

**BANKA KOVANICA d.d.**

**Annual report for the year 2018**

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## **Opinion**

## Responsibility for the financial statements

Pursuant to the Croatian Accounting Act (Official Gazette 78/15, 134/15, 120/16 and 116/18), 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 the financial statements, the responsibilities of the Management Board include ensuring that:

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

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Act (Official Gazette 78/15, 134/15, 120/16 and 116/18). 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.

The Management Board is also responsible for the preparation and content of the Management Report, as required by the Croatian Accounting Act. The Management Report was approved by the Management Board on 29 March 2019 and signed accordingly.

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. Preradovića 29

Varaždin

29 March 2019

**BANKA KOVANICA d.d.  
VARAŽDIN**

**MANAGEMENT REPORT  
for the year 2018**

Enclosed: audited financial statements as at 31 December 2018

### ***Management Board Report***

In 2018, the Republic of Croatia recorded the fourth consecutive year of economic growth, with real GDP growing +2.8% and almost unchanged forecasts for 2019 (+2.7%) and 2020 (+2.6%). Private consumption and tourism remain the main drivers of growth, given also the reduction of exports in the second half of the year. These are positively affected by growing salaries and employment as support to available income and consumer confidence. In the coming years, the growth rate should decrease in a moderate inflationary environment (base inflation estimated at +1.4% in 2019 and 2020), despite rising pressures on salaries. The risks associated with the insolvency proceedings of the leading Croatian business group were contained; it is expected that the private investment dynamics will be moderate, while companies will still benefit from favourable financial conditions. The expected increase in financial resources in accessing European funds should facilitate the recovery of public investments, which will, however, remain below pre-crisis levels. The fiscal consolidation process continued in 2018, albeit at lower levels due to increased public spending, including public guarantees activated to address the shipbuilding crisis. Monetary policy remained accommodative, with large interbank reserves and low rates of money and commercial markets. Bank lending is growing higher than the inflation rate and is driven by the retail sector, with a double-digit growth in general-purpose consumer loans, while lending to non-financial companies remains almost unchanged. In 2019, the sovereign rating improved to "BBB-/stable" (S&P), restoring the so-called investment grade after 63 months (below-investment since December 2012). The upgrade reflects the improved public finance data, with a primary surplus since 2015 and a decreased public debt to less than 70% of GDP. In 2020, the Republic of Croatia plans the accession to the European Exchange Rate Mechanism (ERM II) and, in the future, the Eurozone.

In 2018, the Croatian banking system recorded a cumulative profit from continuing operations before tax of HRK 5.6 billion (preliminary data, source: CNB), which is 44.6% higher than in 2017. In a relatively concentrated banking system (the first eight banks with assets exceeding 5% of total assets hold a cumulative market share exceeding 93%), in terms of total assets Banka Kovanica d.d. holds rank 19<sup>o</sup> (market share: 3%), and in terms of own funds it holds rank 17<sup>o</sup>. In the peer group of 13 small banks with assets lower than 1% of total assets (average HRK 2.1 billion), the Bank has a market share of 4.6%. In 2018, this group of small banks recorded a cumulative profit from continuing operations before tax of HRK 74.9 million, with 4 of 11 banks in loss. The Bank realised a profit from continuing operations before tax of HRK 14.5 million, which is 19.4% of the total group, with a double-digit return on equity and it is positioned among the top performing small banks. The budget deviation (target ROE: 18.3%) is primarily attributable to lower interest income from corporations, due to the prudent reduction of exposures to legal entities as a result of the extraordinary administration of the aforementioned conglomerate of systemic importance, and lower income from treasury-related activities due to predominantly negative interest rates on the money market and negative government spreads.

***Most important financial and business achievements:***

- rising economic performance with a ROE of 10.3%, confirming the Bank's high income capacity at the top of the peer group of small banks, as a successful completion of the corporate restructuring that has been implemented by the Management Board in charge since 2014;
- the total capital adequacy ratio increased further to 16.8% (excluding interim profit), for a satisfactory capital base in view of the anticipated lending growth targets, focused on consumer loans and, secondarily, the financing of working capital of small and medium-sized enterprises;
- net loans over 90 days past due, are further and significantly declining for a ratio against equity and supplementary capital tending to 30% (Texas ratio proxy), confirming a prudent lending policy and an effective collection of non-performing exposures;
- the development of digital banking along with the new Internet banking looking for cooperation with *fintech* companies, in order to take opportunity from the new regulatory framework starting from the area of advanced mobile payments (PSD 2).

Further to the Bank's upcoming General Assembly, the net profit in the amount of HRK 8,606,257.03, reported in the audited financial statements as at 31 December 2018 is proposed to be allocated to the Bank's reserves in accordance with the 2017-2020 Business Plan, in order to increase the Bank's capital base, converging towards the average values of the domestic banking system.

The Management wishes to thank all business partners, clients and shareholders for their trust as well as the members of the Supervisory Board for their cooperation and dedication. We also wish to thank the Bank's employees whom we would like to ask for extra effort to reach the challenging goals set out in the Business Plan.

***General information on the Bank and organisational structure***

The Bank has been operating continuously since 1997 when it was registered in the Registry of the Commercial Court in Varaždin as Štedionica Kovanica (savings bank). In April 2002, the savings bank was transformed into a bank and in 2005 it was granted a license from the Croatian National Bank (CNB).

The address of the Bank's registered office is in Varaždin, Petra Preradovića 29.

The share capital amounts to HRK 106,961,910, and is divided among 3,565,397 shares with a nominal value of HRK of 30.00, fully paid. The majority shareholder's share is 99.694% (Cassa di Risparmio della Repubblica di San Marino S.p.A.). The shares of private domestic shareholders comprise 0.3018%, while the Bank's treasury shares comprise 0.0042%.

The Bank is registered for the performance of the following business activities:

- accepting cash deposits,
- granting loans and other placements in its own name and for its own account,
- issuing electronic money,
- issuing guarantees or 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,
- 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.

The Bank joined SWIFT and the Croatian Credit Information Registry (HROK).

Shares are not listed.

The company's bodies as at 31/12/2018 are as follows:

#### **General Assembly**

Appointed at the assembly	President
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#### **Supervisory Board**

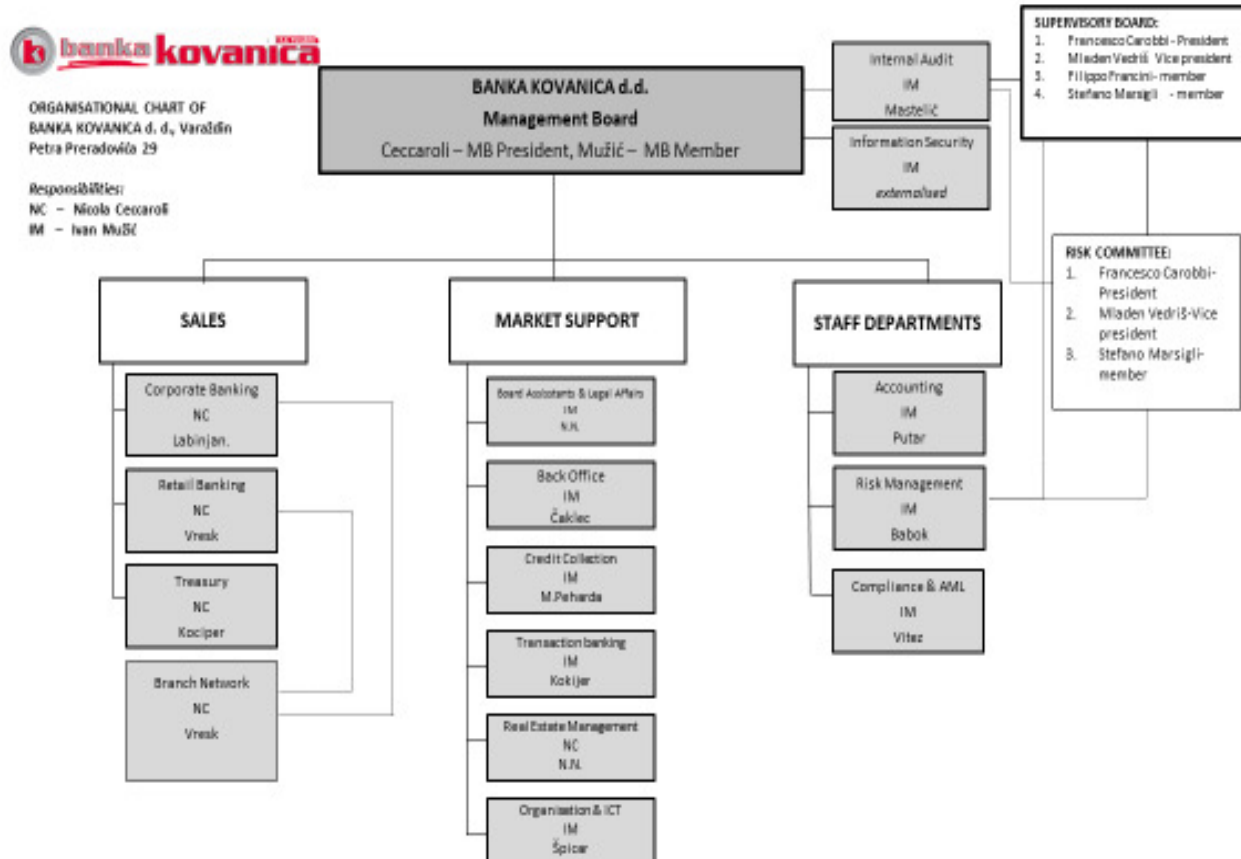
Francesco Carobbi	President (since 7 May 2018)
Filippo Francini	Member (since 7 May 2018)
Stefano Marsigli Rossi Lombardi	Member (since 7 May 2018)
Mladen Vedriš	Vice President
Emanuele Restelli Prandoni Della Fratta	President (until 7 May 2018)
Ivan Majdak	Vice President (until 5 July 2018)
Marino Albani	Member (until 7 May 2018)
Pietro Giacomini	Member (until 7 May 2018)

#### **Management Board**

Nicola Ceccaroli	President
Ivan Mužić	Member



The Bank operates through 12 branch offices and 7 ATMs on the domestic territory, offering services to individuals and legal entities, with a functional organisation based on Basel II requirements, the Credit Institutions Act, recommendations and guidelines of the CNB and on the basis of the specific needs of a modern bank. The Bank's Management Board is committed to further rationalise the branch network, taking into account digital banking, including the potential opening of a new branch office in the Istrian County where there is a lack of territorial presence, excluding future consolidation options between small and medium-sized banks.



Valid as of: 01.01.2019.

The Bank's operations are managed by the Management Board consisting of two members with direct management responsibilities based on the separation of back and front office operations. Based on the scheme adopted in 2014, the Bank is organised in 6 Sectors and 7 Business Support Departments.

The consolidation of administrative services at the Bank's headquarters represents the basis of certain organisational changes intended primarily for the purpose of more efficient operational processes and reduction of operational risk:

- merging the Human Resources Department with the Management and Legal Affairs Department;
- merging the Departments for Payment Transactions, Treasury and Letters of Credit into a new Transaction Banking Department;
- the transfer of the FINA-filing order and Back Office (Payment) activities from the Loan Collection Department and Back Office to the Banking Transactions Department.

The Bank belongs to a group of smaller banks in a heavily concentrated banking market with the general license to perform all lending, billing and payment services in foreign currencies and receiving deposits, payment services and other financial services.

In July 2007, the Bank was taken over by Cassa di Risparmio della Repubblica di San Marino S.p.A., the oldest bank in the Republic of San Marino. In the course of its operations, the Bank's capital has been increased by the majority owner on several occasions, with the latest capital increase amounting to HRK 3.0 million (and a simultaneous dividend payment and capital reserves in the same amount) in line with the General Assembly's decision of 28 April 2017, which was entered into the Register of the Commercial Court in Varaždin, as a result of which the total share capital now amounts to HRK 106,961,910.

### ***Human Resources***

The Human Resources Department was established in 2009 and in 2014, it was merged with the Management and Legal Affairs Department. The Department is, among other things, responsible for hiring new employees and ensuring that the employees' professional training assignments are met.

During 2018, the Bank hired 10 new employees, while 10 employees were dismissed, hence as at 31 December 2018 the Bank had 97 employees (2017: 97 employees). As a rule, staff are generally full-time permanent employees. 4 employees are temporarily employed, mainly as a substitute for employees on maternity leave or because of a temporary workload increase in some offices. Excluding employees replacing those on maternity leave, the Bank's actual number of employees as at 31 December 2018 (FTE) is 93, corresponding to a Total assets/FTE ratio up to HRK 13 million. The Management Board will continue to strive to further improve this efficiency index to bring it closer to the peer group's target values, through the optimization of back-office and middle-office staff as a result of the exchange of the banking information system.

Of the total number of employees, 74% of employees are women, the average age of employees is 41 years and 42% of employees are less than 40 years old.

In 2018, the Bank had HRK 59 thousand employee training expenses in terms of attending seminars and training courses, acquiring new knowledge, improving the quality of work and adjusting to legal changes, including periodic training within the Bank by responsible persons within individual Sectors.

***Movements in the Bank's assets, financial results and the Bank's position***

The audit of the Bank's financial statements was performed by an independent auditor - the auditing company PricewaterhouseCoopers d.o.o. The financial statements comprise the statement of financial position as at 31 December 2018, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the year then ended, 31 December 2018, and notes to the financial statements. After performing the audit of the financial statements, the independent auditor expressed their unqualified opinion. As at 31 December 2018, total assets amounted to HRK 1,235.4 million, which is an 8% increase compared to the previous year 2017: the cause of such increase primarily lies in the increase in granting loans to clients. As at 31 December 2018, the Bank's loan portfolio amounted to HRK 893.7 million, which is a 10% increase compared to 2017. Thereof, loans to citizens increased by 6% and reached an amount of HRK 783.0 million, while loans to companies increased by 52% annually and reached an amount of HRK 110.7 million, after all exposures to the largest group of companies in the Republic of Croatia, which is subject to extraordinary administration since April 2017, have been cancelled. Cash decreased by 4% compared to the previous year and amounted to HRK 148.0 million. The obligatory reserve amounted to HRK 72.8 million, which is an annual increase of 14%.

Financial assets at fair value through other comprehensive income increased primarily due to investments in Eurozone government bonds with short maturities. As at 31 December 2018, total Bank deposits amounted to HRK 1,058.3 million, and they account for almost all deposits of citizens, which represents an increase compared to the previous year by 12%, while continuing the decrease in the average interest rate on time deposits. As at 31 December 2018, the Bank's regulatory capital amounted to HRK 147.00 million and the capital adequacy rate was 16.8% (excluding operating profit in 2018), which represents an increase compared to the planned amount and is above the minimum required amount (12%). The Bank's total interest income in 2018 was HRK 75.0 million, which is almost unchanged compared to 2017. Interest expenses are also almost unchanged compared to 2017, with a realised net interest income in the amount of HRK 59.1 million, almost identical to that in 2017. Commission and fee income amounted to HRK 8.5 million, which represents an increase of 12% compared to the previous period, while commission and fee expenses amounted to HRK 2.2 million, which represents a decrease of 8% compared to the previous year. Net commission and fee income increased by 20% in 2018 compared to 2017. Net other non-interest income amounted to HRK -1.5 million in 2018, compared to HRK -14.5 million in 2017. The reason for such increase is primarily the value adjustment in respect of a multi-year court dispute, for which the responsibility is held by the President of the Management Board who was in office at the time of initiating the legal dispute (FY 2009), to which the notes to the financial statements audited by external auditing companies have been referring since 2011. General administrative expenses and depreciation/amortisation amounted to HRK 34.7 million, up 13% primarily due to the reclassification of the deposit insurance cost and the disbursement of one-off bonuses pertaining to a multi-year period. Value adjustments amounted to HRK 16.9 million, representing an annual increase of 24%, primarily due to the adoption of the new IFRS 9 accounting standard and due to the result of writing-off a part of the non-performing consumer loans as a result of a sale transfer. The Bank realised a net profit before taxation of HRK 12.1 million and a net profit of HRK 8.6 million which represents an increase of 62%. Net operating profit after taxation was decreased as a result of releasing an amount of HRK 3.5 million of deferred tax assets, which was recorded in 2012 in the amount of HRK 5.5 million.

**Basic products and services of the Bank****1. Lending operations**

With respect to lending operations with natural persons, the Bank offers several types of general-purpose loans. The Bank's clients have the following types of cash general-purpose loans available:

- general-purpose cash short-term loan with currency clause  
in Euros for the Bank's clients for a repayment period of up to 12 months;
- general-purpose cash loan with a EUR currency clause for a repayment period up to 180 months;
- general-purpose cash loan in HRK for a repayment period of to 180 months;
- general-purpose cash loan with a EUR currency clause with a pledge over property;
- general-purpose loan with a pledge (term deposit or life insurance policy);

In its offer the Bank adjusts loan terms and conditions to market requirements and competition.

For promotional purposes, for a limited period of time and plafond, in 2018, the Bank granted general-purpose long-term cash loans with a EUR currency clause and a repayment period up to 15 years in the maximum amount of EUR 40,000.00.

The Bank also offers special-purpose loans, including mortgage loans with a repayment period up to 30 years.

**2. Deposit operations**

As part of deposit operations, the Bank offers a wide range of savings products with fixed and variable interest rates, demand and term savings, and individually approaches each client when defining terms and conditions. The Bank offers the following savings products:

- Top-up term savings in HRK, HRK with currency clause and foreign currencies for periods from 3 to 60 months;
- Profit term savings in HRK, HRK with currency clause and foreign currencies for periods from 3 to 60 months;
- Perpetuity term deposits in HRK, HRK with currency clause and foreign currencies for periods from 3 to 60 months.
- Children's savings Klinko in HRK and EUR.

Since October 2015, the Bank offers term deposits to natural persons in the Federal Republic of Germany under the "EU Passport" regime in cooperation with SAVEDO GmbH (Deposit Solutions Group). The online platform manager and the banking partner together manage the entire customer life cycle in German (online/offline client acquisition, application form, customer service). The cross-border collection of bank savings aims to achieve three key results: reducing financing costs; diversification of the customer base; consolidation of maturity of liabilities. The cross-border savings are supervised by the Croatian National Bank upon registration of the German supervisory body (BaFin).

### **3. Invoices-financial transactions**

The Bank offers solutions that enable efficient, fast and secure transactions in managing funds.

#### **3.1. Current accounts**

Opening a current account offers a wide range of products and services tailored to the individual needs of each client:

- *Konto konekt* current account - current account package in three different models, depending on the range of additional services available to the client;
- allowed overdraft;
- cheques;
- standing order;
- Maestro debit card;
- *ko-net* on-line banking;
- mKovanica mobile banking;
- paying in instalments;
- SMS service.

In 2018, the Bank expanded its functionality by implementing the new internet banking (KoNet). The Bank also further enhanced its user experience the new graphical and functional design of the interface.

In 2018, the Bank launched a series of initiatives to be continued in 2019, of which the new Payments Services Directive (PSD2) and the implementation of new payment schemes (SEPA Instant Payment - SEPA Inst) and SEPA Direct Debit can be pointed out.

#### **3.2. Giro accounts - citizens**

Giro account holders can use the *ko-net* internet banking services, which offers them the most convenient means of managing the funds in the account.

#### **4. Credit card operations**

The Bank offers the following credit cards:

- Maestro debit card - the technology used in developing this chip card guarantees the improvement of the Bank's services as well as providing additional services related to the Maestro debit card;
- MasterCard charge;
- MasterCard revolving;
- Business master card.

In 2018, the Bank completed the implementation of the *3DSecure* security protocol as part of the initiative to increase the security of Internet payments via cards, all in line with the requirements of credit card companies and regulations. In 2019, the Bank will also offer new debit and credit cards with contactless payment option and a new graphic design.

#### **5. ATM machines**

The Maestro debit card allows cash withdrawals on ATMs and payments via POS devices in the Republic of Croatia and cash withdrawal ATM (Cirrus) and POS payments (Maestro) abroad. On the Bank's and the MBNET network's ATMs, cash can be withdrawn without paying a fee (pre-defined number of free monthly operations). In 2018, the Bank introduced the option of paying in instalments by means of POS devices as well as withdraw cash from ATM machines with periodic charges to the current account.

#### **Main risks and uncertainties faced by the Bank**

The Bank's operating activities are exposed to various types of risks, which must be managed systematically. Risk management involves the identification, analysis, assessment, control and risk monitoring as prescribed by policies and procedures and by setting the limits for risk levels that are acceptable to the Bank.

The most significant types of risk to which the Bank is exposed are credit risk, liquidity risk, market risk (including interest rate risk, foreign currency risk and price risk) and operational risk.

For a more detailed analytical financial risk report, please refer to Notes 30, 31 and 32 to the accompanying audited annual financial statements as at 31 December 2018.

#### **Operational risk**

Operational risk is the risk of loss due to inadequate or unsuccessful internal processes, people and systems or external events, including compliance risk. Operational risk is inherent in all the Bank's activities, processes, products and systems.

The capital requirement for operational risk is calculated using the Basic Indicator Approach (BIA).

The Bank adopted the Operational Risk Management Policy and Guidelines for the Classification of Operational Risk using the mapping method. The significant risk threshold has been defined and, in case of such an event, a detailed analysis of the causes and consequences of the event is performed, all with a view to prevent the reappearance of such an event or to mitigate its consequences.

***Significant events in progress and future activities***

From the beginning of 2014, the new Management Board started a restructuring and developing process with the Bank's return to operating profit in 2014 and net profit in 2015, with all asset quality indicators of the credit portfolios in significant progress and converging towards the average values of the domestic banking system despite a poor loan portfolio inherited at the beginning of the term of office, thus confirming the prudent loan policy adopted by the new Management Board. In 2018, the Bank recorded a 56.1% cost/income ratio and a double-digit return on equity and is positioned at the top of the group of small domestic banks (ROE index: 10.3%), in a successful completion of the corporate restructuring launched by the Management Board in 2014. The budget deviation (target ROE: 18.3%) is primarily attributable to lower interest income from corporations, due to the prudent reduction of exposure to legal entities as a result of the extraordinary administration of the aforementioned conglomerate of systemic importance and lower treasury income due to predominantly negative interest rates on the money market and negative government spreads.

Despite a significant improvement in the Bank's income and risk profile, the 2017-2020 Business Plan update (stand-alone) assumes more moderate key performance indicators, in line with the guidelines of the parent company, to reflect a context that is influenced by significant and growing competitive and regulatory pressures on margins and investments, especially for the so-called less significant institutions. In addition, regardless of the nature of the retail bank specialising in general-purpose consumer loans, these guidelines apply a more detailed diversification by types of loans and in line with the supervisory measures of the Croatian National Bank, with preference for short-term exposures for the financing of working capital of small and medium-sized companies.

The annual Supervisory Review and Evaluation Process (SREP 2018) acknowledged multiple improvements that the Bank achieved regarding its income, assets and financial position and assessed the overall business risk as moderate. However, the additional capital requirement in an unfavourable scenario in accordance with Art. 92.1. c) of Regulation (EU) No. 575/2013 reached 3.3%, i.e. a total capital ratio of 15.3%, taking into account the counterparty risk as a result of the regular inspection report relating to general-purpose consumer lending and concentration risk. As part of the aforementioned regular inspection report, the Bank acknowledged areas for improvement in the process of general-purpose consumer lending and applied the accompanying supervisory measures to further strengthen the risk management function in accordance with the expectations of supervision and in accordance with best banking practices, applicable to small and non-complex banks.

The Bank is strengthening its position in the retail segment in order to become the Bank of choice for families and small and medium-sized enterprises, basing their own competitive advantage on "listening" as the real differentiating factor.

Priority is reflected in developing the capability of generating revenue and in the capability of internally generating capital based on a strengthened balance sheet. The change in the banking information system plays a key role in implementing the digital banking offer.

The Bank's Business Plan is primarily a margin plan as well as secondarily a volume plan: namely, growth targets are necessarily conditioned by complying with capital requirements, and the investment dynamics intends to preserve the capital buffer (CRR/CRD IV) and the own funds add-on (SREP). The Business Plan guidelines continue to represent ambitious targets but foresee a revision towards lowering key performance indicators applying a more moderate stance, in order to limit the risk of execution both in agreement with the supervision's recommendations, and to achieve a greater diversification of the lending base in favour of small and medium-sized enterprises, to limit the growth rate in retail banking while maintaining a focus on general-purpose consumer loans.

The main risks to which the Bank remains exposed are as follows:

- growing competitive dynamics in the context of banking consolidation, technological innovation and changes in client preferences, aggravated by continued exceptionally low interest rates;
- continuous issuance of new national and international rules and regulatory measures, with high cost of alignment and high strategic, operational and reputational risks, especially for the so-called “less significant institutions”;
- a high rate of default of counterparties’ obligations, particularly in the segment of legal entities, in addition to the inefficiency and delays in civil proceedings regarding the collection of receivables.

#### ***Statement of the Management Board***

Responsible Bank management represents the basis of the Bank's identity and is considered to be the most important condition for generating long-term value for all shareholders, clients and employees. The Bank does not have its own corporate governance code but refers to the code of the Croatian Banking Association.

The Bank's Management Board states that the Bank has established an organisational structure that is suitable for operations, while respecting applicable regulations in force in the Republic of Croatia and in accordance with the needs of modern banking activities. The Management Board continues to be committed to strengthening the principles of corporate culture to encourage a meritocratic, result-oriented organisational environment.

The Management Board and Supervisory Board cooperate through transparent communication and at regular meetings where the Management Board submits all necessary reports on the Bank's position and business operations, while the Supervisory Board provides the necessary support for the conduct of the business.

#### ***Corporate governance***

The Bank's shareholders exercise their rights at the General Assembly, with the right to participate held by shareholders registered at the Central Depository Agency on the day as determined by the invitation to the General Assembly.

Each share entitles to one vote at the General Assembly, the right to dividend payment and other rights set forth by the law and the Bank's Articles of Association.

#### ***General Assembly of the Bank***

The Management Board convenes the General Assembly at least once a year, by announcing an invitation to all shareholders in the Official Gazette, the Bank's bulletin, or by inviting each shareholder via registered mail. Apart from being convened regularly in the first eight months of the financial year, the Management Board or the Supervisory Board convenes the General Assembly whenever the Bank's interests so require, or when there is a need for changes in business operations that require the decisions of the General Assembly.

The regular General Assembly meeting is usually held in the first six months of the financial year and is convened by the Management Board once the Supervisory Board examines the annual financial statements and business reports. The regular General Assembly acknowledges the annual financial statements as well as the annual report of the Management Board on the Bank's position accordingly making decisions on dismissing members of the Supervisory Board and the Management Board. The General Assembly decides on matters specifically defined by the law and the Bank's Articles of Association, and in particular on the election and dismissal of the members of the Supervisory Board, the appointment of an auditing company, share capital increase and decrease and other status changes.

The General Assembly decides on the principle of ordinary majority if, for individual decisions, the law or the Bank's Articles of Association do not specify otherwise.



*Supervisory Board*

For the benefit of the Bank, its successful operation and development, the cooperation between the Supervisory Board and the Management Board is continuous and effective. In this regard, the Management Board makes strategic decisions with the approval of the Supervisory Board.

Pursuant to the provisions of the Law, the Articles of Association and the Rules of Procedure of the Supervisory Board, decisions have been reached that can be adopted only with the approval of the Supervisory Board, such as: change of organisational structure, approval of large exposures, appointment of an auditing company, acquisition and disposal of real estate, opening and closing branch offices, entering interest groups, determining the annual plan and budget.

An important element of effective cooperation between the two bodies is constant communication, both through comprehensive and detailed reports, as well as through informal communication.

As at 31 December 2018, the Supervisory Board consists of five members, one of whom is the president and the other the vice president of the Supervisory Board. Members of the Supervisory Board are elected by the General Assembly. In accordance with applicable regulations, one member of the Supervisory Board must be independent.

The Supervisory Board oversees the management of the Bank's operations, appoints and dismisses the members of the Bank's Management, directs the Bank's business policy and actively contributes to its realisation. Members of the Supervisory Board receive remuneration for their work in accordance with the decision of the General Assembly of the Bank.

*Avoiding conflicts of interest in the work of the Bank's Supervisory Board*

All members of the Supervisory Board must represent the Bank's best interests and

well-being: for the purpose of avoiding conflict of interest in the work of the Supervisory Board, the rules applicable to Management Board members apply.

*Risk and Audit Committee*

The Supervisory Board has established a Risk and Audit Committee with a view to thoroughly monitoring the Bank's activities. The Risk and Audit Committee, whose duties are set out in the Audit Act and the Credit Institutions Act, deals with issues in accordance with applicable regulations, in particular regarding issues related to financial statements, processes and effectiveness of the internal audit and the internal control system, risks, overseeing the audit of financial statements and the work of independent auditors.

*Management Board of the Bank*

The Management Board of the Bank consists of two members, one of which is the president who manages the work of the Management Board, coordinates all business functions and reports to the Supervisory Board and the General Assembly on behalf of the Management Board.

The Bank's Management Board manages the Bank's operations at its own risk and represents the Bank in such a way that the President of the Management Board represents the Bank solely and independently, whereas a Member of the Management Board represents the Bank jointly with the President of the Management Board, simultaneously adhering to the limits set forth in the provisions of the Articles of Association, the decisions of the Supervisory Board and the General Assembly and the Rules of Procedure of the Management Board.

In conducting business, the Bank's Management Board ensures that the Bank operates in accordance with all applicable regulations and rules of the profession, in particular with regard to monitoring all risks to which it is exposed, monitoring and achieving an adequate level of capital in relation to the necessary capital requirements. The Management Board guarantees the correct preparation of financial statements in accordance with accounting policies and standards of Croatian laws and regulations of the Croatian National Bank.

*Avoiding conflicts of interest in the work of the Bank's Management Board*

By complying with applicable regulations and internal rules, the Bank's Management ensures that the issue of conflict of interest is regulated in a transparent and functional manner. In this respect, the members of the Management Board adhere to applicable regulations and internal acts regulating their relationship with the Bank at all levels.

In managing the Bank's operations, members of the Management Board are not allowed to make and implement decisions that are contrary to or in conflict with the Bank's interests, including the use of confidential data for the purpose of achieving personal gain.

The Management Board of the Bank is supported by the following committees: The Assets and Liabilities Committee, the Loan Committee and the Asset Quality Assurance Committee.

*Internal control system*

In order to protect the Bank's assets and the entire business operations, a system of internal controls has been established in accordance with applicable regulations. The internal control system should be further improved in a way to ensure maximum operating efficiency, financial reporting reliability and consistent compliance with laws and by-laws and good business practices, primarily in order to manage loan and operational risk on a market characterised by a large number of doubtful receivables and reduced efficiency of the judiciary, all in order to reduce legal disputes and the duration of proceedings. In carrying out these controls all organisational parts of the Bank participate directly or indirectly, together with the members of the Management Board and the Supervisory Board.

*Transparent and timely reporting*

The Bank is especially concerned with the timely and complete communication with the Croatian National Bank, which is realised through periodic reports and the delivery of other important documentation and information.

**Banka Kovanica d.d.**  
**Statement of comprehensive income**  
for the year ended 31 December 2018

	<b>Note</b>	<b>2018</b> <b>HRK'000</b>	<b>2017</b> <b>HRK'000</b>
Interest income		75,055	74,920
Interest expense		(15,907)	(15,955)
<b>Net interest income</b>	<b>4</b>	<b>59,148</b>	<b>58,965</b>
Fee and commission income		8,469	7,589
Fee and commission expense		(2,225)	(2,402)
<b>Net fee and commission income</b>	<b>5</b>	<b>6,244</b>	<b>5,187</b>
Foreign exchange differences – net	6	1,201	640
Realised (losses)/gains from financial assets at fair value through other comprehensive income	17	(10)	-
Realised (losses)/gains from available-for-sale financial assets	17	-	4
Other operating income	7	2,937	1,594
Impairment charge for credit losses – net	8	(16,906)	(13,631)
Administration costs	9	(34,657)	(30,703)
Other operating expenses	10	(5,900)	(16,749)
<b>Profit before tax</b>		<b>12,057</b>	<b>5,307</b>
Income tax	11	(3,451)	-
<b>Profit after tax</b>		<b>8,606</b>	<b>5,307</b>
Unrealised gains from available-for-sale financial assets		-	66
Unrealised gains from financial assets at fair value through other comprehensive income		497	-
<b>Other comprehensive income</b>		<b>497</b>	<b>66</b>
<b>Total comprehensive income</b>		<b>9,103</b>	<b>5,373</b>
Earnings per share	12	2.4	1.5

*The accompanying accounting policies and notes form an integral part of these financial statements.*

**Banka Kovanica d.d.**  
**Statement of financial position**

as at 31 December 2018

	Note	31 December 2018 HRK'000	31 December 2017 HRK'000
<b>ASSETS</b>			
Cash	13	147,957	154,031
Obligatory reserve with the Croatian National Bank	14	72,810	63,838
Placements with banks	15	1,005	1,018
Loans and advances to customers	16	893,680	809,998
Available-for-sale financial assets	17	-	43,616
Financial assets at fair value through other comprehensive income	17	62,632	-
Property and equipment	18	10,964	14,909
Intangible assets	18	2,006	2,347
Reposessed collateral	19	32,008	32,933
Other assets	20	12,356	22,400
<b>Total assets</b>		<b>1,235,418</b>	<b>1,145,090</b>
<b>LIABILITIES</b>			
Deposits from customers	21	1,058,262	948,364
Due to banks	22	5,889	8,661
Hybrid instruments	23	39,510	39,881
Other liabilities	25	16,059	31,233
		<b>1,119,720</b>	<b>1,028,139</b>
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	26	106,962	106,962
Treasury shares		(38)	(38)
Reserves		10,525	4,720
(Accumulated loss)/Retained earnings		(1,751)	5,307
		<b>115,698</b>	<b>116,951</b>
<b>Total liabilities and shareholders' equity</b>		<b>1,235,418</b>	<b>1,145,090</b>

*The accompanying accounting policies and notes form an integral part of these financial statements.*

**Banka Kovanica d.d.**  
**Statement of changes in equity**

for the year ended 31 December 2018

	Share capital	Treasury shares	Capital reserves	Other reserves	Fair value reserves	Retained earnings/ (accumulated loss)	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
<b>Balance at 1 January 2017</b>	<b>103,944</b>	<b>(38)</b>	<b>653</b>	<b>5,007</b>	<b>(353)</b>	<b>2,365</b>	<b>111,578</b>
Coverage of accumulated losses	-	-	-	-	-	-	-
Transfer to reserves	-	-	-	-	-	-	-
Dividends paid	-	-	(653)	-	-	(2,363)	(3,018)
Contributions in equity	3,018	-	-	-	-	-	3,018
Profit for the year	-	-	-	-	-	5,307	5,307
Unrealised gains from available-for-sale financial assets	-	-	-	-	66	-	66
<b>Total comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>66</b>	<b>5,307</b>	<b>5,373</b>
<b>Balance at 31 December 2017</b>	<b>106,961</b>	<b>(38)</b>	<b>-</b>	<b>5,007</b>	<b>(287)</b>	<b>5,307</b>	<b>116,951</b>
<b>Balance at 1 January 2018</b>	<b>106,961</b>	<b>(38)</b>	<b>-</b>	<b>5,007</b>	<b>(287)</b>	<b>5,307</b>	<b>116,951</b>
Reconciliation of retained earnings due to IFRS 9 application (Note 2.3.)	-	-	-	-	1	(10,357)	(10,356)
<b>Balance at 1 January 2018 after reconciliation</b>	<b>106,961</b>	<b>(38)</b>	<b>-</b>	<b>5,007</b>	<b>(286)</b>	<b>(5,050)</b>	<b>106,595</b>
Coverage of accumulated losses	-	-	-	-	-	-	-
Transfer to reserves	-	-	-	5,307	-	(5,307)	-
Contributions in equity	-	-	-	-	-	-	-
Profit for the year	-	-	-	-	-	8,606	8,606
Unrealised gains from financial assets at fair value through other comprehensive income	-	-	-	-	497	-	497
<b>Total comprehensive income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>497</b>	<b>8,606</b>	<b>9,103</b>
<b>Balance at 31 December 2018</b>	<b>106,961</b>	<b>(38)</b>	<b>-</b>	<b>10,314</b>	<b>211</b>	<b>(1,751)</b>	<b>115,698</b>

The accompanying accounting policies and notes form an integral part of these financial statements.

**Banka Kovanica d.d.**  
**Statement of cash flows**

for the year ended 31 December 2018

	<b>Note</b>	<b>2018 HRK'000</b>	<b>2017 HRK'000</b>
<b>Cash flow from operating activities</b>			
Profit for the year		8,606	5,307
Depreciation and amortisation	9, 18	1,574	1,556
Gain on sale of property and equipment and intangible assets	18	(471)	-
Impairment charge for credit losses – net	8	16,906	13,630
Result of available-for-sale financial assets – net		-	726
Result of financial assets at fair value through other comprehensive income		(1,193)	-
Other non-cash items		(672)	4,368
<b>Operating result before changes in operating assets</b>		<b>24,750</b>	<b>25,587</b>
(Increase)/decrease in assets with the Croatian National Bank		(8,489)	5,261
(Increase) in loans and advances to customers		(111,448)	(7,679)
Decrease/(increase) in repossessed and other assets		7,347	(9,007)
Increase/(decrease) in deposits from customers		109,898	(65,551)
(Decrease)/increase in hybrid instruments		(371)	24
(Decrease)/increase in other liabilities		(15,998)	19,341
<b>Net cash used in operating activities</b>		<b>5,689</b>	<b>(31,841)</b>
<b>Cash flow from investing activities</b>			
Purchase of property and equipment and intangible assets	18	(1,034)	(979)
Proceeds from sale of property and equipment and intangible assets	18	4,217	183
Proceeds from sale of repossessed collateral		4,139	4,067
Purchase of financial assets at fair value through other comprehensive income	17	(17,325)	-
Purchase of available-for-sale financial assets	17	-	(33,876)
Disposal of available-for-sale financial assets	17	-	67,832
<b>Net cash used in investing activities</b>		<b>(10,003)</b>	<b>37,227</b>
<b>Cash flow from financing activities</b>			
Contributions in equity		-	3,018
Dividends paid		-	(3,016)
Increase/(decrease) in deposits from banks		14	(7,041)
Increase/(decrease) in bank borrowings		(2,786)	(7,767)
<b>Net cash from financing activities</b>		<b>(2,772)</b>	<b>(14,806)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(7,086)</b>	<b>(9,603)</b>
Cash and cash equivalents at beginning of year		154,031	163,633
Effect of IFRS 9		1,012	-
<b>Cash and cash equivalents at end of year</b>	13	<b>147,957</b>	<b>154,031</b>

The accompanying accounting policies and notes form an integral part of these financial statements.

## **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 (leasing)
- 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.

### **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.

## **2. Basis of presentation of financial statements**

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

The main difference between the requirements of International Financial Reporting Standards as adopted by the European Union (IFRS) and the CNB refers to the recognition of provisions for impairment of financial assets. In accordance with CNB regulations, banks domiciled in the Republic of Croatia should recognise provisions on the portfolio basis at the minimally prescribed rates on balance sheet and off-balance sheet exposure to credit risk of counterparties for whom impairment on individual basis is not determined, while IFRS requires that provisions on the portfolio basis should be determined for expected credit losses on the basis of valuation models taking into account individual characteristics of the bank and the counterparty in the portfolio (e.g. collateral, customers' scoring, etc.). The impairment amounts in line with CNB requirements may differ from those in line with IFRS requirements.

The Bank calculates impairment losses on individually identified loans to legal entities as the present value of expected future cash flows, discounted at the instrument's original effective interest rate, in accordance with IFRS, with the application of prescribed minimum amounts of provisions for impairment losses for specifically identified impaired exposures, as prescribed by the CNB, which may differ from the impairment losses calculated in accordance with IFRS.

The CNB requires the amortisation of the calculated discount, provided that it meets the definition, to be presented in the income statement within the movement in impairment losses on loans and advances to customers and other assets, rather than as interest income, as required by 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 financial assets at fair value through other comprehensive income. 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.



## 2.3. Adoption of new accounting standards

### A. New and amended standards adopted by the Bank

The Bank has adopted the following new and amended standards for its annual reporting period commencing 1 January 2018 which were endorsed by the European Union and which are relevant for the Bank's financial statements:

- *IFRS 9 Financial Instruments*

in HRK'000

Description	IAS 39		New classification under IFRS 9	Net value IAS 39	Net value IFRS 9	Effect of revaluation
	Portfolio	Measurement categories	Measurement categories	closing balance at 31 December 2017	opening balance at 1 January 2018	
Cash	Cash and cash equivalents	Amortised cost	Amortised cost	154,031	155,043	1,012
Deposits with credit institutions	Loans and receivables	Amortised cost	Amortised cost	63,838	64,321	483
Financial assets at fair value through other comprehensive income	Available-for-sale financial assets	Fair value through OCI	Fair value through OCI	43,616	43,077	(539)
Financial assets at amortised cost	Held-to-maturity investments	Amortised cost	Amortised cost	1,018	1,021	3
Financial assets at amortised cost	Loans and receivables	Amortised cost	Amortised cost	809,998	799,122	(10,876)
Other assets	Other	Amortised cost	Amortised cost	22,400	22,107	(293)
				<b>1,094,901</b>	<b>1,084,691</b>	<b>(10,210)</b>
Financial liabilities at fair value	Financial liabilities	Fair value through P&L	Fair value through P&L	(996,906)	(996,906)	-
Other liabilities	Other liabilities	Amortised cost	Amortised cost	(31,233)	(31,087)	(146)
				<b>(1,028,139)</b>	<b>(1,027,993)</b>	<b>(146)</b>
<b>TOTAL</b>						<b>(10,356)</b>

- *IFRS 15 Revenue from Contracts with Customers and related amendments to various other standards.* The IASB has issued a new standard for the recognition of revenue, which 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. The adoption of this standard did not have a significant impact on the financial statements.

### B. Standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2018 reporting periods and have not been early adopted by the Bank. The Bank's assessment of the impact of these new standards and interpretations is set out below:

- *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: (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 lease assets separately from interest on lease liabilities in the statement of comprehensive income. 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.

During 2018, the Bank reviewed all lease agreements of the Bank in the light of the new lease accounting rules under IFRS 16. The standard will affect primarily the accounting for the Bank's operating leases.

## **2.3. Adoption of new accounting standards (continued)**

### **C. Standards and interpretations not yet adopted (continued)**

At the reporting date, the Bank has non-cancellable operating lease commitments in the amount of HRK 7,618 thousand (Note 27). Of these commitments, approximately HRK 7,618 thousand relate to short-term leases which will be recognised on a straight-line basis in profit or loss over the lease period.

The Bank expects to recognise assets (right-of-use assets) of approximately HRK 5,872 thousand on 1 January 2019 and lease liabilities of HRK 5,872 thousand (after adjustments for prepayments and accrued lease payments recognised as at 31 December 2018).

- *IFRIC 23 "Uncertainty over Income Tax Treatments" (issued on 7 June 2017 and effective for annual periods beginning on or after 1 January 2019).*

IAS 12 specifies how to account for current and deferred tax, but not how to reflect the effects of uncertainty. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments.

- *Amendments to the Conceptual Framework for Financial Reporting (issued on 29 March 2018 and effective for annual periods beginning on or after 1 January 2020)*

The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance – in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting.

- *Definition of materiality – Amendments to IAS 1 and IAS 8 (issued on 31 October 2018 and effective for annual periods beginning on or after 1 January 2020).*

The amendments clarify the definition of materiality and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

## **2.3. Adoption of new accounting standards (continued)**

### **C. Standards and interpretations effective until 31 December 2017:**

- *IAS 39 – Financial Instruments: Recognition and Measurement*

Financial assets held by the Bank are categorized into portfolios in accordance with the Bank's intent on 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 recognized and derecognized 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 recognized 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 acceptable valuation models. The Bank includes unrealised gains and losses in 'Result of trading assets - net'. Interest earned on assets at fair value through profit or loss representing coupons on debt securities is accrued on a daily basis and reported as 'Interest income' in the income statement.

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

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

## **2.3. Adoption of new accounting standards (continued)**

### **C. Standards and interpretations effective until 31 December 2017 (continued):**

#### **(b) Financial assets at fair value through profit or loss**

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

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

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

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

## **2.3. Adoption of new accounting standards (continued)**

### **C. Standards and interpretations effective until 31 December 2017 (continued):**

#### **(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 asset is impaired if its carrying amount exceeds its recoverable amount which is equal to the present value of the expected future cash flows discounted at the instrument's original effective interest rate. 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 recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

## **2.3. Adoption of new accounting standards (continued)**

### **C. Standards and interpretations effective until 31 December 2017 (continued):**

#### **(d) Loans and receivables (continued)**

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

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

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

#### **(e) Financial liabilities**

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

#### **2.4. Critical accounting judgements and key sources of estimation uncertainty**

In applying 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.

According to the requirements of IFRS 9 Standards, all receivables carried at amortised cost must be classified into one of the three stages based on risk criteria. As explained in the previous paragraphs, receivables in default are classified in stage 3, receivables with a significant increase in credit risk are classified in stage 2, while all other receivables are included in stage 1. The stated criteria will be clearly defined below.

##### **a) Default**

Default occurs in one or both of the following events:

- The client's material exposure is 90 days past due,
- It is probable that the client will not fully meet contractual obligations.

The Bank has established a systemic process ensuring recognition of default status at the client level.

The client level implies that in the case of the client's default on any risk exposure, all the client's balance sheet and off-balance exposures shall be considered defaulted. In the event of the client's default, the Bank systematically assesses whether the default of the client (as the principal debtor) has resulted in a deteriorated financial position of the guarantors. In case there is an obvious uncertainty as to the payments of the overall loan exposure by the client's guarantors, such guarantors shall also be considered defaulted. In that case the default status is also determined at the client level.

The same principle applies to a group of related parties, where the default of one client may cause deterioration in the financial position of other clients, regardless of whether they are guarantors or not. Therefore, for each client in that group, it is individually estimated whether the default of one or more members of a group of related parties significantly deteriorates the financial position of that client, and therefore obligations are not expected to be fully settled without realising the collateral. In that case the client is considered defaulted.

## **2.4. Critical accounting judgements and key sources of estimation uncertainty (continued)**

### **b) Significant increase in credit risk ("SICR")**

Bearing in mind that IFRS 9 does not clearly define the "significant increase in credit risk" and taking into account that the Bank must use all available information according to the same requirements, in this item a significant increase in credit risk will be defined, considering the availability of information, the development of the Bank's risk management system, as well as the Bank's portfolio size and structure.

The Bank considers receivables with a significant increase in credit risk to be those receivables that meet at least one of the following conditions:

- delay in payment over 30 days,
- restructured placement,
- blocked account,
- client deceased.

## **3. Significant accounting policies**

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

### **3.1. Interest income and expense**

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

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

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



### **3.2. Fee and commission income and expense**

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

### **3.3. Taxation**

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

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

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised. Deferred tax is recognised as an expense or income in profit or loss, except when 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.

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

Exchange differences arising on the settlement of monetary items, and on 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 recognized directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognized directly in equity.

The Bank has assets and liabilities originated in HRK, which are linked to 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 middle exchange rate of CNB valid at the balance sheet date or by the exchange rate agreed by the option (rate valid at origination), whichever is higher.

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

### **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 three months or less.

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

### **3.7. Financial assets**

All types of financial assets are classified entirely using two criteria:

- business model for managing the financial assets
- the contractual cash flow characteristics of the financial assets

Types of business models for managing financial assets:

- business model whose objective is to hold assets solely to collect the contractual cash flows (hold-to-collect) under which financial assets are managed to realise cash flows by collecting contractual payments over the life of the instrument and not for sale in order to realise profit. The objective of an entity's business model might be to hold financial assets in order to collect contractual cash flows, even if the financial assets are sold or expected to be sold in future periods, provided that they are infrequent (even if they are significant in value) or insignificant in value, both individually or in aggregate (even if they are frequent).
- business model whose objective is both to collect contractual cash flows and sell financial assets (hold-to-collect and sell) for day-to-day purposes of managing liquidity, realising yield or matching the maturities of financial assets and liabilities.
- Other business models include assets that are not held in the hold-to-collect business model or the hold-to-collect and sell business model. In this model, financial assets are measured at fair value through profit or loss, and financial assets are managed in order to realise cash flows through the sale of assets.

Depending on the business model of financial asset management and the contractual characteristics of cash flows, financial assets are classified as:

- Financial assets subsequently measured at fair value through profit or loss
- Financial assets subsequently measured at amortised cost
- Financial assets subsequently measured at fair value through comprehensive income (FVOCI):
  - FVOCI – debt securities
  - FVOCI – equity securities

Financial assets at amortised cost - are subsequently measured at amortised cost if both of these conditions are met:

- the financial assets are held in the business model whose purpose is to hold a financial asset for the purpose of collecting contractual cash flows (hold to collect) and
- based on the contractual terms of financial assets, on specific dates cash flows are generated that are solely payments of principal and interest (SPPI).

Financial assets at fair value through OCI - they are subsequently measured at fair value through other comprehensive income if both of these conditions are met:

- the financial assets are held in the business model for the purpose of collecting contractual cash flows and selling financial assets (hold to collect and sell); and
- based on the contractual terms of financial assets, on specific dates cash flows are generated that are solely payments of principal and interest (SPPI), if debt securities are involved.

Financial assets are measured at fair value through profit or loss unless they are measured at:

- amortised cost or
- at fair value through other comprehensive income.

### **3.7. Financial assets (continued)**

#### **Recognition of financial assets**

All financial assets including derivative instruments are recognised in the balance sheet when the Bank becomes party to a binding agreement on financial assets.

Purchase and sales transactions of financial instruments (foreign exchange, securities and similar financial instruments), which are spot transactions or transactions where the period from the trading date to the settlement date is not longer than the one established by generally accepted convention, are recorded in the Bank's balance sheet at the settlement date. Considering the above, acquired financial assets are recognised or recorded on appropriate balance sheet accounts at the date the transaction value is settled with the counterparty, and from the trading date to the settlement date, they are recorded on off-balance sheet accounts.

For the purpose of determining the foreign exchange position, all spot transactions denominated in foreign currencies and with foreign currency clause are recorded on the trading day on off-balance sheet accounts (account groups 96 and 99).

Financial assets are initially measured at their fair value, which, in the case of financial assets not designated at fair value through profit or loss, increases or decreases by transaction costs directly attributable to the acquisition or issue of a financial asset.

#### **Subsequent measurement**

Upon initial recognition, all financial assets classified as at fair value through profit or loss and assets at fair value through OCI are stated at fair value other than those financial assets whose price is not quoted in an active market and whose fair value cannot be reliably determined. The value of such financial assets is carried at cost, including transaction costs, less any amortisation and impairment losses.

Loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated using the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the relevant instrument's carrying amount and are amortised based on the instrument's effective interest.

The fair value of financial assets is based on the market price on the balance sheet date, without deducting transaction costs. If the market price is not available, the fair value of the asset is measured at cost.

Where the discounted cash flow method is used, estimated future cash inflows are based on management's best estimates and the discount rate is the market rate effective at the balance sheet date and used for financial instruments with similar features and conditions.

The fair value of derivative instruments that are not traded in an active market is estimated based on the value of proceeds or expenditures that the Bank would have if it would terminate the contract at the balance sheet date, taking into account current market assessments and the counterparty's credit risk.

Gains or losses from financial assets at fair value through profit or loss are recognised in profit or loss.

Gains or losses from financial assets at fair value through other comprehensive income are recognised directly in equity except for impairment losses and foreign exchange differences until the derecognition of instruments, when cumulative gains and losses previously recognised in equity, are recognised in profit or loss.

#### **Loss on impairment of financial assets**

With a view to timely recognising losses, the impairment model reflects expected credit losses (ECL), i.e. for impairment it is no longer necessary for a credit event to have occurred. The amount of expected losses is updated by the Bank at each reporting date to reflect changes in credit risk since initial recognition.

As to the regularity in settlement of outstanding liabilities, the Bank's placements can be categorised into three basic groups:

STAGE 1 – performing placements with no significant increase in the credit risk of the debtor's exposure upon initial recognition. For Stage 1 placements interest is recognised in the full amount in profit or loss, while impairment and provisions for exposures are made in an amount equalling 12-month expected credit losses.

STAGE 2 – underperforming placements with a significant increase in the credit risk of the debtor's exposure upon initial recognition. For Stage 2 placements interest is recognised in the full amount in profit or loss, while impairment and provisions for exposures are made in an amount equalling lifetime expected credit losses.

STAGE 3 – credit impaired placements with a significant increase in credit risk upon initial recognition. For Stage 3 placements impairment and provisions for exposures are made in the amount equalling lifetime expected credit losses, which are computed as the positive difference between the gross carrying amount of each exposure and the present value of the estimated debtor's future cash flows discounted using the effective interest rate.

Expected losses are measured on any of the following grounds:

- 12-month expected credit losses - part of lifetime expected credit losses which represents expected credit losses resulting from default in relation to a financial instrument and which may arise within a period of 12 months after the reporting date.
- Lifetime expected credit losses - losses arising from any default events over the expected lifetime of the financial instrument

The recoverable amount of loans and receivables and held-to-maturity investments is calculated as the present value of expected future cash flows, discounted at the original effective interest rate of the instrument.

If future cash flows are expected within one year from the balance sheet date, cash flows do not have to be discounted.

The recoverable amount of the Bank's held-to-maturity investment securities and receivables is calculated as the present value of expected future cash inflows and outflows, discounted at the original effective interest rate, as explained in the policies of impairment of financial instruments.

The recognised impairment loss on securities or receivables held to maturity is charged if the subsequent increase in the recoverable amount can be objectively associated with an event that occurs after the recognition of the impairment loss. Income cannot exceed the original loss amount.

### **Derecognition of financial assets**

When assets at fair value through OCI and at fair value through profit or loss are sold, they are derecognised, i.e. they are eliminated from the respective balance sheet accounts at the date the transaction is settled with the counterparty.

Held-to-maturity assets and loans and receivables are derecognised on the date when contractual rights to cash flows from financial assets expire, when financial assets are transferred or when the Bank loses control over them. Financial assets are transferred if and only if contractual rights to receive cash flows from financial assets are transferred or if the contractual right to receive cash flows from financial assets is retained, but the contractual obligation is assumed to pay cash flows to one or more recipients.

### **3.8. Special financial instruments**

#### ***Investments in debt securities***

Debt securities include bills of exchange, notes and bonds with floating or fixed interest rates and other debt-backed debt instruments regardless of who the issuer is. Debt securities are quoted on behalf of the bearer and are issued in series (there are several securities of the same characteristics).

Debt securities may be classified at acquisition in any of the existing categories of financial assets, depending on the specifics of the debt security and in accordance with the above-mentioned classification criteria.

Debt securities classified as financial assets at fair value through profit or loss or at fair value through other comprehensive income are, as a minimum, reconciled with the estimated or fair value at the end of the month. For debt securities whose price is quoted in an active market, fair value is determined on the basis of the price valid on the revaluation date (as a minimum on a monthly basis, on the last day of the month).

Debt securities acquired with an intention to hold to maturity are carried at amortised cost less impairment losses. Amortised cost is calculated using the effective interest rate method. Discounts and premiums, including initial transaction costs, are included in the carrying amount of the instrument, they are amortised on the basis of the effective interest rate and are recognised as interest income or expense. In the business records, the principal, discount or premium are recorded separately, and the corresponding interest is recorded per each security.

The Bank will reclassify financial assets if it changes its business model in order to manage these financial assets. These changes are expected to be very rare. Such changes are determined by senior management based on external and internal changes. They must be significant for the Bank's operations and provable to external parties. The objective of an entity's business model must be changed before the reclassification date.

#### ***Investments in equity securities***

Equity securities comprise shares or interests in companies. Equity securities entitle the Bank to participate in the company's profits and assets after the rights of creditors and other financial providers are met.

Equity securities are classified as financial assets at fair value through profit or loss (assets held for trading and assets initially recognised at fair value through profit or loss) or as financial assets at fair value through other comprehensive income.

### **3.8. Special financial instruments**

#### ***Investments in equity securities (continued)***

Equity securities classified as financial assets at fair value through profit or loss (assets held for trading and assets initially recognised at fair value through profit or loss) and at fair value through other comprehensive income are adjusted to fair value, as a minimum at the end of the month. For equity securities quoted in an active market, the fair value is determined on the basis of the closing price on that market. If an equity security is not quoted in an active market, it can be recorded at fair value if the fair value can be measured reliably. It is considered that fair value can be measured reliably if:

- the change in value within a reasonable number of fair value estimates of the same instrument is not significant, or
- the probability of different estimates within a number of estimates can reasonably be estimated and used when estimating fair value.

If the number of reasonable estimates of the equity instrument's fair value is significant and the probability of different estimates cannot reasonably be estimated, such instrument is not measured at fair value but at cost.

#### ***Loans to credit institutions and customers***

Loans comprise current and non-current receivables based on:

- approved loans and advances
- acceptance credits
- payments made on guarantees and other warranties
- utilized lines of credit
- repo loans

If there is a permanent deterioration in the value of the loans, due to existing objective evidence that the receivable will not be fully settled, a value adjustment (provision) of the placement is performed where potential losses are identified on an individual basis. In addition to these provisions, a provision is made for losses or impairment on a collective basis for placements classified in risk category A.

Provisions or impairment of the placements referred to in the previous paragraph are charged to provision costs.

When a loan is known to be unrecoverable, all the necessary legal procedures have been completed and the final loss has been determined, the loan is written off. If impairment losses decrease in the following period due to collection, the collected amount is recognised in the income statement.

#### ***Contracts with the right to repurchase***

The Bank contracts purchases (sales) of investments by negotiating the resale (repurchase) of substantially the same investments at a certain date in the future at a fixed price. Investments purchased with a future resale obligation are not recognised in the balance sheet, but expenditures under these contracts are recognised as loans granted to banks or customers. It is also recorded that the purchased receivables are secured by appropriate security instruments from the repurchase agreement. Investments sold on the basis of a repurchase agreement continue to be recognised in the balance sheet in accordance with the accounting policy for assets at fair value through other comprehensive income or held-to-maturity assets, whichever is the most appropriate. Proceeds from the sale of investments are recorded as liabilities to credit institutions or customers.

The difference between the amount of sales and re-purchase is recognised on the basis of the calculation over the transaction period and is recorded as income in the income statement.

### **3.9. Income tax**

The tax expense comprises current tax and deferred tax. Current tax is the tax payable on the taxable income for the year, using tax rates at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates in effect at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the unutilised tax loss can be utilised. The recorded tax loss can be utilised within 5 years after the year of its occurrence. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### **3.10. 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:

	<b>2018</b>	<b>2017</b>
	<b>%</b>	<b>%</b>
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 recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for fixed assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

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



### **3.11. 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.

### **3.12. Non-current assets held for sale**

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

### **3.13. 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. Provisions are increased in each period to reflect the passage of time. This increase is recognised as interest expense.

### **3.14. 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.

### **3.15. Borrowings**

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

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

### **3.16. 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.

### **3.17. Share capital and treasury shares**

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

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

4. Net interest income

	2018 HRK`000	2017 HRK`000
<b>Interest income</b>		
Loans and advances:		
- to customers	72,990	73,252
- to banks	1	33
Securities	2,064	1,635
	<b>75,055</b>	<b>74,920</b>
<b>Interest expense</b>		
Deposits from customers	(12,401)	(12,917)
Hybrid instruments	(2,774)	(2,625)
Other borrowed funds	(732)	(413)
	<b>(15,907)</b>	<b>(15,955)</b>
<b>Net interest income</b>	<b>59,148</b>	<b>58,965</b>

5. Net fee and commission income

	2018 HRK`000	2017 HRK`000
<b>Fee and commission income</b>		
Payment transactions	3,492	3,490
Guarantees and letter of credits given	54	116
Other	4,923	3,983
	<b>8,469</b>	<b>7,589</b>
<b>Fee and commission expense</b>		
Payment transactions	(372)	(399)
Other	(1,853)	(2,003)
	<b>(2,225)</b>	<b>(2,402)</b>
<b>Net fee and commission income</b>	<b>6,244</b>	<b>5,187</b>

**6. Foreign exchange differences – net**

	<b>2018</b> <b>HRK`000</b>	<b>2017</b> <b>HRK`000</b>
Net foreign exchange gains on foreign exchange dealing	895	698
Foreign exchange gains/(losses) on translation of balance sheet items to middle exchange rate	306	(58)
	<b>1,201</b>	<b>640</b>

**7. Other operating income**

	<b>2018</b> <b>HRK`000</b>	<b>2017</b> <b>HRK`000</b>
Court costs refund	141	166
Other	2,796	1,428
	<b>2,937</b>	<b>1,594</b>

**8. Impairment charge for credit losses - net**

	<b>2018</b> <b>HRK`000</b>	<b>2017</b> <b>HRK`000</b>
Loans and advances to customers (Note 16)	16,327	13,074
Collected receivables written off in previous years	(490)	(369)
Other assets (Note 20)	1,161	1,076
Provision for contingent liabilities and commitments (Note 25)	(92)	(150)
	<b>16,906</b>	<b>13,631</b>

**9. Administration costs**

	<b>2018</b> <b>HRK`000</b>	<b>2017</b> <b>HRK`000</b>
<b>Staff costs</b>		
Net salaries	11,655	10,540
Pension insurance contributions	3,176	2,767
Health insurance contributions	3,010	2,643
Other contributions and taxes on salaries	2,642	2,057
Other staff costs	1,106	845
	<b>21,589</b>	<b>18,852</b>
Other administration costs	11,168	9,994
Impairment of repossessed collateral (Note 19)	326	301
Depreciation and amortisation (Note 18)	1,574	1,556
	<b>34,657</b>	<b>30,703</b>

As at 31 December 2018, the Bank had 97 employees (2017: 97 employees).

**10. Other operating expenses**

	2018 HRK`000	2017 HRK`000
Rental costs	1,914	1,662
Deposits insurance charge	3,288	3,038
Provisions for legal disputes (Note 25)	624	11,877
Accrued unused vacation	(23)	106
Other	97	66
	<b>5,900</b>	<b>16,749</b>

**11. Income tax**

	2018 HRK`000	2017 HRK`000
Current tax	-	-
Deferred tax	1,281	-
<b>Income tax</b>	<b>1,281</b>	<b>-</b>

	2018 HRK`000	2017 HRK`000
<b>Accounting profit before tax</b>	<b>12,057</b>	<b>5,307</b>
Effect of items increasing tax base	5,748	11,560
Effect of items decreasing tax base	(6,843)	(4,270)
<b>Tax base</b>	<b>10,962</b>	<b>12,597</b>
Income tax at 18%	2,170	2,268
Effect of recognition of deferred tax assets	-	(2,268)
Effect of release of unutilised deferred tax assets	1,281	-
<b>Income tax</b>	<b>3,451</b>	<b>-</b>
<b>Effective tax rate</b>	<b>28.62%</b>	<b>-</b>

Movements in tax losses carried forward were as follows:

	2018 HRK`000	2017 HRK`000
<b>Tax losses carried forward from the previous period</b>	<b>(54,467)</b>	<b>(117,702)</b>
Utilisation of tax losses	7,511	12,598
Expiration of tax losses carried forward	35,778	50,637
<b>Tax loss available for carry forward in future periods</b>	<b>(11,178)</b>	<b>(54,467)</b>
Deferred tax assets at 18% (2017: 18%)	2,012	9,804
Recognised deferred tax assets (Note 20)	2,012	5,463
Unrecognised deferred tax assets	-	4,341

## 11. Income tax (continued)

Movements in deferred tax assets were as follows:

	<b>2018</b> <b>HRK`000</b>	<b>2017</b> <b>HRK`000</b>
<b>At 1 January</b>	<b>5,463</b>	<b>5,463</b>
Release of unrecognised deferred tax assets	(3,451)	(2,268)
Recognition of deferred tax assets	-	2,268
<b>At 31 December</b>	<b>2,012</b>	<b>5,463</b>

The Bank may utilise the recorded tax loss in the amount of HRK 11,178 thousand, for which deferred tax assets were recognised in the amount of HRK 2,012 thousand, by 2020 at the latest.

## 12. Earnings per share

### Basic

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

	<b>2018</b>	<b>2017</b>
Profit for the year (in HRK'000)	8,606	5,307
Weighted average number of shares in issue excluding treasury	3,565,244	3,527,203
Basic earnings per share – ordinary (in HRK)	<b>2.41</b>	<b>1.50</b>

### Diluted

Diluted earnings per share for 2018 and 2017 are equal to basic earnings per share, since the Bank did not have any convertible instruments or share options outstanding during either period.

**13. Cash**

	<b>31 December 2018</b>	<b>31 December 2017</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Cash on hand	15,425	13,985
Cash on the clearing account	38,452	46,563
Foreign currency account	94,506	94,898
Expected credit losses	(426)	-
Provisions for unidentified losses on a collective basis	-	(1,415)
	<b>147,957</b>	<b>154,031</b>

**14. Obligatory reserve with the Croatian National Bank**

	<b>31 December 2018</b>	<b>31 December 2017</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Earmarked obligatory reserve:		
- in HRK	72,992	64,483
Expected credit losses	(182)	-
Provisions for unidentified losses on a collective basis	-	(645)
	<b>72,810</b>	<b>63,838</b>

The obligatory reserve rate as at 31 December 2018 was 12% of HRK and foreign currency deposits, loans taken and debt securities issued (31 December 2017: 12%).

**15. Placements with banks**

	<b>31 December 2018</b>	<b>31 December 2017</b>
	<b>HRK`000</b>	<b>HRK`000</b>
Loans	5,138	5,138
Deposits	1,015	1,028
	<b>6,153</b>	<b>6,166</b>
Expected credit losses	(5,148)	-
Provisions for identified losses	-	(5,138)
Provisions for unidentified losses on a collective basis	-	(10)
	<b>1,005</b>	<b>1,018</b>

Movement in the provision for identified losses:

	<b>31 December 2018</b>	<b>31 December 2017</b>
	<b>HRK`000</b>	<b>HRK`000</b>
<b>At 1 January</b>	<b>5,148</b>	<b>5,148</b>
<b>At 31 December</b>	<b>5,148</b>	<b>5,148</b>

16. Loans and advances to customers

				31 December 2018 HRK'000	31 December 2017 HRK'000
	Stage 1	Stage 2	Stage 3	Total	Total
<b>Retail customers</b>	<b>753,795</b>	<b>14,418</b>	<b>93,168</b>	<b>861,381</b>	<b>797,335</b>
Housing loans	22,495	505	1,405	24,405	28,013
Cash general-purpose loans	695,550	13,524	61,657	770,731	698,109
Other loans	35,750	389	30,106	66,245	71,213
<b>Corporate customers</b>	<b>83,519</b>	<b>1,583</b>	<b>196,049</b>	<b>281,151</b>	<b>249,375</b>
Working capital loans	16,285	641	111,789	128,715	137,163
Factoring	41,150	-	1,732	42,882	11,556
Other loans	26,084	942	82,528	109,554	100,656
<b>Gross loans and advances</b>	<b>837,314</b>	<b>16,001</b>	<b>289,217</b>	<b>1,142,532</b>	<b>1,046,710</b>
<b>Retail customers</b>	<b>(7,020)</b>	<b>(1,049)</b>	<b>(70,329)</b>	<b>(78,397)</b>	<b>(60,246)</b>
Housing loans	(205)	(32)	(283)	(520)	(501)
Cash general-purpose loans	(6,395)	(1,003)	(45,945)	(53,343)	(33,861)
Other loans	(420)	(14)	(24,101)	(24,534)	(25,884)
<b>Corporate customers</b>	<b>(1,326)</b>	<b>(200)</b>	<b>(168,927)</b>	<b>(170,455)</b>	<b>(176,466)</b>
Working capital loans	(328)	(57)	(97,272)	(97,657)	(103,612)
Factoring	(473)	-	(1,694)	(2,166)	(1,792)
Other loans	(525)	(143)	(69,961)	(70,632)	(71,062)
<b>Provisions for impairment</b>	<b>(8,346)</b>	<b>(1,249)</b>	<b>(239,256)</b>	<b>(248,852)</b>	<b>(236,712)</b>
<b>Net loans and advances</b>	<b>828,968</b>	<b>14,751</b>	<b>49,961</b>	<b>893,680</b>	<b>809,998</b>

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

2018	Individuals HRK'000	Corporate customers HRK'000	Total HRK'000
<b>At 1 January</b>	<b>60,246</b>	<b>176,466</b>	<b>236,712</b>
<b>IFRS 9 (Note 2.3.)</b>	<b>9,372</b>	<b>1,504</b>	<b>10,876</b>
Additional provisions (Note 8)	19,681	9,988	29,669
Stage 1	2,598	965	3,563
Stage 2	742	-	742
Stage 3	16,342	9,023	25,364
Collected amounts (Note 8)	(10,201)	(3,141)	(13,342)
Stage 1	(4,703)	(424)	(5,127)
Stage 2	(346)	(154)	(500)
Stage 3	(5,152)	(2,563)	(7,715)
Write-offs	(65)	(13,538)	(13,603)
Stage 3	(65)	(13,538)	(13,603)
Foreign exchange differences	(636)	(824)	(1,460)
<b>At 31 December</b>	<b>78,398</b>	<b>170,455</b>	<b>248,852</b>
<b>2017</b>	<b>Retail customers HRK'000</b>	<b>Corporate customers HRK'000</b>	<b>Total HRK'000</b>
<b>At 1 January</b>	<b>52,501</b>	<b>175,080</b>	<b>227,578</b>
Additional provisions (Note 8)	11,290	7,934	19,225
Collected amounts (Note 8)	(3,132)	(3,019)	(6,151)
Write-offs	(271)	(3,097)	(3,368)
Foreign exchange differences	(142)	(433)	(575)
<b>At 31 December</b>	<b>60,246</b>	<b>176,465</b>	<b>236,712</b>



17. Financial assets at fair value through other comprehensive income

	31 December 2018 HRK`000	31 December 2017 HRK`000
Bonds and treasury bills	61,811	42,785
Equity securities – listed	681	690
Equity securities – unlisted	141	141
Expected credit losses	(1)	-
	<b>62,632</b>	<b>43,616</b>

Movements in financial assets at fair value through other comprehensive income are as follows:

	31 December 2018 HRK`000	31 December 2017 HRK`000
<b>At 1 January</b>	<b>43,616</b>	<b>78,232</b>
IFRS 9 (Note 2.3.)	539	-
Additions	17,325	33,876
Disposals	-	(67,832)
Unrealised (losses) / gains	(89)	66
Result of assets at fair value through other comprehensive income	(10)	-
Result of assets available for sale - net	-	4
Interest payment	239	536
Foreign exchange differences	1,012	(1,266)
<b>At 31 December</b>	<b>62,632</b>	<b>43,616</b>

Bonds and treasury bills as at 31 December 2018:

Name	Maturity	Nominal amount (in thousands)	Currency	Carrying amount HRK`000	Unrealised gains/(losses) HRK`000
XS0757376610	21 March 2022	500	EUR	4,091	54
US857524AC63	22 January 2024	500	USD	3,375	(92)
IT0004536949	1 March 2020	2,500	EUR	19,658	93
XS0982708926	18 February 2019	200	USD	1,311	2
HRRHMFT906X3	7 February 2019	4,500	EUR	33,376	-
				<b>61,811</b>	<b>(57)</b>

As at 31 December 2018, there were no bonds pledged as collateral in repurchase agreements.

18. Property and equipment and intangible assets

	Land and buildings	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
<b>At 31 December 2016</b>	<b>17,421</b>	<b>6,695</b>	<b>12,791</b>	<b>36,907</b>	<b>8,461</b>	<b>-</b>	<b>14,907</b>	<b>23,368</b>
Additions	-	266	6	272	174	448	195	817
Transfers	-	-	-	-	-	(110)	-	(110)
Disposals	(187)	(538)	(195)	(920)	-	-	-	-
<b>At 31 December 2017</b>	<b>17,234</b>	<b>6,423</b>	<b>12,602</b>	<b>32,259</b>	<b>8,635</b>	<b>338</b>	<b>15,102</b>	<b>24,075</b>
Additions	-	176	290	466	111	201	775	1,087
Transfers	-	-	-	-	-	(519)	-	(519)
Disposals	(4,673)	(694)	(3,172)	(8,539)	-	-	(155)	(155)
<b>At 31 December 2018</b>	<b>12,561</b>	<b>5,905</b>	<b>9,720</b>	<b>28,186</b>	<b>8,746</b>	<b>20</b>	<b>15,722</b>	<b>24,488</b>
<b>Accumulated depreciation/amortisation</b>								
<b>At 31 December 2016</b>	<b>3,203</b>	<b>6,495</b>	<b>11,732</b>	<b>21,430</b>	<b>8,138</b>	<b>-</b>	<b>12,691</b>	<b>20,829</b>
Depreciation/amortisation charge for the period	302	98	257	657	314	-	585	899
Disposals	(8)	(534)	(195)	(737)	-	-	-	-
<b>At 31 December 2017</b>	<b>3,497</b>	<b>6,059</b>	<b>11,794</b>	<b>21,350</b>	<b>8,452</b>	<b>-</b>	<b>13,276</b>	<b>21,728</b>
Depreciation/amortisation charge for the period	284	136	245	665	260	-	649	909
Disposals	(992)	(694)	(3,107)	(4,793)	-	-	(155)	(155)
<b>At 31 December 2018</b>	<b>2,789</b>	<b>5,501</b>	<b>8,932</b>	<b>17,222</b>	<b>8,712</b>	<b>-</b>	<b>13,770</b>	<b>22,482</b>
<b>Net book amount</b>								
<b>As at 31 December 2017</b>	<b>13,737</b>	<b>364</b>	<b>808</b>	<b>14,909</b>	<b>183</b>	<b>338</b>	<b>1,826</b>	<b>2,347</b>
<b>As at 31 December 2018</b>	<b>9,772</b>	<b>404</b>	<b>788</b>	<b>10,964</b>	<b>34</b>	<b>20</b>	<b>1,952</b>	<b>2,006</b>

## 19. Repossessed collateral

Movements in repossessed collateral during the year:

	31 December 2018 HRK`000	31 December 2017 HRK`000
<b>At 1 January</b>	<b>32,933</b>	<b>37,301</b>
Additions	2,404	-
Disposals	(3,003)	(4,067)
Impairment (Note 9)	(326)	(301)
<b>At 31 December</b>	<b>32,008</b>	<b>32,933</b>

The Bank's repossessed collateral as at 31 December 2018 included property in the total amount of HRK 4,492 thousand (2017: HRK 3,357 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.

## 20. Other assets

	31 December 2018 HRK`000	31 December 2017 HRK`000
Deferred tax assets	2,012	5,463
Receivables for court costs refunds	7,354	6,803
Trade receivables	4,735	4,078
Other prepayments	237	189
Prepaid expenses	1,969	1,924
Court receivables for sold property	4,647	7,947
Other	1,035	4,794
	<b>21,989</b>	<b>31,198</b>
Expected credit losses	(9,633)	-
Provisions for identified losses	-	(8,646)
Provisions for unidentified losses on a collective basis	-	(152)
	<b>12,356</b>	<b>22,400</b>

**20. Other assets (continued)**

Movement in expected credit losses during the year:

	<b>31 December 2018</b>	<b>31 December 2017</b>
	<b>HRK`000</b>	<b>HRK`000</b>
<b>At 1 January</b>	<b>8,798</b>	<b>8,239</b>
IFRS 9 (Note 2.3.)	293	-
Additional provisions (Note 8)	3,042	2,201
Collected amounts (Note 8)	(1,881)	(1,125)
Write-off	(619)	(517)
<b>At 31 December</b>	<b>9,633</b>	<b>8,798</b>

**21. Deposits from customers**

Deposits comprise demand deposits and term deposits:

	<b>31 December 2018</b>	<b>31 December 2017</b>
	<b>HRK`000</b>	<b>HRK`000</b>
<b>Demand deposits</b>		
Corporate customers	18,544	7,527
Retail customers	168,908	149,671
	<b>187,452</b>	<b>157,198</b>
<b>Term deposits</b>		
Corporate customers	7,550	4,612
Retail customers	863,260	786,554
	<b>870,810</b>	<b>791,166</b>
<b>Deposits from customers</b>	<b>1,058,262</b>	<b>948,364</b>
Current portion	537,430	601,010
Non-current portion	520,832	347,354

**22. Due to banks**

	<b>31 December 2018 HRK`000</b>	<b>31 December 2017 HRK`000</b>
Borrowings:		
- Croatian Bank for Reconstruction and Development	5,443	8,235
Deposits	446	426
	<b>5,889</b>	<b>8,661</b>
Current portion	446	426
Non-current portion	5,443	8,235

As at 31 December 2018 and 31 December 2017, all deposits from banks are current.

**23. 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.

	<b>31 December 2018 HRK`000</b>	<b>31 December 2017 HRK`000</b>
Foreign entities	29,895	30,151
Domestic entities	9,615	9,730
	<b>39,510</b>	<b>39,881</b>

**24. Repurchase agreements**

As at 31 December 2018 and 31 December 2017, the Bank did not have any repurchase agreements.

25. Other liabilities

	31 December 2018 HRK`000	31 December 2017 HRK`000
Provisions for legal disputes	361	12,341
Provisions for contingent liabilities and commitments	202	148
Payables in the course of settlement	11,522	8,143
Trade payables	640	843
Employee payables – salaries and contributions	1,643	1,488
Liabilities for deposits insurance charge	739	737
Accrued unused vacation	282	305
Other liabilities	670	7,228
	<b>16,059</b>	<b>31,233</b>

Movement in provisions for legal disputes:

	31 December 2018 HRK`000	31 December 2017 HRK`000
<b>At 1 January</b>	<b>12,340</b>	<b>471</b>
Additional provisions (Note 10)	637	11,927
Release of provisions (Note 10)	(13)	(50)
Payments made per court verdicts	(12,603)	(8)
<b>At 31 December</b>	<b>361</b>	<b>12,340</b>

Movement in provisions for contingent liabilities and commitments:

	31 December 2018 HRK`000	31 December 2017 HRK`000
<b>At 1 January</b>	<b>148</b>	<b>298</b>
<b>IFRS 9 (Note 2.3.)</b>	<b>146</b>	
Additional provisions (Note 8)	1,387	850
Release of provisions (Note 8)	(1,479)	(1,000)
<b>At 31 December</b>	<b>202</b>	<b>148</b>

## **26. Shareholders' equity**

### **Share capital**

As at 31 December 2018, the Bank's share capital amounted to HRK 106,962 thousand (31 December 2017: HRK 106,962 thousand), and it is divided among 3,565,397 ordinary shares (31 December 2017: 3,565,397) (VSK-R-A) with a nominal value of HRK 30 per share.

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

<b>Shareholder</b>	<b>31 December 2018</b>		<b>31 December 2017</b>	
	<b>Number of shares</b>	<b>% in share capital</b>	<b>Number of shares</b>	<b>% in share capital</b>
Cassa di Risparmio della Repubblica di San Marino	3,554,514	99.69	3,554,514	99.69
Treasury shares	153	0.00	153	0.00
Other	10,730	0.31	10,730	0.31
<b>Total</b>	<b>3,565,397</b>	<b>100.00</b>	<b>3,565,397</b>	<b>100.00</b>

## **27. Contingent liabilities and commitments**

### **Legal disputes**

The Bank is currently subject to 8 legal proceedings. As at 31 December 2018, provisions for legal disputes for which the Bank anticipates outflow of economic benefits amount to HRK 362 thousand (2017: HRK 12,340 thousand).

### **Capital commitments**

As at 31 December 2018 and 31 December 2017, the Bank had no capital commitments in respect of purchases of buildings and equipment.

## 27. Contingent liabilities and commitments

### 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 2018	31 December 2017
	HRK`000	HRK`000
Guarantees	1,236	556
Loan and other commitments	13,761	14,247
Less: Provision for contingent liabilities and commitments (Note 25)	-	-
<b>Total</b>	<b>14,997</b>	<b>14,803</b>

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

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

Guarantees and undrawn loan commitments are subject to similar credit risk monitoring and credit policies as utilised in the approval of loans. The Management 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

Of the total amount of minimum payments, HRK 4,529 thousand refers to the lease of licenses. Leasing of licenses (which are the subject of the agreement with ABBA for the use of software) are not subject to this standard. Also, the ITSOFT agreement is a classic "cloud" model of "infrastructure as a service" (IaaS) fully virtualised on the common hardware infrastructure of the service provider (we do not use any dedicated equipment). Also, all licenses are based on subscription and apply only for the same period the Bank pays for infrastructure services.

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

	31 December 2018	31 December 2017
	HRK`000	HRK`000
Up to 1 year	3,784	1,807
From 2 to 5 years	6,641	5,289
Over 5 years	1,452	2,471
<b>Total</b>	<b>11,877</b>	<b>9,567</b>



## 28. 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 2018 and 2017, transactions with related parties were as follows:

	<b>Supervisory Board, Management Board and their related parties</b>	
	<b>2018</b>	<b>2017</b>
	<b>HRK'000</b>	<b>HRK'000</b>
<b>Income and expenses</b>		
Interest income	2	3
Interest expense	34	25
<b>Loans</b>		
At 1 January	120	120
Increase	-	-
Decrease	-	-
<b>At 31 December</b>	<b>120</b>	<b>120</b>
<b>Deposits received</b>		
At 1 January	2,751	3,085
Increase	2,951	2,077
Decrease	(2,513)	(2,411)
<b>At 31 December</b>	<b>3,189</b>	<b>2,751</b>

	<b>Cassa di Risparmio della Repubblica di San Marino</b>	
	<b>2018</b>	<b>2017</b>
	<b>HRK'000</b>	<b>HRK'000</b>
<b>Income and expenses</b>		
Interest income	-	1
Other operating income	10	-
Other operating expenses	(462)	(466)
Interest expense	(1,265)	(1,116)
<b>Given deposits and cash</b>		
At 1 January	1,224	4
Increase	3	1,220
Decrease	(16)	-
<b>At 31 December</b>	<b>1,211</b>	<b>1,224</b>
<b>Deposits received</b>		
At 1 January	549	1,428
Increase	-	-
Decrease	(8)	(879)
<b>At 31 December</b>	<b>541</b>	<b>549</b>
<b>Hybrid instruments</b>		
At 1 January	17,697	17,543
Increase	-	170
Decrease	(97)	(16)
<b>At 31 December</b>	<b>17,600</b>	<b>17,697</b>

At 31 December 2018 , the exposure towards the majority shareholder amounted to HRK 1,211 thousand, which represents 0.82% of the Bank's regulatory capital (2017: 0.88%, 2016: 0.00%, 2015: 15.36%). 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.

	<b>Nekretnine plus d.o.o.</b>	
	<b>2018</b>	<b>2017</b>
	<b>HRK'000</b>	<b>HRK'000</b>
<b>Income and expenses</b>		
Interest income	312	318
Other operating income	195	116
Other operating expenses	(526)	(526)
Interest expense	(678)	(670)
<b>Loans given</b>		
At 1 January	6,202	6,188
Increase	-	116
Decrease	(201)	(102)
<b>At 31 December</b>	<b>6,001</b>	<b>6,202</b>
<b>Deposits received</b>		
At 1 January	821	1,024
Increase	1,525	36
Decrease	-	(239)
<b>At 31 December</b>	<b>2,346</b>	<b>821</b>
<b>Hybrid instruments</b>		
At 1 January	9,730	9,787
Increase	-	-
Decrease	(115)	(57)
<b>At 31 December</b>	<b>9,615</b>	<b>9,730</b>

**Key management and Supervisory Board compensation**

	<b>31 December</b>	<b>31 December</b>
	<b>2018</b>	<b>2017</b>
	<b>HRK'000</b>	<b>HRK'000</b>
Gross salaries and other short-term benefits	5,001	3,893

## **29. Financial risk management**

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

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

Risk management is the responsibility of the Management Board and the Assets and Liabilities Committee (ALCO) and the Committee for credit risk management (RICO). Management identifies, evaluates and hedges financial risks in close co-operation with the Bank's operating units. 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.

### **29.1. 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.

### **29.1. Credit risk (continued)**

The Bank calculates provisions in accordance with the IFRS 9 Expected Credit Loss model (ECL model).

ECL is expected credit loss per financial instrument, being defined as lifetime expected credit loss of a financial instrument (Stage 2), but by limiting the T parameter for one year it can be easily redefined as 12-month expected credit loss (Stage 1). ECL for Stage 3 does not assume the use of such pattern and the parameters defined, therefore it is not subject to this part of the methodology.

EAD (Exposure At Default) represents the exposure as per financial instrument at the moment of default. From the presented pattern it is clear that EAD will not be constant over time, it will change with the passage of time, due to repayments (repayments per amortisation schedule as well as due to early repayments) and due to new withdrawals (e.g. lines of credit). Per IFRS 9 requirements, it is necessary to project the EAD over the life of a financial instrument, since keeping the EAD constant would result in a higher than realistic ECL, while for cases where the exposure is increasing, the usage of a constant EAD parameter would result in a lower than actual ECL.

MPD (Marginal Probability of Default) represents the marginal probability of default for a financial instrument in a given time period (t). The MPD estimate represents the most challenging area of provision calculation in accordance with IFRS 9. MPD over the life of a financial instrument should reflect all relevant factors that influence this probability, i.e. in addition to considering historical data based on the PD and DR (default rate) statistics, it is also necessary to include macroeconomic assumptions for the future period, all with a view to project ECL as realistically as possible. There are several possible approaches to MPD parameter modelling and this methodology provides two alternative approaches: the basic approach and the advanced approach. The basic approach is based on Markov chain matrices, it assumes generation of three base cases (the base, expansion, recession), after which macroeconomic assumptions are implemented by use of the z-shift model, while the time dimension is brought by multiplying the adequate matrices based on the projections for future periods. This model is simplified and it is recommended if historical data is not sufficiently representative for applying advanced approaches.

LDG (Loss Given Default) is a loss in case of a default status of a financial instrument. LGD also requires consideration of projections for future periods, if it is determined that projections of relevant factors influencing LGD indicate significant changes in this parameter, which would further reflect also on the level of calculated lifetime ECL. If it is determined that no significant changes are expected which would influence this parameter or if it is not possible to link the movement of relevant factors with the LGD, the appropriate solution may be maintaining this factor on the same level for future periods. In accordance with IFRS 9, a collateral can no longer be used as an item decreasing the base for provision calculation, which implies that LGD should include all possible settlement alternatives for a certain receivable, i.e. it is necessary to approximate the comprehensive LGD which incorporates both collection (LGD unsecured) and realisation of collaterals (LGD secured). Furthermore, it is necessary to consider possible recoveries from NPL to PL status.

DF (Discount Factor) is the factor used for discounting throughout a certain period, based on the effective interest rate.

Other than the discount factor which is calculated in a familiar manner and which is based on the effective interest rate whose definition has not been changed, all other factors require certain modelling and should be considered individually.

Adequate modelling of parameters is necessary for a good calculation of the value adjustment and the approximation of each of the above parameters respecting the requirements imposed by IFRS 9 is set out below.

### **29.1. Credit risk (continued)**

Alternatively, the Bank can apply the Single Parameter Approach (SP).

#### **EAD model**

EAD represents the estimated gross carrying amount at the moment of default, considering cash flows of the financial instrument, as well as future withdrawals from the credit line until the date of default, i.e. over the life of the financial instrument. Although IFRS 9 does not explicitly require banks to model EAD, the expectation that the exposure to credit risk will evolve over time is key for an unbiased assessment of expected credit loss. The major challenge with EAD is to assess this parameter for financial instruments for which lifetime expected credit loss is calculated (Stage 2). By ignoring the expected decrease in the exposure, the expected credit loss can be overstated (e.g. for loans repaid successively), i.e. ignoring the expected increase in the exposure can lead to an understated expected credit loss (e.g. for credit line withdrawals).

In order to determine the lifetime expected credit loss, it is necessary to determine EAD for each year over the life of the financial instrument (and not only for one upcoming year as prescribed by Basel II).

In order to determine EAD, financial instruments can be divided in accordance with the following criteria:

are there contractual cash flows?

does a financial instrument have a defined maturity?

In order to calculate lifetime EAD, financial instruments can be divided into 4 categories:

Financial instruments with contractually defined cash flows and with defined maturity: cash loans, housing loans, consumer loans, investment loans, working capital loans, general-purpose loans as well as other loan types which the Bank has in its offering. For these financial instruments lifetime EAD is estimated based on existing contractual repayment schedules.

Financial instruments which do not have contractually defined cash flows and with defined maturity: frame credit lines with defined maturity. For these financial instruments, the Bank will use CCF factors as prescribed by relevant regulations.

Financial instruments which do not have contractually defined cash flows and without defined maturity: current accounts, credit cards, unused limits, credit lines without defined maturity. For these financial instruments, the Bank will use CCF factors as prescribed by relevant regulations.

Financial instruments with contractually defined cash flows and without defined maturity: preference shares. These financial instruments are not specific to market conditions and this methodology does not provide a solution for EAD assessment of such assets.

## **29.1. Credit risk (continued)**

### **PD model**

PD or Probability of Default is a probability that the client will enter the default status. The term lifetime PD represents an equal probability for the entire remaining life of a financial instrument. Marginal PD or MPD (t) represents a probability (unconditional) of entering into default within the time period t, while cumulative PD or CPD (t) represents the sum of all marginal PDs starting from initial recognition up to a given time moment t.

Considering the size and structure of the portfolio, as well as the availability of data, for PD calculation the Bank has selected an approach based on Markov chain transition matrices, using the homogeneous matrices in discrete time. The approach of this technique is to multiply migration matrices from one time period to another, while assuming that the migration schedule in the upcoming period depends solely on the current period schedule. While constructing the homogeneous matrices, transitions between days past due time buckets are observed.

Homogeneous matrices assume an identical migration structure from one time period to another, e.g. transitions between buckets are not dependant on the time period in which they are observed. Therefore, it is assumed that there is approximately the same migration schedule in a year t compared to a period t+1 or t-2. Discrete matrices follow the migration at period-end, comparing it to the end of the previous period (migrations during the year are not considered). For example, migrations on 31 December 2016 compared to 31 December 2015 are observed, or migrations on 31 July 2016 compared to 31 July 2015.

In order to introduce forward-looking information, the Bank converts PD calculated based on previously described matrices from TTC PD (Through-the-Cycle PD) to PIT PD (Point-in-Time PD). This is achieved by introducing macroeconomic variables.

Considering that comparing the Bank's data with the development of macroeconomic variables did not lead to a conclusion that there is a correlation between portfolio quality development and macroeconomic variables, the Bank makes its best estimate of expectations for portfolio quality development (in terms of PD development) as described in the upcoming paragraphs.

The Bank's management estimates the development of 3 macroeconomic parameters: % of change in GDP, % of change in unemployment rate and % of change in inflation rate. The values (scores) have been defined for each macroeconomic parameter, as well as the scale for transformation of scores to values for applying the z-shift. Management presents 3 scenarios of the development of parameters (basic, optimistic and pessimistic) as well as probability weights assigned to each defined scenario, therefore enabling the application of the probability weighted approach. This estimate is performed once annually.

Before preparing the matrices, the portfolio is segmented based on characteristics, considering that there should be sufficient data for constructing steady matrices. Based on current data, considering the portfolio size, structure and number of exposures with default status, it is estimated that the only possible segmentation is a split between legal entities (including companies and sole proprietors) and natural persons. In the upcoming revisions of this methodology, the Bank will assess whether the conditions will be met for an additional or more detailed portfolio segmentation.

The basic matrix is based on historical data and it is compiled using at least 3 annual matrices. It represents the weighted average of historical annual matrices in which the Bank defines weights considering the portfolio development per years, changes in the risk management system as well as other factors which may cause deviations in terms of portfolio development.

By applying the z-shift, the effects of macroeconomic variables development are added to the basic matrix in accordance with the scores set. From the basic matrix, a matrix of cumulative probabilities is created. The last column and row are cancelled (they do not affect the result) and for the values from the remaining matrix inverse values are found to which the macro variable score is added. The newly generated matrix is returned to the matrix of cumulative values, from which the final one-year matrix of marginal probabilities is derived – from which further, by multiplying with itself, PD parameter values are generated for the upcoming years until the final maturity of each financial instrument.

## **29.1. Credit risk (continued)**

### **LGD model**

Considering the complexity of IFRS 9 requirements for the LGD model development, as well as the Bank's size, a relatively simple portfolio structure and small data sample size, for the purposes of the provision calculation the Bank will use LGD parameter values as defined by the Basel framework. According to assessment of regulatory LGD parameter values, the Bank will add a conservative factor of 5bps.

LGD parameter values in use by the Bank:

retail secured – 40%  
retail unsecured – 80%  
corporate – 50%

### **Unique parameter approach**

The Bank may apply the unique parameter SP which is estimated based on historical data on costs of risk for a certain portfolio. The SP parameter is assessed as the average cost of risk for a certain portfolio during at least 3 previous years. Such calculated parameter is applied for calculation using the following formula:

for Stage 1:  $ECL = EAD \times SP$   
for Stage 2:  $ECL = EAD \times SP \times M$   
where M is the number of years to maturity.

### **Calculation of impairment allowance**

After calculating the parameters, a provision for the impairment allowance is calculated. By using the data from the existing portfolio, after segmentation in accordance with calculated parameters (segments based on which PD and LGD parameters have been estimated), at first the criteria for classification into Stages are applied. After that, provisions for Stage 1 and Stage 2 exposures are calculated, while for Stage 3 exposures the impairment allowance is determined as the positive difference between the gross book value and present value of estimated future cash flows, discounted using the effective interest rate.

The Bank calculates a provision for the impairment allowance on each reporting date (quarterly), while the PD and LGD parameters are estimated at least once a year and they are effective for a period of one year.

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

The Bank assesses the counterparty's credit worthiness using the external rating tools. The tools combine statistical analysis with financial advisor 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.



## **29.1. Credit risk (continued)**

### **Calculation of impairment allowance (continued)**

#### **(b) Debt securities and other bills**

For debt securities and other bills, external rating such as Standard & Poor's, Moody's, Fitch, BCA 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.

#### **29.1.2. 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 (stage1, stage 2, stage 3) 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.

### 29.1.3. 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

	2018		2017	
	Loans and advances	Provisions for impairment	Loans and advances	Provisions for impairment
	HRK'000	HRK'000	HRK'000	HRK'000
1. Fully recoverable placements	853,315	9,595	768,816	7,688
2. Partially recoverable placements	133,513	83,553	126,607	77,737
3. Unrecoverable placements	155,703	155,703	151,287	151,287
	<b>1,142,531</b>	<b>248,851</b>	<b>1.046.710</b>	<b>236,712</b>

#### Bank's rating

	2018		2017	
	Loans and advances (%)	Provision for impairment (%)	Loans and advances (%)	Provision for impairment (%)
	HRK'000	HRK'000	HRK'000	HRK'000
1. Fully recoverable placements	76.68	3.85	73.45	3.25
2. Partially recoverable placements	11.69	33.58	12.10	32.84
3. Unrecoverable placements	13.63	62.57	14.45	63.91
	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>	<b>100.00</b>

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

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

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

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

					31 December 2018 HRK`000	31 December 2017 HRK`000
	No impact	Stage 1	Stage 2	Stage 3		
<b>Credit risk exposure relating to balance sheet assets</b>						
Cash on hand and balances with banks	15,925	132,032	-	-	147,957	154,031
Obligatory reserve with the Croatian National Bank	-	72,810	-	-	72,810	63,838
Placements with banks	-	1,005	-	-	1,005	1,018
Loans and advances to customers	-	828,968	14,751	49,961	893,680	809,998
Financial assets at fair value through other comprehensive income	822	61,810	-	-	62,632	-
Available-for-sale financial assets						43,616
Other assets	4,031	7,428	897	-	12,356	22,400
	<b>20,778</b>	<b>1,104,053</b>	<b>15,648</b>	<b>49,961</b>	<b>1,190,440</b>	<b>1,094,901</b>
<b>Credit risk exposure relating to off-balance sheet assets</b>						
Financial guarantees	-	1,236	-	-	1,236	556
Letters of credit	-	-	-	-	-	-
Loan commitments and other credit related liabilities	-	13,756	5	-	13,761	14,247
	-	<b>14,992</b>	<b>5</b>	-	<b>14,997</b>	<b>14,803</b>

The above table represents the Bank's maximum exposure to credit risk as at 31 December 2018 and 2017, 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, 75.07% of the total maximum exposure is derived from loans and advances to banks and customers (2017: 74.07%).

### 29.1.5. Loans and advances

Loans and advances are summarised as follows:

	31 December 2018		31 December 2017	
	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks
	HRK'000	HRK'000	HRK'000	HRK'000
Neither past due nor impaired	845,558	1,015	751,524	1,028
Past due but not impaired	7,756	-	17,293	-
Individually impaired	289,217	5,138	277,893	5,138
<b>Gross</b>	<b>1,142,531</b>	<b>6,153</b>	<b>1,046,710</b>	<b>6,166</b>
Less: provision for impairment	(248,851)	(5,148)	(236,712)	(5,148)
<b>Net</b>	<b>893,680</b>	<b>1,005</b>	<b>809,998</b>	<b>1,018</b>

The total impairment provision for loans and advances is HRK 248,851 thousand (2017: HRK 236,712 thousand) of which HRK 239,256 thousand (2017: HRK 229,024 thousand) represents individually impaired loans and the remaining amount of HRK 9,595 thousand (2017: HRK 7,688 thousand) represents the provision for the portfolio of fully recoverable placements. Further information of the impairment provision for loans and advances to banks and to customers is provided in Notes 15 and 16

The breakdown of the gross amount of loans and advances by class held by the Bank are 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
<b>31 December 2018</b>				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	764,003	81,555	<b>845,558</b>	1,015
<i>Past due but not impaired</i>				
Past due up to 30 days	1,954	3,342	<b>5,296</b>	-
Past due from 30 to 90 days	2,255	205	<b>2,460</b>	-
<i>Individually impaired</i>				
Individually impaired loans	93,169	196,049	<b>289,218</b>	5,138
<b>Total</b>	<b>861,381</b>	<b>281,151</b>	<b>1,142,532</b>	<b>6,153</b>
<b>31 December 2017</b>				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	717,212	34,312	<b>751,524</b>	1,028
<i>Past due but not impaired</i>				
Past due up to 30 days	1,845	122	<b>1,967</b>	-
Past due from 30 to 90 days	9,146	6,180	<b>15,326</b>	-
<i>Individually impaired</i>				
Individually impaired loans	69,132	208,761	<b>277,893</b>	5,138
<b>Total</b>	<b>797,335</b>	<b>249,375</b>	<b>1,046,710</b>	<b>6,166</b>

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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.

				<b>31 December 2018</b>
				<b>HRK`000</b>
	Gross exposure	Value adjustment	Carrying amount	Exposure amount secured by collateral
<b>Retail customers</b>	<b>861,381</b>	<b>78,397</b>	<b>782,984</b>	<b>61,502</b>
Housing loans	24,405	520	23,885	23,361
Cash general-purpose loans	770,731	53,343	717,388	19,609
Other loans	66,245	24,534	41,711	18,532
<b>Corporate customers</b>	<b>281,151</b>	<b>170,455</b>	<b>110,696</b>	<b>98,427</b>
Working capital loans	128,715	97,657	31,058	46,214
Factoring	42,882	2,166	40,716	4,707
Other loans	109,554	70,632	38,922	47,506
<b>Total impairment of credit assets</b>	<b>1,142,532</b>	<b>248,852</b>	<b>893,680</b>	<b>159,929</b>

				<b>31 December 2017</b>
				<b>HRK`000</b>
	Gross exposure	Accumulated depreciation/ amortisation	Carrying amount	Exposure amount secured by collateral
<b>Retail customers</b>	<b>797,335</b>	<b>60,246</b>	<b>737,089</b>	<b>68,494</b>
Housing loans	28,013	501	27,512	27,214
Cash general-purpose loans	698,109	33,861	664,248	18,071
Other loans	71,213	25,884	45,329	23,209
<b>Corporate customers</b>	<b>249,375</b>	<b>176,466</b>	<b>72,909</b>	<b>110,310</b>
Working capital loans	137,163	103,612	33,551	61,911
Factoring	11,556	1,792	9,764	935
Other loans	100,656	71,062	29,594	47,464
<b>Total impairment of credit assets</b>	<b>1,046,710</b>	<b>236,712</b>	<b>809,998</b>	<b>178,804</b>

				31 December 2018 HRK`000
<b>Housing loans</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Expected credit losses as at 1 January 2018</b>	<b>158</b>	<b>78</b>	<b>260</b>	<b>496</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	(21)	-	21	-
Stage 2 to Stage 1	-	-	-	-
Stage 3 to Stage 1	8	-	(8)	-
PD/LGD/EAD changes (Note 8)	60	(46)	-	14
Changes in assumptions and methodology (Note 8)	-	-	13	13
Foreign exchange differences and other movements	-	-	(3)	(3)
<b>Total net impact on profit for the year</b>	<b>47</b>	<b>(46)</b>	<b>23</b>	<b>24</b>
<b>Other movements without impact on profit for the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Movements:				
Stage 2 to Stage 3	-	-	-	-
Stage 3 to Stage 2	-	-	-	-
Write-offs	-	-	-	-
<b>Total expected credit losses as at 31 December 2018</b>	<b>205</b>	<b>32</b>	<b>283</b>	<b>520</b>

				31 December 2018 HRK`000
<b>Housing loans</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Gross carrying amount as at 1 January 2018</b>	<b>25,748</b>	<b>576</b>	<b>1,633</b>	<b>28,013</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	(665)	-	665	-
Stage 2 to Stage 3	-	-	-	-
Stage 3 to Stage 1	893	-	(893)	-
Stage 2 to Stage 1	-	-	-	-
No change	(3,481)	(71)	(56)	(3,608)
Write-offs	-	-	-	-
<b>Total gross carrying amount as at 31 December 2018</b>	<b>22,495</b>	<b>505</b>	<b>1,349</b>	<b>24,405</b>

				31 December 2018 HRK`000
<b>Cash general-purpose loans</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Expected credit losses as at 1 January 2018</b>	<b>7,571</b>	<b>1,893</b>	<b>33,558</b>	<b>43,022</b>
Movements:				
Stage 1 to Stage 2	(749)	749	-	-
Stage 1 to Stage 3	(3,201)	-	3,201	-
Stage 2 to Stage 1	56	(56)	-	-
Stage 3 to Stage 1	19	-	(19)	-
PD/LGD/EAD changes (Note 8)	2,699	9	-	2,708
Changes in assumptions and methodology (Note 8)	-	-	7,990	7,990
Foreign exchange differences and other movements	-	-	(377)	(377)
<b>Total net impact on profit for the year</b>	<b>(1,176)</b>	<b>702</b>	<b>10,795</b>	<b>10,321</b>
<b>Other movements without impact on profit for the year</b>			-	
Movements:				
Stage 2 to Stage 3	-	(1,683)	1,683	-
Stage 3 to Stage 2	-	92	(92)	-
Write-offs	-	-	-	-
<b>Total expected credit losses as at 31 December 2018</b>	<b>6,395</b>	<b>2,595</b>	<b>44,353</b>	<b>53,343</b>

				31 December 2018 HRK`000
<b>Cash general-purpose loans</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Gross carrying amount as at 1 January 2018</b>	<b>630,011</b>	<b>14,113</b>	<b>53,985</b>	<b>698,109</b>
Movements:				
Stage 1 to Stage 2	(9,894)	9,894	-	-
Stage 1 to Stage 3	(11,489)	-	11,489	-
Stage 2 to Stage 3	-	(3,638)	3,638	-
Stage 3 to Stage 1	2,061	-	(2,061)	-
Stage 2 to Stage 1	6,199	(6,199)	-	-
Stage 3 to Stage 2	-	1,266	(1,266)	-
No change	78,660	(1,912)	(4,126)	72,622
Write-offs	-	-	-	-
<b>Total gross carrying amount as at 31 December 2018</b>	<b>695,548</b>	<b>13,524</b>	<b>61,659</b>	<b>770,731</b>

				31 December 2018 HRK`000
Other loans to retail customers	Stage 1	Stage 2	Stage 3	Total
<b>Expected credit losses as at 1 January 2018</b>	<b>461</b>	<b>36</b>	<b>25,632</b>	<b>26,129</b>
Movements:				
Stage 1 to Stage 2	(8)	8	-	-
Stage 1 to Stage 3	(66)	-	66	-
Stage 2 to Stage 1	6	(6)	-	-
Stage 3 to Stage 1	4	-	(4)	-
PD/LGD/EAD changes (Note 8)	23	(19)	-	4
Changes in assumptions and methodology (Note 8)	-	-	(1,279)	(1,279)
Foreign exchange differences and other movements	-	-	(255)	(255)
<b>Total net impact on profit for the year</b>	<b>(41)</b>	<b>(17)</b>	<b>(1,472)</b>	<b>(1,530)</b>
<b>Other movements without impact on profit for the year</b>				
Movements:				
Stage 2 to Stage 3	-	(11)	11	-
Stage 3 to Stage 2	-	5	(5)	-
Write-offs	-	-	(65)	(65)
<b>Total expected credit losses as at 31 December 2018</b>	<b>420</b>	<b>13</b>	<b>24,101</b>	<b>24,534</b>

				31 December 2018 HRK`000
Other loans to retail customers	Stage 1	Stage 2	Stage 3	Total
<b>Gross carrying amount as at 1 January 2018</b>	<b>36,136</b>	<b>562</b>	<b>34,515</b>	<b>71,213</b>
Movements:				
Stage 1 to Stage 2	(132)	132	-	-
Stage 1 to Stage 3	(331)	-	331	-
Stage 2 to Stage 3	-	(11)	11	-
Stage 3 to Stage 1	169	-	(169)	-
Stage 2 to Stage 1	273	(273)	-	-
Stage 3 to Stage 2	-	230	(230)	-
No change	(362)	(251)	(4,290)	(4,903)
Write-offs	-	-	(65)	(65)
<b>Total gross carrying amount as at 31 December 2018</b>	<b>35,753</b>	<b>389</b>	<b>30,103</b>	<b>66,245</b>



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Notes to the financial statements

				31 December 2018 HRK`000
<b>Working capital loans</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Expected credit losses as at 1 January 2018</b>	<b>250</b>	<b>222</b>	<b>103,675</b>	<b>104,147</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	-	-	-	-
Stage 2 to Stage 1	6	(6)	-	-
Stage 3 to Stage 1	-	-	-	-
PD/LGD/EAD changes (Note 8)	72	(158)	-	(86)
Changes in assumptions and methodology (Note 8)	-	-	7,620	7,620
Foreign exchange differences and other movements	-	-	(486)	(486)
Total net impact on profit for the year	<b>78</b>	<b>(164)</b>	<b>7,134</b>	<b>7,048</b>
<b>Other movements without impact on profit for the year</b>				
Movements:				
Stage 2 to Stage 3	-	(1)	1	-
Stage 3 to Stage 2	-	-	-	-
Write-offs	-	-	(13,538)	(13,538)
<b>Total expected credit losses as at 31 December 2018</b>	<b>328</b>	<b>57</b>	<b>97,272</b>	<b>97,657</b>

				31 December 2018 HRK`000
<b>Working capital loans</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Gross carrying amount as at 1 January 2018</b>	<b>10,916</b>	<b>1,668</b>	<b>124,579</b>	<b>137,163</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	-	-	-	-
Stage 2 to Stage 3	-	(21)	21	-
Stage 3 to Stage 1	-	-	-	-
Stage 2 to Stage 1	246	(246)	-	-
Stage 3 to Stage 2	-	-	-	-
No change	5,123	(760)	732	5,095
Write-offs	-	-	(13,543)	(13,543)
<b>Total gross carrying amount as at 31 December 2018</b>	<b>16,285</b>	<b>641</b>	<b>111,789</b>	<b>128,715</b>

				31 December 2018 HRK`000
<b>Factoring</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Expected credit losses as at 1 January 2018</b>	<b>224</b>	<b>-</b>	<b>1,694</b>	<b>1,918</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	-	-	-	-
Stage 2 to Stage 1	-	-	-	-
Stage 3 to Stage 1	-	-	-	-
PD/LGD/EAD changes (Note 8)	247	-	-	247
Changes in assumptions and methodology (Note 8)	-	-	-	-
Foreign exchange differences and other movements	-	-	-	-
Total net impact on profit for the year	<b>247</b>	<b>-</b>	<b>-</b>	<b>247</b>
<b>Other movements without impact on profit for the year</b>				
Movements:				
Stage 2 to Stage 3	-	-	-	-
Stage 3 to Stage 2	-	-	-	-
Write-offs	-	-	-	-
<b>Total expected credit losses as at 31 December 2018</b>	<b>471</b>	<b>-</b>	<b>1,694</b>	<b>2,165</b>

				31 December 2018 HRK`000
<b>Factoring</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>	<b>Total</b>
<b>Gross carrying amount as at 1 January 2018</b>	<b>9,824</b>	<b>-</b>	<b>1,732</b>	<b>11,556</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	-	-	-	-
Stage 2 to Stage 3	-	-	-	-
Stage 3 to Stage 1	-	-	-	-
Stage 2 to Stage 1	-	-	-	-
Stage 3 to Stage 2	-	-	-	-
No change	31,326	-	-	31,326
Write-offs	-	-	-	-
<b>Total gross carrying amount as at 31 December 2018</b>	<b>41,150</b>	<b>-</b>	<b>1,732</b>	<b>42,882</b>

				31 December 2018 HRK`000
Other loans to corporate customers	Stage 1	Stage 2	Stage 3	Total
<b>Expected credit losses as at 1 January 2018</b>	<b>250</b>	<b>181</b>	<b>71,474</b>	<b>71,905</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	-	-	-	-
Stage 2 to Stage 1	-	-	-	-
Stage 3 to Stage 1	-	-	-	-
PD/LGD/EAD changes (Note 8)	276	(38)	-	237
Changes in assumptions and methodology (Note 8)	-	-	(1,141)	(1,141)
Foreign exchange differences and other movements	-	-	(372)	(372)
<b>Total net impact on profit for the year</b>	<b>276</b>	<b>(38)</b>	<b>(1,513)</b>	<b>(1,276)</b>
<b>Other movements without impact on profit for the year</b>				
Movements:				
Stage 2 to Stage 3	-	-	-	-
Stage 3 to Stage 2	-	-	-	-
Write-offs	-	-	-	-
<b>Total expected credit losses as at 31 December 2018</b>	<b>526</b>	<b>143</b>	<b>69,961</b>	<b>70,629</b>

				31 December 2018 HRK`000
Other loans to corporate customers	Stage 1	Stage 2	Stage 3	Total
<b>Gross carrying amount as at 1 January 2018</b>	<b>10,917</b>	<b>1,103</b>	<b>88,636</b>	<b>100,656</b>
Movements:				
Stage 1 to Stage 2	-	-	-	-
Stage 1 to Stage 3	-	-	-	-
Stage 2 to Stage 3	-	-	-	-
Stage 3 to Stage 1	-	-	-	-
Stage 2 to Stage 1	-	-	-	-
Stage 3 to Stage 2	-	-	-	-
No change	15,169	(162)	(6,109)	8,898
Write-offs	-	-	-	-
<b>Total gross carrying amount as at 31 December 2018</b>	<b>26,086</b>	<b>941</b>	<b>82,527</b>	<b>109,554</b>

### 29.1.6. Repossessed collateral

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

### 29.1.7. 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 2018. For this table, the Bank has allocated exposures to regions based on the country of domicile of its counterparties.

	<b>Croatia</b> <b>HRK'000</b>	<b>European Union</b> <b>HRK'000</b>	<b>Other countries</b> <b>HRK'000</b>	<b>Total</b> <b>HRK'000</b>
Cash on hand and balances with banks	132,854	13,903	1,200	147,957
Obligatory reserve with the Croatian National Bank	72,810	-	-	72,810
Placements with banks	1,005	-	-	1,005
Loans and advances to customers	891,275	2,405	-	893,680
Financial assets at fair value through other comprehensive income	34,198	28,434	-	62,632
Other assets	11,929	416	11	12,356
<b>At 31 December 2018</b>	<b>1,144,071</b>	<b>45,158</b>	<b>1,211</b>	<b>1,190,440</b>
<b>At 31 December 2017</b>	<b>1,074,215</b>	<b>19,467</b>	<b>1,220</b>	<b>1,094,902</b>

#### (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.

	<b>Financial institutions</b> <b>HRK'000</b>	<b>Manu- facturing</b> <b>HRK'000</b>	<b>Properties</b> <b>HRK'000</b>	<b>Wholesale and retail trade</b> <b>HRK'000</b>	<b>Public sector</b> <b>HRK'000</b>	<b>Other industries</b> <b>HRK'000</b>	<b>Individuals</b> <b>HRK'000</b>	<b>Total</b> <b>HRK'000</b>
Placements with banks	1,005	-	-	-	-	-	-	1,005
Loans and advances to customers	703	29,319	19,514	35,571	6,159	19,431	782,983	893,680
Assets at fair value through OCI	28,751	5	206	141	33,376	153	-	62,632
Other assets	4,760	1,266	29	21	4,161	564	1,555	12,356
<b>At 31 December 2018</b>	<b>35,219</b>	<b>30,590</b>	<b>19,749</b>	<b>35,733</b>	<b>43,696</b>	<b>20,148</b>	<b>784,538</b>	<b>969,673</b>
<b>At 31 December 2017</b>	<b>22,073</b>	<b>13,091</b>	<b>17,369</b>	<b>20,444</b>	<b>40,937</b>	<b>17,853</b>	<b>745,265</b>	<b>877,033</b>

### **30. 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.

### 30.1. Currency risk

The Bank is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank manages its currency risk by setting principles and limits for foreign currency exposures and by monitoring exposure with respect to limits. The Bank directs its business activities trying to minimise the gap between assets and liabilities denominated in or linked to 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
<b>At 31 December 2018</b>					
<b>Assets</b>					
Cash on hand and balances with banks	48,921	89,900	1,704	7,432	147,957
Obligatory reserve with the CNB	72,810	-	-	-	72,810
Placements with banks	-	1,005	-	-	1,005
Loans and advances to customers	185,579	708,013	88	-	893,680
Financial assets at fair value through other comprehensive income	822	57,125	4,685	-	62,632
Other assets	12,356	-	-	-	12,356
<b>Total financial assets</b>	<b>320,488</b>	<b>856,043</b>	<b>6,477</b>	<b>7,432</b>	<b>1,190,440</b>
<b>Liabilities</b>					
Deposits from customers	221,007	823,627	6,323	7,305	1,058,262
Due to banks	84	5,805	-	-	5,889
Hybrid instruments	-	39,510	-	-	39,510
Other liabilities	15,805	254	-	-	16,059
<b>Total financial liabilities</b>	<b>236,896</b>	<b>869,196</b>	<b>6,323</b>	<b>7,305</b>	<b>1,119,720</b>
<b>Net on-balance sheet financial position</b>	<b>83,592</b>	<b>(13,153)</b>	<b>154</b>	<b>127</b>	<b>70,720</b>
Loan commitments	9,789	3,972	-	-	13,761

30.1. Currency risk (continued)

	HRK	EUR	USD	Other currencies	Total
	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000
<b>At 31 December 2017</b>					
<b>Assets</b>					
Cash on hand and balances with banks	55,829	91,587	1,454	5,161	154,031
Obligatory reserve with the CNB	63,838	-	-	-	63,838
Placements with banks	-	1,018	-	-	1,018
Loans and advances to customers	150,720	659,278	-	-	809,998
Available-for-sale financial assets	831	37,980	4,805	-	43,616
Other assets	18,405	3,730	31	234	22,400
<b>Total financial assets</b>	<b>289,623</b>	<b>793,593</b>	<b>6,290</b>	<b>5,395</b>	<b>1,094,901</b>
<b>Liabilities</b>					
Deposits from customers	179,417	757,475	6,134	5,338	948,364
Due to banks	755	7,906	-	-	8,661
Hybrid instruments	-	39,881	-	-	39,881
Other liabilities	30,753	480	-	-	31,233
<b>Total financial liabilities</b>	<b>210,925</b>	<b>805,742</b>	<b>6,134</b>	<b>5,338</b>	<b>1,028,139</b>
<b>Net on-balance sheet financial position</b>	<b>78,698</b>	<b>(12,149)</b>	<b>156</b>	<b>57</b>	<b>66,762</b>
Loan commitments	6,594	7,653	-	-	14,247

### 30.2. Interest rate risk

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

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
<b>At 31 December 2018</b>							
<b>Assets</b>							
Cash on hand and balances with banks	-	-	-	-	-	147,957	147,957
Obligatory reserve with the CNB	-	-	-	-	-	72,810	72,810
Placements with banks	-	-	-	-	-	1,005	1,005
Loans and advances to customers	77,180	23,995	72,202	151,079	559,263	9,961	893,680
Financial assets at fair value through other comprehensive income	404	34,667	-	19,396	7,344	821	62,632
Other assets	-	-	-	-	-	12,356	12,356
<b>Total financial assets</b>	<b>77,584</b>	<b>58,662</b>	<b>72,202</b>	<b>170,475</b>	<b>566,607</b>	<b>244,910</b>	<b>1,190,440</b>
<b>Liabilities</b>							
Deposits from customers	117,079	85,666	343,954	256,935	132,733	121,895	1,058,262
Due to banks	35	472	1,504	2,212	1,226	440	5,889
Hybrid instruments	-	-	-	14,984	24,526	-	39,510
Other liabilities	-	-	-	-	-	16,059	16,059
<b>Total financial liabilities</b>	<b>117,114</b>	<b>86,138</b>	<b>345,458</b>	<b>274,131</b>	<b>158,485</b>	<b>138,394</b>	<b>1,119,720</b>
<b>Net on-balance sheet financial position</b>	<b>(39,530)</b>	<b>(27,476)</b>	<b>(273,256)</b>	<b>(103,656)</b>	<b>408,122</b>	<b>106,516</b>	<b>70,720</b>



### 30.2 Interest rate risk (continued)

	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
<b>At 31 December 2017</b>							
<b>Assets</b>							
Cash on hand and balances with banks	-	-	-	-	-	154,031	154,031
Obligatory reserve with the CNB	-	-	-	-	-	63,838	63,838
Placements with banks	-	-	-	-	-	1,018	1,018
Loans and advances to customers	45,639	7,741	19,386	40,284	691,828	5,120	809,998
Available-for-sale financial assets	-	-	-	33,776	-	9,840	43,616
Other assets	-	-	-	-	-	22,400	22,400
<b>Total financial assets</b>	<b>45,639</b>	<b>7,741</b>	<b>19,386</b>	<b>74,060</b>	<b>691,828</b>	<b>256,247</b>	<b>1,094,901</b>
<b>Liabilities</b>							
Deposits from customers	110,327	84,455	318,683	240,706	83,225	110,968	948,364
Due to banks	1,145	-	690	-	6,400	426	8,661
Hybrid instruments	-	-	-	9,730	30,151	-	39,881
Other liabilities	-	-	-	-	-	31,233	31,233
<b>Total financial liabilities</b>	<b>111,472</b>	<b>84,455</b>	<b>319,373</b>	<b>250,436</b>	<b>119,776</b>	<b>142,627</b>	<b>1,028,139</b>
<b>Net on-balance sheet financial position</b>	<b>(65,833)</b>	<b>(76,714)</b>	<b>(299,987)</b>	<b>(176,377)</b>	<b>572,052</b>	<b>113,622</b>	<b>66,763</b>

### 30.3. 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.

### 30.3.1. Funding approach

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

### 30.3.2. 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.

<b>31 December 2018</b>	<b>Up to 1 month HRK'000</b>	<b>1 - 3 months HRK'000</b>	<b>3 - 12 months HRK'000</b>	<b>1 - 3 years HRK'000</b>	<b>Over 3 years HRK'000</b>	<b>Total HRK'000</b>
Deposits from customers	238,767	85,666	343,972	256,996	132,861	1,058,262
Due to banks	475	472	1,504	2,212	1,226	5,889
Hybrid instruments	-	-	-	14,984	24,526	39,510
Other liabilities	15,919	30	99	9	2	16,059
<b>Total liabilities</b> (contractual maturity dates)	<b>255,161</b>	<b>86,168</b>	<b>345,575</b>	<b>274,201</b>	<b>158,615</b>	<b>1,119,720</b>
<b>Total liabilities on unused loans</b> (expected maturity dates)	<b>4,925</b>	<b>1,906</b>	<b>6,055</b>	<b>775</b>	<b>100</b>	<b>13,761</b>

<b>31 December 2017</b>	<b>Up to 1 month HRK'000</b>	<b>1 - 3 months HRK'000</b>	<b>3 - 12 months HRK'000</b>	<b>1 - 3 years HRK'000</b>	<b>Over 3 years HRK'000</b>	<b>Total HRK'000</b>
Deposits from customers	221,062	84,455	318,683	240,782	83,382	948,364
Due to banks	1,571	-	690	-	6,400	8,661
Hybrid instruments	-	-	-	9,730	30,151	39,881
Other liabilities	18,441	14	12,696	4	78	31,233
<b>Total liabilities</b> (contractual maturity dates)	<b>241,074</b>	<b>84,469</b>	<b>332,069</b>	<b>250,516</b>	<b>120,011</b>	<b>1,028,139</b>
<b>Total liabilities on unused loans</b> (expected maturity dates)	<b>929</b>	<b>1,386</b>	<b>4,233</b>	<b>503</b>	<b>7,752</b>	<b>14,803</b>

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.

for the period from 1 January to 31 December 2018

### 30.3.3. 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.

	<b>No later than 1 year HRK'000</b>	<b>1 to 3 years HRK'000</b>	<b>Over 3 years HRK'000</b>	<b>Total HRK'000</b>
<b>31 December 2018</b>				
Loan commitments	12,886	775	100	13,761
Guarantees, letters of credit and other	1,236	-	-	1,236
<b>Total</b>	<b>14,122</b>	<b>775</b>	<b>100</b>	<b>14,997</b>
<b>31 December 2017</b>				
Loan commitments	5,992	8,254	-	14,246
Guarantees, letters of credit and other	557	-	-	557
<b>Total</b>	<b>6,549</b>	<b>8,254</b>	<b>-</b>	<b>14,803</b>

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.

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#### **30.4. 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

	<b>31 December 2018</b>			<b>31 December 2017</b>		
	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Total</b>
	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>	<b>HRK`000</b>
Bonds	61,810	-	61,810	42,785	-	42,785
Shares	681	141	822	690	141	831
	<b>62,491</b>	<b>141</b>	<b>62,632</b>	<b>43,475</b>	<b>141</b>	<b>43,616</b>

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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	
	2018 HRK'000	2017 HRK'000	2018 HRK'000	2017 HRK'000
<b>Financial assets</b>				
Placements with banks	1,005	1,018	1,005	1,018
Loans and advances to customers	893,680	809,998	893,680	809,998
Other assets	12,356	22,400	12,356	22,400
<b>Total financial assets</b>	<b>907,041</b>	<b>833,416</b>	<b>907,041</b>	<b>833,416</b>
<b>Financial liabilities</b>				
Deposits from customers	1,058,262	948,364	1,058,262	948,364
Due to banks	5,889	8,661	5,889	8,661
Hybrid instruments	39,510	39,881	39,510	39,881
Other liabilities	16,059	31,233	16,059	25,242
<b>Total financial liabilities</b>	<b>1,119,720</b>	<b>1,028,139</b>	<b>1,119,720</b>	<b>1,022,148</b>

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

*(a) Cash and funds with Central bank*

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

*(b) Held-to-maturity financial assets*

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

*(c) Due from other banks*

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

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*(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 applied to deposits of similar remaining maturities.

### **32.5. Capital 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 additional tier for capital protection (2.5%) and the additional tier for structural systemic risk (1.5%).

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The table below summarises the composition of regulatory capital and the Bank's ratios at 31 December 2018 and 2017.

	<b>31 December 2018 HRK'000</b>	<b>31 December 2017 HRK'000</b>
<b>Regulatory capital</b>		
Share capital	106,924	106,924
Supplementary capital	34,103	36,548
Deductions from regulatory capital	5,948	(3,090)
<b>Regulatory capital</b>	<b>146,975</b>	<b>140,382</b>
<b>Structure of risk exposure</b>		
Exposure amount weighted by credit risk	762,255	704,040
Market risk exposure	363	756
Operational risk exposure	113,752	107,532
<b>Total risk exposure</b>	<b>876,370</b>	<b>812,328</b>
<b>Structure of capital requirements</b>		
Capital requirements for total capital ratio (8%)	70,110	64,986
Additional tier for capital protection (2.5%)	21,909	20,308
Additional tier for structural system risk (1.5%)	13,145	12,185
Capital requirements for total capital ratio (2017: 2.6%; 2016: 3.09%)	22,786	12,121
<b>Total capital requirements</b>	<b>127,950</b>	<b>118,600</b>
<b>Capital adequacy</b>	<b>16.77%</b>	<b>17.28%</b>