BKS Bank d.d.
Annual report and financial statements for 2012.

Rastite s nama!

BKS Bank

CONTENT

Report by the President of the Management Board

On behalf of the Management Board of BKS Bank d.d. Rijeka, I wish to present the business results of the Bank achieved in the year 2012.

At the macroeconomic level, this was another year affected by the crisis, with the GDP falling by 1.8%. Cumulatively, since 2008 until today, GDP fell by about 10%. Of course, this economic decline of activities, that lasts through many years, brings other unwanted effects, the increase of unemployment (about 20%), the growth of public debt (54% in relation to GDP), reduced purchasing power, inflation (3-4%) and generally a very poor investment climate, which also resulted in a reduction of the investment rating by the rating agencies.

However, we still have the confidence of foreign creditors, which resulted in lower rates of government borrowing, as well as in the country and abroad.

Several years of stagnation and decline in economic activities, the introduction of strict financial controls, and the tax burden of the economic sector, has resulted in numerous bankruptcies of companies and job losses. At the end of 2012 the Government introduced Prebankruptcy settlement procedures, through which creditors are trying to save those companies with problems that have perspective and a market for their products through settlements.

For the banking sector, these procedures mean new problems and provision bookings for non-performing loans, and thus the business losses.

In the Corporate sector, non-performing loans represent 25% of total loans, and according to some indicators, even 40% of debtors have serious difficulties in its operations and with repayment of loans. Small banks are particularly affected, so that, according to unaudited indicators, such as many as 14 small banks will show an operating loss for the year 2012.

Unfortunately, BKS Bank d.d. Rijeka, follows this trend; year 2012 ended with a positive operating result of EUR 295,3 thousand but provisions for problem loans and interest and fee receivables amount to EUR 1,030.9 thousand, so that the loss before tax for year 2012 amounts to EUR 735,7 thousand.

Year 2012 ended with a balance sheet of EUR 159.4 million, which is 11.88% more, if compared to previous year, and 6% higher than planned for 2012. Loans to customers increased by 10% and amounted to EUR 98.7 million, but the budget was achieved with 92%, although as of 30.9.2012 the annual budget reached 95%. In fact, in the last quarter, due to the overall crisis and bad indicators, the Bank led significantly tighter credit policies.

In the Banks' liabilities, customer deposits prevail with EUR 70.2 million (53.4% of total liabilities) and loans from BKS Bank AG in the amount of EUR 49.5 million (31%) and capital with reserves of EUR 27.7 million (17.4% of the Balance sheet total).

At the end of 2012 there were 61 employees employed, resulting in assets per employee amounting to HRK 19.7 million.

Report by the President of the Management Board (continued)

Although during 2013 we expect the Croatia's accession to the European Union, we have no illusions that the macroeconomic environment will significantly change and improve. Therefore, in this situation, our priority tasks remain:

- Loans growth and decrease in deposit prices, and consequently a higher profitability and operating result according to the budget
- Further development of retail operations, through the expansion of credit and deposit base, and a significant increase in the number of retail clients
- Management of non-performing loans, given that the proportion of non-preforming loans in the total loans increased from 2.8% in 2011 to 11.1% in 2012. First of all we need to reduce the percentage of non-performing loans through collection of available assets or restructuring of liabilities of those clients who have a perspective and a chance for survival. Our priority will be reducing the share of problem loans and we will achieve it through a restrictive and conservative credit policy.

I would like to use this opportunity to thank all our clients and business partners for their confidence and support, and all the employees for their hard work and dedication during this challenging year.

Goran Rameša
President of the Management Board

Financial data from profit and loss account

During the course of financial year 2012 the Bank recorded a loss after taxes in amount of HRK 5,33 million.

In 2012 interest income amounted to HRK 50.9 million, which was HRK 6.5 million higher (14.6%) compared to the previous year. The highest increase in interest income was the result of the growth of loans to customers. Interest income from loans to customers contributed with 93% in the total recorded interest income.

Interest expenses for 2012 amounted to HRK 22.2 million. They consist of interest expenses for deposits from customers amounting to HRK 16.1 million (73%) and interest expenses for interbank loans of HRK 6.1 million. During 2012 corporate clients primarily kept term deposits in HRK and in HRK with FX clauses, while retail clients maintained term deposits in foreign currency.

Net income from fees amounted to HRK 3.4 million and was for HRK 1.8 million lower if compared to the previous year.

In 2012, total operating income amounted to HRK 34 million, while in 2011 operating income amounted to HRK 33.8 million, representing a decline of 0.6%.

Expenses arising from the increase of credit risk related provisions amounted to HRK 7.0 million.

In the current year the Bank has no obligation to pay income tax. Loss after tax amounts to HRK 5.33 million, while in 2011 profit after tax amounted to HRK 55 thousand.

Funds sources

FUND SOURCES

The balance sheet total of BKS Bank d.d. Rijeka, reached in 2012 HRK 1,201 million, that represents an increase of 11.88% when compared with the previous year.

The structure of total sources, has involved changes as follows: the share of borrowed (deposits and taken loans) funds decreased from 87.46% to 82.58%, meaning that own funds (capital, profit and reserves) contribute to 17.42% of total funds. This increase, results in its major part from the recapitalization performed in November 2013 in amount of HRK 80 million.

Within borrowed funds, the share of taken deposits and other liabilities decrease for 5.9 percentage points to 55.6%, while the secondary sources increased from 36.67 to 42.34%. This increase is a result of taking additional borrowings from our parent bank, BKS Bank AG in the total amount of EUR 11 million.

Total deposits compared to prior year have decreased by more than HRK 26 million or 4.5%, and their share in total liabilities has decreased for 5.83 percentage points, to the level of 55.63%.

Deposits in HRK, decreased by 36.6%, to HRK 159 million, and their share in the whole deposit portfolio represents 29%.

Deposits in foreign currency increased and amount to HRK 163 million.

Corporate deposits dominate with 74.80%, while retail deposits amount to 25.14%.

OBLIGATORY RESERVE, LIQUIDITY AND TREASURY

Aiming to stabilize the kuna vs. euro exchange rate, i.e. to ease depreciation pressures, to speed economic recovery by larger and more favorable loans to be granted for projects contributing to healthy growth, rational employment and balance of payment improvement, in 2012, Central National Bank, on two occasions modified the reserve requirement rate. First intervention was in January, when the rate increased from 14% to 15%, and the second was in April, with a decrease to 13.5%.

With the first intervention, CNB withdraw approximately HRK 3.1bn from the banking system (HRK 2.6bn from the kuna component and HRK 0.5bn from the foreign exchange component of reserve requirements).

With the intervention in April, CNB also exclude the funds received from five multilateral development banks from the calculation base with aim were the release to banks an approximate amount of HRK 4.1bn from the kuna component and slightly over EUR 110m from the foreign exchange component of reserve requirements.

Total calculated obligatory reserve in HRK has scaled up with increase of deposits in range from HRK 57 million in January up to HRK 79 million in December. Calculated obligatory reserve in foreign currencies has been at its minimum in January (EUR 1,056 thousand and USD 526 thousand) and highest in December (EUR 1,528 thousand and USD 770 thousand).

During the 2012, the Bank's HRK liquidity position oscillated, from periods of overliquidity to periods of high liquidity needs.

In periods of high liquidity Bank invested in reserves, particularly held in shares in investment funds nominated in HRK and currency close in EUR. Also in Treasury bills nominated in currency close in EUR, and in EUR, deposits within CNB and loans to other Croatian Banks.

Funds sources (continued)

Loans to other banks amounted on average to HRK 2.35 million daily, and the average amount invested in investment funds were about HRK 7.9 million daily.

In periods of high liquidity and no possibilities of placements to other banks, the Bank held overnight deposits within CNB accounts with under 0.25% interest rate.

In the 2012, the Bank holds treasury bills in the average amount of HRK 13.34 million with the maturity of 91 and 364 days and with interest rate from 3.5% till 4.5% for treasury bills with currency close.

In 2012, Croatian Ministry of Finance, for the first time release Treasury Bills in EUR. On auction held in February, the Bank has bought bills of EUR 2.5 million with interest rate 5.25%.

As at 31st December 2012 the Bank held in its books treasury bills in amount of EUR 2.5 million with maturity of 1.5 years (in August 2013) with interest rate 5.25%.

Also, on 31st December 2012, the Bank held in its books shares in investment funds in amount of HRK 26.54 million and HRK 19.23 million linked to EUR with currency clause.

Average interest rate, for placements in HRK, during the 2012 did oscillate, and was from 0.8% up to 2%.

According to money market prices the weighted average rates for overnight lent deposits, were from 0.62% to 1.02%, although the average rates for term deposits were from 0.70 till 1.61%.

As in previous years Bank has borrowed HRK funds from its parent Bank, BKS AG Klagenfurt with an average of HRK 4.96 million daily, and funds for liquidity from other banks on the Money market average HRK 5.6 million.

In the periods of higher placements to customers Bank has borrowed funds from BKS Bank AG as tranches of the Master loan agreement. The Bank has withdrawn additional EUR 11 million funds with an interest rate of 3 months EURIBOR plus a margin of 0.5% (average interest of 0.70% p.a.).

On 31st December 2012, total funds withdrawn from BKS Bank AG amounted to EUR 49.5 million.

Foreign currency liquidity was higher than in the previous year, and it was maintained at levels in accordance with the Banks needs and applicable regulations.

During 2012 minimal ratio of receivables and liabilities in foreign currency was higher than minimum requirements. This percentage ranged between 19.37% and 25.08%

Funds in foreign currencies, has been placed to other domestic and foreign banks as short term deposits (average EUR 9.06 million). As that interest rates on foreign currency deposits were lower than in the previous year this resulted in lower income from such positions (income amounted to EUR 31 thousand).

According to the Bank's internal policy and regulatory requirements, a daily analysis of risk exposure was done.

In the situations of long or short currency position, the Bank, whenever possible, managed its positions on the foreign exchange market, selling or buying foreign currencies with other banks. In these operations, the Bank recorded a total income of HRK 1.03 million which was by 13.87% higher if compared to the previous year.

Operations with corporate clients

During 2012 the Bank was focused on its business activities, as in the previous year, besides maintenance of existing portfolio of customers, on acquisition within a market segment of medium and large companies. Besides that, several steps have been performed in regards with financing of state owned companies as well as regional governments and municipalities, and these will remain as one of the goals of the corporate department in 2013. This strategy came as a consequence of ongoing market crisis and market resilience of these medium and large private and state owned companies.

Currently, the Bank operates on two locations, Rijeka and Zagreb, therefore majority of customers and credit portfolio refers to companies from these two regions. In addition, Bank also gradually develops and expands other markets such as Istria, Varaždin and Split regions where in accordance with development and future strategy, new offices / branches might be established. Although it was originally planned to open a branch office in Varaždin, considering the market situation this decision was postponed, especially considering the option of opening a branch in Split - given the positive experience in dealing with customers from that region. Customized service and development of IT sector allow us establishment of a business relationship with a dislocated corporate clients on the entire Croatian territory.

Corporate department is organized through two regional centers located in Rijeka and Zagreb under the authority of Head of corporate department. Each center is organized in teams of 5 employees - Group leader, two corporate account managers and two associates for corporate and (assistant).

Total corporate portfolio (loans and discounted bills of exchange) as of 31 December 2012 amounted HRK 715 milion. Largest share of placements refers to short-term and long-term loans to customers amounting HRK 685 million or 95% of the total exposure towards corporate customers. Remaining amount of HRK 30 million or 5 % of the total exposure to corporate customers refers to discounted bills of exchange. Total exposure of documentary business amounts HRK 59 million. Total amount of unused loans as of 31 December 2012 amounts to HRK 27 million.

Total portfolio growth (corporate clients) in 2012 when compared to 31 December 2011 amounted to 8.6%.

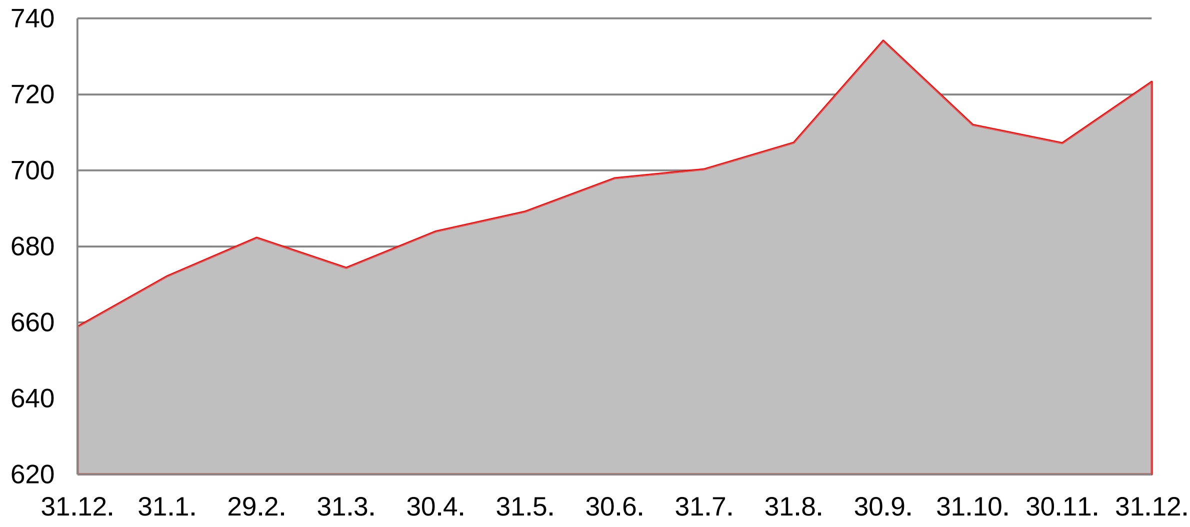
Corporate department Rijeka has achieved significant growth in loans during 2012, more precisely an increase of 11% compared to the exposure on 31 December 2011. Exposure on 31 December 2012 also represents the highest amount of loans to customers placed by Rijeka branch since establishment of the Bank itself. Zagreb branch also records an increase in loans, more precisely 8.8% in comparison with the level of placements on 31 December 2011.

Out of total generated interest revenues on Bank level in 2012, loans towards corporate clients generated 89% of total interest income.

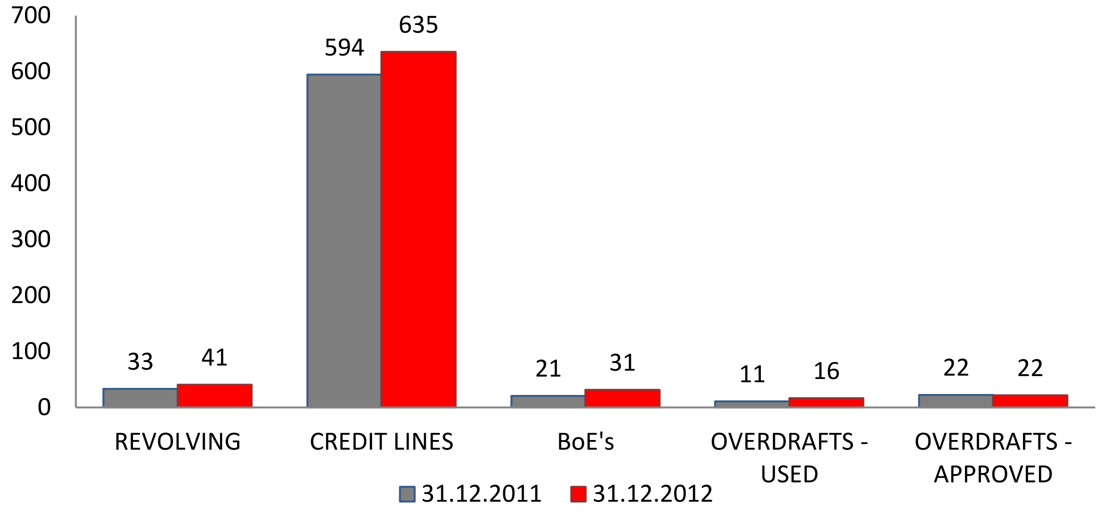
On 31 December 2012 total amount of deposits from legal entities amounted HRK 383 million, out of which HRK 320 million relates to HRK deposits and HRK deposits with FX clause while the rest is related to deposits in other currencies.

Operations with corporate clients (continued)

Graph 1 On-balance exposure development 2012 in HRK million



Graph 2 Comparative exposure by products in HRK million



Operations with corporate clients (continued)

Concentration of risk by economic sector in the portfolio of loans to customers may be presented as follows:

	in HRK thousand					in EUR thousand	
	2012	%	2011	%	Index 2012/2011	2012	2011
Trade and Commerce	229,739	30	195,933	28	117	30,447	26,019
Construction	215,241	28	205,034	29	105	28,525	27,227
Metallurgy	34,340	5	28,886	4	119	4,551	3,836
Transport, warehousing and public services	21,488	3	19,304	3	111	2,848	2,563
Energy	3,018	0	5,700	1	53	400	757
Shipbuilding	15,696	2	23,578	3	67	2,080	3,131
Services	150,151	20	143,711	21	104	19,899	19,084
Individuals and unincorporated businesses	70,654	9	56,460	8	125	9,364	7,498
Miscellaneous	22,153	3	22,061	3	100	2,936	2,930
Total	**762,480**	**100**	**700,667**	**100**	**109**	**101,050**	**93,045**

The analysis of exposures presented above shows that the largest proportion of exposures is recorded in the construction and trade industry. There is also an increase of the exposures to the Shipbuilding sector.

Retail operations

DEPOSITS

Retail deposits as at 31 December 2012 amount to HRK 165 million (€21.7 million) which represents an increase of 29% if compared to 2011. Breakdown of retail deposits as of 31 Decemeber 2011 and 2012 are shown in Table 1 below:

Table1

	In HRK million			In EUR million*	
DESCRIPTION	**31.12.2012**	**31.12.2011**	**INDEKS**	**31.12.2012**	**31.12.2011**
	2	1	3 (2/1*100)	5	4
1. HRK DEPOSITS	**67.5**	**59.9**	**113**	**8.9**	**7.9**
- transaction accounts	2.3	1.0	230	0.3	0.1
- resident giro accounts	51.5	48.4	106	6.8	6.4
- non-resident giro accounts	0.6	0.0	0	0.1	0.0
- saving accounts in HRK	1.7	2.0	85	0.2	0.3
- term deposits in HRK	11.4	8.5	134	1.5	1.1
2. FOREIGN DEPOSITS	**97.2**	**67.5**	**144**	**12.8**	**8.9**
a) residents	71.1	47	151	9.4	6.2
- a vista	5.1	4.5	113	0.7	0.6
- term deposits	66.0	42.5	155	8.7	5.6
b) non-residents	26.1	20.5	127	3.4	2.7
- a vista	2.4	1.6	150	0.3	0.2
- term deposits	23.7	18.9	125	3.1	2.5
RETAIL DEPOSITS TOTAL (1+2)	**164.7**	**127.4**	**129**	**21.7**	**16.8**
DEPOSITS TOTAL	551.4	577.4	95	73.0	76.7
RETAIL DEPOSITS SHARE IN TOTAL DEPOSITS in %	29.8	22.0		29.8	22.0

*CNB exchange rate as of 31 December 2012 1€ = 7,545624 HRK

From the above figures it is evident that the most significant growth was achieved in position of transaction accounts with domestic physical persons, which primarily relates to the balance of giro account of buildings (reserve funds). Term deposits in domestic and foreign currency also grew significantly.

Retail operations (continued)

LOANS

As of 31 December 2012 retail loans amounted to HRK 70.7 million (€ 9.4 million) which represents growth of HRK 14.2 million, or 25% when compared to 31 December 2011. This increase is mostly due to increase of loans to private persons and loans for buildings.

Within total Bank's loan portfolio, retail loans participated with 9% which if compared to 31 December 2011 presents an increase of 1.2%.

RETAIL DEPARTMENT BUSINESS ACTIVITIES IN 2012.

During 2012 the Bank has intensified its orientation towards retail clients (especially in the Zagreb area), adaption to the needs of clients, and acitivities of monitoring market trends.

At the same time, the Department was actively involved in adapting to new legislation, as well as in modification of existing application systems of the Bank.

Human resources

Business year 2012, from the perspective of the human resource management, can be characterized as a year of investment in the existing employees in the manner of improving knowledge, skills and other competencies, investing in their motivation, commitment and mutual loyalty and, under conditions of severe economic situation, providing and reserving of various social and other rights and conditions that our employees have and which significantly exceed the statutory level.

During 2011, within the segment of business with clients, a team of experienced and highly market-oriented young people had been acquired, and we entered in 2012 well-staffed. Guided by the idea that for achievement of business goals, after ensuring the optimal number and profile of employees, it is necessary to support and enable them to acquire knowledge and skills, for employees in *front* departments (corporate and retail), a comprehensive education program in sales skills, with our external associates (companies: *Vernar-Adria* and *Develor)*, was organized.

Furthermore, in 2012 in cooperation with company *Develor* the developmental educational program in management skills that began in 2010, and that, during the entire period, through various forms (trainings, workshops, coaching), included heads of the organizational units and members of the Management Board, has been continued.

Best practice education for IT employees, needed for innovation and standardization of the management of IT processes in the bank and their integration into the bank's operations, were also ensured.

Aware of the fact that the overall operations and the result of the Bank depend on the commitment and motivation of each employee, the system of setting individual goals and monitoring work performance through annual interviews between the employee and superior, has been implemented. This system is treated as an excellent tool to increase the work efficiency (of employee/organizational unit/bank) as well as a great opportunity to dicuss career planning, raising satisfaction and motivation for work and identify opportunities for promotion for each employee.

As a part of the group program on active promotion of health, all employees are provided with additional medical insurance policy which ensure a high quality program of preventive medical examinations, specialist and diagnostic tests and therapies. In 2012, a new two-year policy, with our long-term partner in the health insurance, was concluded.

After an active and propulsive previous period in terms of growth and turnover of the staff, the year 2012 represents a rather stagnant period — the most significant change occurred in the Controlling and accounting department where there was a change in head position, and some other, internal transfers and changes on work positions within or between departments. In the next year, a significant increase in the number of employees is also not anticipated, but some internal changes with respect to the announced restructuring and reorganization of certain business processes, are expected.

In the forthcoming period the key activities related to human resources will be based on the normative regulation and harmonization with EU legislation, particularly in the area of employee benefits (wages, bonuses, awards, etc.), the continuation in the organization of educational programs with a focus on employees in Retail, and finding options to maintain a secure, long-term jobs for all employees.

Human resources (continued)

Basic descriptive statistics about employees:

- On December 31, 2012 there were 61 employees (Management Board included) - 52 in headquarter in Rijeka and 9 in Branch office in Zagreb
- Gender: 44 female, 17 men
- Average age: 38.36
- Qualification structure

MR	=	Master of science (4 — 7%)
VSS	=	University degree (42 — 69%)
VŠS	=	Two-three years post secondary school degree; bacc (4 — 7%)
SSS	=	Secondary school degree (11 - 17%)

- 60 employed under indefinite period work contract (open-ended work contract); 1 employed under fix-term contract

Information technology

During 2012 The Bank has worked on the standardization of information technology to provide faster response to technological change to which it is exposed on daily basis. A number of improvements to the information systems have been made, including upgrading of internal control systems and introduction of new modules and improvements to the existing sollutions thereby increasing automation of business processes and reduction of operational risk.

We have conducted a number of tests and the implementation of the Disaster Recovery and „Plan of Business continuity“ that enables to us continuity in providing services to our customers.

The Bank has tested and implemented a number of virtual solutions for critical IT processes that significantly facilitates administration of our information systems and results in significant economic savings.

Change management system has been improved over the CORE application systems that forms the base of support banking operations.

Major attention during 2012 was a focus on security awareness, where great efforts were made to ensure greater safety for our clients. One of the results of these efforts was that in the last quarter of 2012, the Bank started the process of implementing IBM Guardium solutions.

Bank corporate management report

Corporate management consists of a set of relations between the Management Board, the Supervisory Board, the managers, the shareholders and all other interested parties. It represents a structure in the framework where the company's goals are defined together with the ways of achieving them and of monitoring the results.

Responsible corporate management in BKS Bank d.d. is a prerequisite for the creation of durable values both for the shareholders and for all the others who are interested in the successful, safe and stable activity of the Bank accompanied by permanent maintenance and strengthening of confidence in the Bank.

As such, the Bank implements both the applicable external and internal regulations, and the rules of its parent company — BKS Bank AG, Klagenfurt, while ensuring that the latter are not contrary to the regulations in force in the Republic of Croatia, and it also monitors the alignment of its organizational structure, to be able to modify, i.e. adjust it promptly.

In addition to fulfilling the regulatory requirements, the Bank shall promote its corporate management by promoting the corporate culture and the awareness of the importance of the corporate management system.

The key principles of corporate management in the Bank are accomplished through:

(1) safeguarding of the shareholders' rights,
(2) establishment of an organizational structure that permits the setting of strategic goals and the affirmation of basic corporative values as well as an adequate infrastructure focused on their realization and monitoring. This is accomplished, among other things, through the monitoring of the business activities by the Supervisory Board and the functioning of the internal controls system.
(3) successful cooperation of the Supervisory Board and the Management Board of the Bank,
(4) setting up of a clear responsibility line within the Bank,
(5) maintaining good and transparent relations and communication with all banking bodies, employees, management, shareholders, Bank clients and the general public.

The Bank's Management and Supervisory Boards are obliged to ensure the implementation of the corporate management's basic principles. The Bank intends to document the external principles of good corporate management as well as its own practice in writing, in an internal document. The Bank implements the corporate management principles in the following way:

1. Shareholders and Bank General Meeting

1.1. Shareholders

Shareholders realize their voting right at the Bank General Meeting, and the right to participate goes to all subjects that have been registered as shareholders 15 days before the General Meeting is held.

Each share entitles its holder to one vote, to the dividends and other rights stemming from the law and the Bank Statute.

1.2. General Meeting

The Bank Management Board calls a General Meeting at least once a year.

Ordinary General Meeting shall be called by the Bank Management Board with no delay after the Supervisory Board has examined the annual financial reports, the Bank's Business Report and the draft decision on profit allocation.

Bank corporate management report (continued)

1.2. General Meeting (continued)

The General Meeting takes notice of the annual financial reports and the Management Board Report regarding the situation in the Bank, and in line with this passes the statement of release, approving the way in which the members of the Bank Management and Supervisory Boards managed the Bank business in the business year in question and also approving the decision on profit allocation.

In line with the law and the Bank Statute, the General Meeting decides on Statute amendments, share capital increases or reductions, appointment and release of the Supervisory Board members and the appointment of an auditor to audit the Bank's activites.

2. Cooperation between the Bank Management and Supervisory Boards

An efficient cooperation has been established between the Bank Management Board and the Supervisory Board. To this end the Management Board, with the approval of the Supervisory Board, adopts the basic business documents — business strategy, risk management strategy and IT strategy as well as the budget (financial plan) for the current year. The Management Board reports regularly (through financial reports submitted on a quarterly and a yearly basis) to the Supervisory Board regarding the Bank’s activities and respective budget fulfillment.

In addition to the activities that, by law, need to be approved by the Bank Supervisory Board, the Management Board, in line with the Rule Book on Management Board (MB) Operations, must obtain approval also for the establishment of new companies and /or for the purchase or sale of shares, for the participation in other legal entities, for the acquisition and the sale of real estate, for the stipulation of contracts of lease of real estate, movables and equipment the duration of which exceeds one year if the annual rental fees exceed the amount of HRK 0.05 million, for investments of the single value exceeding HRK 0.3 million or of the total value in one year above HRK 1 million, for taking loans from a client or related group of clients if the value of one deal i.e. the total value exceeds the amount of HRK 10 million (except for money market and interbank market transactions), for the conclusion of deals causing the exposure towards a single client and the persons related to it in excess of the amounts foreseen by the Bank lending rules, for the definition of the Bank's business policy and strategy, for the definition of the Bank's financial plans, of the yearly general internal audit program, giving of procuration, setting up or cessation of branches or subsidiaries, representative offices, etc.

An important element for a successful cooperation is the presentation of diligently prepared, true and timely reports to the Supervisory Board by the Bank Management Board, in written form — as a rule - on financial plans, risks management, operations that could have an impact on business profitability and Bank liquidity, on the course of business, especially the cash flow and the Bank Balance Sheet as well as on other principled issues of the business activity. At the same time, the Supervisory Board may require any information from the Bank Management Board regarding issues related to the Bank's activity, which have or could have a material impact on its position.

The good cooperation is manifested in the always open debate between the Bank Management Board and the Supervisory Board, as well as among the members in both these bodies.

3. Bank’s Management Board

The Management Board manages the Bank's activity on its own responsibility and represents the Bank before third parties. The Management Board shall act in the Bank's best interest and shall not be guided by personal interests, nor shall it ask or accept any type of benefit from third parties.

Bank corporate management report (continued)

3.1. Competence, structure and remuneration of the Management Board members

Managing the activity the Bank Management Board ensures in particular: that the Bank operates in line with risk management regulations; that it monitors the risks it is exposed to in its activity and that it secures and maintains the adequate level of capital in terms of the risks the Bank is exposed to; the functioning of control functions; the undisturbed performance of external and internal audit; that it conducts business and other books and business documentation, compiles accounting documents, assesses assets and liabilities realistically, draws up financial and other reports in line with accounting rules and standards; that it reports and informs the Croatian National Bank in line with the regulations and that it implements the measures set by the Central Bank.

The Bank Management Board consists of three members at the most. By law, the minimal number of members is two. The exact number of Management Board members shall be defined by the decision of the Supervisory Board. One of the members has to be appointed President of the Management Board.

All Management Board members manage the activity jointly while the single members manage specific business areas as defined by the Rule Book. If the Management Board consists of two members, decisions must be made unanimously. The Management Board members are in charge and responsible for specific business areas. The bank is jointly represented by at least two Management Board members or one member of the Management Board jointly with one authorized signatory.

The remuneration of the Management Board members consist of an agreed fixed pay and a variable portion decided by the Supervisory Board upon the presentation of business and financial reports, taking into account the result that the Bank achieved in the previous year. The variable part of the income (yearly reward — bonus) is limited to a maximum corresponding to 25% of the annual basic pay of the Management Board member. The Supervisory Board and the Bank Management Board take into account the adequacy of income of the MB members compared to the Bank employees, other similar institutions in Croatia and the comparability with similar positions within BKS Bank AG.

3.2. Conflict of interests

The regulations (internal and external) which regulate the conflict of interests are transparent and are followed in the Bank in the best possible way.
Pursuant to the mentioned regulations, and particularly the provisions of the Code of Professional Conduct, the Rule Book on MB Operations as well as the contracts on the managers' rights and obligations, Bank`s Management Board members:

(1) must not, without the consent of the Supervisory Board, participate in third parties or partnerships, either directly or indirectly,
(2) must not, either for their own or for some other's account, perform activities falling under the scope of the activity of the Bank (competition ban),
(3) may not be Supervisory Board members of a third company without the consent of the Supervisory Board,
(4) are obliged to report to the Bank`s Supervisory Board any activity whereby a member of the Management Board or next of his kin of first degree acquires or sells - directly or indirectly shares or other securities issued by the Bank,
(5) are obliged to report to the Bank`s Supervisory Board a transaction by which a member of his closest family, directly or indirectly, individually or jointly acquire or release shares or business interests that exceed or fall below a qualified share. shares or other securities issued by the Bank Likewise, Management Board members shall not use, either for their own or for the account of third parties any notions, information and business contacts, that they can obtain while carrying out their office of Management members.

Bank corporate management report (continued)

3.2. Conflict of interests (continued)

Pursuant to statutory regulations, Bank lending to the Management Board members, to the members of their immediate family, to legal entities related to the Bank Management Board members — is subject to Supervisory Board approval.

In performing their duties Management Board members must not be guided by their personal interests, nor are they allowed to ask or accept any benefit and/or advantage, either for themselves or for any other party, nor to promise or grant any such benefit and/or advantage — on behalf and for account of the Bank - to these parties. Moreover, the Management Board is obliged to undertake all adequate and reasonable measures in order to ensure that the members of the Management Board and the Bank employees do not act contrary to the ban on divulgation and utilization of privileged information prescribed by the Securities Market Act.

3.3. Bank Management Board Committees

The Bank Management Board may establish various permanent or temporary bodies to assist it in the performance of its functions (e.g. ALCO Committee, etc.)

4. Bank's Supervisory Board

4.1. Competence, structure and remuneration of the Supervisory Board members

Once a year the Bank Supervisory Board submits to the Bank General meeting a report on its work and the work of the committees it has established.

The Bank Supervisory Board monitors the performance of the Bank's operations and in particular: appoints and recalls the members of the Management Board, convokes the General Meeting as required, gives the order to the auditor to examine the annual financial reports, participates in the definition of the annual financial reports, submits a written report on performed supervision to the General Meeting, represents the Bank before the Management Board, gives prior approval to the Management Board decisions when this is prescribed by law, the Statute or the Rule Book on MB Operations. In this way, the Supervisory Board directs the Bank' activity and supervises the business management actively.

In line with the Bank's Statute, the Supervisory Board may have at least three, five or seven members appointed by the Bank's General Meeting, but one of the Supervisory Bord members must be independent one. The General Meeting also decides which of the mentioned number of members to choose. The Supervisory Board members appoint the president and his deputy among themselves.

The Supervisory Board members may be granted a reward for their work in the Board. The decision in this respect is made by the General Meeting. No reward has been paid to the Supervisory Board members.

4. Bank's Supervisory Board

4.2. Conflict of interests

All the Bank Supervisory Board members are obliged to act in the Bank's best interest and in making decisions they cannot be guided by their own profit nor may they use their position in order to acquire some personal benefit.

Bank corporate management report (continued)

4.2. Conflict of interests (continued)

The Supervisory Board members may not point out their membership in the Supervisory Board in public with the purpose of gaining any illicit, personal or professional benefit which may jeopardize the Bank's reputation or any other interest of the Bank. They are also compelled to report to the bank any operation whereby the member or any of their kin of first degree, acquires or disposes of the shares or any other securities issued by the Bank, either directly or indirectly.

The Supervisory Board members shall inform the CNB about the appointment or termination of their office in management or supervisory boards of other legal entities, as well as about any deals based on which they or the members of their immediate family have, directly or indirectly, individually or jointly, acquired shares in the legal entity, based on which they have acquired or their shares have fallen below the qualified share.

4.3. Bank Supervisory Board Committees

For the purpose of quality preparations under the competence of the Bank Supervisory Board and the monitoring of the implementation of the decisions made and in order to increase the Supervisory Board's efficiency, the Audit Committee, the Personnel Committee and the Working Committee have been established to perform the monitoring within the scope of their competence and to make the decisions that fall under the competence of the Supervisory Board, prepare the draft decisions to be adopted at the Supervisory Board. The committees also report their activities to the Supervisory Board.

The Auditing Committee supervises the financial reporting; it monitors the efficiency of the system of internal control, audit and risk management systems; it supervises the financial reports' auditing, monitors the auditors' independence and gives recommendations to the Supervisory Board for the appointment of an independent auditor and performs other tasks in line with statutory regulations.
The Working Committee monitors all loans, assessments and other asset-related commercial activities (assets BKS Bank d.d.). Moreover the Committee is responsible for monitoring the Bank's overall activities that are subject to Supervisory Board approval.

The Personnel Committee monitors and deals with the relations between the Management Board and the Bank itself. Given the fact that the decision on appointment and revocation of the Management Board members as well as on the Bank's representation before the Management Board falls under the competence of the Supervisory Board, the Personnel Committee shall supervise and examine the relevant documentation to the extent of its powers, it will discuss the problems and the measures and prepare the draft decisions for the decisions to be adopted by the Supervisory Board.

5. Internal controls system

The internal controls system is a system of processes and procedures set up to monitor the Bank's business efficiency, the reliability of its financial information and the compliance with the laws, regulations and good practice, all in order to protect the Bank's assets.

For this purpose an internal controls system has been established in the Bank as a system of procedures and processes for monitoring the efficiency of the Bank's operations, the reliability of financial reporting and adherence to statutory regulations and good business practice. This system is structured according to the size, structure and scope of activity and of the identified risks. This system is the subject of permanent upgrading and adjustment to the standards of the parent bank.

Bank corporate management report (continued)

5. Internal controls system (continued)

In addition to the members of the Bank Management Board and of the Supervisory Board, all employees and organizational units of the Bank take also part in the implementation of the mentioned control measures, integrated either directly or indirectly in the business processes.

The internal control system in the Bank functions through three mutually independent functions:

(1) the risks monitoring function,
(2) the compliance monitoring function; and
(3) the internal audit function.

Here we also need to add the activities linked to the prevention of both money laundering and the financing of terrorist activities.

A well established internal controls system enables the Bank a timely monitoring and detection of any materially significant risk to which it may be exposed while performing its activity. The Bank develops an internal controls system adjusted to the standards of its parent Bank.

6. Transparent and timely reporting, external and internal communication

The responsibility for communicating with the public lies with the Management Board.

PR as well as the marketing functions are centralized at BKS Bank AG level, wherefrom, with the agreement of the Management Board, both public relations and internal communications get coordinated and managed. The Bank puts special emphasis on relations and communication with the clients, which are subject to provisions of the Code of Conduct, and the Ethics Code in Business, approved by the Croatian Chamber of Commerce, which has been accepted by the Bank.

The Bank's shareholders and the general public receive timely information through the mass media about the Bank's business, the financial results and the material facts that could have an impact on the Bank's structure and the value of its capital.

The Bank's financial statements are audited on a regular basis by a recognised auditing company that, in principle, belongs to the same auditing group as the company that audits the reports of the parent bank.

In line with the above mentioned, BKS Bank d.d. Rijeka hereby declares that a corporative structure has been established in the Bank, adequate to the business size, scope and structure and to the risks the Bank is exposed to, and that the Bank, considering its position within the BKS Bank AG Group as well as the environment in which it operates, is well organized and that business in 2012 was conducted adhering to the principles and guidelines of corporative management, which will continue to be followed in future as well.

Goran Rameša
President of the Management Board

General data

Bank Bodies	
General Meeting	Chairman is elected among the Supervisory Board members
Supervisory Board	Herta Stockbauer, President Dieter Vinzenz Krassnitzer, Deputy President Josef Morak, member Harald Richard Brunner, member Ludwig - Hubert Ankele, member
Management Board	Goran Rameša, President Peter Christian Pettinger, member

Address
Mljekarski trg 3, 51000 Rijeka, Hrvatska

SWIFT :
BFKKHR22

Web :
www.bks.hr

Giro account:
2488001-1011111116

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

The Management Board of the Bank is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Bank and of the results of its operations and cash flows, in accordance with accounting requirements for banks in Croatia, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

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

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements for acceptance. If the Supervisory Board approves the annual financial statements they are deemed confirmed by the Management Board and Supervisory Board.

The financial statements set out on pages 24 to 78, as well as supplementary information prescribed by a decision of the Croatian National Bank on pages 79 to 89, which is not part of financial statements, were authorised by the Management Board on 5 March 2013 for issue to the Supervisory Board and are signed below to signify this.

For and on behalf of BKS Bank d.d.:

Goran Rameša
President of the Management Board

Peter Christian Pettinger
Member of the Management Board

Independent Auditors' Report to the shareholder of BKS Bank d.d.

We have audited the accompanying financial statements of BKS Bank d.d. ("the Bank"), which comprise the balance sheet as at 31 December 2012, the income statement, statement of changes in equity and cash flow statement for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with statutory accounting requirements for banks in Croatia, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2012, and of its financial performance and its cash flows for the year then ended in accordance with statutory accounting requirements for banks in Croatia.

Independent Auditor's Report to the shareholder of BKS Bank d.d. (continued)

Other legal and regulatory requirements

Pursuant to the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of Banks, dated 30 May 2008 (Official Gazette 62/08), the Management Board of the Bank has prepared the schedules set out on pages 79 to 85 ("the Schedules"), which comprise an alternative presentation of the balance sheet as of 31 December 2012, and of the income statement, statement of changes in equity and cash flow statement for the year then ended, and a reconciliation ("the Reconciliation"), as presented on pages 86 to 89, of the Schedules with the financial statements as presented on pages 24 to 78. The Management Board of the Bank is responsible for the Schedules and the Reconciliation. The financial information in the Schedules is derived from the financial statements of the Bank set out on pages 24 to 78 on which we have expressed an opinion as set out above.

Zagreb, 5 March 2013

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

For and on behalf of KPMG Croatia d.o.o. za reviziju:

Joško Džida
Director and Croatian Certified Auditor

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

FOR THE YEAR ENDED 31 DECEMBER

(in thousands of HRK)	Note	2012	2011
Interest and similar income	4a	50,906	44,422
Interest expense and similar charges	4c	(22,155)	(17,949)
Net interest income		**28,751**	**26,473**
Fee and commission income	5a	5,067	7,084
Fee and commission expense	5b	(1,618)	(1,823)
Net fee and commission income		**3,449**	**5,261**
Net trading income from dealing in foreign currencies		1,087	945
Net income from investment securities	6	316	514
Other operating income	7	459	650
Operating income		**34,062**	**33,843**
Impairment losses on loans and advances to customers	14b	(5,037)	(3,431)
Other impairment losses and provisions	8	(2,742)	(1,059)
Operating expenses	9	(31,834)	(29,309)
(Loss)/Profit before income tax		**(5,551)**	**44**
Income tax benefit	10a	217	11
(Loss)/Profit for the year		**(5,334)**	**55**

The accompanying accounting policies and other notes on pages 28 to 78 form an integral part of these financial statements.

BALANCE SHEET

AS AT

(in thousands of HRK)	Note	31 December 2012	31 December 2011
ASSETS			
Cash reserves	11	123,598	128,514
Obligatory reserve with the Croatian National Bank	12	95,009	66,996
Loans and advances to banks	13	103,363	83,522
Loans and advances to customers	14a	745,062	687,946
Financial assets at fair value through profit or loss	15	45,772	21,000
Available-for-sale financial assets	16	1,276	1,376
Held-to-maturity investments	17	48,693	42,212
Property and equipment	18	23,208	24,369
Intangible assets	19	6,171	7,157
Deferred tax assets	10b	875	658
Other assets	20	8,021	9,756
Total assets		**1,201,048**	**1,073,506**
LIABILITIES AND EQUITY			
LIABILITIES			
Deposits from banks	21	22,119	28,263
Deposits from customers	22	529,354	549,198
Borrowings	23	419,941	344,349
Provisions for liabilities and charges	24	2,534	1,807
Other liabilities	25	17,852	15,307
Total liabilities		**991,800**	**938,924**
EQUITY			
Issued share capital	26	200,000	120,000
Statutory reserve	27a	2,778	2,775
Reserve for general banking risks	27b	-	-
Retained earnings	27c	6,470	11,807
Total equity		**209,248**	**134,582**
Total liabilities and equity		**1,201,048**	**1,073,506**

The accompanying accounting policies and other notes on pages 28 to 78 form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUITY

(in thousands of HRK)	**Issued share capital**	**Statutory reserve**	**Reserve for general banking risks**	**Retained earnings**	**Total**
Balance at 1 January 2011	**120,000**	**2,757**	**1,842**	**9,928**	**134,527**
Profit for the year	-	-	-	55	55
Total recognised income for 2011	-	-	-	55	55
Transfer to statutory reserve	-	18	-	(18)	-
Transfer to retained earnings	-	-	(1,842)	1,842	-
Balance at 31 December 2011	**120,000**	**2,775**	**-**	**11,807**	**134,582**
Balance at 1 January 2012	**120,000**	**2,775**	**-**	**11,807**	**134,582**
Loss for the year	-	-	-	(5,334)	(5,334)
Total recognised loss for 2012	-	-	-	*(5,334)*	*(5,334)*
Transfer to statutory reserve (Note 27a)	-	3	-	(3)	-
Increase in share capital (Note 26)	80,000	-	-	-	80,000
Balance at 31 December 2012	**200,000**	**2,778**	**-**	**6,470**	**209,248**

The accompanying accounting policies and other notes on pages 28 to 78 form an integral part of these financial statements.

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER

(in thousands of HRK)	Note	2012	2011
Cash flows from operating activities			
(Loss)/Profit for the year		**(5,334)**	**55**
Adjustment for:			
Depreciation and amortisation	9	4,975	5,715
Net foreign exchange loss from translation of monetary assets and liabilities	7	377	191
Impairment losses on loans and advances to customers	14b	5,037	3,431
Other impairment losses and provisions	8	2,742	1,059
Income tax benefit	10a	(217)	(11)
Cash flows from operating activities before changes in operating assets and liabilities		**7,580**	**10,440**
Changes in operating assets and liabilities			
Net increase in obligatory reserve with the Croatian National Bank		(28,013)	(19,145)
Net increase in loans and advances to banks		(19,257)	(18,064)
Net increase in loans and advances to customers		(60,623)	(210,864)
Net increase in financial assets at fair value		(24,856)	(1,971)
Net increase in other assets		(180)	(2,924)
Net increase/(decrease) in deposits from banks		(6,144)	6,032
Net increase/(decrease) in deposits from customers		(20,416)	147,093
Net increase in other liabilities		2,557	2,413
Net cash outflow from operating activities before tax		**(149,352)**	**(86,990)**
Income tax paid		-	-
Net cash outflow from operating activities		**(149,352)**	**(86,990)**
Cash flows from investing activities			
Purchase of property and equipment		(510)	(2,274)
Purchase of intangible assets		(2,318)	(1,979)
Net increase in held-to-maturity investments		(6,673)	(7,393)
Net cash outflow from investing activities		**(9,501)**	**(11,646)**
Cash flows from financing activities			
Net increase in borrowings		73,937	164,331
Paid in share capital		80,000	-
Net cash inflow from financing activities		**153,937**	**164,331**
Effect of foreign exchange differences on cash and cash equivalents		-	12
Net increase in cash and cash equivalents		**(4,916)**	**65,707**
Cash and cash equivalents at beginning of year		**128,514**	62,807
Cash and cash equivalents at end of year	11	**123,598**	**128,514**

The accompanying accounting policies and other notes on pages 28 to 78 form an integral part of these financial statements.

1 REPORTING ENTITY

BKS Bank d.d., Rijeka (“the Bank”) is a joint stock company incorporated and domiciled in Croatia. The Bank was formerly known as Kvarner banka d.d. Rijeka. The registered office is at Mljekarski trg 3, in Rijeka. The Bank started its activities in April 1993 and its operations include receiving cash deposits, granting loans and making other placements. The Bank is focused on medium-sized companies and sole traders. The Bank is registered at the Commercial Court in Rijeka with authorised share capital in the amount of HRK 200,000 thousand (31 December 2011: HRK 120,000 thousand).

2 BASIS OF PREPARATION

A) Accounting framework

The financial statements have been prepared in accordance with statutory accounting requirements for banks in Croatia.

Banking operations in Croatia are subject to the Credit Institutions Law, in accordance with which the Bank’s financial reporting is regulated by the Croatian National Bank (“the CNB”) which is the central monitoring institution of the banking system in Croatia. These financial statements have been prepared in accordance with these banking regulations.

The financial statements were approved by the Bank's Management Board on 5 March 2013 for approval by the Supervisory Board.

The principal accounting policies applied in the preparation of these financial statements are summarised below. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards (“IFRS”), reference may be made to certain Standards in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards applicable at 31 December 2012. The accounting regulations based on which these financial statements have been prepared differ from IFRS both in terms of presentation and disclosures as well as in terms of recognition and measurement.

Attention is drawn to the following differences between the accounting regulations of the CNB and recognition and measurement requirements of IFRS:

- The CNB requires banks to recognise impairment losses, in income statement, on assets not identified as impaired (including sovereign risk assets) at prescribed rates (excluding assets carried at fair value). The Bank has made portfolio-based provisions of HRK 10,438 thousand (2011: HRK 9,998 thousand) carried in the balance sheet in compliance with these regulations, and has recognised a charge against income in respect of such provisions of HRK 440 thousand within the charge for impairment losses for the year (2011: charge of HRK 2,727 thousand). Although, in accordance with IFRS, such provisions should more properly be presented as an appropriation within equity, the Bank continues to recognise such provisions in the income statement as a substitute for existing but unidentified impairment losses calculated in accordance with the requirements of IFRS.
- A further difference between IFRS and the accounting regulations of the CNB relates to the determination of impairment losses by discounting the estimated cash flows of the impaired asset at the instrument’s original effective interest rate. The Bank calculates impairment losses on individually significant items by estimating the future cash flows and discounting these estimated amounts at the instrument’s original effective interest rate. The Bank generally recognises the amortisation of such discounts as a release of impairment allowance rather than as interest income. In certain cases, however, collections are recognised as interest income once impairment losses are fully reversed.
- Additionally the CNB prescribes minimum levels of impairment losses against certain specifically identified impaired exposures, which may be different from the impairment loss required to be recognised in accordance with IFRS.

2 BASIS OF PREPARATION (CONTINUED)

B) Basis of measurement

The financial statements are prepared on the fair value basis for financial assets at fair value through profit or loss and financial assets available for sale, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities, and non-financial assets and liabilities, are stated at amortised or historical cost.

C) Use of estimates and judgements

In preparing the financial statements, management has made judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosure of commitments and contingencies at the balance sheet date, as well as amounts of income and expense for the period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances and information available at the date of the preparation of the financial statements, the results of which form the basis for making judgements about the carrying amounts of assets and liabilities that are not readily apparent from other sources. 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 and any future periods affected.

Information about judgements made by management in the application of applicable standards that have significant effect on the financial statements and about estimates that have a significant risk of resulting in a material adjustment within the next financial year are included in Note 33.

D) Functional and presentation currency

The financial statements are presented in Croatian kuna (HRK), which is the Bank's functional and presentation currency. Amounts are rounded to the nearest thousand (unless otherwise stated). As at 31 December 2012 the exchange rates used for translation were HRK 5.7268 to USD 1 and HRK 7.5456 to EUR 1 (31 December 2011: HRK 5.8199 to USD 1 and HRK 7.5304 to EUR 1).

E) Financial crisis impact

The Bank places significant attention on the credit function in order to mitigate the risk of credit portfolio impairment. The impairment allowances and potential losses are regularly monitored.

Although the impact of the financial crisis cannot be predicted, the Bank has undertaken a number of activities focusing on the quality of the portfolio of its existing clients. This includes constant communication with clients and co-operation in terms of adjustment of terms and dynamics of payment, monitoring of the values of collateral obtained and obtaining of additional collateral from client and from the parent bank.

3 SIGNIFICANT ACCOUNTING POLICIES

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

3.1 Interest income and expense

Interest income and expense are recognised in the income statement as they accrue for all interest-bearing financial instruments measured at amortised cost, using the effective interest rate method, i.e. at the rate that discounts estimated future cash flows to net present value over the life of the underlying contract, or an applicable floating rate. Such income and expenses are presented as interest and similar income or interest expense and similar charges in the income statement.

Interest income and expense also include fee and commission income and expense in respect of loans and advances to customers or borrowings from other banks, premium or discount amortisation, and other differences between the initial carrying amount of an interest-bearing financial instrument and its value at maturity, recognised on an effective interest basis.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank does not consider future credit losses. The calculation includes all fees and percentage points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

3.2 Fee and commission income and expense

Fees and commissions mainly comprise fees related to domestic and foreign payments, the issue of guarantees and letters of credit and fees for credit risk analysis services, and are recognised in the income statement upon performance of the relevant service, unless they have been included in the effective interest calculation.

Loan commitment fees for loans that are likely to be drawn down are deferred and recognised as an adjustment to the effective interest rate on the loan. Commitment fees in relation to facilities where draw down is not probable are recognised over the term of the commitment. Other service fees are recognised based on the applicable service contracts.

3.3 Net trading income from dealing in foreign currencies

This category includes spreads earned from foreign exchange trading.

3.4 Net income from investment securities

This category includes gains and losses from disposals of available-for-sale financial assets and financial assets at fair value through profit or loss, and dividend income.

Dividend income on equity securities is credited to the income statement when the right to receive the dividend is established. There was no dividend income recognised in 2012 and 2011.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.5 Foreign currency translation

Transactions in foreign currencies are translated into HRK at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into HRK at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currency that are stated at fair value are translated in HRK at the foreign exchange rates ruling at the dates when the fair values were determined. Non-monetary assets and items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at the balance sheet date.

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

3.6 Employee benefits

Defined pension contributions

The Bank has obligations for defined contributions to pension funds on a mandatory, contractual basis. The Bank has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due.

Provisions for retirement benefits and jubilee awards

In calculating provisions for retirement benefits and jubilee awards, the Bank discounts expected future cash flows in respect of the liabilities, using discount rates that, in opinion of the Bank's management, best represents the time value of money.

3.7 Lease payments

Payments made by the Bank as lessee under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

3.8 Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: financial assets at fair value through profit or loss, available-for-sale financial assets, held-to-maturity investments, loans and receivables or other financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. Management determines the classification of its financial instruments upon initial recognition and, where appropriate, re-evaluates this designation at every reporting date.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.8 Financial instruments (continued)

A) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets which are classified as held for trading or on initial recognition designated by the Bank as at fair value through profit or loss. The Bank does not apply hedge accounting.

As stated above this category has two sub-categories: financial instruments held for trading, and those designated by management as at fair value through profit or loss at inception. Trading assets are those assets that the Bank acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking.

The Bank designates financial assets at fair value through profit or loss when either:

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

Financial instruments at fair value through profit or loss include investments in investment fund units.

At the reporting date the Bank had no financial liabilities measured at fair value through profit or loss.

B) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. Financial assets designated as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates or foreign exchange rates. Available-for-sale financial assets include equity securities.

C) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity. These include Ministry of Finance treasury bills and corporate bills of exchange.

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. They arise when the Bank provides money to a debtor with no intention of trading with the receivable and include loans and advances to banks, loans and advances to customers and the obligatory reserve with the Croatian National Bank.

E) Other financial liabilities

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.8 Financial instruments (continued)

Recognition and derecognition

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

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

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

Initial and subsequent measurement

Financial assets and liabilities are recognised initially at their fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

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

Loans and receivables and held-to-maturity investments and other financial liabilities are measured at amortised cost using the effective interest method.

Gains and losses

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

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

Dividend income is recognised in the income statement. Upon sale or other derecognition of available-for-sale assets, any cumulative gains or losses on the instrument are transferred to the income statement.

Gains or losses arising from financial instruments carried at cost or amortised cost may also be recognised in the income statement when a financial instrument is derecognised or when its value is impaired.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.8 Financial instruments (continued)

Fair value measurement principles

The fair values of quoted investments are based on current closing bid prices.

Impairment of financial assets

Impairment of financial assets identified as impaired

A) Financial assets carried at amortised cost

At each reporting date the Bank assesses 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 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 has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

I) significant financial difficulty of the borrower or issuer;
II) a breach of contract, such as a default or delinquency in interest or principal payments by a borrower;
III) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that it would not otherwise consider;
IV) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
V) the disappearance of an active market for the financial asset because of financial difficulties; or
VI) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.8 Financial instruments (continued)

Impairment of financial assets identified as impaired (continued)

Financial assets are tested for impairment on an individual basis. Those individually significant assets which are not impaired are included in the basis for collective impairment assessment.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (ie, on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

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

B) Financial assets carried at fair value

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity or debt investments classified as available for sale, a significant or prolonged decline in the fair value of the investment below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available for sale financial assets, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity securities are not subsequently reversed through the income statement, but all value increases until the final sales are recognised in equity.

If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss. Changes in impairment provisions attributable to the time value of money are reflected as a component of interest income.

The Bank had no financial assets carried at fair value classified as available for sale at the balance sheet date.

C) Financial assets carried at cost

These include equity securities classified as available for sale for which there is no reliable fair value. The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If such indication exists, impairment loss is recognised in income statement.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.8 Financial instruments (continued)

Impairment of financial assets not identified as impaired

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

Specific instruments

A) *Debt securities*

Debt securities are classified as held-to-maturity investments.

B) *Loans and advances to banks*

Loans and advances to banks are classified as loans and receivables.

C) *Loans and advances to customers*

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

D) *Equity securities*

Equity securities are classified as available for sale and are stated at cost, less impairment, in the absence of any reliable measure of fair value.

E) *Investments in investment funds*

Investments in investment funds are classified as financial assets at fair value through profit or loss and are carried at current fair value.

F) *Cash and cash equivalents*

For the purpose of the cash flow statement, cash and cash equivalents comprise cash in hand and current accounts with bank.

G) *Interest-bearing borrowings*

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

H) *Current accounts and deposits from banks and customers*

Current accounts and deposits are classified as other liabilities and initially measured at fair value less transaction costs, and subsequently stated at their amortised cost (using the effective interest method).

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.8 Financial instruments (continued)

Offsetting of financial instruments

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

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

3.9 Property and equipment

Property and equipment are tangible items that are held for use in the supply of services or for administrative purposes. Property and equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land and assets under development are not depreciated. Depreciation of other assets is recognised in income statement on a straight-line basis over their estimated useful lives as follows:

Buildings	40 years
IT equipment	4 years
Office furniture and other equipment	5-10 years

Depreciation methods and the assets' useful lives are reassessed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

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

3.10 Intangible assets

Intangible assets acquired by the Bank are measured at cost less accumulated amortisation and impairment losses.

Expenditure on development activities are capitalised if all of the features required by International Accounting Standard 38 "*Intangible Assets*" are satisfied. Intangible assets are amortised on a straight-line basis over their estimated useful economic lives as follows:

Software	4 years
Leasehold improvements	5 years

The assets' useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.11 Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or non-current liabilities.

3.12 Impairment of property and equipment and intangible assets

Assets that have an indefinite useful life are not subject to amortisation and depreciation and are tested at least annually for impairment. At the balance sheet date the Bank did not have such assets. Assets that are subject to amortisation and depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets still not brought into use are reviewed at each reporting date. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount.

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

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

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.13 Provisions for labilities and charges

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made, or as required by the law in the case of provisions for unidentified impairment of off-balance-sheet credit risk exposures, as previously referred to in Note 3.8 *"Financial instruments"*.

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of incurred losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

3.14 Issued share capital

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

Dividends are recognised as a liability in the period in which they are declared.

3.15 Retained earnings

Any profit or loss for the year is included in retained earnings. Appropriations from retained earnings such as dividends and transferrs to other reserves are recognised when approved by shareholders.

3.16 Reserve for general banking risks

The Bank recognised a reserve for general banking risks in 2006, which represented a reserve for potential losses in excess of those expected and provided for through recognised impairment losses. The reserve was calculated in accordance with a previous regulation of the CNB which required that a certain percentage of net profit for the year be set aside as a reserve within equity if the growth of risk assets on an annual basis exceeded a specific level. The reserve for general banking risks was not allowed to be transferred to retained earnings or other reserves or be otherwise distributed until the expiry of a consecutive three year period in which the Bank recorded annual growth not exceeding 15%. In 2011, as this requirement no longer exists, the Bank transferred amount of the reserve for general banking risks to retained earnings.

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

3.17 Off-balance-sheet commitments and contingent liabilities

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

3.18 Managed funds for and on behalf of third parties

The Bank manages funds for and on behalf of corporate and retail customers. These amounts do not represent the Bank's assets and are excluded from the balance sheet. For the services rendered the Bank charges a fee.

NOTE 4 — NET INTEREST INCOME

	2012	2011
	(in thousands of HRK)	
a) Interest and similar income — analysis by source		
Companies	43,723	37,186
Individuals	3,719	3,692
State and public sector	2,029	1,457
Banks and other financial institutions	502	1,114
Other organisations	933	973
	50,906	**44,422**
b) Interest and similar income — analysis by product		
Loans and advance to customers	46,952	40,752
Debt securities and bills of exchange	3,452	2,556
Loans and advances to banks and other financial institutions	502	1,088
Obligatory reserve with the Croatian National Bank	-	26
	50,906	**44,422**

	2012	2011
	(in thousands of HRK)	
c) Interest expense and similar charges — analysis by source		
Companies	11,009	9,045
Individuals	5,059	3,540
Banks	6,073	5,347
Other organisations	14	17
	22,155	**17,949**
d) Interest expense and similar charges — analysis by product		
Deposits from companies and other organisations	11,023	9,062
Deposits from individuals	5,059	3,540
Borrowings and deposits from banks	6,073	5,347
	22,155	**17,949**

NOTE 5 — NET FEE AND COMMISSION INCOME

	2012	2011
	(in thousands of HRK)	
a) Fee and commission income		
Domestic payment transactions	3,392	3,211
International payment transactions	713	585
Guarantees and letter of credits given	951	938
Commission for credit risk analysis	-	2,334
Other	11	16
	5,067	**7,084**
b) Fee and commission expense		
Domestic payment transactions	1,479	1,694
International payment transactions	78	78
Other	61	51
	1,618	**1,823**

NOTE 6 — NET INCOME FROM INVESTMENT SECURITIES

	2012	2011
	(in thousands of HRK)	
Realised gain on disposal of financial assets at fair value through profit or loss	316	514
	316	**514**

NOTE 7 — OTHER OPERATING INCOME

	2012	2011
	(in thousands of HRK)	
Recharged operating expenses to BKS AG	530	515
Net foreign exchange loss from translation of monetary assets and liabilities	(377)	(191)
Other income	306	326
	459	**650**

NOTE 8 — OTHER IMPAIRMENT LOSSES AND PROVISIONS

	2012	2011
	(in thousands of HRK)	
Increase/(release)in provisions for off-balance-sheet exposures (Note 24)	16	(80)
Increase in provisions for severance payments and jubilee awards (Note 24)	711	119
Impairment loss on other assets (Note 20)	1,915	1,020
Impairment loss on available for sale financial assets (Note 16)	100	-
	2,742	**1,059**

NOTE 9 — OPERATING EXPENSES

	2012	2011
	(in thousands of HRK)	
Personnel expenses	13,119	11,701
Professional services and material costs	4,405	3,906
Depreciation and amortisation	4,975	5,715
Software maintenance costs	4,100	4,089
Rent expenses	1,662	2,036
Administration and marketing expenses	1,499	1,009
Savings deposit insurance expenses	1,253	389
Other	821	464
	31,834	**29,309**

Personnel expenses include HRK 2,103 thousand (2011: HRK 1,899 thousand) of defined pension contributions payable into obligatory pension plans. Contributions are calculated as a percentage of employees' gross salaries.

During 2012, the Bank had 62 employees on average (2011: 58 employees).

NOTE 10 — INCOME TAX

a) Income tax benefit recognised in the income statement

	2012	2011
	(in thousands of HRK)	
Current tax	-	-
Deferred tax	217	11
Income tax benefit	**217**	**11**

b) Movement in deferred tax asset

	2011	Charged to income statement	2012
		(in thousands of HRK)	
Deferred tax assets			
Provisions for severance payments and jubilee awards and unused holiday accrual	207	142	349
Deferred fee and interest income	451	75	526
Total deferred tax assets	**658**	**217**	**875**

	2010	Charged to income statement	2011
		(in thousands of HRK)	
Deferred tax assets			
Provisions for severance payments and jubilee awards and unused holiday accrual	250	(43)	207
Deferred fee and interest income	397	54	451
Total deferred tax assets	**647**	**11**	**658**

NOTE 10 — INCOME TAX (continued)

c) Reconciliation of the profit before tax and income tax expense

The reconciliation between tax expense and profit before tax is shown as follows:

	2012	2011
	(in thousands of HRK)	
Profit before income tax	(5,551)	44
Income tax at 20% (2011: 20%)	(1.110)	9
Non deductible expenses	927	501
Tax exempt income	(565)	(458)
Utilisation of tax losses	-	(52)
Income tax benefit	(748)	-
Effective income tax rate	-	-

d) Tax losses carried forward

A tax loss may be carried forward for five years subsequent to the year in which it was incurred by the Bank. The availability of tax losses available for offset against taxable income in future periods, calculated at the tax rate of 20% enacted at the reporting date, subject to review by Ministry of Finance, is as follows:

	2012	2011
	(in thousands of HRK)	
No more than 1 year	-	-
No more than 2 years	-	-
No more than 3 years	-	-
No more than 4 years	-	-
No more than 5 years	(748)	-
Total net tax losses available for carry forward not recognised as deferred tax asset	(748)	-

NOTE 11 — CASH RESERVES

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Cash in hand	5,160	4,601
Current accounts with other banks	95,878	48,729
Current accounts with the Croatian National Bank	22,560	75,184
	123,598	**128,514**

NOTE 12 — OBLIGATORY RESERVE WITH THE CROATIAN NATIONAL BANK

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Obligatory reserve		
- in kuna	79,070	56,974
- in foreign currency	15,939	10,022
	95,009	**66,996**

The CNB determines the requirement for banks to calculate an obligatory reserve, which is required to be deposited with the CNB and held in the form of other liquid receivables.

The obligatory reserve requirement as of 31 December 2012 amounted to 13.5% (in 2011: 14%) of kuna and foreign currency deposits, borrowings and issued debt securities.

As of 31 December 2012, the required rate of maintenance of the kuna obligatory reserve with the CNB amounted to 70% (2011: 70%), while the remaining 30% (2011: 30%) had to be held in the form of other liquid receivables. These ratios include the part of foreign currency obligatory reserve required to be held in HRK (see below).

At least 60% (2011: 60%) of the obligatory reserve calculated on foreign currency liabilities must be deposited with the CNB, while the remaining 40% (2011: 40%) (or less to the extent that the amount deposited with the CNB exceeds 60%) must be held in the form of other liquid receivables, after adjusting for the obligatory reserve requirement arising from foreign currency funds from non-residents and related parties (which is required to be held in full with the CNB). From 14 January 2009, 75% of the obligatory reserve arising from foreign currency is required to be held in HRK and is added to the kuna part of the obligatory reserve.

NOTE 13 — LOANS AND ADVANCES TO BANKS

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Domestic banks	21,115	11,983
Foreign banks	82,512	71,838
Impairment allowance	(264)	(299)
	103,363	**83,522**

The movements in impairment allowances for loans and advances to banks:

	2012	2011
	(in thousands of HRK)	
Balance at 1 January	**299**	**293**
Impairment losses	17	13
Reversal of impairment losses	(52)	(7)
Movement of impairment allowance recognised in income statement	**(35)**	**6**
Balance at 31 December	**264**	**299**

The decrease in impairment allowance in the amount of HRK 35 thousand (2011: increase of HRK 6 thousand) relates to foreign exchange differences recognised within net foreign exchange loss from translation of monetary assets and liabilities in Note 7 "Other operating income".

NOTE 14 — LOANS AND ADVANCES TO CUSTOMERS

a) analysis by recipient

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Companies and similar organisations	691,826	644,206
Individuals and unincorporated businesses	70,654	56,461
Total loans	**762,480**	**700,667**
Portfolio based allowance for unidentified losses	(9,651)	(9,281)
Impairment allowance for identified losses	(7,767)	(3,440)
Total impairment allowance	**(17,418)**	**(12,721)**
	745,062	**687,946**
Total impairment allowance as a percentage of gross loans and advances to customers	**2.28%**	**1.82%**

b) Movements in impairment allowance for loans and advances to customers:

	2012	2011
	(in thousands of HRK)	
Balance at 1 January	**12,721**	**9,349**
Impairment losses	15,361	3,969
Reversal of impairment losses	(10,324)	(538)
Impairment losses on loans and advances to customers recognised in the income statement	**5,037**	**3,431**
Amounts written off	(340)	(59)
Balance at 31 December	**17,418**	**12,721**

NOTE 15 — FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Investments in investment funds, quoted	45,772	21,000
	45,772	**21,000**

NOTE 16 — AVAILABLE—FOR—SALE FINANCIAL ASSETS

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Unlisted equity securities	1,376	1,376
Impairment allowance	(100)	-
	1,276	**1,376**

Movement in impairment allowance for available-for-sale investment securities:

	2012	2011
	(in thousands of HRK)	
Balance at 1 January	-	-
Charge for the year (note 8)	100	-
Balance at 31 December	**100**	-

NOTE 17 — HELD—TO—MATURITY INVESTMENTS

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Unlisted		
Republic of Croatia Ministry of Finance treasury bills	18,268	22,088
Corporate bills of exchange	30,425	20,124
	48,693	**42,212**

NOTE 18 — PROPERTY AND EQUIPMENT

(in thousands of HRK)	Buildings	IT equipment	Office furniture and other equipment	Other	Assets acquired but not brought into use	TOTAL
Cost						
At 1 January 2012	**25,055**	**5,150**	**4,705**	**337**	**1,465**	**36,712**
Additions	-	-	-	-	510	510
Transfers	1,102	814	19	-	(1,935)	-
Write off	-	(508)	(4)	-	-	(512)
At 31 December 2012	**26,157**	**5,456**	**4,720**	**337**	**40**	**36,710**
Accumulated depreciation and impairment losses						
At 1 January 2012	**4,947**	**4,637**	**2,697**	**62**	**-**	**12,343**
Charge for the year	651	475	536	9	-	1,671
Write off	-	(508)	(4)	-	-	(512)
At 31 December 2012	**5,598**	**4,604**	**3,229**	**71**	**-**	**13,502**
Carrying value						
1 January 2012	**20,108**	**513**	**2,008**	**275**	**1,465**	**24,369**
31 December 2012	**20,559**	**852**	**1,491**	**266**	**40**	**23,208**

(in thousands of HRK)	Buildings	IT equipment	Office furniture and other equipment	Other	Assets acquired but not brought into use	TOTAL
Cost						
At 1 January 2011	25,050	5,140	4,117	337	83	34,727
Additions	-	-	-	-	2,274	2,274
Transfers	5	114	773	-	(892)	-
Write off	-	(104)	(185)	-	-	(289)
At 31 December 2011	**25,055**	**5,150**	**4,705**	**337**	**1,465**	**36,712**
Accumulated depreciation and impairment losses						
At 1 January 2011	4,322	4,311	2,216	53	-	10,902
Charge for the year	625	430	666	9	-	1,730
Write off	-	(104)	(185)	-	-	(289)
At 31 December 2011	**4,947**	**4,637**	**2,697**	**62**	**-**	**12,343**
Carrying value						
1 January 2011	**20,728**	**829**	**1,901**	**284**	**83**	**23,825**
31 December 2011	**20,108**	**513**	**2,008**	**275**	**1,465**	**24,369**

Depreciation charge for the year is included within operating expenses in the income statement (Note 9).

NOTE 19 — INTANGIBLE ASSETS

(in thousands of HRK)	Software	Leasehold improvements	Assets acquired but not brought into use	TOTAL
Cost				
At 1 January 2012	**20,095**	**1,709**	**1,104**	**22,908**
Additions	-	-	2,318	2,318
Transfers	3,312	-	(3,312)	-
At 31 December 2012	**23,407**	**1,709**	**110**	**25,226**
Accumulated amortisation and impairment losses				
At 1 January 2012	**14,807**	**944**	**-**	**15,751**
Charge for the year	2,962	342	-	3,304
At 31 December 2012	**17,769**	**1,286**	**-**	**19,055**
Carrying value				
1 January 2012	**5,288**	**765**	**1,104**	**7,157**
31 December 2012	**5,638**	**423**	**110**	**6,171**

Cost				
At 1 January 2011	18,880	1,515	534	20,929
Additions	-	-	1,979	1,979
Transfers	1,215	194	(1,409)	-
At 31 December 2011	**20,095**	**1,709**	**1,104**	**22,908**
Accumulated amortisation and impairment losses				
At 1 January 2011	11,132	634	-	11,766
Charge for the year	3,675	310	-	3,985
At 31 December 2011	**14,807**	**944**	**-**	**15,751**
Carrying value				
1 January 2011	**7,748**	**881**	**534**	**9,163**
31 December 2011	**5,288**	**765**	**1,104**	**7,157**

Amortisation charge for the year is included within operating expenses in the income statement (Note 9).

NOTE 20 — OTHER ASSETS

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Accrued interest — not yet due	3,901	4,091
Accrued interest — due	5,534	4,139
Accrued fees	671	599
Receivable for commision for credit risk analysis	-	1,739
Property in lieu of uncollected receivables	693	286
Other	667	432
	11,466	**11,286**
Impairment allowance against accrued interest	(3,181)	(1,261)
Impairment allowance against accrued fees	(264)	(269)
	(3,445)	**(1,530)**
	8,021	**9,756**

The movements in impairment allowances for other assets are as follows:

	2012	2011
	(in thousands of HRK)	
Balance at 1 January	**1,530**	**510**
Reversal of impairment losses	(1,650)	(819)
Impairment losses	3,565	1,839
Movement of impairment allowance recognised in income statement (note 8)	**1,915**	**1,020**
Balance at 31 December	**3,445**	**1,530**

Net movement of impairment allowance on other assets is recognised within "Other impairment losses and provisions" in the income statement (Note 8).

NOTE 21 — DEPOSITS FROM BANKS

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Current accounts	214	3,234
Term deposits	21,905	25,029
	22,119	**28,263**

NOTE 22 — DEPOSITS FROM CUSTOMERS

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Companies and similar organisations		
- current accounts	65,504	138,764
- term deposits	299,113	282,891
Individuals and unincorporated businesses		
- current accounts and demand deposits	63,453	57,586
- term deposits	101,284	69,957
	529,354	**549,198**

NOTE 23 — BORROWINGS

In accordance with their terms, borrowings from the Croatian Bank for Reconstruction and Development ("HBOR") are used to fund loans to customers for eligible construction and development projects at preferential interest rates.

Borrowings from Croatian Bank for Reconstruction and Development				**31 December 2012**	**31 December 2011**
Currency	**Principal '000**	**Maturity**	**Interest rate**		
HRK (EUR currency clause)	95	2012	4.00%	-	107
HRK (EUR currency clause)	1,093	2013	2.00%	824	2,468
HRK (EUR currency clause)	1,590	2014	2.00%	4,799	5,131
HRK (EUR currency clause)	209	2014	2.00%	262	524
HRK (EUR currency clause)	805	2013	Euribor + 1.92%	217	1,298
HRK (EUR currency clause)	680	2017	Euribor + 1.92%	2,533	3,272
HRK (EUR currency clause)	41	2018	4.00%	173	206
HRK (EUR currency clause)	2,200	2023	Euribor + 1.89%	13,088	14,337
HRK (EUR currency clause)	300	2013	4.00%	242	592
HRK (EUR currency clause)	334	2018	2.75%	1,891	2,281
HRK (EUR currency clause)	276	2020	3.00%	1,613	1,817
HRK (EUR currency clause)	993	2020	3.00%	7,493	7,478
HRK (EUR currency clause)	275	2016	5.00%	1,949	2,074
HRK	12,058	2016	5.00%	9,546	12,058
HRK (EUR currency clause)	104	2016	3.00%	629	784
HRK (EUR currency clause)	239	2018	3.00%	1,174	-
				46,433	**54,427**
Borrowings from foreign banks - BKS Bank AG Klagenfurt, Austria					
Currency	**Principal '000**	**Maturity**	**Interest rate**		
EUR	17,000	2012	Euribor + 0.50%	-	128,017
EUR	23,000	2013	Euribor + 0.50%	173,549	45,183
EUR	15,500	2014	Euribor + 0.50%	116,957	116,722
EUR	11,000	2015	Euribor + 0.50%	83,002	-
				373,508	**289,922**
Total borrowings				**419,941**	**344,349**

NOTE 24 — PROVISIONS FOR LIABILITIES AND CHARGES

(in thousands of HRK)	Portfolio based provision for off-balance sheet exposures	Provision for identifed off-balance sheet exposures	Total provisions for off-balance sheet exposures	Provisions for severance payments and jubilee awards	Total
Balance at 1 January 2012	**717**	**54**	**771**	**1,036**	**1,807**
Net (release)/increase to income statement	70	(54)	16	711	727
Balance at 31 December 2012	**787**	**-**	**787**	**1,747**	**2,534**
Balance at 1 January 2011	**851**	**-**	**851**	**917**	**1,768**
Net increase/(release) to income statement	(134)	54	(80)	119	39
Balance at 31 December 2011	**717**	**54**	**771**	**1,036**	**1,807**

Net increase/decrease in provisions for liabilities and charges is recognised within “Other impairment losses and provisions” in the income statement (Note 8).

NOTE 25 — OTHER LIABILITIES

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Interest payable — not yet due	9,631	7,552
Interest payable — due	213	365
Fees payable	104	129
Deferred interest income	2,539	2,181
Deferred fee income	87	76
Payables to suppliers	1,786	1,195
Accrued salary expenses	1,012	938
Unused holiday accrual	156	262
Items in transfer	108	128
Payments in advance by customers	1,476	2,214
Other liabilities	740	267
	17,852	**15,307**

NOTE 26 — ISSUED SHARE CAPITAL

	Total share capital
	(in thousands of HRK)
As at 1 January 2012	120,000
Increase in share capital	80,000
As at 31 December 2012	**200,000**

As at 31 December 2012 the registered, subscribed and fully paid capital comprises 2,000,000 ordinary shares (2011: 1,200,000) with a nominal value of HRK 100 each (2011: HRK 100).

During 2012 the sole shareholder paid in HRK 80,000 thousand of additional share capital.

The shareholder structure of the Bank is:

	At 31 December 2012		At 31 December 2011	
	Number of shares issued	%	Number of shares issued	%
BKS Bank AG, Klagenfurt	2,000,000	100.00	1,200,000	100.00
Total	2,000,000	100.00	**1,200,000**	**100.00**

Dividends

Dividends payable are accounted for as a liability after having been ratified at the Annual General Meeting. During 2012 and 2011 there were no dividend payments.

NOTE 27 — OTHER RESERVES, FAIR VALUE RESERVE AND RETAINED EARNINGS

a) Statutory reserve

A statutory reserve has been created in accordance with Croatian law, which requires 5% of the profit for the year to be transferred to this reserve until it reaches 5% of issued share capital. The statutory reserve, in the amount of up to 5% of issued share capital, can be used for the coverage of current and prior year losses.

b) Reserve for general banking risks

In accordance with former regulations of the CNB, the Bank was required to create and maintain provisions for general banking risks, as a result of the rapid growth of the Bank's balance sheet and off-balance-sheet exposure. As a result of an increase in certain categories of risk exposure by more than 15% from 31 December 2005 to 31 December 2006, the Bank recognised an increase in the reserve for general banking risks in the amount of HRK 1,842 thousand as an appropriation within equity from retained earnings.

The Bank was not obliged to make further appropriations to general banking risk reserve after 2006 and in 2011 transferred the balance on this reserve in the amount of HRK 1,842 thousand back to retained earnings.

c) Retained earnings

Retained earnings comprise accumulated unappropriated net profits of prior years.

NOTE 28 — CONCENTRATION OF ASSETS AND LIABILITIES

The assets and liabilities of the Bank are concentrated on amounts due from and to the Republic of Croatia, as follows:

	Note	31 December 2012	31 December 2011
		(in thousands of HRK)	
Current accounts with the Croatian National Bank	11	22,560	75,184
Obligatory reserve with the Croatian National Bank	12	95,009	66,996
Republic of Croatia Ministry of Finance treasury bills	17	18,268	22,088
Accrued interest and other assets		165	79
Decreased by:			
Other liabilities		(502)	(460)
		135,500	**163,887**

As at 31 December 2012 total exposure towards the Republic of Croatia amounted to 11.28% of total assets (2011: 15.3%).

NOTE 29 — MANAGED FUNDS FOR AND ON BEHALF OF THIRD PARTIES

The Bank manages a number of loans on behalf of third parties in return for a fee. These assets are not the Bank's assets and are not recognised on the Bank's balance sheet.

Managed funds for and on behalf of third parties are as follows:

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Assets		
Loans and advances to customers		
- individuals and unincorporated businesses	32	32
Interest receivable	1	1
	33	**33**
Liabilities		
Deposits from local government	32	32
Interest payable	1	1
	33	**33**

NOTE 30 — CONTINGENT LIABILITIES AND COMMITMENTS

Legal proceedings

As of 31 December 2012 there were no significant legal proceedings outstanding against the Bank. Accordingly, in management opinion no provision was required in the financial statements.

Off-balance-sheet exposure

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

	31 December 2012	31 December 2011
	(in thousands of HRK)	
Guarantees and letters of credit	59,041	45,356
Commitments for facilities not withdrawn	27,363	32,418
	86,404	**77,774**

NOTE 31 — RELATED PARTY TRANSACTIONS

As at 31 December 2012 the sole shareholder of the Bank was Bank für Kaernten und Steiermark AG, Klagenfurt, Austria ("BKS Bank AG"). The Bank considers that it has an immediate related party relationship with BKS Bank AG and its shareholders, subsidiaries and associates; the Supervisory and Management Board members and the Head of Corporate Department and the Zagreb Branch Director ("key management personnel"); close family members of key management personnel; and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members.

The Bank enters into a number of transactions with related parties in the normal course of business.

Parent bank

The Bank obtains borrowings and deposits and also places deposits and holds current accounts with the parent bank. As of 31 December 2012 the Bank had borrowings from the parent bank in the amount of HRK 373,508 thousand (2011: HRK 289,922 thousand) and deposits from the parent bank in the amount of HRK 22,119 thousand (2011: HRK 28,263 thousand). Total interest payable to the parent bank as at 31 December 2012 amounts to HRK 416 thousand (2011: HRK 528 thousand). During 2012, the Bank recorded HRK 4,334 thousand (2011: HRK 3,436 thousand) of interest expense, fee expenses in the amount of HRK 61 thousand (2011: HRK 42 thousand) and net foreign exchange loss in the amount of HRK 1,388 thousand (2011: HRK 3,111 thousand) in respect of borrowings and deposits received from the parent bank.

In addition, as of 31 December 2012 the Bank held current accounts in the amount of HRK 13,865 thousand (2011: HRK 6,689 thousand) with, and had no placements with the parent bank (2011: HRK 22,592 thousand). Total interest receivable from the parent bank as at 31 December 2012 amounts to HRK 11 thousand (2011: HRK 38 thousand) and total interest income in 2012 amounted to HRK 79 thousand (2011: HRK 368 thousand).

In 2011 the Bank provided credit analysis services to the parent bank. During 2011 the Bank earned HRK 2,334 thousand from fee income for credit analysis services of which HRK 1,739 thousand was receivable as at 31 December 2011. In 2012 the Bank provided no such services.

In addition, the Bank recognised other income of HRK 555 thousand (2011: HRK 515 thousand), of which HRK 56 thousand (2011: HRK 56 thousand) was receivable as at 31 December 2012, and other expense of HRK 805 thousand (2011:-).

Related companies

BKS Leasing Croatia d.o.o. is a related company which has deposits with the Bank in the amount of HRK 112,894 thousand as of 31 December 2012 (2011: HRK 89,578 thousand) upon which the Bank incurred interest payable in the amount of HRK 3,119 thousand (2011: HRK 2,674 thousand). In 2012 the Bank recorded interest expense in the amount of HRK 3,065 thousand (2011: HRK 4,111 thousand) in relation to deposits placed by BKS Leasing Croatia d.o.o., and other expense of HRK 111 thousand (2011:-).

NOTE 31 — RELATED PARTY TRANSACTIONS (continued)

Key management personnel

In 2012, the total remuneration of the Management Board was HRK 1,467 thousand (2011: HRK 1,251 thousand) and of other key management personnel was HRK 1,007 thousand (2011: HRK 483 thousand) and consisted of short-term benefits only. Out of these benefits, in 2012, the Bank made pension contributions into obligatory pension funds for Management Board in the amount of HRK 240 thousand (2011: HRK 226 thousand) and to other key management in the amount of HRK 192 thousand (2011: HRK 94 thousand). As of the date of approval of these financial statements by the Management Board, no management bonuses were accrued for.

The Bank has granted loans to key management personnel in the amount of HRK 1,360 thousand (2011: HRK 1,416 thousand) as at 31 December 2012. As a result, during 2012 the Bank recorded interest income in the amount of HRK 52 thousand (2011: HRK 97 thousand).

The Bank also has deposits from key management personnel in the amount of HRK 2,710 thousand (2011: HRK 994 thousand) as at 31 December 2012 on which it has recorded interest expense in the amount of HRK 72 thousand during 2012 (2011: HRK 46 thousand).

Companies under the significant influence of key management personnel and their close family members and Supervisory Bord members

Mr Goran Rameša, President of the Management Board, is also the President of the Supervisory Board of the company Rapska plovidba d.d., Rab, which the Bank considers to be a related party. The Bank has granted loans to Rapska plovidba d.d., Rab in the amount of HRK 11,549 thousand (2011: HRK 11,349 thousand) and has recorded interest income in the amount of HRK 737 thousand during 2012 (2011: HRK 765 thousand). The Bank also has deposits from Rapska plovidba d.d. in the amount of HRK 34 thousand (2011: HRK 56 thousand) and as a result has recorded interest expense in the amount of HRK 1 thousand (2011: HRK 1 thousand).

Other companies under the significant influence of key management personnel are Konto d.o.o. and Darin d.o.o. The Bank has deposits from Konto d.o.o. and Darin d.o.o. The Bank also provides payment transaction services to these companies.

No fees to Supervisory Board members were paid during 2012 and 2011.

NOTE 31 — RELATED PARTY TRANSACTIONS (continued)

Key transactions with immediate related parties and related amounts arising from transactions with immediate related parties were as follows:

2012	Assets HRK'000	Liabilities HRK'000	Income HRK'000	Expense HRK'000
Key shareholder	13,932	396,043	634	6,588
BKS Bank AG, Klagenfurt				
Other related companies				
BKS Leasing Croatia d.o.o.	9	116,013	97	3,176
Key management personnel				
Management Board				
Short-term benefits (bonuses, salaries and fees)	-	113	-	1,467
Loans and deposits	21	2,681	1	72
Other key management personnel				
Short-term benefits (bonuses, salaries and fees)	-	81	-	1,007
Loans and deposits	1,339	29	52	-
Companies under the significant influence of key management personnel and their close family members and Supervisory Board members				
Rapska plovidba d.d., Rab	11,549	34	737	1
Other	-	270	5	1
Total	26,850	515,264	1,526	12,312

2011	Assets HRK'000	Liabilities HRK'000	Income HRK'000	Expense HRK'000
Key shareholder				
BKS Bank AG, Klagenfurt	31,111	318,713	3,217	6,589
Other related companies				
BKS Leasing Croatia d.o.o.	1	92,252	10	4,111
Key management personnel				
Management Board				
Short-term benefits (bonuses, salaries and fees)	-	97	-	1,251
Loans and deposits	44	994	14	46
Other key management personnel				
Short-term benefits (bonuses, salaries and fees)	-	39	-	483
Loans and deposits	1,372	-	83	-
Companies under the significant influence of key management personnel and their close family members and Supervisory Board members				
Rapska plovidba d.d., Rab	11,349	56	765	1
Other	-	165	4	1
Total	**43,877**	**412,316**	**4,093**	**12,482**

NOTE 32 — FINANCIAL RISK MANAGEMENT

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

An integrated system of risk management is being established by introducing a set of policies and procedures, determining the limits of risk levels acceptable to the Bank and monitoring their implementation. Methodologies and models for managing operational risk are being developed.

a) Credit risk

The Bank is subject to credit risk through its lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties.

The risk that counterparties to financial instruments might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the Bank deals with counterparties of good credit standing, and when appropriate, obtains collateral.

The Bank's primary exposure to credit risk arises through its loans and advances to banks and customers, and held-to-maturity investments. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the balance sheet. In addition the Bank is exposed to off-balance-sheet credit risk through commitments to extend credit and guarantees issued (refer to Note 30).

Exposure to credit risk is managed in accordance with the Bank's policies. Credit exposures to portfolios and individual client/group exposures are reviewed on a regular basis taking into account set limits. Any proposed substantial increases in credit exposure are reviewed by an appropriate decision-making level. The Management Board is regularly informed of all significant changes in quantity and quality of the portfolio, including proposed impairment losses. Credit risk assessment is continuously monitored and reported, thus enabling the early identification of impairment in the credit portfolio. The Management Board believes that the Bank continually applies prudent methods in the process of credit risk assessment.

A significant part of credit risk exposures is secured with collateral in the form of cash, guarantees, mortgages and other forms of security.

Geographic concentrations of assets, liabilities and off balance sheet items

	31 December 2012			31 December 2011		
(in thousands of HRK)	**Assets**	**Liabilities**	**Off balance sheet items**	**Assets**	**Liabilities**	**Off balance sheet items**
Croatia	1,045,896	567,501	86,404	955,061	597,932	77,774
European Union	155,152	422,109	-	118,445	339,280	-
Other	-	2,190	-	-	1,712	-
	1,201,048	**991,800**	**86,404**	**1,073,506**	**938,924**	**77,774**

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Industry segmentation of loans and advances:

(in thousands of HRK)	31 December 2012	%	31 December 2011	%
Gross balances before impairment allowances				
Trade and commerce	229,739	30	195,933	28
Construction	215,241	28	205,034	29
Metallurgy	34,340	5	28,886	4
Transport, warehousing and public services	21,488	3	19,304	3
Energy	3,018	0	5,700	1
Shipbuilding	15,696	2	23,578	3
Services	150,151	20	143,711	21
Individuals and unincorporated businesses	70,654	9	56,460	8
Miscellaneous	22,153	3	22,061	3
	762,480	**100**	**700,667**	**100**

Maximum exposure to credit risk relating to balance sheet assets and off-balance sheets items

(in thousands of HRK)	Note	31 December 2012	31 December 2011
ASSETS			
Current accounts with CNB and other banks	11	118,438	123,913
Obligatory reserve with the Croatian National Bank	12	95,009	66,996
Loans and advances to banks	13	103,363	83,522
Loans and advances to customers	14a	745,062	687,946
Financial assets at fair value through profit or loss	15	45,772	21,000
Held-to-maturity investments	17	48,693	42,212
Accrued interest and fees,net	20	6,661	7,299
Total credit risk exposed assets		**1,162,998**	**1,032,888**
OFF-BALANCE SHEET			
Guarantees and letters of credit	30	59,041	45,356
Commitments for facilities not withdrawn	30	27,363	32,418
		86,404	**77,774**

The above table represents the maximum direct credit risk exposure of the Bank as at 31 December 2012 and 31 December 2011, without taking into account of any collateral held or other credit enhancements attached or exposure to investment funds investing in debt instruments. For on-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the balance sheet.

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

a) Credit risk (continued)

Impairment losses

(in thousands of HRK)	31 December 2012		31 December 2011	
CNB rating	Loans	Impairment allowance for identified losses	Loans	Impairment allowance for identified losses
A	677,927	-	680,776	-
B	82,568	5,782	17,900	1,449
C	1,985	1,985	1,991	1,991
	762,480	**7,767**	**700,667**	**3,440**

The rate of impairment allowance on the non-performing loan portfolio (CNB Ratings B and C) is 9.19% (2011: 17.30%).Total impairment allowance for loans and receivables is HRK 17,418 thousand (2011: HRK 12,721 thousand) of which HRK 7,767 thousand (2011: HRK 3,440 thousand), disclosed in the table above, represents specific impairment allowance and the remaining amount of HRK 9,651 thousand (2011: HRK 9,281 thousand) represents the general provision calculated on a portfolio basis for on-balance sheet exposures. The analysis by performance of loans and advances to customers net of specific impairment allowances, is as follows:

Loans and advances to individuals and unincorporated business	**31 December 2012**	**31 December 2011**
	(in thousands of HRK)	
Gross		
Not due and not impaired	67,911	53,955
Not due and impaired	302	1,865
Due but not impaired	493	111
Due and impaired	1,948	530
	70,654	56,461
Impairment allowance for identified losses	(913)	(540)
Net loans and advances to individuals and unincorporated business	**69,741**	**55,921**

Loans and advances to companies	**31 December 2012**	**31 December 2011**
	(in thousands of HRK)	
Gross		
Not due and not impaired	580,633	615,241
Not due and impaired	23,179	2,139
Due but not impaired	29,616	11,469
Due and impaired	58,398	15,357
	691,826	644,206
Impairment allowance for identified losses	(6,854)	(2,900)
Net loans and advances to companies	**684,972**	**641,306**

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

b) Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate timeframe. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw downs and guarantees and other cash settled calls. 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 Management Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The Bank manages liquidity reserves daily, ensuring also accomplishment of all customer needs.

The table below analyses assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date, except for the obligatory reserve which is presented as maturing within one month. In addition, financial assets at fair value through profit or loss are presented as maturing within one month, and available-for-sale financial assets are presented as maturing in over 3 years.

(in thousands of HRK)	Up to 1 month	1-3 months	3-12 months	1 - 3 years	Over 3 years	Total
As at 31 December 2012						
ASSETS						
Cash reserves	123,598	-	-	-	-	123,598
Obligatory reserve with CNB	95,009	-	-	-	-	95,009
Loans and advances to banks	90,993	7,923	2,288	2,159	-	103,363
Loans and advances to customers	132,203	46,909	246,609	104,829	214,512	745,062
Financial assets at fair value through profit or loss	45,772	-	-	-	-	45,772
Available-for-sale financial assets	-	-	-	-	1,276	1,276
Held-to-maturity investments	4,137	473	44,083	-	-	48,693
Property and equipment	-	-	-	-	23,208	23,208
Intangible assets	-	-	-	-	6,171	6,171
Deferred tax assets	-	-	-	875	-	875
Other assets	6,803	294	914	10	-	8,021
Total assets	**498,515**	**55,599**	**293,894**	**107,873**	**245,167**	**1,201,048**
LIABILITIES AND EQUITY						
Deposits from banks	214	-	21,905	-	-	22,119
Deposits from customers	158,758	97,949	221,595	9,231	41,821	529,354
Borrowings	991	24,168	159,335	216,757	18,690	419,941
Provisions for liabilities and charges	-	787	-	-	1,747	2,534
Other liabilities	10,064	3,083	3,800	698	207	17,852
Total equity	-	-	-	-	209,248	209,248
Total liabilities and equity	**170,027**	**125,987**	**406,635**	**226,686**	**271,713**	**1,201,048**
Net liquidity gap	**328,488**	**(70,388)**	**(112,741)**	**(118,813)**	**(26,546)**	**-**

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

b) Liquidity risk (continued)

(in thousands of HRK)	Up to 1 month	1-3 months	3-12 months	1 - 3 years	Over 3 years	Total
As at 31 December 2011						
ASSETS						
Cash reserves	128,514	-	-	-	-	128,514
Obligatory reserve with CNB	66,996	-	-	-	-	66,996
Loans and advances to banks	55,948	22,968	-	4,606	-	83,522
Loans and advances to customers	82,312	29,229	245,778	123,769	206,858	687,946
Financial assets at fair value through profit or loss	21,000	-	-	-	-	21,000
Available-for-sale financial assets	-	-	-	-	1,376	1,376
Held-to-maturity investments	10,527	768	30,917	-	-	42,212
Property and equipment	-	-	-	-	24,369	24,369
Intangible assets	-	-	-	-	7,157	7,157
Deferred tax assets	-	-	-	658	-	658
Other assets	8,760	662	334	-	-	9,756
Total assets	**374,057**	**53,627**	**277,029**	**129,033**	**239,760**	**1,073,506**
LIABILITIES AND EQUITY						
Deposits from banks	3,234	22,591	2,438	-	-	28,263
Deposits from customers	215,040	81,291	172,194	35,488	45,185	549,198
Borrowings	1,067	1,187	136,371	180,962	24,762	344,349
Provisions for liabilities and charges	-	771	-	-	1,036	1,807
Other liabilities	8,495	2,310	3,255	1,179	68	15,307
Total equity	-	-	-	-	134,582	134,582
Total liabilities and equity	**227,836**	**108,150**	**314,258**	**217,629**	**205,633**	**1,073,506**
Net liquidity gap	**146,221**	**(54,523)**	**(37,229)**	**(88,596)**	**34,127**	**-**

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

c) Currency risk

The Bank is exposed to currency risk through transactions in foreign currencies. Foreign currency exposure arises from credit, deposit-taking, investment and trading activities. It is monitored regularly, in accordance with legislation and internally set limits, for each currency and for the total balance sheet denominated in or linked to foreign currency.

The Bank manages its currency risk by setting principles and limits for foreign currency exposures and monitoring against these limits. The Bank directs its business activities towards trying to minimise the gap between assets and liabilities denominated in or linked to foreign currency, and maintaining the daily business activities within daily potential loss limits.

In measuring foreign currency exposure, the Bank relies on regulations prescribed by the CNB. In calculating the capital requirement for currency risk the standard method has been used in accordance with the CNB regulation on capital adequacy.

At 31 December 2012, if HRK had strengthened/weakened by 1% against EUR with all other variables held constant, the effect on the Bank's profit after tax for the year would have been HRK 87 thousand lower/higher. Due to the insignificant difference between financial assets and financial liabilities denominated or linked to EUR no sensitivity to change in HRK/EUR was calculated as of 31 December 2011.

Assets and liabilities are analysed by currency as follows:

(in thousands of HRK)	EUR	EUR linked	USD	Other currencies	HRK	Total
As at 31 December 2012						
ASSETS						
Cash reserves	93,943	-	2,589	1,761	25,305	123,598
Obligatory reserve with CNB	11,530	-	4,409	-	79,070	95,009
Loans and advances to banks	89,416	-	-	-	13,947	103,363
Loans and advances to customers	-	557,143	-	-	187,919	745,062
Financial assets at fair value through profit or loss	-	19,230	-	-	26,542	45,772
Available-for-sale financial assets	12	-	-	-	1,264	1,276
Held-to-maturity investments	18,268	-	-	-	30,425	48,693
Property and equipment	-	-	-	-	23,208	23,208
Intangible assets	-	-	-	-	6,171	6,171
Deferred tax assets	-	-	-	-	875	875
Other assets	67	3,167	-	-	4,787	8,021
Total assets	**213,236**	**579,540**	**6,998**	**1,761**	**399,513**	**1,201,048**
LIABILITIES AND EQUITY						
Deposits from banks	21,905	-	-	-	214	22,119
Deposits from customers	132,712	229,341	6,821	1,327	159,153	529,354
Borrowings	373,508	36,888	-	-	9,545	419,941
Provisions for liabilities and charges	-	-	-	-	2,534	2,534
Other liabilities	3,112	4,038	133	2	10,567	17,852
Total equity	-	-	-	-	209,248	209,248
Total liabilities and equity	531,237	270,267	6,954	1,329	391,261	1,201,048
Net foreign exchange position	**(318,001)**	**309,273**	**44**	**432**	**8,252**	**-**

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

c) Currency risk (continued)

(in thousands of HRK)	EUR	EUR linked	USD	Other currencies	HRK	Total
As at 31 December 2011						
ASSETS						
Cash reserves	44,730	-	3,624	1,875	78,285	128,514
Obligatory reserve with CNB	7,176	-	2,846	-	56,974	66,996
Loans and advances to banks	71,916	-	-	-	11,606	83,522
Loans and advances to customers	-	517,778	-	-	170,168	687,946
Financial assets at fair value through profit or loss	-	-	-	-	21,000	21,000
Available-for-sale financial assets	12	-	-	-	1,364	1,376
Held-to-maturity investments	-	22,088	-	-	20,124	42,212
Property and equipment	-	-	-	-	24,369	24,369
Intangible assets	-	-	-	-	7,157	7,157
Deferred tax assets	-	-	-	-	658	658
Other assets	91	3,031	1	-	6,633	9,756
Total assets	**123,925**	**542,897**	**6,471**	**1,875**	**398,338**	**1,073,506**
LIABILITIES AND EQUITY						
Deposits from banks	25,029	-	-	-	3,234	28,263
Deposits from customers	103,858	189,417	6,188	1,646	248,089	549,198
Borrowings	289,922	42,369	-	-	12,058	344,349
Provisions for liabilities and charges	-	-	-	-	1,807	1,807
Other liabilities	1,873	3,404	156	3	9,871	15,307
Total equity	-	-	-	-	134,582	134,582
Total liabilities and equity	**420,682**	**235,190**	**6,344**	**1,649**	**409,641**	**1,073,506**
Net foreign exchange position	**(296,757)**	**307,707**	**127**	**226**	**(11,303)**	**-**

d) Interest rate risk

In the course of its business operations, the Bank is exposed to interest rate risk to the extent to which its interest-earning assets and interest-bearing liabilities mature or their interest rates change at various times and in various amounts. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in re-pricing characteristics of the various floating rate indices, and different types of interest. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies.

The majority of loans to and receivables from companies and individuals and deposits from companies and individuals are at variable interest rates.

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

d) Interest rate risk (continued)

Sensitivity is calculated for significant financial assets (loans and advances to customers) and financial liabilities (deposits and from customers and borrowings) which bear variable interest rates at year end. No sensitivity was calculated for held-to-maturity investments since they bear interest at a fixed rate and are carried at amortised cost.

Sensitivity is calculated to reflect possible changes of average interests rate applicable on underlying financial assets and financial liabilities. Should the average interest rate on interest- earning assets and interest bearing liabilities increase/decrease by 1 percentage point with all other variables held constant, the Bank's after tax profit for the year would be HRK 201 thousand (2011: HRK 468 thousand) lower/higher.

The table below summarises the Bank's exposure to interest rate risks. The tables are management's estimate of the interest rate risk for the Bank as of 31 December 2012 and 31 December 2011 and are not necessarily indicative of the positions at other times but provide some indication of the sensitivities of the Bank's earnings to movements in interest rates. Earnings will also be affected by the currency of the assets and liabilities and equity. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates:

(in thousands of HRK)	Up to 1 month	1-3 months	3-12 months	1 -3 years	Over 3 years	Non-interest bearing	Total	Fixed interest
As at 31 December 2012								
ASSETS								
Cash reserves	52,285	-	-	-	-	71,313	123,598	-
Obligatory reserve with CNB	-	-	-	-	-	95,009	95,009	-
Loans and advances to banks	95,440	7,923	-	-	-	-	103,363	89,416
Loans and advances to customers	693,355	148	49,617	813	1,129	-	745,062	62,349
Financial assets at fair value through profit or loss	-	-	-	-	-	45,772	45,772	-
Available-for-sale financial assets	-	-	-	-	-	1,276	1,276	-
Held-to-maturity investments	4,137	473	44,083	-	-	-	48,693	48,693
Property and equipment	-	-	-	-	-	23,208	23,208	-
Intangible assets	-	-	-	-	-	6,171	6,171	-
Deferred tax assets	-	-	-	-	-	875	875	-
Other assets	-	-	-	-	-	8,021	8,021	-
Total assets	**845,217**	**8,544**	**93,700**	**813**	**1,129**	**251,645**	**1,201,048**	**200,458**
LIABILITIES AND EQUITY								
Deposits from banks	22,119	-	-	-		-	22,119	-
Deposits from customers	461,393	11,914	52,599	577	990	1,881	529,354	67,647
Borrowings	419,941	-	-	-	-	-	419,941	-
Provisions for liabilities and charges	-	-	-	-	-	2,534	2,534	-
Other liabilities	-	-	-	-	-	17,852	17,852	-
Total equity	-	-	-	-	-	209,248	209,248	-
Total liabilities and equity	**903,453**	**11,914**	**52,599**	**577**	**990**	**231,515**	**1,201,048**	**67,647**
Interest sensitivity gap	**(58,236)**	**(3,370)**	**41,101**	**236**	**139**	**20,130**	**-**	**132,811**

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

d) Interest rate risk (continued)

(in thousands of HRK)	Up to 1 month	1-3 months	3-12 months	1 -3 years	Over 3 years	Non-interest bearing	Total	Fixed interest
As at 31 December 2011								
ASSETS								
Cash reserves	20,194	-	-	-	-	108,320	128,514	-
Obligatory reserve with CNB	-	-	-	-	-	66,996	66,996	-
Loans and advances to banks	60,931	22,591	-	-	-	-	83,522	49,324
Loans and advances to customers	685,706	209	802	1,071	158	-	687,946	10,093
Financial assets at fair value through profit or loss	-	-	-	-	-	21,000	21,000	-
Available-for-sale financial assets	-	-	-	-	-	1,376	1,376	-
Held-to-maturity investments	10,527	768	30,917	-	-	-	42,212	42,212
Property and equipment	-	-	-	-	-	24,369	24,369	-
Intangible assets	-	-	-	-	-	7,157	7,157	-
Deferred tax assets	-	-	-	-	-	658	658	-
Other assets	-	-	-	-	-	9,756	9,756	-
Total assets	**777,358**	**23,568**	**31,719**	**1,071**	**158**	**239,632**	**1,073,506**	**101,629**
LIABILITIES AND EQUITY								
Deposits from banks	5,672	22,591	-	-	-	-	28,263	-
Deposits from customers	426,727	44,480	75,867	980	730	414	549,198	147,149
Borrowings	344,349	-	-	-	-	-	344,349	-
Provisions for liabilities and charges	-	-	-	-	-	1,807	1,807	-
Other liabilities	-	-	-	-	-	15,307	15,307	-
Total equity	-	-	-	-	-	134,582	134,582	-
Total liabilities and equity	**776,748**	**67,071**	**75,867**	**980**	**730**	**152,110**	**1,073,506**	**147,149**
Interest sensitivity gap	**610**	**(43,503)**	**(44,148)**	**91**	**(572)**	**87,522**	**-**	**(45,520)**

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

d) Interest rate risk (continued)

The table below summarises average effective interest rates by major currencies for monetary financial instruments:

2012	EUR	USD	HRK (including EUR linked)
	%	%	%
Assets			
Cash and balances with the Croatian National Bank	0.11	0.04	0.25
Loans and advances to banks	0.26	-	0.85
Loans and advances to customers	-	-	8.19
Held-to-maturity investments	5.25	-	10.96
Liabilities			
Deposits from banks	0.69	-	0.50
Deposits from customers	4.11	2.72	2.47
Deposits and loans from financial institutions	1.25	-	2.53
Borrowings	1.11	-	1.52

The table below summarises average nominal interest rates by major currencies for monetary financial instruments:

	2012			2011		
2011	EUR	USD	HRK (including EUR linked)	EUR	USD	HRK (including EUR linked)
	%	%	%	%	%	%
Assets						
Cash and balances with the Croatian National Bank	0.11	0.04	0.25	-	-	0.34
Loans and advances to banks	0.26	-	0.85	0.97	-	0.99
Loans and advances to customers	-	-	6.72	-	-	6.52
Held-to-maturity investments	5.25	-	8.17	-	-	7.52
Liabilities						
Deposits from banks	0.69	-	0.50	1.52	-	0.75
Deposits from customers	4.11	2.72	2.47	2.21	3.01	3.79
Deposits and loans from financial institutions	1.25	-	2.53	-	-	2.65
Borrowings	1.11	-	1.52	1.96	-	3.44

e) Price risk

Price risk is the possibility that prices will fluctuate, affecting the fair value of investments and other instruments that derive their value from a particular investment. The primary exposure to price risk arises from the Bank's holding of investments in units in investment funds.

Should the prices of investment funds at 31 December 2012 increase/decrease by 5% with all other variables held constant, the Bank's after tax profit for the year would be HRK 2,288 thousand (2011: HRK 840 thousand) higher/lower.

NOTE 32 — FINANCIAL RISK MANAGEMENT (continued)

f) Operational risk

Operational risk is the possibility of financial loss due to errors, breaches, terminations or damages caused by internal processes, employees of the Bank, systems as well as by events caused by external factors. Operational risk is defined as legal and compliance risk but not strategic and reputational risk.

The Bank is exposed to operational risk in all segments of its activities. The Bank seeks to manage its operational risk in accordance with defined principles, with the final purpose being to mitigate or avoid operational risk. Methodologies and models for managing operational risk are being developed.

g) Capital adequacy

The amount of capital allocated by individual activity is based primarily on regulatory requirements. The procedure of capital allocation for specific activities is performed independently from responsible personnel for certain activities.

The rate of capital adequacy is calculated as the ratio between guarantee capital and the sum of credit-risk-weighted assets, exposure to market risks (currency risk) and operational risk and the estimated exposure of the open foreign exchange position to currency risk.

Regulatory capital and capital adequacy ratio according to CNB requirements (as of the date of issuance of these financial statements information on risk-weighted assets and guarantee capital is unaudited), are as follows:

	31 December 2012	31 December 2011
	(in thousands of HRK)	
GUARANTEE CAPITAL		
Ordinary share capital and reserves	208,825	134,527
Supplementary capital	-	-
Deductions	(1,360)	(1,416)
Total guarantee capital	**207,465**	**133,111**
Risk weighted assets (unaudited)		
Credit-risk-weighted assets and other risk exposures	935,899	833,089
CREDIT- RISK- WEIGHTED ASSETS AND OTHER RISK EXPOSURES	**935,899**	**833,089**
Capital adequacy ratio	**22.17%**	**15.98%**

NOTE 33 — ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated, and are based on historical experience and other factors such as the expected flow of future events that can be rationally assumed in existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a possible material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

a) Impairment losses on loans and advances to customers

The Bank monitors the creditworthiness of its customers on an ongoing basis. In accordance with regulations, the need for impairment of the Bank's on- and off-balance-sheet credit risk exposure is assessed at least quarterly. Impairment losses are made mainly against the carrying value of loans and advances to corporate and retail customers (summarised in Note 14b), and as provisions arising from off-balance-sheet risk exposure to customers, mainly in the form of undrawn lending commitments, guarantees and letters of credit (summarised in Note 24). Impairment losses are also considered for credit risk exposures to banks, and for other assets not carried at fair value, where the primary risk of impairment is not credit risk.

A summary of impairment allowances on exposures to customers is presented below:

	Note	31 December 2012	31 December 2011
		(in thousands of HRK)	
Impairment allowance on loans and advances to customers	14b	17,418	12,721
Provisions for off-balance-sheet exposures	24	787	771
		18,205	**13,492**

NOTE 33 — ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

Financial assets carried at amortised cost

The Bank first assesses whether objective evidence of impairment exists. However, assets assessed individually as unimpaired are then included in groups of assets with similar credit risk characteristics. These portfolios are then assessed collectively for impairment.

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

The Bank takes into consideration the combined effect of several events when assessing impairment and uses its experienced judgment in cases where the observable data required to estimate impairment is limited. In estimating impairment losses on items individually or collectively assessed as impaired, the Bank also has regard to the ranges of specific impairment loss rates prescribed by the CNB.

Since 2012, up to the end of February 2013, 5 debtors of the Bank with carrying value at 31 December 2012 of HRK 20.2 million (net of impairment allowance of HRK 448 thousand) commenced the process of pre-bankruptcy settlement in accordance with the Law on Financial Transactions and Pre-bankruptcy Settlement (National Gazette 108/2012 and 144/2012) („the Law“). Management is unable to determine the effect of the pre-bankruptcy settlement process on the realisable value of its credit-risk exposures as the consequences of the application of the newLaw have yet to be determined in practice.

The Bank has recognised an impairment allowance calculated on a portfolio basis in accordance with the range of impairment loss rates of 0.85% to 1.20% prescribed by the CNB to be calculated on all credit risk exposures except those carried at fair value through profit or loss, including off-balance-sheet amounts (including undrawn lending commitments) and sovereign risk. Amounts assessed as impaired are excluded from this calculation.

The amount of impairment allowance at 31 December 2012 calculated on a portfolio basis in accordance with local regulations amounted to HRK 9,651 thousand (2011: HRK 9,281 thousand) and HRK 787 thousand (2011: HRK 717 thousand) of the relevant on- and off-balance-sheet exposure for the Bank respectively. The amount of total portfolio based impairment losses against loans and advances to customers also includes portfolio based impairment losses calculated on debt securities classified as held to maturity and loans and advances to banks.

At the minimum rate prescribed by the CNB, these portfolio based impairment losses would be HRK 769 thousand (2011: HRK 721 thousand) lower than the amount recognised by the Bank. At the maximum rate prescribed by the CNB, portfolio based impairment losses would be HRK 3,212 thousand (2011: HRK 2,336 thousand) higher than the amount recognised by the Bank.

b) Impairment of available-for-sale equity investments

The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. The impairment may be appropriate when there is evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

NOTE 33 — ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (continued)

c) Held-to-maturity investments

The Bank follows the guidance of IAS 39 on classifying non derivative financial assets with fixed or determinable payments and fixed maturity as held to maturity. This classification requires significant judgement. In making this judgement, the Bank evaluates its intention and ability to hold such investments to maturity.

d) Taxation

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

e) Regulatory requirements

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

f) Litigation and claims

The Bank performs individual assessment of all court cases. The initial assessment is made by the Bank's Legal Department. The Bank is a defendant in two smaller lawsuits of immaterial value that have arisen in the course of the Bank's ordinary business. Management is of the opinion that the final outcome of these court cases will be in the Bank's favour, therefore no provision has been made.

NOTE 34 — FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Financial assets at fair value through profit or loss are measured at their current fair value.

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted price (unadjusted) in an active market;
- Level 2: inputs other than quoted prices included in Level 1 that are observable for the financial assets, either directly (for example prices) or indirectly (for example derived from prices);
- Level 3: inputs for assets are not based on observable market data (for example valuation techniques using significant unobservable inputs).

	Level 1	Level 2	Level 3	Total
31 December 2012				
Financial assets at fair value through profit or loss				
Investment funds	45,772	-	-	**45,772**
31 December 2011				
Financial assets at fair value through profit or loss				
Investment funds	21,000	-	-	**21,000**

During 2012 and 2011 there have been no transfers of assets between Level 1 and Level 2 of the fair value hierarchy and there have been no any transfers to or from Level 3

Financial assets available for sale are measured at cost less impairment. Loans and receivables and held-to-maturity assets are measured at amortised cost less impairment.

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments.

Loans and advances

The carrying value of loans with variable interest rate approximates their fair value. It is not practicable to calculate the fair value of the Bank's portfolio of fixed rate loans. However, as the Bank has a limited portfolio of loans and advances with both fixed rate and longer term maturity, management believes that the fair value of loans and advances is not significantly different from their carrying value at the balance sheet date, not taking into account general provisions as required by the CNB and expected future losses.

NOTE 34 — FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values. The carrying value of the Bank's deposits which are given with variable rate, being market rate, approximates their fair value. It is not practicable to calculate the fair value of deposits with fixed interest rates, however, since these deposits are with short term maturity the Bank believes that their fair value is not significantly different to their carrying value.

Borrowings

Most of the Bank's long-term debt has no quoted market prices. It is not practicable for the Bank to estimate the fair value of this debt.

NOTE 35 — OPERATING LEASES

The Bank leases offices for business purposes under operating leases. The lease is cancellable, runs for an initial period of five years and does not include contingent rental expenses.

During 2012, the Bank recognised HRK 1,662 thousand as an expense in the income statement in respect of operating leases (2011: HRK 2,036 thousand) (Note 9).

Supplementary information prescribed by a decision of the Croatian National Bank

Schedules prepared in accordance with CNB decision

a) Balance sheet

Assets	31 December 2012	31 December 2011
	(in thousands of HRK)	
1. Cash and deposits with CNB		
1.1. Cash	5,160	4,601
1.2. Accounts and deposits with CNB	117,569	142,180
2. Deposits with banks	185,294	120,645
3. Treasury bills of Ministry of finance and Treasury bills of CNB	-	22,088
4. Securities and other financial instruments classified as held for trading	-	-
5. Securities and other financial instruments classified as available for sale	1,276	1,376
6. Securities and other financial instruments classified as held to maturity	48,693	20,124
7. Securities and other financial instruments not actively traded but measured at fair value through profit or loss	45,772	21,000
8. Derivative financial assets	-	-
9. Loans and advances to banks	13,947	11,606
10. Loans and advances to customers	745,062	687,946
11. Investments in subsidiaries. associates and joint ventures	-	-
12. Foreclosed assets	693	286
13. Property and equipment (net of depreciation)	23,208	24,369
14. Interest,fees and other assets	14,374	17,285
Total assets	**1,201,048**	**1,073,506**

Supplementary information prescribed by a decision of the Croatian National Bank

Schedules prepared in accordance with CNB decision (continued)

a) Balance sheet (continued)

Liabilities and equity	**31 December 2012**	**31 December 2011**
	(in thousands of HRK)	
1. Borrowings from financial institutions		
1.1. Short term borrowings	105,639	105,426
1.2. Long term borrowings	314,302	238,923
2. Deposits		
2.1. Deposits on gyro and current accounts	114,364	185,547
2.2. Savings deposits	14,808	14,038
2.3. Term deposits	422,301	377,876
3. Other borrowings	-	-
3.1. Short term borrowings	-	-
3.2. Long term borrowings	-	-
4. Derivative and other trading financial liabilities not actively traded	-	-
5. Issued debt securities	-	-
5.1. Short term issued debt securities	-	-
5.2. Long term issued debt securities	-	-
6. Issued subordinated instruments	-	-
7. Issued hybrid instruments	-	-
8. Interest. fees and other liabilities	20,386	17,114
Total liabilities	**991,800**	**938,924**
Equity		
1. Share capital	200,000	120,000
2. Profit/(Loss) for the year	(5,334)	55
3. Retained earnings	11,804	11,752
4. Legal reserves	2,778	2,775
5. Statutory and other equity reserves	-	-
6. Unrealised gain/(loss) on fair value measurement of available-for-sale financial assets	-	-
Total equity	**209,248**	**134,582**
Total liabilities and equity	**1,201,048**	**1,073,506**

Schedules prepared in accordance with CNB decision (continued)

b) Income statement for the year ended 31 December

	2012	2011
	(in thousands of HRK)	
1. Interest income	50,906	44,420
2. (Interest expense)	(23,396)	(18,433)
3. Net interest income	**27,510**	**25,987**
4. Fee and commission income	5,067	7,084
5. (Fee and commission expense)	(1,618)	(1,823)
6. Net fee and commission income	**3,449**	**5,261**
7. Gain/(Loss) from investments in subsidiaries. associates and joint ventures	-	-
8. Gain/(Loss) from trading activities	1,087	945
9. Gain/(Loss) from embedded derivatives	-	-
10. Gain/(Loss) from assets not actively traded but measured as at fair value through profit or loss	316	514
11. Gain/(Loss) from financial assets classified as available for sale	-	-
12. Gain/(Loss) from financial assets classified as held to maturity	-	-
13. Gain/(Loss) arising from hedging transactions	-	-
14. Income from investments in subsidiaries. associates and joint ventures	-	-
15. Income from other equity investments	-	-
16. Gain/(Loss) from foreign exchange differences	(389)	(94)
17. Other income	836	841
18. Other expenses	-	-
19. General administrative expenses and depreciation	(30,581)	(28,920)
20. Net income from business activities before impairment losses and provisions	**2,228**	**4,534**
21. Impairment losses and provisions	(7,779)	(4,490)
22. Profit/(Loss) before tax	**(5,551)**	**44**
23. Income tax	217	11
24. Profit/(Loss) for the year	**(5,334)**	**55**

Schedules prepared in accordance with CNB decision (continued)

c) Cash flow statement for the year ended 31 December

	2012	2011
	(in thousands of HRK)	
Operating activities		
1.1. (Loss)/Profit before taxation	(5,551)	44
1.2. Impairment losses and provisions	7,779	4,490
1.3. Depreciation and amortisation	4,975	5,715
1.4. Net unrealised (gain)/loss from financial assets classified as fair value through profit or loss	-	-
1.5. (Gain)/loss from disposal of tangible assets	-	-
1.6. Other (gains)/losses	377	191
1. Cash flows from operating activities before changes in operating assets (1.1. to 1.6.)	**7,580**	**10,440**
2.1. Deposits with CNB	(28,013)	(19,145)
2.2. Treasury bills of Ministry of finance and treasury bills of CNB	-	2,178
2.3. Deposits with banks and loans and advances to financial institutions	(19,841)	(18,064)
2.4. Loans and advances to customers	(62,154)	(210,864)
2.5. Securities and other financial instruments classified as held for trading	-	-
2.6. Securities and other financial instruments classified as available for sale	-	-
2.7. Securities and other financial instruments not actively traded but measured at fair value through profit or loss	(24,772)	(1,971)
2.8. Other operating assets	(178)	(2,924)
2. Net (increase)/decrease of operating assets (2.1 to 2.8.)	**(134,958)**	**(250,790)**
Increase/(decrease) of operating liabilities		
3.1. A vista deposits	(71,184)	75,960
3.2. Savings and term deposits	45,195	77,165
3.3. Derivative financial liabilities and other trading liabilities	-	-
3.4. Other liabilities	2,166	2,425
3. Net increase/(decrease) of operating liabilities (3.1. to 3.4.)	**(23,823)**	**155,550**
4. Net cash flow from operating activities before tax (1+2+3)	(151,201)	(84,800)
5. Income tax paid		-
6. Net inflow/(outflow) of cash from operating activities (4-5)	**(151,201)**	**(84,800)**
Investment activities		
7.1. Proceeds from disposal/(consideration paid) of/for tangible and intangible assets	(2,827)	(4,253)
7.2. Proceeds from disposal/(consideration paid) of/for investments in subsidiaries. associates and joint ventures	-	-
7.3. Proceeds from disposal/(consideration paid) of/for financial assets and other financial instruments classified as held to maturity	(6,481)	(9,571)
7.4. Dividends received	-	-
7.5. Other inflow/(outflow) from investment activities	-	-
7. Net cash flow from investment activities (7.1. to 7.5)	**(9,308)**	**(13,824)**

Schedules prepared in accordance with CNB decision (continued)

c) *Cash flow statement for the year ended 31 December (continued)*

Financing activities		
8.1. Net increase/(decrease) of borrowings	75,593	164,331
8.2. Net increase/(decrease) of issued debt securities	-	-
8.3. Net increase/(decrease) of subordinated and hybrid instruments	-	-
8.4. Inflow from share capital issue	80,000	-
8.5. (Dividend paid)	-	-
8.6. Other inflow/(outflow) from financing activities	-	-
8. Net cash flow from financing activities (8.1. to 8.6.)	**155,593**	**164,331**
9. Net increase/(decrease) of cash and cash equivalents (6+7+8)	**(4,916)**	**65,707**
10. Effect of foreign exchange differences on cash and cash equivalents	-	-
11. Net increase/(decrease) of cash and cash equivalents (9+10)	**(4,916)**	**65,707**
12. Cash and cash equivalents at the beginning of the year	**128,514**	**62,807**
13. Cash and cash equivalents at the end of the year	**123,598**	**128,514**

Supplementary information prescribed by a decision of the Croatian National Bank

Schedules prepared in accordance with CNB decision (continued)

d) Statement of changes in equity

	In thousands of HRK	Share capital	Treasury shares	Legal, statutory and other reserves	Retained earnings/ (losses)	Profit/ (Loss) for the year	Unrealised loss/gain on measurement of financial assets available for sale	Minority interest	Total
1,	**Balance at 1 January 2012**	**120,000**	**-**	**2,775**	**11,807**	**-**	**-**	**-**	**134,582**
2,	Change of accounting policies and correction of errors	-	-	-	-	-	-	-	-
3,	**Restatement of balance at 1 January of current year (1+2)**	**120,000**	**-**	**2,775**	**11,807**	**-**	**-**	**-**	**134,582**
4,	Disposal of financial assets available for sale	-	-	-	-	-	-	-	-
5,	Change of fair value of available for sale portfolio	-	-	-	-	-	-	-	-
6,	Tax on items directly recognised in equity	-	-	-	-	-	-	-	-
7,	Other gains and losses directly recognised in equity	-	-	-	-	-	-	-	-
8,	**Net gains/losses recognised directly in equity (4+5+6+7)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
9,	Profit/(loss) for the year	-	-	-	-	**(5,334)**	-	-	(5,334)
10,	**Total recognised income and expenses for the year (8+9)**	**-**	**-**	**-**	**-**	**(5,334)**	**-**	**-**	**(5,334)**
11,	Increase/decrease of share capital	80,000	-	-	-	-	-	-	80,000
12,	Increase/decrease of treasury shares	-	-	-	-	-	-	-	-
13,	Other changes	-	-	-	-	-	-	-	-
14,	Transfers to reserves	-	-	3	(3)	-	-	-	-
15,	Payment of dividends	-	-	-	-	-	-	-	-
16,	**Profit distribution (14+15)**	**-**	**-**	**3**	**(3)**	**-**	**-**	**-**	**-**
17,	**Balance at 31 December 2012 (3+10+11+12+13+16)**	**200,000**	**-**	**2,778**	**11,804**	**(5,334)**	**-**	**-**	**209,248**

Schedules prepared in accordance with CNB decision (continued)

d) Statement of changes in equity (continued)

	In thousands of HRK	Share capital	Treasury shares	Legal, statutory and other reserves	Retained earnings/ (losses)	Profit/ (Loss) for the year	Unrealised loss/gain on measurement of financial assets available for sale	Minority interest	Total
1,	**Balance at 1 January 2011**	**120,000**	**-**	**4,599**	**9,928**	**-**	**-**	**-**	**134,527**
2,	Change of accounting policies and correction of errors	-	-	-	-	-	-	-	-
3,	**Restatement of balance at 1 January of current year (1+2)**	**120,000**	**-**	**4,599**	**9,928**	**-**	**-**	**-**	**134,527**
4,	Disposal of financial assets available for sale	-	-	-	-	-	-	-	-
5,	Change of fair value of available for sale portfolio	-	-	-	-	-	-	-	-
6,	Tax on items directly recognised in equity	-	-	-	-	-	-	-	-
7,	Other gains and losses directly recognised in equity	-	-	-	-	-	-	-	-
8,	**Net gains/losses recognised directly in equity (4+5+6+7)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
9,	Profit/(loss) for the year	-	-	-	-	**55**	-	-	55
10,	**Total recognised income and expenses for the year (8+9)**	**-**	**-**	**-**	**-**	**55**	**-**	**-**	**55**
11,	Increase/decrease of share capital	-	-	-	-	-	-	-	-
12,	Increase/decrease of treasury shares	-	-	-	-	-	-	-	-
13,	Other changes	-	-	(1,842)	1,842	-	-	-	-
14,	Transfers to reserves	-	-	18	(18)	-	-	-	-
15,	Payment of dividends	-	-	-	-	-	-	-	-
16,	**Profit distribution (14+15)**	**-**	**-**	**18**	**(18)**	**-**	**-**	**-**	**-**
17,	**Balance at 31 December 2011 (3+10+11+12+13+16)**	**120,000**	**-**	**2,775**	**11,752**	**55**	**-**	**-**	**134,582**

Retained earnings line in the Annual report includes profit or loss for the year, The CNB schedules show result for the year as a separate line.

Legal, statutory and other reserves in the Annual report are presented separately. In the CNB schedules, these items are presented within single line — Legal, statutory and other reserves.