

CROATIA BANKA d.d.

ANNUAL REPORT FOR 2017

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INTRODUCTION

The Annual Report includes the Management Board Report on the Bank's position, an overview of financial and operational performance, audited financial statements, together with the Independent Auditor's Report, and other regulatory reports for the Croatian National Bank. Unless otherwise noted, all amounts in the Annual Report are presented in thousands of kunas.

Legal form

The Annual Report has been prepared pursuant to the Accounting Act and the Companies Act which require reporting to the shareholders at the annual meeting of shareholders by the company management. Pursuant to the Companies Act, the full statutory set of financial statements consists of the statement of financial position, the statement of comprehensive income, the statement of changes in equity, the cash flow statement and notes to the financial statements, and the Companies Act stipulates in Article 250a an obligation to submit an annual report on the Bank's state of affairs.

The annual financial statements have been prepared in line with the legal requirements for bank accounting in Croatia and audited in accordance with International Standards on Auditing.

Abbreviations

In this Annual Report, Croatia banka d.d. is referred to as the "Bank", the Croatian National Bank as the "CNB", the Croatian Bank for Reconstruction and Development as the "CBRD", the State Agency for Deposit Insurance and Bank Rehabilitation as the "DAB" and the Financial Agency as "FINA", European Union as the "EU" and gross domestic product as the "GDP".

Exchange rates

For the purpose of translating the amounts in foreign currencies into HRK amounts, the following mid exchange rates of the CNB were used:

At 31 December 2017 EUR 1 = HRK 7.513648; USD 1 = HRK 6.269733

At 31 December 2016 EUR 1 = HRK 7.557787; USD 1 = HRK 7.168536

Operational summary and key financial indicators
(amounts in millions of HRK)

Indicator / Year	2017	2016	2015	2014	2013
Key indicators					
Profit/(loss) before tax	(31)	3	2	5	(25)
Net profit/(loss)	(31)	2	(15)	4	(25)
Total assets	2,491	3,110	3,109	3,038	2,629
Loans and advances to customers	1,153	1,591	1,893	1,906	1,630
Total deposits received	2,156	2,609	2,616	2,593	2,066
Capital and reserves	152	190	182	200	195
Other indicators					
Ratio of operating expenses in operating income	72.7%	71.5%	73.00%	79.70%	113.70%
Return on equity	(17.9%)	0.9%	(8.3%)	2.0%	(12.6%)
Assets return	(1.1%)	0.1%	(0.5%)	0.1%	(0.9%)
Own funds	146	174	175	171	193
Total capital ratio	15.85%	16.81%	15.91%	13.29%	14.00%

Historical development of the Bank

Croatia banka d.d., Zagreb was founded on 22 December 1989, under the name Banka male privrede, d.d., Zagreb. On that day, 50 shareholders paid in socially owned capital contributions to form the initial (share) capital of 22,340,435,000 former Yugoslav dinars, equivalent to DEM 319,149 (which was then the condition for establishing a bank), which was subsequently divided into 4,565 founders' shares. On 25 January 1990 the Bank received from the Yugoslav National Bank the Decision granting full banking licence and had it registered at the court on 18 July 1990. On 4 May 1990 the Bank changed its name from Banka male privrede d.d. Zagreb into Croatia banka male privrede d.d. Zagreb, (abbreviated: "Croatia banka d.d. Zagreb"), and on 21 June 1995 it changed its name into Croatia banka d.d. Zagreb.

As a result of difficulties faced by the Bank, a procedure to rehabilitate the Bank was initiated in 1999 and, pursuant to Article 15(1), Article 16(1) and Article 17(1) of the Bank Rehabilitation and Restructuring Act (Croatian Official Gazette no 44/94) and Point VII of the Decision of the Government of the Republic of Croatia on the rehabilitation and restructuring of Croatia banka d.d. Zagreb of 27 September 1999 and the Decision of the Government of the Republic of Croatia on amendments to the Decision on rehabilitation and restructuring of Croatia banka d.d. Zagreb of 24 May 2000, the General Assembly of Croatia banka d.d. adopted on 13 September 2000 a Decision on issuing new replacement shares in the amount of HRK 204.6 million and a Decision on amendments to the Statute of Croatia banka d.d., which formally ended the process of the Bank's rehabilitation. The DAB contributed capital to the Bank in the amount of the replacement shares, and the Bank continued to operate as a Croatian public limited company (Croatian: 'dioničko društvo') fully owned by the State.

Information on economic trends and forecasts¹

Economic activity continued to grow steadily in the third quarter of 2017, with the highest growth in exports of goods, services and personal consumption. Real GDP could rise in 2017 by 3.1% and the growth rate in 2018 could be lower due to a slower personal consumption growth of 2.9%. It is estimated that the unemployment rate could fall to around 10% in 2018.

Average annual consumer price inflation was 1.2% in 2017, mostly as a result of rising food and energy prices. With the growth of import prices and slight revival of domestic inflationary pressures, considering that the cyclical position of the domestic economy will change, continued acceleration of inflation is expected during 2018, but the inflation rate could remain low or lower than the long-term average. The deficit and general government debt could continue to decline in 2017, according to the Ministry of Finance forecast. Monetary policy will continue to support economic growth by maintaining its expansionary character by supporting the high liquidity of the monetary system and maintaining the stability of the kuna against euro.

Labour market

On the labour market, favourable trends are expected and the projected administrative unemployment rate is 12.4% for 2017, or 11.3% for 2018. Growth in the number of employed persons is expected, as well as intensification of the growth of real net wages due to the Government's decision to increase salaries for public and civil servants, more favorable changes to the law on income taxation and lower private sector wage growth.

Prices

Average annual inflation in consumer prices is 1.2% in 2017, while inflation in the year 2018 may slightly increase to 1.6%. This is expected as a result of import price pressures and continued growth in unit labor costs.

External sector

The trend of reducing external imbalances which has been positive since 2012, continues to decline. The surplus in the current account in 2017 is expected to increase further, mainly as a result of the unfavourable impact of Agrokor's crisis on the commercial banks' profits. On the other hand, reduction of surplus in the current account can be expected during 2018, which will mostly be the result of foreign trade deficit growth due to further recovery of domestic economic activity and strengthening of import demand. According to projections, the share of general government debt in GDP will continue to fall in 2017 and 2018.

Current and capital account of balance of payments

In the year 2017, there was still a noticeable surplus in the current and capital account. In the third quarter of 2017, it rose significantly in relation to the same period last year, not only because of the exceptionally good tourist season, whose movements temporarily overcame the worsening of foreign exchange shortages, but also because of the lower deficit on the primary income account associated with the situation in Agrokor. That completely explains the improvement of the total surplus on current and capital account in the previous part of the year, when the surplus growth in the exchange of services was accompanied by a stronger increase in trade shortages. The on current and capital account in the third quarter of 2017, if cumulative gains over the last year were observed, amounted to 4.7% of GDP (or 3.7% of GDP excluding Agrokor's effect on bank profits).

¹Macroeconomic trends and forecast, CNB, December 2017

Information on economic trends and forecasts (continued)

Monetary policy

The Croatian National Bank has continued to implement expansive monetary policy by supporting the high liquidity of the monetary system. Due to the appreciation pressures on domestic currency, the CNB bought from the banks EUR 1.6 billion and from the Ministry of Finance EUR 29.4 billion in 2017. In addition The CNB continued to support high kuna liquidity in the monetary system. After the structured reverse repo auctions in November 2017 amounted to HRK 0.5 billion (with an interest rate of 1.2 percent), the balance of total assets invested by structural repo operations amounts to HRK 1.3 billion.

The average surplus of HRK liquidity reached the level of 14.8 billion in the first eleven months of 2017., primarily as a result of the creation of primary money by buying foreign currency from banks. The average weighted overnight interbank borrowing rate was 0.07 percent in 2017 (0.41 percent in 2016). The average nominal exchange rate of HRK against EUR was 1.0 percent lower in the first eleven months of 2017 compared to the same period last year.

The CNB will continue to pursue a stable exchange rate policy against the euro and support the high liquidity of the monetary system through structural and regular repo operations, while foreign exchange interventions will be used depending on exchange rate pressures.

Fiscal policy

In June 2017, the Council of the European Union confirmed Croatia's exit from the excessive deficit procedure as the general government deficit fell to 0.8% of GDP in 2016, and in the medium term it is expected to continue to reduce the general government debt at an appropriate pace.

Fiscal data (expressed in ESA 2010 methodology) show a significant reduction of the general government deficit in the first half of 2017, based on annual level.

The general government deficit in the first six months of 2017 was HRK 1.1 billion, i.e. HRK 2.7 billion less than in the same period last year.

According to MoF data, favourable developments in public finances continued in the third quarter of 2017. Under the influence of positive achievements in the previous part of the year, the Government of the Republic of Croatia in November adopted amendments to the state budget and budget plans of budget users reducing the planned general government deficit. According to new projections, the general government deficit according to the ESA 2010 methodology could amount to 0.6% of GDP in 2017, which is 0.7 basis points less than the previous expectations. Therefore, the annual nominal deficit of the general government could continue to fall, as started in 2014.

Business description

The Bank's activities include all types of deposit and loan operations for legal and natural persons, domestic and foreign payments, issuing guarantees, avals and other forms of guarantees, purchase and sale of securities and other banking activities.

The Bank is fully (100%) owned by the state and ranked by assets (HRK 2.5 billion) as the 13th of a total of 26 banks. As at 31 December 2017, the Bank has 13 branches and 3 premises.

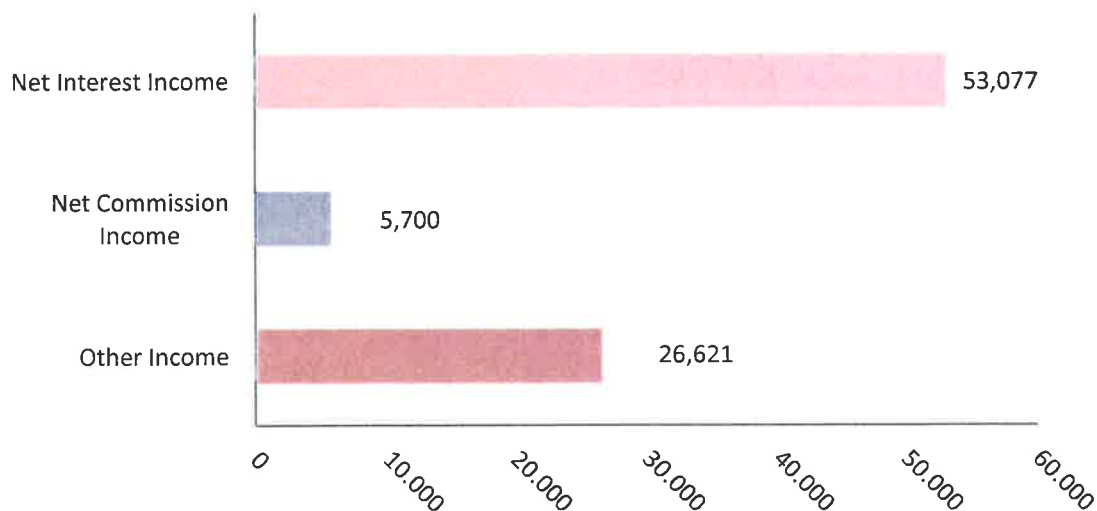
The Bank's own (regulatory) capital as at 31 December 2017 amounts to HRK 146,181 thousand, and the regulatory capital adequacy rate is 15.85%.

In 2017 the Bank generated a pre-tax loss in the amount of HRK 31,287 thousand, and the loss after tax amounts to HRK 30,631 thousand.

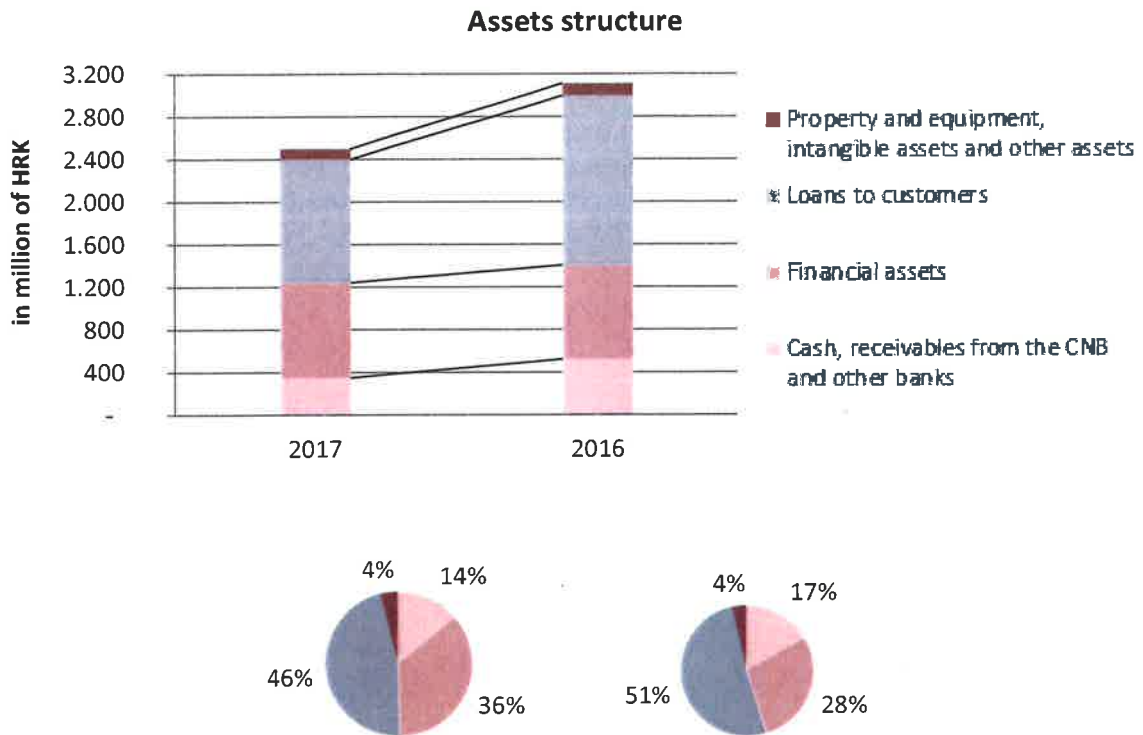
The operating profit for the year amounts to HRK 23,328 thousand, the impairment and provisioning expense amounts to HRK 54,615 thousand.

Total net operating income decreased by 1.7%, while operating expenses decreased by 0.1% compared to 2016 which contributed to a drop in operating profit in 2017. Interest income represents the most significant share of the total income and amounts to 62.2 percent (HRK 53,077 thousand).

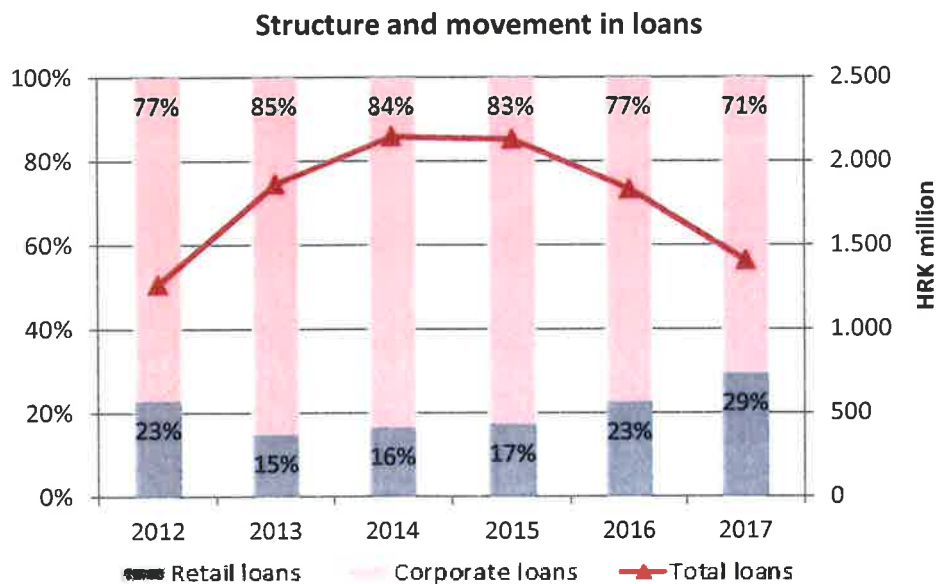
Structure of operating income in 2017
(in thousands of HRK)



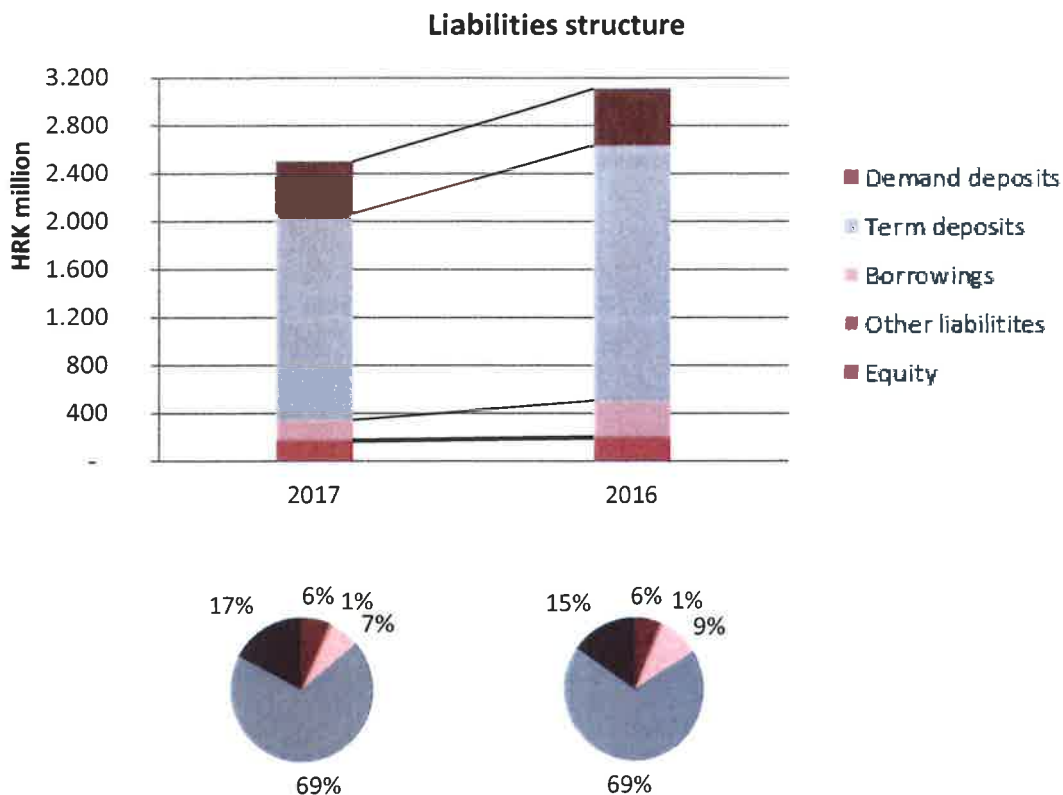
At the end of 2017 the Bank's assets amount to HRK 2,501,460 thousand, HRK 608,571 thousand less than at the end of 2016. Loans and receivables from customers represent the largest share (46 percent), followed by financial assets (36 percent) and cash and receivables from the Croatian National Bank and other banks (14 percent).



At 31 December 2017, the balance of total gross loans to customers was HRK 1,406,498 thousand, which is 23.2 percent less than in 2016 mainly due to reduced public sector loans. Loans to legal persons represent 71 percent of the total loans to customers, and loans to individuals (including sole traders) account for 29 percent.

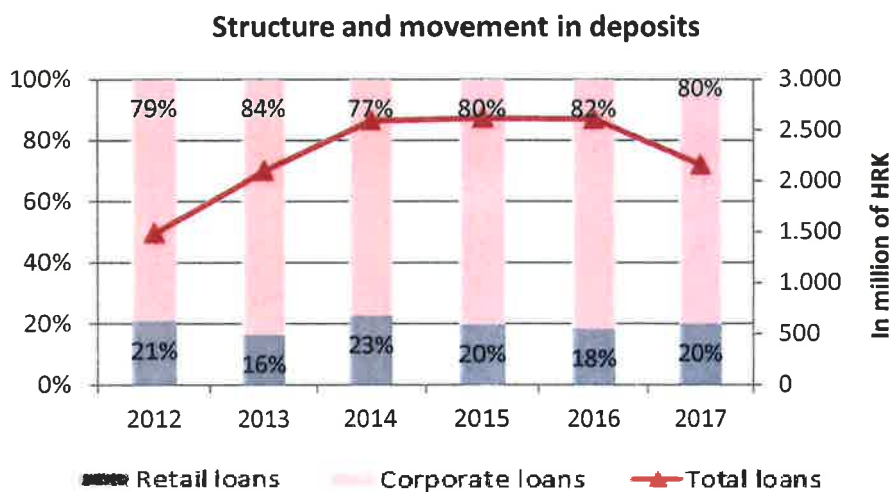


Term deposits represent the largest portion of liabilities and account for 69 percent, followed by demand deposits which represent 17 percent.



Total deposits at the end of 2017 amounted to 2.1 billion, which presents a decrease compared to the end of 2016 by 17.3 percent, wherein retail deposits increased by 8.9 percent, and corporate deposits decreased by 40.4 percent.

As regards the structure of total deposits, term deposits (80 percent) prevail by far over demand deposits (20 percent). Customers term deposits decreased by 19 percent, and their share in total deposits is lower for 2 pp. In 2017 demand deposits record decrease by 9.8 percent.



Retail customer operations

2017 was the year in which more attention was paid to deposit activity, due to the overall consolidation of the liquidity structure at the level of the entire Bank. The biggest impact was the closure of the two big branches (Rijeka and Zadar), which led to a significant level of decrease in the deposits of individuals over a period of several months. It has been suggested that the Bank will reduce excessive and unnecessary liquidity reserves, which resulted in significant reduction of interest costs.

Lending with reduced intensity due to capital constraints, as well as due to the closure of two large subsidiaries, was continued in 2017, which further influenced the reduction of placements.

Despite the decline in the business network, there has been no reduction in the number of current accounts although the closure effects on this issue will be visible in 2018.

Operations with legal persons

Deposits from legal persons (excluding deposits from other banks) account for 16 percent of the Bank's total deposits. They fell by 40,4 percent from the end of 2016 and amount to HRK 335,610 thousand. Of that balance, demand deposits amount to HRK 223,777 thousand, and term deposits amount to HRK 111,833 thousand. The decrease was mostly due to several larger deposits being strategically released for high interest expense.

At the end of 2017, the total gross portfolio of loans to legal persons amounted to HRK 993,350 thousand, which is HRK 426,649 thousand less than at the end of 2016. The same applies to public sector lending. The loans issued to public sector entities were duly repaid in 2017 and were not reprogrammed. Given a lower number of public tendered, the general decline of the public-sector loan demand and the very low interest rates offered to the sector by competitors.

As part of its 2017 plan for corporate customers, the Bank intended to preserve its existing good customers as well as continuously improve the quality of its business processes in cooperation with other organizational units of the Bank, with an emphasis on the lending process, which the Bank succeeded in the most part. The plan is to continue the efforts in 2018. The total number of customers remained more or less the same, compared with previous year, as well as the non-interest income. Fee income decreased, mainly on issued guarantees and letters of credit..

Treasury operations

The Bank maintains its liquidity using available liquid instruments denominated in HRK and foreign currencies (balances on accounts with the Bank, securities, inter-bank loans, repo loans). A more sophisticated instrument used by the Bank to manage its liquidity position is an FX swap. Throughout the year 2017 the Bank maintained a high liquidity as well as a balanced foreign exchange position on all currencies.

In 2017 the securities portfolio (bonds and treasury bills) increased by 4.8 percent (of which bonds by 24.4 percent, but the T-bill portfolio decreased by 7.1 percent). As a result and despite the unfavourable movements on the market and the decrease in active interest rates, the actual interest income and trading results were on budget.

Regarding the quality of the business processes, a key change was creating an internal application for the planning of inflows and outflows in the Business Network. Further progress was made in the area of collecting data relevant for liquidity and quality of Assets Liability Committee reports.

Investment banking

The Bank has obtained all permits from the Croatian National Bank and the Croatian Financial Services Supervisory Agency for providing investment services and activities and has achieved all prerequisites for providing investment services. In the field of investment banking, the Bank offers to its clients brokerage services, custody services for customers' financial assets, margin loan for purchases of financial instruments, as well as general-purpose S-loans against financial instruments placed into the Bank's custody.

Despite the unfavourable situation on the Croatian financial market, which features low transaction volumes and meagre investments, the Bank achieved a significant growth in the investment banking segment. Over the past one-year period, its customer base has grown considerably, and the portfolio of its investment banking customers has multiplied. As a result, the Bank reported a considerable increase in interest income, which supports the sustainability and profitability of this segment in the long run.

Internal control system and internal audit

The internal control system at the Bank's level has been set up by means of internal acts that vertically and horizontally divide responsibilities among the Bank's organizational units.

The internal control system at the Bank has been implemented as a set of established processes and procedures established for the purpose of adequate risk control, monitoring the efficiency and effectiveness of the Bank's operations, reliability of its financial and other information, and regulatory compliance, including compliance with internal acts, standards and codes, to ensure the stability of the Bank's operations.

Internal audit

The internal audit function has been set up as a separate organizational unit that is functionally and organizationally independent of activities it audits as well as of other organizational units of the Bank.

The Annual Audit Plan is based on documented risk assessments and contains all the relevant elements from the Decision on the internal control system and internal acts. The annual work plan of the internal audit is approved by the Bank's Management Board based on a prior consent of the Audit Committee and/or the Supervisory Board.

Internal audit reports are delivered to all members of the Management Board, persons responsible for the Bank's organizational part audited and the Audit Committee.

The Internal Audit also prepares its activity reports and submits them to the Management Board and the Audit Committee on a quarterly basis, to the Supervisory Board semi-annually, as well as the annual report for the CNB.

Implementation of the Corporate Governance Code

Pursuant to the provisions of Article 272 of the Companies Act, the Management Board of Croatia bank d.d. Zagreb hereby declares that the Bank implements the Corporate Governance Positions of the Croatian National Bank for Banks on a voluntary basis.

In 2017, the Bank continuously followed and applied the recommendations determined in the CNB's Positions, disclosing all information the disclosure of which is provided by positive regulations as well as making disclosures that are in the interest of the Bank's owners and clients.

Pursuant to the corporate governance requirements and in line with the provisions of the Companies Act, the Supervisory Board performs the internal oversight by regular controls of submitted reports. Members of the Supervisory Board regularly obtain detailed information on the Bank's management and operations. At the Supervisory Board meetings, all issues from the Board's area of responsibilities are discussed and decided on.

The Bank keeps business and other records and business documentation, prepares accounting documents, realistically assesses assets and liabilities, prepares financial statements and other reports in accordance with accounting regulations and standards and the applicable legislation.

Corporate governance at the Bank is implemented not only by meeting regulatory requirements, but it also derives from the culture of corporate and personal integrity of the management and employees. Main features of the implemented internal oversight and risk management relevant for financial reporting are described further below.

Nominees for the president and members of the Bank's Management Board must meet all requirements prescribed by legislation governing banking operations and other relevant regulations. Once the Croatian National Bank approves the nominees, the Supervisory Board appoints the president and members of the Management Board with a mandate of up to four years. The powers of the Bank's Management Board are defined by law and the Statute. The division of the respective responsibilities of the Management Board and its president are determined in a separate decision adopted with the consent of the Supervisory Board.

Decisions on amendments to the Statute are adopted at the Bank's General Assembly, in line with the Act and the Statute.

For the purpose of protecting the interests of the owners, clients, employees and all other stakeholders, Croatia banka d.d. Zagreb aims to maintain its operations in line with highest corporate governance standards.

Governance structure of the Bank

In accordance with the Companies Act, the Credit Institutions Act and the Bank's Statute, the Bank's governance structure comprises the Supervisory Board and the Management Board, whose duties and responsibilities are also regulated by those acts.

Other information

The Bank did not carry out any research and development activities in 2017.

The Bank did not purchase any treasury shares during in 2017.

The Bank does not own other legal entities.

Purchase and sale of financial instruments constitute an integral part of the Bank's operations and are described in detail in these financial statements.

Details about the Bank's financial risk management goals and policies, its exposure to price risk, credit risk, liquidity risk and other risks are provided in the accompanying financial statements.

CROATIA BANKA d.d.
RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Pursuant to the Croatian Accounting Law, the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with local accounting requirements for banks, to give a true and fair view of the state of affairs and results of Croatia banka d.d. ("Bank") for that period.

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

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

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

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Law (Official Gazette no. 78/15, 134/15 and 120/16). The Management Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Management Board is responsible for preparation and content of the annual report in accordance with the article 19 of the Accounting Act (Official Gazette 78/15, 134/15 and 120/16), and also for other regulatory supplementary reports.

For and on behalf of the Management Board

26 April 2018

Branka Grabovac
Member of the Management Board



CROATIA BANKA
d.d. Zagreb
UPRAVA



Zoran Sabolić
Member of the Management Board

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Croatia banka d.d.

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Croatia banka d.d. (the Bank), which comprise the statement of financial position as at 31 December 2017, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with law requirements for accounting for banks in Republic of Croatia.

Basis for Opinion

We conducted our audit in accordance with the Audit Act and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

The company was registered at Zagreb Commercial Court: MBS 030022053; paid-in initial capital: Kn 44,900.00; Board Members: Branislav Vrtačnik, Marina Tonžetić, Juraj Moravek and Dražen Nimčević; Bank: Zagrebačka banka d.d., Trg bana Josipa Jelačića 10, 10 000 Zagreb, bank account no. 2360000-1101896313; SWIFT Code: ZABHR2X IBAN: HR2723600001101896313; Privredna banka Zagreb d.d., Radnička cesta 50, 10 000 Zagreb, bank account no. 2340009-1110098294; SWIFT Code: PBZGHR2X IBAN: HR3823400091110098294; Raiffeisenbank Austria d.d., Petrinjska 59, 10 000 Zagreb, bank account no. 2484008-1100240905; SWIFT Code: RZBHHR2X IBAN: HR1024840081100240905.

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INDEPENDENT AUDITOR'S REPORT (continued)

Report on the Audit of the Financial Statements (continued)

<p>Key Audit Matter</p>	<p>Impairment losses on loans to customers</p> <p>Please refer to Note 3 for accounting policies and relevant estimates for impairment losses on loans to customers and Notes 7 and 21 for more details on key audit matter</p>
<p>Impairment of loans to customers is considered a matter of most significance, as the assessment process is complex and requires significant management judgment regarding assumptions, which are used when estimating recoverability of loans.</p> <p>Valuation and measurement of loans depend on the credit risk associated with the borrower. When there is objective evidence that a loan might not be recovered in full or in accordance with the contractual terms, i.e. when there is significant doubt as to the payment of interest or repayment of principal or evidence of breach of the contractual terms, the credit risk and the value of such loan is assessed individually. Management applies judgment to assess the inputs they find relevant for the calculation of impairment losses including, but not limited to the, financial position of the borrower, value of the collateral and the projected realization date, the expected cash flows and the current local and global economic conditions.</p>	
<p>How our audit addressed the key audit matter</p>	
<p>During the audit we gained understanding of the Bank's provisioning process and considered the adequacy of the Bank's policies, procedures, employees' responsibilities and controls over the process. We applied our understanding while designing our procedures which addressed the risks associated with provisions for impairment losses on loans.</p> <p>Our audit procedures were focused on and included the following:</p> <p><u>Operating effectiveness of controls</u></p> <p>We tested design and implementation of the controls, which provided us with the basis for further performance of our detailed audit procedures in the planned nature, timing and extent.</p> <p><u>Individually impaired loans</u></p> <p>In determining the sample for our substantive procedures we analyzed the population of loans to customers in order to identify our focus areas. We selected a sample of loans considering, but not limiting to, credit risk groups and changes between individual groups, number of days past due and the probability of default.</p> <p>We performed tests of details on the selected sample to assess the appropriateness of loan classification and to identify if any impairment indicators exist that would suggest that some performing loans should be designated as non-performing and need recognizing a specific provision in accordance with the CNB's Decision and in accordance with statutory accounting requirements for banks in Croatia.</p>	

INDEPENDENT AUDITOR'S REPORT (CONTINUED)**Report on the Audit of the Financial Statements (continued)**

Key Audit Matter (continued)	Impairment losses on loans to customers (continued)
	<p>Impairment of loans to customers is considered a matter of most significance, as the assessment process is complex and requires significant management judgment regarding assumptions which are used when estimating recoverability of loans.</p> <p>Valuation and measurement of loans depend on the credit risk associated with the borrower. When there is objective evidence that a loan might not be recovered in full or in accordance with the contractual terms, i.e. when there is significant doubt as to the payment of interest or repayment of principal or evidence of breach of the contractual terms, the credit risk and the value of such loan is assessed individually. Management applies judgment to assess the inputs they find relevant for the calculation of impairment losses including, but not limited to the, financial position of the borrower, value of the collateral and the projected realization date, the expected cash flows and the current local and global economic conditions.</p> <p>The Bank recognizes provisions for both collective and specific (individual) impairment losses on loans, in accordance with the statutory accounting requirements for banks in Croatia and the Croatian National Bank's Decision on the classification of placements and off-balance sheet liabilities of credit institutions (Official Gazette no. 41/14, 28/17) (the CNB's Decision).</p> <p>Furthermore, we assessed the appropriateness of specific provision calculation and management's assumptions regarding the recoverability of the loans, value of the collateral and projected loan repayments and recovery rates.</p> <p>We analysed the financial position of the customers and inspected situations of potential breaches of contracts and/or changes of original terms and conditions of the contract. We considered the impact of the current local and global economic conditions, the asset price trends and other factors that may affect the recoverability of the sampled loans.</p> <p><u>Collectively impaired loans</u></p> <p>When evaluating the overall adequacy and calculation of the collective impairment level, we assessed the appropriateness of the Bank's provisioning process, applied methodology and parameters used in the calculation.</p> <p>We recalculated provision for collectively impaired loans to assess whether the Bank adheres to the minimum collective impairment of 1.00% of the total exposure for performing loans (class A under the CNB Decision).</p>

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Report on the Audit of the Financial Statements (continued)

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the financial statements and our auditor's report.

Our opinion on the financial statements does not cover the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. With respect to the Management Report on pages 9 to 19 and the Corporate Governance Statement, which are included in the Annual Report, we have also performed the procedures prescribed by the Accounting Act. These procedures include examination of whether the Management Report and Corporate Governance Statement include required disclosures as set out in the Articles 21 and 22 of the Accounting Act and whether the Corporate Governance Statement includes the information specified in the Article 22 of the Accounting Act.

Based on the procedures performed during our audit, to the extent we are able to assess it, we report that:

1. Information included in the other information is, in all material respects, consistent with the attached financial statements.
2. Management Report has been prepared, in all material respects, in accordance with the Article 21 of the Accounting Act.
3. Corporate Governance Statement has been prepared, in all material aspects, in accordance with the Article 22, paragraph 1, items 3 and 4 of the Accounting Act, and includes also the information from the Article 22, paragraph 1, point 2, 5, 6 and 7.

Based on the knowledge and understanding of the Bank and its environment, which we gained during our audit of the financial statements, we have not identified material misstatements in the other information.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

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

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

INDEPENDENT AUDITOR'S REPORT (continued)

Report on the Audit of the Financial Statements (continued)

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

INDEPENDENT AUDITOR'S REPORT (continued)

Report on Other Legal and Regulatory Requirements

We were appointed as the statutory auditor of the Bank by the Bank's General Assembly on 7 April 2017 to perform audit of accompanying financial statements. Our total uninterrupted engagement has lasted 5 years and covers period from 31 December 2013 to 31 December 2017.

We confirm that:

- our audit opinion on the accompanying financial statements is consistent with the additional report issued to the Audit Committee of the Bank on 26 April 2018 in accordance with the Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council;
- no prohibited non-audit services referred to in the Article 5(1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided.

There are no services, in addition to the statutory audit, which we provided to the Bank and its controlled undertakings, and which have not been disclosed in the Annual Report.

Pursuant to the Decision of the Croatian National Bank on the Structure and Content of Annual Financial Statements of Banks (Official Gazette No. 30/17 and 44/17, hereinafter: "the Decision"), the Bank's management has prepared the forms, as presented in the Appendix to these financial statements on pages 98 to 113, which comprise the Balance sheet as of 31 December 2017, the profit and loss account, the statement of changes in equity and the statement of cash flow for the year then ended, as well as the reconciliation to the financial statements.

These forms and the accompanying reconciliation to the financial statements are the responsibility of the Bank's Management Board, and do not represent components of the financial statements prepared in accordance with statutory accounting requirements for banks in Croatia, which are set out on pages 20 to 97, but rather a requirement specified by the Decision. The financial information provided in those forms has been derived from the financial statements of the Bank.



Branislav Vrtacnik

President of the Board and Certified auditor

Deloitte d.o.o.

27 April 2018
Radnička cesta 80,
10 000 Zagreb,
Croatia

CROATIA BANKA d.d.
 STATEMENT OF COMPREHENSIVE INCOME
 For the year ended 31 December 2017

	Notes	2017	2016
Interest income	5	98,156	131,425
Interest expense	6	(39,503)	(69,569)
Net interest income		58,653	61,856
Fee and commission income	7	10,453	12,056
Fee and commission expense	8	(4,753)	(4,360)
Net fee and commission income		5,700	7,696
Net financial gains	9	15,184	7,751
Net income from exchange differences	10	2,743	3,219
Other operating income	11	8,694	6,361
Total other income		26,621	17,331
Other operating expenses	12	(67,646)	(62,112)
Impairment losses and provisions	13	(54,615)	(22,107)
Total other expenses		(122,261)	(84,219)
Profit before taxation		(31,287)	2,664
Income tax	14	656	(1,026)
Profit/(loss) for the year		(30,631)	1,638
Other comprehensive income			
Beginning balance		5,571	(395)
Items potentially included subsequently in profit or loss:		(6,996)	5,966
Unrealised gains/(losses) from the valuation of financial assets available for sale		(1,814)	7,013
Cumulative loss/(gain) on the sale of available-for-sale financial assets transferred to profit or loss		(6,717)	275
Deferred tax on financial assets available for sale		1,535	(1,322)
Closing balance		(1,425)	5,571
TOTAL COMPREHENSIVE INCOME/LOSS*		(37,627)	7,604
Earnings/(loss) per share	33	(6,45)	0.35

* Total comprehensive income is attributable to the owners

The significant accounting policies and other notes on pages 24 to 97 form an integral part of these financial statements.

CROATIA BANKA d.d.
 STATEMENT OF FINANCIAL POSITION
 At 31 December 2017

	<i>Notes</i>	31 December 2017	31 December 2016
ASSETS			
Cash	15	176,668	276,808
Receivables from the Croatian National Bank	16	149,557	191,709
Placements with banks	17	23,092	53,334
Financial assets available for sale	18	887,053	833,773
Financial assets held to maturity	19	-	50,647
Loans and advances to customers	20	1,153,021	1,590,643
Investment property	21	33,630	33,702
Property and equipment	22	6,280	13,427
Intangible assets	22	4,187	4,926
Foreclosed assets	23	15,397	23,389
Non-current assets held for sale	24	5,280	
Deferred tax assets	14	4,089	1,898
Other assets	25	32,562	35,759
Total assets		2,490,816	3,110,015
EQUITY AND LIABILITIES			
Liabilities to banks	26	62,173	92,095
Demand deposits	27	411,882	471,935
Term deposits	28	1,682,228	2,044,562
Borrowings	29	163,492	292,003
Other liabilities	30	10,663	9,109
Provisions	31	8,370	10,676
Total liabilities		2,338,808	2,920,380
EQUITY			
Share capital	31	474,600	474,600
Accumulated losses		(321,167)	(290,536)
Reserves		(1,425)	5,571
Total equity		152,008	189,635
Total liabilities and equity		2,490,816	3,110,015

The significant accounting policies and other notes on pages 24 to 97 form an integral part of these financial statements.

CROATIA BANKA d.d.
STATEMENT OF CHANGES IN EQUITY
For the year 2017

	Share capital	Accumulated losses	Reserves	Total
Balance at 1 January 2016	474,600	(292,174)	(395)	182,031
<i>Changes in equity in 2015</i>				
Unrealised change in fair value of available-for-sale financial assets	-	-	7,013	7,013
Cumulative gains on the sale of available-for-sale financial assets transferred to profit or loss	-	-	275	275
Deferred tax on available-for-sale financial assets	-	-	(1,322)	(1,322)
<i>Net loss recognised directly in equity</i>	-	-	5,966	5,966
Profit for the year	-	1,638	-	1,638
Balance at 31 December 2016	474,600	(290,536)	5,571	189,635
Balance at 1 January 2017	474,600	(290,536)	5,571	189,635
<i>Changes in equity in 2016</i>				
Unrealized change in fair value of available-for-sale financial assets	-	-	(1,814)	(1,814)
Cumulative gains on the sale of available-for-sale financial assets transferred to profit or loss	-	-	(6,717)	(6,717)
Deferred tax on available-for-sale financial assets	-	-	1,535	1,535
Net income recognised directly in equity	-	-	(6,996)	(6,996)
Profit for the year	-	(30,631)	-	(30,631)
Balance at 31 December 2017	474,600	(321,167)	(1,425)	152,008

The significant accounting policies and other notes on pages 24 to 97 form an integral part of these financial statements.

CROATIA BANKA d.d.
STATEMENT OF CASH FLOWS
For the year 2017

	2017	2016
NET CASH FLOW FROM OPERATING ACTIVITIES		
Profit before taxation	(31,287)	2,664
<i>Adjustment to net cash from operating activities</i>		
Impairment allowance on loans and other assets (net) (Note 13)	54,196	17,139
Reversal of provisions for contingent liabilities (net) (Note 13)	(423)	(102)
Legal cases provisions (net) (Note 13)	1,307	5,282
Other provisions (net) (Note 30)	56	42
Gains on disposal of available-for-sale and held to maturity financial assets (Note 9)	(15,184)	(7,705)
Gains on financial assets at fair value through profit or loss (Note 9)	-	(46)
Amortization and depreciation (Note 22)	3,425	3,470
Foreign exchange differences on translation (Note 10)	(2,743)	(3,219)
Gains on the sale of foreclosed assets (Note 11)	(4,073)	(1,593)
Write-offs of tangible assets	15	2,128
<i>Changes in assets and liabilities from operating activities</i>		
Decrease in receivables from the Croatian National Bank	42,577	34,776
Decrease in loans and advances to customers	415,377	284,781
Decrease/(increase) in other assets	13	(7,820)
Decrease in liabilities to banks	(29,922)	(17,808)
Decrease in a vista deposits	(60,053)	(1,341)
(Decrease)/increase in term deposits	(360,675)	16,543
Decrease in other liabilities	(1,692)	(3,392)
Net cash flow from operating activities	10,914	323,799
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of financial assets available for sale	(956,141)	(921,220)
Sale of financial assets available for sale	917,993	778,896
Purchase/(sale) of financial assets held to maturity	15,520	(2,087)
Purchase of property, equipment and intangible assets	(1,491)	(4,067)
Proceeds from the sale of property	6,717	2,462
Net cash from investing activities	(17,402)	(146,016)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayments of borrowings, net	(128,511)	(723)
Net cash flow from financing activities	(128,511)	(723)
Net change in cash and cash equivalents	(134,999)	177,060
Cash and cash equivalents at beginning of the year (Note 36)	333,258	152,834
Foreign exchange difference change in cash and cash equivalents	3,161	3,364
Cash and cash equivalents at end of the year (Note 35)	201,420	333,258

The significant accounting policies and other notes on pages 24 to 97 form an integral part of these financial statements.

1 GENERAL INFORMATION ABOUT THE BANK

Legal framework and activity

Croatia banka d.d. Zagreb ("the Bank") was registered in the court register as a joint stock company in 1989 under the registration number 080007370. The headquarters of the Bank are at Roberta Frangeša Mihanovića 9, Zagreb, Croatia.

The Bank's activities include all types of deposit and loan operations for legal and natural persons, domestic and foreign payments, issuing guarantees, avals and other forms of guarantees, purchase and sale of securities and other banking activities.

The Bank has 13 branches – Branch Zagreb, Branch Bjelovar, Branch Čakovec, Branch Metković, Branch Osijek, Branch Pula, Branch Požega, Branch Slavonski Brod, Branch Split, Branch Vinkovci, Branch Virovitica, Branch Vukovar, Branch Županja, and 3 outlets: Outlet Šubićeva, Outlet Sky Office, and Outlet Drenovci.

Governance and management

Supervisory Board

The Supervisory Board operates in accordance with the Companies Act, the Credit Institutions Act and the Bank's Statute, whereby its main responsibility is the supervision of Bank's operations and appointment and dismissal of the president and members of the Management Board. In addition, the Supervisory Board approves the Management Board's business policies, financial plans, strategies and policies of risk taking and management, strategies and procedures for assessing the adequacy of internal capital, acts that establish and ensure adequate functioning of the internal control system, plans of control functions operations, salary and other benefits policy, organizational structure of the Bank, and it also decides on other issues as determined by law or the Bank's internal acts.

The Supervisory Board has four members that are elected and appointed for a period of four years.

Supervisory Board members in the beginning of 2018:

Maruška Vizek, President
Josip Lozančić, Deputy President
Zdenka Pogarčić, Member
Ana Michieli Pavuna, Member

Supervisory Board members in 2017:

From 1 January to 24 January 2017

Maruška Vizek, President
Josip Lozančić, Deputy President
Branka Grabovac, Member

From 25 January to 31 December 2017

Maruška Vizek, President
Josip Lozančić, Deputy President
Branka Grabovac, Member
Zdenka Pogarčić, Member
Ana Michieli Pavuna, Member

Supervisory Board members in 2016:

From 1 January to 7 May 2016

Maruška Vizek, President
Josip Lozančić, Deputy President
Branka Grabovac, Member

From 8 to 30 May 2016

Josip Lozančić, Deputy President

From 31 May to 6 June 2016

Josip Lozančić, Deputy President
Maruška Vizek, Member
Branka Grabovac, Member

From 7 June to 30 November 2016,

Maruška Vizek, President
Josip Lozančić, Deputy President
Branka Grabovac, Member

From 1 to 19 December 2016,

Josip Lozančić, Deputy President

From 20 to 27 December 2016

Josip Lozančić, Deputy President
Maruška Vizek, Member
Branka Grabovac, Member

From 28 to 31 December 2016

Maruška Vizek, President
Josip Lozančić, Deputy President
Branka Grabovac, Member

1 GENERAL INFORMATION ABOUT THE BANK (continued)

Management Board

Competences, duties and responsibilities of the Bank's Management Board in managing the operations and representing the Bank are determined by the Companies Act, the Credit Institutions Act, the Statute and the Rules of Procedure of the Bank's Management Board.

Management Board manages its business and manages its assets, and it has the responsibility and power to take any action and make any decision necessary for the successful management of the Bank. In the managing of business operations Management Board in particular is responsible for ensuring that the Bank operates in accordance with the rules on risk management in accordance with the Credit Institutions Act and other legislation and internally set regulations and laws; approving and regularly reviewing risk management strategies and policies, including managing risks that arise from the macroeconomic environment in which the Bank operates, and the state of the business cycle of the Bank; ensuring systematic monitoring, assessment and the strategy for maintaining or reaching the adequate amount of capital in relation to risks to which the Bank is exposed in its operations; ensuring functioning of the internal controls system for all areas of the Bank's operations; ensuring unobstructed internal audit; ensuring that the Bank keeps business and other records and business documentation, prepares accounting documents, realistically estimates assets and liabilities, prepares financial and other reports in accordance with accounting regulations and standards and the Credit Institutions Act and other regulations adopted on the basis of law; ensuring that the Bank reports and informs the Croatian National Bank in line with the Credit Institutions Act and other regulations adopted on the basis of law; and ensuring the implementation of measures ordered by the Croatian National Bank.

The Bank's Management Board consists of at least two to maximum three members, one of which is appointed as the President of the Management Board. The President of the Management Board represents the Bank solely and independently, and a member of the Management Board represents the Bank jointly with another member of the Management Board.

The Bank's Management Board is appointed by the Supervisory Board for a period of not more than four years, with the option of reappointment.

The Members of the Board from the Beginning of the 2018:

Branka Grabovac- Member (from 3 April 2018)

Zoran Sabolić-Member (from 1 February 2018)

Branka Grabovac- President (from 2 January 2018 to 2 April 2018)

Ivan Šverko- Member (from 1 January to 30 January 2018)

The Members of the Board during the 2017 were as follows:

Mladen Duliba- President (until 31 December 2017)

Ivan Šverko- Member (until 31 December 2017)

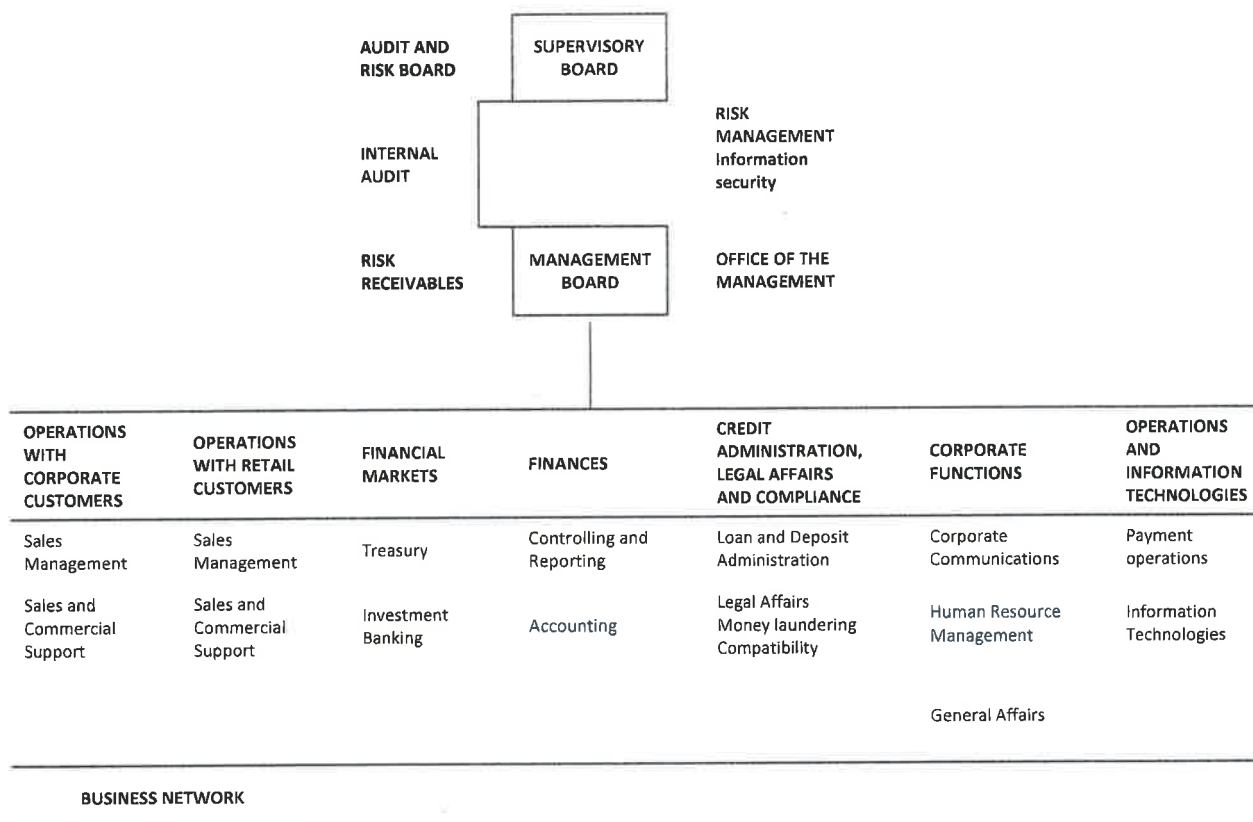
The Members of the Board during the 2016 were as follows:

Mladen Duliba – President

Ivan Šverko – Member

1. GENERAL INFORMATION ABOUT THE BANK (continued)

Organisation chart



2. GOING CONCERN

Capital management

For several years the Bank had not managed to reach operating profit, which is why the Bank's share capital was increased on several occasions, the most recent in the amount of HRK 200 million taking place in October 2012 by converting into equity bonds representing in aggregate a hybrid instrument, i.e. supplementary capital in the amount of HRK 70 million, and contributing HRK 130 million in cash.

Similar to the previous year, in 2017 the Bank's lending activities continued to be focused on extending loans to the government and state-owned companies guaranteed by the Republic of Croatia that, under the applicable regulations, are not subject to capital requirements and still bring a satisfactory level of interest income. Regarding the sources of funds, The Bank achieved a fall in total deposits (in particular deposits of individuals) primarily as a result of the closure of two subsidiaries. Therefore, the Bank reduced excessive and unnecessary liquidity reserves, which resulted in significant reduction of interest costs. The Bank's business plan by 2020 is based on the currently available capital, planning to achieve profitable business operations in accordance with all legal regulations. If necessary for, any reason, the Bank will also consider options for capital increase.

Total capital ratio at 31 December 2017 is 15.85 percent (2016: 16.81 percent).

3. BASIS FOR THE PRESENTATION OF FINANCIAL STATEMENTS

Statement of compliance

These financial statements are prepared in accordance with the legal requirements applicable to accounting for banks in the Republic of Croatia. The Bank's operations are subject to the Credit Institutions Act under which the Bank's financial reporting is regulated by the Croatian National Bank ("the CNB") as the central institution overseeing the banking system in Croatia. These financial statements are prepared in accordance with the above-mentioned banking regulations.

The accounting regulations of the CNB are based on International Financial Reporting Standards ("IFRS"), but differ from them, both in terms of presentation and in terms of recognition and measurement.

The principal differences between the accounting regulations of the CNB and the recognition and measurement requirements of International Financial Reporting Standards are as follows:

- The CNB requires from banks to recognise in their income statements losses on impairment of assets not identified as impaired (including those bearing the Central Government Risk) at prescribed rates (with the exception of financial assets at fair value through profit or loss and assets available for sale). The portfolio-based provisions are presented on the Bank's balance sheet in accordance with the CNB requirements which include the requirement to recognise the related expense within impairment losses for the year.
- The Bank recognises impairment losses on loans and advances to customer by discounting the future expected cash flows using the original effective interest rate of the instrument, in accordance with International Financial Reporting Standards. The CNB requires the amortisation of the discount to be presented in the statement of comprehensive income as a change in impairment losses on loans and advances to customer instead of including them in interest income as required under IFRSs.
- Additionally, the CNB prescribes minimum levels of impairment losses against certain specifically identified impaired exposures, which may differ from the impairment loss required to be recognised in accordance with IFRSs.

3. BASIS FOR THE PRESENTATION OF FINANCIAL STATEMENTS (continued)

- The CNB prescribes minimum provisions for legal actions initiated against the Bank to be set at 1 percent of the total claim for individual claims exceeding 0.1 percent of the Bank's assets based on the audited prior-year financial statements.

Basis of measurement

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

Use of estimates and judgements

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 financial statements date, as well as amounts of income and expense for the period. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

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

The Bank monitors the creditworthiness of its customers on an ongoing basis. On-balance sheet and off-balance sheet credit risk exposures are reviewed for impairment on a quarterly basis. Impairment losses are generally charged to the carrying amount of loans and receivables issued to legal persons and individuals and as provisions for risk and charges arising from off-balance sheet exposures to customers, which mostly take on the form of approved, but not utilised loans, guarantees and letters of credit. In addition to individually identified impairment losses, the Bank monitors and recognises, on an ongoing-basis, impairment losses that are known to exist at the financial statements date, but have not been separately identified. In assessing unidentified impairment losses on a portfolio basis, the Bank seeks to collect sufficient reliable information about appropriate loss rates, based on its historical experience, adjusted to reflect the current circumstances and the period in which the loss is identified. The Bank has recognised a general provision of 1 percent which, pursuant to the CNB regulations, applies to all credit risk exposures other than those measured at fair value, including off-balance sheet credit risk exposures and the central government risk.

Functional and presentation currency

The financial statements are presented in Croatian kunas (HRK), which is the primary currency of the economic environment in which the Bank operates (its functional currency). At 31 December 2017, the official exchange rate of the Croatian kuna against 1 euro was HRK 7.513648 (2016: HRK 7.557787) and for 1 USD it was HRK 6.269733 (2016: HRK 7.168536).

3 BASIS FOR THE PRESENTATION OF FINANCIAL STATEMENTS (continued)

3.1. Initial application of new amendments to the existing Standards and Interpretation effective for current financial period

The following amendments to the existing standards and new interpretation issued by the International Accounting Standards Board (IASB) and adopted by the EU are effective for current financial period:

- Amendments to IAS 7 "Statement of Cash Flows" - Disclosure Initiative – adopted by EU on 6 November 2017 (effective for annual periods beginning on or after 1 January 2017),
- Amendments to IAS 12 "Income Taxes" - Recognition of Deferred Tax Assets for Unrealised Losses – adopted by EU on 6 November 2017 (effective for annual periods beginning on or after 1 January 2017).
- Amendments to various standards "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 8 February 2018 (amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017, amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018)

The adoption of these amendments to the existing standards has not led to any material changes in the Company's financial statements

3.2. Amendments to the existing Standards issued by IASB and adopted by the EU but not yet effective

At the date of authorization of these financial statements the following amendments to the existing standards issued by IASB and adopted by the EU were in issue but not yet effective:

- IFRS 9 "Financial Instruments" - adopted by the EU on 22 November 2016 (effective for annual periods beginning on or after 1 January 2018),
- Amendments to IFRS 15 "Revenue from Contracts with Customers" - Clarifications to IFRS 15 Revenue from Contracts with Customers – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2018).
- IFRS 16 "Leases" – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IFRS 4 "Insurance Contracts" - Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – adopted by the EU on 3 November 2017 (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 "Financial Instruments" is applied first time)
- Amendments to IFRS 15 "Revenue from Contracts with Customers" - Clarifications to IFRS 15 Revenue from Contracts with Customers – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2018).

3 BASIS FOR THE PRESENTATION OF FINANCIAL STATEMENTS (continued)

3.2. Amendments to the existing Standards issued by IASB and adopted by the EU but not yet effective (continued)

- Amendments to various standards “Improvements to IFRSs (cycle 2014-2016)” resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 8 February 2018 (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018)

The Bank has elected not to adopt these new standards and amendments to existing standards in advance of their effective dates. The Bank anticipates that the adoption of these standards and amendments to existing standards will have no material impact on the financial statements of the Company in the period of initial application, except IFRS 9.

3.3. New standards and amendments to the existing standards issued by IASB but not yet adopted by the EU

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the International Accounting Standards Board (IASB) except for the following new standards, amendments to the existing standards and new interpretation, which were not endorsed for use in EU as at [date of publication of financial statements] (the effective dates stated below is for IFRS in full):

- IFRS 14 “Regulatory Deferral Accounts” (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- IFRS 17 “Insurance Contracts” (effective for annual periods beginning on or after 1 January 2021),
- Amendments to IFRS 2 “Share-based Payment” - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),
- Amendments to IFRS 9 “Financial Instruments” - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IFRS 10 “Consolidated Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures” - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),
- Amendments to IAS 19 “Employee Benefits” - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 28 “Investments in Associates and Joint Ventures” - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019),
- Amendments to IAS 40 “Investment Property” - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- Amendments to various standards “Improvements to IFRSs (cycle 2014-2016)” resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 8 February 2018 (amendments to IFRS 12 are to be applied for annual periods beginning on or after 1 January 2017 amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),
- Amendments to various standards due to “Improvements to IFRSs (cycle 2015-2017)” resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after 1 January 2019),

3. BASIS FOR THE PRESENTATION OF FINANCIAL STATEMENTS (continued)

3.3. *New standards and amendments to the existing standards issued by IASB but not yet adopted by the EU*

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the International Accounting Standards Board (IASB) except for the following new standards, amendments to the existing standards and new interpretation, which were not endorsed for use in EU as at 27 April 2018.

- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after 1 January 2018),
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after 1 January 2019).

The Bank anticipates that the adoption of these new standards, amendments to the existing standards and new interpretation will have no material impact on the financial statements of the Company in the period of initial application, except IFRS 9. The impacts of the IFRS 9 are stated below.

3.4. **IFRS 9 "Financial Instruments"**

Regulatory provisions

The New International Financial Reporting Standard 9: The Financial Instruments (hereinafter IFRS 9) was published by the IASB in July 2014 and was adopted by the European Commission in November 2016 by Regulation (EC) 2067/2016. IFRS 9 is in effect from 1 January 2018 and is replaced by IAS 39, which by 31 December 2017 regulated the classification and measurement and impairment of financial instruments.

IFRS 9 is divided into three distinct areas: classification and measurement of financial instruments, impairment and hedge accounting.

Classification and Measurement

According to IFRS 9, financial assets may be classified into three measurement categories: financial assets that are measured at amortized cost, financial assets that are measured at fair value through other comprehensive income, and financial assets that are measured at fair value through profit or loss. The measurement categories did not change in relation to IAS 39.

IFRS 9 introduces the concept of business models that, together with the Solely Payments of Principal and Interest (SPPI) carried out in the business model of holding for billing, define the category of measurement of each financial instrument. The SPPI test is conducted for the purpose of checking whether the cash flows reflect only principal and interest payments on the outstanding principal.

Financial assets can be measured at amortized cost if the financial asset is held in the billing model and if the SPPI test passes. Financial assets can be measured at fair value through other comprehensive income if held in the business model of holding for billing and sale and if the SPPI test passes. Financial assets allocated to other business models (e.g. equity securities, derivatives, complex financial instruments, ...) are always measured at their fair value through profit or loss and are not necessarily implemented by the SPPI test for the specified financial asset.

3 BASIS FOR THE PRESENTATION OF FINANCIAL STATEMENTS (continued)

3.4. IFRS 9 "Financial Instruments" (continued)

In addition, for certain non-trading-equity instruments, it is possible, at initial recognition, to choose the irrevocable measurement option at fair value through other comprehensive income. However, in this case, the accumulated profit or loss in revaluation reserves, when selling such instruments, is not included in the income statement. Regarding the classification and valuation of financial liabilities, significant changes are not introduced in relation to the present standard.

Impairment

For instruments that are valued at amortized cost and fair value through other comprehensive income (for which no option is available at fair value through other comprehensive income), a model based on the concept of expected losses is introduced instead of the present "loss incurred" to recognize the losses earlier. IFRS 9 distinguishes 3 stages in which the allocated financial assets may be affected, thus affecting the calculation of expected credit losses. For financial assets allocated to Stage 1, 12-month expected credit losses that represent a lifelong loss are considered taking into account the likelihood of non-fulfillment of obligations within the next 12 months from the reporting date. For financial assets allocated to Stage 2, life expectancy credit losses are calculated on the basis of the likelihood of a non-fulfillment of obligations during the entire life of the financial asset. For financial assets allocated to Stage 3, life expectancy credit losses are also calculated, but the calculation method does not differ from the recoverable amount in IAS 39.

Expected loan losses reflect the weighted average of expected loan losses by the scenarios.

Hedge accounting

The Bank does not apply hedge accounting.

Implementation project

Due to significant changes introduced by IFRS 9 on operations, in February 2016, the Bank launched a separate project whose basic tasks were to identify gaps between the current IFRS 9 requirements and the classification and measurement area and the impairment area; designing a model for calculating risk parameters for calculating expected credit losses and making functional specifications for the appropriate application solution; an analysis of the quantitative impact of IFRS 9 on the Bank's financial operations and alignment of internal processes and acts of the Bank.

For this project, the Bank has engaged an external partner.

On 12 December 2017, the European Parliament and the Council issued Regulation (EU) 2017/2395 amending Regulation (EU) No. 575/2013 with regard to transition arrangements to mitigate the effects of the introduction of IFRS 9 on regulatory capital and for the treatment of large exposures in the case of certain public sector exposure that are denominated in the domestic currency of any Member State. The said Regulation provides banks with the opportunity to reduce the impact on regulatory capital arising from the introduction of IFRS 9 accounting standard in a transition period of 5 years by gradual inclusion in the CET1 downstream volume of the impact itself. The Bank has decided not to use the transitional arrangements introduced by the Regulation in the Regulatory Capital

Below is a summary of the main activities undertaken within the IFRS 9 introduction project:

The Bank analyzes the credit portfolio of legal and natural persons and the securities portfolio and conducts a test to determine whether the cash flows deriving from the financial instrument are solely principal payments and interest on the solvency principal ("Solely Payments of Principal and Interest" or SPPI test) used a special tool based on the "decision tree" principle. This analysis has shown that only one contract from the existing loan portfolio has not passed the SPPI test and will be run by the Bank in a model that is measured at fair value. Implementation of the SPPI test has shown that the Bank will continue to hedge all portfolio-to-maturity assets and loans and receivables at amortized cost, and there is no change in this respect in relation to IAS 39.

3 BASIS FOR THE PRESENTATION OF FINANCIAL STATEMENTS (continued)

3.4. IFRS 9 "Financial Instruments" (continued)

Implementation project (continued)

An exception is one contract from an existing loan portfolio for which it has been established that meets the requirements of the SPPI test and the Bank will measure it at fair value through profit or loss, by establishing that its net book value reflects the current fair value so that no change will occur. There is no change in measuring mode for other assets. The provisions on classification of exposures in risk groups and the method of determining credit losses made by the Croatian National Bank on 22 November 2017 are taken into account. Given the area of impairment, the criteria for changing the degree of individual exposure and the criteria for determining the expected credit losses for each level are defined.

Concerning the foregoing, the elements that will be the main guideline for identifying "significant deterioration" of credit risk from the moment of first entry (2nd stage distribution) are the following: delay times, internal watch list status, blockade, moratorium, bankruptcy, and restructuring.

As the most important factor of the new approach, there are important data pertaining to future periods, ie the calculation of expected credit losses and, accordingly, a methodological approach that includes the analysis of set scenarios for the calculation of the same (ECL). In accordance with the definition of non-recoverable loan (IFRS) 9, it is equal to the existing accounting standards with several important news to incorporate into estimating expected life-cycle credit, such as:

- inclusion of future data (expected amounts and deadlines, likelihood of turning to even worse placement)
- considering alternative billing scenarios.

Impact on information systems

Significant contribution to the implementation of IFRSs was provided by the IT Support Department which, based on the technical specification, prepared a calculator for the calculation of expected loan losses, with the help of which the Risk Management Service manages the process of determining credit losses and changing the level of exposure level.

Effects of applying IFRS 9

Based on the above, the impact of expected credit losses related to first-time adoption of IFRS 9 on January 1, 2018 is presented below. These effects mainly stem from:

- from the obligation to redefine the fair value of financial assets in the portfolio using the expected loss model (in lieu of the current loss-making model);
- from the calculation of expected credit losses for fully recoverable placements (Stage 1 and 2), whereby a portion of the recoverable portfolio is classified as an important factor in "Stage 2." Furthermore, instead of the fixed 1% of the general reserve calculation, the Bank is now, model, calculated the expected loan losses.

	Effect on net assets on 1 January 2018.
Stage 1 i 2	2.774
Reclassification	-
Total	2.774

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of significant accounting policies adopted in the preparation of financial statements is set out below. The accounting policies have been consistently applied to all the years presented in these financial statements unless stated otherwise.

Where the accounting policies are aligned with accounting principles of International Financial Reporting Standards (hereinafter IFRS or Standards), the description of the Bank's accounting policies may contain a reference to certain standards. Unless otherwise stated, these are the standards applicable at 31 December 2017.

4.1 Financial instruments

Classification

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

Financial liabilities are classified as either financial liabilities at fair value through profit or loss or other financial liabilities.

Loans and receivables

This category comprises all non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Financial assets available for sale

This category comprises non-derivative financial assets not classified as loans and receivables, held-to-maturity investments, or 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 liquidity needs or changes in interest rates, foreign exchange rates, or equity prices.

Financial assets at fair value through profit or loss

This category comprises two subcategories: financial instruments held for trading and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term, for short-term profit taking, or if designated as at fair value through profit or loss by management.

Financial instruments held for trading include shares (units) in investment funds.

Financial assets held to maturity

This category comprises non-derivative financial assets with fixed or determinable payments and fixed maturity not classified as loans and receivables that the Bank intends and is able to hold to maturity. Included in this category are certain debt securities.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.1 Financial instruments (continued)

Other financial liabilities

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

Recognition and derecognition

Purchases and sales of financial assets available for sale are recognised on the trade date, i.e. the date on which the financial instrument is delivered or transferred by the Bank. Loans and receivables, financial assets held to maturity and financial liabilities at amortized cost are recognised at the settlement date when received or issued.

The Bank derecognises financial instruments (in full or part) when the rights to receive cash flows from a financial instrument have expired or when it loses control over the contractual rights to the instrument. This occurs when the Bank has transferred substantially all the risks and rewards of ownership to another entity or when the rights are realized, expired or are surrendered. The Bank derecognises a financial liability only when the liability ceases to exist, i.e. it is discharged, cancelled or expired. If the terms of a financial liability change, the Bank will derecognise the liability and simultaneously recognise a new financial liability with new terms and conditions.

Realized gains and losses from the sale of financial instruments are determined using the weighted average cost method.

Initial and subsequent measurement

Available-for-sale financial assets, loans and receivables, held-to-maturity financial assets and liabilities are recognised initially at fair value plus transaction costs directly attributable to the acquisition or issuance of financial assets or financial liabilities.

Financial assets or liabilities at fair value through profit or loss are recognised initially at fair value, with the transaction costs recognised immediately in profit or loss.

The Bank recognises financial assets available for sale and financial assets or liabilities at fair value through profit or loss subsequently at fair value, without any deduction for transaction costs.

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

Gains and losses

Gains or losses arising from a change in the fair value of available-for-sale financial assets are recognised directly in the fair value reserve 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 profit or loss. When an asset available for sale is sold or otherwise disposed of, any cumulative gains or losses on the instrument are transferred to profit or loss.

Unrealised gains and losses arising from changes in fair value of financial assets at fair value through profit or loss, as well as gains and losses realised on such assets and liabilities when they are sold or otherwise disposed of are included in profit or loss. Interest earned while holding those instrument is included in interest income, and dividends are recognised as dividend income and presented in profit or loss.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.1 Financial instruments (continued)

Gains and losses (continued)

Gains or losses arising from financial assets and financial liabilities carried at amortized cost are included in the income statement over the period of amortization. Gains or losses can also be recognised in profit and loss when the financial instrument is derecognised or impaired.

Fair value measurement of financial instruments

Financial instruments carried at fair value are classified into three-level fair value measurements according to the IFRS fair value hierarchy. Level 1 (based on closing prices on regulated markets), Level 2 (based on valuation techniques using inputs observable on the market), and Level 3 (fair value determined using other available data).

Fair value hierarchy for financial assets

The most reliable fair value measurement is the price quoted in an active market. If the price is observable, it is used as an input for the fair value measurement (Level 1 of the fair value hierarchy).

In absence of a liquid market, the fair value is determined based on observable market indicators, with the instruments measured on the basis of such inputs being classified into Level 2 of the fair value hierarchy.

The fair value of financial instruments traded rarely and whose prices are not readily observable is a less objective measure. Therefore, in calculating the fair value for such a financial asset or liability, all significant risks affecting it should be identified and considered.

In calculating fair value, the Bank considers the rules of the fair value hierarchy that reflect the significance of the measurement inputs. Each instrument is subject to an individual detailed analysis.

Where quoted market prices for a financial instrument are not observable, the fair value of the instrument is determined using valuation models relying on observable market data. If all significant inputs into the model are available, the instrument is classified into Level 2 of the fair value hierarchy.

The fair value hierarchy levels are determined by reference to the lowest level of inputs that are significant for measuring the fair value of the instrument. The fair value measurement levels described further below relate to financial assets reported in the balance sheet at fair value.

Impairment of financial assets

Impairment of assets identified as impaired

Financial assets are reviewed at each 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.

Individually significant financial assets are tested for impairment on an individual basis. Remaining financial assets are reviewed on a collective basis, in accordance with the relevant CNB regulations.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.1 Financial instruments (continued)

Impairment of financial assets (continued)

Financial assets not identified as impaired are included in the impairment test for the purpose of a collective assessment.

The Bank 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.

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

The recoverable amount of financial assets 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. The carrying amounts of assets are impaired through an allowance account, and the impairment losses are recognised in the income statement.

Impairment of assets not identified as impaired

In addition to impairment of assets identified as impaired, the Bank recognises impairment in profit or loss in respect of exposures that are not identified as impaired at total amount of 1 % of total exposures, in accordance with the accounting regulations of the CNB.

Cash and cash equivalents

Cash and cash equivalents include cash and current accounts with the Croatian National Bank with an original maturity of up to 90 days as well as balances with other banks, net of any provision for impairment and uncollectible amounts and items in process of collection.

Debt securities

Debt securities that the Bank holds for the purpose of short-term profit-taking are classified as assets available for sale and carried at fair value.

Placements with banks

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

4.2 Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity or other comprehensive income, in which case it is also recognised in equity or other comprehensive income. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at the financial statements date, and any adjustments to tax payable in respect of previous years.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.2 Income tax (continued)

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are measured at tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates in effect at the balance sheet date.

Deferred taxes are not discounted and are classified in the balance sheet 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 financial statements date, the Bank reviews the unrecognised contingent tax assets and the carrying amount of the recognised tax assets.

4.3 Property and equipment

Items of property and equipment are recognised at historical cost or revalued amount less accumulated depreciation and accumulated impairment losses.

Depreciation is provided on a straight-line basis so as to write down the cost over the estimated useful life of an asset. Land and assets under construction are not depreciated.

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each financial statements date. Where the net carrying amount of an asset exceeds its recoverable amount, it is written down immediately to its recoverable amount. Gains and losses on disposal are determined as the difference between the proceeds and the net carrying amount and included in the income statement.

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

	2017	2016
Buildings	2.50%	2.50%
Computers	25%	25%
Furniture and equipment	10% - 20%	10% - 20%
Motor vehicles	25%	25%
Other tangible assets not mentioned above	5% - 10%	5% - 10%

4.4 Intangible assets

Intangible assets are recognised at cost less accumulated amortization and impairment losses. 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.

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

	2017	2016
Intangible assets (other)	10%–20%	10%–20%
Intangible assets - software	20%–25%	10%–25%

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.5 Foreclosed assets

For assets acquired in lieu of uncollected receivables the Bank assesses the marketability and only marketable assets, the value of which can be measured reliably, are recognised as assets in the statement of financial position. Such assets are stated at the lower of the cost of related outstanding receivables and the current fair value of that asset. Bank's intention is mainly to sell such assets (such assets are not amortised) or held it to earn rentals (such assets are disclosed within Note 21 Investment property).

4.6 Assets available for sale

Tangible assets taken over in exchange for uncollected receivables are stated in the statement of financial position on the assets available for sale if the following conditions are met:

- there is a sales plan and activities are carried out to find a buyer,
- the assets are ready for sale in the present state,
- sales are highly probable,
- assets offered for sale at a reasonable price, or when the price of an asset is acceptable in relation to its market value, and it is unlikely that there will be significant deviations from the sale or resignation plan,
- Sales should be completed within one year from the date of classification, unless the delay is caused by events or circumstances beyond the control of the Bank and there is sufficient evidence that it will remain in accordance with the plan of sale of assets.

In cases where due to the aggravating circumstances of sales caused by events or circumstances beyond the control of the Bank and there is sufficient evidence that the Bank has remained consistent with its sales plan, tangible assets taken over in exchange for uncollected receivables will continue to be recognized, measured and disclosed as an asset intended for sale.

This asset category is initially recognized at fair value, reduced for estimated expected selling costs.

After initial, the listed asset is subsequently measured at a lower value between net book and fair value less costs to sell. If the above conditions are not met, the Bank's material assets taken over in exchange for uncollected receivables are initially recognized as held assets in accordance with International Accounting Standard 2 Inventories.

4.7 Investment property

Investment properties are properties which are held by the Bank either to earn rentals or for capital appreciation.

Investment property is measured initially at cost. At subsequent measurement of investment property, the Bank applies the fair value model. The Bank conducts measurement of fair value on an income basis annually by an independent valuer.

The purchase cost is the amount of money or cash equivalents paid or the fair value of the other consideration paid for the purpose of acquiring the property at the time of its purchase or construction or, where appropriate, the value associated with that asset at initial recognition. Transaction costs are included in initial measurement.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.8 Impairment of non-financial assets

Intangible assets that have an indefinite useful life not subject to amortisation and are tested annually for impairment. Depreciable assets are reviewed for impairment whenever events or changes in the circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is determined as the difference between the carrying amount of an asset and its recoverable amount. Recoverable amount is the higher of 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). Non-financial assets other than goodwill that suffered an impairment loss are reviewed for possible reversal of the impairment at each reporting date.

Property, plant and equipment as well as intangible assets are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recovered.

When the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised in the income statement for items of property, plant and equipment and intangible assets carried at acquisition cost.

4.9 Provisions for liabilities and charges

The Bank recognises provisions when it has a present legal or constructive obligation as a result of past events and if it is probable that it will have an outflow to settle these obligations whose amount can be reliably estimated.

Provisions for liabilities and charges are maintained at a level which Management believes is adequate to absorb probable future losses. Management determines the adequacy of the provision based upon reviews of individual items, current economic conditions, the risk characteristics of the various categories of transactions and other relevant factors.

When the outflow of economic benefits to settle the obligations is no longer probable or less than the estimated provision is reversed. Provisions are released only for those costs which are originally recognised.

4.10 Employee benefits

The Bank pays contributions to pension insurance funds on a mandatory, contractual basis, in accordance with the law. The Bank has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they arise.

The Bank recognises a provision for bonuses when there is a constructive obligation resulting from a contract or past practice. Furthermore, the Management recognises accrued benefits on the basis of annual vacation days outstanding at the date of the financial statements.

In calculating provisions for severance payments and jubilee rewards, discounted expected future cash flows arising from the liabilities is performed, using discount rates that, in the opinion of management, best represent the time value of money.

4.11 Share capital and reserves

Share capital is denominated in the Croatian kunas and stated at nominal value.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.12 Accumulated losses

If the Bank recognises a loss for the financial year, it is transferred to accumulated losses.

4.13 Interest income and expense

Interest income and expense for all interest bearing financial instruments are recognised in the income statement as they accrue, including those measured at amortized cost and those available for sale, using the effective interest rate method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of a financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The calculation inputs include all fees and percentage points paid or received between the parties to the contract that are included in the effective interest rate, as well as transaction costs and all other premiums or discounts. The resulting income and expenses are included in profit or loss within interest income and income expense respectively.

They also include fees and commissions on loans and advances to customers as well as on borrowings from other banks.

4.14 Fee and commission income and expense

Fee and commission income comprises mainly fees received from customers for loans, guarantees, letters of credit and other services provided by the Bank. Fees are recognised as income upon the maturity date of services.

Fee and commission expense consist of fees paid to licensed banks for payment services provided in the foreign exchange operations, as well as to the Financial Agency services (FINA) for domestic payments.

4.15 Foreign currencies

Transactions in foreign currencies are translated into Croatian kunas at the rates of exchange applicable at the dates of the transactions. Monetary assets and liabilities that are denominated in foreign currencies are retranslated at the exchange rate in effect at the financial statements 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 items that are measured in terms of historical cost in a foreign currency are translated at the transaction date but are not retranslated at the balance sheet date.

Changes in the fair value of monetary securities denominated in foreign currencies and classified as available for sale are analysed as the difference between the exchange differences arisen from changes in the security's amortised cost and other changes in the net carrying amount of the security. Exchange differences are recognised in profit or loss as part of exchange gains and losses on revaluation of monetary assets and liabilities.

4.16 Contingent liabilities and commitments

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

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.17 Rents

The Bank rents office space to perform operations that are treated as operating leases. The underlying asset is not recognised in the statement of financial position, and payments under operating leases are recognised in the income statement or loss on a straight-line basis over the lease term.

Rental income under operating leases Bank recognises in the profit or loss on a straight-line basis over the lease term.

4.18 Borrowings

Borrowings are recognised initially at fair value net less costs. Subsequent valuation is carried at amortized cost and the difference between proceeds less transaction costs, and the amount payable at maturity is recognised in the statement of profit or loss during the period of the borrowings as interest expense. The amount was subsequently reduced by the deferred part of the fees paid during the loan approval.

4.19 Activities in the name and on behalf of third parties

The Bank manages assets on behalf of legal persons. These amounts do not represent the Bank's assets and are excluded from the statement of financial position. For the services provided the Bank charges a fee which is recognised in the statement of profit or loss.

4.20 Reporting by business segments

A business segment is an integral part of the Bank that engages in business activities from which it may earn revenues or expenses, including transactions with other parts of the Bank. The bank in 2017 did not apply the internal transfer pricing when determining business performance of individual segments.

4.21 Accounting estimates and judgements in the application accounting policies

The Bank produces estimates and assumptions on uncertain events, including estimates and assumptions on the future. Such accounting assumptions and estimates are regularly reviewed, and they are based on historical experience and other factors, like the expected flow of future events that may be reasonably assumed in existing circumstances but, despite of this, inevitably represent the sources of estimate uncertainty. Evaluation of losses from impairment of a portfolio exposed to credit risk and evaluation of fair value of collateral in the form of real estate as an integral part of the evaluation, represents the most significant source of estimation uncertainty. This and other key sources of estimation uncertainty, that carry considerable risk of possible significant adjustments of assets' and liabilities' carrying value in the next business year, are described below.

a) Losses from impairment of loans and receivables

Chapter 3 'Basis of preparation of the financial statements' details the estimates and judgments made regarding loans and receivables.

Chapter 4 'Accounting policies' provides detailed explanations of the estimates and judgements applied to financial assets at amortised cost.

b) Deferred tax

The Bank recognises deferred tax asset in line with management estimate. The management estimate is based on the Long-term business plan aimed at future profitable operations.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4.21 Accounting estimates and judgements in the application accounting policies (continued)

c) Regulatory requirements

The CNB and the Croatian Financial Services Supervisory Agency are authorized to exercise regulatory supervision over the Bank's operations and may impose the requirement to revise the assets' and liabilities' carrying amounts, in accordance with relevant regulations.

d) Legal cases

The Bank conducts an individual assessment of all court disputes. The assessment is conducted by the Department of Legal Affairs. As noted in Note 31, the Bank has booked HRK 7,065 thousand in principal and interest on debt obligations (2016: HRK 9,004 thousand). These amounts represent the best estimate of the Bank for Losses in Court Disputes.

e) Holidays and severance payments

The right to vacation shall be recognized by the Bank during the period of its origin. The accrued annual liability is recognized on the basis of the employee's performance until the reporting date.

Repayments for early termination of employment are recognized as an expense when the Bank has a contractual obligation. The Bank does not apply the employee reward system.

f) Property investments

Property investments are stated at cost. The Bank applies a fair value model after a subsequent valuation of an investment in real estate. The Bank performs a measure of fair value measurement on a per-year basis carried out by an independent.

5 INTEREST INCOME

5.1 Interest income analysed by type of customer

	2017	2016
Companies	60,945	79,703
Individuals	26,602	25,763
Government units	9,325	23,364
Banks and other financial institutions	1,211	1,941
Other organisations	73	654
Total	98,156	131,425

Included in interest income is income from partly recoverable placements in the amount of HRK 5.4 million (2016: HRK 5.9 million), of which HRK 4.2 million (2016: HRK 4.4 million) relate to legal persons, and the remaining HRK 1.2 million (2016: HRK 1.5 million) to individuals.

5.2 Interest income analysed by portfolio

	2017	2016
Loans and receivables	89,286	111,011
Financial assets available for sale	5,847	13,545
Financial assets held to maturity	3,023	6,869
Total	98,156	131,425

6 INTEREST EXPENSE

6.1 Interest expense analysed by source

	2017	2016
Individuals	28,558	40,925
Banks and other financial institutions	3,921	9,621
Non-residents	2,602	3,393
Croatian National Bank	2,150	1,673
Companies	1,592	6,581
Government units	527	1,200
Other organisations	153	323
Total	39,503	63,716

6 INTEREST EXPENSE (continued)

6.2 Interest expense by portfolio

	2017	2016
Financial liabilities at amortised cost	39,503	63,716
Total	39,503	63,716

7 FEE AND COMISSION INCOME

	2017	2016
Companies	5,088	6,628
Individuals	4,071	4,067
Financial institutions	730	800
Non-profit organisations	262	265
Government units	219	218
Non-residents	83	78
Total	10,453	12,056

8 FEE AND COMISSION EXPENSE

	2017	2016
Domestic partners	2,948	2,092
Service fees and commissions to FINA	1,602	2,048
Foreign banks	167	179
Republic of Croatia	36	41
Total	4,753	4,360

9 NET FINANCIAL GAINS

	2017	2016
Net gain on financial assets available for sale	9,773	6,679
Net gain on financial assets held to maturity	5,411	1,026
Net gain on financial assets at fair value through profit or loss	-	46
Total	15,184	7,751

The net gain on assets held to maturity represents the result on early redemption of bonds by the bond issuer, which the Bank classified initially as held to maturity.

10 NET INCOME FROM EXCHANGE DIFFERENCES

	2017	2016
Income from foreign currency trading	3,161	3,364
Net foreign exchange gains arising from foreign currency clause	1,659	4,657
Net foreign exchange gains on translation of provision for potential credit losses	148	377
Net foreign exchange losses arising from foreign currency clause	(2,225)	(5,179)
Total	2,743	3,219

11 OTHER OPERATING INCOME

	2017	2016
Rental income	4,196	4,451
Net gains from the sale of property, plant and equipment, and foreclosed assets	4,073	1,593
Collection of previously suspended interest	5	62
Other income	420	255
Total	8,694	6,361

12 OTHER OPERATING EXPENSE

	2017	2016
Net salaries	18,355	19,130
Contributions, taxes and surtaxes	12,556	14,054
Other staff-related costs	2,329	1,899
Net provision for long-term employee benefits (jubilee awards and termination benefits) (Note 30)	46	28
Total staff-related costs	33,286	35,111
Amortization and depreciation (Note 22)	3,425	3,470
Total amortization and depreciation	3,425	3,470
Materials and services	14,736	14,977
Rental costs	5,308	6,041
Marketing expenses	460	435
Judicial and administrative fees	1,415	497
Savings deposit insurance costs	5,576	5,853
Other	3,440	1,581
Total other operating expenses	30,935	29,384
Total	67,646	67,965

12 OTHER OPERATING EXPENSES (continued)

At 31 December 2017, the Bank employed 191 persons (2016: 213 employees).

Personnel expenses include HRK 5,251 thousand (2016: HRK 5,636 thousand) of mandatory pension contributions paid into mandatory pension funds. The contributions are determined at a certain percentage of the employees' gross salaries.

12.1 Rental costs

Rental costs mostly relates to rental costs of office space in which the Bank carries out its activities. The rental cost in 2017 amounts to HRK 5,308 thousand (2016: HRK 6,041 thousand). Below is an outline of future minimum rental payments.

31 December 2017

	<i>In thousands of HRK</i>		
	Up to 1 year	1 to 3 years	3 to 5 years
Rental payment	5,050	5,050	5,050

31 December 2016

	<i>In thousands of HRK</i>		
	Up to 1 year	1 to 3 years	3 to 5 years
Rental payment	6,529	6,529	6,529

13 IMPAIRMENT LOSSES AND PROVISIONS

	2017	2016
Impairment losses on loans and advances to customers (Note 20,2)	(23,809)	(15,066)
Impairment on securities (note 19)	(28,693)	-
Impairment losses on foreclosed and tangible assets (Note 22,23)	(6,988)	(494)
Net change in the provisions for legal actions against the Bank (Note 30)	(1,307)	(5,282)
Impairment losses on other assets (including provisions for unidentified losses on a collective basis)	(1,698)	(899)
Impairment of investment property (Note 21)	(72)	(1,994)
Impairment losses on interest receivable (Note 20,2)	(70)	(20)
(Provisions)/reversal of provision for identified losses for contingent liabilities (Note 31)	(51)	36
Other provisions (Note 30)	(10)	(14)
Reversal of provisions and impairment allowances on loans and other receivables on a collective basis (Notes 15,16,17,19, 20,2, and 24)	7,134	1,348
Subsequently recovered placements written-off as uncollectible in prior years	475	212
Provisions for unidentified losses on a collective basis for contingent liabilities (Note 30)	474	66
Total	(54,615)	(22,107)

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14 INCOME TAX

Movements in deferred tax assets

	Deferred fee income /(expenses) included in effective interest rate on given loans/(borrowings)	Deferred income per impairment of foreclosed assets	Deferred income from unrealised change in the fair value of available-for-sale financial assets	Depreciation above tax rate	Tax losses	Total
At 1 January 2016	2,153	910	99	-	1,084	4,246
Recognised in profit or loss	(582)	355	-	-	(799)	(1,026)
Recognised in equity and other comprehensive income	-	-	(1,322)	-	-	(1,322)
At 31 December 2016	1,571	1,265	(1,223)	-	285	1,898
Recognised in profit or loss	(363)	912	-	106	-	655
Recognised in equity and other comprehensive income	-	-	1,536	-	-	1,536
At 31 December 2017	1,208	2,177	313	106	285	4,089

Reconciliation between the accounting and tax results is shown as follows:

	2017	2016
Accounting profit before taxation	(31,287)	2,664
Effect of income tax at the rate of 18% (2016: 20%)	(5,632)	799
Effect of tax non-deductible expenses	1,657	1,080
Effect of non-taxable income	(955)	(761)
Utilisation of tax losses brought forward	4,930	(1,118)
Effect of change in estimated utilisation of tax losses available for carry forward	(4,274)	92
Income tax	656	(1,026)

14 INCOME TAX (continued)

Unrecognised deductible temporary differences, unused tax losses and tax approval:

Available for transfer up to	Tax loss	The amount of unrecognised deferred tax assets
2018	11,010	1,982
2022	27,384	4,929
Total	38,394	6,911

The possibility of using unrecognised tax approvals expires in 2022.

The amount of unused tax losses are not recognised as deferred tax assets in the statement of comprehensive income because it is not likely that there will be sufficient taxable income to use these deferred tax assets.

15 CASH

	31 December 2017	31 December 2016
Current account balance	67,339	58,866
Cash in hand:		
- in HRK	13,596	14,948
- in foreign currencies	21,769	6,756
Cash on foreign currency accounts with domestic banks	71,340	194,938
Cash on foreign currency accounts with foreign banks	4,046	3,872
Checks and other assets in course of collection	5	5
<i>Provisions for impairment for unidentified losses on a collective basis</i>	(1,427)	(2,577)
Total	176,668	276,808

16 RECEIVABLES FROM THE CROATIAN NATIONAL BANK

	31 December 2017	31 December 2016
Obligatory reserve		
- in HRK	151,068	192,439
Other obligatory deposits	-	1,206
<i>Provisions for impairment for unidentified losses on a collective basis</i>	<i>(1,511)</i>	<i>(1,936)</i>
Total	149.557	191.709

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

The obligatory reserve requirement as at 31 December 2017 was 12 % (2016: 12 %) of deposits, borrowings and issued debt securities denominated in kunas and foreign currencies.

As at 31 December 2017, the required rate for the part of the obligatory reserve calculated based on kuna liabilities to be deposited with the CNB amounted to 70%, 0 percent of the foreign-currency denominated balance (2016: 0%), whereas the remaining 30 percent (2016: 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. The foreign-currency portion of the obligatory reserve is maintained through daily balances of foreign-currency receivables on the Target 2 foreign-currency account with the Croatian National Bank as well as on accounts with foreign banks with appropriate ratings. The minimum share of the foreign-currency reserve funds on the CNB Target2 reserve account is 2 percent, whereas 75 percent of the foreign-currency reserve funds are included in the allocated kuna-denominated obligatory reserve funds and maintained in kunas.

17 PLACEMENTS WITH BANKS

	31 December 2017	31 December 2016
Deposits with foreign banks	22,892	52,016
Deposits with domestic banks	424	1,837
Accrued interest	9	20
<i>Provisions for impairment for unidentified losses on a collective basis</i>	<i>(233)</i>	<i>(539)</i>
Total	23,092	53,334

18 FINANCIAL ASSETS AVAILABLE FOR SALE

	31 December 2017	31 December 2016
Treasury bills /i/	462,839	498,257
Foreign-currency denominated bonds /iii/	228,099	125,265
HRK-denominated bonds /ii/	179,886	202,756
Corporate bills	41,823	774
Shares /iv/	439	439
<i>Provisions for impairment for unidentified losses on a collective basis</i>	<i>(29,467)</i>	<i>(774)</i>
Accrued interest	3,434	7,056
Total	887,053	833,773

18 FINANCIAL ASSETS AVAILABLE FOR SALE (continued)

	Treasury bills	Bonds	Shares	Corporate bills	Accrued interest	TOTAL
At 01 January 2017	498,257	328,021	439	-	7,056	833,773
Increase	502,015	454,126	-	41,049	-	997,190
Changes in fair value	-	(8,531)	-	-	-	(8,531)
Decrease	(537,433)	(365,631)	-	-	(3,622)	(906,686)
Impairment	-	-	-	(29,467)	-	(29,467)
At 31 December 2017	462,839	407,985	439	12,356	3,434	887,053

	Treasury bills	Bonds	Shares	Corporate bills	Accrued interest	TOTAL
At 01 January 2016	520,302	153,697	439	-	3,294	677,732
Increase	582,634	341,254	-	-	3,762	927,650
Changes in fair value	-	7,287	-	-	-	7,287
Decrease	(604,679)	(174,217)	-	-	-	(778,896)
Impairment	-	-	-	-	-	-
At 31 December 2016	498,257	328,021	439	-	7,056	833,773

As of 31 December 2017 Bank has pledged, based on received repo loans of the Croatian National Bank in the amount of HRK 110,000 thousand (2016: HRK 160,000 thousand) and Erste&Steiermärkische Bank, in the amount of HRK 40,000 thousand treasury bills and government bonds worth HRK 162,697 thousand (2016.: HRK 172,603 thousand of treasury bills), whereas it accepted from domestic companies shares in the total amount of HRK 8,924 thousand for repo loans issued in the amount of HRK 6,100 thousand (2016: HRK 3,500 thousand loans, HRK 5,308 thousand collateral).

/i/ The treasury bills relate to:

- HRK 80,000 thousand (nominal) of HRK treasury bills (2016: HRK 130,000 thousand) issued by the Croatian Ministry of Finance with a yield of 0.445% - 0.642% (2016: 0.951% - 1.457%)
- HRK 262.978 thousand (nominal) of foreign currency treasury bills (2016: HRK 287,196 thousand) issued by the Croatian Ministry of Finance with a yield of 0.096% (2016: 0.7%).
- HRK 120.218 thousand (nominal) of treasury bills (2016: HRK 83.136 thousand) issued by the Croatian Ministry of Finance and tied under a currency protection clause, with a yield of 0.05% (2016: 0.171% - 0.249%).

18 FINANCIAL ASSETS AVAILABLE FOR SALE (continued)

/ii/ The foreign-currency denominated bonds comprise the following:
 - HRK 225,409 thousand (nominal) in respect of a bond issued by the Croatian Ministry of Finance that matures on 27 January 2030, with a nominal interest rate of 2.75% (purchased in December 2017)

The bonds with a currency protection clause comprise the following:
 - HRK 60,109 thousand (nominal) in respect of a bond issued by the Croatian Ministry of Finance (2016: HRK 133,367 thousand) that matures on 10 July 2024, with a nominal interest rate of 5.750% (2016: 5,75%)
 - HRK 45,082 thousand (nominal) in respect of a bond issued by the Croatian Ministry of Finance that matures on 29 November 2022, with a nominal interest rate of 5.375% (purchased in November and December 2017)
 - HRK 28,026 thousand (nominal) in respect of a bond issued by the Croatian Ministry of Finance that matures on 5 March 2020, with a nominal interest rate of 6.50% (purchased in December 2017)
 - HRK 13,149 thousand (nominal) in respect of a bond issued by the Croatian Ministry of Finance (2016: HRK 756 thousand) that matures on 22 July 2022, with a nominal interest rate of 6.500% (2016: 6,500%)

/iii/ HRK-denominated bonds comprise the following:
 - HRK 5,000 thousand (nominal) in respect of a bond issued by the Croatian Ministry of Finance that matures on 27 November 2023, with a nominal interest rate of 1.75% (purchased in November 2017)
 - HRK 4,780 thousand (nominal) in respect of a bond issued by the Croatian Ministry of Finance that matures on 10 November 2019, with a nominal interest rate of 5.125% (the same as in 2016)

/iv/ Of the above amount of bonds in 2017, HRK 40,990 thousand refers to the due notes of the client Konzum d.d. and from the provisions impairment losses for identified losses of HRK 28,693 thousand relates to stated client.

/v/ The shares relate to the Bank's equity interest in companies and financial institutions below 20%.
 The shares are not quoted and comprise the following:
 - 1,044 units of the Croatian Register of Debtors
 - 85 shares of Tržište novca Zagreb (TNZ-R-A).

	31 December 2017			31 December 2016		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Foreign-currency bonds	228,099	-	-	125,265	-	-
HRK bonds	179,886	-	-	202,756	-	-
Treasury bills	-	462,839	-	-	498,257	-
Corporate bills	-	-	12,356	-	-	-
Shares	-	-	439	-	-	439
Total	407,985	462,839	12,795	328,021	498,257	439

18 FINANCIAL ASSETS AVAILABLE FOR SALE (continued)

Financial instruments carried at fair value are categorised into three levels of the IFRS fair value hierarchy, as follows:

- Level 1 - instruments that are valued using quoted prices in active markets, liquid markets. These instruments include: liquid debt securities that are traded on liquid stock markets and shares in investment funds.
- Level 2 – Instruments measured using valuation techniques using observable market data. The fair value of those instruments is determined by reference to similar instruments traded on active markets, or where all inputs used in a particular valuation technique are available on the market. These instruments include less liquid debt securities that are valued based on a model that uses Level 1 input.
- Level 3 – instruments measured using valuation techniques that are based on market data not readily available in the market. These are instruments whose fair value cannot be determined directly by reference to available market information and for whose value calculation different valuation techniques are used. These instruments include illiquid debt securities and illiquid equity securities.

19 ASSETS HELD TO MATURITY

	31 December 2017	31 December 2016
Domestic currency bills of exchange	-	46,358
HRK bonds	-	4,766
<i>Accrued interest</i>	-	34
<i>Provisions for impairment for identified losses on an individual basis</i>	-	
<i>Provisions for impairment for unidentified losses on a collective basis</i>	-	(511)
Total	-	50,647

20 LOANS AND ADVANCES TO CUSTOMERS

20.1 Analysis by type of client

Analysis by type of client (including accrued interest and provision for interest)

	31 December 2017	31 December 2016
Private Individuals		
Cash loans	170,883	168,905
Housing loans	56,910	57,895
Loans for agriculture	34,720	48,821
Margin loans	31,894	25,935
Overdrafts on transaction accounts	15,732	14,983
Lombard loan	14,667	15,510
Loans for tourism	13,335	14,869
Mortgage loans	6,641	7,882
Other loans	68,366	57,590
Total loans to individuals	413,148	412,390
<i>Provisions for impairment for identified losses</i>	<i>(38,546)</i>	<i>(32,802)</i>
<i>Provisions for impairment for unidentified losses on a collective basis</i>	<i>(3,557)</i>	<i>(3,575)</i>
<i>Interest impairment provision - individuals</i>	<i>(442)</i>	<i>(437)</i>
<i>Total provisions for impairment - individuals</i>	<i>(42,545)</i>	<i>(36,814)</i>
Accrued interest	2,588	2,585
Total loans to individuals, net	373,191	378,161
Legal persons (Corporate customers)		
Syndicated loans	378,891	704,802
Investment loans	250,205	293,641
Working-capital loans	160,893	175,470
Overdrafts on transaction accounts	37,321	35,833
Loans for agriculture	12,567	13,766
Loans for construction	7,624	9,856
Loans for payments under guarantees	2,458	7,071
Lombard loans	849	28,964
Other loans	142,542	150,596
Total loans to legal persons	993,350	1,419,999
<i>Provisions for impairment for identified losses</i>	<i>(210,113)</i>	<i>(203,784)</i>
<i>Provisions for impairment for unidentified losses on a collective basis</i>	<i>(6,079)</i>	<i>(10,755)</i>
<i>Interest impairment provision - legal persons</i>	<i>(1,794)</i>	<i>(1,893)</i>
Total provisions for impairment	(217,986)	(216,432)
Accrued interest	4,466	8,915
Total loans to legal persons, net	779,830	1,212,482
Total loans	1,413,552	1,843,889
<i>Total loan provision</i>	<i>(260,531)</i>	<i>(253,246)</i>
Total net	1,153,021	1,590,643

20 LOANS AND ADVANCES TO CUSTOMERS (continued)

20.1 Analysis by type of client (continued)

As at 31 December 2017, the total gross exposure arising from partly recoverable and non-recoverable loans was HRK 451,196 thousand (2016: HRK 411,942 thousand), and the associated impairment losses amounted to HRK 248,659 thousand (2016: HRK 236,586 thousand), stated in Note 38.1.7

20.2 Changes in impairment losses and provision for contingent losses

Changes in impairment losses and provision for contingent losses are as follows:

	2017			2016		
	Impairment	Specific provisions for unidentified losses on a collective basis	Total	Impairment	Specific provisions for unidentified losses on a collective basis	Total
Balance at 1 January	238,916	14,330	253,246	232,596	17,352	249,948
Net impairment losses i.e. provisions (Note 13)	23,809	(4,694)	19,115	15,066	(3,022)	12,044
Net impairment losses on interest receivable (Note 13)	70		70	20	-	20
Exchange differences	(157)		(157)	(383)	-	(383)
Write-offs	(11,743)		(11,743)	(8,383)	-	(8,383)
Balance at 31 December	250,895	9,636	260,531	238,916	14,330	253,246

Under the applicable legislation, the Bank has to form reserves for unidentified losses on a loan portfolio basis based on prior experience. Taking into account the legal provisions, the amount of the reserves by the Bank's policies cannot be less than 1% of non-risk assets and 1% of non-risk commitments and contingencies as at 31 December 2017 (2016: 1% of non-risk assets and 1% of non-risk commitments and contingencies).

21 INVESTMENT PROPERTY

	31 December 2017	31 December 2016
Investment property	33.702	35.696
Value adjustment	(72)	(1.994)
Total	33.630	33.702

21 INVESTMENT PROPERTY (continued)

Investment properties are properties which are held by the Bank either to earn rentals or for capital appreciation. Bank made in 2017 an impairment of the asset values in accordance with the new assessment of its market value. Investment property is measured initially at cost. Fair value reflects income from operating leases and other assumptions otherwise considered by other market participant in determining the fair value of investment property under the current market conditions. The reported fair value reflects the market conditions prevailing for an asset at the same location and in the same condition under a similar lease agreement.

Investment property contains one property on the basis of which the Bank earns income from the lease. The contract with the tenant was concluded for an indefinite period and because very good business relationship of many years and the attractiveness of the location, the Bank does not expect contract termination in the coming period of 5 years.

Under the contract, the Bank has no obligation to invest in the premises, and incurred no costs in this respect.

21.1 Lease income

Although the Bank has only one real estate classified as a lease payment, the rental income is also realized on the basis of other real estate that is not classified in the said category, since the Bank intends to sell them instead of long-term realization of their rental income. In 2017, the Bank realized rental income in the amount of HRK 4,196 thousand (2016: HRK 4,451 thousand).

The net book value of the leased real estate on 31 December 2017 amounts to HRK 38,512 thousand (2016: HRK 38,252 thousand).

Below is a description of future expected operating lease income

31 December 2017

	Up to 1 year	1 to 3 years	3 to 5 years
Received lease payments – income	4,320	4,320	4,320

31 December 2016

	Up to 1 year	1 to 3 years	3 to 5 years
Received lease payments - income	3,780	4,200	4,200

21 INVESTMENT PROPERTY (continued)

21.2 Fair value hierarchy

in thousands of HRK

	Level 1	Level 2	Level 3	Total
Balance at 31 December 2017				
Investment property	-	-	33,702	33,702
Total assets	-	-	33,702	33,702

Balance at 31 December 2016				
Investment property	-	-	33,702	33,702
Total assets	-	-	33,702	33,702

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22 PROPERTY AND EQUIPMENT, AND INTAGIBLE ASSETS

	Land and buildings	Furniture and vehicles	Equipment and other tangible assets	Tangible assets under construction	Total tangible assets	Intangible assets	Intangible assets under development	Total intangible assets	Grand total
<i>in ths. of HRK</i>									
Cost									
Balance at 1 January 2016	28,147	8,403	22,781	44	59,375	27,605	270	27,875	87,250
Transferred from/to	-	-	-	(30)	(30)	-	(30)	(30)	(60)
Additions	434	86	1,197	-	1,717	2,410	-	2,410	4,127
Disposals and retirements	(3,873)	(757)	(2,373)	-	(7,003)	(152)	-	(152)	(7,155)
Balance at 31 December 2016	24,708	7,732	21,605	14	54,059	29,863	240	30,103	84,162
Additions	-	38	299	-	337	1,214	180	1,394	1,731
Transferred from/to	-	-	27	-	27	(27)	(240)	(267)	(240)
Disposals and retirements	(12,305)	(2,918)	(3,010)	-	(18,233)	(296)	-	(296)	(18,529)
Balance at 31 December 2017	12,403	4,852	18,921	14	36,190	30,754	180	30,934	67,124
Accumulated depreciation/amortisation									
Balance at 31 December 2015	15,815	7,500	20,465	-	43,780	23,586	-	23,586	67,366
Charge for the year 2016	579	348	800	-	1,727	1,743	-	1,743	3,470
Disposals and retirements	(1,843)	(755)	(2,277)	-	(4,875)	(152)	-	(152)	(5,026)
Balance at 31 December 2016	14,551	7,093	18,988	-	40,632	25,177	-	25,177	65,809
Charge for the year 2017	515	343	701	-	1,559	1,866	-	1,866	3,425
Disposals and retirements	(6,384)	(2,905)	(2,992)	-	(12,281)	(296)	-	(296)	(12,577)
Balance at 31 December 2017	8,682	4,531	16,697	-	29,910	26,747	-	26,747	56,657
Net book value at 31 December 2016	15,613	1,258	2,561	14	19,446	2,530	-	2,530	21,976
Net book value at 31 December 2017	10,157	639	2,616	14	13,427	4,686	240	4,926	18,353
Net book value at 31 December 2017	3,721	321	2,224	14	6,280	4,007	180	4,187	10,467

During the year, the Bank retired certain items of property and equipment with a total cost of HRK 6,183 thousand (2016: HRK 3,047 thousand) and sold a portion in the amount of HRK 40 thousand (2016: HRK 1,980 thousand).

At 31 December 2017 no own assets of the Bank were pledged as collateral, nor in 2016.

At 31 December 2017 the balance of assets still in used although fully written off amounts to HRK 23,351 thousand (2016: HRK 28,262 thousand).

23 FORECLOSED ASSETS

Changes in foreclosed assets for uncollected receivables are as follows:

	31 December 2017	31 December 2016
Balance at 1 January	23,389	24,539
Increase based on foreclosing assets	983	391
New provisions/impairment made (Note 13)	(6,347)	(494)
Other adjustments (transfer of assets upon final settlement)	-	(178)
Foreclosed assets sold	(2,628)	(869)
Balance	15,397	23,389

In 2017 the Bank foreclosed assets in the amount of HRK 2.628 thousand (2016: HRK 869 thousand) and realised a gain in the amount of HRK 4,073 thousand (2016: HRK 1,593 thousand).

24 ASSETS AVAILABLE FOR SALE

	31 December 2017	31 December 2016
Assets available for sale	5,280	-
Total	5,280	-

During 2017, the Bank has reclassified assets (business premises in Zadar and Poreč) not used for business operations to non-current assets held for sale at net book value since fair value of assets is higher than net book value.

25 OTHER ASSETS

	31 December 2017	31 December 2016
Receivables from the state	17,759	17,759
Trade receivables	10,669	8,422
Receivables based on payments deposited with court by third purchasers	5,811	10,593
Other receivables	4,945	3,955
Other receivables from employees	4,537	4,539
Fees and commissions receivable	3,985	4,013
Receivables from domestic legal persons based on paid court costs	2,662	2,656
Items in course of collection	1,908	2,293
Provisions for unidentified losses on a collective basis	(134)	(182)
Provisions for individually identified losses	(19,580)	(18,289)
Total other assets	32,562	35,759

26 LIABILITIES TO BANKS

	31 December 2017	31 December 2016
Demand deposits		
- in HRK	16,545	3,114
- in foreign currencies	651	667
Total demand deposits	17,196	3,781
Term deposits		
- in HRK	43,694	86,900
- in foreign currencies	1,237	1,233
Total term deposits	44,931	88,133
Accrued interest	46	181
Total	62,173	92,095

27 DEMAND DEPOSITS

	31 December 2017	31 December 2016
Demand deposits - individuals		
- in HRK	93,099	86,856
- in foreign currencies	83,318	78,566
Total demand deposits from individuals	176,417	165,422
Demand deposits - corporate		
- in HRK	118,750	190,245
- in foreign currencies	11,280	9,175
Total corporate deposits	130,030	199,420
Demand deposits - financial institutions		
- in HRK	1,187	1,861
- in foreign currencies	2	2
Total deposits from financial institutions	1,189	1,863
Demand deposits - government and other institutions		
- in HRK	59,006	62,648
- in foreign currencies	13,057	12,722
Total demand deposits from government and other institutions	72,063	75,370
Restricted deposits		
- in HRK	5,392	2,630
- in foreign currencies	15,103	16,253
Total restricted deposits	20,495	18,883
Deposits from foreign entities		
- in HRK	1,835	2,031
- in foreign currencies	9,853	8,946
Total deposits from foreign entities	11,688	10,977
Total	411,882	471,935

28 TERM DEPOSITS

	31 December 2017	31 December 2016
Deposits from individuals		
- in HRK	146,294	161,764
- in foreign currencies	1,274,023	1,425,625
Total term deposits from individuals	1,420,317	1,587,389
Deposits - corporate		
- in HRK	73,526	97,051
- in foreign currencies	2,080	35,585
Total corporate term deposits	75,606	132,636
Deposits - financial institutions		
- in HRK	16,000	110,820
- in foreign currencies	676	680
Total term deposits from financial institutions	16,676	111,500
Total term deposits from government and other institutions	19,363	23,740
Deposits from foreign entities		
- in HRK	2,540	3,997
- in foreign currencies	124,066	137,761
Total deposits from foreign entities	126,606	141,758
Deposits from non-profit organisations - foreign-currency denominated	188	-
Accrued interest	23,472	47,539
Total	1,682,228	2,044,562

29 BORROWINGS

	31 December 2017	31 December 2016
Croatian National Bank	110,000	160,000
Domestic banks	50,596	129,922
Accrued interest	2,896	2,081
Total	163,492	292,003

30 OTHER LIABILITIES

	31 December 2017	31 December 2016
Deferred income and accrued expenses	3,072	1,440
Amounts due to employees	2,511	2,771
Other liabilities	2,080	1,357
Liabilities for savings deposit insurance	1,350	1,518
Liabilities to suppliers	245	412
Fees and commissions payable	1,350	1,518
Amounts owed for insured deposits of bankrupt banks /i/	1,146	1,281
Total	10,663	9,109

/i/ The State Agency for Bank Rehabilitation is making payments of insured deposits of bankrupt banks (Credo banka and Centar banka) through the Bank. The amount payable by the Bank in 2017 under claims of insured deposit holders is HRK 245 thousand (2016: HRK 412 thousand).

31 PROVISIONS

	31 December 2017	31 December 2016
Provisions for legal cases	7,065	9,004
Provisions for contingent liabilities and commitments-collective	1,054	1,528
Provisions for contingent liabilities and commitments-individuals	57	6
Vacation accruals	146	100
Other provisions	48	38
Total	8,370	10,676

Movement in provisions is shown as follows:

	2017	2016
Balance at 1 January	10,676	8,186
Income from reversal of provisions for legal claims against the bank (Note 13)	(318)	(848)
New provisions made for legal cases (Note 13)	1,625	6,130
Movement in provisions for commitments and contingencies (Note 13)	(423)	(102)
Income from reversal of provisions for jubilee awards, termination and similar benefits	46	28
Movement in other provisions	10	14
Movement in payments made under legal actions	(3,246)	(2,732)
Balance at 31 December	8,370	10,676

In 2017 the Bank paid HRK 3,246 thousand from the provisions for judicial proceedings (2016: HRK 2,732 thousand).

Provisions for off-balance-sheet exposure to credit risk and legal claims are recognised in profit or loss as other losses from impairment and provisions (Note 13).

32 SHARE CAPITAL

The only shareholder of the Bank as at 31 December 2017 and 31 December 2016 is the State Agency for Deposit Insurance and Bank Rehabilitation.

	31 December 2017	31 December 2016
Share capital	474,600	474,600
Accumulated losses	(290,536)	(292,174)
Reserves	(1,425)	5,571
Profit/(loss) for the year	(30,631)	1,638
Total equity	152,008	189,635

The share capital in the amount of HRK 474,600 thousand (2016: HRK 474,600 thousand) consists of 4,746,000 shares with a nominal value of HRK 100 per share (2016: 4,746,000 shares with a nominal value of HRK 100 per share).

33 EARNING PER SHARE

	2017	2016
(Loss)/profit for the year	(30,631)	1,638
Number of shares (in thousands)	4,746	4,746
(Loss)/earnings per share	(6.45)	0.35

34 CONTINGENT LIABILITIES AND COMMITMENTS

	31 December 2017	31 December 2016
Guarantees	43,067	46,373
Other common risk-bearing off-balance sheet items	30,213	60,444
Revolving loans	29,978	45,278
Unbacked letters of credit	7,821	1,143
Total	111,079	153,238

35 LEGAL CASES

More than 200 legal claims from ex-shareholders of the Bank, and around forty three legal actions on other grounds have been initiated against the Bank.

The Bank assesses the potential outflow of cash under proceedings carrying a risk of loss and forms appropriate provisions in accordance with its internal act and applicable regulations.

As at 31 December 2017, the provisions for losses from legal claims filed against the Bank amounted to HRK 7,065 thousand (2016: HRK 9,004 thousand).

Due to mentioned above, ex-shareholders of the Bank, suing the Bank for the return of shares and compensation for share cancellation, have filed 220 legal claims against the Bank and only three of the disputes are formally active although have been interrupted (from 2008 to 2012) and are not expected to continue.

Until the date of this report almost all proceedings were completed, with the majority being ruled in favour of the Bank, and only several proceedings ruled in favour of the shareholders. However, as these proceedings pertain to the ownership of shares, they do not produce a significant impact on the financial operations of the Bank. Constitutional appeals were filed in cases where the judgements were in favour of the shareholders, and the Constitutional Court made the decision to acknowledge the Bank's constitutional appeals and returned the cases to the commercial court for retrial.

36 CASH AND CASH EQUIVALENTS

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following:

	31 December 2017	31 December 2016
Cash in hand and on current accounts with banks (Note 15)	178,095	279,385
Balances with other banks with maturities of up to 3 months (Note 17)	23,325	53,873
Total	201,420	333,258

37 TRANSACTIONS WITH RELATED PARTIES

The Bank is fully (100%) owned by the State Agency for Deposit Insurance and Bank Rehabilitation (DAB). The Bank considers to be directly related to its shareholder, Supervisory Board and Management Board members and other executive management (jointly referred to as "the key management personnel"), close members of their families, companies jointly controlled or significantly influenced by the Managing Board members and close members of their families, in accordance with the definition of the related party provided in International Accounting Standard 24 "Related Party Disclosures" (IAS 24). Key management includes members of the Management Board, Department directors, directors of branches and directors of control function departments. At 31 December 2017, the key management personnel of the Bank consisted of 24 persons (2016: 29 employees).

The balances of assets and liabilities as well as income and expenses as at 31 December 2017 and 31 December 2016 and for the years then ended resulting from key transactions with related parties are as follows:

2017	Receivables	Liabilities	Income	Expenses
DAB (sole shareholder)	1,611	1,611	14	6,186
Key management personnel				
Short-term (a vista deposits, bonuses, salaries and fees)	4	4	28	8,502
Long-term (loans, deposits and other benefits)	7,003	7,003	290	51
State in narrow and broad definitions	1,367,999	1,367,999	56,214	6,981
Total	1,376,617	1,376,617	56,546	21,720
2016	Receivables	Liabilities	Income	Expenses
DAB (sole shareholder)	61	19,703	11	5,896
Key management personnel				
Short-term (a vista deposits, bonuses, salaries and fees)	4	614	24	9,182
Long-term (loans, deposits and other benefits)	8,832	1,899	324	46
State in narrow and broad definitions	1,659,453	317,276	59,139	10,143
Total	1,668,350	339,492	59,498	25,267

37 TRANSACTIONS WITH RELATED PARTIES (continued)

Key management personnel do not hold any of the Bank's shares. Loans and receivables from customers include HRK 7,003 thousand (2016: HRK 8,402 thousand) of loans to key management personnel. During the year, the Bank collected interest in the amount of HRK 290 thousand (2016: HRK 319 thousand) from loans and receivables in respect of key management personnel, which were approved at annual interest rates ranging from 3.57% - 5.00% (2016: 3.00% to 5.23%). The balance of current accounts and deposits of customers includes term deposits of key management personnel in the amount of HRK 2,545 thousand (2016: HRK 1,889 thousand). The interest paid on those deposits in 2017 amounts to HRK 51 thousand (2016: HRK 46 thousand), and the interest rates ranged from 0.10% to 2.75% (2016: 0.10% to 3.33%).

Expenses in respect of the Supervisory Board for 2017 amount to HRK 350 thousand (2016: HRK 312 thousand).

Expenses of the Management Board of the Bank in 2017 amounted to HRK 1,822 thousand (2016: HRK 1,754 thousand).

Transactions with the state in narrow and broad definitions comprise transactions with:

- the Central Government,
- local governments,
- public non-financial companies,
- public insurance companies and pension funds,
- public auxiliary financial institutions,
- other monetary financial institutions of the state,
- other public financial intermediaries.

As at 31 December 2017, the exposure to the state in narrow and broad definitions comprises the exposure to state-owned company Hrvatske autoceste d.o.o. in the amount of HRK 291,359 thousand (2016: HRK 424,026 thousand) in respect of a syndicated loan.

The Bank's exposure to HŽ Cargo amounts to HRK 84,723 thousand (2016: HRK 94,593 thousand). The Bank is exposed to amounts owed by Borovo d.d. of HRK 16,999 thousand (2016: HRK 17,760 thousand). Receivables from Đuro Đaković Holding amount to HRK 32,510 thousand (2016: HRK 33,673 thousand).

The Bank's exposures to the Ministry of Finance comprise those on the Ministry's quoted bonds in the amount of HRK 669,074 thousand (2016: HRK 620,570 thousand) and the treasury bills in the amount of HRK 200,137 thousand (2016: HRK 212,765 thousand) issued by the Ministry of Finance.

The restricted deposit of the Ministry of Finance amounts to HRK 15,027 thousand (2016: HRK 15,116 thousand).

As at 31 December 2017, the Restructuring and Sale Centre holds on the transaction account at the Bank HRK 22,157 thousand (2016: HRK 36,903 thousand).

As at 31 December 2017, the Bank's shareholder, the State Agency for Deposit Insurance and Bank Rehabilitation, holds on the transaction account HRK 17,215 thousand (2016: HRK 18,185 thousand).

At 31 December 2017 the amount owed by the Bank for loans received from the Croatian Bank for Reconstruction and Development (joint customer lending with CBRD) HRK 10,647 thousand (31 December 2016: HRK 130,754 thousand).

All the above-mentioned significant transactions with the state and state-owned companies were entered into on a market-based principle.

37 TRANSACTIONS WITH RELATED PARTIES (continued)

Income recognised in the profit and loss for 2017 treated as key transactions is as follows:

- income from loans to Hrvatske autoceste for the year 2017 in the amount of HRK 18,675 thousand (2016: HRK 22,188 thousand).
- income from loans to Hrvatske ceste for the year 2017 in the amount of HRK 10,681 thousand (2016: HRK 10,382 thousand).
- income from bonds issued by the Ministry of Finance in the amount of HRK 22,108 thousand (2016 : HRK 17,523 thousand).
- income from treasury bills issued by the Ministry of Finance amounts to HRK 840 thousand (2016 : HRK 1.911 thousand).

Expenses recognised in the profit and loss treated as key transactions is as follows:

- costs of loans received from CBRD in 2017 in the amount of HRK 2,502 thousand (2016: HRK 4,524 thousand).
- expenses in respect of DAB relate to costs for the savings deposit insurance and rental expenses in the amount of HRK 5,576 thousand and to transaction account costs in the amount of HRK 5 thousand (2016: HRK 5,853 thousand : HRK 44 thousand).

Exposures under receivables from key management personnel and the state in broad and narrow definitions include off-balance sheet receivables of the Bank in the following amounts:

	Key management personnel	State in narrow and broad definitions
31 December 2017		
Guarantees	-	5,417
Credit lines	375	1,692
31 December 2016		
Guarantees	-	6,873
Credit lines	430	9,173

The Bank's maximum off-balance sheet exposure to the state in narrow and broader definitions relates Đuro Đaković grupa d.d. and amounts to HRK 5,925 thousand (2016: to Đuro Đaković in the amount of HRK 10.383 thousand). All the exposures presented in this note are presented on a net basis, i.e. less identified and unidentified impairment losses.

38 RISK MANAGEMENT POLICIES

Details on the Bank's exposure to risks and methods the Management Board used to manage those risks are described below. The key financial risks to which the Bank is exposed comprise credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate risk and price risk.

38.1. Credit risks

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

The Bank's primary exposure to credit risk arises from loans and receivables from customers and banks and investments in securities. In addition, the Bank is exposed to credit risk on its off-balance sheet items, reflecting its commitments under undrawn facilities and guarantees issued.

Credit risk is the greatest individual risk arising from the Bank's operations; therefore, all organisational units and functions of the Bank monitor the risk closely. Credit risk management and controls are centralised within the Risk Management Office that provides regular risk reports to the Management Board, other bodies of the Bank, its Supervisory Board and senior management.

For the purpose of credit risk management, the Bank has spread its principal credit risk management activities over the following processes:

- loan approval
- loan monitoring
- loan portfolio analysis
- non-performing loans
- early warning of increased credit risk
- loan classification according to the magnitude of risk.

Establishing appropriate relations between the individual processes is a particularly important process, as it helps prevent any process overlaps and misalignment and establishes the necessary level of segregation of duties and responsibilities for the processes.

Organisational responsibilities for credit risk management are divided among the responsibility structures of sales and back-office/organisational units/functionalities, among control and management functions, and operation support, and are additionally positioned for all credit risk management segments, including:

- risk identification and monitoring
- risk analysis and supervision
- risk measurement/assessment
- risk controls
- risk reporting

38 RISK MANAGEMENT POLICIES (continued)

38.1. Credit risks (continued)

Loan analysis is organisationally placed within the Risk Management Function whose scope of responsibilities directly affect the credit risk management, primarily in developing analyses and opinions regarding the Bank's credit risk appetite, which includes the following sub-processes:

- Providing opinion on new credit placements
- Providing opinion on proposals for changes to the conditions for the already existing placements
- Analysing the viability of proposed renewal and restructuring of the existing placements
- Periodic reviews of all existing placements.

In analysing placements that belong to the credit risk management area, the Risk Management Service also estimates the acceptability of credit risk by individual placements, in accordance with the standards and criteria of best banking practice, i.e. application of the effective (external and internal) normative regulations. It communicates its views/principles of assessing the credit risk acceptability to decision-making individuals and bodies responsible for loans.

Further responsibilities of staff engaged in loan analysis include monitoring credit risk exposure, including the early warning of increased credit risk. The duties and responsibilities of the Risk Management Service include the credit portfolio control activity, which ensures, in cooperation with other organisational units at the Bank, timely identification of clients with potential risk. Such an approach involves a complex management of business relations with customers with the aim to reduce the cost of credit risk as well as improve the quality of the Bank's credit portfolio.

Credit risk control is based on an individual approach to the credit risk assessment specifically tailored to individual clients, including identification of clients with a potential risk, analysis and classification of clients with potential risk, determining the form and manner of managing business relations with clients, and following-up.

Special attention is paid to managing exposures to related parties by reference to the effective organisational normative and operational rules, as well as other aspects of credit risk exposure defined by the Credit Institutions Act and the related by-laws and internal acts governing its implementation.

38.1.1. Credit risk assessment

Loans and receivables (including contingent liabilities)

The Bank assesses the probability of default by individual clients using internal assessment tools created for all groups of customers in line with the internal acts and applicable laws.

Loans and contingent liabilities are classified into the following three key risk groups:

- 1.1. fully recoverable loans (risk group A) – loans assessed as fully recoverable (both principal and interest) and contingent liabilities expected not to result in an outflow of the Bank's resources, or if such an outflow is required, that they will be recovered in full.
- 1.2. partly recoverable loans (risk group B) – loans assessed as not recoverable at contractual amounts (principal and interest) or contingent liabilities expected to result in an outflow of the Bank's resources in excess of the estimated recoverable amount.
- 1.3. irrecoverable loans (risk group C) – loans estimated as fully irrecoverable or insignificantly recoverable and contingent liabilities expected to result in an outflow of the Bank's resources that will never be recovered.

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.1. Credit risk assessment (continued)

Managing credit risk of a portfolio of workout or non-performing (bad) loans is the responsibility of a separate unit within the Bank which is in charge of working out such debt (Workout and Non-performing Loan Department), both owed from legal persons and individuals. These activities are primarily aimed at realising positive effects of the implementation of various forms of financial consolidation of clients' business, including various forms of prolongation, renewal or restructuring of loans with the aim of their recovery and maximising the recoverability of loans and receivables as well as improving the loan and guarantee portfolio of the Bank, or fully or partially stabilising as well as cases of full or partial stabilisation of the clients' business by taking consolidation measures, enabling the inclusion of such loans in "performing" ones.

The Risk Management Service estimates future cash flows from non-performing loans on the basis of which provisions for impairment are determined. Such assessment is prepared for all loans managed.

The Bank makes provisions for identified losses on loans and their impairment as follows:

- a) on an individual basis
 - for loans that are not included in the "small loans portfolio"
- b) on a collective basis
 - for loans classified in risk group "A";
 - for loans classified in the "small loans portfolio";
 - for all loans to a single debtor in bankruptcy procedure, if the Bank does not have the status of a creditor with a separate satisfaction right and assesses these loans on an individual basis.

The small loans portfolio comprises the total Bank's exposure to one person or a group of related persons that is not individually significant, i.e. at the date of assessment does not exceed HRK 250,000. Thereby the total exposure amount includes all active balance sheet and off-balance sheet items that are subject to classification in risk groups.

The large loans portfolio, individually significant exposure, comprises the total exposure to one person or a group of related persons whose total exposure at the estimation date exceeds HRK 250,000.

The credit risk assessment on an individual basis is a separate estimation of future cash flows and determining the existence or non-existence of loss for each individual loan and each individual off-balance sheet liability that the Bank is obliged to apply in assessing loans and off-balance sheet liabilities that make an integral part of individually significant exposure.

Credit risk assessment on a collective basis is a collective estimation of future cash flows and determining the existence or non-existence of loss for groups with similar characteristics of credit risk and off-balance sheet liabilities, and is performed in the following cases:

- in assessing the quality of loans and off-balance sheet liabilities for which evidence of the existence of visible losses was not identified, but which might bear latent losses, estimated on the basis of experience on a collective basis (this assessment includes all loans and off-balance sheet liabilities of the risk group A)
- in assessing identified losses for loans included in the small loans portfolio.

Finally, it should be noted that the Bank is currently in the process of upgrading and modifying the internal rating model, which will be introduced in the Bank's operations in the first half of year 2017. This rating model will improve credit risk assessment and estimation, for the purpose of accurate and timely credit risk management in the Bank.

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.2. Risk limit control and policies for risk mitigation

The Bank manages credit risk levels by limiting credit risk with respect to a single customer, or a group of customers, and geographic and economic activity segments. Limits set by reference to products, industry sectors and countries are approved by the Bank's management. The credit risk exposure is also managed by a regular analysis of the ability of the existing clients and potential clients to settle their liabilities of repaying interest and principal and by changing credit limitations where necessary.

Further specific measures for credit risk control and mitigation are stated below.

(a) Collaterals and credit enhancements

The Bank uses policies of security instruments for receivables that prescribe the main rules aimed at minimising the risk from credit operations. Security instruments for receivables represent the secondary collection source, while the clients' operations and their ability to generate sufficient cash funds for settling financial liabilities are the primary source of collecting the Bank's receivables. The rules that prescribe the obligation to take security instruments for which the normative acts prescribe the conditions for acceptability, individually for each of the specific security instruments categories are standardised. Also, specific modalities of credit protection aimed at decreasing or mitigating credit risks are determined.

The most significant types of security instruments for loans and receivables are as follows:

- a) Mortgage over property,
- b) Pledge over operating/tangible assets,
- c) Pledge over financial instruments such as debt or equity securities
- d) Insurance policies for loan receivables, life insurance policies with redemption values and other instruments whose quality based on evidence may be equalised with the quality of other above-mentioned instruments.

Non-current financial assets, loans to companies and natural persons are generally secured by appropriate security instruments.

In addition, in order to reduce credit loss, the Bank requires additional collaterals from the contractual parties as soon as indicators of impairment for individual relevant loans and advances are determined. The collateral held as security for all financial assets other than loans and advances is determined on the basis of the nature of the instrument. Debt securities, treasury and other bills are generally not secured, with the exception of securities with coverage in assets and similar instruments secured by financial instruments portfolios.

(b) Loan commitments

Loan commitments are unused granted loan amounts in the form of loans, guarantees or letters of credit. With respect to credit risk from loan commitments, the Bank is potentially exposed to loss in the amount equal to the total unused commitments.

However, the potential loss amount is lower than the total amount of unused commitments, since the majority of commitments depends on maintaining specific credit standards by the clients. The Bank monitors the remaining period to loan maturities as non-current liabilities generally have a higher degree of credit risk compared to current liabilities.

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.3. Impairment and provisioning policies

The amount of provisions for impairment in the portfolio of clients monitored on an individual basis is determined using the dynamic approach, on the basis of the calculation of the loan's recoverable value, calculated as the net present value of estimated future cash flows discounted at the effective interest rate of the loan at the moment when it was assessed as "non-performing" (for loans granted at fixed rates it is the original effective rate calculated at the moment of granting). The regulations of the Croatian National Bank on minimum rates of special provisions in special cases are also taken into account.

Instruments of credit protection for which the nominal value is discounted are as follows:

- pledge over housing property
- pledge over other property and movables for which the market exists and which may be sold in acceptable time periods.

Discounting future cash flows to the present value is calculated individually for all long-term loans from the large loans portfolio for which the impairment loss was identified and it is estimated that their future cash flow from operating activities and cash flow from security instruments will not be sufficient.

Based on the repayment on time criteria, loans in the large loans portfolio are classified into the following risk groups:

1) risk group "A" includes loans that meet the following criteria:

- the debtor's current financial situation and estimated future cash flows do not rise any doubts with respect to the debtor's further operations and settlement of their current and future liabilities to the Bank and other creditors,
- the debtor settles their liabilities to the Bank in contracted terms, and only exceptionally and occasionally after their maturity,
- the loans are secured by adequate security instruments for receivables.

2) Risk group B1 (loans for which the determined loss does not exceed 30% of the nominal carrying amount of individual loans).

3) Risk group B2 (loans for which the determined loss is from 30% to 70% of the nominal carrying amount of individual loans).

4) Risk group B3 (loans for which the determined loss is over 70% and less than 100% of the nominal carrying amount of individual loans).

5) Risk group C (fully unrecoverable loans are considered to be Bank's receivables arisen on a disputable legal basis and other receivables for which, due to an exceptionally poor asset and financial position of the debtor, and due to the lack of adequate security instruments, no cash flows may be expected for settling the debtor's liabilities to the Bank). The Bank is obliged to classify such loans in the risk group C. Loans classified in the risk group C, 100% impaired, are recorded by the Bank in the balance sheet until all legal procedures are finalised related to the termination of the debtor's liability, in line with the policies and procedures of the credit institution and the law that regulates civil obligations.

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.3. Impairment and provisioning policies (continued)

Specific provisions for impairment for the remaining portfolio of non-performing small loans (exposures below HRK 250 thousand) are calculated by reference to the regularity of payment.

Based on the timeliness of repayment, loans in the small loans portfolio are classified into the following risk groups:

- 1) Risk group "A" includes fully recoverable loans. For a loan to remain classified in the risk group "A", the following conditions must be met:
 - the debtor's past due liabilities to the Bank are not older than 90 days
 - the full loan amount is covered by a guarantee deposit.
- 2) Risk group "B" or "C" loans must be provided for on the basis of the number of days of late payment according to specially determined tables
- 3) Risk group "C" includes loans that do not meet the conditions for classification in risk groups "A" and "B", and 100% unrecoverable loans, as follows:
 - unsecured loans (default in payments > 365 days);
 - loans classified in the 100% provision position according to specially determined tables.

38.1.4. Debt securities

For the purpose of realising future yield, the Bank usually invests surplus liquid funds in high-quality government debt securities and foreign bonds.

38.1.5. Past due loans and receivables

Past due loans and receivables by type at 31 December 2017

Past due	Cash	Investments and working capital	Agriculture and tourism	Credit cards and overdrafts	Housing	Other	Total
Up to 30 days	82	6,266	2,013	8,259	9	675	17,304
31-60 days	45	1,059	189	77	2	698	2,070
61-90 days	317	4	-	-	1	6	328
Over 90 days	4,429	217,977	17,732	2,720	1,326	83,006	327,190
Total	4,873	225,306	19,934	11,056	1,338	84,385	346,892

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.5. Past due loans and receivables (continued)

Past due loans and receivables by type at 31 December 2016

Past due	Cash	Investments and working capital	Agriculture and tourism	Credit cards and overdrafts	Housing	Other	Total
Up to 30 days	90	4,052	5,097	7,504	10	2,043	18,796
31-60 days	122	11,072	184	-	1	993	12,372
61-90 days	30	317	-	-	1	5	353
Over 90 days	3,416	212,528	18,554	2,630	1,203	89,267	327,598
Total	3,658	227,969	23,835	10,134	1,215	92,308	359,119

38.1.6 Not impaired loans at 31 December 2017

	Cash	Investments and working capital	Agriculture and tourism	Credit cards and overdrafts	Housing	Other	Total
Not yet due	162,267	194,249	49,512	18,681	54,791	468,227	947,727
Due	65	5,179	2,050	3,632	6	148	11,080
Total	162,332	199,428	51,562	22,313	54,797	468,375	958,807

Not impaired loans at 31 December 2016

	Cash	Investments and working capital	Agriculture and tourism	Credit cards and overdrafts	Housing	Other	Total
Not yet due	161,923	251,970	50,845	40,645	56,022	829,749	1,391,154
Due	93	14,160	5,192	7,001	9	2,839	29,294
Total	162,016	266,130	56,037	47,646	56,031	832,588	1,420,448

Not impaired loans and receivables refer to placements classified in risk groups AA. The placements in the risk group AA are loans and receivables regularly repaid by clients and not impaired by the Bank. ž

The line item 'Other' comprises the participation in syndicated loans in the amount of HRK 378,891 thousand (2016: HRK 704,802 thousand), as well as lombard loans in the amount of HRK 15,516 thousand (2016: HRK 43,813), margin loans in the amount of HRK 20,979 thousand (2016: HRK 25,935 thousand) and mortgage loans in the amount of HRK 5,165 thousand (2016: HRK 7,255 thousand). The remaining balance consist of individual smaller loans intended for diverse purposes.

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.7. Impaired loans

Impaired loans at 31 December 2017

	Cash	Investments and working capital	Agriculture and tourism	Credit cards and overdrafts	Housing	Other	Total
Not yet due	3,743	30,551	7,707	23,316	783	49,284	115,384
Due	4,807	220,127	17,885	7,425	1,330	84,238	335,812
Total	8,550	250,678	25,592	30,741	2,113	133,522	451,196
Impairment	5,384	154,890	12,713	3,551	1,093	71,028	248,659

Impaired loans at 31 December 2016

	Cash	Investments and working capital	Agriculture and tourism	Credit cards and overdrafts	Housing	Other	Total
Not yet due	3,325	29,702	6,015	26	658	42,964	82,690
Due	3,564	213,810	18,643	3,133	1,205	88,896	329,251
Total	6,889	243,512	24,658	3,159	1,863	131,860	411,941
Impairment	3,688	146,340	11,688	3,012	809	71,049	236,586

Within the line item 'Other', long-term loans for the restructuring of various placements in the amount of HRK 42,399 thousand (2016: 39.001 thousand) are the largest individual item, followed by long-term financial restructuring loans in cooperation with the CBRD in the amount of HRK 44,223 thousand (2016: HRK 23,813 thousand), construction loans in the amount of HRK 11,110 thousand (2016: HRK 11,637 thousand) and loans for making payments under guarantees and other sureties in the amount of HRK 3,176 thousand (2016: HRK 7,789 thousand). Remainder relates to individually insignificant loans for different purposes.

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.8. Placement structure by client's business

Placement structure by type of activity at 31 December 2017

Activity sector	Total placements and off-balance sheet liabilities	Placements of unimpaired value	Placements of impaired value	Impairment and provisions	% of impairment
Agriculture, hunting, forestry and fishing	122,607	90,590	32,017	20,807	16,97
Manufacturing	248,802	106,965	141,837	67,021	26,20
Construction	417,310	312,764	104,546	79,784	19,12
Wholesale and retail trade, repair of motor vehicles and household items	181,011	62,182	118,829	74,104	40,94
Service activities	225,155	149,576	75,579	27,958	12,42
Financial intermediation	28,376	25,138	3,238	1,222	4,31
Foreign financial institutions	26,947	26,947	0	216	0,80
CNB	272,943	272,943	0	2,184	0,80
Other activities	75,245	39,825	35,420	5,414	7,20
Activity sectors outside the Croatian National Classification	340,008	312,508	27,500	25,707	7,56
TOTAL	1,938,404	1,399,438	538,966	304,417	15,70

Placement structure by type of activity at 31 December 2016

Activity sector	Total placements and off-balance sheet liabilities	Placements of unimpaired value	Placements of impaired value	Impairment and provisions	% of impairment
Agriculture, hunting, forestry and fishing	151,611	118,021	33,590	20,533	13,54
Manufacturing	238,939	110,068	128,871	61,201	25,61
Construction	715,061	628,381	86,680	66,737	9,33
Wholesale and retail trade, repair of motor vehicles and household items	218,177	124,946	93,231	71,160	32,62
Service activities	312,894	256,153	56,741	28,344	9,06
Financial intermediation	53,268	52,269	999	1,461	2,74
Foreign financial institutions	55,908	55,908	0	559	1,00
CNB	428,930	428,930	0	4,289	1,00
Other activities	93,769	65,408	28,361	5,264	5,61
Activity sectors outside the Croatian National Classification	341,821	318,722	23,099	19,250	5,63
TOTAL	2,610,378	2,158,806	451,572	278,798	10,68

38 RISK MANAGEMENT POLICIES (continued)

38.1 Credit risk (continued)

38.1.9. Past due loans and advances to customers in risk groups B and C for which provisions have been made

	Individuals	Corporate customers	Total
31 December 2017			
Total exposure	62,395	388,801	451,196
Provisions	37,974	210,685	248,659
Total net exposure	24,421	178,116	202,537
Fair value of collateral	40,121	204,208	244,329
% of collateral coverage	164,29%	114,65%	120,63%

	Individuals	Corporate customers	Total
31 December 2016			
Total exposure	59,411	352,530	411,941
Provisions	32,230	204,356	236,586
Total net exposure	27,181	148,174	175,355
Fair value of collateral	40,475	200,560	241,035
% of collateral coverage	148,91%	135,35%	137,45%

38.1.10. Concentration risk

The Bank manages, restricts and controls credit risk concentrations in accordance with Credit Policy wherever such risk is identified - particularly in respect of individual clients and groups, economic sectors and countries. Concentration is determined at the level of exposure of a particular debtor (at the level of a group of related persons) in relation to regulatory capital (over 10% of the recognized capital) and also by exposure of a particular activity to the total exposure of the Bank.

The Bank establishes the level of credit risk that it takes by setting limits to the amount of risk accepted in relation to a single client or group of customers, and to the geographical and economic segments. The Bank's Management Board grants credit-limiting restrictions to products, economic sectors and countries.

Exposure to any borrower is further limited by sub-limits covering both balance and off-balance sheet exposure as well as daily limitations (the liability's liability risk) in relation to the items traded. Actual exposure to restrictions is monitored on a daily basis.

38.2. Liquidity risk

Liquidity risk is the risk of loss arising from the existing or expected Bank's inability to settle its cash liabilities at maturities. This risk arises due to a mismatch of maturities of assets and liabilities, and is manifested as the risk that it will not be possible to convert some receivable into cash in suitable term and at suitable price, i.e. that it will not be possible to convert any non-cash form of assets into cash in a suitable timetable without loss.

The Financial Markets Sector, the Risk Management Service and the ALCO Committee are responsible for liquidity risk management, while the Bank's Management Board makes decisions, whereby precise roles in the liquidity management process are allocated to the following organisational parts or Bank's functionalities:

Cost rates are calculated by the Financial Markets Sector and the Treasury Department. The report does not include funds received from the Croatian Bank for Reconstruction and Development.

38 RISK MANAGEMENT POLICIES (continued)

38.2. Liquidity risk (continued)

Internal prices of products are approved by the Asset-Liability Committee (hereinafter: the ALCO). Internal prices are calculated on a monthly basis, directly prior to the ALCO Committee meeting. Internal prices are confirmed by the ALCO Committee and they are effective until their following meeting. The Risk Management Service is responsible for controlling the limit, and if some of the limits are exceeded, it must immediately inform the Management Board, the Liquidity Committee and the Asset-Liability Committee. On the relevant meeting of the Asset-Liability Committee it is decided whether the limit excess is acceptable until a certain date or the Treasury Department has to bring indicators within the prescribed limits in accordance with the strategy determined at the Asset-Liability Committee meeting.

The allowed excess of liquidity indicators and the strategy defining the reasons for allowing the excess are documented by the minutes of the Asset-Liability Committee meeting.

If the limits are not exceeded, but the early warning indicators related to the limits have been reached, the Treasury Department prepares a written explanation for the Management Board and the Liquidity Committee within not more than 3 working days about the reasons why the indicator of early warning has been reached and with the proposal of possible solutions. The Management Board and the Liquidity Committee make the decision on further action.

The Risk Management Service controls limits within the monthly report, and reports the exceeding of limits on the ALCO meetings.

Sources of Bank financing are deposits and equity capital. The Bank continually reassesses liquidity risk by identifying and following changes in financing that are necessary for accomplishing business aims set according to Bank strategy. Moreover, the Bank manages a portfolio of liquid assets as a part of its liquidity risk management strategy.

The Bank adjusts its operations concerning liquidity risk according to legal provisions and internal policies. The Bank manages assets and sources of funds from a viewpoint of financial flows, cash flows and concentration, all with the aim of adjusting cash inflows with Bank outflows.

Managing in that way assumes identification of known, expected and potential cash outflows and the production of different asset and liabilities management strategies in order to secure the Bank needs for cash inflows. According to the stated, the liquidity risk management system comprises the following: evaluation and measurement of liquidity risk exposure, setting limits of liquidity risk exposure and reporting and supervision of limit utilization.

Liquidity risk management is realized by operative management of short-term liquidity and by management of long-term liquidity. Management of short-term liquidity is realized with maintenance of a regular liquidity reserve in HRK and by planning and forecasting daily and weekly cash flows. The Bank produces daily, weekly, monthly and annual liquidity plans and evaluates current and future outflows and inflows based on them.

Indicators related to a possible crisis in the Bank's liquidity and general crisis of the banking system liquidity are monitored by the Risk Management Service and the Treasury Department, they are determined by the Risk Management Service and reported to the Management Board, Liquidity Committee and/or the Asset-Liability Committee.

38 RISK MANAGEMENT POLICIES (continued)

38.2 Liquidity risk (continued)

Future outflows under financial liabilities at 31 December 2017 represent undiscounted cash flows, including future interest payments in the amount of HRK 25,137 thousand on received deposits and borrowings, classified by maturities. Asset items are classified by maturities of the carrying amounts.

2017	Up to 1 month	1 to 3 months	3 to 12 months	1 to 3 years	Over 3 years	Total
ASSETS						
Cash	176,668	-	-	-	-	176,668
Receivables from the Croatian National Bank	149,557	-	-	-	-	149,557
Placements with banks	22,672	-	420	-	-	23,092
Financial assets available for sale	65,381	589	150,397	347,876	322,810	887,053
Financial assets held to maturity	-	-	-	-	-	-
Loans and advances to customers	182,395	33,131	218,358	331,101	388,036	1,153,021
Other assets	32,562	-	-	-	-	32,562
Total assets	629,235	33,720	369,175	678,977	710,846	2,421,953
EQUITY AND LIABILITIES						
Liabilities to banks	17,241	10,116	35,040	-	-	62,397
Demand deposits	411,882	-	-	-	-	411,882
Term deposits	98,573	147,325	705,806	738,176	16,478	1,706,358,00
Borrowings	43,674	764	2,182	93,982	23,673	164,275
Other liabilities	10,663	-	-	-	-	10,663
Total liabilities	582,033	158,205	743,028	832,158	40,151	2,355,575
EQUITY						
Share capital	-	-	-	-	474,600	474,600
Accumulated losses	-	-	-	-	(321,167)	(321,167)
Revaluation reserve	-	-	-	-	(1,425)	(1,425)
Total equity	-	-	-	-	152,008	152,008
Total liabilities and equity	582,033	158,205	743,028	832,158	192,159	2,507,583
Net assets/liabilities and equity	47,202	(124,485)	(373,853)	(153,181)	518,687	(85,630)

38 RISK MANAGEMENT POLICIES (continued)

38.2 Liquidity risk (continued)

Future outflows under financial liabilities at 31 December 2016 reflect undiscounted cash flows, including future interest payments in the amount of HRK 89,597 thousand on received deposits and borrowings classified by maturities. Assets positions are classified by maturities of carrying amounts.

2016	Up to 1 month	1 to 3 months	3 to 12 months	1 to 3 years	Over 3 years	Total
ASSETS						
Cash	276,808	-	-	-	-	276,808
Receivables from the Croatian National Bank	191,709	-	-	-	-	191,709
Placements with banks	52,903	-	431	-	-	53,334
Financial assets available for sale	54,192	37,141	429,479	37,314	275,647	833,773
Financial assets held to maturity	43,809	1,606	515	4,717	-	50,647
Loans and advances to customers	212,947	55,936	392,713	415,789	513,258	1,590,643
Other assets	35,759	-	-	-	-	35,759
Total assets	868,127	94,683	823,138	457,820	788,905	3,032,673
EQUITY AND LIABILITIES						
Liabilities to banks	15,223	7,182	70,080	-	-	92,485
Demand deposits	471,935	-	-	-	-	471,935
Term deposits	166,185	231,338	1,194,414	477,750	12,687	2,082,374
Borrowings	80,008	4,539	25,281	47,626	146,889	304,343
Other liabilities	9,109	-	-	-	-	9,109
Total liabilities	742,460	243,059	1,289,775	525,376	159,576	2,960,246
EQUITY						
Share capital	-	-	-	-	474,600	474,600
Accumulated losses	-	-	-	-	(290,536)	(290,536)
Revaluation reserve	-	-	-	-	5,571	5,571
Total equity	-	-	-	-	189,635	189,635
Total liabilities and equity	742,460	243,059	1,289,775	525,376	349,211	3,149,881
Net assets/liabilities and equity	125,667	(148,376)	(466,637)	(67,556)	439,694	(117,208)

38 RISK MANAGEMENT POLICIES (continued)

38.3. Market risk

Market risks represent potential effects that external conditions may have on the value of assets, liabilities and off-balance sheet positions of the Bank, and are caused by changes in prices and movements in financial markets.

All instruments for trading are subject to market risk, the risk that future changes in market conditions can make an instrument unfavourable or lead to value reduction.

The Bank manages financial instruments available for sale according to changes in market conditions. Exposure to market risk is formally managed by buying or selling instruments according to limits set by Management.

Market risk is the risk of loss on balance sheet and off-balance sheet positions arising from unfavourable movements in prices on some of the 4 fundamental markets: debt securities, foreign currencies, commodity and equity securities markets.

Market risks are as follows:

- Interest rate risk
- Currency risk
- Price risk – risk of a change in prices of equity and debt securities.

Interest rate risk is defined by the impact of changes in market interest rates on the Bank's financial results. The Bank's daily activities depend on the interest rate risk impacted by the terms of collection of assets and liabilities in relation to interest income and expenses or the terms in which interest rates change. These terms are controlled by the ALCO by defining the interest rate limits and coordinating activities that the bank has to take.

Interest rate risk is described in more detail in chapter 38.3.2. of the Report.

The Bank's activities are exposed to the risk of changes in the value of main currencies, which impacts the Bank's financial result and cash flow. The Bank controls foreign currency assets and foreign currency liabilities with the aim to avoid an inadequate currency risk.

The Management Board defined internal limits of open foreign currency position that are below the legally prescribed limits determined in line with the CNB Regulation.

Currency risk is described in more detail in the following chapter of the Report (item 38.3.1.).

Market risk managements is performed in the Financial Markets Sector, Risk Management Service and the ALCO, and the Bank's Management Board is informed and makes decisions.

38 RISK MANAGEMENT POLICIES (continued)

38.4. Currency risk

Currency risk is the risk of loss that results from currency changes.

Exposure to currency risk materializes from holding assets and liabilities and/or off-balance sheet items denominated and/or indexed in foreign currency, or when they are structurally unadjusted in cases of unfavourable movement of HRK towards international currencies as well as unfavourable mutual movements of currencies.

Currency risk management process includes: identifying the Bank's exposure to currency risk, measuring currency risk exposure, defining boundaries and limits of currency risk exposure, instruments and processes for risk optimisation, currency risk management process supervision, reporting on the currency risk exposure.

At the end of each working day, the Bank adjusts its total open FX position so that the total open FX position (increased by the position in gold) does not exceed the amount of regulatory capital determined in line with the regulations of the Croatian National Bank.

The Bank uses the Value at Risk methodology (VaR) to evaluate exposure to market risk and expected maximum loss for the position in trading and other activities. VaR represents a statistically based evaluation of potential losses on the existing portfolio due to unfavourable market movements.

The Value at Risk method measures the maximum expected loss for the Bank in case of most unfavourable foreign currency movements in an observed time interval with normal market conditions and a given level of significance based on historical data. The Bank directs its business activities primarily trying to minimize the mismatch between assets' and liabilities' items denominated in foreign currency or carrying an FX clause. The Bank seeks to manage its assets and liabilities by matching the currencies of the individual asset and liability items to optimise the relationship between risk and profitability in unfavourable inter-currency movements.

The potential maximum daily loss of open foreign currency position (VaR: confidence interval 95%) as of 31.12.2017. was HRK 22 thousand (2016 : HRK 21 thousand).

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38 RISK MANAGEMENT POLICIES (continued)

38.4. Currency risk (continued)

FX assets and liabilities of the Bank as at 31 December 2017 are shown as follows:

2017	EUR	USD	Other	HRK, currency clause	Total FX equivalents	HRK	Total
ASSETS							
Cash	76,000	3,398	17,006	-	96,404	80,264	176,668
Receivables from the Croatian National Bank	-	-	-	-	-	149,557	149,557
Placements with banks	420	14,902	7,770	-	23,092	-	23,092
Financial assets available for sale	491,378	-	-	292,809	784,187	102,866	887,053
Financial assets held to maturity	-	-	-	-	-	-	-
Loans and advances to customers	297,817	4,167	613	351,614	656,052	498,810	1,153,021
Investment property	-	-	-	-	-	33,630	33,630
Property and equipment	-	-	-	-	-	6,280	6,280
Intangible assets	-	-	-	-	-	4,187	4,187
Foreclosed assets	-	-	-	-	-	15,397	15,397
Assets available for sale	-	-	-	-	-	5,280	5,280
Deferred tax assets	-	-	-	-	-	4,089	4,089
Other assets	744	-	3	-	747	31,815	32,562
Total assets	866,359	22,467	25,392	644,423	1,560,482	932,175	2,490,816
EQUITY AND LIABILITIES							
Liabilities to banks	1,804	85	238	-	2,127	60,046	62,173
Demand deposits	121,822	5,543	5,488	-	132,853	279,029	411,882
Term deposits	1,384,255	18,909	19,131	12,274	1,434,569	247,659	1,682,228
Borrowings	-	-	-	414	414	163,078	163,492
Other liabilities	154	2	-	-	156	10,507	10,663
Provisions	-	-	-	-	-	8,370	8,370
Total liabilities	1,508,035	24,539	24,857	12,688	1,570,119	768,689	2,338,808
EQUITY							
Share capital	-	-	-	-	-	474,600	474,600
Accumulated losses	-	-	-	-	-	(321,167)	(321,167)
Revaluation reserve	-	-	-	-	-	(1,425)	(1,425)
Total equity	-	-	-	-	-	152,008	152,008
Total liabilities and equity	1,508,035	24,539	24,857	12,688	1,570,119	920,697	2,490,816
Net assets/liabilities and equity	(641,676)	(2,072)	535	631,735	(11,478)	11,478	-

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38 RISK MANAGEMENT POLICIES (continued)

38.4. Currency risk (continued)

FX assets and liabilities of the Bank as at 31 December 2016 are shown as follows:

2016	EUR	USD	Other	HRK, currency clause	Total FX equivalents	HRK	Total
ASSETS							
Cash	184,262	2,264	19,044	-	205,570	71,238	276,808
Receivables from the Croatian National Bank	-	-	-	-	-	191,709	191,709
Placements with banks	422	43,306	9,606	-	53,334	-	53,334
Financial assets available for sale	413,747	-	-	221,560	635,307	198,466	833,773
Financial assets held to maturity	-	-	-	-	-	50,647	50,647
Loans and advances to customers	611,719	-	732	379,178	991,629	599,014	1,590,643
Investment property	-	-	-	-	-	33,702	33,702
Property and equipment	-	-	-	-	-	13,427	13,427
Intangible assets	-	-	-	-	-	4,926	4,926
Foreclosed assets	-	-	-	-	-	23,389	23,389
Deferred tax assets	-	-	-	-	-	1,898	1,898
Other assets	390	-	13	-	403	35,356	35,759
Total assets	1,210,540	45,570	29,395	600,738	1,886,243	1,223,772	3,110,015
EQUITY AND LIABILITIES							
Liabilities to banks	1,806	98	-	-	1,904	90,191	92,095
Demand deposits	109,774	7,620	8,505	-	125,899	346,036	471,935
Term deposits	1,577,029	40,367	20,825	18,065	1,656,286	388,276	2,044,562
Borrowings	-	-	-	114,926	114,926	177,077	292,003
Other liabilities	149	-	908	-	1,057	8,052	9,109
Provisions	-	-	-	-	-	10,676	10,676
Total liabilities	1,688,758	48,085	30,238	132,991	1,900,072	1,020,308	2,920,380
EQUITY							
Share capital	-	-	-	-	-	474,600	474,600
Accumulated losses	-	-	-	-	-	(290,536)	(290,536)
Revaluation reserve	-	-	-	-	-	5,571	5,571
Total equity	-	-	-	-	-	189,635	189,635
Total liabilities and equity	1,688,758	48,085	30,238	132,991	1,900,072	1,209,943	3,110,015
Net assets/liabilities and equity	(478,218)	(2,515)	(843)	467,747	(13,829)	13,829	-

38 RISK MANAGEMENT POLICIES (continued)

38.5. Interest rate risk

Interest rate risk in the Bank's trading book is the risk of loss arising from possible changes in interest rates, which impact the items in the Bank's book. This risk arises due to a mismatch of assets and liabilities with respect to their type, base and amount of interest rates.

Repricing risk is the risk of a decrease in net interest income due to changes in interest rates and a decrease in economic value of capital due to changes in interest rates.

Interest rate risk is a result of: temporary mismatch in revaluation of assets, liabilities and off-balance sheet items; early repayment of loans, deposit withdrawal (term and without term) or the difference in the movements of active and passive interest rates (basic (primary) risk).

The Bank's operations are exposed to the risk of changes in interest rates to the extent that interest-bearing assets and liabilities mature or their interest rates change in different periods or in different amounts. Risk management activities are directed to optimizing net interest income according to the Bank's business strategy, at the given market rates.

Activities of managing "asset-liability" risks are performed in the context of the Bank's sensitivity to interest rate changes. Exposure to risk of interest rate changes is a consequence of assets' and liabilities' items mismatch considering the possibility of interest rate changes, and it is supervised by applying an analysis of assets' and liabilities' mismatch. The aim of interest rate risk management is to secure an optimal and stable net interest margin, and thus net profit. Interest rate risk is minimized by accepting deposits and approving loans as well as with investments carrying fixed interest rates.

The main elements of the interest rate risk management are as follows:

- interest rate sensitivity analysis
- establishing internal limits and thresholds (limit of a decrease in economic value or maturity periods)
- control of performing/fulfilling/meeting the set limits;
- testing the resistance to stress for interest rate risk and the analysis of the results obtained;
- introducing hedging operations if required.

38 RISK MANAGEMENT POLICIES (continued)

38.5 Interest rate risk (continued)

The table below shows the carrying amounts of the Bank's assets and liabilities at 31 December 2016, classified into categories by the earlier of contractual repricing and maturity.

2017	Up to 1 month	1 to 3 months	3 to 12 months	1 to 3 years	Over 3 years	Non-interest bearing	<i>in thousands of HRK</i>
							Total
ASSETS							
Cash	-	-	-	-	-	176,668	176,668
Receivables from the Croatian National Bank	-	-	-	-	-	149,557	149,557
Placements with banks	23,083	-	-	-	-	9	23,092
Financial assets available for sale	50,000	-	150,195	347,876	322,824	16,158	887,053
Financial assets held to maturity	-	-	-	-	-	-	-
Loans and advances to customers	143,024	36,676	454,204	343,929	73,871	101,317	1,153,021
Investment property	-	-	-	-	-	33,630	33,630
Property and equipment	-	-	-	-	-	6,280	6,280
Intangible assets	-	-	-	-	-	4,187	4,187
Foreclosed assets	-	-	-	-	-	15,397	15,397
Assets available for sale	-	-	-	-	-	5,280	5,280
Deferred tax assets	-	-	-	-	-	4,089	4,089
Other assets	-	-	-	-	-	32,562	32,562
Total assets	216,107	36,676	604,399	691,805	396,695	545,134	2,490,816
EQUITY AND LIABILITIES							
Liabilities to banks	-	10,000	51,890	-	-	283	62,173
Demand deposits	238	-	407,835	-	-	3,809	411,882
Term deposits	94,372	144,045	670,050	728,329	15,001	30,431	1,682,228
Borrowings	40,170	715	1,986	93,694	23,454	3,473	163,492
Other liabilities	-	-	-	-	-	10,663	10,663
Provisions	-	-	-	-	-	8,370	8,370
Total liabilities	134,780	154,760	1,131,761	822,023	38,455	57,029	2,338,808
EQUITY							
Share capital	-	-	-	-	-	474,600	474,600
Accumulated losses	-	-	-	-	-	(321,167)	(321,167)
Revaluation reserve	-	-	-	-	-	(1,425)	(1,425)
Total equity	-	-	-	-	-	152,008	152,008
Total liabilities and equity	134,780	154,760	1,131,761	822,023	38,455	209,037	2,490,816
Net assets/liabilities and equity	81,327	(118,084)	(527,362)	(130,218)	358,240	336,097	-

38 RISK MANAGEMENT POLICIES (continued)

38.5. Interest rate risk (continued)

The table below shows the carrying amounts of the Bank's assets and liabilities at 31 December 2016, classified into categories by the earlier of contractual repricing and maturity.

2016	Up to 1 month	1 to 3 months	3 to 12 months	1 to 3 years	Over 3 years	Non-interest bearing	<i>in thousands of HRK</i>
							Total
ASSETS							
Cash	-	-	-	-	-	276,808	276,808
Receivables from the Croatian National Bank	-	-	-	-	-	191,709	191,709
Placements with banks	53,314	-	-	-	-	20	53,334
Financial assets available for sale	50,000	35,060	428,531	37,314	278,526	4,342	833,773
Financial assets held to maturity	43,000	1,650	500	4,775	-	722	50,647
Loans and advances to customers	169,710	142,568	766,586	316,869	75,178	119,732	1,590,643
Investment property	-	-	-	-	-	33,702	33,702
Property and equipment	-	-	-	-	-	13,427	13,427
Intangible assets	-	-	-	-	-	4,926	4,926
Foreclosed assets	-	-	-	-	-	23,389	23,389
Deferred tax assets	-	-	-	-	-	1,898	1,898
Other assets	-	-	-	-	-	35,759	35,759
Total assets	316,024	179,278	1,195,617	358,958	353,704	706,434	3,110,015
EQUITY AND LIABILITIES							
Liabilities to banks	11,275	7,000	73,402	-	-	418	92,095
Demand deposits	238	-	456,236	-	-	15,461	471,935
Term deposits	159,061	220,053	1,148,531	454,527	11,309	51,081	2,044,562
Borrowings	73,901	4,062	24,664	42,707	141,075	5,594	292,003
Other liabilities	-	-	-	-	-	9,109	9,109
Provisions	-	-	-	-	-	10,676	10,676
Total liabilities	244,475	231,115	1,702,833	497,234	152,384	92,339	2,920,380
EQUITY							
Share capital	-	-	-	-	-	474,600	474,600
Accumulated losses	-	-	-	-	-	(290,536)	(290,536)
Revaluation reserve	-	-	-	-	-	5,571	5,571
Total equity	-	-	-	-	-	189,635	189,635
Total liabilities and equity	244,475	231,115	1,702,833	497,234	152,384	281,974	3,110,015
Net assets/liabilities and equity	71,549	(51,837)	(507,216)	(138,276)	201,320	424,460	-

38 RISK MANAGEMENT POLICIES (continued)

38.5. Interest rate risk (continued)

The table below shows effective interest rates for interest-bearing assets and liabilities.

	2017 <i>(in %)</i>	2016 <i>(in %)</i>
Assets		
Cash	(0.65)-0.00	0.00-0.00
Placements with banks	0.00-4.50	0.00-4.50
Financial assets available for sale	0.05-7.26	0.17-6.50
Loans and advances to customers	2.10-10.50	3.00-10.50
Equity and liabilities		
Liabilities to banks	0.15-1.40	0.90-1.90
Demand deposits	0.00-0.06	0.01-2.50
Term deposits	0.01-2.10	0.07-3.15
Borrowings	0.20-1.80	0.30-5.00

38.6. Price risk

Price risk is the risk that the value of the financial instrument will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market. The risk is managed by setting maximum volumes, limits and other restrictions. The Bank manages the risk by setting Trading Book limits (generally not applied, and the Bank had no positions in the Trading Book at 31 December 2017 and 2016), with the available-for-sale and held-to-maturity portfolio durations being measured, monitored and reported regularly.

38.7. Market risk measurement techniques

Measurement techniques used for measuring and controlling market risks are the Value at Risk (VaR) method and stress tests.

VaR method

The VaR method measures the Bank's maximum loss (the maximum expected loss) in case of unfavourable movements in FX exchange rates in a set time interval under normal market conditions and the set level of reliability on the basis of historical data.

Currency exposure limits

The Bank is obliged to adjust its operations so that at any time the following structural principles are followed:

- the Bank internally determines that the Bank's total open FX position does not exceed 25% of the Bank's regulatory capital,
- the maximum allowed open FX position in EUR amounts to 20% of the regulatory capital,
- the maximum allowed open FX position in USD amounts to 10% of the regulatory capital,
- the maximum allowed open FX position by individual currencies other than EUR and USD amounts to 5% of the regulatory capital.

38 RISK MANAGEMENT POLICIES (continued)

38.6 Market risk measurement techniques (continued)

	Internal limit	At 31.12.2017
Bank's total open FX position	25.00%	2.00%
Maximum open FX position in EUR	20.00%	1.73%
Maximum open FX position in USD	10.00%	0.26%
Maximum open FX position in other currencies	5.00%	0.59% za CHF

Daily VAR calculation

In accordance with the provisions of Basel II agreement on market risk measurement, the Bank has opted for the VaR method for calculating its FX position exposure to changes in foreign currency exchange rates (the impact of unfavourable movements in rates on the amount of open FX position).

For calculating VAR, the Bank develops the application of the Variance-Covariance Model, which implies the assessment of the present open risk on the basis of movements in exchange rates.

The Risk Management Service reports on the Bank's FX position under Value-at-Risk methodology on a daily basis, and to the ALCO at their meetings.

Stress tests

Stress test is a risk management technique used for assessing potential impacts of specific events and/or changes in several risk factors on the Bank's financial position.

The purpose of the stress test is to determine whether the Bank has an appropriate level of capital in case of the specific events and/or changes in several risk factors. These are unfavourable events that are difficult to foresee (extreme, but possible) and that impact the Bank's capital, risk profile and profit. The stress test may be divided into the scenario analysis and sensitivity analysis.

The scenario analysis is a stress test that analyses the impact of simultaneous changes of several risk factors on the Bank's financial position in clearly defined stress scenarios. The sensitivity analysis is a type of stress test that analyses the impact of a particular risk factor on the Bank's financial position without the stress cause being identified. The stress test is performed semi-annually.

In performing liquidity stress tests, the Bank assumes a liquidity shock on the market, such as deposit withdrawal or inability to place on the market the instruments the Bank possesses without incurring significant loss. In doing so, potential outflows are estimated under scenario and sensitivity analyses. In defining a scenario, the Bank considers the circumstances that may arise upon the expiry of a significant volume of deposits or losing a part of its unsecured sources of funding, including deposits from major customers etc. The baseline scenario used for the purpose of the analysis, with individual factors having two levels of disturbance intensity, are defined as follows:

- 1) Internal crisis of the Bank,
- 2) Market crisis
- 3) A combination of both.

VaR is not used in performing liquidity stress tests, as in extreme circumstances the losses exceed the expected losses in a much larger number of instances than envisaged using VaR.

38 RISK MANAGEMENT POLICIES (continued)

38.6. Market risk measurement techniques (continued)

Interest rate risk in the banking book

Interest rate risk in the banking book is the risk of loss arising from possible changes in interest rates that affect items in the Bank's banking book. For the purposes of the stress tests, the Bank uses simplified calculation of the changes in the economic value of the banking book, as defined in the Decision on the interest rate risk in the banking book. A change of 200 and 300 basis points is assumed, exceptionally 500 basis points.

In order to determine the weights over time horizons for a 300-bp change, the following weights are applied:

Time horizon	Time zones centers	Estimated modified duration	Weight (200bp)	Weight (300bp)	Weight (500bp)
Up to 1 month	0.50	0.04	0.08%	0.12%	0.20%
1 to 3 months	2.00	0.16	0.32%	0.48%	0.80%
3 to 6 months	4.50	0.36	0.72%	1.08%	1.80%
6 to 12 months	9.00	0.71	1.43%	2.13%	3.55%
1 to 2 years	1.50	1.38	2.77%	4.14%	6.90%
2 to 3 years	2.50	2.25	4.49%	6.75%	11.25%
3 to 4 years	3.50	3.07	6.14%	9.21%	15.35%
4 to 5 years	4.50	3.85	7.71%	11.55%	19.25%
5 to 7 years	6.00	5.08	10.15%	15.24%	25.40%
7 to 10 years	8.50	6.63	13.26%	19.89%	33.15%
10 to 15 years	12.50	8.92	17.84%	26.76%	44.60%
15 to 20 years	17.50	11.21	22.43%	33.63%	56.05%
Over 20 years	22.50	13.01	26.03%	39.03%	65.05%

The Bank performs the shock-test to determine the impact of a one-off increase or decrease of interest rates by 100 and 20 basis points over a one-year horizon.

The Bank has to align its operations so that the following structural principles are complied with at any time:

The economic value to regulatory capital, pursuant to the methodology of the CNB (200 bp), calculated on 31 December 2017.

	Internal limit	Internal early warning system	At 31 December 2017
Economic value change / own funds	15%	13%	29.20%

38 RISK MANAGEMENT POLICIES (continued)

38.7. Operational risk

The Bank is exposed to operational risk in all its business activities. The aim of operational risk management is identification of all observable forms of operational risk, its control and minimization of exposure.

The Bank is trying to accomplish optimal management of operational risk according to the principles defined by the regulator and Bank policies, and with the purpose of diminishing and mitigating operational risk. In relation to this the Bank collects data on operational risk events, follows key risk indicators, conducts scenario analysis, evaluates operational risk in its operations, reports to Management on operational risk exposure and proposes measures for diminishing, mitigating and transferring operational risk. Operational risk does not have material effect on Bank's operations.

39 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The fair value of a financial instruments is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, the so-called exit price. Financial assets available for sale are measured at fair value, except for treasury bills, which are carried at the balance sheet date at discounted values.

Table below summarises the year-end fair value estimates made by the Management Board.

	Carrying amount		Fair value	
	2017	2016	2017	2016
Financial assets				
Loans to and receivables from banks	23,092	53,334	23,092	53,334
Loans and receivables from customers	1,154,862	1,590,643	1,126,079	1,564,350
Financial assets held to maturity	-	50,647	-	50,647
Financial liabilities				
Deposits from banks	62,173	92,095	62,173	92,095
Deposits from customers	2,094,110	2,516,497	2,059,842	2,485,858
Borrowings	163,492	292,003	163,492	292,003

Loans and receivables from customers and deposits from customers represent aggregate balances received from/owed to corporate and retail customers that bear interest at different average variable rates, and their effects are presented separately in the following tables.

<i>Corporate customers</i>	Carrying amount		Fair value	
	2017	2016	2017	2016
Financial assets				
Loans and receivables from customers	781,671	1,212,482	771,990	1,205,413
Financial assets held to maturity	-	50,647	-	50,647
Financial liabilities				
Deposits from customers	317,637	569,506	316,943	568,034

39 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (continued)

<i>Individuals</i>	Carrying amount		Fair value	
	2017	2016	2017	2016
Financial assets				
Loans and receivables from customers	373,191	378,161	354,089	358,937
Financial liabilities				
Deposits from customers	1,776,473	1,946,991	1,742,899	1,917,824

Set out below is an overview of key methods and assumptions used in estimating the fair values of financial instruments.

Loans to and receivables from banks

Loans and receivables are reported net of provision for impairment. The estimated fair value of loans and receivables represents future cash flows, discounted using the current market rates to arrive at the fair value of those assets.

Loans to and receivables from customers

Loans and receivables are reported net of provision for impairment. The estimated fair value of loans and receivables represents discounted expected future cash flows. Future cash flows are discounted using current market rates to arrive at their fair value. Future expected losses are not considered, and no adjustment is performed to reflect any amounts doubtful of collection (including timing uncertainty) for exposures under due and reprogrammed amounts as well as under exposures not yet due but required to be monitored more closely.

Deposits from banks

Fair value estimates of fixed-maturity deposits are based on expected cash flows discounted using current market rates on deposits with similar remaining maturities, but they may not be lower than the nominal amount of deposits that may be called by customers at any time.

Considering their short maturity, Management considers that their carrying amounts do not differ from their fair values.

Deposits from customers

The fair value estimate of fixed-maturity deposits is based on cash flows discounted at currently valid market rates on deposits with similar remaining maturities, however, the fair value cannot be lower than the nominal amount for those deposits that may be called by customers at any time. The value of client relationships is not taken into account in assessing the fair value.

40 CAPITAL MANAGEMENT

The main goal in managing the Bank's capital is to ensure the compliance with all regulatory capital requirements and maintain the credit rating and total capital adequacy to improve the operations.

The Bank manages its capital structure and adjusts it in accordance with changes in economic conditions and characteristics of its business risks.

In managing capital, the Bank also follows the principles of:

- Compliance with all legally prescribed capital requirements
- Maintaining the Bank's ability to continue operations and achieve the Bank's goals
- Maintaining the strong capital base that will enable a continued and sustainable development with the aim to achieve positive results in the income statement.

The Bank's regulatory capital and the total capital rate, calculated in accordance with the requirements of the Regulation (EU) no 575/2013 only for the Bank, were as follows:

	31 December 2017	31 December 2016
Own funds		
<i>Tier 1 capital</i>		
Issued share capital	474,600	474,600
Share premium	-	-
Accumulated losses (excluding the profit for the current year)	(321,167)	(292,174)
Legal, statutory and other reserves	(7,252)	(8,772)
Deductions pursuant to Regulation (EU) no. 575/2013 /i/	146,181	173,654
Total Tier 1 capital		
<i>Additional capital</i>	-	-
Total additional capital	-	-
Deductions in respect of investments in banks and financial institutions	-	-
Total own funds	146,181	173,654

/i/ The amount includes deferred tax assets, intangible assets, unrealised losses on financial assets available for sale (not offset with gains) and 0.1% on the entire portfolio of financial assets available for sale.

As at 31 December 2017, the Bank's regulatory capital (own funds) amounts to HRK 146,181 thousand (2016: HRK 173,654 thousand).

40 CAPITAL MANAGEMENT (continued)

	31 December 2017	31 Decemeber 2016
Capital adequacy according to the Regulation EU No. 575/2013		
<i>Capital requirements</i>		
Credit risk exposure	61,105	69,243
<i>Balance sheet items</i>	59,652	68,085
<i>Off-balance sheet items</i>	1,453	1,158
Currency risk exposure	-	-
Operating risk exposure	12,681	13,408
Total capital requirement	73,786	82,651
<i>Additional capital requirements</i>		
Additional capital adequacy rate requirement	34,218	29,548
Capital conservation buffer	23,058	25,828
Systemic risk buffer	13,835	15,497
Total capital requirement	144,897	153,524
Common Equity Tier 1 capital ratio	15.85%	16.81%
Tier 1 capital ratio	15.85%	16.81%
Total capital ratio	15.85%	16.81%

The comparative information presents the capital adequacy in accordance with the requirements of the Regulation (EU) no. 575/2013. As at 31 December 2017, the total capital ratio is 15.85% (2016.: 16.81%).

At 31 December 2017 the Bank complied with all capital requirements, as well as at 31 December 2016.

Legal reserve

The Companies Act requires that 5% of profit for the year is added to this reserve until 5% of issued share capital is reached. The legal reserve, amounting to 5% of the issued share capital, may be used to cover the current and prior year losses.

Fair value reserve

The fair value reserve includes unrealized gains and losses from changes in fair value of financial assets available for sale as well as foreign exchange differences resulting from non-monetary financial assets available for sale.

Accumulated losses

Accumulated losses include losses accumulated from previous years.

41 CONCENTRATIONS OF ASSETS, LIABILITIES AND OFF BALANCE SHEET ITEMS

Concentrations of assets, liabilities and off-balance sheet items are shown as follows:

	31 December 2017			31 December 2016		
	Assets	Liabilities	Off-balance sheet items	Assets	Liabilities	Off-balance sheet items
Geographic region						
Republic of Croatia	2,463,640	2,349,920	111,073	3,054,220	2,952,674	153,236
Europe	24,544	127,400	5	16,847	68,251	-
Other	2,632	13,496	-	38,948	89,090	2
Total by geographical region	2,490,816	2,490,816	111,078	3,110,015	3,110,015	153,238
Sector						
Republic of Croatia (state)	902,991	292,250	591	879,076	250,144	1,515
Croatian National Bank	121,860	107,826	-	235,209	161,295	-
Trade and commerce	119,534	23,956	10,447	171,375	29,094	5,552
Finance	55,349	80,828	400	104,035	112,808	5,515
Tourist trade	29,769	3,250	225	35,680	4,358	14
Agriculture	120,530	6,732	2,076	147,855	10,925	3,755
Manufacturing	614,469	41,070	51,909	904,331	44,252	48,470
Individuals	504,567	1,732,430	15,868	542,447	1,901,558	22,026
Other	21,747	202,474	29,562	90,007	595,581	66,391
Total by sector	2,490,816	2,490,816	111,078	3,110,015	3,110,015	153,238
Allocated value of collateral	971,673		37,488	1,379,036		56,963

42 SUBSEQUENT EVENTS

As of 31 December 2017, Mladena Duliba's mandate of President of the Management Board expired. From January 2, 2018, a member of the Supervisory Board Branko Grabovac was appointed as a Deputy member of the Management Board with President of the Management Board function for a period of 3 months, i.e. until 2 April 2018. In that period, Branka Grabovac' role as Supervisory Board's member is put on hold. By decision of the Commercial Court in Zagreb, Branka Grabovac was as appointed member of the Management Board from April 3, 2018, for a period of 6 months, i.e. until 3 October 2018. Due to the incompatibility of the Supervisory Board and Management Board functions, Branka Grabovac, as of April 2, 2018, resigned as a member of the Supervisory Board of the Bank. Ivan Šverko was member of the Bank's Management Board until 31 January 2018, and from 1 February 2018, Zoran Sabolić was appointed as member of the Bank's Management Board until 31 July 2018 in accordance with Commercial Court decision.

Branka Grabovac
 Board Member




Zoran Sabolić

Board Member



CROATIA BANKA d.d.
APPENDIX A – OTHER REGULATORY REQUIREMENTS

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK

The statutory financial statements presented below were prepared under the reporting requirements and the financial reporting schedules determined by the CNB Decision on the structure and content of annual financial statements of banks (the 'Decision').

Balance sheet

	2017	2016
1 CASH AND BALANCES WITH THE CNB (1.1+1.2)	307,880	449,721
1.1 Cash	34,952	20,866
1.2 Balances with the CNB	272,928	428,855
2 DEPOSITS WITH BANKING INSTITUTIONS	44,599	77,162
3 TREASURY BILLS OF THE MINISTRY OF FINANCE AND OF THE CNB	462,839	498,257
4 SECURITIES AND OTHER FINANCIAL INSTRUMENTS HELD FOR TRADING	-	-
5 SECURITIES AND OTHER FINANCIAL INSTRUMENTS AVAILABLE FOR SALE	420,779	328,460
6 SECURITIES AND OTHER FINANCIAL INSTRUMENTS HELD TO MATURITY	-	51,124
7 SECURITIES AND OTHER FINANCIAL INSTRUMENTS AT FVTPL THAT ARE NOT ACTIVELY TRADED	-	-
8 DERIVATIVE FINANCIAL ASSETS	-	-
9 LOANS TO FINANCIAL INSTITUTIONS	6,100	25,564
10 LOANS AND ADVANCES TO OTHER CUSTOMERS	1,161,777	1,582,720
11 INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES	-	-
12 FORECLOSED ASSETS	54,308	57,092
13 TANGIBLE ASSETS (NET OF DEPRECIATION)	6,409	13,504
14 INTEREST, FEES AND OTHER ASSETS	36,206	40,585
TOTAL ASSETS	2,500,897	3,124,189
LIABILITIES		
1 LOANS FROM FINANCIAL INSTITUTIONS (1.1+1.2)	160,631	290,320
1.1 Short-term borrowings	150,613	163,911
1.2 Long-term borrowings	10,018	126,409
2 DEPOSITS (2.1+2.2+2.3)	2,115,332	2,541,631
2.1 Balances on giro and current accounts	287,800	338,669
2.2 Savings deposits	123,845	117,806
2.3 Term deposits	1,703,687	2,085,156
3 OTHER BORROWINGS (3.1+3.2)	-	-
3.1 Short-term borrowings	-	-
3.2 Long-term borrowings	-	-
4 DERIVATIVE FINANCIAL AND OTHER LIABILITIES HELD FOR TRADING	-	-
5 ISSUED DEBT SECURITIES (5.1+5.2)	-	-
5.1 Short-term debt securities issued	-	-
5.2 Long-term debt securities issued	-	-
6 SUBORDINATED INSTRUMENTS ISSUED	-	-
7 HYBRID INSTRUMENTS ISSUED	-	-
8 INTEREST, FEES AND OTHER LIABILITIES	72,926	102,603
TOTAL LIABILITIES	2,348,889	2,934,554

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Balance sheet (continued)

EQUITY

1 SHARE CAPITAL	474,600	474,600
2 PROFIT/(LOSS) FOR THE YEAR	(30,631)	1,638
3 RETAINED PROFIT/(ACCUMULATED LOSSES)	(290,536)	(292,174)
4 LEGAL RESERVES	-	-
5 STATUTORY AND OTHER CAPITAL RESERVES	-	-
6 UNREALISED GAINS/(LOSSES) ON REVALUATION OF FINANCIAL ASSETS AVAILABLE FOR SALE	(1,425)	5,571
7 HEDGING RESERVE	-	-
TOTAL EQUITY	152,008	189,635
TOTAL EQUITY AND LIABILITIES	2,500,897	3,124,189

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Income statement

	2017	2016
1 Interest income	98,078	131,241
2 Interest expense	(44,101)	(69,290)
3 Net interest income	53,977	61,951
4 Fee and commission income	10,452	12,056
5 Fee and commission expenses	(4,753)	(4,360)
6 Net fee and commission income	5,699	7,696
7 Gains/(losses) on investments in subsidiaries, associates and joint ventures	-	-
8 Trading gains/(losses)	3,161	3,405
9 Gains/(losses) on embedded derivatives	-	3
10 Gains / (losses) on assets at FVTPL not actively traded	-	-
11 Gains / (losses) on available-for-sale assets	9,773	6,679
12 Gains / (losses) on held-to-maturity (HTM) assets	5,411	1,026
13 Hedging gains/(losses)	-	-
14 Gains on investments in subsidiaries, associates and joint ventures	-	-
15 Gains on other equity investments	-	-
16 Foreign exchange gains/(losses)	(1,018)	(490)
17 Other income	9,007	7,147
18 Other expenses	(5,427)	(3,221)
19 General administrative expenses and depreciation	(65,794)	(62,468)
20 Net profit from operations before impairment and provisions for losses	14,789	21,728
21 Impairment losses and provisions	(46,076)	(19,064)
22 PROFIT BEFORE TAXATION	(31,287)	2,664
23 INCOME TAX	656	(1,026)
24 (LOSS)/PROFIT FOR THE YEAR	(30,631)	1,638
25 Earnings/loss per share	(6.45)	0.38

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Statement of Other Comprehensive Income

	(30,631)	1,638
1. Profit/(loss) for the year		
2. Other comprehensive income	(6,996)	5,966
2.1. Items that will not be reclassified to profit or loss	-	-
2.1.1. Tangible assets	-	-
2.1.2. Intangible assets	-	-
2.1.3. Actuarial gains/(losses) on remeasurement of employee benefit plans	-	-
2.1.4. Long term assets and discontinued operations held for sale	-	-
2.1.5. Share of other income and expenses accrued by equity method	-	-
2.1.6. Income tax on items that would not be reclassified to profit or loss	-	-
2.2. Items that may be reclassified to profit or loss	(6,996)	5,966
2.2.1. Net investment in foreign operations hedge (effective share)	-	-
2.2.1.1. Gains or (losses) in equity	-	-
2.2.1.2. Transferred to profit or loss	-	-
2.2.1.3. Other reclassifications	-	-
2.2.2. Foreign exchange swap	-	-
2.2.2.1. Gains or (losses) in equity	-	-
2.2.2.2. Transferred to profit or loss	-	-
2.2.2.3. Other reclassifications	-	-
2.2.3. Cash flow hedge (effective share)	-	-
2.2.3.1. Gains or (losses) in equity	-	-
2.2.3.2. Transferred to profit or loss	-	-
2.2.3.3. Transferred to opening balance of hedged items	-	-
2.2.3.4. Other reclassifications	-	-
2.2.4. Financial assets available for sale	(8,531)	7,287
2.2.4.1. Gains or (losses) in equity	(1,814)	7,012
2.2.4.2. Transferred to profit or loss	(6,717)	275
2.2.4.3. Other reclassifications	-	-
2.2.5. Non-current assets and discontinued operations held for sale	-	-
2.2.5.1. Gains or (losses) in equity	-	-
2.2.5.2. Transferred to profit or loss	-	-
2.2.5.3. Other reclassifications	-	-

APPENDIX A – OTHER REGULATORY REQUIREMENTS (continued)

2.2.6. Share in other income and expenses from investments in subsidiaries, venture operations and associates	-	-
2.2.7. Income tax on items that may be reclassified to profit or loss	1,536	(1,322)
3. Total comprehensive income for the year	(37,627)	7,604
4. Attributable to non-controlling interest	-	-
5. Attributable to owners of the Company	(37,627)	7,604

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Cash flow statement

I T E M	2017	2016
Operating activities		
Profit/(loss) before taxation	(31,287)	2,664
Impairment allowance and provisions for losses	55,136	17,139
Depreciation and amortisation	3,425	3,470
Net unrealised (gains)/losses on financial assets and liabilities at FVTPL	-	(46)
(Gains)/losses on sale of tangible assets	(4,073)	(1,593)
Other (gains) / losses	(17,912)	(3,574)
Operating cash flows before changes in operating assets	5,289	18,060
Balances with the CNB	42,577	34,776
Treasury bills of the Ministry of Finance and of the CNB	35,418	22,044
Deposits with banking institutions and loans to financial institutions	-	-
Loans and advances to other customers	419,145	287,821
Securities and other financial instruments available for sale	(78,428)	(174,325)
Securities and other financial instruments held for trading	-	-
Securities and other financial instruments at FVTPL that are not actively traded	-	-
Other operating assets	3,082	(12,923)
Net (increase) / decrease in operating assets	421,794	157,393
Demand deposits	(50,869)	(25,999)
Savings and term deposits	(373,770)	4,544
Other liabilities	(29,679)	28,137
Net increase / (decrease) in operating liabilities	(454,318)	6,682
Net cash flow from operations before income tax	(27,235)	182,135
Income taxes paid	-	-
Net cash inflow / (outflow) from operating activities	(27,235)	182,135
Investing activities		
Proceeds from sale/(Payments for purchases) of tangible and intangible assets	6,717	2,461
Proceeds from sale of/Payments for investments in subsidiaries, associates and joint ventures	-	-
Proceeds from/(Payments to acquire) securities and other financial instruments held to maturity	15,520	(2,746)
Dividends received	-	-
Other receipts/(payments) from financing activities	(1,490)	(4,067)
Net cash from investing activities	20,747	(4,352)
Financing activities		
Net increase/(decrease) in borrowings	(128,511)	(723)
Net increase/decrease of issued debt securities	-	-
Net increase/(decrease) in subordinated and hybrid instruments	-	-
Other receipts/(payments) from financing activities	-	-
Increase in share capital	-	-
Net cash from financing activities	(128,511)	(723)
Net increase / (decrease) in cash and cash equivalents	180,424	26,303
Cash and cash equivalents, beginning of the year	152,834	126,531
The effects of changing foreign exchange rates on cash and cash equivalents	3,161	3,364
Cash and cash equivalents at the end of the year	201,420	333,258

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Statement of changes in equity

Type of change in equity	Share capital	Retained earnings / (Accumulated losses)	Profit/(Loss) for the year	Unrealised gains/losses on revaluation of financial assets available for sale	Total equity
At 1 January of the current year	474,600	(292,174)	1,638	5,571	189,635
Change in the fair value of financial assets available for sale	-	-	-	(6,996)	(6,996)
Net gains/losses recognised directly in equity	-	-	-	-	-
Profit/(Loss) for the year	-	-	(30,631)	-	(30,631)
Total recognised income and expenses for the year	-	-	-	-	-
Increase/Decrease in share capital	-	-	-	-	-
Other changes	-	1,638	(1,638)	-	-
Balance at 31 December of the current year	474,600	(290,536)	(30,631)	(1,425)	152,008

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Balance sheet reconciliation at 31 December 2017

ITEM	CNB Decision	Annual Report	Difference
Assets			
1 CASH AND BALANCES WITH THE CNB (1.1+1.2)	307,880	-	307,880
1.1 Cash	34,952	-	34,952
1.2 Balances with the CNB	272,928	-	272,928
2 DEPOSITS WITH BANKING INSTITUTIONS	44,599	-	44,599
<i>Cash</i>	-	176,668	(176,668)
<i>Balances with the CNB</i>	-	149,557	(149,557)
<i>Placements with banks</i>	-	23,092	(23,092)
3 CNB TREASURY BILLS	462,839	-	462,839
4 SECURITIES AND OTHER FINANCIAL INSTRUMENTS HELD FOR TRADING	-	-	-
5 SECURITIES AND OTHER FINANCIAL INSTRUMENTS AVAILABLE FOR SALE	420,779	887,053	(466,274)
6 SECURITIES AND OTHER FINANCIAL INSTRUMENTS HELD TO MATURITY	-	-	-
7 SECURITIES AND OTHER FINANCIAL INSTRUMENTS AT FVTPL THAT ARE NOT ACTIVELY TRADED	-	-	-
8 DERIVATIVE FINANCIAL ASSETS	-	-	-
9 LOANS TO FINANCIAL INSTITUTIONS	6,100	-	6,100
10 LOANS AND ADVANCES TO OTHER CUSTOMERS	1,161,777	1,153,021	8,756
11 INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES	-	-	-
12 FORECLOSED ASSETS	54,308	15,397	38,911
13 TANGIBLE ASSETS (NET OF DEPRECIATION)	6,409	6,280	129
<i>Investment property</i>	-	33,630	(33,630)
<i>Assets available for sale</i>	-	5,280	(5,280)
<i>Intangible assets</i>	-	4,187	(4,187)
<i>Deferred tax assets</i>	-	4,089	(4,089)
14 INTEREST, FEES AND OTHER ASSETS	36,206	32,562	3,644
TOTAL ASSETS	2,500,897	2,490,816	10,081

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK
(continued)

Balance sheet reconciliation at 31 December 2017 (continued)

ITEM	CNB Decision	Annual Report	Difference
Liabilities and equity			
1 LOANS FROM FINANCIAL INSTITUTIONS (1.1+1.2)	160,631	-	160,631
1.1 Short-term borrowings	150,613	-	150,613
1.2 Long-term borrowings	10,018	-	10,018
<i>Borrowings</i>	-	163,492	(163,492)
2 DEPOSITS (2.1+2.2+2.3)	2,115,332	2,156,283	(40,951)
2.1 Balances on giro and current accounts	287,800	-	287,800
2.2 Savings deposits	123,845	-	123,845
2.3 Term deposits	1,703,687	1,682,228	21,459
<i>Demand deposits</i>	-	411,882	(411,882)
<i>Liabilities to banks</i>	-	62,173	(62,173)
3 OTHER BORROWED FUNDS (3.1+3.2)	-	-	-
3.1 Short-term borrowings	-	-	-
3.2 Long-term borrowings	-	-	-
4 DERIVATIVE FINANCIAL AND OTHER LIABILITIES HELD FOR TRADING	-	-	-
5 ISSUED DEBT SECURITIES (5.1+5.2)	-	-	-
5.1 Short-term debt securities issued	-	-	-
5.2 Long-term debt securities issued	-	-	-
6 SUBORDINATED INSTRUMENTS ISSUED	-	-	-
7 HYBRID INSTRUMENTS ISSUED	-	-	-
8 INTEREST, FEES AND OTHER LIABILITIES	72,926	10,663	62,575
<i>Provisions</i>	-	8,370	(8,370)
TOTAL LIABILITIES (1+2+3+4+5+6+7+8)	2,348,889	2,338,808	10,081
Equity			
1 SHARE CAPITAL	474,600	474,600	-
2 PROFIT/(LOSS) FOR THE YEAR	(30,631)	(30,631)	-
3 RETAINED PROFIT/(ACCUMULATED LOSSES)	(290,536)	(290,536)	-
4 LEGAL RESERVES	-	-	-
5 STATUTORY AND OTHER CAPITAL RESERVES	-	-	-
6 UNREALISED GAINS/(LOSSES) ON REVALUATION OF FINANCIAL ASSETS AVAILABLE FOR SALE	(1,425)	(1,425)	-
7 HEDGING RESERVE	-	-	-
TOTAL EQUITY	152,008	152,008	-
TOTAL LIABILITIES AND EQUITY	2,500,897	2,490,816	10,081

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Balance sheet reconciliation at 31 December 2017 (continued)

The departures on the items included in the Annual Report versus the standard under the CNB Decision comprise the following:

ASSETS

Cash and deposits with the CNB, Deposits with banking institutions and Loans to financial institutions are items separately shown under the CNB standard, while in the Annual report those items are shown within the items Cash, Receivables from the CNB and Placements with banks. The CNB reporting line items Specific reserves for identified losses on a collective basis is included in Interest, fees and other assets, whereas in the Annual Report they are presented along with the items to which they relate.

Treasury bills of the Ministry of Finance and Securities and other financial instruments available for sale, disclosed separately under the CNB standard, are aggregated in the Annual Report under Financial assets available for sale.

The line item 'Loans and advances to customers' reported in the Annual report includes loan principal and the related accrued interest reduced by portfolio-based i.e. collective and individual provisions less overpaid loans and collected interest income relating to future periods. The CNB report line items 'Loans to other customers' and 'Loans to financial institutions' include principal amounts reduced by individual provisions, whereas collective provisions and accrued interest are presented under the line item 'Interest, fees and other assets', and overpaid loans and collected interest income relating to future periods under the line item 'Interest, fees and other liabilities'.

In addition, Tangible assets disclosed under the CNB decision include inventories which are presented in the Annual Report under Other assets.

Intangible assets are presented in the Annual Report separately, while in the CNB report they are included in Interest, fees and other assets. In addition, Interest, fees and other assets disclosed under the CNB requirements relate to the related receivables, whereas in the Annual Report interest receivable is presented along with the items it relates to.

LIABILITIES AND EQUITY

Loans from financial institutions (both short-term and long-term) and other loans are items that are presented separately under the CNB standard, and in the Annual Report they are included in Borrowings.

Giro account and current account balances, Savings deposits and Term deposits represent items under the CNB standard, while in the Annual Report they are included under line items Demand deposits, Term deposits and Liabilities to banks.

Restricted deposits are also included in the Interest, fees and other liabilities under the CNB disclosure requirements, and in the Annual Report they are presented under Demand deposits.

Interest, fees and other liabilities is a separate line item under the CNB presentation requirements, and in the Annual Report the individual components are included in Borrowings, Term deposits, Liabilities to banks, Provisions and Other liabilities, as appropriate.

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Reconciliation of profit and loss items at 31 December 2017

ITEM	CNB Decision	Annual Report	Difference
1 Interest income	98,078	98,156	(78)
2 Interest expense	(44,101)	(39,503)	(4,598)
3 Net interest income	53,977	58,653	(4,676)
4 Fee and commission income	10,452	10,453	(1)
5 Fee and commission expenses	(4,753)	(4,753)	-
6 Net fee and commission income	5,699	5,700	(1)
7 Gains/(losses) on investments in subsidiaries, associates and joint ventures	-	-	-
8 Trading gains/(losses)	3,161	-	3,161
9 Gains/(losses) on embedded derivatives	-	-	-
10 Gains/(losses) on assets at FVTPL not actively traded	-	-	-
<i>Net financial (losses) gains</i>	-	15,184	(15,184)
<i>Net gains from exchange differences</i>	-	2,743	(2,743)
11 Gains/(losses) on available-for-sale assets	9,773	-	9,773
12 Gains/(losses) on held-to-maturity (HTM) assets	5,411	-	5,411
13 Hedging gains/(losses)	-	-	-
14 Gains on investments in subsidiaries, associates and joint ventures	-	-	-
15 Gains on other equity investments	-	-	-
16 Foreign exchange gains/(losses)	(1,018)	-	(1,018)
17 Other income	9,007	8,694	313
18 Other expenses	(5,427)	-	(5,427)
19 General administrative expenses and depreciation	(65,794)	-	(65,794)
<i>Other operating expenses</i>	-	(67,646)	67,646
20 Net profit from operations before impairment and provisions for losses	14,789	23,328	(8,539)
21 Impairment losses and provisions	(46,076)	(54,615)	8,539
22 PROFIT BEFORE TAXATION	(31,287)	(31,287)	-
23 INCOME TAX	656	656	-
24 LOSS FOR THE YEAR	(30,631)	(30,631)	-
25 Loss per share	(6.45)	(6.45)	-

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Reconciliation of profit and loss items at 31 December 2017 (continued)

The line items Interest income/Interest expense under the CNB standard include Net foreign exchange gains which are reported in the Annual Report under Net foreign exchange gains.

Under the CNB standard, Trading gains/(losses), Gains/(losses) on embedded derivatives, Gains/(losses) on exchange differences and the already mentioned net exchange differences on interest income/expense are presented in the Annual Report, except for exchange differences on provisions which are included in the CNB report in Impairment and provisions for losses.

Furthermore, under the CNB standards, Gains/(losses) on available for sale assets and Gains on other equity investments are combined under Net financial (loss)/gains in the Annual Report.

Items Other expenses, General administrative expenses and depreciation under the CNB standard comprise the line item Other operating expenses in the Annual Report, and the difference relates to provisions for legal actions initiated against the Bank and to provisions for liabilities to employees which were included in the Annual Report in Impairment allowance and provisions for losses.

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)**Reconciliation of the Statements of cash flows for 2017**

ITEM	CNB Decision	Annual Report	Difference
Operating activities			
Profit/(loss) before taxation	(31,287)	(31,287)	-
Impairment allowance and provisions for losses	55,136	-	55,136
<i>Impairment allowance on loans and other assets (net)</i>	-	54,196	(54,196)
<i>Provisions for contingent liabilities (net)</i>	-	(423)	423
<i>Litigation provision (net)</i>	-	1,307	(1,307)
<i>Other provisions (net)</i>	-	56	(56)
Depreciation and amortisation	3,425	3,425	-
(Gains)/losses on sale of tangible assets	(4,073)	(4,073)	-
<i>Foreign exchange differences on translation</i>	-	(2,743)	2,743
<i>Write-offs of tangible assets</i>	-	15	(15)
<i>(Gains)/losses on realisation of available-for-sale assets</i>	-	(15,184)	15,184
Other (gains) / losses	(17,912)	-	(17,912)
Operating cash flows before changes in operating assets	5,289	5,289	-
Balances with the CNB	42,577	-	42,577
<i>Decrease / Increase in receivables from the Croatian National Bank</i>	-	42,577	(42,577)
Treasury bills of the Ministry of Finance and of the CNB	35,418	-	35,418
Deposits with banking institutions and loans to financial institutions	-	-	-
Loans and advances to other customers	419,145	-	419,145
<i>(Increase) in loans and advances to customers</i>	-	415,377	(415,377)
Securities and other financial instruments available for sale	(78,428)	-	(78,428)
Securities and other financial instruments held for trading	-	-	-
Securities and other financial instruments at FVTPL that are not actively traded	-	-	-
Other operating assets	3,082	13	3,069
Net (increase) / decrease in operating assets	421,794	457,967	(36,173)
Demand deposits	(50,869)	(60,053)	9,184
Savings and term deposits	(373,770)	(360,675)	(13,095)
<i>Increase/(decrease) in liabilities to other banks</i>	-	(29,922)	29,922
Other liabilities	(29,679)	(1,692)	(29,534)
Net increase / (decrease) in operating liabilities	(454,318)	(452,342)	(1,976)
Net cash flow from operations before income tax	(27,235)	10,914	(38,149)
Income taxes paid	-	-	-
Net cash inflow / (outflow) from operating activities	(27,235)	10,914	(38,149)
Investing activities			
Proceeds from sale/(Payments for purchases) of tangible and intangible assets	6,717	-	6,717
Proceeds from sale of/(Payments for investment)s in subsidiaries, associates and joint ventures	-	-	-
Proceeds from/(Payments to acquire) securities and other financial instruments held to maturity	15,520	-	15,520

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

Reconciliation of the Statements of cash flows for 2017 (continued)

<i>Purchase of financial assets available for sale</i>	-	(956,141)	956,141
<i>Sale of financial assets available for sale</i>	-	917,993	(917,993)
<i>Decrease in financial assets held to maturity</i>	-	15,520	(15,520)
<i>Purchases of property, equipment and intangible assets</i>	-	(1,491)	1,491
<i>Increase in property investment</i>	-	6,717	(6,717)
Other receipts/(payments) from financing activities	(1,490)	-	(1,490)
Net cash from investing activities	20,747	(17,402)	38,149
Financing activities			
Net increase/(decrease) in borrowings	(128,511)	(128,511)	-
<i>Proceeds from borrowings, net</i>	-	-	-
Net increase/(decrease) of issued debt securities	-	-	-
Net increase/(decrease) in subordinated and hybrid instruments	-	-	-
Other receipts/(payments) from financing activities	-	-	-
Increase in share capital	-	-	-
Net cash from financing activities	(128,511)	(128,511)	-
Net increase / (decrease) in cash and cash equivalents	(134,999)	(134,999)	-
Cash and cash equivalents, beginning of the year	333,258	333,258	-
	3,161	3,161	-
Cash and cash equivalents at the end of the year	201,420	201,420	-

The departures on the items included in the Annual Report versus the standard under the CNB Decision comprise the following:

According to the CNB standard, Impairment allowance and provisions for losses as a single amount, while in the Annual Report they are shown within the items Impairment of loans and other assets, Provisions for contingent liabilities, Provisions for judicial proceedings and Other provisions.

MoF treasury bills under the CNB standard, together with items Securities and other financial instruments available for sale and Securities and other financial instruments held for trading are presented in the Annual Report within Investing activities, while under the CNB standard they are presented within Operating activities.

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

In accordance with Article 164 of the Credit Institutions Act, the Bank is required to disclose the following information relating to the previous financial year:

1. Banking and financial services provided, the nature of its activities and the geographic location of services provision;
2. Amount of total income;
3. Number of employees on a full-time equivalent basis;
4. Amount of income tax; and
5. The amount of state subsidies received

Ad.1.

In accordance with the Credit Institutions Act 164, the Bank engages in the following banking and financial services in the country and abroad:

- Receiving cash deposits,
- Granting of loans and other placements on its own behalf and for its own account,
- Issuing means of payment in the form of electronic money,
- Issuing guarantees and other commitments,
- Factoring,
- Finance leasing,
- Lending, including customer loans, mortgage loans and financing commercial transactions (including forfeiting),
- Trading on its own behalf and for its own account or on its own behalf and for the account of the client: money market instruments and other transferable securities, foreign currencies, including currency exchange, financial futures and options, currency and interest rate instruments,
- Payment transactions in the country and abroad in accordance with special laws,
- Collection, analysis and provision of information on the creditworthiness of legal entities and natural persons who perform activities independently,
- Issuing and management of payment instruments,
- Rental of safe deposit boxes,
- Representation in insurance,
- Receipt and transfer of orders in relation to one or more financial instruments,
- Execution of orders on behalf of clients,
- Trading for own account,
- Underwriting services, i.e. the sale of financial instruments with a purchase obligation,
- Underwriting Services, i.e. the sale of financial instruments without a purchase obligation,
- Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash management and security instruments,

SUPPLEMENTARY REPORT FOR THE CROATIAN NATIONAL BANK (continued)

- Providing loans to investors to allow carrying out transactions with one or more financial instruments, if the transactions involve a company that grants loans,
- Foreign exchange services, if related to the provision of investment services,
- Services related to underwriting or selling financial instruments with a purchase obligation.

In accordance with the National Classification of Activities, the activities of Croatia banka are defined as: 64.19 Other monetary intermediation.

In 2017 Croatia banka performed its activities in the Republic of Croatia.

Ad.2.

In 2017, Croatia banka realised a total net income of HRK 85,398 thousand.

Ad.3.

As at 31 December 2017, Croatia banka had 195 employees based on the number of hours of work, but at the end of 2017 the actual number of employees was 191.

Ad.4.

Income tax expense represents the sum of the tax currently payable and deferred tax. The Bank realised a taxable loss for 2017 in total amount HRK 27,384 thousand, but has no obligation to pay income tax because it utilises the benefit of tax losses brought forward from 2012 and 2013.

The amount reported under income tax relates to reversal of deferred tax assets in respect of tax losses upon the revision of the Long-term financial plan and to net deferred tax assets on prepaid/paid benefits.

Ad.5.

In 2017 Croatia banka did not receive any state subsidies.

HEADQUARTERS:

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BUSINESS NETWORK

The City	Address	Phone	Fax
Bjelovar Branch	Ulica Petra Zrinskog 14 43000 Bjelovar	043 241 610 043 241 611	043 241 612
Čakovec Branch	Ulica Ivana Mažuranića 2 40000 Čakovec	040 310 160 040 311 672	040 310 643
Drenovci Branch	Veliki šor 2 32257 Drenovci	032 862 842 032 862 843	032 862 844
Metković Branch	Ulica S.Radića 8 20350 Metković	020 681 013 020 681 082	020 681 089
Osijek Branch	Šamačka ulica 1 31000 Osijek	031 203 001 031 203 005	031 203 002
Pula Branch	Istarska ulica 14 52100 Pula	052 451 202 052 451 304	052 451 505
Požega Branch	Cehovska ulica 3 34000 Požega	034 274 460	034 274 440
Slavonski Brod Branch	Trg Ivane Brlić Mažuranić 15 35000 Slavonski Brod	035 442 112	035 442 110
Split Branch	Ulica Matice Hrvatske 1 21000 Split	021 539 795	021 539 794
Vinkovci Branch	Duga ulica b.b. 32100 Vinkovci	032 331 377	032 331 213
		032 331 453	

CROATIA BANKA d.d.
BUSINESS NETWORK AND CONTACTS (continued)

The City	Address	Phone	Fax
Virovitica Branch	Trg kralja Zvonimira 10 33000 Virovitica	033 725 441	033 725 602
Vukovar Branch	Josipa Jurja Strossmayera 5 32000 Vukovar	032 450 520	032 450 490
Šubićeva Outlet, Zagreb	Šubićeva 67 10000 Zagreb	01 4623 024	01 4623 027
Zagreb Branch / Sky Office Outlet	R.F. Mihanovića 9 10110 Zagreb	01 2391 667 01 2391 282	01 2391 240
Županja Branch	Strossmayerova 5 32270 Županja	032 831 051	032 833 424