

KARLOVAČKA BANKA d.d.
Ivana Gorana Kovačića 1, Karlovac

Annual Financial Statements
and
Independent Auditor's Report
for the year 2018

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**REPORT OF THE MANAGEMENT BOARD ACCOMPANYING AUDITED FINANCIAL
STATEMENTS
FOR THE PERIOD 1 January – 31 December 2018**

Business environment

The continued stable and moderate growth of GDP, reduced unemployment and continued decrease in gross external debt as well as increased placements to individuals in the banking sector are some of the main positive developments in the Republic of Croatia in the previous year.

Macroeconomic forecasts for all basic macroeconomic indicators for 2018 as well as forecasts for 2019 are as follows:

Change rates

	2017.	2018.	2019.
GDP	2,9	2,7	2,7
Private consumption	3,6	3,2	3,5
Government consumption	2,7	3,3	2,6
Fixed capital investments	3,8	3,7	6,0
Exports of goods and services	6,4	3,6	3,4
Imports of goods and services	8,1	5,1	5,3
LABOR MARKET			
Number of employed persons (rate)	1,9	2,4	1,8
Unemployment rate (administ.)	12,1	9,9	8,8
PRICES			
Consumer price index (aver.r.)	1,1	1,5	0,9
EXTERNAL SECTOR			
Current Payments Balance Sheet (% GDP)	4,0	2,9	2,0
Gross external debt (%GDP)	81,8	75,0	70,0
MONETARY TRENDS			
Placements with private sector (trans.)	2,9	4,7	4,8
Placements with private sector (nom.)	-1,2	2,7	3,9

- **Source: CNB publication– Macroeconomic forecasts and trends, December 2018**

At the year level for 2018 the real GDP could increase by 2.7% and the same rate could be recorded in 2019 as well, in addition to the strengthening of domestic demand and weakening of foreign demand. In the next year substantial growth of fixed capital formation is expected, primarily due to the growth of general government's investments owing to more intensive use of funds from EU funds. Investments could also be positively affected by reduction of overall salary contribution rate that reduces the cost of labor for the employer. Stronger personal consumption growth is expected which will also be positively affected by income tax relief. Projection of GDP is characterized by negative effects arising primarily from external environment.

As far as price movements are concerned, inflation is expected to accelerate to 1.5% in 2018, largely as a result of acceleration of annual growth in energy prices due to increased average crude oil price in the world market. Inflation could be reduced to 0.9% in 2019 due to the expected reduction in the contribution of energy prices (mainly petroleum products) and the effect of the reduction in the value added tax rate on certain products. Growth in domestic demand and faster growth in wages than in labor productivity will limit the slowdown in inflation.

The labor market is expected to see increased number of employees and further decrease in the unemployment rate that will reach new historical minimums while the wage growth could continue to be relatively strong due to the shortage of labor in certain parts of the economy and wage increases in the public sector. The surplus on current and capital accounts is expected to be reduced as a result of the deepening of external trade deficit, while the trend of improving relative indicators of external debt could be slowed down.

Monetary policy of the CNB will retain its expansive character and continue to support the recovery of the economy by maintaining a stable exchange rate of the kuna against the euro. In such conditions, the long term trend of improving domestic financial conditions is expected to continue along with continued growth of bank placements to domestic sectors with the same intensity.

Total placements (excluding the government) could increase by 4.7% in 2018 (transaction-based increase). Accelerated growth is a result of stronger growth in placements to business entities and individuals which is in line with continued recovery of economic activity and growth in investments, employment and personal consumption. Nominally, the growth in total placements in 2018 is lower than the transaction-based growth due to impact of the sale of non-performing receivables that is still noticeable. Slight increase in private sector placements growth is expected in 2019.

Risks of achieving projected dynamics of credit growth are balanced. There are still uncertainties regarding the spillover of the negative effects of restructuring of Agrokor on the rest of the economy. Also, the increase in borrowing prices due to increase in interest rates of largest central banks still presents a risk in the medium term. On the other hand, continued bank balance cleaning creates favorable grounds for stronger credit growth in the medium term.

Financial result of the Bank

Karlovačka banka operated successfully in the described conditions and realized profit after taxation from operations that will continue in the amount of HRK 16,136 thousand.

Final profit after taxation and after impairment for operations that will not continue amounts to HRK 13,169 thousand which is an increase of 72% when compared to final profit realized in 2017. The realized return on assets (ROA) is therefore 0.6% and the return on equity (ROE) is 7.5%.

Respecting the described business environment, the size of the bank's assets and its market share held in the conditions of strong competition both in the local market and in the banking market as a whole and all this under the circumstances of still insufficient dynamics of the economic recovery, we find the final operating result for the previous year to be satisfactory.

Profit was realized under the terms and as a result of:

- Approximately realistically held loan volume to other customers; the level of total loans granted to other customers recorded a real growth of 0.3% in terms of kuna appreciation and loans to individuals realized nominal growth of 3.5% and real growth of 4.2%;
- Decrease in interest income but still with retained or even slightly increased level of net interest income and net interest margin;
- Decrease in income from commissions and fees, subject to new regulations and restrictions in household loans that have been in effect since the beginning of 2018;

- Realized increase in general and administrative costs which however did not affect significantly the degree of overall business efficiency;
- Recorded unrealized loss in the portfolio of government bonds held in a portfolio valued at fair value due to the negative trend of their prices in the second and fourth quarter;
- Recorded negative effect on the sale of part of tangible assets or foreclosed assets aiming to realize the measure of continued nominal and relative decrease of this type of property position in the bank's balance sheet, as established by the plan;
- Significantly lower costs of impairment of non-performing loans than those recorded in the previous year, all as a result of their partial collection or reduction as well as achieved required level of provisions

At the end of December the Bank's assets amounted to HRK 2,261,794 thousand. Compared to reported level at the end of 2017, the nominal growth rate was 3.7%. However, given the high share of foreign currency component of assets in total assets, with simultaneous appreciation of kuna, it can be concluded that the Bank's assets recorded a real growth rate of approximately 4.3%.

The positions and indicators shown below are presented in the annual financial statements (GFI) as prescribed by the Decision on the structure and content of the annual financial statements of credit institutions (Official Gazette NN 42/2018.)

Net interest income amounted to HRK 58,309 thousand which was by 2.7% higher than in 2017; the growth was achieved in the conditions of decrease of interest income by 6.4% and decrease of interest expenses at a rate of 32.6%. Decrease of interest income by 6.4% was due to continued reduction of active interest rates and their adjustment with competitive prices throughout the year and partly as a result of continued decline in NRS, due to which on two occasions in 2018 the interest rate reduction in the household sector was made to loan repayments contracted at variable interest rate related to that parameter. However, the net interest margin remained approximately at the same level or recorded a very slight growth of 1.7%.

Net income from commissions and fees amounted to HRK 16,199 thousand or 4.7% less than in 2017. The decline was the result of decrease in income from commissions and fees by 4.8%, with simultaneous decrease in expenses from commissions and fees by 5.3%. Recorded decrease of income from commissions and fees resulted from reduced level of income from retail commissions in one part of the products and based on legal limitations on the effective interest rate as applied since the end of 2017.

Positions of other non-interest bearing income and expenses relate mainly to:

- Income from trading in the amount of HRK 9,171 thousand or 5.3% higher than in 2017;
- Unrealized loss on assets which are not actively traded but valued at fair value through income statement in the amount of HRK 4,503 thousand and on the basis of price decline of government bonds
- Other income and expenses in 2018 that show no significant changes compared to previous year

General and administrative expenses and depreciation amounted to HRK 45,353 thousand being higher than in 2017 by 5.1%. Cost and income ratio of the Bank (C/I ratio) was 65%, excluding the impact of the negative market risk exposure in the Croatian bonds portfolio, 61% as it was approximately a year earlier. General and administrative expenses accounted for 2% in assets value which is equal to that in 2017.

Total cost of impairments and provisions for losses on all bases amounted to approximately HRK 12 million. Their impact on the final result was therefore relatively and nominally significantly lower than in the previous year when they amounted to approximately HRK 27.8 million. Compared to 2017 the Bank reduced the nominal level of bad loans by 11% and also reduced the share of bad loans in total loans, while at the same time retaining the same degree of coverage in allocated provisions.

Relating to profit or loss from operations that will not continue the Bank realized net loss in the approximate amount of HRK 3 million in 2018. This amount is mainly the result of stated expenses from the sale of part of foreclosed assets in exchange for uncollected receivables for which a loss of HRK 3.6 million was realized.

Basic positions of assets and liabilities are as follows:

- **High-cash assets** represented by cash, deposits with CNB and other demand deposits amounted to HRK 405.4 million or 28% more than at the end of 2017
- **High-value assets** represented by bonds of the Republic of Croatia and treasury bills of the Ministry of Finance, allocated to a portfolio that is valued at fair value through income statement and the portfolio at depreciated cost, amounted to HRK 434 million or approximately the same as in the previous year, with retained share in total assets of approximately 19%
- **Loans and advances** amounted to HRK 1,320 million at the end of 2018 or 1% more than at the end of 2017. Principals of net loans to other customers amounted to HRK 1,116 million or 0.5% less than at the end of 2017. However, given the foreign currency component of this position and the fact that kuna appreciated in 2018 it can be concluded that total net loans to other customers recorded slight real growth at a rate of 0.3%.

In this respect, the nominal and real growth of the base was recorded in the portfolio of household loans – the nominal growth rate was 3.5% while the real growth of loans in this customer segment was 4.2%. Looking at the main types of household loans, the highest nominal growth was achieved with housing loans and car buying loans; the nominal growth rate of housing loans was 11%, while the same rate for car buying loans was 19%.

- **Tangible assets** amounted to HRK 29.1 million which accounts for 1.3% of the Bank's total assets, i.e. same as in the previous year
- **Tangible assets held for sale** amounted to HRK 71.1 million at year end or 14% less than in the previous year; the decrease was a result of continued activities on the sale of foreclosed assets resulting in decreased share of this position in the total assets during 2018 from 3.8 to 3.1% of total assets of the Bank
- **Deposits** amounted to HRK 2,077 million or 3.9% higher than that at the end of 2017

Within these, sight, savings and term deposits of customers amounted to HRK 2,004 million, with a nominal growth rate of 3.9% and continued trend of high growth rates of sight deposits and decrease in term deposits.

	31.12.17.	31.12.18.	Index
Giro and current accs.	482.494	558.482	115,7
Savings	262.190	343.579	131,0
Term	1.185.226	1.102.408	93,0
Total	1.929.910	2.004.469	103,9

Deposits from customers at stated amount of HRK 2,004 million and share of 88.6% continue to represent the primary and stable source of financing for the Bank.

Within total customer deposits, total deposits of households recorded a growth at the nominal rate of 1.5%. The real growth rate of these deposits was higher i.e. 2.3%.

- **The Bank's capital** amounted to HRK 156.2 million at the end of December or 11% more than a year earlier accounting for 6.9% of the Bank's total sources.

At the end of 2018, with the established level or regulatory capital in the amount of HRK 186.0 million, the Bank showed the regulatory capital adequacy rate of 17.25% which, to a satisfactory extent, exceeds the established minimum legal and internal rate.

Through continuous structuring of bids under competitive conditions, in 2018 the Bank achieved satisfactory increase in newly-placed loans, especially household and non-purpose loans to individuals as well as loans for the financing of current business of small and medium-sized enterprises, whereby cooperation with local government units continued through special credit lines as well as the cooperation with the Ministry in regard to subsidized housing loans to individuals, which has been in operation since 2017 and is planned to be continued in 2019.

Further increase in number of transaction accounts and mobile and Internet banking users of both business entities and individuals was recorded with further gradual migration of transactions from branches. Aiming to ensure wider availability of products and services and following trends in the banking business, the Bank continued to invest in new technologies and solutions. In the past 2 years all dial up EFTPOS terminals have been replaced by new terminals connected via the Internet. The EFTPOS network is currently moving to contactless technology. We also offer mobile EFTPOS devices. In 2018 the Bank completed the process of complete replacement of ATM network in accordance with the latest IT trends and legal regulations.

Risk management

We appreciate that the fact of good and responsible risk management contributed to the achievement of a satisfactory and positive business result in 2018. With regard to its business model and risk profile, the Bank continues to improve processes of monitoring and controlling of all risks to which it is exposed. Within these risks, the focus in 2018 continued to be on the most significant risks: credit risk, market risks and popularly on the liquidity risk and the operational risk.

Along with achieved stable operating result, the results of successful risk management are also seen in the level of the Bank's exposure to all types of risk, with exposures continuously being within legal and internal limits. In addition to continuous high level of liquidity achieved, the Bank achieved additional positive shifts in 2018 regarding exposure to credit risk through decreased portions and levels of non-performing loans, decreased portions and levels of outstanding loans and further reduction of the concentration degrees i.e. greater diversification within the exposure to credit risk.

Description and overview of the Bank's exposure to these risks are detailed in the Notes accompanying the financial statements for 2018.

Own shares

The Bank did not redeem its own shares.

Plan and expectations of the Bank for 2019

Respecting comparatively favorable macroeconomic forecasts for 2019 which were presented in the introduction, the capital position of the Bank in 2019 as well as the financial position which is characterized by a high degree of liquidity and continuous surpluses, the Bank has defined a business plan for 2019 with basic goals and measures to achieve them. When defining the business plan, the fact that no significant changes in prudential legislation are expected in the current year, as were in previous year and periods, was taken into consideration.

With retained business model, the business plan for 2019 accepts the strategy set out in the Business Plan for the period 2018-2023, which is based on the following basic principles of management:

- Dedication to customers in order to maintain and gain loyalty of existing and new customers
- Equal focus on business with corporate customers and individuals, aiming to achieve and maintain better diversification or risk
- Retention of existing dispersed sales network on the local, regional market where the Bank need to further strengthen its market position, which also demonstrates a good infrastructure base for obtaining primary sources of financing
- Preference for stable deposit base that will support increased credit activity towards customers with whom the Bank has established or will establish a full business relationship
- Continuous change in the structure of the balance sheet to gradually increase interest-bearing assets, operating profit and total profit which will be the exclusive generator of credit growth
- Responsible management of all risks and maintenance and continuous improvement of credit risk monitoring and control within the frame of credit risk

Activities and measures that the Bank will undertake in 2019 will be directed towards achieving the goal of:

- Net operating profit growth
- Credit growth
- Decrease in non-performing loans
- Maintaining existing business efficiency
- Sales of assets acquired in exchange for uncollected receivables

Main items of the financial plan are:

-rate of property change: +2.3%

-rate of deposit change: +1.9%, with the expected continued growing trend of sight deposits and the drop in term deposits

-rate of loan change: +1.7%

The fact that new majority owners of the Bank are locally based is a legitimate expectation for the Bank, its customers and for the wider local community, that the Bank will continue its brand of a regional bank which has been established in more than 65 years of its existence. Offering its services to customers under competitive and financially attractive conditions, for both loans and deposits, the Bank's primary interest will continue to be to encourage domestic, especially regional economic recovery with the aim of further strengthening its regional presence.

I thank our customers and shareholders for their trust, as well as the members of the Supervisory Board for their continuous support and cooperation.

The Bank has based its activities over the past period and will continue to rely on an expert and organized team of employees whom I dedicate my special thanks for their professionalism and dedication.

Karlovac, 22 February 2019

PRESIDENT OF THE MANAGEMENT BOARD



Željka Surač

KARLOVAČKA BANKA
Joint-stock company
SUPERVISORY BOARD

Until 28 February 2018 the Supervisory Board of Karlovačka banka d.d. was composed of: Nedjeljko Strikić, President, Bernarda Ivšić, Deputy President i Željko Tintor, Member.

On 28 February 2018 the constitutive session of the Supervisory Board was held in the new mandate after the nominees Nedjeljko Strikić, Bernarda Ivšić, Željko Tintor, Ana Kirinčić and Mato Crkvenac received the approval to be elected as members of the Supervisory Board of Karlovačka banka d.d.

Nedjeljko Strikić was elected at the constitutive session as the President of the Supervisory Board and Bernarda Ivšić was elected as Deputy President.

At the same session the Supervisory Board established the Risk and Audit Board and elected its members.

The Supervisory Board convened regularly and during 2018 a total of 19 meetings were held, of which 9 were held by fax.

In addition to making decisions that are within the responsibility of the Supervisory Board under the provisions of the Companies Act, the Credit Institutions Act and the Bank's Statute, the activities of the Supervisory Board have been directed, in cooperation with the Bank's Management Board, to the development of the Bank's business and implementation of efficient and reliable management system of the Bank.

Furthermore, the Supervisory Board has been acquainted with all significant ongoing court cases and estimates regarding provisions thereof as well as with their estimated outcome.

During 2018 the Supervisory Board supervised the Management Board's management of the Bank's operations and established that the Bank had operated in accordance with the Law and Acts of the Bank as well as with the decisions of the General Assembly.

The Supervisory Board confirms that the annual financial statements have been prepared in accordance with the Bank's records and that they show true and correct property status and business condition of the Bank.

The Supervisory Board agrees with the proposed Decision on profit allocation which will be submitted to the General Assembly of the Bank.

Karlovac, 07 February 2019

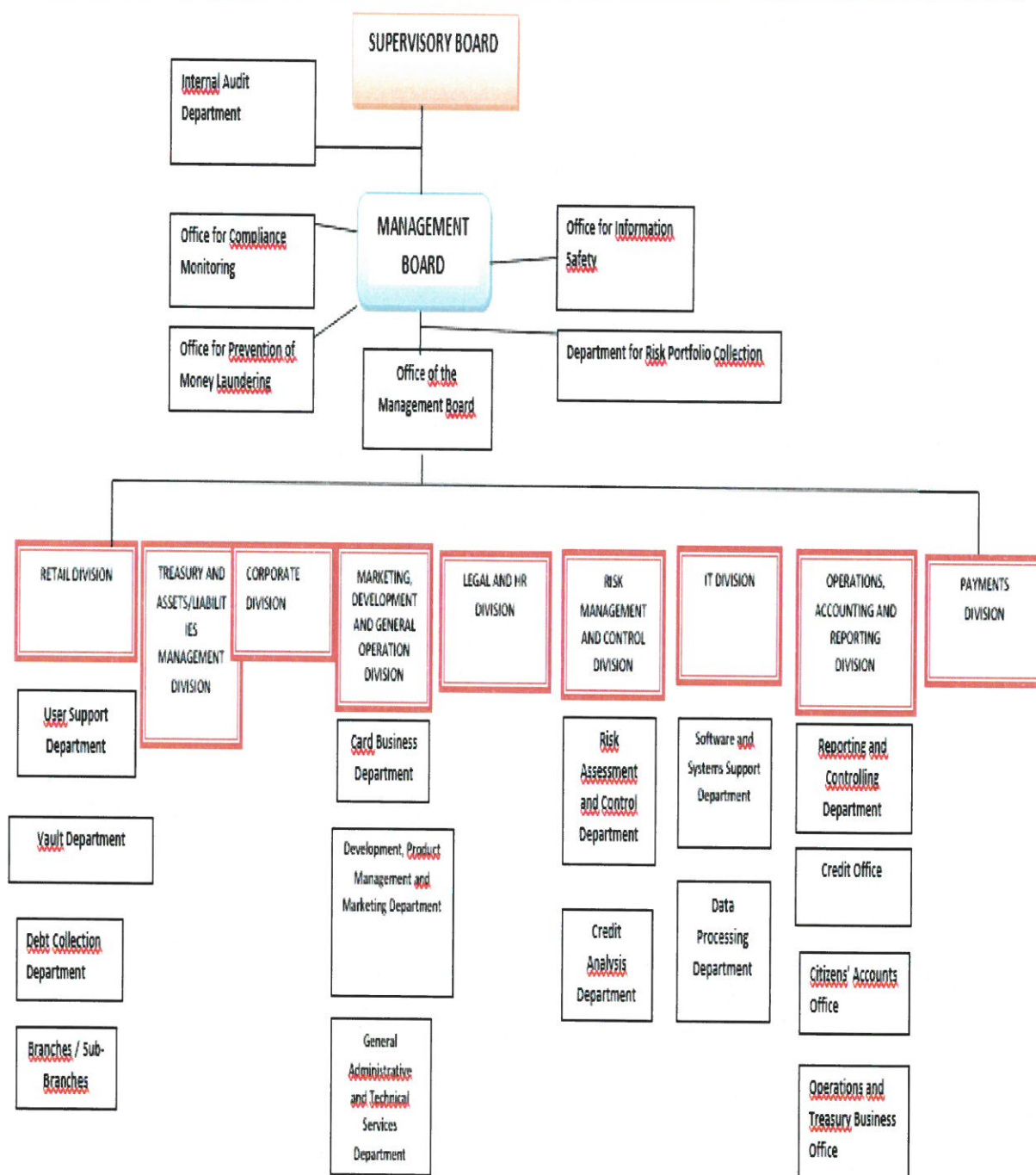
President

mr.sc. Nedjeljko Strikić



Management and Corporate Governance

Organisational chart of Karlovačka banka d.d.



KARLOVAČKA BANKA d.d. KARLOVAC
ANNUAL FINANCIAL STATEMENTS FOR THE YEAR 2018

CORRESPONDENT BANKS-ACCOUNT RELATIONSHIPS

AUD	Hrvatska Poštanska Banka d.d., Zagreb	HPBZ HR 2X	IBAN: HR3423900011900000145		FX	MM
AUD	Privredna banka Zagreb d.d., Zagreb	PBZG HR 2X	IBAN: HR2023400091990016076	CP		
AUD	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547		FX	MM
CAD	Hrvatska Poštanska Banka d.d., Zagreb	HPBZ HR 2X	IBAN: HR3423900011900000145	CP	FX	MM
CAD	Privredna banka Zagreb d.d., Zagreb	PBZG HR 2X	IBAN: HR2023400091990016076	CP		
CAD	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM
CHF	Hrvatska Poštanska Banka d.d., Zagreb	HPBZ HR 2X	IBAN: HR3423900011900000145	CP	FX	MM
CHF	Privredna banka Zagreb d.d., Zagreb	PBZG HR 2X	IBAN: HR2023400091990016076	CP		
CHF	Raiffeisenbank Austria d.d., Zagreb	RZBH HR 2X	IBAN: HR6024840081900001513	CP	FX	MM
CHF	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM
CZK	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM
DKK	Danske Bank A/S, Copenhagen	DABA DK KK	IBAN: DK0230003996057542	CP	FX	MM
DKK	Privredna banka Zagreb d.d., Zagreb	PBZG HR 2X	IBAN: HR2023400091990016076	CP		
DKK	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	HR3423600001900000547	CP	FX	MM
EUR	Banco Bilbao Vizcaya Argentaria SA, Madrid	BBVA ES MM	IBAN: ES3801820061710080109344	CP		
EUR	Erste Group Bank AG, Vienna	GIBA AT WG	IBAN: AT712010040331963300	CP	FX	MM
EUR	Hrvatska Poštanska Banka d.d., Zagreb	HPBZ HR 2X	IBAN: HR3423900011900000145	CP	FX	MM
EUR	Intesa Sanpaolo SpA, Milan	BCIT IT MM	IBAN: IT42J0306940101100100004122	CP		
EUR	Karlovačka banka dd., Karlovac	KALC HR 2X	Member of SEPA payments	CP		
EUR	Karlovačka Banka d.d.,	KALC HR 2X	IBAN: HRPKALC2400008, T2HR	CP	FX	MM

KARLOVAČKA BANKA d.d. KARLOVAC
ANNUAL FINANCIAL STATEMENTS FOR THE YEAR 2018

	Karlovac						
EUR	Privredna banka Zagreb d.d., Zagreb	PBZG HR 2X	IBAN: HR2023400091990016076	CP			
EUR	Raiffeisenbank Austria d.d., Zagreb	RZBH HR 2X	IBAN: HR4524840081900001492	CP	FX	MM	
EUR	UniCredit SpA, Milan	UNCR IT MM	IBAN: IT40L02008329780000000000925	CP	FX	MM	
EUR	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM	
GBP	Hrvatska Poštanska Banka d.d., Zagreb	HPBZ HR 2X	IBAN: HR3423900011900000145	CP	FX	MM	
GBP	Privredna banka Zagreb d.d., Zagreb	PBZG HR 2X	IBAN: HR2023400091990016076	CP			
GBP	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM	
HRK	Karlovačka banka d.d., Karlovac	KALC HR 2X		CP			
JPY	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM	
NOK	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM	
SEK	Hrvatska Poštanska Banka d.d., Zagreb	HPBZ HR 2X	IBAN: HR3423900011900000145	CP	FX	MM	
SEK	Privredna banka Zagreb d.d., Zagreb	PBZG HR 2X	IBAN: HR2023400091990016076	CP			
SEK	Skandinaviska Enskilda Banken AB, Stockholm	ESSE SE SS	IBAN: SE5650000000052018512463	CP	FX	MM	
SEK	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547	CP	FX	MM	
USD	Addiko bank d.d., Zagreb, Zagreb	HAAB HR 22	IBAN: HR6625000091901130196	CP			
USD	Raiffeisenbank Austria d.d., Zagreb	RZBH HR 2X	IBAN: HR8224840081900001505		FX	MM	
USD	Zagrebačka banka d.d., Zagreb	ZABA HR 2X	IBAN: HR3423600001900000547		FX	MM	

BRANCH NETWORK AND CONTACT DETAILS

Branches and sub-branches

BRANCHES

Zagreb

Preradovićeve 15
10 000 Zagreb
Phone (+385 1) 6041 005
Fax (+385 1) 4813 557
www.kaba.hr

Rijeka

Prolaz Marije Krucifikse Kozulić 4 (Zagrad)
51 000 Rijeka
Phone (+385 51) 324 507
Fax (+385 51) 323 641
www.kaba.hr

SUB-BRANCHES / OFFICES

Centrala

Ivana Gorana Kovačića 1
47 000 Karlovac
Phone (+385 47) 417 525
Fax (+385 47) 614 204
www.kaba.hr

Vladka Mačeka

Vladka Mačeka 8
47 000 Karlovac
Phone (+385 47) 417 412
Fax (+385 75) 802 086
www.kaba.hr

Office Draganić

Draganić 10
47 201 Draganići
Phone (+385 47) 715 772
Fax (+385 75) 802 090

Tržnica

Trg hrvatskih branitelja 2
47 000 Karlovac
Phone (+385 47) 412 171
Fax (+385 75) 802 089
www.kaba.hr

Duga Resa

Jozefinska cesta 15
47 250 Duga Resa
Phone (+385 47) 844 537
Fax (+385 47) 801 748
www.kaba.hr

Jastrebarsko

Zrinski-Frankopanska 2
10 450 Jastrebarsko
Phone (+385 1) 6270 203
Fax (+385 75) 802 094
www.kaba.hr

Žakanje

Žakanje 95 d
47 276 Žakanje
Phone (+385 47) 757 914
Fax (+385 75) 802 088
www.kaba.hr

Slunj

Trg dr. Franje Tuđmana 15
47 240 Slunj
Phone (+385 47) 777 320
Fax (+385 75) 802 093
www.kaba.hr

Topusko

Trg Josipa bana Jelačića 7
44 415 Topusko
Phone (+385 44) 885 152
Fax (+385 44) 885 152
www.kaba.hr

Ogulin

Ivana Gorana Kovačića 8

47 300 Ogulin

Phone (+385 47) 537 465

Fax (+385 75) 802 092

www.kaba.hr

Ozalj

Trg braće Radić 2

47 280 Ozalj

Phone (+385 47) 731 188

Fax (+385 47) 638 684

www.kaba.hr

Statement of application of the Corporate Governance Code

As a company with A series shares listed on the Zagreb Stock Exchange, Karlovačka banka d.d. applied voluntarily the recommendations of the Corporate Governance Code in 2018, while deviating from some recommendations and guidelines of the Code, taking into account specifics in the banking sector.

Detailed explanations regarding the non-application of or deviation from the specific recommendations of the Code are given in the annual questionnaire which forms an integral part of the Code that is submitted to the Zagreb Stock Exchange d.d. and HANFA for public announcement and is also available on the Bank's website.

Rules for appointing and recalling members of the Management Board are contained in the Bank's Statute. President and Members of the Management Board shall be appointed by the Bank's Supervisory Board for a maximum period of five years, with the possibility of re-election.

The procedure for amending the Statute is regulated by the Article 74 of the Bank's Statute and accordingly the Statute may be amended by the decision of the General Assembly, in accordance with the law and the Statute of the Bank.

The powers of the Supervisory Board and the Management Board of the Bank are regulated by the Bank's Statute in accordance with applicable regulations, the Companies Act and the Credit Institutions Act.

The system of internal controls and risk management in relation to the financial reporting process is established through the Internal Audit Department, the Risk Management and Control Division and the Office for Compliance Monitoring.

The stock control is held by two shareholders, Mr Marko Vuković and Mr Ivan Žabčić, each holding 6,636,710 shares of the Series B, or 37.56% each, that is, 75.12% in total. Shares of the Series B are not listed on the Stock Exchange.

The manner in which the General Assembly operates is regulated by the Statute of the Bank in accordance with the Companies Act. The decisions of the General Assembly are made by the majority of votes cast at the General Assembly, unless a qualified majority is required for a particular decision.

The right to participate in the General Assembly is given to shareholders who are registered as shareholders of the Bank at the depository of the Central Depository Clearing Company (SKDD d.d.) at the beginning of the 21st day prior to the General Assembly and who have reported their participation no later than 6 days before the General Assembly is held, not counting the date of receipt of the application by the Bank.

In accordance with the provisions of the Capital Market Act, the invitation to the General Assembly is published on the web site of the Bank, the Zagreb Stock Exchange, HANFA and through HINA announcement. The Invitation contains detailed explanations and instructions to shareholders regarding the application, powers of attorney and all necessary forms.

The number of members of the Management Board and the Supervisory Board is stipulated by the Bank's Statute. The Management Board consists of the president and two members, while the Supervisory Board consists of the president, deputy president and three members. The Supervisory Board appoints a combined Risk and Audit Board which consists of three members.

Operations of the Management Board, the Supervisory Board and the Risk and Audit Board are governed by particular rules of procedure.

The Bank adopts policies that prescribe the target structure of the Management Board and the Supervisory Board with regard to education, profession, competences and other specific skills. Policy implementation is ensured when determining proposals for candidates of individual bodies and assessing the suitability of a particular candidate as well as assessing the adequacy of an individual body as a whole.

Diversity is an important factor that provides additional quality in the performance of the highest bodies of the Bank in the reporting period. In this regard, different age groups and both women and men are represented and, given that these are responsible jobs, highly qualified employees of different professions and qualifications are represented.

Pursuant to the provisions of the Article 250a, paragraph 4 and the Article 272p of the Companies Act and the Article 22 of the Accounting Act, this Statement is a separate section and an integral part of the Annual Financial Statements of the Company for the year 2018.

Karlovac, 22 February 2019

President of the Management Board:

Željka Surač



**CORPORATE GOVERNANCE CODE
ANNUAL QUESTIONNAIRE**

BASIC INFORMATION ABOUT THE COMPANY:
CONTACT PERSON AND PHONE NUMBER:
DATE OF THE QUESTIONNAIRE:

Karlovačka banka d.d.
Branka Bakić, 047-417-508
22 February 2019

All questions contained in this questionnaire refer to the one-year period to which the annual financial statements refer as well.

For questions contained in the questionnaire, it is necessary to provide the explanation only if so explicitly requested.

The answers in the questionnaire are evaluated at a certain percentage which is expressed at the beginning of each chapter.

COMMITMENT TO PRINCIPLES OF CORPORATE GOVERNANCE AND SOCIAL RESPONSIBILITY

Answers to this set of questions carry 20% of the overall indicator of compliance with the Corporate Governance Code.

Question number Answer YES/NO	Question Explanation
1.	Has the company accepted the application of the Corporate Governance Code of the Zagreb Stock Exchange? YES
2.	Does the company have its own Corporate Governance Code? NO
3.	Are there adopted principles of the Corporate Governance Code within the internal policies of the company? YES
4.	Does the company publish the compliance with the principles of corporate governance within its annual financial statements? YES

SHAREHOLDERS AND GENERAL ASSEMBLY

Answers to this set of questions carry 30% of the overall indicator of compliance with the Corporate Governance Code.

Question number Answer YES/NO	Question Explanation
5.	Is the company in a relationship of mutual shareholding with another company or companies? (if yey, explain) NO
6.	Does each share of the company have the right to one vote? (if not, explain) NO Ordinary shares entitle to 1 vote and preferred shares entitle to 10 votes

7. Are there cases in which some shareholders are treated differently? (if yes, explain)
- NO
8. Is the issuance of the power of attorney for voting at the General Assembly extremely simplified and without strict formal requirements? (if no, explain)
- YES
9. Has the company provided for empowered persons to vote in accordance with instructions of shareholders who for any reason are not able to vote at the assembly, without any special expenses? (if no, explain)
- NO not prescribed by the Statute
10. When convening the assembly, did the Management Board or the Board of Directors of the company set a date to be used for determining the status of the shares in the registry, which will be applicable for the exercise of voting rights at the assembly, in such a way that it is the date before the assembly and that it is the date no more than six days before the assembly? (if no, explain)
- YES
11. Did the company publish the agenda of the assembly and all the relevant information and documents along with explanations related to the agenda on its website and made them available to shareholders in the company's premises since the first public announcement of the agenda? (if no, explain)
- YES
12. Does the decision on the payment of the dividend or the advance contain the date on which the shareholder acquires the right to a dividend payment and the date or period when the dividend is paid? (if no, explain)
- YES
13. Is the date of the payment of the dividend or the advance set no more than 30 days after the date of the decision? (if no, explain)
- YES
14. Are there cases when certain shareholders are favored at dividend or dividend advance payments? (if yes, explain)
- YES preferred shareholders
15. Is it possible for shareholders to participate and vote at the General Assembly of the company using modern communication technology? (if no, explain)
- NO not prescribed by the Statute
16. Are the conditions for participating at the General Assembly and using the right to vote set (whether or not permitted by law or statute), such as advance attendance, certification of power of attorney, etc.? (if yes, explain)
- YES application must be received 6 days before the General Assembly, prescribed by the Statute
-

17. Did the Management Board of the company announced publicly the decisions of the General Assembly?

YES

18. Did the Management Board of the company publicly disclose information about possible lawsuits to contest these decisions? (if no, explain)

YES

MANAGEMENT AND SUPERVISORY BODIES

STATE NAMES OF THE MANAGEMENT BOARD MEMBERS AND THEIR AND FUNCTIONS:

Željka Surač, B.Sc.Econ., President,
Marino Rade, B.Sc.Econ., Member,
Ljiljana Movre, B.Sc.Econ., Member

STATE NAMES OF THE SUPERVISORY BOARD MEMBERS AND THEIR FUNCTIONS:

Nedjeljko Strikić, M.Sc., President,
Bernarda Ivšić, B.Sc.Econ., Deputy president,
Željko Tintor, Master of Economics, Member
Ana Kirinčić, B.Sc.Econ., Member
Mato Crkvenac, Dr.Sc.Econ., Member

Answers to this set of questions carry 20% of the overall indicator of compliance with the Corporate Governance Code.

Question number	Question
Answer YES/NO	Explanation

19. Did the Supervisory Board or the Management Board make a decision on the framework plan of their activities which includes a list of regular sessions and data that should be made available to the members of the Supervisory Board on a regular and timely basis? (if no, explain)

NO Not prescribed by the Statute.

20. Did the Supervisory Board or the Management Board pass the internal code of conduct?

YES

21. Does the company have independent members in the Supervisory Board and the Management Board? (if no, explain)

YES

22. Is there a long-term succession plan in the company? (if not, explain)

YES

23. Is the reward or fee received by members of the Supervisory Board and the Management Board wholly or partly determined by the contribution to the company's performance? (if no, explain)

NO It depends on the average income of all employees.

24. Is the remuneration of the members of the Supervisory Board and the Management Board determined by the decision of the General Assembly or the Statute (if no, explain)

YES

- 25 Are detailed information on all remuneration and other income from the company or from the affiliated company of each individual member of the Management Board and executive directors, including the remuneration structure, disclosed publicly (in the annual financial statements)? (if no, explain)

NO Depending on the size and the risk profile of the Bank, the total amounts are shown.

- 26 Are detailed information on all remuneration and other income from the company or the related persons of each individual member of the Supervisory Board and the Board of Directors, including the remuneration structure, disclosed publicly (in the annual report)? (if no, explain)

NO Depending on the size and the risk profile of the Bank, the total amounts are shown.

- 27 Does each member of the Supervisory Board and the Management Board report to the company any changes regarding the acquisition, dismissal or the possibility of exercising voting rights for the shares of the company immediately and not later than three working days from the day of the transaction? (if no, explain)

NO There were no such acquisitions.

- 28 Are all the activities, in which the members of the Supervisory Board and the Board of Directors or their related persons and the company and its associated persons participated, clearly stated in the company's reports? (if no, explain)

NO Depending on the size and the risk profile of the Bank, the total amounts are shown.

- 29 Are there any contracts or agreements between members of the Supervisory Board and the Board of Directors of the company and the company itself?

NO

- 30 Have they been previously approved by the Supervisory Board or the Board of Directors? (if no, explain)

NO Such contracts do not exist.

- 31 Are the essential elements of such contracts or agreements contained in the annual financial statements? (if no, explain)

NO Such contracts do not exist.

- 32 Has the Supervisory Board or the Management Board set up a nomination committee?

NO There is no such obligation.

- 33 Has the Supervisory Board or the Management Board set up a remuneration committee?

NO There is no such obligation.

- 34 Has the Supervisory Board or the Management Board set up an audit committee?

YES

- 35 Is the majority of the audit committee members elected from among the independent members of the Supervisory Board? (if no, explain)

NO There is no such obligation.

- 36 Has the audit committee followed the integrity of financial information of the company, in particular the correctness and consistency of accounting methods used by the company and the group to which it belongs, including the criteria for consolidating financial statements of the companies belonging to the group? (if no, explain)

YES

- 37 Has the audit committee assessed the quality of the internal control and risk management system with the aim of adequately identifying, announcing publicly and managing the main risks to which the company is exposed (including the risks associated with compliance to regulations)? (if no, explain)

YES

- 38 Has the audit committee worked to ensure the effectiveness of the internal audit system, in particular by making recommendations when selecting, appointing, re-appointing and dismissing the head of the internal audit department and the available resources and assessing the management of internal findings and recommendations of the internal audit? (if no, explain)

YES

- 39 If there is no internal audit in the company, has the audit committee made an assessment of the need to establish such a function? (if no, explain)

NE There is an internal audit function.

- 40 Has the audit committee monitored the independence and objectivity of an external auditor, particularly with regard to the rotation of authorized auditors within the audit firm and the fees for external audit services paid by the company? (if no, explain)

YES

- 41 Has the audit committee monitored the nature and quantity of services that are not audit services but which the company receives from the audit firm or audit firm's related persons? (if no, explain)

YES

- 42 Has the audit committee drawn up rules on which services an external audit firm and associated persons can not provide to the company, which services can only be provided with prior consent of the committee and which services can be provided without prior consent? (if no, explain)

NO The audit firm does not provide services to the company.

- 43 Has the audit committee considered the efficiency of external audit and senior management in view of recommendations provided by an external auditor? (if no, explain)

NO There were no recommendations

- 44 Has the documentation relevant for the work of the Supervisory Board and the Board of Directors been delivered on time to all members? (if no, explain)

YES

- 45 Have all the decisions and voting records been recorded in the minutes of the Supervisory Board or the Board of Directors meetings? (if no, explain)

YES

- 45 Has the Supervisory Board, that is, the Management Board made an assessment of their work in the last period which includes valuation of contribution and competence of each individual member as well as the joint work of the board, the evaluation of work of the established committees and the evaluation of achieved goals in relation to the company's objectives?

NO Not prescribed by the Statute.

- 46 Have the detailed information on all income and remuneration received by each member of the Management Board or by the Executive Directors from the company been publicly disclosed in the company's annual financial statements? (if no, explain)

NO Depending on the size and the risk profile of the Bank, the total amounts are shown.

- 47 Have all types of remuneration to members of the Management Board and the Supervisory Board, including options and other management benefits, been publicly disclosed in the company's annual financial statements in detail and by individual items and persons? (if no, explain)

NO Remuneration was not stipulated.

- 48 Have all the activities involving members of the Management Board and Executive Directors and their related persons and the company or its associated persons been clearly stated in the company's reports? (if no, explain)

NO Depending on the size and the risk profile of the Bank, the total amounts are shown.

- 50 Does the report presented to the General Assembly by the Supervisory Board, that is, the Management Board contain, apart from the contents prescribed by law, the assessment of the overall performance of the company and of the Management Board and a special reference to the co-operation with the Management Board? (if no, explain)

YES

AUDIT AND INTERNAL CONTROL MECHANISMS

Answers to this set of questions carry 10% of the overall indicator of compliance with the Corporate Governance Code.

Question number	Question
Answer YES/NO	Explanation

- 51 Does the company have an external auditor?

YES

- 52 Does the external auditor have a state or interest in the company?

NO

- 53 Does the external auditor provide the company with other services, alone or through related persons?

NO

- 54 Has the company disclosed publicly the fees paid to the external auditors for the audit performed and other services rendered? (if no, explain)
- YES
- 55 Does the company have internal auditors? (if no, explain)
- YES
- 56 Does the company have an established system of internal control? (if no, explain)
- YES

TRANSPARENCY AND BUSINESS EXPOSURE

Answers to this set of questions carry 20% of the overall indicator of compliance with the Corporate Governance Code.

Question number	Question
Answer YES/NO	Explanation
57	Are annual, semi-annual and quarterly reports available to shareholders?
YES	
58	Has the company prepared a calendar of important events?
NO	
59	Has the company established mechanisms to ensure that persons who have access to or come into contact with privileged information understand the nature and importance of such information and restrictions in that regard?
YES	
60	Has the company established mechanisms to ensure control of privileged information flow and the possible misuse?
YES	
61	Has anybody suffered the negative consequences for pointing out to the competent authorities inside or outside the company the shortcomings in the application of regulations or ethical norms within the company? (if yes, explain)
NO	
62	Has the Management Board held meetings with potential investors in the past year?
NO	
63	Have all the members of the Management Board, the Supervisory Board or the Board of Directors agreed that the statements made in response to the questions in this questionnaire are, to the best of their knowledge, entirely true?
YES	

RESPONSIBILITY FOR THE ANNUAL FINANCIAL STATEMENTS

The Management Board of Karlovačka banka d.d., Karlovac, Ivana Gorana Kovačića 1 ("the Bank") is responsible for ensuring that the annual financial statements for the year 2018 are prepared in accordance with the Accounting Act (Official Gazette No 78/15, 134/15, 120/16) and the International Financial Reporting Standards to give true and fair view of the financial position, business results, changes in equity and cash flows of the Bank for that period.

After making enquiries, the Management Board of the Bank reasonably expects the Bank to have adequate resources to continue to operate in the foreseeable future. Accordingly, the Management Board of the Bank prepared the annual financial statements using the going concern basis of accounting.

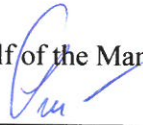
In preparing the annual financial statements, the Management Board of the Bank is responsible for:

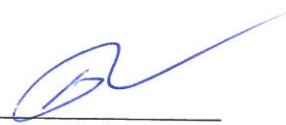
- selection and consistent application of suitable accounting policies in accordance with the applicable financial reporting standards;
- giving reasonable and prudent judgments and estimates;
- preparation of annual financial statements using the going concern basis of accounting, unless it is inappropriate to presume so.

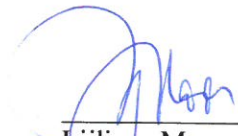
In accordance with the Accounting Act, the Management Board of the Bank is responsible for preparation and contents of the Statement of the Management Board on the Bank's position as well as the Statement on the Corporate Governance Code.

Financial statements on pages 34-108 and the forms on pages 109-116 with accompanying adjustments on pages 117-124, which have been prepared in accordance with the Croatian National Bank's Decision on the structure and content of annual financial statements of credit institutions dated 26 April 2018 (Official Gazette No. 42/2018), have been approved by the Management Board on 22 February 2019 for submitting to the Supervisory Board and signed below.

On behalf of the Management Board:


Željka Surač
President


Marino Rade
Member


Ljiljana Movre
Member



Karlovačka banka d.d.
Ivana Gorana Kovačića 1
47000 Karlovac
Republika Hrvatska
Karlovac, 22 February 2019

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF KARLOVAČKA BANKA d.d. KARLOVAC

Report on the Audit of the Financial Statements

Qualified opinion

We have audited the annual financial statements of Karlovačka banka d.d. (the 'Bank') which comprise the Statement of financial position (the balance sheet) as at 31 December 2018, the Income Statement and the Statement of Other Comprehensive Income, the Cash Flow Statement and the Statement of Changes in Equity for the year then ended as well as the accompanying Notes to the Financial Statements, including a summary of significant accounting policies.

In our opinion, except for effects of the matter described in our report in the basis for qualified opinion section, the accompanying annual financial statements give true and fair presentation of the Bank's financial position as at 31 December 2018, its financial performance and cash flows for the year then ended in accordance with the Accounting Law and International Financial Reporting Standards (IFRSs) as established by the European Commission and published in the official gazette of the European Union.

Basis for qualified opinion

As stated in Note 3.10, the Bank owned 100% of the company Rezidencija Mejaši d.o.o. Karlovac as at 31 December 2018 and 31 December 2017. As defined in the Article 278 of the Credit Institutions Act, this company does not meet the conditions for consolidation within the Karlovačka banka d.d. Group. Accordingly, the Bank is not obliged to include the stated company in the report of the group of credit institutions which it submits to the Croatian National Bank pursuant to the Article 163, Paragraph 1, Item 1 of the said Act. Therefore, the Bank did not prepare consolidated financial statements.

However, the Bank applies International Financial Reporting Standards as a framework for the preparation of financial statements. In accordance with the International Financial Reporting Standard IFRS 10 - Consolidated Financial Statements, the Bank is required to prepare consolidated financial statements in case of controlling a subsidiary. We were unable to determine with certainty the effects that the consolidation of the said company would have on the consolidated financial statements of the Bank.

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

INDEPENDENT AUDITOR'S REPORT – continued**Report on the Audit of the Annual Financial Statements - continued****Highlighting issues**

We refer to Note 33 that states court proceedings referring to the Bank.

In a group of cases in which the Bank has been sued there are two proceedings standing out that are initiated by the Bank's shareholders to challenge the decisions of two General Assembly Meetings held on 10 February 2014 and 2 July 2014 respectively: the decision to reduce the share capital (HRK 92,642 thousand), the decision to exclude the priority right to subscribe for new shares, the decision to increase the share capital (HRK 72,734 thousand and HRK 40,000 thousand) and the decision on partial change of the Statute of the Bank.

In one case, a final verdict was issued in favour of the plaintiff against which the Bank submitted a revision to the Supreme Court of the Republic of Croatia as an extraordinary legal remedy. The Bank is undertaking all available legal actions to protect the interest of the Bank and of other shareholders. It is not possible to assess with certainty the duration and the outcome of these proceedings.

Our opinion has not been modified in this regard.

Key audit matters

Key Audit Matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements of the current period. These matters were addressed in the context of our audit of the annual financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters. Except matters described in the basis for qualified opinion section and the Key audit matters section, we have determined that the issues below will be the key audit matters we need to report in our independent auditor's report.

Key audit matter	How the audit addressed the key audit matter
<p><u>Impairments and provisions for loans and advances to customers</u></p> <p>We refer to Notes 3.9. and 3.18. containing policies for recognition and subsequent valuation of financial assets as well as accounting estimates and judgments in the accounting policies applied, Note 14 and 24 to the financial statements which show provision costs and exposure of the Bank in terms of granted loans and advances and Note 44 which displays the Bank's total exposure to credit risk.</p> <p>In the Statement of financial position (balance sheet) at 31 December 2018 the net value of loans and advances to customers is shown in the amount of HRK 1,111,223 thousand which represents 49% of the total assets of the Bank. Value adjustments amount to HRK 131,036 thousand which represents 5.8% of the Bank's total assets. The estimate of the amount of losses and provisions includes significant estimates and assumptions of the Bank's management.</p>	<p>During the audit we have gained understanding of the Bank's processes related to performed impairments and estimation of provisions by:</p> <ul style="list-style-type: none"> - carrying out audit procedures to ensure the existence and effectiveness of internal controls in the process of granting loans, monitoring loan repayments, determining loan losses, - analyzing the adopted model of estimation and calculation of impairment losses by the Bank, with additional clarification of the process by talking to key personnel in the Bank. <p>We have tested the application of the valuation model to a selected sample of loans of higher individual values in relation to the set criteria: the debtor's timeliness in meeting their obligations towards the Bank, the debtor's financial position, the quality and value of the collateral and the estimate of the time in which the collateral is to be realized when calculating the provision. We have analyzed the calculation of the provisions and the bookkeeping of impairments and provisions.</p>

INDEPENDENT AUDITOR'S REPORT – continued**Report on the Audit of the Annual Financial Statements - continued****Key audit matters - continued**

Key audit matter	How the audit addressed the key audit matter
<p>The level of adjustments depends on the estimate of time and amount of future cash flows, the assumption of the borrower's financial position, the valuation of collateral, the assumption of the time in which the collateral is to be realized and so on.</p> <p>Impairments and value adjustments are recognized on the basis of incurred loan losses and on the basis of expected loan losses.</p> <p>Estimate of impairment losses in the loan portfolio is performed according to the Bank's adopted methodology based on the effective IFRSs and the Croatian National Bank's regulation – Decision on the classification of exposure and the method of determining loan losses (Official Gazette No. 114/2017).</p> <p>Impairments of loans are considered a key audit matter due to the complexity of appraisal process and the significant involvement of key management's judgement when assessing losses.</p>	<p>In addition, the Bank monitors and identifies loan losses in the portfolio of small loans.</p> <p>Exposures from the portfolio of small loans not secured by adequate collateral are evaluated solely on the basis of timeliness in settling liabilities towards the Bank. If there are adequate insurance instruments, the assessment of loan losses is based on two criteria: the debtor's timeliness in meeting their obligations and monitoring the value and the viability of the collateral.</p> <p>We have analyzed and tested the established system for monitoring the number of days from maturity to settlement of liabilities towards the Bank as well as the collateral valuation system to the selected sample of these loans.</p> <p>In accordance with IFRS 9 – Financial instruments and in addition to calculating provisions for incurred loan losses, the Bank has introduced a model for impairment of financial assets and recognition of expected loan losses.</p> <p>The Bank calculates expected loan losses on the basis of an internally developed model based on IFRS 9 – Financial instruments and the CNB's regulation – Decision on classification of exposure and the method of determining loan losses.</p> <p>We have analyzed the established model and the adopted methodology for impairment and provisions that the Bank has carried out on these exposures.</p>

INDEPENDENT AUDITOR'S REPORT – continued
Report on the Audit of the Annual Financial Statements - continued

Other information in the Annual Financial Statements

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

Our opinion on the annual financial statements does not cover the other information, except to the extent expressly stated in the section of our Independent Auditor's Report entitled Report on other legal requirements and we do not express any form of conclusion by expressing our beliefs.

In connection with our audit of the annual financial statements, our responsibility is to read the other information and, in doing so, to consider whether the other information is materially inconsistent with the annual financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, then we are required to report that fact. In this regard, we refer to the matter described in the section of basis for qualified opinion and the impact of the said matter on the same items in the report of the management board.

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

Management is responsible for the preparation of the annual financial statements which give true and fair presentation in accordance with IFRSs as established by the European Commission and published in the official gazette of the European Union and for such internal control as management determines is necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

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

Those charged with governance are responsible for overseeing the financial reporting process established by the Bank.

Auditor's Responsibilities for the Audit of the Annual Financial Statements

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an independent 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 annual financial statements.

INDEPENDENT AUDITOR'S REPORT – continued

Report on the Audit of the Annual Financial Statements - continued

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

- Identify and assess the risks of material misstatement of the annual 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 controls.
- Obtain an understanding of internal controls relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, conclude whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern.

If we conclude that a material uncertainty exists, we are required to draw attention in our independent auditor's report to the related disclosures in the annual 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 independent auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the annual financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

INDEPENDENT AUDITOR'S REPORT – continued

Report on other legal requirements

Report based on the requirements of the Regulation (EU) No. 537/2014

1. We were appointed by the General Assembly of the Bank on 21 June 2018 to perform audit of annual financial statements for 2018.
2. Our uninterrupted engagement has lasted 1 year and covers the period ended 31 December 2018.
3. In addition to the issues we included in our independent auditor's report as a key audit matter within the Report on the Audit of the Annual Financial Statements, we have nothing to report in relation to the point (c) of the Article 10 of the Regulation (EU) No. 537/2014.
4. With our statutory audit of the annual financial statements of the Bank for 2018 we are able to detect irregularities, including fraud under Section 225, *Response to non-compliance with the law and regulations* of the IESBA Code of conduct which requires that during the audit we observe whether the Bank has complied with the laws and regulations which are generally recognized to have a direct impact on the determination of significant amounts and disclosures in their annual financial statements as well as other laws and regulations that do not have a direct impact on the determination of significant amounts and disclosures in its annual financial statements but the observance of which may be crucial for the operational aspects of the Bank's business, its ability to continue as a going concern or to avoid significant penalties.
Except in the event that we encounter or know about non-compliance with any of the aforementioned laws or regulations that is obviously insignificant, in our judgement of its content and impact, whether financial or otherwise for the Bank, its shareholders and the general public, we are obliged to notify the Bank and seek to investigate such case and take appropriate measures to resolve the irregularities and to prevent the occurrence of these irregularities in the future. If as at the audited balance sheet date the Bank fails to correct the irregularities that formed incorrect displays in the audited annual financial reports and which are cumulatively equal to or greater than the amount of significance for the financial statements as a whole, we are then required to modify our opinion in the independent auditor's report.
5. Our audit opinion is consistent with an additional report to the Bank's Risk and Audit Board drawn up in accordance with the provisions of the Article 11 of the Regulation (EU) No. 537/2014.
6. During the period between the initial date of the audited annual financial statements of the Bank for the year 2018 and the date of this report, we did not provide the Bank with prohibited non-audit services and in the business year prior to the aforementioned period we did not provide services for the design and implementation of internal control or risk management processes related to preparation and/or control of financial information or the design and implementation of technological systems for financial information and during the course of the audit we have maintained independence in relation to the Bank.
7. There were no other services, in addition to the statutory audit, which we provided to the Bank.

INDEPENDENT AUDITOR'S REPORT – continued**Report based on the requirements of the Accounting Act**

1. In our opinion, based on the work we performed during the audit, the information contained in the accompanying Report of the Management Board of the Bank for 2018 is in line with the accompanying annual financial statements of the Bank for 2018.
2. In our opinion, based on the work we performed during the audit, the accompanying Report of the Management Board of the Bank for 2018 has been prepared in accordance with the Accounting Act.
3. Based on the knowledge and understanding of the Bank's operations and its environment acquired in the course of the audit, except for the impact of the matter stated in the basis for qualified opinion paragraph, we have not found that there are significant misstatements in the accompanying Report of the Management Board of the Bank.
4. In our opinion, based on the work we have performed during the audit, the statement of application of the corporate governance code which is included in the annual financial statements of the Bank for 2018, is in accordance with the requirements set out in the Article 22, paragraph 1, items 3 and 4 of the Accounting Act.
5. The statement of application of the corporate governance code which is included in the annual financial statements of the Bank for 2018 includes information from the Article 22, paragraph 1, items 2, 5, 6 and 7 of the Accounting Act.

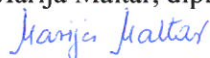
Other legal and regulatory requirements

Pursuant to the Decision on the Structure and Content of Annual Financial Statements of Credit Institutions (Official Gazette No. 42/2018), (hereinafter: 'the Decision'), the Management Board of Karlovačka banka d.d. has prepared the forms as presented on pages 110 to 124, which comprise the Balance Sheet of the Bank as at 31 December 2018, the Income Statement, the Statement of other comprehensive income, the Statement of changes in equity and the Cash flow Statement of the Bank for the year then ended, as well as information on the reconciliation to the financial statements of the Bank. Preparation of these forms and information on the reconciliation is the responsibility of the Management Board and they do not represent components of these financial statements but rather a requirement specified by the Decision.

The financial information provided in the forms has been derived correctly from the financial statements of the Bank.

The engagement partner on the audit resulting in this independent auditor's report is Marija Maltar.

Certified auditor:
Marija Maltar, dipl. oec.

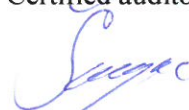


Varaždin 22 February 2019

HLB Revidicon d.o.o.
Ankice Opolski 2
42000 Varaždin
Republika Hrvatska



Director:
Stjepan Šargač, dipl. oec.
Certified auditor



KARLOVAČKA BANKA d.d.
INCOME STATEMENT AND STATEMENT OF OTHER COMPREHENSIVE INCOME
For the year ended 31 December 2018

Description	Note	2018. HRK '000	2017. HRK '000
Interest income	4	71.655	76.574
Interest expense	5	(13.386)	(19.847)
Net interest income		58.269	56.727
Fees and commissions income	6	23.103	24.279
Fees and commissions expenses	7	(6.904)	(7.288)
Net income from fees and commissions		16.199	16.991
Profit from financial activities	8	4.758	9.095
Net foreign exchange gains	9	(87)	(185)
Other income	10	2.102	7.606
Total other income		6.773	16.516
General administrative and other operating expenses	11,12,13	(56.108)	(54.915)
Impairments and provisions	14	(11.964)	(27.651)
Total other expenses		(68.072)	(82.566)
Profit before tax		13.169	(6.076)
Income tax	15	-	-
Profit/ (loss) for the year		13.169	7.669
Profit/(loss) per share in HRK	16	0,75	0,44
Other comprehensive profit / (loss): <i>To be reclassified into income statement</i>			
Unrealized gain from valuation of financial assets available for sale		-	3.374
Other comprehensive profit (loss) for the year, net of tax		-	3.374
TOTAL COMPREHENSIVE PROFIT/(LOSS)		13.169	11.043
Profit/(loss) per share in HRK	16	0,75	0,63

Significant accounting policies and other notes set out on pages 38 to 108 form an integral part of these financial statements.

KARLOVAČKA BANKA d.d.
STATEMENT OF FINANCIAL POSITION
As at 31 December 2018

Description	Note	31.12.2018. HRK '000	31.12.2017. HRK '000
ASSETS			
Cash	18	405.447	317.517
Receivables from the Croatian National Bank	19	157.390	147.517
Placements with banks	20	41.014	32.400
Financial assets through other comprehensive profit	21	150	13.224
Financial assets at amortized cost	22	219.595	153.590
Financial assets at fair value through profit or loss (FOB and FOP)	23	214.650	276.924
Loans and prepayments to customers	24	1.111.223	1.118.783
Investments in subsidiaries	3.10	0	0
Property, plant and equipment	25	40.877	44.229
Intangible assets	26	264	826
Foreclosed assets	27	59.342	66.480
Other assets	28	11.842	9.883
Total assets		2.261.794	2.181.373
LIABILITIES			
Liabilities to banks		43	1
Demand deposits	29	911.973	746.617
Term deposits	30	1.105.567	1.190.310
Loan liabilities	31	5.795	8.558
Other liabilities	32	20.771	33.253
Provisions	33	7.682	7.112
Hybrid instruments	34	53.802	54.162
Total liabilities		2.105.633	2.040.013
CAPITAL			
Share capital	35	176.678	176.678
Reserves of financial assets available for sale		-	-
Profit /(Loss) for the year		13.169	7.669
Transferred loss		(33.686)	(42.987)
Total capital		156.161	141.360
Total liabilities and capital		2.261.794	2.181.373

Significant accounting policies and other notes set out on pages 38 to 108 form an integral part of these financial statements.

KARLOVAČKA BANKA d.d.
STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2018

Description	Share capital	Own shares	Fair value reserves of		Reserves				Profit for the year	Total
			assets through other comp.profit	Capital gain	Retained profit/Transferred loss					
					Legal reserves	Other reserves				
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance as at 31 December 2016	176.678	0	(3.374)	0	0	0	(37.517)	(6.076)	129.712	
Profit allocation	0	0	0	0	0	0	(6.076)	6.076	0	0
Increase in share capital	0	0	0	0	0	0	0	0	0	0
Other changes	0	0	0	0	0	0	605	0	605	0
Other comprehensive income	0	0	3.374	0	0	0	0	0	3.374	0
Loss for the period	0	0	0	0	0	0	0	7.669	7.669	0
Balance as at 31 December 2017	176.678	0	0	0	0	0	(42.987)	7.669	141.360	
Profit allocation	0	0	0	0	0	0	7.669	(7.669)	0	0
Increase in share capital	0	0	0	0	0	0	0	0	0	0
Decrease in share capital	0	0	0	0	0	0	0	0	0	0
Other changes	0	0	0	0	0	0	1.632	0	1.632	0
Other comprehensive income	0	0	0	0	0	0	0	0	0	0
Profit for the period	0	0	0	0	0	0	0	13.169	13.169	0
Balance as at 31 December 2018	176.678	0	0	0	0	0	(33.686)	13.169	156.161	

Significant accounting policies and other notes set out on pages 38 to 108 form an integral part of these financial statements.

KARLOVAČKA BANKA d.d.
CASH FLOW STATEMENTS - INDIRECT METHOD
For the year ended 31 December 2018

Description	2018. HRK'000	2017. HRK '000
NET CASH FLOW FROM OPERATING ACTIVITIES		
(Loss) before tax	13.169	7.669
<i>Adjustment to net cash assets from operating activities</i>		
Depreciation	4.418	3.854
Loan impairments	11.218	11.742
Impairments of other assets	592	(129)
Provisions for court disputes and employees	789	1.701
Impairments of property, plant and equipment and foreclosed assets	1.808	9.395
Other impairments and provisions (net)	(2.443)	4.941
<i>Changes in assets and liabilities from operating activities</i>		
(Increase) / Decrease in receivables from CNB	(10.019)	(11.954)
(Increase) in placements with banks	(3.841)	(7.518)
(Increase) in loans and prepayments to customers	(3.657)	(43.059)
Decrease in financial assets through other comprehensive income	16.574	73.868
(Increase) in financial assets at amortized cost	(4.222)	(15.504)
Decrease / (Increase) in financial assets at fair value through profit or loss	62.274	74.980
(Increase) in other assets	(2.552)	(4.822)
Increase in liabilities to financial institutions	42	-
Increase in demand deposits	165.356	96.742
Increase / (Decrease) in term deposits	(84.743)	(42.656)
(Decrease)/increase in other liabilities	(13.274)	9.821
Net cash flow from operating activities	151.489	169.071
CASH FLOW FROM INVESTING ACTIVITIES		
Acquisition of property, plant and equipment and intangible assets	(4.980)	(3.428)
Decrease in foreclosed assets	5.330	5.105
Purchasing financial assets at amortized cost	(62.103)	(102.065)
Other changes	4.475	(432)
Net cash flow from investing activities	(57.278)	(4.652)
CASH FLOW FROM FINANCIAL ACTIVITIES		
(Decrease) in loan liabilities	(2.763)	(43.351)
Other changes in capital (net)	1.632	605
(Decrease) in hybrid instruments	(360)	(424)
Increase in hybrid instruments	-	10.519
Net cash flow from financial activities	(1.491)	(33.651)
Net change in cash and cash equivalents	92.720	34.600
Cash and cash equivalents at year beginning (Note 37)	337.786	303.186
Cash and cash equivalents at year end (Note 37)	430.506	337.786

Significant accounting policies and other notes set out on pages 38 to 108 form an integral part of these financial statements.

I GENERAL INFORMATION

1.1. Legal framework and activities

Karlovačka banka d.d. Karlovac ("the Bank") is a joint stock company established by the Decision of the General Assembly in 1989. The Bank was registered at the Commercial Court in Zagreb, Permanent Office in Karlovac under registration number MBS 020000334 (OIB/PIN 08106331075). The Bank's headquarters is located in Karlovac, Ivana Gorana Kovačića 1.

The principal activities of the Bank include receiving deposits and other repayable funds, granting credits and loans and issuing guarantees and other bank warranties.

The Bank's share capital as at 31 December 2018 amounted to HRK 176,678 and is divided into 17,570,409 shares, of which 17,559,585 are ordinary shares with a nominal value of HRK 10 and 10,824 are preferred shares with a nominal value of HRK 100. Out of the ordinary shares, 1,328,233 shares are listed on the Zagreb Stock Exchange.

The Bank's shareholders as at 31 December 2018 i 31 December 2017 were:

Shareholder	31.12.2018.	31.12.2017.
	%	%
Marko Vuković	37,56	37,56
Ivan Žabčić	37,56	37,56
Zagreb Archdiocese-Archdiocesan See	7,69	7,69
Marijan Šarić	4,01	4,01
Pinjuh Jakov	1,75	1,75
Stanić Miro	1,75	1,75
Sandi Šola	1,66	1,66
Guerrero Devlahovic Jaime Ivan	0,65	0,65
Čakalo Milenko	0,48	0,48
Rupena Ivan	0,48	0,48
Projekt Mejaši	0,34	0,34
Croatian Veterans' Fund	0,31	0,31
Croatian Handball Association	0,32	0,32
Dario Šimić	0,30	0,30
Other shareholders	5,14	5,14
TOTAL	100,00	100,00

1.2. Management Bodies of the Bank

The Bank's management bodies are: the General Assembly, the Supervisory Board and the Management Board.

As at 31 December 2018 the Bank's management bodies were:

GENERAL ASSEMBLY

Nedjeljko Strikić President since 2 July 2014

SUPERVISORY BOARD

Nedjeljko Strikić President since 16 February 2018
 Bernarda Ivšić Deputy president since 16 February 2018
 Željko Tintor Member since 16 February 2018
 Ana Kirinčić Member since 16 February 2018
 Mato Crkvenac Member since 16 February 2018

MANAGEMENT BOARD

Željka Surač President since 6 March 2015
 Marino Rade Member since 22 April 2014
 Ljiljana Movre Member since 1 September 2017

The President and Members of the Management Board represent the Bank individually and independently.

The Bank's operations are managed by the Management Board.

As at 31 December 2018 the Bank employed 169 employees (31 December 2017: 177). The qualification structure of employees as at 31 December 2018 and 31 December 2017 was as follows:

DESCRIPTION	Number of employees	Number of employees
	31.12.2018.	31.12.2017.
PhD	1	1
Master's degree	2	2
University degree	71	69
College degree	13	16
Secondary school education	82	89
TOTAL	169	177

As at 31 December 2018 the Bank operated through the Central Office in Karlovac, branches in Zagreb and Rijeka and 10 sub-branches and one office: Central Office, Vladka Mačeka with office in Draganići and Tržnica located in Karlovac and also in the following cities: Jastrebarsko, Duga Resa, Ogulin, Ozalj, Slunj, Žakanje and Topusko.

II BASIS FOR PREPARATION OF THE FINANCIAL STATEMENTS

2.1. Statement of compliance

Financial statements of Karlovačka banka d.d. Karlovac have been prepared in accordance with International Financial Reporting Standards ("IFRS") as established by the European Commission and published in the official gazette of the European Union as well as specific legal requirements for accounting of banks in the Republic of Croatia. Banking operations in Croatia are regulated by the Credit Institutions Act, in accordance with which financial reporting is prescribed by the Croatian National Bank ("the CNB").

The accounting regulations of the CNB are based on "IFRSs". Main differences between the accounting regulations of the CNB and IFRSs are the following:

- The Croatian National Bank prescribes the recognition of future impairment losses on exposures classified in risk groups A-1 and A-2 for the year 2018 to a level not less than 0.8% of the gross book value of exposure in these risk subgroups, except for financial assets that are measured at fair value through other comprehensive income. IFRSs do not prescribe the minimum amount of losses. In 2018 the Bank recognized provisions for expected losses on this basis in the amount of HRK 17,202 thousand, representing 0.80% of the gross amount of gross exposure in the risk group A, income from termination of provision in the amount of HRK 557 thousand. The Bank considers the amounts as determined by its own estimation methodology, regardless of CNB regulation, to reflect estimated future loan losses. Additionally, the CNB prescribes minimum amounts of impairment provision for secured placements depending on the time in the default status, while in accordance with the IFRS reporting framework, impairments do not necessarily have to follow the amount and the trend stated by the Decision on the classification.
- The next difference between the IFRSs and accounting rules of CNB relates to provisions for passive legal disputes. According to the 'Decision on obligatory provisioning for passive legal disputes against a credit institution', the Bank is obliged to ensure funds for court disputes for which there is no loss of risk or for which a cash outflow is estimated to be less than 10% of the total amount, if the total amount of court dispute exceeds 0.1% of the assets of the credit institution according to the audited financial statements for the previous year. The provision is made in the amount of estimated cash outflow and at least 1% of the total amount of the court dispute, whereas according to IFRS in such a situation the provision is not necessary to be recognized. On 31 December 2018 the Bank has such provisions for one dispute in the amount of HRK 24 thousand.

Basis for preparation:

Financial statements have been prepared on the basis of fair value for financial assets classified in the valuation portfolio through other comprehensive income as well as financial assets valued at fair value through profit or loss. Other financial assets and liabilities and non-financial assets and liabilities are stated at depreciated or historical cost.

The preparation of financial statements requires Management Board to make estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosure of contingent liabilities at the balance sheet date as well as reported amounts of revenues and expenses and other comprehensive income during the reporting period. Estimates and related assumptions are based on historical experience and various other factors that are believed to be realistic in the current circumstances and information available at the financial position date, the result of which makes the basis for estimating book value of assets and liabilities not directly visible from other sources. Actual results may differ from those estimates.

II BASIS FOR PREPARATION OF THE FINANCIAL STATEMENTS - continued

The key assumptions and estimates are regularly reviewed. Changes to estimates are recognized in the period in which they occur if they exclusively impact that period, or in the period in which they occur or future period if they affect the current or future period.

Key estimates used by the application of accounting policies during preparation of the financial statements relate to depreciation calculation of long-term tangible and intangible property, value decrease of property, value decrease of receivables and provisions for court disputes and other losses and the disclosure of potential liabilities.

III SUMMARY OF ACCOUNTING POLICIES

3.1. Changes in accounting policies

Adoption of new and revised International Financial Reporting Standards

Standards and changes effective in the current period

In the current tax period the following amendments to the existing standards and new interpretations published by the International Accounting Standards Board are in force and are adopted by the European Union:

- Annual improvements from the 2014-2016 cycle deriving from IFRS Annual Compensation Project (IFRS 1, IFRS 12 and IAS 28), primarily for the elimination of discrepancies and clarification of the text, adopted in the European Union on 8 February 2018 (amendments to IFRS 12 are applied to annual periods beginning on or after 1 January 2017 and amendments to IFRS 1 and IFRS 28 are applied to annual periods beginning on or after 1 January 2018).
- IFRS 15 Revenue from contracts with customers – IFRS 15 was issued in May 2014 and represents a new five step model for revenue from customer contracts. The standard replaces IAS 11 and IAS 18. The standard is effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted. The Standard allows for modified transition model that requires no retroactive conversion. The Management Board conducts detailed analysis of possible effects of this standard on the Bank's financial statements.
- Amendments to IFRS 4 Insurance contracts, effective for annual periods beginning on January 2018 or in the year of first application of IFRS 9.
- **Amendments to IFRS 2 Share based payment** – "Classification and measurement of share based payment transactions" (effective for annual periods beginning on or after 1 January 2018).
- **Amendments to IAS 40 Investment property** – "Transfer of property investment" (effective for annual periods beginning on or after 1 January 2018).

The application of above standards had no impact on the Bank's financial statements for 2018.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.1. Changes in accounting policies - continued

- By means of EU Commission Regulation no. 1126/2008 of 22 November 2016 on the adoption of certain international accounting standards in accordance with EUR Regulation no. 1606/2002 of the European Parliament and of the Council, the European Commission adopted a new IFRS 9 – Financial instruments with application to the financial statements starting from 1 January 2018 and thereafter.
- The adoption of the new IFRS 9 consequently included changes in accounting standards (IAS) 1, IAS 2, IAS 8, IAS 10, IAS 12, IAS 20, IAS 21, IAS 23, IAS 28, IAS 32, IAS 33, IAS 36, IAS 37, IAS 39, IFRS 1, IFRS 2, IFRS 3, IFRS 4, IFRS 5, IFRS 7, IFRS 13, Interpretations of the IFRS Interpretations Committee (IFRSIC) 2, IFRSIC 5, IFRSIC 10, IFRSIC 12, IFRSIC 16, IFRSIC 19 and Interpretations of the Standing Interpretations Committee (SIC) 27, to ensure compliance with international accounting standards. Furthermore, IFRS 9 is put out of force IFRSIC 9.

IFRS 9 is applied retroactively in accordance with IAS 8 – Accounting policies, changes in accounting estimates and errors. The change in the standard influenced the change in the estimation model and the calculation of loan losses.

The underlying difference in valuation under IFRS 9 in relation to IAS 39 is the recognition of fair value of financial assets by recognizing expected future losses. Following the above mentioned, the Bank has applied a valuation model to estimate the probability of future losses arising over a period of up to one year or a full term of the financial instrument.

In accordance with IFRS 9, exposures are divided into three stages: Stage 3 comprises exposures in the status of default, Stage 2 comprises exposures in the status of significant increase in credit risk and the Stage 1 comprises all other exposures.

Analysis of financial assets valuation on 1 January 2018 according to the new IFRS 9, in respect of IAS 39, showed impairment losses of HRK 1.632 thousand; a correction was made in the Bank's accounting records on 1 January 2018 – by reducing the transferred losses within the capital and corrections of value adjustments of loans and receivables, financial assets through profit or loss, off-balance sheet provisions.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.1. Changes in accounting policies - continued

The effects of the introduction of IFRS 9 and risk-based valuation differences in relation to IAS 9 are shown below:

31.12.2017.			01.01.2018.			
Class	Base	Provisions	Stage	Class	Base	Provisions
AA	1.941.034	19.410	Stage 1	A1	1.950.025	13.102
			Stage 2	A2		4.677
B1	61.732	6.979	Stage 3	B1	61.732	6.979
B2	40.684	21.568		B2	40.684	21.569
B3	96.525	74.302		B3	96.525	74.302
CC	32.077	32.077		CC	32.077	32.077
	2.172.053	154.338			2.181.043	152.706

HRK
000

Standards, interpretations and amendments adopted by IASB that have not yet entered into force in the EU

On the date of approval of the financial statements, the following new or revised standards and interpretations have been issued but not yet effective for the year ended 31 December 2018.

- IFRS 16 "Leases" – the standard introduces a new comprehensive model of lease identification as well as their accounting treatment on the part of the lessor and the lessee. The said standard replaces the current IAS 17 and interpretations IFRIC 4, SIC 15 and SIC 27. IFRS 16 is effective for periods beginning on or after 1 January 2019. Earlier application is allowed. This standard brings significant changes to the accounting model of the lessee. Consequently, recognition of assets and liabilities in the financial statements of the lessee will be done for most contracts currently recognized as operating leases. This will result in an increase in the Bank's assets and liabilities.
- **IFRS 14 'Regulatory deferral accounts'** (effective for annual periods beginning on or after 1 January 2016) – The European Commission decided to postpone the adoption of this transitional standard until the publication of its final version,
- **IFRS 17 'Insurance contracts'** (effective for annual periods beginning on or after 1 January 2021),
- **Amendments to IFRS 9 'Financial instruments'** – "Advances with negative compensation" (effective for annual periods beginning on or after 1 January 2019)
- **Amendments to IFRS 10 'Consolidated financial statements' and IAS 28 'Investments in associates and joint ventures'** – "Sale or investment of assets between the investor and its affiliated entity or joint venture" and subsequent changes (the initial date of entry into force was delayed until the completion of the research project on the application of the share method),

III SUMMARY OF ACCOUNTING POLICIES – continued

3.1. Changes in accounting policies - continued

- **Amendments to IAS 19 'Employee benefits'** entitled "Amendments, deduction of rights and payout from benefit plans" (in effect for annual periods beginning on or after 1 January 2019),
- **Amendments to IAS 28 'Investments in associates and joint ventures'** – "Long-term investments in associates and joint ventures" (in effect for annual periods beginning on or after 1 January 2019),
- **Amendments to various standards entitled 'Adjustment of IFRSs from the 2015-2017 cycle'**, resulted from annual adjustment of IFRSs (IFRS 3, IFRS 11, IAS 12 and IAS 23), primarily for the purpose of eliminating discrepancies and explaining the text (in effect for annual periods beginning on or after 1 January 2019),
- **Interpretation of IFRIC 22 'Foreign currency transactions and advance consideration'** (in effect for annual periods beginning on or after 1 January 2018),
- **Interpretation of IFRIC 23 'Uncertainty over income tax treatments'** (in effect for annual periods beginning on or after 1 January 2019).

The Bank's Management Board anticipates that the adoption of stated standards, amendments and interpretations will have no material impact on the financial statements in the period of their initial application.

3.2. Interest income and expenses

Interest income and expenses are recognized in the income statement as they occur for all interest-bearing financial instruments, including those measured at depreciated cost and at fair value, using the effective interest rate method. The effective interest rate method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

Claims on interest income accrued for exposures in risk categories A1, A2 and B1 are recorded within the Bank's balance accounts.

For claims on interest rates of exposures classified in the risk category B1, with the recording of income, an adjustment of the receivables at 100% is made at the same time within the balance sheet positions.

The effective interest rate is the rate that discounts estimated future cash payments or receipts over the expected life of the financial instrument.

When loan repayment becomes doubtful, the principal amount is decreased to its recoverable amount and interest income is excluded from the income statement, and is subsequently recognized as collected excluded receivables only in the case of actual collection after the collection of the principal.

Interest income related to loan fees included in the calculation of effective interest rate is recognized only for loans with a maturity term of up to one year, while for long-term placements it is accrued to the entire lifetime of placements charge.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.3. Fee and commission income and expenses

Fee and commission income and expenses comprise fees and commissions from domestic and international payment transactions, guarantees, letters of credit, card business and assets management, and are recognized in the income statement when the corresponding service is provided, except when they are included in effective interest rate calculation.

Fees and commissions expenses comprise fees to the authorized banks for executed foreign payment transactions and for the services of the Financial Agency (FINA) and the Croatian National Bank for domestic payment and card transactions.

3.4. Net gains and losses from financial instruments at fair value through profit or loss and the result of foreign exchange trading and exchange rate differences arising on translation of monetary assets and liabilities

This category includes earnings from foreign currency trading, realized and unrealized gains and losses from debt and equity securities held for trading, other financial instruments carried at fair value through profit or loss and derivative financial instruments.

3.5. Foreign currency translation

Transactions in foreign currencies are translated into HRK (Croatian Kuna) at the exchange rate ruling at the date of the transaction. The Croatian Kuna is the official currency of the Bank and the financial statements are presented in that currency.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to HRK at the middle foreign exchange rate of the CNB ruling at that date. Foreign exchange differences arising on translation are recognized in the income statement.

Non-monetary items denominated in foreign currencies valued at fair value are translated to HRK using the exchange rates at the date when the fair value is determined. Non-monetary items in foreign currency valued at cost are to be stated using the exchange rates at the dates of the transaction.

Gains and losses arising on translation and foreign currency trading are recognized in the income statement for the related year.

3.6. Cash and cash equivalents

Cash and cash equivalents include highly liquid assets as defined within the cash flow policy.

Cash comprises cash and funds in bank accounts.

Cash includes cash in cash registers in domestic and foreign currency.

Funds in bank accounts include: funds in transaction accounts with the Central bank and with domestic and foreign banks in domestic and foreign currency.

Cash equivalents comprise placements with banks with maturity of up to 90 days.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.7. Taxation

Income tax is the cumulative amount of the current tax liability and deferred tax.

a) Current tax

Current tax liability is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement for amounts not included in the tax base as well as the amounts of non-deductible expenses. The Bank's current tax liability is calculated using tax rates that are effective, i.e. valid at the balance sheet date.

The Management Board periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation.

b) Deferred tax

Deferred tax is calculated using the liability method and presents tax effects on all significant differences between the tax base, assets and liabilities and the amounts expressed in the financial statements. Deferred tax assets and liabilities are measured at the tax rates that are expected to be applied in the period when the property will be recovered or the liability settled, based on tax rates and tax laws that are effective or partially applicable at the financial position reporting date.

Deferred tax assets are recognized up to the amount of future taxable profit that is likely to be available to utilize temporary differences.

3.8. Employment benefits

Defined contribution schemes

The Bank pays contributions for defined contribution schemes on compulsory contractual basis. Once the defined contribution is paid, the Bank has no further obligations. Contributions are recognized as cost of employees when occurred.

The Bank has no other retirement arrangements separate from the state pension system of the Republic of Croatia.

Severance payments

Termination benefits are recognized as an expense when the Bank is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan either to terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised if the Bank has made an offer of voluntary redundancy, it is probable that the offer will be accepted and the number of acceptances can be estimated

Jubilee awards

The Bank pays its employees certain benefits for long service (jubilee awards). Jubilee award amounts from HRK 1,500 to HRK 5,000 net for continuous work in the bank from 10 to 40 years of interrupted work. The decision on payments is made individually for each tax period.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.9. Financial instruments

Financial assets of the Bank are classified into portfolios based on the Bank's intention at the time of the acquisition of a financial instrument and in accordance with the Bank's investment strategy. Financial assets and financial liabilities are classified into the following categories: 'at fair value through income statement', 'at depreciated value', 'at fair value through other comprehensive income', 'loans and receivables' and 'other financial liabilities'.

All financial assets and liabilities are recognized or derecognized at the settlement date when ownership has been transferred and the sale itself is recorded in the books as at the contracted transaction date.

At initial recognition of a financial asset or a financial liability, the Bank measures the asset or the liability at fair value increased by transaction cost (excluding financial assets at fair value through income statement) which are directly attributable to the acquisition or issue of the financial asset or liability.

Classification and measurement of financial assets according to the new IFRS 9

New IFRS 9 – Financial instruments has introduced a new approach to the classification of financial assets according to the characteristics of cash flow and the business model in which the asset is held. The Bank recognizes financial assets in portfolios valued at:

- depreciated cost
- fair value through the income statement
- fair value through other comprehensive income

Depending on the chosen business model based on contracted cash flows.

Impairment

IFRS 9 has introduced a model for impairment of financial assets and recognition of loan losses by recognizing expected future losses instead of the previously applied model of the resulting loss, estimating probability of future losses in a period of up to one year or the entire duration of the financial instrument.

According to IFRS 9 exposures are divided into three Stages, whereby:

Stage 1 (risk group A/1) comprises exposures with undetermined evidence of impairment and absence of significant credit risk increase in relation to the recognition date of the financial asset.

In this category, future losses are calculated for a period of up to one year.

Stage 2 (risk group A/2) comprises exposures with undetermined evidence of impairment but there is a significant increase in credit risk in relation to the recognition date of the financial asset.

In this category, future losses are calculated for the entire duration of the financial instrument.

Stage 3 (risk groups B and C) comprises exposures for which there is objective evidence of impairment or that are in the status of default.

The Bank calculated expected credit losses on the basis of an internally developed model (Stage 1, Stage 2).

III SUMMARY OF ACCOUNTING POLICIES – continued

3.9. Financial instruments – continued

For assets that the Bank identified credit losses (Stage 3 – risk groups B and C), the Bank has maintained the existing methodology for calculating and estimating credit losses.

Depending on the selected business model and the classification of financial assets and based on contracted cash flows, the Bank measures the financial assets as follows:

a) Loans and advances measured at depreciated cost

This type of property includes all loans granted by the Bank, deposits, payments under guarantees and other warranties if they are classified in accordance with IFRS 9 into assets held for collection of contracted cash flows and are measured at depreciated cost, as well as paid advances and related interest determined by contracts or by the Bank's decisions.

Each individual is recognized at the time of the payment to the recipient of the asset referred to in the preceding paragraph.

Loans and advances represent financial assets held by the bank for the payment of contracted cash flows on principal and interest.

These investments are measured at cost initially and at depreciation cost subsequently using the effective interest rate method, subject to impairment testing due to expected loan losses.

Value adjustment for expected losses is determined and formed in accordance with the arrangement of financial assets in certain risk groups.

In case there is no objective evidence of impairment or there is no increase in credit risk in relation to the recognition date, the asset is allocated to the risk group A1.

If there is no objective evidence of impairment but there has been a significant increase in credit risk in relation to the date of recognition of the financial asset, the asset is allocated to the risk group A2.

When there is a realistic likelihood that the Bank will not be able to collect all the amounts claimed or there is evidence of impairment of the financial asset, the asset is allocated to partially recoverable assets, i.e. risk groups B to C, in accordance with the Rules on the classification of exposures into risk groups and the method of determining loan losses of Karlovačka banka d.d.

b) Securities and other financial instruments valued at fair value through Income statement

This portfolio includes securities which are aimed at collecting contracted cash flows and at sales.

These instruments are not actively traded, except for the purpose of risk management, primarily liquidity risk and where appropriate interest rate risk and other risks.

Initially they are measured at fair value (cost of acquisition, excluding transaction costs) and subsequent applications are included in the income statement for the period in which they incurred.

Fair value adjustments are carried out on a monthly basis.

Purchase of financial assets is recognized in the balance sheet at settlement date. The change in value between the trading date and the settlement date is recognized in net profit or loss for the period.

Sold assets are derecognized on the settlement date of the transaction value of the other contractual party.

Reclassification of the instrument can only be carried out in an exceptional case.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.9. Financial instruments – continued

c) Securities and other financial instruments valued at fair value through Income statement

This portfolio includes securities which are aimed at a higher return on sales.

Initial valuation is carried out at fair value, i.e. the cost of acquisition.

Gains or losses arising from subsequent fair value adjustments are recognized in the income statement for the period in which they incurred.

Purchase of financial assets is stated in the balance sheet at settlement date. The change in value between the trading date and the settlement date is recognized in net profit or loss for the period.

Sold assets are derecognized on the settlement date of the transaction value of the other contractual party.

Reclassification of the instrument may only be carried out in an exceptional case in accordance with IFRS 9, section 5.6.3. and 5.6.6.

In this portfolio, the Bank has distributed shares acquired in lieu of uncollected receivables which are quoted in a regulated market and shares in cash funds.

Fair value adjustments are recognized in the income statement for the period when they incurred.

Fair value adjustments are carried out on a monthly basis.

d) Securities and other financial instruments valued at depreciated cost

This category of assets comprises instruments aimed at collecting contracted cash flows on principal and interest payments on the outstanding principal amount.

Securities and financial instruments valued at depreciated cost are initially measured at investment cost, including transaction costs and subsequently at depreciation cost, subject to impairment testing.

Relocating debt securities to another portfolio shall be performed in exceptional and justified cases only.

Property valuation in the new manner shall be done prospectively, i.e. from the day of the reclassification (IFRS 9, section 5.6.2. and 5.6.4.).

e) Securities at fair value through other comprehensive income

This portfolio contains reclassified securities that the Bank acquired during the period when the selection of this portfolio was obligatory. These are shares that are not quoted in the active market and that do not have fair value and that are carried at cost.

Financial instruments classified as financial assets valued at fair value through other comprehensive income are initially measured at fair value (acquisition cost including transactions costs).

Gains or losses arising from changes in fair value are recognized in equity and after the derecognition the cumulative result is not transferred to profit or loss but remains in equity.

Fair value measurement is carried out at least once a month if input parameters exist.

Reclassification of these instruments is not allowed.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.9. Financijski instrumenti – nastavak

f) Other financial liabilities

Other financial liabilities include all financial liabilities that are not held for trading or are not classified at fair value through the income statement.

Financial liabilities are valued at depreciated cost using the effective interest rate method.

3.10. Investments in subsidiaries

Investments in affiliated companies and subsidiaries in which the investor (the Bank) has majority ownership, influence or control are stated in separate financial statements by the investment cost method and with the impairment of the carrying amount of this property up to its recoverable amount.

The Bank has an investment in Rezidencija Mejaši d.o.o. Karlovac with 100% ownership.

The company is registered for real estate business which has not been conducted but for past several years.

Stock (land intended for construction) make up for almost all of the property of the company and is pledged for loan granted by the Bank and for other liabilities of the company. Since the company does not perform its activity, its existing liabilities can only be settled from the sale of said land. The Bank has been trying for years to enforce its claims over the said land in order to settle its claims. Execution of enforcement is in the competence of the commercial court and the Bank has limited possibilities of influencing the time of completion of the enforcement proceedings.

The company's management also conducts activities on the sale of the said land.

The Bank has no intention of supporting the continuation of this company's business after the completion of the enforcement proceedings, i.e. the sale of said land and settlement or partial settlement of the company's obligations.

Since according to the Article 278 of the Credit Institutions Acts the company Rezidencija Mejaši d.o.o. does not meet the conditions for consolidation, the Bank is not obliged to include the said company in the reports of the group of credit institutions in accordance with the said Act. Therefore, the Bank uses the exception from consolidation of the financial statements with the related subsidiary in relation to the reporting in accordance with the regulations of the Croatian National Bank.

In its business books the company states its investment in land (inventory) in the amount of investment cost and its loan liabilities in the amount of gross principal plus interest. Given that the company has no expected cash flows to settle its liabilities toward the Bank other than from the sale of land, the Bank has valued its exposure to the company based on granted loan in accordance with the accounting rules for banks, collateral valuation, that is, expected future cash flows from the sale of land expected to be taken over in enforcement proceedings and has recorded loan losses.

In its business books the Bank recorded losses on granted loan related to settlement from the sale of the land in question with the estimation being that the effect of consolidation would not have a negative impact on the reported business results of the Bank. The Bank has fully matched its investment in said company in the amount of HRK 20 thousand.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.11. Intangible assets

Intangible assets are stated at cost less accumulated depreciation and impairment. Costs arising from development activities are recognized as intangible assets if the requirements according to IAS 38 "Intangible Assets" are met. Depreciation of intangible assets is calculated on a straight line basis over the estimated useful life of assets as follows:

Description	2018.	2017.
Software	4 years	4 years
Leasehold investments	to 10 years	to 10 years
Other intangible assets	4 years	4 years

3.12. Property and equipment

Property and equipment are stated at cost less accumulated depreciation and/or accumulated impairment losses, and make tangible assets if their useful life is longer than one year and single value is greater than HRK 3.500 at the acquisition date. Cost includes purchase price, import duties and tax and other dependent costs of bringing assets to working condition for intended use, decreased by trade discounts.

Subsequent expenditure on already recognized items of tangible assets is added to the carrying value of that asset only if it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

At each balance sheet date the Bank assesses whether there is any indication that a tangible asset may be impaired, and if such an indicator exists, the Bank estimates the recoverable amount of the asset taking into account indicators in paragraph 12-14 of IAS 36.

For a subsequent measurement of the value of the real estate, the Bank uses a comparative method which applies a comparison of the value of real estate that is being valued and the value of real estate sold in the area in the near term. If there are no data on prices of the sale of similar real estate, then the cost method is used.

The impairment loss on an individual asset is recognized by reducing the carrying amount to the recoverable amount at the expense of the period in which the loss is estimated.

If the increase in carrying amount is above the value of forfeited loss, the increase is recognized as a part of comprehensive income and is stated cumulatively in equity as a revaluation reserve.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.12. Property and equipment – continued

Depreciation is calculated when the acquisition value of property, apart from current investments is written off according to the straight-line method during useful life as follows:

Description	2018.	2017.
Buildings	40 years	40 years
IT equipment	4 years	4 years
Furniture	10 years	10 years
Personal vehicles	5 years	5 years
Other equipment	10 years	10 years

During 2017 Karlovačka banka carried out the division of the purchase value of buildings into the value of land and the value of buildings themselves in accordance with provisions of IAS 16, p.58.

At the same time, the correction of the depreciation rates of buildings was carried out in such a way that they were calculated on the basis of the residual useful life.

The Bank is active in finding a buyer for real estate that are not in use and intends to sell them.

3.13. Assets acquired in lieu of uncollected receivables

The Bank assesses marketability of assets acquired in lieu of uncollected receivables and recognizes as assets only marketable assets the value of which can be measured reliably.

Such assets are stated at the lower of the cost of related loans or the fair value of that asset, depending on which is the lower one.

When such assets are sold, the difference between the purchase price and the carrying value is stated within other income or expenses.

Assets acquired in lieu of uncollected receivables are originally intended for sale and rented only exceptionally until such time when an appropriate bid for sale is made.

3.14. Liabilities for loans

Liabilities for receivables are recognized in accounting records at nominal value arising from the business transaction based on the contract or another credible accounting record.

Subsequently, these liabilities are measured at depreciated cost and thus presented in the Bank's financial statements.

3.15. Received deposits

Received deposits are classified as: funds in transaction accounts, savings deposits, time deposits and other deposits.

Deposit liabilities are stated at agreed nominal value and subsequent measurement is carried out in accordance with the portfolio policy at depreciated cost.

3.16. Earnings per share

Earning per share is calculated by dividing the net profit by the weighted average number of existing shares (ordinary shares) for the period, without own shares.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.17. Issued subordinated and hybrid instruments

The bank uses these instruments as a rule to collect funds with the aim of creating additional capital. These instruments may be recognized as supplementary capital only if they fulfil the conditions prescribed by special decisions of the central bank regulating the content of regulatory capital and the EU regulations as well.

Subsequent valuation and presentation of subordinated and hybrid instruments is carried out in accordance with the portfolio policy at depreciated cost.

3.18. Use of estimates

The preparation of the Bank's financial statements in accordance with the IFRS requires that the Bank's Management Board makes estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. The estimates and related assumptions are based on historical experience and various other factors that are believed to be realistic in the circumstances and information available at the date of preparing the financial statements, the results of which form the basis for judgments about carrying values of assets and liabilities that are not easily ascertainable from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on a regular basis. Revisions to accounting estimates are recognized in the period in which they are incurred if they only affect that period or the period in which they are incurred and future periods if they affect current and future periods.

a) Losses from impairment of loans

The Bank conducts loan assessment procedures at a minimum quarterly level. The rules/methods of assessment are defined by the internal act on classification of placements. The assessment is basically based on the acceptance of basic classification criteria – creditworthiness, regularity and quality of insurance instruments.

Impairment losses on exposures that are not secured by adequate collateral are carried out on the basis of default days, while estimates for exposures secured by adequate collateral use default days as well as the criteria for quality and value of the instruments, types of measures taken for collection and also historic data on the maturity terms applying the reduction factor for a particular type of insurance instrument. Impairment is determined as a positive difference between the gross carrying amount of a given exposure and the present value of estimated future cash flows discounted using the effective interest rate.

b) Losses from court disputes

Provisions for court disputes are conducted in accordance with the rules established by the internal act of the bank which is based on the basic provisions of the relevant decision of the CNB.

3.19. Contingent liabilities and commitments

In the ordinary course of business, the Bank issued guarantees and letters of credit and granted loans that were not fully utilized and other contingencies and these are stated as contingent liabilities and commitments in the off-balance records. These financial instruments are stated in the Bank's balance sheet when and if the Bank settled the matured liability.

Provisions for possible losses by contingent liabilities and commitments are made at a level the Bank's Management Board believes are adequate to absorb probable future losses.

The Management Board determines the adequacy of the provisions based on reviews of individual items, current economic conditions, the risk characteristics of various categories of transactions and other pertinent factors.

Impaired values are implemented at a minimum quarterly level in accordance with the criteria and rules prescribed by the internal act on classification of placements and off-balance liabilities.

III SUMMARY OF ACCOUNTING POLICIES – continued

3.19. Potencijalne i preuzete obveze – nastavak

Regarding the classification criteria and the division according to the degree of risk, the Bank applies the same rules as those for balance sheet items. The amount of the offsetting for a certain off-balance obligation is equal to the amount of expected future expenditures for settling off-balance obligation that the Bank will not be able to offset

If the effect of the time value of money is significant, the amount of the provision is equal to the discounted value of the expected future irreparable outflows for settling the off-balance obligation using a discount rate corresponding to the current market value of money. It is considered that the effect of the time value of money is significant when it is estimated that the cash outflow will be in a period of more than one year and the expected outflow of more than 0.1% of the bank's assets.

3.20. Cash flow statement

For the cash flow reporting purposes, cash and cash equivalents are defined as cash, placements and deposits to banks with maturity up to 90 days.

3.21. Operating segments

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, i.e. the function responsible for allocating resources and evaluating the performance of the operating segments, has been identified as the Bank's Management Board that makes strategic decisions.

The Bank has identified four primary segments: Retail, Corporate, Financial institutions and Other. Segment information is based on information provided to management for management purposes.

3.22. Regulatory requirements

The Bank is required to comply with the regulations of the Croatian National Bank, which include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off-balance sheet commitments and provisioning to cover credit risk, liquidity risk, interest risk and investments in tangible assets. Regarding the applicable regulatory limits from all the above mentioned areas, as at 31 December 2018 the Bank showed an excess of investments in tangible assets. Adjustment to this limit is carried out continuously by the Bank in accordance with decisions of the CNB and, based on a valid one, comprehensive adjustment of up to 40% of the recognized capital should be executed by 31 March 2019.

The regulatory capital rate as at 31 December 2018 amounted to 17.25% (31 December 2017: 17.00%) which is a level that exceeds the regulatory and internal limit of this indicator.

3.23. Comparative information

Comparative information has been reclassified where necessary for the purpose of comparability with the current year.

The cost of the savings deposit insurance premium for 2017 was reclassified in the amount of HRK 5,123 thousand in such a way that it was excluded from interest expense and reclassified to other expenses.

NOTES TO THE INCOME STATEMENT

4. Interest income

a) Interest income – Analysis by source

Description	2018. HRK '000	2017. HRK '000
Corporates	13.561	14.635
Individuals	36.318	38.964
Financial institutions	603	1.163
Public sector	19.420	21.723
Other	1.753	89
Total interest income	71.655	76.574

b) Interest income – analysis by product

Description	2018. HRK '000	2017. HRK '000
Loans and receivables from financial institutions	1.042	1.050
Debt securities	11.368	14.263
Loans and receivables from customers	59.222	61.236
Other	23	25
Total interest income	71.655	76.574

NOTES TO THE INCOME STATEMENT – continued

5. Interest expenses

a) Interest expenses – analysis by recipient

Description	2018. HRK '000	2017. HRK '000
Corporates	42	89
Individuals	12.796	18.601
Financial institutions	373	979
Public sector	24	16
Non-profit institutions	16	40
Other	135	122
Total interest expense	13.386	19.847

a) Interest expenses – analysis by product

Description	2018. HRK '000	2017. HRK '000
Current accounts and deposits from individuals	9.583	15.229
Current accounts and deposits from corporates and other companies	924	1.186
Loans	135	784
Hybrid instruments	2.744	2.647
Other	-	1
Total interest expenses	13.386	19.847

NOTES TO THE INCOME STATEMENT – continued

6. Fee and commission income

Description	2018. HRK '000	2017. HRK '000
Payment operations	10.344	10.161
Authorized loans	123	988
Guarantees and letters of credit	1.011	819
Self-service devices	4.633	4.674
Account maintenance fee	3.098	3.255
Giro and current account cards	104	397
Credit cards	401	592
Mobile, Phone and Internet Banking	1.199	1.023
Mandates	89	90
Other	2.101	2.280
Total fee and commission income	23.103	24.279

7. Fee and commission expenses

Description	2018. HRK '000	2017. HRK '000
Payment service fee	3.466	3.591
Card transactions	2.679	2.969
Other	759	728
Total fee and commission expenses	6.904	7.288

NOTES TO THE INCOME STATEMENT – continued

8. Profit from financial activities

Description	2018. HRK '000	2017. HRK '000
Profit/loss from foreign currency trading	9.191	8.732
Loss from trading in Croatian Kuna	(20)	(19)
Profit/loss from securities not actively traded but valued at fair value through income statement	(4.413)	3.018
Loss from activities in assets valued through Other comprehensive income	-	(3.594)
Profit from activities in assets valued at amortized cost	-	958
Total profit from financial activities	4.758	9.095

9. Net foreign exchange income

Description	2018. HRK '000	2017. HRK '000
Currency differences on translations	6.758	2.997
Currency differences from currency clause	(6.845)	(3.182)
Total net foreign exchange income	(87)	(185)

10. Other operating income

Description	2018. HRK '000	2017. HRK '000
Income from sale of tangible assets	154	2.252
Tax assets	709	-
Write offs of old and inactive accounts	227	134
Court settlements and reimbursements	101	4.348
Office leases	554	463
Collection of damages and interest from previous years	87	192
Income from various contractual relationships	85	1
Other unspecified income	185	216
Total other operating income	2.102	7.606

NOTES TO THE INCOME STATEMENT – continued

a) General administrative and other operating expenses

Description	2018. HRK '000	2017. HRK '000
Employees (Note 12)	26.203	24.965
Depreciation (Notes 25 and 26)	4.418	3.854
Other operating expenses (Note 13)	25.487	26.096
Total other operating expenses	56.108	54.915

b) Staff costs

Description	2018. HRK '000	2017. HRK '000
Net salaries	13.746	13.767
Taxes and contributions from salaries	5.500	5.485
Contributions	3.360	3.359
Reimbursements to employees	3.597	2.354
Total staff costs	26.203	24.965

As at 31 December 2018 the Bank employed 169 employees (31 December 2017: 177 employees).

13. Other operating expenses

Description	2018. HRK '000	2017. HRK '000
Costs of material and similar expenses	2.017	1.764
Costs of services	11.069	11.304
Entertainment, advertising and promotion expenses	879	806
Remuneration of Supervisory Board	536	348
Losses from sold and depreciated fixed assets	3.704	2.102
Costs of court proceedings, settlements and penalties	446	2.761
Savings deposits insurance	5.464	5.122
Other	1.371	1.889
Total other operating expenses	25.486	26.096

NOTES TO THE INCOME STATEMENT – continued

14. Impairment and provision costs

Description	2018.	2017.
	HRK'000	HRK'000
Impairment of loans and prepayments to customers (Note 24)	12.938	11.743
Impairment of other assets (Note 28)	593	(129)
Special reserves for identified losses (Note 24)	(1.720)	748
Impairment of financial assets held to maturity (Note 22)	320	1.180
Collected receivables previously written-off	(43)	(1.217)
Provisions for contingent liabilities (Note 33)	618	163
Provisions for court disputes (Note 33)	789	1.701
Impairment of bank placements (Note 20)	27	(225)
Impairment of receivables from CNB (Note 19)	2	113
Impairment of cash (Note 18)	132	679
Impairment of tangible assets intended for sale (Note 25 a) and 27)	1.808	9.395
Impairment of assets in the portfolio through Other Comprehensive Income (Note 21)	(3.500)	3.500
Total impairment and provision costs	11.964	27.651

15. Income tax

Description	2018.	2017.
	HRK '000	HRK '000
Accounting profit/loss	13.169	7.669
Items which increase tax base	20.452	42.681
Items which decrease tax base	(17.366)	(4.533)
Income tax base	16.255	45.817
Tax loss carried forward	(26.311)	(72.128)
Income tax rate	18%	18%
Tax loss available for transfer	4.379	(26.311)

Income tax is calculated in accordance with Croatian legislation. Tax rate on taxable income is 18% (2017: 18%). As at 31 December 2018 there was no obligation to pay income tax based on tax balance due to transferred tax loss from previous years.

NOTES TO THE INCOME STATEMENT – continued

15. Income tax (continued)

The Bank can use tax loss as deduction of accrued income tax base in the following 5 accounting periods, after which the unused tax loss is abolished. Tax loss benefits have not been recognized in the financial statements due to uncertainty of their future use.

The Bank's tax losses and their maturities are shown in the following table:

Year of tax loss	Total amount of tax loss	Mature in
HRK '000		
2016.	4.379	2021.

16. Earnings per share

For the purpose of calculating earnings per share, earnings are calculated as the profit for the period attributable to shareholders. The number of ordinary shares is the weighted average number of ordinary shares outstanding during the year after deducting the number of ordinary treasury shares. The weighted average number of ordinary shares used to calculate basic earnings per share was 17,559,585 (2017.: 17,559,585). Since there is no effect of dilution of other instruments, basic and diluted earnings per share are the same.

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Profit / (Loss) for the year	13.169	7.669
Weighted average number of ordinary shares (in thousand)	17.560	17.560
Profit(Loss) per share	0,75	0,44

NOTES TO THE INCOME STATEMENT – continued

17. Financial information by segment

The Bank classifies customers by segment and sub segments depending on their size.
 Segment Retail includes: individuals, craftsmen and free-lance professions.
 Segment Corporate includes: public companies and private companies.
 Segment Financial institutions includes: credit institutions, funds, insurance companies and other institutions performing financial activities.
 Segment Other includes assets and liabilities not included within other segments.

Operating activities and customers are located mostly in Croatia and for that reason the geographical details by segments are not published.

a) Income statement by segment for 2018 – operating segments

Description	Individuals HRK'000	Corporates HRK'000	Financial institutions HRK'000	Other HRK'000	Total HRK'000
Net interest income	23.991	13.049	229	21.000	58.269
Net fees and commissions income	11.869	6.557	(2.676)	449	16.199
Provisions and placement impairments	(4.001)	(5.579)	(162)	(2.222)	(11.964)
Other	-	4.758	-	(54.093)	(49.335)
Result by segment	31.859	18.785	(2.609)	(34.866)	13.169
Income tax	-	-	-	-	-
Net result by segment	31.859	18.785	(2.609)	(34.866)	13.169

a) Income statement by segment for 2017 – operating segments

Description	Individuals HRK'000	Corporates HRK'000	Financial institutions HRK'000	Other HRK'000	Total HRK'000
Net interest income	20.241	14.546	184	16.634	51.605
Net fees and commissions income	13.067	6.134	(3.021)	811	16.991
Provisions and placement impairments	(2.906)	(11.923)	(718)	(12.104)	(27.651)
Other	-	-	-	(33.276)	(33.276)
Result by segment	30.402	8.757	(3.555)	(27.935)	7.669
Income tax	-	-	-	-	-
Net result by segment	30.402	8.757	(3.555)	(27.935)	7.669

NOTES TO THE INCOME STATEMENT – continued

17. Financial information by segment - continued

b) Statement of financial position (Balance sheet) as at 31 December 2018 godine – operating segments

Description	Individuals HRK'000	Corporates HRK'000	Financial institutions HRK'000	Other HRK'000	Total HRK'000
Net placements	625.423	278.475	6.202	201.123	1.111.223
Financial assets through Other comprehensive income	-	-	150	-	150
Financial assets at depreciated cost	-	16.135	8.130	195.330	219.595
Financial assets at fair value through income statement	-	43.400	-	171.250	214.650
Other	6.026	5.803	603.851	100.496	716.176
Assets by segment	631.449	343.813	618.333	668.199	2.261.794
Deposits and hybrids	1.739.657	187.212	339	144.177	2.071.385
Loans	-	-	5.795	-	5.795
Other	11.280	2.208	311	14.654	28.453
Liabilities by segment	1.750.937	189.420	6.445	158.831	2.105.633

a) Statement of financial position (Balance sheet) as at 31 December 2017 godine – operating segments

Description	Individuals HRK'000	Corporate s HRK'000	Financial institution s HRK'000	Other HRK'000	Total HRK'000
Net placements	604.439	298.062	7.044	209.238	1.118.783
Financial assets through Other comprehensive income	-	13.224	-	-	13.224
Financial assets at depreciated cost	-	6.077	8.210	139.303	153.590
Financial assets at fair value through income statement	-	25.094	25.300	226.530	276.924
Other	6.894	306	497.154	114.498	618.852
Assets by segment	611.333	342.763	537.708	689.569	2.181.373
Deposits	1.667.060	162.585	179	161.265	1.991.089
Loans	-	-	8.558	-	8.558
Other	6.000	3.538	85	30.743	40.366
Liabilities by segment	1.673.060	166.123	8.822	192.008	2.040.013

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET

18. Cash

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Giro account	185.596	142.017
Cash in hand		
- HRK	24.026	24.796
- foreign currency	16.181	8.342
Cash in foreign accounts with foreign banks	97.760	112.577
Cash in foreign accounts with domestic banks	82.142	32.863
Impairment	(258)	(3.078)
Total cash	405.447	317.517

Impairment relates to special reserves which are determined for placements of the risk group A. Movements on impairments are shown as follows:

Description	2018. HRK '000	2017. HRK '000
Balance as at 1 January	(3.078)	(2.399)
Correction as per IFRS 9	2.952	-
Net impairment (Note 14)	(132)	(679)
Balance as at 31 December	(258)	(3.078)

19. Receivables from the Croatian National Bank

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Obligatory reserve		
- HRK	152.914	143.928
Other deposits	4.512	5.079
Impairment	(36)	(1.490)
Total receivables from the Croatian National Bank	157.390	147.517

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

19. Receivables from the Croatian National Bank - continued

According to CNB Decision the Bank is required to calculate obligatory reserves in the amount of 12% (2017: 12%) of the average daily balance of deposits and loans. The Bank cannot use the amount of obligatory reserves for its daily operations.

The Kuna share in the minimum reserve requirement calculated as above is increased by 75% of calculated minimum reserve requirement on foreign currency deposits and loans. The percentage of allocation of the Kuna share in the minimum reserve requirement amounts to 70% (2017: 70%). The Kuna share in the minimum reserve requirement is allocated with CNB by transfer of the calculated funds to the allocated minimum reserve requirement account kept at CNB.

Starting from 2017, 100% of the foreign currency portion of obligatory reserves are kept in form of other liquid receivables.

CNB Decision on the minimum reserve requirement introduced a 100% maintenance of foreign currency minimum reserve requirement. Decision also introduced the obligation of banks to maintain at least 2% of the foreign currency minimum reserve requirement by the average daily balance of funds on their own EUR settlement accounts with the CNB, respectively on their own PM accounts in TARGET2-HR (accounts used to settle transactions in EURO in actual time, on a gross base).

Impairment refers to special reserves which are determined on cumulative basis for placements of the risk group A as shown below:

Description	2018. HRK '000	2017. HRK '000
Balance as at 1 January	(1.490)	(1.377)
Net impairment (Note 14)	(2)	(113)
Correction as per IFRS 9	1.456	-
Balance as at 31 December	(36)	(1.490)

20. Placements with banks

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Short term deposits with foreign banks	25.102	20.269
Guarantee deposit	15.996	12.253
Impairment	(84)	(122)
Total placements with banks	41.014	32.400

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

20. Placements with banks - continued

Impairment refers to special reserves which are determined on cumulative basis for placements of the risk group A. Movements are shown as follows:

Description	2018. HRK '000	2017. HRK '000
Balance as at 1 January	(123)	(348)
Net impairment (Note 14)	(27)	225
Correction of IFRS-9	66	-
Balance as at 31 December	(84)	(123)

21. Financial assets valued through other comprehensive income

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Investments in equity securities	150	733
Bills of exchange	-	15.995
Impairment	-	(3.504)
Total financial assets through other comprehensive income	150	13.224

/i/ Investments in equity securities refer to the following:

DESCRIPTION	31.12.2018. HRK'000	31.12.2017. HRK'000
Varteks d.d. Varaždin	-	583
Središnja depozitarna agencija d.d. Zagreb	8	8
Tržište novca d.d. Zagreb	1	1
Hrvatski registar obveza po kreditima d.o.o	141	141
Total shares	150	733

/ii/ Part of bills of exchange which were discounted in previous year was collected at the beginning of 2018 and the other part changed the form of exposure and was transferred through the decision of pre-settlement to the loan portfolio valued at depreciation cost.

/iii/ Equity investments relate to shares the Bank holds in the portfolio based on participation on the financial market and its share in banking associations.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

22. Financial assets valued at depreciation cost

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Treasury bills of the Ministry of Finance	111.736	92.512
Bills and bonds of companies	16.516	6.182
Bonds of the Republic of Croatia	84.083	47.860
Bonds of HBOR	8.149	8.587
Impairment	(889)	(1.551)
Total financial assets	219.595	153.590

/i/ Investments in treasury bills of the Ministry of Finance in EUR that mature in up to 2 months and in 2018 the Bank realized yield of 0.10% (0.60% in 2017).

Investments in treasury bills of the Ministry of Finance in HRK that mature in up to 8 months and in 2018 the Bank realized yield of 0.09% (0.50% in 2017).

/ii/ Bonds of the Republic of Croatia in HRK mature in over 12 months until 2023 and the Bank realized yield of 1.76% (2017: 2.15%). Foreign currency bonds of the Republic of Croatia mature in 2025 and 2027 and the Bank realized yield of 3.05% (2017: 3.05%).

iii/ Bonds of the Republic of Croatia with currency clause in EUR mature in 2019 and 2020 and the Bank realized yield of 0.33%.

/iv/ Bonds of HBOR in foreign currency mature in period up to 2020 and the Bank realized yield of 1.45%.

/v/ Bonds of Hrvatska pošta mature on 10 November 2019 and the Bank realized yield of 2.45% in 2018.

/vi/ Impairment refers to special reserves determined on a group base for placements of risk group A. The changes were as follows:

Description	2018. HRK '000	2017. HRK '000
Balance as at 1 January	(1.551)	(371)
Net impairment (Note 14)	(320)	(1.180)
Correction of IFRS-9	982	-
Balance as at 31 December	(889)	(1.551)

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

23. Financial assets at fair value through profit and loss

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Bonds of the Republic of Croatia	171.250	226.868
Bonds of State enterprises	24.951	7.030
Bonds of other companies	17.932	18.020
Portions in investment funds	-	25.006
Equity securities	517	-
Total financial assets at fair value through profit and loss	214.650	276.924

Bonds of the Republic of Croatia in HRK which are indexed in EUR mature in period up to 10 years and bear yield of 1.75% to 6.75% annually (2017; 1.75% to 6.75 % annually).

Foreign currency bonds of the Republic of Croatia mature in 2022 and bear yield of 3.875% (2017: 2.875 %). In 2018 the Bank had an average interest yield of 3.17% (2017.: 3.88 %) on the portfolio of bonds of the Republic of Croatia and 1.80% including realized and unrealized effects of market prices (2017; 5.08%).

In 2018 the Bank earned the total return of 4.94% (2017; 5.73%) from bonds of other companies which mature on 15 July 2023 and bear yield of 3.875%.

During 2018 the Bank invested part of liquidity surplus into portions in investment funds with an average yield of 0.25% (2017; 0.3%).

24. Loans and prepayments to customers

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Corporates	373.428	586.061
Individuals and sole traders	663.152	646.475
Other	207.890	31.621
Collected fees related to future periods	(2.211)	(2.697)
Loan impairments	(131.036)	(142.677)
Total loans and prepayments to customers	1.111.223	1.118.783

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

24. Loans and prepayments to customers - continued

Movements on impairments were:

Description	2018.			2017.		
	Impairment for losses (B and C)	Impairment for expected losses (A1 and A2)	Total	Impairme nt	Special reserves for ident. losses on group basis	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance as at 1 January	132.305	10.372	142.677	172.077	9.624	181.701
Net impairment/provision (Note 14)	12.938	(1.720)	11.218	11.743	748	12.491
Currency differences	(160)	-	(160)	(126)	-	(126)
Write-offs and other	(27.523)	-	(27.523)	(51.389)	-	(51.389)
Correction of IFRS 9	899	3.925	4.824	-	-	-
Balance as at 31 December	118.459	12.577	131.036	132.305	10.372	142.677

The amount of unused bank overdrafts does not represent a need for the funds in the total amount of approved overdrafts. Overdrafts are granted for a systematic and timely insurance of preconditions for possible and necessary financing. Potential loss from the commitments cannot be determined, but according to experiences from previous accounting periods and the effectiveness of existing mechanisms to protect the Bank in case of deterioration of financial position or performance of the client, the Bank does not expect additional potential losses higher than those stated in the financial statements for 2018.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

Risk concentration by sector in loans to customers portfolio was as follows:

Description	31.12.2018.	31.12.2017.
	HRK '000	HRK '000
Production	115.612	135.590
Trade	109.322	125.034
Tourism	21.283	24.402
Agriculture	27.929	35.189
Construction	198.271	213.734
Services	114.128	105.051
Individuals	614.411	597.642
Other	43.514	27.515
Total by sector	1.244.470	1.264.157
Collected fees related to future periods	(2.211)	(2.697)
Impairment and provision for loan losses	(131.036)	(142.677)
Total loans and prepayments to customers, net	1.111.223	1.118.783

KARLOVAČKA BANKA d.d.
NOTES TO THE FINANCIAL STATEMENTS - continued
For the year ended 31 December 2018

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

25. Property, plant and equipment

Movements on property, plant and equipment are shown as follows:

<i>Cost</i>	<i>O p i s</i>	Buildings and land	Equipment	Furniture and vehicles	Other assets	Flats	Tangible assets under construction	TOTAL
		HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Balance at 31 December 2016		64.940	33.991	11.055	1.957	122	32.370	144.434
Additions		-	-	-	-	-	2.349	2.349
Transfer from assets under construction		2.126	1.067	46	7	-	(3.246)	-
Other transfers		-	-	-	-	-	(25)	(25)
Disposals and sales		-	(1.026)	(186)	(2)	-	-	(1.214)
Balance at 31 December 2017		67.066	34.032	10.914	1.962	122	31.473	145.569
Additions		-	-	-	-	-	-	-
Transfer from assets under construction		116	4.580	251	14	-	4.971	4.971
Other transfers		26.097	-	-	-	-	(4.961)	-
Disposals and sales		(5.959)	(4.311)	(434)	(43)	-	(26.097)	-
Balance at 31 December 2018		87.320	34.300	10.730	1.933	122	5.386	(10.747)
Impairment								139.793
Balance at 31 December 2016		44.989	28.945	9.581	1.498	122	14.257	99.392
Depreciation for 2017		1.009	1.476	550	56	-	171	3.263
Disposals and sales		-	(1.026)	(186)	(2)	-	-	3.263
Other transfers		400	-	-	-	-	(501)	(101)
Balance at 31 December 2017		46.398	29.395	9.945	1.552	122	13.927	101.340
Depreciation for 2018		1.043	2.149	511	39	-	105	3.847
Impairment (depreciation)		381	-	-	-	-	-	381
Disposals and sales		(1.950)	(4.225)	(433)	(43)	-	-	(5.737)
Other transfers		11.560	-	-	-	-	(11.560)	-
Balance at 31 December 2018		57.433	27.319	10.022	1.548	122	2.472	98.916
Net carrying value at 31 December 2017		20.668	4.636	968	410	-	17.546	44.229
Net carrying value at 31 December 2018		29.887	6.981	708	386	-	2.914	40.877

KARLOVAČKA BANKA d.d.
NOTES TO THE FINANCIAL STATEMENTS - continued
For the year ended 31 December 2018

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued
25. a) Assets intended for sale

Movements on property intended for sale are as follows:

Cost	Opis	Buildings and land	Equipment	Furniture and vehicles	Other assets	Flats	Tangible assets under construction	TOTAL
Balance at 31 December 2016		11.091	-	-	-	122	26.097	37.310
Additions		-	-	-	-	-	-	-
Transfer from assets under construction		-	-	-	-	-	-	-
Disposals and sales		-	-	-	-	-	-	-
Balance at 31 December 2017		11.091	-	-	-	122	26.097	37.310
Additions		-	-	-	-	-	-	-
Transfer from assets under construction		-	-	-	-	-	-	-
Other transfers		26.097	-	-	-	-	-	-
Disposals and sales		(5.959)	-	-	-	-	(26.097)	-
Balance at 31 December 2018		31.229	-	-	-	122	-	(5.959)
Impairment								31.351
Balance at 31 December 2016		8.968	-	-	-	122	11.560	20.650
Depreciation/correction for 2017		504	-	-	-	-	-	504
Disposals and sales		-	-	-	-	-	-	-
Balance at 31 December 2017		9.472	-	-	-	122	11.560	21.154
Depreciation/correction for 2018		381	-	-	-	-	-	381
Disposals and sales		(1.950)	-	-	-	-	-	(1.950)
Other transfers		11.560	-	-	-	-	(11.560)	-
Balance at 31 December 2018		19.463	-	-	-	122	-	19.585
Net carrying value at 31 December 2017		1.619	-	-	-	-	14.537	16.156
Net carrying value at 31 December 2018		11.766	-	-	-	-	-	11.766

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

25. Property, plant and equipment- continued

Ownership of the predominant part of the property in which the Bank operates is registered at the Land registry, while for two of the properties procedure to establish certain specific parts of the property should be instituted, which is a prerequisite for the registration of ownership at the Land registry. There are no pledges on the Bank's real estate.

Cost of assets that have been fully depreciated and still used in the Bank's business amounts to HRK 39,835 thousand.

26. Intangible assets

Changes in intangible assets are given below:

Description	Software	Investments in leasehold assets	Other assets	Prepayments / Preparation	TOTAL
Cost					
Balance at 31 December 2016	1.897	7.031	533	-	9.461
Disposals and sales	-	(357)	-	-	(357)
Additions	-	-	-	332	332
Balance at 31 December 2017	1.897	6.674	533	332	9.436
Disposals and sales	-	-	-	-	-
Additions	-	-	-	9	9
Transfer from preparation	341	-	-	(341)	-
Balance at 31 December 2018	2.238	6.674	533	-	9.445
Impairment					
Balance at 31 December 2016	1.887	5.957	533	-	8.377
Depreciation	7	584	-	-	591
Disposals and sales	-	(357)	-	-	(357)
Balance at 31 December 2017	1.894	6.183	533	-	8.610
Depreciation for 2018	80	491	-	-	571
Disposals and sales	-	-	-	-	-
Balance at 31 December 2018	1.974	6.674	533	-	9.181
Net carrying value at 31 December 2017	3	491	-	332	826
Net carrying value at 31 December 2018	264	-	-	-	264

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

27. Foreclosed assets

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Land	41.124	41.124
Buildings	9.724	15.304
Flats and other assets	8.494	10.052
Total foreclosed assets	59.342	66.480

/i/ Land stated at 31 December 2018 in the amount of HRK 41,124 tisuće kuna (31 December 2017: HRK 41,124 thousand) refers to building sites at 5 locations in the Republic of Croatia out of which the two most valuable lands are located in Primorsko goranska County and the City of Zagreb.

/ii/ Buildings stated at 31 December 2018 in the amount of HRK 9,724 thousand refer mostly to foreclosed buildings intended for office purposes; total of 8 buildings located mainly in Karlovac and Karlovačka County and two buildings in the vicinity of Pakrac.

/iii/ Residential buildings and flats in the total amount of HRK 8,494 thousand contain a total of 21 flats, houses and garages which, both in number and in value, mostly relate to those located in Karlovac and Karlovac County.

/iv/ The Bank is currently initiating foreclosures over several properties that are collateral for the Bank's claims on basis of approved loans and other receivables from customers.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

27. Foreclosed assets - continued

Changes in foreclosed assets are shown below:

<i>Cost</i>	Land	Buildings	Flats and other assets	TOTAL
Balance at 31 December 2016	84.113	22.885	16.207	123.205
Takeovers and PPN	15.461	4.488	2.707	22.656
Sales	(29.794)	(4.867)	(2.179)	(36.840)
Balance at 31 December 2017	69.780	22.506	16.734	109.021
Takeovers and PPN	-	1.732	1.603	3.335
Sales	-	(13.424)	(6.896)	(20.320)
Balance at 31 December 2018	69.780	10.814	11.441	92.035
Impairment				
Balance at 31 December 2016	28.656	7.523	6.549	42.728
Takeovers	7.782	168	942	8.892
Sales	(7.782)	(489)	(808)	(9.079)
Balance at 31 December 2017	28.656	7.202	6.683	42.541
Impairment		795	632	1.427
Sales	-	(6.907)	(4.368)	(11.275)
Balance at 31 December 2018	28.656	1.091	2.947	32.696
Net carrying value at 31 December 2016	55.457	15.362	9.657	80.477
Net carrying value at 31 December 2017	41.124	15.304	10.052	66.480
Net carrying value at 31 December 2018	41.124	9.724	8.494	59.342

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

28. Other assets

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Fees and commissions receivables	3.929	2.180
Trade receivables	240	159
Prepayment receivables	918	796
Prepayments	300	455
Deferred tax assets	1.178	579
Regulation of property relations of real estate for sale	5.984	5.954
Card transaction receivables	395	799
Various contractual relations receivables	822	947
Other receivables	464	615
Impairment	(2.388)	(2.601)
Total other assets	11.842	9.883

Movements of impairments are shown below:

Description	2018. HRK '000	2017. HRK '000
Balance at 1 January	2.601	3.458
New impairment (Note 14)	1.844	594
Collected and relieved amounts (Note 14)	(1.251)	(723)
Exchange differences	(2)	(16)
Write-offs and corrections	(753)	(712)
Correction of IFRS 9	(51)	-
Balance at 31 December	2.388	2.601

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

28. Other assets – continued

Deferred tax assets are stated from the following temporary differences:

Description	2018. HRK '000	2017. HRK '000
Balance at 1 January	579	700
Deferred fee for granted loans	(110)	(121)
Unrealized losses from securities	582	-
Property adjustment, net	127	-
Total	1.178	579

Charged fees for granted loans represent a business constant and it is estimated that in the near future a certain use of this property will be made on the basis of these differences. The situation is similar with unrealized losses from securities, while the principle of prudence was taken with unrealized adjustment of property in terms of possibilities and timing of the sale.

Adjustments of tax assets are shown below:

	2018. HRK '000	2017. HRK '000
Description	Tax assets HRK '000	Tax assets HRK '000
Balance at 31 January	579	700
Recognition of deferred tax assets	10.974	-
Value adjustment of tax assets	(10.265)	-
Utilization of deferred tax assets	(110)	(121)
Balance at 31 December	1.178	579

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

29. Demand deposits

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Demand deposits – individuals		
- HRK	361.875	319.562
- foreign currency	253.256	208.915
Total individuals	615.131	528.477
Demand deposits - corporates		
- HRK	120.792	121.704
- foreign currency	48.692	25.131
Total corporates	169.484	146.835
Demand deposits – financial institutions		
- HRK	289	179
- foreign currency	7	-
Total financial institutions	296	179
Demand deposits – State and other institutions		
- HRK	94.037	61.336
- foreign currency	2.066	782
Total State and other institutions	96.103	62.118
Restricted deposits		
- HRK	3.596	1.544
- foreign currency	6.346	385
Total restricted deposits	9.942	1.929
Demand deposits - foreigners		
- HRK	1.518	1.718
- foreign currency	19.499	5.362
Total foreigners	21.017	7.080
Total demand deposits	911.973	746.617

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

30. Term deposits

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Deposits – individuals		
- HRK	337.536	345.433
- foreign currency	733.188	794.083
Total individuals	1.070.724	1.139.516
Deposits - corporates		
- HRK	3.173	1.606
- foreign currency	14.555	14.144
Total corporates	17.728	15.750
Deposits – State and other institutions		
- HRK	227	697
- foreign currency	-	1.052
Total State and other institutions	227	1.749
Deposits - foreigners		
- HRK	1.176	1.151
- foreign currency	15.711	32.144
Total foreigners	16.887	33.295
Total term deposits	1.105.566	1.190.310

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

31. Loan liabilities

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Domestic banks	5.811	8.590
Paid loan fees related to future periods	(16)	(32)
Total loan liabilities	5.795	8.558

The liability to HBOR at 31 December 2018 amounted to HRK 5,795 thousand (2017: HRK 8,558 thousand). These funds are intended for loans to enterprises and individuals in accordance with HBOR programs for the promotion of small and medium enterprises, tourism and agriculture, with an average interest rate of 3.3% (2017: 3%).

32. Other liabilities

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Fees and commissions payables	293	381
Liabilities to employees	2.866	2.373
Liabilities for taxes and contributions	103	1.287
Liabilities toward suppliers	903	1.166
Liabilities for prepayments on loans	3.938	5.246
Accrued loan interests and receivables discount	2.034	2.640
Liabilities for closed accounts	-	7.755
Premium for deposit insurance	1.251	1.292
Liabilities for transactions at POS terminals	311	856
Liabilities for management of foreclosed assets intended for sale	5.984	5.799
Orders sent to the NCS (National Clearing System-NKS)	1.376	2.337
Liabilities for public housing	189	235
Collected deferred income	635	652
Liabilities for purchased cash in HRK	-	310
Liabilities for tax and surtax on savings interest	239	391
Bearer savings	113	113
Other liabilities	536	420
Total other liabilities	20.771	33.253

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

33. Provisions

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Provisions for employees	613	683
Provisions for court disputes	3.683	3.610
Provisions for identified losses by off-balance contingent liabilities	251	109
Special provisions for identified cumulative losses by commitments	3.135	2.710
Total provisions	7.682	7.112

/i/ Changes in provisions are shown below:

Description	2018. HRK '000	2017. HRK '000
Balance at 1 January	7.112	5.248
Changes in provisions for court disputes and employees (Note 14)	789	1.701
Changes in provisions for contingent liabilities and commitments (Note 14)	618	163
Utilization of reserves	(787)	-
Correction of IFRS 9	(50)	-
Balance at 31 December	7.682	7.112

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

/ii/ As at 31 December 2018 the Bank is involved in 84 legal disputes against corporates and 145 legal disputes against individuals..

The Bank is involved in 5 procedures for the collection of real estate on which the Bank is registered as a fiduciary owner.

The Bank is involved in 49 procedures for payment pursuant to bankruptcy procedures initiated against corporate debtors and 3 procedures initiated against individual debtors (consumers).

/iii/ Procedures in which the Bank was sued relate to litigation for payment and litigation in order to establish.

In procedures for payment there are three court cases that are more significant when the amount is concerned. Those are civil proceedings initiated by individuals who were granted loans in the Bank that were directly placed into capitalization account of the joint stock company and which were not repayed to the Bank in full and in the manner and under the conditions stipulated and also civil proceedings of the Republic of Croatia for payment. The Bank regularly arranges allocation of disputes into relevant risk groups and, depending on the estimated outcome and in accordance with internal acts, makes provisions for court disputes which could result in potential outflow of funds.

For procedures initiated to establish there is no commitment to allocate procedures to risk groups and to make provisions.

In this group procedures initiated by two shareholders of the Bank to challenge the decisions of the General Assembly stand out:

1. Decision of the General Assembly dated 10 February 2014 to reduce the share capital for HRK 92.642 million, to exclude the right to subscribe for new shares, to increase the share capital for HRK 72,734 million and to change partially the Company's Statute.

In this case, a final verdict was issued in favour of the plaintiff and the Bank submitted a revision to the Supreme Court of the Republic of Croatia as an extraordinary remedy. It is not possible to estimate in what time frame and in what was will the Supreme Court decide on the revision.

2. Decision of the General Assembly dated 2 July 2014 being the decision on the confirmation of the decisions of the General Assembly of 10 February 2014, decision on the increase in share capital for the amount of HRK 40 million and the decision on partial change of the Statute.

In this procedure a first-instance decision was made in favour of the Bank and the subject is to be resolved before the High Commercial Court in Zagreb following the plaintiff's appeal. It is not possible to estimate the duration of the proceedings nor how will the High Commercial Court decide on the plaintiff's appeal.

In this case the Bank also submitted a proposal for issuing a measure under the Article 366.a, which protects the effect of decisions that are contested in litigation. The request was partially rejected and partly returned for reinstatement to the Commercial Court in Zagreb. Given the absence of court practice on this legal issue, the Bank has made an extraordinary review to the Supreme Court against the part of the decision that rejected the motion of the Bank as it is a legal matter that the Supreme Court has not yet assumed its position on. Also, due to the violation of entrepreneurial freedom and the protection of invested capital under the Article 48. of the Constitution of the Republic of Croatia, the Bank filed a lawsuit with the Constitutional Court of the Republic of Croatia.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

33. Provisions - continued

In these proceedings the Bank is undertaking all available actions to protect the interests of the shareholders and of the Bank as well as to protect the public interest and is regularly informing the supervisory body on the status of the matter. Given the absence of relevant court practice, it is not possible to assess the duration and outcome of initiated proceedings, especially as the Bank initiated, by its actions taken after the validity of the judgement in the case of challenge of the decision of the General Assembly of 10 February 2014, some additional questions on which the courts in the Republic of Croatia so far have not yet decided

In case the litigation to challenge the decision of the General Assembly of 2 July 2014 should also be ruled in favour of the plaintiff and the Bank has not been able to previously protect the effect of entered decisions by measure from the Article 366.a of the Companies Act, the Bank shall, depending on the circumstances and facts at a given moment, undertake such actions which enable its business continuity in accordance with the law.

34. Hybrid instruments

Hybrid instruments represent special instruments of investments into the capital, stakes without payment possibilities before the expiry of the contracted periods, except for entry into the equity, respectively for the conversion of hybrid instruments into shares. According to CNB regulations these instruments affect the increase of the Bank's regulatory capital in calculating capital adequacy. Hybrid instruments balance as of 31 December 2018 amounted to HRK 53,802 thousand (2017: HRK 54,162 thousand).

The balance includes 13 hybrid instruments that mature from April 2021 to May 2023. Instruments are subject to linear depreciation and their non-depreciated value is included in the calculation of regulatory capital or HRK 31,515 thousand (2017: HRK 41,772 thousand).

35. Share capital

The Bank's share capital as at 31 December 2018 amounted to HRK 176,678 thousand and is divided into 17,570,409 shares, of which 17,559,585 are ordinary shares with a nominal value of HRK 10 and 10,824 of preferred shares with a nominal value of HRK 100. Ordinary shares are quoted on the Zagreb Stock Exchange in the amount of 1,328,233. Preferred shares are entitled to a dividend of 7% of the nominal value and difference up to dividends entitled to the holders of ordinary shares. Preferred shares are also listed and traded.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

35. Share capital – continued

Regulatory capital

The regulatory capital of the Bank and the capital adequacy rate for 2018 were calculated in accordance with the requirements of the Decision on IT solutions for the submission of reports of credit institutions in accordance with EU regulations (Official Gazette no. 9/2018 and 120/2018). The said Decision is in conformity with the provisions of the Implementing Regulation of the EU Commission EU no. 680/2014 and Regulation no. 2018/1624. As at 31 December 2018 the regulatory capital of the Bank amounted to HRK 172,786 thousand (2017: HRK 180,992 thousand) while the capital adequacy rate amounted to 17.25% (2017: 17.00%) in relation to the prescribed minimum rate of 12%.

Description	2018. HRK'000	2017. HRK'000
Regulatory capital		
<i>Share capital</i>		
<i>Regular share capital</i>	154.440	139.220
Issued stock capital	154.440	139.220
Retained profit (excluding profit for the year)	175.436	175.869
Net profit/(loss) for the year	(33.687)	(42.987)
<i>Deductions in line with CNB regulations</i>	13.169	7.668
Intangible assets		
Impairment of CET1 due to prudential filters	(264)	(826)
	(215)	(70)
Total regular share capital	154.440	139.220
Additional share capital	0	0
Share capital	154.440	139.220
Supplementary capital	31.515	41.771
Total regulatory capital	185.955	180.992
Total amount of risk exposure	1.078.288	1.064.522
Capital adequacy rate	17,25%	17,00 %

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

36. Contingent liabilities and commitments

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Performance guarantees		
- HRK	49.798	48.680
- foreign currency	231	2.190
Payment guarantees		
- HRK	5.557	6.402
- foreign currency	15.586	12.416
Letters of credit		
- foreign currency	-	-
Not withdrawn loan facilities	248.196	202.887
Other	2.424	2.545
Total contingent liabilities and commitments	321.792	275.120
Provisions for contingent liabilities and commitments	(251)	(109)
Total contingent liabilities and commitments, net	321.541	275.011

37. Cash and cash equivalents

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Cash	405.447	317.517
Placements with other banks with maturity up to 3 months	25.059	20.269
Total cash and cash equivalents	430.506	337.786

38. Funds for and on behalf of third parties

The Bank manages funds for and on behalf of third parties mainly placed in the form of borrowings. These funds are booked separately from the Bank's funds. Income and expenses based on these funds are booked as income or expense of certain sources and the Bank does not bear any risk in this respect. The Bank charges fees for its services which are debited to these funds.

Description	2018. HRK '000	2017. HRK '000
Total sources	8.985	9.120
Less: assets	(8.985)	(9.120)
Unused funds	-	-

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

39. Transactions with persons in a special relation with the Bank and their related parties

Persons in a special relation with the credit institution are:

- 1) The credit institution's shareholders owning 5% or more of shares with voting rights at the credit institution's general assembly meeting,
- 2) The members and procurators of the credit institution's management board and supervisory board,
- 3) Persons responsible for the work of control functions, persons responsible for business with corporates and persons responsible for business with individuals,
- 4) Legal entities in which the credit institution has a participating interest
- 5) Legal entities being members of the Management Board or the Supervisory Board or Procurators,
- 6) Legal entities whose board member has 10% or more of the voting rights of the credit institution,
- 7) Member of the Management Board or the Supervisory Board or a Procurator of the parent company or a subsidiary,
- 8) Third persons acting for the account of persons referred to in points 1) to 7)

Persons in a special relation with the credit institution shall also be persons connected with such persons defined as follows: two or more natural or legal persons and their immediate family members, who, unless it is shown otherwise, constitute a single risk for the credit institution because:

- 1) One of them has, directly or indirectly, control over the other or the others or
- 2) They are so interconnected that there is a high likelihood that the economic and financial condition of one or more persons will deteriorate or improve as a result of the deterioration or improvement of the economic and financial conditions of one person, especially if between them there is a possibility of transferring loss, profit, creditworthiness or if difficulties in funding sources, or settlement of a person's obligations, can cause difficulties in sources of funding, or settlement of the obligations of one person or other persons.

Immediate family members are:

- 1) Spouse or a person living in a common household who, according to a special law, has the position equal to that in a marital community,
- 2) Children or adopted children of the person or children or adopted children of the person from item 1 of this paragraph without full legal capacity and
- 3) Other persons without full legal capacity and placed under custody of that person.

Credit institution may enter into a legal arrangement with the person in a special relationship with the Bank and persons connected with such persons, only if such an arrangement is agreed under conditions that are not more favourable than the usual conditions of a credit institution.

The exposure of a credit institution to persons in a special relationship with the Bank and persons connected with such persons that exceeds HRK 50,000 thousand may incur or increase only by unanimous approval of all the Bank's Management Board members and with the prior approval of the Bank's Supervisory Board. Exceptionally, member of the Management Board or Supervisory Board cannot vote on the approval of exposure, if the exposure would relate to them, or persons connected with them.

KARLOVAČKA BANKA d.d.
NOTES TO THE FINANCIAL STATEMENTS - continued
For the year ended 31 December 2018

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

39. Transactions with persons in a special relation with the Bank and their related parties (continued)

/i/ Receivables and payables of related parties at 31 December 2018 are shown below:

	2018. HRK '000			
Related parties	Loans and receivables	Contingent liabilities and commitments	Deposits and hybrids	Other liabilities
Shareholders with over 5% of ordinary shares and their related parties	21	12.333	217.967	6.013
Supervisory Board	1.147	92	3.260	52
Management Board	251	129	436	135
Procurators	-	-	-	-
Persons responsible for control functions with corporates and individuals	1.254	328	1.751	154
Legal entities in which the Bank has a participating interest	30.837	8	2	-
Member of the Management Board of a Subsidiary	1	59	8	13
TOTAL	33.511	12.949	223.424	6.367

/ii/ Receivables and payables of related parties at 31 December 2017 are shown below:

	2017. HRK '000			
Related parties	Loans and receivables	Contingent liabilities and commitments	Deposits	Other liabilities
Shareholders with over 5% of ordinary shares and their related parties	481	8.370	231.570	5.806
Supervisory Board	663	58	1.275	27
Management Board	270	125	1.432	125
Procurators	-	-	-	-
Persons with concluded employment contracts with special conditions	1	58	122	10
Legal entities in which the Bank has a participating interest	30.768	-	5	-
TOTAL	32.183	8.611	234.404	5.968

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

39. Transactions with persons in a special relation with the Bank and their related parties (continued)

/iii/ Income and expenses with related persons for 2018 and 2017 are shown below:

Description	2018. HRK '000	2017. HRK '000
Income		
Shareholders with over 5% or ordinary shares and their related parties	6.074	5.423
Members of the Management Board and their related persons	9	12
Members of the Supervisory Board and their related persons	69	41
Others (employees and their related persons)	55	2
Legal entities in which the Bank has a participating interest	1	1
Member of the Management Board of a Subsidiary	2	-
Total income	6.210	5.479
Expenses		
Shareholders with over 5% or ordinary shares and their related parties	3.823	3.644
Members of the Management Board and their related persons	1.644	1.708
Members of the Supervisory Board and their related persons	593	348
Others (employees with special contracts and their related persons)	1.908	151
Legal entities in which the Bank has a participating interest	1.375	2.785
Member of the Management Board of a Subsidiary	151	-
Total expenses	9.494	8.636

/iv/ Remuneration to key personnel:

Description	31.12.2018. HRK '000	31.12.2017. HRK '000
Net salaries	1.876	2.534
Taxes and contributions	1.497	2.155
Total	3.373	4.689

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

40. Interest risk

Interest risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. Therefore the period in which the interest rate is fixed for a financial instrument indicates to what extent it is exposed to interest rate risk. The table below provides information on the extent of the Bank's interest rate exposure, based either on the contractual maturity date of its financial instruments or, in the case of instruments that re-price to a market rate of interest before maturity, the next re-pricing date. Those assets and liabilities that do not have a contractual maturity date or are not interest bearing are grouped in 'Interest free' category.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

40. Interest risk - continued

2018.	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	Interest free	TOTAL
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS							
Cash	-	-	-	-	-	405.447	405.447
Receivables from CNB	-	-	157.390	-	-	-	157.390
Placements with banks	5.697	23.025	12.292	-	-	-	41.014
Financial assets through other comprehensive income	-	-	-	-	-	150	150
Financial assets at depreciated cost	23.500	66.758	63.294	34.582	31.461	-	219.595
Financial assets valued at fair value	-	-	17.896	95.132	101.104	518	214.650
Loans and prepayments to customers	436.888	407.619	57.873	88.099	120.744	-	1.111.223
Investments into subsidiary	-	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	-	40.877	40.877
Intangible assets	-	-	-	-	-	264	264
Foreclosed assets	-	-	-	-	-	59.342	59.342
Other assets	-	-	-	-	-	11.842	11.842
Total assets	466.085	497.402	308.745	217.813	253.309	518.440	2.261.794
LIABILITIES							
Due to banks	43	-	-	-	-	-	43
Demand deposits	356	911.617	-	-	-	-	911.973
Term deposits	126.447	219.448	626.552	122.452	10.668	-	1.105.567
Hybrid instruments	-	-	-	43.417	10.385	-	53.802
Liabilities for loans received	2.873	112	336	850	1.624	-	5.795
Other liabilities	-	-	-	-	-	20.771	20.771
Provisions	-	-	-	-	-	7.682	7.682
Total liabilities	129.719	1.131.177	626.888	166.719	22.677	28.453	2.105.633
CAPITAL							
Share capital	-	-	-	-	-	176.678	176.678
Own shares	-	-	-	-	-	-	-
Unrealized profit/loss from impaired financial assets through other comprehensive income	-	-	-	-	-	-	-
Reserves	-	-	-	-	-	-	-
Profit for the year	-	-	-	-	-	-	-
Retained profit /(loss)	-	-	-	-	-	13.169	13.169
Total capital	-	-	-	-	-	(33.686)	(33.686)
Total liabilities and capital	129.719	1.131.177	626.888	166.719	22.677	184.614	2.261.794
Net assets/liabilities and capital	336.366	(633.775)	(318.143)	51.094	230.632	333.826	-

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

40. Interest risk - continued

2017.	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	Interest free	TOTAL
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS							
Cash	-	-	-	-	-	317.517	317.517
Receivables from CNB	-	-	147.517	-	-	-	147.517
Placements with banks	4.094	10.084	6.102	12.079	-	41	32.400
Financial assets through other comprehensive income	-	-	-	-	-	13.224	13.224
Financial assets at depreciated cost	9.900	-	14.850	80.366	47.266	1.208	153.590
Financial assets at fair value through income statement	9.532	2.380	15.929	128.128	117.644	3.311	276.924
Loans and prepayments to customers	411.898	441.813	58.068	84.642	117.958	4.404	1.118.783
Property, plant and equipment	-	-	-	-	-	44.229	44.229
Intangible assets	-	-	-	-	-	826	826
Foreclosed assets	-	-	-	-	-	66.480	66.480
Other assets	-	-	-	-	-	9.883	9.883
Total assets	435.424	454.277	242.466	305.215	282.868	461.123	2.181.373
LIABILITIES							
Due to banks	1	-	-	-	-	-	1
Demand deposits	209	-	746.402	-	-	6	746.617
Term deposits	125.270	235.615	663.400	154.257	6.684	5.084	1.190.310
Hybrid instruments	-	-	-	-	54.162	-	54.162
Liabilities for loans received	5.160	114	341	910	2.033	-	8.558
Other liabilities	-	-	-	-	-	33.253	33.253
Provisions	-	-	-	-	-	7.112	7.112
Total liabilities	130.640	235.729	1.410.143	155.167	62.879	45.455	2.040.013
CAPITAL							
Share capital	-	-	-	-	-	176.678	176.678
Own shares	-	-	-	-	-	-	-
Unrealized profit/loss from impaired financial assets through other comprehensive income	-	-	-	-	-	-	-
Capital gain	-	-	-	-	-	-	-
Reserves	-	-	-	-	-	-	-
Loss for the year	-	-	-	-	-	-	-
Retained profit	-	-	-	-	-	7.669	7.669
Total capital	-	-	-	-	-	(42.987)	(42.987)
						141.360	141.360
Total liabilities and capital	130.640	235.729	1.410.143	155.167	62.879	186.815	2.181.373
Net assets/liabilities and capital	304.784	218.548	(1.167.677)	150.048	219.989	274.308	-

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

40. Interest risk - continued

Below table is a summary of effective interest rates for interest bearing assets and liabilities:

	2018.	2017.
	%	%
Assets		
Receivables from CNB	-0,6-0	-0,6-0
Placements with banks	-0,5-2,62	-0,4-1,82
Financial assets through other comprehensive income	-	-
Financial assets at depreciated cost	0,10-6,75	0,10-6,00
Loans and prepayments to customers	2,00-11,00	2,00-11,00
Liabilities		
Due to banks (HBOR)	0,0 -5,12	0,0-5,12
Demand deposits	0,00-0,01	0,00-0,10
Term deposits	0,00-6,5	0,00-6,5

41. Fair value of financial assets and liabilities

Fair value represents the amount to which funds can be exchanged or liabilities settled in the best interest of all parties. Since market prices for the major part of the Bank's financial assets and liabilities are not available, the fair value of these items is based on the estimates of the Management Board according to the type of assets and liabilities. According to the estimation of the Management Board, the market value is not materially different from the carrying value of all categories of assets and liabilities.

42. Concentration of assets, liabilities and off-balance sheet items

The Bank has no assets, liabilities and commitments in any other country other than Croatia, excluding current foreign currency accounts and term deposits with foreign banks in the European Union and insignificant funds with banks outside the European Union.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

43. Liquidity risk

Liquidity risk as a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank maintains its liquidity profiles in accordance with regulations prescribed by the Croatian National Bank.

Remaining maturity of the Bank's assets and liabilities as at 31 December 2018 is shown as follows:

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

43. Liquidity risk - continued

	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	TOTAL
2018.	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash	405.447	-	-	-	-	405.447
Receivables from CNB	157.390	-	-	-	-	157.390
Placements with banks	5.697	23.025	12.292	-	-	41.014
Financial assets through other comprehensive income	-	-	-	-	150	150
Financial assets at depreciated cost	23.500	66.758	63.294	34.582	31.461	219.595
Financial assets at fair value through income statement	-	-	17.896	95.132	101.622	214.650
Loans and prepayments to customers	436.888	407.619	57.873	88.099	120.744	1.111.223
Investment into associated company	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	40.877	40.877
Intangible assets	-	-	-	-	264	264
Foreclosed assets	-	-	-	-	59.342	59.342
Other assets	3.058	8.266	518	-	-	11.842
Total assets	1.031.980	505.668	151.873	217.813	354.460	2.261.794
LIABILITIES						
Due to banks	43	-	-	-	-	43
Demand deposits	911.973	-	-	-	-	911.973
Term deposits	126.447	219.448	626.552	122.452	10.668	1.105.567
Hybrid instruments	-	-	-	43.417	10.385	53.802
Liabilities for loans received	2.873	112	336	850	1.624	5.795
Other liabilities	19.109	1.662	-	-	-	20.771
Provisions	7.682	-	-	-	-	7.682
Total liabilities	1.068.127	221.222	626.888	166.719	22.677	2.105.633
CAPITAL						
Share capital	-	-	-	-	176.678	176.678
Own shares	-	-	-	-	-	-
Unrealized profit/loss from impaired financial assets through other comprehensive income	-	-	-	-	-	-
Reserves	-	-	-	-	-	-
Profit for the year	-	-	-	-	13.169	13.169
Retained profit/(loss)	-	-	-	-	(33.686)	(33.686)
Total capital	-	-	-	-	156.161	156.161
Total liabilities and capital	1.068.127	221.222	626.888	166.719	178.838	2.261.794
Net assets/liabilities and capital	(36.147)	284.446	(475.015)	51.094	175.622	-

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

43. Liquidity risk - continued

	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	TOTAL
2017.	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS						
Cash	317.517	-	-	-	-	317.517
Receivables from CNB	147.517	-	-	-	-	147.517
Placements with banks	4.965	10.289	9.154	7.992	-	32.400
Financial assets through other comprehensive income	12.463	28	-	-	733	13.224
Financial assets at depreciated cost	10.226	882	14.850	80.366	47.266	153.590
Financial assets at fair value through income statement	25.901	2.417	5.133	125.829	117.644	276.924
Loans and prepayments to customers	150.788	35.962	119.342	418.799	393.892	1.118.783
Investment into associated company	-	-	-	-	-	-
Property, plant and equipment	-	-	-	-	44.229	44.229
Intangible assets	-	-	-	-	826	826
Foreclosed assets	-	-	-	-	66.480	66.480
Other assets	2.445	6.611	827	-	-	9.883
Total assets	671.822	56.189	149.306	632.986	671.070	2.181.373
LIABILITIES						
Due to banks	1	-	-	-	-	1
Demand deposits	746.617	-	-	-	-	746.617
Term deposits	124.508	242.267	667.010	154.883	1.642	1.190.310
Hybrid instruments	-	-	-	-	54.162	54.162
Liabilities for loans received	73	570	1.855	3.995	2.065	8.558
Other liabilities	33.253	-	-	-	-	33.253
Provisions	7.112	-	-	-	-	7.112
Total liabilities	911.564	242.837	668.865	158.878	57.869	2.040.013
CAPITAL						
Share capital	-	-	-	-	176.678	176.678
Own shares	-	-	-	-	-	-
Unrealized profit/loss from impaired financial assets through other comprehensive income	-	-	-	-	-	-
Capital gain	-	-	-	-	-	-
Reserves	-	-	-	-	-	-
Profit for the year	-	-	-	-	7.669	7.669
Retained profit/(loss)	-	-	-	-	(42.987)	(42.987)
Total capital	-	-	-	-	141.360	141.360
Total liabilities and capital	911.564	242.837	668.865	158.878	199.229	2.181.373
Net assets/liabilities and capital	(239.742)	(186.648)	(519.559)	474.108	471.841	-

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

44. Credit risk

The Bank is exposed to credit risk which is the risk that a counterparty will be unable to pay amounts in full when due. The Bank structures the levels of credit risk by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Risks are monitored regularly and are subject to an annual or more frequent review.

Exposure to credit risk is managed by the Bank through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

The primary purpose of credit commitments is to ensure that funds are available to a customer as required. Guarantees which represent irrevocable commitments that the Bank will settle the payment to third parties if the customers are not able to, bear the same credit risk as loans.

Contingent credit commitments represent undrawn portions of authorized loans and guarantees. According to credit risk related to contingent credit commitments, the Bank takes on potential loss exposure to the amount equal to total undrawn contingent commitments. However, possible loss amount is lower than total amount of undrawn contingent commitments, as most of the contingent credit commitments are related to maintenance of specific credit standards by customers. The Bank monitors the term of maturity of contingent credit commitments because longer-term commitments generally have a greater degree of credit risk than short-term commitments..

Exposure to credit risk related to balance sheet records is as follows:

	31.12.2018. HRK'000	31.12.2017. HRK'000
Current accounts with CNB and other banks	365.240	284.379
Receivables from CNB	157.390	147.517
Placements with banks	41.014	32.400
Financial assets through other comprehensive income	150	13.224
Financial assets at depreciated cost	219.595	153.590
Financial assets at fair value through income statement	214.650	276.924
Loans and prepayments to customers	1.111.223	1.118.783
Other assets	11.842	9.883
Total	2.121.104	2.036.700

Exposure to credit risk related to off-balance sheet records is as follows:

	31.12.2018. HRK'000	31.12.2017. HRK'000
Guarantees	71.172	69.689
Unused placements and other	250.620	205.432
Total	321.792	275.121
Reserves	(3.386)	(2.818)
Total off-balance	318.406	272.303
Total exposure to credit risk	2.439.510	2.309.003

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

44. Credit risk - continued

In the table above the Bank's highest exposure to credit risk is stated as at 31 December 2018 and 31 December 2017, without collaterals taken into consideration. Balance sheet records stated in the table above are presented at net carrying value less provisions for value decrease, as shown in the balance sheet. Off-balance sheet records are based on the approved amounts, except for the undrawn portions of authorized loans and limits on credit cards, based on the undrawn portions of the amount.

46.04% (2017: 49.9%) of the highest exposure to credit risk arises from loans and receivables from banks and clients. Undrawn portions of authorized loans, credit card limits and other items represent 9.4% (2017: 8.9%) of the Bank's total exposure.

The Management Board is confident in its ability to further monitor and manage the Bank's credit risk, which arises from the loan portfolio and taken over liabilities due to the following reasons:

- 83.9% (2017: 82.4%) of loans and receivables from clients are classified in the risk category A,
- 83.1% (2017: 81.6%) of gross loans and receivables from clients are loans that are not yet due and have not been impaired,
- 16.1% (2017: 17.6%) of gross loans and receivables from clients are classified as impaired loans.

Loans and receivables from clients are insured with various types of collateral. The Management Board considers that loans and receivables from clients are sufficiently recoverable by provisions for impairment and by collaterals.

Impairment

Classification of the Bank	31.12.2018. HRK'000		31.12.2017. HRK'000	
	Loans and receivables from clients	Provisions for impairment	Loans and receivables from clients	Provisions for impairment
A	1.041.578	12.578	1.037.045	10.372
B1	59.367	6.760	57.659	6.934
B2	28.528	15.444	40.650	24.486
B3	92.737	76.205	96.241	71.020
C	20.049	20.049	29.865	29.865
Total	1.242.259	131.036	1.261.460	142.677

- Provisions for impairment of loans and receivables from clients classified in the risk category A are related to general provisions,
- Provisions for impairment stated as a percentage of gross loans and receivables from clients amount to 10.5% (2017: 11.1%),
- Decrease in provisions during 2018 is a result of the collection of risk placements, new evaluation of placements and relocation of part of the risk category C portfolio to off-balance sheet records

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

44. Credit risk - continued

Uncertainty related to the valuation of property collateral

Most housing loans are insured with mortgages on residential property. Also, a significant part of corporate portfolios is insured with real estate mortgages. The Real estate market in Croatia has not been liquid for several years, but despite the drop in prices, a relatively small number of transactions have been realized. Decrease in prices and non-liquidity of the real estate market have a negative impact on recoverability of the assets and the expected time of its realization in cases when borrowers have financial difficulties and the Bank would normally rely on collection through collaterals.

Rescheduled loans and receivables

The Bank has rescheduled certain loans to clients during the year to increase the possibility for their ultimate repayment. This measure was taken as a response to the deteriorating financial position of borrowers, that is, as a preventative measure. Wherever possible, the Bank has tried to improve its position by obtaining additional collaterals. Restructured loans are constantly monitored and in case of additional deterioration or breach of contractual obligations, necessary measures for collection of receivables are considered.

Loans and receivables from clients: impact analysis

<i>Granted loans</i>	31.12.2018. HRK'000	31.12.2017. HRK'000
Not yet due	1.032.573	1.027.346
Due	9.005	9.699
Impaired loans	200.681	224.415
Gross total	1.242.259	1.261.460
Provisions for impairment	(131.036)	(142.677)
Net amount	1.111.223	1.118.783

Total provisions of the Bank for impairment of loans and receivables from clients amount to HRK 131,036 thousand (2017: HRK 142,678 thousand), out of which the amount of HRK 118,458 thousand (2017: HRK 132,306 thousand) relates to specific provisions for impairment while the remaining amount of HRK 12,578 thousand relates to general provisions (2017: HRK 10,372 thousand).

a) *Loans and receivables from clients – not yet due – risk group A/1*

Loans and receivables from customers that are not yet due and not impaired are being monitored regularly and reviewed in detail for the purpose of early detection of any irregularities or warning signs, in order to take timely actions.

Risk group A/1 is classified as exposures with undetermined evidence of impairment and the absence of significant credit risk increases in relation to the recognition date of the financial asset. In this category, future losses are calculated for a period of up to one year.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

44. Credit risk - continued

b) Due loans and receivables from customers that are classified as group A

For loans and receivables from customers with delays of up to 90 days, no losses are considered incurred unless other details indicate otherwise. For these loans impairment provisions for expected losses are calculated. The gross amount of loans and receivables from customers that are due but not impaired is shown below:

Description	31.12.2018. HRK'000	31.12.2017. HRK'000
Due within 30 days – risk group A/1	7.294	7.856
Due in 31-60 days – risk group A/2	1.170	1.261
Due in 61-90 days – risk group A/2	541	582
TOTAL	9.005	9.699

Risk group A/2 is classified as exposures with undetermined evidence of impairment but with significant increase in credit risk in relation to the recognition date of the financial assets. For this category, future losses are counted for in the entire duration of the instrument.

It is not practical to present the estimated value of the collateral.

c) Loans and receivables from customer for which there is objective evidence of impairment (risk group B and C)

Overview of loans and receivables from customers for which an individual impairment has been recognized, net provisions for impairment, is shown below:

Description	31.12.2018. HRK'000	31.12.2017. HRK'000
Impaired loans, gross	200.681	224.415
Impairment	(118.458)	(132.305)
Impaired loans, net	82.223	92.110

It is not practical to present the estimated value of the collateral.

The Management Board believes that impaired loans and receivables from customers are adequately covered by collaterals and impairment provisions.

Risk group B and C are classified as exposures for which there are objective evidence of impairment or that are in the status of default.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

45. Market risk

Market risk is defined as the direct effect that changes in market prices have on the Bank's Income statement and the Balance sheet. Primary risk factors are:

- own

45.1. Currency risk

Currency risk management is performed with the aim of minimizing losses that may occur as a result of open FX position per currency and as a result of foreign exchange balance mismatching from the point of remaining maturity by key currencies.

The Bank is exposed to currency risk through transactions in foreign currencies that have effect on its financial position and cash flows.

The following table represents the analysis of main foreign currencies related to the Bank currency risk exposure. Other foreign currencies are comprised in 'Other currencies'. The Bank monitors its foreign currency risk exposure daily in accordance with legislation prescribed by the CNB and internally set limits. The Bank endeavours to match its assets and liabilities in foreign currencies in order to avoid exposure to currency risk.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

45.1. Currency risk - continued

Foreign currency assets and liabilities of the Bank at 31 December 2018 are shown below:

2018.	EUR	USD	Other currencie s	HRK with currenc y clause	Total foreign currency equivalent s	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS							
Cash	139.382	38.63	17.852	-	195.868	209.579	405.447
Receivables from CNB	-	-	-	-	-	157.390	157.390
Placements with banks	4.922	36.09	-	-	41.014	-	41.014
Financial assets through	-	-	-	-	-	150	150
Financial assets at depreciated cost	101.210	-	-	31.167	132.377	87.218	219.595
Financial assets at fair through income statement	24.980	-	-	44.003	68.983	145.667	214.650
Loans and prepayments	205.646	-	-	474.765	680.411	430.812	1.111.22
Investments into	-	-	-	-	-	-	-
Property and equipment	-	-	-	-	-	40.877	40.877
Intangible assets	-	-	-	-	-	264	264
Foreclosed assets	-	-	-	-	-	59.342	59.342
Other assets	4.367	-	-	864	5.231	6.611	11.842
Total assets	480.507	74.72	17.852	550.799	1.123.884	1.137.91	2.261.79
LIABILITIES							
Due to banks	-	-	-	-	-	43	43
Demand deposits	277.592	33.25	19.009	-	329.851	582.122	911.973
Term deposits	721.212	33.86	6.797	-	761.875	343.692	1.105.56
Hybrid instruments	27.802	-	-	-	27.802	26.000	53.802
Loan liabilities	-	-	-	5.679	5.679	116	5.795
Other liabilities	6.315	266	66	-	6.647	14.124	20.771
Provisions	-	-	-	-	-	7.682	7.682
Total liabilities	1.032.92	67.38	25.872	5.679	1.131.854	973.779	2.105.63
CAPITAL							
Share capital	-	-	-	-	-	176.678	176.678
Unrealized profit/loss	-	-	-	-	-	-	-
Profit for the year	-	-	-	-	-	13.169	13.169
Retained profit / (loss)	-	-	-	-	-	(33.686)	(33.686)
Total capital	-	-	-	-	-	156.161	156.161
Total liabilities and	1.032.92	67.38	25.872	5.679	1.131.854	1.129.94	2.261.79
Net assets/liabilities and	(552.414)	7.344	(8.020)	545.120	(7.970)	7.970	-

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

45.1. Currency risk - continued

Foreign currency assets and liabilities of the Bank at 31 December 2017 are shown below:

2017.	EUR	USD	Other currencie s	HRK with currenc y clause	Total foreign currency equivalen ts	HRK	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
ASSETS							
Cash	125.313	11.84	15.165	-	152.326	165.191	317.517
REceivables from CNB	-	-	-	-	-	147.517	147.517
Placements with banks	304	24.38	7.711	-	32.400	4.732	32.400
Financial assets through other comprehensive	-	-	-	-	-	13.224	13.224
Financial assets at depreciated cost	101.798	-	-	-	101.798	51.792	153.590
Financial assets at fair value through income	25.559	14.29 4	-	99.683	139.536	137.388	276.924
Loans and prepayments to customers	204.583	-	-	480.30 7	684.890	433.893	1.118.78 3
Property, plant and Intangible assets	-	-	-	-	-	44.229	44.229
Foreclosed assets	-	-	-	-	-	826	826
Other assets	4.195	-	-	956	5.151	66.480	66.480
						4.732	9.882
Total assets	461.752	50.52	22.876	580.94	1.116.101	1.065.27	2.181.37
LIABILITIES							
Due to banks	-	-	-	-	-	1	1
Demand deposits	211.452	15.06	14.063	-	240.579	506.038	746.617
Term deposits	797.397	35.62	8.645	10	841.673	348.637	1.190.31
Hybrid instruments	-	-	-	28.162	28.162	26.000	54.162
Liabilities for loans	-	-	-	8.205	8.205	353	8.558
Other liabilities	12.235	515	128	-	12.878	20.375	33.253
Provisions	-	-	-	-	-	7.112	7.112
Total liabilities	1.021.084	51.20	22.836	36.377	1.131.497	908.516	2.040.01
CAPITAL							
Share capital	-	-	-	-	-	176.678	176.678
Unrealized profit/loss at impairment of financial	-	-	-	-	-	-	-
Profit for the year	-	-	-	-	-	7.669	7.669
Retained profit / (lossw)	-	-	-	-	-	(42.987)	(42.987)
Total capital						141.360	141.360
Total liabilities and	1.021.084	51.20	22.836	36.377	1.131.497	1.049.87	2.181.37
Net assets/liabilities and	(559.332)	(673)	40	544.56	(15.396)	15.396	-

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

45.1. Currency risk - continued

The currency management system is determined by the extent of the business in foreign exchange trading which does not assume trading for speculative purpose. The aim of the Bank is to maintain the balanced position in terms of minimizing the impact of open position on the operating result.

Stress tests related to this risk are indirectly involved through the liquidity risk testing and also in cases of announced potential changes in regulations to the extent that it directly or indirectly affects the amount of an open foreign exchange position.

45.2. Interest rate risk

Interest rate risk refers to the sensitivity of the Bank's income and market value of the Bank's capital to changes in interest rates.

Interest rate risk management policy is adopted and implemented by the Bank in order to protect and minimize potential adverse effects on its financial result (net interest income) as well as the economic value of the Bank's portfolio, which could occur due to changes in interest rates.

Policy of interest rate risk management takes into consideration the short term as well as the long term focus when managing this risk.

Short term focus

In order to protect and minimize potential adverse effects on its financial result (net interest income), the Bank uses a re-pricing model (GAP analysis). For this purpose, nominal and weighted GAP's values are determined for each period as well as cumulatively in the period up to 1 year in all major currencies, and then for all currencies in total. The weighted value is considered in relation to the annual level of net interest income.

Long term focus

In order to protect and minimize the potential negative effects on the economic value of the Bank's portfolio, the Bank uses a simplified calculation of estimates of economic value by applying the standard interest rate shock on the positions in all major currencies and all currencies in total, and in the manner prescribed by the CNB in its applicable regulation.

In order to minimize the potential impact of changes in interest rates on net interest income and the economic value, the following objectives and constraints were set by the Policy:

1. Gradual decrease of existing net weighted positions in all major currencies and the total, with the aim of reducing possible changes in annual net interest income to a maximum level of 10%. Maximum changes in economic value of the Bank's portfolio, as a result of the application of the standard interest rate shock which is expressed as a ratio set of change in economic value and the liable capital must not be greater than 10%.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

45.3. Securities price risk

Objectives of investments in investment portfolio are:

1. to ensure a satisfactory structure of assets in terms of the liquidity level
2. to enable the provision of repo loans or loans based on eligible collaterals in the domestic interbank market
3. to achieve an acceptable rate of return

When purchasing a particular security, the Bank is guided by the principle of minimizing:

- concentration risk
- market risk
- credit risk
- liquidity risk
- interest risk

In order to minimize each of the above mentioned risks, the Bank has established appropriate limits.

45.4. Concentration risk

Concentration risk management is achieved through:

- Defined target structure of investment portfolios of which the bulk of the portfolio or 75% consists of debt securities issued by the Republic of Croatia;
- The maximum amount of the portfolio per issuer from 0.25 to 5% of the regulatory capital.

With regard to the set limits on concentration risk, at the end of 2016 the limit for investing in domestic company bonds was exceeded. As it was investment in state-owned companies, this is considered less significant.

46. Operational risk

The Bank is exposed to operational risk in all its business activities and therefore seeks to manage operational risk in accordance with the prescribed principles and policies, as defined for the purpose of avoiding or mitigating operational risk.

Operational risk is managed through its identification, assessment, control and monitoring and the appropriate organizational chart and internal acts are set for that purpose. The Bank's policy for managing operational risk, beside the definition of the risk and its categories, determines also the classification of operational risk events in a way that it takes the classification from the current subordinate regulations. Furthermore, as part of the assessment and measurement of risk, the Bank covers the events that occurred and resulted in operating losses as well as the events which have occurred but for which the operating loss was avoided. Area of operational risk management is also regulated by special internal documents. For that purpose specific functions for operating segments related to the risk of outsourcing, compliance, anti-money laundering and terrorist financing, risk information systems and business continuity have been set.

For the purposes of identification and assessment of operational risk exposure, the Bank uses both qualitative and quantitative methods.

In case of crisis, the activities of the Bank are regulated by the Business continuity plan.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

47. Fair value of financial instruments

Fair values of financial assets and financial liabilities are determined as follows:

- Fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets is determined with reference to quoted market prices.
- Fair value of other financial assets and financial liabilities is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.
- Fair value of derivative instruments is calculated using listed prices. Where such prices are not available, the analysis uses discounted cash flows by applying the current yield curve for the period of non-derivative instruments.
- This note provides information on methods used by the Bank to determine the fair value of various financial assets and financial liabilities.

The table below provides information on how to determine their fair value, more precisely, valuation methods and used input data:

Financial assets/financial liabilities	Fair value as at		Fair value hierarchy	Valuation method and main input data
	31.12.2018.	31.12.2017.		
1) Listed bonds (Note 23.)	<i>Listed debt securities – government bonds – HRK 195.895 thousand (book value. = HRK 183.133 thousand)</i>	<i>Listed debt securities – government bonds – HRK 226.868 thousand (book value = HRK 207.304 thousand)</i>	1.level	Market price model – the average daily price in the active market on the day of valuation or on the last trading day preceding the valuation.
2) Listed bonds (Note 23.)		<i>Listed debt securities – bonds of public companies (HEP) – HRK 7.030 thousand (book value = HRK 6.340 thousand)</i>	1.level	Market price model – the average daily price in the active market on the day of valuation or on the last trading day preceding the valuation.
3) Listed bonds (Note 23.)	<i>Listed debt securities – bonds of other companies (Zgb.holding) – HRK 18.238 thousand (book value = HRK 17.255 thousand)</i>	<i>Listed debt securities – bonds of other companies (Zgb.holding) – HRK 18.020 thousand (book value = HRK 17.256 thousand)</i>	1.level	Market price model – the average daily price in the active market on the day of valuation or on the last trading day preceding the valuation.

KARLOVAČKA BANKA d.d.
NOTES TO THE FINANCIAL STATEMENTS - continued
For the year ended 31 December 2018

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

47. Fair value of financial instruments - continued

4) Listed shares in investment funds (Note 23.)		<i>Listed securities – shares in investment funds – HRK 25.006 thousand (book value = HRK 25.000 thousand)</i>	1.level	Market price model – published share price on the day of valuation.
5) Shares in joint-stock companies (Note 22.)	<i>Listed securities .2,03 % of shares of Varteks d.d. – HRK 518 thousand (book value = HRK 451 thousand)</i>	<i>Listed securities .2,48 % of shares of Varteks d.d. – HRK 583 thousand (book value = HRK1.326 thousand.)</i>	1.level	Fair value estimation model – weighted average market price less a corrective factor
6) Shares in limited liability companies (Note 22.)	<i>Unlisted shares 1,04 % of shares of HROK HRK 141 thousand</i>	<i>Unlisted shares 1,04 % of shares of HROK HRK 141 thousand</i>	3.level	Book value at cost of acquisition
7) Shares in joint-stock companies (Note 22.)	<i>Unlisted shares 0,08 % of shares of SDA d.d. – HRK 8 thousand</i>	<i>Unlisted shares 0,87% of shares of SDA d.d. – HRK 8 thousand</i>	3.level	Book value at cost of acquisition
8)) Shares in joint-stock companies (Note 22.)	<i>Unlisted shares 4,555% shares of Tržište novca d.d. – HRK 1 thousand</i>	<i>Unlisted shares 4,555% shares of Tržište novca d.d. – HRK 1 thousand</i>	3.level	Book value at cost of acquisition
9) Bills of exchange (Note 22.)		<i>Discounted bill of exchange of Uljanik HRK 8.952 thousand</i>	3.level	Discounted value
10) Bills of exchange		<i>Discounted bill of exchange of AWT HRK 7.000 thousand with HRK 3.500 thousand of impairment</i>	3.level	Discounted value less credit risk

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

47. Fair value of financial instruments - continued

Fair value measurements recognized in the Statement of financial position / Balance sheet

The table analyses financial instruments subsequently measured at fair value, classified within three groups according to IFRS 13:

1. level of available indicators – fair value indicators are derived from (uncoordinated) quoted market prices for identical assets or liabilities
2. level of available indicators – fair value indicators are derived from inputs other than quoted prices from level 1 which relate to the asset or liability (their prices) or indirectly (derived from prices) and
3. level of indicators – indicators derived using valuation methods in which the input data are not based on available market data (unobservable inputs).

Levels of fair value recognized in the Statement of financial position / Balance sheet:

	1. level HRK '000	2. level HRK '000	3. level HRK '000	Total HRK '000
2018				
Financial assets through other comprehensive income	0	0	150	150
Financial assets at fair value through income statement	517	0	0	517
Financial assets at fair value through income statement	214.133	0	0	214.133
2017				
Financial assets through other comprehensive income	583	0	12.641	13.224
Financial assets at fair value through income statement	276.924	0	0	276.924

48. Auditors' fee

Auditors' fee for the audit of annual financial statements of the Bank in 2018 amounted to HRK 190 thousand plus VAT (2017: HRK 214 thousand plus VAT). Services included: audit of annual financial statements, audit for CNB and audit of IT system.

NOTES TO THE STATEMENT OF FINANCIAL POSITION / BALANCE SHEET - continued

49. Subsequent events

Following the Balance sheet date there were no events that could have material impact to the annual financial statements of the Bank for 2018 and that should be published accordingly.

50. Approval of the financial statements

The Management Board approved and authorized for issue these financial statements on 22 February 2019.



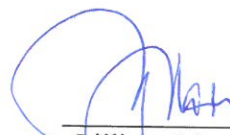
Željka Surač
President

of the Management Board



Marino Rade
Member

of the Management Board



Ljiljana Movre
Member

of the Management Board



**ADDITIONAL REPORTS ACCORDING TO CNB'S DECISION ON STRUCTURE AND
CONTENT OF ANNUAL FINANCIAL STATEMENTS OF CREDIT INSTITUTIONS**

Annual financial statements of Karlovačka banka d.d. as prescribed by the Croatian National Bank in the Decision on structure and content of annual financial statements of credit institutions (Official Gazette no. 42/2018) are shown below:

- Income statement for 2018
- Statement of other comprehensive income for 2018
- Balance Sheet as at 31 December 2018
- Cash flow statement for 2018
- Statement of changes in equity for 2018

The financial information presented in the following financial statements (hereinafter referred to as the "CNB Report") derived from financial statements shown on pages 34-37 (hereinafter referred to as the "Basic financial statements").

Accounting policies have been applied in preparation of these financial statements as well as in the preparation of basic financial statements in terms of valuation of individual positions of the balance sheet, income statement, cash flow statement and changes in equity but the grouping and presentation of individual positions has been carried out in accordance with the said Decision on structure and content of annual financial statements of credit institutions.

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

INCOME STATEMENT FOR 2018

Description	2018. HRK '000	2017. HRK 000
Interest income	71.695	76.631
(Interest expenses)	(13.386)	(19.856)
Income from fees and commissions	23.103	24.279
(Fees and commissions expenses)	(6.904)	(7.289)
Profit/(loss) after recognition of financial assets and liabilities not measured at fair value through income statement	-	(2.636)
Profit/(loss) from financial assets and liabilities held for trading, net	9.171	8.713
Profit/(loss) from financial assets not trade but measured at fair value through income statement, net	90	52
Profit/(loss) from financial assets and liabilities at fair value through income statement, net	(4.503)	2.966
Profit/(loss) from accrued foreign exchange differences	(127)	(233)
Other operating income	908	873
(Other operating expenses)	(6.524)	(6.703)
Total operative income (net)	<u>73.523</u>	<u>76.797</u>
(Administrative expenses)	(40.935)	(38.832)
(Depreciation)	(4.419)	(4.315)
(Provisions or (-) termination of provisions)	(1.477)	(2.487)
(Impairment or (-) termination of impairment of financial assets not measured at fair value through income statement)	(8.747)	(16.391)
(Impairment or (-) termination of impairment of non-financial assets)	(1.809)	(8.934)
Profit/(loss) before tax from operations which will continue	16.136	5.837
Tax expense from operations which will continue	-	-
Profit/(loss) after tax from operations which will continue	<u>16.136</u>	<u>5.838</u>
Profit or (-) loss before tax from operations which will not continue	(2.967)	1.831
(Tax expense) related to operations which will not continue	-	-
Profit/(loss) after tax from operations which will not continue	(2.967)	1.831
Profit/loss for the year before tax	13.169	7.669
Income tax	-	-
Profit/(loss) for the year	<u>13.169</u>	<u>7.669</u>

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

STATEMENT ON OTHER COMPREHENSIVE INCOME

STATEMENT ON OTHER COMPREHENSIVE INCOME	2018	2017
Description		
Profit or (-) loss for the year	13.169	7.669
Other comprehensive income	-	3.374
Items not to be reclassified as profit or loss	-	-
Tangible assets	-	-
Intangible assets	-	-
Actuarial gain or (-) loss on sponsored pension plans	-	-
Fixed assets and alienation groups intended for sale	-	-
Portion of other recognized income and expense from third parties calculated using share portion method	-	-
Changes in fair value of equity instruments measured at fair value through other comprehensive income	-	-
Gains/(losses) from accounting protection of equity instruments measured at fair value through other comprehensive income	-	-
Changes in fair value of equity instruments measured at fair value through other comprehensive income (protected item)	-	-
Changes in fair value of financial liabilities measured at fair value through income statement that are attributed to changes in credit risk	-	-
Income tax referring to items that will not be reclassified	-	-
Items that may be reclassified as profit or loss	-	3.374
Protection of net investments in foreign operations (effective portion)	-	-
Foreign currency exchange	-	-
Cash flow protection (effective portion)	-	-
Hedging instruments (elements not specified)	-	-
Debt instruments at fair value through other comprehensive income	-	3.374
Fixed assets and alienation groups intended for sale	-	-
Portion of other recognized income and expense from investments into subsidiaries, joint ventures and associates	-	-
Income tax referring to items that may be reclassified as profit/(loss)	-	-
Total comprehensive income for the year	13.169	11.043

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

BALANCE SHEET AS AT 31 DECEMBER 2018

Description	31.12.2018.	31.12.2017.
	HRK '000	HRK '000
ASSETS		
Cash, receivables from central banks and other demand deposits		
Cash in hand	405.447	317.720
Cash receivables from central banks	40.208	33.138
Other demand deposits	192.439	146.529
Financial assets held for trading	172.800	138.053
Financial assets not traded but measured at fair value through income statement	-	-
Financial assets at fair value through profit or loss	517	-
Financial assets at fair value through other comprehensive income	214.133	276.924
Financial assets at depreciated cost	150	13.224
Debt securities	1.539.487	1.460.830
Loans and prepayments	219.595	153.590
Investments in subsidiaries, joint ventures and associates	1.319.892	1.307.239
Tangible assets	-	-
Intangible assets	29.110	28.226
Tax assets	264	826
Other assets	1.189	580
Fixed assets and alienation groups intended for sale	388	560
	71.109	82.483
Total assets	2.261.794	2.181.373
LIABILITIES		
Financial liabilities held for trading	-	-
Financial liabilities at fair value through profit or loss	-	-
Financial liabilities measured at depreciation cost	2.077.449	2.000.025
Deposits	2.077.156	1.999.644
Other financial liabilities	293	381
Provisions	7.682	7.112
Tax liabilities	204	1.324
Other liabilities	20.298	31.552
Total liabilities	2.105.633	2.040.013
CAPITAL		
Share capital	176.678	176.678
Retained profit (loss)	(33.686)	(42.987)
Revaluations reserves	-	-
Other reserves	-	-
Profit (loss) for the year	13.169	7.669
Statutory and other capital reserves	0	0
Total capital	156.161	141.360
Total liabilities and capital	2.261.794	2.181.373

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

CASH FLOW STATEMENT FOR 2018

Description	Same period last year	On the reporting date of the current period
	HRK '000	HRK '000
1	3	4
Business activities and adjustments		
Profit/(loss) before tax	7.669	13.169
Impairments and provisions	27.509	11.964
Depreciation	3.854	4.418
Net unrealized (profit)/loss from financial assets and liabilities at fair value through income statement	2.864	(89)
(Profit)/loss from sale of tangible assets	150	(3.618)
Other non-cash items	-	-
Changes in assets and liabilities from operating activities		
Deposits with CNB	(11.953)	(10.019)
Deposits with financial institutions and loans to financial institutions	668	(4.406)
Loans and prepayments to other customers	(64.788)	(24.336)
Securities and other financial instruments at fair value through other comprehensive income	61.799	16.574
Securities and other financial instruments held for trading	-	-
Securities and other financial instruments not actively traded, at fair value through income statement	70.891	60.596
Securities and other financial instruments required at fair value through income statement	-	-
Securities and other financial instruments at depreciated cost	(15.526)	(13.379)
Other assets from operating activities	(4.822)	(2.552)
Increase/decrease in operating liabilities		
Deposits from financial institutions	-	43
Transaction accounts of other customers	88.280	84.099
Savings deposits of other customers	7.851	81.389
Term deposits of other customers	(46.784)	(70.208)
Derivative financial liabilities and other trading liabilities	-	-
Other liabilities from operating activities	14.552	(13.084)
Interest collected from operating activities [indirect method]	34.417	32.114
Dividends received from operating activities [indirect method]	-	-
Interest paid from operating activities [indirect method]	(7.410)	(11.186)
(Income tax paid)	-	-

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

CASH FLOW STATEMENT FOR 2018
- continued

Description	Same period last year	On the reporting date of the current period
	HRK '000	HRK '000
1	3	4
A) Net cash flow from operating activities	169.220	151.489
Investment activities		
Receipts from sale of / payments for tangible and intangible assets	1.527	4.825
Receipts from sale of / payments for investments into affiliates, associates and joint ventures	-	-
Receipts from collections of / payments for securities and other financial instruments held to maturity	(102.497)	(62.103)
Dividends received from investment activities	-	-
Other receipts / payments from investment activities	-	-
B) Net cash flow from investment activities	(100.970)	(57.278)
Financial activities		
Net increase/(decrease) in received loans	(44.351)	(2.763)
Net increase/(decrease) in issued debt securities	-	-
Net increase/(decrease) in supplementary capital instruments	10.095	(360)
Increase in share capital	-	-
(Dividend paid)	-	-
Other receipts/(payments) from financial activities	605	1.632
C) Net cash flows from financial activities	(33.651)	(1.491)
D) Net increase/(decrease) of cash and cash equivalents	34.599	92.720
Cash and cash equivalents at the beginning of the year	303.187	337.786
Effects of changes in foreign exchange rates on cash and cash equivalents	-	-
Cash and cash equivalents at the end of the year	337.786	430.506

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK - Continued

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Appendix A - Other legal and regulatory requirements

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

STATEMENT OF CHANGES IN EQUITY IN 2018																HRK '000	
R.b.	Description	Attributable to equity holders											Minority share		Total		
		Capital	Share premium	Issued equity instruments other than equity	Other equity instruments	Accumulated other comprehensive income	Retained profit	Revaluation reserves	Other reserves	Treasury shares	Profit or (–) loss attributable to owners of the parent company	Dividends during financial year	Accumulated other comprehensive income	Other items			
	1	3	4	5	6	7	8	9	10	11	12	13	14	15	16		
14.	Reclassification of financial instruments from equity instruments to liabilities	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
15.	Reclassification of financial instruments from liabilities to equity instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
16.	Transfers between components of equity instruments	-	-	-	-	-	7.669	-	-	-	-7.669	-	-	-	-		
17.	Share-based payments	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
18.	Other increase or (-) decrease in equity instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
19.	Total comprehensive income for the year	-	-	-	-	-	-	-	-	-	13.169	-	-	-	13.169		
20.	Increase or (-) decrease in equity instruments resulting from business combinations	-	-	-	-	-	-	-	-	-	-	-	-	-	-		
21.	Closing balance [current year] (from 4. to 20.)	176.678	-	-	-	-	(33.686)	-	-	-	13.169	-	-	-	156.161		

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

Reconciliation of statutory financial statements prepared in accordance with reporting framework and statutory financial statements prescribed by the CNB's Decision on structure and content of annual financial statements of banks:

A) RECONCILIATION OF THE INCOME STATEMENT FOR 2018

Description	CNB Decision	Basic financial statements	Difference	Note
	HRK '000	HRK 000	HRK '000	
Interest income	71.695	71.655	40	1
(Interest expenses)	(13.386)	(13.386)	-	
Income from fees and commissions	23.103	23.103	-	
(Expenses from fees and commissions)	(6.904)	(6.904)	-	
Profit/(loss) on termination of recognition of financial assets and liabilities not measured at fair value through profit or loss	-	-	-	
Profit/(loss) on financial assets and financial liabilities held for trading, net	9.171		9.171	2
Profit/(loss) on financial assets not traded which are measured at fair value through profit or loss, net	90		90	2
Profit/(loss) on financial assets and financial liabilities at fair value through profit or loss, net	(4.503)		-4.503	2
Profit from financial operations		4.758	-4.758	2
Profit/(loss) from accrued foreign exchange differences	(127)	(87)	-40	1
Other operating income	908	2.102	-1.194	3
(Other operating expenses)	(6.524)	-	-6.524	4
Total operating income (net)	73.523	81.241	-7.718	
General administrative costs and other operating costs		(56.108)	56.108	
(Administrative expenses)	(40.935)		-40.935	4
(Depreciation)	(4.419)		-4.419	4
(Provisions or (-) termination of provisions)	(1.477)		-1.477	4
(Impairment or (-) termination of impairment of financial assets not measured at fair value through profit or loss)	(8.747)	(11.964)	3.217	5
(Impairment or (-) termination of impairment of non-financial assets)	(1.809)		-1.809	5
Profit/(loss) before tax from continuing operations	16.136	13.169	2.967	
Tax expense from continuing operations	-	-	-	
Profit/(loss) after tax from continuing operations	16.136	13.169	2.967	
Profit or (-) loss before tax from operations that will not continue	(2.967)	-	(2.967)	3
(Tax expenses) related to operations that will not continue	-	-	-	

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

A) RECONCILIATION OF THE INCOME STATEMENT FOR 2018 - continued

Description	CNB Decision	Basic financial statements	Difference	Note
	HRK '000	HRK 000	HRK '000	
Profit/(loss) after tax from operations that will not continue	(2.967)	-	-2.967	3
Profit/loss for the year before tax	13.169	13.169	-	
Income tax	-			
Profit/(loss) for the year	13.169	13.169	-	

A) RECONCILIATION OF THE INCOME STATEMENT FOR 2018 - NOTES

1. According to the CNB's Decision, *Interest income* position does not include the net result of foreign exchange interest gains which amounted to HRK 40 thousand in 2018. This effect is reported in the *Profit/(loss) from accrued from foreign exchange differences*.
2. In accordance with the CNB's Decision Profit/(loss) from financial assets in the net amount of HRK 4,758 thousand is presented in several positions depending on the portfolio while in the financial statements the net financial effect is presented in total in one position – *Profit from financial operations* and is detailed in the accompanying notes.
3. In the report according to the CNB's Decision *Other operating income* comprises those revenues which are related to the business that will be continued, while the difference of HRK 1,194 thousand is reported under *Loss from operations which will not continue*.
4. In accordance with the CNB's Decision *Other operating expenses* show other expenses for operations that will continue while the amount of other expenses from operations that will not continue of HRK 4,161 thousand presented in *Loss from operations that will not continue*. In Basic financial statements *Other expenses* are reported under *General administrative and other operating expenses* and are details in the notes.
 In addition to what is stated in the explanatory note no. 4, *General administrative and other expenses* in Basis financial statements include *Administrative expensed, Depreciation and Provisions or (-) termination of provisions*. These are stated separately in the report according to the CNB's Decision.
5. According to the CNB's Decision, Impairment, provisions and termination of provisions are presented in three separate positions in the total amount of HRK 12,034 thousand. According to Basic financial statements, impairment costs amount to HRK 11,964 thousand. The difference of HRK 70 thousand refers to the net effect of the provision for employees which, according to the CNB's Decision are included within administrative costs.

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

B) RECONCILIATION OF THE STATEMENT OF OTHER COMPREHENSIVE INCOME FOR 2018

STATEMENT OF OTHER COMPREHENSIVE INCOME	In line with CNB's Decision	Basic financial statements	Difference
	HRK '000	HRK '000	HRK '000
Description			
Profit or (-) loss for the year	13.169	13.169	
Other comprehensive income	-	-	-
Items not to be reclassified into profit or loss	-	-	-
Tangible assets	-	-	-
Intangible assets	-	-	-
Actuarial gain or (-) losses on sponsored pensions plans	-	-	-
Fixed assets and alienation groups intended for sale	-	-	-
Portion of other recognized income and expense from third parties which is calculated using share portion method	-	-	-
Changes in fair value of equity instruments measured at fair value through other comprehensive income	-	-	-
Gains/(losses) from accounting protection of equity instruments measured at fair value through other comprehensive income	-	-	-
Changes in fair value of equity instruments measured at fair value through other comprehensive income (protected item)	-	-	-
Changes in fair value of financial liabilities measured at fair value through profit / (loss) attributed to changes in credit risk	-	-	-
Income tax related to items that will not be reclassified	-	-	-
Items that may be reclassified into profit or loss	-	-	-
Protection of net investments in foreign operations (effective portion)	-	-	-
Conversion of foreign currencies	-	-	-
Protection of cash flows (effective portion)	-	-	-
Hedging instruments (elements which are not specified)	-	-	-
Debt instruments at fair value through other comprehensive income	-	-	-
Fixed assets and alienation groups intended for sale	-	-	-
Share of other recognized income and expenses from investments in subsidiaries, joint ventures and associates	-	-	-
Income tax relating to items that may be reclassified to profit / (loss)	-	-	-
Total comprehensive income for the year	13.169	13.169	-

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK - Continued
C) RECONCILIATION OF STATEMENT OF FINANCIAL POSITION – BALANCE SHEET

Description	In line with CNB's Decision.	Basic financial statements	Difference	Note
	HRK '000	HRK '000	HRK '000	
ASSETS				
Cash, receivables from central banks and other demand deposits	405.447	405.447	-	
Cash in hand	40.208			
Cash receivables from central banks	192.439			
Other demand deposits	172.800			
Receivables from CNB		157.390	-157.390	1
Placements with banks		41.014	-41.014	1
Financial assets held for trading	-	-	-	
Financial assets not traded and measured at fair value through profit or loss	517	-	517	2
Financial assets at fair value through profit or loss	214.133	214.650	-517	2
Financial assets at fair value through other comprehensive income	150	150	-	
Financial assets at depreciated cost	1.539.487	1.330.818	208.669	1
Debt securities	219.595	219.595	-	
Loans and prepayments	1.319.892	1.111.223	208.669	1
Investments in subsidiaries, joint ventures and associates	-	-	-	
Tangible assets	29.110	40.877	-11.767	3
Intangible assets	264	264	-	
Tax assets	1.189	-	1.189	3
Other assets	388	11.842	-11.454	3
Fixed assets and alienation groups classified for sale	71.109	-	71.109	3
Foreclosed assets		59.342	-59.342	3
Total assets	2.261.794	2.261.794	-	
LIABILITIES				
Financial liabilities held for trading	-	-		
Financial liabilities at fair value through profit or loss	-	-		
Financial liabilities measured at depreciated cost	2.077.449	2.077.180	269	
Deposits (demand, term, hybrids)	2.077.156	2.071.385	5.771	4
Loans received	-	5.795	-5.795	4
Other financial liabilities	293	-	293	4
Provisions	7.682	7.682	-	
Tax liabilities	204	-	204	4
Other liabilities	20.298	20.771	473	4
Total liabilities	2.105.633	2.105.633	-	

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

C) RECONCILIATION OF STATEMENT OF FINANCIAL POSITION – BALANCE SHEET
- continued

	In line with CNB's Decision.	Basic financial statements	Difference	Note
Description	HRK '000	HRK '000	HRK '000	
CAPITAL				
Share capital	176.678	176.678	-	
Retained profit (loss)	(33.686)	(42.987)	-	
Revaluation reserves	-	-		
Other reserves	-	-		
Profit (loss) for the year	13.169	7.669	-	
Statutory and other capital reserves	0	0		
Total capital	156.161	141.360	-	
Total liabilities and capital	2.261.794	2.181.373	-	

C) RECONCILIATION OF STATEMENT OF FINANCIAL POSITION – NOTES

ASSETS

1. In the Basic financial statements *Receivables from CNB* and *Placements with banks* are disclosed separately, the amounts of which, in accordance with the CNB's Decision are among others included in position of *Financial assets at depreciated cost – Loans and prepayments*. This position, according to the CNB's Decision also included the majority of the assets which are included in *Other assets* in the Basic financial statements.
2. The position of *Financial assets not traded but valued at fair value through profit or loss* in the amount of HRK 517 thousand is stated separately in accordance with the CNB's Decision whereas in the Basic financial statements it is stated in *Financial assets at fair value through profit or loss*.
3. According to the CNB's Decision *Tangible assets* comprise the tangible assets that the Bank uses in its operations while the position of *Fixed assets and alienation groups classified for sale states foreclosed assets in exchange for uncollected receivables and assets no longer used for regular business*.

In the Basic financial statements, tangible assets that the Bank uses in its operations or holds as investment in real estate are reported under Property, plant and equipment while foreclosed assets in exchange for uncollected receivables is reported under *Foreclosed assets*.

Tax assets in the Basic financial statements is stated under *Other assets*.

LIABILITIES AND CAPITAL

4. *Deposits* according to the CNB's Decision comprises all types of deposits and loans received as well as hybrid instruments, whereas in the Basic financial statements these items are presented separately. Loans received are presented separately in the Basic financial statements. Other differences refer to the different reclassification of all other liabilities.

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK - Continued

D) RECONCILIATION OF THE CASH FLOW STATEMENT FOR 2018

Description	In line with CNB's Decision	Basic financial statements	Note
	HRK '000	HRK '000	HRK '000
1	3	4	
Operating activities and adjustments			
Profit/(loss) before tax	13.169	13.169	-
Impairments and provisions	11.964	11.964	-
Depreciation	4.418	4.418	-
Net unrealized (profit)/loss from financial assets and liabilities at fair value through profit and loss	(89)	-	(89)
(Profit)/loss from tangible assets sold	(3.618)	-	(3.618)
Other non-cash items	-	-	-
Changes in assets and liabilities from operating activities			
Deposits with CNB	(10.019)	(10.019)	-
Deposits with financial institutions and loans to financial institutions	(4.406)	(3.841)	(565)
Loans and prepayments to other customers	(24.336)	(3.657)	(20.679)
Securities and other financial instruments at fair value through other comprehensive income	16.574	16.574	-
Securities and other financial instruments held for trading	-	-	-
Securities and other financial instruments not traded, at fair value through profit and loss	60.596	62.274	(1.678)
Securities and other financial instruments at fair value through profit and loss	-	-	-
Securities and other financial instruments at depreciated cost	(13.379)	(4.222)	(9.157)
Other assets from operating activities	(2.552)	(2.552)	-
Increase/decrease in operating liabilities			
Deposits from financial institutions	43	43	-
Transaction accounts of other customers	84.099	83.967	132
Savings deposits of other customers	81.389	81.389	-
Term deposits of other customers	(70.208)	(84.743)	14.535
Derivative financial liabilities and other liabilities traded	-	-0	-
Other liabilities from operating activities	(13.084)	(13.274)	190
Collected interest from operating activities [indirect method]	32.114	-	32.114
Dividends received from operating activities [indirect method]	-	-	-
Paid interest from operating activities [indirect method]	(11.186)	-	(11.186)
(Paid income tax)	-	-	-

ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN NATIONAL BANK
- Continued

D) RECONCILIATION OF THE CASH FLOW STATEMENT FOR 2018
- Continued

Description	In line with CNB's Decision	Basic financial statements	Difference
	HRK '000	HRK '000	HRK '000
1	3	4	
A) Net cash flows from operating activities	151.489	151.489	-
Investment activities			
Receipts from sale of / payments for tangible and intangible assets	4.825	4.825	-
Receipts from sale of / payments for investments into subsidiaries, associates and joint ventures	-	-	-
Receipts from sale of / payments for securities and other financial instruments held to maturity	(62.103)	(62.103)	-
Dividends received from investment activities	-	-	-
Other receipts / payments from investment activities	-	-	-
B) Net cash flows from investment activities	(57.278)	(57.278)	
Financial activities			
Net increase/(decrease) in received loans from financial activities	(2.763)	(2.763)	-
Net increase/(decrease) in issued debt securities	-	-	-
Net increase/(decrease) in supplementary capital instruments	(360)	(360)	-
Increase in share capital	-	-	-
(Dividend paid)	-	-	-
Other receipts/(payments) from financial activities	1.632	1.632	-
C) Net cash flows from financial activities	(1.491)	(1.491)	-
D) Net increase/(decrease) in cash and cash equivalents	92.720	92.720	-
Cash and cash equivalents at the beginning of the year	337.786	337.786	-
Effects of foreign exchange rate changes on cash and cash equivalents	-	-	-
Cash and cash equivalents at the end of the year	430.506	430.506	-

**ADDITIONAL REPORTS ACCORDING TO THE DECISION OF THE CROATIAN
NATIONAL BANK**
- Continued

D) RECONCILIATION OF THE CASH FLOW STATEMENT FOR 2018
- NOTES

Deviations from the cash flow position in the basic financial statements in relation to the report prescribed by the CNB's Decision derive from:

- The difference in presentation of certain balance positions as explained in the overview of balance sheet items difference in the basic financial statements in relation to the standard prescribed by the CNB's Decision.
- The Cash flow statement represents, in accordance with the CNB's Decision a combination of indirect method and direct cash flows, while the same report in the basic financial statements is prepared using the indirect method.

However, considering the total of the three activity groups, these cash flows do not differ.

E) RECONCILIATION OF THE STATEMENT OF CHANGES IN EQUITY FOR 2018

Apart from differences in the description of individual transactions, other differences in the statement of changes in equity were not identified.