

BANKA KOVANICA d.d.

**Financial statements as at
31 December 2016 together with the
Independent Auditor's Report**

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Responsibility for the financial statements

Pursuant to the Croatian Accounting Act (Official Gazette 78/15 and 134/15), the Management Board is responsible for ensuring that the financial statements are prepared for each financial year in accordance with statutory accounting regulations applicable to banks in Croatia, in order to give a true and fair view of the financial position and results of the Bank for that period.

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

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

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

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Act (Official Gazette 78/15 and 134/15). The Management Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Management Board:

Nicola Ceccaroli

President of the Management Board

Ivan Mužić

Member of the Management Board

Banka Kovanica d.d.
P. Preradovićeve 29
Varaždin

28 March 2017



Independent Auditor's Report

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

Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Banka Kovanica d.d. (the "Bank") as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with accounting regulations applicable to banks in Croatia as set out in Note 2.1 - 'Accounting framework' to the financial statements.

What we have audited

The Company's financial statements comprise:

- the statement of financial position as at 31 December 2016;
 - the statement of comprehensive income for the year then ended;
 - the statement of changes in equity for the year then ended;
 - the statement of cash flows for the year then ended; and
 - the notes to the financial statements, which include significant accounting policies and other explanatory information.
-

Emphasis of matter

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

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

Independence

We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code). We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

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Responsibilities of management and those charged with governance for the financial statements

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

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

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

Auditor's responsibilities for the audit of the financial statements

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

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.



- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our independent auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our independent auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

PricewaterhouseCoopers d.o.o.
Ulica kneza Ljudevita Posavskog 31, Zagreb
28 March 2017

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

Statement of comprehensive income

for the period from 1 January to 31 December 2016

	Note	2016 HRK'000	2015 HRK'000
Interest income		76,965	81,145
Interest expense		(23,699)	(29,515)
Net interest income	4	53,266	51,630
Fee and commission income		6,667	6,648
Fee and commission expense		(2,121)	(1,465)
Net fee and commission income	5	4,546	5,183
Foreign exchange differences – net	6	1,532	1,683
Gain from assets available for sale - net	17	469	261
Other operating income	7	4,331	1,547
Impairment charge for credit losses - net	8	(17,188)	(5,769)
Administration costs	9	(40,062)	(37,200)
Other operating expenses	10	(6,462)	(6,587)
Profit/(loss) before income tax		432	10,747
Income tax	11	-	-
Profit/loss after tax		432	10,747
Unrealised (loss)/gains from available-for-sale financial assets		216	(161)
Other comprehensive loss/(profit)		216	(161)
Total comprehensive income/loss		648	10,586
Earnings per share	12	0.13	3.20

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

Statement of financial position

as at 31 December 2016

	Note	31 December 2016 HRK'000	31 December 2015 HRK'000
ASSETS			
Cash on hand and balances with banks	13	163,635	173,906
Obligatory reserve with the Croatian National Bank	14	69,099	81,926
Placements with banks	15	1,024	38,833
Loans and advances to customers	16	792,908	743,953
Available-for-sale financial assets	17	78,232	65,362
Held-to-maturity financial assets	18	21,982	901
Property and equipment	19	15,477	15,255
Intangible assets	19	2,538	2,479
Reposessed collateral	20	37,301	37,868
Other assets	21	18,515	27,404
Total assets		1,200,710	1,187,887
LIABILITIES			
Deposits from customers	22	1,013,915	1,000,566
Due to banks	23	23,469	22,075
Hybrid instruments	24	39,857	34,594
Other liabilities	26	11,892	19,710
		1,089,133	1,076,946
SHAREHOLDERS' EQUITY			
Share capital	27	103,943	333,834
Treasury shares		(38)	(38)
Share premium		652	76,453
Reserves		4,655	921
Retained earnings/accumulated loss		1,933	(310,976)
Profit for the year		432	10,747
		111,577	110,941
Total liabilities and shareholders' equity		1,200,710	1,187,887

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

Statement of changes in equity

for the year from 1 January to 31 December 2016

	Share capital HRK'000	Treasury shares HRK'000	Capital reserves HRK'000	Other reserves HRK'000	Fair value reserves HRK'000	Accumulated loss HRK'000	Total HRK'000
Balance at 31 December 2014	333,834	(38)	76,453	1,490	(408)	(310,976)	100,355
Profit for the year	-	-	-	-	-	10,747	10,747
Unrealised gains on available-for- sale financial assets					(161)		(161)
Total comprehensive income/(loss)	-	-	-		(161)	10,747	10,586
Balance at 31 December 2015	333,834	(38)	76,453	1,490	(569)	(300,229)	110,941
Coverage of accumulated losses	(233,032)	-	(76,453)	(1,490)	-	310,976	-
Transfer to reserves	(652)	-	652	5,008	-	(5,008)	-
Payment of dividends	-	-	-	-	-	(3,806)	(3,806)
Contributions in equity	3,793						3,793
Profit for the year	-	-	-	-	-	432	432
Unrealised gains on available-for- sale financial assets	-	-	-		216	-	216
Total comprehensive income/(loss)	-	-	-	-	216	432	648
Balance at 31 December 2016	103,943	(38)	652	5,008	(353)	2,365	111,577

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

Statement of cash flows

for the year from 1 January to 31 December 2016

	Note	2016 HRK'000	2015 HRK'000
Cash flow from operating activities			
Profit/(loss) for the year		432	10,747
Depreciation and amortisation	9, 19	1,877	3,311
Write-off and disposals of property and equipment	19	37	7
Impairment charge for credit losses - net	8	17,189	5,769
Result of assets available for sale - net		(355)	5,975
Other non-cash items		783	(507)
Operating result before changes in operating assets		19,963	25,302
(Increase)/decrease in assets with the Croatian National Bank		12,827	9,622
(Increase)/decrease in loans and advances to customers		(28,866)	242
(Increase)/decrease in bills of exchange		(21,301)	806
(Increase)/decrease in repossessed and other assets		9,641	(14,474)
Increase/(decrease) in deposits from customers		13,350	26,696
Increase/(decrease) in hybrid instruments		5,263	19,669
Increase/(decrease) in other liabilities		(7,818)	10,008
Net cash outflow from operating activities		3,059	77,870
Cash flow from investing activities			
Purchase of property and equipment and intangible assets	19	(2,196)	(1,559)
Purchase of available-for-sale financial assets	17	(93,267)	(165,747)
Disposal of available-for-sale financial assets	17	80,752	167,034
Net cash outflow from investing activities		(14,711)	(272)
Cash flow from financing activities			
Contributions in equity	27	3,793	-
Dividend payout		(3,806)	
Increase/(decrease) of deposits from banks		6,269	(21,986)
Increase/(decrease) in bank borrowings		(4,875)	(10,476)
Net cash inflow from financing activities		(1,381)	(32,462)
Net (decrease)/increase in cash and cash equivalents		(10,271)	45,136
Cash and cash equivalents at beginning of year		173,906	128,770
Cash and cash equivalents at end of year	28	163,635	173,906

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

1. General information

Activities

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

The Bank's registered activities are as follows:

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

Supervisory Board

Emanuele Restelli Prandoni Della Fratta	President
Ivan Majdak	Vice president
Pietro Giacomini	Member
Albani Marino	Member
Mladen Vedriš	Member

Management Board

Nicola Ceccaroli	President
Ivan Mužić	Member

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

2. Basis of presentation of financial statements

The principal accounting policies applied in the preparation of these financial statements are summarised below. Where specific accounting policies are aligned with the accounting principles set out in International Financial Reporting Standards (IFRS), reference may be made to certain Standards in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards applicable in the European Union as at 31 December 2016.

2.1. Compliance with Croatian bank accounting requirements and IFRS

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

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

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

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

2.2. Basis of preparation

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

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

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

Standards and interpretations issued and effective:

New standards, amendments and interpretations which are effective for the financial year beginning on 1 January 2016 are not relevant to the Bank's financial statements..

Standards and interpretations issued but not yet effective:

Certain new standards and interpretations have been published that are not mandatory for 31 December 2016 reporting periods and have not been early adopted by the Bank. None of these is expected to have a significant effect on the Bank's financial statements, except for the following standards:

- *IFRS 9 Financial instruments and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)*

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

- *IFRS 15 Revenue from contracts with customers and associated amendments to various other standards (effective for annual periods beginning on or after 1 January 2018)*

The IASB has issued a new standard for the recognition of revenue. This will replace IAS 18 which covers contracts for goods and services and IAS 11 which covers construction contracts.

The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

Key changes to current practice are:

- Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements
- Revenue may be recognised earlier than under current standards if the consideration varies for any reason (such as for incentives, rebates, performance fees, royalties, success of an outcome, etc.)

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

- The point at which revenue is able to be recognised may shift: some revenue which is currently recognised at a point in time at the end of a contract may have to be recognised over the contract term and vice versa
- There are new specific rules on licenses, warranties, non-refundable upfront fees and consignment arrangements, to name a few, and
- As with any new standard, there are also increased disclosures.

Entities will have a choice of full retrospective application, or prospective application with additional disclosures. The Bank is currently assessing the impact of the amendments on its financial statements, but does not expect any impact. The Bank plans to adopt this amendment on its effective date.

- *IFRS 16 Leases (issued in January 2016 and effective for annual periods beginning on or after 1 January 2019)*

The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise in the income statement: a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value, and b) depreciation of leased assets separately from interest on lease liabilities. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. The Bank is currently assessing the impact of the amendments on its financial statements.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

2.3. Critical accounting estimates and key sources of estimation uncertainty

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

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

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

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

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

3. Summary of significant accounting policies

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

3.1. Interest income and expense

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

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

3.2. Fee and commission income and expense

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

3.3. Taxation

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

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

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

3.4. Segment reporting

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

3.5. Foreign currency translation

(a) Functional and presentation currency

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

(b) Transactions and balances

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

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

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

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

31 December 2016	EUR 1 = HRK 7.557787	USD 1 = HRK 7.168536
31 December 2015	EUR 1 = HRK 7.635047	USD 1 = HRK 6.991801

3.6. Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash on hand, balances with CNB, balances with banks on giro accounts and term deposits with other banks with remaining maturities of 3 months or less.

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

3.7. Financial assets

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

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

When a financial asset or financial liability is recognised initially, the Bank measures it at its 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.

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

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

A financial asset is classified as held for trading if:

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

Measurement:

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

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

(b) Assets available for sale

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

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

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

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

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

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

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

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

(c) Held-to-maturity investments

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

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

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

(d) Loans and receivables

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

This portfolio comprises loans provided to customers.

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

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

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

(e) Financial liabilities

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

3.8. Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking products. Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight-line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of the Management Board.

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

3.9. Derivative financial instruments

Derivative financial instruments include foreign exchange rate forward contracts and are initially recognised in the balance sheet at fair value and subsequently re-measured at their fair value. Fair values are obtained from quoted market prices or pricing models as appropriate. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Derivative financial instruments include contracts with a one-way currency clause. The contracted value is initially recognised in the off-balance-sheet records and as a loan given with a one-way currency clause in the balance sheet. They are subsequently measured at amortised cost as for all other placements that carry credit risk in the balance sheet. Increase in exchange rates (fair value of the embedded derivative) above the contracted is recorded in the balance sheet as an embedded derivative and recognised within profit or loss from embedded derivatives in the income statement. The Bank's derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement under net trading income. However, the gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in 'net income from financial instruments designated at fair value'.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

3.10. Sale and repurchase agreements

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

3.11. Offsetting of financial instruments

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

3.12. Non-current tangible and intangible assets

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

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

	2016	2015
	%	%
Property	2.5	2.5
Leasehold improvements	20	20
Electronic equipment	20	20
Other assets	20-25	20-25
Software	20	20
Leasehold improvements	20	20

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

3.13. Leases

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

3.14. Non-current assets held for sale

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

3.15. Provisions

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

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

3.16. Employee benefits

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

3.17. Borrowings

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

3.18. Fiduciary activities

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

3.19. Share capital and treasury shares

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

4. Net interest income**Interest income**

	2016	2015
	HRK'000	HRK'000
Loans and advances:		
- to customers	72,017	76,409
- to banks	1,584	3,393
Securities	3,364	1,343
	76,965	81,145

Interest expense

	2016	2015
	HRK'000	HRK'000
Customers deposits	20,799	27,323
Hybrid instruments	2,215	1,224
Other borrowed funds	685	968
	23,699	29,515

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

	2016	2015
	HRK'000	HRK'000
Payment transactions	3,269	3,340
Guarantees and letter of credits given	334	409
Other	3,064	2,899
	6,667	6,648

Fee and commission expense

	2016	2015
	HRK'000	HRK'000
Payment transactions	389	372
Other	1,732	1,093
	2,121	1,465

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

6. Foreign exchange differences – net

	2016	2015
	HRK'000	HRK'000
Foreign exchange gains on foreign exchange dealing transactions	1,340	2,651
Foreign exchange gains/(losses) on translation of balance sheet items to middle exchange rate	192	(968)
	1,532	1,683

7. Other operating income

	2016	2015
	HRK'000	HRK'000
Court costs refund	191	161
Other	4,140	1,386
	4,331	1,547

8. Impairment charge for credit losses - net

	2016	2015
	HRK'000	HRK'000
Loans and advances to customers (Note 18)	18,032	6,685
Collected receivables written off in previous years	(238)	(379)
Held-to-maturity financial assets (Note 20)	220	(698)
Other assets (Note 21)	(752)	162
Provision for contingent liabilities and commitments (Note 27)	(73)	-
	17,188	5,769

9. Administration costs

	2016	2015
	HRK'000	HRK'000
Staff costs		
Net salaries	10,266	10,806
Pension insurance contributions	2,780	2,946
Health insurance contributions	2,831	2,931
Other contributions and taxes on salaries	2,468	2,615
Other staff costs	1,005	1,048
	19,350	20,346
Other administration costs	12,749	13,543
Write off of repossessed assets	6,086	-
Depreciation and amortisation (Note 19)	1,877	3,311
	40,062	37,200

As at 31 December 2016, the Bank had 104 employees (2015: 111 employees).

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

10. Other operating expenses

	2016	2015
	HRK'000	HRK'000
Rental costs	1,972	2,225
Deposits insurance charge	3,282	2,976
Provisions for legal disputes	6	(170)
Accrued unused vacation	(70)	77
Other	1,272	1,479
	6,462	6,587

11. Income tax

	2016	2015
	HRK'000	HRK'000
Accounting loss before tax	432	10,747
Effect of items increasing tax base	12,086	5,703
Effect of items decreasing tax base	(4,879)	(5,628)
Tax gain	7,639	10,822
Income tax at 20%	1,528	2,149
Effect of tax losses carried forward	(1,528)	(2,149)
Income tax	-	-
Effective tax rate	-	-

Movement of tax losses carried forward was as follows:

	2016	2015
	HRK'000	HRK'000
Tax losses carried forward from the previous period	(136,975)	(213,754)
Utilisation of tax losses	7,639	10,822
Expiration of tax losses carried forward	11,637	65,957
Tax loss available for carry forward in future periods	(117,699)	(136,975)
Deferred tax assets at 18% (2015.: 20%)	21,186	27,395
Recognised deferred tax assets (Note 21)	5,463	5,463
Unrecognised deferred tax assets	15,723	21,932

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

Movements in deferred tax assets were as follows:

	2016 HRK'000	2015 HRK'000
At 1 January	5,463	5,463
Reversal of deferred tax assets	(1,528)	(2,149)
Effect of change in income tax rate	(546)	-
Recognition of deferred tax assets	2,074	2,149
At 31 December	5,463	5,463

In 2016, the Bank utilised a portion of its deferred tax assets, i.e. the portion of tax losses carried forward used to settle the current income tax charge. The Bank also recognised deferred tax assets in the same amount on the basis of the conservative estimate of future period planned profits expected to be realised. The Bank has not recognised deferred tax assets in the further amount of HRK 15,723 thousand in the process of adopting the new five-year plan.

The Bank may utilise the recorded tax loss in the amount of HRK 117,699 thousand not later than in a period of 5 years:

- tax loss for 2012 in the amount of HRK 63,235 thousand not later than (including) 2018
- tax loss for 2013 in the amount of HRK 43,287 thousand not later than (including) 2019
- tax loss for 2014 in the amount of HRK 11,177 thousand not later than (including) 2020

12. Earnings/loss per share**Basic**

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

	2016	2015
Earnings/(loss) for the year (in HRK'000)	432	10,747
Weighted average number of shares in issue excluding treasury shares	3,433,196	3,338,344
Basic earnings/(loss) per share – ordinary (in HRK)	0.13	3.22

Diluted

Diluted earnings/loss per share for 2016 and 2015 is equal to the basic earnings/loss per share, since the Bank did not have any convertible instruments or options outstanding during either period.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

13. Cash on hand and balances with banks

	31 December 2016 HRK'000	31 December 2015 HRK'000
Cash on hand	15,977	16,295
Cash on the clearing account	48,956	65,916
Foreign currency account	100,194	93,287
Provisions for unidentified losses on collective basis	(1,492)	(1,592)
	163,635	173,906

14. Obligatory reserve with the Croatian National Bank

	31 December 2016 HRK'000	31 December 2015 HRK'000
Earmarked obligatory reserve		
- in HRK	69,797	68,904
- in foreign currency	-	13,850
Provision for unidentified losses on collective basis	(698)	(828)
	69,099	81,926

The obligatory reserve rate as at 31 December 2016 was 12% of HRK and foreign currency deposits, loans taken and debt securities issued (31 December 2015: 12%).

15. Placements with banks

	31 December 2016 HRK'000	31 December 2015 HRK'000
Loans	5,138	5,138
Deposits	1,034	39,225
	6,172	44,363
Provision for identified losses	(5,138)	(5,138)
Provision for unidentified losses on collective basis	(10)	(392)
	1,024	38,833

Movement in the provision for identified losses:

	31 December 2016 HRK'000	31 December 2015 HRK'000
At 1 January	5,530	5,138
Additional provisions (Note 8)	-	392
Collected amounts (Note 8)	(382)	-
At 31 December	5,148	5,530

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

16. Loans and advances to customers

	31 December 2016	31 December 2015
	HRK'000	HRK'000
Retail customers	710,186	643,936
Corporate customers	309,007	310,215
Gross loans and advances	1,019,193	954,151
Less: Provisions for impairment	(226,285)	(210,198)
Net loans and advances	792,908	743,953
Current portion	123,971	108,140
Non-current portion	668,937	635,813

The movements in the provisions for impairment on loans and advances to customers is as follows:

2016	Retail customers	Corporate customers	Total
	HRK'000	HRK'000	HRK'000
At 1 January	39,696	170,502	210,198
Additional provisions (Note 8)	32,822	70,958	103,780
Collected amounts (Note 8)	(25,677)	(60,071)	(85,748)
Write-off	(209)	(915)	(1,124)
Foreign exchange differences	266	(1,087)	(821)
At 31 December	46,898	179,387	226,285
2015	Retail customers	Corporate customers	Total
	HRK'000	HRK'000	HRK'000
At 1 January	35,781	169,799	205,580
Additional provisions (Note 8)	17,490	33,000	50,489
Collected amounts (Note 8)	(13,446)	(30,359)	(43,804)
Write-off	(135)	(1,711)	(1,846)
Foreign exchange differences	6	(226)	(220)
At 31 December	39,698	170,502	210,198

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

17. Available-for-sale financial assets

	31 December 2016 HRK'000	31 December 2015 HRK'000
Bonds and treasury bills	77,219	62,477
Corporate bonds	-	2,152
Equity securities – listed	872	592
Equity securities – unlisted	141	141
	78,232	65,362

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

	31 December 2016 HRK'000	31 December 2015 HRK'000
At 1 January	65,362	72,624
Additions	93,267	165,747
Disposals	(80,752)	(167,034)
Unrealised (loss)/gain	216	(161)
Result of assets available for sale - net	469	261
Interest payment	472	4,426
Foreign exchange differences	(802)	(10,501)
At 31 December	78,232	65,362

Bonds and treasury bills as at 31 December 2016:

Name	Maturity	Nominal amount (in thousands)	Currency	Carrying amount HRK'000	Unrealised gains/(losses) HRK'000
XS0757376610	21 March 2022	500	EUR	4,344	64
US857524AC63	22 January 2024	500	USD	3,745	(172)
XS0982708926	18 February 2019	200	USD	1,512	15
HRRHMFT745X5	9 November 2017	9,000	EUR	62,617	-
				77,218	(93)

As at 31 December 2016, there were no bonds pledged as collateral in repurchase agreements.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

18. Held-to-maturity financial assets

	31 December 2016 HRK'000	31 December 2015 HRK'000
Bills of exchange	23,275	1,977
	23,275	1,977
Provision for identified losses	(1,067)	(1,067)
Provision for unidentified losses on collective basis	(226)	(9)
	21,982	901

Movements in provisions:

	31 December 2016 HRK'000	31 December 2015 HRK'000
At 1 January	1,076	1,765
Additional provisions (Note 8)	217	9
Collected amounts (Note 8)	-	(698)
Write-off	-	-
At 31 December	1,293	1,076

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

19. Property and equipment and intangible assets

	Land and buildings	Leasehold improvements	Electronic equipment	Other assets	Total property and equipment	Software	Assets under construction	Leasehold improvements	Total intangible assets
Cost	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
At 1 January 2015	17,234	12,979	9,334	12,369	51,916	8,833	-	-	8,833
Additions	187	9	67	4	267	564	1,150	12,570	14,284
Disposals	-	(12,988)	(2,762)	(349)	(16,099)	(1,060)	-	-	(1,060)
At 31 December 2015	17,421	-	6,639	12,024	36,084	8,337	1,150	12,570	22,057
Additions	-	-	60	826	886	123	1,173	2,337	3,633
Transfers	-	-	-	-	-	-	(2,323)	-	(2,323)
Disposals	-	-	(4)	(59)	(63)	-	-	-	-
At 31 December 2016	17,421	-	6,695	12,791	36,907	8,460	-	14,907	23,367
Impairment									
At 1 January 2015	2,600	10,471	9,009	11,449	33,529	7,730	-	-	7,730
Amortisation/depreciation charge for the period	299	1,766	151	424	2,640	669	-	11,958	12,627
Disposals	-	(12,237)	(2,755)	(349)	(15,341)	(780)	-	-	(780)
At 31 December 2015	2,899	-	6,405	11,524	20,828	7,619	-	11,957	19,576
Amortisation/depreciation charge for the period	304	-	94	228	626	519	-	734	1,253
Disposals	-	-	(4)	(20)	(24)	-	-	-	-
At 31 December 2016	3,203	-	6,495	11,732	21,430	8,138	-	12,691	20,829
Net book amount									
At 31 December 2015	14,522	-	233	500	15,255	717	1,150	612	2,479
At 31 December 2016	14,218	-	200	1,059	15,477	322	-	2,216	2,538

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

20. Repossessed collateral

Movements in repossessed collateral during the year:

	31 December 2016 HRK'000	31 December 2015 HRK'000
At 1 January	37,868	37,519
Additions	7,457	983
Disposals	(1,938)	(634)
Write off	(6,086)	-
At 31 December	37,301	37,868

The Bank's repossessed collateral as at 31 December 2016 included property in the total amount of HRK 3,357 thousand (2015: HRK 5,452 thousand) which was not in the Bank's possession. The Bank took over formal ownership over the property in exchange for outstanding receivables in the process of obtaining physical possession.

21. Other assets

	31 December 2016 HRK'000	31 December 2015 HRK'000
Deferred tax assets	5,463	5,463
Receivables for court costs refunds	5,032	4,137
Trade receivables	70	1,737
Other prepayments	273	246
Prepaid expenses	1,666	185
Due for court costs	11,099	23,254
Other	3,150	787
	26,753	35,809
Provision for identified losses	(8,123)	(8,186)
Provision for unidentified losses on collective basis	(115)	(220)
	18,515	27,404

Movement in the provision for identified losses during the year:

	31 December 2016 HRK'000	31 December 2015 HRK'000
At 1 January	8,404	8,580
Additional provisions (Note 8)	2,820	1,797
Collected amounts (Note 8)	(2,934)	(1,945)
Write-off	(51)	(28)
At 31 December	8,239	8,404

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

22. Deposits from customers

Deposits comprise demand deposits and term deposits:

	31 December 2016 HRK'000	31 December 2015 HRK'000
Demand deposits		
Corporate customers	12,240	13,279
Retail customers	146,804	105,771
	159,044	119,050
Term deposits		
Corporate customers	6,636	5,843
Retail customers	848,235	875,673
	854,871	881,516
Deposits from customers	1,013,915	1,000,566
Current portion	811,610	886,716
Non-current portion	202,305	113,850

23. Due to banks

	31 December 2016 HRK'000	31 December 2015 HRK'000
Borrowings:		
- Croatian Bank for Reconstruction and Development	16,002	20,877
Deposits	7,467	1,198
	23,469	22,075
Current portion	7,467	1,198
Non-current portion	16,002	20,877

As at 31 December 2016 and 31 December 2015, all deposits from banks are short-term.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

24. Hybrid instruments

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

	31 December 2016 HRK'000	31 December 2015 HRK'000
Foreign entities	30,070	24,707
Domestic entities	9,787	9,887
	39,857	34,594

25. Repurchase agreements

As at 31 December 2016 and 31 December 2015, the Bank did not have any repurchase agreements.

26. Other liabilities

	31 December 2016 HRK'000	31 December 2015 HRK'000
Provisions for legal disputes	472	629
Provision for contingent liabilities and commitments	298	367
Payables in the course of settlement	6,178	11,729
Trade payables	821	2,240
Employee payables – salaries and contributions	1,721	1,633
Liabilities for deposits insurance charge	808	743
Accrued unused vacation (Note 10)	199	269
Other liabilities + provisions for conversion	1,395	2,100
	11,892	19,710

Movement in provisions for legal disputes:

	31 December 2016 HRK'000	31 December 2015 HRK'000
At 1 January	629	799
Additional provisions	75	36
Release of provisions	(69)	(206)
Payments made per court verdicts	(163)	-
At 31 December	472	629

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

Movement in provisions for contingent liabilities and commitments

	31 December 2016 HRK'000	31 December 2015 HRK'000
At 1 January	368	368
Additional provisions	1,564	1,202
Release of provisions	(1,634)	(1,202)
At 31 December	298	368

27. Shareholders' equity**Share capital**

As at 31 December 2016, the Bank's share capital amounted to HRK 103,944 thousand (31 December 2015: HRK 333,834 thousand), and it is divided among 3,464,787 ordinary shares (31 December 2015: 3,338,344) (VSK-R-A) with a nominal value of HRK 30 per share.

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

Shareholder	31 December 2016		31 December 2015	
	Number of shares	% in share capital	Number of shares	% in share capital
Cassa di Risparmio della Repubblica di San Marino	3,453,904	99.69	3,327,461	99.67
Treasury shares	153	0.00	153	0.01
Other	10,730	0.31	10,730	0.32
Total	3,464,787	100.00	3,338,344	100.00

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

28. Cash and cash equivalents

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

	Note	31 December 2016 HRK'000	31 December 2015 HRK'000
Cash on hand and balances with banks	13	163,635	173,906
Placements with banks	15	1,024	38,833
		164,659	212,739

29. Contingencies and commitments**Legal disputes**

The Bank is currently subject to 13 legal proceedings. As at 31 December 2016, provisions for legal disputes for which the Bank anticipates outflow of economic benefits amount to HRK 472 thousand (2015: HRK 628 thousand). Total contingent liabilities arising from the dispute with the company Prvi Faktor d.o.o. per the instituted enforcement proceedings against the Bank in the amount of EUR 710 thousand as at 31 December 2016 amounted to HRK 10,654 thousand, and the total provisions for contingent liabilities arising from the dispute amounted to HRK 107 thousand. It is a guarantee issued by the Bank in favour of the company Prvi Faktor d.o.o. for the loan payment to the company Glas Istre d.o.o. The first-instance court ruling was issued in the Bank's favour, rejecting the plaintiff's claim.

Capital commitments

As at 31 December 2016 and 31 December 2015, the Bank had no capital commitments in respect of purchases of buildings and equipment.

Loan commitments, guarantees and other financial instruments

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

	31 December 2016 HRK'000	31 December 2015 HRK'000
Guarantees	5,639	6,686
Letters of credit	11,095	8,277
Loan and other commitments	13,111	21,773
Less: provision for contingencies and commitments (Note 26)	-	-
Total	29,845	36,736

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

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

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

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

Operating lease commitments where the Bank is the lessee

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

	31 December 2016 HRK'000	31 December 2015 HRK'000
Up to 1 year	1,814	2,060
From 2 to 5 years	5,850	6,368
Over 5 years	3,233	4,113
Total	10,897	12,541

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

30. Related party transactions

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

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

In 2016 and 2015, transactions with related parties were as follows:

	Supervisory Board, Management Board and their related parties	
	2016	2015
	HRK'000	HRK'000
Interest income	2	52
Interest expense	33	15
Loans		
At 1 January	1,241	1,432
Increase	70	-
Decrease	(1,191)	(192)
At 31 December	120	1,240
Deposits received		
At 1 January	1,406	1,005
Increase	1,731	448
Decrease	(52)	(47)
At 31 December	3,085	1,406

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

		Cassa di Risparmio della Repubblica di San Marino	
		2016	2015
		HRK'000	HRK'000
Interest income		61	237
Other operating income		6	1
Interest expense		(765)	(642)
Given deposits and cash			
At 1 January		19,115	19,199
Increase		-	19,089
Decrease		(19,111)	(19,173)
At 31 December		4	19,115
Deposits received			
At 1 January		1,082	23,154
Increase		346	-
Decrease		-	(22,073)
At 31 December		1,428	1,081
Hybrid instruments			
At 1 January		14,818	14,802
Increase		2,725	16
Decrease		-	-
At 31 December		17,543	14,818

As at 31 December 2016, the exposure towards the majority shareholder amounts to HRK 4 thousand, which represents 0.00% of the Bank's regulatory capital (2015: 15.36%, 2014: 18.66%). The regulatory limit exposure to one person or group of related persons is a maximum of 25% of the regulatory capital of a credit institution.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

	NEKRETNINE PLUS DOO	
	2016	2015
	HRK'000	HRK'000
Interest income	333	328
Other operating income	111	130
Interest expense	(675)	(352)
Loans receivable		
At 1 January	6,285	6,377
Increase	-	-
Decrease	(97)	(92)
At 31 December	6,188	6,285
Deposits received		
At 1 January	764	1,166
Increase	260	-
Decrease	-	(402)
At 31 December	1,024	764
Hybrid instruments		
At 1 January	9,887	-
Increase	-	9,887
Decrease	(100)	-
At 31 December	9,787	9,887

Key management and Supervisory Board compensation

	31 December	31 December
	2016	2015
	HRK'000	HRK'000
Gross salaries and other short-term benefits	3,694	3,640

31. Financial risk management

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

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

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

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

31.1. Credit risk

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

31.1.1. Credit risk measurement

(a) Loans and advances

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

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

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

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

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

(b) Debt securities and other bills

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

31.1.2. Risk limit control and mitigation policies

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

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

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

Some other specific control and mitigation measures are outlined below:

(a) Collateral

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

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

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

(b) Commitments related to loans

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

31.1.3. Impairment and provisioning policies

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

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

Bank's rating

	2016		2015	
	Loans and advances HRK'000	Provisions for impairment HRK'000	Loans and advances HRK'000	Provisions for impairment HRK'000
1 Fully recoverable placements	719,939	7,196	662,298	6,623
2 Partially recoverable placements	159,474	79,309	164,768	76,495
3 Unrecoverable placements	139,780	139,780	127,085	127,080
	1,019,193	226,285	954,151	210,198

Bank's rating

	2016		2015	
	Loans and advances (%)	Provision for impairment (%)	Loans and advances (%)	Provision for impairment (%)
	HRK'000	HRK'000	HRK'000	HRK'000
1 Fully recoverable placements	70.64	3.18	69.41	3.15
2 Partially recoverable placements	15.65	35.05	17.27	36.39
3 Unrecoverable placements	13.71	61.77	13.32	60.46
	100.00	100.00	100.00	100.00

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

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

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

	31 December 2016 HRK'000	31 December 2015 HRK'000
Credit risk exposure relating to balance sheet assets is as follows:		
Cash on hand and balances with banks	163,635	173,906
Obligatory reserve with the Croatian National Bank	69,099	81,926
Placements with banks	1,024	38,833
Loans and advances to customers	792,908	743,953
Available-for-sale financial assets	78,232	65,362
Held-to-maturity financial assets	21,982	901
Other assets	18,515	27,404
	1,145,395	1,132,285
Exposure to credit risk relating to off-balance-sheet assets is as follows:		
Financial guarantees	5,639	6,686
Letters of credit	11,095	8,277
Loan commitments and other credit related liabilities	13,111	21,773
	29,845	36,736

The above table represents Bank's maximum exposure to credit risk as at 31 December 2016 and 2015, without taking into account any collateral held or other credit enhancements attached. For balance sheet items, exposures set out above are based on net carrying amounts as reported in the balance sheet. As indicated above, 69.32% of the total maximum exposure is derived from loans and advances to banks and customers (2015: 69.13%).

31.1.5. Loans and advances

Loans and advances are summarised as follows:

	31 December 2016 Loans and advances to customers HRK'000	31 December 2016 Loans and advances to banks HRK'000	31 December 2015 Loans and advances to customers HRK'000	31 December 2015 Loans and advances to banks HRK'000
Neither past due nor impaired	711,017	1,034	644,072	39,225
Past due but not impaired	8,921	-	18,226	-
Individually impaired	299,255	5,138	291,853	5,138
Gross	1,019,193	6,172	954,151	44,363
Less: provisions for impairment	(226,285)	(5,148)	(210,198)	(5,530)
Net	792,908	1,024	743,953	38,833

The total impairment provision for loans and advances is HRK 231,433 thousand (2015: HRK 215,728 thousand) of which HRK 224,227 thousand (2015: HRK 208,713 thousand) represents the individually impaired loans and the remaining amount of HRK 7,206 thousand (2015: HRK 7,015 thousand) represents the provision for the fully recoverable placements portfolio. Further information of the impairment provision for loans and advances to banks and to customers is provided in Notes 15 and 16.

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

The breakdown of the gross amount of loans and advances by class is as follows:

	Retail customers	Corporate customers	Total loans and advances to customers	Loans and advances to banks
	HRK'000	HRK'000	HRK'000	HRK'000
31 December 2016				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	634,620	76,397	711,017	1,034
<i>Past due but not impaired</i>				
Past due up to 30 days	3,714	700	4,415	-
Past due from 30 to 90 days	759	3,748	4,507	-
<i>Individually impaired</i>				
Individually impaired loans	71,092	228,162	299,254	5,138
Total	710,185	309,007	1,019,193	6,172

	Retail customers	Corporate customers	Total loans and advances to customers	Loans and advances to banks
	HRK'000	HRK'000	HRK'000	HRK'000
31 December 2015				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	579,739	64,333	644,072	39,225
<i>Past due but not impaired</i>				
Past due up to 30 days	2,020	303	2,323	-
Past due from 30 to 90 days	4,109	11,794	15,903	-
<i>Individually impaired</i>				
Individually impaired loans	58,068	233,785	291,853	5,138
Total	643,936	310,215	954,151	44,363

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

31.1.6. Repossessed collateral

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

31.1.7. Concentration of risks of financial assets with credit risk exposure

(a) Geographical sectors

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorised by geographical region as at 31 December 2016. For this table, the Bank has allocated exposures to regions based on the country of domicile of its counterparties.

	Croatia HRK'000	European Union HRK'000	Other countries HRK'000	Total HRK'000
Cash on hand and balances with banks	158,955	4,669	13	163,635
Obligatory reserve with the Croatian National Bank	69,099	-	-	69,099
Placements with banks	1,024	-	-	1,024
Loans and advances to customers	792,135	773	-	792,908
Available-for-sale assets	68,629	9,603	-	78,232
Held-to-maturity financial assets	21,982	-	-	21,982
Other assets	18,515	-	-	18,515
At 31 December 2016	1,130,337	15,045	13	1,145,395
At 31 December 2015	1,014,768	60,672	56,845	1,132,285

(b) Industry sectors

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

	Financial institutions HRK'000	Manufac- turing HRK'000	Real Estate HRK'000	Wholes- ale and retail HRK'000	Public sector HRK'000	Other industri- es HRK'000	Individu- als HRK'000	Total HRK'000
Placements with banks	1,024	-						1,024
Loans and advances to customers	11,147	25,963	50,825	18,318	3,128	25,013	658,514	792,908
Available-for-sale assets	393	8	222	189	77,219	201	-	78,232
Held-to-maturity financial assets	-	-	6,875	14,723	-	385	-	21,982
Other assets	7,306	17	21	30	10,997	22	122	18,515
At 31 December 2016	19,870	25,988	57,943	33,260	91,344	25,621	658,636	912,661
At 31 December 2015	66,142	31,901	35,876	39,313	66,186	37,092	599,943	876,453

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

32. Market risk

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

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

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

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

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

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

32.1. Foreign exchange risk

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

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

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

	HRK	EUR	USD	Other currencies	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
At 31 December 2016					
Assets					
Cash on hand and balances with banks	57,565	96,841	2,697	6,532	163,635
Obligatory reserve with the CNB	69,099	-	-	-	69,099
Placements with banks	-	1,024	-	-	1,024
Loans and advances to customers	147,362	645,546	-	-	792,908
Available-for-sale financial assets	1,013	71,962	5,257	-	78,231
Held-to-maturity financial assets	384	21,598	-	-	21,982
Other assets	18,488	14	13	-	18,515
Total financial assets	293,911	836,985	7,967	6,532	1,145,395
Liabilities					
Deposits from customers	204,470	794,969	7,966	6,510	1,013,915
Due to banks	12,409	11,060	-	-	23,469
Hybrid instruments	-	39,857	-	-	39,857
Other liabilities	11,501	317	74	-	11,892
Total financial liabilities	228,380	846,203	8,040	6,510	1,089,133
Net balance-sheet gap	65,531	(9,218)	(73)	22	56,262
Loan commitments	7,299	5,813	-	-	13,112
At 31 December 2015					
Total financial assets	317,885	792,825	12,000	9,575	1,132,285
Total financial liabilities	251,721	803,662	12,248	9,314	1,076,945
Net balance-sheet gap	66,163	(10,837)	(248)	261	55,339
Loan commitments	8,496	10,657	2,620	-	21,773

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

32.2. Interest rate risk

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

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

	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non- interest bearing	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
At 31 December 2016							
Assets							
Cash on hand and balances with banks	-	-	-	-	-	163,635	163,635
Obligatory reserve with the CNB	-	-	-	-	-	69,099	69,099
Placements with banks	-	-	-	-	-	1,024	1,024
Loans and advances to customers	52,259	38,031	32,639	41,605	624,279	4,095	792,908
Available-for-sale financial assets	9,602	-	67,617	-	-	1,013	78,232
Held-to-maturity financial assets	1	10,271	11,710	-	-	-	21,982
Other assets	-	-	-	-	-	18,515	18,515
Total financial assets	61,861	48,303	111,965	41,605	624,279	255,182	1,145,395
Liabilities							
Deposits from customers	137,245	117,861	453,839	142,485	55,448	107,037	1,013,915
Due to banks	1,366	-	-	1,610	13,026	7,467	23,469
Hybrid instruments	-	-	-	-	39,857	-	39,857
Other liabilities	-	-	-	-	-	11,892	11,892
Total financial liabilities	138,611	117,861	453,839	144,095	108,331	126,396	1,089,133
Net balance-sheet gap	(76,749)	(69,559)	(341,873)	(102,490)	515,948	130,985	56,262
At 31 December 2015							
Total financial assets	151,901	27,039	107,506	135,826	425,276	274,737	1,132,285
Total financial liabilities	214,053	138,661	559,067	77,291	63,971	23,902	1,076,945
Net balance-sheet gap	(62,152)	(111,622)	(451,561)	58,535	361,305	260,834	55,339

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

32.3. Liquidity risk

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

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

32.3.1. Funding approach

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

32.3.2. Non-derivative cash flows

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

31 December 2016	Up to 1 month HRK'000	1 - 3 months HRK'000	3 - 12 months HRK'000	1 - 3 years HRK'000	Over 3 years HRK'000	Total HRK'000
Deposits from customers	243,988	117,868	453,857	142,553	55,648	1,013,915
Due to banks	8,834	-	-	1,610	13,025	23,469
Hybrid instruments					39,857	39,857
Other liabilities	10,902	74	855	5	56	11,892
Total liabilities (contractual maturity dates)	263,724	117,943	454,712	144,168	108,586	1,089,133
Total liabilities on unused loans (expected maturity dates)	1,028	1,214	4,734	547	5,588	13,111

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

31 December 2015	Up to 1 month HRK'000	1 - 3 months HRK'000	3 - 12 months HRK'000	1 - 3 years HRK'000	Over 3 years HRK'000	Total HRK'000
Deposits from customers	214,763	137,888	555,681	68,060	24,174	1,000,566
Due to banks	1,613	778	3,579	9,315	6,790	22,075
Hybrid instruments	1,191	-	-	-	33,403	34,594
Other liabilities	16,041	1,548	2,117	4	-	19,710
Total liabilities (contractual maturity dates)	233,608	140,214	561,377	77,379	64,367	1,076,945
Total liabilities on unused loans (expected maturity dates)	5,437	48	15,923	365	-	21,773

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

32.3.3. Off-balance-sheet items

(a) Loan commitments

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

(b) Other financial instruments

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

	No later than 1 year HRK'000	1 to 3 years HRK'000	Over 3 years HRK'000	Total HRK'000
31 December 2016				
Loan commitments	6,976	6,135	-	13,111
Guarantees, letters of credit and other	16,734	-	-	16,734
Total	23,710	6,135	-	29,845
31 December 2015				
Loan commitments	21,408	365	-	21,773
Guarantees, letters of credit and other	14,963	-	-	14,963
Total	36,371	365	-	36,736

Notes to the financial statements (continued)

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

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

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

32.4. Fair value of financial assets and liabilities

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

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

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

	31 December 2016			31 December 2015		
	Level 1	Level 2	Total	Level 1	Level 2	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Bonds	77,219	-	77,219	64,629	-	64,629
Shares	872	141	1,013	592	141	733
	78,091	141	78,232	65,221	141	65,362

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

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

	Carrying amount		Fair value	
	2016	2015	2016	2015
	HRK'000	HRK'000	HRK'000	HRK'000
Financial assets				
Placements with banks	1,024	38,833	1,024	38,833
Loans and advances to customers	792,908	743,953	792,908	743,953
Held-to-maturity financial assets	21,982	901	21,982	901
Other assets	18,515	27,403	18,515	27,403
Total financial assets	834,429	811,090	834,429	811,090
Financial liabilities				
Deposits from customers	1,013,915	1,000,566	1,013,915	1,000,566
Due to banks	23,469	22,075	23,469	22,075
Hybrid instruments	39,857	34,594	39,857	34,594
Other liabilities	11,892	19,710	11,892	19,710
Total financial liabilities	1,089,133	1,076,945	1,089,133	1,076,945

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

(a) Cash and funds with central bank

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

(b) Held-to-maturity financial assets

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

(c) Due from banks

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

(d) Loans to and receivables from customers

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

(e) Due to other banks and customers

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

32.5. Capital risk management

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

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

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

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

Notes to the financial statements (continued)

for the year from 1 January to 31 December 2016

The table below summarises the composition of regulatory capital and the ratios of the Bank for the year ended 31 December 2016.

	31 December 2016 HRK'000	31 December 2015 HRK'000
Regulatory capital		
Share capital	104,558	409,478
Supplementary capital	34,965	32,432
Deductions from regulatory capital	(1,796)	(317,427)
Regulatory capital	137,727	124,483
Structure of risk exposure		
Exposure amount weighted by credit risk	739,532	729,318
Market risk exposure	1,204	713
Operational risk exposure	99,247	89,392
Total risk exposure	839,983	819,423
Structure of capital requirements		
Capital requirements for total capital ratio (8%)	67,199	65,554
Additional tier for capital protection (2.5%)	21,000	20,486
Additional tier for structural system risk (1.5%)	12,600	12,291
Capital requirements for total capital ratio (3.09%)	25,955	-
Total capital requirements	126,753	98,331
Capital adequacy	16.40%	15.19%

Approval of the financial statements

for the year from 1 January to 31 December 2016

33. Approval of the financial statements

The financial statements set out on pages 5 to 57 were approved by the Management Board of the Bank on 28 March 2017.

Nicola Ceccaroli

President of the Management Board

Ivan Mužić

Member of the Management Board