

# CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

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Annual financial statements for 2017

Zagreb, March 2018

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## ANNUAL REPORT OF THE CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT GROUP FOR 2017

Zagreb, March 2018

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### STATEMENT OF PERSONS RESPONSIBLE FOR THE PREPARATION OF THE ANNUAL REPORT

To the best of our knowledge the 2017 Annual Report contains a truthful development of events and business results as well as the position of the Croatian Bank for Reconstruction and Development and the Group and the description of the most significant risks and contingencies the Croatian Bank for Reconstruction and Development and the Group are exposed to.

President of the Management Board



Tamara Perko, MSc

Member of the Management Board



Hrvoje Čuvalo, MSc

Zagreb, 19 March 2018

## MANAGEMENT REPORT FOR 2017

The Annual Report includes the summary of financial information, description of operations and audited Annual Financial Statements with the Independent auditor's report for the year ended 31 December 2017. Revised Financial Statements are shown for the Croatian Bank for Reconstruction and Development Group and the Croatian Bank for Reconstruction and Development.

### Legal status

The Annual Report includes the annual financial statements prepared in accordance with the International Financial Reporting Standards and the Accounting Act and audited in accordance with the International Standards on Auditing. The compliance of the Annual Report with the Annual Financial Statements has been confirmed by auditors, pursuant to Article 17 of the Accounting Act.

### Establishment

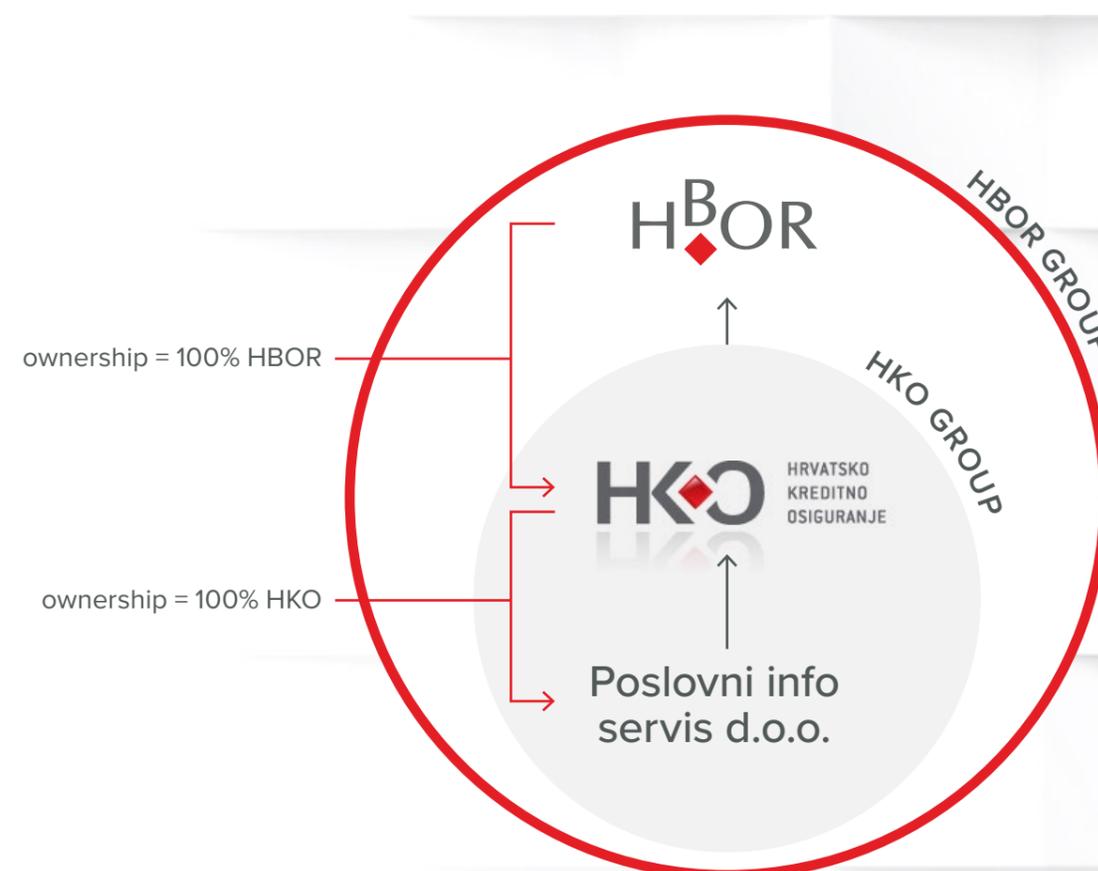
Hrvatska banka za obnovu i razvitak was established on 12 June 1992 by the Act on Hrvatska kreditna banka za obnovu (HKBO). The Bank was renamed Hrvatska banka za obnovu i razvitak (Croatian Bank for Reconstruction and Development) by changes and amendments to the above Act in December 1995. In December 2006, the Croatian Parliament passed a new Act on HBOR, which came into force on 28 December 2006. On 15 February 2013, the Croatian Parliament passed the Act on Amendments to the Act on the Croatian Bank for Reconstruction and Development, whereby the Supervisory Board of HBOR was amended and increased by one member – the Minister of Regional Development and EU Funds, and now consists of ten members.

## Hrvatska banka za obnovu i razvitak Group

Hrvatska banka za obnovu i razvitak (HBOR) is the parent company of the HBOR group that was formed in 2010. The Group consists of the parent company, Hrvatsko kreditno osiguranje d.d. (HKO) and Poslovni info servis d.o.o. (PIS).

Name	Role within the group	% of participation	Headquarters	Business activities
Hrvatsko kreditno osiguranje d.d.	Subsidiary company, direct equity participation	100% HBOR	Republic of Croatia	Insurance for company's foreign and domestic short-term receivables, regarding shipments of goods and services
Poslovni info servis d.o.o.	Subsidiary company, indirect equity participation	100% HKO	Republic of Croatia	Providing analysis, credit risk assessment and information on creditworthiness

### Illustration of the HBOR Group structure



## Strategic goals

In its operations, and within the framework of its powers and authorisations, HBOR promotes systematic, sustainable and balanced economic and social development pursuant to the overall strategic goals of the Republic of Croatia.

## Priority activity areas

- Promoting start-ups and the development of SMEs
- Promoting exports
- Developing tourism
- Financing innovation and development of new technologies
- Financing the development of agriculture
- Promoting the EU funds utilisation
- Financing projects of environmental protection, energy efficiency and renewable energy resources

### *Breakdown of the most significant financial information for HBOR*

In HRK million

	2013	2014	2015	2016	2017
Total assets	26,162.59	25,777.05	25,540.78	27,374.92	28,055.80
Gross loans	24,941.60	24,721.41	24,722.82	26,343.12	26,332.99
Total equity	8,888.79	9,430.13	9,662.45	10,037.98	10,268.83
Total income	983.08	918.13	917.11	924.00	919.36
Total expense	(793.92)	(749.79)	(711.88)	(610.47)	(758.58)
Profit	189.16	168.34	205.23	313.53	160.78
Interest income	955.25	903.57	872.61	870.34	866.20
Interest expense	(520.91)	(490.16)	(474.53)	(452.67)	(390.46)
Net interest income	434.34	413.41	398.08	417.67	475.74

## Credit rating as at 31 December 2017

- Ba2 by Moody's
- BB by Standard & Poor's

## Regional offices

- Regional office for Slavonia and Baranja
- Regional office for Dalmatia
- Regional office for Istria
- Regional office for Lika
- Regional office for Primorje and Gorski kotar

## Number of employees

On 31 December 2017, there were 336 active employees in HBOR.

On 31 December 2017, there were 353 active employees in HBOR Group

## Exchange rate

For the purpose of converting amounts in foreign currencies into HRK, the following middle exchange rates of the Croatian National Bank have been applied:

31 December 2017 EUR 1 = HRK 7.513648

USD 1 = HRK 6.269733

31 December 2016 EUR 1 = HRK 7.557787

USD 1 = HRK 7.168536

# STATEMENT ON THE CODE OF CORPORATE GOVERNANCE APPLICATION

## Hrvatska banka za obnovu i razvitak (HBOR)

HBOR applies HBOR's Code of Corporate Governance (hereinafter: the Code) dated February 2013.

The Code contains the basic principles determined by the Decision on Passing the Code of Corporate Governance in Companies with Shares or Participations owned by the Republic of Croatia (Official Gazette of the Republic of Croatia No. 112/2010) (hereinafter: the Decision) and the principles determined in the EBA (The European Banking Authority Guidelines on Internal Governance GL 44, September/2011) (hereinafter: the Guidelines).

In accordance with the text of the Decision, the basic principles of corporate governance are applied to HBOR that it incorporated in its Code of Corporate Governance, whereas the principles stated in the Guidelines are implemented to a degree to which they are applicable due to the fact that the Guidelines relate to credit institutions and are not fully applicable to HBOR as a special financial institution.

HBOR applies fully the Code of Corporate Governance of HBOR that was adopted by the Management Board and the Supervisory Board and published on the web pages of HBOR.

A new Decision on Passing the Code of Corporate Governance in Companies in which the Republic of Croatia owns

Shares or Stakes (Official Gazette of the Republic of Croatia No. 132/17) was published on 29 December 2017. By coming into force of this Decision (on 6 January 2018), the Decision published in the Official Gazette No. 112/10, from which HBOR took over the basic principles in the Code, ceased to be valid.

Based on the new Decision, HBOR will adjust the principles and rules of corporate governance of HBOR.

As a measure of good corporate governance in terms of strengthening the transparency and determining the criteria for the selection of members of the Management Board of HBOR, the valid Decree on the Criteria for the Implementation of Procedures for Selection and Appointment of Presidents and Members of Management Board of Companies and Other Legal Entities of Strategic and Special Interest for the Republic of Croatia is applied to HBOR. By the Decree, the requirements by which the policy of diversity in terms of age, gender, education, and profession would be applied, are not prescribed.

Compliance with laws and regulations and adherence to internal rules are the basis of responsible corporate governance and a necessary condition for sustainable business success. HBOR continuously monitors legislation and best practices in the field of corporate

governance and integrates corporate governance principles in its operations pursuant to sound banking practices.

The Code of Corporate Governance establishes the standards of corporate governance and the transparency and upgrading of HBOR's operations for effective and responsible management of public capital, as well as the activities of special social significance for the development of the Croatian economy. In order to achieve the standard of corporate governance, HBOR's Code describes the relationships with governing bodies and stakeholders, as well as the adopted business principles aimed at mitigating the risks of operating in adverse market conditions.

The Code of Conduct of HBOR prescribes specific values and rules for the prevention of corruption and assurance of professional conduct, and provides for the possibility of filing a report on the grounds of violation of the Code. The report form, the e-mail address for filing reports and the description of the filing are available on HBOR's websites. The person in charge of compliance monitoring reports annually on reports filed and proceedings initiated in respect of reports filed on the grounds of violation of the Code of Conduct.

In accordance with the principles of public business, in the reporting period the financial statements of the Bank and the Group were published on the web sites of HBOR and the Luxembourg Stock Exchange. HBOR's annual financial statements on an unconsolidated and consolidated basis are confirmed by the Supervisory Board and submitted to the Croatian Parliament for approval. HBOR's

rating is assessed annually by two international independent rating agencies (Standard & Poor's, Moody's). Pursuant to the Freedom of Information Act, HBOR submits a report on the implementation of this act to the Public Relations Commissioner.

In the reporting period, the duties, responsibilities and powers of the members of the Management Board and the Supervisory Board were regulated by the Act on HBOR (Official Gazette of the Republic of Croatia, No. 138/06) and by the Act on Amendments to the Act on HBOR (Official Gazette of the Republic of Croatia, No. 25/13) and further elaborated in the By-laws of HBOR. The Management Board and the Supervisory Board successfully co-operate through open discussions; the timely submission of thorough written reports to the Supervisory Board represents the basis for this co-operation. The Act on HBOR, the By-laws of HBOR and decisions made by the Supervisory Board determine the activities that HBOR may perform only with the prior consent of the Supervisory Board.

The **Supervisory Board** determines the principles of operating policy and strategy, supervises the business activities of the Bank, adopts HBOR's lending policies, adopts the Annual Financial Statements, and examines the Internal Audit reports and reports drafted by external independent auditors and by the State Audit Office. The Supervisory Board also monitors and controls the legality of the business activities of the Management Board, and appoints and dismisses the President and the members of the Management Board. According to the Act, the Supervisory Board consists

of ten members: six ministers in the Government of the Republic of Croatia, three Members of Parliament, and the President of the Croatian Chamber of Economy.

In 2017, the members of the Supervisory Board were as follows:

- Zdravko Marić, DSc, Minister of Finance, President of the Supervisory Board
- Martina Dalić, DSc, Deputy Prime Minister of the Republic of Croatia and Minister of the Economy, Entrepreneurship and Trade, Vice President of the Supervisory Board
- Slaven Dobrović, DSc, Minister of Environmental Protection and Energy (until 25 May 2017)
- Lovro Kuščević, Minister of Construction and Physical Planning, since 9 June 2017 Public Administration Minister (from 25 May 2017 to 4 August 2017)
- Predrag Štromar, Deputy Prime Minister of the Republic of Croatia and Minister of Construction and Physical Planning (since 4 August 2017)
- Gabrijela Žalac, Minister of Regional Development and EU Funds
- Gari Cappelli, Minister of Tourism
- Tomislav Tolušić, Minister of Agriculture
- Luka Burilović, President of the Croatian Chamber of the Economy
- Boris Lalovac, MSc, Member of the Croatian Parliament
- Ivana Ninčević-Lesandrić, Member of the Croatian Parliament (until 14 July 2017)
- Božica Makar, of the Croatian

Parliament (since 14 July 2017)

- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament

The **Management Board** represents HBOR, conducts HBOR's business and administers its assets, and is obliged and authorised to undertake all actions and pass all resolutions it considers necessary for the legal and successful conduct of business. The powers of the Management Board also include adopting normative acts that determine the manner of operations and the internal organisation of HBOR, adopting loan programmes, making individual loan approval decisions and decisions on other financial transactions, making decisions on the appointment and dismissal of employees with special powers, making decisions on the rights and obligations of employees and reporting to the Supervisory Board.

Members of the Management Board of HBOR until 31 January 2017:

- Dušan Tomašević, President of the Management Board
- Goran Filipić, Member of the Management Board
- Martina Jus, Member of the Management Board.

The Supervisory Board of HBOR, based on the proposal of the Government of the Republic of Croatia, made a decision on the dismissal of the President and the Members of the Management Board of HBOR from their duties and the appointment of a new Management Board pursuant to the Decree on the Criteria for the Implementation of Procedures for Selection and

Appointment of Presidents and Members of Management Boards of Companies and Other Legal Entities of Strategic and Special Interests for the Republic of Croatia (Official Gazette Nos. 33/16, 43/16 and 109/16), but for the maximum period of six months (such a decision was also made on 1 August 2017). The members of the Management Board of HBOR until 15 October 2017 were as follows:

- Tamara Perko, MSc, President of the Management Board
- Martina Jus, Member of the Management Board.

By the Decision of the Supervisory Board of HBOR, based on the proposal of the Government of the Republic of Croatia, on 16 October 2017, a new Management Board was appointed for a five-year term of office with the following members:

- Tamara Perko, MSc, President of the Management Board
- Hrvoje Čuvalo, MSc, Member of the Management Board.

On the basis of HBOR's Code of Corporate Governance and the Audit Act, the Audit Committee of HBOR has been established pursuant to a decision of the Supervisory Board. The Audit Committee is comprised of three members, one of whom is appointed from among the members of the Supervisory Board of HBOR and the other two, at least one of whom must be an independent member, are appointed by the Supervisory Board. The President is appointed by the Supervisory Board from among the independent members of the Audit Committee.

The Audit Committee was appointed by the Decision of the Supervisory

Board dated 25 July 2017. Until the appointment, the function of the Audit Committee was performed by the Supervisory Board.

Members of the Audit Committee of HBOR are:

- Prof.DSc. Lajoš Žager, Dean of the Faculty of Economics and Business of the University of Zagreb, Chairman of the Audit Committee,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament, Vice Chairman of the Audit Committee,
- Aurora Volarević, Director of Internal Controls, Audit and Risk in Hrvatski Telekom d.d., member of the Audit Committee.

In order to ensure as effective and as high-quality risk management as possible and reduce the risks to the lowest level possible, the following committees operate under the Management Board: the Assets and Liabilities Management Committee, the Credit Risk Evaluation and Measurement Committee, the Information System Management Committee and the Business Change Management Committee.

The internal control system of HBOR is organised through independent organisational units as follows:

- Independent organisational unit for risk management conducts the identification, assessment, measurement, supervision and control of all risks that HBOR is exposed or may be exposed to within the framework of its

- operations
- HBOR's Internal Audit, as an independent organisation unit, is in charge of verifying the adequacy of the risk management procedures and the internal control system, including risk control function and compliance function, as well as implementing the internal policies and procedures, and activities related to the prevention of money laundering
- Independent compliance function organizes, coordinates and directs the activities concerning compliance at the level of HBOR, advises on matters of compliance, controls measures taken to minimize compliance risk, incorporates information on compliance monitoring, identifies and assesses the risks of compliance and provides regular reports. The main tasks of the compliance function are to limit the non-compliance risk and its possible negative effects, ensure compliance of all internal documents and business processes with the relevant regulations and promote the principles of ethical business.

## Hrvatsko kreditno osiguranje d.d. (HKO)

The internal control system of Hrvatsko kreditno osiguranje d.d. is organised through the following independent functions:

- compliance function
- risk management function
- internal audit function and
- actuarial function.

HKO has established an adequate

internal control system on the basis of the internal regulation, the Ordinance on the Internal Control System, thus increasing the probability of timely detecting fraud and contributing to the reduction of unjustified costs, the reduction of abuse and error, the prevention of inappropriate acts and the reduction of risks related to compliance with the legislative framework. In proportion to its size, to the type, scope and complexity of operations and in accordance with its risk profile, the Company establishes permanent and effective controls that are independent from the business processes and activities in which risks arise and which they monitor and supervise.

Legal status, organisation and management of HKO as well as other issues important for the operations of the Company are determined by the Statutes of the Company pursuant to the provisions of the Companies Act and the Insurance Act.

Company management bodies are the Management Board, the Supervisory Board and the Shareholders' Meeting. HKO is managed by the two-member Management Board that makes its decision in accordance with the Rules of Procedure for the Management Board. All decisions are made by following the "double check principle" ("four eyes principle") supported by the suitable system of authorisation.

HKO has not adopted the Code of Corporate Governance, however, to the extent adequate to the size and development status of the Company, it voluntarily applies the principles of corporate governance code on its

operations that have been prepared by the Croatian Financial Services Supervisory Agency (HANFA) and Zagrebačka burza d.d. (Zagreb Stock Exchange).

This Statement is considered to be part of the Annual Report of the HBOR Group for the period from 1 January to 31 December 2017.

# DESCRIPTION OF OPERATIONS OF HBOR GROUP IN 2017

## OPERATIONS OF CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

In 2017, HBOR celebrated 25 years of operations, during which it supported more than 58 thousand projects of Croatian entrepreneurs with almost HRK 160 billion, of which HRK 104.56 billion relate to approved loans, HRK 26.09 billion to issued guarantees, and HRK 28.72 billion to mandate transactions, of which the most important transactions relate to insurance of export receivables in the amount of HRK 24.28 billion.

During 2017, special emphasis in HBOR's operations was placed on the development of products and services intended primarily for small and medium-sized enterprises (framework loans with commercial banks and leasing companies), on the implementation of financial instruments from the EU funds (ESIF Growth and Expansion Loans, ESIF Energy Efficiency Loans), on facilitating the loan terms and conditions for projects financed from the EU funds (EU private and public sector and rural development) as well as on the improvement of the terms and conditions for farmers and public sector investments.

As in its business operations so far, HBOR was primarily focused on providing services complementary to those of commercial banks, enhancement of co-operation with financial intermediaries (commercial banks and leasing companies), further implementation of

the risk sharing model with the aim to encourage commercial banks to increase loan placements, approval of loans with or without state aid, project financing, insurance of export receivables and encouragement of entrepreneurs to use the available proceeds of the EU funds and financial instruments.

Several introduced measures, of which the most significant ones relate to the enhancement of co-operation with financial intermediaries, reduction of interest rates and loan application processing fees, resulted in 2,428 projects supported with an amount exceeding HRK 7.40 billion during 2017. Of the total number of supported projects in this period, 2,183 projects were supported through lending in the total amount of HRK 5.15 billion, issuing of 31 guarantees in the total amount of HRK 521.93 million and insurance of export receivables in the amount of HRK 1.73 billion.

In accordance with its main task of even development of all regions of the Republic of Croatia, in 2017 HBOR supported projects in all counties through lending. In the counties classified by the development index in the first and second category of counties as developed lower than average, almost 30 percent of the totally approved amount was placed, just like in the counties that

belong to the third group of development according to the development index. The remaining funds were approved to the counties developed above the average.

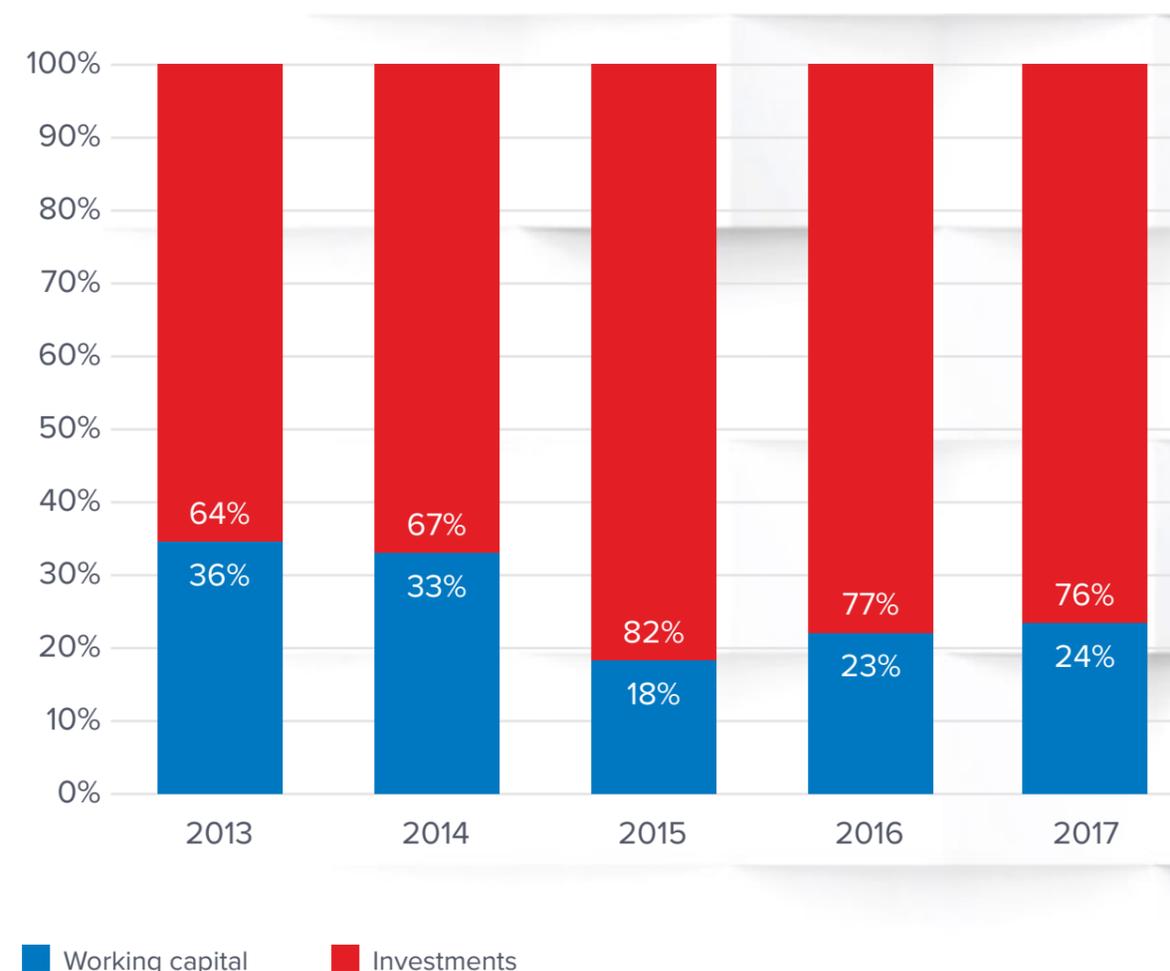
During 2017, out of the total loans approved, 76 percent were approved for capital investments, whereas for working capital 24 percent.

This is the result of continued implementation of measure of interim reduction in interest rates for new investments by 1 percentage point that was in 2017 extended to the projects of renewable energy in cases when such projects do not include state aid. In 2017,

the loan application processing fee for all loan programmes was reduced from the then valid 0.8 or 1 percent to 0.5 percent. The validity of this measure has also been extended for the loans that will be approved in 2018.

Beside the promotion of investments, in the circumstances arisen relating to the operations of the Agrokor group and possible consequences on the operations of entrepreneurs that are economically and financially dependent on the group, financing of working capital in kuna was provided under the loan programme Liquidity.

*Structure of approved funds by purpose from 2013 to 2017*



## SMALL AND MEDIUM-SIZED ENTERPRISES – 96 PERCENT OF ALL PROJECTS APPROVED

Under all loan programmes, 2,093 loans were extended to small and medium-sized enterprises totalling HRK 2.30 billion, i.e. 96 percent of all approved loans.

In 2017, loans were extended to small and medium-sized enterprises under 32 HBOR loan programmes that are implemented either directly or via commercial banks and leasing companies. Due to simple and efficient procedure of framework loan approval, in 2017, the largest number of projects was supported via framework loans to leasing companies and commercial banks – 1,665 projects in the amount of almost HRK 900.00 million. The extension of co-operation with leasing companies facilitated the approval of 954 contracts on financial leasing in the total amount of HRK 185.00 million through this distribution channel.

By using HBOR proceeds, small and medium-sized enterprises invested more than HRK 1.16 billion in new investment projects. For sensitive target groups, such as micro enterprises, start-ups, female entrepreneurs and young entrepreneurs, 205 projects were supported with the total amount of HRK 57.82 million, whereas for the realisation of projects co-financed from the EU funds, small and medium-sized enterprises used the amount of almost HRK 140.00 million.

During 2017, beside the mentioned measures of reducing fees, interest rates by 1 percentage point and facilitated terms and conditions for financing liquidity, small and medium-sized enterprises had the

possibility to use reduced interest rates within the Jobs for Youth Initiative of the European Investment Bank, through which investments of small and medium-sized companies into education, skills and employment of young people are financed. The main feature of this Initiative is saving on interest rate by 0.50 percentage points for entities employing or training young persons. The reduction in interest rate was also made possible under the InnovFin Programme in co-operation with the European Investment Fund.

As continuation of long-term co-operation between HAMAG BICRO and HBOR, within the framework of which many projects of small and medium-sized companies were supported and realised, in March 2017, the Financing Agreement for Issuing of Individual Guarantees Financed from ESI Funds was signed. The respective Agreement represents a framework for the continuation co-operation with the aim to support further small and medium-sized companies via HBOR loan funds and guarantees of HAMAG BICRO.

Also, in the last quarter of 2017, HAMAG BICRO initiated the realisation of the guarantee portfolio programme by the invitation to commercial banks to express interest for their participation in the programme. HBOR, together with 5 commercial banks, met the prescribed criteria. In 2018, it will continue the negotiations on the manner of implementation of the programme, the purpose of which is to facilitate additionally access to favourable sources of funding.

## INFRASTRUCTURE - MORE THAN HRK 1 BILLION APPROVED

Investments in business and tourist infrastructure create the preconditions for better development of individual regions and further investments of private sector, as well as the creation of new jobs.

For the purpose of promoting such investments, in 2017 HBOR reduced interest rate from 3.00 to 2.50 percent for financing projects of units of local and regional government and legal entities majority-owned by them, as well as for private entities implementing projects of public interest that are not primarily profit-oriented. Also, the possibility of financing in HRK was introduced without the payment of commitment fee in order to further reduce burden and total costs for borrowers.

Since the units of local and regional government are essential in withdrawing the proceeds of the EU funds, HBOR has developed a special loan programme for pre-financing and co-financing of candidate projects for the proceeds of the EU funds. Financing of public sector under this programme was implemented in 2017 at a reduced interest rate of 2.50 percent and repayment period up to 15 years, and a possible grace period of up to 5 years.

The mentioned measures resulted in 48 financed projects of units of local and regional government, the total approved amount of which reached HRK 1.17 billion.

## TOURISM - 250 PROJECTS OF THE TOURISM SECTOR SUPPORTED

By its favourable funds, HBOR has been financing investments in tourism made by companies, crafts businesses, family farms and institutions. The purpose of these investments is to extend tourist season and they mostly relate to the enhancement and extension of accommodation capacities, as well as the introduction of new services and facilities. Tourist companies recognise increasingly the advantages of utilisation of grants of the EU funds for co-financing such projects, the funding plan of which can also be completed by favourable HBOR loan programmes.

In 2017, HBOR approved an amount exceeding HRK 630.00 million for 249 projects in the tourism industry. More than 90 percent of loan funds were approved for investments in the Adriatic region, and the majority of funds were approved in Split-Dalmatia county in the total amount of almost HRK 280.00 million.

In 2017, HBOR continued to implement favourable terms and conditions of financing intended for investments in the tourism sector at interest rates reduced by 1 percentage point, which means that interest rates for tourism projects ranged from 2 to 3 percent, depending on the successfulness of operations of the final borrower and the region of investment.

Repayment terms for loans are adjusted to the tourism sector, i.e. up to 17 years, with the possibility of approving a grace period of up to 4 years.

However, most smaller projects in the tourism industry in 2017, i.e. 107 of them in the total amount of HRK 108.00 million were supported via framework loans to commercial banks and leasing companies. Such manner of financing has been very well accepted by borrowers due to fast and simple processing.

## **AGRICULTURE - EASIER ACCESS TO LOAN FUNDS**

Agricultural production is one of the foundations of economic development of the Republic of Croatia.

Within the framework of special loan programmes intended for the financing of agriculture, it is possible to obtain funds for the preparation of agricultural production and investment in fixed assets: equipment, livestock, land, construction facilities or perennial plants. Agricultural producers also have at their disposal loan funds for the completion of the financial plan of the projects co-financed out of the proceeds of the EU funds.

In 2017, agricultural sector was supported with an amount of almost HRK 300 million, and in the second half of 2017, a number of new measures was passed for the purpose of increasing investments in agriculture and accelerating the dynamics of withdrawal of proceeds from the EU agricultural and fisheries funds.

For the financing of projects of rural development and wine envelope projects co-financed from the EU funds, interest rate was reduced from original 3.00 percent to 1.70 percent p.a. for loans with repayment terms of up to 10 years and 1.90 percent for loans with longer repayment periods.

Recognising the specific nature of operations and financing of family farms (OPG), for all family agricultural holdings, regardless of whether they are within the VAT system or not, in 2017 HBOR made it possible to apply for a loan under all loan programmes intended for small and medium-sized companies. Also, the possibility of direct lending of family farms within the VAT system was made possible via individual loan programmes, and under loan programmes Start-ups and Youth Entrepreneurship, owners of family farms are exempt from the obligation of self-employment upon the realisation of investment.

## **FINANCING OF PROJECTS CO-FINANCED OUT OF THE EU FUNDS - INTEREST RATES REDUCED FOR ALL SECTORS**

Beside the mentioned loan programmes for the financing of EU public sector and EU rural development projects, HBOR also supports beneficiaries applying for the proceeds out of the EU funds through the loan programme EU private sector financing.

For the purpose of encouraging new investments, initiating an investment cycle and better utilisation of the proceeds of ESI funds, HBOR, while taking into account limitations regarding the state aid, beside the reduction in interest rates under loan programmes EU rural development and EU public sector, additionally reduced interest rates for certain purposes under the loan programme EU private sector as follows: to 2.40 percent for loans with a repayment period up to 10 years and 2.70 percent for loans with a repayment period over 10 years.

Under HBOR loan programmes, financing of eligible, but also ineligible project costs is made possible, i.e. the completion of the funding plan of the entire investment. Financing is implemented either via commercial banks or through a direct placement. In certain cases, grant proceeds can be used for the reduction of loan principal, and in case of direct lending, HBOR allows up to 70.00 percent of grant proceeds as borrower's own share in the project. Beside the mentioned, HBOR also offers the possibility of using advance payment guarantees to beneficiaries of grant proceeds from the EU funds, i.e. for direct borrowers that plan to use an EU advance payment.

## **FINANCIAL INSTRUMENTS FROM THE EUROPEAN STRUCTURAL AND INVESTMENT FUNDS**

Beside promoting the use of grant proceeds from the EU funds, in 2017, HBOR enabled entrepreneurs to use the advantages of Financial instruments from the European Structural and Investment Funds.

### ***„ESIF Growth and Expansion Loans“***

In October 2017, the Funding Agreement for the Implementation of Financial Instrument „ESIF Growth and Expansion Loans“ was signed between HBOR and financial intermediaries Erste & Steiermärkische Bank d.d., Privredna banka Zagreb d.d. and Zagrebačka banka d.d.

Through this financial instrument, small and medium-sized companies have at their disposal around HRK 1.50 million of favourable funds for long-term investment loan, with repayment periods of up to 12 years, i.e. up to 17 years in the tourism sector, respectively. Loans under this financial instrument are financed 50 percent out of the European Structural and Investment Funds (ESIF) at 0 percent interest rate, and 50 percent out of the commercial banks' sources at market interest rate to be determined by commercial banks. Such manner of financing means that the final interest rate for entrepreneurs is half of the interest rate that would be charged if no ESIF funds were utilised.

Through co-operation with financial intermediaries and extensive network of their branches, the financial instrument is available in the whole territory of the Republic of Croatia.

### „ESIF Energy Efficiency Loans“

In December 2017, the Funding Agreement was signed between HBOR and the Ministry of Regional Development and European Union funds for the implementation of a new financial instrument „ESIF Energy Efficiency Loans“ in the public sector buildings. This is the financial instrument in the amount of HRK 190.00 million, the funds for which are provided from ESIF. The aim is to support investments in energy efficiency and to promote the use of renewable energy resources in public sector buildings for the purpose of achieving energy savings that will result in reduction of heating/cooling energy consumption on year level of at least 50 percent. Loans are approved directly to HBOR.

### CROATIAN EXPORTS - SUPPORTED WITH AN AMOUNT OF HRK 4.59 BILLION

By implementing its export finance programmes, HBOR contributes to the increase in competitiveness and value of Croatian exports and improvement of the recognisability and quality of Croatian products and services in the foreign market.

Within the framework of its export promotion task, HBOR, through its loan programmes, issuing of bank guarantees at the request of an exporter and insurance of export receivables, provides support to exporters in all stages of an export transaction, starting from negotiations until the final payment for an export transaction. HBOR, as the Croatian export bank and export credit agency, developed a system of providing exporters with financial support as other export banks and export-credit agencies in order to provide Croatian exporters with equal competitive conditions in international markets.

Along with the programmes intended for export transactions exclusively, HBOR supports exporters through short-term and long-term credit lines at favourable interest rates. Investment loans are also available to exporters intended for expansion and modernisation of the production, construction of new plants, but also various loans for working capital that are not necessarily tied to export transaction exclusively. The utilisation of such funds is intended to increase the competitiveness of entrepreneurs, which is a precondition for the realisation of successful entry into foreign markets.

In 2017, Croatian exporters were backed by HBOR with the total amount of HRK 4.59 billion: under all loan programmes, exporters were approved 377 loans totalling HRK 2.36 billion, which accounted for 46.00 percent of total lending activity, through export credit insurance policies export turnover insured amounted to HRK 1.73 billion and 17 bank guarantees at the request of exporters issued totalling almost HRK 500.00 million.

In 2017, the criteria of eligible borrowers for direct lending were changed, thus enabling a larger number of potential borrowers to apply for loan funds. Also, direct lending for amounts higher than HRK 1.50 million for pre-export finance was made possible.

## EXPORT CREDIT INSURANCE IN 2017

Export credit insurance activities include a number of insurance programmes through which HBOR can insure exporter's receivables for delivered goods and services to foreign buyers, financial loans for pre-shipment or financing buyers abroad, bank guarantees issued for export transactions and the reinsurance of short-term export receivables to private insurers for the risk that cannot be insured or reinsured in the private market.

In 2017, HBOR through its export credit insurance activities supported exports of capital projects, but also small and medium-sized companies for exports of consumer goods.

### Summary of results by export credit insurance transactions

In HRK million

Description	2016	2017
Total approved sum insured	759.52	1,002.32
Total insured export turnover	1,440.00	1,727.86
Gross exposure as at 31 December	1,660.00	2,130.00
Insurance premium paid	15.98	14.46
Paid indemnities to insured	8.81	30.04
Recourse collections from debtors	1.50	0.04
Balance of Guarantee fund as at 31 December	332.36	327.95

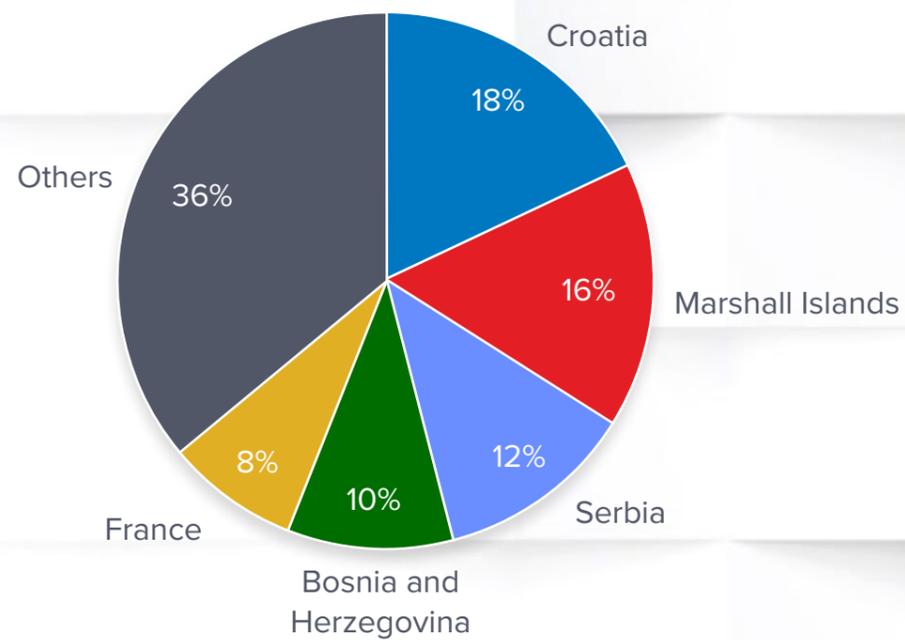
In 2017, HBOR approved coverage to Croatian exporters and banks that support exporters in the total amount of HRK 1.0 billion, an increase of HRK 242.80 million, i.e. 31.97 percent in comparison with 2016.

### TOTAL EXPORT TURNOVER INSURED

In 2017, HBOR provided for the Croatian export turnover in the amount of HRK 1.73 billion, an increase of HRK 285.46 million, or rise by 19.79 percent in comparison with 2016.

In 2017, HBOR through its export credit insurance programmes supported exports of Croatian goods and services to 54 countries worldwide.

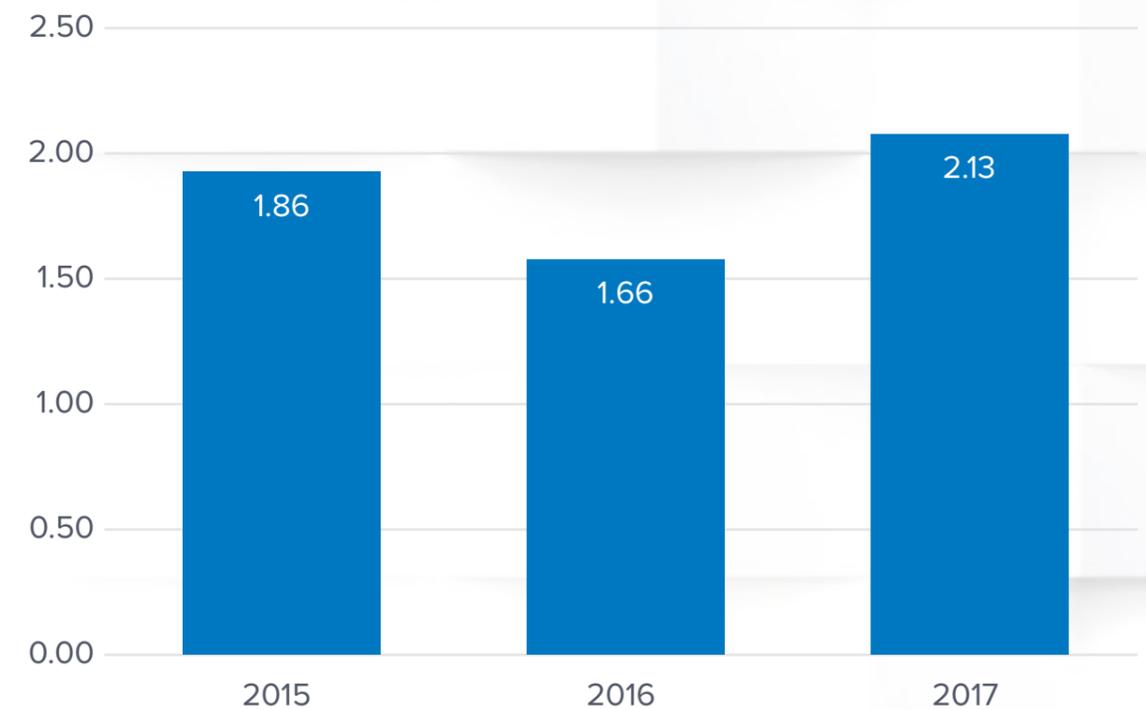
*Approved insurance in 2017, by countries*



## GROSS EXPOSURE

As at 31 December 2017, gross exposure of HBOR under export credit insurance transactions amounted to HRK 2.13 billion, which represents an increase of HRK 470 million, i.e. an increase of 28.31 percent in comparison with the same date in 2016. The increase in gross exposure was for the major part affected by the increase in gross exposure under the Buyer Credit Insurance Programme and the Pre-Export Financing Insurance Programme, within the framework of which export of capital goods and consumer goods was supported.

*Exposure by year*  
In HRK billion

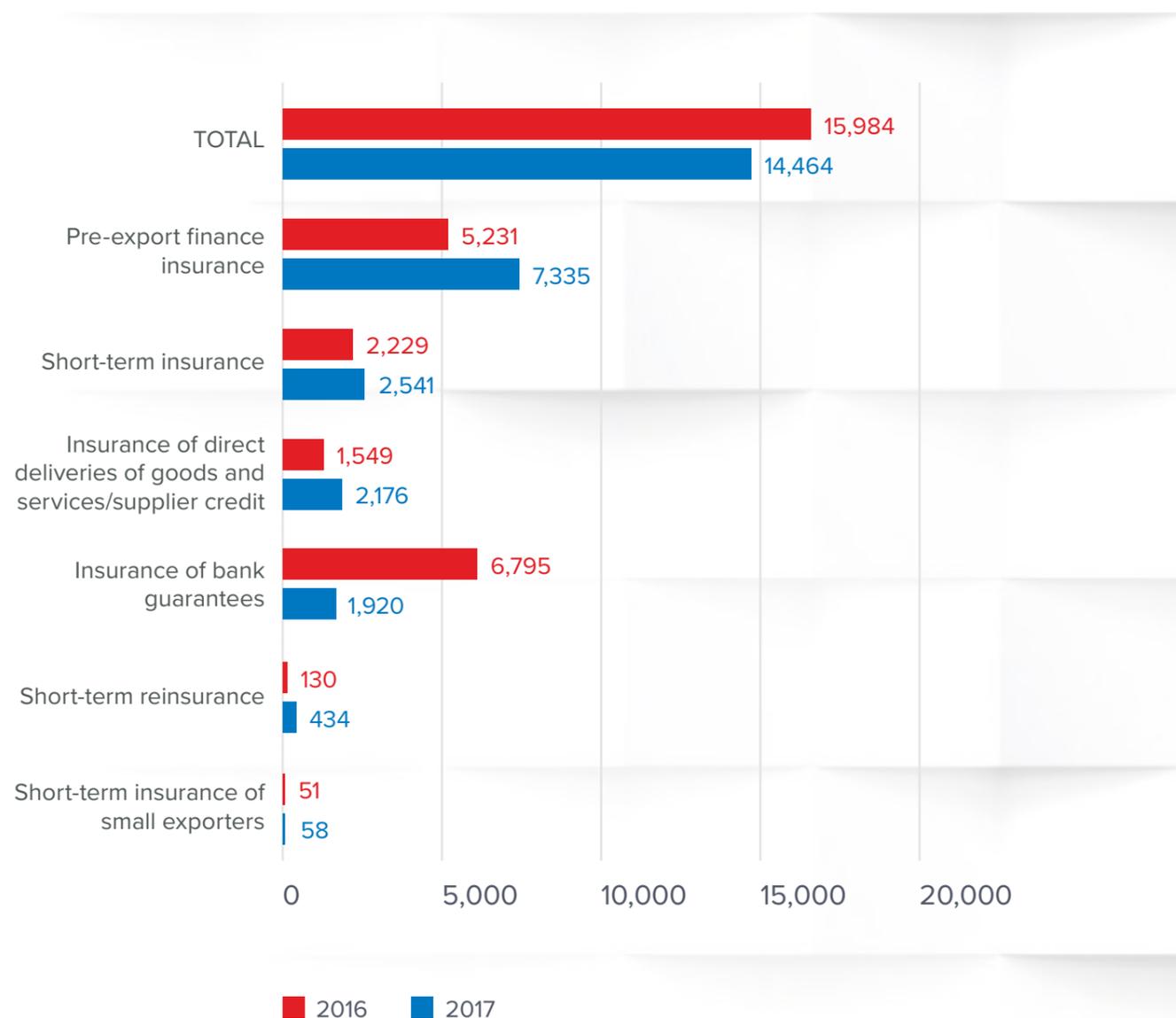


## INSURANCE PREMIUM CHARGED

In 2017, the total charged insurance premium under export credit insurance transactions amounted to HRK 14.46 million.

### Premiums charged by type of insurance in 2016 and 2017

In HRK thousand



## PAID INDEMNITIES

In 2017, one indemnity was paid in the total amount of HRK 30.04 million, i.e. an indemnity paid under the Programme for the Insurance of Performance-Related Bank Guarantees. The mentioned indemnity was paid to the bank that made payments under advance payment guarantees and performance guarantees issued for the export transaction of construction and delivery of 6 coastal patrol boats to Greece.

## RECOVERIES FROM DEBTORS

In 2017, total recoveries amounted to HRK 40.00 thousand based on previously paid indemnities for debtors from Italy, Croatia, Montenegro, Germany and Serbia.

## INSURANCE AND REINSURANCE OF SHORT-TERM EXPORT RECEIVABLES

In 2017, HBOR provided insurance of consumer goods in the amount of HRK 879.79 million, which represents an increase of HRK 137.66 million, i.e. increase by 18.55 percent in comparison with 2016. Through the programmes of insurance and reinsurance of short-term export receivables, exporters mainly supported were engaged in the production of glass packaging, freight wagons, pharmaceutical products, wood products, aluminium products, solar panels and in wholesale trade.

The largest export turnover with insurance coverage was realised for buyers in Serbia, Bosnia and Herzegovina, France, Macedonia and Italy.

## INSURANCE OF SHORT-TERM EXPORT RECEIVABLES FOR SMALL EXPORTERS

The Programme for the Insurance of Short-Term Export Receivables for Small Exporters is intended for exporters with annual export turnover of up to EUR 2.00 million, i.e. those that begin to sell their products and services in the foreign market.

For this group of exporters, insurance in the total amount of HRK 5.52 million was approved in 2017, representing an increase of HRK 1.00 million, i.e. increase by 21.00 percent in comparison with 2016. Most of supported transactions related to exports of the processing industry (export of sanitary facilities, PVC package, paper and cardboard products, wood products, books etc).

## **INSURANCE OF DIRECT DELIVERIES OF GOODS AND SERVICES/SUPPLIER CREDIT**

Under the Programme of Insurance of Direct Deliveries of Goods and Services, in 2017, insured export turnover amounted to HRK 13.68 million, by which deliveries of LTE equipment, related software, extension of network and related services for a buyer in Armenia were insured.

## **INSURANCE OF BUYER/BUYER'S BANK CREDIT**

Under the programme for insurance of buyer credit, in 2017, insurance of a credit was approved in the amount of HRK 279.12 million for the purpose of delivery of a cruiser for polar cruising that will fly the flag of the Netherlands for the foreign buyer registered on the Marshall Islands. The mentioned project is the first one of such kind of a Croatian shipyard. The respective approval is also the most significant transaction supported in terms of its value under all export credit insurance programmes in 2017.

## **INSURANCE OF PRE-EXPORT FINANCING LOANS**

In 2017, through the Pre-Export Financing Insurance Programme, coverage for loans in the amount of HRK 304.36 million was approved, thus enabling the banks to finance working capital of exporters in the phase of manufacturing of export goods.

Based on the approved insurance, HBOR supported exporters in the shipbuilding, manufacturing of motor vehicles, fisheries, textile, metal and wood industries.

## **INSURANCE OF BANK GUARANTEES**

In 2017, HBOR approved coverage for issued bank guarantees in the total amount of HRK 245.38 million, a increase of HRK 19.75 million, i.e. by 8.75 percent in comparison with 2016.

The most significant transactions in terms of value are insured guarantees for exporters in the energy sector in the markets of Norway and Ukraine and in the building sector in the markets of Algeria and Montenegro.

During 2017, terms and conditions of the Programme for Insurance of Bank Guarantees were changed with the aim to make the insurance policy an acceptable collateral instrument and to additionally encourage exporters when entering new export markets.

## **FUND RAISING: FAVOURABLE SOURCES OF FINANCE PROVIDED IN THE AMOUNT OVER EUR 500 MILLION**

In order to ensure funds for further favourable support of Croatian business entities, in 2017, HBOR continued its long-term successful co-operation with international financial institutions.

In March 2017, the Finance Contract amounting to EUR 44.00 million was signed with the EIB for the financing of projects in the tourism industry. In November 2017, the Finance Contract was signed in the amount of EUR 250.00 million for the financing of projects of small and medium-sized enterprises, and in December 2017, the Finance Contract in the amount of EUR 100.00 million for the financing of mid-caps and other priorities.

As for other activities of fund raising, in September 2017, HBOR signed the Loan Contract with Bayerische Landesbank in the amount of EUR 33.30 million for the requirements of construction of wind turbines in the Republic of Croatia.

In November 2017, The Framework Loan Contract in the amount of EUR 100.00 million was signed with the Council of Europe Development Bank (CEB) intended for the financing of small and medium-sized companies, local and regional government and/or other public sector entities.

# RISK MANAGEMENT

Pursuant to the Act on HBOR, the Bank is obliged to reduce risks in its operations to the lowest level possible by applying the principles of banking operations. In the risk management process, the Bank continuously identifies, assesses, measures, monitors, contains and controls risks it is or may be exposed to in its operations. The manner, procedures and frequency of measurements and assessments in risk management are prescribed by the Bank's general documents. In the Bank's day-to-day operations, credit risk, liquidity risk, interest rate risk in the banking book, currency risk, operational risk and outsourcing risk are managed through policies, procedures, methodologies, ordinances, limits and controls.

The Bank has a functionally and organisationally separate and independent organisational unit for controlling business risks that is directly responsible to the Management Board. This organisational unit is responsible for the identification, assessment, measurement, supervision and control of risks the Bank is or may be exposed to in its operations. The Risk Management Unit performs its function also by analysing and giving suggestions and recommendations for adequate management of exposure to credit and non-credit risks, by developing risk-related policies, ordinances, procedures and methodologies, by recommending exposure limits and monitoring the adherence to the adopted exposure limits as well as by risk-related reporting to the Management Board and the risk management committees.

When assessing and measuring risks, the Bank takes into account historical data, business plans, current and expected market conditions and specific features of the Bank as a special financial institution. The results of measurements/assessments and analyses conducted in the field of risks are reported to the risk management committees, the Management Board and the Supervisory Board. A system of limits has been established for the purpose of managing, monitoring and controlling credit risk, liquidity risk, interest rate risk in the banking book and currency risk. The Bank performs sensitivity analyses and scenario analyses by assuming changes in one or more risk factors in regular and stressful circumstances of operations and it reports on the results of such analyses to HBOR's bodies in charge. Systems of proactive risk management are continuously developed for the purpose of mitigating potential future risks.

The Management Board of HBOR is responsible for the implementation of the risk management strategy and for the establishment and implementation of an effective and reliable system for the management of all risks. For the purpose of accomplishing its function, the Management Board has delegated its powers to four risk management committees:

- Asset and Liability Management Committee – manages liquidity risk, interest rate risk in the banking book and currency risk through the prescribed policies and procedures that regulate this area

- Credit Risk Assessment and Measurement Committee – manages credit risk through the prescribed policies, procedures and other internal documents that are related to credit risk
- HBOR Information System Management Committee – manages the resources of the information system and adequately manages the risks that arise from the use of information technology
- Business Change Management Committee – manages business changes (co-ordination of the procedures for the suggestion, approval, monitoring and implementation of business changes) in order to reduce the risks associated with the implementation of business changes.

The risk management strategy aims to achieve and maintain a good and efficient system of risk management in line with the local and international banking practices and the recommendations of the Croatian National Bank (HNB), the European regulations and the Basel Committee recommendations applicable to HBOR as a special financial institution.

## Credit risk

The Bank controls credit risk through credit policies, ordinances and prescribed procedures that determine the internal control systems with an objective to act preventively.

HBOR's Management Board conducts a conservative credit risk management policy. The credit risk management system represents the most important part of HBOR's business policy and an important factor of its business strategy. Therefore, this area is regulated by a separate document called the Credit Risk Management Procedures that applies to all phases of the credit process (from the development of new banking products, to loan applications, client monitoring and final loan repayments). The Credit Risk Management Procedures represent a comprehensive document comprised of separate methodologies aiming to evaluate various client target groups.

In order to mitigate credit risk and reduce operating costs, the Bank, in accordance with the HBOR Act, on-lends part of its placements via commercial banks that assume the risk of collecting repayments from final borrowers. For the purpose of facilitating access to HBOR's funds, the Bank on-lends part of its placements through risk sharing models. Generally, all direct placements and placements through the risk sharing models are secured by mortgages on immovable property, and, if possible, the Bank requires guarantees issued by HAMAG BICRO and also other types of guarantees and warranties. The Bank has determined the required ratio between placement value and collateral value according to the type of collateral, the loan programme, the general terms and conditions of security and the decision of the body in charge.

The Bank's development loan programmes cover the entire territory of the Republic of Croatia with a focus on the areas of special state concern. Credit risk is diversified by geographical regions, activities, sectors and loan programmes. The Bank aims to

prevent the excessive concentration of credit risk and, by providing more favourable terms and conditions and creating new loan programmes (products), to promote the development of less developed regions of the Republic of Croatia in accordance with the state development strategy for individual activities.

## Liquidity risk, currency risk and interest rate risk in the banking book

The Bank ensures quality management of liquidity, currency and interest rate risks in the banking book through the Asset and Liability Management Committee. The management of these risks implies a reduction of interest rate risk, currency risk and liquidity risk to the lowest possible level. The majority of the Bank's organisational units are included, directly and indirectly, in the operations of the Asset and Liability Management Committee in order to ensure a high-quality, integrated and comprehensive system for the management of these risks.

### Liquidity risk

The basic principles for managing HBOR's liquidity risk are defined in internal documents as well as in the decisions and conclusions made by the Supervisory Board, the Management Board and the Asset and Liability Management Committee.

For the purposes of managing liquidity risk, the Bank has established a system of limits. The Bank monitors and verifies that the limits are obeyed. It maintains the necessary level of liquidity reserves, continuously monitors current and planned liquidity and provides sufficient kuna and foreign currency funds necessary for the timely settlement of obligations and disbursements under committed loans and planned commitments. The Bank monitors and strives to achieve compatibility of the existing and planned placements and the sources in terms of maturity. The Bank does not take deposits from citizens and is therefore not exposed to wide daily fluctuations in liquidity. The Bank monitors liquidity risk also through scenario analyses and sensitivity analyses both under regular business conditions and under stress. Early warning signals and procedures for liquidity crisis indication or occurrence are determined in the Liquidity Risk Management Ordinance.

### Interest rate risk in the banking book

The basic principles for managing the Bank's interest rate risk are defined in separate internal documents and in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. For the purpose of measuring and monitoring interest rate risk, the Bank analyses the interest rate gap. The interest rate gap is analysed with respect to specific periods in terms of possible changes in interest rates and it illustrates the sensitivity of the Bank to such changes in interest rates. Interest rates are elaborated in detail per currency, type and level of interest rates,

and projections of developments in average weighted interest rates on the sources and placements are prepared. In addition to adjustment of interest rates applied on sources and placements, current market conditions and development projections for basic market indicators are also monitored.

### Currency risk

The basic principles for HBOR's currency risk management are defined in internal documents as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. The methods for the measurement/assessment, monitoring and management of currency risk have been established, the limits and procedures in the case of crisis indication or occurrence have been determined, and the reports necessary for overall currency risk containment have been defined.

For the measurement of exposure to currency risk, the Bank monitors the open foreign currency position. In addition to the daily monitoring of the open foreign currency position and the preparing of its development projections, the Bank uses the VAR model as an auxiliary model for the purpose of assessing and measuring currency risk. The Bank regularly reports on the maximum possible losses under major currencies to the bodies in charge. Scenario analyses and sensitivity analyses are conducted both under regular business conditions and under stress.

### Operational risk

The basic principles for operational risk management are determined in the umbrella document, the Operational Risk Management Policies. The system structure of management and responsibility has been set up, the approach to the calculation of capital requirements for operational risk has been defined and the reporting system has been established.

Information System Management Committee has been formed with the task of monitoring and supervising IT system performance. Its purpose is to manage the IT resources and to set up the appropriate level of efficiency and security of IT in order to provide, among other things, appropriate management of risks arising from IT technology utilisation. The supervision of the IT system security is covered by the IT system security control function. Within this function, a system for the management of HBOR's business continuity has been set up.

### Outsourcing risk

The Bank manages the outsourcing risk on the basis of internal documents that are in compliance with the regulations prescribed by the Croatian National Bank applicable

to the Bank as a special financial institution. The internal documents that determine the management of this risk determine also the procedures for the outsourcing of activities, the rules for the management of relations with the service providers and the obligation to reduce the risk to the lowest level.

The central records of outsourced activities have been established. Reports on materially significant outsourced activities are submitted to the Management Board and the Supervisory Board of the Bank on an annual basis.

## Asset Quality Review of HBOR

On 28 April 2016, the Republic of Croatia adopted the 2016 National Reform Programme and the 2016 Convergence Programme for Croatia obliging the Republic of Croatia to prepare, among other things, the asset quality review of HBOR in accordance with the guidelines of the European Central Bank (ECB) (hereinafter: AQR - Asset Quality Review). Consequently, AQR was carried out by the auditing company PriceWaterhouseCoopers (hereinafter: PwC) in 2017.

The objective of the AQR was to identify the areas in which HBOR may deviate from the usual accounting principles and market standards and to determine possible adjustments to the accounting value of HBOR's assets as at 31 December 2016.

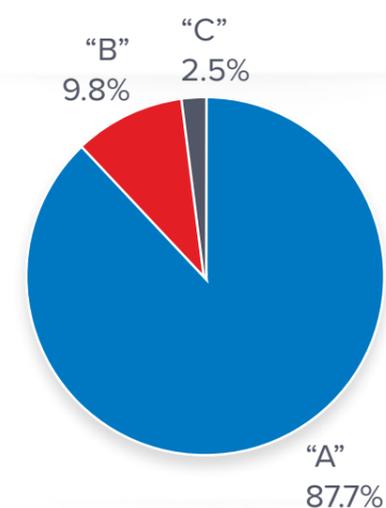
As a result of the review of the loan portfolio, processes and policies, and taking into account the existing projects of harmonising HBOR's operations with the business practice in the banking industry as well as the implementation of the International Financial Reporting Standard 9 (IFRS 9) (adoption of the new Credit Risk Management Ordinance, automated calculation of basic credit rating of companies, etc.), no materially significant deviations were identified.

As at 31 December 2017, HBOR's total portfolio amounted to approximately HRK 36,828.8 million. Of the total portfolio, 87.70 percent was classified into the risk category "A", 9.80 percent was classified into the risk category "B" and 2.50 percent into the risk category "C".

Having in mind the fact that the loans comprised 72.00 percent of the total portfolio, there was no significant difference in the quality of total portfolio and total loans. Of total loans, 83.10 percent was classified into the risk category "A", and 16.90 percent was classified into the risk categories "B" and "C".

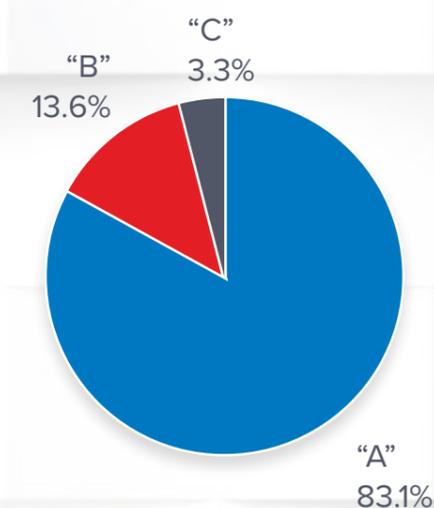
## Total portfolio by risk categories

As at 31 December 2017



## Total gross loans by risk categories

As at 31 December 2017



## INVESTMENT PLAN FOR EUROPE

Pursuant to the Decision of the Government of the Republic of Croatia, HBOR, as the national development bank, was entrusted the key activities related to the implementation of the Investment Plan for Europe.

In the implementation of the Investment Plan for Europe, HBOR co-operates with the relevant state administration bodies, agencies and other legal entities with public authority that appointed national coordinators for the support in the implementation of the Investment Plan for Europe.

In the past two years, HBOR has initiated a number of activities with the objective of familiarising private and public investors and key partners with the possibilities available under the Investment Plan for Europe. As a result, the following activities can be highlighted for 2017:

1. Activities related to the promotion of, and familiarisation of key stakeholders with, the Investment Plan for Europe
2. Activities related to the identification of existing private and public projects in the Republic of Croatia

In 2017, HBOR actively participated in the process of identifying potential projects that can be nominated for any form of funding and/or consultancy support provided by the EIB Group. The following projects can be identified as the most important projects in the Republic of Croatia approved in 2017:

- a. Project in the tourism sector – approved in January in the amount of EUR 60.00 million, of which EUR 44.00 million was approved via HBOR and EUR 16.00 million was approved by the EIB to the borrower directly as the first private project in Croatia financed under the Investment Plan for Europe. By this project, the EIB approved finance for a major individual project in the tourism industry, which is particularly important for the Republic of Croatia in terms of continued support for the development of tourism and the attraction of new investors to this sector.
- b. Project in the energy sector – approved in June with the total investment value of EUR 195.00 million, for which the financing of EUR 50.00 million was approved.

In addition to the above projects, in 2017, the structuring of another investment in the energy sector was initiated with the expected value between EUR 300.00 and 350.00 million as well as of a project in the health care sector with the expected value of EUR 130.00 million.

## Access to the European Investment Advisory Hub

For the purpose of supporting the implementation of measures aimed at increasing employment, growth and investment, HBOR signed the Memorandum of Understanding

with the EIB. The objective of the Memorandum is enabling access to a wide range of advisory services offered by the European Investment Advisory Hub (EIAH), which provides its services both at the EU level and at the local level through promotional banks. The main purpose of EIAH is to provide advice to investors – private and public project promoters with the objective of preparing and monitoring projects.

On 29 March 2017, in co-operation with the Ministry of Finance, Ministry of Regional Development and EU Funds of the Republic of Croatia and EIAH, a workshop took place in Zagreb whose objective was to present the possibilities offered by EIAH with a special focus on the preparation, development, financial structuring and monitoring of projects in the public sector. Projects in the Croatian health care and energy sectors were also presented during the workshop.

In addition, EIAH provided free technical assistance for the preparation and structuring of the hospital development project in Croatia. In the second half of 2017, selected consultants participated in the preparation of the hospital strategic document in accordance with the trends in the operations of the hospital systems and the Croatian National Health Care Strategy.

In co-operation with EIAH, other public sector projects are being prepared together with the continuation of efforts aimed at familiarising all stakeholders with the services offered by EIAH.

## CONTROL AND AUDIT

The Control and Audit unit is part of HBOR's supervision system. It is in charge of monitoring the overall operations on the basis of the principles of legality and HBOR's internal regulations by applying the internal audit standards. The organisational unit of Control and Audit carries out its tasks independently and determines the manner of operating and reporting as well as preparing its findings, opinions and recommendations on its own. It is administratively responsible to the Management Board and functionally to the Audit Committee and the Supervisory Board of HBOR, to which reports are submitted quarterly/semi-annually. Based on the audit report and according to the recommendations of the Control and Audit unit, the Management Board makes the necessary decisions to take corrective measures and activities.

## COMPLIANCE MONITORING FUNCTION

The function of monitoring compliance has been established as an independent and permanent function. Compliance monitoring activities include the identification and assessment of compliance risks to which HBOR is or might be exposed as well as the provision of advice to the Management Board and other responsible persons on the manner of applying relevant legislation, standards and rules, including the information on the latest news regarding these issues.

The compliance monitoring function evaluates the impacts that the amendments to the relevant regulations will have on the operations of HBOR, assesses the compliance of new products or new procedures with the relevant laws and regulations and with the amendments to the regulations, provides advice during the preparation of compliance-related training programmes, provides advice and training relating to ethical behaviour, participates in the management of procedures pertaining to complaints and reported irregularities and supervises the implementation and fulfilment of the provisions of the Code of Conduct. The compliance monitoring function submits periodical reports to the Management Board, the Audit Committee and the Supervisory Board of HBOR.

## HUMAN RESOURCES

In 2017, HBOR renewed the Employer Partner Certificate that is awarded by Selectio d.o.o. for excellence in human resource management. Since 2006, when HBOR joined the project, permanent growth and development have been observed in all aspects of human resource management.

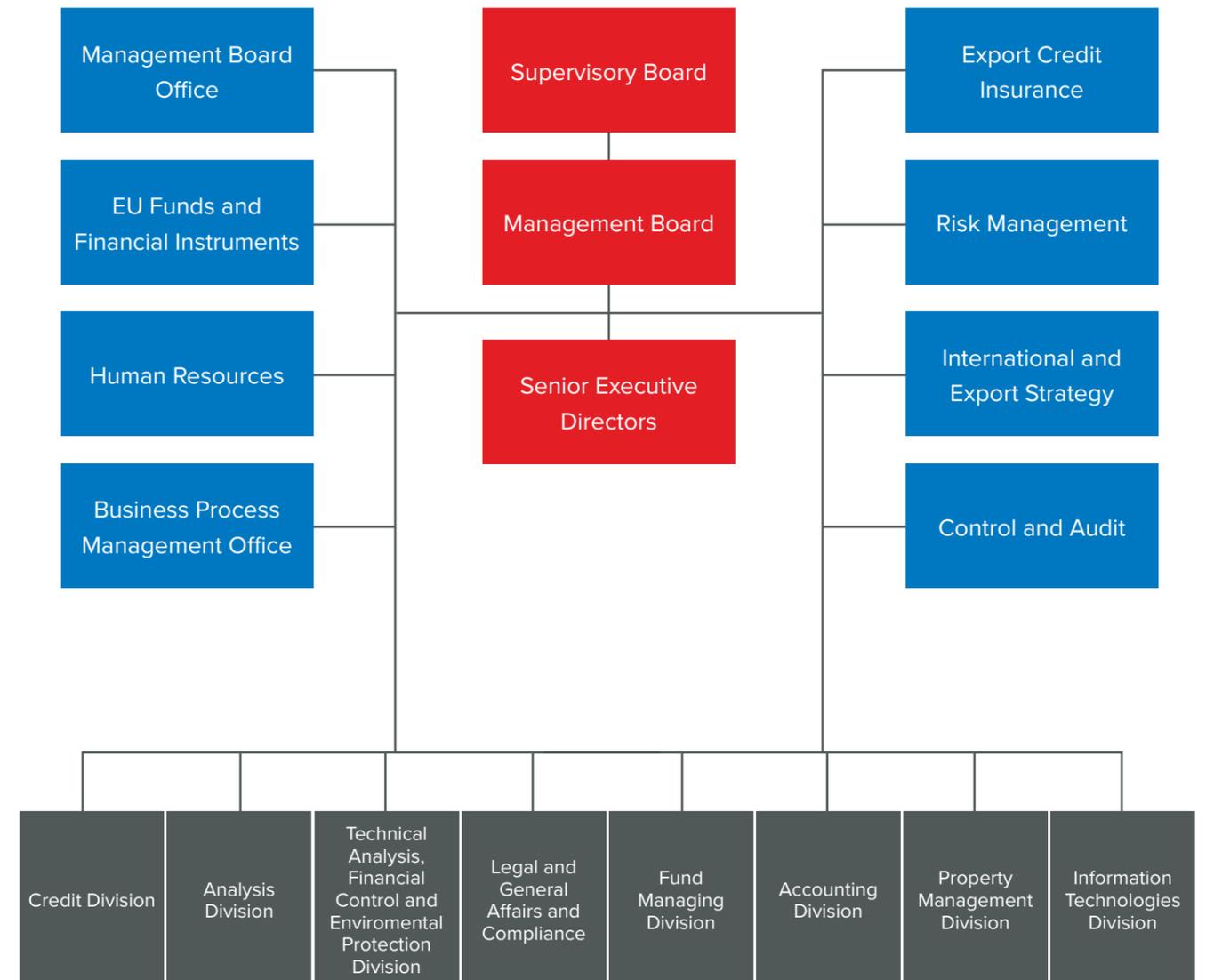
In 2017, HBOR achieved the respectable score of 86 percent and retained the same score as in the previous certification despite the tightening of standards across all 45 human resource management processes under certification.

Such a result was attained as a consequence of established processes in all five areas assessed and due to continuous efforts of the Bank in the development of employee management process aimed at meeting the needs of both the bank and the market.

The goal of the human resource management process is to select quality employees and ensure permanent development of their potential and continuous upgrading of their competences as the only way to achieve excellence in work. Regular processes and activities related to the management of human resources cover the entire career of an employee in the organisation and provide support to the management in key issues associated with human resources: selection and employment of candidates, management of employees' goals and competences, remuneration as well as development of employees' skills. After employment, that is carried out on the basis of clear selection criteria, new employees are introduced to business through in-house training programmes. Success at work of all employees is monitored and documented on a quarterly basis, whereas individual interviews take place on an annual basis. Training and development of competences considered crucial in the activities that are performed by employees are organised through in-house workshops and through participation in individual programmes and trainings organised outside of the Bank.

As at 31 December 2017, there were altogether 336 active employees, of which 292, i.e. 87.00 percent, holding a university degree. The average age of employees was 42. The share of women in the total number of employees was 63 percent and the share of men 37 percent.

## Organisational structure of HBOR as at 31 December 2017



## OTHER ACTIVITIES

In 2017, HBOR announced the public invitation called “I WOULD LIKE TO HAVE A JOB, TOO” seeking applications for the award of grants for projects increasing employment of vulnerable and marginalised groups that are difficult to employ.

The grants were awarded to 12 projects totalling slightly above HRK 580.00 thousand. Data on all grant recipients were published on HBOR’s websites.

In June 2017, HBOR published its Social Responsibility Report for 2016, i.e. HBOR’s eighth report on the manner of and progress in the implementation of the UN Global Compact principles in the areas of human rights, labour standards, environment and anti-corruption. At the end of 2016, HBOR joined the project “In Pursuit of Full Equality between Men and Women: Harmonisation of Private and Business Life”. The objective of the project is to provide support for organisations when changing attitudes, to identify stereotypes and to introduce new forms of organisation through focusing on the significance of implementing measures aimed at harmonising private and business obligations for the purpose of enabling employed mothers to develop their professional careers whilst simultaneously being responsible mothers and for the purpose of adjusting working conditions to increased family obligations of fathers. After the audit, concrete policies and measures were suggested, which HBOR was obliged to implement, and consequently HBOR was awarded, in December 2017, the basic MAMFORCE COMPANY® Standard. The project implementing entity is the Office of Ombudswoman for Gender Equality of the Republic of Croatia, and the project is for the most part financed from the Rights, Equality and Citizenship Programme (REC) of the European Commission.

## International co-operation and internationalisation

HBOR pays special attention to the establishment and maintenance of successful relations with international financial institutions, development banks, export-credit agencies, associations and clubs such as the European Association of Public Banks (EAPB), the Network of European Financial Institutions for SMEs (NEFI), the Banking Association for Central and Eastern Europe (BACEE), the Berne Union, the United Nations Environment Programme Finance Initiative (UNEP FI), the UN Global Compact, the International Development Finance Club (IDFC), numerous bilateral chambers of commerce and, as an establishing member, the European Long Term Investors association (ELTI). Memberships of the above associations are a means for developing business and upgrading knowledge as well as for effectively exchanging best practices and specific expertise among members on various business issues.

Since the beginning of 2017, HBOR has been a member of the Management Committee of the Berne Union that is the leading global association for the export credit agencies.

This is the result of HBOR’s long-lasting active participation in this association and it has enabled the representative of HBOR, in the two year term of office, to promote HBOR’s activities in the field of export credit insurance, to participate in the activities pertaining to major issues and to have an impact on the shaping of the activities of the association.

In September 2017, HBOR hosted the meetings of the International Development Finance Club (IDFC). The major topics of the meetings were: sustainable development, infrastructure finance, co-operation in the area of export finance, project preparation, climate change and other operating topics. This event proved to be an opportunity for the strengthening of co-operation with the partners coming from far-away markets.

In November, HBOR signed the Inter-Bank Association Founding Agreement between the People’s Republic of China and sixteen countries of Central and Eastern Europe aimed at establishing co-operation between these countries and strengthening their economic and financial interaction.

In 2017, in co-operation with the Ministry of Finance, HBOR continued its activities in the Exports Credits Group of the Council of the European Union. In addition, HBOR further developed its co-operation with the Ministry of Foreign and European Affairs of the Republic of Croatia targeted at exports, development co-operation and humanitarian assistance and remained an active member of the Inter-Departmental Working Group for Development Co-operation and Humanitarian Assistance.

HBOR actively co-operated with the Croatian Chamber of Economy and the Ministry of the Economy, Entrepreneurship and Crafts in internationalisation activities. For the purpose of promoting and supporting exporters, co-operation with the Croatian Exporters association was continued, and the internationalisation of the economy was promoted by HBOR’s participation in the Croatian economic delegation to the Russian Federation and in economic forums held in the Republic of Croatia.

In order to strengthen the competitiveness of the Croatian businessmen, increase exports and improve business conditions in general, HBOR focused on the co-operation with the foreign embassies in the Republic of Croatia and particularly with the foreign chambers of commerce in Croatia through the participation of HBOR’s representatives in the activities of the committees relevant for HBOR and Croatian businessmen.

In November, HBOR’s 16th International Conference on Export Promotion took place under the auspices of the Government of the Republic of Croatia. The Conference gathered almost 300 representatives of Croatian exporters, domestic and international institutions and banks that exchanged knowledge and experience and created new contacts and possibilities for co-operation. At the Conference, a panel discussion was held about the topic: “Role of Development Banks in the Internationalisation of National Economies” and two workshops were organised called: “Financial Instruments – Loans for Growth and Development” and “How to Win New Clients – Export Finance & Bond Insurance”.

## GENERAL DATA PROTECTION REGULATION

General Data Protection Regulation (GDPR) covers the protection of personal data of the citizens of the European Union. The purpose of the GDPR is to enable the citizens of the EU to control their personal data as well as to create a high and balanced level of data protection in the European Union. The Regulation shall enter into force in May 2018. Due to the fact that HBOR is obliged to implement the Regulation, HBOR started at the end of 2017, in co-operation with a consulting company, the process of preparation for the purpose of ensuring compliance with the Regulation in order to be able to implement the Regulation effectively in the given deadlines. Compliance with the Regulation implies the adoption of internal documents and the implementation of measures that meet the principles of technical data protection and integrated data protection.

## REGIONAL OFFICES

The network of regional offices is focused on the promotion of HBOR's regional presence and the increase in the visibility of the Bank. Regional offices are particularly targeted at providing consultancy and information to entrepreneurs about HBOR as the source of funding for the start-up, growth and development of their businesses.

The regional offices cover the territory of 14 counties and, therefore, more than 112.00 thousand active companies and crafts businesses (i.e. 55% of the total number of business entities in the country) are oriented towards them.

In 2017, the regional offices organised altogether 306 workshops and education events, 27 of which were workshops called "In 7 Steps to a Loan". This workshop is intended to strengthen the financial literacy of potential entrepreneurs. Start-up entrepreneurs, young entrepreneurs and female entrepreneurs are the most usual participants in these workshops.

Individual consultancy services to entrepreneurs, both start-up and experienced ones, are provided through info-days that are organised in co-operation with offices for the economy, chambers of commerce, entrepreneurial centres or development agencies. In 2017, altogether 76 info-days were held.

## PUBLIC DISCLOSURE OF ACTIVITIES

HBOR puts special focus on providing information to the public about its goals and about the measures for their attainment as well as about the results of its activities by simultaneously following the principle of bank secrecy and its function. Therefore, through various forms of providing information, HBOR regularly informed the public about all its important activities in 2017.

In the reporting year, HBOR published 18 press releases informing the public about the operations, attained results, new loan programmes and amendments to the existing ones. All business information can be accessed on HBOR's websites, except for the information subject to the bank secrecy provisions of the Credit Institutions Act.

During the reporting period, 21 public procurement procedures were published in the Electronic Public Procurement Classifieds. Since 1 July 2017, simple procurements procedures have also been published on HBOR's websites.

In 2017, altogether 29 requests for access to information pursuant to the Act on the Right of Access to Information were received.

## OPERATIONS OF HRVATSKO KREDITNO OSIGURANJE GROUP

### HRVATSKO KREDITNO OSIGURANJE D.D. and POSLOVNI INFO SERVIS D.O.O.

Hrvatsko kreditno osiguranje d.d. (HKO) is a joint-stock insurance company specialised in the insurance of short-term receivables (payment terms of up to 2 years) arisen from the sale of goods or services among business entities. The insurance covers political and commercial risk.

In 2017, HKO offered the following insurance products: insurance of domestic and export receivables, insurance of domestic and export factoring.

In October 2010, HKO established the company called Poslovni info servis and started to operate as the Hrvatsko kreditno osiguranje Group (HKO Group) and to prepare consolidated financials. Within the HKO Group, Poslovni info servis d.o.o. (PIS) is in charge of analysing and assessing credit risks relating to insurance transactions.

As at 31 December 2017, the HKO Group employed 17 active employees, of which 14 were employed with Hrvatsko kreditno osiguranje d.d. and 3 with PIS. Fifteen employees have university degrees and two have secondary school education.

### Ownership structure

HKO is 100% owned by the Croatian Bank for Reconstruction and Development.

## Management

Legal status, organisation and management of the Company, all other issues important for the operations of the Company as well as all harmonisation issues provided for in the Companies Act and the Insurance Act are determined by the Statutes of the Company. Company management bodies are: Management Board, Supervisory Board and Shareholders' Meeting.

## People authorised to represent

### Management Board

- Zvonimir Samodol, Chairman of the Management Board since 1. April 2017
- Ružica Adamović, Member of the Management Board since 11 October 2017

## Changes in the membership of the Management Board in 2017

- Marija Jerkić, Deputy Member of the Management Board in accordance with the decision made by the Supervisory Board on 1 April 2016, whereas her term of office as the Member of the Supervisory Board is suspended. The term of office of the Member of the Management Board lasted until 31 March 2017
- Ksenija Sanjković, Member of the Management Board until 5 June 2017
- Ante Artuković, Deputy Member of the Management Board in accordance with the decision of the Supervisory Board from 6 June 2017 until 11 October 2017

## Authorised Representative

Ružica Adamović, until 11 October 2017

## Supervisory Board of HKO

In 2017, the membership of the Supervisory Board of HKO was as follows:

- Goran Filipić, Chairman of the Supervisory Board until 1 March 2017
- Tamara Perko, Chairman of the Supervisory Board since 15 March 2017
- Marko Topić, Deputy Chairman of the Supervisory Board
- Ante Artuković, Deputy Chairman of the Supervisory Board, his term of office was suspended from 6 June 2017 to 11 October 2017
- Marija Jerkić, Member of the Supervisory Board, her term of office was suspended from 1 April 2016 to 31 March 2017
- Andreja Mergeduš, Member of the Supervisory Board since 2 January 2017

## Poslovni info servis d.o.o.

Ružica Adamović performed the function of the Manager of PIS until 11 October 2017. Jelena Boromisa has performed the function of the Manager of PIS since 11 October 2017.

Ivana Paic has been the authorised representative.

## HKO Audit Committee

RIn 2017, the membership of the Audit Committee of HKO was as follows:

- Ante Artuković, Chairman of the Audit Committee
- Goran Filipić, Deputy Chairman of the Audit Committee until 1 March 2017
- Andreja Sekušak, Member of the Audit Committee,
- Marija Jerkić, Deputy Chairman of the Audit Committee since 29 May 2017

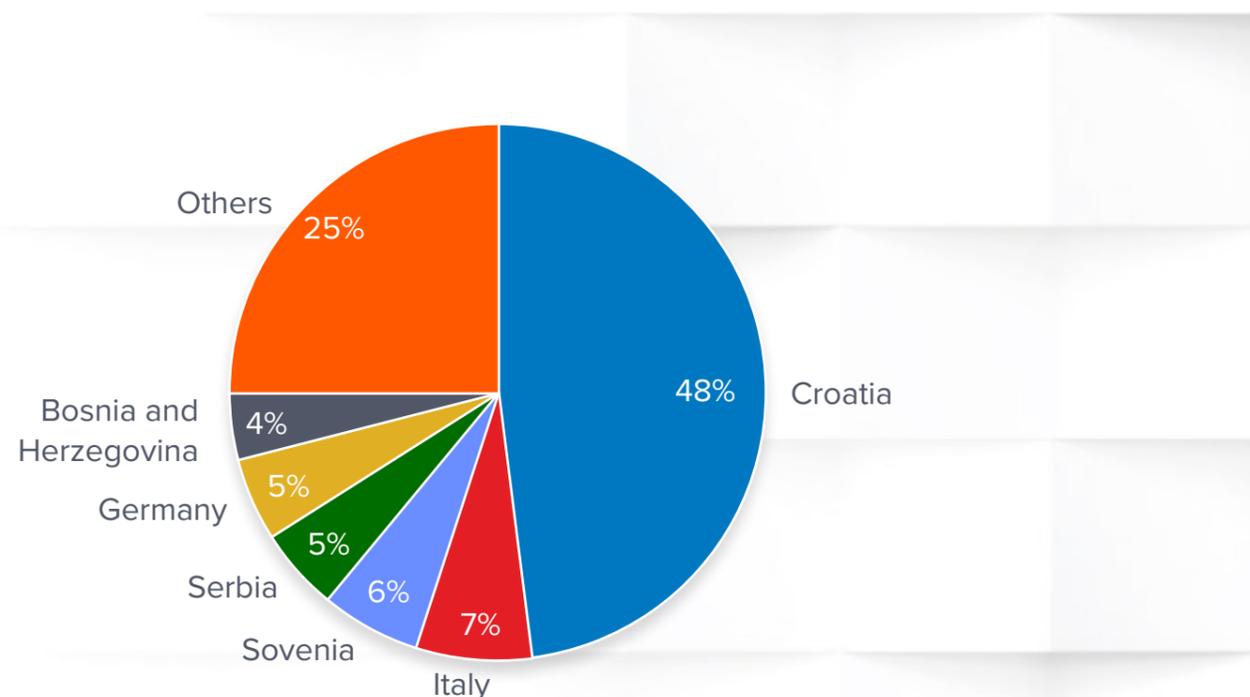
## Reporting to the supervisory bodies

In 2017, the Company provided regular reports to the supervisory bodies on all relevant facts and changes in the Company pursuant to the Insurance Act, the ordinances of the Croatian Financial Services Supervisory Agency and other regulations in force. The Company regularly met all requirements of the supervisory bodies in terms of control of operations and submission of the Company's data.

## OPERATIONS IN 2017

In 2017, Hrvatsko kreditno osiguranje d.d. concluded 131 insurance contracts. A total of 4,203 credit limits were covered by the insurance, i.e. an increase of 38.90 percent on the previous year. Within the total structure of limits, 2,781 credit limits were related to domestic receivables, and 1,422 credit limits were related to export receivables towards 68 countries of the world.

### Exposure by countries according to limit amounts as at 31 December 2017



The total volume of insured transactions in 2017 amounted to HRK 3.90 billion, whereas in 2016 it amounted to HRK 3.80 billion, an increase of 2.63 percent.

In 2017, the total charged premium amounted to HRK 10.59 million, a decrease of 10.33 percent on 2016 when it stood at HRK 11.81 million.

In the reporting period, the Company paid 12 indemnities. In 2017, the total amount of paid indemnities amounted to HRK 6.21 million, whereas the amount of paid indemnities in the previous year equalled HRK 1.72 million. The paid indemnities were related to buyers in Montenegro, Italy, Hungary, Slovenia, Serbia and Croatia.

### Insurance business indicators

HRK thousand

	2015	2016	2017
Volume of insured receivables	3,684,431.54	3,798,540.23	3,904,430.83
Exposure as at 31 December	1,579,198.16	1,709,409.46	1,886,028.64
Gross premium charged	12,167.19	11,814.18	10,594.00
Amount of paid indemnities	2,207.67	1,717.33	6,212.88
Number of active limits as at 31 December	2,428	3,026	4,203

Acquisition costs, marketing costs, administration costs and other operating expenses of the HKO Group in 2017 amounted to HRK 6.95 million, whereas, at the Company level, they amounted to HRK 6.12 million.

The business year 2017 is the seventh full year of operations. Prior to consolidation with the parent's financial statements, the HKO Group recorded profit before taxes for the year in the amount of HRK 660.00 thousand, whereas 2016 ended with a profit of HRK 1.12 million.

As at 31 December 2017, the total assets of the HKO Group amounted to HRK 55.88 million, an increase of 7.40 percent on the previous year. As at 31 December 2017, the total capital amounted to HRK 40.43 million and technical reserves to HRK 11.51 million net.

# PRINCIPLES OF FINANCIAL REPORTING

The HBOR Group prepares:

1. Separate financial statements of the parent company – HBOR, and
2. Consolidated financial statements that include HBOR and the companies under its control – subsidiary companies.

When preparing and presenting its annual financial statements, the HBOR Group applies the International Financial Reporting Standards (IFRS). Consequently, all data and financial statements for consolidation are prepared by the members of the HBOR Group in accordance with the IFRSs.

Financial statements are prepared and presented in order to provide information on the financial position, success in operations and changes in the financial position of HBOR and the HBOR Group in order to enable their users to make appropriate economic decisions.

Financial statements are prepared and presented for the purpose of making information available to their users on a regular basis regarding the financial position, success in operations and changes in the financial position of HBOR and the HBOR Group as well as for giving financial information about how the strategy of HBOR's Group is carried out.

For the purpose of financial reporting and disclosures, the HBOR Group applies the following principles:

- **Transparency in disclosure** in order to enhance its users' understanding of the presented information,
- **Consistency in presentation** within each reporting period and between reporting periods,
- **Simplicity in disclosure** in order to allow the users to gain an easier understanding of the financial position, business performance and changes in financial position, as well as to ease decision-making,
- **Focusing on legal requirement** in order to ensure compliance,
- **Application of the best presentation practices** appropriate to the HBOR Group's activities with respect to up-to-date international trends in financial reporting as well as market requirements.

## OVERVIEW OF FINANCIAL PERFORMANCE IN 2017

The financial statements include both HBOR and the HBOR Group. The financial statements of the HBOR Group consist of the consolidated financial statements of HBOR and its subsidiaries. However, the separate, non-consolidated, financial statements of the parent company are also presented.

In the text to follow, an overview of the financial performance and operations is given separately for the HBOR Group and for HBOR as the parent company and the entity subject to this report.

The separate and consolidated Annual Financial Statements of HBOR for 2017, which can be found enclosed, have been audited by the audit company Ernst & Young d.o.o. that expressed an unqualified opinion in the Independent Auditor's Report.

## OVERVIEW OF FINANCIAL OPERATIONS OF HBOR GROUP

Having in mind the size of the subsidiary companies and the volume of their operations compared with the operations of the parent company, their financial data in the first years of the HBOR Group are not significant so as to be particularly highlighted within the framework of the consolidated financial statements. Consequently, they do not have a material effect on the consolidated financial statements in comparison with the separate statements of HBOR as the parent company. The HKO Group represent 0.20 percent of the parent company's assets.

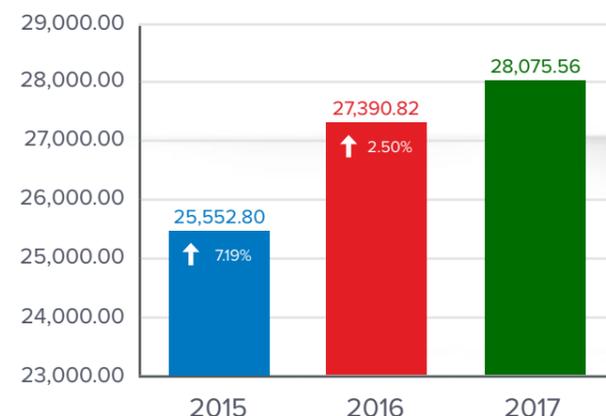
## BREAKDOWN OF THE MOST SIGNIFICANT FINANCIAL INFORMATION OF HBOR GROUP

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	2015	2016	2017
Total assets	25,552.80	27,390.82	28,075.56
Gross loans	24,722.82	26,343.12	26,332.99
Total equity	9,664.54	10,042.70	10,275.78
Total income	927.29	933.67	930.81
Total expense	(721.02)	(618.83)	(768.61)
Profit	206.27	314.84	162.20
Interest income	874.00	871.98	867.83
Interest expense	(474.53)	(452.67)	(390.46)
Net interest income	399.47	419.31	477.37

## TOTAL ASSETS

HRK million



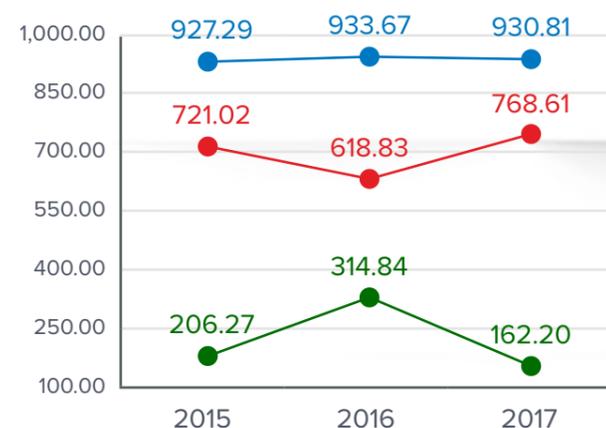
## GROSS LOANS

HRK million



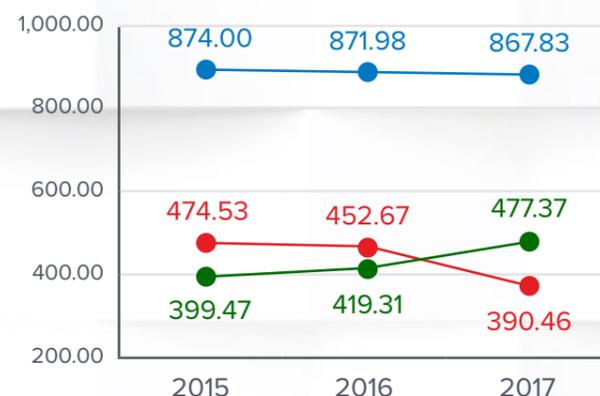
## TOTAL INCOME, TOTAL EXPENSE AND PROFIT

HRK million



## INTEREST INCOME, INTEREST EXPENSE AND NET INTEREST INCOME

HRK million



● Total income  
● Total expense  
● Profit

● Interest income  
● Interest expense  
● Net interest income

## Results of the HBOR Group

In 2017, the HBOR Group generated profit after tax in the amount of HRK 162.20 million. The recorded profit is by 48.48 percent lower as compared to the previous year, and the reasons are stated in the description of HBOR's financial performance.

Pursuant to the provisions of the Act on HBOR, the parent company is exempt from income tax and income tax liabilities arise exclusively from the activities of the other members of the HBOR Group.

In 2017, total income on consolidated basis amounted to HRK 930.81 million, whereas total expenses amounted to HRK 768.61 million.

In the structure of income of the HBOR Group, the largest portion, i.e. 93.23 percent, relates to interest income as a result of operation of the parent company.

The major part of total expenses, i.e. 50.80 percent, relates to interest income as a result of operation of the parent company.

The consolidated operating expenses in 2017 amounted to HRK 159.00 million and consisted of general and administrative expenses and other operating expenses.

There were 353 active employees in the HBOR Group on 31 December 2017, whereas there had been 346 active employees in the HBOR Group at the end of 2016.

## Assets and liabilities of the HBOR Group

Total assets of the HBOR Group on consolidated basis amount to HRK 28,075.56 million, an increase of 2.50 percent compared with the beginning of the year.

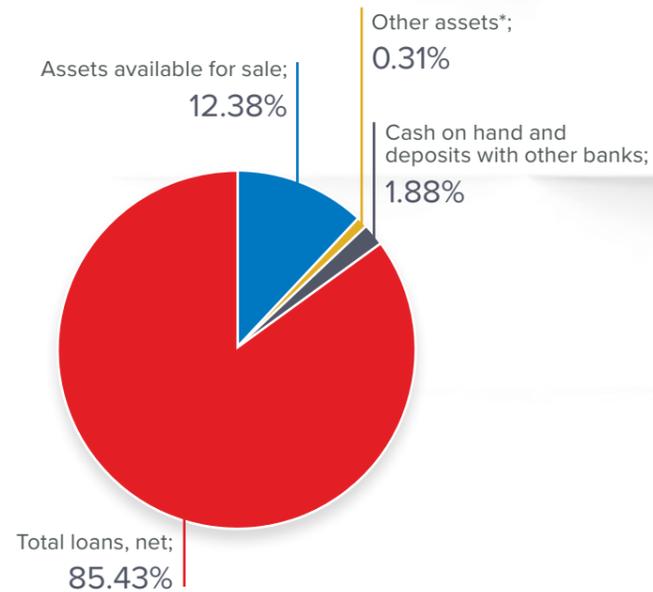
In the structure of assets, the major portion relates to the lending activities of the parent company, i.e. net loans account for 82.70 percent of total assets.

Total liabilities and total equity as at 31 December 2017 amount to HRK 28,075.56 million and, out of this amount, total liabilities amount to HRK 17,799.78 million, i.e. 63.40 percent.

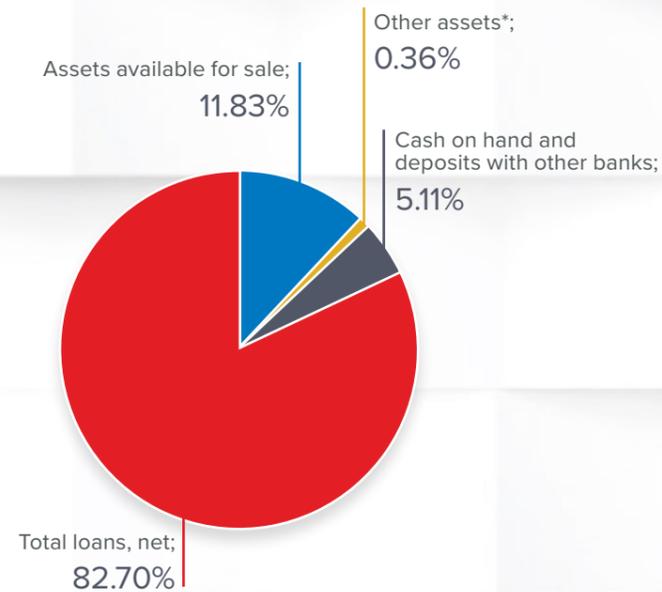
In total liabilities and total equity of the HBOR Group, the major portion, i.e. 58.95 percent, consists of borrowings and bonds payable of the parent company.

At the end of the reporting period, total equity on consolidated basis amounted to HRK 10,275.78 million and accounted for 36.60 percent of total liabilities and total equity of the HBOR Group.

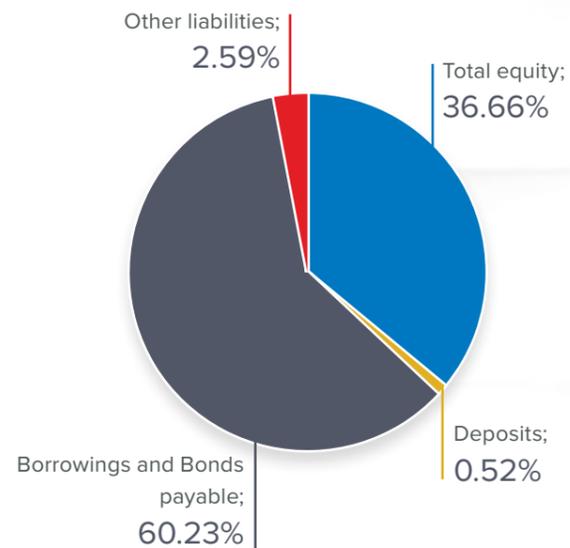
## TOTAL ASSETS Dec 31, 2016



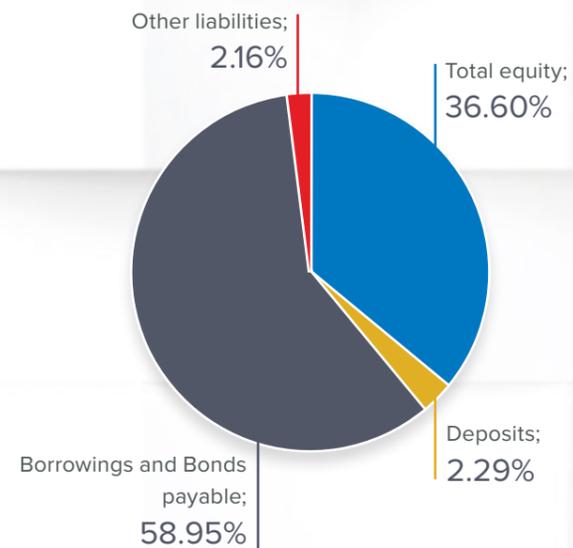
## TOTAL ASSETS Dec 31, 2017



## TOTAL LIABILITIES AND TOTAL EQUITY Dec 31, 2016



## TOTAL LIABILITIES AND TOTAL EQUITY Dec 31, 2017



\*Financial assets at fair value through profit or loss, Assets held to maturity, Property, plant and equipment and intangible assets, Non-current assets held for sale and Other assets

## OVERVIEW OF FINANCIAL OPERATIONS OF HBOR

The following text gives an overview and explanation of the significant changes in financial position and operating performance in the reporting year.

### Financial performance

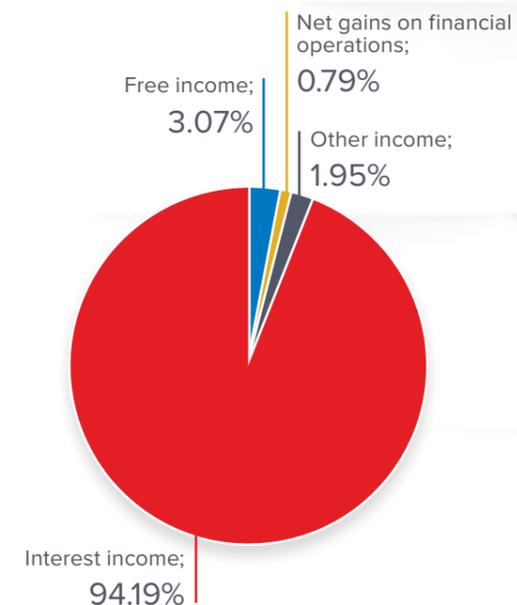
In 2017, HBOR generated total income of HRK 919.36 million, expenses of HRK 758.58 million and profit in the amount of HRK 160.78 million. HBOR's profit generated in 2017 decreased by HRK 152.75 million compared with the profit generated in 2016, i.e. 48.72 percent.

Lower profit in 2017 was mostly a result of an increase in total expenses of HRK 148.11 million. The circumstances that affected the financial result achieved in 2017 compared to the results generated in 2016 are:

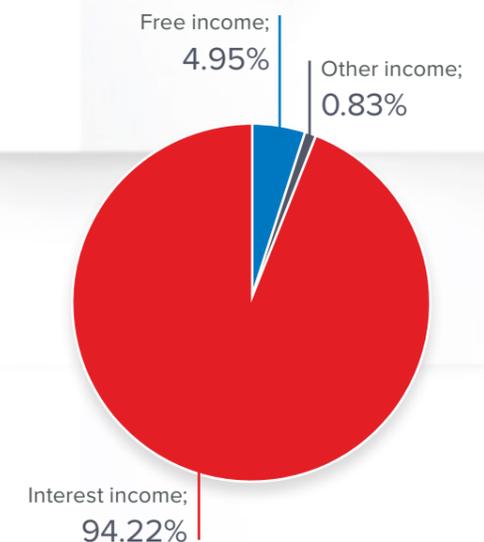
- decrease in interest expenses of HRK 62.21 million,
- decrease in operating expenses of HRK 2.80 million,
- net losses from financial activities of HRK 20.63 million, whereas net gains from financial activities in the previous year amounted to HRK 7.31 million, and
- increase in impairment loss and provisions of HRK 192.61 million compared with 2016.

A detailed description of trends is given for each category separately in the following text.

## TOTAL INCOME 1 January - 31 December 2016

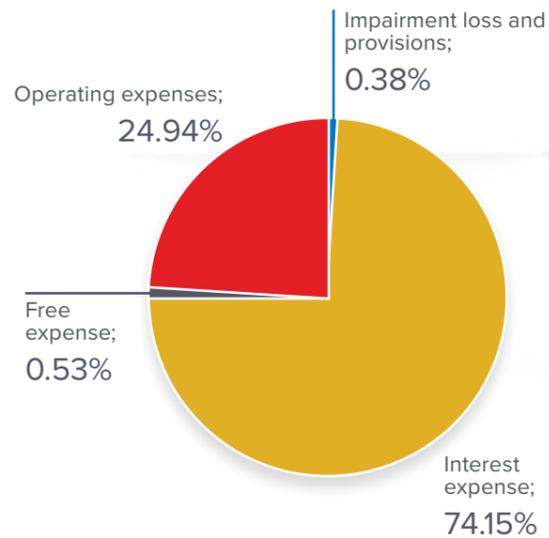


## TOTAL INCOME 1 January - 31 December 2017



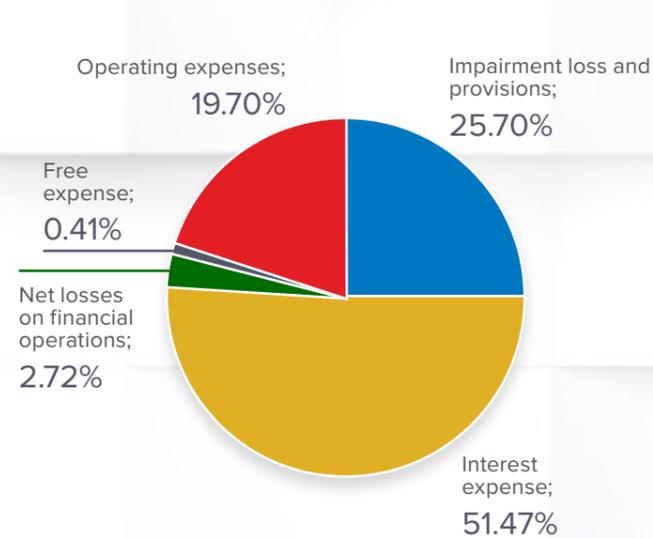
## TOTAL EXPENSE

1 January - 31 December 2016



## TOTAL EXPENSE

1 January - 31 December 2017



## Net interest income

Net interest income amounted to HRK 475.74 million, an increase of 13.90 percent on the previous reporting year.

Interest income amounted to HRK 866.20 million and remained at the level of interest income generated in 2016. This trend is in line with the projections and is mostly a result of the following circumstances:

- interest rate reduction measure implemented by HBOR in the last six business years,
- recalculation of interest due to the restructuring of loans,
- early repayments of loans in 2016 and during the reporting 2017,
- low interest rates on liquidity reserve funds.

Through the measure of reducing interest rates for certain categories of final borrowers and investments in the last six years, HBOR gave up a portion of its profits in order to provide support to Croatian business entities in crisis conditions.

Interest expenses amounted to HRK 390.46 million, a decrease of 13.74 percent compared with the previous reporting year mostly as a result of the redemption of bonds that had been issued at a higher interest rate as well as of the utilisation of credit lines from special financial institutions at more favourable interest rates.

Having in mind the described trends in interest income and interest expenses, net interest margin rose by 0.14 percentage points compared to the previous year and stood at 1.72 percent.

## Net fee income

Net fee income amounted to HRK 42.40 million, an increase of 69.13 percent compared to the previous year as a result of increased volume of guarantees issued and higher fee income from new mandate transactions performed.

## Net gains/(losses) from financial activities

Net gains/(losses) from financial activities are comprised of net foreign exchange gains/(losses) on the principal amount of receivables and liabilities, net revenues or expenditures arising out of the loan contracts with embedded „call option”, gains/(losses) arising out of value adjustment of assets stated at fair value through profit or loss and realised gains/(losses) arising out of assets available for sale.

In the reporting period, net losses from financial activities amounted to HRK 20.63 million, whereas, in the previous year, net gains amounted to HRK 7.31 million.

A breakdown of changes in the exchange rate of HRK against the EUR and the USD:



Note:

A = HRK appreciation 2017/2016

A = HRK appreciation 2017/2016

Foreign currency and foreign currency indexed assets and sources of funds are converted by HBOR into HRK equivalent value by applying the exchange rate of the Croatian National Bank valid at the reporting date.

Foreign currency revenues and expenditures are converted in accordance with the exchange rate at the transaction date. The resulting foreign exchange gains or losses are recorded in the Statement of Profit or Loss and Other Comprehensive Income in net figures.

## Other income

Other income amounted to HRK 7.62 million, a considerable decrease compared with the previous year. This trend is a result of a one-off effect of income in 2016 recorded as a consequence of the taking of a loan in the amount of HRK 10.35 million into direct relationship from Jadranska banka d.d., Šibenik that is undergoing the process of rehabilitation.

## Operating expenses

Operating expenses that include general and administrative expenses and other operating expenses stood at HRK 149.43 million, a decrease of 1.84 percent compared with the previous year due to a decrease in other expenses of 53.71 percent as a result of an absence of a one-off effect of recalculation that was material in 2016.

The total number of active employees at the end of 2017 stood at 336, whereas at the end of the previous year the number of HBOR's active employees stood at 332.

## Impairment loss and provisions

In accordance with the regulations and internal acts, HBOR determines the amount of impairment loss and provisions and maintains it at the level it considers adequate for the coverage of possible future risks.

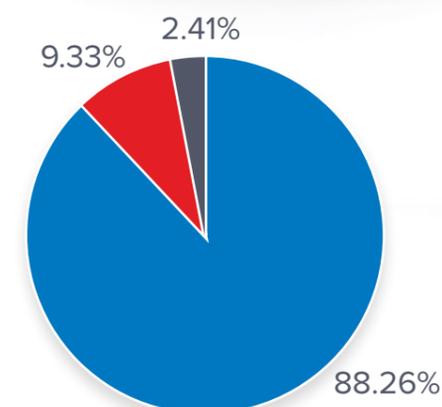
In the reporting period, net impairment loss stood at HRK 194.92 million.

The impairment losses resulted from the assessment of risk inherent to the placements, mostly placements to clients undergoing bankruptcy or pre-bankruptcy settlement proceedings, placements with recorded delays in the settlement of obligations and restructured placements.

The following text contains a breakdown of the quality of portfolio:

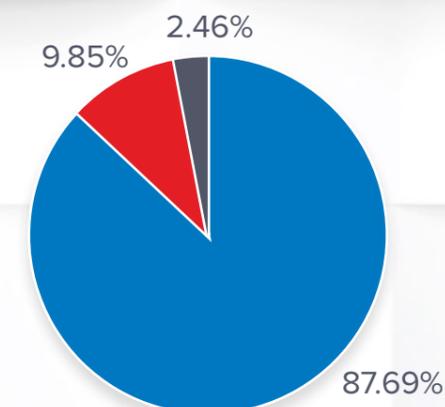
### TOTAL GROSS PORTFOLIO

Dec 31, 2016



### TOTAL GROSS PORTFOLIO

Dec 31, 2017



■ A ■ B ■ C

	2016		2017	
	HRK million	Structure (%)	HRK million	Structure (%)
<b>Total gross portfolio</b>	<b>36,481.66</b>	<b>100.00</b>	<b>36,828.81</b>	<b>100.00</b>
Out of which:				
- financial institutions	15,888.50	43.55	15,163.51	41.17
- direct	20,593.16	56.45	21,665.30	58.83
<b>Total provisions</b>	<b>3,042.51</b>	<b>100.00</b>	<b>3,201.97</b>	<b>100.00</b>
Out of which:				
- financial institutions	395.46	13.00	259.82	8.11
- direct	2,647.05	87.00	2,942.15	91.89
<b>Provisions/gross portfolio</b>	<b>8.34 percent</b>	-	<b>8.69 percent</b>	-

## Significant changes in the financial position

Total assets of HBOR as at 31 December 2017 amounted to HRK 28,055.80 million, an increase of 2.49 percent compared with the beginning of the year.

### Cash on hand and deposits with other banks

At the end of 2017, cash on hand and deposits with other banks amounted to HRK 1,430.29 million representing 5.10 percent of total assets. This item increased by 177.96 percent compared with the previous year as a result of reallocation of liquidity reserve funds and borrowings.

### Loans to financial institutions and other customers

Total net loans decreased by 0.77 percent compared with the previous year and stood at HRK 23,219.76 million at the end of 2017 representing 82.76 percent of total assets.

Total gross loans amounted to HRK 26,332.99 million and remained at the level recorded in the previous year. Gross loans to other customers increased by 8.29 percent compared with the beginning of the year, which is mostly due to disbursements under the loan programmes for the promotion of exports and the reconstruction and development of the economy and infrastructure. Gross loans to financial institutions decreased by 9.62 percent compared with the previous year as a result of reallocation of liquid funds into other financial instruments and premature repayment of loans.

At the end of 2017, the ratio between gross loans approved through financial institutions and direct placements was 42.05 percent : 57.95 percent.

### Assets available for sale

Assets available for sale were comprised primarily of liquidity reserve funds, further to which assets available for sale were comprised primarily of debt instruments and, to a minor extent, of investments into investment funds and equity instruments.

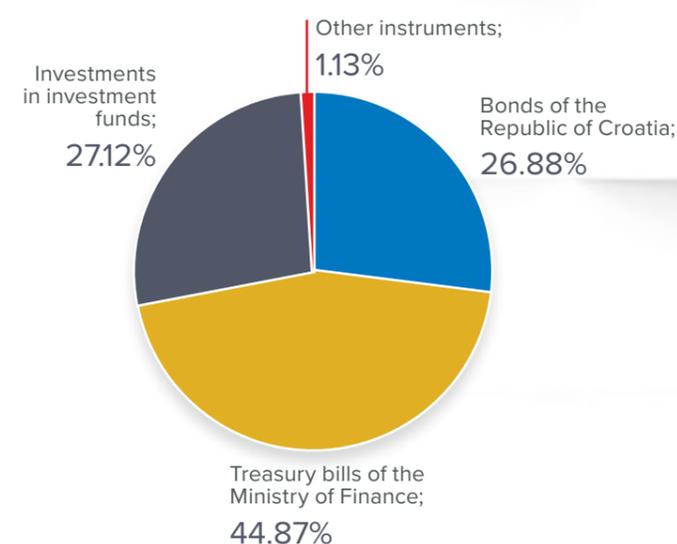
This item amounted to HRK 3,277.19 million, a decrease of 1.99 percent compared with the beginning of the year due to the higher maturity of these assets (HRK 2,217.16 million) compared with investments during 2017 (HRK 2,134.99 million).

In 2017, investment in the following instruments of assets available for sale was made:

	HRK million
Treasury bills of the Ministry of Finance	1,895.68
Bonds of the Republic of Croatia	221.36
Investment in investment funds in the Republic of Croatia	17.95
<b>Total</b>	<b>2,134.99</b>

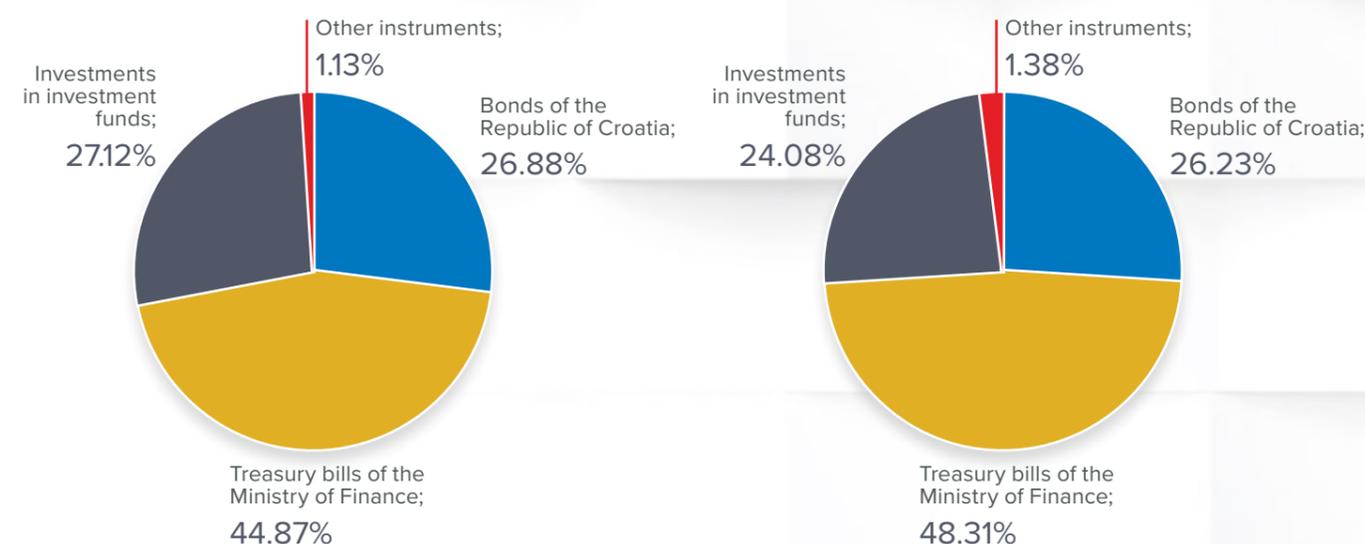
### ASSETS AVAILABLE FOR SALE

Dec 31, 2016



### ASSETS AVAILABLE FOR SALE

Dec 31, 2017



## Total liabilities

At the end of 2017, total liabilities amounted to HRK 17,786.97 million, representing 63.40 percent of total liabilities and total equity. The major part of total liabilities consists of HBOR's foreign borrowings and bonds payable in the total amount of HRK 16,549.58 million.

Borrowings in the amount of HRK 15,387.88 million rose by 14.91 percent due to the drawdown of borrowed funds.

Long-term bonds in the amount of HRK 1,161.70 million decreased by 62.59 percent due to a one-off payment under the long-term bonds in the amount of HRK 1,852.05 million, with the interest of HRK 92.60 million (bonds issued in the amount of EUR 250.00 million with maturity period of 10 years at fixed interest rate of 5.00 percent).

## Total equity

Total equity amounted to HRK 10,268.83 million, representing 36.60 percent of total liabilities and total equity.

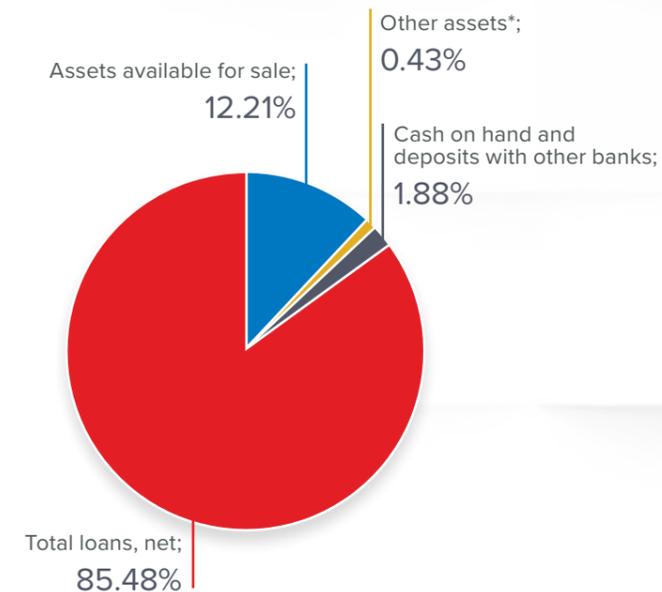
Total equity of HBOR is comprised of the capital and the guarantee fund. HBOR's capital is comprised of founder's capital contributed from the budget of the Republic of Croatia, retained earnings from the profits generated in the previous years, other reserves and profits for the current year.

In the reporting period, the amount of HRK 50.00 million was contributed from the budget of the Republic of Croatia into the founder's capital, and the total amount of capital contributed from the budget of the Republic of Croatia amounted to HRK 6,583.00 million at the end of 2017. The remaining amount to be contributed to the founder's capital up to the total amount of HRK 7,000.00 million set by the HBOR Act is HRK 417.00 million.

Pursuant to the provisions of the Act on HBOR, the entire profit of the reporting period of the Bank is allocated to reserves.

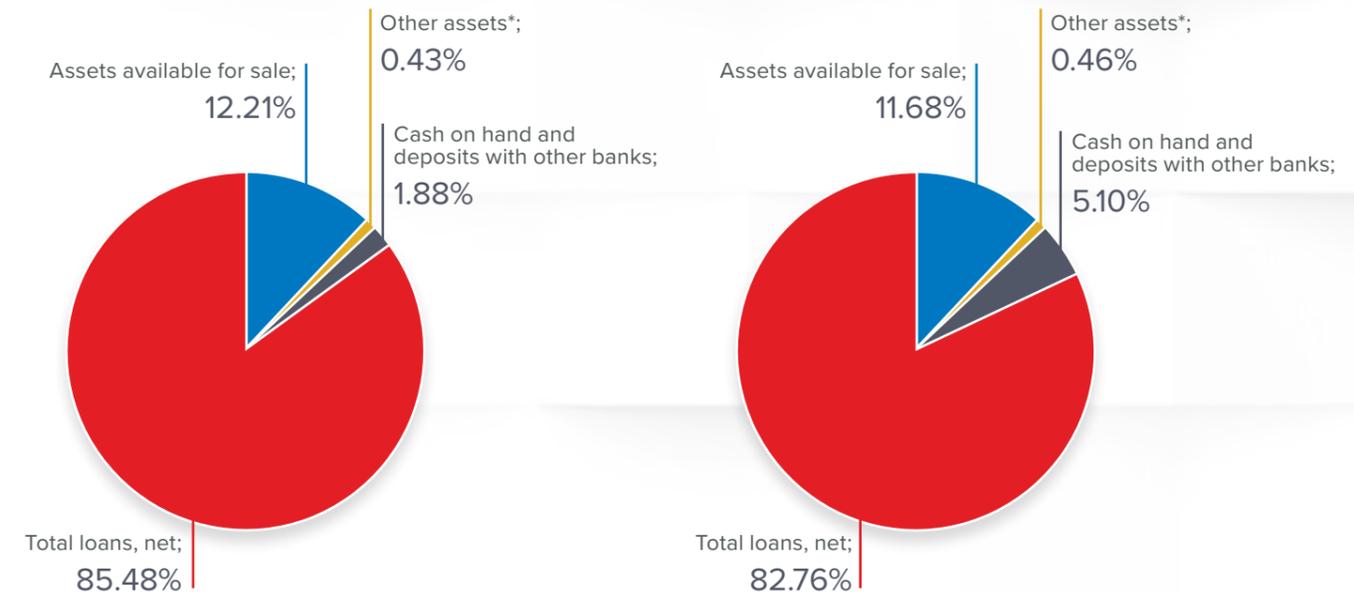
## TOTAL ASSETS

Dec 31, 2016



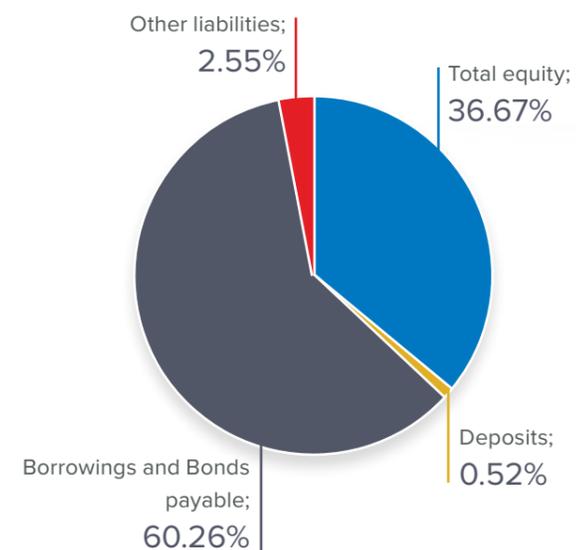
## TOTAL ASSETS

Dec 31, 2017



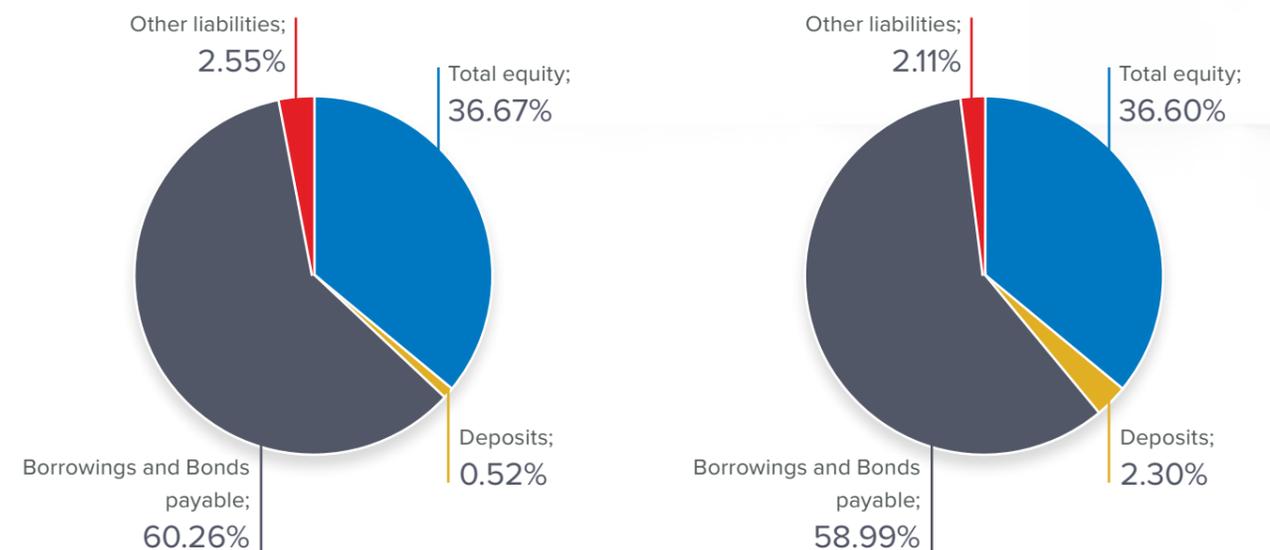
## TOTAL LIABILITIES AND TOTAL EQUITY

Dec 31, 2016



## TOTAL LIABILITIES AND TOTAL EQUITY

Dec 31, 2017



\*Investments in subsidiaries, Property, plant and equipment and intangible assets, Non-current assets held for sale and Other assets

## 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 International Financial Reporting Standards (IFRS) as adopted by the European Union, which give a true and fair view of the state of affairs and results of Croatian Bank for Reconstruction and Development, Zagreb ("the Bank") and the Group for that period.

After making enquiries, the Management Board has a reasonable expectation that the Bank and the Group have 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 and the Group will continue in business.

In the financial statements, materially significant items and information are stated. The estimation of materiality is applied to the entire financial statements, including notes.

When making a decision what data will be published in the financial statements and accompanying notes, professional judgements are applied.

Certain stated items can be analysed in more details, but are stated consistently from period to period on an aggregated basis. Notes that include significant accounting policies and other explanations are presented by order of items stated in the Statement of Profit and Loss and the Statement of Financial Position by structure for financial institutions.

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 the Group and must also ensure that the financial statements comply with the Croatian Accounting Law. The Management Board is also responsible for safeguarding the assets of the Bank and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

For the Croatian Bank for Reconstruction and Development:

  
Vedran Jakšić, MSc  
Senior Executive Director

Tamara Perko, MSc  
President of the Management Board

  
Marin Pranjić  
Accounting Division Executive Director

  
Hrvoje Čuvalo, MSc  
Member of the Management Board

Zagreb, 19 March 2018



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Croatia  
IBAN: HR3324020061100280716  
SWIFT: ESBCHR22

## INDEPENDENT AUDITOR'S REPORT

To the Owner of Hrvatska banka za obnovu i razvitak

### Opinion

We have audited the separate and consolidated financial statements of Hrvatska banka za obnovu i razvitak ("the Bank") and its subsidiaries ("the Group"), which comprise the separate and consolidated statement of financial position as at 31 December 2017, separate and consolidated statement of profit or loss and the separate and consolidated statement of other comprehensive income, separate and consolidated statement of changes in equity and separate and consolidated statement of cash flows for the year then ended, and notes to the separate and consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying separate and consolidated financial statements give a true and fair view of the financial position of the Bank and the Group as at 31 December 2017 and of their separate and consolidated financial performance and their separate and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by EU ("IFRS as adopted by EU").

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the separate and consolidated financial statements* section of our report.

We are independent of the Bank and the Group in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements and 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 separate and consolidated financial statements of the current period. These matters were addressed in the context of our audit of the separate and consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's responsibilities for the audit of the separate and consolidated financial statements section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the separate and consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying separate and consolidated financial statements.

A member firm of Ernst & Young Global Limited  
Miroslavov sud: Trgovački sud u Zagrebu: Trgovački Kapital: 20.000.000 kuna, uplaćen u cijelosti;  
Članovi Uprave: Berislav Horvat, Slavko Đuraković, Zvonimir Madunić  
Applicable comm: Commercial court in Zagreb; Registered share capital is 20,000,000 HRK, fully paid.  
Members of the Board: Berislav Horvat, Slavko Đuraković, Zvonimir Madunić

#### Impairment loss and provisions

Credit impairment is a highly subjective area due to the level of judgement applied by management in determining loan loss provisions.

The identification of impairment and the determination of the recoverable amount are an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, and expected net selling prices of collaterals. The use of different modelling techniques and assumptions could produce significantly different estimates of loan loss provisions.

The portfolios which give rise to the greatest uncertainty are typically those where impairments are derived from estimates of future cash flows and realizable value of collateral, which are unsecured or are subject to potential collateral shortfalls. These are usually part of the Bank's and Group's loan placements to corporate debtors. Judgement is applied to determine appropriate parameters and assumptions used to calculate impairment.

High level of uncertainty is also related to models used for impairment calculation for exposures toward financial institutions. Judgement is required to determine whether a loss has been incurred and a slight change in parameters used in the calculation could significantly affect the level of impairment recognized.

Due to the significance of loans and advances (representing 83% of Total assets of the Bank and 83% of Total assets at the Group level) and the related estimation uncertainty, this is considered a key audit matter.

Our work covered impairment of both Bank's and Group's Loans to other customers ("Corporate portfolio") and Loans to financial institutions (other banks and leasing companies) ("Financial institutions portfolio").

We assessed the design and tested the operating effectiveness of the controls over individual impairment calculations of the Bank's and the Group's Corporate loan portfolio including the quality of underlying data and systems.

We focused on the measurement of impairment of individually significant credit exposures, including the assessment of whether historic experience is appropriate when assessing the amount of incurred losses in the portfolios. In addition, we also focused on individually significant exposures that are not individually impaired, however, either continued to be, have become, or were at risk of being individually impaired.

In addition we performed the following substantive procedures for discrete parts of credit portfolio of the Bank and the Group:

#### Financial Institutions portfolio

We understood management's basis for determining whether the exposure toward certain financial institutions is impaired and assessed the reasonableness using our understanding of the Bank's and Group's products, lending portfolios and our broader industry knowledge. Considering that due days and due debt do not timely reflect occurrence of default event of financial institutions, the Bank and the Group use internally developed rating model which takes into consideration financial and macro-prudential data of each financial institution. We understood and assessed the model used. Where changes had been made during the year in model parameters and assumptions, we understood the reasons why changes had taken place and used our industry knowledge and experience to evaluate the appropriateness of such changes. We also re-performed the provision calculation for entire portfolio applying our judgement.

#### Corporate portfolio

We assessed the criteria for determining whether an impairment event had occurred and tested a sample of performing loans with characteristics that might imply an impairment event had occurred (including customers experiencing financial difficulties or clients with overdue debts for higher number of days for which impairment loss was not recognized) to assess whether all impairment events had been properly and timely identified by management. For a sample of individually impaired credit exposures within the Corporate portfolio we tested the assumptions underlying the impairment identification and quantification including forecasts of future cash flows, valuation of underlying collateral and estimates of recovery on default. This included taking into consideration the impact of forbearance as well as the latest developments at the borrower.

We also assessed whether the separate and consolidated financial statement disclosures appropriately reflect the Bank's and the Group's exposure to credit risk and are compliant with the IFRS as adopted in EU. Refer to Note 31.2 Credit risk for further details.

**Other information included in The Bank's and the Group's 2017 separate and consolidated Annual Report** Management is responsible for the other information. Other information consists of the information included in the separate and consolidated Annual Report which includes the Management report and Corporate Governance Statement, other than the separate and consolidated financial statements and our auditor's report thereon. Our opinion on the separate and consolidated financial statements does not cover the Other information including the Management report and Corporate Governance Statement.

In connection with our audit of the separate and consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the separate and consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

With respect to the Management Report and Corporate Governance Statement, we also performed procedures required by the Accounting Act. Those procedures include considering whether the Management Report includes the disclosures required by Article 21 of the Accounting Act, and whether the Corporate Governance Statement includes the information specified in Article 22 of the Accounting Act.

Based on the procedures undertaken, to the extent we are able to assess it, we report that:

1. the information given in the enclosed Management report for the 2017 financial year are consistent, in all material respects, with the enclosed separate and consolidated financial statements;
2. the enclosed Management report for 2017 financial year is prepared in accordance with requirements of Article 21 of the Accounting Act;
3. Corporate Governance Statement, included in the Bank's and Group's separate and consolidated annual report, includes the information referred to in Article 22., paragraph 1., items 2, 5, 6 and 7 of the Accounting Act; and

4. elements of Corporate Governance Statement containing the information referred to in Article 22, paragraph 1, items 3 and 4 of the Accounting Act, included in the Bank's and Group's separate and consolidated annual report are prepared in accordance with requirements of the Accounting Act and are consistent, in all material respects, with the enclosed separate and consolidated financial statements;

In addition, in the light of the knowledge and understanding of the entity and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the Management Report, Corporate Governance Statement and separate and consolidated Annual report. We have nothing to report in this respect.

#### **Responsibilities of management and Audit Committee for the separate and consolidated financial statements**

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

In preparing the separate and consolidated financial statements, management is responsible for assessing the Bank's and the Group'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 and Group or to cease operations, or has no realistic alternative but to do so.

Audit Committee is responsible for overseeing the Bank's and the Group's financial reporting process.

#### **Auditor's responsibilities for the audit of the separate and consolidated financial statements**

Our objectives are to obtain reasonable assurance about whether the separate and consolidated 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 separate and consolidated 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 separate and consolidated 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 and Group'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 and Group'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 separate and consolidated 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 and Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate and consolidated financial statements, including the disclosures, and whether the separate and consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with Audit Committee 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 Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to 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 Audit Committee, we determine those matters that were of most significance in the audit of the separate and consolidated 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.

#### **Report on Other Legal and Regulatory Requirements**

In compliance with Article 10(2) of Regulation (EU) No. 537/2014 of the European Parliament and the Council, we provide the following information in our independent auditor's report, which is required in addition to the requirements of ISAs:

##### *Appointment of Auditor and Period of Engagement*

We were appointed as the auditors of the Bank and the Group by the Supervisory Board on 23 July 2015 and our uninterrupted engagement has lasted for 3 years.

##### *Consistence with Additional Report to Audit Committee*

We confirm that our audit opinion on the separate and consolidated financial statements expressed herein is consistent with the additional report to the Audit Committee of the Bank and the Group, which we issued on 16 March 2018 in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.

##### *Provision of Non-audit Services*

We declare that no prohibited non-audit services referred to in Article 5(1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided by us to the Bank and the Group. In addition, there are no other non-audit services which were provided by us to the Bank and its controlled undertakings and which have not been disclosed in the separate and consolidated financial statements.

The partner in charge of the audit resulting in this independent auditor's report is Zvonimir Madunić.



Zvonimir Madunić  
Certified auditor and Member of the Board  
Ernst & Young d.o.o.  
Radnička cesta 50, 10000 Zagreb  
19 March 2018

Financial Statements of the Group  
Consolidated Statement of Profit or Loss  
for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Notes	2017 HRK '000	2016 HRK '000
Interest income	3	867,825	871,985
Interest expense	4	(390,460)	(452,673)
<b>Net interest income</b>		<b>477,365</b>	<b>419,312</b>
Fee income	5	48,125	30,434
Fee expense	5	(3,144)	(3,265)
<b>Net fee income</b>		<b>44,981</b>	<b>27,169</b>
Net (losses)/gains on financial operations	6	(20,716)	7,496
Other income		14,860	23,758
		<b>516,490</b>	<b>477,735</b>
Operating expenses	7	(159,000)	(160,288)
Impairment loss and provisions	8	(195,187)	(2,373)
<b>Profit before income tax</b>		<b>162,303</b>	<b>315,074</b>
Income tax	9	(102)	(233)
<b>Profit for the year</b>		<b>162,201</b>	<b>314,841</b>
<b>Attributable to: Equity holder of the parent</b>		<b>162,201</b>	<b>314,841</b>

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss.

Consolidated Statement of Profit or Loss and Other Comprehensive Income  
for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	2017 HRK '000	2016 HRK '000
<b>Profit for the year</b>	<b>162,201</b>	<b>314,841</b>
<b>Other comprehensive income</b>		
<b>Items that are not transferred subsequently to profit or loss:</b>		
Unrealized actuarial (losses)	(579)	(3,255)
<b>Total items that are not transferred subsequently to profit or loss</b>	<b>(579)</b>	<b>(3,255)</b>
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Increase in fair value of assets available for sale	54,174	86,526
Decrease in fair value of assets available for sale	(29,514)	(50,227)
Net foreign exchange on available for sale equity instruments	(154)	(234)
Transfer of realized gains on assets available for sale to statement of profit or loss	(13,930)	(2,114)
Transfer of realized losses on assets available for sale to statement of profit or loss	11,131	16
Deferred tax – other comprehensive income	(178)	(262)
<b>Total items that may be reclassified subsequently to profit or loss</b>	<b>21,529</b>	<b>33,705</b>
<b>Other comprehensive income after income tax</b>	<b>20,950</b>	<b>30,450</b>
<b>Total comprehensive income after income tax</b>	<b>183,151</b>	<b>345,291</b>
<b>Attributable to: Equity holder of the parent</b>	<b>183,151</b>	<b>345,291</b>

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss and Other Comprehensive Income.

Consolidated Statement of Financial Position  
for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Notes	2017 HRK '000	2016 HRK '000
<b>Assets</b>			
Cash on hand and due from banks	10	1,403,680	491,246
Deposits with other banks	11	29,138	23,872
Loans to financial institutions	12	10,836,141	11,889,111
Loans to other customers	13	12,383,623	11,511,194
Financial assets at fair value through profit or loss	14	291	286
Assets available for sale	15	3,321,564	3,390,034
Assets held to maturity	16	1,399	1,422
Investments in associates	18	-	-
Property, plant and equipment and intangible assets	19	53,557	57,305
Non-current assets held for sale	20	16,697	17,230
Other assets	21	29,471	9,122
<b>Total assets</b>		<b>28,075,561</b>	<b>27,390,822</b>
<b>Liabilities</b>			
Deposits	22	644,741	142,844
Borrowings	23	15,387,881	13,391,749
Bonds payable	24	1,161,699	3,105,569
Other liabilities	25	605,453	707,952
<b>Total liabilities</b>		<b>17,799,774</b>	<b>17,348,114</b>
<b>Equity</b>			
Founder's capital	26	7,009,632	6,959,632
Retained earnings and reserves		2,996,968	2,682,127
Other reserves		94,683	73,733
Profit for the year		162,201	314,841
<b>Total equity attributable to equity holder of the parent</b>		<b>10,263,484</b>	<b>10,030,333</b>
Guarantee fund	27	12,303	12,375
<b>Total equity</b>		<b>10,275,787</b>	<b>10,042,708</b>
<b>Total liabilities and total equity</b>		<b>28,075,561</b>	<b>27,390,822</b>

The accompanying accounting policies and notes are an integral part of this Statement of Financial Position.

Consolidated Statement of Cash Flows  
for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Notes	2017 HRK '000	2016 HRK '000
<b>Operating activities</b>			
Profit before income tax		162,303	315,074
Adjustments to reconcile to net cash from and used in operating activities:			
Depreciation		7,539	7,428
Income tax		102	495
Impairment loss and provisions		195,187	2,373
Accrued interest		(59,664)	(47,016)
Deferred fees		(39,093)	10,149
Operating profit before working capital changes		266,374	288,503
Changes in operating assets and liabilities:			
Net (increase)/decrease in deposits with other banks, before provision for impairment		(5,349)	338,749
Net decrease in loans to financial institutions, before provision for impairment		1,175,203	696,187
Net (increase) in loans to other customers, before provision for impairment		(1,186,871)	(2,311,708)
Net (gain) on financial assets at fair value through profit or loss		(7)	(121)
Net realized (gain) on assets available for sale		(2,799)	(2,098)
Decrease/(increase) of discount in assets available for sale, assets held to maturity and bonds payable		2,273	(1,935)
Net decrease in non-current assets held for sale		7	2,438
Net (increase) in other assets, before provision for impairment		(22,991)	(4,837)
Net increase/(decrease) in deposits from banks and companies		501,897	(93,792)
Net (decrease) in other liabilities, before provisions		(83,617)	(125,214)
<b>Net cash provided by/(used in) operating activities</b>		<b>644,120</b>	<b>(1,213,828)</b>
<b>Investment activities</b>			
(Purchase) of financial assets at fair value through profit or loss		-	(8,990)
Sale of financial assets at fair value through profit or loss		-	12,488
Net (purchase) of assets available for sale		(2,141,579)	(2,168,568)
Sale of assets available for sale		2,226,277	1,681,725
Net (purchase) of property, plant and equipment and intangible assets		(3,727)	(2,495)
<b>Net cash provided by/(used in) investment activities</b>		<b>80,971</b>	<b>(485,840)</b>
<b>Financing activities</b>			
Increase in founder's capital		50,000	33,000
Increase in borrowings – withdrawn funds		3,849,787	3,730,867
(Decrease) in borrowings – repayments of principal		(1,729,575)	(1,730,849)
(Decrease) in bonds payable – repayment		(1,852,051)	(224,487)
<b>Net cash provided by financing activities</b>		<b>318,161</b>	<b>1,808,531</b>
<b>Effect of foreign currency to cash and cash equivalents</b>			
Net foreign exchange		(133,039)	(101,281)
<b>Net effect</b>		<b>(133,039)</b>	<b>(101,281)</b>
Net increase in cash and cash equivalents		910,213	7,582
Balance as of 1 January, before provisions		494,325	486,743
Net increase in cash		910,213	7,582
<b>Balance as of 31 December, before provisions</b>	<b>10</b>	<b>1,404,538</b>	<b>494,325</b>
<b>Additional note - Operational cash flows</b>			
Interest paid		462,104	462,758
Interest received		691,738	702,452

The accompanying accounting policies and notes are an integral part of this Statement of Cash Flows.

Consolidated Statement of Changes in Equity  
for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Founder's capital	Retained earnings and reserves	Other reserves HRK '000	Net profit for the year HRK '000	Total equity HRK '000
<b>Balance as of 1 January 2016</b>	<b>6,926,632</b>	<b>2,475,862</b>	<b>43,283</b>	<b>206,265</b>	<b>9,652,042</b>
Profit for the year	-	-	-	314,841	<b>314,841</b>
Other comprehensive income	-	-	30,450	-	<b>30,450</b>
Total comprehensive income	-	-	30,450	314,841	<b>345,291</b>
Capital paid-in from the State Budget (Note 26)	33,000	-	-	-	<b>33,000</b>
Transfer of profit 2015 to retained earnings	-	206,265	-	(206,265)	-
<b>Balance as of 31 December 2016</b>	<b>6,959,632</b>	<b>2,682,127</b>	<b>73,733</b>	<b>314,841</b>	<b>10,030,333</b>
Profit for the year	-	-	-	162,201	<b>162,201</b>
Other comprehensive income	-	-	20,950	-	<b>20,950</b>
Total comprehensive income	-	-	20,950	162,201	<b>183,151</b>
Capital paid-in from the State Budget (Note 26)	50,000	-	-	-	<b>50,000</b>
Transfer of profit 2016 to retained earnings	-	314,841	-	(314,841)	-
<b>Balance as of 31 December 2017</b>	<b>7,009,632</b>	<b>2,996,968</b>	<b>94,683</b>	<b>162,201</b>	<b>10,263,484</b>

The accompanying accounting policies and notes are an integral part of this Statement of Changes in Equity.

Financial Statements of the Bank  
Unconsolidated Statement of Profit or Loss  
for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Notes	2017 HRK '000	2016 HRK '000
Interest income	3	866,198	870,344
Interest expense	4	(390,460)	(452,673)
<b>Net interest income</b>		<b>475,738</b>	<b>417,671</b>
Fee income	5	45,539	28,332
Fee expense	5	(3,144)	(3,265)
<b>Net fee income</b>		<b>42,395</b>	<b>25,067</b>
Net (losses)/gains on financial operations	6	(20,625)	7,312
Other income		7,627	18,016
		505,135	468,066
Operating expenses	7	(149,432)	(152,227)
Impairment loss and provisions	8	(194,920)	(2,314)
<b>Profit before income tax</b>		<b>160,783</b>	<b>313,525</b>
Income tax	2	-	-
<b>Profit for the year</b>		<b>160,783</b>	<b>313,525</b>
<b>Attributable to: Equity holder of the parent</b>		<b>160,783</b>	<b>313,525</b>

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss.

Unconsolidated Statement of Profit or Loss and Other Comprehensive Income  
for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	2017 HRK '000	2016 HRK '000
<b>Profit for the year</b>	<b>160,783</b>	<b>313,525</b>
<b>Other comprehensive income</b>		
<b>Items that are not transferred subsequently to profit or loss:</b>		
Unrealized actuarial (losses)	(579)	(3,255)
<b>Total items that are not transferred subsequently to profit or loss</b>	<b>(579)</b>	<b>(3,255)</b>
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Increase in fair value of assets available for sale	51,762	84,151
Decrease in fair value of assets available for sale	(28,085)	(49,665)
Net foreign exchange on available for sale equity instruments	(154)	(234)
Transfer of realized gains on assets available for sale to statement of profit or loss	(13,929)	(1,878)
Transfer of realized losses on assets available for sale to statement of profit or loss	11,125	16
<b>Total items that may be reclassified subsequently to profit or loss</b>	<b>20,719</b>	<b>32,390</b>
<b>Other comprehensive income after income tax</b>	<b>20,140</b>	<b>29,135</b>
<b>Total comprehensive income after income tax</b>	<b>180,923</b>	<b>342,660</b>
<b>Attributable to:</b>		
<b>Equity holder of the parent</b>	<b>180,923</b>	<b>342,660</b>

The accompanying accounting policies and notes are an integral part of this Statement of Profit or Loss and Other Comprehensive Income.

Unconsolidated Statement of Financial Position  
as of 31 December 2017

(All amounts are expressed in HRK thousand)

	Notes	2017 HRK '000	2016 HRK '000
<b>Assets</b>			
Cash on hand and due from banks	10	1,401,146	490,695
Deposits with other banks	11	29,138	23,872
Loans to financial institutions	12	10,836,141	11,889,111
Loans to other customers	13	12,383,623	11,511,194
Assets available for sale	15	3,277,194	3,343,574
Investments in subsidiaries	17	36,124	36,124
Investments in associates	18	-	-
Property, plant and equipment and intangible assets	19	53,514	57,216
Non-current assets held for sale	20	16,697	17,230
Other assets	21	22,226	5,900
<b>Total assets</b>		<b>28,055,803</b>	<b>27,374,916</b>
<b>Liabilities</b>			
Deposits	22	644,741	142,844
Borrowings	23	15,387,881	13,391,749
Bonds payable	24	1,161,699	3,105,569
Other liabilities	25	592,651	696,774
<b>Total liabilities</b>		<b>17,786,972</b>	<b>17,336,936</b>
<b>Equity</b>			
Founder's capital	26	7,009,632	6,959,632
Retained earnings and reserves		2,995,656	2,682,131
Other reserves		90,457	70,317
Profit for the year		160,783	313,525
<b>Capital</b>		<b>10,256,528</b>	<b>10,025,605</b>
Guarantee fund	27	12,303	12,375
<b>Total equity</b>		<b>10,268,831</b>	<b>10,037,980</b>
<b>Total liabilities and total equity</b>		<b>28,055,803</b>	<b>27,374,916</b>

The accompanying accounting policies and notes are an integral part of this Statement of Financial Position.

## Unconsolidated Statement of Cash Flows for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Notes	2017. HRK '000	2016 HRK '000
<b>Operating activities</b>			
Profit before income tax		160,783	313,525
Adjustments to reconcile to net cash from and used in operating activities:			
Depreciation		7,482	7,359
Impairment loss and provisions		194,920	2,314
Accrued interest		(59,702)	(47,037)
Deferred fees		(39,093)	10,149
Operating profit before working capital changes		264,390	286,310
Changes in operating assets and liabilities:			
Net (increase)/decrease in deposits with other banks, before provision for impairment		(5,349)	335,749
Net decrease in loans to financial institutions, before provision for impairment		1,175,203	696,187
Net (increase) in loans to other customers, before provision for impairment		(1,186,871)	(2,311,708)
Net realized (gain) on assets available for sale		(2,804)	(1,862)
Decrease/(increase) of discount in assets available for sale and bonds payable		1,865	(2,341)
Net decrease in non-current assets held for sale		7	2,438
Net (increase) in other assets, before provision for impairment		(18,298)	(2,680)
Net increase/(decrease) in deposits from banks and companies		501,897	(93,792)
Net (decrease) in other liabilities, before provisions		(85,261)	(125,907)
<b>Net cash provided by/(used in) operating activities</b>		<b>644,779</b>	<b>(1,217,606)</b>
<b>Investment activities</b>			
Net (purchase) of assets available for sale		(2,134,989)	(2,158,899)
Sale of assets available for sale		2,217,157	1,679,193
Net (purchase) of property, plant and equipment and intangible assets		(3,716)	(2,492)
<b>Net cash provided by/(used in) investment activities</b>		<b>78,452</b>	<b>(482,198)</b>
<b>Financing activities</b>			
Increase in founder's capital		50,000	33,000
Increase in borrowings – withdrawn funds		3,849,787	3,730,867
(Decrease) in borrowings – repayments of principal		(1,729,575)	(1,730,849)
(Decrease) in bonds payable – repayment		(1,852,051)	(224,487)
<b>Net cash provided by financing activities</b>		<b>318,161</b>	<b>1,808,531</b>
<b>Effect of foreign currency to cash and cash equivalents</b>			
Net foreign exchange		(133,162)	(101,454)
<b>Net effect</b>		<b>(133,162)</b>	<b>(101,454)</b>
Net increase in cash and cash equivalents		908,230	7,273
Balance as of 1 January, before provisions		493,774	486,501
Net increase in cash		908,230	7,273
<b>Balance as of 31 December, before provisions</b>	<b>10</b>	<b>1,402,004</b>	<b>493,774</b>
<b>Additional note - Operational cash flows</b>			
Interest paid		462,104	462,758
Interest received		689,666	700,366

The accompanying accounting policies and notes are an integral part of this Statement of Cash Flows.

## Unconsolidated Statement of Changes in Equity for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Founder's capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Net profit for the year HRK '000	Total equity HRK '000
<b>Balance as of 1 January 2016</b>	<b>6,926,632</b>	<b>2,476,903</b>	<b>41,182</b>	<b>205,228</b>	<b>9,649,945</b>
Profit for the year	-	-	-	313,525	313,525
Other comprehensive income	-	-	29,135	-	29,135
Total comprehensive income	-	-	29,135	313,525	342,660
Capital paid-in from the State Budget (Note 26)	33,000	-	-	-	33,000
Transfer of profit 2015 to retained earnings	-	205,228	-	(205,228)	-
<b>Balance as of 31 December 2016</b>	<b>6,959,632</b>	<b>2,682,131</b>	<b>70,317</b>	<b>313,525</b>	<b>10,025,605</b>
Profit for the year	-	-	-	160,783	160,783
Other comprehensive income	-	-	20,140	-	20,140
Total comprehensive income	-	-	20,140	160,783	180,923
Capital paid-in from the State Budget (Note 26)	50,000	-	-	-	50,000
Transfer of profit 2016 to retained earnings	-	313,525	-	(313,525)	-
<b>Balance as of 31 December 2017</b>	<b>7,009,632</b>	<b>2,995,656</b>	<b>90,457</b>	<b>160,783</b>	<b>10,256,528</b>

The accompanying accounting policies and notes are an integral part of this Statement of Changes in Equity.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

**1. General information**

**1.1. Group:**

The Croatian Bank for Reconstruction and Development (“HBOR” or “the Bank”) is the parent company of the Croatian Bank for Reconstruction and Development Group (“Group”) that operates in the Republic of Croatia. The Group primarily performs banking activities and, to the lesser extent, insurance activities and credit risk assessment activities. These Financial Statements include unconsolidated and consolidated financial statements of the Bank and the Group.

The legal address of the Bank is Strossmayerov trg 9, Zagreb, Croatia.

The Group was formed in 2010, the Bank’s subsidiary companies are Hrvatsko kreditno osiguranje d.d. and Poslovni info servis d.o.o. that constitute the Hrvatsko kreditno osiguranje Group (“HKO Group”).

Croatian Bank for Reconstruction and Development is the 100% owner of HKO.

The legal address of the HKO Group is Zagreb, Bednjanska 12.

As of 31 December 2017, the Group had 353 active employees (31 December 2016: 346 active employees).

**1.2. Bank:**

The Croatian Bank for Reconstruction and Development (“HBOR” or “the Bank”) was established on 12 June 1992 under the Act on the Croatian Credit Bank for Reconstruction (“HKBO”). In December 1995, the Bank changed its name to Croatian Bank for Reconstruction and Development. The founder and 100% owner of HBOR is the Republic of Croatia.

The Republic of Croatia guarantees HBOR’s liabilities unconditionally, irrevocably and on first call, without issuing any particular guarantee. The responsibility of the Republic of Croatia as guarantor for HBOR’s liabilities is joint and unlimited.

With the Act on the Croatian Bank for Reconstruction and Development passed in December 2006, HBOR’s founding capital was HRK 7 billion, the payment schedule of which is determined by the State budget.

As of 31 December 2017, HBOR had 336 active employees (31 December 2016: 332 active employees).

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**1. General information (continued)**

**1.2. Bank (continued):**

**1.2.1. Activities of the Bank:**

The principal activities of the Bank comprise the following:

- financing of reconstruction and development of the Croatian economy,
- financing of infrastructure,
- promoting exports,
- providing support to the development of SMEs,
- promoting environmental protection, and
- providing domestic goods and services export insurance against non-market risks for and on behalf of the Republic of Croatia.

HBOR may perform other financial activities according to the decisions of the Government of the Republic of Croatia if, in their opinion, it is in the best interest of the Republic of Croatia.

**1.3. Bodies of the Bank and the Group:**

*Supervisory Board*

During 2017, the Supervisory Board members were as follows:

- Zdravko Marić, DSc, Minister of Finance - ex officio President of the Supervisory Board,
- Martina Dalić, DSc, Deputy Prime Minister of the Republic of Croatia and Minister of the Economy, Entrepreneurship and Trade – ex officio Vice President of the Supervisory Board,
- Predrag Štromar, Deputy Prime Minister of the Republic of Croatia and Minister of Construction and Physical Planning (since 4 August 2017),
- Lovro Kuščević, Minister of Construction and Physical Planning (from 25 May 2017 to 4 August 2017), Public Administration Minister since 9 June 2017,
- Gabrijela Žalac, Minister of Regional Development and EU Funds – ex officio Member of the Supervisory Board,
- Gari Cappelli, Minister of Tourism,
- Tomislav Tolušić, Minister of Agriculture,
- Luka Burilović, President of the Croatian Chamber of Economy – ex officio Member of the Supervisory Board,
- Slaven Dobrović, DSc, Minister of Environmental Protection and Energetics (until 25 May 2017),
- Boris Lalovac, MSc, Member of the Croatian Parliament,
- Božica Makar, Member of the Croatian Parliament (since 14 July 2017),
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament,
- Ivana Ninčević-Lesandrić, Member of the Croatian Parliament (until 14 July 2017).

(All amounts are expressed in HRK thousand)

## 1. General information (continued)

### 1.3. Bodies of the Bank and the Group (continued):

#### *Supervisory Board (continued)*

Pursuant to the Act on Croatian Bank for Reconstruction and Development, the Supervisory Board consists of six ministers of the Government of the Republic of Croatia. The minister in charge of finances, the minister in charge of the economy and the minister in charge of regional development and EU funds are obligatory members of the Supervisory Board, whereas other three ministers are appointed to the Supervisory Board by the Government of the Republic of Croatia among the ministers in charge of tourism, agriculture, environmental protection and construction or entrepreneurship and craft. The Croatian Parliament appoints three members of the Supervisory Board and their permanent deputies among the members of the Croatian Parliament. The President of the Croatian Chamber of Economy is ex officio member of the Supervisory Board.

#### *Management Board*

In 2017, members of the Management Board were as follows:

- Tamara Perko, MSc, President of the Management Board (since 1 February 2017),
- Hrvoje Čuvalo, MSc, Member of the Management Board (since 16 October 2017),
- Dušan Tomašević, President of the Management Board (until 31 January 2017),
- Martina Jus, Member of the Management Board (until 15 October 2017),
- Goran Filipić, Member of the Management Board (until 31 January 2017).

#### *Audit Committee*

By the Decision of the Supervisory Board of 25 July 2017, the Audit Committee was appointed, consisting of the following members:

- Prof.DSc. Lajoš Žager, Dean of the Faculty of Economics and Business of the University of Zagreb, acting as the Chairman of the Audit Committee,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament, acting as the Vice Chairman of the Audit Committee,
- Aurora Volarević, Director of Internal Controls, Audit and Risk in Hrvatski telekom d.d., acting as a Member of the Audit Committee.

(All amounts are expressed in HRK thousand)

## 1. General information (continued)

### 1.4. Current economic situation and its impact on the Bank

So far, the economic situation in the Republic of Croatia has not had a significant impact on the financial position and performance of the Bank. The Bank monitors closely the credit, liquidity, interest rate and foreign exchange risk on a regular basis.

The highest exposure of credit portfolio until the end of 2015 was the one towards financial institutions, which minimizes the level of credit risk due to strictly regulated banking sector by the central bank. However, in 2016, there was a tendency of increased direct exposures to other customers that has been continued in 2017, and the proportion of gross placements via financial institutions and direct placements is 42% : 58% (in 2016: 47% : 53%).

The economy is gradually recovering and real GDP growth in 2016 is reported at 3.2%\*. This rate of growth was likely maintained in 2017, as economic activity was strong in the first three quarters of 2017, although some indicators point to a slowdown in the last quarter.

The continuation of such favorable trend is primarily the result of increase in total exports and the growth of personal consumption. Slower momentum in the fourth quarter will likely carry over to 2018, with real GDP growth forecast at 2.8%\* and 2.7%\* in 2019. At this pace, the economy is set to reach its pre-recession volume of output by the end of 2019.

Since GDP growth projections for 2017 are at the growth level in 2016, it seems that so far, the crisis in Agrokor has had only a limited impact on the economic activity in 2017, and it has mostly reflected on the slowdown in investment activity. However, investment is expected to pick up as credit activity is growing in the corporate sector, although the outcome of Agrokor's operational and financial restructuring still presents risks.

The Management Board of HBOR maintains its expectations for an increase in loan restructuring applications as it was the case in the previous business years. Additionally, there are uncertainties with regard to the possibility of collection under the collateral in view of the still illiquid real estate market that is still not influenced by the economic growth as well as the decline in their value.

In 2018, HBOR will continue to make use of financial instruments out of the European Structural and Investment Funds (ESIF), which represent an efficient manner of application of financial resources available in the Republic of Croatia. Financial instruments help to mobilise additional public and private co-investments, and they can be used in the form of loans, guarantees or other mechanisms.

The Bank has sufficient funds and sufficient level of liquidity for financing planned loan activities, meeting obligations and liabilities and maintaining required level of liquidity reserves.

\* Source: European Commission web pages: Winter 2018 Economic Forecast for the Republic of Croatia dated 7 February 2018. Such forecasts are prepared by the Directorate General for Economic and Financial Affairs (ECFIN).

## Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 2. Summary of significant accounting policies

#### 2.1. Accounting policies

Principal accounting policies applied when preparing these financial statements are summarized below.

Accounting policies were consistently applied to all periods presented in these financial statements.

##### Basis of accounting

The Bank and the Group maintain their accounting records in HRK in accordance with Croatian law and the accounting principles and practices observed by financial institutions in the Republic of Croatia.

##### Statement of compliance

These consolidated and unconsolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), as issued by International Accounting Standards Board ("IASB") and endorsed by the EU.

##### Basis of financial statements presentation

The financial statements are prepared under the historical cost convention, with an exception of certain financial assets and financial liabilities that are measured and stated at fair value, as it can be seen in the following text:

Items	Measurement basis
Financial assets at fair value through profit or loss	Fair value
Assets available for sale	Fair value

The financial statements are prepared on an accrual and a going concern basis.

##### Reporting currency

The financial statements of the Bank and the Group are prepared in Croatian Kuna (HRK) as the functional and reporting currency of the Bank and the Group.

Amounts presented are rounded to a nearest thousand, unless otherwise stated.

The effective exchange rate of HRK as of 31 December 2017 was HRK 7.513648 per 1 Euro and HRK 6.269733 per 1 United States dollar (31 December 2016: HRK 7.557787 per 1 Euro and HRK 7.168536 per 1 United States dollar), unless otherwise contracted.

## Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 2. Summary of significant accounting policies (continued)

#### 2.1. Accounting policies (continued)

##### Basis of consolidation

The financial statements include the Bank and the Group. The financial statements of the Group include the consolidated financial statements of the Bank and its subsidiary companies. Unconsolidated financial statements of the parent company are also stated.

##### Subsidiary companies

Subsidiary companies are all those companies that are controlled by the Bank.

Subsidiary companies are included into consolidated financial statements in accordance with the full consolidation method from the moment when the actual control is transferred to the Bank. The consolidation ceases from the moment they are sold or liquidated, i.e. from the moment when the control is lost.

With the beginning of application of new definition of control according to IFRS 10 Consolidated Financial Statements, the Group made a re-assessment of control and relations within the Group. The scope and substance of control are unchanged in the context of new requirements and definitions.

Investments in subsidiary companies are stated at investment cost, i.e. in accordance with the cost method.

When preparing data and consolidated financial statements, the amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated, and intragroup balances and transactions, revenues and expenditures as well as unrealised gains and losses are eliminated in full.

The accounting policies of subsidiary companies are in line with those of the parent company in order to ensure comparability at the level of the Group.

The acquisition of subsidiaries is accounted by using the purchase method. The cost of the business combination is measured as the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed and equity instruments issued in exchange for control over the acquiree. Acquisition costs incurred are expensed and included in operating costs.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the parent's ownership interests in them. Non-controlling interests in the net assets consist of the amount of those non-controlling interests at the date of the initial recognition of investment in the subsidiary company and the non-controlling interests' share of changes in equity since the date of acquisition of the interest. Losses incurred by a subsidiary company will be allocated between controlling and non-controlling interests even if losses exceed the non-controlling equity investment in the subsidiary.

Subsequent acquisition of a non-controlling interest is not a business combination and is accounted for as an equity transaction.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Basis of consolidation (continued)**

*Subsidiary companies (continued)*

For measurement of changes in relative interests of the parent and non-controlling interest in the subsidiary on the date of acquisition, the Group used the approach of taking into account the proportionate share of the acquiree's identifiable net assets. The amount of positive movements in the parent equity is recognised in other reserves.

In cases when investments into subsidiary companies that are stated by investment cost are classified as investments intended for sale or distribution, they are stated pursuant to IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations. In such circumstances, measurement of investments calculated pursuant to IAS 39/IFRS 9 is not changed.

*Associated companies*

Associates are all those companies, in which the Group has directly or indirectly (e.g. through subsidiaries) a significant influence, i.e. is entitled to participate in decisions on the financial and operating policies of the investee, but does not have control of those policies. The Group has significant influence if holds, directly or indirectly 20% or more of the voting power of the investee.

Investments in associated companies are recognised using the equity method in the consolidated and separate financial statements. By applying the equity method, such investment is stated at investment cost at initial recognition, and its carrying amount of assets is increased or decreased on the basis of HBOR equity recognition in the profit or loss of the investee after the acquisition date. HBOR's equity in the profit or loss of the investee is included in the profit and loss of HBOR.

The amounts that the investee paid to HBOR reduce the carrying amount of the investment.

The changes in HBOR's proportional part occurred as a result of changes in other comprehensive income of the associated company (changes arising from revaluation of real estate, plants and equipment and foreign exchange gains/losses) are stated within other comprehensive income.

In case there is an intention to sell the entire or a portion of equity in associated companies, IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations is applied, namely to the portion held for sale.

The remaining equity in associated companies intended to be hold, over which there is still a significant influence, will continue to be stated by applying the equity method.

Should over the remaining portion that is intended to be kept such significant influence cease, it will be stated as financial instrument pursuant to the provisions of IAS 39/IFRS 9 only after the sale of the equity.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Fair value measurement**

Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction at the measurement date in the principal or the most advantageous market under current market conditions.

Basic price is an exit price, regardless of whether that price is directly observable or estimated using another valuation technique.

At initial recognition, when an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price).

The fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price).

If another IFRS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the Group shall recognize the resulting gain or loss in profit or loss unless that IFRS specifies otherwise.

For measuring fair value the Group is maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

The Group selects inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability.

If an asset or a liability measured at fair value has a bid price and an ask price (e.g. an input from a dealer market), the Group uses the price within the bid-ask spread as the most representative of fair value.

Pursuant to aforesaid, the carrying amounts of cash and balances with the Croatian National Bank approximately present their fair values.

The estimated fair value of deposits approximates their carrying amounts since all deposits mature up to 90 days.

Loans and advances to banks and other customers are presented net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. The interests subsidies that are recognized as deferred income in discounted amounts are presented within other liabilities are taken into account in estimating fair value. The fair value of HRK loans with one-way currency clause is assessed as described under the "Foreign currency transactions and foreign currency clause" paragraph.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Fair value measurement (continued)**

The Bank's long-term borrowings have no quoted market price, and their fair value is estimated as the present value of future cash flows, discounted at interest rates in effect at the Statement of Financial Position date for new borrowings of a similar nature and with a similar remaining maturity. As the Bank's long term borrowings mostly bear variable interest, the Bank estimates that its carrying amount is reasonable approximation of fair value.

The fair value of bonds issued by HBOR on 31 December 2017 is stated in Note 24 and is presented by using level 2 inputs that are observable at Bloomberg service on the basis of mid-rate of Bloomberg Generic (BGN) prices.

BGN or Bloomberg Generic price is the simple average price that includes indicative prices and executable prices. The mid-rate is the average between the quoted "ask" price and the "bid" price.

The Group takes care of the fair value hierarchy presentation that comprises of three levels of inputs to valuation techniques used to measure fair value as follows:

	Level 1	Level 2	Level 3
Inputs:	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.	Unobservable inputs for the asset or liability or adjusted market inputs.

The Group discloses transfers between levels of the fair value hierarchy at the end of the reporting period during which the transfer occurred.

**Interest income and expense**

Interest income and expense are recognized in the statement of profit or loss and other comprehensive income when earned or incurred. Interest income and expense are recognized in the statement of profit or loss and other comprehensive income for all interest-bearing instruments on an accrual basis using the effective interest rate, which is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or on a shorter period, where appropriate. Interest income includes coupons earned on fixed income investments.

Loan origination fees, together with estimated related costs, are deferred and proportionally recognized as an adjustment to the effective yield on the loan over the term of loan.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Interest income and expense (continued)**

Notional interest is recognized on impaired loans and other financial assets based on the rate used to discount future cash flows to their net present value and are recognized in the statement of profit or loss.

**Fee and commission income**

Fee and commission income is comprised mainly of fees receivable from companies for guarantees granted and other services rendered by the Group, together with commissions for managing funds for and on behalf of legal entities and fees for foreign and domestic payment transactions. Fees and commissions are generally recognized in the period when the related service is rendered.

Fees on issued financial/payment guarantees are deferred and are proportionally recognized and reported in the statement of profit or loss and other comprehensive income over the term of guarantee. Fee and commission income of non-interest income character (loan management fees for and on behalf of other parties, payment transaction fees, other fees of non-interest type) are recognized in the statement of profit or loss as they incur.

**Employee benefits**

Pursuant to local legislation, the Group is obliged to pay contributions to the State Pension and Health Insurance Funds. This obligation relates to full-time employees and provides for paying contributions as certain percentages determined on the basis of the gross salary as follows:

	2017	2016
Contributions for state health insurance fund	15.00%	15.00%
Contributions for employment fund	1.70%	1.70%
Special contribution for employment of disabled persons	-	-
Contribution for health protection at work	0.50%	0.50%

The Group is also obliged to withhold and pay contributions from gross pay on behalf of the employees to the State Pension Fund and Mandatory Pension Fund.

The Group does not have pension arrangements separate from the state pension system of the Republic of Croatia. This system requires that current contributions by the employer be calculated as a percentage of current gross salary payments; these expenses are charged to the statement of profit or loss and other comprehensive income in the period the related compensation is earned by the employee.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Employee benefits (continued)**

The contributions on behalf of employees and on behalf of the employer are charged to expense in the period to which they relate. The Group calculates and pays required personal income tax and surtax on personal income tax from gross salary for each employee.

The Group recognizes provisions for other liabilities towards employees when there is a contractual obligation or practice in the past based on which the obligation has arisen. Further, the Group recognizes the liabilities for accumulated vacation allowances based on unutilised vacation days as of the date of the financial statements.

**Foreign currency transactions and foreign currency clause**

Assets and liabilities expressed in foreign currencies are converted into HRK at the exchange rates quoted by the Croatian National Bank at the Statement of Financial Position date or at the contract exchange rates. Income and expense arising in foreign currencies are converted at the rate of exchange on the transaction date. The resulting foreign exchange gains and losses are recorded in the Statement of Profit or Loss and Other Comprehensive Income.

The Bank has assets originated in HRK and linked to a foreign currency with a one-way currency clause. Due to this clause, the Bank has the option to revalue the asset using a foreign exchange rate, if beneficial for the Bank valid as of the date of maturity, compared to the foreign exchange rate valid as of the date of origination of asset.

Changes arising from one-way currency clause contracts, based on which the value of receivables and liabilities denominated in a functional currency is changed with regard to the respective contract foreign currency (embedded derivatives – weighted exchange rate) imply changes in the fair value of embedded derivatives. The Bank has assets originated in HRK that are linked to a foreign currency with two-way currency clause. These assets are translated to HRK as if they were originated in foreign currency.

The principal rates of exchange set forth by the Croatian National Bank and used in the preparation of the financial statements at the reporting dates were as follows:

31 December 2017	1 EUR = HRK 7.513648	1 USD = HRK 6.269733
31 December 2016	1 EUR = HRK 7.557787	1 USD = HRK 7.168536

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Taxation**

Based on Article 9 of the Act on the HBOR, the parent company is exempt from income tax.

Income tax liabilities arise exclusively from the activities of the other members of the Group.

Income tax is charged on taxable profits in accordance with tax regulations and at the statutory tax rate.

Income tax expense is comprised of current and deferred tax. The amount of the income tax is reported in the statement of profit or loss and other comprehensive income except for the income tax that relates to the items that are recognised directly in equity and reserves when income tax is recognised in equity and reserves.

Current tax is the expected tax payable charged on the taxable amount of profits for the year by applying the tax rates in effect at the reporting date and all tax liability adjustments for previous periods.

The amount of deferred tax is calculated by applying the balance sheet liability method, providing for all temporary differences between the carrying amounts of assets and liabilities recorded for reporting purposes and the amounts used for tax calculation purposes. Deferred tax is calculated at the tax rates that are expected to apply on temporary differences when remunerated or settled in accordance with the valid regulations.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax liabilities are reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefits will be realisable.

Deferred tax assets and liabilities are not discounted; they are recognised as long-term assets and/or long-term liabilities.

**Cash and cash equivalents**

For the purposes of the cash flows reporting, cash and cash equivalents comprise cash and current accounts with the Croatian National Bank and other banks less provisions for impairment and un-collectable amounts.

**Financial instruments**

Financial assets and financial liabilities presented in the Statement of Financial Position include cash and cash equivalents, debt instruments, trade and other accounts receivable and payable, long-term loans and leases, deposits and investments.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Financial instruments (continued)**

The Group classifies its own financial instruments into following categories:

- financial assets at fair value through profit or loss,
- available-for-sale financial assets,
- held-to-maturity financial assets,
- loans and receivables.

Financial instruments are classified into the above categories pursuant to the intention at acquisition. Classification of financial instruments at initial recognition and accounting principles of their measurement are prescribed by accounting policies brought by the Management Board.

The principal difference among the categories relates to the measurement approach of financial assets and the recognition of their fair values in the financial statements that is described in the text below.

All securities held by the Group are recognized using settlement date accounting and are initially measured at cost and directly attributable transaction costs when investments are not recognised at fair value through the statement of profit or loss.

The Bank does not make acquisitions of financial instruments and investments to attain gain from short term trading activities.

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

The above category is divided into two sub-categories: financial instruments held for trading purposes and those initially classified by the management into this category that are not traded actively.

Upon initial recognition, financial assets carried at fair value through profit or loss are accounted for and presented at fair value which corresponds to the quoted prices or amounts obtained by the application of acceptable valuation models. When measuring the fair value of shares in cash investment funds, the price that is applied is the price of the share in the fund as of a given date acquired from the investment fund management company. The Group includes unrealized gains and losses in 'Net gains/(losses) on financial operations'.

**b) Available-for-sale financial assets**

Assets available for sale are financial assets designated as available for sale or not classified as either held to maturity or carried at fair value through profit or loss or loans and receivables.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Financial instruments (continued)**

**b) Available-for-sale financial assets (continued)**

Financial assets classified as assets available for sale are provided for the purposes of maintaining liquidity reserves or for the purpose of placement of available funds until their further placement in long-term loans. In the available-for-sale assets portfolio, investments in long-term securities and in other financial instruments are recorded, as well as equity instruments with the intention to hold over 90 days that are held for an unlimited period and shares in investment funds that the Bank intends to hold for a period of over 30 days.

Subsequent to initial recognition, available-for-sale financial assets are re-measured at fair value based on quoted prices or amounts derived from cash flow models. In circumstances where the quoted market prices are not readily available, the fair value of debt instruments is estimated using various valuation techniques including the use of present value of future cash flows and mathematical models, while the fair value of unquoted equity instruments is estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer.

For available for sale assets, unrealized gains and losses arising from changes in fair value are recognized directly in other comprehensive income, until their disposal or impairment, at which time the realized gain or loss is included in the statement of profit or loss.

Impairment losses on assets available for sale are presented in the statement of profit or loss. If the fair value of an equity instrument subsequently increases, the increase will be recognized in other comprehensive income, and will not be subsequently reversed in the statement of profit or loss. Impairment losses recognized in statement of profit or loss for debt instruments are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition.

When a decline in the fair value of available-for-sale financial assets has been recognized in other comprehensive income and there is an objective evidence that the asset is impaired according to IAS 39 provisions, the cumulative loss that has been recognized in other comprehensive income shall be reclassified from other comprehensive income to statement of profit or loss as a reclassification adjustment, even though the financial asset has not been derecognized.

The objective evidence on impairment loss on certain investment in an equity instrument includes information on significant adverse changes with impact on the technological, market, economic or legal conditions of operation of the issuer and indicates that the cost of investment in debt instruments cannot be recovered.

Significant or prolonged decline in the fair value of investments into debt instruments below their cost is also an objective evidence of impairment.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Financial instruments (continued)**

**b) Available-for-sale financial assets (continued)**

Interest earned whilst holding available for sale instruments is accrued on a daily basis and is reported as 'Interest income' in the statement of profit or loss.

Foreign exchange gains/(losses) related to available for sale equity instruments held in foreign currency are recognized together with fair value gains and losses in other comprehensive income until the financial asset is sold. Foreign exchange gains/(losses) related to available-for-sale debt instruments in foreign currency are reported in the statement of profit or loss.

**c) Held-to-maturity financial assets**

Investments held-to-maturity are financial assets with fixed or identifiable payments and fixed maturities for which the Group has the intent and ability to hold to maturity. This portfolio generally comprises instruments issued for a period exceeding one year, such as bonds, bills of exchange etc.

Financial assets held to maturity are initially recognised at fair value, increased by transaction costs. After initial recognition, assets held to maturity are measured and stated at amortized investment cost, i.e. acquisition cost (nominal value of purchased securities increased/decreased by a discount/premium and transaction costs) adjusted by amortized discount/premium.

Interest earned is recognized as interest receivable on the date of settlement and is not HBOR's income.

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

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Financial instruments (continued)**

**d) Loans to financial institutions and other customers**

Amounts paid-out by HBOR in providing funds directly to the borrower at drawdown are categorized as loans to customers and are carried at amortized cost derived from using the effective interest method and adjusted for possible impairment.

The amount of the subsidized interest provided for the final user under the Programme of Preferential Financing through HBOR's Loan Programmes is presented as deferred interest income in other liabilities and released over the term of the loan and is shown in the statement of profit or loss on a time basis during the repayment of the loan applying effective interest rate method.

All loans and advances are recognized when cash is paid-out to borrowers.

Provision for impairment is performed if there is objective evidence that HBOR will not be able to collect all amounts due. The Management Board of HBOR determines the adequacy of the provision based upon analysis of various factors, the structure of the loan portfolio and past experience (see Note 31.2. Risk management – Credit risk).

The amount of the provision is the difference between the carrying and recoverable amounts of the balance outstanding, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted based on the effective interest rate.

The loan loss provision is also assessed on portfolio basis covering losses where there is objective evidence that possible losses are present, specifically identified in components of the loan portfolio at the Statement of Financial Position date. These have been estimated based upon historical patterns of losses (in each component, the credit ratings allocated to the borrowers and reflecting the current economic climate in which the borrowers operate).

If there is no objective evidence that an impairment loss has been incurred, whether it is significant or not, the financial asset is classified into the group of assets with similar credit risk characteristics and all assets from this group are subject to joint estimation for the purpose of a collective evaluation of impairment. Contracted cash flows and historical loss experience for assets with similar credit risk characteristics are subject to collective evaluation of expected cash flows.

When a loan is deemed uncollectible, it is written off against the related provision for impairment. Subsequent recoveries of these loans are recognized in the statement of profit or loss.

Securities purchased under agreements to purchase and resell ('reverse repos') are not recognized in the Statement of Financial Position of the Bank and expenses based on such contracts are recognized in the statement on financial position as loans to financial institutions collateralized by securities that are the subject matter of contracts. Interest earned in the period from the purchase until the resale of the security is accrued on a daily basis and reported as 'Interest income' in the statement of profit or loss.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Financial instruments (continued)**

**d) Loans to financial institutions and other customers**

At the end of 2017, the Group's REPO deals amounted to HRK 236,400 thousand (31 December 2016: HRK 232,489 thousand) collateralized by securities in the amount of HRK 249,727 thousand (31 December 2016: HRK 247,026 thousand).

**Property, plant and equipment and intangible assets**

Property, plant and equipment and intangible assets are initially recognized and subsequently measured at acquisition cost. Depreciation is charged using the linear method, by applying the annual rates ranging from 3.03% to 33.3% to the cost of assets over their estimated useful lives.

Estimated useful lives are as follows:

	<b>2017</b>	<b>2016</b>
	years	years
Buildings	33	33
Computers	3	3
Furniture and Equipment	5 - 8	5 - 8
Vehicles	3	3
Other assets and investments not mentioned	5	5
Intangible Assets	3 - 5	3 - 5

Depreciation is not charged on property, plant and equipment and intangible assets in the course of construction, until they are available for use. Repairs and maintenance are expensed in the statement of profit or loss and other comprehensive income as incurred. Expenditure that increases the future economic benefits of existing tangible and intangible assets (improvements) is capitalized.

**Impairment of assets**

An assessment of financial assets is made at the reporting date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, the estimated recoverable amount of that asset and any impairment loss, based on the net present value of future anticipated cash flows including anticipated recoveries from guarantees and collateral instruments, discounted by the original effective interest rate, is recognized in the statement of profit or loss.

Property, plant and equipment and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in the statement of profit or loss and other comprehensive income for items of property, plant and equipment and intangible assets carried at cost. The recoverable amount is the higher of an asset's net selling price and its value in use.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Investments in property**

Investments in property include investments of the Group in the real estate for the purpose of generating income from rent, but not investments held for sale within the framework of regular operations or for administration purposes.

Investments in property are initially recognized at purchase cost including the transaction costs. After initial recognition, investments in real estate are carried at purchase cost reduced by accumulated depreciation and impairment losses.

Investments in property are amortized by linear method through a period of 33 years.

Investments in property cease to be recognized at sale or at final withdrawal of investments in property from use or when no future economic benefits are expected from sale.

Gains or losses from withdrawal or sale of investments in property are recognized in the statement of profit or loss in the period of withdrawal or sale.

These assets are stated in note 21 Other assets due to immaterial amount.

**Non-current assets held for sale**

Non-current assets held for sale consist of property, plant and equipment that the Group acquired in settlement of uncollected receivables. The Group expects that the carrying amount of these assets will be recovered principally through a sale transaction rather than through continuing use.

This category of assets is initially stated at fair value less estimated expected costs to sell.

The Group measures these assets at the lower of its carrying amount and fair value (determined by an independent assessor) less estimated expected costs to sell.

Depreciation on these assets is not charged.

The Bank recognises an impairment provision for any initial or subsequent partial write-off of these assets up to the fair value less costs to sell. It recognises a gain for any subsequent increase in fair value of assets less costs to sell up to the amount of cumulative impairment provision that has been recognised.

Impairment provisions are recognized in the statement of profit or loss and other comprehensive income, as well as gains/losses upon subsequent measurement and on sale of the non-current assets.

The cases in which due to more difficult circumstances of sale because of objective circumstances and events beyond the Bank's control, the sale will not be completed in the planned period, or the period necessary for the conclusion of sale should be prolonged even after the period of one year, and a decision of an authorised body on giving up the sale or the plan of sale has not been made, and the activities are further undertaken to find a buyer and there is enough evidence that the Bank has remained consistent

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Non-current assets held for sale (continued)**

with the plan of sale of such type of assets, do not exclude that the assets are still classified as non-current assets held-for-sale.

**Bank's borrowings and bonds payable**

Financial liabilities of the Bank and the Group arise from received loans and securities issued.

Financial liabilities are initially recognized at fair value, adjusted by transaction costs. After initial recognition, financial liabilities are measured at amortized cost determined using the effective interest rate method.

Financial liabilities are stated in the contracted currency translated to Kuna at the middle exchange rate of the Croatian National Bank, contract exchange rate or determined rate arising from business and financial transactions based on documentation.

The Group recognises interest expense related to borrowings and bonds payable in the statement of profit or loss.

Investments sold on the basis of repurchase agreement (repo agreements) continue to be recognized in the statement on financial position and are valued in compliance with the accounting policy for the respective financial asset. Receipts from sale of securities are stated as collateralized loans taken from financial institutions. Interest earned in the period from the sale of securities until the repurchase is calculated daily and stated in the statement on profit and loss under interest expenses.

At the end of 2017, the Group had no contracted repo transactions (31 December 2016: HRK 315,416 thousand, for which the Group sold securities in the amount of HRK 345,049 thousand).

**Government grants**

Interest for the borrowers qualifying for subsidized interest under the Programme of Preferential Financing through HBOR's Loan Programmes, is subsidized by the Republic of Croatia – the Ministry of Finance during the entire loan repayment period.

The discounted amount of the interest subsidies provided for the final user is presented as deferred interest income in other liabilities and is recognized in the statement of profit or loss and other comprehensive income on a time basis during the repayment of the loan. Consequently, loans are measured at amortized cost by using interest rate without taking into account the effects of subsidies contributed by the State.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Guarantees and other loan related commitments**

In the ordinary course of business, the Bank issues financial guarantees, including letters of credit that are recorded off-balance sheet. Financial guarantee contracts are initially measured at their fair values. Subsequent to initial recognition, guarantees are measured at fair value at the higher of the amount of the obligation under the contract and the amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with the revenue recognition policies.

Contingent liabilities under guarantees are, to the extent of 82%, collateralized by the guarantees and deposits or the liability was taken over by the Republic of Croatia. Letters of credit are entirely covered by deposits.

Provisions for commitments upon undrawn loans and issued guarantees are maintained at a level considered as adequate by the Management Board in order to absorb potential losses.

Provisions are recognized when the Bank has a present legal or contractual obligation as a result of past events, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and when a reliable estimate of the amount of the obligation can be made.

**Segment reporting**

The Segment is a unique component of the Group and its operations are the supply of products or services (business segment) or the supply of products or services within a certain business environment (geographical segment) subject to unique risks and benefits, different from the ones in other segments.

The general format of business segments is based on the decision of the Management Board and the stated segments are in line with financial statements which are prepared in accordance with the International Financial Reporting Standards.

The Group has identified three main segments: banking activities, insurance activities and other activities.

Since the Group predominantly operates in the Republic of Croatia, there are no secondary (geographical) segments.

**Managed funds for and on behalf of third parties**

The Bank manages significant assets for and on behalf of the Ministry of Finance, Ministry of the Economy, Entrepreneurship and Trade, Ministry of the Sea, Transport and Infrastructure, Ministry of Agriculture, Ministry of Regional Development and EU Funds, Ministry of Environmental Protection and Energetics, Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for SMEs, Innovation and Investments ("HAMAG-BICRO"), that are used for the financing of reconstruction and development programmes.

These amounts do not represent assets of HBOR and are excluded from the Bank's Statement of financial position but are recorded separately from the Bank's operations.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.1. Accounting policies (continued)**

**Managed funds for and on behalf of third parties (continued)**

Revenues and expense relating to this business activity are charged to third parties, and the Bank does not have other liabilities nor bears any risks. For services provided within the framework of some of the programmes, the Bank charges a fee, whereas other programmes are performed by the Bank free of charge (see Note 29).

**2.2. Significant accounting judgments and estimates**

For the preparation of financial statements in accordance with IFRS's, the Management Board is required to give estimations and make assumptions that influence the reported balances of assets and liabilities and to disclose contingent amounts of assets and liabilities at the date of financial statements, and present income and expense for the reporting period. As a result of uncertainties which inherent in business activities, some items in the financial statements cannot be measured with precision but can only be estimated.

The procedure of estimation includes the judgements based on latest reliable information available at the reporting date, so that actual amounts may differ from those estimated.

The changes in accounting estimates are adjustments of the carrying amount of some assets or liabilities or the pattern of consumption during useful life arising through the estimation of the current situation and expected future benefits and obligations associated with these assets and liabilities.

The use of reasonable estimations is essential part of the preparation of financial statements and does not undermine their reliability.

The changes in accounting estimates occur if there are changes in circumstances based on which the estimation was based as a result of new information or more experience. The changes in estimates do not relate to prior periods and is not the correction of an error.

In the process of applying the Bank's accounting policies, the management has made judgments and estimates in determining the amounts recognized in the financial statements. The most significant use of judgments and estimates are as follows:

**a) Fair value of financial instruments**

If there is no active market for a certain financial instrument, or if for any other reason the fair value of financial assets and financial liabilities presented in the Statement of Financial Position cannot be reliably measured by the market price, the Group determines the fair value by using various valuation techniques including the use of mathematical models. The input data for these models are taken from other recognizable markets where possible, but if it is not possible, there is a certain degree of judgment required in determining fair values.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.2. Significant accounting judgments and estimates (continued)**

**b) Valuation of financial instruments**

The Bank's accounting policy on fair value measurements is discussed in Note 2.1. Fair value measurement and 32 Fair value of financial assets and financial liabilities .

**c) Loan impairment provisions**

The Bank regularly monitors its loans and receivables to assess impairment. The Bank uses its experience of judgments to estimate the amount of any impairment loss in cases where a borrower is in financial difficulties and there are several available sources of historical data relating to similar borrowers.

Similarly, the Bank estimates changes in future cash flows using the data indicating an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

The management uses estimates based on the historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the group of loans and receivables. The Bank uses its experience and judgment to adjust available data for a group of loans or receivables according to current market conditions.

**d) Provisions for legal cases**

The Group performs a risk classification of legal cases taking into consideration the legal basis of the claim, prior legal practice, opinions of relevant in-house lawyers, opinions of the outsourced attorneys and the Bank's own experience.

The Group makes provisions for legal cases in proportion with the total amount and estimated likelihood of not winning the case. In estimating provisions, the Bank takes into account the due legal process in the Republic of Croatia, which allows a multiple appeal procedure in certain cases.

Provisions for costs arising from initiated legal proceedings are reversed in the period in which legally valid sentence, arbitration award or settlement in the conciliation proceedings was made, pursuant to the procedures of monitoring legal cases against HBOR.

**e) Provisions for retirement and jubilee benefits**

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

Provisions for regular retirement and jubilee benefits are calculated and determined by a licensed actuary. Unrealised actuarial gains/(losses) arising from the calculation of provisions are stated within the framework of other comprehensive income so that net assets or liability may reflect the entire value of deficit or surplus planned.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards

The following new and amended IFRSs have been applied in the current year and have affected presentation and disclosures in these financial statements.

a) *New and amended International Financial Reporting Standards effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements:*

- Amended IAS 12 Income Taxes (effective for periods beginning on or after 1 January 2017, adopted in the European Union on 6 November 2017) – Recognition of Deferred Tax Assets for Unrealised Losses. IASB has concluded that the diversity in practice around the recognition of a deferred tax asset that is related to a debt instrument measured at fair value is mainly attributable to uncertainty about the application of some of the principles in IAS 12. Therefore, the amendments consist of some clarifications and an illustrating example.

This amendment does not affect the Group after the initial application.

- Amended IAS 7 Statement of Cash Flows (effective for periods beginning on or after 1 January 2017, adopted in the European Union on 6 November 2017) – Disclosure Initiative. The amendments come with the objective that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes.

This amendment does not affect the Group after the initial application.

b) *New and amended International Financial Reporting Standards effective in the reporting period and that have not been adopted in the European Union yet:*

- Annual improvements 2014-2016 - The primary objective of the process is to enhance the quality of standards, by amending existing IFRSs to clarify guidance and wording, or to correct for relatively minor unintended consequences, conflicts or oversights.

The issues included in this cycle are:

IFRS 12 Disclosure of Interests in Other Entities (effective for periods beginning on or after 1 January 2017, but have not been adopted in the European Union yet): Clarified the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10–B16, apply to an entity's interests listed in paragraph 5 that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

This amendment will not affect the Group after the initial application.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

b) *New and amended International Financial Reporting Standards effective in the reporting period and that have not been adopted in the European Union yet (continued):*

- Annual Improvements 2014-2016 (continued)

- IFRS 1 First-time Application of International Financial Reporting Standards and IAS 28 Investments in Associates and Joint Ventures under Annual Improvements 2014-2016 that are effective for periods beginning on or after 1 January 2018 but have not been adopted in the European Union yet are described under d) New and amended International Financial Reporting Standards that become effective after the reporting period and have not been adopted in the European Union yet.

c) *New and amended International Financial Reporting Standards not effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements:*

- New IFRS 15 Revenue from Contracts with Customers (effective for periods beginning on or after 1 January 2018, adopted in the European Union on 22 September 2016) establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. After its effective date, it will supersede the following standards and interpretations: IAS 18 Revenues; IAS 11 Construction Contracts; IFRIC 13 Customer Loyalty Programmes; IFRIC 15 Agreements for the Construction of Real Estate; IFRIC 18 Transfer of Assets from Customers and SIC 31 Revenue – Barter Transactions Involving Advertising Services.

The core principle of IFRS 15 is for companies to recognise revenues to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The standard establishes a five-step model framework that will be applied to revenues generated from contracts with customers irrespective of the type of transaction or activity as follows: identify the contract(s) with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract and recognise revenues when (or as) the entity satisfies a performance obligation. However, the standard does not apply to financial instruments and other contractual rights or obligations within the scope of IAS 39 Financial Instruments: Recognition and Measurement, i.e. IFRS 9 Financial Instruments, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures, insurance contracts within the scope of IFRS 4 Insurance Contracts, and consequently it will not affect the Group after the initial application.

- IFRS 9 Financial instruments - in July 2014, the final wording of the new IFRS 9 Financial Instruments (effective for periods beginning on or after 1 January 2018, adopted in the European Union on 22 November 2016), that shall from the date of its effectiveness completely replace IAS 39 Financial Instruments: Recognition and Measurement, and contains requirements relating to the recognition and measurement, impairment, de-recognition and hedge accounting in general.

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

c) *New and amended International Financial Reporting Standards not effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements (continued):*

- IFRS 9 Financial instruments (continued)

*Classification and measurement of financial assets and financial liabilities* - according to IFRS 9, all financial assets are classified as assets that, after initial recognition, in the business books is measured by: amortised cost, fair value through other comprehensive income or fair values through profit or loss.

The classification of financial assets in subsequent measurement categories is based on: the business model of financial asset management and SPPI test (Solely payments of principal and interest).

If the financial asset is held for the purpose of collecting contractual cash flows, it is measured at amortised cost, and if the financial asset is held to achieve both objectives: collecting the contractual cash flows and selling the financial assets, it is measured at fair value through other comprehensive income. All other financial assets that do not meet either the criteria for asset allocation at fair value through other comprehensive income or for asset allocation at amortised cost are measured at fair value through profit or loss.

*Impairment* – IFRS 9 introduces a uniform model of impairment that applies to both financial assets and off-balance sheet exposure to credit risk (undrawn loans and financial guarantees) and replaces the concept of incurred loss with the model of expected credit loss, with a view of timely recognition of losses.

The entities recognise the annual expected credit loss or the life time expected credit loss of a financial instrument, depending on whether the credit risk has increased significantly since initial recognition. Any measurement of expected credit losses shall reflect the probability of outcome, incorporate the time value of money and be based on reasonable and supportable information.

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

The Group shall not apply IFRS 9 in the period before its obligatory application.

During 2016, the Bank started the IFRS 9 Implementation Project by engaging external consultants, and a Project team was also established by HBOR.

The IFRS 9 Implementation project is in the final stage, and the Group is preparing for the first application of the new Standard, for the implementation of application support and complete application of work procedures based on the adopted new documents pursuant to the requirements of IFRS 9, and in compliance with the business model of HBOR.

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

c) *New and amended International Financial Reporting Standards not effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements (continued):*

- IFRS 9 Financial instruments (continued)

By the internal document relating to the classification and measurement of financial assets, business models, classification and reclassification of financial assets, allocation of financial assets to business models, SPPI test and financial assets modification are identified, as well as checklist issues for the implementation of SPPI test.

SPPI test is performed:

- for each financial asset, allocated to a business model whose purpose is to hold financial assets for the payment of contracted cash flows and a business model for the purpose of collecting contractual cash flows and selling financial assets on the date of initial recognition,
- for each financial asset in cases where the original asset has been significantly modified and therefore re-recognised as new assets,
- when introducing new models and/or loan programmes to determine in advance the eligibility of the considered loan terms and conditions in relation to the need to subsequently monitor the value of any financial assets that would arise out of them.

Business models for managing financial assets have been determined that reflect the manner in which a group of financial assets is managed together to achieve a particular business objective. Financial assets grouped into one business model are managed equally, such assets are assessed together, and reports on such assets are prepared together. A business model defines the manner in which financial assets are expected to generate cash flows, such as by collecting contractual cash flows, by selling financial assets or in both ways.

Business models of HBOR are as follows:

- Hold to collect business model (the assets meet the SPPI test):
  - Cash on hand and funds on transaction accounts,
  - Deposits with banks,
  - Loans,
  - Other receivables,
- Hold to collect and sell business model:
  - Debt securities (the assets meet the SPPI test),
  - Equity securities (the assets do not meet the SPPI test),
  - Shares in investment funds (the assets do not meet the SPPI test),
- FVPL business model (does not meet the SPPI test):
  - Derivative financial assets (in 2017, there are no these assets in the portfolio).

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

c) New and amended International Financial Reporting Standards not effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements (continued):

- IFRS 9 Financial instruments (continued)

Most of the business model is subject to SPPI test for the purpose of collection and is classified into financial assets that are valued at amortised cost. Two loans are not subject to SPPI test and are classified into financial assets measured at fair value through profit or loss.

Business model for the collection and sale that is subject to SPPI test is measured at fair value through other comprehensive income, and the one that is not subject to it, is measured at fair value through profit or loss.

HBOR does not intend to sell a part of equity securities and they are subject to irrevocable option of subsequent measurement of fair value through other comprehensive income without "recycling".

Internal document covering impaired value determines the manners of measuring and recognising provisions for impaired value for the expected credit losses on financial instruments, the categories of credit risk, the measurement of the expected credit losses on modified financial assets and the purchased or originated credit-impaired financial assets (POCI assets).

This documents defines the criteria for the classification of clients to the categories of credit risk, determines the models for the calculation of expected credit losses for every category of credit risk and the criteria for the reclassification of clients from one credit risk category to another.

Credit risk is assessed on an aggregate basis for all clients classified in stage 1 and stage 2 and for clients belonging to the small loans portfolio in stage 3, whereas individually it is assessed for all individually significant clients classified in stage 3 and for POCI assets.

Criteria for the classification of clients' financial instruments by credit risk stages:

Stage 1 – financial instruments of clients with low credit risk are classified to this stage as follows:

- Financial instruments of clients with an investment rating according to external credit rating agencies
- Exposures to the Republic of Croatia or units of local or regional government, the Croatian National Bank, the European Investment Bank or other promotional banks.

Client's financial instruments are not considered to have low credit risk simply because of the value of collateral as they are not considered to be low credit risk instruments without such collateral.

For financial instruments of clients classified to this stage, impairment value is calculated on a collective basis as 12-month expected credit losses.

Stage 2 – this stage includes financial instruments of clients that have a significant increase in credit risk or that have been introduced into the watch list as individually significant clients.

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

c) New and amended International Financial Reporting Standards not effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements (continued):

- IFRS 9 Financial instruments (continued)

A significant increase in credit risk is assessed on the basis of the criteria defined for the inclusion of clients into the watch list.

For financial instruments of clients classified to stage 2, impairment provisions are calculated on a collective basis as lifetime expected credit losses.

Stage 3 – financial instruments of a client that is in the default status – includes clients with objective evidence of impairment of the financial instrument's value and purchased or originated credit impaired financial assets – POCI.

The measurement of expected credit losses on a collective basis is used for clients in stages 1 and 2 and for clients in stage 3 belonging to the portfolio of small loans (the gross exposure amount is equal to or less than HRK 1,500 thousand), whereas individual estimates are made for financial instruments of clients in the status of default. When measuring expected credit losses on a collective basis HBOR has defined the following homogeneous groups based on common credit risk characteristics:

- Central government and local (regional) government,
- Financial institutions,
- Direct MICRO,
- Direct SME,
- Direct citizens,
- Direct large and
- Other receivables.

For the group of central and local and regional government, when calculating expected credit losses – PDs (Probability of default) the rating of external credit rating agencies for the Republic of Croatia was used according to the rating of the agency S&P and the publicly available reports of credit rating agencies on historical rates of the default status.

Credit losses of financial institutions are assessed on the basis of the mapping of ratings of HBOR with the probability of default (PD) of the S&P rating agency, with the rating of Zagrebačka banka and the PD of Zagrebačka banka being a benchmark because that bank has a determined rating.

For the groups of direct loans (large, small, medium, micro, citizens) and others in the case of PD modeling, a migration matrix approach was used – developments in exposures under the following risk categories:

- From 0 to 30 days past due – stage 1
- From 31 to 90 days past due – stage 2
- More than 90 days past due and restructuring – event of non-fulfilment of obligations - default.

Pursuant to the above paragraphs, accounting policies and other documents relating to the management of credit risk and the early warning systems for increased credit risk have been amended.

Based on the foregoing, the following is an estimate of the effects expected for the first-time adoption of IFRS 9 on 1 January 2018, with emphasis that, based on the selected accounting policies, the Group will not reverse the comparable data for initial application of IFRS 9, but the one-off effect, i.e. the differences in the carrying amounts of financial assets and financial liabilities

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.3. Adoption of new and amended International financial reporting standards (continued)**

c) *New and amended International Financial Reporting Standards not effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements (continued):*

- IFRS 9 Financial instruments (continued)

arising from the application of IFRS 9, will be recognised in retained earnings and reserves as at 1 January 2018.

Due to the non-material influence of the subsidiary, below is an assessment of the effect for the parent company only:

Bank	<b>Effect IFRS 9 HRK '000</b>
Impairment of financial assets with no significant credit risk – Stage 1	131,486
Impairment of financial assets with significantly increased credit risk – Stage 2	289,059
Impairment of financial assets reduced by credit losses – Stage 3	49,584
Reclassification of financial instruments	(718)
<b>Total</b>	<b>469,411</b>

The impact of the impairment of the financial asset value classified to stage 3 is a result of the implementation of more scenarios under IFRS 9 against IFRS 39 where only one expected scenario was used.

The effect of reclassification on equity securities and investments in investment funds amounts to HRK 28,247, but has no impact on the amount of total equity.

- New IFRS 16 Leases (effective for periods beginning on or after 1 January 2019, adopted in the European Union on 31 October 2017) – sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer (“lessee”) and the supplier (“lessor”). The new standard requires lessees to recognise most leases on their financial statements. Lessees will have a single accounting model for all leases, with certain exemptions.

The above new IFRS will not affect the significantly Group after the initial application.

- Changes and amendments to IFRS 15 Revenue from Contracts with Customers (effective for periods beginning on or after 1 January 2018, adopted in the European Union on 31 October 2017) – Clarifications to IFRS 15 issued.

The amendments do not change the underlying principles of the standard, just clarify and offer some additional transition relief.

The standard 15 does not apply to financial instruments and other contractual rights or obligations within the scope of IAS 39 Financial Instruments: Recognition and Measurement, i.e. IFRS 9 –

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**2. Summary of significant accounting policies (continued)**

**2.3. Adoption of new and amended International financial reporting standards (continued)**

c) *New and amended International Financial Reporting Standards not effective in the reporting period and adopted in the European Union with the assessment of impact on the financial statements (continued):*

- Changes and amendments to IFRS 15 Revenue from Contracts with Customers (continued)

Financial Instruments, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures, insurance contracts within the scope of IFRS 4 Insurance Contracts, and consequently it will not affect the Group after the initial application.

- Amendments to IFRS 4 Insurance Contracts - Applying IFRS 9 Financial Instruments with IFRS 4 (effective for periods beginning on or after 1 January 2018, adopted in the European Union on 3 November 2017) – the Amendments to existing requirements—IFRS 4 Insurance Contracts:
  - the „temporary exemption“ - permits entities whose predominant activities are connected with insurance to defer the application of IFRS 9 until 2021; and
  - the „overlay approach“ - permits all issuers of insurance contracts to recognise in other comprehensive income, rather than profit or loss, the volatility that could arise when IFRS 9 is applied before the new insurance contracts Standard is issued.

Temporary exemption has been granted to the subsidiary company – the HKO Group – owing to immateriality and will be applied from 1 January 2018 to 1 January 2021, i.e. the start of the implementation of the new insurance contracts Standard, unless otherwise determined by the Croatian Financial Services Supervisory Agency (HANFA).

d) *New and amended International Financial Reporting Standards that become effective after the reporting period and that have not been adopted in the European Union:*

- Amended IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures (application deferred for an indefinite period) dealing with the sale or contribution of assets between an investor and its associate or joint venture in the way that, in a transaction involving an associate or a joint venture, the extend of gain or loss recognition depends on whether the assets sold or contributed constitute a business. The Group shall apply the above amendments if such a transaction arises in the period after the start of the standard application.

- Annual improvements 2014-2016 - The primary objective of the process is to enhance the quality of standards, by amending existing IFRSs to clarify guidance and wording, or to correct for relatively minor unintended consequences, conflicts or oversights. The issues included in this cycle are:

- IFRS 1 First-time Application of International Financial Reporting Standards (effective for periods beginning on or after 1 January 2018, but have not been adopted in the European Union yet): Deleted the short-term exemptions in paragraphs E3–E7 of IFRS 1, because they have now served their intended purpose.

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

d) *New and amended International Financial Reporting Standards that become effective after the reporting period and that have not been adopted in the European Union (continued):*

- Annual improvements 2014-2016 (continued)
  - IAS 28 Investments in Associates and Joint Ventures (effective for periods beginning on or after 1 January 2018, but have not been adopted in the European Union yet): Clarified that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.
- Changes and amendments to IFRS 2 Share-Based Payment (effective for periods beginning on or after 1 January 2018, but have not been adopted in the European Union yet) – issued clarifications of IFRS 2 regarding the classification and measurement of share-based payment transactions. This amendment will not affect the Group after the initial application.
- New interpretation - IFRIC 22 Foreign Currency Transactions and Advance Consideration (effective for periods beginning on or after 1 January 2018, but have not been adopted in the European Union yet) – clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency.  
The Interpretation covers foreign currency transactions when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognises the related asset, expense or income. It does not apply when an entity measures the related asset, expense or income on initial recognition at fair value or at the fair value of the consideration received or paid at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability. Also, the Interpretation need not be applied to income taxes, insurance contracts or reinsurance contracts.  
  
The interpretations Committee came to the following conclusion:
  - The date of the transaction, for the purpose of determining the exchange rate, is the date of initial recognition of the non-monetary prepayment asset or deferred income liability.
  - If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt.
- Amendments to IAS 40 Investment Property—Transfers of investment property (effective for periods beginning on or after 1 January 2018, but have not been adopted in the European Union yet).  
The amendments in Transfers of Investment Property are:

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

d) *New and amended International Financial Reporting Standards that become effective after the reporting period and that have not been adopted in the European Union (continued):*

- Amendments to IAS 40 Investment Property (continued)
  - Paragraph 57 has been amended to state that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in management's intentions for the use of a property by itself does not constitute evidence of a change in use.
  - The list of evidence in paragraph 57(a) – (d) was designated as non-exhaustive list of examples instead of the previous exhaustive list.
- New IFRS 17 Insurance Contracts (effective for periods beginning on or after 1 January 2021, but have not been adopted in the European Union yet) - replaces IFRS 4 Insurance Contracts. The overall objective of IFRS 17 is to provide a more useful and consistent accounting model for insurance contracts among entities issuing insurance contracts globally. The Group plans to adopt the standard after it has become effective and currently estimates its impact.
- New Interpretation - IFRIC 23 Uncertainty over Income Tax Treatments (effective for periods beginning on or after 1 January 2019, but have not been adopted in the European Union yet) The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of IAS 12. The Interpretation does not apply to taxes or levies outside the scope of IAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Group currently estimates the impact of these interpretations on financial reporting.
- Amendments to IFRS 9 - „Prepayment Features with Negative Compensation“ (effective for periods beginning on or after 1 January 2019, but have not been adopted in the European Union yet).  
The amendments to the financial instruments Standard IFRS 9 allow companies to measure particular prepayable financial assets with so-called negative compensation at amortised cost or at fair value through other comprehensive income if a specified condition is met—instead of at fair value through profit or loss.  
The Group currently estimates the impact of these interpretations on financial reporting.
- Amendments to IAS 28 Investments in Associates and Joint Ventures (effective for periods beginning on or after 1 January 2019, but have not been adopted in the European Union yet).The Amendments clarify that an entity applies IFRS 9 Financial Instruments to long-term interests in an associate or joint venture that, in substance, form part of the net investment in the associate or joint venture but to which the equity method is not applied.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 2. Summary of significant accounting policies (continued)

### 2.3. Adoption of new and amended International financial reporting standards (continued)

d) *New and amended International Financial Reporting Standards that become effective after the reporting period and that have not been adopted in the European Union yet (continued):*

- Amendments to IAS 28 (continued)

An entity applies IFRS 9 to such long-term interests before it applies IAS 28. In applying IFRS 9, the entity does not take account of any adjustments to the carrying amount of long-term interests that arise from applying IAS 28.

The Group currently estimates the impact of these interpretations on financial reporting.

- Annual improvements 2015-2017 (effective for the periods beginning on or after 1 January, but have not been adopted in the European Union) – yet) – include the following changes and amendments:

- IFRS 3 Business Combinations and IFRS 11 Joint Arrangements – changes and amendments to IFRS 3 clarifying how a company accounts for increasing its interest in a joint operation that meets the definition of a business.

- if a party maintains (or obtains) joint control, then the previously held interest is not remeasured,
- if a party obtains control, then the transaction is a business combination achieved in stages and the acquiring party remeasures the previously held interest at fair value.

- IAS 12 Income Taxes – changes and amendments clarifying that all income tax consequences of dividends (including payments on financial instruments classified as equity) are recognised consistently with the transactions that generated the distributable profits – i.e. in profit or loss, other comprehensive income or equity.

- IAS 23 Borrowing Costs – changes and amendments clarifying the borrowing costs meeting the capitalisation requirements – clarify that the general borrowings pool used to calculate eligible borrowing costs excludes only borrowings that specifically finance qualifying assets that are still under development or construction. Borrowings that were intended to specifically finance qualifying assets that are now ready for their intended use or sale – or any non-qualifying assets are included in that general pool.

As the costs of retrospective application might outweigh the benefits, the changes are applied prospectively to borrowing costs incurred on or after the date an entity adopts the amendments.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 3. Interest income

Interest income by borrowers:

	2017 HRK '000	Group 2016 HRK '000	2017 HRK '000	Bank 2016 HRK '000
Public sector	113,744	118,604	112,117	117,020
State-owned companies	51,300	42,607	51,300	42,607
Foreign companies	13,566	13,111	13,566	13,111
Domestic companies	359,964	340,611	359,964	340,611
Domestic financial institutions	246,331	284,149	246,331	284,092
Foreign financial institutions	845	136	845	136
Penalty interest	14,461	14,164	14,461	14,164
Other	67,614	58,603	67,614	58,603
	<b>867,825</b>	<b>871,985</b>	<b>866,198</b>	<b>870,344</b>

Interest income by type of facility:

	2017 HRK '000	Group 2016 HRK '000	2017 HRK '000	Bank 2016 HRK '000
Interest on loans				
- financial institutions	248,613	284,291	248,613	284,291
- other customers	577,814	538,468	577,814	538,468
	<b>826,427</b>	<b>822,759</b>	<b>826,427</b>	<b>822,759</b>
Investments in securities	40,540	48,987	38,913	47,403
Deposits	858	239	858	182
	<b>867,825</b>	<b>871,985</b>	<b>866,198</b>	<b>870,344</b>

The difference between interest income and interest received or collected (see Statement of Cash Flows) mostly relates to the income in respect to interest subsidies inflows that are recorded upon payment. The discounted amount of the interest subsidies provided for the final user is presented as deferred interest income (see Note 25 Other liabilities) and is recognized in the statement of profit or loss and other comprehensive income on a time basis during the repayment of the loan. Interest income earned on this basis in 2017 amounts to HRK 99,635 thousand (31 December 2016: HRK 128,312 thousand).

Further, the difference between interest income and interest collected relates to the amount of loan fees and accrued interest. Loan fees are collected after origination of the loan, but their recognition in the statement of profit or loss and other comprehensive income is performed using effective interest rate method. Accrued interest is recognized in the statement of profit or loss and other comprehensive income on a time basis.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

#### 4. Interest expense

Interest expense by type of payee:

	2017	Group 2016	2017	Bank 2016
	HRK '000	HRK '000	HRK '000	HRK '000
Domestic financial institutions	2,246	11,627	2,246	11,627
Foreign financial institutions	388,214	441,046	388,214	441,046
	<b>390,460</b>	<b>452,673</b>	<b>390,460</b>	<b>452,673</b>

Interest expense by type of facility:

	2017	Group 2016	2017	Bank 2016
	HRK '000	HRK '000	HRK '000	HRK '000
Borrowings	276,128	280,115	276,128	280,115
Debt securities	113,340	172,518	113,340	172,518
Deposits	992	40	992	40
	<b>390,460</b>	<b>452,673</b>	<b>390,460</b>	<b>452,673</b>

The difference between interest expense and interest paid (see the Statement of Cash Flows) mostly relates to the changes in the amount of the interest accrued in relation to the prior year and the amortization of discount for issued debt securities.

#### 5. Net fee income

	2017	Group 2016	2017	Bank 2016
	HRK '000	HRK '000	HRK '000	HRK '000
Fee income:				
From issued guarantees	30,741	20,945	30,741	20,945
From managed funds for and on behalf of third parties	14,201	6,733	14,201	6,733
From payment operations	526	585	526	585
Reinsurance commission income	2,586	2,102	-	-
Other	71	69	71	69
	<b>48,125</b>	<b>30,434</b>	<b>45,539</b>	<b>28,332</b>
Fee expense	(3,144)	(3,265)	(3,144)	(3,265)
<b>Net fee income</b>	<b>44,981</b>	<b>27,169</b>	<b>42,395</b>	<b>25,067</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

#### 6. Net gains on financial operations

	2017	Group 2016	2017	Bank 2016
	HRK '000	HRK '000	HRK '000	HRK '000
Net foreign exchange gains/(losses) on foreign currency assets:				
Cash on hand, accounts at banks and due from banks	(9,680)	(2,107)	(9,680)	(2,107)
Loans given to financial institutions and other customers	(149,163)	(98,092)	(149,163)	(98,092)
Financial assets at fair value through profit or loss	(2)	(44)	-	-
Assets held to maturity	4	(15)	-	-
Assets available for sale	(9,855)	(10,047)	(9,764)	(9,931)
Other	(72)	1,811	(72)	1,811
	<b>(168,768)</b>	<b>(108,494)</b>	<b>(168,679)</b>	<b>(108,319)</b>
Net foreign exchange gains/(losses) on foreign currency liabilities:				
Deposits	322	1,355	322	1,355
Borrowings and issued long-term securities	144,257	112,780	144,257	112,780
Other	667	(364)	671	(366)
	<b>145,246</b>	<b>113,771</b>	<b>145,250</b>	<b>113,769</b>
<b>Net foreign exchange (losses)/gains on foreign currency assets and liabilities</b>	<b>(23,522)</b>	<b>5,277</b>	<b>(23,429)</b>	<b>5,450</b>
Gains on assets at fair value through profit or loss and realized gains on assets available for sale	2,806	2,219	2,804	1,862
<b>Net (losses)/gains on financial operations</b>	<b>(20,716)</b>	<b>7,496</b>	<b>(20,625)</b>	<b>7,312</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 7. Operating expenses

Operating expenses can be shown as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
General and administrative expenses:				
Employee expenses	90,055	87,801	86,518	84,830
Depreciation	7,539	7,428	7,482	7,359
Administration expenses	15,831	15,163	15,537	14,851
Material and services	34,074	29,862	32,041	28,220
	<u>147,499</u>	<u>140,254</u>	<u>141,578</u>	<u>135,260</u>
Other expenses:				
Recalculation expenses	5,487	13,637	5,487	13,637
Other expenses	6,014	6,397	2,367	3,330
	<u>11,501</u>	<u>20,034</u>	<u>7,854</u>	<u>16,967</u>
	<b><u>159,000</u></b>	<b><u>160,288</u></b>	<b><u>149,432</u></b>	<b><u>152,227</u></b>

Material and services contain audit costs as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Audit services	731	645	513	525
Non-audit services (subproject audit)	30	75	30	75
	<u>761</u>	<u>720</u>	<u>543</u>	<u>600</u>

Other expenses of the Group presented contain changes in technical reserves:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Change in the claims provision	3,685	(2,251)	-	-
Change in the claims provision, reinsurer's share	(2,204)	2,217	-	-
<b>Expenses of insurance operations</b>	<b><u>1,481</u></b>	<b><u>(34)</u></b>	<b><u>-</u></b>	<b><u>-</u></b>

The most significant part of provisions for losses relates to IBNR provision. The Bornhuetter-Ferguson method used was not changed as compared to the previous year. The provisions and the share of reinsurance increased in gross amount as compared to the same reporting date of the previous year. The reinsurance share is determined in accordance with the valid terms and conditions of the reinsurance contract.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 8. Impairment loss and provisions

The provision for impairment losses on placements may be summarized as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Impairment losses on cash on hand and due from financial institutions	(2,221)	(714)	(2,221)	(714)
Impairment losses on deposits with other banks	106	(3,462)	106	(3,462)
Impairment losses on loans to financial institutions	(123,846)	(39,164)	(123,846)	(39,164)
Impairment losses on loans to other customers and interest	337,888	20,690	337,888	20,690
Impairment losses on non-current assets held for sale	526	2,047	526	2,047
Impairment losses on other assets	2,195	528	1,908	531
	<u>214,648</u>	<u>(20,075)</u>	<u>214,361</u>	<u>(20,072)</u>
Total increase in provision for impairment losses on assets				
Provision for guarantees and commitments	(10,355)	11,922	(10,355)	11,922
Other provisions	(9,106)	10,526	(9,086)	10,464
	<u>(19,461)</u>	<u>22,448</u>	<u>(19,441)</u>	<u>22,386</u>
Total increase in provision for guarantees and commitments and other provisions				
<b>Total increase of provisions</b>	<b><u>195,187</u></b>	<b><u>2,373</u></b>	<b><u>194,920</u></b>	<b><u>2,314</u></b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**9. Income tax**

Based on Article 9 of the Act on the HBOR, the parent company is exempt from income tax. Income tax liabilities arise exclusively from the activities of the other members of the Group.

	<b>2017</b>	<b>Group</b>
	<b>HRK '000</b>	<b>2016</b>
		<b>HRK '000</b>
<b>Recognised in the Statement of Profit or Loss</b>		
Current tax - recognised in the statement of profit or loss	(102)	-
Deferred tax expenditure	-	(233)
<b>Income tax</b>	<b>(102)</b>	<b>(233)</b>
<b>Income tax reconciliation</b>		
<b>Profit before tax</b>	<b>1,520</b>	<b>1,548</b>
Income tax at 20% rate	-	(224)
Income tax at 18% rate	(54)	-
Income tax at 12% rate	(43)	-
Non-deductible expense	(5)	(40)
Tax-exempt income	-	31
<b>Deferred tax liabilities throughout the year</b>	<b>(102)</b>	<b>(233)</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**10. Cash on hand and due from banks**

	<b>2017</b>	<b>Group</b>	<b>2017</b>	<b>Bank</b>
	<b>HRK 000</b>	<b>2016</b>	<b>HRK 000</b>	<b>2016</b>
		<b>HRK 000</b>		<b>HRK 000</b>
Account with the Croatian National Bank	1,316,536	186,167	1,316,536	186,167
Due from domestic banks in foreign currency	1,544	1,626	1,544	1,626
Due from foreign banks in foreign currency	83,924	305,981	83,924	305,981
Due from domestic banks in HRK	2,534	551	-	-
	<u>1,404,538</u>	<u>494,325</u>	<u>1,402,004</u>	<u>493,774</u>
Provisions for impairment losses	(858)	(3,079)	(858)	(3,079)
	<u>1,403,680</u>	<u>491,246</u>	<u>1,401,146</u>	<u>490,695</u>

The movements in the provision for impairment losses on amounts due from banks may be summarized as follows:

	<b>2017</b>	<b>Group</b>	<b>2017</b>	<b>Bank</b>
	<b>HRK 000</b>	<b>2016</b>	<b>HRK 000</b>	<b>2016</b>
		<b>HRK 000</b>		<b>HRK 000</b>
Balance as at 1 January	3,079	3,793	3,079	3,793
Increase of provision for impairment losses on amounts due from banks	-	-	-	-
Release of provision for impairment losses on amounts due from banks	(2,221)	(714)	(2,221)	(714)
<b>Balance as at 31 December</b>	<b>858</b>	<b>3,079</b>	<b>858</b>	<b>3,079</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

#### 11. Deposits with other banks

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Deposits with foreign banks	-	20,789	-	20,789
Deposits with domestic banks	29,468	3,330	29,468	3,330
Accrued interest	24	1	24	1
	<u>29,492</u>	<u>24,120</u>	<u>29,492</u>	<u>24,120</u>
Provisions for impairment losses	(354)	(248)	(354)	(248)
	<u><b>29,138</b></u>	<u><b>23,872</b></u>	<u><b>29,138</b></u>	<u><b>23,872</b></u>

The movements in the provision for impairment losses on deposits with other banks may be summarized as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January	248	3,710	248	3,710
Increase of provisions for impairment losses on deposits with other banks	106	-	106	-
Release of provision for impairment losses on deposits with other banks	-	(3,462)	-	(3,462)
<b>Balance as of 31 December</b>	<u><b>354</b></u>	<u><b>248</b></u>	<u><b>354</b></u>	<u><b>248</b></u>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

#### 12. Loans to financial institutions

Loans to financial institutions, net of provision for impairment losses, may be summarized as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Long-term loans under loan programmes	10,868,288	11,918,947	10,868,288	11,918,947
Short-term loans and reverse repo transactions	236,400	362,489	236,400	362,489
Accrued interest	27,672	37,363	27,672	37,363
Deferred recognition of loan origination fees	(58,293)	(66,371)	(58,293)	(66,371)
	<u>11,074,067</u>	<u>12,252,428</u>	<u>11,074,067</u>	<u>12,252,428</u>
Provisions for impairment losses	(237,926)	(363,317)	(237,926)	(363,317)
	<u><b>10,836,141</b></u>	<u><b>11,889,111</b></u>	<u><b>10,836,141</b></u>	<u><b>11,889,111</b></u>

The movements in the provision for impairment losses on loans to financial institutions may be summarized as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January	363,317	471,946	363,317	471,946
Increase of provision for impairment losses on loans to financial institutions	7,949	45,864	7,949	45,864
Release of provision for impairment losses on loans to financial institutions	(131,795)	(85,028)	(131,795)	(85,028)
Net foreign exchange losses on provision for impairment losses	(1,438)	(1,927)	(1,438)	(1,927)
Acquisition of immovable property	(1,105)	-	(1,105)	-
Provisions transferred from loans to other customers	998	203	998	203
Provisions transferred to loans to other customers	-	(67,741)	-	(67,741)
<b>Balance as of 31 December</b>	<u><b>237,926</b></u>	<u><b>363,317</b></u>	<u><b>237,926</b></u>	<u><b>363,317</b></u>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**12. Loans to financial institutions (continued)**

Loans to financial institutions, net of provision for impairment losses, by purpose of the loan programme may be summarized as follows:

	<b>2017</b>	<b>Group</b>	<b>2017</b>	<b>Bank</b>
	<b>HRK '000</b>	<b>2016</b>	<b>HRK '000</b>	<b>2016</b>
		<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
Loan programme for reconstruction and development of the economy	2,218,744	2,775,682	2,218,744	2,775,682
Export financing	2,935,166	3,466,148	2,935,166	3,466,148
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	1,584,242	1,602,331	1,584,242	1,602,331
Loan programme for small and medium-sized enterprises	4,121,412	4,064,711	4,121,412	4,064,711
Loan programme for war-torn and demolished housing and business facilities	8,724	10,075	8,724	10,075
Other	236,400	362,489	236,400	362,489
Accrued interest	27,672	37,363	27,672	37,363
Deferred recognition of loan fees	(58,293)	(66,371)	(58,293)	(66,371)
	<u>11,074,067</u>	<u>12,252,428</u>	<u>11,074,067</u>	<u>12,252,428</u>
Provisions for impairment losses	(237,926)	(363,317)	(237,926)	(363,317)
	<u><b>10,836,141</b></u>	<u><b>11,889,111</b></u>	<u><b>10,836,141</b></u>	<u><b>11,889,111</b></u>

Average interest rates for total loans to financial institutions are stated at 0.90% (31 December 2016: 1.07%) and are equal to average interests rates for loans under HBOR loan programmes excluding the liquidity reserve.

Average interest rates reflect the ratio of interest income generated from the mentioned placements and average assets.

Item "Other" refers to reverse REPO agreements in the total amount of HRK 236,400 thousand (31 December 2016: HRK 232,489 thousand). The above placements are collateralized by securities in the amount of HRK 249,727 thousand (31 December 2016: HRK 247,026 thousand).

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**13. Loans to other customers**

Loans to other customers, net of provision for impairment losses, may be summarized as follows:

	<b>2017</b>	<b>Group</b>	<b>2017</b>	<b>Bank</b>
	<b>HRK '000</b>	<b>2016</b>	<b>HRK '000</b>	<b>2016</b>
		<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
Domestic companies	11,294,141	10,463,392	11,294,141	10,463,392
State-owned companies	1,260,227	1,183,103	1,260,227	1,183,103
Public sector	1,744,426	1,528,564	1,744,426	1,528,564
Foreign companies	316,005	237,429	316,005	237,429
Non-profit institutions	3,407	1,712	3,407	1,712
Other	653,179	712,400	653,179	712,400
Accrued interest	101,042	83,423	101,042	83,423
Deferred recognition of loan origination fees	(113,501)	(119,328)	(113,501)	(119,328)
	<u>15,258,926</u>	<u>14,090,695</u>	<u>15,258,926</u>	<u>14,090,695</u>
Provisions for impairment losses	(2,875,303)	(2,579,501)	(2,875,303)	(2,579,501)
	<u><b>12,383,623</b></u>	<u><b>11,511,194</b></u>	<u><b>12,383,623</b></u>	<u><b>11,511,194</b></u>

The movements in the provision for impairment losses on loans to other customers may be summarized as follows:

	<b>2017</b>	<b>Group</b>	<b>2017</b>	<b>Bank</b>
	<b>HRK '000</b>	<b>2016</b>	<b>HRK '000</b>	<b>2016</b>
		<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
Balance as of 1 January	2,579,501	2,505,156	2,579,501	2,505,156
Increase of provision for impairment losses on loans to other customers and interest	553,952	256,313	553,952	256,313
Release of provision for impairment losses on loans to other customers and interest	(213,979)	(234,827)	(213,979)	(234,827)
Net foreign exchange losses on provision for impairment losses	(3,643)	(9,333)	(3,643)	(9,333)
Collection of off-balance sheet receivables	(2,085)	(796)	(2,085)	(796)
Provisions transferred from off-balance sheet	2,085	796	2,085	796
Acquisition of immovable property	(284)	(1,078)	(284)	(1,078)
Write-offs	(7,610)	(4,268)	(7,610)	(4,268)
Sale of receivables	(31,636)	-	(31,636)	-
Provisions transferred to loans to financial institutions	(998)	(203)	(998)	(203)
Provisions transferred from loans to financial institutions	-	67,741	-	67,741
<b>Balance as of 31 December</b>	<u><b>2,875,303</b></u>	<u><b>2,579,501</b></u>	<u><b>2,875,303</b></u>	<u><b>2,579,501</b></u>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**13. Loans to other customers (continued)**

Loans to other customers, net of provision for impairment losses, may be summarized by loan programme as follows:

	2017	Group	2017	Bank
	HRK '000	2016	HRK '000	2016
		HRK '000		HRK '000
Loan programme for reconstruction and development of the economy	4,546,833	4,123,892	4,546,833	4,123,892
Export financing	5,274,935	4,687,115	5,274,935	4,687,115
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	3,392,439	3,075,022	3,392,439	3,075,022
Loan programme for small and medium-sized enterprises	2,010,315	2,158,612	2,010,315	2,158,612
Other	46,863	81,959	46,863	81,959
Accrued interest	101,042	83,423	101,042	83,423
Deferred recognition of loan origination fees	(113,501)	(119,328)	(113,501)	(119,328)
	<u>15,258,926</u>	<u>14,090,695</u>	<u>15,258,926</u>	<u>14,090,695</u>
Provisions for impairment losses	(2,875,303)	(2,579,501)	(2,875,303)	(2,579,501)
	<u>12,383,623</u>	<u>11,511,194</u>	<u>12,383,623</u>	<u>11,511,194</u>

Average interest rates on loans to other customers are stated at 2.08% (31 December 2016: 2.04%).

Average interest rates reflect the ratio of interest income from generated the mentioned placements and average assets.

**14. Financial assets at fair value through profit or loss**

	2017	Group	2017	Bank
	HRK '000	2016	HRK '000	2016
		HRK '000		HRK '000
Shares in investment funds recognised at fair value through profit or loss	291	286	-	-
<b>Balance as at 31 December</b>	<b>291</b>	<b>286</b>	<b>-</b>	<b>-</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**15. Assets available for sale**

	2017	Group	2017	Bank
	HRK '000	2016	HRK '000	2016
		HRK '000		HRK '000
<b>Debt instruments:</b>				
<b>Listed debt instruments:</b>				
Bonds of the Ministry of Finance of the Republic of Croatia	884,763	925,887	846,428	884,914
Financial institution bonds	-	910	-	-
Corporate bonds	770	1,161	-	-
Treasury bills of the Ministry of Finance of the Republic of Croatia	1,583,313	1,500,420	1,583,313	1,500,420
Accrued interest	13,836	14,495	13,269	13,890
	<u>2,482,682</u>	<u>2,442,873</u>	<u>2,443,010</u>	<u>2,399,224</u>
<b>Unlisted debt instruments:</b>				
Corporate bonds	522	502	522	502
Accrued interest	167	99	167	99
	<u>689</u>	<u>601</u>	<u>689</u>	<u>601</u>
<b>Equity instruments:</b>				
<b>Listed equity instruments:</b>				
Investments in companies' shares	18,951	10,938	18,951	10,938
	<u>18,951</u>	<u>10,938</u>	<u>18,591</u>	<u>10,938</u>
<b>Unlisted equity instruments:</b>				
Investments in shares of foreign legal entities	35	32	35	32
Investments in financial institutions shares	161	161	161	161
Shares of foreign financial institutions – EIF (Note 28)	25,427	25,815	25,427	25,815
Investments in companies' shares	16,725	16,725	16,725	16,725
Provision for impairment losses	(16,725)	(16,725)	(16,725)	(16,725)
	<u>25,623</u>	<u>26,008</u>	<u>25,623</u>	<u>26,008</u>
<b>Investments in investment funds:</b>				
Shares classified as assets available for sale	793,619	909,614	788,921	906,803
	<u>793,619</u>	<u>909,614</u>	<u>788,921</u>	<u>906,803</u>
<b>Balance as at 31 December</b>	<b>3,321,564</b>	<b>3,390,034</b>	<b>3,277,194</b>	<b>3,343,574</b>

The movements in the provision for impairment losses on assets available for sale may be summarized as follows:

	2017	Group	2017	Bank
	HRK '000	2016	HRK '000	2016
		HRK '000		HRK '000
Balance as at 1 January	16,725	23,834	16,725	23,834
Increase of provisions for impairment losses on assets available for sale	-	2,721	-	2,721
Reversal of provisions for impairment losses on assets available for sale	-	(2,721)	-	(2,721)
Carrying at fair value	-	(7,109)	-	(7,109)
Balance as at 31 December	<u>16,725</u>	<u>16,725</u>	<u>16,725</u>	<u>16,725</u>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**15. Assets available for sale (continued)**

The following text contains investment breakdown:

	Date of issue	Date of maturity	Interest rate (%)	2017 HRK '000	2016 HRK '000	Group 2017 HRK '000	Bank 2016 HRK '000
<b>Debt instruments:</b>							
Listed debt instruments:							
<i>Bonds of the Republic of Croatia indexed to foreign currency:</i>							
RHMF-O-19BA	29.11.2004	29.11.2019.	5.375	46,963	48,602	45,979	47,588
RHMF-O -227E	22.7.2011.	22.7.2022.	6.5	173,791	172,432	173,791	172,432
RHMF-O-247E	10.7.2013.	10.7.2024.	5.75	18,286	17,802	12,891	12,558
RHMF-O-203E	5.3.2010.	5.3.2020.	6.5	851	875	-	-
<i>Bonds of the Republic of Croatia in foreign currency:</i>							
XS0645940288	8.7.2011.	9.7.2018.	5.875	54,184	57,370	54,184	57,370
XS0776179656	27.4.2012.	27.4.2017.	6.25	-	14,529	-	14,529
XS1117298916	11.3.2015.	11.3.2025.	3.0	56,748	53,248	56,748	53,248
<i>Bonds of the Republic of Croatia in HRK:</i>							
RHMF-O-172A	8.2.2007.	8.2.2017.	4.75	-	100,995	-	100,410
RHMF-O-187A	10.7.2013.	10.7.2018.	5.25	102,600	42,406	97,467	37,094
RHMF-O-17BA	25.11.2010.	25.11.2017.	6.25	-	161,910	-	157,185
RHMF-O-203A	5.3.2010.	5.3.2020.	6.75	2,969	3,003	-	-
RHMF-O-257A	9.7.2015.	9.7.2025.	4.5	9,774	9,335	-	-
RHMF-O-26CA	14.12.2015.	14.12.2026.	4.25	43,835	41,909	34,684	33,089
RHMF-O-217A	8.7.2016.	8.7.2021.	2.75	208,446	201,471	206,327	199,411
RHMF-O-222A	7.2.2017.	7.2.2022.	2.25	72,864	-	72,864	-
RHMF-O-282A	7.2.2017.	7.2.2028.	2.875	12,259	-	10,300	-
RHMF-O-023BA	27.11.2017.	27.11.2023.	1.75	81,193	-	81,193	-
<i>Financial institution bonds in HRK:</i>							
RIBA-O-17BA	23.11.2012.	23.11.2017.	5.88	-	522	-	-
<i>Financial institution bonds indexed to foreign currency:</i>							
RIBA-O-177A	18.7.2011.	18.7.2017.	6.5	-	388	-	-
<i>Corporate bonds in HRK:</i>							
JDGL-O-20CA	21.12.2015.	21.12.2020.	5.81	770	770	-	-
<i>Corporate bonds indexed to foreign currency:</i>							
JRLN-O-17AA	24.10.2012.	24.10.2017.	6.5	-	391	-	-
Treasury bills in HRK up to 115 days			0.728	39,967	-	39,967	-
			0.690 –				
Treasury bills indexed to foreign currency up to 364 days			0.856	1,243,145	1,087,406	1,243,145	1,087,406
Treasury bills in foreign currency up to 455 days			0.267	300,201	413,014	300,201	413,014
Accrued interest				13,836	14,495	13,269	13,890
				<b>2,482,682</b>	<b>2,442,873</b>	<b>2,443,010</b>	<b>2,399,224</b>
<b>Unlisted debt instruments:</b>							
<i>Corporate bonds indexed to foreign currency:</i>							
LNGU-O-31AE	24.7.2015.	15.10.2031.	4.5	522	502	522	502
Accrued interest				167	99	167	99
				<b>689</b>	<b>601</b>	<b>689</b>	<b>601</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**15. Assets available for sale (continued)**

The following text contains investment breakdown (continued):

	2017. HRK '000	Grupa 2016. HRK '000	2017. HRK '000	Banka 2016. HRK '000
<b>Equity instruments:</b>				
Listed equity instruments:				
Investments in companies' shares	18,951	10,938	18,951	10,938
	<b>18,951</b>	<b>10,938</b>	<b>18,951</b>	<b>10,938</b>
<b>Unlisted equity instruments:</b>				
Investments in shares of foreign legal entities in foreign currency	35	32	35	32
Investments in financial institutions' shares	161	161	161	161
Investments in shares of foreign financial institutions in foreign currency - EIF	25,427	25,815	25,427	25,815
Investments in companies' shares	16,725	16,725	16,725	16,725
Provisions for impairment losses	(16,725)	(16,725)	(16,725)	(16,725)
	<b>25,623</b>	<b>26,008</b>	<b>25,623</b>	<b>26,008</b>
<b>Investments in investments funds in the Republic of Croatia</b>	<b>793,619</b>	<b>909,614</b>	<b>788,921</b>	<b>906,803</b>
<b>Total</b>	<b>3,321,564</b>	<b>3,390,034</b>	<b>3,277,194</b>	<b>3,343,574</b>

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-19BA) issued with foreign currency clause on 29 November 2004 are repayable over 15 years with an interest rate of 5.375%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 46,963 thousand (31 December 2016: HRK 48,602 thousand) and for the Bank HRK 45,979 thousand (31 December 2016: HRK 47,588 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-227E) issued with foreign currency clause on 22 July 2011 are repayable over 11 years with an interest rate of 6.5%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 173,791 thousand (31 December 2016: HRK 172,432 thousand) and for the Bank HRK 173,791 thousand (31 December 2016: HRK 172,432 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-247E) issued with foreign currency clause on 10 July 2013 are repayable over 11 years with an interest rate of 5.75%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 18,286 thousand (31 December 2016: HRK 17,802 thousand) and for the Bank HRK 12,891 thousand (31 December 2016: HRK 12,558 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-203E) issued with foreign currency clause on 5 March 2010 are repayable over 10 years with an interest rate of 6.5%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 851 thousand (31 December 2016: HRK 875 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (XS0645940288) issued in foreign currency on 8 July 2011 are repayable over 7 years with an interest rate of 5.875%. As of 31 December 2017, the value of these outstanding bonds for the Group and for the Bank amounted to HRK 54,184 thousand (31 December 2016: HRK 57,370 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (XS0776179656) issued in foreign currency on 27 April 2012 are repayable over 5 years with an interest rate of 6.25%. The bonds were deemed upon maturity on 27 April 2017 (31 December 2016: HRK 14,529 thousand).

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**15. Assets available for sale (continued)**

Bonds of the Ministry of Finance of the Republic of Croatia (XS1117298916) issued in foreign currency on 11 March 2015 are repayable over 10 years with an interest rate of 3.0%. As of 31 December 2017, the value of these outstanding bonds for the Group and for the Bank amounted to HRK 56,748 thousand (31 December 2016: HRK 53,248 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-172A) issued in kuna on 8 February 2007 are repayable over 10 years with an interest rate of 4.75%. The bonds were deemed upon maturity on 8 February 2017 (31 December 2016: HRK 100,995 for the Group and for the Bank HRK 100,410 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-187A) issued in kuna on 10 July 2013 are repayable over 5 years with an interest rate of 5.25%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 102,600 thousand (31 December 2016: HRK 42,406 thousand) and for the Bank HRK 97,467 thousand (31 December 2016: HRK 37,094 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-17BA) issued in kuna on 25 November 2010 are repayable over 7 years with an interest rate of 6.25%. The bonds were deemed upon maturity on 25 November 2017 (31 December 2016: HRK 161,910 for the Group and for the Bank HRK 157,185 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-203A) issued in kuna on 5 March 2010 are repayable over 10 years with an interest rate of 6.75%. As of 31 December 2017, the value of these outstanding bonds amounted to HRK 2,969 thousand (31 December 2016: HRK 3,003 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-257A) issued in kuna on 9 July 2015 are repayable over 10 years with an interest rate of 4.5%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 9,774 thousand (31 December 2016: HRK 9,335 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-26CA) issued in kuna on 14 December 2015 are repayable over 11 years with an interest rate of 4.25%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 43,835 thousand (31 December 2016: HRK 41,909 thousand) and for the Bank HRK 34,684 thousand (31 December 2016: HRK 33,089 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-217A) issued in kuna on 8 July 2016 are repayable over 5 years with an interest rate of 2.75%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 208,446 thousand (31 December 2016: HRK 201,471 thousand) and for the Bank HRK 206,327 thousand (31 December 2016: HRK 199,411 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-222A) issued in kuna on 7 February 2017 are repayable over 5 years with an interest rate of 2.25%. As of 31 December 2017, the value of these outstanding bonds for the Group and for the Bank amounted to HRK 72,864 thousand (31 December 2016: HRK 0 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-282A) issued in kuna on 7 February 2017 are repayable over 11 years with an interest rate of 2.875%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 12,259 thousand (31 December 2016: HRK 0 thousand), and for the Bank HRK 10,300 thousand (31 December 2016: HRK 0 thousand).

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**15. Assets available for sale (continued)**

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-023BA) in kuna on 27 November 2017 repayable over 6 years with an interest rate of 1.75%. As of 31 December 2017, the value of these outstanding bonds for the Group and for the Bank amounted to HRK 81,193 thousand (31 December 2016: HRK 0 thousand).

Financial institution bonds (RIBA-O-17BA) issued in kuna on 23 November 2012 and are repayable over 5 years with an interest rate of 5.88%. The bonds were deemed upon maturity on 23 November 2017 (31 December 2016: HRK 522 thousand).

Financial institution bonds (RIBA-O-177A) issued with foreign currency clause on 18 July 2011 and are repayable over 6 years with an interest rate of 6.5%. The bonds were deemed upon maturity on 18 July 2017 (31 December 2016: HRK 388 thousand).

Corporate bonds (JDGL-O-20CA) issued in kuna on 21 December 2015 and are repayable over 5 years with an interest rate of 5.81%. As of 31 December 2017, the value of these outstanding bonds for the Group amounted to HRK 770 thousand (31 December 2016: HRK 770 thousand).

Corporate bonds (JRLN-O-17AA) issued with foreign currency clause on 24 October 2012 and are repayable over 5 years with an interest rate of 6.5%. The bonds were deemed upon maturity on 24 October 2017 (31 December 2016: HRK 391 thousand).

Corporate bonds (LNGU-O-31AE) issued with foreign currency clause on 24 July 2015 and are repayable over 16 years with an interest rate of 4.5%. As of 31 December 2017, the value of these outstanding bonds for the Group and Bank amounted to HRK 522 thousand (31 December 2016: HRK 502 thousand). By the Agreement on Transfer of Bonds of the company Lanište d.o.o. concluded on 10 September 2015 between HBOR and Ingra d.d., 203,078 bonds issued by the company Lanište d.o.o. were transferred for the settlement of HBOR's claims (fees for issued counter-guarantees and other receivables), and pursuant to the pre-bankruptcy settlement concluded between Ingra and the creditor in the pre-bankruptcy settlement procedure. In the settlement procedure, it was established that HBOR's claim would be settled by transfer of bonds. The bonds of the company Lanište d.o.o. are not listed.

In 2007, HBOR made acquisitions of five shares of the European Investment Fund (EIF), and on 15 July 2014 it made acquisitions of three more shares of EIF that were as of 31 December 2017 stated under Assets available for sale in the total amount of HRK 25,427 thousand (31 December 2016: HRK 25,815 thousand). The payment made represents 20% of the nominal amount of purchased shares and the other 80% makes a contingent liability towards EIF. On 31 December 2017 this contingent liability was EUR 6.4 million (31 December 2016: EUR 6.4 million) (Note 28).

The General Meeting, acting on a proposal from the Board of Directors, may require payment of the subscribed but not paid capital to the extent required for the Fund to meet its liabilities towards its creditors. Such payment shall be effected within 90 days from the decision of the General Meeting.

Corporate shares comprise shares in capital of the company for the production of agricultural products, Vinka d.d., and of the shipyard company Brodografište Viktor Lenac d.d., Rijeka. The shares were acquired within restructuring measures for those companies in exchange for a portion of receivables. In March 2010, when all preconditions were met, HBOR's receivables were partly turned into an equity share in the company Vinka d.d., Vinkovci amounting to HRK 16,725 thousand, representing a 5.1823% of the equity share belonging to HBOR in the company's equity.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**15. Assets available for sale (continued)**

HBOR effected a 100% impairment of value for the complete amount of the equity share since it was estimated uncollectable.

In 2011, however, owing to an increase in capitalisation, the percentage of HBOR's share in the company's equity was changed to 0.9365%. The shares of the company Vinka d.d., Vinkovci (LPVC-R-B) are not listed.

In 2011, owing to an increase in capitalisation, the percentage of HBOR's share in the equity of Brodogradilište Viktor Lenac d.d., Rijeka was changed to 8.1321%. The shares of the company (VLEN-R-B) were listed in 2008 at the Zagreb Stock Exchange, and trade started in May 2009. Quoted price per share as of 31 December 2017 amounted to HRK 13.86 (31 December 2016: HRK 8.00 per share).

Pursuant to the decision of the subsidiary's management dated 23 January 2017, 22 February 2017 and 7 June 2017 shares in investment funds were classified as assets available for sale.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**16. Assets held to maturity**

	2017 HRK '000	Group 2016 HRK '000	2017 HRK '000	Bank 2016 HRK '000
<b>Debt instruments:</b>				
<b>Listed debt instruments:</b>				
Bonds of the Ministry of finance of the Republic of Croatia	1,385	1,408	-	-
Accrued interest	14	14	-	-
<b>Balance as at 31 December</b>	<b>1,399</b>	<b>1,422</b>	<b>-</b>	<b>-</b>

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-203E) issued with foreign currency clause on 5 March 2010 are repayable over 10 years with an interest rate of 6.5%. As of 31 December 2017, the value of these outstanding bonds amounted to HRK 467 thousand (31 December 2016: HRK 476 thousand).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-19BA) issued with foreign currency clause on 29 November 2004 are repayable over 15 years with an interest rate of 5.375%. As of 31 December 2017, the value of these outstanding bonds amounted to HRK 918 thousand (31 December 2016: HRK 932 thousand).

**17. Investments in subsidiaries**

As at 31 December 2017, the Bank's subsidiaries are as follows:

Consolidated company	Activity	Ownership 2017	Ownership 2016	Investment 2017	Investment 2016
<b>Direct share</b>					
Hrvatsko kreditno osiguranje d.d. Zagreb, Republic of Croatia	Providing insurance for company's foreign and domestic short-term receivables regarding shipments of goods and services	100%	100%	36,124	36,124
<b>Total</b>				<b>36,124</b>	<b>36,124</b>

Result of the subsidiary has been disclosed in Appendix – Financial performance of the HKO Group.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 18. Investments in associates

	2017 HRK '000	Group 2016 HRK '000	2017 HRK '000	Bank 2016 HRK '000
Investments in associates	21,873	23,687	21,873	23,687
Value adjustments	(21,873)	(23,687)	(21,873)	(23,687)
	-	-	-	-

Investments in associates were carried out within a Program of investments in the equity of companies – small and medium sized entrepreneurs or pursuant to single decisions of authorized bodies of HBOR. The investments were made for a period ranging from 4 to 6 years with the right of HBOR to sell the shares after the contracted term of holding an equity stake.

Line of business	% ownership in 2017	% ownership in 2016
Bila boja d.o.o., Grohote, in bankruptcy	-	17.96%
THC d.o.o., Obrovac	38.45%	38.45%
Tri D Drvo d.o.o., Vrhovine, in bankruptcy	26.00%	26.00%
Pounje d.d., Hrvatska Kostajnica	13.55%	13.55%
Metal-Sint Oklaj d.d., Oklaj	40.84%	40.84%

The value of investment was 100% adjusted in prior years due to assessed non-recoverability of the investment.

By the Decision of the Management Board of 7 July 2017., the share in the company Bila boja d.o.o. Grohote was derecognised, since all attempts of regular and compulsory collection were exhausted, the bankruptcy proceedings completed and the company deleted from the court register.

Changes in provisions for possible losses from investments in associates can be presented as follows:

	2017 HRK '000	Group 2016 HRK '000	2017 HRK '000	Bank 2016 HRK '000
Balance as of 1 January	23,687	23,687	23,687	23,687
Decrease of provisions for possible losses from investments in associates due to derecognition	(1,814)	-	(1,814)	-
<b>Balance as at 31 December</b>	<b>21,873</b>	<b>23,687</b>	<b>21,873</b>	<b>23,687</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 19. Property, plant and equipment and intangible assets

Group	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>							
Cost							
<b>At 31 December 2016</b>	<b>77,102</b>	<b>11,218</b>	<b>15,236</b>	<b>1,036</b>	<b>104,592</b>	<b>25,582</b>	<b>130,174</b>
Additions	-	-	-	3,736	3,736	-	3,736
Transfer from assets not yet ready for use	-	624	370	(4,064)	(3,070)	3,070	-
Disposals and write-offs	-	(1,865)	(225)	-	(2,090)	-	(2,090)
<b>At 31 December 2017</b>	<b>77,102</b>	<b>9,977</b>	<b>15,381</b>	<b>708</b>	<b>103,168</b>	<b>28,652</b>	<b>131,820</b>
Accumulated depreciation							
<b>At 31 December 2016</b>	<b>28,145</b>	<b>9,682</b>	<b>13,173</b>	-	<b>51,000</b>	<b>21,869</b>	<b>72,869</b>
Depreciation for 2017	2,336	1,381	992	-	4,709	2,766	7,475
Disposals and write-offs	-	(1,857)	(224)	-	(2,081)	-	(2,081)
<b>At 31 December 2017</b>	<b>30,481</b>	<b>9,206</b>	<b>13,941</b>	-	<b>53,628</b>	<b>24,635</b>	<b>78,263</b>
<b>Net book value at 31 December 2017</b>	<b>46,621</b>	<b>771</b>	<b>1,440</b>	<b>708</b>	<b>49,540</b>	<b>4,017</b>	<b>53,557</b>
<b>Net book value at 31 December 2016</b>	<b>48,957</b>	<b>1,536</b>	<b>2,063</b>	<b>1,036</b>	<b>53,592</b>	<b>3,713</b>	<b>57,305</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

#### 19. Property, plant and equipment and intangible assets (continued)

Group	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Cost							
<b>At 31 December 2015</b>	<b>77,102</b>	<b>11,690</b>	<b>15,133</b>	<b>896</b>	<b>104,821</b>	<b>27,611</b>	<b>132,432</b>
Additions	-	-	-	2,539	2,539	-	2,539
Transfer from assets not yet ready for use	-	294	321	(2,399)	(1,784)	1,784	-
Adjustment of intangible assets	-	-	-	-	-	17	17
Disposals and write-offs	-	(766)	(218)	-	(984)	(3,830)	(4,814)
<b>At 31 December 2016</b>	<b>77,102</b>	<b>11,218</b>	<b>15,236</b>	<b>1,036</b>	<b>104,592</b>	<b>25,582</b>	<b>130,174</b>
Accumulated depreciation							
<b>At 31 December 2015</b>	<b>25,809</b>	<b>8,891</b>	<b>12,358</b>	-	<b>47,058</b>	<b>23,136</b>	<b>70,194</b>
Depreciation for 2016	2,336	1,546	1,000	-	4,882	2,546	7,428
Adjustment of intangible assets - Amortisation	-	-	-	-	-	17	17
Disposals and write-offs	-	(755)	(185)	-	(940)	(3,830)	(4,770)
<b>At 31 December 2016</b>	<b>28,145</b>	<b>9,682</b>	<b>13,173</b>	-	<b>51,000</b>	<b>21,869</b>	<b>72,869</b>
<b>Net book value at 31 December 2016</b>	<b>48,957</b>	<b>1,536</b>	<b>2,063</b>	<b>1,036</b>	<b>53,592</b>	<b>3,713</b>	<b>57,305</b>
<b>Net book value at 31 December 2015</b>	<b>51,293</b>	<b>2,799</b>	<b>2,775</b>	<b>896</b>	<b>57,763</b>	<b>4,475</b>	<b>62,238</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

#### 19. Property, plant and equipment and intangible assets (continued)

Group	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Cost							
<b>At 31 December 2016</b>	<b>77,102</b>	<b>10,830</b>	<b>15,034</b>	<b>1,036</b>	<b>104,002</b>	<b>24,951</b>	<b>128,953</b>
Additions	-	-	-	3,725	3,725	-	3,725
Transfer from assets not ready for use	-	624	368	(4,054)	(3,062)	3,062	-
Disposals and write-offs	-	(1,865)	(225)	-	(2,090)	-	(2,090)
<b>At 31 December 2017</b>	<b>77,102</b>	<b>9,589</b>	<b>15,177</b>	<b>707</b>	<b>102,575</b>	<b>28,013</b>	<b>130,588</b>
Accumulated depreciation							
<b>At 31 December 2016</b>	<b>28,145</b>	<b>9,329</b>	<b>13,016</b>	-	<b>50,490</b>	<b>21,247</b>	<b>71,737</b>
Depreciation for 2017	2,336	1,351	977	-	4,664	2,754	7,418
Disposals and write-offs	-	(1,857)	(224)	-	(2,081)	-	(2,081)
<b>At 31 December 2017</b>	<b>30,481</b>	<b>8,823</b>	<b>13,769</b>	-	<b>53,073</b>	<b>24,001</b>	<b>77,074</b>
<b>Net book value at 31 December 2017</b>	<b>46,621</b>	<b>766</b>	<b>1,408</b>	<b>707</b>	<b>49,502</b>	<b>4,012</b>	<b>53,514</b>
<b>Net book value at 31 December 2016</b>	<b>48,957</b>	<b>1,501</b>	<b>2,018</b>	<b>1,036</b>	<b>53,512</b>	<b>3,704</b>	<b>57,216</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**19. Property, plant and equipment and intangible assets (continued)**

Bank	Buildings	Computers	Furniture, equipment and vehicles	Property, plant and equipment and intangible assets not ready for use	Total property, plant and equipment	Intangible assets	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2016</b>							
Cost							
<b>At 31 December 2015</b>	<b>77,102</b>	<b>11,311</b>	<b>14,895</b>	<b>896</b>	<b>104,204</b>	<b>26,990</b>	<b>131,194</b>
Additions	-	-	-	2,511	2,511	-	2,511
Transfer from assets not yet ready for use	-	285	312	(2,371)	(1,774)	1,774	-
Adjustment of intangible assets	-	-	-	-	-	17	17
Returned to service	-	(766)	(173)	-	(939)	(3,830)	(4,769)
<b>At 31 December 2016</b>	<b>77,102</b>	<b>10,830</b>	<b>15,034</b>	<b>1,036</b>	<b>104,002</b>	<b>24,951</b>	<b>128,953</b>
Accumulated depreciation							
<b>At 31 December 2015</b>	<b>25,809</b>	<b>8,575</b>	<b>12,201</b>	-	<b>46,585</b>	<b>22,526</b>	<b>69,111</b>
Depreciation for 2016	2,336	1,509	980	-	4,825	2,534	7,359
Adjustment of intangible assets - Amortisation	-	-	-	-	-	17	17
Returned to service	-	(755)	(165)	-	(920)	(3,830)	(4,750)
<b>At 31 December 2016</b>	<b>28,145</b>	<b>9,329</b>	<b>13,016</b>	-	<b>50,490</b>	<b>21,247</b>	<b>71,737</b>
<b>Net book value at 31 December 2016</b>	<b>48,957</b>	<b>1,501</b>	<b>2,018</b>	<b>1,036</b>	<b>53,512</b>	<b>3,704</b>	<b>57,216</b>
<b>Net book value at 31 December 2015</b>	<b>51,293</b>	<b>2,736</b>	<b>2,694</b>	<b>896</b>	<b>57,619</b>	<b>4,464</b>	<b>62,083</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**20. Non-current assets held for sale**

	2017 HRK '000	Group 2016 HRK '000	2017 HRK '000	Bank 2016 HRK '000
Non-current assets held for sale	48,225	47,639	48,225	47,639
Provisions for impairment losses	(31,528)	(30,409)	(31,528)	(30,409)
	<b>16,697</b>	<b>17,230</b>	<b>16,697</b>	<b>17,230</b>

In 2017, acquisitions of property took place with current value in the amount of HRK 154 thousand, acquisition value of HRK 1,827 thousand and provisions of HRK 1,673 thousand, and relates to land plot (in 2016, acquisition of property took place with current value of HRK 0 thousand, acquisition value of HRK 1,692 thousand, and relates to buildings of debtor in the bankruptcy proceedings).

Fair value of acquired property at the end of 2017 amounted to HRK 2,908 thousand.

In 2017, a sale of non-current assets held for sale took place with current value in the amount of HRK 317 thousand, acquisition value of HRK 1,333 thousand and provisions of HRK 1,016 thousand, and relates to land plot in the amount of HRK 27 thousand, buildings in the amount of HRK 26 thousand and dwellings in the amount of HRK 264 thousand (in 2016, sale of non-current assets held for sale took place in the amount of HRK 923 thousand, which relates to buildings).

In 2017, this property was transferred to lease on the item Investments in property in the amount of HRK 1,807 thousand (2016: HRK 1,872 thousand), which is presented under Other assets due to immaterial significance. In 2017, this property was depreciated in the amount of HRK 64 thousand.

The fair value of non-current assets held for sale at the beginning of the reporting period stood at HRK 25,741 thousand and the end of the reporting period at HRK 27,773 thousand.

The movements in the provision for impairment losses on non-current assets held for sale may be summarized as follows:

	2017 HRK '000	Group 2016 HRK '000	2017 HRK '000	Bank 2016 HRK '000
Balance as of 1 January	30,409	27,754	30,409	27,754
Increase of provisions for impairment losses on non-current assets held for sale	711	2,275	711	2,275
Decrease of provisions for impairment losses on non-current assets held for sale	(185)	(228)	(185)	(228)
Written off impairment for non-current assets held for sale	(1,014)	(668)	(1,014)	(668)
Write-offs	-	(4)	-	(4)
Return on provisions at taking over	1,607	1,715	1,607	1,715
Reclassification of assets	-	(435)	-	(435)
<b>Balance as of 31 December</b>	<b>31,528</b>	<b>30,409</b>	<b>31,528</b>	<b>30,409</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 21. Other assets

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Receivables from customers	2,327	2,687	2,327	2,687
Fees receivable	9,363	886	9,363	886
Prepaid expenses	2,146	1,023	2,146	1,023
Accrued income	6,113	-	6,113	-
Premium receivables	6,318	592	-	-
Receivables for reinsurance commissions	583	393	-	-
Receivables for risk assessment fees	259	247	-	-
Deferred tax assets	231	54	-	-
Other assets	8,868	7,781	8,723	5,841
	<u>36,208</u>	<u>13,663</u>	<u>28,672</u>	<u>10,437</u>
Provisions for impairment losses	(6,737)	(4,541)	(6,446)	(4,537)
	<u>29,471</u>	<u>9,122</u>	<u>22,226</u>	<u>5,900</u>

The movements in the provision for impairment losses on other assets may be summarized as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as at 1 January	4,541	4,041	4,537	4,029
Increase of provision for impairment losses on other assets	2,756	1,221	2,399	1,191
Release of provision for impairment losses on other assets	(559)	(675)	(489)	(659)
Collection of off-balance sheet receivable items	(2)	(18)	(2)	(1)
Provisions transferred from off-balance sheet	2	1	2	1
Acquisition of immovable property	-	(13)	-	(13)
Write-offs	(1)	(16)	(1)	(11)
<b>Balance as of 31 December</b>	<u>6,737</u>	<u>4,541</u>	<u>6,446</u>	<u>4,537</u>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 22. Deposits

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Bank deposits	489,364	1,324	489,364	1,324
Foreign currency regular accounts of companies	6	6	6	6
Foreign currency account of the Ministry of Finance of the Republic of Croatia	31,250	34,124	31,250	34,124
Foreign currency special purpose accounts of the companies	27,237	59,163	27,237	59,163
Deposits by state institutions	88,179	40,058	88,179	40,058
Other deposits	8,705	8,169	8,705	8,169
	<u>644,741</u>	<u>142,844</u>	<u>644,741</u>	<u>142,844</u>

Bank deposits relate for the major part to loro deposit of the European Investment Bank (EIB).

The foreign currency account of the Ministry of Finance of the Republic of Croatia relates to the Export Insurance Guarantee Fund comprising of reinsurance premiums paid for export insurance operations of HRK 18,747 thousand (31 December 2016: HRK 19,829 thousand), grant funds provided by the Global Environment Facility (GEF) aimed at the Renewable Energy Resources Project of HRK 6,860 thousand (31 December 2016: HRK 7,843 thousand), the grant funds provided by the GEF aimed at the Programme of issuing bank guarantees for energy efficiency projects within the Energy Efficiency Project of HRK 5,643 thousand (31 December 2016: HRK 6,452 thousand), all managed by HBOR for and on behalf of the Republic of Croatia.

Demand deposits by State institutions relate to the Bank's operations carried out for and on behalf of the Ministry of Finance, the Ministry of the Economy, Entrepreneurship and Crafts, the Ministry of the Sea, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development and EU Funds, the company Vodovod i kanalizacija d.o.o., Split.

Foreign currency special purpose accounts of the companies relate to the inflow of funds and disposition of the advance payment funds paid to the company's account in relation to the issued guarantees of HBOR for the repayment of advance for export transactions. The funds of the advance are used exclusively for the specified purpose of implementation of an export contract, with the consent of HBOR.

HBOR does not pay interest on the above deposits

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 23. Borrowings

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January	13,378,057	11,453,796	13,378,057	11,453,796
New borrowings	3,849,787	3,730,867	3,849,787	3,730,867
Repayments	(1,729,575)	(1,730,849)	(1,729,575)	(1,730,849)
Net foreign exchange (losses)/gains	(98,481)	(75,757)	(98,481)	(75,757)
	<u>15,399,788</u>	<u>13,378,057</u>	<u>15,399,788</u>	<u>13,378,057</u>
Accrued interest	63,737	64,018	63,737	64,018
Deferred recognition of borrowing origination fees	(75,644)	(50,326)	(75,644)	(50,326)
<b>Balance as of 31 December</b>	<b><u>15,387,881</u></b>	<b><u>13,391,749</u></b>	<b><u>15,387,881</u></b>	<b><u>13,391,749</u></b>

Interest rates on borrowings ranged from 0.60% fixed per annum to variable interest rates on the International money market (EURIBOR) increased by 0.00 percentage points annually.

The Bank is subject to different financial covenants arising from contracts. During 2017 and as at 31 December 2017, the Bank was in compliance with all the required contractual financial covenants.

Average interest rates on borrowings are 1.57% (31 December 2016: 1.69%).

Average interest rates represent ratio of interest expenses on borrowings and average total liabilities.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 24. Bonds payable

The book value of bonds includes interest.

Group and Bank	Effective interest rate	Fair value	Net book value	Fair value	Net book value
		2017	2017	2016	2016
	%	HRK '000	HRK '000	HRK '000	HRK '000
Bonds EUR 250 million	5.076	-	-	1,915,899	1,888,837
Bonds EUR 150 million	6.37	1,255,316	1,118,122	1,270,695	1,121,261
Accrued interest		-	43,909	-	95,932
Deferred recognition of bond payable origination fees		-	(332)	-	(461)
		<u>1,255,316</u>	<u>1,161,699</u>	<u>3,186,594</u>	<u>3,105,569</u>

The fair value of bonds issued by HBOR is presented by using level 2 inputs corroborated by the market and observable at Bloomberg service on the basis of the mid-rate of Bloomberg Generic prices (BGN).

Average interest rates on bonds payable are 0.65% (31 December 2016: 1.04%).

Average interest rates represent ratio of interest expenses on bonds payable and average total liabilities.

According to the Agreement between HBOR and UBS Investment Bank and Deutsche Bank AG London (as joint lead managers), HBOR issued bonds on 14 June 2007 of EUR 250,000 thousand (HRK 1,888,837 thousand as at 31 December 2016) with maturity period of 10 years and fixed interest rate of 5.0%.

On 13 June 2017, HBOR redeemed long-term securities of HRK 1,852,051 thousand together with interest of HRK 92,603 thousand.

According to the Agreement between HBOR and Deutsche Bank AG London Branch and J.P. Morgan Securities PLC (as joint lead managers), HBOR issued bonds on 13 August 2013 of EUR 150,000 thousand (HRK 1,118,112 thousand as at 31 December 2017 and HRK 1,121,261 thousand as at 31 December 2016) with maturity period of 6 years and 9 months and fixed interest rate of 6.0%. Interest is paid annually, in arrears. Bonds were listed in Luxembourg Stock Exchange quotation on 25 August 2015 and were delisted from the Vienna Stock Exchange quotation on 29 September 2015.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**25. Other liabilities**

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Deferred recognition of interest income	314,271	425,347	314,271	425,347
Liabilities in respect of subsidized interest	107,262	95,422	107,262	95,422
Provisions for guarantees and commitments	64,360	75,103	64,360	75,103
Provisions for other liabilities	76,980	85,507	76,723	85,230
Accrued salaries	6,997	6,845	6,660	6,699
Liabilities to suppliers	1,393	3,015	1,261	2,938
Liabilities for prepaid receivables	2,759	1,920	2,759	1,920
Deferrable premium	2,925	3,358	-	-
Provisions for claims	5,235	3,960	-	-
Provisions for return premiums	642	452	-	-
Liabilities to re-insurers	1,165	1,172	-	-
Deferred tax liabilities	889	480	-	-
Other liabilities	20,575	5,371	19,355	4,115
	<b>605,453</b>	<b>707,952</b>	<b>592,651</b>	<b>696,774</b>

Liabilities in respect of subsidized interest represent advances taken in respect of interest subsidies on loans, which are provided for final customers at a lower interest rate in accordance with the following programmes implemented by HBOR for and on behalf of the Republic of Croatia (see Note 29). These liabilities include:

- HRK 107,262 thousand in respect of the Programme of Preferential Financing through HBOR's Loan Programmes (31 December 2016: HRK 95,327 thousand),
- HRK 0 thousand (31 December 2016: HRK 95 thousand) in respect of the Loan Programme for the Financing of Youth Entrepreneurship.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**25. Other liabilities (continued)**

Deferred recognition of interest income of HRK 314,271 thousand (31 December 2016: HRK 425,347 thousand) consists of state subsidies for interest in respect of loans which are provided and drawn down by final borrowers at lower interest rates but are not yet in repayment stage, amounting to HRK 11,305 thousand (31 December 2016: HRK 26,463 thousand), and in respect of those already in repayment stage amounting to HRK 302,966 thousand (31 December 2016: HRK 398,884 thousand) (see Note 2).

Provisions for guarantees and commitments represent the best estimation of the outflow for settlement of the outstanding liabilities at the Statement of Financial Position date and are determined in accordance with IAS 37 – Provisions, contingent liabilities and contingent assets.

Out of the total provisions for guarantees and commitments, HRK 20,653 thousand relates to financial institutions (31 December 2016: HRK 28,811 thousand), HRK 36,604 thousand relates to domestic companies (31 December 2016: HRK 38,900 thousand), HRK 1,153 thousand relates to state-owned companies (31 December 2016: HRK 170 thousand), HRK 4,291 thousand relates to the public sector (31 December 2016: HRK 7,164 thousand), HRK 195 thousand relates to other liabilities (31 December 2016: HRK 58 thousand), HRK 1,439 thousand to foreign legal entities (31 December 2016: HRK 0 thousand) and HRK 25 thousand to non-profit institutions (31 December 2016: HRK 0 thousand).

Movements in the provision for guarantees, commitments and other liabilities may be summarized as follows:

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as at 1 January	75,103	62,785	75,103	62,785
Increase in provision for guarantees and commitments	11,523	51,006	11,523	51,006
Release in provision for guarantees and commitments	(21,878)	(39,084)	(21,878)	(39,084)
Net foreign exchange gains/(losses) on provision for impairment losses	(388)	396	(388)	396
<b>Provision for guarantees and commitments</b>	<b>64,360</b>	<b>75,103</b>	<b>64,360</b>	<b>75,103</b>
Balance as at 1 January	85,507	71,726	85,230	71,511
Increase in provision for other liabilities	21,599	53,102	21,295	52,756
Release in provision for other liabilities	(30,705)	(42,576)	(30,381)	(42,292)
Unrealized actuarial	579	3,255	579	3,255
<b>Provisions for other liabilities</b>	<b>76,980</b>	<b>85,507</b>	<b>76,723</b>	<b>85,230</b>
<b>Balance as at 31 December</b>	<b>141,340</b>	<b>160,610</b>	<b>141,083</b>	<b>160,333</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**25. Other liabilities (continued)**

In 2017, provisions for other liabilities for the Group totalled HRK 76,980 thousand (31 December 2016: HRK 85,507 thousand) and for the Bank stood at HRK 76,723 thousand (31 December 2016: HRK 85,230 thousand). The total amount of provisions for other liabilities was comprised of HRK 24,929 thousand for court proceedings initiated against the Bank (31 December 2016: HRK 35,820 thousand), HRK 27,459 thousand for liabilities for the Group and for the Bank based on benefits defined in accordance with IAS 19 Employee Benefits (31 December 2016: HRK 26,007 thousand), and in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets HRK 24,592 thousand for provisions for other liabilities for the Group (31 December 2016: HRK 23,680 thousand) and HRK 24,335 thousand for the Bank (31 December 2016: HRK 23,403 thousand).

The latest actuarial assessment of present value of liabilities based on defined benefits as at 31 December 2017 was performed by a certified actuary. The model took into account mortality and discount rate, and the calculations for every employee considered age, gender, years of service, expected mortality and discount rate, i.e. the long-run sustainable yield rate on bonds.

The applied discount rate that represents the yield rate on bonds sustainable in the long run is 4.25%, the same as in 2016.

Unrealised actuarial gains/(losses) arising from the calculation of provisions are stated within the framework of other comprehensive income so that net assets or liability may reflect the entire value of deficit or surplus planned.

**26. Founder's capital and reserves**

Under the HBOR Act, the prescribed founder's capital should amount to HRK 7,000,000 thousand, paid from the State Budget and from other sources as specified by separate laws.

The schedule of annual amounts of payment and the time schedule of payments out of the State Budget into the capital are not set in advance, but are determined by the Croatian Parliament as part of the process of adoption of the State Budget of the Republic of Croatia.

Within its Accounting policies, the Group has set out its objectives of capital management, category of capital managed by the Bank as well as measuring and assessing the policies for capital management. Capital management is described and presented in Note 34.

Founder's capital of the subsidiary Hrvatsko kreditno osiguranje d.d. amounts to HRK 37,500 thousand and is 100% owned by the Bank, and the founder's capital of the company Poslovni info servis d.o.o. amounts to HRK 300 thousand and is 100% owned by Hrvatsko kreditno osiguranje d.d.. The capital of both companies is subscribed and paid in full.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**27. Guarantee fund**

<b>Group and Bank</b>	<b>HRK '000</b>
<b>Balance as of 1 January 2016</b>	<b>12,502</b>
Net foreign exchange	(127)
	<hr/>
<b>Balance as of 31 December 2016</b>	<b>12,375</b>
Net foreign exchange	(72)
	<hr/>
<b>Balance as of 31 December 2017</b>	<b>12,303</b>
	<hr/>

The Guarantee fund, of HRK 12,303 thousand and HRK 12,375 thousand as of 31 December 2017 and 2016 respectively, relates to funds of the guarantee fund from Deutsche Investitions- und Entwicklungsgesellschaft (DEG) in respect of a financial contribution (granted funds) for the account of the German Government, which are used for covering contingent losses on guarantees issued for loans granted under the Programme for financing business start-ups in Croatia. The funds of the Guarantee fund are unconditionally contributed and have no maturity. The funds of the Guarantee fund give the Government of the Federal Republic of Germany neither controlling rights nor a right to a share of the operating results of the Group.

**28. Guarantees and commitments**

In its regular activities, the Group contracts various commitments and contingent liabilities. The purpose of these instruments is to ensure that the funds are available to a customer when required.

These obligations contain credit risk and are therefore part of the overall risk of the Group although they are not recognised in the Statement of financial position.

<b>Group and Bank</b>	<b>2017 HRK '000</b>	<b>2016 HRK '000</b>
Guarantees issued in HRK	34,338	32,409
Guarantees issued in foreign currency	2,475,971	2,007,578
Undrawn loans	3,021,163	3,978,340
EIF – subscribed, not called up capital (Note 15)	48,087	48,370
Other irrevocable contingent liabilities	339	339
	<hr/>	<hr/>
	5,579,898	6,067,036
	<hr/>	<hr/>
Provisions for guarantees and commitments	(64,360)	(75,103)
	<hr/>	<hr/>
	<b>5,515,538</b>	<b>5,991,933</b>
	<hr/>	<hr/>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 28. Guarantees and commitments (continued)

### Guarantees

Issued guarantees and open letters of credit represent the liability to the Bank to make payments on behalf of customers if the customer is unable to honour its commitments towards third parties or in the event of a specific act, generally related to the export or import of goods and other purposes specified in the contracts with the customers. Guarantees and letters of credit bear the same credit risk as loans.

Bank guarantees are, to the extent of 82%, collateralized by the guarantees, deposits and bank guarantees or the liability was taken over by the Republic of Croatia.

### Commitments upon undrawn loans

The Bank has an obligation to disburse funds for loans and revolving loans upon committed undrawn loans. The expiry date of disbursement or other termination clause is determined by the contract. Disbursements are exercised in several withdrawals, depending on the purpose of the loan, phase of the project or documentation needed for disbursement. Since commitments may expire without being drawn upon, the total contractual amounts do not necessarily represent future cash outflows.

Committed undrawn loans include less potential credit risk than loans, since most commitments depend upon meeting specific terms and conditions by the customers in order to use the funds. The Bank monitors the terms to maturity of loan commitments.

### Other irrevocable contingent liabilities

Other irrevocable contingent liabilities relate to HBOR's obligation based on the Agreement concluded on 24 January 2014 with HBOR – Export Credit Insurance performing transactions for and on behalf of the Republic of Croatia. Pursuant to this Agreement, HBOR shall, in case of disposal of the real estate taken over and the recovery from debtors in a pre-bankruptcy settlement, provided that certain conditions have been fulfilled, pay the recovered funds to the Guarantee fund of the Export Credit Insurance.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 29. Managed funds for and on behalf of third parties

The Group manages funds on behalf of and for the account of the Ministry of Finance, the Ministry of the Economy, Entrepreneurship and Crafts, the Ministry of the Sea, Transport and Infrastructure, the Ministry of Agriculture, the Ministry of Regional Development and EU Funds, the Ministry of Environment and Energy, the company Vodovod i kanalizacija d.o.o., Split and the Croatian Agency for SMEs, Innovation and Investment ("HAMAG-BICRO"), that are mainly used for various reconstruction and development programmes. These assets are separated from the Group's assets. The income and expense relating to these transactions are charged to the principal, and the Group does not have any other liabilities. The Group charges a fee for part of the services and part of the services are performed free of charge depending on the contract with the customer and taking into account that the stated amounts are insignificant for the Group.

Agency business funds per individual programmes amount to:

Group and Bank Programme	2017	2016
	HRK '000	HRK '000
Development and Reconstruction of Rural Housing	29,092	29,895
Employment of Former Soldiers	340,344	332,614
Municipal Environmental Infrastructure Investment Program – MEIP	863,297	853,298
Collection of receivables under HAMAG-BICRO guarantees	193	211
Insurance of export transactions	331,431	339,524
Programme of Preferential Financing through HBOR's Loan Programmes	107,262	95,327
Programme for Regional Development of the Republic of Croatia - loans	9,131	11,196
Renewable Energy Resources Project	24,142	25,522
VIK – EKO account A – dedicated water charge	630,090	596,857
VIK – EKO account B – VAT	154,732	153,819
Programme of Issuing Bank Guarantees for Energy Efficiency Projects – IBRD	5,643	6,452
Financing the Establishment of Fishing Infrastructure – Ministry of the Sea, Transport and Infrastructure	46,665	46,665
Model of financing investment in the adjustment of fishing fleet and investment in fishing boats – Ministry of Agriculture	-	12,904
Micro-Loans with EU Support – commercial banks	303	30
Loan Programme for the Financing of Youth Entrepreneurship - interest subsidy	-	95
Transactions related to investments in the Economic Co-operation Funds*	548,520	524,080
ESIF – Growth and Expansion Loans	414,277	-
	<b>3,505,122</b>	<b>3,028,489</b>

\*The fair value of net assets value of the Economic Co-operation Funds in 2017 is recognised on the basis of the latest available data and does not represent the final fair value, whereas, in 2016, the amount was recognised in accordance with the audited financial statements.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 30. Related-party transactions

Related parties are companies that directly or indirectly, through one or more intermediaries, control, or are controlled by, the reporting company.

The majority of related-party transactions relate to the transactions with the Republic of Croatia, the 100% owner of the Bank and state-owned companies over which the Republic of Croatia has the controlling influence. All transactions stated were carried out under usual/regular conditions of the Bank.

As of 31 December 2017 and 31 December 2016, balances arising from transactions with related parties, including the Bank's key management personnel, include the following:

#### a) Related-party transactions

Group	Exposure		Liabilities		Income		Expense	
	2017	2017	2017	2017	2016	2016	2016	2016
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Owner	3,059,698	185,536	82,760	581	3,193,565	153,374	91,685	6,643
Government funds, executive authorities and agencies	1,076,606	30,358	31,099	1,327	1,087,460	14,214	21,905	1,199
State-owned companies	1,354,828	1	60,539	20,066	1,193,668	2	55,269	7,511
Associates	1	-	4,001	-	6	-	858	-
Other intra-group transactions	-	-	-	-	-	-	-	71
Key management personnel	5,073	-	147	9	4,289	-	147	-
<b>Total</b>	<b>5,496,206</b>	<b>215,895</b>	<b>178,546</b>	<b>21,983</b>	<b>5,478,988</b>	<b>167,590</b>	<b>169,864</b>	<b>15,424</b>

Bank	Exposure		Liabilities		Income		Expense	
	2017	2017	2017	2017	2016	2016	2016	2016
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Owner	3,059,698	185,536	82,760	581	3,193,565	153,374	91,685	6,643
Government funds, executive authorities and agencies	1,032,525	30,199	29,783	751	1,044,382	14,079	20,135	658
State-owned companies	1,354,442	-	60,521	19,997	1,193,271	-	55,251	7,443
Subsidiary companies	36,124	-	-	-	36,124	-	-	-
Associates	1	-	4,001	-	6	-	858	-
Key management personnel	4,844	-	139	9	4,000	-	137	-
<b>Total</b>	<b>5,487,634</b>	<b>215,735</b>	<b>177,204</b>	<b>21,338</b>	<b>5,471,348</b>	<b>167,453</b>	<b>168,066</b>	<b>14,744</b>

Exposures include loans to other customers, available-for-sale assets, assets held to maturity, other assets and off-balance sheet exposure relating to guarantees, letters of credit and commitments.

Liabilities include deposits and other liabilities.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 30. Related-party transactions (continued)

#### a) Related-party transactions (continued)

Income includes interest income, fee income, other income and reversal of impairment losses and provisions.

Expense includes impairment losses and provisions and other expense.

#### b) Collateral received

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
The Republic of Croatia	4,235,919	3,092,258	4,138,695	3,007,698
State agencies	573,727	603,215	573,727	603,215
<b>Total</b>	<b>4,809,646</b>	<b>3,695,473</b>	<b>4,712,422</b>	<b>3,610,913</b>

Collateral received relates to first-class collateral instruments received as security for HBOR's placements comprising the Republic of Croatia guarantees, HAMAG-BICRO guarantees, insurance policies of export transactions against political and/or commercial risks and statutory guarantees in cases when the Republic of Croatia or other state executive body guarantees the liabilities of certain borrowers pursuant to provisions of certain laws. HBOR issues reinsurance policies for and on behalf of the Republic of Croatia, i.e. covers a proportional part (quota reinsurance) of political and commercial risks of export loans and receivables arising from export of goods and services. The reinsurer covers all non-marketable (non-market) risks underwritten by the Insurer or Hrvatsko kreditno osiguranje d.d. in the percentage ranging from 15% to 90% of an insured amount.

#### c) Salaries of key management personnel

The key management personnel are: the President and the Members of the Management Board, the Head of the Management Board Office, Senior Executive Directors, Executive Directors and Assistant Executive Directors. Salaries include compensation paid for regular work, annual vacation, national holidays, paid leave, sick leave, jubilee awards and payments under contractual agreements. In 2017, salaries for the Group amounted to HRK 7,435 thousand (31 December 2016: HRK 7,746 thousand), and for the Bank HRK 7,033 thousand (31 December 2016: HRK 6,719 thousand).

Remuneration for the work of the members of the Supervisory Board in 2017 amounted to HRK 287 thousand for the Group (31 December 2016: HRK 320 thousand) and for the Bank HRK 143 thousand (31 December 2016: HRK 193 thousand) and it relates to the members of supervisory boards at associates and subsidiaries who were appointed by HBOR.

*(All amounts are expressed in HRK thousand)*

## 31. Risk management

### 31.1. Introduction

Based on the Act on the Croatian Bank for Reconstruction and Development, the Bank is obliged to mitigate business risks directed by the principles of banking operations.

In the process of risk management, the Bank identifies, estimates, measures, monitors, contains and controls the risks to which it is or might be exposed in the course of business and reports about them to the bodies in charge. By the mentioned procedures, appropriate internal documents and adequate organisational structure, a comprehensive and complete risk management system is provided.

The most significant risks the Bank is exposed to: credit risk, liquidity risk, interest rate risk in the Bank's book and foreign exchange risk, operational risk and outsourcing risk. These risks are managed daily in accordance with the policies, ordinances, procedures, methodologies and limit systems as well as decisions/ conclusions of the Supervisory Board, the Management Board and the risk management committees.

The Bank implements the sensitivity analyses and scenario analyses, provided that one or several risk factors are changed in regular or stressful circumstances, and the systems of pro-active risk management are continuously developed for the purpose of reducing possible future risks.

#### Risk management structure

**The Supervisory Board** is responsible for monitoring the appropriateness and effectiveness of the risk management process in the Bank. The Supervisory Board adopts HBOR's Risk Management Strategy that lays out the main principles and standards of risk management and defines the tendency towards risk-taking.

**The Management Board** of the Bank is responsible for implementing the risk management strategy and establishing an effective and reliable risk management system. In order to accomplish its task, the Management Board delegated their risk management authority to four committees.

#### Risk management committees

- **Assets and Liabilities Management Committee (ALCO)** – manages liquidity risk, interest rate risk in the Bank's book and currency risk within the framework of the Liquidity Risk Management Ordinance, the Currency Risk Management Procedures and the Interest Rate Risk Management Procedures, the Assets and Liabilities Management Policies as well as other documents of the Bank that regulate this area,
- **Credit Risk Evaluation and Measurement Committee** – manages credit risk within the framework set through accepted Loan Policies, Credit Risk Management Procedures, methodologies, ordinances and other internal acts that cover issues related to credit risk,
- **HBOR Information System Management Committee** – manages the resources of the information system and adequately manages the risks that result from the use of information technology,
- **Business Change Management Committee** – manages business changes (co-ordination of procedures for the suggestion, approval, monitoring and implementation of business changes) in order to reduce risks associated with the implementation of business changes.

*(All amounts are expressed in HRK thousand)*

## 31. Risk management (continued)

### 31.1. Introduction (continued)

#### Organizational unit for Risk Management

The Risk Management unit is organised as a functionally and organizationally separate and independent organizational unit for the control of business risks, which is directly responsible to the Management Board. This organisational unit is responsible for defining, evaluating or measuring, monitoring and controlling the risks to which the Bank is exposed in the course of its business.

The Risk Management unit carries out its role by performing risk analyses and evaluations or measurements, developing risk management ordinances, procedures and methodologies, supervising and monitoring their application, recommending and controlling the accepted exposure limits, giving suggestions and recommendations for adequate risk management as well as reporting to the bodies in charge.

The risk management strategy is directed towards achieving and maintaining the system that would provide quality and efficiency in risk management complied with domestic and international banking practices and Croatian National Bank, European regulations and Basel Committee recommendations applicable to the Bank as a special financial institution.

#### Organizational unit for Control and Audit

Control and audit is organized as a separate organizational unit, functionally and organizationally independent from the activities subject to its audit and other organizational units of HBOR. The Control and Audit unit is responsible to the Management Board, Supervisory Board and Audit committee. The Control and Audit unit verifies the application and efficiency of the procedures and methodologies for risk management. Their role is achieved through testing of the risk management system according to the principles of operational stability, including managing IT resources and other associated technologies.

#### Organisational unit State Aid and Compliance Department

The State Aid and Compliance Department is in charge of the activities covered by the function responsible for monitoring compliance and harmonisation of HBOR's operations with the state aid rules.

The compliance monitoring function has been established in the Legal and General Affairs and Compliance Division as an independent and permanent function.

The compliance monitoring function is in charge of monitoring and controlling the following risks: legal and regulatory risks (the risk of disobedience of the laws, legislation and professional practice in effect), sanction risk (the risk of court, administrative or disciplinary sanctions and/or measures resulting from breaches of law, legislation, rules, standards and/or contractual obligations) and reputational risk.

#### Risk measurement and reporting systems

When assessing or measuring risk, the Bank takes into account historical data, business plans, current and expected market conditions and the specific characteristics of the Bank as a special financial institution. The results of risk assessments or measurements, analyses carried out and stress test are presented at the meetings of the Risk Management Committee, the Management Board and the Supervisory Board. For the purpose of risk monitoring and control, systems of limits are introduced for the management of credit risk, liquidity risk, interest rate risk in the Bank's book and currency risk.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

### **31. Risk management (continued)**

#### **31.1. Introduction (continued)**

##### **Risk measurement and reporting systems (continued)**

Bodies in charge are systematically reported on the quality of the loan portfolio, high exposure and the highest permissible exposure, regulatory capital adequacy, collection of receivables and risk placements, changes in internal ratings of commercial banks and measures taken in case of rating deterioration, a number of liquidity status indicators and projections of open foreign currency positions, possible losses by significant currencies, interest rate gap, projections of average weighted rates for sources and placements of financial institutions, etc. The reporting dynamics and the risk measurement and assessment methodologies are prescribed by the Bank's internal documents.

#### **31.2. Credit risk**

The Bank controls credit risk by way of credit policies, ordinances and prescribed procedures for the management of this risk that determine internal control systems aiming to act preventively.

The credit risk management system is a crucial part of the Bank's business policy and it is an important strategic factor of business conduct, and therefore this area is regulated by a separate act - Credit risk management procedures, that are applied on all phases of the credit process (from the development of new bank products or from the credit application, monitoring of the client's business operations until the final loan repayment).

Credit risk management procedures are included in a comprehensive document comprised of methodologies aimed at the evaluation of business operations of different targeted groups of clients:

- Credit risk evaluation methodologies which encompass:
  - o Credit rating evaluation methodology,
  - o Methodology for the analysis of clients who keep their business records in accordance with the Income Tax Act,
  - o Methodology for the analysis of business monitoring of clients who keep their business records in accordance with the Income Tax Act,
  - o Methodology for the evaluation of the risk inherent to the branch of activity,
  - o Methodology for the quarterly monitoring of clients' business,
  - o Methodology for the evaluation and selection of leasing companies,
  - o Collateral evaluation methodology,
- Credit scoring methodologies,
- Methodologies for evaluation and selection of banks,
- Methodologies for evaluation and selection of foreign banks.

In the case of direct clients, the Bank uses the Credit risk evaluation methodology (for loans over HRK 1,500 thousand) or the Credit scoring methodology (for loans below HRK 1,500 thousand) to determine creditworthiness. The Credit scoring methodology is used to determine creditworthiness of clients that belong to the "small portfolio" and contains five scoring models: placements up to HRK 300 thousand to companies, crafts businesses and farmers, placements to start-ups up to HRK 300 thousand, placements from HRK 300 thousand to HRK 1,500 thousand to companies, placements to start-ups from HRK 300 thousand to HRK 1,500 thousand and placements from HRK 300 thousand to HRK 1,500 thousand for all other entrepreneurs.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

### **31. Risk management (continued)**

#### **31.2. Credit risk**

Pursuant to the HBOR Act, the Bank on-lends part of its placements via commercial banks or leasing companies. The assessment of commercial banks is based on the Methodology for the Evaluation and Selection of Banks and the Methodology for the Evaluation and Selection of Foreign Banks, whereas the assessment of leasing companies is based on the Methodologies for the Evaluation and Selection of Leasing Companies.

The Bank controls related party risk on the occasion of direct credit approval and for the duration of a business relationship when it is requested from the clients to state their related parties. The information thereby gathered is verified and the type and nature of intra-relationship is determined as well as the existence of a group of related parties and the occurrence of the influence of the improvement or worsening of economic and financial conditions of one related party to the economic or financial position of the related party.

The Bank, as a developmental financial institution, supports growth and development of the Croatian economy through investment. For this reason, the clients mainly approach the Bank with applications for credit financing of investment projects. In order to minimize risk and objectively estimate economic sustainability of the project as well as a return on investment, the Bank is constantly improving existing organizational and technical solutions, reports and internal acts and proposes new organization regulations and implementation instructions.

By continuous monitoring and evaluation of the clients' businesses, the Bank makes an effort to identify difficulties in their operation on a timely basis. For clients with difficulties, the Bank tries to find appropriate ways to collect receivables by considering the possibilities of alternative repayment terms with a view to continue the production process and employment increase. Special emphasis is placed on identifying and monitoring reasons for bad debts, and procedures for prevention are built in operational procedures with a view to decreasing the share of high risk placements of the Bank.

Also, large exposure limits as well as highest amount of credit risk exposure toward single client and his related parties were determined.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure**

The table below shows the highest gross credit risk exposures existing in the Statement of Financial Position and in guarantees and commitments as of the reporting date, before the effect of mitigation through collateral received:

	Group		Bank	
	Gross highest exposure 2017	Gross highest exposure 2016	Gross highest exposure 2017	Gross highest exposure 2016
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>				
Cash on hand and due from banks	1,403,663	491,243	1,401,130	490,692
Deposits with other banks	29,138	23,872	29,138	23,872
Loans to financial institutions	10,836,141	11,889,111	10,836,141	11,889,111
Loans to other customers	12,383,623	11,511,194	12,383,623	11,511,194
Financial assets at fair value through profit or loss	291	286	-	-
Assets available for sale	3,276,990	3,353,086	3,232,620	3,306,628
Assets held to maturity	1,399	1,422	-	-
Other assets	19,297	6,249	12,282	3,079
<b>Total</b>	<b>27,950,542</b>	<b>27,276,463</b>	<b>27,894,934</b>	<b>27,224,576</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,993	32,082	33,993	32,082
Issued guarantees in foreign currency	2,446,324	1,982,969	2,446,324	1,982,969
Undrawn loans	2,986,798	3,928,177	2,986,798	3,928,177
Other irrevocable contingent liabilities	335	335	335	335
<b>Total</b>	<b>5,467,450</b>	<b>5,943,563</b>	<b>5,467,450</b>	<b>5,943,563</b>
<b>Total credit risk exposure</b>	<b>33,417,992</b>	<b>33,220,026</b>	<b>33,362,384</b>	<b>33,168,139</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

The Bank, with its developmental loan programmes, covers the entire Republic of Croatia with a special emphasis on special concern areas, hill or mountain areas and the islands. Through development of new loan programmes (products), the Bank takes into account concentration of credit risk with a view to evenly develop all areas of the Republic of Croatia.

Through financing of different sectors by stimulating production and development with the purpose of developing the Croatian economy, the Bank is creating a better base for repayment of loans and minimization of risk.

As of 31 December 2017, the highest credit exposure of the Group and the Bank to one debtor equalled HRK 2,536,756 thousand (31 December 2016: HRK 3,147,235 thousand), without considering the effect of mitigation through collateral received. The collateral policy is disclosed further in Note 31.2.

As a special financial institution, the Bank performs its development role by granting loans to final borrowers via commercial banks with which it has entered into co-operation agreements. Since the exposure towards some of the banks has reached the maximum permitted level, the Bank, in order to be able to continue performing its development role and make the loans accessible to as many final borrowers as possible, has an approval from the Supervisory Board for an increase in the exposure towards the banks and their associated entities that have, in accordance with HBOR's internal methodology, been assigned a high rating. The exposure level is maintained by using all instruments and techniques available for mitigating HBOR's exposure towards the banks.

This exposure increase approved by the Supervisory Board was used by the Bank for further operating activities carried out with two banks.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received, is as follows:

Group 2017	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
<b>Assets</b>				
Cash on hand and due from banks	1,320,578	82,884	201	1,403,663
Deposits with other banks	29,116	22	-	29,138
Loans to financial institutions	10,836,141	-	-	10,836,141
Loans to other customers	12,075,474	-	308,149	12,383,623
Financial assets at fair value through profit or loss	291	-	-	291
Assets available for sale	3,276,990	-	-	3,276,990
Assets held to maturity	1,399	-	-	1,399
Other assets	13,105	6,045	147	19,297
<b>Total</b>	<b>27,553,094</b>	<b>88,951</b>	<b>308,497</b>	<b>27,950,542</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,391	602	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	2,446,324
Undrawn loans	2,844,366	-	142,432	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,324,416</b>	<b>602</b>	<b>142,432</b>	<b>5,467,450</b>
<b>Total credit risk exposure</b>	<b>32,877,510</b>	<b>89,553</b>	<b>450,929</b>	<b>33,417,992</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received (continued):

Group 2016	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
<b>Assets</b>				
Cash on hand and due from banks	188,322	301,354	1,567	491,243
Deposits with other banks	3,291	20,581	-	23,872
Loans to financial institutions	11,889,111	-	-	11,889,111
Loans to other customers	11,281,848	-	229,346	11,511,194
Financial assets at fair value through profit or loss	286	-	-	286
Assets available for sale	3,353,086	-	-	3,353,086
Assets held to maturity	1,422	-	-	1,422
Other assets	5,644	605	-	6,249
<b>Total</b>	<b>26,723,010</b>	<b>322,540</b>	<b>230,913</b>	<b>27,276,463</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	31,480	602	-	32,082
Issued guarantees in foreign currency	1,982,969	-	-	1,982,969
Undrawn loans	3,928,177	-	-	3,928,177
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,942,961</b>	<b>602</b>	<b>-</b>	<b>5,943,563</b>
<b>Total credit risk exposure</b>	<b>32,665,971</b>	<b>323,142</b>	<b>230,913</b>	<b>33,220,026</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.2. Credit risk (continued)

##### Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received (continued):

Bank 2017	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
<b>Assets</b>				
Cash on hand and due from banks	1,318,045	82,884	201	1,401,130
Deposits with other banks	29,116	22	-	29,138
Loans to financial institutions	10,836,141	-	-	10,836,141
Loans to other customers	12,075,474	-	308,149	12,383,623
Assets available for sale	3,232,620	-	-	3,232,620
Other assets	11,911	224	147	12,282
<b>Total</b>	<b>27,503,307</b>	<b>83,130</b>	<b>308,497</b>	<b>27,894,934</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,391	602	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	2,446,324
Undrawn loans	2,844,366	-	142,432	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,324,416</b>	<b>602</b>	<b>142,432</b>	<b>5,467,450</b>
<b>Total credit risk exposure</b>	<b>32,827,723</b>	<b>83,732</b>	<b>450,929</b>	<b>33,362,384</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.2. Credit risk (continued)

##### Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received (continued):

Bank 2016	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
<b>Assets</b>				
Cash on hand and due from banks	187,771	301,354	1,567	490,692
Deposits with other banks	3,291	20,581	-	23,872
Loans to financial institutions	11,889,111	-	-	11,889,111
Loans to other customers	11,281,848	-	229,346	11,511,194
Assets available for sale	3,306,628	-	-	3,306,628
Other assets	2,844	235	-	3,079
<b>Total</b>	<b>26,671,493</b>	<b>322,170</b>	<b>230,913</b>	<b>27,224,576</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	31,480	602	-	32,082
Issued guarantees in foreign currency	1,982,969	-	-	1,982,969
Undrawn loans	3,928,177	-	-	3,928,177
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,942,961</b>	<b>602</b>	<b>-</b>	<b>5,943,563</b>
<b>Total credit risk exposure</b>	<b>32,614,454</b>	<b>322,772</b>	<b>230,913</b>	<b>33,168,139</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, according to industry, before and after the effect of mitigation through collateral received, is as follows:

Group	Gross highest exposure	Net highest exposure	Gross highest exposure	Net highest exposure
	2017	2017	2016	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Financial intermediation and insurance	14,785,159	-	15,359,154	-
Water and electric supply and other infrastructure	1,260,064	931,740	1,322,277	959,881
Tourism	3,550,174	268,536	3,630,150	363,739
Transport, warehousing and connections	1,979,350	857,758	1,714,718	836,069
Shipbuilding	2,994,248	416,604	2,257,050	572,383
Agriculture and fishery	455,716	68,992	515,711	68,982
Food industry	952,014	143,121	1,159,546	205,632
Construction industry	1,225,516	52,841	1,225,887	53,900
Other industry	493,034	149,251	527,352	138,850
Public administration	2,473,206	2,473,206	2,426,716	2,426,716
Education	47,201	42,085	47,020	40,956
Manufacture of basic metals and fabricated metal products, except machinery and equipment	321,123	55,470	407,254	62,818
Manufacture of chemicals and chemical products	403,043	89,662	255,576	16,761
Manufacture of other non-metallic mineral products	261,053	55,823	273,959	4,399
Pharmaceutical industry	544,777	891	572,470	809
Other	1,672,314	476,561	1,525,185	311,092
<b>Total credit risk exposure</b>	<b>33,417,992</b>	<b>6,082,541</b>	<b>33,220,026</b>	<b>6,062,987</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

Concentration of assets and guarantees and commitments, according to industry, before and after the effect of mitigation through collateral received, is as follows:

Bank	Gross highest exposure	Net highest exposure	Gross highest exposure	Net highest exposure
	2017	2017	2016	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Financial intermediation and insurance	14,771,725	-	15,352,325	-
Water and electric supply and other infrastructure	1,260,064	931,740	1,322,277	959,881
Tourism	3,550,170	268,533	3,630,150	363,739
Transport, warehousing and connections	1,979,333	857,741	1,714,322	835,673
Shipbuilding	2,994,248	416,604	2,257,050	572,383
Agriculture and fishery	455,679	68,956	515,702	68,974
Food industry	951,920	143,027	1,159,491	205,577
Construction industry	1,225,514	52,839	1,225,813	53,826
Other industry	492,757	148,974	527,143	138,641
Public administration	2,432,805	2,432,805	2,383,635	2,383,635
Education	47,201	42,085	47,020	40,956
Manufacture of basic metals and fabricated metal products, except machinery and equipment	321,017	55,363	407,200	62,764
Manufacture of chemicals and chemical products	403,025	89,644	255,537	16,721
Manufacture of other non-metallic mineral products	261,037	55,807	273,896	4,336
Pharmaceutical industry	543,887	-	571,663	-
Other	1,672,002	476,249	1,524,915	310,823
<b>Total credit risk exposure</b>	<b>33,362,384</b>	<b>6,040,367</b>	<b>33,168,139</b>	<b>6,017,929</b>

Concentration of assets and guarantees and commitments according to industry for both years has been compiled in accordance with the National Classification of Activities 2007 ("NKD 2007").

In the preparation of the Note, a combined approach is applied, which takes into consideration business activities of a debtor, retains the names of activities different from those in the National Classification of Activities and unites similar business activities.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Concentration of risk and maximum credit risk exposure (continued)**

The fair value of collateral for the Group in 2017 amounted to HRK 27,335,451 thousand (31 December 2016: HRK 27,157,039 thousand) and for the Bank HRK 27,322,017 thousand (31 December 2016: HRK 27,150,210 thousand).

In the total net highest exposure of the Bank in 2017, the credit risk of HRK 3,966,003 thousand (31 December 2016: HRK 4,136,125 thousand) is not covered with ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 619,922 thousand (31 December 2016: HRK 867,410 thousand), from local (regional) authorities of HRK 510,573 thousand (31 December 2016: HRK 395,629 thousand), state-owned companies for whose commitments the Republic of Croatia guarantees jointly and unconditionally of HRK 240,099 thousand (31 December 2016: HRK 242,735 thousand), government funds of HRK 43 thousand (31 December 2016: HRK 1,250 thousand), government bonds and Treasury bills of the Ministry of Finance of HRK 2,443,010 thousand (31 December 2016: HRK 2,399,224 thousand). In addition, an amount of HRK 152,356 thousand (31 December 2016: HRK 229,877 thousand) relates to receivables from a majority state-owned company (controlling influence).

Part of the placements with net exposure relates to placements provisionally and partially covered with collateral and the further increase in exposure has been stopped pending the submission of the full collateral necessary for compliance with the requested collateral coverage ratio.

Financial intermediation includes mainly commercial banks; the operation and collateral quality for placements with commercial banks is described further in Note 31.2 under Collateral for placements with commercial banks.

**Credit risk exposure by internal credit rating:**

Internal credit rating	Historical default rate (%)	Historical default rate (%)	Group		Bank	
	2017	2016	2017	2016	2017	2016
			HRK '000	HRK '000	HRK '000	HRK '000
A	1.12%	1.52%	31,790,961	31,671,378	31,735,353	31,619,491
B	35.05%	34.08%	1,627,031	1,548,648	1,627,031	1,548,648
C	96.02%	95.56%	-	-	-	-
<b>Total</b>			<b>33,417,992</b>	<b>33,220,026</b>	<b>33,362,384</b>	<b>33,168,139</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk assessment internal methodologies**

For the analysis and evaluation of various target groups of clients, the Bank has prescribed internal methodologies. They represent the guidelines for decisions on approval of loans, guarantees and letters of credit and one of criteria for determination of the placement risk category.

Methodology for evaluation of credit rating is applied when determining the creditworthiness of clients in the case of direct placements over HRK 1,500 thousand. It comprises three main evaluation areas: client evaluation, project/investment evaluation and evaluation of client by means of analysing future operations. All evaluation areas consist of three basic parts: financial, non-financial analysis and correction of evaluation based on currency-induced credit risk (VIKR) for placements in foreign currency or in kuna indexed to foreign currency.

Methodologies of credit scoring are used during credit risk evaluation for all direct placements below HRK 1,500 thousand where the Bank is exposed to credit risk. The quality and value of collateral for the placement are a part of the credit scoring procedure.

Methodologies for the analysis of clients who keep their business records in accordance with the Income Tax Act (commitments) are applied on the occasion of determining the creditworthiness of clients in the case of direct lending for placements above HRK 1,500 thousand together with the evaluation of the project based on the Methodology for the evaluation of credit rating (project evaluation).

The Methodology for evaluation and selection of banks and the Methodology for evaluation and selection of foreign banks are used for evaluation of domestic and foreign banks. The Methodology for the evaluation and selection of leasing companies is used for evaluation of leasing companies. The methodologies include the estimation of the financial risk (quantitative evaluation), the estimation of business risks for banks/leasing companies analysed (qualitative evaluation) and the estimation of reputation risk.

The result of application of the above methodologies is the rating of the client.

**Impairment loss and provisions**

The Bank forms provisions for identified losses in accordance with International Financial Reporting Standards and internal rules. Forming provisions is under the competence of the Credit risk evaluation and measurement committee.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.2. Credit risk (continued)

##### Provisioning on an individual basis

Provisioning on an individual basis represents impairment of partly recoverable and irrecoverable investments (risk groups "B" and "C"). Allocation of placements on an individual basis into risk groups is performed by the following criteria:

- creditworthiness,
- debtors' regularity of repayment upon maturity, and
- quality of placement collateral.

Placements that represent the portfolio of small loans are classified by the criteria of regular repayment upon maturity. The Bank does not determine the present value of discounted cash flows for partially recoverable placements where the expected inflow is expected within one year of the financial statements date.

##### Provisioning on a collective basis

Provisions on a collective basis are formed for fully recoverable placements or placements and commitments allocated in risk group "A". Allocation of debtors within the risk group is performed according to industry risk factor, geographical affiliation, type and the debtor's foreign currency alignment.

Regardless of other classification criteria, investments which are at least 80% covered by first class collateral are allocated in risk group "A".

The Management Board of HBOR believes that the policies and procedures of forming provisions are adequate and that they ensure sufficient provisions for losses.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.2. Credit risk (continued)

##### Credit risk quality according to type of financial assets

Credit risk analysis, before and after the effect of mitigation through collateral received according to the type of financial assets on positions of assets and guarantees and commitments by internal credit rating, is as follows:

Group	Gross exposure of portfolio of risk group A	Gross exposure of portfolio of risk group B	Gross exposure of portfolio of risk group C	Gross exposure of total portfolio	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>								
<b>Assets</b>								
Cash on hand and due from banks	1,403,663	-	-	1,403,663	-	-	-	-
Deposits with other banks	29,138	-	-	29,138	-	-	-	-
Loans to financial institutions	10,624,635	211,506	-	10,836,141	-	-	-	-
Loans to other customers	10,990,700	1,392,923	-	12,383,623	2,761,223	50,706	-	2,811,929
Financial assets at fair value through profit or loss	291	-	-	291	-	-	-	-
Assets available for sale	3,276,990	-	-	3,276,990	2,483,384	-	-	2,483,384
Assets held to maturity	1,399	-	-	1,399	1,399	-	-	1,399
Other assets	18,871	426	-	19,297	10,608	426	-	11,034
<b>Total</b>	<b>26,345,687</b>	<b>1,604,855</b>	<b>-</b>	<b>27,950,542</b>	<b>5,256,614</b>	<b>51,132</b>	<b>-</b>	<b>5,307,746</b>
<b>Guarantees and commitments</b>								
Guarantees issued in HRK	33,993	-	-	33,993	1,254	-	-	1,254
Issued guarantees in foreign currency	2,425,975	20,349	-	2,446,324	330,170	-	-	330,170
Undrawn loans	2,984,971	1,827	-	2,986,798	443,036	-	-	443,036
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
<b>Total</b>	<b>5,445,274</b>	<b>22,176</b>	<b>-</b>	<b>5,467,450</b>	<b>774,795</b>	<b>-</b>	<b>-</b>	<b>774,795</b>
<b>Total credit risk exposure</b>	<b>31,790,961</b>	<b>1,627,031</b>	<b>-</b>	<b>33,417,992</b>	<b>6,031,409</b>	<b>51,132</b>	<b>-</b>	<b>6,082,541</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial assets (continued)**

Credit risk analysis, before and after the effect of mitigation through collateral received according to the type of financial assets on positions of assets and guarantees and commitments by internal credit rating, is as follows (continued):

Group	Gross exposure of portfolio of risk group A	Gross exposure of portfolio of risk group B	Gross exposure of portfolio of risk group C	Gross exposure of total portfolio	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2016</b>								
<b>Assets</b>								
Cash on hand and due from banks	491,243	-	-	491,243	-	-	-	-
Deposits with other banks	23,872	-	-	23,872	-	-	-	-
Loans to financial institutions	11,472,130	416,981	-	11,889,111	-	-	-	-
Loans to other customers	10,415,684	1,095,510	-	11,511,194	2,484,106	34,930	-	2,519,036
Financial assets at fair value through profit or loss	286	-	-	286	-	-	-	-
Assets available for sale	3,353,086	-	-	3,353,086	2,442,549	-	-	2,442,549
Assets held to maturity	1,422	-	-	1,422	1,422	-	-	1,422
Other assets	5,853	396	-	6,249	3,270	396	-	3,666
<b>Total</b>	<b>25,763,576</b>	<b>1,512,887</b>	<b>-</b>	<b>27,276,463</b>	<b>4,931,347</b>	<b>35,326</b>	<b>-</b>	<b>4,966,673</b>
<b>Guarantees and commitments</b>								
Guarantees issued in HRK	32,082	-	-	32,082	-	-	-	-
Issued guarantees in foreign currency	1,964,149	18,820	-	1,982,969	437,160	-	-	437,160
Undrawn loans	3,911,236	16,941	-	3,928,177	658,819	-	-	658,819
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
<b>Total</b>	<b>5,907,802</b>	<b>35,761</b>	<b>-</b>	<b>5,943,563</b>	<b>1,096,314</b>	<b>-</b>	<b>-</b>	<b>1,096,314</b>
<b>Total credit risk exposure</b>	<b>31,671,378</b>	<b>1,548,648</b>	<b>-</b>	<b>33,220,026</b>	<b>6,027,661</b>	<b>35,326</b>	<b>-</b>	<b>6,062,987</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial assets (continued)**

Credit risk analysis, before and after the effect of mitigation through collateral received according to the type of financial assets on positions of assets and guarantees and commitments by internal credit rating, is as follows (continued):

Bank	Gross exposure of portfolio of risk group A	Gross exposure of portfolio of risk group B	Gross exposure of portfolio of risk group C	Gross exposure of total portfolio	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>								
<b>Assets</b>								
Cash on hand and due from banks	1,401,130	-	-	1,401,130	-	-	-	-
Deposits with other banks	29,138	-	-	29,138	-	-	-	-
Loans to financial institutions	10,624,635	211,506	-	10,836,141	-	-	-	-
Loans to other customers	10,990,700	1,392,923	-	12,383,623	2,761,223	50,706	-	2,811,929
Assets available for sale	3,232,620	-	-	3,232,620	2,443,699	-	-	2,443,699
Other assets	11,856	426	-	12,282	9,518	426	-	9,944
<b>Total</b>	<b>26,290,079</b>	<b>1,604,855</b>	<b>-</b>	<b>27,894,934</b>	<b>5,214,440</b>	<b>51,132</b>	<b>-</b>	<b>5,265,572</b>
<b>Guarantees and commitments</b>								
Guarantees issued in HRK	33,993	-	-	33,993	1,254	-	-	1,254
Issued guarantees in foreign currency	2,425,975	20,349	-	2,446,324	330,170	-	-	330,170
Undrawn loans	2,984,971	1,827	-	2,986,798	443,036	-	-	443,036
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
<b>Total</b>	<b>5,445,274</b>	<b>22,176</b>	<b>-</b>	<b>5,467,450</b>	<b>774,795</b>	<b>-</b>	<b>-</b>	<b>774,795</b>
<b>Total credit risk exposure</b>	<b>31,735,353</b>	<b>1,627,031</b>	<b>-</b>	<b>33,362,384</b>	<b>5,989,235</b>	<b>51,132</b>	<b>-</b>	<b>6,040,367</b>

In the total net highest exposure of the Group and the Bank, the amount of loans to other customers of HRK 1,521,624 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 618,596 thousand, local (regional) authorities of HRK 510,573 thousand and public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 240,099 thousand. An additional amount of HRK 152,356 thousand relates to receivables from majority state-owned companies (controlling influence).

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.2. Credit risk (continued)

##### Credit risk quality according to type of financial assets (continued)

The amount of assets available for sale and held to maturity is not covered by ordinary collateral but it relates to government bonds and treasury bills of the Ministry of Finance of HRK 2,483,310 thousand for the Group and HRK 2,443,010 thousand for the Bank.

Other assets of HRK 1,034 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.2. Credit risk (continued)

##### Credit risk quality according to type of financial asset (continued)

Credit risk analysis, before and after the effect of mitigation through collateral received according to the type of financial assets on positions of assets and guarantees and commitments by internal credit rating, is as follows (continued):

Bank	Gross exposure of portfolio of risk group A	Gross exposure of portfolio of risk group B	Gross exposure of portfolio of risk group C	Gross exposure of total portfolio	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2016</b>								
<b>Assets</b>								
Cash on hand and due from banks	490,692	-	-	490,692	-	-	-	-
Deposits with other banks	23,872	-	-	23,872	-	-	-	-
Loans to financial institutions	11,472,130	416,981	-	11,889,111	-	-	-	-
Loans to other customers	10,415,684	1,095,510	-	11,511,194	2,484,106	34,930	-	2,519,036
Assets available for sale	3,306,628	-	-	3,306,628	2,399,825	-	-	2,399,825
Other assets	2,683	396	-	3,079	2,358	396	-	2,754
<b>Total</b>	<b>25,711,689</b>	<b>1,512,887</b>	<b>-</b>	<b>27,224,576</b>	<b>4,886,289</b>	<b>35,326</b>	<b>-</b>	<b>4,921,615</b>
<b>Guarantees and commitments</b>								
Guarantees issued in HRK	32,082	-	-	32,082	-	-	-	-
Issued guarantees in foreign currency	1,964,149	18,820	-	1,982,969	437,160	-	-	437,160
Undrawn loans	3,911,236	16,941	-	3,928,177	658,819	-	-	658,819
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
<b>Total</b>	<b>5,907,802</b>	<b>35,761</b>	<b>-</b>	<b>5,943,563</b>	<b>1,096,314</b>	<b>-</b>	<b>-</b>	<b>1,096,314</b>
<b>Total credit risk exposure</b>	<b>31,619,491</b>	<b>1,548,648</b>	<b>-</b>	<b>33,168,139</b>	<b>5,982,603</b>	<b>35,326</b>	<b>-</b>	<b>6,017,929</b>

In the total net highest exposure of the Group and the Bank, the amount of loans to other customers of HRK 1,498,400 thousand is not covered by ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 628,961 thousand, local (regional) authorities of HRK 395,629 thousand, public companies for whose liabilities the Republic of Croatia guarantees jointly and unconditionally of HRK 242,735 thousand and the government funds of HRK 1,198 thousand. An additional amount of HRK 229,877 thousand relates to receivables from majority state-owned companies (controlling influence).

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial asset (continued)**

The amount of assets available for sale and held to maturity is not covered by ordinary collateral but it relates to government bonds and treasury bills of the Ministry of Finance of HRK 2,442,203 thousand for the Group and HRK 2,399,224 thousand for the Bank.

Other assets of HRK 922 thousand are not covered by ordinary collateral, but relate to receivables from the Republic of Croatia and the government funds.

The amount of HRK 237,245 thousand relates to a guarantee issued in foreign currency, for which the liability was assumed by the Republic of Croatia. The guarantee was removed from business records of HBOR on 13 February 2017 due to the cessation of payment obligation resulting from arbitration decision.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial asset (continued)**

Credit risk quality according to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category:

Group	Gross exposure neither past due nor impaired	Gross exposure past due not impaired	Gross exposure individually impaired	Total
	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>				
<b>Assets</b>				
Cash on hand and due from banks	1,403,663	-	-	1,403,663
Deposits with other banks	29,138	-	-	29,138
Loans to financial institutions	10,430,232	194,403	211,506	10,836,141
Loans to other customers	10,859,418	131,282	1,392,923	12,383,623
Financial assets at fair value through profit or loss	291	-	-	291
Assets available for sale	3,276,990	-	-	3,276,990
Assets held to maturity	1,399	-	-	1,399
Other assets	10,452	8,419	426	19,297
<b>Total</b>	<b>26,011,583</b>	<b>334,104</b>	<b>1,604,855</b>	<b>27,950,542</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,993	-	-	33,993
Issued guarantees in foreign currency	2,425,975	-	20,349	2,446,324
Undrawn loans	2,984,971	-	1,827	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,445,274</b>	<b>-</b>	<b>22,176</b>	<b>5,467,450</b>
<b>Total credit risk exposure</b>	<b>31,456,857</b>	<b>334,104</b>	<b>1,627,031</b>	<b>33,417,992</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial asset (continued)**

Credit risk quality according to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category (continued):

Group	Gross exposure neither past due nor impaired	Gross exposure past due not impaired	Gross exposure individually impaired	Total
	HRK '000	HRK '000	HRK '000	HRK '000
<b>2016</b>				
<b>Assets</b>				
Cash on hand and due from banks	491,243	-	-	491,243
Deposits with other banks	23,872	-	-	23,872
Loans to financial institutions	11,259,676	212,454	416,981	11,889,111
Loans to other customers	10,249,918	165,766	1,095,510	11,511,194
Financial assets at fair value through profit or loss	286	-	-	286
Assets available for sale	3,353,086	-	-	3,353,086
Assets held to maturity	1,422	-	-	1,422
Other assets	4,528	1,325	396	6,249
<b>Total</b>	<b>25,384,031</b>	<b>379,545</b>	<b>1,512,887</b>	<b>27,276,463</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	32,082	-	-	32,082
Issued guarantees in foreign currency	1,964,149	-	18,820	1,982,969
Undrawn loans	3,911,236	-	16,941	3,928,177
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,907,802</b>	<b>-</b>	<b>35,761</b>	<b>5,943,563</b>
<b>Total credit risk exposure</b>	<b>31,291,833</b>	<b>379,545</b>	<b>1,548,648</b>	<b>33,220,026</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial asset (continued)**

Credit risk quality according to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category (continued):

Bank	Gross exposure neither past due nor impaired	Gross exposure past due not impaired	Gross exposure individually impaired	Total
	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>				
<b>Assets</b>				
Cash on hand and due from banks	1,401,130	-	-	1,401,130
Deposits with other banks	29,138	-	-	29,138
Loans to financial institutions	10,430,232	194,403	211,506	10,836,141
Loans to other customers	10,859,418	131,282	1,392,923	12,383,623
Assets available for sale	3,232,620	-	-	3,232,620
Other assets	3,700	8,156	426	12,282
<b>Total</b>	<b>25,956,238</b>	<b>333,841</b>	<b>1,604,855</b>	<b>27,894,934</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	33,993	-	-	33,993
Issued guarantees in foreign currency	2,425,975	-	20,349	2,446,324
Undrawn loans	2,984,971	-	1,827	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,445,274</b>	<b>-</b>	<b>22,176</b>	<b>5,467,450</b>
<b>Total credit risk exposure</b>	<b>31,401,512</b>	<b>333,841</b>	<b>1,627,031</b>	<b>33,362,384</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial asset (continued)**

Credit risk quality due to the gross exposure of the type of financial assets on positions of assets and guarantees and commitments by risk category (continued):

Bank	Gross exposure neither past due nor impaired	Gross exposure past due not impaired	Gross exposure individually impaired	Total
	HRK '000	HRK '000	HRK '000	HRK '000
<b>2016</b>				
Assets				
Cash on hand and due from banks	490,692	-	-	490,692
Deposits with other banks	23,872	-	-	23,872
Loans to financial institutions	11,259,676	212,454	416,981	11,889,111
Loans to other customers	10,249,918	165,766	1,095,510	11,511,194
Assets available for sale	3,306,628	-	-	3,306,628
Other assets	1,666	1,017	396	3,079
<b>Total</b>	<b>25,332,452</b>	<b>379,237</b>	<b>1,512,887</b>	<b>27,224,576</b>
<b>Guarantees and commitments</b>				
Guarantees issued in HRK	32,082	-	-	32,082
Issued guarantees in foreign currency	1,964,149	-	18,820	1,982,969
Undrawn loans	3,911,236	-	16,941	3,928,177
Other irrevocable contingent liabilities	335	-	-	335
<b>Total</b>	<b>5,907,802</b>	<b>-</b>	<b>35,761</b>	<b>5,943,563</b>
<b>Total credit risk exposure</b>	<b>31,240,254</b>	<b>379,237</b>	<b>1,548,648</b>	<b>33,168,139</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial asset (continued)**

Aging analysis of past due but not impaired loans per class of financial asset:

Group 2017	Up to 15 days	16 to 30 days	31 to 60 days	61 to 90 days	Over 90 days	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Loans to financial institutions	188,902	2,000	3,500	-	1	194,403
Loans to other customers	95,698	68	1,276	1,066	33,174	131,282
Other assets	504	160	485	6,626	644	8,419
<b>Total</b>	<b>285,104</b>	<b>2,228</b>	<b>5,261</b>	<b>7,692</b>	<b>33,819</b>	<b>334,104</b>
<b>Group 2016</b>						
<b>Assets</b>						
Loans to financial institutions	200,364	552	4,000	17	7,521	212,454
Loans to other customers	109,035	36	8,072	803	47,820	165,766
Other assets	936	200	125	38	26	1,325
<b>Total</b>	<b>310,335</b>	<b>788</b>	<b>12,197</b>	<b>858</b>	<b>55,367</b>	<b>379,545</b>
<b>Bank 2017</b>						
<b>Assets</b>						
Loans to financial institutions	188,902	2,000	3,500	-	1	194,403
Loans to other customers	95,698	68	1,276	1,066	33,174	131,282
Other assets	440	75	396	6,601	644	8,156
<b>Total</b>	<b>285,040</b>	<b>2,143</b>	<b>5,172</b>	<b>7,667</b>	<b>33,819</b>	<b>333,841</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Credit risk quality according to type of financial asset (continued)**

Aging analysis of past due but not impaired loans per class of financial asset (continued):

Bank 2016	Up to 15 days	16 to 30 days	31 to 60 days	61 to 90 days	Over 90 days	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Loans to financial institutions	200,364	552	4,000	17	7,521	212,454
Loans to other customers	109,035	36	8,072	803	47,820	165,766
Other assets	862	73	38	18	26	1,017
<b>Total</b>	<b>310,261</b>	<b>661</b>	<b>12,110</b>	<b>838</b>	<b>55,367</b>	<b>379,237</b>

Since the amount of past due but not impaired receivables of the subsidiary company is immaterial, the following text contains the breakdown of changes in past due but not impaired loans of the parent company.

From total due and not impaired loans to financial institutions in 2017, an amount of HRK 6,200 thousand or 3% relates to not executed extensions of short-term revolving loans.

Due to the maturity falling on 31 December 2017 being a non-working day, an amount of HRK 184,650 thousand, i.e. 95% of due but not impaired loans to financial institutions, was collected on 2 January 2018 being the first following working day.

If the total amount of due and not impaired loans to financial institutions is reduced by the debt of banks under the short-term revolving loans, the remaining debt equals HRK 188,203 thousand.

From total due and not impaired loans to other customers in 2017, an amount of HRK 95,698 thousand or 73% relates to delays of up to 15 days, of which the amount of HRK 10,053 thousand, i.e. 11%, was guaranteed by the Republic of Croatia.

From total due and not impaired loans to financial institutions in 2016, an amount of HRK 11,448 thousand or 5% relates to not executed extensions of short-term revolving loans.

Due to the maturity falling on 31 December 2016 being a non-working day, an amount of HRK 193,524 thousand, i.e. 91% of due but not impaired loans to financial institutions, was collected on 2 January 2017 being the first following working day.

From total due and not impaired loans to other customers in 2016, an amount of HRK 109,035 thousand or 66% relates to delays of up to 15 days, of which the amount of HRK 10,430 thousand, i.e. 10%, was guaranteed by the Republic of Croatia.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Collateral and other instruments**

Collateral for the Bank's placements are:

1. obligatory (bills of exchange and promissory notes),
2. ordinary (property, ships, airplanes, bank guarantees, guarantees from the Republic of Croatia, guarantees from the local (regional) authorities, guarantees from HAMAG-BICRO (Croatian Agency for SMSs, Innovation and Investment), insurance policy against political and/or commercial risks), and
3. other collateral (movable property, bills of exchange or guarantees from other companies with solid creditworthiness, fiduciary or pledge of companies' equity instruments, repossession of cash receivables or assignment for collectible receivables, deposit repossession, restriction of transferability on insurance policy of assets and/or person, pledge on a trademark, etc.).

All Bank placements have to be secured with obligatory collateral. Low-exposure placements must be secured with one obligatory instrument of collateral at least.

Acceptable standard and other collateral are classified according to quality in five groups. The evaluation of collateral is based on quality, estimated based on marketability, documentation and possibility of supervision by the Bank as well as the possibility of enforced collection. Only the acceptable collateral is evaluated while the sixth group of collateral is unacceptable.

When deciding on loan approval, weak creditworthiness cannot be replaced by quality collateral, except when the security instruments are first class instruments: guarantees from the Republic of Croatia, guarantees of local/regional authorities (JLPS), guarantees from HAMAG-BICRO, insurance policy against political and/or commercial risks and when the Republic of Croatia, JLPS or other government bodies guarantee for clients implicitly (through legal acts).

**Collateral for placements with commercial banks**

For the purpose of mitigation of credit risk and reduction of business costs, and in compliance with the Act on the Croatian Bank for Reconstruction and Development, the Bank approves part of its placements with commercial banks/leasing companies. As collateral for placements approved to final customers through financial institutions, the Bank uses mandatory collateral from commercial banks/leasing companies. The commercial bank or the leasing company is obliged to deliver them based on the Mutual business cooperation agreement, but not for each individual placement to the final customer based on that Agreement. In the individual contracts for placements to the final customers, the use of obligatory collateral delivered with the Agreement on mutual business cooperation is contracted. As the commercial bank or the leasing company takes on the risk of default by the final customer, they are given the option to contract sufficient collateral with the final customer.

Where the loan is approved through a commercial bank, depending on the financial institution's internal rating, the Bank contracts a sub-mortgage. In this case, either the commercial bank transfers the ownership over the collateral, while the Bank takes a mortgage over the same collateral, or the commercial bank forms a mortgage on the collateral, while the Bank takes a sub-mortgage on the same collateral.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**31. Risk management (continued)**

**31.2. Credit risk (continued)**

**Collateral and other instruments (continued)**

**Collateral for placements with commercial banks (continued)**

By signing the Agreement on mutual business cooperation, a transfer of any claims the commercial bank may have towards the final customer is made to HBOR. Pursuant to the Agreement, the commercial bank authorises HBOR to unilaterally inform the bank in written form that, in the case of the commercial bank's insolvency or threat of liquidation, untimely repayments or default on the commitments agreed in the individual contract on interbank loan or actual (insolvent or regular) liquidation, the Bank assumes the receivable towards the final customer from the commercial bank, with the effect of assignment of receivables instead of contract fulfilment.

Additionally, based on the Agreement on mutual business cooperation and based on the said unilateral statement, the commercial bank authorises HBOR that HBOR may, without having to obtain any further consent or approval from the commercial bank, enter itself into all public registers, books or records as the creditor instead of the commercial bank under any security arrangements for assigned receivables as well as under any other proceedings.

From the moment of the assignment, the final customer is obliged to make all payments related to the assigned receivable directly to HBOR. Should the commercial bank receive any payments in the name of collection of receivables per particular placement, the bank is obliged to immediately transfer the funds to HBOR.

**Collateral for direct placements**

All direct placements are mainly secured with a transfer of ownership or with a mortgage over real estate and, if that is possible, the Bank obtains as security against credit risk a guarantee from HAMAG-BICRO, a guarantee from the local (regional) authority, a guarantee from the Republic of Croatia, etc.

The Bank has the right to verify the appraisal of the collateral value and such a confirmed appraisal is considered as the final collateral value.

Depending on the type of collateral, the credit programme, the general terms of security or the decision of an authorised body, the Bank has determined the necessary ratio of placements and collateral.

For real estate, the necessary ratio between the amount of placement and the appraised value of the real estate is 1:1.3 except for investments on islands, in areas of special concern and hill or mountain areas, where the ratio is 1:1.2. For movable property, the necessary ratio between the amount of placement and the appraised value of the property is 1:2.

The Bank continuously monitors the value of the collateral by verification/statistical evaluation. Monitoring of the value of mortgaged real estate is performed once a year for business real estate, and every three years for residential buildings. The Bank has formed a special organizational unit for:

- evaluation and verification of already appraised and offered collateral (real estate and movables),
- technical and technological analysis of investment projects, and
- financial supervision over the withdrawal of loan funds for the purpose of the construction of the investment project.

**31. Risk management (continued)**

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

*(All amounts are expressed in HRK thousand)*

**31.2. Credit risk (continued)**

**Collateral and other instruments (continued)**

**Collateral for direct placements (continued)**

In the event that it is not possible for the Bank to collect from regular operations, the Bank starts collection from the collateral at its disposal. This encompasses initiating collection from the obligatory collateral, then from first-class, unconditional collateral payable on first demand and then from the mortgage or fiduciary ownership of the real estate or movable property, including their repossession with a view to decreasing or fully settling the Bank's receivables. The Bank does not use repossessed assets for business purposes.

**Collateral for placements under the risk-sharing models**

In the case of risk-sharing models, collateral is created by commercial banks depending on the type of the model:

- in accordance with their own internal documents and good banking practices, and, consequently, HBOR's documents and collateral ratios prescribed in them do not apply,
- or collateral is created by commercial banks and HBOR for their respective shares in the loan in accordance with their own documents, decisions and/or procedures.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.3. Liquidity risk

Liquidity risk management includes liquidity risk assessment, measurement, control, containment and reporting, the establishing of limits and the monitoring of limit utilisation, the determining of procedures, responsibilities and accountabilities for all organisational units that participate in the management of liquidity risk.

In order to manage liquidity risk, the Bank maintains the adequate level of liquidity reserve, continuously monitors current and planned liquidity, ensures HRK and foreign currency funds necessary for timely settlement of liabilities and for disbursements of approved loans and planned loan approvals.

The Bank's liquidity reserve is set in the amount of at least 10% of net assets.

Managing short term liquidity encompasses the monitoring and managing of daily liquidity, particularly on the basis of the limits established for investing in instruments aimed at the maintenance of liquidity reserve, the monitoring and managing of cash flow mismatch for the next 5 weeks and for 1-year period for the purpose of timely determining the activities targeted at the accomplishment of business plans and simultaneously maintaining the established liquidity reserve level.

By long term liquidity risk management, the Bank manages the mismatch between contracted and planned placements and their sources of funding in the period over one year, within the framework of which guidelines/resolutions/decisions on further activities are made by bodies in charge on the basis of long-term inflow and outflow projections as well as based on the relationship between the funding requirements of the Bank and the availability of funding sources.

Within the framework of stress tests, the Bank considers internal and external risk factors, and the results of such tests are reported to the Asset and Liability Management Committee and the Management Board.

Liquidity risk management is ensured by the established system of limits and a regular review of their adequacy, reporting to the competent authorities on the projected size of available resources and liquidity reserves in the short and long term, which also represent the basis for making conclusions by the Asset and Liability Management Committee/decisions by the Management Board about activities ensuring business continuity within the prescribed limits.

The Bank does not hold deposits of citizens and is therefore not exposed to significant daily fluctuations in liquidity.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.3. Liquidity risk (continued)

The table below provides an analysis of total assets and total liabilities and equity as of 31 December 2017 and 31 December 2016 placed into relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date, as follows:

Group 2017	Up to 1 month HRK '000	1 - 3 months HRK '000	3 - 12 months HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
<b>Assets</b>						
Cash on hand and due from banks	1,403,680	-	-	-	-	1,403,680
Deposits with other banks	29,138	-	-	-	-	29,138
Loans to financial institutions*	499,790	411,937	1,369,798	2,888,174	5,666,442	10,836,141
Loans to other customers	2,048,659	396,509	885,769	2,116,638	6,936,048	12,383,623
Financial assets at fair value through profit or loss	291	-	-	-	-	291
Assets available for sale	3,308,009	13,532	23	-	-	3,321,564
Assets held to maturity	-	9	5	-	1,385	1,399
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	53,557	53,557
Non-current assets held for sale	-	-	1,932	2,827	11,938	16,697
Other assets	18,904	7,543	1,397	497	1,130	29,471
<b>Total assets (1)</b>	<b>7,308,471</b>	<b>829,530</b>	<b>2,258,924</b>	<b>5,008,136</b>	<b>12,670,500</b>	<b>28,075,561</b>
<b>Liabilities</b>						
Deposits	251,822	187	171,291	211,134	10,307	644,741
Borrowings	168,310	307,151	1,155,999	3,853,447	9,902,974	15,387,881
Bonds payable	-	43,909	-	1,117,790	-	1,161,699
Other liabilities	186,306	22,257	81,485	152,731	162,674	605,453
<b>Total liabilities</b>	<b>606,438</b>	<b>373,504</b>	<b>1,408,775</b>	<b>5,335,102</b>	<b>10,075,955</b>	<b>17,799,774</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	7,009,632	7,009,632
Retained earnings and reserves	-	-	-	-	2,996,968	2,996,968
Other reserves	-	-	-	-	94,683	94,683
Net profit for the year	-	-	-	-	162,201	162,201
<b>Total equity attributable to equity holders of the parent</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,263,484</b>	<b>10,263,484</b>
Guarantee fund	-	-	-	-	12,303	12,303
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,275,787</b>	<b>10,275,787</b>
<b>Total liabilities and total equity (2)</b>	<b>606,438</b>	<b>373,504</b>	<b>1,408,775</b>	<b>5,335,102</b>	<b>20,351,742</b>	<b>28,075,561</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>6,702,033</b>	<b>456,026</b>	<b>850,149</b>	<b>(326,966)</b>	<b>(7,681,242)</b>	<b>-</b>
<b>Net cumulative assets/liabilities</b>	<b>6,702,033</b>	<b>7,158,059</b>	<b>8,008,208</b>	<b>7,681,242</b>	<b>-</b>	<b>-</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 236,400 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 150,000 thousand was placed in the 3 months up to 1 year maturity category.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.3. Liquidity risk (continued)

Group 2016	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000				
<b>Assets</b>						
Cash on hand and due from banks	491,246	-	-	-	-	491,246
Deposits with other banks	-	23,872	-	-	-	23,872
Loans to financial institutions*	684,891	441,872	1,774,961	3,131,823	5,855,564	11,889,111
Loans to other customers	1,423,234	385,784	948,959	1,850,611	6,902,606	11,511,194
Financial assets at fair value through profit or loss	286	-	-	-	-	286
Assets available for sale	3,375,864	14,074	96	-	-	3,390,034
Assets held to maturity	-	10	4	-	1,408	1,422
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	57,305	57,305
Non-current assets held for sale	-	-	27	11,450	5,753	17,230
Other assets	6,225	748	530	620	999	9,122
<b>Total assets (1)</b>	<b>5,981,746</b>	<b>866,360</b>	<b>2,724,577</b>	<b>4,994,504</b>	<b>12,823,635</b>	<b>27,390,822</b>
<b>Liabilities</b>						
Deposits	75,581	-	12,687	46,407	8,169	142,844
Borrowings	355,456	237,339	1,017,892	3,060,113	8,720,949	13,391,749
Bonds payable	-	95,932	1,888,837	-	1,120,800	3,105,569
Other liabilities	151,186	29,918	105,330	194,459	227,059	707,952
<b>Total liabilities</b>	<b>582,223</b>	<b>363,189</b>	<b>3,024,746</b>	<b>3,300,979</b>	<b>10,076,977</b>	<b>17,348,114</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	6,959,632	6,959,632
Retained earnings and reserves	-	-	-	-	2,682,127	2,682,127
Other reserves	-	-	-	-	73,733	73,733
Net profit for the year	-	-	-	-	314,841	314,841
<b>Total equity attributable to equity holders of the parent</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,030,333</b>	<b>10,030,333</b>
Guarantee fund	-	-	-	-	12,375	12,375
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,042,708</b>	<b>10,042,708</b>
<b>Total liabilities and total equity (2)</b>	<b>582,223</b>	<b>363,189</b>	<b>3,024,746</b>	<b>3,300,979</b>	<b>20,119,685</b>	<b>27,390,822</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>5,399,523</b>	<b>503,171</b>	<b>(300,169)</b>	<b>1,693,525</b>	<b>(7,296,050)</b>	<b>-</b>
<b>Net cumulative assets/liabilities</b>	<b>5,399,523</b>	<b>5,902,694</b>	<b>5,602,525</b>	<b>7,296,050</b>	<b>-</b>	<b>-</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 232,489 thousand relate to reverse REPO agreements and were placed in the up to 1 month maturity category.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.3. Liquidity risk (continued)

The table below provides an analysis of total assets and total liabilities and equity as of 31 December 2017 and 31 December 2016 placed into relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date, as follows:

Bank 2017	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000				
<b>Assets</b>						
Cash on hand and due from banks	1,401,146	-	-	-	-	1,401,146
Deposits with other banks	29,138	-	-	-	-	29,138
Loans to financial institutions*	499,790	411,937	1,369,798	2,888,174	5,666,442	10,836,141
Loans to other customers	2,048,659	396,509	885,769	2,116,638	6,936,048	12,383,623
Assets available for sale	3,263,758	13,436	-	-	-	3,277,194
Investments in subsidiaries	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	53,514	53,514
Non-current assets held for sale	-	-	1,932	2,827	11,938	16,697
Other assets	17,831	1,648	1,350	497	900	22,226
<b>Total assets (1)</b>	<b>7,260,322</b>	<b>823,530</b>	<b>2,258,849</b>	<b>5,008,136</b>	<b>12,704,966</b>	<b>28,055,803</b>
<b>Liabilities</b>						
Deposits	251,822	187	171,291	211,134	10,307	644,741
Borrowings	168,310	307,151	1,155,999	3,853,447	9,902,974	15,387,881
Bonds payable	-	43,909	-	1,117,790	-	1,161,699
Other liabilities	185,299	21,082	76,872	144,072	165,326	592,651
<b>Total liabilities</b>	<b>605,431</b>	<b>372,329</b>	<b>1,404,162</b>	<b>5,326,443</b>	<b>10,078,607</b>	<b>17,786,972</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	7,009,632	7,009,632
Retained earnings and reserves	-	-	-	-	2,995,656	2,995,656
Other reserves	-	-	-	-	90,457	90,457
Net profit for the year	-	-	-	-	160,783	160,783
<b>Capital</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,256,528</b>	<b>10,256,528</b>
Guarantee fund	-	-	-	-	12,303	12,303
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,268,831</b>	<b>10,268,831</b>
<b>Total liabilities and total equity (2)</b>	<b>605,431</b>	<b>372,329</b>	<b>1,404,162</b>	<b>5,326,443</b>	<b>20,347,438</b>	<b>28,055,803</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>6,654,891</b>	<b>451,201</b>	<b>854,687</b>	<b>(318,307)</b>	<b>(7,642,472)</b>	<b>-</b>
<b>Net cumulative assets/liabilities</b>	<b>6,654,891</b>	<b>7,106,092</b>	<b>7,960,779</b>	<b>7,642,472</b>	<b>-</b>	<b>-</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 236,400 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 150,000 thousand was placed in the 3 months up to 1 year maturity category.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.3. Liquidity risk (continued)**

<b>Bank 2016</b>	<b>Up to 1 month</b>	<b>1 - 3 months</b>	<b>3 - 12 months</b>	<b>1 - 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Assets</b>						
Cash on hand and due from banks	490,695	-	-	-	-	490,695
Deposits with other banks	-	23,872	-	-	-	23,872
Loans to financial institutions*	684,891	441,872	1,774,961	3,131,823	5,855,564	11,889,111
Loans to other customers	1,423,234	385,784	948,959	1,850,611	6,902,606	11,511,194
Assets available for sale	3,329,585	13,989	-	-	-	3,343,574
Investments in subsidiaries	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	57,216	57,216
Non-current assets held for sale	-	-	27	11,450	5,753	17,230
Other assets	3,505	326	504	620	945	5,900
<b>Total assets (1)</b>	<b>5,931,910</b>	<b>865,843</b>	<b>2,724,451</b>	<b>4,994,504</b>	<b>12,858,208</b>	<b>27,374,916</b>
<b>Liabilities</b>						
Deposits	75,581	-	12,687	46,407	8,169	142,844
Borrowings	355,456	237,339	1,017,892	3,060,113	8,720,949	13,391,749
Bonds payable	-	95,932	1,888,837	-	1,120,800	3,105,569
Other liabilities	150,555	28,649	100,528	188,186	228,856	696,774
<b>Total liabilities</b>	<b>581,592</b>	<b>361,920</b>	<b>3,019,944</b>	<b>3,294,706</b>	<b>10,078,774</b>	<b>17,336,936</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	6,959,632	6,959,632
Retained earnings and reserves	-	-	-	-	2,682,131	2,682,131
Other reserves	-	-	-	-	70,317	70,317
Net profit for the year	-	-	-	-	313,525	313,525
<b>Capital</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,025,605</b>	<b>10,025,605</b>
Guarantee fund	-	-	-	-	12,375	12,375
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,037,980</b>	<b>10,037,980</b>
<b>Total liabilities and total equity (2)</b>	<b>581,592</b>	<b>361,920</b>	<b>3,019,944</b>	<b>3,294,706</b>	<b>20,116,754</b>	<b>27,374,916</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>5,350,318</b>	<b>503,923</b>	<b>(295,493)</b>	<b>1,699,798</b>	<b>(7,258,546)</b>	<b>-</b>
<b>Net cumulative assets/liabilities</b>	<b>5,350,318</b>	<b>5,854,241</b>	<b>5,558,748</b>	<b>7,258,546</b>	<b>-</b>	<b>-</b>

The items with undefined maturity are included in terms over 3 years.

\* Receivables of HRK 232,489 thousand relate to reverse REPO agreements and were placed in the up to 1 month maturity category.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.3. Liquidity risk (continued)**

The table below indicates the remaining contractual maturity of financial liabilities of the Group in undiscounted amounts:

<b>Group 2017</b>	<b>Up to 1 month</b>	<b>1 - 3 months</b>	<b>3 - 12 months</b>	<b>1 - 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Financial liabilities</b>						
Deposits	251,822	187	171,291	211,134	10,307	644,741
Borrowings	197,142	283,160	1,358,672	4,292,634	10,758,724	16,890,332
Bonds payable	-	-	67,623	1,253,036	-	1,320,659
Other liabilities	186,306	22,257	81,485	152,731	162,674	605,453
<b>Total</b>	<b>635,270</b>	<b>305,604</b>	<b>1,679,071</b>	<b>5,909,535</b>	<b>10,931,705</b>	<b>19,461,185</b>
<b>Group 2016</b>						
	<b>Up to 1 month</b>	<b>1 - 3 months</b>	<b>3 - 12 months</b>	<b>1 - 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Financial liabilities</b>						
Deposits	75,581	-	12,687	46,407	8,169	142,844
Borrowings	382,184	208,630	1,261,178	3,598,035	9,694,025	15,144,052
Bonds payable	-	-	2,051,330	136,040	1,188,820	3,376,190
Other liabilities	151,186	29,918	105,330	194,459	227,059	707,952
<b>Total</b>	<b>608,951</b>	<b>238,548</b>	<b>3,430,525</b>	<b>3,974,941</b>	<b>11,118,073</b>	<b>19,371,038</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.3. Liquidity risk (continued)**

The table below indicates the remaining contractual maturity of financial liabilities of the Bank in undiscounted amounts:

<b>Bank 2017</b>	<b>Up to 1 month</b>	<b>1 - 3 months</b>	<b>3 - 12 months</b>	<b>1 - 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Financial liabilities</b>						
Deposits	251,822	187	171,291	211,134	10,307	644,741
Borrowings	197,142	283,160	1,358,672	4,292,634	10,758,724	16,890,332
Bonds payable	-	-	67,623	1,253,036	-	1,320,659
Other liabilities	185,299	21,082	76,872	144,072	165,326	592,651
<b>Total</b>	<b>634,263</b>	<b>304,429</b>	<b>1,674,458</b>	<b>5,900,876</b>	<b>10,934,357</b>	<b>19,448,383</b>

<b>Bank 2016</b>	<b>Up to 1 month</b>	<b>1 - 3 months</b>	<b>3 - 12 months</b>	<b>1 - 3 years</b>	<b>Over 3 years</b>	<b>Total</b>
	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>	<b>HRK '000</b>
<b>Financial liabilities</b>						
Deposits	75,581	-	12,687	46,407	8,169	142,844
Borrowings	382,184	208,630	1,261,178	3,598,035	9,694,025	15,144,052
Bonds payable	-	-	2,051,330	136,040	1,188,820	3,376,190
Other liabilities	150,555	28,649	100,528	188,186	228,856	696,774
<b>Total</b>	<b>608,320</b>	<b>237,279</b>	<b>3,425,723</b>	<b>3,968,668</b>	<b>11,119,870</b>	<b>19,359,860</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk**

Management of market risks at the Bank implies the reduction of interest rate risk and the currency risk to a minimal level.

**31.4.1. Interest rate risk**

The interest rate risk management at the Bank implies the management of interest rate risk in the Bank's book. As development and export special financial institution, the Bank does not perform trading activities.

For the purpose of measurement and monitoring of interest rate risk, the Bank carries out interest rate gap analysis. Interest rate gap is calculated for certain periods according to the possibilities of interest rate changes (fixed or floating rates) and presents the sensitivity of the Bank to the changes in interest rates. Interest rates are structured per currency, type and value, and projections of average weighted interest rates for Bank's funds and placements are made.

Based on the mentioned reports, the sensitivity of Bank's statement of profit or loss and other comprehensive income to possible interest rate fluctuations is monitored simultaneously with the endeavours to match the interest bearing total assets, total liabilities and equity. In this way, the Bank reduces its market movement sensitivity as well as its sensitivity to reference interest rates fluctuations. Furthermore, current market conditions and movements in forecasted market indicators are also monitored.

The Bank continuously analyses net interest rate margins by preparing projections on the basis of selected scenarios and among other things, assesses the impact of the change in interest rates by Bank's loan programmes, change in interest reference rates and change in prices of fund sources. The result of the analyses performed are reported to the ALCO and the Management Board with the aim to act proactively and insure further operations in accordance with the set of limits established for the purpose of risk management.

As a special financial institution, the Bank is not profit driven and, consequently, does not use derivative instruments. The use of derivatives is allowed for the purpose of position hedging only.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.1. Interest rate risk (continued)**

The following tables demonstrate the sensitivity of the Group to the interest rate risk as of 31 December 2017 and 2016 on the basis of known dates of changes in prices of assets and liabilities to which floating and fixed interest rates are applied. Periods of interest rates changes are determined on the basis of residual maturity and contracted period when interest rates change, depending on which is shorter.

Assets and liabilities on which interest is not charged are placed into the non-interest bearing category. The tables below demonstrate the estimation of Group's interest rate risk exposure as of 31 December 2017 and 2016 which may not be indicative for the positions in other periods.

Group 2017	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non-interest bearing	Total
	HRK '000	HRK '000	HRK '000				
<b>Assets</b>							
Cash on hand and due from banks	2,534	-	-	-	-	1,401,146	1,403,680
Deposits with other banks	29,114	-	-	-	-	24	29,138
Loans to financial institutions	474,348	733,865	1,345,038	2,759,113	5,496,436	27,341	10,836,141
Loans to other customers	2,104,487	745,415	927,758	1,848,681	6,689,547	67,735	12,383,623
Financial assets at fair value through profit or loss	-	-	-	-	-	291	291
Assets available for sale	2,473,578	-	-	-	-	847,986	3,321,564
Assets held to maturity	-	-	-	-	1,385	14	1,399
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	53,557	53,557
Non-current assets held for sale	-	-	-	-	-	16,697	16,697
Other assets	-	-	-	-	-	29,471	29,471
<b>Total assets (1)</b>	<b>5,084,061</b>	<b>1,479,280</b>	<b>2,272,796</b>	<b>4,607,794</b>	<b>12,187,368</b>	<b>2,444,262</b>	<b>28,075,561</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.1. Interest rate risk (continued)**

Group 2017	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non-interest bearing	Total
	HRK '000	HRK '000					
<b>Liabilities</b>							
Deposits	150,273	-	169,057	169,057	-	156,354	644,741
Borrowings	168,310	243,414	1,155,999	3,853,447	9,902,974	63,737	15,387,881
Bonds payable	-	-	-	1,117,790	-	43,909	1,161,699
Other liabilities	-	-	-	-	-	605,453	605,453
<b>Total liabilities</b>	<b>318,583</b>	<b>243,414</b>	<b>1,325,056</b>	<b>5,140,294</b>	<b>9,902,974</b>	<b>869,453</b>	<b>17,799,774</b>
<b>Equity</b>							
Founder's capital	-	-	-	-	-	7,009,632	7,009,632
Retained earnings and reserves	-	-	-	-	-	2,996,968	2,996,968
Other reserves	-	-	-	-	-	94,683	94,683
Net profit for the year	-	-	-	-	-	162,201	162,201
<b>Total equity attributable to equity holders of the parent</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,263,484</b>	<b>10,263,484</b>
Guarantee fund	-	-	-	-	-	12,303	12,303
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,275,787</b>	<b>10,275,787</b>
<b>Total liabilities and total equity (2)</b>	<b>318,583</b>	<b>243,414</b>	<b>1,325,056</b>	<b>5,140,294</b>	<b>9,902,974</b>	<b>11,145,240</b>	<b>28,075,561</b>
<b>Net assets/liabilities (1) - (2)</b>	<b>4,765,478</b>	<b>1,235,866</b>	<b>947,740</b>	<b>(532,500)</b>	<b>2,284,394</b>	<b>(8,700,978)</b>	<b>-</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.4. Market risk (continued)

##### 31.4.1. Interest rate risk (continued)

Group 2016	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non- interest bearing	Total
	HRK '000	HRK '000	HRK '000				
<b>Assets</b>							
Cash on hand and due from banks	551	-	-	-	-	490,695	491,246
Deposits with other banks	-	23,871	-	-	-	1	23,872
Loans to financial institutions	652,666	836,489	1,873,910	2,926,641	5,562,538	36,867	11,889,111
Loans to other customers	1,517,371	824,285	1,081,418	1,506,407	6,522,314	59,399	11,511,194
Financial assets at fair value through profit or loss	-	-	-	-	-	286	286
Assets available for sale	2,431,379	-	-	-	-	958,655	3,390,034
Assets held to maturity	-	-	-	-	1,408	14	1,422
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	57,305	57,305
Non-current assets held for sale	-	-	-	-	-	17,230	17,230
Other assets	-	-	-	-	-	9,122	9,122
<b>Total assets (1)</b>	<b>4,601,967</b>	<b>1,684,645</b>	<b>2,955,328</b>	<b>4,433,048</b>	<b>12,086,260</b>	<b>1,629,574</b>	<b>27,390,822</b>
<b>Liabilities</b>							
Deposits	-	-	-	-	-	142,844	142,844
Borrowings	355,442	171,450	1,020,722	3,059,168	8,720,949	64,018	13,391,749
Bonds payable	-	-	1,888,837	-	1,120,800	95,932	3,105,569
Other liabilities	-	-	-	-	-	707,952	707,952
<b>Total liabilities</b>	<b>355,442</b>	<b>171,450</b>	<b>2,909,559</b>	<b>3,059,168</b>	<b>9,841,749</b>	<b>1,010,746</b>	<b>17,348,114</b>
<b>Equity</b>							
Founder's capital	-	-	-	-	-	6,959,632	6,959,632
Retained earnings and reserves	-	-	-	-	-	2,682,127	2,682,127
Other reserves	-	-	-	-	-	73,733	73,733
Net profit for the year	-	-	-	-	-	314,841	314,841
<b>Total equity attributable to equity holders of the parent</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,030,333</b>	<b>10,030,333</b>
Guarantee fund	-	-	-	-	-	12,375	12,375
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,042,708</b>	<b>10,042,708</b>
<b>Total liabilities and total equity (2)</b>	<b>355,442</b>	<b>171,450</b>	<b>2,909,559</b>	<b>3,059,168</b>	<b>9,841,749</b>	<b>11,053,454</b>	<b>27,390,822</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>4,246,525</b>	<b>1,513,195</b>	<b>45,769</b>	<b>1,373,880</b>	<b>2,244,511</b>	<b>(9,423,880)</b>	<b>-</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.4. Market risk (continued)

##### 31.4.1. Interest rate risk (continued)

The following tables demonstrate the sensitivity of HBOR to the interest rate risk as of 31 December 2017 and 2016 on the basis of known dates of changes in prices of assets and liabilities to which floating and fixed interest rates are applied. Periods of interest rates changes are determined on the basis of residual maturity and contracted period when interest rates change, depending on which is shorter.

Assets and liabilities on which interest is not charged are placed into the non-interest bearing category. The tables below demonstrate the estimation of HBOR's interest rate risk exposure as of 31 December 2017 and 2016 which may not be indicative for the positions in other periods.

Bank 2017	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non- interest bearing	Total
	HRK '000	HRK '000	HRK '000				
<b>Assets</b>							
Cash on hand and due from banks	-	-	-	-	-	1,401,146	1,401,146
Deposits with other banks	29,114	-	-	-	-	24	29,138
Loans to financial institutions	474,348	733,865	1,345,038	2,759,113	5,496,436	27,341	10,836,141
Loans to other customers	2,104,487	745,415	927,758	1,848,681	6,689,547	67,735	12,383,623
Assets available for sale	2,430,262	-	-	-	-	846,932	3,277,194
Investments in subsidiaries	-	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	53,514	53,514
Non-current assets held for sale	-	-	-	-	-	16,697	16,697
Other assets	-	-	-	-	-	22,226	22,226
<b>Total assets (1)</b>	<b>5,038,211</b>	<b>1,479,280</b>	<b>2,272,796</b>	<b>4,607,794</b>	<b>12,185,983</b>	<b>2,471,739</b>	<b>28,055,803</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.4. Market risk (continued)

##### 31.4.1. Interest rate risk (continued)

Bank 2017	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non- interest bearing	Total
	HRK '000	HRK '000					
<b>Liabilities</b>							
Deposits	150,273	-	169,057	169,057	-	156,354	644,741
Borrowings	168,310	243,414	1,155,999	3,853,447	9,902,974	63,737	15,387,881
Bonds payable	-	-	-	1,117,790	-	43,909	1,161,699
Other liabilities	-	-	-	-	-	592,651	592,651
<b>Total liabilities</b>	<b>318,583</b>	<b>243,414</b>	<b>1,325,056</b>	<b>5,140,294</b>	<b>9,902,974</b>	<b>856,651</b>	<b>17,786,972</b>
<b>Equity</b>							
Founder's capital	-	-	-	-	-	7,009,632	7,009,632
Retained earnings and reserves	-	-	-	-	-	2,995,656	2,995,656
Other reserves	-	-	-	-	-	90,457	90,457
Net profit for the year	-	-	-	-	-	160,783	160,783
<b>Capital</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,256,528</b>	<b>10,256,528</b>
Guarantee fund	-	-	-	-	-	12,303	12,303
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,268,831</b>	<b>10,268,831</b>
<b>Total liabilities and total equity (2)</b>	<b>318,583</b>	<b>243,414</b>	<b>1,325,056</b>	<b>5,140,294</b>	<b>9,902,974</b>	<b>11,125,482</b>	<b>28,055,803</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>4,719,628</b>	<b>1,235,866</b>	<b>947,740</b>	<b>(532,500)</b>	<b>2,283,009</b>	<b>(8,653,743)</b>	<b>-</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.4. Market risk (continued)

##### 31.4.1. Interest rate risk (continued)

Bank 2016	Up to 1 month	1 - 3 months	3 - 12 months	1 - 3 years	Over 3 years	Non- interest bearing	Total
	HRK '000	HRK '000	HRK '000				
<b>Assets</b>							
Cash on hand and due from banks	-	-	-	-	-	490,695	490,695
Deposits with other banks	-	23,871	-	-	-	1	23,872
Loans to financial institutions	652,666	836,489	1,873,910	2,926,641	5,562,538	36,867	11,889,111
Loans to other customers	1,517,371	824,285	1,081,418	1,506,407	6,522,314	59,399	11,511,194
Assets available for sale	2,385,835	-	-	-	-	957,739	3,343,574
Investments in subsidiaries	-	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	-	57,216	57,216
Non-current assets held for sale	-	-	-	-	-	17,230	17,230
Other assets	-	-	-	-	-	5,900	5,900
<b>Total assets (1)</b>	<b>4,555,872</b>	<b>1,684,645</b>	<b>2,955,328</b>	<b>4,433,048</b>	<b>12,084,852</b>	<b>1,661,171</b>	<b>27,374,916</b>
<b>Liabilities</b>							
Deposits	-	-	-	-	-	142,844	142,844
Borrowings	355,442	171,450	1,020,722	3,059,168	8,720,949	64,018	13,391,749
Bonds payable	-	-	1,888,837	-	1,120,800	95,932	3,105,569
Other liabilities	-	-	-	-	-	696,774	696,774
<b>Total liabilities</b>	<b>355,442</b>	<b>171,450</b>	<b>2,909,559</b>	<b>3,059,168</b>	<b>9,841,749</b>	<b>999,568</b>	<b>17,336,936</b>
<b>Equity</b>							
Founder's capital	-	-	-	-	-	6,959,632	6,959,632
Retained earnings and reserves	-	-	-	-	-	2,682,131	2,682,131
<b>Other reserves</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>70,317</b>	<b>70,317</b>
Net profit for the year	-	-	-	-	-	313,525	313,525
<b>Capital</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,025,605</b>	<b>10,025,605</b>
Guarantee fund	-	-	-	-	-	12,375	12,375
<b>Total equity</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,037,980</b>	<b>10,037,980</b>
<b>Total liabilities and total equity (2)</b>	<b>355,442</b>	<b>171,450</b>	<b>2,909,559</b>	<b>3,059,168</b>	<b>9,841,749</b>	<b>11,037,548</b>	<b>27,374,916</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>4,200,430</b>	<b>1,513,195</b>	<b>45,769</b>	<b>1,373,880</b>	<b>2,243,103</b>	<b>(9,376,377)</b>	<b>-</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.1. Interest rate risk (continued)**

Total assets, total liabilities and equity on the basis of a possibility of changes in interest rates (fixed or variable):

	<b>2017</b>	<b>Group</b>	<b>2017</b>	<b>Bank</b>
	<b>HRK '000</b>	<b>2016</b>	<b>HRK '000</b>	<b>2016</b>
		<b>HRK '000</b>		<b>HRK '000</b>
<b>Assets</b>				
Fixed interest rate assets	24,358,273	23,991,858	24,311,039	23,944,355
Variable interest rate assets	1,273,025	1,769,390	1,273,025	1,769,390
Non-interest bearing	2,444,263	1,629,574	2,471,739	1,661,171
<b>Total assets</b>	<b>28,075,561</b>	<b>27,390,822</b>	<b>28,055,803</b>	<b>27,374,916</b>
<b>Liabilities</b>				
Fixed interest rate liabilities	16,440,995	16,333,589	16,440,995	16,333,589
Variable interest rate liabilities	489,326	3,779	489,326	3,779
Non-interest bearing	11,145,240	11,053,454	11,125,482	11,037,548
<b>Total liabilities and total equity</b>	<b>28,075,561</b>	<b>27,390,822</b>	<b>28,055,803</b>	<b>27,374,916</b>

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.1. Interest rate risk (continued)**

**Sensitivity analysis**

Assumptions used in preparing the interest risk sensitivity analysis relate to possible changes in reference interest rates in order to assess the hypothetical effect on HBOR's profit.

Volatility of reference interest rates for 2017 has been determined using the standard deviation method on the daily changes of the reference interest rates linked to EUR and USD. On the basis of the above volatility, possible changes in reference interest rates linked to EUR and USD have been established and used in the sensitivity analysis.

The analysis presents the sensitivity of interest rates to reasonably expected changes in basis points of variable interest rates. All other variables remain constant.

The sensitivity of profit is influenced by hypothetical changes in interest rates during a period of one year based on interest bearing assets and liabilities with a variable interest rate.

<b>Currency</b>	<b>Increase in b.p. in 2017</b>	<b>Effect on profit in 2017</b>	<b>Increase in b.p. in 2016</b>	<b>Effect on profit in 2016</b>
		<b>HRK '000</b>		<b>HRK '000</b>
EUR	+1	93	+4	535
USD	+10	349	+11	472
<b>Currency</b>	<b>Decrease in b.p. in 2017</b>	<b>Effect on profit in 2017</b>	<b>Decrease in b.p. in 2016</b>	<b>Effect on profit in 2016</b>
		<b>HRK '000</b>		<b>HRK '000</b>
EUR	-1	(93)	-4	(535)
USD	-10	(349)	-11	(472)

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.2. Currency risk**

By the internal documents, the Bank has established the methods for the assessment, i.e. measurement, monitoring, management and control of the currency risk, as well as the limits and proceedings both in cases indicating to a crisis and in crisis conditions. Responsibilities and accountabilities have been determined for those organisational units of the Bank that participate in the currency risk management as well as reports necessary for comprehensive perception of this risk.

Exposure to currency risk is monitored daily on the basis of the total open foreign currency position and on the basis of the open foreign currency positions in significant currencies. In addition to the daily monitoring of open foreign currency positions, the projections of their developments are also prepared. The projections of the developments in the open foreign currency positions provide the basis for the Asset and Liability Management Committee to adopt guidelines and resolutions and for the Management Board to make decisions in order to secure the timely undertaking of activities aiming to maintain the Bank's operations within the established currency risk management limits. For the measurement/assessment of currency risk, the Bank uses VaR model as an auxiliary model and regularly reports to the bodies in charge on maximum possible losses on significant currencies.

The Bank performs stress tests under the assumption of extensive appreciation/depreciation of HRK against significant currencies and reports on test results to the ALCO and the Management Board.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.2. Currency risk (continued)**

Total assets, total liabilities and equity as of 31 December 2017 and 31 December 2016 in HRK and foreign currencies can be shown as follows:

Group	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>2017</b>						
<b>Assets</b>						
Cash on hand and due from banks	239	82,947	1,424	84,610	1,319,070	1,403,680
Deposits with other banks	29,115	23	-	29,138	-	29,138
Loans to financial institutions	-	6,075,420	-	6,075,420	4,760,721	10,836,141
Loans to other customers	429,298	9,092,613	-	9,521,911	2,861,712	12,383,623
Financial assets at fair value through profit or loss	-	291	-	291	-	291
Assets available for sale	-	735,821	-	735,821	2,585,743	3,321,564
Assets held to maturity	-	1,399	-	1,399	-	1,399
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	53,557	53,557
Non-current assets held for sale	-	-	-	-	16,697	16,697
Other assets	-	6,308	-	6,308	23,163	29,471
<b>Total assets (1)</b>	<b>458,652</b>	<b>15,994,822</b>	<b>1,424</b>	<b>16,454,898</b>	<b>11,620,663*</b>	<b>28,075,561</b>
<b>Liabilities</b>						
Deposits	20,112	527,668	77	547,857	96,884	644,741
Borrowings	410,011	14,977,870	-	15,387,881	-	15,387,881
Bonds payable	-	1,161,699	-	1,161,699	-	1,161,699
Other liabilities	3,291	18,222	2,665	24,178	581,275	605,453
<b>Total liabilities</b>	<b>433,414</b>	<b>16,685,459</b>	<b>2,742</b>	<b>17,121,615</b>	<b>678,159</b>	<b>17,799,774</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	7,009,632	7,009,632
Retained earnings and reserves	-	-	-	-	2,996,968	2,996,968
Other reserves	-	-	-	-	94,683	94,683
Net profit for the year	-	-	-	-	162,201	162,201
<b>Total equity attributable to equity holders of the parent</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,263,484</b>	<b>10,263,484</b>
Guarantee fund	-	12,303	-	12,303	-	12,303
<b>Total equity</b>	<b>-</b>	<b>12,303</b>	<b>-</b>	<b>12,303</b>	<b>10,263,484</b>	<b>10,275,787</b>
<b>Total liabilities and total equity (2)</b>	<b>433,414</b>	<b>16,697,762</b>	<b>2,742</b>	<b>17,133,918</b>	<b>10,941,643</b>	<b>28,075,561</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>25,238</b>	<b>(702,940)</b>	<b>(1,318)**</b>	<b>(679,020)</b>	<b>679,020</b>	<b>-</b>

\* Amounts linked to a one-way currency clause represent HRK 157,325 thousand.

\*\* Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under "Other liabilities".

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.2. Currency risk (continued)**

Group	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
2016	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and due from banks	1,606	301,338	1,584	304,528	186,718	491,246
Deposits with other banks	20,581	-	3,291	23,872	-	23,872
Loans to financial institutions	-	6,655,483	-	6,655,483	5,233,628	11,889,111
Loans to other customers	527,661	7,768,328	-	8,295,989	3,215,205	11,511,194
Financial assets at fair value through profit or loss	-	286	-	286	-	286
Assets available for sale	14,686	1,100,197	-	1,114,883	2,275,151	3,390,034
Assets held to maturity	-	1,422	-	1,422	-	1,422
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	57,305	57,305
Non-current assets held for sale	-	-	-	-	17,230	17,230
Other assets	-	369	-	369	8,753	9,122
<b>Total assets (1)</b>	<b>564,534</b>	<b>15,827,423</b>	<b>4,875</b>	<b>16,396,832</b>	<b>10,993,990*</b>	<b>27,390,822</b>
<b>Liabilities</b>						
Deposits	48,380	42,778	3,459	94,617	48,227	142,844
Borrowings	315,434	13,076,315	-	13,391,749	-	13,391,749
Bonds payable	-	3,105,569	-	3,105,569	-	3,105,569
Other liabilities	163	9,664	2,885	12,712	695,240	707,952
<b>Total liabilities</b>	<b>363,977</b>	<b>16,234,326</b>	<b>6,344</b>	<b>16,604,647</b>	<b>743,467</b>	<b>17,348,114</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	6,959,632	6,959,632
Retained earnings and reserves	-	-	-	-	2,682,127	2,682,127
Other reserves	-	-	-	-	73,733	73,733
Net profit for the year	-	-	-	-	314,841	314,841
<b>Total equity attributable to equity holders of the parent</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,030,333</b>	<b>10,030,333</b>
Guarantee fund	-	12,375	-	12,375	-	12,375
<b>Total equity</b>	<b>-</b>	<b>12,375</b>	<b>-</b>	<b>12,375</b>	<b>10,030,333</b>	<b>10,042,708</b>
<b>Total liabilities and total equity (2)</b>	<b>363,977</b>	<b>16,246,701</b>	<b>6,344</b>	<b>16,617,022</b>	<b>10,773,800</b>	<b>27,390,822</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>200,557</b>	<b>(419,278)</b>	<b>(1,469)**</b>	<b>(220,190)</b>	<b>220,190</b>	<b>-</b>

\* Amounts linked to a one-way currency clause represent HRK 249,278 thousand.

\*\* Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under "Other liabilities".

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.2. Currency risk (continued)**

Total assets, total liabilities and equity as of 31 December 2017 and 31 December 2016 in HRK and foreign currencies can be shown as follows:

Bank	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
2017	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and due from banks	239	82,947	1,424	84,610	1,316,536	1,401,146
Deposits with other banks	29,115	23	-	29,138	-	29,138
Loans to financial institutions	-	6,075,420	-	6,075,420	4,760,721	10,836,141
Loans to other customers	429,298	9,092,613	-	9,521,911	2,861,712	12,383,623
Assets available for sale	-	724,243	-	724,243	2,552,951	3,277,194
Investments in subsidiaries	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	53,514	53,514
Non-current assets held for sale	-	-	-	-	16,697	16,697
Other assets	-	488	-	488	21,738	22,226
<b>Total assets (1)</b>	<b>458,652</b>	<b>15,975,734</b>	<b>1,424</b>	<b>16,435,810</b>	<b>11,619,993*</b>	<b>28,055,803</b>
<b>Liabilities</b>						
Deposits	20,112	527,668	77	547,857	96,884	644,741
Borrowings	410,011	14,977,870	-	15,387,881	-	15,387,881
Bonds payable	-	1,161,699	-	1,161,699	-	1,161,699
Other liabilities	3,054	10,696	2,611	16,361	576,290	592,651
<b>Total liabilities</b>	<b>433,177</b>	<b>16,677,933</b>	<b>2,688</b>	<b>17,113,798</b>	<b>673,174</b>	<b>17,786,972</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	7,009,632	7,009,632
Retained earnings and reserves	-	-	-	-	2,995,656	2,995,656
Other reserves	-	-	-	-	90,457	90,457
Net profit for the year	-	-	-	-	160,783	160,783
<b>Capital</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,256,528</b>	<b>10,256,528</b>
Guarantee fund	-	12,303	-	12,303	-	12,303
<b>Total equity</b>	<b>-</b>	<b>12,303</b>	<b>-</b>	<b>12,303</b>	<b>10,256,528</b>	<b>10,268,831</b>
<b>Total liabilities and total equity (2)</b>	<b>433,177</b>	<b>16,690,236</b>	<b>2,688</b>	<b>17,126,101</b>	<b>10,929,702</b>	<b>28,055,803</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>25,475</b>	<b>(714,502)</b>	<b>(1,264)**</b>	<b>(690,291)</b>	<b>690,291</b>	<b>-</b>

\* Amounts linked to a one-way currency clause represent HRK 157,325 thousand.

\*\* Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under "Other liabilities".

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.2. Currency risk (continued)**

Bank	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
2016	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
<b>Assets</b>						
Cash on hand and due from banks	1,606	301,338	1,584	304,528	186,167	490,695
Deposits with other banks	20,581	-	3,291	23,872	-	23,872
Loans to financial institutions	-	6,655,483	-	6,655,483	5,233,628	11,889,111
Loans to other customers	527,661	7,768,328	-	8,295,989	3,215,205	11,511,194
Assets available for sale	14,686	1,089,520	-	1,104,206	2,239,368	3,343,574
Investments in subsidiaries	-	-	-	-	36,124	36,124
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	57,216	57,216
Non-current assets held for sale	-	-	-	-	17,230	17,230
Other assets	-	-	-	-	5,900	5,900
<b>Total assets (1)</b>	<b>564,534</b>	<b>15,814,669</b>	<b>4,875</b>	<b>16,384,078</b>	<b>10,990,838*</b>	<b>27,374,916</b>
<b>Liabilities</b>						
Deposits	48,380	42,778	3,459	94,617	48,227	142,844
Borrowings	315,433	13,076,316	-	13,391,749	-	13,391,749
Bonds payable	-	3,105,569	-	3,105,569	-	3,105,569
Other liabilities	-	2,895	2,840	5,735	691,039	696,774
<b>Total liabilities</b>	<b>363,813</b>	<b>16,227,558</b>	<b>6,299</b>	<b>16,597,670</b>	<b>739,266</b>	<b>17,336,936</b>
<b>Equity</b>						
Founder's capital	-	-	-	-	6,959,632	6,959,632
Retained earnings and reserves	-	-	-	-	2,682,131	2,682,131
Other reserves	-	-	-	-	70,317	70,317
Net profit for the year	-	-	-	-	313,525	313,525
<b>Capital</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>10,025,605</b>	<b>10,025,605</b>
Guarantee fund	-	12,375	-	12,375	-	12,375
<b>Total equity</b>	<b>-</b>	<b>12,375</b>	<b>-</b>	<b>12,375</b>	<b>10,025,605</b>	<b>10,037,980</b>
<b>Total liabilities and total equity (2)</b>	<b>363,813</b>	<b>16,239,933</b>	<b>6,299</b>	<b>16,610,045</b>	<b>10,764,871</b>	<b>27,374,916</b>
<b>Net assets/liabilities (1) – (2)</b>	<b>200,721</b>	<b>(425,264)</b>	<b>(1,424)**</b>	<b>(225,967)</b>	<b>225,967</b>	<b>-</b>

\* Amounts linked to a one-way currency clause represent HRK 249,278 thousand.

\*\* Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under „Other liabilities”.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

**31. Risk management (continued)**

**31.4. Market risk (continued)**

**31.4.2. Currency risk (continued)**

**Sensitivity analysis**

Sensitivity analysis of the Bank's total assets and total liabilities to fluctuations in foreign exchange rates is carried out for those foreign currencies that represent Bank's significant currencies as at the reporting date.

An assumption of reasonably possible fluctuations in EUR exchange rates against HRK was used in the foreign currency risk sensitivity analysis, with the other variables remaining stable, in order to assess the hypothetical effect on HBOR's profit as of 31 December 2017.

Volatility of the exchange rate EUR/HRK, determined using the standard deviation method on the changes of the foreign exchange rate EUR/HRK, equalled 1.6% in 2017 (31 December 2016: 1.5%).

The effect of the assumed changes in the foreign exchange rate EUR/HRK by total asset, total liabilities and equity items denominated or indexed to EUR on HBOR's profits is stated below.

	Change in currency rate in 2017	Effect on profit in 2017	Change in currency rate in 2016	Effect on profit in 2016
	%	000 kuna	%	000 kuna
EUR	+1.6%	(190)	+1.5%	5,912
EUR	-1.6%	1,697	-1.5%	(5,020)

**31.5. Operational risk**

The Bank has established a framework for operational risk management that is, to a considerable extent, aligned with regulations prescribed by the Croatian National Bank applicable to the Bank's business and good banking practices in the area of risk management and that was introduced in 2012.

The basic principles of operational risk management were identified in the umbrella act, Operational Risk Management Policies which prescribes the elements of the system for management of these risks, which include identifying, measuring, assessing, containing and monitoring operational risk. A structure of management and accountability in the system has been set up, an approach for the calculation of capital requirements for operational risk has been determined and a reporting system has been established.

A particular feature of operational risk compared to other types of risk is reflected in the presence of this risk throughout the entire organisation and the management of this risk in all organisational parts of the Bank.

Monitoring of operational risks is supported by a software solution that enables recording of operational risk events.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 31. Risk management (continued)

#### 31.5. Operational risk (continued)

Overall evaluation of operational risk is performed through the Operational Risk Map, which identifies and evaluates operational risk the Bank is exposed to, in order to identify further risk containment measures.

The operational risk is assessed also on the occasion of introducing new products and business changes and on the occasion of outsourcing business activities.

The Bank is trying to minimise the operational risk by active monitoring, management and control of operational risk exposures.

The Committee for the management of information system of HBOR was established in order to monitor IT system performance with the purpose of IT resources management by setting the appropriate level of efficiency and security of IT for providing, among other things, appropriate management of risks arising from IT technology utilisation. Considering the significant level of operational risk arising from IT utilisation, the Bank has established a function for the control of IT system security. Within this function, a system for the management of business continuity was established for the purpose of ensuring the recovery of operations and limiting the adverse effects in the case of significantly impaired or discontinued operations.

#### 31.6. Outsourcing risk

The aim of outsourcing is to reduce the operating costs, to achieve a higher level of services and to use the professional know-how of service providers in the performance of daily activities.

The Bank manages the outsourcing risk on the basis of internal documents that are in compliance with the regulations prescribed by the Croatian National Bank and good banking practices applicable to the Bank's business.

In addition to the management of this risk, the internal documents determine also the procedures for the outsourcing of activities to the service providers, the rules for the management of relations with the service providers and the obligation to reduce the risk to the lowest level possible.

Central records of outsourced activities have been established and reports on materially significant outsourced activities are submitted to the Management Board and the Supervisory Board of the Bank on an annual basis.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 32. Fair value of financial assets and financial liabilities

The accounting policy on fair value measurements is discussed in Note 2.

#### 32.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value

The Group measures certain financial assets and financial liabilities at fair value at the end of each reporting period:

Group	2017			2016		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
<b>Financial assets at fair value through profit or loss:</b>						
Shares in investment funds recognised at fair value through profit or loss	291	-	-	286	-	-
<b>Total financial assets at fair value through profit or loss</b>	<b>291</b>	<b>-</b>	<b>-</b>	<b>286</b>	<b>-</b>	<b>-</b>
<b>Assets available for sale:</b>						
<b>Debt instruments:</b>						
<b>Listed debt instruments:</b>						
<i>Bonds of the Ministry of Finance of the Republic of Croatia</i>	884,763	-	-	925,887	-	-
Financial institution bonds	-	-	-	910	-	-
Corporate bonds	770	-	-	1,161	-	-
Treasury bills of the Ministry of Finance of the Republic of Croatia	1,583,313	-	-	1,500,420	-	-
Accrued interest	13,836	-	-	14,495	-	-
<b>Unlisted debt instruments:</b>						
<i>Corporate bonds</i>	-	-	522	-	-	502
Accrued interest	-	-	167	-	-	99
<b>Total debt instruments</b>	<b>2,482,682</b>	<b>-</b>	<b>689</b>	<b>2,442,873</b>	<b>-</b>	<b>601</b>
<b>Equity instruments:</b>						
<b>Listed equity instruments:</b>						
<i>Corporate shares</i>	18,951	-	-	10,938	-	-
<b>Unlisted equity instruments:</b>						
<i>Investment in shares of foreign companies</i>	-	35	-	-	32	-
Investment in financial institutions shares	-	161	-	-	161	-
Shares of foreign financial institutions – EIF	-	25,427	-	-	25,815	-
Corporate shares	-	-	-	-	-	-
<b>Total equity instruments</b>	<b>18,951</b>	<b>25,623</b>	<b>-</b>	<b>10,938</b>	<b>26,008</b>	<b>-</b>
<b>Investments in investment funds:</b>						
<b>Shares classified as assets available for sale</b>	<b>793,619</b>	<b>-</b>	<b>-</b>	<b>909,614</b>	<b>-</b>	<b>-</b>
<b>Total investments in investment funds</b>	<b>793,619</b>	<b>-</b>	<b>-</b>	<b>909,614</b>	<b>-</b>	<b>-</b>
<b>Total assets available for sale</b>	<b>3,295,252</b>	<b>25,623</b>	<b>689</b>	<b>3,363,425</b>	<b>26,008</b>	<b>601</b>

Treasury Bills of the Ministry of Finance of the Republic of Croatia were classified within Level 1 of the fair value hierarchy because credit institutions in the country started to list prices at Bloomberg, and quoted market price is used as the valuation technique.

Debt Instruments: Corporate Bonds were classified within Level 3 of the fair value hierarchy. The valuation technique used was the method of the discounted cash flows based on market interest rates, spread linked to internal credit-rating and internally determined spread linked to financial instrument liquidity.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 32. Fair value of financial assets and financial liabilities (continued)

### 32.1. Fair value of financial assets and financial liabilities initially recognized and measured at fair value (continued)

Bank	2017			2016		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
<b>Assets available for sale:</b>						
<b>Debt instruments:</b>						
<b>Listed debt instruments:</b>						
Bonds of the Ministry of Finance of the Republic of Croatia	846,428	-	-	884,914	-	-
Treasury bills of the Ministry of finance of the Republic of Croatia	1,583,313	-	-	1,500,420	-	-
Accrued interest	13,269	-	-	13,890	-	-
<b>Unlisted debt instruments:</b>						
Corporate bonds	-	-	522	-	-	502
Accrued interest	-	-	167	-	-	99
<b>Total debt instruments</b>	<b>2,443,010</b>	<b>-</b>	<b>689</b>	<b>2,399,224</b>	<b>-</b>	<b>601</b>
<b>Equity instruments:</b>						
<b>Listed equity instruments:</b>						
Corporate shares	18,951	-	-	10,938	-	-
<b>Unlisted equity instruments:</b>						
Investment in shares of foreign companies	-	35	-	-	32	-
Investment in financial institutions shares	-	161	-	-	161	-
Shares of foreign financial institutions – EIF	-	25,427	-	-	25,815	-
Corporate shares	-	-	-	-	-	-
<b>Total equity instruments</b>	<b>18,951</b>	<b>25,623</b>	<b>-</b>	<b>10,938</b>	<b>26,008</b>	<b>-</b>
<b>Investments in investment funds:</b>						
Shares classified as assets available for sale	788,921	-	-	906,803	-	-
<b>Total investments in investment funds</b>	<b>788,921</b>	<b>-</b>	<b>-</b>	<b>906,803</b>	<b>-</b>	<b>-</b>
<b>Total assets available for sale</b>	<b>3,250,882</b>	<b>25,623</b>	<b>689</b>	<b>3,316,965</b>	<b>26,008</b>	<b>601</b>

Treasury Bills of the Ministry of Finance of the Republic of Croatia were classified within Level 1 of the fair value hierarchy because credit institutions in the country started to list prices at Bloomberg, and quoted market price is used as the valuation technique.

Debt Instruments: Corporate Bonds were classified within Level 3 of the fair value hierarchy. The valuation technique used was the method of the discounted cash flows based on market interest rates, spread linked to internal credit-rating and internally determined spread linked to financial instrument liquidity.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

## 32. Fair value of financial assets and financial liabilities (continued)

### 32.2. Fair value of financial assets and financial liabilities carried at amortized cost

The Management Board estimates that their carrying amounts of financial assets and financial liabilities carried at amortized cost are a reasonable approximation of fair value. The fair value of bonds payable that is determined by using adjusted observable prices is presented in Note 24 as disclosed in Note 2.

## 33. Reporting by segments

General information on segments is given in relation to business segments of the Group. Since the Group does not allocate administrative costs and interest by segments, the profitability of segments is not presented.

Assets and liabilities by segments are presented in net terms, i.e. gross after impairment and provisioning, and before the effect of mitigation through collateral received.

Business operations of segments are divided in terms of organisation and management. Each segment as a whole provides various products and services and operates in various markets.

### Business segments:

The Group has following business segments:

#### Segment:

Banking activities

Insurance activities

Other

#### Business activities of the segment include:

Financing reconstruction and development of the Croatian economy, financing of infrastructure, export promotion, support for the development of small and medium-sized companies, environmental protection, and export credit insurance of Croatian goods and services against non-market risks for and on behalf of the Republic of Croatia.

Insurance of foreign and domestic short-term receivables of business entities relating to deliveries of goods and services.

Preparation of analyses, credit risk assessment and providing information on creditworthiness.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 33. Reporting by segments (continued)

2017	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	475,738	1,627	-	-	477,365
Net fee income	42,395	1,398	1,188	-	44,981
Net income/(expenses) from financial operations	(20,625)	(96)	5	-	(20,716)
Net premiums earned	-	7,151	-	-	7,151
Other income	7,627	86	289	(293)	7,709
<b>Income from operating activities</b>	<b>505,135</b>	<b>10,166</b>	<b>1,482</b>	<b>(293)</b>	<b>516,490</b>
Operating costs	(149,432)	(6,120)	(1,117)	293	(156,376)
Impairment loss and provisions	(194,920)	(272)	5	-	(195,187)
Expenses for insured cases	-	(876)	-	-	(876)
Net change in provisions	-	(1,481)	-	-	(1,481)
Other expenses	-	(267)	-	-	(267)
<b>Operating expenses</b>	<b>(344,352)</b>	<b>(9,016)</b>	<b>(1,112)</b>	<b>293</b>	<b>(354,187)</b>
<b>Profit before income tax</b>	<b>160,783</b>	<b>1,150</b>	<b>370</b>	<b>-</b>	<b>162,303</b>
Income tax	-	(59)	(43)	-	(102)
<b>Profit for the year</b>	<b>160,783</b>	<b>1,091</b>	<b>327</b>	<b>-</b>	<b>162,201</b>
Assets of segment	28,055,803	55,213	1,201	(36,656)	28,075,561
<b>Total assets</b>	<b>28,055,803</b>	<b>55,213</b>	<b>1,201</b>	<b>(36,656)</b>	<b>28,075,561</b>
Liabilities of segment	17,786,972	12,680	152	(30)	17,799,774
Total equity and guarantee fund	10,268,831	5,033	749	1,174	10,275,787
<b>Total liabilities and total equity</b>	<b>28,055,803</b>	<b>17,713</b>	<b>901</b>	<b>1,144</b>	<b>28,075,561</b>

Intra-group transactions are presented under "Unallocated".

For the purposes of this Note, Net income/(expenses) from financial operations is reported as an income item, regardless the actual realization, to enable comparison of the amounts stated in the Statement of profit or loss and other comprehensive income.

The Group decided to apply a simple approach of stating operating segments by taking into consideration the main business model of each member of the Group as previously described in this Note.

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 33. Reporting by segments (continued)

2016	Banking activities HRK '000	Insurance activities HRK '000	Other activities HRK '000	Unallocated HRK '000	Total HRK '000
Net interest income	417,671	1,641	-	-	419,312
Net fee income	25,067	1,032	1,070	-	27,169
Net income/(expenses) from financial operations	7,312	178	6	-	7,496
Net premiums earned	-	5,681	-	-	5,681
Other income	18,016	76	285	(300)	18,077
<b>Income from operating activities</b>	<b>468,066</b>	<b>8,608</b>	<b>1,361</b>	<b>(300)</b>	<b>477,735</b>
Operating costs	(152,227)	(5,219)	(1,073)	301	(158,218)
Impairment loss and provisions	(2,314)	(64)	5	-	(2,373)
Expenses for insured cases	-	(1,591)	-	-	(1,591)
Net change in provisions	-	34	-	-	34
Other expenses	-	(513)	-	-	(513)
<b>Operating expenses</b>	<b>(154,541)</b>	<b>(7,353)</b>	<b>(1,068)</b>	<b>301</b>	<b>(162,661)</b>
<b>Profit before income tax</b>	<b>313,525</b>	<b>1,255</b>	<b>293</b>	<b>1</b>	<b>315,074</b>
Income tax	-	(176)	(57)	-	(233)
<b>Profit for the year</b>	<b>313,525</b>	<b>1,079</b>	<b>236</b>	<b>1</b>	<b>314,841</b>
Assets of segment	27,374,916	51,667	895	(36,656)	27,390,822
<b>Total assets</b>	<b>27,374,916</b>	<b>51,667</b>	<b>895</b>	<b>(36,656)</b>	<b>27,390,822</b>
Liabilities of segment	17,336,936	11,049	159	(30)	17,348,114
Total equity and guarantee fund	10,037,980	3,119	436	1,173	10,042,708
<b>Total liabilities and total equity</b>	<b>27,374,916</b>	<b>14,168</b>	<b>595</b>	<b>1,143</b>	<b>27,390,822</b>

Intra-group transactions are presented under "Unallocated".

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 34. Capital management

The primary objectives of the Bank's capital management are to ensure the presumptions of going concern and to respect regulatory and contracted demands imposed by creditors regarding a certain capital adequacy level.

The Bank has identified own funds as a manageable capital category.

Own funds have to be, at every moment, at least at the level of share capital or at the level that ensures that the capital adequacy ratio is at least 8% and that is sufficient for covering capital requirements regarding business risks.

Own funds consist of original own funds (Tier 1) and additional own funds (Tier 2).

The Bank has determined measures for the implementation and monitoring of the capital management policy as follows:

- At the reporting date, own funds have to be at least at the level of founder's capital for the reporting period.
- The capital adequacy ratio at the reporting date has to be at the level prescribed for the banks in the Republic of Croatia as well as at the level stated within regular financial covenants determined in loan contracts and contracts with special financial institutions that HBOR has concluded as a borrower.

In regard to the calculation of the capital adequacy ratio, HBOR voluntarily decided to apply the relevant bank regulation previously prescribed by the Croatian National Bank in accordance with Basel I and the Bank's internal acts.

	Group		Bank	
	2017	2016	2017	2016
	HRK '000	HRK '000	HRK '000	HRK '000
Original own funds – Tier 1	10,167,489	9,956,604	10,166,071	9,955,288
Additional own funds – Tier 2	319,857	333,571	319,857	333,571
<b>Total own funds</b>	<b>10,487,346</b>	<b>10,290,175</b>	<b>10,485,928</b>	<b>10,288,859</b>
Risk weighted assets	16,159,625	16,415,582	16,183,382	16,447,428
Capital requirements for currency risk	129,933	609,631	113,018	597,377
<b>Total capital requirements</b>	<b>16,289,558</b>	<b>17,025,213</b>	<b>16,296,400</b>	<b>17,044,805</b>
	%	%	%	%
<b>Capital ratio (Tier 1)</b>	<b>62,42</b>	<b>58,48</b>	<b>62,38</b>	<b>58,41</b>
<b>Capital adequacy ratio</b>	<b>64,38</b>	<b>60,44</b>	<b>64,35</b>	<b>60,36</b>
	HRK '000	HRK '000	HRK '000	HRK '000
<b>Own funds needed for ensuring capital adequacy according to regulatory requirements</b>	<b>1,303,165</b>	<b>1,362,017</b>	<b>1,303,712</b>	<b>1,363,584</b>

Minimum capital adequacy ratio at the end of 2017 was 8% (31 December 2016: 8%).

Notes to the Financial Statements include significant accounting policies and other explanations for the year ended 31 December 2017 (continued)

(All amounts are expressed in HRK thousand)

### 34. Capital management (continued)

Due to the extensive changes in the existing support application for the Bank's operations, the Management Board has prolonged a transitional period for the implementation and testing of new applications and the use will begin with respect to the first reporting period after the implementation of the software solution for the calculation of the adequacy ratio of own funds. Until then, the capital adequacy and exposure calculations will be made in the existing manner.

The Management Board of the Group does not expect any adverse effects on the level of capital adequacy as a result of application of the new regulations for credit institutions, taking into account that the bank's capital adequacy ratio at the end of 2017 was 8 times higher than the prescribed one. This was primarily due to the model of operation and its orientation to the lending operations.

### 35. Earnings per share

Pursuant to the HBOR Act, the equity capital of the Bank consists of one share in the company that may not be divided, transferred or pledged and is owned solely by the Republic of Croatia.

For the purpose of calculation of earnings per share, earning is presented as net profit after taxation.

Appendix - financial performance of the HKO Group  
Statement of Profit or Loss and Other Comprehensive Income for the year ended 31  
December 2017

(All amounts are expressed in HRK thousand)

	2017 HRK '000	2016 HRK '000
<b>Premium earned</b>		
Gross premium written	10,594	11,814
Premium impairment allowance originated and reserved on collection	(270)	-
Gross outward reinsurance premium	(3,877)	(4,964)
<b>Net premium written</b>	<b>6,447</b>	<b>6,850</b>
Changes in the gross unearned premium reserve	1,184	(1,649)
Changes in the gross unearned premium reserve, reinsurer's share	(750)	480
Net premium earned	6,881	5,681
Fee and commission income	2,586	2,102
Net investment income	1,540	1,824
Other operating income	82	60
<b>Net income</b>	<b>11,089</b>	<b>9,667</b>
Gross expense for returned premiums	(464)	(1,117)
Reinsurer's share	197	604
Gross reserve for returned premiums	(288)	(2)
Reinsurer's share	97	(43)
<b>Net expense and reserve for returned premiums</b>	<b>(458)</b>	<b>(558)</b>
Claims incurred	(6,213)	(1,713)
Claims incurred, reinsurer's share	5,337	122
Change in the claims provision	(3,397)	2,253
Change in the claims provision, reinsurer's share	2,107	(2,174)
<b>Net claims incurred</b>	<b>(2,166)</b>	<b>(1,512)</b>
Marketing and provision expenses	(886)	(822)
Administrative expenses	(5,949)	(5,023)
Other operating expenses	(107)	(205)
Net exchange differences other than those on financial instruments	(4)	1
<b>Profit before income tax</b>	<b>1,519</b>	<b>1,548</b>
Income tax	(102)	(233)
<b>Profit for the year</b>	<b>1,417</b>	<b>1,315</b>
<b>Other comprehensive income</b>		
<b>Items that are not transferred subsequently to profit or loss:</b>		
Deferred tax – adjustment for previous period	-	-
<b>Total items that are not transferred subsequently to profit or loss</b>	<b>-</b>	<b>-</b>
<b>Items that may be reclassified subsequently to profit or loss:</b>		
Gains on revaluation of financial assets available for sale	2,413	2,374
Decrease in the fair value of financial assets available for sale	(1,429)	(562)
Transfer of realized gains on asset available for sale to statement of profit or loss	5	(236)
Deferred tax	(178)	(262)
<b>Total items that may be reclassified subsequently to profit or loss:</b>	<b>811</b>	<b>1,314</b>
<b>Other comprehensive income after income tax</b>	<b>811</b>	<b>1,314</b>
<b>Total comprehensive income after income tax</b>	<b>2,228</b>	<b>2,629</b>
<b>Attributable to:</b>		
Equity holder of the parent	2,228	2,629

Appendix - financial performance of the HKO Group  
Statement of Financial Position for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	2017 HRK '000	2016 HRK '000
<b>Assets</b>		
<b>Non-current assets</b>		
Property and equipment	41	86
Intangible assets	2	5
Held to maturity investments	1,399	1,422
Deferred tax	231	54
<b>Total non-current assets</b>	<b>1,673</b>	<b>1,567</b>
<b>Current assets</b>		
Investments available for sale	44,370	46,459
Investments at fair value through profit or loss	291	286
Deposits with banks	-	-
Receivables from insurance operations	6,631	985
Other receivables	385	2,185
Cash and cash equivalents	2,534	551
<b>Total current assets</b>	<b>54,211</b>	<b>50,466</b>
<b>Total assets</b>	<b>55,884</b>	<b>52,033</b>
<b>Equity and liabilities</b>		
<b>Equity</b>		
Share capital	37,500	37,500
Accumulated losses	1,167	(148)
Other reserves	2,999	2,188
Profit for the year	1,417	1,315
<b>Total equity</b>	<b>43,083</b>	<b>40,855</b>
<b>Technical provisions</b>		
Gross technical provisions	16,726	14,225
Technical provisions, reinsurer's share	(7,873)	(6,419)
	8,853	7,806
<b>Current liabilities</b>		
Liabilities from insurance operations	1,183	1,190
Other liabilities	2,765	2,182
<b>Total liabilities</b>	<b>3,948</b>	<b>3,372</b>
<b>Total equity and liabilities</b>	<b>55,884</b>	<b>52,033</b>

Appendix - financial performance of the HKO Group  
Statement of Cash Flows for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	2017 HRK '000	2016 HRK '000
<b>Operating activities</b>		
Profit before income tax	1,520	1,548
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>		
Depreciation	58	70
Impairment loss and provisions	267	59
Income tax	102	233
Accrued interest	37	22
<i>Operating profit before working capital changes</i>	<i>1,984</i>	<i>1,932</i>
<b>Changes in operating assets and liabilities:</b>		
Net decrease in deposits with other banks	-	3,000
Net realized (gain) on assets available for sale	5	(236)
Decrease of discount in assets available for sale and assets held to maturity	408	406
Net gain on financial assets at fair value through profit or loss	(7)	(121)
Premium receivables	(5,917)	148
Net decrease/(increase) in other assets	1,224	(2,570)
Net decrease of assets and liabilities from insurance operations	(7)	(413)
Net increase in technical provisions	1,046	1,135
Net increase in other liabilities	603	497
<b>Net cash (used in)/provided by operating activities</b>	<b>(661)</b>	<b>3,778</b>
<b>Investment activities</b>		
Net (purchase) of financial assets at fair value through profit or loss	-	(8,990)
Net sale of financial assets at fair value through profit or loss	-	12,488
Net (purchase) of assets available for sale	(6,590)	(9,669)
Net sale of assets available for sale	9,120	2,532
(Purchase) of assets held to maturity	-	-
Collection of assets held to maturity when due	-	-
Net (purchase) of property, plant and equipment and intangible assets	(10)	(3)
<b>Net cash provided/(used in) investment activities</b>	<b>2,520</b>	<b>(3,642)</b>
<b>Effect of foreign currency to cash and cash equivalents</b>		
Net foreign exchange	124	173
<b>Net effect</b>	<b>124</b>	<b>173</b>
Net increase in cash and cash equivalents	1,983	309
Balance as of 1 January	551	242
Net increase in cash	1,983	309
<b>Balance as of 31 December</b>	<b>2,534</b>	<b>551</b>

Appendix - financial performance of the HKO Group  
Statement of Changes in Equity for the year ended 31 December 2017

(All amounts are expressed in HRK thousand)

	Share capital 000 kuna	Accumulated losses 000 kuna	Other reserves 000 kuna	Profit/(loss) for the year 000 kuna	Total equity attributable to the equity holders of the Company 000 kuna	Total equity 000 kuna
<b>Balance as of 1 January 2016</b>	<b>37,500</b>	<b>(1,184)</b>	<b>874</b>	<b>1,036</b>	<b>38,226</b>	<b>38,226</b>
Profit for the year	-	-	-	1,315	1,315	1,315
Other comprehensive income	-	-	1,314	-	1,314	1,314
Total comprehensive income	-	-	1,314	1,315	2,629	2,629
Transfer of profit 2015 to retained earnings	-	1,036	-	(1,036)	-	-
<b>Balance as of 31 December 2016</b>	<b>37,500</b>	<b>(148)</b>	<b>2,188</b>	<b>1,315</b>	<b>40,855</b>	<b>40,855</b>
Profit for the year	-	-	-	1,417	1,417	1,417
Other comprehensive income	-	-	811	-	811	811
Total comprehensive income	-	-	811	1,417	2,228	2,228
Transfer of profit 2016 to retained earnings	-	1,315	-	(1,315)	-	-
<b>Balance as of 31 December 2017</b>	<b>37,500</b>	<b>1,167</b>	<b>2,999</b>	<b>1,417</b>	<b>43,083</b>	<b>43,083</b>

