# HRVATSKA POŠTANSKA BANKA d.d.

Annual report for 2014

Zagreb, April 2015

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## Introduction

The Annual report includes a summary of financial information, description of operations and audited financial statements together with the independent auditor's opinion for the year ended 31 December 2014, in Croatian and English language.

***Legal status***

The Annual report includes the annual financial statements prepared in accordance with statutory accounting requirements for banks in Republic of Croatia and audited in accordance with International Standards on Auditing.

The Annual report has been prepared in accordance with the Accounting Act and the Companies Act that require reporting to shareholders at the annual shareholders' meeting of the Management Board. According to the Accounting Law the statutory financial statements are statement of financial position, income statement with a statement of comprehensive income, statement of changes in equity, cash flow statement and notes to the financial statements, and the Companies Act, in accordance Article 250.a and 250.b, prescribes the obligation to submit an annual report on the state of the Bank, other members of the HPB Group and consolidated annual report of the Group.

***Abbreviations***

In the Annual report Hrvatska poštanska banka d.d. is referred to as «the Bank» or «HPB», Hrvatska poštanska banka Group is referred to as «the HPB Group» or just «the Group», the Croatian National Banks is referred to as «the CNB» and the Croatian Bank for Reconstruction and Development is referred to as «the CBRD».

***Exchange Rates***

For the purpose of translation of foreign currencies into Croatian kuna, the following exchange rates of the CNB were used:

| | | |
|---|---|---|
| 31 December 2014 | 1 EUR = 7.661471 HRK | 1 USD = 6.302107 HRK |
| 31 December 2013 | 1 EUR = 7.637643 HRK | 1 USD = 5.549000 HRK |

## Summary of operation and key financial indicators

in million HRK

| **Group** | **2014** | **2013** | **2012** | **2011** | **2010** |
|---|---|---|---|---|---|
| **Basic indicators** | | | | | |
| Net (loss)/profit for the year | (629) | 36 | 102 | 86 | 52 |
| Operating profit | 307 | 259 | 275 | 211 | 196 |
| Total assets | 17,570 | 18,598 | 17,266 | 16,692 | 14,978 |
| Loans to customers | 10,474 | 11,754 | 10,769 | 9,709 | 8,946 |
| Received deposits | 14,459 | 15,103 | 13,634 | 12,988 | 11,381 |
| Share capital and reserves | 843 | 1,445 | 1,411 | 1,243 | 1,182 |
| **Other indicators** | | | | | |
| Return on equity | -65.11% | 3.70% | 10.57% | 9.10% | 5.40% |
| Return on assets | -3.58% | 0.19% | 0.59% | 0.51% | 0.35% |
| The ratio of operating expenses[1] to operating income | 60.36% | 63.90% | 63.61% | 71.03% | 71.62% |

| **Bank** | **2014** | **2013** | **2012** | **2011** | **2010** |
|---|---|---|---|---|---|
| **Basic indicators** | | | | | |
| Net (loss)/profit for the year | (635) | 42 | 94 | 88 | 51 |
| Operating profit | 300 | 266 | 266 | 213 | 194 |
| Total assets | 17,351 | 18,357 | 17,045 | 16,452 | 14,787 |
| Loans to customers | 10,335 | 11,656 | 10,679 | 9,622 | 8,873 |
| Received deposits | 14,254 | 14,885 | 13,449 | 12,766 | 11,208 |
| Share capital and reserves | 845 | 1,453 | 1,411 | 1,255 | 1,190 |
| **Other indicators** | | | | | |
| Return on equity | -65.73% | 4.39% | 9.73% | 9.08% | 5.26% |
| Return on assets | -3.66% | 0.23% | 0.55% | 0.53% | 0.34% |
| The ratio of operating expenses[1] to operating income | 60.15% | 62.48% | 63.63% | 70.15% | 71.00% |
| Regulatory capital | 645 | 1.573 | 1.669 | 1.492 | 1.654 |
| The capital adequacy | 6.65% | 13.51% | 14.89% | 14.23% | 16.82% |

[1] *general and administrative expenses, depreciation and amortization and other costs*

## Supervisory board report of condition

Dear shareholders, on behalf of the Supervisory Board of Hrvatska poštanska banka d.d. we present you financial results for the financial year 2014.

Unfavourable economic conditions in Croatia are reflected in the reduction in lending activity of the banking sector and the banks in the Republic of Croatia, in the absence of an opportunity to lend, held a significant amount of funds in liquid forms of assets and year 2014 ended with the decline of assets. However, at the end of 2014 the double amount of profit was realized in comparison to prior year. This is due to significantly lower amount of provisions for losses in comparison to year 2013 when banks in Republic of Croatia applied the new secondary legislation on the classification of placements and contingent liabilities for the first time. Nevertheless, operating profit of banks in Republic of Croatia at the end of 2014 was higher by 2.3 percent, whereby net interest income and net income from fees and commissions were increased by approximately the same amounts, which for net interest income amounts 1.2 percent, while for net income from fees and commissions amounts 4.3 percent with a slightly lower general and administrative expenses.

We can express satisfaction that the Hrvatska poštanska banka at the end of 2014 recorded the highest operating profit so far amounting HRK 300 million, which represents a significant growth as much as 13 percent. However, significant value adjustments and provisions for losses determined mainly on the portfolio old six and more years have resulted in a net loss of HRK 635 million. Hereby, the share of non-performing loans did not significantly increase, but the provision coverage for the same has increased to 61.2 percent, which is more than the system average. Further to this result, the Bank's capital adequacy of 6.7 percent is lower than the prescribed rate, and process of overcoming the lack of capital through the capital increase by the owners of the Bank in 2015 is in progress.

Consequently to the established provisions, Bank is faced with a lack of capital. Therefore, actions of optimization of risk exposure have been initiated, which is primarily reflected in the decline of the loan portfolio and assets in year 2014. With obtained cheaper sources in the form of loans, and a stable and growing savings of our loyal customers - the citizens, the sources of funds in form of other deposits of financial institutions and corporations have decreased.

Despite the lower level of assets at the end of 2014, higher operating profit was achieved on the basis of strong growth in net interest income – by 12.1 percent, and on the basis of better results from securities trading, which annulled drop in income from fees and commissions.

After the previous management of the Bank during its mandate, which expired in September 2014, began the process of rationalization, consolidation and stabilization, the new management took over the position in September 2014, and immediately began an intense process of restructuring. This process, in addition to optimization of cost-effectiveness, includes strengthening the risk management process, with the aim of improving and enhancing the Bank's market position.

On this occasion I would like to thank all the employees of the Hrvatska poštanska banka which continued with the upgrading and optimizing operating results in these difficult times. I thank the Management Board for showing effort and prompt actions towards restructuring and improving future operations of the Bank, and also I would like to thank my colleagues on the Supervisory Board for their cooperation. My special thanks to all our clients for the trust they have placed in us, for which we have a duty and which we intend to justify in the coming period to mutual satisfaction.

Dražen Kobas
President of Supervisory board

**Management Board report of condition**

Dear clients and shareholders,

on behalf of the Management Board, I present to you the operating results of the Hrvatska poštanska banka in year 2014, which was a challenging and complex. I hold the position of the President of the Management Board from the beginning of September 2014, and I am proud to say that the Bank, although faced with a challenging situation because of the legacy of the past, achieved a very good operating results, and we started with business improvements that will serve as a foundation on which we build our business excellence.

***Financial results of the Hrvatska poštanska banka***

As a result of activities carried out back five years, which were focused on rationalization and increasing efficiency, the HPB achieved in 2014 **the highest operating profit** in its corporate history – HRK 300 million with an annual increase of 13 percent.

Despite the record operating results, the Bank has recorded **a loss after tax** in the amount of HRK 635 million due to **impairment of loans and other assets** (= HRK 932,000,000). Carried out provisions mainly relate to loans approved 6 years ago or more, and who have been identified as impaired. The above mentioned is reflected in the slight increase of the proportion of bad loans in total loans (2014.: 26.0%, in 2013: 23.4%), and strong growth of non-performing loans coverage provision (2014: 61.2%, in 2013: 39.3%) which is above the average of the sector (= 51.0%).

Growth of operating profit in 2014 results from the increase in **net interest income** by 12.1 percent. Specifically, as a result of average higher principal placements during the year the gross interest income has increased (+3.0 percent), while interest expenses decreased (8.1 percent) following the active policy of price and contracting of favourable long-term credit sources.

**Net fee and commission income** fell compared to 2013 by 2.9 percent, as a result of changes in tariffs for payment transactions for portion of transfers that are performed in the externalized network. Despite the fall of income from payment transactions, the Bank took over the second place per share in number of transactions in the National Clearing System during 2014, with a market share of 22 percent. In contrast to a declining trend in the segment of payment transactions, the growth in revenues from products and services in the segments of retail banking and credit card operations is emphasized. Namely, development of new products and services is continued, among which the particular emphasis is on new HPB combinations and introduction of the possibility of Dynamic Currency Conversion transactions at ATMs.

The stagnation the domestic capital market and further narrowing of spreads in the foreign exchange market did not reflect on the effects of **securities trading and foreign exchange**. Furthermore, in 2014 there was an increase in trading profit by 17.6 percent, which is mostly due to the sale of securities in AFS portfolio.

Due to our orientation to rational management, growth of general and administrative expenses, depreciation and amortization in 2014 was limited (+2.1%). I would like to point out that we initiated major restructuring and reorganizations, which along with one-off costs in 2015, in the following years will result in significant cost reduction and convergence of best banking practice in all relevant processes.

However, the increase in costs was fully offset by a jump in operating income, which is reflected through the improvement of **C/I efficiency indicator** by 2.3 percentage points in 2014, to 60.2 percent.

**Assets** of the Bank has decreased by 5.5 percent due to provisions established in 2014 and at the end of 2014 was HRK 17.4 billion, with which the Hrvatska poštanka banka takes up a market share of 4.4 percent in the banking sector of Republic of Croatia.

Provisions in 2014 reduced the capital base of the Bank, and the total capital is decreased to HRK 845 million and **adequacy rate of regulatory capital** fell below the regulatory minimum and amounted to 6.7 percent. The Bank and its owners are making a maximum effort so that we can strengthened the capital position through a capital increase in the first half of 2015, with which the required adequacy rate of regulatory capital will be realized.

One of the activities that the Bank had at its disposal to strengthen the capital adequacy prior to additional capitalization is the optimization of risk-weighted assets (RWA). Accordingly, **gross loans to customers** were decreased in 2014 by 4.2%, which is related to loans to legal entities (-9.4%). As the Bank with the slogan "equal for all" we gained loyalty and trust 630,000 citizens. The same is evident not only from the continuation of significant growth rate of loans to households (+7.3 per cent) as opposed to a multi-year sector deleveraging trend of that sector, but also in the continued growth in household deposits (+1.9 percent).

Although **deposits** continue to represent the primary source of financing for the Bank (=80% in the structure of liabilities), part of the deposit during 2014 was substituted by other sources, which is why the total deposits fell by 4.2 percent, primarily in the segments of banks (-4.2 percent) and other legal persons (-6.7 percent).

***The consolidated financial results of the Hrvatska poštanska banka Group***

The HPB Group, except the parent company, the Hrvatska poštanska banka, constitutes of HPB Stambena štedionica, HPB Invest (company for the management of investment funds) and HPB Nekretnine (a company specialized in real estate). All subsidiaries recorded profit after taxi in year 2014, where HPB Stambena štedionica made a profit in the amount of HRK 4.4 million, HPB Nekretnine HRK 0.2 million, while the company HPB Invest made profit of HRK 1.3 million.

Due to the financial results of the parent, the HPB Group in 2014 recorded a loss after tax in the amount of HRK 629.4 million. Given that the assets of the Group almost entirely relate to assets of the Bank, its movement in 2014 was determined by the movement of parent's assets, and fell by 5.5 percent and amounts HRK 17.4 billion.

***Plan of Hrvatska poštanska banka in year 2015***

In addition to mentioned additional capitalization, with which our capital base will be strengthened, the restructuring process that we started will transform the Hrvatska poštanska banka. It will not only be reflected in the increase of business efficiency and cost reduction, but will also lead to changes in state of mind in the Bank and of the Bank. We want to be modern and the most innovative banking institution in the country, what will be contributed by the development of modern information technology and mobile solutions for the products, but also the establishment of a new organizational unit in charge of quality control services, with which our already successful reclamation center will be completed. Innovation and product development are in line with our policy that, at low cost, we offer our services to everyone and that we are equal to everyone.

Clients are precious to us, and responsibility towards them is crucial. The Bank will therefore continue to nurture a transparent relationship with clients, and promote responsible and sustainable debt on the one hand, and savings on the other. At the same time we want to participate in the economic recovery of our country, through the support of small and medium enterprises, and propulsive export sector - tourism and manufacturing.

In the end I would like to thank our clients for their trust, and shareholders for their support which we need in the coming period so that we become excellent banking firm focused on sustainable growth and responsible business.

Tomislav Vuić

President of the Management Board

## Management Board

**TOMISLAV VUIĆ, President of the Management Board (since 10 September 2014)**

Responsibilities: Office of the Board, Internal Audit, Human resources management, Marketing and Product Development, Organization and project management, Retail banking, Corporate banking, Legal affairs, Financial management

**DUBRAVKA KOLARIĆ, member of the Management Board (since 10 September 2014 in new mandate)**

Responsibilities: Compliance office, Corporate security, Financial markets, Business support department (Credit card support division, Direct banking support division)

**MLADEN MRVELJ, member of the Management Board (since 17 December 2014)**

Responsibilities: IT sector, Payment operations, Business support department (Business support division), Procurement and general affairs

**DOMAGOJ KARADJOLE, member of the Management Board (since 22 December 2014)**

Responsibilities: Risk Management, Collection Management

## Macroeconomic trends in the Republic of Croatia in 2014

During 2014, the growth of the world economy is continued following the economic growth in the US and countries with emerging markets while the European Union recorded only a slight recovery.

In Republic of Croatia during 2014 was not registered strengthening of economic activity as a precondition for sustainable growth and exit from the recession so that the real GDP declined by 0.4% year on year.

Although the growth of exports of goods and services was continued, due to the absence of strengthening of domestic demand there was a stagnation in economic activity. Nevertheless, during the fourth quarter slight increase year on year was registered thanks to the growth in exports, but it was largely offsetted by a decrease of gross fixed capital investments.

**The banking sector of Republic of Croatia**

Assets of banks (aggregate, without housing savings banks) at the end of 2014 amounted to HRK 395.9 billion, which is 0.6 percent less than a year earlier. The decline of the assets, as well as last year, reflected through weak domestic demand and a smaller volume of lending activities in the real sector so that the surplus funds were redirected in government securities and investments in liquid assets. This continued a long-term trend growth of the share of the state in the Bank's assets while the deleveraging of the private sector together with the deterioration of the quality of placements to this sector decreased their share in assets. Methods of resolving non-performing loans did not for now give more significant results. Although it was expected to improve performance of the corporate sector through the implementation of pre-bankruptcy settlements, this has not happened for now.

Mild increase in corporate deposits was primarily the result of borrowing of public enterprises and the temporary deposit of funds on transaction accounts with banks. Banks have almost completely focused their inflow of domestic sources of in foreign assets that is debt repayment to foreign owners.

Despite unfavourable economic developments, business results of the banks are almost three times higher than in 2014 because they formed significantly lower provisions with the growth in net interest income and net income from fees and commissions.

**Labour market**

In 2014 the number of employees has stagnated or remained unchanged from the end of last year. On the other hand there has been a significant reduction in the number of unemployed primarily as a result of removal of persons who have not complied with legal requirements from the Croatian Employment Service records. At the level of the whole 2014 for the first time since 2010 was recorded growth of nominal wages. At the same time as compared to the 2013, real wages increased slightly following the slight decline in consumer prices.

**Inflation**

At the end of 2014 the negative annual inflation rate of -0.2% was realized, which is 2.40 p.p. less than the previous year. This decrease was primarily influenced by decrease in the annual rate of change in energy prices following the decline in prices of petroleum products and the reduction of food ingredients.

**Foreign trade**

Due to continued positive trends in the international exchange of goods and services during the fourth quarter the deficit on the current account balance of payments was reduced which has not fully compensate the negative effects of movement on account of primary and secondary income for the entire year 2014. The surplus on the current account has decreased to 0.7% of GDP in 2014.

**Monetary policy**

The Croatian National Bank in 2014 continued expansive monetary policy through the promotion of credit and economic activity while maintaining a low level of interest rates.

In December of last year the reserve requirement rate was reduced (from 13.5% to 12%), but with the purchase of compulsory CNB bills, which are released to banks depending on the growth of placements. Thus, in 2014, printing of obligatory treasury bills was continued in order to stimulate credit activity focused on the economy (total from the beginning of the implementation by the end of 2014 HRK 0.7 billion of compulsory CNB bills was printed).

At the end of 2014 the exchange rate was 7.66 EUR/HRK, which is 0.3% higher than at the end of 2013.

**Public finances**

In the first nine months of 2014 general government income amounted to HRK 102.4 billion or 0.5% less than in the same period last year. These negative development are result from the reduction of tax revenues (income tax, VAT) while revenues from social contributions increased primarily due to an increase in contribution rates for health insurance. General government expenditure in the observed period has increased by 1.5% due to an increase in interest expense and other current transfers for payments to the budget of the European Union. The deficit of general consolidated government in the first three quarters amounted to HRK 15.1 billion (an increase of HRK 2.2 billion compared to the same period in 2013). To cover the deficit the state was financed by borrowing, which increased general government debt, but still that growth was somewhat slower than in the previous period due to the use of funds from the deposits insured by borrowing at the end of last year.

## Description of Hrvatska poštanska banka Group operations

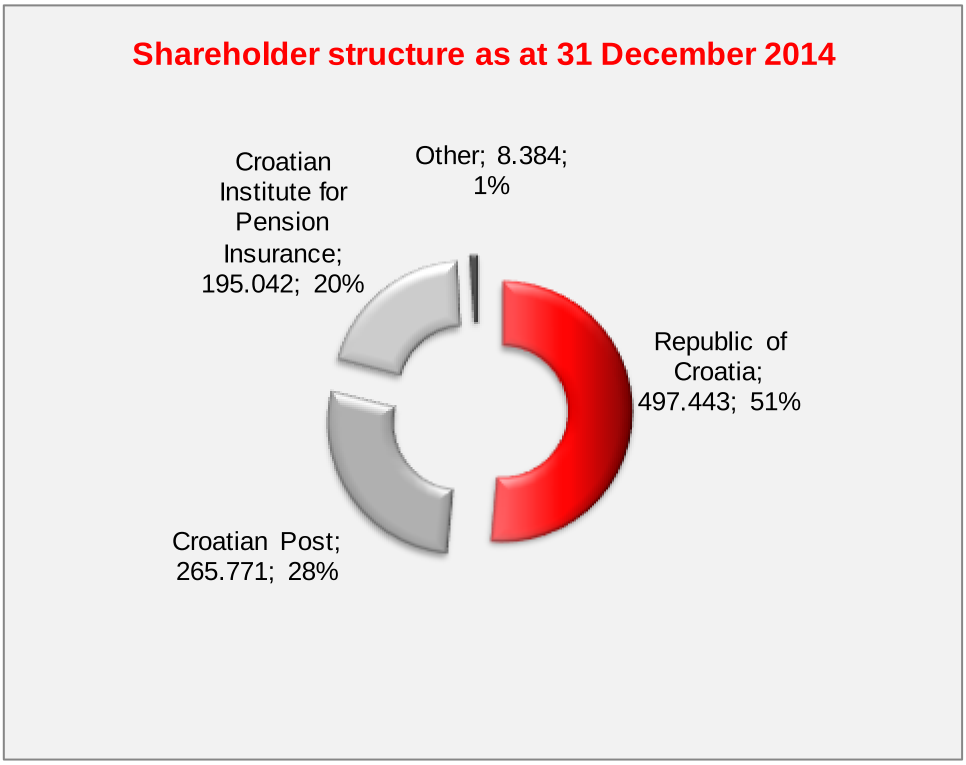
### Hrvatska poštanska banka d.d.

Hrvatska poštanska banka d.d., Zagreb, was founded and registered as a joint stock company in accordance with regulations applicable in Republic of Croatia, and is authorized to perform banking activities in the Republic of Croatia. Bank’s headquarter is located in Jurišićeva 4, in Zagreb. As per December 31 2014, Bank operated through eight branches, forty three outlets and ten detached tellers.

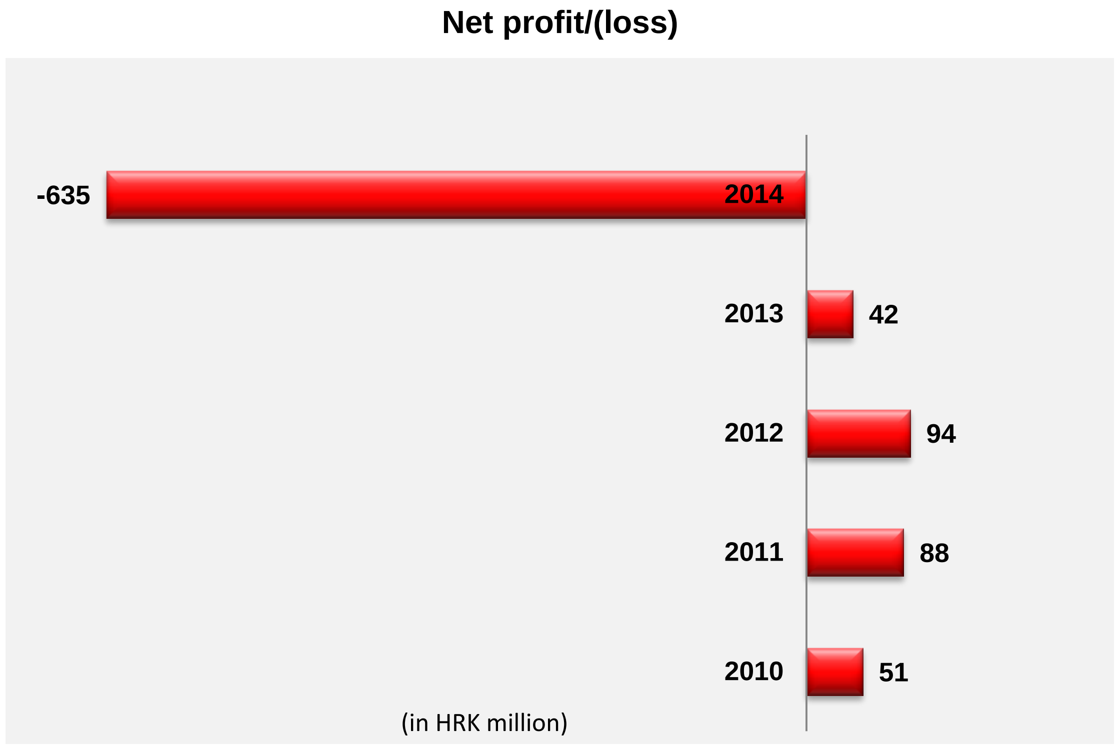
Bank's main activity comprises all kinds of deposit and loan operations for corporate and retail customers in domestic and foreign currency, performing domestic and foreign payment transactions, issue of guarantees, sureties and other forms of guarantees, foreign currency and securities trading, and other banking activities.

As a bank under domestic ownership, HPB is ranked seventh among 30 banks in Croatia, with assets amounting to HRK 17.4 billion.

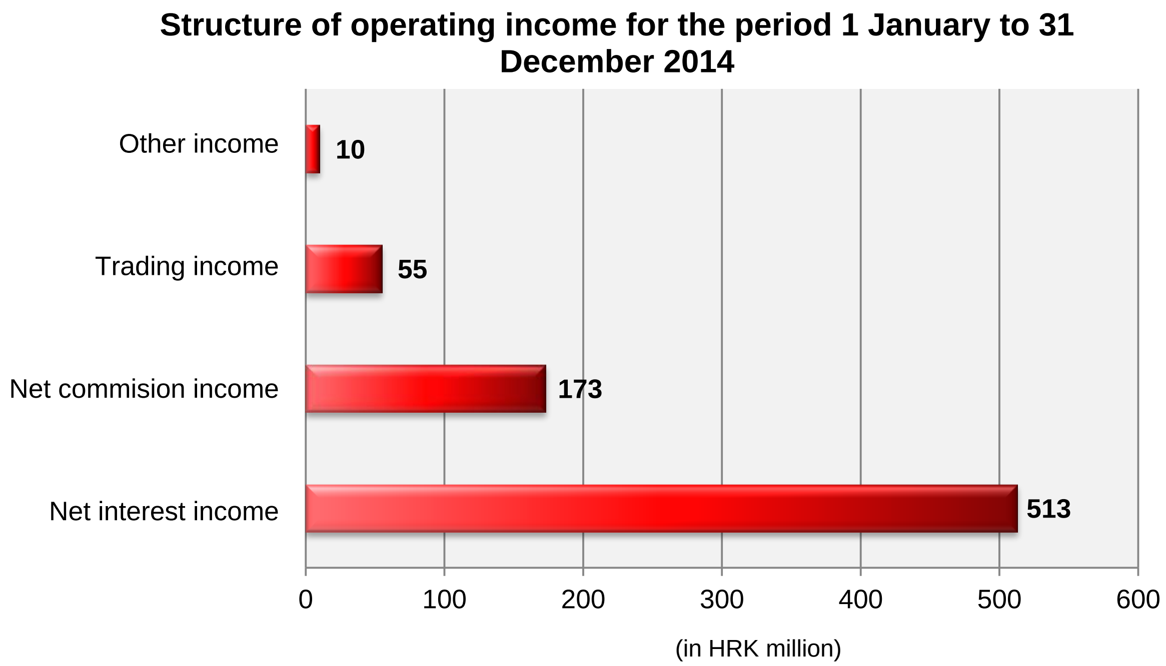
Bank is 100% owner of HPB Stambena štedionica d.d., HPB Invest d.o.o., investment fund management company, and HPB Nekretnine d.o.o., company for real estate and construction, which together form the HPB Group.



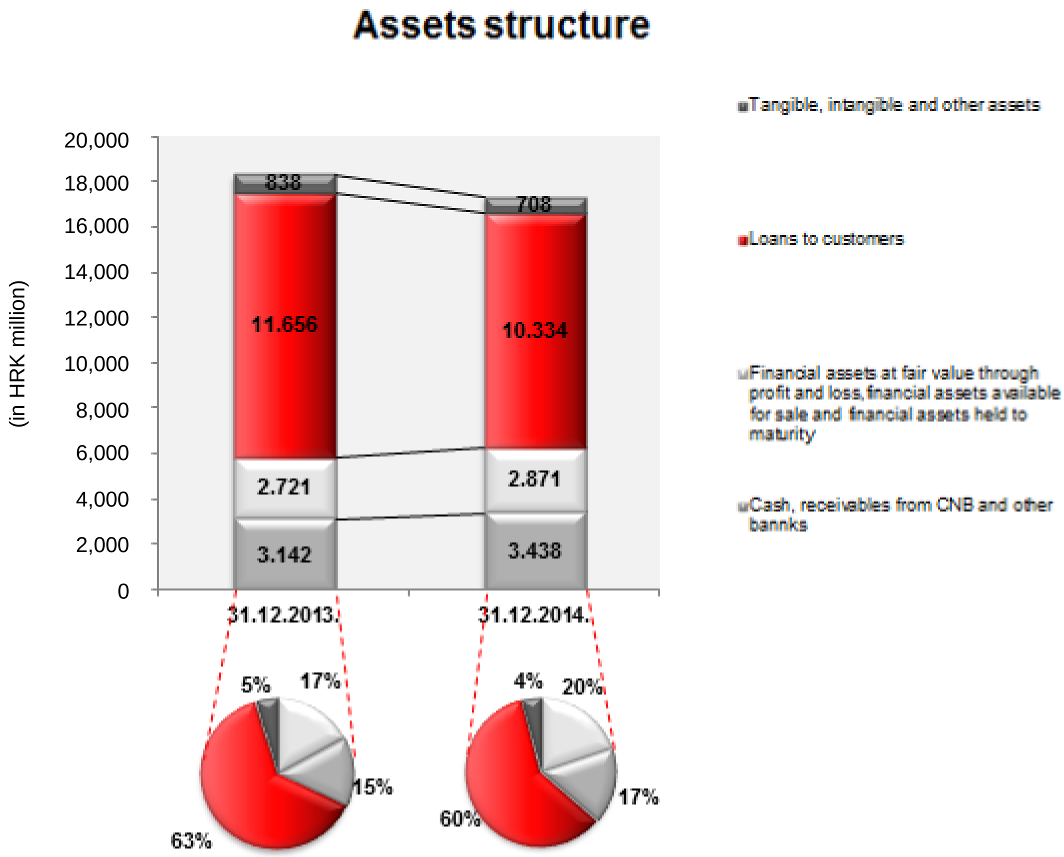
Bank has realized loss after tax in the amount to HRK 635.4 million during 2014. Profit before provisions for impairments amounted to HRK 299.5 million. Provisions for impairment losses on loans and other assets amounted to HRK 931.8 million and provisions for liabilities and expenses amounted to HRK 4.8 million.



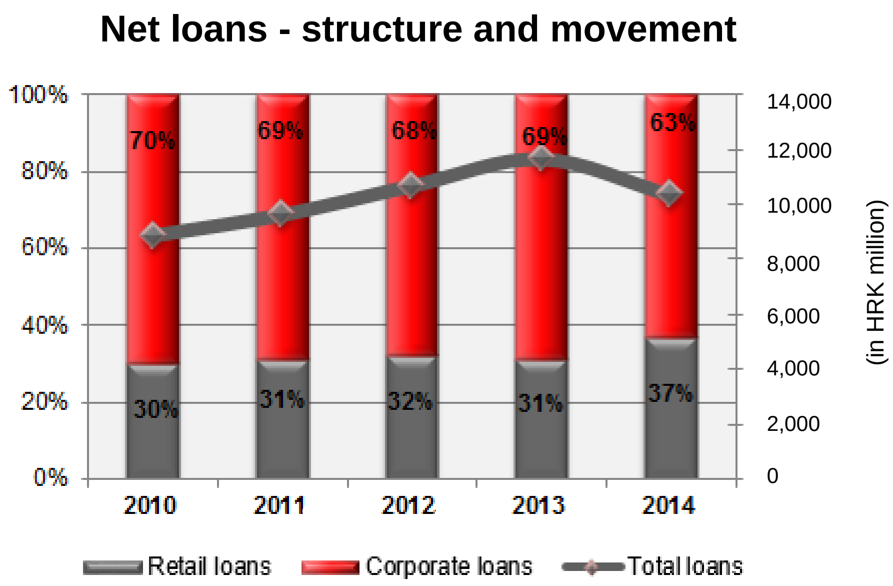

In 2014 total operating income increased by 6.1% compared to 2013. Net interest income, amounting to HRK 513.4 million is generating a share of 68.3% in total operating income.



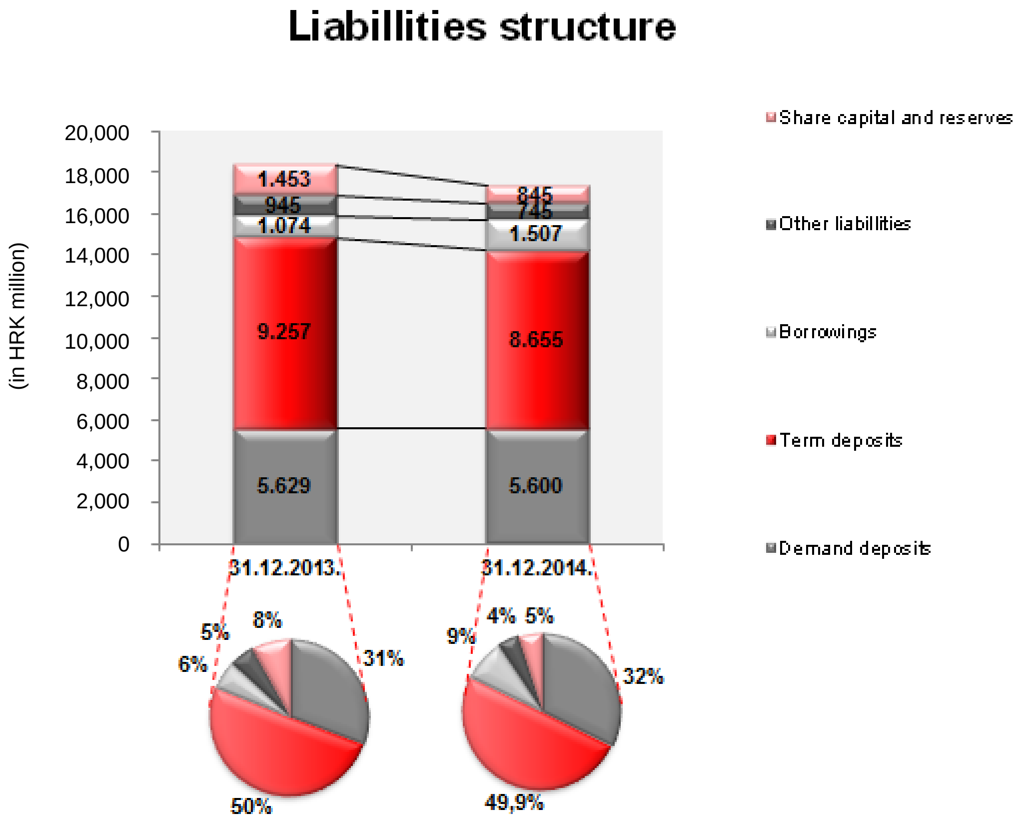
At 2014 year-end, Bank's assets amounted to HRK 17,351 million, representing a HRK 1,006 million decrease (-5.5 percent) compared to 2013. Loans and advances to customers represent the majority of Bank's assets with a share of 59.6%. Furthermore, placements with and loans to other banks, CNB obligatory reserve and other cash funds represent 19.8% of assets. Financial assets available for sale follows with a share of 11.5 percent.




Total loans amounted to HRK 10,334 million, having decreased by HRK 1,321.1 million compared to 2013. Increase of corporate loans' share within the structure of net loans to customers is clearly observable and equals 36.7 percent as per 2014 year-end. Share of loans to legal entity's has consequently decreased and equals 63.3 percent.



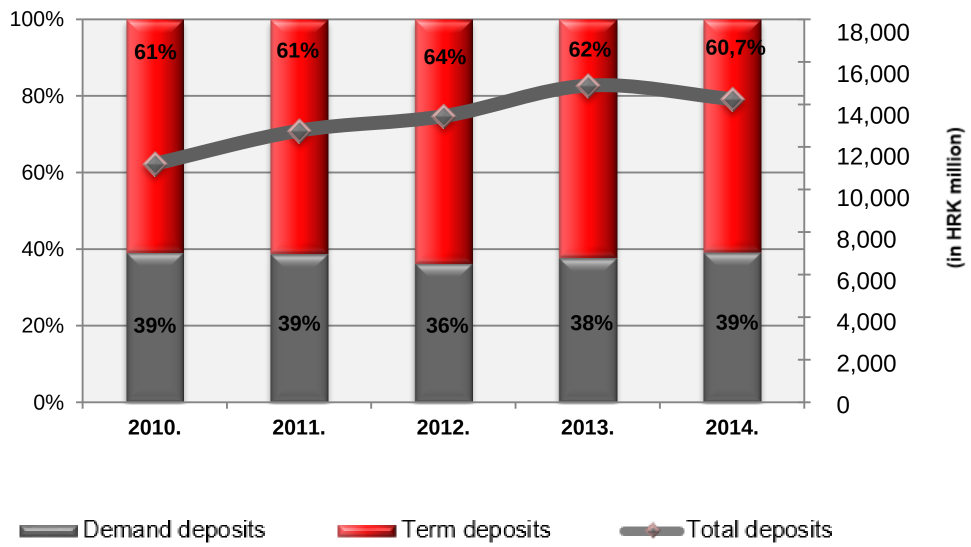
Term deposits form the majority within the liabilities' structure with a 49.9 percent share, followed by demand deposits with a 32.3 percent share, representing an increase of 1.6 percentage points compared to 2013.



Deposits from customers decreased by 1.9% during 2014 (HRK 264.5 million) compared to 2013. Total deposit decline (including deposits received from banks) amounts to HRK 631.1 million or 4.2 percent.

Deposit structure is still dominated by term deposits (60.7%). During 2014 demand deposits have increased their share in total deposits from 37.8 to 39.3 percent.

## Structure and movement in deposits



*Retail operation*

HPB performs retail operation through its own operational network which comprises 8 branches, 43 outlets and 10 detached tellers. Retail services are also offered through more than 1,000 postal offices throughout the territory of Republic of Croatia.


In 2014, the Bank has enabled to its clients sale of products and services in Požega County by opening a new branch in the city of Požega, as well as the relocation of certain branches to better locations. Bank has also continued to improve its distribution channels of direct banking services by installing 16 new ATMs. At the end of 2014, Bank had its own network of 360 ATMs and 1,819 EFTPOS terminals.

Business cooperation with strategic partner Hrvatska Pošta is improved by sales promotion of products and services at the counters of post offices.

During 2014 HPB has intensified its cooperation with Croatia osiguranje through the sale of bank insurance which allowed additional non-interest income and the realization of bonus premiums.

During 2014 the Bank recorded significant results in sales, over 165 thousand of products were sold as well as over 33 thousand of HPB group of products were contracted. Based on mentioned sale in group of products the Bank increased non-interest bearing income by 7.4 percent in comparison with prior year.

Retail deposit constitute 57 percent within overall deposit structure. They have increased by 1,9 percent during 2014 and amount to HRK 8.16 billion as per 2014 year-end. Therein, demand deposits amount to HRK 2.22 billion and remained at the level of 2013, and term deposit amount to HRK 5.93 billion, representing a 2.45 percent increase. The growth of term deposits is the result of quality service, customer loyalty, excellent marketing promotion and Bank's recognition as a safe financial player within Croatian banking industry.

Gross retail loan portfolio amounted to HRK 4.37 billion at the end 2014. Within total gross loans structure, retail loans have a share of 35 percent.

Within retail loans structure, major part relates to commercial loans followed by overdrafts. Meanwhile, share of housing loans is increasing, with a growth rate of 11 percent (+HRK 85 million) during 2014.

Achieved results were realized primarily by a maximum contribution of sales staff, quality of service, loyalty of existing customers, acquisition of new customers and improve co-operation with professional services and logistics support.

***Corporate operations***

Corporate division provides banking services for more than 7,500 active clients, ever striving to improve services and introduce innovations in order to meet customer needs better.

Corporate operations during 2014 were primarily impacted by continuation of economic crisis and slow economic recovery in Croatia and at the end of the year started the adjustment of capital requirements. However, even during this macro economically challenging period, many positive developments have been achieved in this segment.

Accordingly, gross corporate loans decreased by 9.4% compared to 2013, and at the end of 2014 amount to HRK 8.0 billion. Loan structure is dominated by loans to companies with a share of 61.5%, followed by loans to government units representing 30.7% of total corporate loans. Remainder of corporate loans is comprised of loans to financial institutions.

As per 31 December 2014 total deposits of corporate entities (excluding bank deposits) amounted to HRK 5.6 billion, wherein demand deposits slightly increased by 0.3 percent and term deposits increased by 5.6 percent in comparison to 2013.

Total income from corporate banking increased by 3.2 percent compared to 2013 in which the greatest impact was the increase in interest income from Corporate Banking by 4.7 percent.
The increase in guarantees issued to legal entities by 5.3 percent compared to the year 2013 are also one of the positive indicators.

As always, Bank will continue to intensively collaborate with and offer loan support to corporate entities, state units and local-municipal units, but with an emphasis on growth of small and medium enterprises portfolio in order to adapt to market conditions. The focus will be on the increase in non-interest income with constant quality improvement and expansion of services.

### ***Operations on financial markets***

*Treasury*

During 2014 the main feature of financial markets was extremely high liquidity on both the domestic and the international market and further lowering of interest rates under the influence of measures of the ECB and the creation of additional liquidity in the system of the Eurozone. The Bank's operations and the Treasury was focused on effective management of liquidity and reserves formed in liquid instruments on the money market.

The Bank was intensively cooperating with the companies for managing open investment funds on the money market, and in order to achieve higher returns activities were expanded to foreign markets trading in short-term and long-term debt instruments.

Bank has the whole time maintained its position as one of the leading banks in domestic money market, while simultaneously keeping coefficients and liquidity ratios within prescribed limits. In cooperation with foreign partners, favourable financing was insured through contracting large foreign currency loans.

Trading with foreign exchange on the domestic market in 2014 was marked by the growth of EUR exchange rate compared to the HRK and further narrowing of spreads in trading with a slightly lower volatility compared to the previous year.

In the Sales department of risky products and Department of foreign exchange trading the Bank has increased its activity in cooperation with corporate clients through contracting the spot and forward purchase and sale of foreign currencies.

Also, the Bank continuously improves operations with cash and through cooperation with FINA cash services offers competitive service in trading and supply of cash. The Bank continues to be one of the most important participants in the Croatian market in the area of operations with cash and during the year 2014 has intensified cooperation in the purchase of foreign cash through a growing network of authorized exchange offices of the Bank.

*Investment banking*

Combined with financial intermediation services on domestic, regional and world capital markets, Bank has enhanced its activities in the segment of electronic trading and electronic trade-orders. Apart from easier access to information and easier placing of trade orders, this also represents a cheaper solution for the clients as well as for the Bank. Turnover in domestic and regional markets in 2014 are slightly increased but without new listing of securities and new initial public offerings of shares trading levels will remain significantly below those recorded in the best years.

Aiming to increase trading volume, Bank has enabled its clients to access international markets at lower rates, with additional liquidity. Namely, margin loan offer was improved with continuous risk management and reconciliation of the list of acceptable securities.

Bank is still participating as one of the issuing agents in Croatian bond issues, and has therefore participated in bond issue by Croatian Ministry of finance during 2014. Also the Bank participated as arranger in the preparation and implementation of bond issues of Hrvatska pošta.

In line with new regulation changes and requirements, Bank has improved its custody and depository services during 2014 and the Bank has intensively worked on the adaptation of contract documentation and the improvement of custody services and depositary bank. The level of assets on custody was stable at levels above 3.9 billion kuna.

***Internal controls system and internal audit***

Internal controls are a constituent part of the managing process of the management and all employees of the Bank.

Internal controls represent a reasonable guarantee that business goals will be achieved in a scheduled manner within a given time frame, by applying current regulations.

Principles of the internal control system are reflected through:

- clear lines of responsibility;
- separation of duties and activities;
- specific control procedures; and
- internal audit function.

The management and all employees are responsible for the implementation and application of the elements of internal control systems.

The elements of internal control systems are described in the internal regulations and implementing documents of business areas.

Internal Audit provides an independent assessment of the adequacy and effectiveness of internal controls of audited areas.

***Internal audit***

Internal audit is organized as an independent organizational part, and is based on professional principles of internal auditing, alongside associated regulations.

Internal audit procedures are performed in accordance with general internal audit standards and regulatory requirements, in four phases, as follows:

- planning;
- research;
- reporting; and
- results monitoring.

Planning is based on documented risk assessment and Yearly Operational Program is adopted by the Management Board with prior consent of the Audit Committee and the Supervisory Board.

Internal Audit covers all business areas of the Bank and is structurally divided into audit of retail, general audit, audit of information system and audit of the financial markets.

Report on audit results is submitted to accountable person within the subject of internal audit, and member of the Bank's Management Board in-charge, and Audit Committee. Internal audit prepares the report on work on semi-annual basis and submits it to the Management Board, Audit Committee and the Supervisory Board.

The report contains information on the achievement of annual work plan, a summary of the most important facts established during the audits carried out, the recommendations and the status of execution of the removal of the recommendations and measures identified during the audit.

***Development plan***

Faced with the capital shortfall, the Bank has developed, along with the primary activities aimed at enhancing its capital, a strategic framework to advance and transform the current model by introducing significant improvements in the areas of risk management, recovery of receivables, cost management, efficiency and to increase the non-interest income as a prerequisite for sustaining the operations in the long run with a moderate risk appetite.

The key strategy elements of HPB are as follows:

**I Responsibility to customers**

The HPB client base consists of around 630 thousand customers and represents its fundamental asset. The Bank will increase the quality of its service and products and preserve the high customer confidence. In addition, the lines of product on offer will be further enriched with new modern products, services and solution in line with the increasingly demanding customers who are at the same time increasingly price sensitive.

**II. Responsibility to shareholders**

The Bank will focus, in addition on customers, on preserving and enhancing the shareholder value which will be best measurable, before the planned privatization.

The performance will be measured in terms of sustainable and consistent levels of profit, with a clearly implemented compliance with all applicable legislation.

**III. Focus on responsible corporate governance**

The Bank will improve its corporate governance, including its structure and processes.

This mainly includes implementing improvements in the areas of risk management, HR and career management, planning processes, etc. The ultimate goal is to improve the level of culture in achieving defined goals.

**IV. Focus on profitable segments and segments with a growth potential**

HPB is, first of all, *a retail* bank with the highest level of customer confidence and among banks whose customers are most satisfied on the Croatian banking market. The Bank will build upon this position and seek to benefit from it by improving software support and using products with a growth potential, as well as the level of coordination of its divisions in approaching its customers. This will result in serving better the current customers and opening of the Bank towards younger generations with modern, rounded services.

**V. Focus on operational efficiency and cost management**

The Bank has initiated organizational changes to improve its efficiency and effectiveness. The expected changes comprise setting up an easily manageable organizational structure that will enable faster and more efficient processes.

**VI. Cooperation with Hrvatska pošta (HP)**

Hrvatska pošta, apart from being one of the Bank's shareholders, is also a major partner of the Bank, mainly in the area of outsourced payment operations, enabling HPB the second position in Croatia by the number of cash transactions carried out in 2014.

HPB will continue developing its cooperation with Hrvatska pošta at several levels so as to leverage the joint operations to the benefit of both partners.

***Risks exposure***

Most important types of risks to which the Bank is exposed to are: credit risk, liquidity risk, market risk, currency risk, operational risk and interest rate risk in the non-trading book. Market risk includes risk of changes in FX rates, risk of changes in interest rates and risk of changes in prices of financial instruments.

Bank is subject to credit risk through its lending and investing activities and in situations where it acts as an intermediary on behalf of customers or other third parties. Bank's primary exposure to credit risk arises from loans and advances to customers. Amount of credit exposure in this regard, and in respect of held-to-maturity debt securities valued at amortized cost, is represented by the carrying amounts of the assets in the balance sheet. In addition, the Bank is exposed to the credit risk through off-balance-sheet items, through commitments arising from undisbursed loans and guarantees issued.

Main categories of liquidity risk to which the Bank is exposed are: liquidity financing risk (structural liquidity risk) and market liquidity risk.

Exposure to market risk occurs in respect of balance sheet and off-balance-sheet positions recognized at market (fair) value, including financial assets held for trading, financial assets available for sale and positions denominated in foreign currency (including placements and liabilities linked to foreign currencies via foreign currency clause).

Exposure to interest rate risk in the non-trading book arises as a consequence of mismatch between assets and liabilities distributed according to the possibility of interest rate change criterion (repricing gaps) and various natures of interest rates (referent interest rates), by which the Bank brokers placements and sources of funding.

Operational risk is attributable to all of business activities, processes, products and systems of the Bank. Operational risk is a risk of an event which inflicts losses on the Bank, with the cause being inadequate or ineffective internal processes, systems, human resources, or external influences. This definition includes legal risk.

Detailed description of risk management of the Group and the Bank is outlined in note 2, within financial reports.

## HPB Invest d.o.o.

**HPB Invest d.o.o.** (in further text referred to as Company) is a company for investment funds management, which was founded on July 19 2005 and is 100% owned by Hrvatska poštanska banka. Company started with operations on October 5 2005, and shareholder's capital amounts to HRK 5.0 million.

As per December 31 2014, the Company manages five open-end investment funds with public offer. Company also manages Umirovljenički fond, which is a special purpose fund, established by Croatian government, for repayment of pensioners' debt.

Total assets under management by the Company amount to HRK 427 million.

Structure of assets under management is as follows:

| **Fond** | **Assets under management HRK '000** | **Yield from the beginning of the year %** |
|---|---|---|
| HPB Dionički fond | 21,879 | 9.16% |
| HPB Global fond | 56,367 | 12.52% |
| HPB Novčani fond | 303,468 | 0.82% |
| HPB Obveznički fond | 29,507 | 8.30% |
| HPB Euronovčani | 15,577 | 1.08% |

As per December 31 2014, balance sheet of the Company amounted to HRK 8.8 million. Company has achieved net earnings amounting to HRK 1.3 million as of 31 December 2014. Company had 11 employees as per 2014 year-end.

***Development plan***

Goal of the Company is investment fund management and growth of assets under management parallel to market share growth. Achievement of competitive yields and stronger sales activities directly targeting clients and distribution channels, represents a prerequisite for the above mentioned goals. Company will continue to be devoted to professional asset management as well as to providing high quality services to its clients in order to ensure the preservation of sustainable value growth of their financial assets. With continuous investment in development policy of the Company, which implies continuous professional, personnel, organizational and technological advancements, parallel to more and more demanding legal and regulatory adjustment of operations, long lasting and attractive range of funds and investment products should be ensured, that can, depending on investment goals, horizon and clients' risk appetite, with professional management and adequate yields, meet the needs of investors.

***Risks exposure***

Most significant types of financial risks that the Company is exposed to are: credit risk, liquidity risk, market risk and operating risk. Market risk includes exchange rate risk, interest rate change risk and price risk. HPB Invest is not significantly exposed to liquidity risk, and according to assessment of the Company, no risk exists that it will not be able to settle its short term obligations. Interest rate risk is linked with exposure to placements to banks. Company manages operational risks by its own.

**HPB Stambena štedionica d.d.**

HPB Stambena štedionica (in further text: "Štedionica") is a credit institution which collects long-term savings with a purpose to resolve housing needs of depositors. Furthermore, it approves housing loans bearing fixed interest rates and with state subsidies.

As the fifth savings-bank on the market, Štedionica was founded in 2006. As per 2014 year-end it has 103,689 registered savings contracts, with a value of EUR 458.3 million. Operations are performed through the branch network of Hrvatska poštanska banka, through postal offices of Hrvatska pošta and through authorized agents. HPB Stambena štedionica has 19 full-time employees.

Štedionica has brokered 7,312 new housing savings contracts during 2014. Hrvatska poštanska banka is defined as a primary sales channel, through which 6,896 contracts were contracted. Remainder of the contracts was brokered through Hrvatska pošta having been brokered through authorized agents.

Value of total housing loans amounts HRK 148.1 million and is higher by 15 percent (HRK 21 million) compared to the previous year.

Štedionica has recorded profit amounting to HRK 4.4 million during 2014.

As per 31 December 2014 total assets of Štedionica amounted to HRK 276.8 million, representing an annual decrease of 10 percent.

***Development plan***

Further development of collaboration with Hrvatska pošta d.d., improvement of coordination in achieving mutual goals and developing products with Hrvatska poštanska banka, and development of IT support represent main foundations of Štedionica's business development. Štedionica continues with endeavours to positively contribute to Group's results.

***Risks exposure***

Risk management system in HPB Stambena štedionica is accomplished through internal risk management acts, through organizational structure with clearly defined responsibilities and authorizations with regard to risk management, through risk management process and through effective internal control system. Štedionica expresses its risk tolerance by defining targeted risk profile, while taking into account all demands impacting adequacy of available regulatory capital.

Most significant types of risks which could have impact on HPB Stambena štedionica are: interest rate risk in non-trading book, liquidity risk, market risks, credit risk and operational risk.

HPB Stambena štedionica evaluates interest rate risk in the non-trading book from two perspectives:

- perspective of economic value, e.g. possible market value decrease of the non-trading book due to interest rate changes
- earnings perspective, potential decrease of net interest income due to interest rate changes on the market.

When measuring interest rate risk from the economic value perspective, simplified calculus is used for assessment of economic value of the non-trading book as prescribed by CNB’s Decision on managing interest rate risk in the non-trading book, which takes into account adjusted entry data i.e. Adjusted model, which is applied by savings banks from October 20, 2011.

When measuring interest rate risk from the earnings perspective, Štedionica applies basic simulation of parallel interest rate changes (positive and negative) observed over a time horizon of twelve months, and effects on realized annualized net interest income during the observed period (from the beginning of the year).

Liquidity risk management comprises assessment and measurement of liquidity risk exposure, setting liquidity risk limits, reporting, monitoring and controlling those limits. Liquidity risk management is realized through operative management of daily and short-term liquidity, as well as through structural liquidity management.

For assessment and measuring of exposure to market risks internal model of Hrvatska poštanska banka d.d. is used. This model is based on risk value method, which measures maximum potential loss that could be inflicted on Štedionica in a specific time period, with statistical reliability.

Credit risk management is based on evaluation of loan capacity of the debtor. Quality and value of the collateral obtained are also assessed, as well as historical regularity of debt repayment.

Quality of the loan portfolio is monitored by Risk control function, which reports quarterly to Štedionica's Management about the quality of loan portfolio with regard to risk group qualification and impairments made. Reports about the loan portfolio also comprise overview of quality by loan type, by large exposures, by loan concentration and geographical concentration.

In order to determine and estimate operational risk exposure, Štedionica collects and analyses internal data about certain events caused by operational risk. Also performed are self-assessments of exposure to operational risk and self-assessment of control quality, estimation of risks linked to externalization, risk assessment regarding IT system and analysis of effects of unavailability of resources for critical processes within the business continuity scope.

Štedionica’s exposure to risks has been within limits defined by the law throughout the whole year.

## HPB Nekretnine d.o.o.

HPB Nekretnine d.o.o. is a company specialized in real estate business which started its business activities in August 2005, and is fully owned by the Bank. Shareholders' capital amounts to HRK 0.5 million.

Primary business activities of HPB Nekretnine are: real estate value estimation, advisory services, project development and real estate transactions.

As per 31 December 2014, balance sheet of HPB Nekretnine amounted to HRK 11.4 million, with net profit for 2014 amounting to HRK 220 thousand.

***Development plan***

In the upcoming period focus will be on the active market promotion and on further improvements in quality of services rendered. Company's business and development policy will be built on expected rise in market demand for specific services which the Company offers, as well as for new services of energy certification. Company should therefore contribute to Group becoming more recognizable, and a synergy effect will be accomplished.

***Risks exposure***

Most significant types of risk that the Company is exposed to are: credit risk, liquidity risk, market risk and operational risk. Market risk includes exchange rate changes, risk of interest rate gaps and price risk. The Company manages its risks according to prescribed policies and procedures of Hrvatska poštanska banka, described in Note 2.

## Statement on the application of the Corporate Governance Codex

### *Application of the Corporate Governance Codex*

In accordance with article 272.p of Commercial Companies Law the Management Board and the Supervisory Board state that the Bank voluntarily implements the Corporate Governance Codex which was established by Hrvatska agencija za nadzor financijskih usluga (“HANFA”) and Zagreb Stock Exchange (Zagrebačka burza d.d. – „ZSE“). Also, the Bank implemented the Corporate Governance Codex for Commercial Companies in which Republic of Croatia has shares or stakes which was established by the Croatian Government („Narodne novine“, number 112/2010).

During 2014 business year the Bank deviated from the recommendations in stated Codes in sections which refer to calendar announcement of important occurrences on Bank’s web pages because it comprised general deadlines, whereat all important occurrences were publicly announced immediately after accurate dates had been set. Also, the Bank did not publish General Assembly's agenda, relevant information and documents in English, considering that over 99 percent of shares are owned by Croatian government, as well as due to minority shareholder structure. According to the Statute, Bank sets the condition for registration to participate in the General Assembly and verifying authorization, to ensure optimal organization of the General Assembly and to determine validity of voting authorization. Furthermore, participation and voting in the General Assembly by using modern communication technology is not possible, because no such requirements were made by shareholders. Supervisory Board did not determine long term succession plan due to regulations which determine appointment of management board members in credit institutions, or jurisdiction of management bodies over appointment of officials in legal entities with special government interest. In addition, Supervisory Board members’ fee is not determinated according to their contribution to the Company's performance, because it is regulated by Croatian Government's decision on fees to supervisory and management board members. Most of the Auditing Committee members are independent members who are not Supervisory Board members, and the Committee’s work departs from the recommendations for delivering financial statements and related documents to the Auditing Committee before public announcement, considering that these statements are submitted to the Supervisory Board. A detailed explanation regarding implementation of stated Codes is presented in annual questionnaire which is publicly published and delivered to Zagreb Stock Exchange together with annual financial statements, and is also available on the Bank's web page.

Together with recommendations outlined in codes, and in accordance with credit institutions regulations, active efforts are made to improve corporate management of the Bank, by taking into account structure and Bank's organization, strategy and business goals, distribution of authorizations and responsibility with particular emphasis on efficient procedures for determination, measurement, monitoring and reporting on risks in Bank’s operations, as well as establishing corresponding internal control mechanisms.

A description of basic characteristics of internal supervision in the Company and risk management with respect to financial reporting is provided in descriptions of Bank’s operations in Note 2.

***Significant shareholders and limitations on share rights***

Republic of Croatia is shareholder with a share equalling 51.46 percent. Together with Hrvatski zavod za mirovinsko osiguranje and Hrvatska pošta d.d., Republic of Croatia holds over 99% of total share capital and voting rights at the General Assembly, thereby entirely controlling the Bank. Besides this, there are no shareholders in Bank's ownership structure with special controlling rights. According to Bank's Statute, voting rights are not limited in any way, nor are there any other limitations with respect to the realization of voting rights.

***Rules for the appointment and removal of Management Board members, bringing amendments to the Statute and certain Management Board authorizations***

In accordance with Bank's Statute, the Management Board consists of a minimum of two and a maximum of five members. Decision of the Supervisory Board from 29 November 2014 outlines that the Management Board has four members. Members and the President of the Management Board are appointed by the Supervisory Board for a period of up to five years, and can be reappointed with no restrictions. Only individuals who meet the criteria prescribed by the law and sub-law regulations regarding bank operations, and who have the prior approval of Hrvatska narodna banka can be appointed as Management Board members. Supervisory Board can bring a decision to remove the President of the Management Board and Members of the Board when there are valid grounds for such a decision. President and Members of the Management Board can also resign by submitting their resignation in written form.

Statute can only be amended by General Assembly's decision. A decision is considered brought if voted for by at least three quarters of share capital represented at the General Assembly. A proposed Decision on amendments to the Statue is submitted by the Management Board to the Supervisory Board, which is authorized to accept the proposal and submit it to the General assembly for consideration.

Bank's Management Board is authorized, with prior written approval by the Supervisory Board, during the period of up to five years from 30 December 2010, to bring one or more decisions to increase the Bank's share capital with a cash payment, by issuing new shares where the total amount of such share capital increase must not exceed HRK 450,000,000.00. Bank's Management Board is authorized, with the prior written approval of the Supervisory Board, with respect to shares issued based on the above mentioned authorization, to exclude priority in the subscription of new shares. Decisions regarding scope of rights from the shares issued based on the above-mentioned authorization, and of the terms and conditions for the issue of such shares, are made by the Management Board with prior written approval by the Supervisory Board. It is Supervisory Board's obligation to grant all approvals based on a majority vote of all it's members. In line with the decisions made in XXXI. General Assembly of the Bank, held on 15 December 2010, Management Board is authorized to acquire Bank's treasury shares on regulated market or outside regulated market during a period of up to five years, where total amount of such capital regarding treasury shares, together with treasury shares that the Bank already owns, must not exceed one tenth of share capital.

***Supervisory Board members and activities***

Supervisory Board’s authorizations are regulated by Commercial Companies Act, Credit Institutions Act and the Bank’s Statute. Supervisory Board has set up an Audit Committee, Committee for receipts, Nomination Committee and the Risk committee. as a supporting body.

Since 1 January until 14 April 2014, Supervisory Board had following five members:

- Dražen Kobas, president
- dr.sc. Nada Karaman Aksentijević, vice president
- Sanja Martinko, member
- Marin Palada, member
- mr. sc. Niko Raič, member

As of 14 April 2014, based on the given resignation of a member of the Supervisory Board, Ms. Sanja Martinko, stopped hers membership in the Supervisory Board of the Bank, therefore Supervisory Board had four members from 15 April to 31 December 2014.

Members of the Supervisory Board do not possess Bank's shares or any other securities issued by the Bank.

***Structure and operations of the Management Board***

Authorizations, obligations and responsibility of the Management Board in managing Bank’s operations and representation of the Bank are as prescribed by Companies Act, Credit Institutions Act, Bank’s Statute and Rules of procedure of the Management Board. Management Board sets up permanent and temporary committees and delegations with respect to requirements of business processes. Permanent committees are: Loan Approval Committee, Assets and Liability Management Committee and Operational Risk Committee.

Since 1 January until 9 September 2014, Management Board had following four members:

- Čedo Maletić, president of the Management Board
- Dubravka Kolarić, member of the Management Board
- Boženka Mostarčić, member of the Management Board
- Tanja Šimunović, member of the Management Board

Due to the expiration of the mandate of the previous members of the Management Board, with the Supervisory Board Decision from 24 July 2014, it was determined that the Management Board for the new term consists of two members, who are subject to prior approval of the Croatian National Bank and appointed by a decision of the Supervisory Board, so that in the period from 10 September untill 16 December 2014, the Management Board acted in the following composition:

- Tomislav Vuić, president of the Management Board
- Dubravka Kolarić, member of the Management Board

With the decision of the Supervisory Board of the Bank dated 29 October 2014, the Management Board has been expanded to four members, and based on the decision of the Supervisory Board of the Bank and with the prior approval of the Croatian National Bank in the composition of the Management Board entered two new members:

- Mladen Mrvelj, member of the Management Board since 17 December 2014
- Domagoj Karadjole, member of the Management Board since 22 December 2014.

The members of the Management Board do not possess the Bank's shares or any other securities issued by the Bank.

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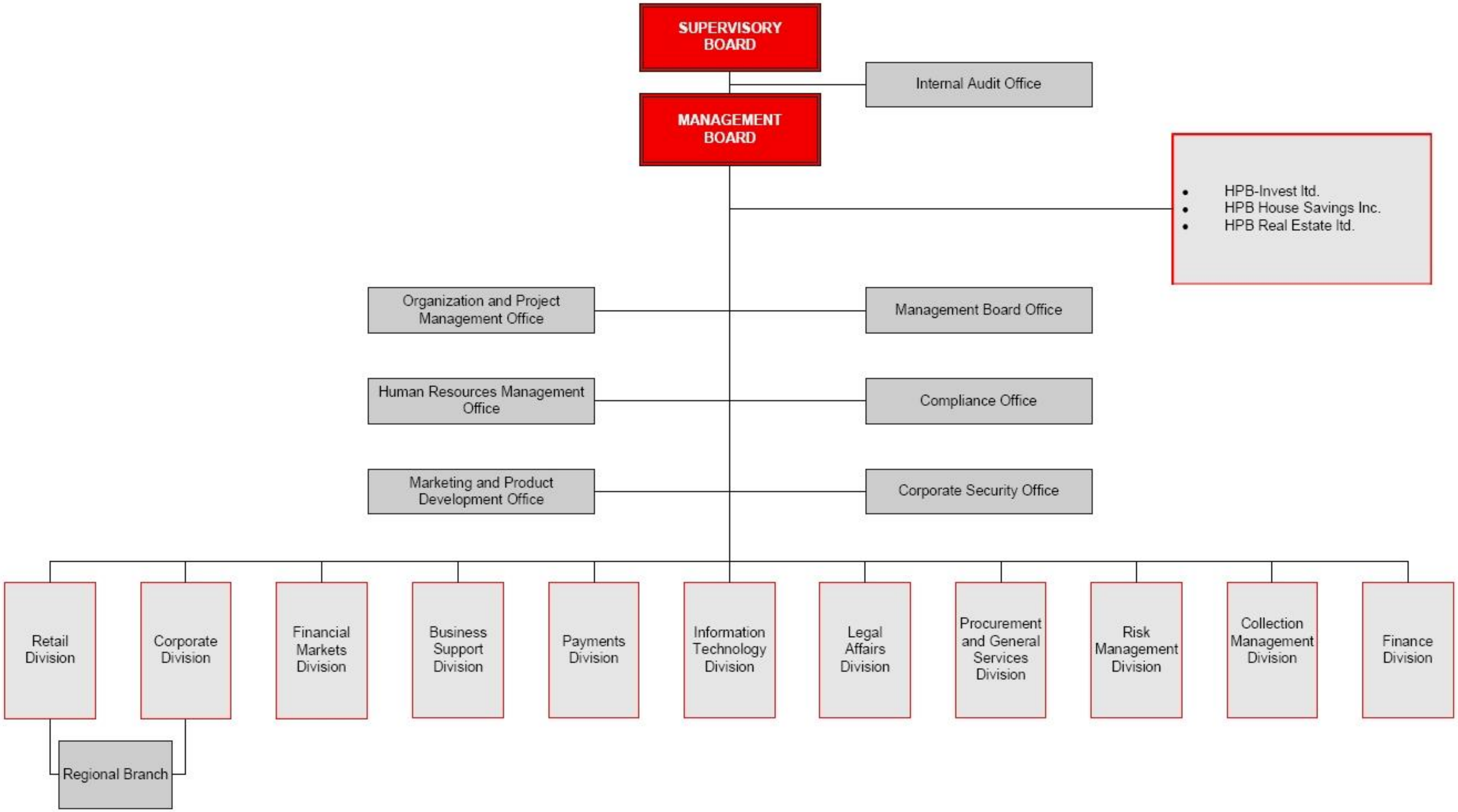
***Organizational scheme of Hrvatska poštanska banka d.d.***



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

Management Board of the Bank is required to prepare unconsolidated and consolidated financial statements of Hrvatska poštanska banka d.d. ("Bank") and its subsidiaries ("Group") for each financial year. These statements give a true and fair view of financial position of the Bank and the Group and of the results of their operations and cash flows, in accordance with applicable accounting standards. Management Board is also responsible for maintaining proper accounting records needed for preparation of such financial statements at any given time. Management Board has a general responsibility for taking available measures aiming to safeguard Bank's and Group's assets, and to prevent and detect fraud and other irregularities.

Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; making judgments 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 and the Group will continue in business.

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

Unconsolidated and consolidated financial statements set out on pages between 43 and 167 were approved by the Management Board on 21 April 2015 for their issue to the Supervisory Board, which is confirmed by the signature below:

Signed in the name of Hrvatska poštanska banka d.d.

Tomislav Vuić

President of the Management Board

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**Independent Auditor's Report**

**To the Shareholders of Hrvatska poštanska banka d.d. Zagreb:**

We have audited the accompanying separate financial statements of Hrvatska poštanska banka d.d. Zagreb ('the Bank') and the consolidated financial statements of the Hrvatska poštanska banka d.d. Group ('the Group'), which comprise the statements of financial position at 31 December 2014, and the related statement of income, statement of other comprehensive income, statement of changes in equity and reserves and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

*Management's responsibility for the financial statements*

The Management Board of the Bank is also responsible for the preparation and fair presentation of the separate and consolidated financial statements in accordance with statutory accounting requirements for banks in the Republic of Croatia and for such internal controls the Management Board considers necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the unconsolidated and consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the separate and consolidated 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 and the Group's internal controls. 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 separate and consolidated financial statements.

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

*Opinion*

In our opinion, the separate and consolidated financial statements present fairly in all material respects, the financial position of the Bank and the Group at 31 December 2014, and the results of their operations and their cash flows for the year then ended in accordance with the statutory accounting requirements for banks in the Republic of Croatia.

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**Independent Auditor's Report (continued)**

*Emphasis of matter*

We draw attention to Note 1 which makes reference to the draft of the restructuring plan for the period 2015-2019 intended to achieve capital adequacy rate in accordance with regulatory requirements and which was submitted to the European Commission on 23 March 2015 for approval. Receipt of owners funds to increase capital in the estimated amount of HRK 550 million is conditional upon response of the capital increase model by the European Commission. Our audit opinion is not qualified for this matter.

**Other legal and regulatory requirements**

i. Pursuant to the Decision of the Croatian National Bank on the Form and Content of the Annual Financial Statements of Banks (Official Gazette No. 62/08; hereinafter: 'the Decision') the Management Board of the Bank has prepared reporting forms, set out on pages 168 to 183, which comprise the separate balance sheet at 31 December 2014, the separate income statement, the separate statement of changes in equity and the separate statement of cash flows for the year then ended, together with the notes about the reconciliations with the separate statutory financial statements. These forms and the notes thereto are the responsibility of the Bank's Management Board and they do not constitute a part of the financial statements prepared under the statutory accounting requirements for banks in Croatia, which are set out on pages 43 to 167, but rather a requirement imposed by the above-mentioned decision. The financial information provided in those forms have been derived from the statutory financial statements of the Bank.

ii. Pursuant to the Accounting Act, the Management Board is also responsible for preparing the Annual Report. Our responsibility is to issue an opinion on the consistency of the Annual Report with the separate and consolidated financial statements based on our audit. Our procedures have been conducted in accordance with the International Standards on Auditing and limited solely to assessing of whether information disclosed in the Annual Report is consistent, in all material respects, with the information presented in the separate and consolidated financial statements. We have not audited any data or information other than the financial information obtained from the separate and consolidated financial statements and accounting ledgers. We believe that the performed audit provides a reasonable basis for our audit opinion.

   In our opinion, the financial information presented in the Annual Report is consistent, in all material respects, with the above mentioned separate and consolidated financial statements at 31 December 2014.

**Branislav Vrtačnik,**

President of the Management Board and certified auditor

**Deloitte d.o.o.**

Zagreb, 21 April 2015

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| | Notes | Group 2014 HRK '000 | Group 2013 HRK '000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and amounts due from banks | 5 | 1,308,452 | 1,177,543 |
| Obligatory reserve with Croatian National Bank | 6 | 1,545,787 | 1,442,045 |
| Loans to and receivables from banks | 7 | 583,784 | 522,772 |
| Financial assets at fair value through profit or loss | 8 | 381,801 | 343,841 |
| Financial assets available for sale | 9 | 2,002,974 | 1,715,416 |
| Financial assets held to maturity | 10 | 597,943 | 821,305 |
| Loans and receivables from customers | 11 | 10,473,750 | 11,753,691 |
| Assets held for sale | 12 | 7,930 | 41,551 |
| Property and equipment | 14 | 153,225 | 147,987 |
| Investment property | 15 | 9,828 | 9,938 |
| Intangible assets | 16 | 140,342 | 168,709 |
| Deferred tax assets, net | 17 | 16,603 | 22,869 |
| Tax prepayment | | 53 | 50 |
| Other assets | 18 | 347,439 | 430,070 |
| **TOTAL ASSETS** | | **17,569,911** | **18,597,787** |
| **LIABILITIES** | | | |
| Financial liabilities at fair value through profit or loss | 19 | 508 | 8 |
| Deposits from banks | 20 | 374,750 | 741,207 |
| Customer deposits | 21 | 14,084,725 | 14,361,365 |
| Borrowings | 22 | 1,507,327 | 1,074,013 |
| Hybrid instruments | 23 | 260,921 | 410,802 |
| Provisions for liabilities and expenses | 24 | 29,758 | 42,748 |
| Other liabilities | 25 | 469,194 | 522,150 |
| **TOTAL LIABILITIES** | | **16,727,183** | **17,152,293** |
| **EQUITY** | | | |
| Share capital | 26 | 966,640 | 966,640 |
| Capital reserve | 26 | 228,136 | 228,136 |
| Treasury shares | 26 | (874) | (874) |
| Statutory reserve | 26 | 10,578 | 8,458 |
| Fair value reserve | 26 | 72,867 | 45,941 |
| Revaluation reserve | 26 | 887 | 1,189 |
| (Accumulated loss)/Retained earnings | 26 | (435,506) | 196,004 |
| **TOTAL EQUITY** | | **842,728** | **1,445,494** |
| **TOTAL LIABILITIES AND EQUITY** | | **17,569,911** | **18,597,787** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

# Consolidated Income Statement
# For the year ended 31 December 2014

| | Notes | Group 2014 HRK '000 | Group 2013 HRK '000 |
|---|---|---|---|
| Interest and similar income | 28 | 872,407 | 848,221 |
| Interest and similar expense | 29 | (355,587) | (385,440) |
| **Net interest income** | | **516,820** | **462,781** |
| Fee and commission income | 30 | 499,034 | 549,742 |
| Fee and commission expense | 31 | (313,407) | (356,729) |
| **Net fee and commission income** | | **185,627** | **193,013** |
| Gains less losses arising from securities at fair value through profit or loss | 32 | 6,293 | 2,594 |
| Gains less losses arising from securities available for sale | 33 | 17,348 | 8,607 |
| Gains less losses arising from dealing in foreign currencies | | 36,625 | 36,088 |
| Other operating income | 34 | 10,627 | 15,007 |
| **Trading and other income** | | **70,893** | **62,296** |
| **Operating income** | | **773,340** | **718,090** |
| General and administrative expenses | 35 | (413,220) | (405,876) |
| Depreciation and amortization | 14,15,16 | (53,571) | (53,006) |
| Impairment losses on loans and receivables to customers and other assets | 36 | (932,942) | (236,917) |
| Provisions for liabilities and expenses | 24 | (3,969) | 14,077 |
| **Operating expenses** | | **(1,403,702)** | **(681,722)** |
| **(LOSS)/PROFIT BEFORE TAX** | | **(630,362)** | **36,368** |
| Income tax income/(expense) | 37 | 972 | (630) |
| **(LOSS)/PROFIT FOR THE YEAR** | | **(629,390)** | **35,738** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

| | Group 2014 HRK '000 | Group 2014 HRK '000 |
|---|---|---|
| **(Loss)/profit for the year** | **(629,390)** | **35,738** |
| **Other comprehensive income** | | |
| *Items that will not be reclassified subsequently to profit or loss:* | | |
| Revaluation reserve | (317) | (69) |
| Income tax relating to items that will not be reclassified subsequently | 15 | 14 |
| | **(302)** | **(55)** |
| *Items that may be reclassified subsequently to profit or loss:* | | |
| Gain/(loss) from financial assets available for sale | 34,703 | (2,103) |
| Income tax relating to items that may be reclassified subsequently | (7,777) | 1,256 |
| | **26,926** | **(847)** |
| **Other comprehensive gain/(loss) for the year** | **26,624** | **(902)** |
| **Other comprehensive (loss)/income for the year, net of income tax** | **(602,766)** | **34,836** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

| Group | Share capital HRK '000 | Capital reserve HRK '000 | Treasury shares HRK '000 | Legal reserves HRK '000 | Fair value reserve HRK '000 | Revaluation reserve of long term tangible assets HRK '000 | Retained earnings HRK '000 | Total HRK '000 |
|---|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2014** | **966,640** | **228,136** | **(874)** | **3,755** | **46,788** | **1,244** | **164,969** | **1,410,658** |
| Revaluation reserve | - | - | - | - | - | (69) | - | **(69)** |
| Change in the fair value of financial assets available for sale | - | - | - | - | (2,103) | - | - | **(2,103)** |
| Deferred tax | - | - | - | - | 1,256 | 14 | - | **1,270** |
| Net profit for 2014 | - | - | - | - | - | - | 35,738 | **35,738** |
| **Total comprehensive income for the year 2014** | **-** | **-** | **-** | **-** | **(847)** | **(55)** | **35,738** | **34,836** |
| Transfer to statutory reserve | **-** | **-** | **-** | 4,703 | - | - | (4,703) | **-** |
| **Balance at 31 December 2014** | **966,640** | **228,136** | **(874)** | **8,458** | **45,941** | **1,189** | **196,004** | **1,445,494** |
| **Balance at 1 January 2014** | **966,640** | **228,136** | **(874)** | **8,458** | **45,941** | **1,189** | **196,004** | **1,445,494** |
| Revaluation reserve | - | - | - | - | - | (317) | - | **(317)** |
| Change in the fair value of financial assets available for sale | - | - | - | - | 34,703 | - | - | **34,703** |
| Deferred tax | - | - | - | - | (7,777) | 15 | - | **(7,762)** |
| Net loss for 2014 | - | - | - | - | - | - | (629,390) | **(629,390)** |
| **Total comprehensive loss for the year 2014** | **-** | **-** | **-** | **-** | **26,926** | **(302)** | **(629,390)** | **(602,766)** |
| Transfer to statutory reserve | **-** | **-** | **-** | 2,120 | - | - | (2,120) | **-** |
| **Balance at 31 December 2014** | **966,640** | **228,136** | **(874)** | **10,578** | **72,867** | **887** | **(435,506)** | **842,728** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

# Consolidated Statement of Cash Flows
For the year ended 31 December 2014

| | Notes | Group 2014 HRK '000 | Group 2014 HRK '000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| (Loss)/profit before taxation | | (630,362) | 36,368 |
| Adjusted by: | | | |
| - Depreciation and amortization | 14,15,16 | 53,571 | 53,006 |
| - Foreign exchange gains | 34 | (4,161) | (5,756) |
| - Net impairment losses on loans and receivables from customers and other assets | 36 | 932,942 | 236,917 |
| - Impairment losses/(gains) on provisions for liabilities and expenses | 24 | 3,969 | (14,077) |
| - Net unrealized (gains)/losses on financial assets at fair value through profit or loss | 32 | (4,458) | 1,859 |
| ***Changes in operating assets and liabilities*** | | | |
| Net decrease in loans to and receivables from banks | | 62,302 | 130,863 |
| Net (increase)/decrease in financial assets at fair value through profit or loss | | (33,502) | 235,519 |
| Net (increase)/decrease in loans to and receivables from customers | | 498,072 | (1,239,304) |
| Net (increase)/decrease in other assets | | 78,675 | (120,141) |
| Net (decrease)/increase in deposits from banks | | (366,457) | 231,689 |
| Net (decrease)/increase in customer deposits | | (276,640) | 1,236,507 |
| Net decrease in other liabilities | | (69,415) | (50,151) |
| **Net cash inflow from operating activities before tax** | | **244,536** | **733,299** |
| Income tax paid | | (295) | (173) |
| **Net cash inflow from operating activities** | | **244,241** | **733,126** |
| **Cash flows from investing activities** | | | |
| Purchases of property, equipment and intangible assets | | (30,501) | (18,226) |
| Disposal of financial assets available for sale | | 846,586 | 399,782 |
| Acquisition of financial assets available for sale | | (1,129,243) | (737,381) |
| Maturity/(acquisition) of financial assets held to maturity | | 222,466 | (132,137) |
| Dividends received | | 1,359 | 3,112 |
| **Net cash outflow from investing activities** | | **(89,333)** | **(484,850)** |
| **Cash flows from financing activities** | | | |
| Decrease in hybrid instruments | | (150,000) | - |
| Increase in borrowings | | 1,108,382 | 706,242 |
| Repayments of borrowings | | (675,068) | (751,483) |
| **Net cash inflow/(outflow) from financing activities** | | **283,314** | **(45,241)** |
| Effect of foreign exchange differences on cash and cash equivalents | | (1,912) | 481 |
| **Net increase in cash and cash equivalents** | | **436,310** | **203,516** |
| **Cash and cash equivalents at the beginning of the year** | 40 | **2,979,950** | **2,776,434** |
| **Cash and cash equivalents at the end of the year** | 40 | **3,416,260** | **2,979,950** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

| | Notes | Bank 2014 HRK '000 | Bank 2014 HRK '000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and amounts due from banks | 5 | 1,308,449 | 1,177,540 |
| Obligatory reserve with Croatian National Bank | 6 | 1,545,787 | 1,442,045 |
| Loans to and receivables from banks | 7 | 583,784 | 522,772 |
| Financial assets at fair value through profit or loss | 8 | 284,011 | 277,046 |
| Financial assets available for sale | 9 | 1,988,682 | 1,623,041 |
| Financial assets held to maturity | 10 | 597,943 | 821,305 |
| Loans and receivables from customers | 11 | 10,335,154 | 11,655,515 |
| Assets held for sale | 12 | 7,930 | 41,551 |
| Investments in subsidiaries | 13 | 45,490 | 45,490 |
| Property and equipment | 14 | 153,107 | 147,861 |
| Intangible assets | 16 | 140,301 | 168,519 |
| Deferred tax assets, net | 17 | 15,868 | 21,951 |
| Tax prepayment | | 53 | - |
| Other assets | 18 | 344,456 | 412,442 |
| **TOTAL ASSETS** | | **17,351,015** | **18,357,078** |
| **LIABILITIES** | | | |
| Financial liabilities at fair value through profit or loss | 19 | 508 | 8 |
| Deposits from banks | 20 | 374,750 | 741,207 |
| Customer deposits | 21 | 13,879,406 | 14,144,022 |
| Borrowings | 22 | 1,507,327 | 1,074,013 |
| Hybrid instruments | 23 | 260,921 | 410,802 |
| Provisions for liabilities and expenses | 24 | 29,748 | 41,789 |
| Other liabilities | 25 | 453,760 | 491,847 |
| **TOTAL LIABILITIES** | | **16,506,420** | **16,903,688** |
| **EQUITY** | | | |
| Share capital | 26 | 966,640 | 966,640 |
| Capital reserve | 26 | 228,136 | 228,136 |
| Treasury shares | 26 | (874) | (874) |
| Statutory reserve | 26 | 10,578 | 8,458 |
| Fair value reserve | 26 | 72,741 | 45,850 |
| Revaluation reserve | 26 | 887 | 1,189 |
| (Accumulated loss)/Retained earnings | 26 | (433,513) | 203,991 |
| **TOTAL EQUITY** | | **844,595** | **1,453,390** |
| **TOTAL LIABILITIES AND EQUITY** | | **17,351,015** | **18,357,078** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

# Separate Income Statement
## For the year ended 31 December 2014

| | Notes | Bank 2014 HRK '000 | Bank 2013 HRK '000 |
|---|---|---|---|
| Interest and similar income | 28 | 862,370 | 837,456 |
| Interest and similar expense | 29 | (348,982) | (379,617) |
| **Net interest income** | | **513,388** | **457,839** |
| Fee and commission income | 30 | 484,933 | 533,187 |
| Fee and commission expense | 31 | (312,103) | (355,163) |
| **Net fee and commission income** | | **172,830** | **178,024** |
| Gains less losses arising from securities at fair value through profit or loss | 32 | 1,370 | 3,438 |
| Gains less losses arising from securities available for sale | 33 | 17,353 | 7,537 |
| Gains less losses arising from dealing in foreign currencies | | 36,625 | 36,088 |
| Other operating income | 34 | 10,064 | 25,590 |
| **Trading and other income** | | **65,412** | **72,653** |
| **Operating income** | | **751,630** | **708,516** |
| General and administrative expenses | 35 | (399,025) | (390,221) |
| Depreciation and amortization | 14,16 | (53,078) | (52,478) |
| Impairment losses on loans and receivables to customers and other assets | 36 | (931,762) | (237,033) |
| Provisions for liabilities and expenses | 24 | (4,818) | (13,962) |
| **Operating expenses** | | **(1,388,683)** | **(665,770)** |
| **(LOSS)/PROFIT BEFORE TAXATION** | | **(637,053)** | **42,746** |
| Tax income/(expense) | 37 | 1,669 | (336) |
| **(LOSS)/EARNINGS FOR THE YEAR** | | **(635,384)** | **42,410** |
| | | **HRK** | **HRK** |
| **(Loss)/earnings per share (in HRK)** | 38 | **(723.70)** | **48.30** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

| | Group 2014 HRK '000 | Group 2013 HRK '000 |
|---|---|---|
| **(Loss)/profit for the year, net** | **(635,384)** | **42,410** |
| **Other comprehensive income** | | |
| *Items that will not be reclassified subsequently to profit or loss:* | | |
| Revaluation reserve | (317) | (69) |
| Income tax relating to items that will not be reclassified subsequently | 15 | 14 |
| | **(302)** | **(55)** |
| *Items that may be reclassified subsequently to profit or loss:* | | |
| Gain/(loss) from available for sale financial assets | 34,658 | (981) |
| Tax (expense)/income relating to items that may be reclassified subsequently | (7,767) | 1,032 |
| | **26,891** | **51** |
| **Other comprehensive gain/(loss) for the year, net** | **26,589** | **(4)** |
| **Other comprehensive (loss)/income for the year, net of income tax** | **(608,795)** | **42,406** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

# Separate Statement of Changes in Equity
For the year ended 31 December 2014

| Bank | Share capital HRK '000 | Capital reserve HRK '000 | Treasury shares HRK '000 | Reserves HRK '000 | Fair value reserve HRK '000 | Revaluation reserve of long term tangible assets HRK '000 | Retained earnings HRK '000 | Total HRK '000 |
|---|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2013** | **966,640** | **228,136** | **(874)** | **3,755** | **45,799** | **1,244** | **166,285** | **1,410,985** |
| Revaluation reserve | - | - | - | - | - | (69) | - | **(69)** |
| Change in the fair value of financial assets available for sale | - | - | - | - | (981) | - | - | **(981)** |
| Deferred tax | - | - | - | - | 1,032 | 14 | - | **1,046** |
| Net profit for 2013 | - | - | - | - | - | - | 42,410 | **42,410** |
| **Total comprehensive income for the year 2013** | **-** | **-** | **-** | **-** | **51** | **(55)** | **42,410** | **42,406** |
| Transfer to statutory reserve | - | - | - | 4,703 | - | - | (4,703) | **-** |
| **Balance at 31 December 2013** | **966,640** | **228,136** | **(874)** | **8,458** | **45,850** | **1,189** | **203,991** | **1,453,390** |
| **Balance at 1 January 2014** | **966,640** | **228,136** | **(874)** | **8,458** | **45,850** | **1,189** | **203,991** | **1,453,390** |
| Revaluation reserve | - | - | - | - | - | (317) | - | **(317)** |
| Change in the fair value of financial assets available for sale | - | - | - | - | 34,658 | | - | **34,658** |
| Deferred tax | - | - | - | - | (7,767) | 15 | - | **(7,752)** |
| Net loss for 2014 | - | - | - | - | - | - | (635,384) | **(635,384)** |
| **Total comprehensive loss for the year 2014** | **-** | **-** | **-** | **-** | **26,891** | **(302)** | **(635,384)** | **(608,795)** |
| Transfer to statutory reserve | **-** | **-** | **-** | 2,120 | - | - | (2,120) | **-** |
| **Balance at 31 December 2014** | **966,640** | **228,136** | **(874)** | **10,578** | **72,741** | **887** | **(433,513)** | **844,595** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

## Separate Statement of Cash Flows
## For the year ended 31 December 2014

| | Notes | Bank 2014 HRK '000 | Bank 2013 HRK '000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| (Loss)/profit before taxation | | (637,053) | 42,746 |
| Adjusted by: | | | |
| - Depreciation and amortization | 14,16 | 53,078 | 52,478 |
| - Foreign exchange gains | 34 | (4,180) | (5,891) |
| - Impairment losses on loans and other assets | 36 | 931,762 | 237,033 |
| - Provisions for liabilities and expenses | 24 | 4,818 | (13,962) |
| - Net unrealized (gains)/loss on financial assets at FVPL | 32 | (119) | 714 |
| ***Changes in operating assets and liabilities*** | | | |
| Net decrease in loans to and receivables from banks | | 62,302 | 130,816 |
| Net (increase)/decrease in financial assets at FVPL | | (6,846) | 235,464 |
| Net decrease/(increase) in loans to customers | | 539,497 | (1,231,109) |
| Net decrease/(increase) in other assets | | 64,266 | (125,627) |
| Net (decrease)/increase in deposits from banks | | (366,457) | 231,689 |
| Net (decrease)/increase in customer deposits | | (264,616) | 1,204,619 |
| Net decrease in other liabilities | | (54,446) | (46,674) |
| **Net cash inflow from operating activities before tax** | | **322,006** | **712,296** |
| Income tax paid | | (53) | - |
| **Net cash inflow from operating activities** | | **321,953** | **712,296** |
| | | | |
| **Cash flows from investing activities** | | | |
| Investments in subsidiaries | | - | 8,500 |
| Purchases of property, equipment and intangible assets | | (30,107) | (18,194) |
| Disposal of financial assets available for sale | | 768,458 | 404,460 |
| Acquisition of financial assets available for sale | | (1,129,243) | (732,381) |
| Maturity/(acquisition) of financial assets held to maturity | | 222,465 | (132,137) |
| Dividends received | | 1,359 | 8,112 |
| **Net cash outflow from investing activities** | | **(167,068)** | **(461,640)** |
| | | | |
| **Cash flows from financing activities** | | | |
| Decrease in hybrid instruments | | (150,000) | - |
| Increase in borrowings | | 1,108,382 | 706,242 |
| Repayments of borrowings | | (675,068) | (751,483) |
| **Net cash inflow/(outflow) from financing activities** | | **283,314** | **(45,241)** |
| Effect of FX differences on cash and cash equivalents | | (1,920) | 481 |
| | | | |
| **Net increase in cash and cash equivalents** | | **436,279** | **205,896** |
| **Cash and cash equivalents at the beginning of the year** | 40 | **2,979,947** | **2,774,051** |
| **Cash and cash equivalents at the end of the year** | 40 | **3,416,226** | **2,979,947** |

The significant accounting policies and other notes on pages 53-167 form an integral part of these financial statements.

## 1. SIGNIFICANT ACOUNTING POLICIES

Hrvatska poštanska banka d.d. Zagreb ("the Bank") is a joint stock company incorporated and domiciled in the Republic of Croatia. The Bank is the parent of the Hrvatska poštanska banka Group ("the Group").

Bank has control over following subsidiaries that contains HPB Group:

| | Industry | State | Ownership as of 31 December 2014 % |
|---|---|---|---|
| HPB Invest d.o.o. | Investment funds management | Croatia | 100 |
| HPB Nekretnine d.o.o. | Real estate agency and construction | Croatia | 100 |
| HPB Stambena štedionica d.d. | Savings bank | Croatia | 100 |

Overview of Bank's subsidiaries and method of their consolidation is provided in Note 13, while the basis of consolidation is provided in Note 1, section e).

These financial statements comprise both the separate and the consolidated financial statements of the Bank as defined in International Financial Reporting Standard 10 "Consolidated Financial Statement" and International Accounting Standard 27 "Separate Financial Statements".

These financial statements were prepared under the going-concern assumptions and were authorized by Management Board for approval by the Supervisory Board on 21 April 2015.

Despite HRK 300 million of operating profit for 2014, the highest level generated so far, the Bank closed the year with a net loss in the amount of HRK 635 million. The loss is due to the recognition of the additional impairment of loans and other assets in the amount of HRK 932 million, which comprise mainly loans approved six and more years ago already previously identified as impaired. As a result, the capital adequacy ratio of 6.65 percent is below the regulatory requirement of 8 percent. In addition, the Bank did not comply with the regulatory capital preservation and structural systematic risk requirement which is 4 percent. The Croatian National Bank, the regulatory body, imposed the Bank in the last quarter of 2014 an additional capital requirement of 2 percent for a period of one year, starting from 30 June 2015 (please see Note 2.7 and 27)

Already in November 2014 the Bank tried to cover a part of the capital requirements by issuing new subordinated debt instruments and intensifying the discussions with its owner regarding the share capital increase required to meet the overall regulatory minimum capital adequacy requirement. The Bank simultaneously launched measures to optimize its risk exposure, which reflected themselves through a decline of the loan and asset portfolios in 2014. The planned issue of subordinated instruments did not take place.

The Bank's owner has initiated negotiations with the European Commission regarding the model to be applied in increasing its own the share capital of the Bank that would be appropriate to reach the regulatory minimum capital adequacy requirement (including other capital buffers). On 23 March 2015 the owner of the Bank sent to the European Commission a Draft Business Plan for the period 2015 - 2019 and the delivery of additional documentation in support of the Plan defined after a meeting held in Brussels on 1 April 2015 is under way.

The entire share capital increase process, following the response of the European Commission regarding the model of its implementation, should be finalized until 30 June 2015.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***a) Statement of compliance***

These financial statements are prepared in accordance with the legal requirements applicable to accounting for banks in the Republic of Croatia. Group's financial reporting is regulated by Croatian National Bank ("the CNB") which is the central supervisory institution of Croatian banking system. These financial statements have been prepared in accordance with the above-mentioned banking regulations.

These statutory financial statements are prepared for the purpose of compliance with legal requirements and for general information and not for any specific purpose, user or transaction. Accordingly, users should not rely exclusively on these financial statements and should undertake other appropriate inquiries before making decisions.

The accounting regulations of the CNB rely on International Financial Reporting Standards ("IFRSs") adopted by European Union. The principal differences between the accounting regulations of the CNB and recognition and measurement requirements of International Financial Reporting Standards are as follows:

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

- In line with amendments to CNB's Decision on the classification of placements and off-balance-sheet liabilities of credit institutions, in force from October 01 2013, CNB prescribes minimum levels of impairment losses for certain specifically identified impaired exposures, which may be different from impairment loss calculated in accordance with International Financial Reporting Standards (IFRSs).

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***b) Basis of preparation***

These financial statements represent the general-purpose financial statements of the Bank and the Group. The financial statements were prepared for the reporting period from January 1 2014 to December 31 2014 in compliance with existing accounting regulations applicable in Croatia.

These financial statements are prepared for the purpose of compliance with legal requirements of the Group and Bank. Group is legally required to obtain an independent audit of its financial statements. Scope of that audit is limited to an audit of general purpose statutory financial statements to fulfill the legal requirement for audit of these financial statements. Audit scope comprehends the statutory financial statements taken as a whole and does not provide assurance on any individual line item, account or transaction. Audited financial statements are not intended for use by any party for purposes of decision making concerning any ownership, financing or any other specific transactions relating to the Group. Accordingly, users of the audited statutory financial statements should not rely exclusively on the financial statements and should undertake other procedures before making decisions.

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

In preparing the financial statements, management is required to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosure of commitments and contingencies at the reporting date, as well as amounts of income and expense for the period. Estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under current circumstances, the results of which form the basis of making the judgments about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on a regular basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Judgments made by management in the application of applicable standards that have significant effects on financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 2.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***b) Basis of preparation (continued)***

***Accounting standards, interpretations and changes to existing standards***

***New and Amended Standards effective in current period with evaluation of the impact on the Financial Statements***

- Amendments to IAS 32 “Financial instruments: presentation” – Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2014). Amendments provide clarifications on the application of the offsetting rules and focus on four main areas (a) the meaning of “currently has a legally enforceable right of set-off”; (b) the application of simultaneous realisation and settlement; (c) the offsetting of collateral amounts; (d) the unit of account for applying the offsetting requirements.

  This Standard has no impact on the financial statements of the Group.

- New and amended standards on consolidation, joint ventures, related parties and publication of group information include:
  - Amendments to IFRS: IAS 27 “Separate Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures”
  - Amendments to IFRS: IFRS 10 “Consolidated Financial Statements”, IFRS 11 “Joint Arrangements” and IFRS 12 “Disclosures of Interests in Other Entities”

Amendments in IFRS 27 and 28 are result of approved new standards regulating the question of consolidation, joint ventures, associates and the disclosure in Other Entities.

IFRS 10 introduces a new definition of control, based on whether an investor has 1) power over the investee; 2) exposure, or rights, to variable returns from its involvement with the investee; and 3) the ability to use its power over the investee to affect the amount of the returns. In order to have overall control over the Entity, Investors have to fulfil all three criteria.

IFRS 11 “Joint Arrangements”, with the basic principle that the parties in the joint venture determines the type of joint venture in which is included with the assessment of their rights and obligations, based on which it should record and report them accordingly to assessment.

IFRS 12 will require enhanced disclosures about both consolidated entities and unconsolidated entities in which an entity has involvement. The objective of IFRS 12 is to require information so that financial statement users may evaluate the basis of control, any restrictions on consolidated assets and liabilities, risk exposures arising from involvements with unconsolidated structured entities and non-controlling interest holders' involvement in the activities of consolidated entities.

Pursuant to the statements of IFRS 10 Group has assessed the existence and degree of control over the entities that are subject to investment and also has assessed that there is no effect on the financial statements of the reporting period. In relation to the application of IFRS 12 Group will expand the scope of reporting to the extent which show necessary. Those standards have no impact on the reported financial position and performance.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***b) Basis of preparation (continued)***

***Standards, interpretations and changes to published standards (continued)***

- Amendments to IAS 36 “Impairment of assets” These narrow-scope amendments to IAS 36 address the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal.
- Amendments to IAS 39 “Financial Instruments: Recognition and Measurement” ovation of Derivatives and Continuation of Hedge Accounting – The narrow-scope amendments allow hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws or regulation, if specific conditions are met (in this context, a novation indicates that parties to a contract agree to replace their original counterparty with a new one)

These amendments to IAS 36 and IAS 39 have no impact on the Group's financial statements.

- Interpretation of IFRIC 21 “Levies”, an interpretation of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. IAS 37 sets out criteria for the recognition of a liability, one of which is the requirement for the entity to have a present obligation as a result of a past event (known as an obligating event). The Interpretation clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy.

  These interpretation has no impact on the Group's financial statements.

***The new and revised International Financial Reporting Standards adopted by the EU which will enter into force after the Reporting Period:***

- Amendments to IFRS from the series 2010th to 2012th "resulting from the Annual Improvements to IFRSs:
  - IFRS 2 Share-based Payment – definition of vesting condition
  - IFRS 3 Business Combinations – the accounting when an acquirer obtains control of a business (e.g. an acquisition or merger). Scope exception for joint ventures
  - IFRS 8 Operating Segments – aggregation of operating segments, reconciliations of assets
  - IFRS 13 Fair Value Measurement– short- term receivables and payables
  - IFRS 16 Property, Plant and Equipment – proportionate restatement of accumulated depreciation under the revaluation method,
  - IAS 24 Related Party Disclosures – key management personnel services
  - IAS 38 Intangible Assets - revaluation method

  The changes are the result of removing inconsistencies and clarification of the text, which have been adopted in the European Union at 17 December 2014 (applicable to annual periods beginning on or after 1 February 2015).

- Amendments to IFRS from the series 2011th to 2013th "resulting from the Annual Improvements to IFRSs:
  - IAS 1Presentation of Financial Statements – clarifying the meaning of the application of IFRS in force at the end of the first reporting period for entities that for the first time adopt IFRS standards.
  - IFRS 3 Business Combinations – the scope of exemptions joint ventures
  - IFRS 13 fair Value Measurement – the scope of paragraph 52 is amended in order to clarify the exceptions in the portfolio,
  - IAS 40 Investment Property – explains the interrelationship of IFRS 3 Business Combinations and IAS 40 Investment Property.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***b) Basis of preparation (continued)***

***Standards, interpretations and changes to published standards (continued)***

The changes are the result of removing inconsistencies and clarification of the text, and adopted by the European Union on 18 December 2014 (applicable to annual periods beginning on or after 1 January 2015),

- Amendments to IAS 19 "Employee Benefits" - Defined Benefit Plans: Employee Contributions adopted in the European Union; 17 December 2014 (effective for annual periods beginning on or after 1 February 2015).

  The narrow scope amendments apply to contributions from employees or third parties to defined benefit plans. The objective of the amendments is to simplify the accounting for contributions that are independent of the number of years of employee service, for example, employee contributions that are calculated according to a fixed percentage of salary.

All these changes will have no significant impact on the financial statements of the Group after initial application.

***The new and revised International Financial Reporting Standards issued by the Board of IFRS but not yet adopted by the EU, and will enter into force after the reporting period:***

- IFRS 9 "Financial Instruments" issued on 24 July 2014 is the IASB's replacement of IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting

  **Classification and Measurement** - IFRS 9 introduces new approach (effective for annual periods beginning on or after 1 January 2018), for the classification of financial assets, which is driven by cash flow characteristics and the business model in which an asset is held. This single, principle-based approach replaces existing rule-based requirements under IAS 39. The new model also results in a single impairment model being applied to all financial instruments.

  **Impairment** - IFRS 9 has introduced a new, expected-loss impairment model that will require more timely recognition of expected credit losses. Specifically, the new Standard requires entities to account for expected credit losses from when financial instruments are first recognised and to recognise full lifetime expected losses on a more timely basis.

  **Hedge accounting** - IFRS 9 introduces a substantially-reformed model for hedge accounting, with enhanced disclosures about risk management activity. The new model represents a significant overhaul of hedge accounting that aligns the accounting treatment with risk management activities.

  Given the comprehensiveness of the entire project replacing the existing IAS 39 and duration, also looking the importance of methodology impairment on the financial statements, the Group will evaluate and quantify the potential effects upon the completion of all phases of the project in order to gain a complete picture.

- IFRS 14 "Regulatory Deferral Accounts" (effective for annual periods beginning on or after 1 January 2016), this Standard is intended to allow entities that are first-time adopters of IFRS, and that currently recognise regulatory deferral accounts in accordance with their previous GAAP, to continue to do so upon transition to IFRS.

The Bank and the Group have not assessed the impact of on financial statements of mentioned IFRS after initial application.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***b) Basis of preparation (continued)***

***Standards, interpretations and changes to published standards (continued)***

- IFRS 15 “Revenue from Contracts with Customers” (effective for annual periods beginning on or after 1 January 2017),specifies how and when an IFRS reporter will recognise revenue as well as requiring such entities to provide users of financial statements with more informative, relevant disclosures. The standard supersedes IAS 18 “Revenue”, IAS 11 “Construction Contracts” and a number of revenue-related interpretations. Application of the standard is mandatory for all IFRS reporters and it applies to nearly all contracts with customers: the main exceptions are leases, financial instruments and insurance contracts. The core principle of the new Standard is for companies to recognise revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new Standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements.

These new IFRS will have no impact on the Group after initial application.

- Amendments to IAS 10 "Consolidated Financial Statements" and IAS 28 " Investments in Associates and Joint Ventures”, (effective for annual periods beginning on or after 1 January 2016) - dealing with the contradictions between the requirements of IAS 28 and those under IFRS 10. Amendments explain that the expression of gain or loss in the transaction, which involves the associate or joint venture depends on whether the assets are sold or entered into an entity.

  With the current business business strategy mentioned amendments of IAS and IFRS will have no impact on the Group after initial application.

- Amendments to IFRS 10 “Consolidated Financial Statements”, IFRS 12 “Disclosures of Interests in Other Entities” and IAS 28 " Investments in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2016) In the section "Investment subjects: application of the exemption from consolidation" .- Purpose are amendments of small scale in order to clarify the requirements in accounting for investment companies. They are provided for the exemption from applying in certain circumstances.

These amendments of IAS and IFRS will not have a significant impact on the Group after initial application.

Amendments to IFRS 11 “Joint Arrangements” – (effective for annual periods beginning on or after 1 January 2016),introduces new accounting requirements for joint arrangements, The option to apply the proportional consolidation method when accounting for jointly controlled entities is removed

With the current business strategy mentioned amendments to IFRS will have no impact on the Bank and the Group after initial application.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***b) Basis of preparation (continued)***

***Standards, interpretations and changes to published standards (continued)***

- Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards (effective for annual periods beginning on or after 1 January 2016). In the "Initiative for publishing " subject is instructed to use professional judgment in determining the information to be published in its financial statements. It was explained that the concept of materiality applies to all financial statements, as well as the insertion of information that are immaterial may reduce relevance of published financial information. Furthermore, professional judgment should be applied in determining the sort and order in presentation of the financial information.

  Amendments to IFRS will not have a significant impact on the disclosure of financial statements of the Group after initial application.

- Amendments to IFRS 16 Property, Plant and Equipment and IFRS 38 Intangible Assets (effective for annual periods beginning on or after 1 January 2016), which complement the instructions of existing standards which explains acceptable depreciation method.

  Before the application of amendments to this standard, the group will assess the impact on its financial position and results.

- Amended IAS 27 Consolidated and Separate Financial Statements - „Separate Financial Statements (effective for annual periods beginning on or after 1 January 2016).. They brought back the interest method as an option for the calculation of investments in subsidiaries, joint ventures and associates in the separate financial statements of the reporting entity.

  Before the application of amendments to this standard, the group will assess the impact on its financial position and results.

- Amendments to IFRS from the series 2012th to 2014th "resulting from the Annual Improvements to IFRSs:

  - IFRS 5 Non-current Assets Held for Sale and Discontinued Operations – changes in methods of disposal
  - IFRS 7 Financial Instruments: Disclosures - servicing contracts and applicability of the amendments to IFRS 7 to condensed interim financial statements
  - IAS 19 Employee Benefits discount rate: regional market issue
  - IAS 34 Interim Financial Reporting – disclosure of information elsewhere in the interim financial report

  The changes are the result of removing inconsistencies and clarification of the text (applicable to annual periods beginning on or after 1 January 2016)

These changes will have no significant impact on the Bank and the Group after initial application.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***c) Functional and presentation currency***

The Group's and the Bank's financial statements are presented in Croatian kuna (HRK), which is the functional currency. Amounts are rounded to the nearest thousand (unless otherwise stated).

***d) Changes in presentation or classification of the items in the financial statements***

There were no changes in the classification of the significant amounts or items in the financial statements in the reporting period.

***e) Basis of consolidation***

Financial statements are presented for the Group and the Bank. The Group financial statements comprise the consolidated financial statements of the Bank and its subsidiaries: HPB Nekretnine d.o.o., a real estate agency; HPB Invest d.o.o., an investment fund management company; and HPB Stambena štedionica d.d., a specialized financial institution involved in collecting deposits from retail customers and granting subsided housing loans to Croatian citizens in the Republic of Croatia. All subsidiaries are 100% owned by the Bank and are incorporated and domiciled in Croatia.

Investment in subsidiaries are disclosed at purchase cost, minus possible impairments in non-consolidated financial statements of the Bank. Investments in subsidiaries are consolidated by full-consolidation method in consolidated financial statements of the Group.

*Subsidiaries*

Subsidiaries are all enterprises controlled by the Bank. Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary. Profit or loss and each component of other comprehensive income are attributed to the owners of the Company and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

*Transactions eliminated on consolidation*

All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***e) Basis of consolidation (continued)***

The purchase cost method of accounting is used to account for the acquisition of subsidiaries at the Group. The cost of acquiring a subsidiary is measured at fair value of assets given, equity instruments issued and of liabilities incurred or assumed as of the date of exchange, increased by all costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired including intangible assets is recorded as goodwill.

If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

***f) Interest income and expense***

Interest income and expense are recognized in the income statement as they accrue for all interest bearing financial instruments, including those measured at amortized cost, at fair value through profit or loss and available for sale, using the effective interest rate method. Such income and expense is presented as interest and similar income or interest expense and similar charges in the income statement. Interest income and expense also includes fee and commission income and expense in respect of loans provided to customers or borrowings from other banks, premium or discount amortization, and other differences between the initial carrying amount of an interest-bearing financial instrument and its value at maturity, recognized on a basis of effective interest rate. Interest income and expense on all trading assets and liabilities are presented as interest income or expense.

***g) Fee and commission income and expense***

Fee and commission income and expense arise on financial services provided by the Group and received by the Group, and mainly comprise fees related to domestic and foreign payments, the issue of guarantees and letters of credit, credit card business and other services provided by and to the Group. Fee and commission income and expense are recognised in the income statement when the related service is performed.

Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) 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. Loan syndication fees are recognised as revenue when the syndication has been completed and the Group has retained no part for itself, or has retained a part at the same effective interest rate as the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts. Asset management fees related to investment fund management are recognised on an accrual basis over the period in which the service is provided. The same principle is applied for custody services that are continuously provided over an extended period of time.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***h) Dividend income***

Dividend income on equity investments is recognised in the income statement when the right to receive dividends is established.

***i) Gains less losses from financial instruments at fair value through profit or loss and financial instruments available for sale***

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

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

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For AFS equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

For all other financial assets, objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty, or
- breach of contract, such as a default or delinquency in interest or principal payments, or
- it becoming probable that the borrower will enter bankruptcy or financial re-organisation, or
- the disappearance of an active market for that financial asset because of financial difficulties.

In respect of AFS equity securities, impairment losses previously recognised in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognised in other comprehensive income and accumulated under the heading of investments revaluation reserve. In respect of AFS debt securities, impairment losses are subsequently reversed through profit or loss if an increase in the fair value of the investment can be objectively related to an event occurring after the recognition of the impairment loss.

***j) Gains less losses arising from dealing in foreign currencies***

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

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***k) Foreign currencies***

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

The fair value of AFS monetary financial assets denominated in a foreign currency is determined in that foreign currency and translated at the spot rate prevailing at the end of the reporting period. The foreign exchange gains and losses that are recognised in profit or loss are determined based on the amortised cost of the monetary asset. Other foreign exchange gains and losses are recognised in other comprehensive income.

***l) Financial instruments***

***i) Classification***

The Group classifies its financial instruments in the following categories: at fair value through profit or loss, loans and receivables, available for sale and held to maturity. The classification depends on the purpose for which the financial instruments were acquired. The management determines the classification of financial instruments upon initial recognition.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***l) Financial instruments (continued)***

***i) Classification (continued)***

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

This category comprises two subcategories: financial instruments held for trading (including derivatives), and those designated by management as at fair value through profit or loss at inception. The Group designates financial assets and liabilities at fair value through profit or loss when:

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

Financial assets at fair value through profit or loss include equity and debt securities, units/shares in investment funds and derivative financial instruments.

*Loans and receivables*

Loans and receivables comprise non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money to a debtor with no intention of trading with the receivable and include loans to and receivables from banks, loans to and receivables from customers, and the obligatory reserve with the CNB.

*Financial instruments held to maturity*

This category comprises non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group has the positive intention and ability to hold to maturity. This category includes debt securities.

*Financial assets available for sale*

This category comprises non-derivative financial assets which are defined as available for sale or are not included in loans and receivables or held-to-maturity investments, or classified as financial assets at fair value through profit or loss. Financial assets 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, foreign exchange rates, or equity prices. Available-for-sale financial assets include debt and equity securities.

*Other financial liabilities*

Other financial liabilities include all financial liabilities not designated as at fair value through profit or loss.

***ii) Recognition and derecognition***

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

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***l) Financial instruments (continued)***

***ii) Recognition and derecognition (continued)***

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

This occurs when the Group transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realised, surrendered or have expired. The Group derecognises financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Group 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.

***iii) Initial and subsequent measurement***

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

After initial recognition, the Group measures financial instruments at fair value through profit or loss and financial assets available for sale at their fair value, without any deduction for costs of sale. Instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are initially recognized at acquirement cost, and afterwards measured applying internal models of fair value estimation.

Loans and receivables and held-to-maturity investments and financial liabilities not designated at fair value through profit or loss are measured at amortised cost.

***iv) Gains and losses***

Gains and losses on changes in the fair value of 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 within equity and are disclosed in the statement of changes in equity. Impairment losses, foreign exchange differences, 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 amortised cost may also be recognised in the income statement when a financial instrument is derecognised or when its value is impaired.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***l) Financial instruments (continued)***

***v) Determination of fair value of financial instruments***

The fair value of quoted financial assets in an active market is based on their closing price. If there is no active market for the financial instrument, or if, due to any other reason, the fair value cannot be reliably measured by the market price, the Group uses an internal evaluation model for fair value estimation. Such models include the use of prices achieved in recent transactions, by reference to similar financial instruments, and discounted cash flow analysis, making maximum use of market inputs and relying as little as possible on entity-specific inputs. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimate and the discount rate is a market rate.

The fair value of non-traded derivatives is estimated at the amount that the Group would receive or pay to terminate the contract at the reporting date, taking into account current market conditions, its own credit risk and the current creditworthiness of the counterparties.

***vi) Impairment of financial assets***

*Impairment of assets identified as impaired*

Financial assets are reviewed at financial statements date to determine whether there is objective evidence of impairment. If any such indication exists, the recoverable amount of an item is estimated.

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

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

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

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

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***l) Financial instruments (continued)***

***vi) Impairment of financial assets (continued)***

*Impairment of assets not individually identified as impaired*

In addition to recognised impairment losses on assets, the Group recognises in its income statement latent losses on its on-balance sheet and off-balance sheet items exposed to credit risk at a level not lower than 0.80% of the total placements and off-balance sheet exposures in accordance with the CNB regulations.

At the reporting date, debt securities carried at fair value at the reporting date, initially recognized as financial assets at fair value through profit or loss, as well as financial assets available for sale, are excluded from the calculation basis of these impairments.

***vii) Reclassifications***

According to IFRSs, the Group has the possibility to reclassify certain financial instruments out of the category at fair value through profit or loss into available for sale or held to maturity instruments.

***m) Specific financial instruments***

*Cash and cash equivalents*

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

*Derivative financial instruments*

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

Derivative financial instruments include foreign currency agreements, forward agreements, futures and other financial derivatives and are initially recognised at fair value which is the value of consideration paid to acquire the instrument less transaction costs. Subsequent to initial recognition, derivatives are measured at fair value. The fair value is determined based on the quoted market price or, if more appropriate, based on the discounted cash flow. All derivative instruments are presented as assets if their fair value is positive and as liabilities if their fair value is negative.

Some hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is termed as an embedded derivative. Except as required to the contrary by the CNB, when the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract and when the hybrid contract is not itself carried at fair value through profit or loss, the embedded derivative is treated as a separate derivative and classified at fair value through profit or loss with all unrealised gains and losses recognised in the income statement, unless there is no reliable measure of their fair value.

Changes in the fair value of derivatives are included in gains less losses arising from dealing securities.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***m) Financial instruments (continued)***

*Treasury bills and debt securities*

Treasury bills and debt securities that the Group holds for the purpose of short-term profit taking are classified as at fair value through profit or loss or as available-for-sale assets, and are carried at fair value. Treasury bills and debt securities that the Group has the intent and ability to hold to maturity are classified as held-to-maturity assets.

*Equity securities and investments in open-ended investment funds*

Equity securities and investments in open-ended investment funds are classified as at fair value through profit or loss or as available-for-sale assets.

*Placements with banks*

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

*Loans and advances to customers*

Loans and advances to customers are presented net of impairment losses. Purchased loans that the Group has the intent and ability to hold to maturity are classified as held-to-maturity assets.

In accordance with CNB requirements, the amortization of any discounts included within impairment losses is presented in impairment losses.

*Investments in subsidiaries*

In the Bank's unconsolidated financial statements, investments in subsidiaries are recorded at cost.

*Borrowings*

Interest-bearing borrowings are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings as interest. The amount is subsequently reduced by not deferred portion of the fee paid at the point of loan approval.

*Repurchase agreements and linked transactions*

The Group enters into purchases/(sales) of investments under agreements to resell (repurchase) essentially identical investments, or in a series of linked sales and buy-back transactions at a certain future date at a fixed price. The amounts paid are recognised in loans and advances to either banks or customers. The receivables are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the statement of financial position and are measured in accordance with the accounting policy for the relevant financial asset at amortised cost or at fair value, as appropriate. The proceeds from the sale of the investments are reported as liabilities to either banks or customers.

The difference between the sale and repurchase amount is recognised on an accrual basis over the period of the transaction and is included in interest income or expense.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***n) Income tax***

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current tax payable is based on taxable profit for the year. Taxable profit differs from ‘profit before tax’ as reported in the consolidated income statement and consolidated statement of other comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from the initial recognition (other than in a business combination) of assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

The measurement of deferred tax liabilities and assets reflects the amount that the Bank expects, at the end of the financial statements date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are not discounted and are classified in the statement of financial position as non-current assets and/or non-current liabilities. Deferred tax assets are recognised only to the extent that it is probable that the related tax benefit will be realised. At each reporting date, the Group reviews the unrecognised potential tax assets and the carrying amount of the recognised tax assets.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***o) Property and equipment***

Property and equipment are tangible assets that are held for use in the supply of services or other administrative purposes.

*Recognition and measurement*

An item of property whose fair value can be measured reliably is subsequently carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluation is made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date. The fair value of land and buildings is determined by the independent professional surveyor.

Any revaluation increase arising on the revaluation of such land and buildings is recognised in other comprehensive income and accumulated in equity, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously expensed. A decrease in the carrying amount arising on the revaluation of such land and buildings is recognised in profit or loss to the extent that it exceeds the balance, if any, held in the properties revaluation reserve relating to a previous revaluation of that asset. Depreciation is recognized in the income statement on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Land is not depreciated.

Equipment is measured at cost, less accumulated depreciation and accumulated impairment losses.

The estimated useful lives are as follows:

| | **2014** | **2013** |
|---|---|---|
| Buildings | 40 years | 40 years |
| Computers | 3 years | 3 years |
| Furniture and equipment | 3-4 years | 3-4 years |
| Motor vehicles | 5 years | 5 years |
| Other assets | 10 years | 10 years |

Depreciation methods and useful lives are reassessed at each reporting date. Gains and losses on disposal are determined by comparing the proceeds with the carrying amount, and are included in the income statement.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***p) Investment property***

Investment properties are properties which are held by the Group either to earn rentals or for capital appreciation, or both. Investment property is carried at cost less accumulated depreciation and any impairment losses.

Depreciation is provided on all investment property, except for investment property not yet brought into use, on a straight-line basis at prescribed rates designed to write off the cost over the estimated useful life of the asset as follows:

| | **2014** | **2013** |
|---|---|---|
| Investment property | 40 years | 40 years |

***q) Intangible assets***

Intangible assets are carried at cost less accumulated amortisation and impairment. Development costs are capitalized if all the requirements specified in IAS 38 "Intangible Assets" are met. Amortisation is provided on a straight-line basis over the estimated useful life of an intangible asset. Maintenance costs are recognised as an expense when they are incurred.

Amortisation is provided on a straight-line basis over the estimated useful life of an asset as follows:

| | **2014** | **2013** |
|---|---|---|
| Leasehold improvements | 4 years | 4 years |
| Software | 3-10 years | 3-10 years |
| Licences | 3-10 years | 3-10 years |

***r) Impairment of non-financial assets***

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

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

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***s) Non-current assets held for sale***

Tangible assets gained in exchange for uncollected receivables Group records as assets held for sale in accordance with International Financial Reporting Standard 5 (IFRS 5). Only exceptionally, if the assets can be used for the Group's business operations decision on using the assets and accounting treatment will be in accordance with International Financial Reporting Standard 16.

The Group initially recognise (classifies) non-current assets as assets held for sale if its value be through sale, rather than used for the purpose of conducting business activities through depreciation. Such assets are classified at the lower of carrying amount or fair market value less costs to sell.

Subsequent measurement of assets held for sale is carried at the lower of carrying value and the current fair market value less costs to sell.

In case of events that may extend the period to perform the sale of the property does not preclude the classification of assets as held for sale if the circumstances beyond the control of the Group occur and if there is evidence that the Group will continue in line with the plans to continue selling the same.

The Group does not perform depreciation of assets held for sale.

Impairment losses arising on the subsequent measurement of assets is recorded in the income statement of the Group.

Subsequent gains from increase in the fair value of previously impaired assets will be recognized in the income statement at the time of sale.

If it is determined that the non-current assets classified as held for sale do not meet the criteria for initial recognition of the Group does not recognize those assets as assets held for sale.

Group does not recognize assets held for sale in the event that such property is sold. Gain or loss on sale of assets held for sale are recognized in the income statement.

***t) Provisions for liabilities and expenses***

The Group recognises a provision when it has a present obligation as a result of a past event, and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and if a reliable estimate can be made of the obligation. Provisions are also made for off-balance sheet credit risk exposures on a portfolio basis.

Provision for liabilities and charges represents the best estimate of the expenditures needed to settle the present obligation at the reporting date. The management determines the adequacy of the provision based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of the various categories of transactions and other pertinent factors.

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

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***u) Operating lease***

Leases where the Group as lessor retains substantially all the risks and rewards incidental to ownership are included in tangible and intangible assets at cost net of accumulated depreciation. Rental income under operating leases is recognised in the income statement on a straight-line basis over the term of the lease.

The Group leases office space under operating leases. Payments under operating leases are recognised in the income statement over the term of the underlying lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense. The Group does not have operating lease contracts with the termination period longer than one year.

***v) Employee benefits***

*Defined pension contributions*

The Group pays contributions to pension-insurance funds on a mandatory, contractual basis. The Group 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 severance payments and jubilee awards*

In calculating provisions for severance payments and jubilee awards, the Group discounts expected future cash flows in respect of the liabilities, using discount rates that, in opinion of the Group's management, best represent the time value of money.

**1. SIGNIFICANT ACOUNTING POLICIES (continued)**

***w) Share capital and reserves***

*Share capital and reserves*

Share capital is denominated in the Croatian kuna and stated at nominal value. The amount of fees paid on repurchase of share capital, including directly attributable costs, is recognised as a deduction from equity and classified as treasury shares.

*Dividends*

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

*Retained earnings/ accumulated losses*

Loss for the period is charged on the accumulated retained earnings. Any remaining loss above recorded retained earnings is covered from the profit of future periods.

*Earnings per share*

The Bank presents earnings or loss per share data for its ordinary shares. Earnings/loss per share is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. EPS is not presented for the Group.

***x) Contingencies and commitments***

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

***y) Funds managed for and on behalf of third parties***

The Group manages funds for and on behalf of corporate and retail customers. These amounts do not represent the Group's assets and are excluded from the statement of financial position. For the services rendered, the Group charges a fee which is recognised in the income statement on an accruals basis. The Group also manages five open-end funds with a public offering: HPB Equity Fund, HPB Global Fund, HPB Cash Fund, HPB Bond Fund, and HPB Eurocash Fund. The Group also manages HPB Umirovljenički fund, a special-purpose fund, established by the Croatian Government.

Investment funds assets that is managed by the Group is not part of consolidated statements of the Group.

The investment of the parent company in the investment funds of the parent company are stated at fair value through profit and loss.

***z) Segment reporting***

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment) which achieves econcomic benefits or costs, including the transactions with other parts of the Group. The Group did not used internal transfer prices in determining the success of the segments.

The Group has identified three major segments: Corporate Banking; Retail Banking; and Financial Markets, the latter including treasury and investment banking, together with custody services (business segment). The business segments and their financial performance are presented in Note 4 to the financial statements.

Bank's operations, its total assets as well as the majority of its clients are based in Croatia (geographical segment).

## 2. RISK MANAGEMENT

This note details the Group's risk exposures as well as the methods applied by the management to identify, measure and manage those risks for the purpose of preserving capital. The most important types of financial risk to which the Group is exposed are credit risk, liquidity risk, interest rate risk in the Bank's non-trading book, market risk and operational risk. Market risk includes currency risk, interest rate risk and price risk.

An integrated system of risk management is established at the Group level by introducing a set of policies, procedures and manuals, determining the limits of risk levels acceptable to the Group and monitoring their implementation. The limits are set with respect to the amount of regulatory capital and are applied to all types of risk. Additionally, the Bank sets limits for annual potential losses measured by Value-at-Risk techniques for its market risk exposure. Internal methodologies and models for managing other types of risks are also being developed.

The responsibility for determining the framework of the Group's risk management lies with the Bank's Management Board which has delegated the risk management tasks to the Asset and Liability Committee, Credit Committee and Operational Risk Management Committee.

### 2.1 Credit risk

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

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 evaluates debtors' creditworthiness, and in order to minimize credit risk, obtains appropriate collateral.

At reporting date, the Group's credit risk exposure to financial instruments classified as at fair value through profit or loss is presented by the positive fair value of these instruments, as recorded in the statement of financial position. Notional amounts disclosed in the notes to the financial statements do not represent the amounts to be exchanged by the parties in derivative transactions and do not measure the Group's exposure to credit or market risks. The amounts to be exchanged are based on the terms of the derivatives.

The Group is exposed to credit risk primarily through loans and receivables from customers. The amount of credit exposure in this regard, as well as held-to-maturity debt securities recognised at amortised cost, is represented by the carrying amounts of the assets on the balance sheet. In addition, the Bank is exposed to the credit risk through off-balance-sheet items, i.e. through commitments arising from unused facilities and guarantees issued, as disclosed in Note 40.

Credit risk management comprises assessment of placements' credit risk, subsequent monitoring, supervision, and evaluation of recoverability of placements and off-balance sheet commitments, as well as formation of required impairments and provisions for identified losses on placements and off-balance sheet commitments, and reporting to the Management Board of the Bank.

**2. RISK MANAGEMENT (continued)**

**2.1. Credit risk (continued)**

**2.1.1 Credit risk assessment**

Assessment of the individual credit risk exposure comprises the following:

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

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

**2.1.2. Classification of placements into risk categories**

The Bank classifies placements into risk categories depending on the estimated recovery rate of placements, and in accordance with the CNB's Decision on Classification of Placements and Off-balance Sheet Liabilities of Credit Institutions. All placements that the Bank estimates are fully recoverable are classified in risk category A. Upon initial approval, the Bank classifies all placements into risk category A. Placements that the Bank estimates are partly recoverable are classified into risk category B, depending on the loss percentage: in subcategory B1 (loss is estimated at below 30% of nominal carrying value of the placement), in subcategory B2 (loss is estimated at between 30% and 70% of nominal carrying value of the placement), and in subcategory B3 (loss is estimated at above 70%, but below 100% of nominal carrying value of the placement). Placements estimated to be fully irrecoverable are classified into risk category C.

**2.1.3. Placements impairment policy**

When estimating the recoverable amount of placements, the Bank separates placements between small and large portfolios.

Small portfolio represents placements and off-balance sheet commitments whose gross value (before any impairment loss) does not exceed HRK 700 thousand towards a single debtor or a single group of related parties at the date of estimation.

Generally, the Bank estimates the recoverability of placements to retail customers according to criteria established for the small portfolio, whereas the recoverability of placements to corporate clients is estimated according to criteria which do not apply to the small portfolio.

## 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

#### 2.1.3. Impairment policy on placements (continued)

***Individual assessment***

The recoverable amount of placements that are not classified within the small loan portfolio of the Bank is estimated on an individual basis according to the following criteria:

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

***Portfolio-based assessment***

The Bank estimates the recoverable amount of exposures that are classified on a portfolio basis by having regard principally to the debtors' timeliness in meeting their obligations. In arriving at the recoverable amount, the present value of future cash flows from the placements is estimated by reducing the principal by reference to the loan type and the number of days in default.

The following tables present the classification of exposures into risk categories for the Group and the Bank and the allocation of the corresponding impairment losses as a percentage of gross principal.

## 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

### 2.1.3 Impairment policy on placements (continued)

**Group**

| % | Loans and receivables from customers | Impairment allowance | Loans to and receivables from banks | Impairment allowance | Financial assets held to maturity | Impairment allowance | Balances with the CNB | Impairment allowance | Fees receivable | Impairment allowance |
|---|---|---|---|---|---|---|---|---|---|---|
| **2014** | | | | | | | | | | |
| A | 73.65 | 1.09 | 99.91 | - | 95.54 | 0.96 | 100.00 | - | 59.39 | - |
| A - 90 days | 0.64 | 1.09 | - | - | - | - | - | - | - | - |
| B and C | 25.70 | 61.17 | 0.09 | 100.00 | 4.46 | 82.58 | - | - | 40.61 | 100.00 |
| **2013** | | | | | | | | | | |
| A | 76.39 | 1.07 | 99.90 | - | 95.89 | 0.64 | 100.00 | - | 90.27 | - |
| A - 90 days | 0.27 | 1.07 | - | - | - | - | - | - | - | - |
| B and C | 23.34 | 39.29 | 0.10 | 100.00 | 4.11 | 67.04 | - | - | 9.73 | 100.00 |

**Bank**

| % | Loans and receivables from customers | Impairment allowance | Loans to and receivables from banks | Impairment allowance | Financial assets held to maturity | Impairment allowance | Balances with the CNB | Impairment allowance | Fees receivable | Impairment allowance |
|---|---|---|---|---|---|---|---|---|---|---|
| **2014** | | | | | | | | | | |
| A | 73.39 | 1.10 | 99.91 | - | 95.54 | 0.96 | 100.00 | - | 58.66 | - |
| A - 90 days | 0.65 | 1.10 | - | - | - | - | - | - | - | - |
| B and C | 25.96 | 61.24 | 0.09 | 100.00 | 4.46 | 82.58 | - | - | 41.34 | 100.00 |
| **2013** | | | | | | | | | | |
| A | 76.22 | 1.07 | 99.90 | - | 95.89 | 0.64 | 100.00 | - | 90.21 | - |
| A - 90 days | 0.27 | 1.07 | - | - | - | - | - | - | - | - |
| B and C | 23.51 | 39.29 | 0.10 | 100.00 | 4.11 | 67.04 | - | - | 9.78 | 100.00 |

## 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

### 2.1.3 Impairment policy on placements (continued)

**Maximum exposure to credit risk before consideration of collateral**

The table below shows the maximum exposure of the Bank and the Group to credit risk as at 31 December 2014 and 31 December 2013, not considering the collateral, if any. The exposures presented below are net of impairment losses and provisions.

| **Maximum exposure** | | **Group** | | **Bank** | |
|---|---|---|---|---|---|
| | | **2014** | **2013** | **2014** | **2013** |
| | Notes | **HRK '000** | **HRK '000** | **HRK '000** | **HRK '000** |
| Giro account with the CNB and other banks | 5 | 947,334 | 682,106 | 947,334 | 682,106 |
| Obligatory reserve with Croatian National Bank | 6 | 1,545,787 | 1,442,045 | 1,545,787 | 1,442,045 |
| Loans to and receivables from banks | 7 | 583,784 | 522,772 | 583,784 | 522,772 |
| Held-to-maturity investments | 10 | 597,943 | 821,305 | 597,943 | 821,305 |
| Loans and receivables from customers | 11 | 10,473,750 | 11,753,691 | 10,335,154 | 11,655,515 |
| Fees receivable | 18 | 14,370 | 92,238 | 13,945 | 91,625 |
| | | | | | |
| **Off-balance sheet exposure** | 41 | **1,653,458** | **1,805,846** | **1,652,388** | **1,800,822** |
| Undisbursed lending commitments | | 1,319,379 | 1,470,883 | 1,318,309 | 1,465,859 |
| Guarantees | | 302,272 | 287,043 | 302,272 | 287,043 |
| Other contingent liabilities | | 31,807 | 47,920 | 31,807 | 47,920 |
| **Total credit exposure** | | **15,816,426** | **17,120,003** | **15,676,335** | **17,016,190** |

## 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

#### 2.1.4. Assets exposed to credit risk

| Group 2014 | Loans and receivables from customers | Loans to and receivables from banks | Financial assets held to maturity | Balances with the CNB | Fees receivable |
|---|---|---|---|---|---|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Loans neither overdue nor impaired | 9,243,362 | 583,784 | 598,814 | 2,133,130 | 14,370 |
| Overdue loans not impaired | 80,654 | - | - | - | - |
| Impaired loans | 3,225,750 | 500 | 27,978 | - | 9,826 |
| **Total gross** | **12,549,766** | **584,284** | **626,792** | **2,133,130** | **24,196** |
| Individually identified losses | (1,974,201) | (500) | (23,103) | - | (9,826) |
| Portfolio-based losses | (101,815) | - | (5,746) | - | - |
| **Total identified losses** | **(2,076,016)** | **(500)** | **(28,849)** | **-** | **(9,826)** |
| **Total** | **10,473,750** | **583,784** | **597,943** | **2,133,130** | **14,370** |

| Group 2013 | Loans and receivables from customers | Loans to and receivables from banks | Financial assets held to maturity | Balances with the CNB | Fees receivable |
|---|---|---|---|---|---|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| Loans neither overdue nor impaired | 9,974,623 | 522,772 | 815,041 | 1,799,784 | 92,236 |
| Overdue loans not impaired | 35,221 | - | - | - | 2 |
| Impaired loans | 3,048,274 | 500 | 34,917 | - | 9,937 |
| **Total gross** | **13,058,118** | **523,272** | **849,958** | **1,799,784** | **102,175** |
| Individually identified losses | (1,197,517) | (500) | (23,408) | - | (9,937) |
| Portfolio-based losses | (106,910) | - | (5,245) | - | - |
| **Total identified losses** | **(1,304,427)** | **(500)** | **(28,653)** | **-** | **(9,937)** |
| **Total** | **11,753,691** | **522,772** | **821,305** | **1,799,784** | **92,238** |

## 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

#### 2.1.4. Assets exposed to credit risk (continued)

| Bank 2014 | Loans and receivables from customers HRK '000 | Loans to and receivables from banks HRK '000 | Financial assets held to maturity HRK '000 | Balances with the CNB HRK '000 | Fees receivable HRK '000 |
|---|---|---|---|---|---|
| Loans neither overdue nor impaired | 9,106,699 | 583,784 | 598,814 | 2,133,130 | 13,945 |
| Overdue loans not impaired | 80,615 | - | - | - | - |
| Impaired loans | 3,221,236 | 500 | 27,978 | - | 9,826 |
| **Total gross** | **12,408,550** | **584,284** | **626,792** | **2,133,130** | **23,771** |
| Individually identified losses | (1,972,766) | (500) | (23,103) | - | (9,826) |
| Portfolio-based losses | (100,630) | - | (5,746) | - | |
| **Total identified losses** | **(2,073,396)** | **(500)** | **(28,849)** | **-** | **(9,826)** |
| **Total** | **10,335,154** | **583,784** | **597,943** | **2,133,130** | **13,945** |

| Bank 2013 | Loans and receivables from customers HRK '000 | Loans to and receivables from banks HRK '000 | Financial assets held to maturity HRK '000 | Balances with the CNB HRK '000 | Fees receivable HRK '000 |
|---|---|---|---|---|---|
| Loans neither overdue nor impaired | 9,876,557 | 522,772 | 815,041 | 1,799,784 | 91,623 |
| Overdue loans not impaired | 35,194 | - | - | - | 2 |
| Impaired loans | 3,046,744 | 500 | 34,917 | - | 9,937 |
| **Total gross** | **12,958,495** | **523,272** | **849,958** | **1,799,784** | **101,562** |
| Individually identified losses | (1,197,153) | (500) | (23,408) | - | (9,937) |
| Portfolio-based losses | (105,827) | - | (5,245) | - | - |
| **Total identified losses** | **(1,302,980)** | **(500)** | **(28,653)** | - | **(9,937)** |
| **Total** | **11,655,515** | **522,772** | **821,305** | **1,799,784** | **91,625** |

**2. RISK MANAGEMENT (continued)**

**2.1. Credit risk (continued)**

**2.1.4. Assets exposed to credit risk (continued)**

In accordance with applicable acts, the Bank utilizes the following common types of collateral: bank guarantees; HAMAG (“Croatian Agency for Small Entrepreneurship”) and other corporate guarantees; bills of exchange accepted by a bank; pledged property and equipment; insurance policies; pledged shares, bonds, commercial papers, and units in open-ended investment funds; assignment of receivables (cessions) from corporate clients and the Government; pledged concessions; pledged industrial and intellectual property; and other common financial execution instruments, such as bills of exchange and promissory notes.

Collateral value is reviewed along the lines of internal policies and procedures, and in accordance with good business practice and current market trends.

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | | 2014 | 2013 | 2014 | 2013 |
| **Asset type** | **Collateral type** | **'000 HRK** | **'000 HRK** | **'000 HRK** | **'000 HRK** |
| **Financial assets held to maturity** | | **-** | **3,043** | **-** | **3,043** |
| | Real estate – non-business purposes | - | 3,043 | - | 3,043 |
| **Loans to and advances from customers** | | **8,584,905** | **9,592,616** | **8,343,536** | **9,100,591** |
| | Deposits | 123,941 | 132,863 | 123,941 | 132,863 |
| | Debt securities | 33,010 | - | 33,010 | - |
| | Guarantees and warranties of Republic of Croatia | 1,422,428 | 932,102 | 1,422,428 | 932,102 |
| | Real estate – non-business purposes | 2,481,618 | 2,670,837 | 2,256,490 | 2,183,405 |
| | Real estate – business purposes | 3,497,173 | 4,023,858 | 3,497,174 | 4,023,858 |
| | Movable property (equipment, supplies, vehicles, ships...) | 328,467 | 636,710 | 328,467 | 636,710 |
| | Investments in equity securities and funds | 186,180 | 173,429 | 186,180 | 173,429 |
| | Land | 512,088 | 1,022,817 | 495,848 | 1,018,224 |
| **Total** | | **8,584,905** | **9,595,659** | **8,343,538** | **9,103,634** |

### 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

### 2.1.4. Assets exposed to credit risk (continued)

Below is presented an overview of due receivables aging structure based on days of delay regarding the principal of the loans:

| Group u '000 kn | Total | Undue exposure to credit risk | Days past due 1-30 | Days past due 31-60 | Days past due 61-90 | Days past due 91-180 | Days past due 180 and more |
|---|---|---|---|---|---|---|---|
| **Balance at 31 December 2014** | | | | | | | |
| Government | 2,754,692 | 2,754,566 | 123 | - | - | 1 | 2 |
| Other corporate clients | 5,223,787 | 3,412,671 | 39,453 | 35,882 | 34,213 | 24,390 | 1,677,178 |
| Retail | 4,517,588 | 3,947,545 | 15,825 | 4,571 | 2,931 | 21,095 | 525,621 |
| **Total** | **12,496,067** | **10,114,782** | **55,401** | **40,453** | **37,144** | **45,486** | **2,202,801** |
| **Balance at 31 December 2013** | | | | | | | |
| Government | 2,806,550 | 2,806,549 | 4 | - | - | - | - |
| Other corporate clients | 5,984,620 | 4,216,185 | 114,770 | 11,677 | 10,710 | 84,334 | 1,546,944 |
| Retail | 4,199,257 | 3,673,499 | 151,320 | 2,399 | 1,644 | 11,104 | 359,291 |
| **Total** | **12,990,427** | **10,696,233** | **266,094** | **14,076** | **12,354** | **95,438** | **1,906,235** |

| Bank u '000 kn | Total | Undue exposure to credit risk | Days past due 1-30 | Days past due 31-60 | Days past due 61-90 | Days past due 91-180 | Days past due 180 and more |
|---|---|---|---|---|---|---|---|
| **Balance at 31 December 2014** | | | | | | | |
| Government | 2,754,692 | 2,754,566 | 123 | - | - | 1 | 2 |
| Other corporate clients | 5,233,177 | 3,422,061 | 39,453 | 35,882 | 34,213 | 24,390 | 1,677,178 |
| Retail | 4,367,485 | 3,797,720 | 15,758 | 4,570 | 2,901 | 20,940 | 525,596 |
| **Total** | **12,355,354** | **9,974,347** | **55,334** | **40,452** | **37,114** | **45,331** | **2,202,776** |
| **Balance at 31 December 2013** | | | | | | | |
| Government | 2,806,550 | 2,806,549 | 4 | - | - | - | - |
| Other corporate clients | 6,013,057 | 4,244,622 | 114,770 | 11,677 | 10,710 | 84,334 | 1,546,944 |
| Retail | 4,071,356 | 3,545,962 | 151,102 | 2,354 | 1,621 | 11,029 | 359,288 |
| **Total** | **12,890,963** | **10,597,133** | **265,876** | **14,031** | **12,331** | **95,363** | **1,906,232** |

The gross balance of fully recoverable amounts not identified as past due beyond 90 day and as individually impaired at the reporting date sheet day, together with the underlying collateral at its fair value, expressed as a percentage of net placements is as follows:

## 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

### 2.1.4. Assets exposed to credit risk (continued)

#### *(a) Assets exposed to credit risk but not impaired (risk category A)*

| **Group 2014 HRK '000** | Government units | Financial institutions (excl. banks) | Companies | Housing loans | Mortgage loans | Credit cards | Other loans | **Total loans and receivables from customers** | **Loans to and receivables from banks** | **Financial assets held to maturity** | **Balances with the CNB** | **Fees receivable** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross amount | 2,771,920 | 31,508 | 2,583,366 | 963,401 | 912 | 152,032 | 2,741,131 | **9,244,270** | 583,784 | 598,814 | 2,133,130 | 14,370 |
| Total portfolio-based losses | (30,361) | (345) | (28,389) | (10,036) | (10) | (1,665) | (30,024) | **(100,830)** | - | (5,746) | - | - |
| Net amount | **2,741,559** | **31,163** | **2,554,977** | **953,365** | **902** | **150,367** | **2,711,107** | **9,143,440** | **583,784** | **593,068** | **2,133,130** | **14,370** |
| Collateral value | 962,971 | 33,010 | 2,262,579 | 1,618,967 | 3,422 | - | 439,621 | **5,320,570** | - | - | - | - |
| Collateral coverage in % | 35.12 | 105.93 | 88.56 | 169.82 | 379.38 | - | 16.22 | **58.19** | - | - | - | - |

| **Group 2013 HRK '000** | Government units | Financial institutions (excl. banks) | Companies | Housing loans | Mortgage loans | Credit cards | Other loans | **Total loans and receivables from customers** | **Loans to and receivables from banks** | **Financial assets held to maturity** | **Balances with the CNB** | **Fees receivable** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross amount | 2,829,087 | 368,377 | 3,183,210 | 861,973 | 1,366 | 134,473 | 2,596,137 | **9,974,623** | 522,772 | 815,041 | 1,799,784 | 92,236 |
| Total portfolio-based losses | (30,206) | (3,933) | (34,290) | (8,936) | (15) | (1,436) | (27,719) | **(106,535)** | - | (5,245) | - | - |
| Net amount | **2,798,881** | **364,444** | **3,148,920** | **853,037** | **1,351** | **133,037** | **2,568,418** | **9,868,088** | **522,772** | **809,796** | **1,799,784** | **92,236** |
| Collateral value | 314,588 | 13,520 | 2,777,587 | 1,665,553 | 7,488 | - | 500,807 | **5,279,543** | - | - | - | - |
| Collateral coverage in % | 11.24 | 3.71 | 88.21 | 195.25 | 554.26 | - | 19.50 | **53.50** | - | - | - | - |

**2. RISK MANAGEMENT (continued)**

**2.1. Credit risk (continued)**

**2.1.4. Assets exposed to credit risk (continued)**

***(a) Assets exposed to credit risk but not impaired (risk category A) (continued)***

| **Bank 2014 HRK ‘000** | Govern ment units | al instituti ons (excl. | Compan es | Housin g loans | Mortga ge loans | Credit cards | Other loans | **loans and receiva bles from custo** | **Loans to and receiva bles from banks** | **asset s held to** | **Balan ces with the CNB** | **Fees receiva ble** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross amount | 2,771,920 | 31,508 | 2,591,847 | 817,349 | 912 | 152,032 | 2,741,131 | **9,106,699** | 583,784 | 598,814 | 2,133,130 | 13,945 |
| Total portfolio-based losses | (30,361) | (345) | (28,389) | (8,953) | (10) | (1,665) | (30,024) | **(99,747)** | - | (5,746) | - | - |
| Net amount | **2,741,559** | **31,163** | **2,563,458** | **808,396** | **902** | **150,367** | **2,711,107** | 9,006,952 | **583,784** | **593,068** | **2,133,130** | **13,945** |
| Collateral value | 962,971 | 33,010 | 2,262,580 | 1,380,399 | 3,422 | - | 439,621 | **5,082,003** | - | - | - | - |
| Collateral coverage in % | 35.12 | 105.93 | 88.26 | 170.76 | 379.38 | - | 16.22 | **56.42** | - | - | - | - |

| **Bank 2013 HRK ‘000** | Government units | Financial institutions (excl. banks) | Companies | Housing loans | Mortgage loans | Credit cards | Other loans | **Total loans and receivables from customers** | **Loans to and receivables from banks** | **Financial assets held to maturity** | **Balances with the CNB** | **Fees receivable** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross amount | 2,829,087 | 368,377 | 3,211,646 | 735,471 | 1,366 | 134,473 | 2,596,137 | **9,876,557** | 522,772 | 815,041 | 1,799,784 | 91,623 |
| Total portfolio-based losses | (30,206) | (3,933) | (34,290) | (7,853) | (15) | (1,436) | (27,719) | **(105,452)** | - | (5,245) | - | - |
| Net amount | **2,798,881** | **364,444** | **3,177,356** | **727,618** | **1,351** | **133,037** | **2,568,418** | 9,771,105 | **522,772** | **809,796** | **1,799,784** | **91,623** |
| Collateral value | 314,588 | 13,520 | 2,777,588 | 1,179,821 | 7,488 | - | 500,807 | **4,793,812** | - | - | - | - |
| Collateral coverage in % | 11.24 | 3.71 | 87.42 | 162.15 | 554.26 | - | 19.50 | **49.06** | - | - | - | - |

**2. RISK MANAGEMENT (continued)**

**2.1. Credit risk (continued)**

**2.1.4. Assets exposed to credit risk (continued)**

***(b) Assets exposed to credit risk in the risk category A that are past due beyond 90 days but not impaired***

The gross balance and the coverage of those assets with collateral at fair value, presented as a percentage of net placements is as follows:

| **Group 2014 HRK 000** | **Loans and receivables from customers** | | | | | **Fees receivable** |
|---|---|---|---|---|---|---|
| | Government units | Companies | Housing loans | Other loans | **Total** | |
| Gross amount | - | 71,229 | 27 | 9,385 | 80,641 | - |
| Total portfolio-based losses | - | (780) | - | (103) | (883) | - |
| **Net amount** | **-** | **70,449** | **27** | **9,282** | **79,758** | **-** |
| Collateral value | - | 81,942 | - | 14,624 | 96,566 | |
| **Collateral coverage in %** | **-** | **116.31** | **-** | **157.55** | **121.07** | **-** |

| **Group 2013 HRK 000** | **Loans and receivables from customers** | | | | | **Fees receivable** |
|---|---|---|---|---|---|---|
| | Government units | Companies | Housing loans | Other loans | **Total** | |
| Gross amount | - | 21,583 | 895 | 12,743 | 35,221 | 2 |
| Total portfolio-based losses | - | (230) | (9) | (136) | (375) | - |
| **Net amount** | **-** | **21,353** | **886** | **12,607** | **34,846** | **2** |
| Collateral value | - | 50,266 | 1,291 | 23,259 | 74,816 | |
| **Collateral coverage in %** | **-** | **235.40** | **145.71** | **184.49** | **214.70** | **-** |

**2. RISK MANAGEMENT (continued)**

**2.1. Credit risk (continued)**

**2.1.4. Assets exposed to credit risk (continued)**

***(b) Assets exposed to credit risk in the risk category A that are past due beyond 90 days but not impaired (continued)***

| **Bank 2014 HRK '000** | **Loans and receivables from customers** | | | | | **Fees receivable** |
|---|---|---|---|---|---|---|
| | Government units | Companies | Housing loans | Other loans | **Total** | |
| Gross amount | - | 71,229 | - | 9,385 | **80,614** | - |
| Total portfolio-based losses | - | (780) | - | (103) | **(883)** | |
| **Net amount** | **-** | **70,449** | **-** | **9,282** | **79,731** | **-** |
| Collateral value | - | 81,942 | - | 14,624 | **96,566** | |
| **Collateral coverage in %** | - | 116.31 | - | 157.55 | 121.11 | - |

| **Bank 2013 HRK '000** | **Loans and receivables from customers** | | | | | **Fees receivable** |
|---|---|---|---|---|---|---|
| | Government units | Companies | Housing loans | Other loans | **Total** | |
| Gross amount | - | 21,583 | 868 | 12,743 | **35,194** | 2 |
| Total portfolio-based losses | - | (230) | (9) | (136) | **(375)** | |
| **Net amount** | **-** | **21,353** | **859** | **12,607** | **34,819** | **2** |
| Collateral value | - | 50,266 | 1,291 | 23,259 | **74,816** | |
| **Collateral coverage in %** | - | 235.40 | 150.29 | 184.49 | 214.87 | - |

**2. RISK MANAGEMENT (continued)**

**2.1. Credit risk (continued)**

**2.1.4. Assets exposed to credit risk (continued)**

***(c) Credit risk on impaired assets in risk categories B and C***

The table below shows the amount of loans and advances both individually impaired and impaired on a portfolio basis, and their coverage by collateral at fair value, expressed as a percentage of the net amount:

| **Group 2014 HRK '000** | **Loans to customers** | | | | | | **Loans to and receivables from banks** | **Financial assets held to maturity** | **Fees receivable** |
|---|---|---|---|---|---|---|---|---|---|
| | Companies | Housing loans | Mortgage loans | Credit cards | Other loans | **Total** | | | |
| Gross amount | 2,528,782 | 35,648 | 82 | 10,332 | 647,922 | **3,222,766** | 500 | 27,978 | 9,826 |
| Total identified losses | (1,450,986) | (14,571) | (8) | (8,995) | (498,570) | **(1,973,130)** | (500) | (23,103) | (9,826) |
| **Net amount** | **1,077,796** | **21,077** | **74** | **1,337** | **149,352** | **1,249,636** | **-** | **4,875** | **-** |
| Collateral value | 2,784,441 | 53,109 | 697 | - | 329,522 | **3,167,769** | - | - | - |
| **Collateral coverage in %** | **258.35** | **251.98** | **941.89** | **-** | **220.63** | **253.50** | **-** | **-** | **-** |

| **Group 2013 HRK '000** | **Loans to customers** | | | | | | **Loans to and receivables from banks** | **Financial assets held to maturity** | **Fees receivable** |
|---|---|---|---|---|---|---|---|---|---|
| | Companies | Housing loans | Mortgage loans | Credit cards | Other loans | **Total** | | | |
| Gross amount | 2,408,527 | 31,748 | 382 | 9,134 | 598,483 | **3,048,274** | 500 | 34,917 | 9,937 |
| Total identified losses | (808,509) | (7,241) | (8) | (7,506) | (374,253) | **(1,197,51)** | (500) | (23,408) | (9,937) |
| **Net amount** | **1,600,018** | **24,507** | **374** | **1,628** | **224,230** | **1,850,757** | **-** | **11,509** | **-** |
| Collateral value | 3,814,511 | 53,590 | 667 | - | 369,489 | **4,238,257** | - | - | - |
| **Collateral coverage in %** | **238.40** | **218.67** | **178.34** | **-** | **164.78** | **229.00** | **-** | **-** | **-** |

## 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

### 2.1.4. Assets exposed to credit risk (continued)

***(c) Credit risk on impaired assets in risk categories B and C (continued)***

| **Bank 2014 HRK '000** | **Loans to customers** | | | | | | **Loans to and receivables from banks** | **Financial assets held to maturity** | **Fees receivable** |
|---|---|---|---|---|---|---|---|---|---|
| | Companies | Housing loans | Mortgage loans | Credit cards | Other loans | **Total** | | | |
| Gross amount | 2,528,782 | 34,118 | 82 | 10,332 | 647,922 | **3,221,236** | 500 | 27,978 | 9,826 |
| Total identified losses | (1,450,986) | (14,207) | (8) | (8,995) | (498,570) | **(1,972,766)** | (500) | (23,103) | (9,826) |
| **Net amount** | **1,077,796** | **19,911** | **74** | **1,337** | **149,352** | **1,248,470** | **-** | **4,875** | **-** |
| Collateral value | 2,784,441 | 50,309 | 697 | - | 329,522 | **3,164,969** | - | - | - |
| **Collateral coverage in %** | **258.35** | **252.67** | **941.89** | **-** | **220.63** | **253.51** | **-** | **-** | **-** |

| **Bank 2013 HRK '000** | **Loans to customers** | | | | | | **Loans to and receivables from banks** | **Financial assets held to maturity** | **Fees receivable** |
|---|---|---|---|---|---|---|---|---|---|
| | Companies | Housing loans | Mortgage loans | Credit cards | Other loans | **Total** | | | |
| Gross amount | 2,408,527 | 30,218 | 382 | 9,134 | 598,483 | **3,046,744** | 500 | 34,917 | 9,937 |
| Total identified losses | (808,509) | (6,877) | (8) | (7,506) | (374,253) | **(1,197,153)** | (500) | (23,408) | (9,937) |
| **Net amount** | **1,600,018** | **23,341** | **374** | **1,628** | **224,230** | **1,849,591** | **-** | **11,509** | **-** |
| Collateral value | 3,814,511 | 47,296 | 667 | | 369,489 | **4,231,963** | - | - | - |
| **Collateral coverage in %** | **238.40** | **202.63** | **178.34** | **-** | **164.78** | **228.81** | **-** | **-** | **-** |

**2. RISK MANAGEMENT (continued)**

**2.1. Credit risk (continued)**

**2.1.4. Assets exposed to credit risk (continued)**

***(d) Prolonged and rescheduled loans to customers***

Prolongation of a loan is approved to customers because of common and current financing needs of their business activities.

Loans are most often rescheduled when borrowers' business operations are disrupted, with considerable changes made to the previously agreed lending terms and conditions.

| | | **Bank** |
|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** |
| **Gross loans and advances to customers** | | |
| Corporate | 1,592,406 | 2,215,000 |
| Small and middle enterprises | 239,097 | 260,678 |
| Retail | 112,283 | 111,035 |
| **Total** | **1,943,786** | **2,586,713** |

**2.1.5. Credit risk concentration by industry:**

An analysis of the concentration of credit risk by industry is presented in the table below:

| | **Group** | **Group** |
|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** |
| Public administration and defence; compulsory social security | 1,796,691 | 2,306,478 |
| Manufacturing | 1,459,161 | 1,535,414 |
| Construction | 1,432,713 | 870,705 |
| Transportation and storage | 685,143 | 578,999 |
| Wholesale and retail trade; repair of motor vehicles and motorcycles | 540,708 | 721,260 |
| Professional, scientific and technical activities | 412,783 | 397,361 |
| Accommodation and food service activities | 230,574 | 259,685 |
| Agriculture, forestry and fishing | 228,338 | 224,549 |
| Arts, entertainment and recreation | 77,147 | 80,150 |
| Other | 680,360 | 1,257,736 |
| **Total gross loans to corporate customers** | **7,978,480** | **8,791,170** |
| **Loans to retail customers (gross)** | **4,517,588** | **4,199,257** |
| Collateralised | 8,584,905 | 9,592,616 |
| Accrued interest | 53,699 | 67,691 |
| Provisions for impairment losses | (2,076,017) | (1,304,427) |
| **Total** | **10,473,750** | **11,753,691** |

### 2. RISK MANAGEMENT (continued)

### 2.1. Credit risk (continued)

### 2.1.5. Credit risk concentration by industry (continued)

| | Bank 2014 HRK '000 | Bank 2013 HRK '000 |
|---|---|---|
| Public administration and defense; compulsory social security | 1,796,691 | 2,306,478 |
| Manufacturing | 1,459,161 | 1,535,414 |
| Construction | 1,432,713 | 870,705 |
| Transportation and storage | 685,143 | 578,999 |
| Wholesale and retail trade; repair of motor vehicles and motorcycles | 540,708 | 721,260 |
| Professional, scientific and technical activities | 412,783 | 425,798 |
| Agriculture, forestry and fisheries | 228,338 | 224,549 |
| Accommodation and food service activities | 230,574 | 259,685 |
| Information and communication | 203,164 | 287,636 |
| Electricity, gas, steam and air conditioning supply | 134,802 | 152,235 |
| Arts, entertainment and recreation | 96,896 | 118,962 |
| Administrative and support service activities | 77,147 | 80,150 |
| Other | 689,750 | 1,257,736 |
| **Total gross loans to corporate customers** | **7,987,870** | **8,819,607** |
| | | |
| **Loans to retail customers (gross)** | **4,367,485** | **4,071,356** |
| | | |
| Collateralised | 8,343,536 | 9,100,591 |
| | | |
| Accrued interest | 53,196 | 67,532 |
| Provisions for impairment losses | (2,073,397) | (1,302,980) |
| **Total** | **10,335,154** | **11,655,515** |

**2. RISK MANAGEMENT (continued)**

**2.2. Liquidity risk**

Liquidity risk arises in the general funding of the Bank's and the Group's activities and in the management of its positions. The main categories of liquidity risk to which the Bank and the Group is exposed are as follows:

- liquidity funding risk (structural liquidity risk): risk that the Bank and the Group will not be able to meet efficiently its expected and unexpected present and future cash and collateral requirements without impacting its day-to-day operations or its own financial result,
- market liquidity risk, risk that the Bank and the Group will not be able to offset its positions or liquidate positions at market price due to a market disturbance or the market being insufficiently deep.

The Bank and the Group manage liquidity risk in accordance with the legal and regulatory requirements. In addition to those requirements, liquidity risk management is governed by the following internal regulations:

- Risk Management Policy,
- Liquidity Risk Management Manual.

The system for managing liquidity risk, in line with defined polices, includes:

- estimation and measurement of liquidity risk exposure;
- setting liquidity risk exposure limits,
- reporting and monitoring the limits used,
- the mechanism for the distribution of liquidity costs and benefits,
- control function.

Liquidity risk management is realized through:

- operational management of daily liquidity,
- operational management of short-term liquidity,
- structural liquidity management.

Operational management of daily and short-term liquidity is performed through:

- planning and projecting daily/ten-day/monthly cash flows
- maintaining minimum weekly and monthly liquidity coefficient in HRK, total of all convertible currencies and non-convertible currencies individually, and total minimum weekly and monthly liquidity coefficient, calculated according to CNB's Decision on Liquidity Risk Management, within the prescribed limit.

Structural liquidity management is performed through:

- maintaining positions depending on gap limits between receivables and liabilities according to remaining contractual maturity,
- maintaining positions in accordance with liquidity risk exposure limits,
- diversification of sources of funding.

**2. RISK MANAGEMENT (continued)**

**2.2. Liquidity risk (continued)**

Risk Management Division is reporting monthly about liquidity risk and liquidity risk exposure limits during sessions of Assets and Liability Management Committee.

The Bank and the Group are submitting monthly reports to the CNB in form and in deadline prescribed by Decision on Liquidity Risk Management, with end-of-the-month status. Prescribed quantitative requirements consist of following reports: about the amount of highly liquid assets (presently marketable assets), about the maturity gap of assets and liabilities (expected inflows and outflows form), about the level of minimal liquidity coefficient and funds concentration within total liabilities. Information is delivered for two periods: up to one week and up to one month, separately for HRK, convertible currencies and each non-convertible currency individually (if they represent a significant amount) and on portfolio basis for HRK and convertible currencies. The Bank and the Group have maintained all limits above prescribed levels during 2014. The Bank and the Group maintain obligatory reserve and minimal foreign currency receivables within limits prescribed by Decision on Reserve Requirements and Decision on Minimum Required Amount of Foreign Currency Claims.

The Treasury Division reports monthly to Assets and Liability Management Committee about planned outflows and inflows.

Ultimate responsibility for liquidity risk management rests with the Bank's Management Board. The Bank's Asset and Liability Committee is authorized by the Management Board to manage liquidity risk. The Committee makes decisions and conclusions regarding liquidity management in it's sessions. Each division to which these decisions and conclusions made by the committee relate, is obliged to enact them.

As a part of liquidity risk management system, authority, responsibilities and procedures in conditions of liquidity crisis are determined separately.

The Bank and the Group prescribe and implement stress tests of it's liquidity. Risk division conducts tests of immunity to stress by taking into account all the factors specific to the Bank and the Group (internal factors) and market factors (external factors).

Immunity to stress tests are conducted for HRK and total convertible currencies, for periods up to one week and up to one month.

Long-term liquidity is managed by maintaining positions in accordance with the limits of exposure to liquidity risk.

**2.2.1 Maturity analysis**

A maturity analysis of assets and liabilities, as well as equity, of the Bank and the Group, based on their remaining contractual maturity, except for financial assets at fair value through profit and loss that are analysed as current based on their classification and the Bank's and the Group's trading intention, as at 31 December 2014 and 31 December 2013, is presented in the tables below.

### 2. RISK MANAGEMENT (continued)

### 2.2. Liquidity risk (continued)

### 2.2.1. Maturity analysis (continued)

**Group 2014**
**HRK '000**

| | 0-30 days | 31-90 days | 91-360 days | 1 to 3 years | Over 3 years | Total |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and amounts due from banks | 1,308,452 | - | - | - | - | 1,308,452 |
| Obligatory reserve with Croatian National Bank | 1,545,787 | - | - | - | - | 1,545,787 |
| Loans to and receivables from banks | 459,293 | 80,450 | 10,762 | 257 | 33,022 | 583,784 |
| Financial assets at fair value through profit or loss | 379,518 | 2,283 | - | - | - | 381,801 |
| Financial assets available for sale | 11,661 | 394,902 | 303,397 | 627,437 | 665,577 | 2,002,974 |
| Financial assets held to maturity | 82,472 | 17,827 | 227,445 | 255,290 | 14,909 | 597,943 |
| Loans and receivables from customers | 2,086,755 | 492,852 | 2,750,437 | 2,239,853 | 2,903,853 | 10,473,750 |
| Assets held for sale | - | - | - | 7,930 | - | 7,930 |
| Property and equipment | - | - | - | - | 153,225 | 153,225 |
| Investment property | - | - | - | - | 9,828 | 9,828 |
| Intangible assets | - | - | - | - | 140,342 | 140,342 |
| Deferred tax assets, net | - | - | 735 | - | 15,868 | 16,603 |
| Tax prepayment | - | - | 53 | - | - | 53 |
| Other assets | 150,369 | 113 | 34,718 | 5,609 | 156,630 | 347,439 |
| **TOTAL ASSETS** | **6,024,307** | **988,427** | **3,327,547** | **3,136,376** | **4,093,254** | **17,569,911** |
| | | | | | | |
| **LIABILITIES** | | | | | | |
| Financial liabilities at fair value through profit or loss | 508 | - | - | - | - | 508 |
| Deposits from banks | 43,838 | 263,308 | 67,604 | - | - | 374,750 |
| Customer deposits | 6,442,699 | 1,704,129 | 4,682,584 | 1,126,172 | 129,141 | 14,084,725 |
| Borrowings | 36,543 | 23,802 | 375,948 | 736,794 | 334,240 | 1,507,327 |
| Hybrid instruments | 52,537 | 8,384 | 200,000 | - | - | 260,921 |
| Provisions for liabilities and expenses | 15,524 | 806 | 4,036 | 9,372 | 20 | 29,758 |
| Other liabilities | 397,591 | 15,343 | 30,518 | 7,533 | 18,209 | 469,194 |
| Total equity | - | - | - | - | 842,728 | 842,728 |
| **TOTAL LIABILITIES AND EQUITY** | **6,989,240** | **2,015,772** | **5,360,690** | **1,879,871** | **1,324,338** | **17,569,911** |
| | | | | | | |
| **MATURITY GAP** | **(964,933)** | **(1,027,345)** | **(2,033,143)** | **1,256,505** | **2,768,916** | **-** |
| **CUMMULATIVE MATURITY GAP** | **(964,933)** | **(1,992,278)** | **(4,025,421)** | **(2,768,916)** | **-** | **-** |

**2. RISK MANAGEMENT (continued)**

**2.2. Liquidity risk (continued)**

**2.2.1. Maturity analysis (continued)**

| **Group 2013**<br>**HRK '000** | **0-30 days** | **31-90 days** | **91-360 days** | **1 to 3 years** | **Over 3 years** | **Total** |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and amounts due from banks | 1,177,543 | - | - | - | - | 1,177,543 |
| Obligatory reserve with Croatian National Bank | 1,442,045 | - | - | - | - | 1,442,045 |
| Loans to and receivables from banks | 421,150 | 159 | - | 21,689 | 79,774 | 522,772 |
| Financial assets at fair value through profit or loss | 275,723 | 2,417 | 12 | - | 65,689 | 343,841 |
| Financial assets available for sale | 62,783 | 253,554 | 126,832 | 632,340 | 639,907 | 1,715,416 |
| Financial assets held to maturity | 259,607 | 116,687 | 64,644 | 216,024 | 164,343 | 821,305 |
| Loans and receivables from customers | 2,769,519 | 566,326 | 3,203,449 | 2,050,034 | 3,164,363 | 11,753,691 |
| Assets held for sale | - | - | - | - | 41,551 | 41,551 |
| Property and equipment | - | - | - | - | 147,987 | 147,987 |
| Investment property | - | - | - | - | 9,938 | 9,938 |
| Intangible assets | - | - | - | - | 168,709 | 168,709 |
| Deferred tax assets, net | - | - | 918 | - | 21,951 | 22,869 |
| Tax prepayment | - | 50 | - | - | - | 50 |
| Other assets | 153,635 | 10,000 | 26,982 | 22,820 | 216,633 | 430,070 |
| **TOTAL ASSETS** | **6,562,005** | **949,193** | **3,422,837** | **2,942,907** | **4,720,845** | **18,597,787** |
| **LIABILITIES** | | | | | | |
| Financial liabilities at fair value through profit or loss | 8 | - | - | - | - | 8 |
| Deposits from banks | 493,261 | 187,446 | 60,500 | - | - | 741,207 |
| Customer deposits | 6,767,966 | 1,671,261 | 4,955,846 | 858,627 | 107,665 | 14,361,365 |
| Borrowings | 202,623 | 40,475 | 99,716 | 305,029 | 426,170 | 1,074,013 |
| Hybrid instruments | - | 8,429 | 150,000 | 252,373 | - | 410,802 |
| Provisions for liabilities and expenses | 18,633 | 10,789 | 5,284 | 7,961 | 81 | 42,748 |
| Other liabilities | 435,849 | 23,267 | 31,851 | 9,501 | 21,682 | 522,150 |
| Total equity | - | - | - | - | 1,445,494 | 1,445,494 |
| **TOTAL LIABILITIES AND EQUITY** | **7,918,340** | **1,941,667** | **5,303,197** | **1,433,491** | **2,001,092** | **18,597,787** |
| **MATURITY GAP** | **(1,356,335)** | **(992,474)** | **(1,880,360)** | **1,509,416** | **2,719,753** | **-** |
| **CUMMULATIVE MATURITY GAP** | **(1,356,335)** | **(2,348,809)** | **(4,229,169)** | **(2,719,753)** | **-** | **-** |

## 2. RISK MANAGEMENT (continued)

### 2.2. Liquidity risk (continued)

#### 2.2.1. Maturity analysis (continued)

**Bank 2014**
**HRK '000**

| | 0-30 days | 31-90 days | 91-360 days | 1 to 3 years | Over 3 years | Total |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and amounts due from banks | 1,308,449 | - | - | - | - | 1,308,449 |
| Obligatory reserve with Croatian National Bank | 1,545,787 | - | - | - | - | 1,545,787 |
| Loans to and receivables from banks | 459,293 | 80,450 | 10,762 | 257 | 33,022 | 583,784 |
| Financial assets at fair value through profit or | 283,014 | 997 | - | - | - | 284,011 |
| Financial assets available for sale | 11,661 | 394,632 | 289,376 | 627,437 | 665,576 | 1,988,682 |
| Financial assets held to maturity | 82,472 | 17,827 | 227,445 | 255,290 | 14,909 | 597,943 |
| Loans and receivables from customers | 2,082,556 | 491,512 | 2,743,625 | 2,218,229 | 2,799,232 | 10,335,154 |
| Assets held for sale | - | - | - | 7,930 | - | 7,930 |
| Investments in subsidiaries | - | - | - | - | 45,490 | 45,490 |
| Property and equipment | - | - | - | - | 153,107 | 153,107 |
| Intangible assets | - | - | - | - | 140,301 | 140,301 |
| Deferred tax assets, net | - | - | - | - | 15,868 | 15,868 |
| Other assets | - | - | 53 | - | - | 53 |
| **TOTAL ASSETS** | 149,277 | 49 | 34,113 | 5,609 | 155,408 | 344,456 |
| | **5,922,509** | **985,467** | **3,305,374** | **3,114,752** | **4,022,913** | **17,351,015** |
| **LIABILITIES** | | | | | | |
| Financial liabilities at fair value through profit or loss | 508 | - | - | - | - | 508 |
| Deposits from banks | 43,838 | 263,308 | 67,604 | - | - | 374,750 |
| Customer deposits | 6,457,695 | 1,696,470 | 4,637,597 | 1,017,887 | 69,757 | 13,879,406 |
| Borrowings | 36,543 | 23,802 | 375,948 | 736,794 | 334,240 | 1,507,327 |
| Hybrid instruments | 52,537 | 8,384 | 200,000 | - | - | 260,921 |
| Provisions for liabilities and expenses | 15,523 | 806 | 4,026 | 9,372 | 21 | 29,748 |
| Other liabilities | 391,751 | 10,417 | 29,884 | 7,533 | 14,175 | 453,760 |
| Total equity | - | - | - | - | 844,595 | 844,595 |
| **TOTAL LIABILITIES AND EQUITY** | **6,998,395** | **2,003,187** | **5,315,059** | **1,771,586** | **1,262,788** | **17,351,015** |
| **MATURITY GAP** | **(1,075,886)** | **(1,017,720)** | **(2,009,685)** | **1,343,166** | **2,760,125** | **-** |
| **CUMMULATIVE MATURITY GAP** | **(1,075,886)** | **(2,093,606)** | **(4,103,291)** | **(2,760,125)** | **-** | **-** |

## 2. RISK MANAGEMENT (continued)

### 2.2. Liquidity risk (continued)

#### 2.2.1. Maturity analysis (continued)

**Bank 2013**
**HRK '000**

| | 0-30 days | 31-90 days | 91-360 days | 1 to 3 years | Over 3 years | Total |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Cash and amounts due from banks | 1,177,540 | - | - | - | - | 1,177,540 |
| Obligatory reserve with Croatian National Bank | 1,442,045 | - | - | - | - | 1,442,045 |
| Loans to and receivables from banks | 421,150 | 159 | - | 21,689 | 79,774 | 522,772 |
| Financial assets at fair value through profit or loss | 275,723 | 1,323 | - | - | - | 277,046 |
| Financial assets available for sale | 41,465 | 221,673 | 126,832 | 603,200 | 629,871 | 1,623,041 |
| Financial assets held to maturity | 259,607 | 116,687 | 64,644 | 216,024 | 164,343 | 821,305 |
| Loans and receivables from customers | 2,766,943 | 586,228 | 3,198,041 | 2,033,075 | 3,071,228 | 11,655,515 |
| Assets held for sale | - | - | - | - | 41,551 | 41,551 |
| Property and equipment | - | - | - | - | 45,490 | 45,490 |
| Investment property | - | - | - | - | 147,861 | 147,861 |
| Intangible assets | - | - | - | - | 168,519 | 168,519 |
| Deferred tax assets, net | - | - | - | - | 21,951 | 21,951 |
| Tax prepayment | 154,345 | 49 | 20,310 | 22,820 | 214,918 | 412,442 |
| Other assets | **6,538,818** | **926,119** | **3,409,827** | **2,896,808** | **4,585,506** | **18,357,078** |
| **TOTAL ASSETS** | | | | | | |
| **LIABILITIES** | | | | | | |
| Financial liabilities at fair value through profit or loss | 8 | - | - | - | - | 8 |
| Deposits from banks | 493,261 | 187,446 | 60,500 | - | - | 741,207 |
| Customer deposits | 6,739,575 | 1,660,139 | 4,909,920 | 769,169 | 65,219 | 14,144,022 |
| Borrowings | 202,623 | 40,475 | 99,716 | 305,029 | 426,170 | 1,074,013 |
| Hybrid instruments | - | 8,429 | 150,000 | 252,373 | - | 410,802 |
| Provisions for liabilities and expenses | 18,835 | 10,789 | 4,122 | 7,961 | 82 | 41,789 |
| Other liabilities | 433,140 | 12,384 | 24,863 | 9,501 | 11,959 | 491,847 |
| Total equity | - | - | - | - | 1,453,390 | 1,453,390 |
| **TOTAL LIABILITIES AND EQUITY** | **7,887,442** | **1,919,662** | **5,249,121** | **1,344,033** | **1,956,820** | **18,357,078** |
| **MATURITY GAP** | **(1,348,624)** | **(993,543)** | **(1,839,294)** | **1,552,775** | **2,628,686** | **-** |
| **CUMMULATIVE MATURITY GAP** | **(1,348,624)** | **(2,342,167)** | **(4,181,461)** | **(2,628,686)** | **-** | **-** |

**2. RISK MANAGEMENT (continued)**

**2.3 Market risk**

The exposure to market risk occurs with respect to balance sheet and off-balance-sheet positions recognised at fair value:

- financial assets held for trading,
- financial assets available for sale,
- positions denominated in foreign currency (including placements and liabilities linked to foreign currencies).

All trading instruments are subject to market risk, which is the risk that future changes in market conditions may make an instrument less valuable or more onerous (i.e. impaired). Trading financial instruments are recognised at fair value, and all changes in market conditions directly affect trading income. The Bank and the Group manage their use of trading instruments in response to changing market conditions. Exposure to market risk is formally managed through acquisitions or disposals of financial instruments in accordance with the risk limits set in Market Risk Management Guidelines.

Market risk management of the Bank and the Group are conducted in accordance with regulatory requirements, as is defined by internal policies and procedures regarding market risks which are regularly revised by the Risk Management Division.

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

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

- Capital requirement calculated by the standard method calculated in accordance with the Croatian National Bank's Decision on the capital adequacy of financial institutions,
- Value at Risk (VaR) which represents the maximum potential loss that the Bank could incur as a result of changes in market risk factors (interest rates, exchange rate and share prices) for a period of retaining the same position for 10 days at statistical accuracy of 99%. VaR is calculated at the end of the day and does not include daily exposure arising from a change in position. To calculate VaR, a database containing 250 historical figures is used,
- Capital requirement calculated by an internal model (VaR x multiplying factor depending on the backward number of overdrafts in the test results - *backtesting*).

In addition the Bank and the Group use the following internally prescribed measures in measuring exposure to debt instrument position risks:

- Duration (measure of the sensitivity of debt security prices to changes in interest rates),
- PV01 which represents the decline of portfolio value in a scenario where interest rates increase by 0.01%.

The Risk Management Division reports daily to the Treasury Division on the usage of market risk exposure limits, daily to the Finance Division regarding the capital requirements for currency risk and position risks, and monthly to the Asset and Liability Management Committee on market risk exposure.

## 2. RISK MANAGEMENT (continued)

### 2.3 Market risk (continued)

#### a) Trading portfolio

The table below shows the movements in those measures at 31 December 2014 and 31 December 2013.

**Bank**

| **2014** | **Position HRK '000** | **VaR** |
|---|---|---|
| Currency risk | 38,268 | (225) |
| Debt instrument position risk | 95,682 | (849) |
| Equity instrument position risk | 33,588 | (2,207) |
| Position risk of units in investment funds | 166,052 | (1,005) |
| Correlation effect | - | 1,582 |
| **Market risk** | | **(2,704)** |
| **2013** | | |
| Currency risk | 165,264 | (2,038) |
| Debt instrument position risk | 81,380 | (866) |
| Equity instrument position risk | 43,120 | (2,201) |
| Position risk of units in investment funds | 159,203 | (1,417) |
| Correlation effect | - | 2,658 |
| **Market risk** | | **(3,864)** |

**2. RISK MANAGEMENT (continued)**

**2.3 Market risk (continued)**

**b) Available-for-sale portfolio**

The available-for-sale portfolio consists of debt and equity securities.

The table below shows market value and VaR movements for the portfolio of debt and equity securities available for sale.

**Bank**

| Debt securities | Market value HRK '000 | VaR HRK '000 |
|---|---|---|
| **2014** | 2,014,200 | (19,228) |
| **2013** | 1,625,715 | (21,727) |

| Equity securities | Market value HRK '000 | VaR HRK '000 |
|---|---|---|
| **2014** | 6,349 | - |
| **2013** | - | - |

**2. RISK MANAGEMENT (continued)**

**2.4 Interest rate risk in the Bank's non-trading book**

Interest rate risk in the Bank’s non-trading book is a risk which can have a negative effect on economic value of the Bank’s book and earnings (net interest income), because of variation of market interest rates. Exposure to interest rate risk in the Bank’s non-trading book arises as a consequence of:

- mismatch between assets and liabilities distributed according to the possibility of interest rate change criterion (repricing gaps),
- various natures of interest rates (reference rates) applied by the Bank in arranging its lending and borrowing activities.

Accordingly, all interest-rate sensitive items in the Bank’s non-trading book are exposed to interest rate risk.

The Bank manages interest rate risk in its non-trading book in accordance with the legal and regulatory requirements. In line with CNB’s Decision on the Management of Interest rate risk in the Bank’s non-trading book, in effect from 31 March 2010, the Bank is required to submit quarterly reports to the CNB about the interest rate risk in the bank’s non-trading book, on unconsolidated and consolidated basis both.

Apart from those regulations, managing interest rate risk in the Bank’s non-trading book is regulated by:

- Risk Management Policy, and
- Manual on Managing Interest Rate Risk in the Bank's non-trading book.

The Manual on Managing Interest Rate Risk in the Bank's non-trading nook defines the management process, evaluation methods and measures of exposure to interest rate risk in the Bank's non-trading book, as well as exposure limits, manner and frequency of reporting about the Bank's exposure to that risk.

The Bank assesses interest rate risk in the bank’s non-trading book by observing this risk from two perspectives:

- Perspective of economic value: a potential market value decrease of the Bank's non-trading book because of interest rate movements in the market,
- Profit perspective: a potential decrease of net interest income because of movements in market interest rates.

***Perspective of economic value of capital***

The Bank uses simplified calculation of estimated change in economic value of the bank’s book by applying standard interest shock on non-trading book positions which are exposed to interest rate risk, for all significant currencies separately and other currencies jointly. Interest sensitive positions of the non-trading book are distributed in 13 time zones, whereby positions with fixed interest rate, variable interest rate and interest rate that can be changed by Management Board’s decision (administrative interest rate) are distinguished, and estimates a change in market value of the Bank’s non-trading book by applying basic simulation of parallel interest rates movements by 2 basis points. The Bank calculates a ratio between the change in economic value of the non-trading book and regulatory capital, and maintains it on a level below 18% (legal ratio prescribed by the CNB’s Decision equals 20%). Change in economic value of capital amounts to HRK 55,427 thousand or 8.59% of regulatory capital as per 2014 year-end .

**2. RISK MANAGEMENT (continued)**

**2.4 Interest rate risk in the Bank's non-trading book (continued)**

***Profit perspective***

The profit perspective takes into account the potential decrease in net interest income as a result of a change in market interest rates. To measure interest rate risk from the profit perspective, the Bank simulates basic parallel movements in interest rates ± 2%, through a time period of 12 months, and the potential decrease in net interest income is to be maintained within a 10% limit of realized net interest income for the observed period (from beginning of the year) projected to a yearly basis. Potential increase in net interest income amounts to HRK 38,195 thousand, representing 7.44% of net interest income (2013: increase by HRK 25,047 thousand, or 5.47% of net interest income).

Additionally, at least once a year stress tests are conducted, whereby the Bank tests effects of adverse interest rate movements for specific product types on the market, on net interest income, by assuming a decrease of active interest rates and an increase of passive interest rates.

Risk Division is reporting monthly to the Asset and Liabilities Committee about exposure the interest rate risk in the Bank's non-trading book.

**2.5 Foreign exchange risk**

The Bank and the Group are exposed to currency risk through transactions in foreign currencies.

Foreign currency exposure arises from credit, deposit-taking, investment and trading activities. It is monitored daily 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 and the Group direct their business activities trying to minimize the gap between assets and liabilities denominated in or linked to foreign currency.

The Bank and the Group manage their currency risk by setting principles and limits for foreign currency exposures and monitoring exposures against these limits. The Bank and the Group direct their business activities towards trying to minimize the gap between assets and liabilities denominated in or linked to a foreign currency, and maintaining daily business activities within the internal and regulatory limits per currency.

The Bank and the Group are primarily exposed to changes in the euro exchange rate. As at 31 December 2014, value of assets denominated in euro or in euro linked currencies amounted to HRK 6,346,949 thousand (2013: HRK 6,072,991 thousand), while liabilities denominated in euro or in euro linked currencies amounted to HRK 6,460,308 thousand (2013: HRK 5,961,316 thousand). Hence, a 1% fall in the HRK/EUR exchange rate (appreciation of the HRK) would affect the result in the amount of HRK -1,134 thousand (2013: HRK 1,117 thousand).

**2.5.1 Currency risk analysis**

The following tables illustrate the value of total assets and liabilities of the Group and Bank at 31 December 2014 and 31 December 2013 in HRK and foreign currencies (values denominated in HRK with foreign currency clause are mostly linked to EUR).

## 2. RISK MANAGEMENT (continued)

### 2.5. Foreign exchange risk (continued)

### 2.5.1 Currency risk analysis (continued)

**Group 2014**

| HRK '000 | HRK | HRK, currency clause | EUR | Other foreign currencies | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and amounts due from banks | 880,851 | - | 303,477 | 124,124 | 1,308,452 |
| Obligatory reserve with Croatian National Bank | 1,437,461 | - | 108,326 | - | 1,545,787 |
| Loans to and receivables from banks | 384,469 | - | 112,494 | 86,821 | 583,784 |
| Financial assets at fair value through profit or loss | 229,123 | 152,678 | 0 | 0 | 381,801 |
| Financial assets available for sale | 1,023,285 | 394,344 | 524,112 | 61,233 | 2,002,974 |
| Financial assets held to maturity | 544,038 | 53,905 | - | - | 597,943 |
| Loans and receivables from customers | 5,546,414 | 3,498,327 | 1,397,581 | 31,428 | 10,473,750 |
| Assets held for sale | 7,930 | - | - | - | 7,930 |
| Property and equipment | 153,225 | - | - | - | 153,225 |
| Investment property | 9,828 | - | - | - | 9,828 |
| Intangible assets | 140,342 | - | - | - | 140,342 |
| Deferred tax assets, net | 16,603 | - | - | - | 16,603 |
| Tax prepayment | 53 | - | - | - | 53 |
| Other assets | 304,036 | 186 | 29,737 | 13,480 | 347,439 |
| **TOTAL ASSETS** | **10,677,658** | **4,099,440** | **2,475,727** | **317,086** | **17,569,911** |
| **LIABILITIES** | | | | | |
| Financial liabilities at fair value through profit or loss | - | - | - | 508 | 508 |
| Deposits from banks | 332,781 | - | 28,315 | 13,654 | 374,750 |
| Customer deposits | 8,677,512 | 252,035 | 4,926,060 | 229,118 | 14,084,725 |
| Borrowings | 88,793 | 583,405 | 835,129 | - | 1,507,327 |
| Hybrid instruments | 208,349 | 52,572 | - | - | 260,921 |
| Provisions for liabilities and expenses | 29,758 | - | - | - | 29,758 |
| Other liabilities | 450,091 | - | 10,310 | 8,793 | 469,194 |
| Total equity | 842,728 | - | - | - | 842,728 |
| **TOTAL LIABILITIES AND EQUITY** | **10,630,012** | **888,012** | **5,799,814** | **252,073** | **17,569,911** |
| **NET FOREIGN EXCHANGE POSITION** | **47,646** | **3,211,428** | **(3,324,087)** | **65,013** | **-** |

## 2. RISK MANAGEMENT (continued)

### 2.5. Foreign exchange risk (continued)

### 2.5.1 Currency risk analysis (continued)

**Group 2013**

| HRK '000 | HRK | HRK, currency clause | EUR | Other foreign currencies | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and amounts due from banks | 723,712 | - | 318,123 | 135,708 | 1,177,543 |
| Obligatory reserve with Croatian National Bank | 1,346,735 | - | 95,310 | - | 1,442,045 |
| Loans to and receivables from banks | 172,727 | - | 344,917 | 5,128 | 522,772 |
| Financial assets at fair value through profit or loss | 204,084 | 133,532 | - | 6,225 | 343,841 |
| Financial assets available for sale | 1,116,147 | 245,494 | 303,559 | 50,216 | 1,715,416 |
| Financial assets held to maturity | 740,845 | 80,460 | - | - | 821,305 |
| Loans and receivables from customers | 6,881,428 | 4,185,041 | 600,120 | 87,102 | 11,753,691 |
| Assets held for sale | 41,551 | - | - | - | 41,551 |
| Property and equipment | 147,987 | - | - | - | 147,987 |
| Investment property | 9,938 | - | - | - | 9,938 |
| Intangible assets | 168,709 | - | - | - | 168,709 |
| Deferred tax assets, net | 22,869 | - | - | - | 22,869 |
| Tax prepayment | 50 | - | - | - | 50 |
| Other assets | 429,472 | 314 | 265 | 19 | 430,070 |
| **TOTAL ASSETS** | **12,006,254** | **4,644,841** | **1,662,294** | **284,398** | **18,597,787** |
| **LIABILITIES** | | | | | |
| Financial liabilities at fair value through profit or loss | - | - | - | 8 | 8 |
| Deposits from banks | 560,756 | - | 149,677 | 30,774 | 741,207 |
| Customer deposits | 8,885,755 | 287,965 | 4,954,147 | 233,498 | 14,361,365 |
| Borrowings | 319,122 | 699,187 | 55,704 | - | 1,074,013 |
| Hybrid instruments | 358,393 | 52,409 | - | - | 410,802 |
| Provisions for liabilities and expenses | 42,748 | - | - | - | 42,748 |
| Other liabilities | 500,602 | - | 8,059 | 13,489 | 522,150 |
| Total equity | 1,445,494 | - | - | - | 1,445,494 |
| **TOTAL LIABILITIES AND EQUITY** | **12,112,870** | **1,039,561** | **5,167,587** | **277,769** | **18,597,787** |
| **NET FOREIGN EXCHANGE POSITION** | **(106,616)** | **3,605,280** | **(3,505,293)** | **6,629** | **-** |

## 2. RISK MANAGEMENT (continued)

### 2.5. Foreign exchange risk (continued)

#### 2.5.1 Currency risk analysis (continued)

**Bank 2014**
**HRK '000**

| | HRK | HRK, currency clause | EUR | Other foreign currencies | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and amounts due from banks | 880,848 | - | 303,477 | 124,124 | 1,308,449 |
| Obligatory reserve with Croatian National Bank | 1,437,461 | - | 108,326 | - | 1,545,787 |
| Loans to and receivables from banks | 384,469 | - | 112,494 | 86,821 | 583,784 |
| Financial assets at fair value through profit or loss | 197,039 | 86,972 | - | - | 284,011 |
| Financial assets available for sale | 1,023,285 | 380,052 | 524,112 | 61,233 | 1,988,682 |
| Financial assets held to maturity | 544,038 | 53,905 | - | - | 597,943 |
| Loans and receivables from customers | 5,555,804 | 3,350,341 | 1,397,581 | 31,428 | 10,335,154 |
| Assets held for sale | 7,930 | - | - | - | 7,930 |
| Investments in subsidiaries | 45,490 | - | - | - | 45,490 |
| Property and equipment | 153,107 | - | - | - | 153,107 |
| Intangible assets | 140,301 | - | - | - | 140,301 |
| Deferred tax assets, net | 15,868 | - | - | - | 15,868 |
| Other assets | 53 | - | - | - | 53 |
| **TOTAL ASSETS** | 301,287 | (48) | 29,737 | 13,480 | 344,456 |
| | **10,686,980** | **3,871,222** | **2,475,727** | **317,086** | **17,351,015** |
| **LIABILITIES** | | | | | |
| Financial liabilities at fair value through profit or loss | - | - | - | 508 | 508 |
| Deposits from banks | 332,781 | - | 28,315 | 13,654 | 374,750 |
| Customer deposits | 8,699,711 | 24,517 | 4,926,060 | 229,118 | 13,879,406 |
| Borrowings | 88,793 | 583,405 | 835,129 | - | 1,507,327 |
| Hybrid instruments | 208,349 | 52,572 | - | - | 260,921 |
| Provisions for liabilities and expenses | 29,748 | - | - | - | 29,748 |
| Other liabilities | 434,657 | - | 10,310 | 8,793 | 453,760 |
| Total equity | 844,595 | - | - | - | 844,595 |
| **TOTAL LIABILITIES AND EQUITY** | **10,638,634** | **660,494** | **5,799,814** | **252,073** | **17,351,015** |
| **NET FOREIGN EXCHANGE POSITION** | **48,346** | **3,210,728** | **(3,324,087)** | **65,013** | **-** |

**2. RISK MANAGEMENT (continued)**

**2.5. Foreign exchange risk (continued)**

**2.5.1 Currency risk analysis (continued)**

**Bank 2013**
**HRK '000**

| | HRK | HRK, currency clause | EUR | Other foreign currencies | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and amounts due from banks | 723,709 | - | 318,123 | 135,708 | 1,177,540 |
| Obligatory reserve with Croatian National Bank | 1,346,735 | - | 95,310 | - | 1,442,045 |
| Loans to and receivables from banks | 172,727 | - | 344,917 | 5,128 | 522,772 |
| Financial assets at fair value through profit or loss | 198,990 | 71,831 | - | 6,225 | 277,046 |
| Financial assets available for sale | 1,069,422 | 199,844 | 303,559 | 50,216 | 1,623,041 |
| Financial assets held to maturity | 740,845 | 80,460 | - | - | 821,305 |
| Loans and receivables from customers | 6,909,864 | 4,058,429 | 600,120 | 87,102 | 11,655,515 |
| Assets held for sale | 41,551 | - | - | - | 41,551 |
| Investments in subsidiaries | 45,490 | - | - | - | 45,490 |
| Property and equipment | 147,861 | - | - | - | 147,861 |
| Intangible assets | 168,519 | - | - | - | 168,519 |
| Deferred tax assets, net | 21,951 | - | - | - | 21,951 |
| Other assets | 412,025 | 133 | 265 | 19 | 412,442 |
| **TOTAL ASSETS** | **11,999,689** | **4,410,697** | **1,662,294** | **284,398** | **18,357,078** |
| **LIABILITIES** | | | | | |
| Financial liabilities at fair value through profit or loss | - | - | - | 8 | 8 |
| Deposits from banks | 560,756 | - | 149,677 | 30,774 | 741,207 |
| Customer deposits | 8,914,244 | 42,133 | 4,954,147 | 233,498 | 14,144,022 |
| Borrowings | 319,122 | 699,187 | 55,704 | - | 1,074,013 |
| Hybrid instruments | 358,393 | 52,409 | - | - | 410,802 |
| Provisions for liabilities and expenses | 41,789 | - | - | - | 41,789 |
| Other liabilities | 470,299 | | 8,059 | 13,489 | 491,847 |
| Total equity | 1,453,390 | - | - | - | 1,453,390 |
| **TOTAL LIABILITIES AND EQUITY** | **12,117,993** | **793,729** | **5,167,587** | **277,769** | **18,357,078** |
| **NET FOREIGN EXCHANGE POSITION** | **(118,304)** | **3,616,968** | **(3,505,293)** | **6,629** | **-** |

**2. RISK MANAGEMENT (continued)**

**2.6. Operational risk management**

Operational risk is inherent to all activities, processes, products and systems of the Bank and the Group. The Bank and the Group ensure appropriate operational risk management by applying procedures and a system of authorizations and responsibilities specified in detail in its internal by-laws, the Risk Management Policy and the Internal Operational Risk Management Manual as root documents. The operational risk management system has been established through appropriate bodies of the Bank and the Group and an efficient internal control system.

The Bank and the Group define operational risk as a risk of an event which, as a consequence, exposes the Bank and the Group to financial losses, with the cause being inadequate or ineffective internal processes, systems, human resources, or external influences. This definition includes legal risk. Significant operational risk is a risk of an event resulting in significant loss because of operational risk.

In order to efficiently manage the overall exposure to operational risk, the Bank and the Group apply the following:

- Collecting and analysing internal data about operational risk events,
- Self-assessment of risks and controls,
- Assessment of information technology risk, and
- Business Impact Analysis of unavailability of key business processes.

The Bank and the Group assess the outsourcing risk as an additional exposure to all significant risks arising from the fact that the Bank and the Group do not itself perform the outsourced activities, but rather that those activities are performed by external vendors; hence, the impact of outsourcing on the Bank's risk profile is assessed.

The Bank and the Group assess the impact of introducing a new product on the Bank's and the Group’s risk profile, which includes exposure to all significant risks.

For the purpose of efficient operational risk management, the Bank has set up the Operational Risk Management Committee. Based on the reports on the Bank's exposure to operational risk, the Operational Risk Management Committee draws conclusions and makes decisions about appropriate measures necessary to undertake in order to overmaster the exposure to operational risk.

The Bank and the Group apply the Standardized Approach in calculating the capital requirement for operational risk.

**2.7. Capital management**

*Capital allocation*

The amount of capital allocated to individual operations is based primarily on regulatory requirements. The allocation of capital to specific activities is performed independent of individuals in charge of those activities.

Capital requirement calculations are based on exposures to customers classified into the prescribed exposure categories, which are then weighted according to risk depending on the exposure category of the customer (exposure to sovereign debt, to institutions, public bodies, individuals, etc.), remaining maturity, type of collateral (i.e. residential or commercial property), diversification of loans, identified number of days past due and the amount of provisions made, as defined in the Decision on Regulatory Capital Adequacy. The Bank and the Group apply standardized approach when calculating capital requirements.

**2. RISK MANAGEMENT (continued)**

**2.7 Capital management (continued)**

| | 2014<br>HRK '000 | 2013<br>HRK '000 |
|---|---|---|
| **REGULATORY CAPITAL** | | |
| Share capital | 631,397 | 1,365,959 |
| Basic share capital | 631,397 | - |
| Supplementary capital | 13,949 | 252,373 |
| Items deductible from regulatory capital | - | (45,000) |
| **Total regulatory capital** | **645,346** | **1,573,332** |

| | 2014,<br>'000 kn | 2013,<br>'000 kn |
|---|---|---|
| **Credit risk exposure (Standardized Approach)** | **7,920,115** | **9,733,866** |
| Exposure to currency and positional risk | 417,426 | 577,821 |
| Exposure to operational risk | 1,372,452 | 1,336,240 |
| Exposure to credit valuation adjustments | 218 | - |
| **Total amount of risk exposure** | **9,710,211** | **11,647,927** |
| | | |
| **Total capital adequacy ratio in %** | **6,65** | **13,51** |

Adequacy ratio of the total capital of HPB amounts 6.65 percent on 31 December 2014.

Hereby, the HPB meet only part of the limits prescribed in Article 92 of Directives (EU) No. 575/2013 of the European Parliament and of the Council dated 26 June 2013 on prudential requirements for credit institutions and investment funds and amending Directives (EU) No. 648/2012 (EU Official Journal L 176/2013), according to which institutions must meet the following capital requirements: (a) the regular rate of share capital of 4.5%; (b) share capital ratio of 6%; (c) the rate of the total capital of 8%. Furthermore, HPB's capital is not covered by a protective layer for the preservation of capital, and that under Article 117 of the Credit Institutions Act (Official Gazette no. 159/2013.) amounts 2.5 percent, or a protective layer for structural systemic risk at a rate of 1.5 percent based on the Decision on the application of the protective layer for structural systemic risk (Official Gazette no. 61/2014.). In addition, the CNB has ordered the Bank supervisory measures to increase the rate of total capital by an additional 2 percent of which must be maintained on a consolidated basis in the period from 30 June 2015 to and including 30 June 2016. The planned share capital increase in amount HRK 550mil to meet the regulatory minimum capital adequacy and capital buffer requirements should be finalised until 30 June 2015.

## 3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group 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 Group's portfolio exposed to credit risk represents the major source of estimation uncertainty. This and other key sources of estimations 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.

***Impairment losses on loans and receivables***

The Group monitors the creditworthiness of its customers on an ongoing basis. In accordance with CNB regulations, the need for impairment of the Group's on and off-balance-sheet credit risk exposure is assessed at least quarterly. Impairment losses are made mainly against the carrying amount of loans and advances to corporate and retail customers (summarized in Note 10), and as provisions for liabilities and expenses arising from off-balance-sheet risk exposure to customers, mainly in the form of guarantees, documentary credits and undrawn loan commitments (summarized in Notes 23 and 40). 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.

Following tables represent the summary of impairment losses of loans to and receivables from customers, as well as provisions for off-balance sheet exposures:

| **Group** | **Notes** | **2014 HRK '000** | **2013 HRK '000** |
|---|---|---|---|
| Impairment losses on loans to and receivables from customers | 11 | 2,076,016 | 1,304,427 |
| Provisions for off-balance-sheet exposures | 24 | 18,824 | 21,167 |
| **Total** | | **2,094,840** | **1,325,594** |

| **Bank** | **Notes** | **2014 HRK 000** | **2013 HRK 000** |
|---|---|---|---|
| Impairment losses on loans to and receivables from customers | 11 | 2,073,396 | 1,302,980 |
| Provisions for off-balance-sheet exposures | 24 | 18,814 | 21,125 |
| **Total** | | **2,092,210** | **1,324,105** |

### 3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

*Financial assets at amortized cost*

The Group first assesses whether objective evidence of impairment exists individually for assets that are individually significant (mainly corporate exposures) and collectively for assets that are not individually significant (mainly retail exposures). 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 Group 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, when and where these changes can be correlated with defaults.

The Group 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 Group also has regard to the ranges of specific impairment loss rates prescribed by the CNB.

Gross value of specifically impaired loans and other receivables classified in risk groups B and C, and the rates of recognized impairment losses, were as follows as per year end:

| **Group** | **2014** | **2013** |
|---|---|---|
| **Gross exposures (in HRK '000)** | **3,264,054** | **3,093,628** |
| Impairment loss (in HRK ‘000) | 2,007,630 | 1,231,362 |
| **Impairment rate** | **61.51%** | **39.80%** |

| **Bank** | **2014** | **2013** |
|---|---|---|
| **Gross exposures (in HRK '000)** | **3,259,540** | **3,092,098** |
| Impairment loss (in HRK ‘000) | 2,006,195 | 1,230,998 |
| **Impairment rate** | **61.55%** | **39.81%** |

Each additional increase of one percentage point in the impairment rate on the gross portfolio at 31 December 2014 would lead to recognition of additional impairment loss amounting to HRK 32,641thousand for the Group (2013: HRK 30,936 thousand), and HRK 32,596 thousand for the Bank (2013: HRK 30,921 thousand).

The Group also seeks to recognise impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified. In assessing impairment losses on a portfolio basis, historical loss rates are used which are determined in accordance with an internal methodology. The Group considers impairment losses depending on the type of assets, whereby the overall impairment rate may not be below 0.80% of the total on-balance sheet and off-balance sheet credit risk exposure, except in the case of available-for-sale assets at fair value through profit or loss. The amounts assessed as impaired on an individual basis are excluded from this calculation.

### 3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

*Financial assets at amortized cost (continued)*

The amount of impairment allowance at 31 December 2014 estimated on a portfolio basis amounted to HRK 126,932 thousand (2013: HRK 133,322 thousand) of relevant on- and off-balance-sheet exposure of the Group, and HRK 125,091 thousand (2013: HRK 132,198 thousand) of relevant on- and off-balance-sheet exposure of the Bank, classified in A risk category. At the minimum rate prescribed by the CNB, portfolio based impairment allowances would be HRK 9,937 thousand (2013: HRK 9,822 thousand) lower than the amount recognised by the Group and HRK 8,853 thousand (2013: HRK 9,928 thousand) lower than the amount recognised by the Bank.

If the Bank and the Group did not have its internal methodology for assessing latent losses on a portfolio basis, it would have to apply the impairment rate equal to 1.00 percent of the relevant on-balance sheet and off-balance sheet credit risk exposure. In that case, impairment losses on a portfolio basis be HRK 19,851 thousand (2013: HRK 21,053 thousand) higher than the amount recognised by the Group and HRK 20,205 thousand (2013: HRK 20,640 thousand) higher than the amount recognised by the Bank.

***Market value of pledged property and foreclosed assets***

As disclosed (in Note 2.1.4 (c)), loans and receivables to customers at 31 December 2014 include exposures with a carrying value of HRK 3,259,540 thousand classified by the Bank as impaired in view of delinquencies in payment. A proportion of these loans is secured with collateral in the form of property, plant and equipment. When assessing loan recoverability based on pledged property, market value of pledged property is discounted to present value by applying discount factors and periods prescribed by internal acts, and in accordance with the CNB decision. In addition, as disclosed in Note 18, other assets at 31 December 2014 include property, plant and equipment with carrying value of HRK 258,180 thousand (2013: HRK 237,703 thousand), representing foreclosed assets collected in settlement of non-performing debt.

The Bank and the Group recognised loss on above stated property in the amount of HRK 75,111 thousand at the end of the reporting period (2013: HRK 2,052 thousand).

Net book value of repossessed assets ad of 31 December 2014 amounts HRK 155,408 thousand (2013: HRK 209,418 thousand).

Information and fair value hierarchy of foreclosed assets of the Group as of 31 December 2014 is presented below:

| | Level 1 | Level 2 | Level 3 | Fair value as of 31 December 2014 |
|---|---|---|---|---|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| - land | - | - | 58,927 | 58,927 |
| - buildings | - | - | 90,989 | 90,989 |
| - equipment | - | - | 5,492 | 5,492 |
| **TOTAL** | **-** | **-** | **155,408** | **155,408** |

During the year 2014 there were no transfers between Level 1 and 2 in the period and vice versa.

**3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)**

***Fair value of derivatives***

Fair value of OTC derivatives that are quoted on active market is determined using their closing market price. For derivatives that are not traded on active markets, Bank determines contractual value applying internally developed models for fair value assessment.

***Fair value of treasury bills***

The Group determines the fair value of treasury bills issued by the Ministry of Finance of the Republic of Croatia using an internal model which takes into account their remaining maturity and latest available auction prices of equivalent instruments. As at 31 December 2014, the Bank did not have treasury bills classified as financial assets at fair value through profit or loss (2013: -). As at 31 December 2014, carrying amount of treasury bills classified as financial assets available for sale amounted to HRK 141,256 thousand (2013: HRK 433,670 thousand).

***Provisions for court cases initiated against the Bank and the Group***

In calculating provisions for court expenses, the Bank and the Group discount expected future cash flows with respect to the liabilities using the CNB's discount rate.

***Taxation***

The Group recognises tax liabilities in accordance with the tax laws of the Republic of Croatia. Tax returns are subject to the approval of tax authorities that are entitled to carry out subsequent inspections of taxpayers' records.

## 4. SEGMENT REPORTING

The Group's business segments represent the primary reportable segments. The primary format is based on the Bank's and the Group's management and internal reporting structure. As the Bank and the Group do not allocate overhead expenses and equity to segments, segment profitability is not reported.

***Business segments***

The Bank and the Group comprises following primary reportable segments:

- *Corporate Banking* — Includes loans, deposits and other transactions and balances with corporate customers,
- *Retail Banking* — Includes loans, deposits and other transactions and balances with retail customers,
- *Financial market* — Group financing operations and the aggregate liquidity and foreign exchange risk activities in respect of borrowings, transactions with debt securities, use of derivatives and investments in liquid assets. It also includes asset management, securities custody and brokerage services.

The Bank and the Group do not apply internal transfer prices in determining the financial results of segments.

Classification of individual sectors for the purposes of notes on the results and position of segments differs from other parts of the financial statements. This primarily refers to the owner of small enterprises, who are part of Corporate Banking in the statement of segmentation, while in the financial statements part of positions related to the Retail Banking.

### 4. SEGMENT REPORTING (continued)

**Group**

| | Corporate | Retail | Financial market | Unallocated | 2014 HRK '000 Total |
|---|---|---|---|---|---|
| Net interest income | 303,350 | 117,634 | 92,404 | 3,432 | 516,820 |
| Net fee and commission income | 46,913 | 123,180 | 3,898 | 11,636 | 185,627 |
| Trading and investment income | - | - | 55,347 | 4,919 | 60,266 |
| Other income | (87) | 869 | 5,697 | 4,148 | 10,627 |
| **Operating income** | **350,176** | **241,683** | **157,346** | **24,135** | **773,340** |
| General and administrative expenses | (21,086) | (166,401) | (6,171) | (219,562) | (413,220) |
| Depreciation and amortisation | - | - | - | (53,571) | (53,571) |
| Impairment losses on loans and other assets | (691,449) | (135,401) | (29,803) | (76,290) | (932,942) |
| Provisions for liabilities and expenses | - | - | - | (3,969) | (3,969) |
| **Operating expenses** | **(712,535)** | **(301,802)** | **(35,974)** | **(353,392)** | **(1,403,702)** |
| **Profit before taxation** | **-** | **-** | **-** | **-** | (630,362) |
| Deferred income tax | - | - | - | 972 | 972 |
| **Profit for the year** | **-** | **-** | **-** | **972** | **(629,390)** |
| Segment assets | 6,993,481 | 4,304,567 | 5,857,076 | - | 17,155,124 |
| Unallocated assets | | | | 414,787 | 414,787 |
| **Total assets** | **6,993,481** | **4,304,567** | **5,857,076** | **414,787** | **17,569,911** |
| Segment liabilities | 7,438,342 | 8,408,606 | 607,046 | - | 16,453,994 |
| Unallocated equity and liabilities | - | - | - | 1,115,917 | 1,115,917 |
| **Total equity and liabilities** | **7,438,342** | **8,408,606** | **607,046** | **1,115,917** | **17,569,911** |

## 4. SEGMENT REPORTING (continued)

**Group**

| | | | | | 2013 HRK '000 |
|---|---|---|---|---|---|
| | **Corporate** | **Retail** | **Financial market** | **Unallocated** | **Total** |
| Net interest income | 279,616 | 94,484 | 83,739 | 4,942 | 462,781 |
| Net fee and commission income | 44,307 | 130,827 | 3,919 | 13,960 | 193,013 |
| Trading and investment income | - | - | 47,065 | 224 | 47,289 |
| Other income | 5,149 | 612 | 9,109 | 137 | 15,007 |
| **Operating income** | **329,072** | **225,923** | **143,832** | **19,263** | **718,090** |
| General and administrative expenses | (23,620) | (159,612) | (7,155) | (215,489) | (405,876) |
| Depreciation and amortisation | - | - | - | (53,006) | (53,006) |
| Impairment losses on loans and other assets | (182,328) | (50,592) | (2,061) | (1,936) | (236,917) |
| Provisions for liabilities and expenses | - | - | - | 14,077 | 14,077 |
| **Operating expenses** | **(205,948)** | **(210,204)** | **(9,216)** | **(256,354)** | **(681,722)** |
| **Profit before taxation** | **-** | **-** | **-** | **-** | 36,368 |
| Deferred tax expense | - | - | - | (630) | (630) |
| **Profit for the year** | **-** | **-** | **-** | **(630)** | **35,738** |
| Segment assets | 8,872,741 | 4,250,812 | 5,013,406 | - | 18,136,959 |
| Unallocated assets | - | - | - | 460,828 | 460,828 |
| **Total assets** | **8,872,741** | **4,250,812** | **5,013,406** | **460,828** | **18,597,787** |
| Segment liabilities | 6,836,749 | 8,277,933 | 1,444,346 | - | 16,559,028 |
| Unallocated equity and liabilities | - | - | - | 2,038,759 | 2,038,759 |
| **Total equity and liabilities** | **6,836,749** | **8,277,933** | **1,444,346** | **2,038,759** | **18,597,787** |

## 4.SEGMENT REPORTING (continued)

**Bank** — 2014, HRK '000

| | Corporate | Retail | Financial market | Unallocated | Total |
|---|---|---|---|---|---|
| Net interest income | 303,350 | 117,634 | 92,404 | - | 513,388 |
| Net fee and commission income | 46,913 | 123,180 | 3,898 | (1,161) | 172,830 |
| Trading and investment income | - | - | 55,347 | - | 55,347 |
| Other income | 3,499 | 869 | 5,697 | - | 10,065 |
| **Operating income** | **353,762** | **241,683** | **157,346** | **(1,161)** | **751,630** |
| General and administrative expenses | (21,086) | (166,401) | (6,171) | (205,367) | (399,025) |
| Depreciation and amortisation | - | - | - | (53,078) | (53,078) |
| Impairment losses onloans and other assets | (691,449) | (135,401) | (29,803) | (75,110) | (931,762) |
| Provisions for liabilities and expenses | - | - | - | (4,818) | (4,818) |
| **Operating expenses** | **(712,535)** | **(301,802)** | **(35,974)** | **(338,373)** | **(1,388,683)** |
| **Profit before taxation** | **-** | **-** | **-** | **-** | (637,053) |
| Deferred income tax | - | - | - | 1,669 | 1,669 |
| **Profit for the year** | **-** | **-** | **-** | **1,669** | **(635,384)** |
| Segment assets | 7,002,868 | 4,156,581 | 5,744,994 | - | 16,904,443 |
| Unallocated assets | - | - | - | 446,572 | 446,572 |
| **Total assets** | **7,002,868** | **4,156,581** | **5,744,994** | **446,572** | **17,351,015** |
| Segment liabilities | 7,460,541 | 8,181,088 | 607,046 | - | 16,248,675 |
| Unallocated equity and liabilities | - | - | - | 1,102,340 | 1,102,340 |
| **Total equity and liabilities** | **7,460,541** | **8,181,088** | **607,046** | **1,102,340** | **17,351,015** |

## 4. SEGMENT REPORTING (continued)

**Bank**

| | | | | | 2013<br>HRK '000 |
|---|---|---|---|---|---|
| | **Corporate** | **Retail** | **Financial market** | **Unallocated** | **Total** |
| Net interest income | 279,616 | 94,484 | 83,739 | - | 457,839 |
| Net fee and commission income | 44,307 | 130,827 | 3,919 | (1,029) | 178,024 |
| Trading and investment income | - | - | 47,063 | - | 47,063 |
| Other income | 7,967 | 612 | 17,011 | - | 25,590 |
| **Operating income** | **331,890** | **225,923** | **151,732** | **(1,029)** | **708,516** |
| General and administrative expenses | (23,620) | (159,612) | (7,155) | (199,834) | (390,221) |
| Depreciation and amortisation | - | - | - | (52,478) | (52,478) |
| Impairment losses onloans and other | (182,328) | (50,592) | (2,061) | (2,052) | (237,033) |
| Provisions for liabilities and expenses | - | - | - | 13,962 | 13,962 |
| **Operating expenses** | **(205,948)** | **(210,204)** | **(9,216)** | **(240,402)** | **(665,770)** |
| **Profit before taxation** | **-** | **-** | **-** | **-** | 42,746 |
| Deferred tax expense | - | - | - | (336) | (336) |
| **Profit for the year** | **-** | **-** | **-** | **(336)** | **42,410** |
| Segment assets | 8,901,175 | 4,124,199 | 4,854,236 | - | 17,879,610 |
| Unallocated assets | - | - | - | 477,468 | 477,468 |
| **Total assets** | **8,901,175** | **4,124,199** | **4,854,236** | **477,468** | **18,357,078** |
| Segment liabilities | 6,865,200 | 8,032,101 | 1,444,346 | - | 16,341,647 |
| Unallocated equity and liabilities | - | - | - | 2,015,431 | 2,015,431 |
| **Total equity and liabilities** | **6,865,200** | **8,032,101** | **1,444,346** | **2,015,431** | **18,357,078** |

## 5. CASH AND RECEIVABLES FROM BANKS

| Group | 2014 HRK '000 | | | 2013 HRK '000 | | |
|---|---|---|---|---|---|---|
| | HRK | in foreign currency | Total | HRK | in foreign currency | Total |
| **Cash in hand** | | | | | | |
| Held by the Group | 166,725 | 67,591 | 234,316 | 190,818 | 129,414 | 320,232 |
| Held by other parties | 126,784 | - | 126,784 | 175,155 | - | 175,155 |
| Cheques in the course of collection | - | 18 | 18 | - | 50 | 50 |
| | **293,509** | **67,609** | **361,118** | **365,973** | **129,464** | **495,437** |
| **Amounts due from banks** | | | | | | |
| Current accounts with domestic banks | - | 14,282 | 14,282 | - | 8,300 | 8,300 |
| Current accounts with foreign banks | - | 345,709 | 345,709 | - | 316,067 | 316,067 |
| Giro account with the CNB | 587,343 | - | 587,343 | 357,739 | - | 357,739 |
| | **587,343** | **359,991** | **947,334** | **357,739** | **324,367** | **682,106** |
| **Total** | **880,852** | **427,600** | **1,308,452** | **723,712** | **453,831** | **1,177,543** |

| Bank | 2014 HRK '000 | | | 2013 HRK '000 | | |
|---|---|---|---|---|---|---|
| | HRK | in foreign currency | Total | HRK | in foreign currency | Total |
| **Cash in hand** | | | | | | |
| Held by the Bank | 166,722 | 67,591 | 234,313 | 190,815 | 129,414 | 320,229 |
| Held by other parties | 126,784 | - | 126,784 | 175,155 | - | 175,155 |
| Cheques in the course of collection | - | 18 | 18 | - | 50 | 50 |
| | **293,506** | **67,609** | **361,115** | **365,970** | **129,464** | **495,434** |
| **Amounts due from banks** | | | | | | |
| Current accounts with domestic banks | - | 14,282 | 14,282 | - | 8,300 | 8,300 |
| Current accounts with foreign banks | - | 345,709 | 345,709 | - | 316,067 | 316,067 |
| Giro account with the CNB | 587,343 | - | 587,343 | 357,739 | - | 357,739 |
| | **587,343** | **359,991** | **947,334** | **357,739** | **324,367** | **682,106** |
| **Total** | **880,849** | **427,600** | **1,308,449** | **723,709** | **453,831** | **1,177,540** |

## 6. OBLIGATORY RESERVE WITH CROATIAN NATIONAL BANK

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Obligatory reserve | | | | |
| - in HRK | 1,220,856 | 1,130,130 | 1,220,856 | 1,130,130 |
| - in foreign currency | 108,326 | 95,310 | 108,326 | 95,310 |
| Obligatory treasury bills | 216,605 | 216,605 | 216,605 | 216,605 |
| Accrued interest due | - | - | - | - |
| **Total** | **1,545,787** | **1,442,045** | **1,545,787** | **1,442,045** |

The obligatory reserve with the CNB represents the amount required to be deposited with the CNB.

The obligatory reserve requirement was set at 12 percent of HRK and foreign currency deposits, borrowings and issued debt securities (31 December 2013: 12%).

As at December 31 2014 required minimum rate of maintenance of the HRK obligatory reserve with the CNB equalled 70% (2013: 70%), whereas the remaining 30 percent (2013: 30%) could be held in the form of other liquid receivables. This includes the part of foreign currency obligatory reserve required to be held in HRK (see below).

60% of the foreign currency obligatory reserve (2013: 60%) is maintained with the CNB, while the remaining 40% (2013: 40%) 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). 75% (2013: 75%) of the foreign currency obligatory reserve is required to be held in HRK and is added to the HRK obligatory reserve (see above).

The reduced mandatory reserve rate is one of the measures taken to facilitate the economic recovery in the Republic of Croatia. Namely, the released mandatory reserve funds were used by banks to subscribe the CNB treasury bills to be released to the banks depending on the pace of business lending growth. The Bank's quota on this basis amounts to HRK 216.6 million, which is the maximum return on the subscribed treasury bills.

The CNB does not pay the fee on obligatory reserve fund.

## 7. LOANS TO AND RECEIVABLES FROM BANKS

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** | **2014 HRK '000** | **2013 HRK '000** |
| Short-term placements with domestic banks | 99,154 | - | 99,154 | - |
| Short-term placements with foreign banks | 427,562 | 343,694 | 427,562 | 343,694 |
| Short-term loans to domestic banks | - | - | - | - |
| **Total short-term placements and loans banks** | **526,716** | **343,694** | **526,716** | **343,694** |
| Guarantee deposits with foreign banks | 12,577 | 6,230 | 12,577 | 6,230 |
| Long-term placements with domestic banks | 10,762 | 21,475 | 10,762 | 21,475 |
| Long-term loans to domestic banks - HBOR | 33,022 | 151,000 | 33,022 | 151,000 |
| **Total short-term placements and loans banks** | **56,361** | **178,705** | **56,361** | **178,705** |
| Short-term placements with domestic non-banking financial institutions | 500 | 500 | 500 | 500 |
| Long-term placements with domestic non-banking financial institutions | 257 | 214 | 257 | 214 |
| **Long-term placements with domestic non-banking financial institutions** | **757** | **714** | **757** | **714** |
| **Provisions for impairment losses (non banking financial institutions)** | **(500)** | **(500)** | **(500)** | **(500)** |
| Accrued interest not yet due | 450 | 159 | 450 | 159 |
| **Total interest receivable** | **450** | **159** | **450** | **159** |
| **Total** | **583,784** | **522,772** | **583,784** | **522,772** |

Long-term placements with domestic banks include an amount of HRK 10,762 thousand (2013: HRK 21,475 thousand) held at domestic banks, pledged as collateral for the repayment of long-term borrowings with maturity 14 September 2015. Guarantee deposits mainly relate to deposits for card operations.

***Movements in impairment allowance***

No changes in impairment allowance for loans and receivables from banks occurred in 2014 (2013: -).

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** | **2014 HRK '000** | **2013 HRK '000** |
| Balance at 1 January | 500 | 500 | 500 | 500 |
| (Decrease)/increase in impairment loss on loans to and receivables from banks | - | - | - | - |
| **Balance at 31 December** | **500** | **500** | **500** | **500** |

## 8. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| **Trading instruments** | | | | |
| **Debt securities quoted on active markets** | | | | |
| Bonds of the Ministry of Finance | 178,650 | 139,079 | 83,373 | 73,390 |
| Corporate bonds and commercial bills | - | - | - | - |
| **Debt securities quoted in an active market** | **178,650** | **139,079** | **83,373** | **73,390** |
| **Units in investment funds quoted in an active market** | **167,280** | **159,203** | **166,053** | **159,203** |
| **Equity securities quoted in an active market** | **33,588** | **43,120** | **33,588** | **43,120** |
| | **379,518** | **341,402** | **283,014** | **275,713** |
| **Positive fair value of financial instruments** | | | | |
| - forward contracts, OTC | - | 22 | - | 10 |
| | **-** | **22** | **-** | **10** |
| Accrued interest not yet due | 2,283 | 2,417 | 997 | 1,323 |
| **Total** | **381,801** | **343,841** | **284,011** | **277,046** |

## 9. FINANCIAL ASSETS AVAILABLE FOR SALE

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** | **2014 HRK '000** | **2013 HRK '000** |
| **Debt securities not quoted on active markets** | | | | |
| Bonds of the Ministry of Finance | 1,353,292 | 971,468 | 1,339,271 | 901,523 |
| Corporate bonds | 127,220 | 130,870 | 127,220 | 130,870 |
| Foreign government bonds | 382,752 | 137,655 | 382,752 | 137,655 |
| | **1,863,264** | **1,239,993** | **1,849,243** | **1,170,048** |
| **Debt securities not quoted on active markets** | | | | |
| Treasury bills of the Croatian Ministry of Finance | 141,256 | 433,670 | 141,256 | 433,670 |
| **Equity securities not quoted on active markets** | | | | |
| - Corporate | 12,981 | 6,022 | 12,981 | 6,022 |
| - Non-banking financial institutions | 1,670 | 1,670 | 1,670 | 1,670 |
| | **14,651** | **7,692** | **14,651** | **7,692** |
| **Equity securities quoted in an active market** | | | | |
| - Corporate | - | - | - | - |
| - Non-banking financial institutions | - | 21,318 | - | - |
| | **-** | **21,318** | **-** | **-** |
| Accrued interest due | - | - | - | - |
| Accrued interest not yet due | 23,971 | 23,109 | 23,700 | 21,997 |
| **Provisions for impairment losses** | **(40,168)** | **(10,366)** | **(40,168)** | **(10,366)** |
| **Total** | **2,002,974** | **1,715,416** | **1,988,682** | **1,623,041** |

In accordance with the applicable accounting policies, the Bank recognizes available-for-sale financial assets at fair value with changes in fair value recognized within a fair value reserve in other comprehensive income.

## 9. FINANCIAL ASSETS AVAILABLE FOR SALE (continued)

***Movement in impairment allowance for financial assets available for sale***

| **Group** | | | **2014 HRK '000** | | | **2013 HRK '000** |
|---|---|---|---|---|---|---|
| | **Individually identified losses** | **Portfolio-based losses** | **Total** | **Individually identified losses** | **Portfolio-based losses** | **Total** |
| **At 1 January** | 10,366 | **-** | **10,366** | 10,366 | **-** | **10,366** |
| Increase/(decrease) of impairment losses | 29,802 | - | **29,802** | - | - | **-** |
| **At 31 December** | **40,168** | **-** | **40,168** | **10,366** | **-** | **10,366** |

| **Bank** | | | **2014 HRK '000** | | | **2013 HRK '000** |
|---|---|---|---|---|---|---|
| | **Individually identified losses** | **Portfolio-based losses** | **Total** | **Individually identified losses** | **Portfolio-based losses** | **Total** |
| **At 1 January** | **10,366** | **-** | **10,366** | **10,366** | **-** | **10,366** |
| Increase/(decrease) of impairment losses | 29,802 | - | **29,802** | - | - | **-** |
| **At 31 December** | **40,168** | - | **40,168** | **10,366** | - | **10,366** |

## 10. FINANCIAL ASSETS HELD TO MATURITY

| | Group 2014 HRK '000 | Group 2013 HRK '000 | Bank 2014 HRK '000 | Bank 2013 HRK '000 |
|---|---|---|---|---|
| Bonds of the Ministry of Finance | 388,476 | 409,537 | 388,476 | 409,537 |
| HBOR bonds (Croatian development bank) | - | - | - | - |
| Corporate bonds | - | 9,938 | - | 9,938 |
| Bills of exchange | 231,675 | 423,425 | 231,675 | 423,425 |
| | **620,151** | **842,900** | **620,151** | **842,900** |
| Accrued interest not yet due | 6,641 | 7,058 | 6,641 | 7,058 |
| **Provisions for impairment losses** | **(23,103)** | **(23,408)** | **(23,103)** | **(23,408)** |
| **Portfolio based impairment allowance for identified losses** | **(5,746)** | **(5,245)** | **(5,746)** | **(5,245)** |
| **Total** | **597,943** | **821,305** | **597,943** | **821,305** |

### *Movement in impairment allowance for financial assets held to maturity*

The movements in the impairment allowance for financial assets held to maturity, recognised in the income statement, were as follows:

| **Group** | **2014 Individually identified losses HRK '000** | **2014 Portfolio-based losses HRK '000** | **2014 Total HRK '000** | **2013 Individually identified losses HRK '000** | **2013 Portfolio-based losses HRK '000** | **2013 Total HRK '000** |
|---|---|---|---|---|---|---|
| **At 1 January** | **23,408** | **5,245** | **28,653** | **26,194** | **6,558** | **32,752** |
| Increase/(decrease) of impairment losses | 396 | 501 | **897** | (2,786) | (1,313) | **(4,099)** |
| Other | (701) | **-** | **(701)** | - | - | **-** |
| **At 31 December** | **23,103** | **5,746** | **28,849** | **23,408** | **5,245** | **28,653** |

| **Bank** | **2014 Individually identified losses HRK '000** | **2014 Portfolio-based losses HRK '000** | **2014 Total HRK '000** | **2013 Individually identified losses HRK '000** | **2013 Portfolio-based losses HRK '000** | **2013 Total HRK '000** |
|---|---|---|---|---|---|---|
| **At 1 January** | **23,408** | **5,245** | **28,653** | **26,194** | **6,558** | **32,752** |
| Increase/(decrease) of impairment losses | 396 | 501 | **897** | (2,786) | (1,313) | **(4,099)** |
| Other | (701) | - | **(701)** | - | - | **-** |
| **At 31 December** | **23,103** | **5,746** | **28,849** | **23,408** | **5,245** | **28,653** |

## 11. LOANS TO AND RECEIVABLES FROM CUSTOMERS

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014** | **2013** | **2014** | **2013** |
| | **HRK '000** | **HRK '000** | **HRK '000** | **HRK '000** |
| **Short-term loans** | | | | |
| Corporate | 2,595,158 | 3,367,459 | 2,596,066 | 3,367,459 |
| Retail | 1,117,046 | 1,037,089 | 1,117,046 | 1,037,089 |
| **Total short-term loans** | **3,712,204** | **4,404,548** | **3,713,112** | **4,404,548** |
| **Long-term loans** | | | | |
| Corporate | 5,383,321 | 5,423,711 | 5,391,803 | 5,452,148 |
| Retail | 3,400,542 | 3,162,168 | 3,250,439 | 3,034,267 |
| **Total long-term loans** | **8,783,863** | **8,585,879** | **8,642,242** | **8,486,415** |
| **Total gross loans** | **12,496,067** | **12,990,427** | **12,355,354** | **12,890,963** |
| Accrued interest due | 13,747 | 27,312 | 13,719 | 27,153 |
| Accrued interest not yet due | 39,952 | 40,379 | 39,477 | 40,379 |
| **Provisions for impairment losses** | **(1,974,201)** | **(1,197,517)** | **(1,972,766)** | **(1,197,153)** |
| **Portfolio based impairment allowance for identified losses** | **(101,815)** | **(106,910)** | **(100,630)** | **(105,827)** |
| **Total** | **10,473,750** | **11,753,691** | **10,335,154** | **11,655,515** |
| Total impairment allowance and provisions as a percentage of gross loans to customers | 16.61% | 10.04% | 16.78% | 10.11% |

### 11. LOANS TO AND RECEIVABLES FROM CUSTOMERS (continued)

***Movements in impairment allowance***

Movements in the impairment allowance on loans to and receivables from customers were as follows:

| **Group** | | | **2014 HRK '000** | | | **2013 HRK '000** |
|---|---|---|---|---|---|---|
| | **Individually identified losses** | **Portfolio-based losses** | **Total** | **Individually identified losses** | **Portfolio-based losses** | **Total** |
| **At 1 January** | **1,197,517** | **106,910** | **1,304,427** | **987,691** | **119,088** | **1,106,779** |
| Increase/ (decrease) of impairment losses | 782,333 | (5,095) | **777,238** | 237,510 | (12,178) | **225,332** |
| Net foreign exchange loss/(gain) | 3,966 | - | **3,966** | 2,178 | - | **2,178** |
| Write-offs and other | (9,615) | - | **(9,615)** | (29,862) | - | **(29,862)** |
| **At 31 December** | **1,974,201** | **101,815** | **2,076,016** | **1,197,517** | **106,910** | **1,304,427** |

| **Bank** | | | **2014 HRK '000** | | | **2013 HRK '000** |
|---|---|---|---|---|---|---|
| | **Individually identified losses** | **Portfolio-based losses** | **Total** | **Individually identified losses** | **Portfolio-based losses** | **Total** |
| **At 1 January** | **1,197,153** | **105,827** | **1,302,980** | **987,549** | **117,643** | **1,105,192** |
| Increase/ (decrease) of impairment losses | 781,266 | (5,197) | **776,069** | 237,312 | (11,816) | **225,496** |
| Net foreign exchange loss/(gain) | 3,962 | - | **3,962** | 2,154 | - | **2,154** |
| Write-offs and other | (9,615) | - | **(9,615)** | (29,862) | - | **(29,862)** |
| **At 31 December** | **1,972,766** | **100,630** | **2,073,396** | **1,197,153** | **105,827** | **1,302,980** |

## 12. ASSETS HELD FOR SALE

*a) The Group's assets held for sale include:*

| | Industry | Domicile | Ownership at 31 December 2014 % |
|---|---|---|---|
| H1 Telekom d.d. | Telecommunications | Croatia | 41.25 |
| Drvna Industrija Spačva d.d. | Other carpentry and component production | Croatia | 26.48 |

Based on the concluded pre bankruptcy settlement of the company Spačva d.d., the Bank has acquired shares in the company through conversion of it's receivables into share capital. The subscription of new shares is conducted on 12 August 2013.

The Group intends to recover its investments in the companies mainly through a sale, rather than through the exercise of its rights as the equity holder having a significant influence on the operations of those companies. The investments are available for their immediate sale, and the Group has been actively developing a strategy that will enable it to sell the investments within a time frame common for similar transactions. The Group considers that the current value reflects the value at which the equity investments could be sold.

The Group recorded impairment on equity securities in above stated companies in the amount of HRK 33,621 thousand (2013: no change).

Business results of the companies are not included in the consolidated financial statements of the Group.

*b) Assets held for sale are as follows:*

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| **Total as of 31 December** | **7,930** | **41,551** | **7,930** | **41,551** |

## 12. ASSETS HELD FOR SALE (continued)

*c) Movements in assets held for sale:*

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| **Balance at 1 January** | **41,551** | **21,551** | **41,551** | **21,551** |
| Acquisition of shares | - | 20,000 | - | 20,000 |
| Impairment of shares | (33,621) | - | (33,621) | - |
| **Balance at 31 December** | **7,930** | **41,551** | **7,930** | **41,551** |

## 13. INVESTMENTS IN SUBSIDIARIES

*a) The Group's subsidiaries are as follows:*

| | Industry | Domicile | Ownership at 31 December 2014 % |
|---|---|---|---|
| HPB Invest d.o.o. | Investment fund management | Croatia | 100 |
| HPB Nekretnine d.o.o. | Real estate agency and construction | Croatia | 100 |
| HPB Stambena štedionica d.d. | Savings bank | Croatia | 100 |

All the subsidiaries are fully consolidated in the Group's financial statements.

*b) Investments in subsidiaries are as follows:*

| | Bank | |
|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 |
| HPB Invest d.o.o. | 5,000 | 5,000 |
| HPB Nekretnine d.o.o. | 490 | 490 |
| HPB Stambena štedionica d.d. | 40,000 | 40,000 |
| **Total** | **45,490** | **45,490** |

The following table presents summary financial information on the Bank's investment in subsidiaries:

| | 2014 '000 HRK | 2013 '000 HRK |
|---|---|---|
| Short term assets | 55,433 | 115,497 |
| Long term assets | 241,631 | 231,589 |
| Short term liabilities | (74,099) | (163,226) |
| Long term liabilities | (175,309) | (142,232) |
| **Net assets, book value of subsidiaries** | **47,656** | **41,628** |
| **Share of revenue and profit** | 100% | 100% |
| Income | 35,441 | 32,223 |
| Net profit | 5,994 | 1,341 |

## 13. INVESTMENTS IN SUBSIDIARIES (continued)

*c) Movements of investments in subsidiaries:*

| | Bank | |
|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** |
| **Balance at 1 January** | **45,490** | **53,990** |
| Decrease of investments in HPB Invest d.o.o. in 2014 | - | (8,500) |
| **Balance at 31 December** | **45,490** | **45,490** |

There were no changes in book value of investments in subsidiaries in 2014 (2013: share capital of the company was reduced for the amount of HRK 8,500 thousand).

## 14. PROPERTY AND EQUIPMENT

**Group**

| **2014** | **Land and buildings HRK '000** | **Computers, equipment and motor vehicles HRK '000** | **Assets under construction HRK '000** | **Total HRK '000** |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at 1 January 2014 | 157,297 | 305,359 | 6,387 | 469,043 |
| Additions | (982) | - | - | (982) |
| Amounts written-off | 118 | - | 26,512 | 26,630 |
| Brought into use | - | (12,745) | - | (12,745) |
| **Balance at 31 December 2014** | 13,096<br>**169,529** | 10,458<br>**303,072** | (23,554)<br>**9,345** | -<br>**481,946** |
| **Accumulated depreciation** | | | | |
| Balance at 1 January 2014 | (56,550) | (264,506) | - | (321,056) |
| Charge for the year | (2,969) | (17,408) | - | (20,377) |
| Revaluation | - | - | - | - |
| Amounts written-off | - | 12,712 | - | 12,712 |
| **Balance at 31 December 2014** | **(59,519)** | **(269,202)** | **-** | **(328,721)** |
| **Net book value** | | | | |
| Balance at 1 January 2014 | 100,747 | 40,853 | 6,387 | 147,987 |
| **Balance at 31 December 2014** | **110,010** | **33,870** | **9,345** | **153,225** |

**Group**

| **2013** | **Land and buildings HRK '000** | **Computers, equipment and motor vehicles HRK '000** | **Assets under construction HRK '000** | **Total HRK '000** |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at 1 January 2013 | 152,612 | 295,088 | 3,819 | 451,519 |
| Additions | - | - | 21,075 | 21,075 |
| Amounts written-off | - | (3,551) | - | (3,551) |
| Brought into use | 4,685 | 13,822 | (18,507) | - |
| **Balance at 31 December 2013** | **157,297** | **305,359** | **6,387** | **469,043** |
| **Accumulated depreciation** | | | | |
| Balance at 1 January 2013 | (53,859) | (251,198) | - | (305,057) |
| Charge for the year | (2,622) | (16,736) | - | (19,358) |
| Revaluation | (69) | - | - | (69) |
| Amounts written-off | - | 3,428 | - | 3,428 |
| **Balance at 31 December 2013** | **(56,550)** | **(264,506)** | **-** | **(321,056)** |
| **Net book value** | | | | |
| Balance at 1 January 2013 | 98,753 | 43,890 | 3,819 | 146,462 |
| **Balance at 31 December 2013** | **100,747** | **40,853** | **6,387** | **147,987** |

As at 31 December 2014, assets in the course of construction comprise equipment at cost of HRK 9,345 thousand (2013: HRK 6,387 thousand). The carrying value of land owned by the Group as at 31 December 2014 was HRK 45,895 thousand (2013: HRK 43,409 thousand).

**14. PROPERTY AND EQUIPMENT (continued)**

**Bank**

| **2014** | **Land and buildings HRK '000** | **Computers, equipment and motor vehicles HRK '000** | **Assets under construction HRK '000** | **Total HRK '000** |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at 1 January 2014 | **157,297** | 304,972 | 6,388 | **468,657** |
| Revaluation of land and buildings | (982) | - | - | **(982)** |
| Additions | 118 | - | 26,424 | **26,542** |
| Amounts written-off | - | (12,700) | - | **(12,700)** |
| Brought into use | 13,096 | 10,369 | (23,465) | **-** |
| **Balance at 31 December 2014** | **169,529** | **302,641** | **9,347** | **481,517** |
| | | | | |
| **Accumulated depreciation** | | | | |
| Balance at 1 January 2014 | **(56,550)** | **(264,246)** | - | **(320,796)** |
| Charge for the year | (2,969) | (17,330) | - | **(20,299)** |
| Revaluation of land and buildings | - | - | - | **0** |
| Amounts written-off | - | 12,685 | - | **12,685** |
| **Balance at 31 December 2014** | **(59,519)** | **(268,891)** | **-** | **(328,410)** |
| | | | | |
| **Net book value** | | | | |
| Balance at 1 January 2014 | **100,747** | **40,726** | **6,388** | **147,861** |
| **Balance at 31 December 2014** | **110,010** | **33,750** | **9,347** | **153,107** |

**Bank**

| **2013** | **Land and buildings HRK '000** | **Computers, equipment and motor vehicles HRK '000** | **Assets under construction HRK '000** | **Total HRK '000** |
|---|---|---|---|---|
| **Cost** | | | | |
| Balance at 1 January 2013 | 152,612 | 294,725 | 3,820 | 451,157 |
| Additions | - | - | 21,040 | 21,040 |
| Amounts written-off | - | (3,540) | - | (3,540) |
| Brought into use | 4,685 | 13,787 | (18,472) | - |
| **Balance at 31 December 2013** | **157,297** | **304,972** | **6,388** | **468,657** |
| | | | | |
| **Accumulated depreciation** | | | | |
| Balance at 1 January 2013 | (53,859) | (250,999) | - | (304,858) |
| Charge for the year | (2,622) | (16,664) | - | (19,286) |
| Revaluation of land and buildings | (69) | - | - | (69) |
| Amounts written-off | - | 3,417 | - | 3,417 |
| **Balance at 31 December 2013** | **(56,550)** | **(264,246)** | **-** | **(320,796)** |
| | | | | |
| **Net book value** | | | | |
| Balance at 1 January 2013 | **98,753** | **43,726** | **3,820** | **146,299** |
| **Balance at 31 December 2013** | **100,747** | **40,726** | **6,388** | **147,861** |

As at 31 December 2014, assets in the course of construction comprise equipment at cost of HRK 9,347 thousand (2013: HRK 6,388 thousand). The carrying value of land owned by the Group as at 31 December 2014 was HRK 45,895 thousand (2014: HRK 43,409 thousand).

## 15. INVESTMENT PROPERTIES

| **Group** | **2014**<br>**HRK '000** | **2013**<br>**HRK '000** |
|---|---:|---:|
| **Cost** | | |
| Balance at 1 January | 11,596 | 11,596 |
| Additions | 148 | - |
| Amounts written-off | - | - |
| Disposals | - | - |
| **Balance at 31 December** | **11,744** | **11,596** |
| | | |
| **Accumulated depreciation** | | |
| Balance at 1 January | (1,658) | (1,402) |
| Disposals | - | - |
| Charge for the year | (258) | (256) |
| **Balance at 31 December** | **(1,916)** | **(1,658)** |
| | | |
| **Net book value** | | |
| Balance at 1 January | 9,938 | 10,194 |
| **Balance at 31 December** | **9,828** | **9,938** |

Fair value hierarchy of investment properties as of 31 December 2014 was as follows:

| | Level 1 | Level 2 | Level 3 | Fair value as of 31 December 2014 |
|---|---:|---:|---:|---:|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| **TOTAL** | - | **-** | **27,141** | **27,141** |

Fair value hierarchy of investment properties as of 31 December 2013 was as follows:

| | Level 1 | Level 2 | Level 3 | Fair value as of 31 December 2014 |
|---|---:|---:|---:|---:|
| | HRK '000 | HRK '000 | HRK '000 | HRK '000 |
| **TOTAL** | - | **-** | **18,637** | **18,637** |

The fair value of foreclosed assets is determined by HPB Nekretnine d.o.o. using the cost method, taking into account several factors in arriving at the current market value. The valuation method did not change during the year.

## 16. INTANGIBLE ASSETS

**Group**

| 2014 | Software HRK '000 | Leasehold improvements HRK '000 | Licences HRK '000 | Assets under construction HRK '000 | Total HRK '000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2014 | 226,321 | 78,998 | 64,580 | 17,192 | 387,091 |
| Additions | - | - | - | 4,705 | 4,705 |
| Brought into use | 808 | 2,558 | 936 | (4,299) | 3 |
| Amounts written-off | - | (3,824) | (112) | - | (3,936) |
| **Balance at 31 December 2014** | **227,129** | **77,732** | **65,404** | **17,598** | **387,863** |
| **Accumulated amortisation** | | | | | |
| Balance at 1 January 2014 | (105,884) | (67,491) | (45,007) | - | (218,382) |
| Charge for the year | (23,125) | (5,650) | (4,161) | - | (32,936) |
| Amounts written-off | - | 3,685 | 112 | - | 3,797 |
| **Balance at 31 December 2014** | **(129,009)** | **(69,456)** | **(49,056)** | **-** | **(247,521)** |
| **Net book value** | | | | | |
| Balance at 1 January 2014 | 120,437 | 11,507 | 19,573 | 17,192 | 168,709 |
| **Balance at 31 December 2014** | **98,120** | **8,276** | **16,348** | **17,598** | **140,342** |

**Group**

| 2014 | Software HRK 000 | Leasehold improvements HRK 000 | Licences HRK 000 | Assets under construction HRK 000 | Total HRK 000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2014 | 224,362 | 80,121 | 62,822 | 19,084 | 386,389 |
| Additions | - | - | - | 6,779 | 6,779 |
| Brought into use | 2,104 | 4,198 | 2,369 | (8,671) | - |
| Amounts written-off | (145) | (5,321) | (611) | - | (6,077) |
| **Balance at 31 December 2014** | **226,321** | **78,998** | **64,580** | **17,192** | **387,091** |
| **Accumulated amortisation** | | | | | |
| Balance at 1 January 2014 | (82,477) | (66,929) | (41,633) | - | (191,039) |
| Charge for the year | (23,551) | (5,855) | (3,986) | - | (33,392) |
| Amounts written-off | 144 | 5,293 | 612 | - | 6,049 |
| **Balance at 31 December 2014** | **(105,884)** | **(67,491)** | **(45,007)** | **-** | **(218,382)** |
| **Net book value** | | | | | |
| Balance at 1 January 2014 | 141,885 | 13,192 | 21,189 | 19,084 | 195,350 |
| **Balance at 31 December 2014** | **120,437** | **11,507** | **19,573** | **17,192** | **168,709** |

As at 31 December 2014 assets in the course of construction comprise application software, licences and leasehold improvements at a cost of HRK 17,598 thousand (2013: HRK 17,192 thousand) which are being prepared for use by the Group.

## 16. INTANGIBLE ASSETS (continued)

**Bank**

| **2014** | **Software HRK '000** | **Leasehold improvements HRK '000** | **Licences HRK '000** | **Assets under construction HRK' 000** | **Total HRK '000** |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2014 | **225,390** | **78,749** | **64,580** | **17,189** | **385,908** |
| Additions | - | - | | 4,699 | 4,699 |
| Brought into use | 799 | 2,558 | 936 | (4,293) | - |
| Amounts written-off | - | (3,686) | (112) | - | (3,798) |
| **Balance at 31 December 2014** | **226,189** | **77,621** | **65,404** | **17,595** | **386,809** |
| **Accumulated amortisation** | | | | | |
| Balance at 1 January 2014 | (105,064) | (67,318) | (45,007) | - | (217,389) |
| Charge for the year | (23,019) | (5,599) | (4,161) | - | (32,779) |
| Amounts written-off | - | 3,548 | 112 | - | 3,660 |
| **Balance at 31 December 2014** | **(128,083)** | **(69,369)** | **(49,056)** | **-** | **(246,508)** |
| **Net book value** | | | | | |
| Balance at 1 January 2014 | 120,326 | 11,431 | 19,573 | 17,189 | 168,519 |
| **Balance at 31 December 2014** | **98,106** | **8,252** | **16,348** | **17,595** | **140,301** |

**Bank**

| **2013** | **Software HRK 000** | **Leasehold improvements HRK 000** | **Licences HRK 000** | **Assets under construction HRK 000** | **Total HRK 000** |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| Balance at 1 January 2014 | **223,439** | **79,872** | **62,822** | **19,081** | **385,214** |
| Additions | - | - | - | 6,771 | 6,771 |
| Brought into use | 2,096 | 4,198 | 2,369 | (8,663) | - |
| Amounts written-off | (145) | (5,321) | (611) | - | (6,077) |
| **Balance at 31 December 2014** | **225,390** | **78,749** | **64,580** | **17,189** | **385,908** |
| **Accumulated amortisation** | | | | | |
| Balance at 1 January 2014 | (81,795) | (66,819) | (41,633) | - | (190,247) |
| Charge for the year | (23,413) | (5,793) | (3,986) | - | (33,192) |
| Amounts written-off | 144 | 5,294 | 612 | - | 6,050 |
| **Balance at 31 December 2014** | **(105,064)** | **(67,318)** | **(45,007)** | **-** | **(217,389)** |
| **Net book value** | | | | | |
| Balance at 1 January 2014 | 141,644 | 13,053 | 21,189 | 19,081 | 194,967 |
| **Balance at 31 December 2014** | **120,326** | **11,431** | **19,573** | **17,189** | **168,519** |

As at 31 December 2014 assets in the course of construction comprise application software, licences and leasehold improvements at a cost of HRK 17,595 thousand (2013: HRK 17,189 thousand) which are being prepared for use by the Bank.

## 17. NET DEFERRED TAX ASSETS

### *a) Recognised deferred tax assets and liabilities - Group*

Changes in the temporary differences and portions of deferred tax assets and deferred tax liabilities, and the related balances at the Group in 2014 are presented below:

| Group<br><br>2014 | 2014<br>HRK '000 | Recognised as income/(expense) in the income statement<br>HRK '000 | Recognized through other comprehensive income<br>HRK '000 | 2013<br>HRK '000 |
|---|---|---|---|---|
| **Deferred tax assets** | | | | |
| Loans and advances to customers | 10,905 | (958) | - | 11,863 |
| Other provisions | 1,140 | 14 | - | 1,126 |
| Financial assets | 24,056 | 2,131 | - | 21,925 |
| Fair value reserve | (34) | - | (10) | (24) |
| **Deferred tax liability** | | | | |
| Borrowings | (468) | 210 | - | (678) |
| Revaluation reserve | (282) | - | 15 | (297) |
| Fair value reserve | (18,185) | - | (7,767) | (10,418) |
| Prepaid expenses | (529) | 99 | - | (628) |
| **Deferred tax assets, net** | **16,603** | **1,496** | **(7,762)** | **22,869** |

Changes in the temporary differences and portions of deferred tax assets and deferred tax liabilities, and the related balances at the Group in 2013 are presented below:

| Group<br><br>2013 | 2013<br>HRK '000 | Recognised as income/(expense) in the income statement<br>HRK '000 | Recognized through other comprehensive income<br>HRK '000 | 2012<br>HRK '000 |
|---|---|---|---|---|
| **Deferred tax assets** | | | | |
| Loans and advances to customers | 11,863 | (492) | - | 12,355 |
| Other provisions | 1,126 | 4 | - | 1,122 |
| Financial assets | 21,925 | 13 | - | 21,912 |
| Fair value reserve | (24) | - | 224 | (248) |
| **Deferred tax liability** | | | | |
| Borrowings | (678) | 118 | - | (796) |
| Revaluation reserve | (297) | - | 14 | (311) |
| Fair value reserve | (10,418) | - | 1,032 | (11,450) |
| Prepaid expenses | (628) | 81 | - | (709) |
| **Deferred tax assets, net** | **22,869** | **(276)** | **1,270** | **21,875** |

## 17. NET DEFERRED TAX ASSETS (continued)

### *b) Recognised deferred tax assets and liabilities - the Bank*

Changes in the temporary differences and portions of deferred tax assets and deferred tax liabilities, and the related balances at the Bank in 2014 are presented below:

| **Bank**<br>**2014** | **2014**<br>**HRK '000** | **Recognised as income/(expense) in the income statement**<br>**HRK '000** | **Recognized through other comprehensive income**<br>**HRK '000** | **2013**<br>**HRK '000** |
|---|---|---|---|---|
| **Deferred tax assets** | | | | |
| Loans and advances to customers | 9,894 | (672) | - | 10,567 |
| Other provisions | 1,119 | - | - | 1,118 |
| Financial assets | 24,056 | 2,131 | - | 21,925 |
| Fair value reserve | - | - | - | |
| **Deferred tax liability** | | | | |
| Borrowings | (734) | 210 | - | (944) |
| Revaluation reserve | (282) | - | 15 | (297) |
| Fair value reserve | (18,185) | - | (7,767) | (10,418) |
| **Deferred tax assets, net** | **15,868** | **1,669** | **(7,752)** | **21,951** |

Changes in the temporary differences and portions of deferred tax assets and deferred tax liabilities, and the related balances at the Bank in 2013 are presented below:

| **Bank**<br>**2013** | **2013**<br>**HRK '000** | **Recognised as income/(expense) in the income statement**<br>**HRK '000** | **Recognized through other comprehensive income**<br>**HRK '000** | **2012**<br>**HRK '000** |
|---|---|---|---|---|
| **Deferred tax assets** | | | | |
| Loans and advances to customers | 10,567 | (467) | - | 11,034 |
| Other provisions | 1,118 | - | - | 1,118 |
| Financial assets | 21,925 | 13 | - | 21,912 |
| Fair value reserve | - | - | - | - |
| **Deferred tax liability** | | | | |
| Borrowings | (944) | 118 | - | (1,062) |
| Revaluation reserve | (297) | - | 14 | (311) |
| Fair value reserve | (10,418) | - | 1,032 | (11,450) |
| **Deferred tax assets, net** | **21,951** | **(336)** | **1,046** | **21,241** |

## 18. OTHER ASSETS

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Fees receivable | 24,196 | 102,175 | 23,771 | 101,562 |
| Foreclosed tangible assets | 258,180 | 237,703 | 258,180 | 237,703 |
| Items in course of collection | 94,855 | 16,509 | 94,824 | 16,509 |
| Deferred fee expense | 1,191 | 1,664 | - | 1 |
| Prepaid expenses | 7,918 | 7,072 | 7,783 | 7,038 |
| Receivables arising from syndicated loans | 56,170 | 65,145 | 56,170 | 65,145 |
| Other receivables | 25,918 | 44,849 | 24,717 | 29,499 |
| **Total other assets, gross** | **468,428** | **475,117** | **465,445** | **457,457** |
| **Impairment loss** | **(120,989)** | **(45,047)** | **(120,989)** | **(45,015)** |
| **Total** | **347,439** | **430,070** | **344,456** | **412,442** |

Items in course of collection mainly relate to HRK and foreign currency receivables from corporations in course of settlement, amounting to HRK 42,950 thousand (2013: -), as well as other receivables in course of settlement (card operations, payment services, currency trade).

***Movements in impairment allowance***

Movements in the impairment allowance on other assets were as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Balance at 1 January | 45,047 | 41,438 | 45,015 | 41,416 |
| Increase in impairment losses | 80,351 | 6,632 | 80,351 | 6,600 |
| Amounts reversed (utilised) | (4,409) | (3,023) | (4,377) | (3,001) |
| **Balance at 31 December** | **120,989** | **45,047** | **120,989** | **45,015** |

### 18. OTHER ASSETS (continued)

At 31 December 2014 the gross carrying amount of foreclosed assets by the Bank amounted to HRK 237,703 thousand. Those assets comprise buildings in the amount of HRK 164,064 thousand (2013: HRK 152,306 thousand), land in the amount of HRK 82,534 thousand (2013: HRK 73,815 thousand) and equipment in the amount of HRK 11,583 thousand (2013: HRK 11,583).

The Bank and the Group recorded loss on above stated assets in the amount of HRK 75,111 thousand (2013: HRK 2,052 thousand).

***Movements in foreclosed tangible assets***

The following table represents movements in foreclosed assets during 2014:

**Group and Bank**

| *Gross carrying value* | **HRK '000** |
|---|---|
| **Balance as at January 1** | **237,703** |
| Foreclosed in 2014 | 23,884 |
| Leased out in 2014 | (4,104) |
| Investment property (or investments in facilities) and other | 697 |
| **Balance as at December 31** | **258,180** |
| ***Impairment losses*** | |
| **Balance as at January 1** | **(28,285)** |
| Impairment loss charged to the income statement | (75,111) |
| Leased out in 2014 | 624 |
| **Balance as at December 31** | **(102,772)** |
| ***Net carrying value*** | |
| **Balance as at January 1** | **209,418** |
| **Balance as at December 31** | **155,408** |

## 19. FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK ´000 | 2013 HRK ´000 | 2014 HRK ´000 | 2013 HRK ´000 |
| Negative fair value of forward foreign exchange contracts | - | - | - | - |
| Negative fair value of cross currency swaps | 508 | 8 | 508 | 8 |
| **Balance at 31 December** | **508** | **8** | **508** | **8** |

## 20. DEPOSITS FROM BANKS

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK ´000 | 2013 HRK ´000 | 2014 HRK ‘000 | 2013 HRK ‘000 |
| Demand deposits | | | | |
| - in HRK | 20,340 | 96,367 | 20,340 | 96,367 |
| - in foreign currency | 23,498 | 19,773 | 23,498 | 19,773 |
| Term deposits | | | | |
| - in HRK | 310,137 | 462,733 | 310,137 | 462,733 |
| - in foreign currency | 18,460 | 160,640 | 18,460 | 160,640 |
| Interest payable not yet due | - | - | - | - |
| Interest payable - due | 2,315 | 1,694 | 2,315 | 1,694 |
| **Total** | **374,750** | **741,207** | **374,750** | **741,207** |

## 21. DEPOSITS FROM CUSTOMERS

| Group | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | HRK | In foreign currency | Total | HRK | In foreign currency | Total |
| **Demand deposits** | | | | | | |
| Retail | 1,879,099 | 337,961 | 2,217,060 | 1,880,634 | 328,015 | 2,208,649 |
| Corporate | 1,465,478 | 152,219 | 1,617,697 | 1,685,216 | 180,592 | 1,865,808 |
| **Restricted deposits** | | | | | | |
| Retail | 5,761 | 636 | 6,397 | 9,013 | 101 | 9,114 |
| Corporate | 1,635,249 | 57,197 | 1,692,446 | 1,360,346 | 53,782 | 1,414,128 |
| | **4,985,587** | **548,013** | **5,533,600** | **4,935,209** | **562,490** | **5,497,699** |
| **Term deposits** | | | | | | |
| Retail | 2,330,817 | 3,828,453 | 6,159,270 | 2,284,316 | 3,751,263 | 6,035,579 |
| Corporate | 1,579,733 | 732,371 | 2,312,104 | 1,920,287 | 820,883 | 2,741,170 |
| | **3,910,550** | **4,560,824** | **8,471,374** | **4,204,603** | **4,572,146** | **8,776,749** |
| Interest payable - due | - | - | - | - | - | - |
| Interest payable - not yet due | 33,542 | 46,209 | 79,751 | 34,283 | 52,634 | 86,917 |
| **Total** | **8,929,679** | **5,155,046** | **14,084,725** | **9,174,095** | **5,187,270** | **14,361,365** |

| Bank | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | HRK | In foreign currency | Total | HRK | In foreign currency | Total |
| **Demand deposits** | | | | | | |
| Retail | 1,879,099 | 337,961 | 2,217,060 | 1,880,634 | 328,015 | 2,208,649 |
| Corporate | 1,487,023 | 152,351 | 1,639,374 | 1,698,969 | 180,967 | 1,879,936 |
| **Restricted deposits** | | | | | | |
| Retail | 5,761 | 636 | 6,397 | 9,013 | 101 | 9,114 |
| Corporate | 1,635,771 | 57,197 | 1,692,968 | 1,360,346 | 53,782 | 1,414,128 |
| | **5,007,654** | **548,145** | **5,555,799** | **4,948,962** | **562,865** | **5,511,827** |
| **Term deposits** | | | | | | |
| Retail | 2,103,299 | 3,828,453 | 5,931,752 | 2,038,502 | 3,751,263 | 5,789,765 |
| Corporate | 1,579,733 | 732,371 | 2,312,104 | 1,934,645 | 820,883 | 2,755,528 |
| | **3,683,032** | **4,560,824** | **8,243,856** | **3,973,147** | **4,572,146** | **8,545,293** |
| Interest payable - due | - | - | - | - | - | - |
| Interest payable - not yet due | 33,542 | 46,209 | 79,751 | 34,268 | 52,634 | 86,902 |
| **Total** | **8,724,228** | **5,155,178** | **13,879,406** | **8,956,377** | **5,187,645** | **14,144,022** |

Restricted deposits mainly relate to client deposits which are predetermined for special purposes, such as those based on court orders.

### 22. BORROWINGS

| Group | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | **HRK** | **In foreign currency** | **Total** | **HRK** | **In foreign currency** | **Total** |
| Short-term loans from other financial institutions | 30,000 | 1,152 | 31,152 | - | 1,528 | 1,528 |
| Short-term loans from domestic banks and HBOR | - | - | - | 237,700 | - | 237,700 |
| Long-term bank borrowings | - | 833,638 | 833,638 | - | 53,545 | 53,545 |
| Long-term borrowing from HBOR | 641,264 | - | 641,264 | 780,224 | - | 780,224 |
| Accrued interest due | 2 | - | 2 | - | - | - |
| Accrued interest not yet due | 1,088 | 183 | 1,271 | 752 | 264 | 1,016 |
| **Total** | **672,354** | **834,973** | **1,507,327** | **1,018,676** | **55,337** | **1,074,013** |

| Bank | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | **HRK** | **In foreign currency** | **Total** | **HRK** | **In foreign currency** | **Total** |
| Short-term loans from other financial institutions | 30,000 | 1,152 | 31,152 | - | 1,528 | 1,528 |
| Short-term loans from domestic banks and HBOR | - | - | - | 237,700 | - | 237,700 |
| Long-term bank borrowings | - | 833,638 | 833,638 | - | 53,545 | 53,545 |
| Long-term borrowing from HBOR | 641,264 | - | 641,264 | 780,224 | - | 780,224 |
| Accrued interest due | 2 | - | 2 | - | - | - |
| Accrued interest not yet due | 1,088 | 183 | 1,271 | 752 | 264 | 1,016 |
| **Total** | **672,354** | **834,973** | **1,507,327** | **1,018,676** | **55,337** | **1,074,013** |

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

## 23. HYBRID INSTRUMENTS

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Hybrid instruments | 252,537 | 402,373 | 252,537 | 402,373 |
| Accrued interest not yet due | 8,384 | 8,429 | 8,384 | 8,429 |
| **Balance at 31 December** | **260,921** | **410,802** | **260,921** | **410,802** |

Hybrid instruments are included in Group's supplementary capital, and are without limitations available for payoff to creditors should a liquidation occur. Repayment of these instruments is subordinated to all other liabilities of the Group.

Hybrid instruments bear fixed interest rate, and have a contracted maturity period of 61 months. The average interest rate on these instruments during the year 2014 amounted to 7.25 percent (during the year 2013: 7.64 percent).

Group's hybrid instruments amounts HRK 52,295 thousand will expire in January 2015, whilst other HRK 200,000 thousand are to expire in March 2015. Since the hybrid instruments are part of Tier II according to the time up to the maturity, instruments are part of the supplementary capital of the Bank in the amount of HRK 13,949 thousand.

## 24. PROVISIONS FOR LIABILITIES AND EXPENSES

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Litigation provisions | 10,540 | 21,021 | 10,540 | 20,104 |
| Provision for contingent liabilities | 100 | - | 100 | - |
| Provisions for other liabilities | 394 | 560 | 394 | 560 |
| Provisions for off-balance-sheet exposures | 18,724 | 21,167 | 18,714 | 21,125 |
| **Balance at 31 December** | **29,758** | **42,748** | **29,748** | **41,789** |

***Movements in provisions for liabilities and expenses***

The movements in provisions for liabilities and expenses were as follows:

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Balance at 1 January | 42,748 | 57,596 | 41,789 | 56,522 |
| Increase/(decrease) in provisions in the income statement | 3,969 | (14,077) | 4,818 | (13,962) |
| Amounts utilised | (16,959) | (771) | (16,859) | (771) |
| **Balance at 31 December** | **29,758** | **42,748** | **29,748** | **41,789** |

## 25. OTHER LIABILITIES

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Trade accounts payable | 26,283 | 21,251 | 25,833 | 20,785 |
| Salaries, amounts to be withheld from salaries, taxes and contributions | 14,112 | 14,510 | 13,379 | 13,514 |
| Provisions for retirement benefits, termination benefits and similar liabilities | 15,922 | 10,521 | 15,922 | 10,521 |
| Fees payable | 11,543 | 67,962 | 11,496 | 67,866 |
| Items in course of settlement | 241,321 | 254,797 | 241,321 | 254,797 |
| Deferred fee income | 16,244 | 13,618 | 12,184 | 3,923 |
| Other liabilities | 143,769 | 139,491 | 133,625 | 120,441 |
| **Balance at 31 December** | **469,194** | **522,150** | **453,760** | **491,847** |

Items in the course of settlement mainly relate to liabilities for repayment of pensions on behalf of the Croatian Pension Fund in the amount of HRK 194 million (2013: HRK 206 million) and liabilities for transfer of cash inflows from the Bank's account to customers who do not hold accounts with the Bank in the amount of HRK 27 million (2013: HRK 27 million).

## 26. EQUITY

### *a) Share capital*

At 31 December 2014, the Company's authorized, subscribed and fully paid-in capital amounted to HRK 966,640 thousand (2013: HRK 966,640 thousand) and comprised of 878,764 (2013: HRK 878,764 thousand) of authorized ordinary shares with a nominal value of HRK 1,100 each. At 31 December 2014 the Bank held 795 treasury shares (2013: 795) in the total amount of HRK 874 thousand (2013: HRK 874 thousand).

The ownership structure is as follows:

| | | 2014 | | 2013 |
|---|---|---|---|---|
| | Paid-in capital HRK '000 | Ownership in % | Paid-in capital HRK '000 | Ownership in % |
| Republic of Croatia (Agency for State Property Management) | 497,443 | 51.46% | 497,443 | 51.46% |
| Hrvatska pošta d.d. | 265,771 | 27.49% | 265,771 | 27.49% |
| Croatian State Pension Insurance Fund | 195,042 | 20.18% | 195,042 | 20.18% |
| Others | 8,384 | 0.87% | 8,384 | 0.87% |
| **Total** | **966,640** | **100.00%** | **966,640** | **100.00%** |

## 26. EQUITY (continued)

### *b) Capital gain*

Capital gain is the excess amount paid with respect to nominal value of shares at the issue of new shares. At the end of 2014 the Bank had realized capital gains amounting to HRK 228,136 thousand (2013: HRK 228,136 thousand).

### *c) Statutory reserve*

The Bank is required to build legal reserves by appropriating 5% of net profit for the year until these reserves reach 5% of share capital. The balance of legal reserve at 31 December 2014 amounted to HRK 10,578 thousand (2013: HRK 8,458 thousand), or 1.1% (2013: 0.9%) of the share capital.

### *d) Fair value reserve*

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

The movements of fair value reserve during 2014 and 2013 were as follows:

| **Group** | **2014**<br>HRK '000 | **2013**<br>HRK '000 |
|---|---|---|
| Balance at 1 January | **45,941** | **46,788** |
| Net unrealized gain from financial assets available for sale | 42,924 | 7,191 |
| The cumulative gain on the sale of available-for-sale assets was transferred to the income statement. | (8,222) | (9,294) |
| Deferred taxes in respect of profits on revaluation of available-for-sale financial assets | (7,776) | 1,256 |
| **Balance at 31 December** | **72,867** | **45,941** |

| **Bank** | **2014**<br>HRK 000 | **2013**<br>HRK 000 |
|---|---|---|
| Balance at 1 January | **45,850** | **45,799** |
| Net unrealized gain from financial assets available for sale | 42,880 | 3,897 |
| The cumulative gain on the sale of available-for-sale assets was transferred to the income statement. | (8,222) | (4,878) |
| Deferred taxes in respect of profits on revaluation of available-for-sale financial assets | (7,767) | 1,032 |
| **Balance at 31 December** | **72,741** | **45,850** |

## 26. EQUITY (continued)

### *e) Revaluation reserve*

A revaluation reserve in the amount of HRK 887 thousand (2014: HRK 1,189 thousand), net of tax, arises from the revaluation of land and buildings of the Group.

In 2014 change on the position of revaluation reserve amounts HRK 302 thousand (2013: decrease by HRK 55 thousand). The movements of revaluation reserve in 2014 and 2013 were as follows:

| **Group and Bank** | **2014**<br>HRK '000 | **2013**<br>HRK '000 |
|---|---|---|
| Balance at 1 January | **1,189** | **1,244** |
| Decrease in the revaluation reserve on depreciation of assets | (317) | (69) |
| Deferred tax in respect of the revaluation reserve | 15 | 14 |
| **Balance at 31 December** | **887** | **1,189** |

### *f) Proposed dividends*

Dividends payable are not accounted for until they have been ratified at the General Assembly of Shareholders. The Management Board will not propose any dividend payment for the year ended 31 December 2014 (2013: -).

### *g) Other reserves*

Other reserves as at December 31, 2014 amounted to HRK 0 thousand (2013: -).

### *h) Retained earnings or accumulated losses*

The Management Board will propose to General Assembly to be held in 2014, that profit realized in 2013 (after abstraction of legal reserve) should be transferred to retained earnings within the equity reserves.

## 27. REGULATORY CAPITAL

During 2014 total share capital decreased by HRK 927,986 thousand, mostly due to the net loss achieved in reporting period but also due to the changes in regulation based on which changes in calculation of regulatory capital occurs in 2014. The regulatory capital is reduced by the net book value of intangible assets on 31 December 2014 that amounts to HRK 140,301 thousand (the Bank). A further influence on the reduction, which is reflected in the total regulatory capital, had the 'depreciation' of supplementary capital (hybrid instruments) as it approaches its maturity. Accordingly, due to reduced capital base, rate of total regulatory capital fell by almost 7 percentage points, and amounted to 6.7 percent.

Regulatory minimum of regulatory adequacy rate prescribed by the law amounts 8 percent (2013: 12 percent). Required and minimum protective layers for the preservation of capital and structural systemic risk, which in the case of the Bank amounted to 4 percent. In addition, the supervisory protective layer in the amount of 2 percent for a period of one year starting from 30 June 2015 is prescribed for Bank.

| **Item** | **31 December 2014** | **31 December 2013** |
|---|---|---|
| | **Amount (HRK '000) / Rate (%)** | **Amount (HRK '000) / Rate (%)** |
| **Basic share capital** | **631,397** | **-** |
| **Rate of basic share capital** | **6.50%** | **-** |
| **Share capital** | **631,397** | **1,343,458** |
| **Rate of share capital** | **6.50%** | **-** |
| **Total regulatory capital** | **645,346** | **1,573,332** |
| **Rate of total regulatory capital** | **6.65%** | **13.51%** |

Coverage of the lack of capital is planned to cover based on the recapitalization of the owner in 2015. Bank have launched optimization measures of risk exposure.

## 28. INTEREST AND SIMILAR INCOME

***a) Analysis by product:***

| | **Group** | | **Bank** | |
|---|---|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** | **2014 HRK '000** | **2013 HRK '000** |
| Loans and advances to customers | | | | |
| - Corporate | 424,229 | 404,189 | 425,554 | 404,766 |
| - Individuals | 312,044 | 310,874 | 306,286 | 306,669 |
| | **736,273** | **715,063** | **731,840** | **711,435** |
| Loans and advances to customers | 2,615 | 5,819 | 2,611 | 5,783 |
| Debt securities | 111,542 | 107,956 | 105,942 | 100,855 |
| Bills of exchange | 21,977 | 19,383 | 21,977 | 19,383 |
| **Total** | **872,407** | **848,221** | **862,370** | **837,456** |

## 28. INTEREST AND SIMILAR INCOME (continued)

### *b) Analysis by source:*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK 000** | **2013 HRK 000** | **2014 HRK 000** | **2013 HRK 000** |
| Corporate | 261,052 | 257,552 | 262,377 | 258,129 |
| Retail | 312,044 | 310,874 | 306,286 | 306,669 |
| Government and public sector | 291,859 | 265,441 | 286,259 | 258,340 |
| Banks and other financial institutions | 3,328 | 9,673 | 3,324 | 9,637 |
| Other organisations | 4,124 | 4,681 | 4,124 | 4,681 |
| **Total** | **872,407** | **848,221** | **862,370** | **837,456** |

## 29. INTEREST AND SIMILAR EXPENSE

### *a) Analysis by product*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK ‘000** | **2013 HRK ‘000** | **2014 HRK ‘000** | **2013 HRK ‘000** |
| Borrowings | 39,282 | 25,438 | 39,282 | 25,437 |
| Customer deposits | | | | |
| - Corporate | 116,916 | 137,429 | 117,124 | 139,015 |
| - Retail | 190,053 | 214,376 | 183,255 | 206,968 |
| | **306,969** | **351,805** | 300,379 | **345,983** |
| Deposits from banks | 7,063 | 7,509 | 7,063 | 7,509 |
| Other | 2,273 | 688 | 2,258 | 688 |
| **Total** | **355,587** | **385,440** | **348,982** | **379,617** |

### *b) Analysis by recipient*

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK ‘000** | **2013 HRK ‘000** | **2014 HRK ‘000** | **2013 HRK ‘000** |
| Corporate | 37,262 | 40,968 | 37,455 | 42,554 |
| Retail | 190,053 | 214,377 | 183,255 | 206,968 |
| Government and public sector | 40,676 | 46,592 | 40,676 | 46,592 |
| Banks and other financial institutions | 78,696 | 74,715 | 78,696 | 74,715 |
| Others | 8,900 | 8,788 | 8,900 | 8,788 |
| **Total** | **355,587** | **385,440** | **348,982** | **379,617** |

## 30. FEE AND COMMISSION INCOME

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Cash payment operations | 302,089 | 359,147 | 302,090 | 359,147 |
| Non-cash payment operations | 42,998 | 41,714 | 42,998 | 41,714 |
| Retail and credit card operations | 107,989 | 100,257 | 102,560 | 94,602 |
| Letters of credit, guarantees and foreign-exchange payment operations | 17,643 | 15,249 | 17,643 | 15,249 |
| Other fee and commission income | 28,315 | 33,375 | 19,642 | 22,475 |
| **Total** | **499,034** | **549,742** | **484,933** | **533,187** |

## 31. FEE AND COMMISSION EXPENSE

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Cash payment operations | 262,172 | 304,520 | 262,172 | 304,520 |
| Non-cash payment operations | 16,259 | 17,328 | 16,259 | 17,328 |
| Card operations | 26,576 | 25,655 | 26,576 | 25,655 |
| Other fee and commission income | 8,400 | 9,226 | 7,096 | 7,660 |
| **Total** | **313,407** | **356,729** | **312,103** | **355,163** |

## 32. GAINS LESS LOSSES FROM FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| **Net unrealised losses/(gains) on financial assets at fair value through profit or loss** | | | | |
| **Realised gains/(losses)** | | | | |
| - Debt securities | 796 | 996 | 813 | 695 |
| - Equity securities | 465 | - | (136) | - |
| - Investment funds | 1,328 | 2,352 | 1,328 | 2,352 |
| - Forward contracts, OTC | (754) | 1,105 | (754) | 1,105 |
| | **1,835** | **4,453** | **1,251** | **4,152** |
| **Unrealised gains/(losses)** | | | | |
| -Debt securities | 9,342 | (1,263) | 5,003 | (118) |
| - Investment funds | 6,445 | (772) | 6,445 | (772) |
| - Equity securities | (10,819) | 610 | (10,819) | 610 |
| - Forward contracts, OTC | (510) | (434) | (510) | (434) |
| | **4,458** | **(1,859)** | **119** | **(714)** |
| **Total** | **6,293** | **2,594** | **1,370** | **3,438** |

## 33. GAINS LESS LOSSES FROM FINANCIAL ASSETS AVAILABLE FOR SALE

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Realised gains on disposal of debt securities available for sale | - | 1,070 | - | - |
| Realised gains on disposal of foreign state equity securities | 17,348 | - | 17,353 | - |
| Realised gains on disposal of equity securities available for sale | - | 7,537 | - | 7,537 |
| **Total** | **17,348** | **8,607** | **17,353** | **7,537** |

## 34. OTHER OPERATING INCOME

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Dividend income | 1,359 | 3,112 | 1,359 | 11,012 |
| Net foreign exchange gain from translation of monetary assets and liabilities | 4,161 | 5,756 | 4,180 | 5,891 |
| Income on dormant customer accounts | 46 | 35 | 46 | 35 |
| Other income | 5,061 | 6,104 | 4,479 | 8,652 |
| **Total** | **10,627** | **15,007** | **10,064** | **25,590** |

## 35. GENERAL AND ADMINISTRATIVE EXPENSES

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Materials and services | 139,886 | 137,234 | 137,924 | 135,243 |
| Administration and marketing | 11,906 | 13,462 | 11,609 | 12,612 |
| Postage and telecommunications | 30,761 | 31,529 | 30,235 | 31,215 |
| Staff costs | 185,865 | 186,271 | 176,509 | 176,051 |
| Savings deposit insurance costs | 25,177 | 24,182 | 24,461 | 23,392 |
| Other general and administrative expenses | 19,625 | 13,198 | 18,287 | 11,708 |
| **Total** | **413,220** | **405,876** | **399,025** | **390,221** |

### *a) Staff costs*

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Net salaries, termination and other employee benefit costs | 87,577 | 89,651 | 83,396 | 85,162 |
| Taxes and contributions (including contributions payable by employers) | 87,927 | 85,922 | 84,086 | 81,582 |
| Other fees to employees | 9,180 | 9,542 | 8,804 | 9,064 |
| Fees to Supervisory Board Members | 1,181 | 1,156 | 223 | 243 |
| **Total** | **185,865** | **186,271** | **176,509** | **176,051** |

As at 31 December 2014, Bank had 1,084 employees (2013: 1,075), and 1,120 persons were employed in the Group (2013: 1,114 employees).

## 36. IMPAIRMENT LOSSES ON LOANS TO AND RECEIVABLES FROM CUSTOMERS AND OTHER ASSETS

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | Notes | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| **Individually identified impairment losses** | | | | | |
| Loans and receivables from customers | 11 | (782,333) | (237,510) | (781,266) | (237,312) |
| Interest receivable | | (11,476) | (10,230) | (11,465) | (10,214) |
| Financial assets available for sale | 9 | (29,802) | - | (29,802) | - |
| Financial assets held to maturity | 10 | (396) | 2,786 | (396) | 2,786 |
| Other assets | 18 | (80,351) | (6,632) | (80,351) | (6,600) |
| Assets held for sale | | (33,621) | - | (33,621) | - |
| Gains from recovery of placements written-off in previous years | | 443 | 1,178 | 443 | 1,178 |
| **Total reversal/(charge)** | | **(937,536)** | **(250,408)** | **(936,458)** | **(250,162)** |
| | | | | | |
| **Portfolio based provisions for identified losses** | | | | | |
| Loans and receivables from customers | 11 | 5,095 | 12,178 | 5,197 | 11,816 |
| Financial assets held to maturity | 10 | (501) | 1,313 | (501) | 1,313 |
| Other assets | 18 | - | - | - | - |
| Loans to and receivables from banks | 7 | - | - | - | - |
| **Total charge** | | **4,594** | **13,491** | **4,696** | **13,129** |
| | | | | | |
| **Total portfolio based and individually identified losses** | | | | | |
| Loans and receivables from customers | 11 | (777,238) | (225,332) | (776,069) | (225,496) |
| Interest receivable | | (11,476) | (10,230) | (11,465) | (10,214) |
| Financial assets available for sale | 9 | (29,802) | - | (29,802) | - |
| Financial assets held to maturity | 10 | (897) | 4,099 | (897) | 4,099 |
| Other assets | 18 | (80,351) | (6,632) | (80,351) | (6,600) |
| Assets held for sale | | (33,621) | - | (33,621) | - |
| Loans to and receivables from banks | 7 | - | - | - | - |
| Gains from recovery of placements written-off in previous years | | 443 | 1,178 | 443 | 1,178 |
| **Total charge** | | **(932,942)** | **(236,917)** | **(931,762)** | **(237,033)** |

## 37. INCOME TAX

Total recognized income tax expense, calculated at the income tax rate of 20%, comprises income tax expense recognized in the income statement and movements in deferred tax recognized in equity, as follows:

### Income tax expense recognised in the income statement

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK '000** | **2013 HRK '000** | **2014 HRK '000** | **2013 HRK '000** |
| Current tax | (524) | (354) | - | - |
| Deferred tax income/(expense) in respect of origination and reversal of temporary differences | 1,496 | (276) | 1,669 | (336) |
| **Total current tax recognised in the income statement** | **972** | **(630)** | **1,669** | **(336)** |

### Movements in the income tax recognized through other comprehensive income:

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK 000** | **2013 HRK 000** | **2014 HRK 000** | **2013 HRK 000** |
| Deferred tax income in respect of unrealised losses on available-for-sale assets not recognised in the fair valuation reserve | (7,767) | 1,256 | (7,767) | 1,032 |
| Deferred tax income in respect of revaluation of property | 15 | 14 | 15 | 14 |
| **Total tax income/(expense) recognized directly in equity** | **(7,752)** | **1,270** | **(7,752)** | **1,046** |

### Reconciliation of income tax expense

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

| | Group | | Bank | |
|---|---|---|---|---|
| | **2014 HRK 000** | **2013 HRK 000** | **2014 HRK 000** | **2013 HRK 000** |
| (Loss)/profit before taxation | (630,362) | 36,368 | (637,053) | 42,746 |
| Income tax at the rate of 20% (2013: 20%) | 126,072 | (7,274) | 127,411 | (8,549) |
| Tax non-deductible expenses | (21,539) | (14,058) | (21,531) | (12,068) |
| Non-taxable income | 9,099 | 8,716 | 8,463 | 8,370 |
| Effect of unrecognised deferred tax | (112,660) | 11,986 | (112,674) | 11,911 |
| | **972** | **(630)** | **1,669** | **(336)** |
| Effective income tax rate | **-** | **1.7%** | **-** | **0.8%** |

### 37. INCOME TAX (continued)

**Unrecognized deferred tax in respect of tax losses disposable in prospective periods**

At 31 December 2014 the Bank held 550,218thousand (2013: HRK 160,113 thousand) accumulated tax losses available for utilisation until 31 December 2019. According to the achieved losses as of 31 December 2014 new tax losses occurs in the amount of HRK 710,331 thousand, available for utilisation until 31 December 2019. No deferred tax assets with respect to tax losses carry forward were recognized because the realisation of sufficient future taxable profits against which the losses could be utilised is not certain.

### 38. EARNINGS/(LOSS) PER SHARE

For the purposes of determining earnings/losses per share, earnings(losses) represent the Bank's net profit/(loss) for the year attributable to the equity holders of the Bank. The number of ordinary shares is the weighted average number of ordinary shares outstanding during the year after deducting the number of ordinary treasury shares. The weighted average number of ordinary shares used in determining the basic earnings/(losses) per shares was 877,969 (2013: 877,969). As there is no impact of any options, convertible bonds or similar effects, the weighted average number of ordinary shares used in determining diluted earnings/(losses) per share would be equal as the one used in determining basic earnings/(losses) per share i.e. 877,969 (2013: 877,969).

| | | **Bank** |
|---|---|---|
| | **2014**<br>**HRK '000** | **2013**<br>**HRK '000** |
| Net (loss)/profit for the year | (635,384) | 42,410 |
| Profit allocated to cover losses from previous years | (635,384) | 42,410 |
| Average number of ordinary shares in issue (excluding treasury shares) | 877,969 | 877,969 |
| **(Losses)/earnings per share (in HRK):** | **(723.70)** | **48.30** |

## 39. CONCENTRATION OF ASSETS AND LIABILITIES

The assets and liabilities of the Bank are significantly concentrated on amounts directly due from and to the Republic of Croatia. The amounts at year end, including accrued interest, are as follows:

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | Notes | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Giro account with the CNB | 5 | 587,343 | 357,739 | 587,343 | 357,739 |
| Obligatory reserve with Croatian National Bank | 6 | 1,545,787 | 1,442,045 | 1,545,787 | 1,442,045 |
| Bonds of the Republic of Croatia | | 1,976,744 | 1,548,521 | 1,838,904 | 1,410,681 |
| Treasury bills of the Croatian Ministry of Finance | | 141,256 | 433,670 | 141,256 | 433,670 |
| Loans and advances to the Republic of Croatia | | 1,788,255 | 2,265,307 | 1,788,255 | 2,265,307 |
| Deposits from the Republic of Croatia | | (2,192,207) | (2,113,735) | (2,192,207) | (2,113,735) |
| **Total** | | **3,847,178** | **3,933,547** | **3,709,338** | **3,795,707** |

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

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Loans | 1,014,902 | 563,780 | 1,014,902 | 563,780 |
| Deposits | (196,314) | (295,129) | (196,314) | (295,129) |
| **Total** | **818,588** | **268,651** | **818,588** | **268,651** |

## 40. CASH AND CASH EQUIVALENTS

| | | Group | | Bank | |
|---|---|---|---|---|---|
| | Notes | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Cash and amounts due from banks | 5 | 1,308,452 | 1,177,543 | 1,308,449 | 1,177,540 |
| Obligatory reserve with Croatian National Bank | 6 | 1,545,787 | 1,442,045 | 1,545,787 | 1,442,045 |
| Deposits with banks with original maturities of up to 90 days | | 467,166 | 343,853 | 467,166 | 343,853 |
| Items in course of collection | 18 | 94,855 | 16,509 | 94,824 | 16,509 |
| **Total** | | **3,416,260** | **2,979,950** | **3,416,226** | **2,979,947** |

## 41. CONTINGENT LIABILITIES

| | Group | | Bank | |
|---|---|---|---|---|
| | 2014 HRK '000 | 2013 HRK '000 | 2014 HRK '000 | 2013 HRK '000 |
| Guarantees denominated in HRK | 300,066 | 284,864 | 300,066 | 284,864 |
| Guarantees denominated in foreign currency | 2,206 | 2,179 | 2,206 | 2,179 |
| Letters of credit | 31,807 | 47,920 | 31,807 | 47,920 |
| Undrawn lending commitments | 1,319,379 | 1,470,883 | 1,318,309 | 1,465,859 |
| **Total** | **1,653,458** | **1,805,846** | **1,652,388** | **1,800,822** |

At 31 December 2014, the Group and the Bank recognized portfolio-based provisions for off-balance-sheet risks arising from the issue of guarantees, letters of credit and undrawn lending commitments, the Group in the amount of HRK 18,724 thousand, (2013: HRK 21,167 thousand), and the Bank in the amount of HRK 18,714 thousand (2013: HRK 21,125 thousand) thousand which are included in Provisions for liabilities and expenses (see Note 24).

## 42. DERIVATIVE INSTRUMENTS AND DEALINGS IN FOREIGN CURRENCIES

The Bank and the Group had the following derivative contracts, accounted for as trading instruments, open at year-end.

| **Group and Bank** | **Notional amount, remaining life** | | | | | **Fair value** | |
|---|---|---|---|---|---|---|---|
| | **Up to 3 months** | **3 to 12 months** | **1 to 5 years** | **Over 5 years** | **Total** | **Assets** | **Liabilities** |
| **2014** | **HRK 000** | **HRK 000** | **HRK 000** | **HRK 000** | **HRK 000** | **HRK 000** | **HRK 000** |
| Forward foreign exchange contracts - OTC | - | - | - | - | - | - | - |
| Cross currency swap contracts - OTC | 76,615 | - | - | - | 76,615 | - | 508 |
| Futures | - | - | - | - | - | - | - |
| | **76,615** | **-** | **-** | **-** | **76,615** | **-** | **508** |

| **Group and Bank** | **Notional amount, remaining life** | | | | | **Fair value** | |
|---|---|---|---|---|---|---|---|
| | **Up to 3 months** | **3 to 12 months** | **1 to 5 years** | **Over 5 years** | **Total** | **Assets** | **Liabilities** |
| **2013** | **HRK '000** | **HRK '000** | **HRK '000** | **HRK '000** | **HRK '000** | **HRK '000** | **HRK '000** |
| Forward foreign exchange contracts - OTC | - | - | - | - | - | - | - |
| Cross currency swap contracts - OTC | 12,717 | - | - | - | 12,717 | 10 | 8 |
| Futures | - | - | - | - | - | - | - |
| | **12,717** | **-** | **-** | **-** | **12,717** | **10** | **8** |

## 43. RELATED PARTY TRANSACTIONS

The Bank is the parent of the Hrvatska poštanska banka Group. Key shareholders of the Bank and of the Group are the Republic of Croatia, Hrvatska pošta d.d. ("HP") and the Croatian Pension Insurance Fund (“HZMO”) which together own 99.13% (2013: 99.13%) of the Bank's shares. The remaining 0.87% (2013: 0.87%) are publicly traded.

***a) Key transactions with related parties***

Hrvatska pošta d.d. ("HP") performs domestic payment transactions for and on behalf of the Bank. Exposure to Hrvatska pošta d.d. mainly comprises fees receivable based on domestic payment transactions performed for and on behalf of the Bank, as well as placements in debt securities issued by Hrvatska pošta d.d. Liabilities towards Hrvatska pošta d.d. mainly relate to demand and term deposits. Income and expenses mostly relate to commissions for services provided.

Exposure to the state is shown in Note 39, *Concentration of assets and liabilities*.

The exposure to members of HPB Group mainly consists of investment into share capital. The Bank performs payment transactions on behalf of its subsidiaries and, accordingly, recognizes income. Expenses payable to HPB Nekretnine relate to the services performed by the subsidiary in respect of estimation of collateral.

Key management personnel held no ordinary shares at the year-end (2013: -).

**43. RELATED-PARTY TRANSACTIONS (continued)**

***b) Amounts arising from transactions with related parties***

Assets and liabilities and off-balance-sheet exposure and income and expense as at and for the years ended 31 December 2014 and 31 December 2013 of the Group, arising from transactions with related parties were as follows:

| **Group 2014** | **Exposure* HRK '000** | **Liabilities HRK '000** | **Income HRK '000** | **Expenses HRK '000** |
|---|---|---|---|---|
| **Key shareholders** | | | | |
| Hrvatska pošta d.d. | 251,901 | 192,990 | 325,310 | 300,483 |
| HZMO | 2,981 | 51 | 13 | 7 |
| Republic of Croatia | - | - | - | - |
| **Key management personnel** | | | | |
| Short-term benefits (bonuses, salaries and fees) | 896 | 4,310 | 27 | 19,882 |
| Long-term benefits (loans and deposits) | 11,135 | 174 | 627 | 98 |
| Severance payments | - | - | - | 484 |
| **Companies under significant influence** | **91,849** | **19,951** | **9,509** | **5,574** |
| **Total** | **358,762** | **217,476** | **335,486** | **326,528** |

| **Group 2013** | **Exposure* HRK '000** | **Liabilities HRK '000** | **Income HRK '000** | **Expenses HRK '000** |
|---|---|---|---|---|
| **Key shareholders** | | | | |
| Hrvatska pošta d.d. | 339,659 | 117,535 | 373,392 | 344,792 |
| HZMO | - | 36,859 | 1 | 207 |
| Republic of Croatia | - | - | - | - |
| **Key management personnel** | | | | |
| Short-term benefits (bonuses, salaries and fees) | 1,045 | 3,615 | 29 | 14,545 |
| Long-term benefits (loans and deposits) | 17,747 | 1,703 | 774 | 41 |
| Severance payments | - | - | - | 407 |
| **Companies under significant influence** | 167,688 | 22,124 | 5,453 | 4,097 |
| **Total** | **526,139** | **181,836** | **379,649** | **364,089** |

*Exposure comprises amounts advanced in cash or kind, commitments and contingencies, interest and other receivables, and includes HRK 51,603 thousand (2013: HRK 51,798 thousand) of off-balance-sheet exposure, whereof HRK 51,457 thousand (2013: HRK 51,798 thousand) relates to Hrvatska pošta d.d. and key management personnel.

Exposure to key members of the Group's Management include loan receivables in the amount of HRK 12,031 thousand (2013: HRK 14,837 thousand).

Expenses does not include impairment nor provisions for losses.

### 43 RELATED-PARTY TRANSACTIONS (continued)

***b) Amounts arising from transactions with related parties (continued)***

Assets and liabilities and off-balance-sheet exposure and income and expense as at and for the years ended 31 December 2014 and 31 December 2013 of the Bank, arising from transactions with related parties were as follows:

| **Bank 2014** | **Exposure* HRK '000** | **Liabilities HRK '000** | **Income HRK '000** | **Expenses HRK '000** |
|---|---|---|---|---|
| **Key shareholders** | | | | |
| Hrvatska pošta d.d. | 251,901 | 192,990 | 325,310 | 300,483 |
| HZMO | 2,981 | 51 | 13 | 7 |
| Republic of Croatia | - | - | - | - |
| **Subsidiaries** | | | | |
| HPB Invest d.o.o. | 5,156 | 6,929 | 740 | 137 |
| HPB Nekretnine d.o.o. | 10,754 | 77 | 2,487 | 1,719 |
| HPB Stambena štedionica d.d. | 40,081 | 15,316 | 668 | 71 |
| **Key management personnel** | | | | |
| Short-term benefits (bonuses, salaries and fees) | 821 | 4,310 | 20 | 18,151 |
| Long-term benefits (loans and deposits) | 9,338 | 174 | 510 | 92 |
| Severance payments | - | - | - | 484 |
| **Companies under significant influence** | **91,849** | **19,951** | **9,509** | **5,574** |
| **Total** | **412,881** | **239,798** | **339,257** | **326,718** |

| **Bank 2013** | **Exposure* HRK '000** | **Liabilities HRK '000** | **Income HRK '000** | **Expenses HRK '000** |
|---|---|---|---|---|
| **Key shareholders** | | | | |
| Hrvatska pošta d.d. | 339,659 | 117,535 | 373,392 | 344,792 |
| HZMO | - | 36,859 | 1 | 207 |
| Republic of Croatia | - | - | - | - |
| **Subsidiaries** | | | | |
| HPB Invest d.o.o. | 5,160 | 6,443 | 5,723 | 380 |
| HPB Nekretnine d.o.o. | 32,625 | 87 | 5,411 | 1,625 |
| HPB Stambena štedionica d.d. | 40,113 | 22,115 | 802 | 1,206 |
| **Key management personnel** | | | | |
| Short-term benefits (bonuses, salaries and fees) | 903 | 3,583 | 24 | 12,200 |
| Long-term benefits (loans and deposits) | 13,596 | 1,703 | 580 | 41 |
| Severance payments | - | - | - | 240 |
| **Companies under significant influence** | 167,688 | 22,124 | 5,453 | 4,097 |
| **Total** | **599,744** | **210,449** | **391,386** | **364,788** |

*Exposure comprises amounts advanced in cash or kind, commitments and contingencies, interest and other receivables, and includes HRK 51,573 thousand (2013: HRK 51,896 thousand) of off-balance-sheet exposure. Expenses does not include impairment nor provisions for losses.

### 43. RELATED-PARTY TRANSACTIONS (continued)

***c) State owned companies***

Major shareholders of the Bank, which together own 99.13% of its shares, are state agencies or state owned companies, all mainly funded from the State Budget. Accordingly, transactions and balances with other state owned companies, including credit risk exposures guaranteed by the state, also represent related party relationships. The Bank has a significant exposure to these parties, which is disclosed in Note 39.

### 44. REPURCHASE AND RESALE AGREEMENTS

The Bank raises funds by selling financial instruments under agreements to repay the funds by repurchasing the instruments at future dates at the same price plus interest at a predetermined rate.

Repurchase agreements are commonly used as a tool for short-term financing of interest-bearing assets, depending on the prevailing interest rates. The financial instruments sold are not derecognised and the proceeds are accounted for as interest bearing borrowings. At the end of the year assets sold under repurchase agreements were as follows:

| | Fair value of securities HRK '000 | Carrying amount of corresponding liabilities HRK '000 | Repurchase date | Repurchase price HRK '000 |
|---|---|---|---|---|
| **Debt securities at fair value through profit or loss - repurchase agreements** | | | | |
| 2014 | 31,517 | 32,080 | January to December 2014 | 31,879 |
| 2013 | 196,750 | 205,638 | January to December 2014 | 196,788 |

Related transactions, according to IAS 39 *Financial instruments Recognition and Measurement* are recognized as repurchase agreements.

The Bank and the Group also purchase financial instruments under agreements to resell them at future dates ("reverse repurchase agreements"). The seller commits to repurchase the same or similar instruments at an agreed future date. Reverse repurchase agreements are entered into as a facility to provide funds to customers and are accounted for as loans and advances to customers; the underlying financial instruments are not recognised.

| | Fair value of receivables HRK '000 | Carrying amount of collaterals HRK '000 | Repurchase date | Repurchase price HRK '000 |
|---|---|---|---|---|
| **Loans to customers – reverse repo agreements** | | | | |
| 2014 | 33,012 | 31,508 | January 2014. | 31,513 |
| 2013 | - | - | - | - |

**45. FUNDS MANAGED FOR AND ON BEHALF OF CORPORATE AND RETAIL CUSTOMERS**

The Bank provides trust and custody services to companies, banks, individuals, and investment funds (Group's investment funds) whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. The Bank receives fee income for providing these services. Trust assets are not assets of the Bank and are not recognized in the Bank's statement of financial position. The Bank is not exposed to any credit risk relating to such placements, nor does it guarantee for investments.

At 31 December 2014, the total assets under custody held by the Bank on behalf of customers, including the funds within the HPB Group, amounted to HRK 3.92 billion (2013: HRK 4.04 billion).

In addition, at 31 December 2014, total assets of investment and pension funds to which the Bank act as a depository bank, amounted to HRK 3.71 billion (2013: HRK 3.64 billion).

Furthermore, the Bank manages loan exposures of other parties as follows:

| | 2014<br>HRK '000 | 2013<br>HRK '000 |
|---|---|---|
| **Assets** | | |
| Corporate | 66,212 | 67,415 |
| Retail | 605,636 | 615,895 |
| Giro accounts | 287,285 | 230,694 |
| **Total assets** | **959,133** | **914,004** |
| | | |
| **Liabilities** | | |
| Croatian Employment Office | 72,149 | 71,173 |
| Counties | 15,713 | 17,389 |
| Government of the Republic of Croatia | 860,067 | 813,387 |
| HBOR | 9,329 | 9,337 |
| Development and Employment Fund | - | 498 |
| Other liabilities | 1,875 | 2,220 |
| **Total liabilities** | **959,133** | **914,004** |

## 46. AVERAGE INTEREST RATES

Average interest rates calculated as the weighted average of each category of interest-earning asset and interest-bearing liability, are presented below:

| **Group** | **Average interest rates 2014** | **Average interest rates 2013** |
|---|---|---|
| **Assets** | | |
| Cash and amounts due from banks | 0.05% | 0.13% |
| Obligatory reserve with Croatian National Bank | - | - |
| Loans to and receivables from banks | 0.44% | 0.86% |
| Financial assets at fair value through profit or loss | 5.37% | 5.15% |
| Financial assets available for sale | 4.39% | 5.19% |
| Financial assets held to maturity | 6.29% | 6.06% |
| Loans and receivables from customers | 6.59% | 6.33% |
| **Liabilities** | | |
| Deposits from banks | 1.27% | 1.51% |
| Customer deposits | 2.00% | 2.36% |
| Borrowings | 3.05% | 2.50% |
| Hybrid instruments | 7.25% | 7.64% |

| **Bank** | **Average interest rates 2014** | **Average interest rates 2013** |
|---|---|---|
| **Assets** | | |
| Cash and amounts due from banks | 0.05% | 0.13% |
| Obligatory reserve with Croatian National Bank | - | - |
| Loans to and receivables from banks | 0.44% | 0.86% |
| Financial assets at fair value through profit or loss | 5.79% | 5.15% |
| Financial assets available for sale | 4.41% | 5.20% |
| Financial assets held to maturity | 6.29% | 6.06% |
| Loans and receivables from customers | 6.63% | 6.34% |
| **Liabilities** | | |
| Deposits from banks | 1.27% | 1.51% |
| Customer deposits | 1.99% | 2.34% |
| Borrowings | 3.05% | 2.50% |
| Hybrid instruments | 7.25% | 7.64% |

### 47. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is the amount for which an asset could be exchanged, or a liability settled, in an arm's-length transaction.

Financial instruments at fair value through profit or loss or available-for-sale financial assets are measured at fair value. Loans and receivables, and held-to-maturity investments are measured at amortised cost less impairments. Financial assets at fair value through profit or loss and financial assets available for sale are disclosed at their fair value that arises from price quotes of these instruments on active markets. Financial liabilities at fair value through profit or loss are disclosed at fair values calculated on the basis of available conditions of these instruments.

Set out below is an overview of key methods and assumptions used in estimating the fair values of financial instruments.

*Loans*

The fair value of loans and advances is calculated based on discounted expected future cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. Expected future cash flows are estimated considering credit risk and any indication of impairment including portfolio based provisions for performing (i.e. A-risk rated) loans calculated at rates prescribed by the CNB. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans. The Group has a limited portfolio of loans with fixed rates, where there is a difference between the fair value and the carrying amount.

*Investments carried at cost*

For equity investments for which a quoted market price is not available, fair value is, where possible, estimated using discounted cash flow techniques. Estimated future cash flows are based on management's best estimates and the discount rate is a market related rate for a similar instrument at the reporting date. Where discounted cash flow techniques provide insufficiently reliable valuations due to a number of uncertainties related to estimations of future cash flows, investments are carried at cost less impairment.

*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 reporting 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.

*Borrowings*

Most of the Group's long-term debt has no quoted market price and fair value is estimated as the present value of future cash flows, discounted at interest rates available at the reporting date to the Group for new debt of similar type and remaining maturity.

The following table represents the Group's and the Bank's estimate of the fair value hierarchy of financial instruments as of 31 December 2014 and 31 December 2013:

## 47. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

| Group<br>2014 (HRK '000) | Fair value | Fair value level | Valuation technique(s) and key input(s) | Book value | Unrecognized gains/(losses) |
|---|---|---|---|---|---|
| ***Financial Assets*** | | | | | |
| **Cash and receivables from banks** | **1,308,452** | **Level 1** | **Cash and cash equivalents** | **1,308,452** | **-** |
| **Obligatory reserve with Croatian National Bank** | **1,545,787** | **Level 1** | **Cash equivalent** | **1,545,787** | **-** |
| **Loans and advances from banks** | **583,411** | **Level 3** | **Cash equivalent other than assets with a defined maturity > 30 days at a fixed rate, where the fair value is the present value of discounted cash flows** | **583,784** | **(373)** |
| **Financial assets at fair value through profit and loss** | **381,801** | | | **381,801** | **-** |
| - Ministry of Finance bonds | 178,650 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 178,650 | - |
| - Investments in open-end funds | 167,280 | Level 1 | Value of an individual share at the measurement date | 167,280 | - |
| - Equity securities | 33,588 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 33,588 | - |
| - The fair value of forward contracts | , | Level 3 | Internal valuation model for FX contracts using future discounted cash flows | - | - |
| - Interest receivables | 2,283 | not applicable | not applicable | 2,283 | - |
| **Financial assets available for sale** | **2,002,975** | | | **2,002,975** | **-** |
| - Ministry of Finance treasury bills | 141,256 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 141,256 | - |
| - Ministry of Finance bonds | 1,353,292 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 1,353,292 | - |
| - Foreign government bonds | 382,752 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 382,752 | - |
| - Corporate bonds in state-run companies | 75,391 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 75,391 | - |
| - Corporate bonds of other companies | 11,662 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 11,662 | - |
| - Equity securities – not quoted | 14,651 | Level 3 | Comparable Companies Method, using the average of the standard multiples EV/EBITDA, P/E, P/S, P/B. | 14,651 | - |
| - Interest receivables | 23,971 | not applicable | not applicable | 23,971 | - |
| **Financial assets held to maturity** | **558,882** | **Level 3** | **Present value of future discounted cash flows** | **597,943** | **(39,061)** |
| **Loans and advances to customers** | **10,429,101** | **Level 3** | **Present value of future discounted cash flows** | **10,473,750** | **(44,649)** |
| **Total financial assets** | **16,810,409** | | | **16,894,492** | **(84,083)** |
| ***FINANCIAL LIABILITIES*** | | | | | |
| **Financial assets at fair value through profit and loss** | **508** | **Level 3** | **Internal valuation model for an FX swap agreement using future discounted cash flows** | **508** | **-** |
| **Bank deposits** | **373,789** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **374,750** | **961** |
| **Customer deposits** | **13,995,100** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **14,084,725** | **89,625** |
| **Loans** | **1,502,455** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **1,507,327** | **4,872** |
| **Total financial liabilities** | **15,871,852** | | | **15,967,310** | **95,458** |
| **TOTAL** | | | | | **11,375** |

## 47. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

| Group<br>2013 (HRK '000) | Fair value | Fair value level | Valuation technique(s) and key input(s) | Book value | Unrecognized gains/(losses) |
|---|---|---|---|---|---|
| ***FINANCIAL ASSETS*** | | | | | |
| **Cash and receivables from banks** | **1,177,543** | **Level 1** | **Cash and cash equivalents** | **1,177,543** | **-** |
| **Obligatory reserve with Croatian National Bank** | **1,442,045** | **Level 1** | **Cash equivalent** | **1,442,045** | **-** |
| **Loans and advances from banks** | **521,035** | **Level 3** | **Cash equivalent other than assets with maturities > 30 days at a fixed rate, where the fair value is the present value of discounted cash flows** | **522,772** | **(1,737)** |
| **Financial assets at fair value through profit and loss** | **343,841** | | | **343,841** | **-** |
| - Ministry of Finance bonds | 139,079 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 139,079 | - |
| - Investments in open-end funds | 159,203 | Level 1 | value of an individual share at the measurement date | 159,203 | - |
| - Equity securities | 43,120 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 43,120 | - |
| - The fair value of forward contracts | 22 | Level 3 | Internal valuation model for an FX swap agreement using future discounted cash flows | 22 | - |
| - Interest receivables | 2,417 | not applicable | not applicable | 2,417 | - |
| **Financial assets available for sale** | **1,715,416** | | | **1,715,416** | **-** |
| - Ministry of Finance treasury bills | 433,670 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 433,670 | - |
| - Ministry of Finance bonds | 971,468 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 971,468 | - |
| - Foreign state bonds | 137,655 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 137,655 | - |
| - Corporate bonds in state-run companies | 79,040 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 79,040 | - |
| - Corporate bonds of other companies | 41,464 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 41,464 | - |
| - Equity securities – not quoted | 7,692 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 7,692 | - |
| - Equity securities – quoted | 21,318 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 21,318 | - |
| - Interest receivables | 23,109 | not applicable | not applicable | 23,109 | **-** |
| **Financial assets held to maturity** | **760,630** | **Level 3** | **Present value of future discounted cash flows** | **821,305** | **(60,675)** |
| **Loans and advances to customers** | **11,693,751** | **Level 3** | **Present value of future discounted cash flows** | **11,753,691** | **(59,940)** |
| **Total financial assets** | **17,654,261** | | | **17,776,613** | **(122,352)** |
| ***FINANCIAL LIABILITIES*** | | | | | |
| **Financial assets at fair value through profit and loss** | **8** | **Level 3** | **Internal valuation model for an FX swap agreement using future discounted cash flows** | **8** | **-** |
| **Bank deposits** | **740,307** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **741,207** | **900** |
| **Customer deposits** | **14,261,336** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **14,361,365** | **100,029** |
| **Loans** | **1,067,015** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **1,074,013** | **6,998** |
| **Total financial liabilities** | **16,068,666** | | | **16,176,593** | **107,927** |
| **TOTAL** | | | | | **(14,425)** |

## 47. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

| **Bank**<br>**2014 (HRK '000)** | **Fair value** | **Fair value level** | **Valuation technique(s) and key input(s)** | **Book value** | **Unrecognized gains/(losses)** |
|---|---|---|---|---|---|
| ***FINANCIAL ASSETS*** | | | | | |
| **Cash and receivables from banks** | **1,308,449** | **Level 1** | **Cash and cash equivalents** | **1,308,449** | **-** |
| **Obligatory reserve with Croatian National Bank** | **1,545,787** | **Level 1** | **Cash equivalent** | **1,545,787** | **-** |
| **Loans and advances from banks** | **583,411** | **Level 3** | **Cash equivalent other than assets with a defined maturity > 30 days at a fixed rate, where the fair value is the present value of discounted cash flows** | **583,784** | **(373)** |
| **Financial assets at fair value through profit and loss** | **284,011** | | | **284,011** | **-** |
| - Ministry of Finance bonds | 83,373 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 83,373 | - |
| - Investments in open-end funds | 166,053 | Level 1 | Value of an individual share at the measurement date | 166,053 | - |
| - Equity securities | 33,588 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 33,588 | - |
| - The fair value of forward contracts | - | Level 3 | Internal valuation model for FX contracts using future discounted cash flows | - | - |
| - Interest receivables | 997 | not applicable | not applicable | 997 | - |
| **Financial assets available for sale** | **1,988,683** | | | **1,988,683** | **-** |
| - Ministry of Finance treasury bills | 141,256 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 141,256 | - |
| - Ministry of Finance bonds | 1,339,271 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 1,339,271 | - |
| - Foreign government bonds | 382,752 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 382,752 | - |
| - Corporate bonds in state-run companies | 75,391 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 75,391 | - |
| - Corporate bonds of other companies | 11,662 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 11,662 | - |
| - Equity securities – not quoted | 14,651 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 14,651 | - |
| - Interest receivables | 23,700 | not applicable | not applicable | 23,700 | - |
| **Financial assets held to maturity** | **558,882** | **Level 3** | **Present value of future discounted cash flows** | **597,943** | **(39,061)** |
| **Loans and advances to customers** | **10,318,049** | **Level 3** | **Present value of future discounted cash flows** | **10,335,154** | **(17,105)** |
| **Total financial assets** | **16,587,272** | | | **16,643,811** | **(56,539)** |
| ***FINANCIAL LIABILITIES*** | | | | | |
| **Financial assets at fair value through profit and loss** | **508** | **Level 3** | **Internal valuation model for an FX swap agreement using future discounted cash flows** | **508** | **-** |
| **Bank deposits** | **373,789** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **374,750** | **961** |
| **Customer deposits** | **13,799,577** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **13,879,406** | **79,829** |
| **Loans** | **1,502,455** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **1,507,327** | **4,872** |
| **Total financial liabilities** | **15,676,329** | | | **15,761,991** | **85,662** |
| **TOTAL** | | | | | **29,123** |

## 47. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

| Bank 2013 (HRK '000) | Fair value | Fair value level | Valuation technique(s) and key input(s) | Book value | Unrecognized gains/(losses) |
|---|---|---|---|---|---|
| ***FINANCIAL ASSETS*** | | | | | |
| **Cash and receivables from banks** | **1,177,540** | **Level 1** | **Cash and cash equivalents** | **1,177,540** | **-** |
| **Obligatory reserve with Croatian National Bank** | **1,442,045** | **Level 1** | **Cash equivalent** | **1,442,045** | **-** |
| **Loans and advances from banks** | **521,035** | **Level 3** | **Cash equivalent other than assets with a defined maturity > 30 days at a fixed rate, where the fair value is the present value of discounted cash flows** | **522,772** | **(1,737)** |
| **Financial assets at fair value through profit and loss** | **277,046** | | | **277,046** | **-** |
| - Ministry of Finance bonds | 73,390 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 73,390 | - |
| - Investments in open-end funds | 159,203 | Level 1 | Value of an individual share at the measurement date | 159,203 | - |
| - Equity securities | 43,120 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 43,120 | - |
| - The fair value of forward contracts | 10 | Level 3 | Internal valuation model for an FX swap agreement using future discounted cash flows | 10 | - |
| - Interest receivables | 1,323 | not applicable | not applicable | 1,323 | - |
| **Financial assets available for sale** | **1,623,041** | | | **1,623,041** | **-** |
| - Ministry of finance treasury bills | 433,670 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 433,670 | - |
| - Ministry of finance bonds | 901,523 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 901,523 | - |
| - Corporate bonds in state-run companies | 137,655 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 137,655 | - |
| - Corporate bonds of other companies | 79,040 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 79,040 | - |
| - Equity securities – not quoted | 41,464 | Level 3 | *mark-to-model* using the internal model for determining the present value of future cash flows | 41,464 | - |
| - Equity securities – quoted | 7,692 | Level 1 | *mark-to-market* according to the prices quoted in an active market | 7,692 | - |
| - Interest receivables | 21,997 | not applicable | not applicable | 21,997 | - |
| **Financial investements held to maturity** | **760,630** | **Level 3** | **Present value of future discounted cash flows** | **821,305** | **(60,675)** |
| **Loans and advances to customers** | **11,618,369** | **Level 3** | **Present value of future discounted cash flows** | **11,655,515** | **(37,146)** |
| **Total financial assets** | **17,419,706** | | | **17,519,264** | **(99,558)** |
| ***FINANCIAL LIABILITIES*** | | | | | |
| **Financial assets at fair value through profit and loss** | **8** | **Level 3** | **Internal valuation model for an FX swap agreement using future discounted cash flows** | **8** | **-** |
| **Bank deposits** | **740,307** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **741,207** | **900** |
| **Customer deposits** | **14,052,825** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **14,144,022** | **91,197** |
| **Loans** | **1,067,015** | **Level 3** | **Present value of discounted cash flows under the currently effective interest rates** | **1,074,013** | **6,998** |
| **Total financial liabilities** | **15,860,155** | | | **15,959,250** | **99,095** |
| **TOTAL** | | | | | **(463)** |

**48. EVENTS AFTER BALANCE SHEET DATE**

On 28 January 2015, a hybrid instrument of the Group had matured amounting to 6,857 thousand euros and at the end of 2014, due to the fall of the capital adequacy rate below the legally prescribed rate in accordance with Article. 6 of the Agreement on investing in additional capital conditions were created for the conversion of hybrid instruments in the capital of the Bank. The remaining HRK 200,000 thousand of hybrid instrument matures on April 30 2015.

The Bank is in the process of acquiring additional shares in the company H1 Telekom d.d. (mentioned in Note 12), based on the completed pre-bankruptcy settlement, and by converting a portion of its receivables in the share capital of the Company. As of the date of this report the decision was made by Commercial Court from 27 January 2015, with which pre-bankruptcy settlement of the H1 Telekom d.d. became legally effective, and on 30 March 2015 Annual General Meeting of the Company was held. Based on the decision of the General Assembly, the Bank will obtain 3,584,990 shares valued at 35,850 thousand by entering its receivables into the capital of the Company, until April 24, 2015 year. Hereby, the Bank will acquire 58.2 percent or more shares in the Company depending on the subscription of new shares by the other creditors from pre-bankruptcy settlement.

In order to successfully restructure the Bank and improve business efficiency, at the end of 2014 a number of operational and organizational changes and initiatives for improvement were made, which will be implemented during 2015. These changes are based on several key concepts and assumptions of operational improvement business: simplification and changes in organizational structure of the Bank, with an emphasis on reducing the complexity of the overall organizational structure, redesign and centralization of risk management and portfolio management of non-performing loans, increasing the quality and structure of management reporting and reducing operating costs.

**Balance sheet as at December 31 2014**

| | 2014<br>HRK 000 | 2013<br>HRK 000 |
|---|---|---|
| Cash and balances with the CNB | 2,494,250 | 2,295,261 |
| -- Cash | 361,122 | 495,477 |
| -- Deposits with the CNB | 2,133,129 | 1,799,784 |
| Deposits with banking institutions | 910,047 | 695,766 |
| Treasury bills of the Ministry of Finance and the CNB bills | - | 299,483 |
| Securities and other financial instruments held for trading | 283,013 | 275,713 |
| Securities and other financial instruments available for sale | 1,964,980 | 1,301,561 |
| Securities and other financial instruments held to maturity | 591,300 | 814,250 |
| Securities and other financial instruments at fair value through profit or loss - not actively traded | - | - |
| Derivative financial assets | - | 10 |
| Loans to financial institutions | 64,522 | 518,961 |
| Loans to other customers | 10,236,030 | 11,205,416 |
| Investments in subsidiaries, associates and joint ventures | 53,420 | 87,041 |
| Foreclosed assets | 155,408 | 209,418 |
| Tangible assets (less depreciation) | 159,118 | 153,282 |
| Interest, fees and other assets | 458,135 | 512,620 |
| **TOTAL ASSETS** | **17,370,224** | **18,368,782** |
| **LIABILITIES** | | |
| Borrowings from financial institutions | 699,300 | 1,072,997 |
| - short-term borrowings | 31,152 | 239,228 |
| - long-term borrowings | 668,148 | 833,769 |
| Deposits | 12,473,921 | 13,368,152 |
| - giro and current account deposits | 2,914,496 | 3,078,289 |
| - savings deposits | 986,972 | 1,121,197 |
| - term deposits | 8,572,453 | 9,168,666 |
| Other borrowings | 806,753 | - |
| - short-term borrowings | - | - |
| - long-term borrowings | 806,753 | - |
| Derivative financial and other liabilities held for trading | 508 | 8 |
| Issued debt securities | - | - |
| - short-term debt securities issued | - | - |
| - long-term debt securities issued | - | - |
| Subordinated debt issued | - | - |
| Issued hybrid instruments | 252,537 | 402,373 |
| Interest, fees and other liabilities | 2,292,610 | 2,071,862 |
| **TOTAL LIABILITIES** | **16,525,629** | **16,915,392** |
| **EQUITY** | | |
| Share capital | 1,193,902 | 1,193,902 |
| Profit/(Loss) for the year | (635,384) | 42,410 |
| Retained earnings / (Accumulated losses) | 200,996 | 160,707 |
| Legal reserves | 10,578 | 8,458 |
| Statutory and other capital reserves | 1,762 | 2,063 |
| Unrealised gains/(losses) on revaluation of financial assets available for sale | 72,741 | 45,850 |
| Hedging reserve | - | - |
| **TOTAL EQUITY** | **844,595** | **1,453,390** |
| **TOTAL LIABILITIES AND EQUITY** | **17,370,224** | **18,368,782** |

## Income Statement for the period January 01 – December 31 2014

| | 2014 HRK 000 | 2013 HRK 000 |
|---|---|---|
| Interest income | 863,360 | 839,634 |
| Interest expense | (373,633) | (403,670) |
| **Net interest income** | **489,727** | **435,964** |
| Fee and commission income | 484,933 | 533,190 |
| Fee and commission expense | (312,103) | (355,163) |
| **Net fee and commission income** | **172,830** | **178,027** |
| Losses on investments in subsidiaries, associates and joint ventures | (33,621) | - |
| Trading gains | 37,995 | 39,527 |
| Gains/(losses) on embedded derivatives | - | - |
| Gains/(losses) on assets at fair value through profit or loss not actively traded | - | - |
| Gains on available-for-sale assets | 17,353 | 7,537 |
| Gains / (losses) on held-to-maturity assets | - | - |
| Hedging gains/(losses) | - | - |
| Income from investments in subsidiaries, associates and joint ventures | - | - |
| Income from other equity investments | 1,359 | 11,012 |
| Foreign exchange gains/(losses) | 6,216 | 8,508 |
| Other income | 14,106 | 19,355 |
| Other expenses | (41,004) | (33,240) |
| General and administrative expenses, and depreciation | (478,458) | (404,715) |
| **Net profit from operations before provisions and impairment losses** | **186,503** | **261,975** |
| Impairment losses and provisions | (823,556) | (219,229) |
| **(LOSS)/PROFIT BEFORE TAXATION** | **(637,053)** | **42,746** |
| **INCOME TAX (EXPENSE)/INCOME** | (1,669) | 336 |
| **(LOSS)/PROFIT FOR THE YEAR** | **(635,384)** | **42,410** |
| (Loss)/earnings per share | (723.70) | 48.30 |

**Changes in equity during 2014**

| **Bank** | **Share capital HRK 000** | **Treasury shares HRK 000** | **Legal, statutory and other reserves HRK 000** | **Retained profit / (Accumulated losses) HRK 000** | **Profit /loss for the year HRK 000** | **Unreal. gains /losses on remeasurement of financial assets available for sale HRK 000** | **Total equity HRK 000** |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2014** | **1,194,776** | **(874)** | **10,522** | **160,707** | **42,410** | **45,850** | **1,453,390** |
| Effects of changes in accounting policies and | - | - | - | - | - | - | **-** |
| Restated balance at 1 January 2014 | 1,194,776 | (874) | 10,522 | 160,707 | 42,410 | 45,850 | 1,453,390 |
| Disposal of financial assets available for sale | - | - | - | - | - | - | **-** |
| Change in the fair value of financial assets available for | - | - | - | - | - | 34,658 | **34,658** |
| Tax on items recognized directly in/transferred from | - | - | 15 | - | - | (7,767) | **(7,752)** |
| Other gains and losses recognised directly in equity | - | - | (317) | - | - | - | **(317)** |
| **Net gains/(losses) recognised directly in equity** | **-** | **-** | **(302)** | **-** | **-** | **26,891** | **26,589** |
| Profit /(loss) for the year | - | - | - | - | (635,384) | **-** | (635,384) |
| **Total recognised income and expenses for 2014** | **-** | **-** | **(302)** | **-** | **(635,384)** | **26,891** | **(608,795)** |
| Increase/(decrease) in share capital | - | - | - | - | - | - | - |
| Purchase/(sale) of treasury shares | - | - | - | - | - | - | - |
| Other changes | - | - | - | - | - | - | - |
| Transferred to reserves | - | - | 2,120 | 40,290 | (42,410) | - | - |
| Dividends paid | - | - | - | - | - | - | - |
| Profit allocation | **-** | **-** | **2,120** | **40,290** | **(42,410)** | **-** | **-** |
| **Balance at 31 December 2014** | **1,194,776** | **(874)** | **12,340** | **200,997** | **(635,384)** | **72,741** | **844,595** |

**Changes in equity during 2013**

| Bank | Share capital HRK 000 | Treasury shares HRK 000 | Legal, statutory and other reserves HRK 000 | Retained profit / (Accumulated losses) HRK 000 | Profit /loss for the year HRK 000 | Unreal. gains /losses on remeasurement of financial assets available for sale HRK 000 | Total equity HRK 000 |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2013** | **1,194,776** | **(874)** | **5,874** | **71,348** | **94,062** | **45,799** | **1,410,985** |
| Effects of changes in accounting policies and corrections of errors | - | - | - | - | - | - | **-** |
| Restated balance at 1 January 2013 | 1,194,776 | (874) | 5,874 | 71,348 | 94,062 | 45,799 | 1,410,985 |
| Disposal of financial assets available for sale | - | - | - | - | - | - | **-** |
| Change in the fair value of financial assets available for sale | - | - | - | - | - | (981) | **(981)** |
| Tax on items recognised directly in/transferred from equity | - | - | 14 | - | - | 1,032 | **1,046** |
| Other gains and losses recognised directly in equity | - | - | (69) | - | - | - | **(69)** |
| **Net gains/losses recognised directly in equity** | **-** | **-** | **(55)** | **-** | **-** | **50** | **(5)** |
| Profit /(loss) for the year | - | - | - | - | 42,410 | - | 42,410 |
| **Total recognised income and expenses for 2013** | **-** | **-** | **(55)** | **-** | **42,410** | **50** | **42,405** |
| Increase/(decrease) in share capital | - | - | - | - | - | - | - |
| Purchase/(sale) of treasury shares | - | - | - | - | - | - | - |
| Other changes | - | - | - | - | - | - | - |
| Transferred to reserves | - | - | 4,703 | 89,359 | (94,062) | - | - |
| Dividends paid | - | - | - | - | - | - | - |
| Profit allocation | **-** | **-** | **4,703** | **89,359** | **(94,062)** | **-** | **-** |
| **Balance at 31 December 2013** | **1,194,776** | **(874)** | **10,522** | **160,707** | **42,410** | **45,850** | **1,453,390** |

**Cash flows for the year 2014**

| | 2014 | 2013 |
|---|---|---|
| | HRK 000 | HRK 000 |
| **OPERATING ACTIVITIES** | | |
| **Operating cash flows before changes in operating assets** | **348,306** | **313,118** |
| (Loss)/profit before taxation | (637,053) | 42,746 |
| Impairment losses and provisions | 936,580 | 223,071 |
| Depreciation and amortisation | 53,078 | 52,478 |
| Net unrealised (losses)/gains on financial assets and liabilities at fair value through profit or loss | (119) | 714 |
| Gains/(losses) on sale of tangible assets | - | - |
| Other losses | (4,180) | (5,891) |
| **Net decrease/(increase) in operating assets** | **286,816** | **(1,224,952)** |
| Treasury bills of the Ministry of Finance and the CNB bills | 299,483 | 67,577 |
| Deposits with banking institutions and loans to financial institutions | 398,763 | (139,815) |
| Loans to other customers | 208,121 | (873,057) |
| Securities and other financial instruments held for trading | (7,181) | 233,487 |
| Securities and other financial instruments available for sale | (658,486) | (387,517) |
| Other operating assets | 46,116 | (125,627) |
| **Net increase/decrease in operating liabilities** | **(673,901)** | **1,316,209** |
| Demand deposits | (163,793) | 487,092 |
| Savings and term deposits | (730,438) | 687,584 |
| Derivative financial and other liabilities held for trading | 500 | (362) |
| Other liabilities | 219,830 | 141,895 |
| **Net cash flow from operations before income tax** | **(38,779)** | **404,375** |
| Income taxes paid | (53) | - |
| **Net cash inflow/outflow from operating activities** | **(38,832)** | **404,375** |
| **INVESTING ACTIVITIES** | | |
| **Net cash from investing activities** | **193,717** | **(153,719)** |
| Proceeds from sale/(Payments for purchases) of tangible and intangible assets | (30,106) | (18,194) |
| Proceeds from sale of/Payments for investments in subsidiaries, associates and joint ventures | | (11,500) |
| Proceeds from/(Payments to acquire) securities and other financial instruments held to maturity | 222,464 | (132,137) |
| Dividends received | 1,359 | 8,112 |
| **FINANCING ACTIVITIES** | | |
| **Net cash from financing activities** | **283,314** | **(45,241)** |
| Net increase/decrease in borrowings | 433,314 | (45,241) |
| Net increase/(decrease) in subordinated debt and hybrid instruments | | - |
| Proceeds from issuance of share capital | (150,000) | - |
| **Net increase in cash and cash equivalents** | **438,199** | **205,415** |
| Effect of changes in foreign exchange rates on cash and cash equivalents | (1,920) | 481 |
| **Net increase in cash and cash equivalents** | **436,279** | **205,896** |
| **Cash and cash equivalents at the beginning of the year** | **2,979,947** | **2,774,051** |
| **Cash and cash equivalents at the end of the year** | **3,416,226** | **2,979,947** |

**Reconciliation of the balance sheet as at 31 December 2014**

| | CNB requirements | Per Financial Statements | Difference |
|---|---|---|---|
| | HRK 000 | HRK 000 | HRK 000 |
| Cash and balances with the CNB | | | |
| -- Cash | 361,122 | - | 361,122 |
| -- Deposits with the CNB | 2,133,129 | - | 2,133,129 |
| Cash and amounts due from banks | - | 1,308,449 | (1,308,449) |
| Obligatory reserve with Croatian National Bank | - | 1,545,787 | (1,545,787) |
| Deposits with banking institutions | 910,047 | - | 910,047 |
| Loans to and receivables from banks | | 583,784 | (583,784) |
| Treasury bills of the Ministry of Finance and the CNB bills | - | - | - |
| Securities and other financial instruments held for trading | 283,013 | | 283,013 |
| Financial assets at fair value through profit or loss | - | 284,011 | (284,011) |
| Securities and other financial instruments available for sale | 1,964,980 | | 1,964,980 |
| Financial assets available for sale | - | 1,988,682 | (1,988,682) |
| Securities and other financial instruments held to maturity | 591,300 | - | 591,300 |
| Financial assets held to maturity | - | 597,943 | (597,943) |
| Securities and other financial instruments at fair value through profit or loss not actively traded | - | - | - |
| Derivative financial assets | - | - | - |
| Loans to financial institutions | 64,522 | - | 64,522 |
| Loans to other customers | 10,236,030 | - | 10,236,030 |
| Loans and receivables from customers | - | 10,335,154 | (10,335,154) |
| Investments in subsidiaries, associates and joint ventures | 53,420 | | 53,420 |
| Assets held for sale | - | 7,930 | (7,930) |
| Investments in subsidiaries | - | 45,490 | (45,490) |
| Foreclosed assets | 155,408 | - | 155,408 |
| Tangible assets (less depreciation) | 159,118 | - | 159,118 |
| Property and equipment | - | 153,107 | (153,107) |
| Intangible assets | - | 140,301 | (140,301) |
| Deferred tax assets, net | - | 15,868 | (15,868) |
| Prepaid income tax | - | 53 | (53) |
| Interest, fees and other assets | 458,135 | - | 458,135 |
| Other assets | - | 344,456 | (344,456) |
| **TOTAL ASSETS** | **17,370,224** | **17,351,015** | **19,209** |

### Reconciliation of the balance sheet as at 31 December 2014 (continued)

| LIABILITIES | Under CNB requirements HRK 000 | Per Financial Statements HRK 000 | Difference HRK 000 |
|---|---|---|---|
| Financial liabilities at fair value through profit or loss | - | 508 | (508) |
| *Borrowings from financial institutions* | - | - | - |
| Short-term borrowings | 31,152 | - | 31,152 |
| Long-term borrowings | 668,148 | - | 668,148 |
| Borrowings | - | 1,507,327 | (1,507,327) |
| *Deposits* | - | - | - |
| Giro and current account deposits | 2,914,496 | - | 2,914,496 |
| Savings deposits | 986,972 | - | 986,972 |
| Term deposits | 8,572,453 | - | 8,572,453 |
| Deposits from banks | - | 374,750 | (374,750) |
| Deposits from customers | - | 13,879,406 | (13,879,406) |
| *Other borrowings* | - | - | - |
| Short-term borrowings | - | - | - |
| Long-term borrowings | 806,753 | - | 806,753 |
| Derivative financial and other liabilities held for trading | 508 | - | 508 |
| *Issued debt securities* | - | - | - |
| Short-term debt securities issued | - | - | - |
| Long-term debt securities issued | - | - | - |
| Subordinated debt issued | - | - | - |
| Issued hybrid instruments | 252,537 | - | 252,537 |
| Hybrid instruments | - | 260,921 | (260,921) |
| Provisions for liabilities and expenses | - | 29,748 | (29,748) |
| Deferred tax liabilities, net | - | - | - |
| Interest, fees and other liabilities | - | - | - |
| Other liabilities | 2,292,610 | 453,760 | 1,838,850 |
| **TOTAL LIABILITIES** | **16,525,629** | **16,506,420** | **19,209** |
| **EQUITY** | | | |
| Share capital | 1,193,902 | 966,640 | 227,262 |
| Capital gains | - | 228,136 | (228,136) |
| Treasury shares | - | (874) | 874 |
| Profit /(loss) for the year | (635,384) | - | (635,384) |
| Retained earnings | 200,996 | (433,513) | 634,509 |
| Legal reserves | 10,578 | 10,578 | - |
| Other reserves | - | - | - |
| Statutory and other capital reserves | 1,762 | - | 1,762 |
| General banking risk reserve | - | - | - |
| Revaluation reserve | - | 887 | (887) |
| Unrealised gains/losses on revaluation of financial assets available for sale | 72,741 | 72,741 | - |
| **TOTAL EQUITY** | **844,595** | **844,595** | **-** |
| **TOTAL LIABILITIES AND EQUITY** | **17,370,224** | **17,351,015** | **19,209** |

**Reconciliation of the balance sheet at 31 December 2014 (continued)**

1 Foreign currency accounts' balance with foreign banks in the amount of HRK 345,709 thousand is included in the regulatory statements in Deposits with banking institutions and in the statutory financial statements it is reported within Cash and amounts due from banks.

2 Foreign currency accounts' balance with domestic banks in the amount of HRK 14,282 thousand is included in the regulatory financial statements in Deposits with banking institutions and in the statutory financial statements it is reported within Cash and amounts due from banks.

3 Amount of HRK 587,343 thousand – giro account balance with the CNB is included in the regulatory statements in Deposits with the CNB and in the statutory financial statements it is reported within Cash and amounts due from banks.

4 Reclassification of deposits held with non-banking financial institutions in the amount of HRK 257 thousand (accounts 5214) from the item Interest, fees and other assets in the balance sheet per the CNB regulatory requirements to Loans to and receivables from banks in the financial statements.

5 Reclassification of the HBOR loan in the amount of HRK 33,022 thousand from Loans to financial institutions in the balance sheet per CNB's regulatory requirements to Loans to and receivables from banks in the financial statements.

6 Reclassification of receivables from interest accruals not yet due in the amount of HRK 71,269 thousand from Interest, fees and other assets in the balance sheet per the CNB regulatory requirements into the following line items in the financial statements: HRK 450 thousand to Loans to and receivables from banks; HRK 997 thousand to Financial assets at fair value through profit or loss; HRK 23,702 thousand to Financial assets available for sale; HRK 6,643 thousand to Financial assets held to maturity; and HRK 39,477 thousand to Loans and receivables from customers.

7 Interest accruals due in the amount of HRK 13,719 thousand included in the in the balance sheet per the CNB regulatory requirements in Interest, fees and other assets, is reclassified into Loans and receivables from customers in the financial statements.

8 Portfolio based provisions for identified losses on income-based receivables are included in the balance sheet per the CNB regulatory requirements in Interest, fees and other assets in the amount of HRK 825 thousand. On the other hand, this item is presented in the financial statements as impairment allowance within Loans to and receivables.

9 Intangible assets in the amount of HRK 140,301 thousand are included in the balance sheet per the CNB regulatory requirements in Interest, fees and other assets, and in the financial statements in Intangible assets.

10 Reclassification of loans to other and non-banking financial institutions in the amount of HRK 31,500 thousand reported in the balance sheet per the CNB regulatory requirements within Loans to financial institutions to Loans to and receivables from customers in the financial statements.

11 Reclassification of credit card receivables in the amount of HRK 15,320 thousand (accounts 14811 and 1471) from Interest, fees and other assets in the balance sheet per the CNB regulatory requirements to Loans to and receivables from customers in the financial statements.

12 Reclassification of impairment losses on credit card receivables in the amount of HRK 64 thousand (account 1493) from Interest, fees and other assets in the balance sheet per the CNB regulatory requirements to Loans and receivables from customers in the financial statements.

**Reconciliation of the balance sheet at 31 December 2014 (continued)**

13 Deferred tax assets in the amount of HRK 35,069 thousand included in the balance sheet per the CNB regulatory requirements in Interest, fees and other assets reclassified to Deferred tax assets, net, in the financial statements.

14 Netting-off of the deferred tax liability in the amount of HRK 19,202 thousand within Interest, fees and other liabilities in the balance sheet per the CNB regulatory requirements and its inclusion in Deferred tax assets, net, in the financial statements.

15 Prepaid income tax (account 1400) in the amount of HRK 53 thousand from Interest, fees and other assets in the balance sheet per the CNB regulatory requirements to Prepaid income tax in the financial statements.

16 Foreclosed assets in the amount of HRK 155,408 thousand included in the balance sheet per the CNB regulatory requirements are included in the financial statements within Other assets.

17 Reclassification of the stock of office supplies of HRK 6,011 thousand from Tangible assets (less depreciation) in the balance sheet per the CNB regulatory requirements to Other assets in the financial statements.

18 Investments in H1 telekom d.d. and Drvna industrija Spačva d.d. amounting to HRK 7,903 thousand is included in the balance sheet per the CNB regulatory requirements in Investments in subsidiaries, associates and joint ventures, whereas in the financial statements it is reported within Assets held for sale.

19 Reclassification of long-term borrowings of HRK 668,148 thousand from Borrowings from financial institutions in the balance sheet per the CNB regulatory requirements and HRK 806,753 from Long-term borrowings per the CNB regulatory requirements into Borrowings in the financial statements in the amount of HRK 1,474,901 thousand.

20 Derivative financial liabilities and other financial liabilities held for trading in the total amount of HRK 508 thousand reported in the balance sheet per the CNB regulatory requirements within Financial liabilities at fair value through profit or loss are reclassified in the financial statements to Financial liabilities at fair value through profit or loss.

21 Accrued interest payable not yet due in the amount of HRK 91,722 thousand, included in the balance sheet per the CNB regulatory requirements in Interest, fees and other liabilities are reclassified to the following items in the financial statements: HRK 1,272 thousand to Borrowings, HRK 2,316 thousand to Deposits from banks; HRK 79,751 thousand to Deposits from customers; and HRK 8,384 thousand to Hybrid instruments.

22 Reclassification of temporary transfers for the purpose of investing in domestic companies' share capital in the amount of HRK 710 thousand from Interest, fees and other assets in the balance sheet per the CNB regulatory requirements to Deposits from customers in the financial statements.

23 Reclassification of HRK 7 thousand of retail balances in course of settlement (account 2690) from Interest, fees and other assets in the balance sheet per the CNB regulatory requirements to Cash and amounts due from banks in the financial statements.

24 Reclassification of Restricted deposits in the total amount of HRK 1,700,516 thousand from Interest, fees and other assets in the balance sheet per CNB regulatory requirements to Deposits from customers in the financial statements.

25 Reclassification of Provisions for liabilities and expenses of HRK 29,748 thousand from Interest, fees and other assets in the balance sheet per CNB regulatory requirements to Provisions for liabilities and expenses in the financial statements.

**Reconciliation of the balance sheet at 31 December 2014 (continued)**

26 Items Giro and current account deposits in the amount of HRK 2,914,496 thousand, Savings deposits in the amount of HRK 986,972 thousand and Term deposits in the amount of HRK 8,572,435 thousand in the balance sheet per CNB regulatory requirements are reported in the financial statements as follows: HRK 372,435 thousand within Deposits from banks and HRK 12,101,486 within Deposits from customers.

27 Reclassification of HRK 228,136 thousand from Share capital in the balance sheet per the CNB regulatory requirements to Capital gains in the financial statements.

28 Treasury shares in the amount of HRK 874 thousand are shown in the financial statements as a deduction from share capital.

29 Reclassification of HRK 635,384 thousand from Loss for the year in the balance sheet per the CNB regulatory requirements to Retained earnings/Accumulated loss in the financial statements.

30 Reclassification of the treasury share reserve in the amount of HRK 874 thousand from item Statutory and other capital reserves in the balance sheet per the CNB regulatory requirements to Retained earnings/Accumulated loss in the financial statements.

31 Other liabilities (account 241) in the amount of HRK 3,056 thousand from Interest, fees and other assets in the balance sheet per the CNB regulatory requirements to Deposits to customers in financial statements.

32 Reclassification of HRK 887 thousand from Statutory and other capital reserves in the balance sheet per the CNB regulatory requirements to Revaluation reserve in the financial statements.

**Reconciliation of the income statement for the year 2014**

| | CNB requirements HRK 000 | Per financial statements HRK 000 | Difference HRK 000 |
|---|---|---|---|
| Interest income | 863,360 | 862,370 | 990 |
| Interest expense | (373,633) | (348,982) | (24,651) |
| **Net interest income** | **489,727** | **513,388** | **(23,661)** |
| Fee and commission income | 484,933 | 484,933 | - |
| Fee and commission expense | (312,103) | (312,103) | - |
| **Net fee and commission income** | **172,830** | **172,830** | **-** |
| Gains less losses arising from securities at fair value | | | |
| through profit or loss and held for trading | - | 1,370 | (1,370) |
| Gains less losses arising from securities available for sale | - | 17,353 | (17,353) |
| Gains less losses arising from dealing in foreign currencies | - | 36,625 | (36,625) |
| Other operating income | - | 10,064 | (10,064) |
| **Operating income** | - | **751,630** | (751,630) |
| Other non-interest income | 43,409 | - | 43,409 |
| Other non-interest expenses | (41,004) | - | 41,004 |
| **Other non-interest income, net** | **2,405** | **-** | **2,405** |
| **Net non-interest income** | **175,235** | **-** | 175,235 |
| General and administrative expenses, and depreciation | 478,458 | 452,103 | 26,355 |
| **Net operating income before provisions and impairment losses** | **186,503** | - | **186,503** |
| Impairment losses on loans and receivables to customers | | | |
| and other assets | - | 931,762 | (931,762) |
| Provisions for liabilities and expenses | - | 4,818 | (4,818) |
| **Operating expenses** | **-** | **1,388,683** | **(1,388,683)** |
| Impairment losses and provisions | 830,662 | - | 830,662 |
| Provisions for portfolio based impairment losses | (7,106) | - | (7,106) |
| **Total provisions for impairment losses** | **823,556** | **-** | **823,556** |
| **Profit/loss before taxation** | **(637,053)** | **(637,053)** | **-** |
| Income tax expense | 1,669 | 1,669 | - |
| **Profit /loss for the year** | **(635,384)** | **(635,384)** | **-** |
| **Loss per share in HRK** | **(723.70)** | **(723.70)** | **-** |

**Reconciliation of the income statement for the year 2014 (continued)**

1 Reconciliation of foreign exchange differences

Net foreign exchange differences in the amount of HRK 990 thousand are included in the income statement per the CNB regulatory requirements within Interest income and in the annual financial statements they are reported within Other operating income.

Net foreign exchange differences in the amount of HRK 835 thousand are included in the income statement per the CNB regulatory requirements within Impairment losses and provisions and in the annual financial statements they are reported within Other operating income.

Net foreign exchange differences in the amount of HRK 191 thousand are included in the income statement per the CNB regulatory requirements within Interest expense and in the financial statements they are reported within Other operating income.

Net foreign exchange differences in the amount of HRK 1 thousand are included in the income statement per the CNB regulatory requirements within Income from fees and commissions and in the financial statements they are reported within Other operating income.

Exchange differences in the amount of HRK 6,216 thousand on retranslation of the balance sheet at the mid-exchange rate are included in the income statement per the CNB regulatory requirements in Other non-interest income whereas in the financial statements they are reported within Other operating income.

Exchange differences in the amount of HRK 1,999 thousand on impairment losses (accounts 6409 and 6419) included in the income statement per the CNB regulatory requirements within Impairment losses and provisions are reclassified in the financial statements to Other operating income.

Exchange differences in the amount of HRK 36,625 thousand from foreign currency trading, which are included in the income statement per the CNB regulatory requirements within Other non-interest income are included in the financial statements in Gains less losses arising from dealing in foreign currencies.

2 Reclassification of HRK 24,461 thousand of the insurance premium expense from Interest expense in the income statement per the CNB regulatory requirements to General and administrative expenses and depreciation.

3 The amount of HRK 17,353 thousand from realized gains from financial assets available for sale which are included in the income statement per the CNB regulatory requirements within Other non-interest income are included in the financial statements in Gains less losses from securities available for sale.

4 Reclassification of HRK 2,634 thousand included in the income statement per the CNB regulatory requirements within Gains less losses from securities at fair value through profit or loss and trading and in the financial statements they are reported within Other non-interest income.

5 Reclassification of HRK 1,264 thousand arising from trading derivative financial instruments from Other non-interest income in the income statement per the CNB regulatory requirements Gains less losses from securities at fair value through profit or loss and trading in the financial statements.

6 The amount of HRK 1,359 thousand of dividends received is included in the income statement per the CNB regulatory requirements in Other non-interest income whereas in the financial statements it is included in Other operating income.

7 The amount of HRK 4,203 thousand (other income - accounts 68 less balances on accounts 68010, 6885 and income from reversal of provisions on accounts 6881 and 6882) included in the income statement per the CNB regulatory requirements within Other non-interest income is captured in the financial statements within Other operating income.

**Reconciliation of the income statement for the year 2014 (continued)**

8 The amount of HRK 8,388 thousand (income from provisions reversal, account 6882) included in the income statement per the CNB regulatory requirements in Other non-Interest income is presented in the financial statements in General and administrative expenses.

9 The amount of HRK 1,052 thousand (income from reversal of provisions - accounts 6881, 68810) included in the income statement per the CNB regulatory requirements in Other non-Interest income is presented in the financial statements in Provisions for liabilities and expenses.

10 The amount of HRK 140 thousand (income from reversal of provisions - account 68804) included in the income statement per the CNB regulatory requirements in Other non-Interest income is presented in the financial statements in Provisions for liabilities and expenses.

11 The amount of HRK 11,609 thousand (accounts 627) included in the income statement per the CNB regulatory requirements in Other non-interest expense is presented in financial statements in General and administrative expenses.

12 The amount of HRK 21,073 thousand (accounts 634, 635 and 6311) included in the income statement per the CNB regulatory requirements in Other non-Interest expense is presented in the financial statements in General and administrative expenses.

13 The amount of HRK 8,322 thousand (accounts 633 and 638) included in the income statement per the CNB regulatory requirements in Other non-Interest expense is presented in the financial statements under Provisions for liabilities and expenses.

14 The amount of HRK 323 thousand (income from the sale of foreclosed assets) included in the income statement per the CNB regulatory requirements in Other non-Interest income is presented in the financial statements in Other operating income.

15 The amount of HRK 75,110 thousand (net impairment of tangible assets, account 66293) included in the income statement per the CNB regulatory requirements in General and administrative expenses is presented in the financial statements under Impairment losses on loans to and receivables from customers and other assets.

16 The amount of HRK 33,621 thousand (impairment of equity investments) included in the income statement per the CNB regulatory requirements in Other non-Interest income is presented in the financial statements under Impairment losses on loans to and receivables from customers and other assets.

17 The amount of HRK 827,726 thousand (account 647) included in the income statement per the CNB regulatory requirements in Expenses from value adjustments and provisions for identified losses is presented in the financial statements under Impairment losses on loans to and receivables from customers and other assets.

18 The amount of HRK 4,695 thousand of the cost of provisions for identified portfolio based impairment losses included in the income statement per the CNB regulatory requirements in Expenses from value adjustments and provisions for identified losses on portfolio basis is presented in the financial statements Impairment losses on loans to and receivables from customers and other assets.

19 Reclassification of income from reversals amounting to HRK 2,441 thousand from the item Provisions for portfolio based impairment losses on off-balance sheet exposure in the income statement per the CNB regulatory requirements to Provisions for liabilities and expenses in the financial statements.

20 Reclassification of provisions for off-balance sheet exposures in the amount of HRK 100 thousand included in the income statement per the CNB regulatory requirements within Impairment losses and provisions to Provisions for liabilities and expenses in the financial statements.

**Reconciliation of the Statement of Changes in Equity for the year 2014**

| **Bank** | **Share capital HRK 000** | **Treasury shares HRK 000** | **Legal, statutory and other reserves HRK 000** | **Retained profit / (Accumulated losses) HRK 000** | **Profit /loss for the year HRK 000** | **Unreal. gains /losses financial assets available for sale HRK 000** | **Total equity HRK 000** |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2014** | **1,194,776** | **(874)** | **10,522** | **160,707** | **42,410** | **45,850** | **1,453,390** |
| Effects of changes in accounting policies and corrections of errors | - | - | - | - | - | - | **-** |
| Restated balance at 1 January 2014 | 1,194,776 | (874) | 10,522 | 160,707 | 42,410 | 45,850 | 1,453,390 |
| Disposal of financial assets available for sale | - | - | - | - | - | - | **-** |
| Change in the fair value of financial assets available for sale | - | - | - | - | - | 34,658 | **34,658** |
| Tax on items recognised directly in/transferred from equity | - | - | 15 | - | - | (7,767) | **(7,752)** |
| Other gains and (losses) recognised directly in equity | - | - | (317) | - | - | - | **(317)** |
| **Net gains/(losses) recognised directly in equity** | **-** | **-** | **(302)** | **-** | **-** | **26,891** | **26,589** |
| Profit/(loss) for the year | - | - | - | - | (635,384) | **-** | (635,384) |
| **Total recognised income and expenses for 2014** | **-** | **-** | **(302)** | **-** | **(635,384)** | **26,891** | **(608,795)** |
| Increase/decrease in share capital | - | - | - | - | - | - | - |
| Purchase/sale of treasury shares | - | - | - | - | - | - | - |
| Other changes | - | - | - | - | - | - | - |
| Transferred to reserves | - | - | 2,120 | 40,290 | (42,410) | - | - |
| Dividends paid | - | - | - | - | - | - | - |
| Profit allocation | **-** | **-** | **2,120** | **40,290** | **(42,410)** | **-** | **-** |
| **Balance at 31 December 2014** | **1,194,776** | **(874)** | **12,340** | **200,997** | **(635,384)** | **72,741** | **844,595** |

Items: Legal reserve, General banking risk reserve, Revaluation reserve and Other reserves from the financial statements are presented in the statement of changes in equity per CNB's regulatory requirements in Legal, statutory and other reserves.

Retained earnings from the Annual Report are presented within Retained earnings/(Accumulated losses), Profit/(loss) for the year.

## Reconciliation of cash flows for the year 2014

| | CNB requirements HRK 000 | Per Financial Statements HRK 000 | Difference HRK 000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before taxation | (637,053) | (637,053) | - |
| Adjusted by: | | | - |
| - Depreciation and amortisation | 53,078 | 53,078 | - |
| - Foreign exchange (gains)/ losses | (4,180) | (4,180) | - |
| - Impairment losses on loans and receivables to customers and other assets | - | 931,762 | (931,762) |
| - Impairment losses on provisions for liabilities and expenses | | 4,818 | (4,818) |
| Impairment losses and provisions | 936,580 | - | 936,580 |
| - Gains less losses from financial assets at fair value through profit or loss | (119) | (119) | - |
| *Changes in operating assets and liabilities* | | | - |
| Net increase in loans to and receivables from customers | - | 62,302 | (62,302) |
| Net decrease in financial assets at fair value through profit or loss | - | (6,846) | 6,846 |
| Treasury bills of the Ministry of Finance and the CNB bills | 299,483 | - | 299,483 |
| Deposits with banking institutions and loans to financial institutions | 398,763 | - | 398,763 |
| Loans to other customers | 208,121 | - | 208,121 |
| Securities and other financial instruments held for trading | (7,181) | - | (7,181) |
| Securities and other financial instruments available for sale | (658,486) | - | (658,486) |
| Net (increase)/decrease in loans to and receivables from customers | - | 539,497 | (539,497) |
| Net (increase)/decrease in other assets | 46,116 | 64,266 | (18,150) |
| Net (decrease)/increase in deposits from banks | - | (366,457) | 366,457 |
| Net increase/(decrease) in deposits from customers | - | (264,616) | 264,616 |
| Net increase/(decrease) in other liabilities | - | (54,446) | 54,446 |
| Demand deposits | (163,793) | - | (163,793) |
| Savings and term deposits | (730,438) | - | (730,438) |
| Derivative financial and other liabilities held for trading | 500 | - | 500 |
| Other liabilities | 219,830 | - | 219,830 |
| **Net cash inflow from operating activities before tax** | **-** | **322,006** | **(322,006)** |
| Income taxes paid | (53) | (53) | **-** |
| **Net cash generated from operating activities** | **-** | **321,953** | **(321,953)** |
| **Cash flows from investing activities** | | | |
| Investments in subsidiaries | - | - | **-** |
| Investments in associates | - | - | **-** |
| Purchases of property, plant, equipment and intangible assets | (30,106) | (30,106) | **-** |
| Disposal of financial assets available for sale | - | 768,458 | **(768,458)** |
| Acquisition of financial assets available for sale | - | (1,129,243) | **1,129,243** |
| Net disposal/(acquisition) of financial assets held to maturity | 222,464 | 222,465 | **-** |
| Dividends received | 1,359 | 1,359 | **-** |
| **Net cash inflow/(outflow) from investing activities** | **-** | **(167,068)** | **167,068** |
| **Cash flows from financing activities** | | | |
| Increase in hybrid instruments | (150,000) | (150,000) | **-** |
| Increase in borrowings | - | 1,108,382 | (1,108,382) |
| Repayments of borrowings | | (675,068) | 675,068 |
| Net increase/decrease in borrowings | 433,314 | - | 433,314 |
| Proceeds from issuance of share capital | - | - | **-** |
| **Net cash inflow from financing activities** | **-** | **283,314** | **(283,314)** |
| Effect of foreign exchange differences on cash and cash equivalents | (1,920) | (1,920) | **-** |
| **Net increase/(decrease) in cash and cash equivalents** | **436,279** | **436,279** | **-** |
| **Cash and cash equivalents at the beginning of the year** | **2,979,947** | **2,979,947** | **-** |
| **Cash and cash equivalents at the end of the year** | **3,416,226** | **3,416,226** | **-** |

**Reconciliation of cash flows for the year 2014 (continued)**

1. Reclassification of HRK 936,580 thousand from Impairment losses on loans and receivables from customers and other assets in the cash flow statement per the CNB regulatory requirements into the following items in the financial statements: HRK 931,762 thousand to Impairment losses and provisions, and HRK 4,818 thousand as Impairment losses for liabilities and expenses.

2. Reclassification of HRK 299,483 thousand from Treasury bills issued by the Ministry of finance and CNB bills, HRK 398,763 thousand from Deposits and loans to financial institutions, HRK 208,121 thousand from Loans to other customers, HRK 7,181 Securities and other financial instruments held for trading, HRK 658,486 of Securities and other financial instruments available for sale, HRK 163,793thousand of Demand deposits, HRK 730,438 thousand of Savings and term deposits, HRK 500 thousand of Financial derivatives and other financial liabilities held for trading, HRK 219,830 thousand of Other liabilities, from the cash flow statement as per the CNB reporting requirements to the following items in the financial statements: HRK 62,302 thousand to Net (increase)/decrease in loans and receivables from banks; HRK 6,846 thousand to Net (increase)/decrease in financial assets at fair value through profit or loss; HRK 539,497 thousand to Net (increase)/decrease in loans and receivables from customers; HRK 366,457 thousand to Net (decrease)/increase in deposits from banks; HRK 264,616 thousand to Net (decrease)/increase in deposits from customers; HRK 54,446 thousand to Net (decrease)/increase in other liabilities; and HRK 768,458 to Disposal of financial assets available for sale and HRK 1,129,243 thousand to Acquisition of financial assets available for sale.

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