

BANKA KOVANICA d.d.

**Financial statements as at
31 December 2012 together with
Independent Auditor's Report**

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Responsibility of the Management Board

Pursuant to the Croatian Accounting Law (Official Gazette 109/07), the Management Board is responsible for ensuring that the financial statements are prepared for each financial year in accordance with statutory accounting regulations applicable to banks in Croatia which give a true and fair view of the financial position and results of the Bank for that period.

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

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

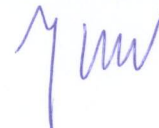
- suitable accounting policies are selected and then applied consistently;
- judgements and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are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

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Law (Official Gazette 109/07). The Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on the behalf of the Management Board:

Gian Luigi Bonfe
President of the Management board

Darko Kosovec
Member of the Management Board



Banka Kovanica d.d.,
Preradovićeve 29
Varaždin

2 April 2013



Independent Auditor's Report

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

We have audited the accompanying financial statements of Banka Kovanica d.d. (hereinafter: "the Bank") which comprise of statement of financial position as at 31 December 2012, the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as presented on pages 4 to 59.

Management's Responsibility

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

Auditor's Responsibility

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

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

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

Basis for Qualified Opinion

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

Qualified Opinion

In our opinion, except for the effects on the financial statements of the matters described in preceding paragraph, the financial statements presented on pages 4 to 59 give a true and fair view of the financial position of the Bank as at 31 December 2012 and the results of its operations and cash flows for the year then ended in accordance with statutory accounting regulations applicable to banks in Croatia.

Emphasis of matter

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

The Bank recorded significant loss in 2012 (following significant losses realised in the previous 3 years). Generation of such significant losses forced the Bank to strengthen its capital structure by capital increase in 2012 by HRK 51.8 million (by transferring hybrid instruments to subscribed capital). Furthermore, as presented in the Note 32.5, the Bank as at 31 December 2012 had capital adequacy ratio below the regulatory limit of 12%. Hence the majority shareholder Cassa Risparmio della Repubblica di San Marino S.p.A in January 2013 paid in a hybrid deposit in the amount of EUR 4 million, after which the capital adequacy ratio increased above the regulatory limit of 12%.

The Bank's operations in the forthcoming period and its going concern substantially depends on whether the Bank will be able to achieve positive cash flow from operations and maintain required regulatory capital adequacy level. To achieve this, continuous support of the majority shareholder Cassa di Risparmio della Repubblica di San Marino S.p.A is required. Since the Management of the Bank actively works on above noted matters, these financial statements for the year ended 31 December 2012 have been prepared under going concern basis.

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

Siniša Dušić,
Certified auditor, Member of the Board



Zagreb, 2 April 2013

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ZAGREB

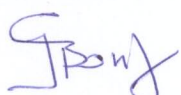
Statement of comprehensive income
for the year ended 31 December 2012

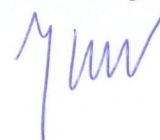
	Notes	2012 HRK'000	2011 HRK'000
Interest income		76,629	84,403
Interest expense		(41,211)	(51,671)
Net interest income	4	35,418	32,732
Fee and commission income		5,648	6,139
Fee and commission expense		(873)	(1,020)
Net fee and commission income	5	4,775	5,119
Foreign exchange differences - net	6	7,212	2,017
Result of assets available for sale - net	17	1,755	375
Other operating income	7	6,294	4,143
Impairment charge for credit losses - net	8	(61,842)	(14,007)
Administrative expenses	9	(49,139)	(51,993)
Other operating expenses	10	(7,630)	(7,077)
Loss before income tax		(63,157)	(28,691)
Income tax expense	11	5,463	-
Loss after taxation		(57,694)	(28,691)
Unrealized (loss) / gains on financial assets available for sale		(1,151)	(1,603)
Other comprehensive income		(1,151)	(1,603)
Total comprehensive loss		(58,845)	(30,294)
Loss per share	12	(22.54)	(15.79)

Financial statements set out on pages 4 to 59 were approved by the Management Board on 2 April 2013.

Gian Luigi Bonfe
President of the Management Board

Darko Kosovec
Member of the Management Board





Statement of financial position

as at 31 December 2012

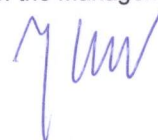
	Notes	31/12/2012 HRK'000	31/12/2011 HRK'000
ASSETS			
Cash in hand and balances with banks	13	115,838	78,358
Obligatory reserve with the Croatian National Bank	14	83,506	51,568
Placements with banks	15	29,703	87,432
Loans and advances to customers	16	728,670	795,854
Available for sale financial assets	17	22,712	33,778
Held to maturity financial assets	18	3,262	3,269
Property and equipment	19	33,251	38,893
Intangible assets	19	2,181	2,529
Reposessed assets	20	26,961	12,356
Other assets	21	10,505	7,958
Total assets		1,056,589	1,111,995
LIABILITIES			
Deposits from customers	22	844,548	839,017
Due to banks	23	78,139	54,278
Hybrid instruments	24	27,576	91,189
Repurchase agreements	25	10,600	26,200
Other liabilities	26	11,117	11,959
		971,980	1,022,643
SHAREHOLDERS' EQUITY			
Share capital	27	260,764	208,964
Treasury shares		(15)	(15)
Share premium		76,430	76,430
Reserves		1,101	(50)
Loss brought forward		(195,977)	(167,286)
Loss for the year		(57,694)	(28,691)
		84,609	89,352
Total liabilities and shareholders' equity		1,056,589	1,111,995

Financial statements set out on pages 4 to 59 were approved by the Management Board on 2 April 2013.

Gian Luigi Bonfe
President of the Management Board

Darko Kosovec
Member of the Management Board





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

Statement of changes in equity

for the year ended 31 December 2012

	Share capital	Treasury shares	Share premium	Reserves	Loss brought forward	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
As at 31 December 2010	142,964	(15)	76,430	1,553	(167,286)	53,646
Loss for the year	-	-	-	-	(28,691)	(28,691)
Increase of capital	66,000	-	-	-	-	66,000
Unrealized gains on assets available for sale	-	-	-	(1,603)	-	(1,603)
Other comprehensive income	-	-	-	(1,603)	-	(1,603)
As at 31 December 2011	208,964	(15)	76,430	(50)	(195,977)	89,352
Loss for the year	-	-	-	-	(57,694)	(57,694)
Increase of capital	51,800	-	-	-	-	51,800
Unrealized loss on assets available for sale	-	-	-	1,151	-	1,151
Other comprehensive income	-	-	-	1,151	-	1,151
As at 31 December 2012	260,764	(15)	76,430	1,101	(253,671)	84,609

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

Statement of cash flows

for the year ended 31 December 2012

	Notes	2012 HRK'000	2011 HRK'000
Cash flows from operating activities			
Loss before taxation		(57,694)	(28,691)
Depreciation and amortisation	9, 19	6,588	6,774
Write off and disposals of property and equipment	19	(500)	(2,648)
Impairment charge for credit losses - net	8	61,842	14,007
Result of financial assets available for sale		(9,312)	375
Other non-cash items		1,155	6,910
Operating result before changes in operating assets		2,079	(3,273)
(Increase) / decrease in assets with the Croatian National Bank		(31,938)	49,273
(Increase) / decrease in loans and advances to customers		8,925	67,780
(Increase) / decrease in bills of exchange		358	1,893
(Increase) / decrease in repossessed and other assets		(6,979)	5,155
Increase / (decrease) in deposits from customers		5,530	(156,338)
Increase / (decrease) in hybrid instruments		(63,613)	74,699
Increase / (decrease) in other liabilities		(842)	(2,503)
Net cash used in operating activities		(86,480)	36,686
Cash flows from investing activities			
Purchase of property and equipment and intangible assets	19	(1,098)	(6,705)
Purchase of financial assets available for sale	17	(34,578)	(32,673)
Proceeds on sale of financial assets available for sale	17	49,252	18,374
Net cash used for investing activities		13,576	(21,004)
Cash flows from financing activities			
Capital increase	27	51,800	-
Increase / (decrease) of deposits from banks		27,786	(61,763)
(Increase) of placements with banks		-	(7,400)
Increase / (decrease) of loans due to banks		(3,927)	2,566
Repayment of loans received		(15,600)	-
Net cash from financing activities		60,059	(66,597)
Net (decrease) / increase in cash and cash equivalents		(12,845)	(50,915)
Cash and cash equivalents at beginning of year		158,388	209,305
Cash and cash equivalents at end of year	28	145,543	158,390

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

Notes to the financial statements

for the year ended 31 December 2012

1. General information

Activities

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

Registered activities of the Bank are as follows:

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

1. General information (continued)

Supervisory Board

Pier Luigi Martelli	President
Ivan Majdak	Vice president
Emanuele Restelli Prandoni Della Fratta	Member from 28 September 2012
Renzi Vladimiro	Member until 25 September 2012
Davor Štern	Member
Gian Primo Giardi	Member

Management Board

Gian Luigi Bonfe	President
Darko Kosovec	Member

The shareholders of the Bank as at 31 December 2011 and 31 December 2010 are disclosed in Note 27.

On 6 June 2007, the Bank's ordinary shares (VSK-R-A) were quoted on the regular listing of shares of joint stock companies on the Zagreb Stock Exchange. On 6 November 2008, such listing was cancelled and the Bank's shares were transferred to the parallel listing on the Zagreb Stock Exchange. The regular listing was cancelled since the Bank had less than a 100 shareholders for a longer period of time, so it does not fulfill the criteria for a joint stock company in accordance with the Securities Market Act.

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

2. Basis of presentation of financial statements

The principal accounting policies applied in preparation of these financial statements are summarized below. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards ("IFRS"), reference may be made to certain Standards applicable in the Republic of Croatia as at 31 December 2012.

2.1. Compliance with Croatian accounting demands and IFRS

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

The main differences between the requirements of the International Financial Reporting Standards ("IFRS") and the accounting regulations of the CNB relates to the recognition of impairment losses of financial assets calculated on portfolio basis. In accordance with CNB regulations, banks with headquarters in Croatia should recognize impairment on the portfolio basis by the prescribed rates from 0.85% to 1.20% on balance sheet and off-balance sheet exposure to credit risk of counterparties for which impairment on individual basis is not determined, while IFRS requires that the provisions on portfolio basis should be determined for existing but unidentified losses on the basis of valuation models taking into account individual characteristics of the Bank and the counterparty (e.g. collateral, customers' scoring and alike).

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

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

2.2. Basis of preparation

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

2. Basis of presentation of financial statements (continued)

2.2. Basis of preparation (continued)

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

The Bank has applied for the year ended 31 December 2012 the following amendments issued which are or have become effective during the year and presented, in accordance with the requirements, comparative data. The application of new standards had no effect on the equity as at 1 January 2012:

- IFRS 7 Financial instruments: Disclosures – Transfers of Financial Assets – amendments effective for annual periods beginning on or after 1 July 2011.

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

At the date of authorisation of these financial statements, certain new standards, amendments and interpretations to existing standards have been published but are not yet effective for the year ended 31 December 2012:

- IFRS 1 First time adoption of IFRS – replacement of fixed dates for certain exceptions – effective for annual periods beginning on or after 1 July 2013,
- IFRS 1 First time adoption of IFRS – additional exemptions for entities ceasing to suffer from severe hyperinflation – effective for annual periods beginning on or after 1 July 2013,
- IAS 12 Income taxes (revised) – limited scope amendment effective for annual periods beginning on or after 1 January 2013.
- IFRS 9 Financial Instruments – new standard effective for annual periods beginning on or after 1 January 2015,
- IFRS 10 Consolidated financial statements – new standard effective for annual periods beginning on or after 1 January 2014,
- IFRS 11 Joint arrangements – new standard effective for annual periods beginning on or after 1 January 2014,
- IFRS 12 Disclosure of interests in other entities – new standard effective for annual periods beginning on or after 1 January 2014,
- Amendments to IFRS 10, IFRS 11 and IFRS 12 – Transition Guidance effective for the annual periods beginning on or after 1 January 2014,
- Amendments to IFRS 10, IFRS 12 and IAS 27 – Investment entities effective for the annual periods beginning on or after 1 January 2014,
- IAS 27 and IAS 28 – consequential amendments due to above mentioned new consolidation standards - effective for annual periods beginning on or after 1 January 2014,

Notes to the financial statements (continued)

for the year ended 31 December 2012

2. Basis of presentation of financial statements (continued)

2.2. Basis of preparation (continued)

- IFRS 13 – Fair value measurement - new standard effective for annual periods beginning on or after 1 January 2013,
- IAS 1 Presentation of Financial Statements (revised) - amendments effective for annual periods beginning on or after 1 July 2012,
- IAS 19 Employee benefits (revised) – amendments effective for annual periods beginning on or after 1 January 2013,
- IAS 32 – Financial instruments: Presentation – amendments to application guidance on the offsetting of financial assets and financial liabilities – effective for annual periods beginning on or after 1 January 2014,
- IFRS 7 Financial instruments: Disclosures – offsetting Financial Asset and Financial Liabilities – amendments effective for annual periods beginning on or after 1 January 2013,
- IFRS 7 Financial instruments: Disclosures – amendments requiring disclosures about the initial application of IFRS 9 effective for annual periods beginning on or after 1 January 2015,
- Amendments to IFRS 1 - Government Loans – effective for annual periods beginning on or after 1 January 2013,
- Annual Improvements to IFRSs 2009-2011 Cycle (IFRS 1, IAS 1, IAS 16, IAS 32 and IAS 34 – effective for annual periods beginning on or after 1 January 2011,
- IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine - effective for annual periods beginning on or after 1 January 2013.

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

2. Basis of presentation of financial statements (continued)

2.3. Critical accounting judgments and key sources of estimation uncertainty

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

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

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

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

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

Economic crisis

The ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates and very high volatility in stock markets. Indeed the full extent of the impact of the ongoing economic crisis is proving to be impossible to anticipate or completely guard against.

Management believes it is taking all the necessary measures to support the sustainability and growth of the Bank's business in the current circumstances.

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies

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

3.1. Interest income and expense

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

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

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

3.2. Fee and commission income and expense

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

3.3. Taxation

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies (continued)

3.3. Taxation (continued)

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

3.4. Segment reporting

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

3.5. Foreign currency translation

(a) Functional and presentation currency

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

(b) Transactions and balances

Transactions denominated in foreign currencies are translated into HRK at the prevailing exchange rates on the date of the transaction.

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies (continued)

3.5. Foreign currency translation (continued)

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

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

31 December 2012	EUR 1 = HRK 7.545624	USD 1 = HRK 5.726794
31 December 2011	EUR 1 = HRK 7.530420	USD 1 = HRK 5.819940

3.6. Cash and cash equivalents

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

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

3.7. Financial assets

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

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

When a financial asset or financial liability is recognized initially, the Bank measures it at its fair value plus, in the case of a financial assets or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

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

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

A financial asset is classified as held for trading if:

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

Measurement:

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

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

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

(b) Assets available for sale

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

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

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

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

Impairment losses recognized in profit or loss for equity investments classified as available-for-sale are not subsequently reversed through profit or loss. Impairment losses recognized in profit or loss for debt instruments classified as available-for-sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss. Interest earned whilst holding available-for-sale securities is accrued on a daily basis using the effective interest rate method and reported as "Interest income" in the income statement.

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

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

(c) Held-to-maturity financial assets

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

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

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

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

(d) Loans and receivables

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

This portfolio comprises loans provided to customers.

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies (continued)

3.7. Financial assets (continued)

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

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

(e) Financial liabilities

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

3.8. Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the life of the guarantee and the best estimate of the expenditure required to settle any financial obligation arising at the balance sheet date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgment of Management.

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies (continued)

3.9. Derivative financial instruments

Derivative financial instruments include foreign exchange rate forward contracts and are initially recognised in the balance sheet at fair value and subsequently re-measured at their fair value. Fair values are obtained from quoted market prices or pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Derivative financial instruments include contracts with one-way currency clause. The contracted value is initially recognised in the off-balance sheet records and as a loan given with a one-way currency clause in the balance sheet. They are subsequently measured at amortised cost as for all other placements that carry credit risk in the balance sheet. Increase in exchange rates (fair value of the embedded derivative) above the contracted, is recorded in the balance sheet as an embedded derivative and recognised within profit or loss from embedded derivatives in the income statement.

The Bank's derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement under net trading income. However, the gains and losses arising from changes in the fair value of derivatives that are managed in conjunction with designated financial assets or financial liabilities are included in 'net income from financial instruments designated at fair value'.

3.10. Sale and repurchase agreements

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

3.11. Offsetting financial instruments

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

3.12. Property and equipment and intangible assets

Property and equipment and intangible assets are started at cost less accumulated depreciation/amortization. Depreciation is calculated on a straight-line basis to write down the cost of such assets to their residual values over their estimated useful lives. Assets in the course of construction are not depreciated.

Notes to the financial statements (continued)

for the year ended 31 December 2012

3. Summary of significant accounting policies (continued)

3.12 Property and equipment and intangible assets (continued)

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

	2012	2011
	%	%
Property	2.5	2.5
Leasehold improvements	20	20
Electronic equipment	20	20
Other assets	20-25	20-25
Leasehold improvements	20	20
Software	20	20

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

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

3.13. Leases

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

3.14. Non-current assets held for sale

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

3.15. Provisions

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

3. Summary of significant accounting policies (continued)

3.15. Provisions (continued)

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

3.16. Employee benefits

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

3.17. Borrowings

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

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

3.18. Fiduciary activities

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

3.19. Share capital and treasury shares

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

4. Net interest income**Interest income**

	2012	2011
	HRK`000	HRK`000
Loans and advances:		
- to customers	73,627	80,944
- to banks	1,991	2,405
Securities	1,011	1,054
	76,629	84,403

Interest expense

	2012	2011
	HRK`000	HRK`000
Customers deposits	37,434	46,709
Hybrid instruments	1,098	2,838
Other borrowed funds	2,679	2,124
	41,211	51,671

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

	2012	2011
	HRK`000	HRK`000
Domestic and foreign currency transactions	3,153	3,306
Guarantees and letter of credits given	40	107
Other	2,455	2,726
	5,648	6,139

Fee and commission expense

	2012	2011
	HRK`000	HRK`000
Domestic and foreign currency transactions	358	433
Other	515	587
	873	1,020

Notes to the financial statements (continued)

for the year ended 31 December 2012

6. Foreign exchange differences - net

	2012	2011
	HRK`000	HRK`000
Net foreign exchange gains from operations	4,405	2,491
Net foreign exchange gains / (losses) on translation of foreign currency assets and liabilities to mid exchange rate	2,807	(474)
	7,212	2,017

7. Other operating income

	2012	2011
	HRK`000	HRK`000
Income from transfer of corporate loan claims to majority shareholder (Note 30)	3,577	1,016
Income from lease	393	1,240
Court costs refund	289	498
Income from provision reversal for legal cases	1,061	-
Other	974	1,389
	6,294	4,143

8. Impairment charge for credit losses - net

	2012	2011
	HRK`000	HRK`000
Loans and advances to customer (Note 16)	55,726	9,395
Placements with banks (Note 15)	2,533	2,605
Collected credit losses written off in previous years	(363)	(583)
Held to maturity financial assets (Note 18)	(351)	380
Other assets (Note 21)	4,433	1,201
Provision for contingent liabilities and commitments (Note 26)	(136)	1,009
	61,842	14,007

9. Administrative expenses

	2012	2011
	HRK`000	HRK`000
Staff costs		
Net salaries	12,511	13,426
Pension contributions	3,749	4,099
Health security contributions	3,034	3,899
Other contributions and taxes on salaries	3,013	3,555
Other staff costs	935	977
	23,242	25,956
Other administrative expenses	19,309	19,263
Depreciation and amortisation (Note 19)	6,588	6,774
	49,139	51,993

As at 31 December 2012, the Bank had 131 employees (2011: 133 employees).

Notes to the financial statements (continued)

for the year ended 31 December 2012

10. Other operating expenses

	2012	2011
	HRK`000	HRK`000
Rental costs	4,804	4,875
Saving deposits insurance charge	2,399	2,522
Provisions for legal cases (Note 26)	652	129
Vacation accruals (Note 26)	(304)	(592)
Other	79	143
	7,630	7,077

11. Income tax expense

	2012	2011
	HRK`000	HRK`000
Accounting loss before tax	(63,157)	(28,691)
Effect of items increasing tax base	7,067	3,574
Effect of items decreasing tax base	(7,144)	(4,962)
Tax loss for the period	(63,234)	(30,079)
Tax losses brought forward	(170,994)	(151,718)
Expiration of tax losses carried forward	24,360	10,803
Tax losses carried forward	(209,869)	(170,994)
Recognized deferred tax assets (IAS 12)	5,463	-
Unrecognized deferred tax assets (statutory tax rate 20%)	36,511	34,199

In these financial statements, the Bank has recognised deferred tax assets for the carryforward of unused tax losses in the amount of HRK 5,463 thousand, for which it estimated represents tax savings to be achieved in the following 5-year period. The Bank has not recognised deferred tax assets in the further amount of HRK 36,511 thousand due to uncertainty of utilisation of the assets.

The Bank may utilise the recorded tax loss in the amount of HRK 209,869 thousand as a deduction item of recorded base for the calculation of tax liability, not later than in a period of 5 years:

- tax loss for 2009 in the amount of HRK 39,777 thousand not later than (including) 2014
- tax loss for 2010 in the amount of HRK 76,778 thousand not later than (including) 2015
- tax loss for 2011 in the amount of HRK 30,079 thousand not later than (including) 2016
- tax loss for 2012 in the amount of HRK 63,234 thousand not later than (including) 2017

In accordance with the regulations of the Republic of Croatia, the Tax Authority may at any time inspect books and records of the Bank within 3 years following the year in which the tax liability is reported, and may impose additional tax assessments and penalties. The Bank's management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

Notes to the financial statements (continued)

for the year ended 31 December 2012

12. Loss per share**Basic**

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

	<u>2012</u>	<u>2011</u>
Loss for the year (in HRK'000)	(57,694)	(28,691)
Weighted average number of shares excluding own shares	2,563,476	1,816,603
Basic loss per share – ordinary (in HRK)	<u>(22.54)</u>	<u>(15.79)</u>

On 30 January 2012 the Bank's share capital increased (Note 27) by issuing 518,000 ordinary shares each in nominal amount of HRK 100.

Diluted

Diluted loss per share for the year 2012 and 2011 is equal to basic loss per share, since the Bank did not have any convertible instruments and share options during both years.

13. Cash in hand and balances with banks

	<u>31/12/2012</u>	<u>31/12/2011</u>
	<u>HRK'000</u>	<u>HRK'000</u>
Cash in hand	14,979	13,289
Cash on the clearing account	31,807	38,345
Foreign currency account	69,052	26,724
	<u>115,838</u>	<u>78,358</u>

14. Obligatory reserve with the Croatian National Bank

	<u>31/12/2012</u>	<u>31/12/2011</u>
	<u>HRK'000</u>	<u>HRK'000</u>
Earmarked obligatory reserve		
- in HRK	68,465	33,794
- in foreign currency	15,041	17,774
	<u>83,506</u>	<u>51,568</u>

In the period from 27 January 2012 until 9 May 2012 the obligatory reserve in HRK and foreign currencies has been accrued at a unique regulatory rate of 15%. From 9 May 2012 regulatory rate has been decreased to 13,5%.

Notes to the financial statements (continued)

for the year ended 31 December 2012

14. Obligatory reserve with the Croatian National Bank (continued)

According to the Croatian National Bank Resolution, the Bank has opted to utilise a portion of the obligatory reserve placed with the Croatian National Bank for maintaining the regular liquidity level, in the amount of HRK 50,000 thousand from 1 December 2011 which The Bank decreased during the year 2012 to amount of HRK 40,000 thousand. The Bank repaid amount of HRK 20,000 thousand as at 12 April 2012 and since the end of the period ending 8 May 2012 did not utilized additional portion of the obligatory reserve placed with the Croatian National Bank for maintaining the regular liquidity level.

15. Placements with banks

	31/12/2012	31/12/2011
	HRK`000	HRK`000
Loans	9,870	10,005
Deposits	24,971	80,032
	34,841	90,037
Allowance for identified losses	(5,138)	(2,605)
	29,703	87,432

Movement in allowance for identified losses:

	31/12/2012	31/12/2010
	HRK`000	HRK`000
As at 1 January	2,605	-
Increase in provisions (Note 8)	2,533	2,605
Collection (Note 8)	-	-
As at 31 December	5,138	2,605

16. Loans and advances to customers

	31/12/2012	31/12/2011
	HRK`000	HRK`000
Retail customers	466,123	425,805
Corporate customers	436,047	486,325
Gross loans and advances	902,170	912,130
Less: Allowance for impairment	(173,500)	(116,276)
Net loans and advances	728,670	795,854
Current	182,538	203,403
Non – current	546,132	592,451

Notes to the financial statements (continued)

for the year ended 31 December 2012

16. Loans and advances to customers (continued)

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

2012	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
As at 1 January	18,015	98,261	116,276
Increase in provisions (Note 8)	20,919	116,492	137,411
Reversal (Note 8)	(17,509)	(64,176)	(81,685)
Write off	-	-	-
Foreign exchange differences	325	1,173	1,498
As at 31 December	21,750	151,750	173,500

2011	Retail customers HRK`000	Corporate customers HRK`000	Total HRK`000
As at 1 January	18,876	88,324	107,200
Increase in provisions (Note 8)	12,551	30,779	43,330
Reversal (Note 8)	(13,309)	(20,626)	(33,935)
Write off	(264)	(25)	(289)
Foreign exchange differences	161	(191)	(30)
As at 31 December	18,015	98,261	116,276

17. Available for sale financial assets

	31/12/2012 HRK`000	31/12/2011 HRK`000
Croatian Government bonds	-	28,386
Foreign Government bonds	19,615	-
Corporate bonds	2,029	2,026
Equity securities – listed	463	2,234
Equity securities – unlisted	141	141
Investment funds	464	470
Undue interest	-	420
Claim for interest paid	-	101
	22,712	33,778

Notes to the financial statements (continued)

for the year ended 31 December 2012

17. Available for sale financial assets (continued)

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

	31/12/2012	31/12/2011
	HRK'000	HRK'000
As at 1 January	33,778	20,280
Additions	34,578	32,673
Disposals	(49,252)	(18,374)
Unrealised (loss) / gain	1,151	(1,603)
Result of assets available for sale - net	1,755	375
Interest payment	1,015	226
Foreign exchange difference	(313)	201
As at 31 December	22,712	33,778

Foreign Governments' bonds as at 31 December 2012:

Name	Maturity	Interest %	Nominal amount	Currency	Book value	Unrealized gains / (loses)
					HRK'000	HRK'000
FR0011337880	25/10/2022	2.25	1,500	EUR	11,625	50
XS0757376S10	21/03/2022	2.25	500	EUR	4,120	(37)
SK4120008871	15/11/2024	3.42	500	EUR	3,870	(98)
					19,615	(85)

As at 31 December 2012, fair value of bonds in the amount of HRK 26,102 thousand (31 December 2011: HRK 28,386 thousand) has been pledged as a collateral a repurchase agreement (Note 25).

Corporate bonds as at 31 December 2012:

Name	Maturity	Interest %	Nominal amount	Currency	Book value	Unrealized gains / (loses)
					HRK'000	HRK'000
ATGR-O-169A	20.9.2016	6.90	2,000	HRK	2,029	-
					2,029	-

Notes to the financial statements (continued)

for the year ended 31 December 2012

18. Held to maturity financial assets

	31/12/2012	31/12/2011
	HRK`000	HRK`000
Bills of exchange	10,196	10,554
	10,196	10,554
Allowance for identified losses	(6,934)	(7,285)
	3,262	3,269

Movement in allowance for identified losses:

	31/12/2012	31/12/2011
	HRK`000	HRK`000
As at 1 January	7,285	6,906
Increase in provisions (Note 8)	209	503
Collection (Note 8)	(560)	(124)
As at 31 December	6,934	7,285

Notes to the financial statements (continued)

for the year ended 31 December 2012

19. Property and equipment and intangible assets

	Land and buildings	Leasehold improvements	Electronic equipment	Other assets	Total property and equipment	Software	Intangible assets under construction	Total intangible assets
	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000
Cost								
As at 1 January 2011	25,686	16,280	9,830	14,076	65,872	6,583	1,374	7,957
Additions	-	5,167	20	9	5,196	1,511		1,511
Disposals	-	(6)	(508)	(1,039)	(1,553)	-	(1,095)	(1,095)
As at 31 December 2011	25,686	21,441	9,342	13,046	69,515	8,094	279	8,373
Additions		570	95	126	791	307		307
Disposals	(548)		(2)	(631)	(1,181)		(11)	(11)
As at 31 December 2012	25,138	22,010	9,435	12,541	69,124	8,400	268	8,668
Accumulated depreciation								
As at 1 January 2011	2,886	5,440	7,646	9,925	25,897	5,227	-	5,227
Charge for the year	473	3,470	815	1,399	6,157	617	-	617
Disposals	-	-	(506)	(926)	(1,432)	-	-	-
As at 31 December 2011	3,359	8,910	7,955	10,398	30,622	5,844	-	5,844
Charge for the year	466	3,857	666	955	5,944	644	-	644
Disposals	(75)		(2)	(614)	(691)		-	
As at 31 December 2012	3,750	12,768	8,619	10,739	35,876	6,487	-	6,487
Net book value								
As at 31 December 2011	22,327	12,531	1,387	2,648	38,893	2,250	279	2,529
As at 31 December 2012	21,388	9,242	816	1,805	33,251	1,913	268	2,181

Notes to the financial statements (continued)

for the year ended 31 December 2012

20. Repossessed assets

Movements in repossessed assets during the year:

	31/12/2012 HRK`000	31/12/2011 HRK`000
As at 1 January	12,356	12,261
Increase	14,846	132
Decrease	(241)	(37)
Written off	-	-
As at 31 December	26,961	12,356

Repossessed assets as at 31 December 2011 included real estate in the amount of HRK 10,380 thousand which was not in the Bank's possession. During 2012, the Bank took over formal ownership over the real estate and is undertaking legal proceedings to get into its possession.

21. Other assets

	31/12/2012 HRK`000	31/12/2011 HRK`000
Lease pre-payments	-	2,587
Receivables for court costs refunds	3,474	2,586
Receivables from customers	4,361	1,371
Other pre-payments	2,402	1,370
Prepaid expenses	5,628	229
Pre-payments of pensions to customers	5	118
Derivative financial asset (Note 30)	105	77
Other	1,939	2,597
	17,914	10,935
Allowance for identified losses	(7,409)	(2,977)
	10,505	7,958

Movement in allowance for identified losses:

	31/12/2012 HRK`000	31/12/2011 HRK`000
As at 1 January	2,977	1,788
Increase in provisions (Note 8)	6,098	2,008
Collection (Note 8)	(1,666)	(807)
Write off	-	(12)
As at 31 December	7,409	2,977

Notes to the financial statements (continued)

for the year ended 31 December 2012

22. Deposits from customers

Deposits comprise demand deposits and time deposits:

	31/12/2012	31/12/2011
	HRK`000	HRK`000
Demand deposits		
Corporate customers	8,142	6,220
Retail customers	49,294	37,651
	57,436	43,871
Time deposits		
Corporate customers	3,460	8,489
Retail customers	783,652	786,657
	787,112	795,146
Deposits from customers	844,548	839,017
Current	719,199	705,558
Non – current	125,349	133,459

23. Due to banks

	31/12/2012	31/12/2011
	HRK`000	HRK`000
Borrowings:		
- Croatian Bank for Reconstruction and Development	37,487	41,413
- other	-	-
Deposits	40,652	12,865
	78,139	54,278
Current	40,652	12,865
Non-current	37,487	41,413

As at 31 December 2012 and 31 December 2011, all deposits from banks are current.

Notes to the financial statements (continued)

for the year ended 31 December 2012

24. Hybrid instruments

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

	31/12/2012	31/12/2011
	HRK'000	HRK'000
Legal entities	26,498	80,232
Citizens	1,078	10,957
	27,576	91,189

25. Repurchase agreements

As at 11 July 2012, the Bank has entered into repurchase agreement with Agram Invest d.d. and pledged as collateral bonds classified as available for sale (Note 17). As at 31 December 2012 book value of repurchase agreements amounts to HRK 10.600 thousand (31 December 2011: HRK 26,200 thousand). Repurchase price is 4.25% with maturity as at 11 January 2013.

26. Other liabilities

	31/12/2012	31/12/2011
	HRK'000	HRK'000
Provisions for legal cases	1,314	790
Provisions for contingent liabilities and commitments	498	1,695
Payables in the course of settlement	3,278	2,267
Liabilities to suppliers	1,932	2,229
Employee payables – salaries and contributions	1,821	1,845
Liabilities for savings deposits insurance charge	612	619
Vacation accruals (Note 10)	256	560
Other	1,406	1,954
	11,117	11,959

Movement in provisions for legal cases:

	31/12/2012	31/12/2011
	HRK'000	HRK'000
As at 1 January	790	2,981
Increase in provision (Note 10)	971	318
Reversal (Note 10)	(319)	(189)
Payments made per court verdicts	(128)	(2,320)
As at 31 December	1,314	790

Notes to the financial statements (continued)

for the year ended 31 December 2012

26. Other liabilities (continued)

Movement in provisions for contingent liabilities and commitments:

	31/12/2012 HRK`000	31/12/2011 HRK`000
As at 1 January	1,695	686
Increase in provision	848	1,061
Reversal of provision	(2,045)	(52)
As at 31 December	498	1,695

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

At the General Assembly meeting held on 30 May 2011, a Decision was made to increase the share capital. The share capital in the amount of HRK 142,964 thousand increased by HRK 66,000 thousand to HRK 208,964 thousand, issuing 660,000 ordinary shares with nominal value of HRK 100, through hybrid instrument from Cassa di Risparmio della Repubblica di San Marino S.p.A.

At the General Assembly meeting held on 30 January 2012, a Decision was made to increase the share capital. The share capital in the amount of HRK 208,964 thousand increased by HRK 51,800 thousand to HRK 260,764 thousand, issuing 518,000 ordinary shares with nominal value of HRK 100, through hybrid instrument from Cassa di Risparmio della Repubblica di San Marino S.p.A.

As at 31 December 2012, the share capital amounts to HRK 260,764 thousand (31 December 2011: 208,964 thousand), and comprises 2,607,644 ordinary shares (31 December 2010: 2,089,644) (VSK-R-A) with a nominal value of HRK 100 per share

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

Shareholder	31/12/2012		31/12/2011	
	Number of shares	% in share capital	Number of shares	% in share capital
Cassa di Risparmio della Repubblica di San Marino	2,596,761	99.58	2,078,761	99.48
Treasury shares	153	0.01	153	0.01
Other	10,730	0.41	10,730	0.51
Total	2,607,644	100.00	2,089,644	100.00

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

28. Cash and cash equivalents

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

	Notes	31/12/2012 HRK`000	31/12/2011 HRK`000
Cash in hand and balances with banks	13	115,838	78,358
Placements with banks	15	29,703	80,032
		145,541	158,390

29. Contingent liabilities and commitments

Legal Proceedings. The Bank is currently subject to several legal proceedings. As at 31 December 2012 provisions for legal proceeding for which the Bank anticipates outflow of economic benefits amounts to HRK 1.314 thousand (2011: HRK 790 thousand) and provision for contingent liabilities amounting to HRK 498 thousand (2011: HRK 1.695 thousand). Legal (initiated enforcement) proceeding of the company Prvi Faktor d.o.o. in the amount of EUR 710 thousand relates to the guarantee issued by the Bank in favour of the company Prvi Faktor d.o.o. for the loan payment toward the company Glas Istre d.o.o. Total contingent liabilities for the legal proceeding of the company Prvi Faktor d.o.o. amounts to HRK 7,823 thousand and provision for contingent liabilities amounts to HRK 78 thousand.

Capital commitments. As at 31 December 2012 and 31 December 2011, the Bank had no capital commitments in respect of buildings and equipment purchases.

Loan commitments, guarantees and other financial instruments

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

	31/12/2012 HRK`000	31/12/2011 HRK`000
Guarantees	11,874	12,228
Letters of credit	3,684	4,366
Loan commitments and other	31,926	42,435
Less: Provision for contingent liabilities and commitments (Note 26)	(498)	(1,695)
Total	46,986	57,334

Notes to the financial statements (continued)

for the year ended 31 December 2012

29. Contingent liabilities and commitments (continued)

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

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

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

Operating lease commitments where the Bank is the lessee

The future minimum lease payments under operating leases are as follows:

	31/12/2012 HRK`000	31/12/2011 HRK`000
Up to 1 year	4,396	2,721
From 2 to 5 years	6,770	9,773
Over 5 years	4,580	4,662
Total	15,746	17,156

Notes to the financial statements (continued)

for the year ended 31 December 2012

30. Related party transactions

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

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

In the year 2012 and 2011, transactions with related parties were as follows:

	Supervisory board, Management board and their related parties	
	31/12/2012	31/12/2011
	HRK`000	HRK`000
Interest income	50	59
Interest expense	150	122
Loans		
As at 1 January	1,563	1,755
Increase	151	-
Decrease	(510)	(192)
As at 31 December	1,204	1,563
Received deposits		
As at 1 January	2,934	3,483
Increase	3,100	2,819
Decrease	(2,868)	(3,368)
As at 31 December	3,166	2,934
Hybrid instruments		
As at 1 January	500	500
Increase	-	-
Decrease	(500)	-
As at 31 December	-	500

Notes to the financial statements (continued)

for the year ended 31 December 2012

30. Related party transactions (continued)

	Cassa di Risparmio della Repubblica si San Marino	
	31/12/2012	31/12/2011
	HRK`000	HRK`000
Interest income	681	8,275
Other income	47	1,016
Impairment charge for credit losses - net	-	(4,737)
Interest expense	(1,310)	(4,292)
Given deposits and cash		
As at 1 January	38,409	15,089
Increase	24,219	38,405
Decrease	(38,438)	(15,085)
As at 31 December	24,190	38,409
Received deposits		
As at 1 January	12,811	54,964
Increase	39,096	12,512
Decrease	(11,320)	(54,665)
As at 31 December	40,587	12,811
Hybrid instruments		
As at 1 January	79,276	66,628
Increase	-	79,535
Decrease	(52,778)	(66,887)
As at 31 December	26,498	79,276

In 2012, the Bank has increased exposure towards majority shareholder Cassa di Risparmio della Repubblica di San Marino S.p.A. in the amount of 14,219 thousand kuna. As at 31 December 2012 exposure towards majority shareholder amounts to 24,190 thousand kuna, which represents 24% of regulatory capital. The regulatory limit exposure to one person or Group of related persons is 25% maximum of regulatory capital.

In order to stabilize the activity of the Bank and the intention to improve the quality of Bank loan portfolio, majority shareholder Cassa di Risparmio della Repubblica di San Marino S.p.A. as at 4 July 2012 has concluded the Agreement with the Bank on the transfer of the loan claims. By this Agreement the Bank has transferred to the majority shareholder, without right of recourse, a portion of its corporate loan portfolio in total amount of 955 thousand euro with all related rights and obligations and collaterals. Instead of fulfilling financial obligations, Bank has received a portion of the majority shareholder's loan portfolio in the amount of 955 thousand euro. This transaction did not have net effect on the Bank's result.

Key management and Supervisory Board compensation

	31/12/2012	31/12/2011
	HRK`000	HRK`000
Gross salaries and other short-term benefits	1,546	2,097

31. Financial risk management

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

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

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

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

31.1. Credit risk

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

31.1.1. Credit risk measurement

(a) Loans and advances

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

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

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

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

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

(b) Debt securities and other bills

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

31.1.2. Risk limit control and mitigation policies

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

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

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

Some other specific control and mitigation measures are outlined below:

(a) Collateral

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

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

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

(b) Credit-related commitments

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

31.1.3. Impairment and provisioning policies

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

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

Bank's rating

	2012		2011	
	Loans and advances	Allowance for impairment	Loans and advances	Allowance for impairment
	HRK`000	HRK`000	HRK`000	HRK`000
1. Fully recoverable placements	576,374	8,057	663,990	9,127
2. Partially recoverable placements	230,999	70,683	194,964	53,973
3. Unrecoverable placements	94,797	94,760	53,176	53,176
	902,170	173,500	912,130	116,276

Bank's rating

	2012		2011	
	Loans and advances	Allowance for impairment	Loans and advances	Allowance for impairment
	(%)	(%)	(%)	(%)
1. Fully recoverable placements	63.89	4.64	72.80	7.85
2. Partially recoverable placements	25.60	40.74	21.37	46.42
3. Unrecoverable placements	10.51	54.62	5.83	45.73
	100.00	100.00	100.00	100.00

Notes to the financial statements (continued)

for the year ended 31 December 2012

31.1.3. Impairment and provisioning policies (continued)

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

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

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

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

	31/12/2012 HRK'000	31/12/2011 HRK'000
Credit risk exposures relating to on-balance sheet assets are as follows:		
Cash in hand and balances with banks	115,838	78,358
Obligatory reserve with the Croatian National Bank	83,506	51,568
Placements with banks	29,703	87,432
Loans and advances to customers	728,670	795,854
Available for sale financial assets	22,711	33,778
Held to maturity financial assets	3,262	3,269
Other assets	10,505	7,958
	994,195	1,058,217
Credit risk exposures relating to off-balance sheet items are as follows:		
Financial guarantees	11,874	12,228
Letters of credit	3,684	4,366
Loan commitments and other	31,926	42,435
	1,041,679	1,117,246

The above table represents the maximum exposure of the Bank to credit risk at 31 December 2012 and 2011, without taking account of any collateral held or other credit enhancements attached. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet. As shown above, 72.80% of the total maximum exposure is derived from loans and advances to banks and customers (2011: 79.06%).

Notes to the financial statements (continued)

for the year ended 31 December 2012

31.1.5. Loans and advances

Loans and advances are summarised as follows:

	31/12/2012		31/12/2011	
	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	547,160	29,703	598,845	84,932
Past due but not impaired	29,214		65,145	-
Individually impaired	325,796	5,138	248,140	5,105
Gross	902,170	34,841	912,130	90,037
Less: allowance for impairment	(173,500)	(5,138)	(116,276)	(2,605)
Net	728,670	29,703	795,854	87,432

The total impairment provision for loans and advances is HRK 173,500 thousand (2011: HRK 116,276 thousand) of which HRK 165,442 thousand (2011: HRK 106,955 thousand) represents the individually impaired loans and the remaining amount of HRK 8,058 thousand (2011: HRK 9,321 thousand) represents the portfolio provision. Further information of the impairment allowance for loans and advances to banks and to customers is provided in Notes 15 and 16.

Notes to the financial statements (continued)

for the year ended 31 December 2012

31.1.5. Loans and advances (continued)

The breakdown of the gross amount of loans and advances by class held by the Bank are as follows:

	Retail customers HRK'000	Corporate customers HRK'000	Total loans and advances to customers HRK'000	Loans and advances to banks HRK'000
As at 31 December 2012				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	407,620	139,540	547,160	29,703
<i>Past due but not impaired</i>				
Due less than 30 days	2,534	2,939	5,473	-
Due 30 – 90 days	13,386	10,355	23,741	-
<i>Individually impaired</i>				
Individually impaired loans	42,584	283,213	325,797	5,138
Total	466,124	436,047	902,170	34,841
As at 31 December 2011				
<i>Neither past due nor impaired</i>				
Fully recoverable placements	375,481	223,364	598,845	84,932
<i>Past due but not impaired</i>				
Due less than 30 days	3,551	19,987	23,538	-
Due 30 – 90 days	5,116	36,491	41,607	-
<i>Individually impaired</i>				
Individually impaired loans	41,657	206,483	248,140	5,105
Total	425,805	486,325	912,130	90,037

Notes to the financial statements (continued)

for the year ended 31 December 2012

31.1.5. Loans and advances (continued)

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

Restructuring activities include extended payment arrangements, modification and deferral of payments. Restructuring policies and practices are based on indicators or criteria which, in the judgment of the Management Board, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to loans for corporate customers financing. Within these loans there were no renegotiated loans that would otherwise be past due or impaired either at 31 December 2012 or 2011.

31.1.6. Repossessed assets

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

31.1.7. Concentration of risks of financial assets with credit risk exposure*(a) Geographical sectors*

The following table breaks down the Bank's main credit exposure at their carrying amounts, as categorised by geographical region as at 31 December 2012. For this table, the Bank has allocated exposures to regions based on the country of domicile of its counterparties.

	Croatia	European Union	Other countries	Total
	HRK'000	HRK'000	HRK'000	HRK'000
Cash in hand and balances with banks	48,702	65,819	1,317	115,838
Obligatory reserve with the CNB	83,506	-	-	83,506
Placements with banks	5,554	-	24,149	29,703
Loans and advances to customers	728,670	-	-	728,670
Available for sale financial assets	3,096	19,615	-	22,711
Held to maturity financial assets	3,262	-	-	3,262
Other assets	10,505	0	0	10,505
As at 31 December 2012	883,295	85,434	25,466	994,195
As at 31 December 2011	952,446	66,951	38,820	1,058,217

(b) Industry sectors

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

	Financial institutions	Manufacturing	Real estate	Wholesale and retail trade	Public sector	Other industries	Individuals	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Placements with banks	29,703	-	-	-	-	-	-	29,703
Loans and advances to customers	10,433	80,172	47,529	59,973	2,265	84,256	444,042	728,670
Available for sale financial assets	20,300	12	208	2,089	-	102	-	22,711
Held to maturity financial assets	-	-	-	193	-	1,695	1,374	3,262
Other assets	9,941	63	18	48	76	98	261	10,505
As at 31 December 2012	70,377	80,247	47,755	62,303	2,341	86,151	445,677	794,851
As at 31 December 2011	110,520	109,589	64,933	83,547	31,073	121,374	407,255	928,291

Notes to the financial statements (continued)

for the year ended 31 December 2012

32. Market risk

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

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

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

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

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

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

32.1. Foreign currency risk

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

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

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

	HRK	EUR	USD	Other currencies	Total
	HRK`000	HRK`000	HRK`000	HRK`000	HRK`000
As at 31 December 2012					
Assets					
Cash and balances with banks	39,627	73,555	1,896	760	115,838
Obligatory reserve with the CNB	68,465	9,085	5,956	-	83,506
Placement with banks	-	29,703	-	-	29,703
Loans and advances to customers	242,923	483,065	-	2,682	728,670
Available for sale financial assets	3,096	19,615	-	-	22,711
Held to maturity financial assets	3,262	-	-	-	3,262
Other assets	10,483	22	-	-	10,505
Total financial assets	367,856	615,045	7,852	3,442	994,195
Liabilities					
Deposits from customers	129,961	706,130	5,822	2,635	844,548
Due to banks	15,098	63,041	-	-	78,139
Hybrid instruments		27,576	-	-	27,576
Repurchase agreements	10,600	-	-	-	10,600
Other liabilities	10,371	746	-	-	11,117
Total financial liabilities	166,030	797,493	5,822	2,635	971,980
Net on-balance sheet financial position	201,826	(182,448)	2,030	807	22,215
Loan commitments	13,158	13,862	4,905	-	31,925
Nominal value of FX Forward	-	14,210	-	-	14,210
As at 31 December 2011					
Total financial assets	233,335	810,067	7,869	6,946	1,058,217
Total financial liabilities	233,464	776,671	8,038	4,470	1,022,643
Net on-balance sheet financial position	(129)	33,396	(169)	(2,476)	35,574
Loan commitments	9,813	27,786	4,836	-	42,435

Notes to the financial statements (continued)

for the year ended 31 December 2012

32.2. Interest rate risk

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

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

	Up to 1 month HRK`000	1-3 months HRK`000	3-12 months HRK`000	1-3 years HRK`000	Over 3 years HRK`00	Non interest HRK`000	Total HRK`000
As at 31 December 2012							
Assets							
Cash and balances with banks	-	-	-	-	-	115,838	115,838
Obligatory reserve with CNB	-	-	-	-	-	83,506	83,506
Placements with banks	21,472	-	4,731	-	-	3,500	29,703
Loans and advances to customers	199,109	31,036	79,402	133,274	285,849	-	728,670
Available for sale financial assets	167	-	-	-	21,476	1,068	22,711
Held to maturity financial assets	1,051	957	1,254	-	-	-	3,262
Other assets	-	-	-	-	-	10,505	10,505
Total financial assets	221,799	31,993	85,388	133,274	307,325	214,416	994,195
Liabilities							
Deposits from customers	146,678	135,149	472,499	66,527	23,695	-	844,548
Due to banks	40,835	1,486	5,482	14,665	15,671	-	78,139
Hybrid instruments	925	-	121	120	26,410	-	27,576
Repurchase agreements	10,600	-	-	-	-	-	10,600
Other liabilities	-	-	-	-	-	11,117	11,117
Total financial liabilities	199,038	136,635	478,102	81,312	65,776	11,117	971,980
Net on-balance sheet financial position	22,761	(104,642)	(392,714)	51,962	241,549	203,299	22,215
As at 31 December 2011							
Total financial assets	326,900	51,599	163,869	193,467	308,978	13,404	1,058,217
Total financial liabilities	169,669	146,653	494,933	69,492	129,937	11,959	1,022,644
Net on-balance sheet financial position	157,232	(95,054)	(331,064)	123,975	179,040	1,445	35,573

Notes to the financial statements (continued)

for the year ended 31 December 2012

32.3. Liquidity risk

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

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

32.3.1. Funding approach

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

32.3.2. Non-derivative cash flows

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

As at 31 December 2012	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
	HRK' 000	HRK' 000	HRK' 000	HRK' 000	HRK' 000	HRK' 000
Deposits from customers	146,678	135,149	472,499	66,527	23,695	844,548
Due to banks	40,835	1,486	5,482	14,665	15,671	78,139
Hybrid instruments	925	-	121	120	26,410	27,576
Repurchase agreements	10,600	-	-	-	-	10,600
Other liabilities	8,162	1,027	1,731	195	1	11,117
Total liabilities (contractual maturity dates)	207,200	137,663	479,833	81,507	65,777	971,980
Total liabilities on unused loans (expected maturity dates)	6,060	1,232	6,310	18,235	88	31,925

Notes to the financial statements (continued)

for the year ended 31 December 2012

32.3.2. Non-derivative cash flows (continued)

As at 31 December 2011	Up to 1 month	1- 3 months	3-12 months	1-3 years	Over 3 years	Total
	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000	HRK'000
Deposits from customers	155,031	143,999	455,495	54,106	30,386	839,017
Due to banks	13,125	1,447	4,908	14,437	20,361	54,278
Hybrid instruments	1,415	1,207	8,428	949	79,190	91,189
Repurchase agreements	98	-	26,102	-	-	26,200
Other liabilities	11,959	-	-	-	-	11,959
Total liabilities (contractual maturity dates)	181,628	146,653	494,933	69,492	129,937	1,022,643
Total liabilities on unused loans (expected maturity dates)	28,232	1,655	8,918	2,404	1,226	42,435

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

32.3.3. 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 instruments (Note 29), are summarised in the table below.

(b) Other financial instruments

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

	No later than 1 year	1-3 years	Over 3 years	Total
	HRK'000	HRK'000	HRK'000	HRK'000
As at 31 December 2012				
Loan commitments	13,602	18,235	88	31,925
Guarantees, letters of credit and other	15,193	365	-	15,558
Nominal value of FX Forward	-	-	-	14,210
Total	28,795	18,600	88	61,693
As at 31 December 2011				
Loan commitments	38,805	2,404	1,226	42,435
Guarantees, letters of credit and other	13,903	2,691	-	16,594
Nominal value of FX Forward	-	-	-	14,210
Total	52,708	5,095	1,226	73,239

Notes to the financial statements (continued)

for the year ended 31 December 2012

32.3.3. Off-balance sheet items (continued)

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

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

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

32.4. Fair values of financial assets and liabilities

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

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

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

	31/12/2012			31/12/2011		
	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000	Level 1 HRK'000	Level 2 HRK'000	Total HRK'000
Bonds	21,644	-	21,644	30,933	-	30,933
Investments funds	464	-	464	470	-	470
Equity securities	463	141	604	2,234	141	2,375
	22,571	141	22,712	33,637	141	33,778

Notes to the financial statements (continued)

for the year ended 31 December 2012

32.4. Fair values of financial assets and liabilities (continued)

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

	Carrying value		Fair value	
	2012	2011	2012	2011
	HRK`000	HRK`000	HRK`000	HRK`000
Financial assets				
Placements with banks	29,703	87,432	29,703	87,432
Loans and advances to customers	728,670	795,854	728,670	795,854
Held to maturity financial assets	3,262	3,269	3,262	3,269
Other assets	10,505	7,958	10,505	7,958
Total financial assets	772,140	894,513	772,140	894,513
Financial liabilities				
Deposits from customers	844,548	839,017	844,548	839,017
Due to banks	78,139	54,278	78,139	54,278
Hybrid instruments	27,576	91,189	27,576	91,189
Repurchase agreements	10,600	26,200	10,600	26,200
Other liabilities	11,117	11,959	11,117	11,959
Total financial liabilities	971,980	1,022,643	971,980	1,022,643

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

(a) Cash and funds with Central bank

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

(b) Financial assets held-to-maturity

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

(c) Due from other banks

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

32.4. Fair values of financial assets and liabilities (continued)

(d) Loans to and receivables from customers

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

(e) Due to other banks and customers

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

32.5. Capital management

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

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

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

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

Notes to the financial statements (continued)

for the year ended 31 December 2012

32.5. Capital management (continued)

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

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

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

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

	2012 HRK'000	2011 HRK'000
Tier 1 capital		
Share capital (less treasury shares)	336,408	284,608
Reserves from profit after taxation	1,013	1,013
Share premium	772	772
Reserves for treasury shares	476	476
Less: Accumulated loss and other deductions	(263,523)	(197,784)
Total qualifying Tier 1 capital	75,146	89,085
Tier 2 capital		
Hybrid instruments	26,531	80,139
Total qualifying Tier 2 capital	26,531	80,139
Total regulatory capital	101,677	169,224
Risk-weighted assets:		
Credit risk exposure	909,441	1,002,613
Operating risk exposure	75,202	60,657
Currency risk exposure	10,249	42,835
Total risk-weighted assets	994,892	1,106,105
Capital adequacy ratio	10.22	15.30

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

According to Decision from 21 July 2011, the Croatian National Bank enforced the Bank to assure the capital adequacy ratio at the level of at least 14% in the period from 30 September 2011 to 30 June 2012, until the revenues realized by the Bank are sufficient to cover all the costs and risks of the Bank's business activities as also support of the regulatory capital increase.

Approval of financial statements

for the year ended 31 December 2012

33. Post balance sheet events

In January 2013, the Bank has signed a contract with its majority owner Cassa Risparmio della Repubblica di San Marino S.p.A on the hybrid deposit in the amount of EUR 4 million. The deposit had positive effect on the Bank's capital adequacy ratio, which, after the deposit has been paid in, arose above the regulatory limit of 12%.

34. Approval of financial statements

Financial statements set out on pages 4 to 59 were approved by the Management Board on 2 April 2013.

Gian Luigi Bonfe
President of the Management Board



Darko Kosovec
Member of the Management Board

