gains and losses arising from spot and forward dealings in foreign currencies.

(f) Foreign currencies

Transactions in foreign currencies are translated into HRK at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into HRK at the foreign exchange rate ruling at that date.

Notes to the financial statements (continued)

Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currency that are stated at fair value are translated in HRK at the foreign exchange rates ruling at the dates when the fair values were determined.

Non-monetary assets and items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at the balance sheet date.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security, and other changes in the carrying amount of the securities. The translation differences are recognised in the income statement as part of the foreign exchange gains or losses on the revaluation of monetary assets and liabilities presented within general and administrative expenses in the income statement or other operating income. Translation differences on non-monetary financial assets, such as equity instruments classified as available for sale, are included in the fair value reserve in equity.

(g) Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: at fair value through profit or 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 determines the classification of financial instruments upon initial recognition.

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

This category comprises two subcategories: financial instruments held for trading (including derivatives), and those designated by management 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 or liabilities are managed, evaluated and reported internally on a fair value basis,
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise; or
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

As of 31 December 2013 the Bank had no financial assets and financial liabilities at fair value through profit and loss (2012: nil).

Loans and receivables

This category comprises of 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, and the obligatory reserve with the Croatian National Bank.

Held-to-maturity investments

This category comprises non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has the positive intention and ability to hold to maturity. These include corporate bills of exchange.

Available for sale financial assets

This category comprises non-derivative financial assets which are defined as available for sale or are not included in loans and receivables or held-to-maturity investments, or classified as 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 equity prices.

Available-for-sale financial assets include debt and equity securities, units in investment funds and units in a private equity fund.

Notes to the financial statements (continued)

Other financial liabilities

Other financial liabilities comprise of all financial liabilities which are not held for trading or designated at fair value through profit or loss.

Recognition and derecognition

Purchases and sales of financial assets and financial liabilities at fair value through profit or loss, and financial assets held to maturity and available for sale, are recognised on the settlement date which is the date when the financial instrument is delivered to or transferred from the Bank. Loans and receivables and financial liabilities at amortised cost are recognised when advanced to borrowers or received from lenders.

The Bank derecognises financial instruments (in full or part) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights over the financial instrument. It 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 of the 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.

Initial and subsequent measurement

Financial assets and liabilities are recognised initially at 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 financial assets available for sale at their fair value, without any deduction for costs of sale. 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.

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.

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 available-for-sale monetary assets are recognised directly in a fair value reserve within equity and are disclosed in the statement of changes in equity. Impairment losses, foreign exchange gains and losses, interest income and amortisation of premium or discount on available-for-sale 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 equity.

Upon disposal or other derecognition of financial assets available for sale all cumulative gains and losses from the financial instrument are transferred to the income statement.

Gains or losses arising from financial assets and financial liabilities carried at amortised cost are recognised as interest in the income statement over the period of amortisation.

Gains or losses may also be recognised in the income statement when a financial instrument is derecognised or when its value is impaired.

Notes to the financial statements (continued)

Determination of fair value of financial instruments

The fair values of quoted available-for-sale financial assets are based on closing prices at the reporting date. If there is no active market for the financial instrument, or if, due to any other reason, the fair value cannot be reliably measured by the market price, the Bank uses an internal evaluation model for fair value estimation.

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

Impairment of financial assets

Impairment of assets identified as impaired

Financial assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The Bank estimates and performs impairment of all financial assets, except financial assets at fair value through profit or loss.

If any evidence of impairment exists for available-for-sale financial assets, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. Significant or prolonged decline in fair value of instruments in equity securities and investments in investment funds is considered as impairment. Impairment losses recognised in the income statement on equity instruments are not reversed through 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.

The recoverable amount of financial assets measured at amortised cost is calculated as the present value of the expected future cash flows, discounted at the instrument's original interest rate. Short-term balances are not discounted. Provisions for uncollectibility are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts (or lower amount if required by applicable CNB regulations). The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties. An increase in impairment losses is recognised in the income statement. When a loan is known to be uncollectable, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly. If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-off, the write-off or impairment loss is reversed through the income statement.

Impairment of assets not identified as impaired

In addition to the above described impairment losses on assets identified as impaired, the Bank recognises impairment losses, in income, in on and off-balance-sheet credit risk exposures not identified as impaired at rates from 0.85 - 1.20%, in accordance with the accounting regulations of the CNB (the Bank uses the rate of 0.85%).

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

(h) Specific financial instruments

Cash and cash equivalents

Cash and cash equivalents comprise of cash balances on hand, cash deposited with Croatian National Bank, placements with other banks with original maturities of three months or less, and items in course of collection.

Notes to the financial statements (continued)

Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to currency risk and interest rate risk arising from operating, financing and investing activities. In accordance with its investment policies, the Bank does not hold or issue derivative financial instruments for the purpose of speculative trading. Hedge accounting has not been applied and consequently, all derivative agreements are classified as financial instruments at fair value through profit or loss.

Derivative financial instruments include foreign currency forward agreements and swaps and are initially recognised at fair value which is the value of 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 derivative instruments are presented 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. Except as required to the contrary by the CNB, when the economic characteristics and risks of embedded derivatives are not closely related to those of the host 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.

Changes in the fair value of derivatives instruments are included in gains less losses arising from dealing with foreign currencies.

Treasury bills and debt securities

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

Equity securities and investments in open-ended investment funds

Equity securities and investments in open-ended and close-ended investment funds are classified as available-for-sale assets.

Placements with banks

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

Loans and advances to customers

Loans and advances to customers are classified as loans and receivables and are presented net of impairment allowances to reflect the estimated recoverable amounts.

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.

Repurchase agreements and linked transactions

The Bank enters into purchases/(sales) of investments under agreements to resell (repurchase) substantially identical investments or in a series of linked sales and buy-back transactions at a certain date in the future at a fixed price. The amounts paid are recognised in loans and advances to either banks or customers. The receivables are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the balance sheet 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 the investments are reported as 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.

Notes to the financial statements (continued)

Offsetting of financial instruments

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

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.

(i) Income tax

The income tax charge is based on taxable profit for the year and comprises of 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 or substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred taxes are calculated by using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted at the balance sheet date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the balance sheet date, to recover or settle the 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 sufficient taxable profits will be available against which the deferred tax assets can be utilised. 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 assets that are held for use in the supply of services or other administrative purposes.

Recognition and measurement

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

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 development 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:

	2013	2012
Buildings	33 years	33 years
Computers	5 years	5 years
Furniture and equipment	7-15 years	7-15 years
Motor vehicles	4 years	4 years
Other assets	10 years	10 years

Notes to the financial statements (continued)

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

(k) Intangible assets

Intangible assets are stated at cost less accumulated amortization and impairment losses. Expenditure on development activities are capitalised if all of the features required by IAS 38 "Intangible Assets" are satisfied. Amortisation is provided on a straight-line basis over the estimated useful lives of intangible assets. Costs associated with maintaining intangible assets are recognised as an expense as incurred.

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

	2013	**2012**
Leasehold improvements	5 years	5 years
Software	5 years	5 years
Licences	5 years	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 purpose 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.

Non-financial assets that have suffered impairment 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 depreciation, if no impairment loss had been recognised.

(m) Provisions for liabilities and charges

Provisions are recognised when the Bank has a present 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 the law in the case of provisions for unidentified impairment of off-balance-sheet credit risk exposures, as previously referred to in note II. (b) "Financial Instruments".

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

Notes to the financial statements (continued)

(n) Operating leases

Leases where the Bank as a lessor retains substantially all the risks and rewards incidental to ownership are classified as financial leases. The Bank did not have any financial leases on the balance sheet date, neither as a lessee or lessor. All leases are operating leases. Rental income under operating leases is recognised in the income statement on a straight-line basis over the term of the lease. The Bank leases office space for conducting its business activities. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.

(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 individual choice. The Bank has no further payment obligations once the contributions have been paid. The pension contributions are recognised as employee benefits 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 balance sheet 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 opinion of the Bank's management, best represent the time value of money.

(p) Share capital and reserves

Issued share capital represents the nominal value of paid-in ordinary shares classified as equity and is denominated in HRK.

Reserve for general banking risks

The Bank recognises a reserve for general banking risks, which represents a reserve for potential losses in excess of those expected and provided for through recognised impairment losses. The reserve is calculated in accordance with applicable regulations which require that a certain percentage of net profit for the year be set aside as a reserve within equity if the growth of risk assets on an annual basis exceeds a specific level. The reserve for general banking risk cannot be transferred to retained earnings or be otherwise distributed until the expiry of a consecutive three year period in which the Bank has recorded annual growth not exceeding 15%.

Accumulated losses

Profit for the year is transferred to accumulated loss. Accumulated losses include losses from previous periods, the profit for the year and expenditures related to acquisition of property in the prior period.

Earnings per share

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

(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 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)

(r) Funds management for and on behalf of third parties

The Bank manages funds for and on behalf of corporate and retail customers. These amounts do not represent the Bank's assets and therefore are excluded from the balance sheet. For the services rendered, the Bank charges a fee which is recognised in the income statement on an accruals basis.

Notes to the financial statements (continued)

2. RISK MANAGEMENT

2.1 Internal assessment of risk of the Bank's operations

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

The Bank has, for the most important risks to which it is exposed, adopted a policy and management strategy that includes objectives and basic principles of risk assumption and management, defines the risk profile and tendency of taking risks and the compliance of the risk profile of the Bank and level of capital.

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

2.1.1 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.

To manage the level of credit risk, the Bank evaluates debtors' creditworthiness, and in order to minimise credit risk, obtains appropriate collateral. Also, the risk that counterparties to financial instruments might default on their obligations is monitored on an ongoing basis.

The Bank's primary exposure to credit risk arises from loans to and receivables from customers. The amount of credit exposure in this regard, and in respect of held-to-maturity securities recognised at amortised cost, is represented by the carrying amounts of the assets on the balance sheet. In addition, the Bank is exposed to the credit risk in respect of the off-balance-sheet items, through commitments arising from unused facilities and guarantees issued.

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.

Policies and strategies of credit risk management is an general document or frame for managing credit risk after which follow procedures, instructions and other documents which are defined in more detail:

- tendency of taking credit risk,
- clear lines of authority and responsibility,
- way of assumption, overcoming and credit risk management,
- 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 product,
- procedures for controlling and monitoring credit risk, including the establishment of exposure limits,
- procedures and measures if there is a deviation from the application of existing policies, procedures and authority for approval of such deviations and
- Stress testing as a preparation of the Bank for possible crisis situations,

making it a comprehensive system of credit risk management.

Notes to the financial statements (continued)

Assessment of credit risk of the placements

Process of credit risk rating of placements comprises the following:

- debtors' creditworthiness,
- debtors' timeliness in meeting their obligations and
- collateral quality.

Assessment of creditworthiness is performed on each loan application, that is, minimum once a year subsequent to the delivery of the annual financial reports by the clients to which the Bank is exposed and who have not filed a loan request for a new risky product.

Creditworthiness implies the ability of a client to comply with credit terms or potential obligations and to ensure fulfilment of accepted obligation towards the Bank with its own funds, in the manner and within period determined by the contract and that client's operations comply with laws and regulations.

Assessment of creditworthiness of a corporate customer is performed at least by following criteria:

1. the nature of the debtor
2. the debtor's capital
3. creditworthiness of the debtor
4. liquidity and profitability
5. cash flow of the debtor
6. the general business terms and conditions and the outlook of the debtor
7. the debtor's exposure to currency indicated credit risk.

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

Credit risk management in 2013 was complex and largely under the influence of macroeconomic trends, as well as efforts to ensure the collection of receivables through the implementation of the restructuring and / or rescheduling. Introducing pre bankruptcy settlement as new, legally permitted and regulated modality for the restructuring of debtors obligations to all creditors was an additional challenge in efforts to restructure operations or financial position of the debtor and improve its ability to repay according to the current market conditions which ultimately leads to more regular payment obligations to the Bank and improve liquidity rating to ensure the stability and viability of the business over the long term.

Classification of placements into risk categories

The process and criteria for the classification of placements into risk categories and calculation of impairment losses is defined by the By-law on classification of placements and contingent liabilities of Vaba d.d. banka, in accordance with the CNB's Decision on Classification of Placements and Contingent Liabilities of Banks.

The Bank assesses quality of placements and contingent liabilities continuously and classifies them based on the following general criteria:

a) creditworthiness of the debtor,
b) debtors' timeliness in meeting their obligations and
c) collateral quality.

The Bank uses all of the criteria in the process of classification of placements, in line with general practice of credit risk management.

Notes to the financial statements (continued)

Exceptionally, in accordance with the CNB's Decision on Classification of Placements and Contingent Liabilities of Banks, the Bank classifies placements from the "small loan portfolio" into risk categories based on the debtors' timeliness in meeting their obligations and/or their collateral quality with individually significant placements being classified based on the collateral quality if the key criteria for the approval of the placement was not the creditworthiness of the debtor, but the collateral quality (with obligatory assessments of fair value and marketability of the collateral).

Based on the criteria and the classification of the placements and contingent liabilities which are defined separately for the "small loan portfolio" (total exposure toward one counterparty or a group of related counterparties less than HRK 200,000 at the assessment date) and for the individually significant exposures (total exposure toward one counterparty or a group of related counterparties more than HRK 200,000 at the assessment date), the Bank classifies all its placements into risk categories with impairment losses as follows:

1. **Risk category A** – newly approved placements upon initial approval and placements that the Bank estimates are fully recoverable – with no impairment losses on individual basis (impairment losses for risk category A placements are calculated on the group basis).
2. **Risk category B –** partly recoverable placements – **risk category B,** which are classified into three subcategories, depending on the percentage of the impairment losses in relation to the initial amount of placements:

    B1 – losses ranging from 1% to 29.99%,

    B2 – losses ranging from 30.00% to 69.99%,

    B3 – losses ranging from 70.00% to 99.99%.
3. **Risk category C** – non-recoverable placements with impairment losses of 100%.

Classification into risk categories is done at least on quarterly basis. Risk categories for "small loan portfolio" are applied systematically with control of Sector for risk management. Assessment of recoverability of placements which are not part of "small loan portfolio" is done continuously and risk categories are updated at least on quarterly basis on suggestion of Sector for risk management.

During 2013 value adjustments of the credit portfolio are significantly higher than the previous year, primarily as a result of deterioration of the loan portfolio due to objective economic situation and unfavourable market conditions, the opening of a large number pre bankruptcy settlements and adjustment due to changes of legislation regulating the classification of placements and off-balance sheet liabilities.

Notes to the financial statements (continued)

Assets exposed to credit risk

Based on the applicable acts, the Bank uses the usual instruments as collaterals: bank guarantees, fiduciary right on real estate and movable assets, insurance policies, fiduciary rights on securities and shares in open-ended investment funds, cessions of receivables from companies and governments, bills of exchanges and pledges of accounts. Fair value appraisals of real estate and movable assets are done by certified appraisers form the Bank's list of certified appraisers. Fair value of collateral is revised based on usual business practice and market movements.

Assets	**Notes**	**31.12.2012 (HRK '000)**	**31.12.2013 (HRK '000)**
Deposits with Croatian National Bank	3	122,683	126,462
Placements with and loans to other banks	4	43,159	50,242
Financial assets available for sale	5	200,146	193,075
Financial assets held to maturity	6	16,248	55,959
Loans and advances to customers	7	722,828	675,690
Other assets	10	30,029	37,288
Total assets exposed to credit risk		1,135,094	1,138,716
Guarantees		49,380	35,916
Letters of credit		348	653
Unused loan commitments		32,562	44,818
Other contingent liabilities		6,353	2,079
Total off balance sheet exposure to credit risk	**31**	88,643	83,466
Total credit exposure		**1,223,737**	**1,222,182**

Notes to the financial statements (continued)

Uncollected due receivables

Uncollected due receivables include gross receivables based on maturity of both due and not due principal, on individual basis, including due but uncollected interest. Total amount of individual placement is allocated to the maturity class of the oldest uncollected receivable, relating to either principal or the interest.

Most of the increase in outstanding debt over 90 days in 2013 refers to loans and advances to customers, primarily corporate loans as a result of deterioration in the financial position of the debtor due to the general economic crisis, which inevitably affected the (in) ability to pay and the deterioration of the loan portfolio of companies. For the most part the growth of outstanding debt is a result of the opening pre bankruptcy settlement and realization of the right to separate settlement secured by law in proceedings pre bankruptcy settlement in which the Bank does not participate.

	31.12.2013				
[000 HRK]	**Gross**	**Not due and due up to 90 days**	***%***	**Due over 90 days**	***%***
Deposits with Croatian National Bank	126,462	126,462	*100%*	-	-
Placements with and loans to other banks	60,416	50,342	*83%*	10,074	*17%*
Financial assets held to maturity	57,935	56,648	*98%*	1,287	*2%*
Loans and advances to customers	803,671	541,153	*67%*	262,518	*33%*
Other assets	63,849	36,448	*57%*	27,401	*43%*
TOTAL	**1,112,333**	**811,053**	***73%***	**301,280**	***27%***

	31.12.2012				
[000 HRK]	**Gross**	**Not due and due up to 90 days**	***%***	**Due over 90 days**	***%***
Deposits with Croatian National Bank	122,683	122,683	*100%*	-	-
Placements with and loans to other banks	43,157	43,157	*100%*	-	-
Financial assets held to maturity	16,983	15,696	*92%*	1,287	*8%*
Loans and advances to customers	776,408	538,648	*69%*	237,760	*31%*
Other assets	48,608	21,207	*44%*	27,401	*56%*
TOTAL	**1,007,839**	**741,391**	***74%***	**266,448**	***26%***

Notes to the financial statements (continued)

[000 HRK]	31.12.2013								
	Gross	%	Impairment loss for identified losses	Impairment loss for unidentified losses	Total impairment loss	Total impairment loss / gross	Net	Collateral value	Collateral value / net
	1	2	3	4	5 = 3 + 4	6 = 5 / 1	7 = 1 - 6	8	9 = 8 / 7
Assets									
Deposits at CNB	126,462	-	-	-	-	-	126,462	-	-
A	126,462	*100,00%*	-	-	-	-	126,462	-	-
Placements at and loans to other banks	60,416	-	10,174	-	10,174	*16,84%*	50,242	-	-
A	40,067	*66,32%*	-	-	-	-	40,067	-	-
B, C	10,174	*16,84%*	10,174	-	10,174	*100,00%*	-	-	-
Financial assets held to maturity	57,935	-	1,439	537	1,976	*3,41%*	55,959	-	-
A	53,650	*92,60%*	-	537	537	*1,00%*	53,113	-	-
B, C	4,285	*7,40%*	1,439	-	1,439	*33,58%*	2,846	-	-
Loans and advances to customers	803,671	-	121,060	6,921	127,981	*15,92%*	675,689	373,322	*55,25%*
A	516,120	*64,22%*	-	6,921	6,921	*1,34%*	509,199	206,251	*40,50%*
B, C	287,551	*35,78%*	121,060	-	121,060	*42,10%*	166,491	167,071	*100,35%*
Retail	162,267	-	31,133	1,539	32,672	*20,13%*	129,595	54,060	*41,71%*
A	114,767	*70,73%*	-	1,539	1,539	*1,34%*	113,228	39,680	*35,04%*
B, C	47,499	*29,27%*	31,133	-	31,133	*65,54%*	16,366	14,380	*87,86%*
Corporate	641,404	-	89,927	5,382	95,309	*14,86%*	546,095	319,262	*58,46%*
A	401,353	*62,57%*	-	5,382	5,382	*1,34%*	395,971	166,571	*42,07%*
B, C	240,051	*37,43%*	89,927	-	89,927	*37,46%*	150,124	152,691	*101,71%*
Other assets	63,849	-	26,561	-	26,561	-	37,288	-	-
A	-	-	-	-	-	-	-	-	-
B, C	-	-	26,561	-	26,561	-	(26,561)	-	-
Total	**1,112,333**	**-**	**159,234**	**7,457**	**166,692**	***14,99%***	**945,641**	**373,322**	***39,48%***

Notes to the financial statements (continued)

[000 HRK]	31.12.2012.								
	Gross	%	Impairment loss for identified losses	Impairment loss for unidentified losses	Total impairment loss	Total impairment loss / gross	Net	Collateral value	Collateral value / net
	1	2	3	4	5 = 3 + 4	6 = 5 / 1	7 = 1 - 6	8	9 = 8 / 7
ASSETS									
Deposits at CNB	122,683		-	-	-	-	122,683	-	-
A	122,683	*100.00%*	-	-	-	-	122,683	-	-
Placements at and loans to other banks	43,157		-	-	-	-	43,157	-	-
A	43,157	*100.00%*	-	-	-	-	43,157	-	-
Financial assets held to maturity	16,983		584	150	734	*4.32%*	16,248	-	-
A	16,398	*96.56%*	-	150	150	*0.91%*	16,248	-	-
B, C	584	*3.44%*	584	-	584	*100.00%*	-	-	-
Loans and advances to customers	776,408		46,508	7,072	53,580	*6.90%*	722,828	317,138	*43.87%*
A	660,422	*85.06%*	-	7,072	7,072	*1.07%*	653,350	266,034	*40.72%*
B, C	115,986	*14.94%*	46,508	-	46,508	*40.10%*	69,478	51,104	*73.55%*
Retail	173,508		25,634	1,514	27,148	*15.65%*	146,360	48,012	*32.80%*
A	141,391	*81.49%*	-	1,514	1,514	*1.07%*	139,877	45,446	*32.49%*
B, C	32,117	*18.51%*	25,634	-	25,634	*79.81%*	6,483	2,566	*39.58%*
Corporate	602,899		20,874	5,558	26,432	*4.38%*	576,468	269,126	*46.69%*
A	519,030	*86.09%*	-	5,558	5,558	*1.07%*	513,472	220,588	*42.96%*
B, C	83,869	*13.91%*	20,874	-	20,874	*24.89%*	62,995	48,538	*77.05%*
Other assets	48,608		18,579	-	18,579	*38.22%*	30,029	-	-
A	-	-	-	-	-	-	-	-	-
B, C	48,608	*100.00%*	18,579	-	18,579	*38.22%*	30,029	-	-
TOTAL	**1,007,838**		**65,671**	**7,222**	**72,893**	***7.23%***	**934,945**	**317,138**	***33.92%***

Notes to the financial statements (continued)

2.1.2 Market risks

The exposure to market risk occurs in respect of positions recognised at fair value and refers to securities and other financial instruments held for trading, securities and other financial instruments available for sale and positions denominated in foreign currency.

2.1.2.1 Foreign exchange risk

Foreign exchange operations of the Bank are subject to risks due to changes in intercurrency 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 foreign currency receivables and liabilities, in accordance with the regulations of the CNB 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. Operational management of foreign currency position, within the prescribed limits is responsibility of the Treasury Department, which has the ability to propose measures to eliminate currency gap through a reduction or increase in loans and deposits with a currency clause, selling or buying the currency, or through arbitration - selling one currency for another.

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

Foreign exchange risk

[000 HRK]	31.12.2013				
	HRK	HRK with FC clause	EUR	Other foreign curencies	Total
ASSETS					
Cash and deposits with CNB	126,869	0	15,318	15,138	157,325
Placements with and loans to other banks	0	0	45,839	4,403	50,242
Financial assets available for sale	37,091	34,398	121,586	0	193,075
Financial assets held to maturity	55,959	0	0	0	55,959
Loans and advances to customers	181,325	450,658	43,402	305	675,690
Property and equipment	30,579	0	0	0	30,579
Intangible assets	17,472	0	0	0	17,472
Other assets	37,206	0	15	67	37,288
TOTAL ASSETS	**486,501**	**485,056**	**226,160**	**19,913**	**1,217,629**
LIABILITIES					
Deposits from banks					0
Deposits from customers	272,510	1,127	686,654	27,222	987,513
Borrowings	84,391	12,202	54,479	0	151,072
Hybrid instruments	0	0	3,055	0	3,055
Provisions for liabilities and charges	1,039	0	0	0	1,039
Other liabilities	5,642	6,785	245	0	12,672
TOTAL LIABILITIES	**363,582**	**20,114**	**744,433**	**27,222**	**1,155,351**
EQUITY					
Share capital	75,020	0	0	0	75,020
Share premium	0	0	0	0	0
Other reserves	94,030	0	0	0	94,030
Fair value reserve	2,677	0	0	0	2,677
Accumulated losses	(109,449)	0	0	0	(109,449)
TOTAL EQUITY	**62,278**	**0**	**0**	**0**	**62,278**
TOTAL LIABILITIES AND EQUITY	**425,860**	**20,114**	**744,433**	**27,222**	**1,217,629**
NET FOREIGN EXCHANGE POSITION	**60,641**	**464,942**	**(518,273)**	**(7,309)**	**0**

Notes to the financial statements (continued)

[000 HRK]	31.12.2012				
	HRK	HRK with FC clause	EUR	Other foreign curencies	Total
ASSETS					
Cash and deposits with Croatian National	119,673	-	9,043	15,636	144,353
Placements with and loans to other banks	24,151	-	17,154	1,853	43,157
Financial assets available for sale	60,520	2,743	136,883	-	200,146
Financial assets held to maturity	16,248	-	-	-	16,248
Loans and advances to customers	202,019	455,143	65,666	-	722,828
Property and equipment	30,536	-	-	-	30,536
Intangible assets	16,971	-	-	-	16,971
Other assets	29,650	-	15	364	30,029
TOTAL ASSETS	**499,768**	**457,886**	**228,761**	**17,853**	**1,204,268**
LIABILITIES					
Deposits from banks					-
Deposits from customers	271,320	2,177	560,163	29,520	863,181
Borrowings	92,658	11,108	94,217	-	197,983
Hybrid instruments	-	-	3,018	-	3,018
Provisions for liabilities and charges	889	-	-	-	889
Other liabilities	8,161	4,094	-	-	12,255
TOTAL LIABILITIES	**373,028**	**17,379**	**657,398**	**29,520**	**1,077,325**
EQUITY					
Share capital	176,523	-	-	-	176,523
Share premium	27,440	-	-	-	27,440
Other reserves	2,552	-	-	-	2,552
Fair value reserve	5,610	-	-	-	5,610
Accumulated losses	(85,183)	-	-	-	(85,183)
TOTAL EQUITY	**126,943**	**-**	**-**	**-**	**126,943**
TOTAL LIABILITIES AND EQUITY	**499,971**	**17,379**	**657,398**	**29,520**	**1,204,269**
NET FOREIGN EXCHANGE POSITION	**(203)**	**440,507**	**(428,637)**	**(11,667)**	**-**

Notes to the financial statements (continued)

2.1.2.2 Position risk

The exposure to position risk relates to risk arising from changes in value of a financial instrument or changes in underlying variable of derivatives.

Financial instruments held for trading are exposed to general position risk, which is the risk of loss due to price change of financial instruments which can occur due to interest rate changes, or more significant changes on capital markets not related to any specific characteristics of financial instruments. Related instruments are also exposed to specific position risk which arises from price changes of individual financial instruments due to factors related to its issuer.

Asset and Liability Management Committee of the Bank establishes limits to exposures to financial assets available for sale. Decision on purchase/sale of a financial instrument and its classification into a category is made by the Management Board. Treasury Division does the transaction while the Risk Management Division controls the compliance with the internal acts and monitors fair values of the financial instruments on daily basis, if available.

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

In the measurement of the market risk exposure, the Bank relies on regulations set out by the Croatian National Bank and monitors the following:

- Capital requirements calculated by the standard method calculated in accordance with the Croatian National Bank's Decision on capital adequacy;
- Internal models of monitoring exposure to interest rate risk in the Bank's records.

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

2.1.2.3 Interest rate risk

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

In line with cautious 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.

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

The Bank utilises the following measures for measurement of interest rate risk exposure:

1. repricing gap analysis;
2. standard interest shock on net interest income;
3. "what if" simulation; and
4. economic value of capital simulation (duration analysis).

Since 31 March 2010, based on the Decision on interest rate management, Risk Management Division reports on interest rate exposure on quarterly basis. For each reporting period in 2013, economic value of capital in relation to capital adequacy was in line with the regulatory requirements.

Measuring exposure to interest rate risk

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

Notes to the financial statements (continued)

Profit perspective

When calculating the effect of interest rate change on net interest income, the Bank uses standard interest shock on net interest income for a 12 month period. The simulation is based on parallel movements in all interest rates, increase/decrease by 2 percentage points for HRK and increase/decrease by 1 percentage point for EUR and all other currencies.

[000 HRK]	2013	2012
Potential decrease in net interest income (HRK 000)	-643	-474
% of budgeted net interest income	-1.72%	-0.67%

Perspective of economic value of capital

The perspective of economic value of capital (duration analysis) represents a long term measure of interest rate risk exposure in the balance sheet. The effect of interest rate changes on economic value of capital is measured by economic value of capital simulation. This model is based on duration analysis and the hypothesis is that economic value of capital is expressed as the difference between the present value of assets and the present value of liabilities. The calculation is based on balance sheet positions which are distributed according to repricing criteria.

The Bank calculates the market value of capital by discounting the balance sheet positions using a rate of 5%. The economic value of capital is expressed as the difference between the present value of assets and the present value of liabilities. The simulation of change in economic value of capital is based on a simultaneous parallel increase of interest rates by 1%.

Risk Management Division reports the results of the interest rate risk exposure to the Asset and Liability Management Committee.

[000 HRK]	2013	2012
Net book value of capital (HRK 000)	62,278	119,961
Economic value of capital (HRK 000)	43,326	100,388
Change in economic value of capital (HRK 000)	-7.46%	-4.54%
Limit of change in market value of capital (HRK 000)	10.00%	10.00%

Interest rate risk stress test

Interest rate risk stress test is performed at least on yearly basis. It represents sensitivity analysis of net interest income and net interest margin on changes in interest rates based on repricing of sensitive positions. Risk Management Division selects at least two scenarios, informing the Asset and Liability Committee on the results.

Notes to the financial statements (continued)

Interest rate gap analysis

The following table shows the Bank's exposure to interest rate risk, analysed on the basis of the contracted maturity, or, with the instruments whose interest rate changes before maturity (administrative interest rate), in the period until the next date of the interest rate change.

[000 HRK]	31.12.2013							
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest fee	**Total**	Fixed interest rate
ASSETS								
Cash and deposits with CNB	14,322	0	72,278	0	0	70,725	**157,325**	0
Placements with and loans to other banks	48,049	0	0	0	0	2,193	**50,242**	0
Financial assets available for sale	7,638	15,275	157,151	0	0	13,011	**193,075**	180,064
Financial assets held to maturity	18,691	12,229	23,507	1,856	0	(324)	**55,959**	56,283
Loans and advances to customers	115,473	58,908	445,284	13,160	10,032	32,833	**675,690**	46,084
Property and equipment	0	0	0	0	0	30,579	**30,579**	0
Intangible assets	0	0	0	0	0	17,472	**17,472**	0
Other assets	0	0	0	0	0	37,288	**37,288**	0
TOTAL ASSETS	**204,173**	**86,412**	**698,220**	**15,016**	**10,032**	**203,777**	**1,217,629**	**282,431**
LIABILITIES								
Deposits from banks	0	0	0	0	0	0	**0**	0
Deposits from customers	92,334	104,955	748,307	19,423	5,124	17,370	**987,513**	459,459
Borrowings	107,781	4,354	22,515	7,371	8,908	143	**151,072**	131,835
Hybrid instruments	0	0	0	3,055	0	0	**3,055**	3,055
Provisions for liabilities and charges	0	0	0	0	0	1,039	**1,039**	0
Other liabilities	0	0	0	0	0	12,672	**12,672**	0
TOTAL LIABILITIES	**200,115**	**109,309**	**770,822**	**29,849**	**14,032**	**31,224**	**1,155,351**	**594,349**
TOTAL EQUITY	**0**	**0**	**0**	**0**	**0**	**62,278**	**62,278**	**0**
TOTAL LIABILITIES AND EQUITY	**200,115**	**109,309**	**770,822**	**29,849**	**14,032**	**93,502**	**1,217,629**	**594,349**
INTEREST GAP	**4,058**	**(22,897)**	**(72,602)**	**(14,833)**	**(4,000)**	**110,275**	**(0)**	**(311,918)**

Notes to the financial statements (continued)

[000 HRK]	31.12.2012							
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest free	**Total**	Fixed interest rate
ASSETS								
Cash and deposits with Croatian National Bank	48,803	-	73,880	-	-	21,670	**144,353**	-
Placements with and loans to other banks	40,992	-	-	-	-	2,166	**43,157**	-
Financial assets available for sale	15,091	22,637	28,677	69,547	47,877	16,316	**200,146**	183,830
Financial assets held to maturity	898	2,559	6,075	-	-	6,717	**16,248**	9,532
Loans and advances to customers	68,762	57,596	530,302	8,730	5,678	51,760	**722,828**	34,368
Property and equipment	-	-	-	-	-	30,536	**30,536**	-
Intangible assets	-	-	-	-	-	16,971	**16,971**	-
Other assets	-	-	-	-	-	30,029	**30,029**	-
TOTAL ASSETS	**174,546**	**82,792**	**638,933**	**78,277**	**53,555**	**176,164**	**1,204,268**	**227,730**
LIABILITIES								
Deposits from banks	-	-	-	-	-	-	**-**	-
Deposits from customers	91,196	122,831	541,901	91,529	1,895	13,828	**863,181**	323,258
Borrowings	133,568	34,161	21,019	5,118	3,806	309	**197,982**	178,809
Hybrid instruments	-	-	-	3,018	-	-	**3,018**	3,018
Provisions for liabilities and charges	-	-	-	-	-	889	**889**	-
Other liabilities	-	-	-	-	-	12,255	**12,255**	-
TOTAL LIABILITIES	**224,765**	**156,992**	**562,920**	**99,665**	**5,702**	**27,282**	**1,077,325**	**505,085**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**126,943**	**126,943**	**-**
TOTAL LIABILITIES AND EQUITY	**224,765**	**156,992**	**562,920**	**99,665**	**5,702**	**154,225**	**1,204,268**	**505,085**
INTEREST GAP	**(50,218)**	**(74,200)**	**76,013**	**(21,388)**	**47,854**	**21,940**	**-**	**(277,355)**

Notes to the financial statements (continued)

2.1.2.4 Liquidity risk

Liquidity risk arises in 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 asset at market in an appropriate timeframe and at a reasonable price - liquidity risk of financial instruments.

The liquidity risk management is conducted in compliance with regulatory requirements, and is also defined with 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 Division and approved by the Bank's Management Board. In accordance with proposals by the Risk Management Division, a revision of internal acts is made.

The liquidity monitoring system is aimed at assessing the Bank's short-term liquidity and its ability to comply with future financing requirements. The Bank continuously aims its activities on improving the quality of the model and the entire process of liquidity management by upgrading the monitoring system, its related assumptions and by enhancing technical support in the procedural process.

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. Framework for a appropriate liquidity risk management comprises of: liquidity management strategy approved by the Management Board within budget and strategic plans, efficient supervision by Asset and Liability Management Committee and the Management Board, clearly defined responsibilities and conducts 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 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 it's business activities the Bank monitors liquidity risk and complies with regulations, following measures are part of liquidity risk management:

- prescribed ratio of short-term foreign currency receivables in relation to payables, which are monitored on a daily basis;
- reserve requirements - HRK;
- reserve requirements - foreign currency; and
- minimum liquidity ratio.

The purpose of management liquidity funds is compliance with regulatory minimum in a method to maintain minimum cost of liquidity funds.

The following liquidity risk indicators are monitored by the Bank:

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

The Bank raises funds using a broad range of instruments including deposits, borrowings, subordinated loans 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.

Notes to the financial statements (continued)

Liquidity stress test

Liquidity stress tests are done based on analysis of different scenarios, i.e. assessment of effects of simultaneous changes in several different factors of risk for the financial position of the Bank in clearly defined stress circumstances. The Bank performs liquidity stress tests adapted to business size and characteristics, strategic goals and plans, 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 relevant function of the Bank for prompt reaction in the case of a liquidity crisis. The development of the liquidity stress test represents the Bank's internal policy and is good practice for liquidity management. Management of the long term liquidity is accomplished by position maintenance with regards to liquidity risk exposure limits.

Stress scenario is arbitrarily selected, approved by the Risk Management Division. Two scenarios are selected, at minimum, one including Bank specific factors, the other including market factors. Different combinations of the factors are possible as well.

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

The following table provides information on the remaining maturity of assets and liabilities of the Bank.

Notes to the financial statements (continued)

Maturity analysis

[000 HRK]	31.12.2013						
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest fee	**Total**
ASSETS							
Cash and deposits with CNB	150,779	0	0	6,546	0	-	**157,325**
Placements with and loans to other banks	48,638	1,604	0	0	0	-	**50,242**
Financial assets available for sale	36,507	16,312	61,135	644	78,477	-	**193,075**
Financial assets held to maturity	20,581	12,106	23,272	0	0	-	**55,959**
Loans and advances to customers	196,185	71,452	125,344	127,135	155,574	-	**675,690**
Property and equipment	0	0	0	0	30,579	-	**30,579**
Intangible assets	0	0	0	0	17,472	-	**17,472**
Other assets	2,435	295	426	283	33,849	-	**37,288**
TOTAL ASSETS	**455,125**	**101,769**	**210,177**	**134,608**	**315,951**	**0**	**1,217,629**
LIABILITIES							
Deposits from banks	0	0	0	0	0	-	**0**
Deposits from customers	177,363	106,382	600,401	96,475	6,892	-	**987,513**
Borrowings	105,569	702	0	25,963	18,838	-	**151,072**
Hybrid instruments	0	0	0	3,055	0	-	**3,055**
Provisions for liabilities and charges	0	0	1,039	0	0	-	**1,039**
Other liabilities	2,462	1,565	5,160	0	3,485	-	**12,672**
TOTAL LIABILITIES	**285,394**	**108,649**	**606,600**	**125,493**	**29,215**	**0**	**1,155,351**
EQUITY	**0**	**0**	**0**	**0**	**0**	**62,278**	**62,278**
TOTAL LIABILITIES AND EQUITY	**285,394**	**108,649**	**606,600**	**125,493**	**29,215**	**62,278**	**1,217,629**
MATURITY GAP	**169,731**	**(6,880)**	**(396,423)**	**9,115**	**286,736**	**(62,278)**	**(0)**

Notes to the financial statements (continued)

[000 HRK]	31.12.2012						
	0 - 30 days	31 - 90 days	91 - 360 days	1 - 3 years	over 3 years	Interest free	**Total**
ASSETS							
Cash and deposits with Croatian National Bank	144,353	-	-	-	-	-	**144,353**
Placements with and loans to other banks	43,157	-	-	-	-	-	**43,157**
Financial assets available for sale	27,242	22,637	30,958	70,939	48,370	-	**200,146**
Financial assets held to maturity	6,168	2,471	7,119	443	47	-	**16,248**
Loans and advances to customers	62,610	65,346	194,881	251,794	148,196	-	**722,828**
Property and equipment	-	-	-	-	30,536	-	**30,536**
Intangible assets	-	-	-	-	16,971	-	**16,971**
Other assets	826	5	30	10,569	18,599	-	**30,029**
TOTAL ASSETS	**284,356**	**90,460**	**232,988**	**333,745**	**262,720**	**-**	**1,204,269**
LIABILITIES							
Deposits from banks	-	-	-	-	-	-	**-**
Deposits from customers	93,536	125,640	493,564	146,790	3,650	-	**863,180**
Borrowings	132,083	33,275	-	6,082	26,543	-	**197,982**
Hybrid instruments	-	-	-	3,018	-	-	**3,018**
Provisions for liabilities and charges	-	-	889	-	-	-	**889**
Other liabilities	10,823	215	88	504	625	-	**12,255**
TOTAL LIABILITIES	**236,442**	**159,130**	**494,541**	**156,394**	**30,818**	**-**	**1,077,325**
TOTAL EQUITY	**-**	**-**	**-**	**-**	**-**	**126,943**	**126,943**
TOTAL LIABILITIES AND EQUITY	**236,442**	**159,130**	**494,541**	**156,394**	**30,818**	**126,943**	**1,204,268**
MATURITY GAP	**47,914**	**(68,670)**	**(261,552)**	**177,350**	**231,901**	**(126,943)**	**-**

Notes to the financial statements (continued)

2.1.3 Operational risks

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

Operational risk exists in every segment of the Bank's operations, requiring knowledge and continuous monitoring of all business processes. Organisational model of operational risk management is set up on centralised and decentralised levels of operational risk management.

Operational risk is managed in accordance with applicable legislation and is defined by the following internal acts:

- policy on operational risk management
- procedure on operational risk management
- methodology for operational risk management
- directive od reporting of operational losses and operational risks

When measuring exposure to the operational risk, The Bank, based on the consequences of a risk event, differs the following:
Loss from operational risk, which represents operational losses affecting the balance sheet and assumes 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.

Self Risk Assessment is performed for every Bank's business process. Self Risk Assessment is done on yearly basis based on questionnaires prepared in accordance with Basel guidelines. Based on the 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, business processes owners, in coordination with the Risk Management Division, propose action for reducing exposure to an operational risk using methods for reduction of effects, i.e. damages and probability of occurrence or transferring the risk to a counterparty. Risk Management Division reports the results of the Self Risk Assessment to the Management Board once a year.

Risk Management Division reports 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. Report on operational losses contains, at minimum, data on amounts of losses, recovered amounts, unrecovered amounts, operational losses per type of event and cause and share of different organisational parts of the Bank in operational losses.

For operational risk management, The Bank has secured the following:

- adequate IT system management by using the following internal acts: Safety policy and Bylaw on adequate use of IT systems
- adequate risk management related to externalisation by using the following internal acts: Bylaw on externalisation and Procedure for externalisation
- adequate compliance risk management by using the following internal acts: Bylaw on compliance monitoring and implementation and Methodology for controls of organisational compliance of processes with internal and external processes
- adequate business continuity management by using the following internal acts: Business continuity policy and Business continuity procedure
- adequate system for prevention of money laundry and financing of terrorism by using the following internal acts: Policies and procedures for prevention of money laundry and financing of terrorism.

Notes to the financial statements (continued)

2.1.4 Concentration risks

Risk of concentration 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 put the Bank's operations in question.

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 capital and liability side of the balance sheet.

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 identification of related parties by internal acts, determining:

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

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 entered into Registry of related parties, comprehensive database.
Identification and measurement of concentration relates to group of exposures connected by common risk factors such as common industry, geographical area or similar operations.
In order to maintain diversified and stable base of financing and to avoid overdependence on only certain sources, concentration is monitored for the following:

- clients or groups of related parties whose deposits make more than 2% of the Bank's total liabilities on both individual and group basis
- deposits from companies and other financial institutions: individual deposit and 10 biggest deponents in relation to the total deposits from companies and financial institutions and relating to the total deposits
- retail deposits: 10 and 100 biggest deponents from retail sector as a percentage of total retail deposits as a percentage of total deposits.

Risk Management Division reports the concentration risk to the Asset and Liability Management Committee on monthly basis.

Concentration risk is also monitored on sector basis, as shown in the following table:

[000 HRK] Gross exposure	**2013**	***%***	**2012**	***%***
Retail	138.597	*12%*	169.902	*17%*
Agriculture and mining	53.392	*5%*	50.580	*5%*
Processing industry	239.374	*22%*	197.838	*20%*
Construction industry	97.997	*9%*	98.753	*10%*
Wholesale and retail sale	150.610	*14%*	109.476	*11%*
Financial services and insurance	268.406	*24%*	188.309	*19%*
Scientific and technical services	86.984	*8%*	67.745	*7%*
Health and social welfare services	6.452	*1%*	17.398	*2%*
Other	70.522	*6%*	107.838	*11%*
	1.112.333	***100%***	**1.007.839**	***100%***

Notes to the financial statements (continued)

2.1.5 Business continuity management

The Bank has adopted internal acts regulating the plan for business continuity management for the main business processes. The plan contains data on key personnel contacts, alternative locations in case of operations discontinuity, descriptions of key processes and strategies for their emergency recovery and documentation to be prepared in the case of operations discontinuity.

2.2 The Bank's general acts

2.2.1 General acts regulating credit policy

General acts regulating credit policy and asset and liability management are given as follows.

2.2.1.1 Credit policy objective

Credit policy objective includes the following:

- establishment of adequate credit risk management environment
- operations in accordance with generally accepted procedure for loan approval
- maintenance of adequate procedures for administration, measurement and monitoring of loans
- maintenance of adequate controls over credit risk
- maintenance of adequate assessment of the quality of assets
- recognition of adequate impairment allowances for identified and unidentified losses.

2.2.1.2 General articles of credit policy

The Bank's credit policy is based on applicable legislation and mission, vision and business policy of the Bank. It includes all important factors needed for ensuring development and reputation of the Bank, realisation of profit and maintenance of real value of capital based on safety, liquidity and profitability principles.

2.2.1.3 Definitions, principles and standards

Intention of the credit policy is establishment of basic principles for approving loans and other placements, relating to implementation of segregation of responsibilities for execution and for controls of activities into processes and procedures.

Basic principles of the credit policy are:

- safety of placements through realistic insight into the client's operations, assessment of its business capacity and its capability of servicing liabilities to the Bank,
- stable liquidity through assessment of repayments of placements in scheduled timeframe, expected inclusion of the debtor's funds into the Bank's deposit system as well as usage of the Bank's other services,
- profitability, i.e. satisfying the investors interests and enhancing self-financing of sales activities,
- quality service and satisfied customer,
- cross selling and enhancing deposit bases through private and corporate banking,
- capital adequacy maintenance through adequate rating of primary credit risk and reduction of the need for capital coverage through collaterals for loans.

Notes to the financial statements (continued)

2.2.1.4 Approval of placements

The Bank has established formal procedure for rating and approval of placements with the objective of maintenance of quality loan portfolio. Approvals are given in accordance with internal acts and are given by an appropriate organisational level. Each placement's approval procedure and the level of approval is properly documented. Segregation of duties of recommendations, approval and execution of a risk product ensures the adequacy of the approval process.

2.2.1.5 Monitoring of placements

Monitoring of placements process includes assessment of creditworthiness of a debtor, the group of its related parties and the quality of collateral during the lifespan of the legal relationship representing the exposure. Adequate system for placement monitoring includes measures:

- ensuring Bank's understanding of the current financial position of the debtor
- for assessment of the current collateral coverage in relation to the debtor's current position
- for identification of overdue payments

Internal acts define organisational units and responsible personnel ensuring all necessary information for undertaking of corrective actions as well as deadlines in which to act, considering potential conflicts of interest.

2.2.1.6 Loan portfolio analysis and process of monitoring of credit risk

The Bank has established the system for monitoring of entire structure and quality of the loan portfolio. Credit Committee, Supervisory Board and Audit Committee are regularly informed on the quality of the portfolio. Analysis of the loan portfolio includes, at minimum, analysis of risk categories, overdue days and the total exposure. Loan portfolio report is prepared by the Risk Management Division / Credit Risk Management Division. 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, certain type of collateral etc.

2.2.1.7 Non-performing loans

Continuous monitoring of collection is an integral part of the loan process. If the borrower does not pay its liabilities before due date, overdue liability exists. The Bank has internally defined actions and procedures for collection of overdue receivables. Primary goal is swift action and the objective is maximum collection with optimal solution for the Bank. Within the process of non-performing loans management, the Bank's objectives are improvement of its loan portfolio, timely reaction to identified collection issues, limitation of impairment losses to minimum and loan portfolio management.

2.2.1.8 Credit risk control and stress test

Credit risk control is one of the Bank's functions organised as a separate organisational part, functionally and organisationally separated from other organisational parts of the Bank and is directly responsible to the Bank's Management Board.

The objective of establishment of the credit risk control is maintenance of the Bank's exposure to the credit risk within the parameters established by the Management Board. Credit risk control assists in ensuring the credit risk stays within the limits acceptable to the Bank.

Credit risk control ensures independent, continuous check of the application and effectiveness of the methods and procedures for the credit risk management. Also, credit risk control includes establishment of measurement and assessment of credit risk which the Bank is or could be exposed to, and making recommendations for adequate credit risk management.

Notes to the financial statements (continued)

In order to function effectively, the credit risk control has the authorization for unlimited and permanent access to all documents, evidences and personnel of the Bank, with strict confidentiality.

Credit risk control function keeps evidence on performed work and reports the results of each separate review to the Management Board.

Stress test

Risk Management Division / Credit Risk Management Division tests the effects of two different factors, at minimum. Stress situation simulated in a test is usually determined by indicators on the market or within the Bank which point to a possibility of occurrence of significant changes in the loan portfolio, resulting in changes to the financial results of the Bank and to the regulatory indicators.

Risk Management Division reports the results of the stress tests to the Credit Committee and recommends the risk management strategy to be maintained or changed, depending on the stress test results.

Notes to the financial statements (continued)

3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated, and are based on historical experience and other factors. Key sources of estimation of uncertainty are described below.

Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. In accordance with the 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 as described in Note 2.1.1. "Credit risk", while provisions for liabilities and charges arise from off-balance-sheet risk exposure to customers, mainly in the form of guarantees, documentary credits and undrawn loan commitments as described in Note 32.

Financial assets carried at amortized cost

Financial assets carried at amortised cost include financial investments held to maturity and loans and advances to customers.

The Bank initially assesses whether objective evidence of impairment exists. Assets for which impairment is not individually assessed are included in group of assets with similar credit risk characteristics. These portfolios are then assessed collectively for impairment.

The Bank estimates impairment losses when it estimates that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets.

The Bank also seeks to recognise impairment losses which are known to exist at the balance sheet date, but which have not yet been specifically identified. In estimating unidentified impairment losses existing in collectively assessed portfolios, and in the absence of reliable data on historical loss rates and the emergence period for the identification of these impairment losses, the Bank considers the range of impairment loss rates at 1% (in 2012 at 0,85%) prescribed by the CNB to be calculated on all credit risk exposures except those carried at fair value, including off-balance-sheet amounts and Croatian sovereign risk. Amounts assessed as impaired on an individual basis are excluded from this calculation.

Fair value of the financial instruments quoted in an active market

In estimating the fair value of quoted financial instruments, the Bank uses closing prices at the date of estimation. If the market for a financial asset is not active (and for unlisted securities), or if, for any other reason, the fair value cannot be reliably measured by market prices, the Bank establishes fair value by using valuation techniques.

Provisions for court cases

The Bank performs individual assessment of outcome of court cases. Initial assessment is made by the Legal department of the Bank. As at 31 December 2013 the Bank is defendant in the total of 6 court cases, all of which are litigations. In 3 out of 6 litigations, the Bank has first instance rulings in its favour. 5 cases have been classified in risk group A with 1 classified in risk group C. As at 31 December 2013 total provisions for court cases amounted to HR 138 thousand.

Regulatory requirements

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

Notes to the financial statements (continued)

4. CASH AND DEPOSITS WITH CROATIAN NATIONAL BANK

[000 HRK] CASH AND DEPOSITS WITH CNB	31.12.2012	31.12.2013
Cash	**21,670**	**30,862**
in HRK	11,737	14,728
in foreign currency	9,933	16,134
Current accounts with CNB	**34,056**	**33,316**
in HRK	34,056	33,316
in foreign currency	0	0
Obligatory reserve with CNB	**88,626**	**86,600**
in HRK	73,880	72,278
in foreign currency	14,746	14,322
Treasury bills with CNB	**0**	**6,546**
in HRK	0	6,546
in foreign currency	0	0
Accrued interest	**0**	**0**
due	0	0
not due	0	0
TOTAL	**144,353**	**157,325**

Croatian National Bank by the Decision on reserve requirements prescribed calculation of maintenance and allocation of reserve requirements for banks and other credit institutions. By the Decision, the rate of obligatory reserve as at 31 December 2013 is set at 12%.

From the calculated part of foreign currency obligatory reserve, 75% is included in the part of the obligatory reserve in kuna and is executed in kuna.

From the calculated part of obligatory reserve requirement banks are required to allocate a certain percentage to the accounts of the CNB. For the kuna reserve requirement, the percentage is set at 70%. For foreign currency reserves calculated based on funds of non-residents or foreign entities in special relation with the Bank, the percentage is set at 100%, with 60% for the remaining part of foreign currency reserves.

The rest of the obligatory reserve banks maintain average daily balances of liquid claims in the maintenance period. The kuna part is maintained average daily balances on the settlement account and in the account to cover the negative balance in the settlement account in the National Clearing System. Foreign part maintains an average daily balance of liquid foreign currency claims and average daily balances of foreign currency and foreign currency checks.

Croatian National Bank pays no fees on the obligatory reserve funds.

Notes to the financial statements (continued)

5. PLACEMENTS WITH AND LOANS TO OTHER BANKS

[000 HRK] PLACEMENTS WITH AND LOANS TO OTHER BANKS	31.12.2012	31.12.2013
Short-term	**34,434**	**58,106**
with foreign banks	15,374	40,481
with domestic banks	19,060	17,625
Long-term	**8,717**	**2,193**
with foreign banks	2,567	2,193
with domestic banks	6,151	0
Accrued interest	**8**	**117**
due	0	116
not due	8	0
Provisions for impairment	**0**	**(10,174)**
identified losses - domestic banks in bankruptcy	0	(10,058)
identified losses - accrued Interest	0	(116)
TOTAL	**43,159**	**50,242**

Out of total placements with other banks at 31 December 2013, the Bank had deposits in the total amount of HRK 50,242 thousand (2012: HRK 37,008 thousand) and loans (HBOR – programme A for support of entrepreneurs) in the amount of HRK 0 kuna (2012: HRK 6,151 thousand).

6. FINANCIAL ASSETS AVAILABLE FOR SALE

[HRK 000] FINANCIAL ASSETS AVAILABLE FOR SALE	31.12.2012	31.12.2013
Debt securities	**183,593**	**185,014**
Croatian MoF bonds	99,212	99,838
Croatian MoF treasury bills	0	0
Foreign government bonds	15,813	15,407
Foreign government treasury bills	66,405	68,687
Obveznice trgovačkih društava	2,163	1,082
Share in investment funds	**12,151**	**4,477**
Equity securities	**0**	**0**
Accrued interest	**4,403**	**3,584**
due	0	0
not due	4,403	3,584
TOTAL	**200,146**	**193,075**

Notes to the financial statements (continued)

The Bank recognises available-for-sale financial assets at fair value with changes in fair value recognised in a fair value reserve in equity, i.e. in the other comprehensive income. Of the total value of financial assets available for sale, as at 31.12.2013 the Bank had given collaterals for repurchase agreements in the total amount of HRK 123,815 thousand (at 2012 in the amount of HRK 174,596 thousand).

Due to prolonged fall in fair value of the investment fund, in 2013 the Bank recognised loss in the amount of HRK 7,674 thousand in the income statement (2012: nill).

Based on Article 3 of the Decision on Classification of Placements and Contingent Liabilities of Banks (Official Gazette (1/2009, 75/2009 and 2/2010) which became effective on 31 March 2010, the Bank classifies its "loans and receivables" and "held to maturity" placements in accordance with IAS 39 under the scope of the Decision. Based on the Article 4 of the Decision, financial assets classified as "at fair value through profit and loss" and "financial assets available for sale" in accordance with IAS 39 do not fall under the scope of the Decision. In accordance with the Decision, no impairment losses on group basis are calculated for financial assets classified as "available for sale".

7. FINANCIAL ASSETS HELD TO MATURITY

[000 HRK] FINANCIAL ASSETS HELD TO MATURITY	31.12.2012	31.12.2013
Debt securities	**16,314**	**56,595**
Bills of exchange	16,314	56,595
Accrued interest	**669**	**1,340**
due	669	1,340
not due	0	0
Impairment	**(734)**	**(1,976)**
identified losses - Bills of exchange	(75)	(103)
identified losses - accrued interest	(510)	(1,336)
identified losses on group basis	(150)	(537)
TOTAL	**16,248**	**55,959**

Financial assets held to maturity consist of discounted bills of exchange from companies. Due to lack of investment activities, short-term forms of financing were in greater focus of the Bank during 2013 than in the previous year. Discounted bills of exchange represent a short-term financial instrument in terms of acceptance of credit risk that is perceived recourse guarantee represents acceptable, exposure for the Bank.

Notes to the financial statements (continued)

8. LOANS AND ADVANCES TO CUSTOMERS

[000 HRK] LOANS AND ADVANCES TO CUSTOMERS	31.12.2012	31.12.2013
Gross loans	**753,128**	**767,678**
retail	169,902	157,269
corporate	583,226	610,409
Accrued interest	**23,280**	**35,992**
due	18,935	32,005
not due	4,345	3,987
Impairment	**(53,580)**	**(127,981)**
identified losses - gross loans	(40,866)	(93,687)
identified losses - accrued interest	(5,642)	(27,373)
identified losses on group basis	(7,072)	(6,921)
TOTAL	**722,828**	**675,690**

[000 HRK] MOVEMENT IN IMPAIRMENT ALLOWANCES	2013		
	Identified losses	Identified losses on group basis	TOTAL
Movement in impairment allowances			
As at 1 January	46,508	7,072	**53,580**
(Decrease) / Increase in impairment losses	75,942	(151)	**75,791**
Write-offs	(1,118)		**(1,118)**
Collected impaired interest			**0**
Net gain / (loss) on foreign exchange differences	(272)		**(272)**
As at 31 December	121,060	6,921	127,981
As at 31 December	**121,060**	**6,921**	**127,981**

[000 HRK] MOVEMENT IN IMPAIRMENT ALLOWANCES	2012		
	Identified losses	Identified losses on group basis	TOTAL
Movement in impairment allowances			
As at 1 Januray	63,086	7,357	**70,443**
(Decrease) / Increase in impairment losses	(12,494)	(285)	**(12,779)**
Write-offs	(4,093)	-	**(4,093)**
Collected impaired interest	-	-	**-**
Net gain / (loss) on foreign exchange differences	8	-	**8**
As at 31 December	**46,508**	**7,072**	**53,580**

The Bank applies the rate of 1% on balance sheet and off balance sheet exposures which are subject to the credit risk (in 2012 0.85%) and for which no identified impairment losses have been recognised.

Notes to the financial statements (continued)

9. PROPERTY AND EQUIPMENT

2013. [000 HRK]	Land and buildings	IT equipment	Office furniture and equipment	Motor vehicles and other	Assets under construction	Total
Cost	**27,788**	**8,722**	**11,196**	**1,849**	**56**	**49,611**
Additions	52				483	535
Purchase	2,122					2,122
Write offs		-56	-166	-8		-230
Disposals						0
Transfers	7	350	76	103	-481	55
Write offs						0
As at 31 December	**29,969**	**9,016**	**11,106**	**1,944**	**58**	**52,093**
Accumulated depreciation						
As at 1 January	3,564	6,533	7,612	1,364	0	19,073
Charge for the year	770	787	1,017	83		2,657
Write offs		-56	-155	-5		-216
Disposals						0
As at 31 December	**4,334**	**7,264**	**8,474**	**1,442**	**0**	**21,514**
Net value	**25.635**	**1.752**	**2.632**	**502**	**58**	**30.579**

[000 HRK]	Land and buildings	IT equipment	2012 Office furniture and equipment	Motor vehices and other	Assets under construction	Total
Cost						
At 1 January	21,882	8,535	11,137	1,902	34	43,490
Additions	5,906	-	-	-	572	6,478
Write offs	-	-	(13)	-	-	(13)
Disposals	-	-	-	(346)	-	(346)
Transfers	-	187	72	293	(552)	0
As at 31 December	**27,788**	**8,722**	**11,196**	**1,849**	**54**	**49,609**
Accumulated depreciation						
At 1 January	2,890	5,414	6,605	1,466	-	16,375
Charge for the year	674	1,119	1,011	79	-	2,883
Write offs	-	-	(4)	-	-	(4)
Disposals	-	-	-	(181)	-	(181)
As at 31 December	**3,564**	**6,533**	**7,612**	**1,364**	**-**	**19,073**
Carrying value	**24,224**	**2,189**	**3,584**	**485**	**54**	**30,536**

The increase in land and buildings in 2013 is described in the note 11.

Notes to the financial statements (continued)

10. INTANGIBLE ASSETS

2013	Software	Leasehold improvements	licenses	Assets under construction	Total
Cost					
As at 1 January	3,607	8,895	5,144	13,142	30,788
Additions	-	-	-	1,965	1,965
Purchase	-	-	-	-	-
Transfers	-	719	328	(1,047)	-
Write offs	-	-	(34)	-	(34)
As at 31 December	**3,607**	**9,614**	**5,438**	**14,060**	**32,719**
Accumulated depreciation					
As at 1 January	1,284	8,418	4,115	-	13,817
Charge for the year	481	398	552	-	1,431
Write offs	-	-	-	-	-
As at 31 December	**1,765**	**8,816**	**4,667**	**-**	**15,248**
Net value	**1,842**	**798**	**771**	**14,060**	**17,472**

	2012					
[000 HRK]	Software	Goodwill	Leasehold improvements	Licences	Assets under construction	Total
Cost						
Balance at 1 January	1,307	2,300	8,857	4,941	11,728	29,133
Additions	-	-	-	-	1,655	1,655
Transfers	-	-	38	203	(241)	-
Write offs	-	-	-	-	-	-
Balance at 31 December	**1,307**	**2,300**	**8,895**	**5,144**	**13,142**	**30,788**
Accumulated depreciation						
Balance at 1 January	1,217	-	7,469	3,346	-	12,032
Charge for the year	67	-	949	769	-	1,785
Write offs	-	-	-	-	-	-
Balance at 31 December	**1,284**	**-**	**8,418**	**4,115**	**-**	**13,817**
Net book value at 31 December	**23**	**2,300**	**477**	**1,029**	**13,142**	**16,971**

Notes to the financial statements (continued)

11. OTHER ASSETS

[000 HRK] OTHER ASSETS	31.12.2012	31.12.2013
Other assets	**48,608**	**63,849**
Fees receivable	856	964
Prepaid expenses	1,100	442
Repossessed assets	16,698	33,422
Inventories	540	427
Other receivables	29,413	28,594
Impairment allowances	**(18,579)**	**(26,561)**
TOTAL	**30,029**	**37,288**

During 2013 the Bank repossessed assets in the total amount of HRK 18,509 thousand (2012: HRK 15,049 thousand), of which HRK 399 thousand relates to land (2012: HRK 7,048 thousand), HRK 18,110 thousand relates to buildings (2012: HRK 7,263thousand) and HRK 0 thousand relates to flats (2012: HRK 738 thousand).

During 2013 repossessed assets sold amounted to HRK 0 thousand (2012: HRK 653 thousand) and entirely relate to flats.

Although the Bank actively works on selling repossessed assets, during 2013 assets in the amount of HRK 2,118 thousand (2011: HRK 5,860 thousand) were reclassified to property and equipment due to time period of 2 years passing from the repossession. In such cases the Bank starts to recognize depreciation of these assets (note 9).

The movement in the impairment allowance of other assets is presented below:

[HRK 000] MOVEMENT IN IMPAIRMENT ALLOWANCES	2012	2013
As at 1 January	**1,327**	**18,611**
Increase / decrease	17,335	9,207
Write offs	(51)	(1,257)
As at 31 December	**18,611**	**26,561**

Notes to the financial statements (continued)

12. DEPOSITS FROM CUSTOMERS

[HRK 000] DEPOSITS FROM CUSTOMERS	31.12.2012	31.12.2013
Demand deposits	**63,388**	**78,649**
retail	16,024	18,785
in HRK	*9,913*	*12,235*
in foreign currency	*6,111*	*6,550*
corporate	47,364	59,864
in HRK	*42,238*	*53,407*
in foreign currency	*5,126*	*6,458*
Restricted deposits	**379**	**705**
Term deposits	**785,967**	**891,494**
retail	685,999	839,102
in HRK	*145,775*	*179,851*
in foreign currency	*540,224*	*659,250*
corporate	99,968	52,392
in HRK	*72,368*	*23,482*
in foreign currency	*27,600*	*28,910*
Accrued interest	**13,449**	**16,666**
due	72	51
not due	13,377	16,615
TOTAL	**863,182**	**987,513**

Notes to the financial statements (continued)

13. BORROWINGS

[HRK 000] BORROWINGS	31.12.2012	31.12.2013
Short-term	**186,088**	**130,400**
from banks	161,224	98,306
in HRK	*86,100*	*63,050*
in foreign currency	*75,124*	*35,256*
from other financial institutions	18,864	32,094
in HRK	*0*	*13,000*
in foreign currency	*18,864*	*19,094*
from other	6,000	0
in HRK	*6,000*	*0*
in foreign currency	*0*	*0*
Long-term	**11,585**	**20,530**
from banks	11,585	20,530
in HRK	*11,585*	*20,530*
in foreign currency		
Accrued interest	**309**	**142**
due	0	0
not due	309	142
TOTAL	**197,982**	**151,072**

Borrowings include repurchase agreements in the total amount of HRK 111,306 thousand (2012: HRK 158,224 thousand). Out of the total amount of the repurchase agreements, HRK 35,256 thousand relate to borrowings denominated in euro (2012: HRK 75,124 thousand) while HRK 76,050 thousand relate to borrowings denominated in kuna (2012: HRK 83,100 thousand).

Borrowings also include a loan from EIF (European Investment Fund) in the amount of HRK 19,094 thousand (2012: HRK 18,864 thousand). These funds relate to credit line for financing of small entrepreneurship.

14. HYBRID INSTRUMENTS

[000 HRK] HYBRID INSTRUMENTS	31.12.2012	31.12.2013
Hybrid instruments	**3,018**	**3,055**
in HRK	3,018	3,055
TOTAL	**3,018**	**3,055**

In September 2009 the Bank received a hybrid instrument with maturity of 5.5 years and fixed interest rate of 7.75%. The hybrid instrument is included in to the Bank’s additional capital. These amounts may be used for covering losses from current operations, in bankruptcy or liquidation, and if the Bank's capital adequacy falls below ¾ of the capital adequacy ratio prescribed by law (or some other ratio prescribed by the CNB).

Notes to the financial statements (continued)

15. PROVISIONS FOR LIABILITIES AND CHARGES

[000 HRK] PROVISIONS FROM LIABILITIES AND CHARGES	31.12.2012	31.12.2013
Provisions for court cases	120	138
Provisions for pensions and other liabilities to employees	0	62
Provisions for contingent and other liabilities	769	839
TOTAL	**889**	**1,039**

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

[HRK 000] MOVEMENT IN PROVISIONS FROM LIABILITIES AND CHARGES	2012	2013
As at 1 January	**729**	**889**
Increase / decrease	160	150
Utilised during the period	0	0
Balance at 31 December	**889**	**1,039**

16. OTHER LIABILITIES

[000 HRK] OTHER LIABILITIES	31.12.2012	31.12.2013
Trade payables	309	224
Liabilities for salaries, deductions from salaries, taxes and contributions	1,925	1,723
Differed fee income	4,141	3,485
Other liabilities	5,881	7,239
TOTAL	**12,255**	**12,672**

17. EQUITY

17.1. Share capital

31.12.2013	Share capital	Ownership share (%)
ALTERNATIVE D.O.O.	3,571,429	66.65
VALIDUS D.D. U STEČAJU	513,477	9.58
RAIFFEISENBANK AUSTRIA D.D. - custody account	283,944	5.30
Small shareholders	989,690	18.47
TOTAL	**5,358,540**	**100.00**

Notes to the financial statements (continued)

31.12.2012	Share capital	Ownership share (%)
VALIDUS D.D. U STEČAJU	513,477	29.09
BALKAN FINANCIAL SECTOR EQUITY FUND C.V.	292,000	16.54
PLURIS D.D. U STEČAJU	158,694	8.99
GARA SECUNDUS D.O.O.	76,000	4.31
FINESA CONCEPTUS D.O.O.	62,276	3.53
INTERFINANCE D.O.O.	62,226	3.53
Small shareholders	600,555	20.74
TOTAL	**1,765,228**	**100.00**

17.2. Share premium

Share premium relates to capital gain incurred on issuance of new shares at a price higher than the nominal value during the recapitalization process in 2006 and 2007.

As at 31 December 2013 the bank does not have premium for issued shares (in 2012 in the amount of HRK 27,440 thousand)

17.3. Other reserves

[000 HRK]	2012	2013
Reserve for own shares	2,552	2,552
Legal reserves		1,235
Other capital reserves		90,243
	2,552	**94,030**

17.4. Fair value reserve

The fair value reserve includes unrealised gains and losses on changes in the fair value of financial assets available for sale.

17.5. Accumulated losses

Accumulated loss comprise previous year accumulated losses and property acquisition cost related to capitalised costs incurred during sale and repurchase transactions of property owned by the Bank in prior years.

17.6. Statutory reserve

The Bank is required to create a statutory reserve by allocating 5% of its net profit for the year, until the reserve reaches 5% of share capital. The legal reserve can be used to cover losses from previous years if the losses are not covered by current year profits or if other reserves are not available.

Notes to the financial statements (continued)

17.7. Reserves for general banking risks

Reserve for general banking risks represents a reserve for potential losses in excess of planned and already established allowances for identified losses.

In accordance with the regulations of the Croatian National Bank, the Bank is required to create provision for general banking risks, if the growth in the Bank's balance-sheet and off-balance-sheet exposure exceeds 15% of balance sheet and off-balance-sheet exposure at the previous year end.

The Bank did not recognised provision for general banking risks.

17.8. Proposed dividends

Dividends payable are not recognized until they are approved at the General Assembly. The Management will not propose a dividend payment for 2013 (2012: nil).

17.9. Capital adequacy

Basic parameters of the capital management policy are given by the Credit Institutions Act.

Basic objectives of the capital management are ensuring of:

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

The regulatory capital adequacy rate as at 31 December 2013 was set at minimum of 12%. With effect from 1 January 2013 on the basis of Regulation 575/2013 of the European Commission, the minimum capital adequacy ratio is prescribed in the amount of 8%, while keeping a protective layer for the preservation of the ordinary capital in the amount of 2.5%.

Guarantee capital is determined as categories 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 for operational risks and to ensure minimum prescribed capital adequacy ratio Regulatory capital is calculated in accordance with prescribed subordinate acts of the CNB.

[HRK 000] CAPITAL ADEQUACY	31.12.2012	31.12.2013
Basic capital	116,943	55,883
Supplementary capital I	3,018	3,055
Deductions	-	-
Supplementary capital II	-	-
REGULATORY CAPITAL	**119,961**	**58,938**
CAPITAL REQUIREMENTS	**118,401**	**108,793**
CAPITAL ADEQUACY RATIO	**12.16%**	**6.50%**

The Bank's activities during 2013 were pointed towards capital increase and finding of strategic partner. Until the date of this report, the Bank received one binding offer and has signed a Memorandum of Understanding with the investor. This was communicated to the investment public. In accordance with the Memorandum, the Management and Supervisory Board are undertaking activities to meet the preconditions for the General Assembly meeting of the Bank which will enable capital increase in the amount of HRK 75 million. With this capital increase the Bank will fully meet the regulatory requirements on capital adequacy.

Notes to the financial statements (continued)

18. INTEREST AND SIMILAR INCOME

[000 HRK] INTEREST AND SIMILAR INCOME	31.12.2012	31.12.2013
Analysis by product	**73,106**	**72,550**
Loans and advances to customers	64,893	62,202
retail	*15,410*	*12,754*
corporate	*49,484*	*49,448*
Deposits	20	338
Debt securities	8,215	9,772
Other	(22)	239
Analysis by source	**73,106**	**72,550**
Retail	15,410	12,754
Corporate	47,302	49,386
State and public sector	7,320	6,290
Financial institutions	250	1,427
Other	2,824	2,694

19. INTEREST EXPENSE AND SIMILAR CHARGES

[000 HRK] INTEREST EXPENSE AND SIMILAR CHARGES	31.12.2012	31.12.2013
Analysis by product	**42,101**	**42,076**
Deposits from customers	35,665	39,666
retail	*29,950*	*35,789*
financial institutions	*266*	*448*
corporate and other	*5,448*	*3,429*
Borrowings	6,217	2,152
Hybrid instruments	225	207
Other	(6)	51
Analysis by recipient	**42,101**	**42,076**
Retail	30,176	35,996
Corporate	4,130	1,878
State and public sector	475	424
Financial institutions	6,483	2,600
Other	836	1,178

Notes to the financial statements (continued)

20. FEE AND COMMISSION INCOME

[000 HRK] FEE AND COMMISSION INCOME	31.12.2012	31.12.2013
Payment transaction fees	3,872	3,927
Letter of credit and guarantee fees	1,478	1,680
Impairment losses	(2)	(79)
Other	867	841
TOTAL	6,215	6,369

21. FEE AND COMMISSION EXPENSE

[000 HRK] FEE AND COMMISSION EXPENSE	31.12.2012	31.12.2013
Payment transaction fees	1,304	1,311
Other	400	447
TOTAL	1,704	1,757

Notes to the financial statements (continued)

22. GAINS LESS LOSSES FROM FINANCIAL ASSETS AVAILABLE FOR SALE

[000 HRK] GAINS LESS LOSSES FROM FINANCIAL ASSETS AVAILABLE FOR SALE	31.12.2012	31.12.2013
Realised	**88**	**1,205**
Shares	(739)	0
Bonds	826	1,205
Treasury bills	1	0
Investment funds	0	0
Value impairment of available for sale assets - inv. funds	**0**	**(7,674)**
TOTAL	**88**	**(6,468)**

23. GAINS LESS LOSSES FROM FOREIGN CURRENCIES

[000 HRK] GAINS LESS LOSSES FROM DEALING IN FOREIGN CURRENCIES	31.12.2012	31.12.2013
Net gains / (losses) from translation of monetary assets and liabilities	**(90)**	**522**
Net gains / (losses) from currency trading	**3,504**	**2,866**
TOTAL	**3,415**	**3,388**

24. OTHER OPERATING INCOME

[000 HRK] OTHER OPERATING INCOME	31.12.2012	31.12.2013
Dividend income	**0**	**0**
Other	**1,916**	**1,032**
TOTAL	**1,916**	**1,032**

Notes to the financial statements (continued)

25. GENERAL AND ADMINISTRATIVE EXPENSES

[000 HRK] GENERAL AND ADMINISTRATIVE EXPENSES	31.12.2012	31.12.2013
Personnel expenses	**24,097**	**22,302**
Savings deposit insurance expenses	**1,905**	**2,391**
Other	**18,175**	**15,798**
TOTAL	**44,176**	**40,491**

At 31 December 2013 the Bank had 142 employees (2012: 163).

26. IMPAIRMENT LOSSES

[000 HRK] impairment losses	31.12.2012	31.12.2013
Identified losses	**4,881**	**96,961**
Deposits	0	0
Financial assets available for sale	0	1,108
Financial assets held to maturity	0	29
Loans and advances to customers	(12,525)	63,658
Interest receivables	73	22,959
Other receivables	17,333	9,207
Accumulate identified losses	**(255)**	**251**
Assets	(255)	251
TOTAL	**4,626**	**97,211**

Notes to the financial statements (continued)

27. INCOME TAX EXPENSE

Income tax expense recognised in the income statement:

[000 HRK] INCOME TAX EXPENSE	31.12.2012	31.12.2013
Profit / (loss) before tax	**(12,699)**	**(109,449)**
Income tax at 20% rate	**(2,540)**	**(21,890)**
Expenses not deductible for tax purposes	2,067	2,420
Income not subject to tax	(1,154)	(1,635)
(Tax losses)/ tax benefit	**(1,627)**	**(21,104)**

In previous years the Bank incurred tax losses. Such tax losses can be carried forward over the following five years in which are incurred. Tax losses and their expiry dates at 31 December 2012 and 2013 were as follows:

[000 HRK] TAX LOSSES		2012.		2013.	
Incurred	Year ofexpiry	Gross tax losses	Tax effect at 20%	Gross tax losses	Tax effect at 20%
2008	2013.	23,653	4,731	23,653	4,731
2010	2015.	7,303	1,461	7,303	1,461
2011	2016.	8,312	1,662	8,312	1,662
2012	2017.	8,137	1,627	8,137	1,627
2013	2018.			105,520	21,104
TOTAL		**47,405**	**9,481**	**152,925**	**30,585**

Notes to the financial statements (continued)

28. BASIC AND DILUTED EARNINGS/(LOSS) PER SHARE

For the purposes of calculating earnings per share, earnings are calculated as the profit for the period attributable to shareholders of the Bank. The number of ordinary shares is the weighted average number of ordinary shares circulating during the year after deducting the number of ordinary treasury shares.

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

	31.12.2012	31.12.2013
Profit / (loss) for the year [000 HRK]	(12,699)	(109,449)
Weighted average number of shares	1,765,228	5,358,540
BASIC AND DILUTED EPS	**(7.19)**	**(20.43)**

29. CONCENTRATION OF ASSETS AND LIABILITIES

[HRK 000]	31.12.2012	31.12.2013
Giro account with the CNB	34,056	33,316
Obligatory reserves with Croatian National Bank	88,626	86,600
Bonds issued by the Ministry of Finance	99,212	67,044
Borrowings from CBRD	(38,482)	(46,380)
TOTAL	**183,409**	**140,581**

The Bank’s exposure towards local government and state institutions not directly funded from the State Budget (excluding companies owned by state) is presented below:

[HRK 000]	31.12.2012	31.12.2013
Loans	11,659	4,962
Deposits	(9,995)	(18,384)
TOTAL	**1,664**	**(13,422)**

30. CASH AND CASH EQUIVALENTS

[HRK 000]	31.12.2012	31.12.2013
Cash and amounts due from banks	71,620	110,076
Placements to banks with original maturity up to 90 days	18,000	-
TOTAL	**89,620**	**110,076**

Notes to the financial statements (continued)

31. COMMITMENTS AND CONTINGENCIES

[000 HRK] COMMITMENTS AND CONTIGENCIES	31.12.2012	31.12.2013
Guarantees	**49,380**	**35,916**
in HRK	45,815	32,844
in currency clause	0	0
in foreign currency	3,564	3,072
Letter of credit	**348**	**653**
in HRK	0	0
in currency clause	0	0
in foreign currency	348	653
Unused loan commitments	**32,562**	**44,818**
in HRK	32,556	44,761
in currency clause	0	0
in foreign currency	6	57
Other	**6,353**	**2,079**
in HRK	0	0
in currency clause	0	0
in foreign currency	6,353	2,079
TOTAL	**88,643**	**83,466**

At 31 December 2013, the Bank recognised unidentified impairment losses for off-balance-sheet risks arising from the issue of guarantees, letters of credit and undrawn lending commitments in the amount of HRK 835 thousand (2012: HRK 769 thousand).

Notes to the financial statements (continued)

32. RELATED PARTY TRANSACTIONS

The key shareholders of the Bank are Validus d.d. and ATJ Invest s.r.o. which together owned 81,53 % of the Bank's shares at year end. The remaining 18,47% of the shares are publicly traded. The Bank considers that it has an immediate related party relationship with its key shareholders; the Supervisory and Management Board members and other executive management (together "key management personnel"); close family members of key management personnel; and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members, in accordance with the definitions contained in International Accounting Standard 24 "Related Party Disclosures" ("IAS 24").

32.1. Key transactions with immediate related parties

At 31 December 2013 the Bank has no high risk product exposure towards its key shareholders (2012: nil). All transactions with key shareholders during the year were generated from deposit activities, while transactions with key management personnel were generated from deposit, lending activities and given benefits. Gross exposure to key shareholders at 31 December 2012 as well as 31 December 2013 is nil.

Liabilities towards the Bank's key shareholders at 31 December 2013 are not and relate to demand deposits held with the Bank (2012: HRK 1 thousand).

Except for salaries, there was no other compensation to the key management in 2013 and 2012. The Bank had no reward policy for 2013 and 2012.

[000 HRK] RELATED PARTIES TRANSACTIONS	2012				2013			
	exposure	liabilities	revenue	expenses	exposure	liabilities	revenue	expenses
Key shareholders	**0**	**1**	**117**	**267**	**0**	**0**	**0**	**15**
Key management	**21**	**50**	**2**	**2,165**	**0**	**23**	**0**	**2,262**
Compensation paid	0	50	0	2,163	0	23	0	2,260
Loans granted	21	0	2	2	0	0	0	2
TOTAL	**21**	**51**	**119**	**2,432**	**0**	**23**	**0**	**2,278**

33. MANAGED FUNDS FOR AND ON BEHALF OF CORPORATE AND RETAIL CUSTOMERS

The Bank manages funds for and on behalf of corporate and retail customers, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. The Bank receives fee income for providing these services. These assets are not assets of the Bank and are not recognised in the balance sheet of the Bank. The Bank is not exposed to any credit risk relating to such placements, as it does not guarantee these investments.

Further, the Bank manages credit exposure of third parties as follows:

Notes to the financial statements (continued)

[000 HRK] managed funds on behalf of corporate and retail customers	31.12.2012	31.12.2013
Assets	**96,991**	**98,628**
Corporate	63,996	66,254
Retail	32,990	32,369
Giro accounts	5	5
Liabilities	**96,991**	**98,628**
Corporate	59,318	60,848
Republic of Croatia	0	0
HBOR	29,043	27,659
Local authorities	801	1,227
Retail	7,829	8,894

34. AVERAGE 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:

[HRK 000]	2012	2013
Assets		
Obligatory reserve with Croatian National Bank	-	-
Placements with and loans to other banks	2.10%	1.97%
Available for sale financial assets	3.31%	3.24%
Held to maturity investments	10.60%	10.77%
Loans and advances to customers	8.72%	8.65%
Liabilities		
Deposits	4.29%	4.27%
Borrowings	3.04%	1.49%
Hybrid instruments	7.50%	7.50%

35. OPERATING LEASE COMMITMENTS

[HRK 000] OPERATING LEASE COMMITMENTS	31.1.2012	31.12.2013
Up to 1 year	4,999	4,510
From 1 to 5 years	14,018	9,959
Over 5 years	0	0
	19,017	**14,469**

Notes to the financial statements (continued)

36. FAIR VALUE OF FINANCIAL ASSETS

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arm's length basis.

The Management Board believes that the fair value of financial assets and liabilities are not significantly different from their carrying values at 31 December 2013.

The following methods were used to estimate the fair value of financial instruments of the Bank:

Cash and amounts due from banks, amounts held with the CNB

Carrying values of cash, amounts due from banks, amounts held with the CNB generally approximate their fair values.

Placements and loans other banks

Estimated fair value of placements and loans to other banks represents a discounted value of future cash flows.

Financial assets available for sale

Fair value of financial assets available for sale is based on their market prices. Financial instruments non quoted on active markets are evaluated through discounted cash flows method or by an alternative method used for fair value estimation.

Loans and advances to customers

Fair value of loans and advances to customers is based on analysis of discounted cash flows of loans by applying current interest rates for loans with similar conditions or characteristics. Fair value of non-performing loans is estimated based on analysis of discounted cash flow or the appraised value of the collateral. Considering that insignificant part of loans and advances to customers is contracted with fixed interest rate or the one which deviates from market rates, The Bank considers the fair value of loans and advances to customers to approximate their carrying value.

Deposits from banks and customers

Fair value of deposits maturing on demand is the carrying amount of obligation payable at the balance sheet date. Fair value of term deposits with variable interest rates approximates their carrying amount at the balance sheet date. Fair value of deposits with fixed interest rate is estimated by discounting future cash flows using interest rates currently used for deposits of similar remaining maturities. The Bank estimates that the fair value of bank and customer deposits do not significantly deviate from their carrying value.

37. EVENTS AFTER THE REPORTING PERIOD

Until the date of this report, the Bank received one binding offer and has signed a Memorandum of Understanding with the investor. This was communicated to the investment public. In accordance with the Memorandum, the Management and Supervisory Board are undertaking activities to meet the preconditions for the General Assembly meeting of the Bank which will enable capital increase in the amount of HRK 75 million. With this capital increase the Bank will fully meet the regulatory requirements on capital adequacy.