ČESKOMORAVSKÁ ZÁRUČNÍ A ROZVOJOVÁ BANKA, a. s.

2012

annual review

In the Czech Republic, we represent a promotional bank aimed at contributing to the efficient development of national infrastructure and economic sectors that have been approved for public support according to the economic policies of the Czech Republic government and its regions.

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Chairman's introduction

Dear clients, business partners and stakeholders,

For 20 years now, Českomoravská záruční a rozvojová banka (CMZRB) has served as a specialised banking entity providing support primarily in the forms of preferential guarantees and development loans for various areas of the economy, but particularly to small and medium-sized enterprises. During that time, the Bank has become an economically strong, stable and reliable implementer of the Czech government's economic policies.

CMZRB has gradually established a necessary, and in the Czech economy unique, base of knowledge relating to both banking activities as well as administration of public funds from the state budget, structural funds and regional budgets and, in its role as a mediating institution, has brought billions of crowns into the Czech economy in the form of long-term financial resources for developing business and municipal infrastructure. The Bank's successful development to date is further evidenced by the fact that its shareholder's equity has progressively increased more than fourfold.

There comes a time in the history of every institution which proves to be of particular importance with respect to its continued operation. The year 2012 was such a time for CMZRB. In the past year, the Bank carried out fundamental changes necessary in order gradually to achieve objectives relating to its project plan incorporated into the International Competitiveness Strategy for the Czech Republic 2012 – 2020, which had been approved by the government at the end of September 2011. The first essential step was a change in the composition of shareholders, whereby the Czech Republic became the sole owner of the Bank's voting shares. The basic documents for its medium- and long-term development were then approved at an extraordinary general meeting. I would like to take this opportunity to thank all our previous shareholders who through their constructive approach have made it possible for the entire process of key changes to proceed without negatively impacting on the Bank's other operations.

We began last year prepared to continue in conducting the long-running successful guarantee and loan programmes financed from structural funds. Despite the utmost efforts by the Ministry of Industry and Trade and other state administrative authorities, they were not able to conclude negotiations with the European Commission that would enable the achievement of that objective. Even under such circumstances, the Bank managed nevertheless to respond accordingly and, in co-operation with the Ministry of Industry and Trade, at mid-year it began accepting applications under two programmes directed to supporting small and medium-sized enterprises. One of these programmes, INOSTART, constitutes the first targeted assistance in the form of financial instruments supporting innovation.

Last year, the Bank continued to broaden its scope of activities. It became the administrator of an urban development fund in the Moravia–Silesia Region established with structural funds under the JESSICA initiative. At the suggestion of the South Bohemia Region, the programme of regional loans was extended also to include assistance to municipalities.

Despite the anticipated complexity of the process to renew activities using structural funds, decisions made by the Bank's shareholders last year made it possible for the Bank to continue in providing guarantees to support enterprises in 2013. It will also continue to administer its extensive portfolio of guarantees and grants provided in previous years for reconstructing apartment buildings, for which acceptance of new applications for support was discontinued last year.

In 2013 and at the start of the following year, however, the Bank must maximise its focus to create the conditions for fulfilling its main development goal – which is to prepare for the greatest possible participation in using guarantees and loans under operational programmes financed from structural funds and designated for the new programming period. Already in the past year, the Bank actively participated in preparing the national and European legislative frameworks for the use of financial instruments, the implementation of which will be fundamentally important to the Bank's further development. These activities will continue also this year. At the same time, very intensive preparations will be underway to prepare products to be used in the new programming period. The Bank's partners in this area will include both state administrative authorities and entities from the banking sector, as well as international financial institutions.

It will continue to be our ambition that the Bank's activities bring new values to our clients and partners. Towards that end, we can draw upon our experiences and determination to achieve the established goals. I am confident that we can continue to rely upon the support of the Bank's shareholder and partners and, last but by no means least, our employees. My thanks go out to all of them for the contribution they made to last year's results.

Ladislav Macka
Chairman of the Board of Directors

Facts and figures for the period 1992 – 2012

In 2012, the Bank celebrated 20 years of operations directed to supporting small and medium-sized enterprises and progressively expanding also to other sectors of the economy. Through this period, the Bank has become both a specialised component of the national banking sector and an important partner particularly for central state administrative authorities, state funds, and even some regions. The Bank's development has been accompanied by a number of changes in its shareholder structure, strategic goals, products, technical equipment, and organisational structure. These changes have been necessary in order for the Bank always to be able to respond effectively to its partners' needs and to fulfil its central long-term vision to be a strong, flexible and effective instrument of the Government of the Czech Republic in implementing the provisions of its economic policy executed through financial instruments of various types, and in particular through preferential guarantees and loans.

Financial and operating results

For 20 years, CMZRB has concluded agreements for the provision of support as follows:

- more than 15,100 guarantees in the amount of CZK 63.3 billion for loans totalling CZK 102.4 billion, of which:
  - some 13,000 guarantees for enterprises in the amount of CZK 53.5 billion, and
  - more than 2,000 guarantees for loans for regeneration of apartment houses in the amount of CZK 9.8 billion,

- 7,300 loans totalling CZK 19.1 billion, of which:
  - more than 7,000 loans to small and medium-sized enterprises totalling CZK 14.2 billion, and
  - 260 loans to municipalities and other entities for financing the development of municipal infrastructure in the amount of CZK 4.9 billion,

- 23,400 contributions for support to enterprises in the amount of CZK 12 billion,

- 10,100 grants to cover interest of loans for regeneration of apartment houses financed from the State Housing Development Fund totalling CZK 13.7 billion; and

- some 14,000 loans for housing and repair of flood damage in the amount of CZK 3.1 billion.

From the start of 2001 to the end of 2012, the Bank has provided as a financial manager overall financing for infrastructure development projects in the total amount of CZK 140.8 billion.

The Bank's services have been used by 51,000 clients, especially enterprises, municipalities, individuals, ministries, state funds and regions, in some cases repeatedly.

The main indicators characterising the Bank's activity have developed as follow:

Selected economic indicators

	Unit	1992	1997	2002	2007	2012
Total assets	CZK mil.	3,327	11,191	89,757	57,055	111,706
Liabilities	CZK mil.	2,214	9,533	86,082	52,185	106,748
Shareholder's equity	CZK mil.	1,113	1,658	3,675	4,870	4,958
Share capital	CZK mil.	305	685	1,976	2,132	2,132
Profit after tax	CZK mil.	8	222	535	795	812
Guarantee portfolio	CZK mil.	1,489	4,257	7,372	11,996	19,039
Capital adequacy	%	47.2	15.7	21.7	20.2	14.4
Average number of employees		47	203	252	239	217
Number of branches		0	5	5	5	5

At different times the Bank has provided the following types of products to support the development of various economic sectors:

Guarantees:

- Preferential individual guarantees for loans to small and medium-sized enterprises in three basic models: guarantees for instalments, guarantees for the unpaid balance of loan principal and gradual guarantees
- Preferential guarantees for loans to small and medium-sized enterprises provided in a simplified procedure (portfolio guarantees)
- Preferential guarantees for loans with a financial contribution towards a guaranteed loan for small and medium-sized enterprises
- Preferential individual and portfolio guarantees for loans for regeneration of apartment houses
- Guarantees for tender bids
- Guarantees for venture capital
- Guarantees for leasing

Credits and loans:

- Preferential loans to small and medium-sized enterprises
- Subordinated loans to small and medium-sized enterprises
- Loans for developing municipal infrastructure using funds from Phare, Housing Guaranty Programme or international institutions
- Preferential loans for water management investments
- Interest-free housing loans
- Preferential loans for inhabitants affected by flooding

Financial contributions and grants:

- Contributions to cover interest costs for loans
- Contributions to cover costs for services of a consulting firm
- Recoverable financial contributions to mortgage loans
- Grants for job positions established for people from underprivileged population groups, acquiring certification, selected activities of trade associations, or acquiring a mobile point of sale
- Grants for supporting the development of industrial enterprises

Overall, the Bank developed, introduced, and for periods of varying duration used 240 product modifications.

Company management and other activities

Shareholders

The Bank had 8 shareholders upon its establishment, 3 of which represented the Government of the Czech Republic while the remaining 5 shareholders were prominent banks operating on the national market at the time of CMZRB's foundation. The Czech government's stake in share capital also grew with the expansion of the Bank's scope of activity, which developed as follows:

	1992	2000	2001	2012
Proportion of the Czech Republic in share capital	32.8 %	59.7 %	72.3 %	72.3 %

Governing bodies

Upon its establishment, the Bank was managed by a Board of Directors composed of its shareholders' representatives. Since 1994, the Board of Directors has been comprised of five senior executives of the Bank. The mandate for members of the Board of Directors is four years.

The Supervisory Board oversees the Bank's activities. Over the years, the number of its members has fluctuated between 5 and 14 people. By law, one-third of the Supervisory Board is elected by employees. The mandate for members of the Supervisory Board is four years.

The Audit Committee was established in 2010 and is comprised of 4 members.

Employees

The Bank has an experienced and long-serving core team, which is continuously added to as needed. The Bank has employed some 700 individuals since its foundation, and its average annual staffing has developed as follows:

	1992 – 1997	**1998 – 2002**	**2003 – 2007**	**2008 – 2012**
Average number of employees	153	234	253	221

Technical equipment

The Bank is equipped with a basic bank account system, which was fully modernised in 2012. It features a highly specialised and continually developing information system which facilitates the fulfilment of informational obligations connected with the administration of public funds and the execution of specialised analyses for the Bank's partners. The internal processes of providing and administering guarantees and loans are conducted without the use of paper documents.

The Bank's membership in associations and organisations

CMZRB is a member of the Czech Banking Association, Trade Union of Banking and Insurance Employees, Confederation of Industry of the Czech Republic, Association of Small and Medium-Sized Enterprises and Crafts of the Czech Republic, as well as other associations and organisations.

Through its international co-operation, the Bank has become a member of the European Association of Mutual Guarantee Societies (AECM), Network of European Financial Institutions for Small and Medium Sized Enterprises (NEFI) and the Development Banks Club (ISLTC).

Company profile

The Government of the Czech Republic adopted a resolution on 23 October 1991 for the founding of a specialised banking institution to support small and medium-sized enterprises. This institution was entered into the Commercial Register in January 1992 under the name Českomoravská záruční a rozvojová banka, a. s. (hereinafter referred to as "CMZRB" or the "Bank").

The Bank's initial scope of business was directed only to implementing government programmes for the support of small and medium-sized enterprises. In subsequent years, the Bank's activity was extended to providing support in the housing area and to financing infrastructure development projects. CMZRB has a full banking licence, a foreign exchange licence, and a securities broker's licence issued under the relevant laws.

At present, CMZRB's main mission is to facilitate primarily small and medium-sized enterprises' access to financing through specialised banking products and, in accordance with the economic policy aims of the Government and the regions of the Czech Republic, to assist in developing other selected areas of the economy that require public support.

Throughout its entire time in operation, the Bank has co-operated closely with ministries, state funds, regions, banks, economic chambers and other representatives of the business community. The specific character of CMZRB's activities, the development of modern banking and communication technologies, and traditionally good cooperation with its partners allow the Bank to provide its clients with high quality banking services across the entire Czech Republic that positively impact those clients' development. Clients may use the services of the Bank's branches in Prague and in the regional centres of Brno, Hradec Králové, Ostrava and Pilsen. The Bank operates a regional office in České Budějovice for even better contact with its clients.

The shareholder holding all voting rights is the Czech Republic, which is represented by:

- Ministry of Industry and Trade
- Ministry of Regional Development
- Ministry of Finance

Last year, the Bank bought back its own shares into treasury from private shareholders – banks amounting in total 27.67 % of the Bank's share capital. These shares do not include voting rights.

BANK´S OFFICES

Branch
Regional office

The Bank provides its clients with bank guarantees, preferential loans, and related banking services. It manages an extensive portfolio of guarantees and grants provided for repair of apartment houses. Financing projects to improve the quality of municipalities' infrastructure and for their development also constitutes part of the Bank's activities. CMZRB also uses resources from international financial institutions and structural funds for these purposes.

The two most important client groups are small and medium-sized enterprises and apartment house owners, especially housing co-operatives and apartment owners associations. Other users of the Bank's services include municipalities, regional authorities, ministries and state funds.

Selected economic indicators

	Unit	2008	2009	2010	2011	2012
Total assets	CZK mil.	75,431	62,135	58,147	58,700	111,706
Liabilities	CZK mil.	70,309	56,686	52,455	52,965	106,748
Shareholder's equity	CZK mil.	5,122	5,449	5,692	5,735	4,958
Share capital	CZK mil.	2,132	2,132	2,132	2,132	2,132
Profit after tax	CZK mil.	802	815	854	849	812
Guarantee portfolio	CZK mil.	13,952	18,565	23,649	21,398	19,039
Capital adequacy	%	15.8	15.2	16.4	17.2	14.4
Average number of employees		230	220	219	217	217
Number of branches		5	5	5	5	5

Governing bodies

Board of Directors

Chairman	Ladislav Macka
Vice-Chairman	Pavel Weiss
Members	Jiří Jirásek
	Lubomír Rajdl
	Jan Ulip

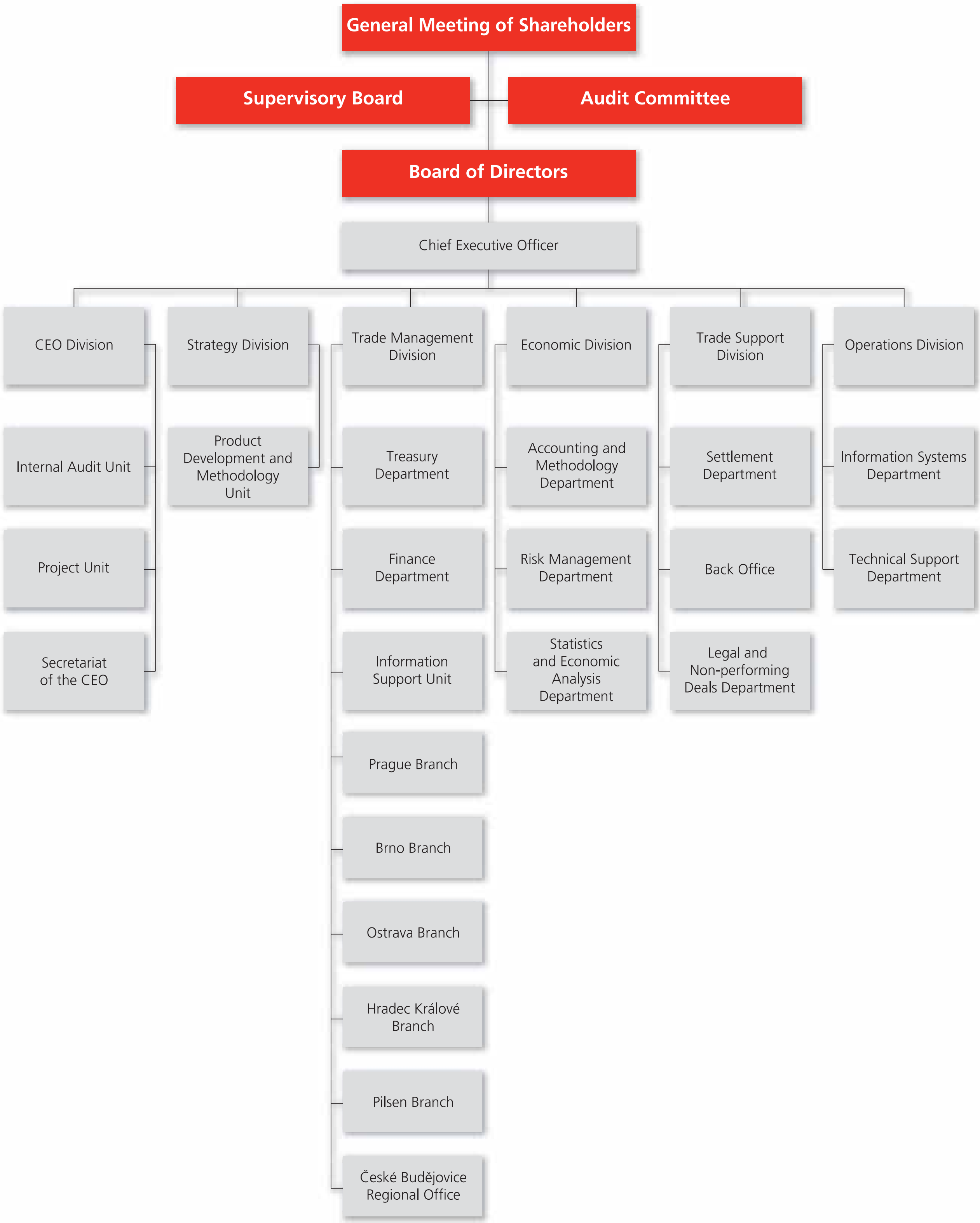
Supervisory Board

Chairman	Robert Szurman
Vice-Chairman	Josef Hájek
Members	Vladimír Bártl
	Daniel Braun
	Josef Doruška
	Růžena Kabilková
	Ladislav Koděra
	Zdeněk Mareš
	Jana Šindelářová

Audit Committee

Chairman	Milan Novák
Vice-Chairman	Josef Hájek
Members	Růžena Kabilková
	Robert Szurman

Organisation chart



Information for readers

The data disclosed up to page 34 of this Annual Review have been derived from the financial statements of Českomoravská záruční a rozvojová banka, a. s., as at 31 December 2012 and for the year then ended prepared in accordance with Czech accounting legislation (“Statutory financial statements“). The full version of the Statutory financial statements is included in the Annual Report of Českomoravská záruční a rozvojová banka, a. s., which is published on www.cmzrb.cz in the original Czech language.

The financial statements of Českomoravská záruční a rozvojová banka, a. s., in this Annual Review are prepared in accordance with International Financial Reporting Standards as adopted by the European Union.

Report of the Board of Directors on the Bank's business activities and financial situation for 2012

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Economic environment and its impact on the Bank's performance

Fulfilling the aims and goals associated with the Bank's activities as established by its shareholders was substantially affected by the extent of resources that CMZRB was able to utilise in carrying out its mission as a specialised banking institution that conducts most of its activities using public funds. The persisting economic recession and lowering of interest rates were also factors to which it was necessary to respond. From a longer-term perspective, it is nevertheless possible to look at the forces stemming from the economic environment in the course of last year with modest optimism, and in particular with respect to the Bank's overall position and the prospects for its future development. The simplification of ownership structure and clarification of basic requirements for the Bank's operation resulting from negotiations and discussions on various levels were the most important and most valuable developments brought about by the economic environment in 2012.

Despite the internal changes occurring last year, CMZRB remains part of the Czech banking sector, which also demonstrated a high degree of stability during 2012. This was further manifested in ongoing stress testing, which confirmed the banking sector's sufficient resilience in the face of possible negative shocks. At the same time, however, the sensitivity of banks' behaviour to the overall perception of credit risk and the ensuing tightening of credit standards for business loans, particularly as regards loan collateral and margin levels, also was confirmed. The slowing growth in the Czech economy and pessimistic expectations for enterprises and consumers were reflected in entrepreneurs' increased caution with respect to long-term indebtedness and continuing need for short-term financing. The deteriorated economic conditions are evident also in the rising number of insolvencies. Thus the Bank's guarantee portfolio was also impacted by performance under guarantees in an amount comparable to that of the previous year.

Over the course of last year, the Czech National Bank also became involved in the effort to revive the economy – a process that proceeded rather slowly in 2012. It repeatedly lowered its 2-week repo rate until it had reached 0.05 %, then indicated its willingness to consider additional possible measures to support economic growth. Financial markets responded to economic developments and the Czech National Bank's intervention with a substantial drop in short-term rates on the interbank market and in long-maturity interest rate swaps. Mirroring this development, there was a rise in the price of government bonds, which comprise a substantial part of the Bank's assets. The development on financial markets thus was generally reflected in the higher-than-expected gains from financial investments achieved through revaluation of the bond and derivatives portfolios.

In the area of support to small and medium-sized enterprises, the Bank was compelled, in co operation with the Ministry of Industry and Trade, to respond to the enduring unsatisfactory position associated with the Ministry's prolonged and as yet still unresolved negotiations with the European Commission on the guarantee and loan fund's continued operation within the Operational Programme Enterprise and Innovation (OPEI). Using national resources revolving from older support programmes and from the Bank's internal resources, it managed at least partially to compensate for this shortfall.

A conceptual change relating to the provision of support for regeneration of apartment houses and a shortage in resources of the State Housing Development Fund for grant activities led to the cessation of accepting applications for guarantees and grants. By concluding a contract with the European Investment Bank, which administers the holding fund created for the Moravia–Silesia region within the JESSICA initiative, the Bank was able to begin using structural funds with the help of loans in a new form as part of the urban development fund. The successful outcome of negotiations among representatives of the state administration on the use of funds from the Swiss–Czech Co-operation Programme for the support of innovative projects enabled the Bank to expand its activities by providing guarantees also in this promising area. The South Bohemia Region's initiative to expand its regional programme, hitherto directed only to supporting small enterprises, to include preferential loans for municipalities contributed to further expansion of the support offer.

The Bank responded to initiated and planned changes in national and European legislation by commencing intensive preparatory activities of various sorts. These changes concerned, in particular, the new Civil Code, the Act on Public Contracts, an amendment to the Act on Budgetary Rules, and the initiation of preparations for an amendment to the Act on Support of Small and Medium-Sized Enterprises. An important document for directing the Bank's other activities is the Conception of Support for Small and Medium-sized Enterprises 2014 – 2020, approved by the government in December 2012. The government's decision on the structure of operational programmes for the new programming period and their managing authorities is also significant. One of programmes for which preparations commenced at the end of last year is the Operational Programme Enterprise and Innovation for Competitiveness, in which a significant increase may be expected in the proportion of funds used for support in the form of financial instruments.

In the field of European legislation, a discussion ensued over the entire legislative framework, which was significantly elaborated in the section on financial instruments, and the Bank continuously monitored and analysed developments. Despite the existing incompleteness of the proposals for these legal norms, one thing is clear: it will be necessary to implement changes to certain principles on the functioning of financial instruments for the new programming period. The changes which the Bank has already implemented in connection with the alteration of its shareholder structure should facilitate the satisfaction of any new requirements to be applied to the administration of financial instruments in the coming years. With respect to developments outside of European influence, we should also mention the Bank’s intensive preparations on measures to ensure compliance with requirements enacted worldwide by the US government in relation to financial institutions and the prevention of tax evasion (Foreign Account Tax Compliance Act).

Project for the transformation of CMZRB

CMZRB has progressively established an essential, and in the Czech economy unique, base of knowledge relating to both banking activities as well as administration of public funds from the state budget, structural funds and regional budgets, has managed the advancement of co operation with renowned foreign partners, and, in its role as an intermediating institution, has brought billions of crowns into the Czech economy in the form of long-term financial resources for developing business and municipal infrastructure. An experienced team of employees using advanced information technologies conducts the Bank's activities, thereby facilitating growth in productivity and improving services for clients. The Bank's shareholder's equity has progressively increased more than four fold. CMZRB demonstrates long-term profitability and readily fulfils all criteria used to assess the reliability and trustworthiness of financial institutions.

Despite these undeniably positive results, it was necessary to consider fundamental changes in the Bank's ownership structure and operating model which were testing their limits. The involvement of private shareholders (i.e. banks) and the related requirement for a minimum rate of return on paid-in capital stated directly in the Bank's Articles of Association had become a fundamental problem. To overcome fundamental barriers to CMZRB's continued meaningful functioning, and to ensure the conditions for expanding the use of support through financial instruments, it was necessary to initiate a process of substantial changes to the Bank. Its foundation was laid by the Government of the Czech Republic in the International Competitiveness Strategy for the Czech Republic 2012 – 2020, a part of which became the so-called "Transformation of CMZRB" project. Its main goal is to enable more extensive use of financial instruments, and in particular loans and guarantees, to conduct the government's economic policy aims through CMZRB in its capacity as a specialised financial institution for this type of support and to which the central state administrative authorities directly entrust the administration of individual support programmes and funds designated for these purposes.

Successful implementation of the project was connected to measures directed to:

- changing the shareholder structure to enable CMZRB's unrestricted participation in the administration of financial instruments, especially those financed from structural funds; and
- creating external and internal conditions for CMZRB's largest possible participation in the administration of national and European funds used to support development in various economic areas by means of financial instruments.

By unanimous agreement of the General Meeting in April 2012, CMZRB bought back its own shares into treasury from Česká spořitelna, Československá obchodní banka and Komerční banka through the procedure established in the Commercial Code. The state thereby became CMZRB's sole voting shareholder. Execution of the state's rights as the shareholder in the Bank remains entrusted to the Ministry of Finance, Ministry of Regional Development and Ministry of Industry and Trade. Although the Bank's shareholder's equity decreased as a result of the buy-back of shares, its amount remains at a sufficient level to begin implementing the aims of its long-term strategy.

At an extraordinary general meeting in October 2012, the Bank's shareholder, as newly constituted, approved two additional basic documents – the Bank's new Articles of Association and its long-term strategy through the year 2020 (basic framework). In accordance with its basic strategic goals, CMZRB's operations will be directed towards expanding its activities in the administration of financial instruments using structural funds beyond the support provided to small and medium-sized enterprises and establishing itself as the most important administrator of loans and guarantees for funding new operational programmes. In addition to structural funds, the Bank also plans to work in the administration of financial instruments using national funds, including those that will shift to the national system after revolving through instruments supported from EU funds.

The new strategy brought about a fundamental change in the Bank's operating model. Its main principle will be that in carrying out new activities that use purpose-designated state funds CMZRB will not strive to earn a profit, but only to break even over the long term. Profitability, however, will continue to be regarded as an important aspect to prevent any undesirable erosion in the real value of capital due to inflation. Adequate capital strength thus remains a prerequisite for the Bank's ability to respond to new requirements relating to its services. Profits will therefore be used first and foremost for strengthening CMZRB's shareholder's equity.

Implementation of the transformational project has thus far progressed successfully. The results achieved last year created the necessary foundation for further steps which will follow in 2013. Their goal will be to prepare for entry into the new programming period products that fulfil the programme originators' requirements for improved efficiency in administering financial instruments and producing meaningful possibilities for financing projects in the supported areas.

Economic results

Unconsolidated data

Basic economic characteristics of the Bank, 2008 – 2012 Table 1

		Unit	2008	2009	2010	2011	2012
Total balance sheet		CZK mil.	75,431	62,135	58,147	58,700	111,706
Assets:							
	Deposits and loans at banks	CZK mil.	32,649	17,531	13,040	16,932	70,045
	Securities accepted by the Czech National Bank for refinancing	CZK mil.	10,166	14,178	16,584	14,384	18,545
	Debt securities	CZK mil.	6,281	6,275	7,235	8,443	5,513
	Payments from guarantees and other classified receivables	CZK mil.	2,826	2,849	3,874	4,324	4,479
Liabilities and equity:							
	Shareholder's equity	CZK mil.	5,122	5,449	5,692	5,735	4,958
	Liabilities	CZK mil.	70,309	56,686	52,455	52,965	106,748
	of which: reserves	CZK mil.	1,991	2,009	2,277	2,219	2,342
	funds to cover credit risks	CZK mil.	1,547	2,437	3,295	2,998	2,680
Off-balance sheet:							
	Guarantees granted	CZK mil.	13,952	18,565	23,649	21,398	19,039
Total revenues		CZK mil.	5,826	5,099	4,924	4,537	4,410
of which:	from securities and interbank operations	CZK mil.	1,394	1,012	828	795	725
	from operations with clients	CZK mil.	1,691	1,431	1,197	1,099	976
Total expenses		CZK mil.	5,024	4,284	4,070	3,688	3,598
of which:	net impairment allowances and provisions	CZK mil.	-150	303	404	184	225
Profit after tax		CZK mil.	802	815	854	849	812
Capital adequacy		%	15.8	15.2	16.4	17.2	14.4

Newly concluded guarantee and loan transactions totalled CZK 5.9 billion during 2012 (CZK 7.5 billion in 2011). The drop in business activity was caused by limited possibilities to draw resources from EU structural funds for support of small and medium-sized enterprises. The total value of the guarantee and loan transactions portfolios thus decreased by 9.5 % to CZK 25.4 billion.

Higher income from bonds, particularly due to revaluation of that portfolio in line with the decline in long-term interest rates, for the most part compensated for the decline in income from business activities due to the diminished portfolios. The profit achieved after tax of CZK 812 million is thus only CZK 37 million lower than in 2011 and also reflects the gain of CZK 311 million from the positive revaluation difference within the Bank's capital. Profit per employee fell from CZK 3.9 million to CZK 3.7 million. The return on average annual shareholder's equity[1], on the other hand, increased from 17.7 % to 18.6 %, while shareholder's equity decreased from CZK 5.7 billion to CZK 5.0 billion. The main reason for the decline in shareholder's equity was the purchase of the Bank's own shares into treasury in the value of CZK 1,894 million, which was partially offset by profit-creation and the gain in the positive revaluation difference. Capital adequacy stood at 14.4 % as of 31 December 2012.

Credit risk represented the Bank's most significant risk exposure by type, and 78 % of capital dedicated to covering risk was related to this type of risk. As of the end of 2012, all expected credit risk losses were fully covered by impairment allowances and provisions in an amount corresponding to Czech and international standards, and the total balance of impairment allowances and provisions for credit risk was CZK 4.1 billion, i.e. 16.1 % of the value of the guarantee and loan portfolio. Credit risks for certain types of guarantee products were covered by funds for credit risks provided by the programme originators in a total value of CZK 2.7 billion. As of the end of the year, moreover, the Bank had at its disposal reserve funds in shareholder's equity of CZK 1.2 billion.

[1] Calculations are made in accordance with the methodology established in the Czech National Bank's Official Information dated 26 October 2007 to Decree 123/2007 Coll., as amended, stipulating the prudential rules for banks, credit unions and securities dealers.

The overall balance sheet at the end of 2012 was 90 % larger than in the previous year and netted to CZK 111.7 billion. This growth was related especially to an increase in short-term amounts due to state institutions (+CZK 58.8 billion) while amounts due to banks simultaneously declined (–CZK 5.4 billion). On the assets side, and corresponding to the changes in liabilities, there was in particular an increase in amounts due from banks (+CZK 53.1 billion). The balance sheet total does not include bank guarantees issued primarily for loans to small and medium-sized enterprises and which comprise a significant part of the Bank's business activities and credit exposure. Their value was CZK 19.0 billion as of the end of 2012.

On the assets side, the Bank had at its disposal a portfolio of financial investments amounting to CZK 94.1 billion (84.2 % of net assets) and placed as bank deposits, primarily in the forms of reverse repos (62.7 % of net assets), as well as state bonds, bonds of selected banks and companies, and zero-coupon state bonds (21.5 % of net assets). Loans provided to state institutions constituted an important net asset item (9.4 % of net assets), as did loans to other clients (5.7 % of net assets) reported in the item amounts due from customers. Non-earning assets comprised 0.3 % of the total balance sheet.

The funding sources on the liabilities and equity side were provided primarily by amounts due to clients (77.9 % of liabilities and equity) and banks (13.7 % of liabilities and equity), shareholder's equity (4.4 % of liabilities and equity), provisions (2.1 % of liabilities and equity), and temporary and other liabilities.

The Bank's financial performance in 2012 was negatively impacted by the decline in business activities as a result of a decrease in financial sources for support of small and medium-sized enterprises. Also having a negative impact was lower pricing of newly concluded transactions by the amount of the profit margin (from mid 2012 as a result of the change to the Bank's strategy after the state acquired 100 % of the Bank's voting rights). A positive factor is that profit managed to remain almost at the level of previous years due to higher profit from financial investments and 2 % savings in operating costs. Improved performance was also evident in the year-on-year decrease in the cost-income ratio from 21.2 % to 20.7 %.

Additional indicators of the Bank's financial performance, 2008 – 2012 Table 2

Indicator	Unit	2008	2009	2010	2011	2012
Total capital (Tier 1)	CZK '000	4,355,718	4,511,388	4,666,426	4,821,166	3,775,768
of which:						
share capital	CZK '000	2,131,550	2,131,550	2,131,550	2,131,550	2,131,550
treasury shares	CZK '000	0	0	0	0	-1,893,740
compulsory reserve fund	CZK '000	800,000	800,000	800,000	800,000	800,000
other profit allocations	CZK '000	350,000	350,000	350,000	350,000	350,000
retained earnings from previous years	CZK '000	1,095,241	1,249,745	1,406,286	1,570,430	2,414,171
deductible items	CZK '000	-21,073	-19,907	-21,410	-30,814	-26,213
of which: intangible fixed assets	CZK '000	-21,073	-19,907	-21,410	-30,814	-26,213
Additional capital (Tier 2)	CZK '000	0	0	0	0	0
Total capital to cover market risks (Tier 3)	CZK '000	0	0	0	0	0
Total capital	CZK '000	4,355,718	4,511,388	4,666,426	4,821,166	3,775,768
Total capital requirements	CZK '000	2,211,711	2,376,281	2,273,135	2,246,537	2,097,747
Credit risk	CZK '000	1,891,115	2,000,579	1,871,630	1,838,117	1,634,586
of which:						
exposures to central governments and banks	CZK '000	0	0	0	4,803	14,616
exposures to institutions	CZK '000	495,097	265,385	234,068	277,217	180,539
corporate exposures	CZK '000	1,259,475	1,595,957	1,501,258	1,425,634	1,315,397
retail exposures	CZK '000	69,281	69,464	44,966	44,822	43,382
exposure to secured property	CZK '000	3,516	3,107	2,571	7,309	7,649
exposures past due	CZK '000	49,493	56,581	80,333	67,619	69,695
short-term exposures to institutions and enterprises	CZK '000	14,253	10,085	8,434	10,713	3,308
Total interest-rate risk	CZK '000	77,234	133,468	162,626	173,402	217,811
of which:						
general interest-rate risk	CZK '000	76,248	76,517	87,948	76,678	111,249
specific interest-rate risk	CZK '000	986	56,951	74,678	96,724	106,562
Equity risk	CZK '000	0	0	0	0	0
Options	CZK '000	0	0	0	0	0
Currency risk	CZK '000	2,622	6,887	7,512	0	0
Commodity risk	CZK '000	0	0	0	0	0
Operational risk	CZK '000	230,781	235,347	231,367	235,017	238,809
Trading portfolio exposure risk	CZK '000	9,959	0	0	0	6,541
Return on average assets (ROAA)[1]	%	1.20	1.24	1.34	1.43	1.19
Return on average equity (ROAE)[1]	%	18.51	18.15	18.39	17.67	18.57
Assets per employee[1]	CZK '000	332,296	279,887	265,510	266,816	514,772
Administrative costs per employee[1]	CZK '000	1,369	1,364	1,385	1,397	1,399
Net profit per employee[1]	CZK '000	3,533	3,670	3,899	3,860	3,740

[1] Calculations are made in accordance with the methodology established in the Czech National Bank's Official Information dated 26 October 2007 to Decree 123/2007 Coll., as amended, stipulating the prudential rules for banks, credit unions and securities dealers.

1/ Products

During 2012, the Bank provided the following products:

a) Guarantees

- Guarantees for bank loans up to 80 % of the loan principal with an increasing level of liability that depends on the time when the request for exercising the guarantee is submitted (hereinafter just “gradual guarantees”) provided under the GUARANTEE (OPPI) programme for small and medium-sized enterprises and based on applications submitted before the end of 2010;
- guarantees for bank loans provided by a simplified procedure and with a limited guaranteed amount for a portfolio of guaranteed loans (hereinafter just “portfolio guarantees”) provided under the GUARANTEE programme (guarantees for loans to small enterprises) for loans up to CZK 5 million and up to 70 % of the loan principal;
- guarantees for bank loans to owners or co-owners of apartment houses up to 80 % of the loan principal (NEW PANEL programme);
- portfolio guarantees for bank loans to owners or co-owners of apartment houses up to 80 % of the loan principal (NEW PANEL programme);
- guarantees for tender bids for small and medium-sized enterprises in amounts of CZK 100,000 to CZK 5 million;
- preferential guarantees for bank loans under the INOSTART programme for entrepreneurs implementing projects in the Moravia–Silesia and Olomouc regions for loans up to CZK 15 million and up to 60 % loan principal.

b) Loans

- Subordinated capital-project loans under the PROGRESS programme for small and medium-sized enterprises in amounts up to CZK 20 million, with a fixed interest rate of 3 % p.a., maturity up to 9 years and grace period up to 3 years;
- loans for small enterprises in the South Bohemia Region in amounts up to CZK 1 million, with a fixed interest rate of 5 % p.a. and maturity up to 5 years under the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemia Region;
- loans for municipalities in the South Bohemia Region in amounts up to CZK 2 million with a fixed interest rate that is continuously updated for new loans according to the development of market interest rates, with maturity up to 10 years under the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in the South Bohemia Region;
- long-term loans under the MUNICIPALITY 2 programme to maintain and develop infrastructure owned by a municipality or association of municipalities and thereby to improve inhabitants’ quality of life, in amounts from CZK 8 million to CZK 250 million, with fixed interest rates, maturity up to 15 years and grace period up to 3 years;
- long-term loans funded by the Regional Development Fund for municipalities or associations of municipalities (with the exception of Prague) to co-finance projects for improving local infrastructure for business and non-business purposes in amounts up to CZK 30 million, with a preferential fixed interest rate, maturity up to 10 years and grace period up to 3 years;
- long-term loans for municipalities under the MUFIS 2 investment programme to maintain and develop infrastructure of municipalities in amounts up to CZK 40 million with fixed or variable interest rate determined individually according to current market conditions and with maturity up to 10 years;
- long-term loans for municipalities and enterprises for projects on the territory of the Moravia–Silesia Region from the urban development fund created from the funds of the Regional Operational Programme Moravia–Silesia in amounts up to CZK 100 million, with fixed or variable interest rate and maturity up to 15 years.

2/ Support to small and medium-sized enterprises

a) Overall results

The Bank provided support to small and medium-sized enterprises (SMEs) especially as agreed with the Ministry of Industry and Trade.

By means of the Operational Programme Enterprise and Innovations (OPEI) that is co-funded with EU structural funds, mainly investment-oriented projects in manufacturing and construction were supported, as well as projects in several other sectors. Support was provided in the form of subordinated loans within the PROGRESS programme.

On the basis of an agreement with the South Bohemia Region, preferential loans were provided to small enterprises. In 2012, the regional programme was expanded to include small preferential loans to municipalities in the South Bohemia Region. One municipality used this option and obtained a loan of CZK 2 million.

In a guarantee programme financed by national funds, applications for guarantees to start-up enterprises received in 2011 were processed during 2012. Applications for guarantees for loans to small enterprises began to be accepted on 15 June 2012. Guarantees were provided for investment loans or loans for the purchase of inventories for projects in the area of industrial production, construction, retail, wholesale and other activities.

In 2012, small and medium-sized enterprises submitted a total of 1,095 applications for support in the form of loan guarantees (see Table 3). A total of 793 applications were approved and 29 applications were rejected because they either did not meet programme criteria or represented risks too high for the project to receive financing. A total of 96 applicants withdrew their applications during processing. The remaining 177 applications were not resolved in 2012 and will carry over into the following year.

Applications for support and their settlement — Table 3

Indicator		2008	2009	2010	2011	2012
Total applications submitted	number	2,531	1,288	2,288	487	1,095
Approved	number	1,900	922	1,318	241	793
Rejected or withdrawn	number	586	184	855	109	125
Carried into following year	number	45	182	115	137	177

The major part of loans and loan guarantees provided was directed to small enterprises with up to 49 employees (see Table 4).

Supported projects divided according to sizes of enterprises — Table 4

	Guarantees (excluding bids to public tenders)				Loans			
	Number		Amount		Number		Amount	
Number of employees		/%/	/CZK mil./	/%/		/%/	/CZK mil./	/%/
0 to 9	361	51.8	688.7	44.9	45	46.9	244.9	31.3
10 to 49	336	48.2	845.3	55.1	35	36.5	321.5	41.1
50 to 249	0	0.0	0,0	0.0	16	16.7	215.9	27.6
Total	**697**	**100.0**	**1 534.0**	**100.0**	**96**	**100.0**	**782.3**	**100.0**

b) Guarantees

The Bank provided 697 guarantees in a total amount of CZK 1,534 million based on guarantee agreements concluded in 2012. The guarantees supported loans of CZK 2,215 million (see Table 5).

Based on a commitment to extend the liability period, the Bank extended this period through appendices to guarantee agreements for 651 guarantees amounting to CZK 3,147 million, which allowed the enterprises to continue drawing loans to finance working capital needs.

In addition to guarantees for bank loans, 246 guarantees were provided for bids to public tenders totalling CZK 247 million.

Guarantees issued and loans guaranteed — Table 5

Indicator		2008	2009	2010	2011	2012
Guarantees issued	number	1,043	878	1,224	111	697
Amount of guarantees issued	CZK mil.	3,529	6,369	6,593	472	1,534
Amount of loans guaranteed	CZK mil.	5,094	9,550	10,070	630	2,215
Average guarantee rate	%	69	67	65	75	69

Guarantees within the national programme were provided in a total amount of CZK 1,485 million. These guarantees were used as security for 696 loans in the total amount of CZK 2,118 million, of which 679 guarantees in the total amount of CZK 1,458 million were provided for small enterprises. The remaining 17 guarantees in the amount of CZK 27 million were acquired by start-up enterprises for applications submitted in 2011. Within OPEI, evaluation of all applications was completed and 1 guarantee in the amount of CZK 49 million was provided.

The largest portion of guarantees was used to support projects located in the Moravia–Silesia Region (see Table 6).

Regional structure of guarantees provided
(in % of contracted value of guarantees issued) — Table 6

Region		2008	2009	2010	2011	2012
Praha (Capital City of Prague)	%	0.4	1.7	5.6	4.3	8.1
Středočeský (Central Bohemia)	%	5.3	8.5	8.2	13.0	4.8
Jihočeský (South Bohemia)	%	4.1	3.5	4.9	2.6	7.5
Plzeňský (Pilsen)	%	6.5	8.4	7.0	6.3	4.3
Karlovarský (Karlovy Vary)	%	0.7	0.9	1.4	1.2	2.2
Ústecký (Ústí nad Labem)	%	7.2	3.1	2.1	1.9	3.0
Liberecký (Liberec)	%	6.0	6.1	9.7	11.3	5.1
Královéhradecký (Hradec Králové)	%	3.1	8.7	10.0	1.2	5.1
Pardubický (Pardubice)	%	8.9	9.0	3.8	13.7	5.2
Vysočina (Bohemian–Moravian Highlands)	%	5.2	7.0	4.7	1.5	5.4
Jihomoravský (South Moravia)	%	9.0	15.8	15.2	4.6	8.4
Olomoucký (Olomouc)	%	12.5	12.9	8.3	19.9	15.4
Zlínský (Zlín)	%	6.8	5.3	7.1	1.3	4.5
Moravskoslezský (Moravia–Silesia)	%	24.4	9.1	12.0	17.1	20.8
Total	%	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The largest number of guarantees was provided to projects in wholesale and retail, followed by manufacturing (see Table 7).

Sector structure of guarantees provided in 2012
(in % of contracted values of newly issued guarantees) — Table 7

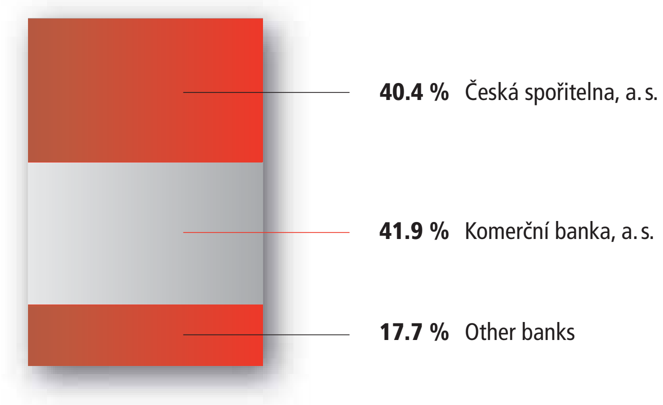
Sector		
Manufacturing (CZ NACE 10-33)	%	30.3
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	3.2
Construction (CZ NACE 41-43)	%	10.5
Wholesale and retail trade; repair of motor vehicles and motorcycles (CZ NACE 45-47)	%	49.0
Accommodation and food service activities (CZ NACE 55-56)	%	1.8
Other service activities (CZ NACE 05-09, 36-39, 49-53, 58-75, 77-82, 84-88, 90-99)	%	5.1
Total	%	**100.0**

During 2012, the majority of guarantees was made for loans from Komerční banka, a.s. and Česká spořitelna, a.s., (see Graph 1). Among other banks, GE Money Bank, a.s. (9.2 %) and Raiffeisenbank, a.s. (4.9 %) had the greatest shares in guarantee transactions.

Percentage breakdown of guarantee transactions by lending banks in 2012

Graph 1

Percentage breakdown of guarantee transactions by lending banks (2012)



c) Loans

The Bank provided a total of 96 loans during 2012 for small and medium-sized enterprises amounting to CZK 782 million (see Table 8).

These consisted of:

- subordinated loans under OPEI's PROGRES programme. The number of loans provided was 91 and these totalled CZK 776 million; and
- reduced-interest loans under the South Bohemia Regional Programme. The number of loans provided was 5 and these totalled CZK 6 million.

Preferential loans provided

Table 8

Indicator		2008	2009	2010	2011	2012
Loans provided	number	105	44	94	136	96
Amount of loans provided	CZK mil.	286	209	629	1,090	782
Average loan amount	CZK mil.	2.7	4.7	6.7	8.0	8.1

The largest proportion of loans in 2012 was used by entrepreneurs in the South Moravia Region (see Table 9).

Regional structure of loans provided
(in % of contracted value of newly issued loans)

Table 9

Region		2008	2009	2010	2011	2012
Praha (Capital City of Prague)	%	1.3	0.0	0.0	0.0	0.0
Středočeský (Central Bohemia)	%	16.4	9.3	5.0	7.0	8.3
Jihočeský (South Bohemia)	%	7.7	13.6	9.8	12.9	12.1
Plzeňský (Pilsen)	%	19.4	33.4	16.0	12.0	7.5
Karlovarský (Karlovy Vary)	%	2.4	9.6	3.6	1.6	0.0
Ústecký (Ústí nad Labem)	%	3.4	1.7	8.2	0.7	4.0
Liberecký (Liberec)	%	2.3	2.9	0.0	3.4	7.4
Královéhradecký (Hradec Králové)	%	6.2	3.2	1.1	7.1	5.6
Pardubický (Pardubice)	%	10.2	4.5	6.2	8.3	3.7
Vysočina (Bohemian–Moravian Highlands)	%	6.1	2.4	11.2	10.6	4.5
Jihomoravský (South Moravia)	%	1.3	12.6	8.3	13.5	18.6
Olomoucký (Olomouc)	%	3.7	1.2	7.7	6.3	5.8
Zlínský (Zlín)	%	10.4	4.7	8.5	7.9	13.4
Moravskoslezský (Moravia–Silesia)	%	9.3	1.0	14.4	8.6	9.2
Total	%	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The conditions established under the PROGRES programme and the general investment climate were the main factors causing a high proportion of supported projects to be in manufacturing (see Table 10).

Sector structure of loans provided
(in % of contracted value of newly issued loans) Table 10

Sector		
Manufacturing (CZ NACE 10-33)	%	54.1
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	3.8
Construction (CZ NACE 41-43)	%	3.5
Wholesale and retail trade; repair of motor vehicles and motorcycles (CZ NACE 45-47)	%	0.0
Accommodation and food service activities (CZ NACE 55-56)	%	26.3
Other service activities (CZ NACE 05-09, 36-39, 49-53, 58-75, 77-82, 84-88, 90-99)	%	12.3
Total	**%**	**100.0**

3/ Assistance for regeneration of apartment houses

Assistance for regeneration of apartment houses from funds provided by the State Housing Development Fund in the form of grants was discontinued in 2011 and in the form of guarantees in July 2012.

In 2012, the Bank issued 39 guarantees totalling CZK 105 million (of which 5 were portfolio guarantees amounting to CZK 12 million), which helped applicants to obtain loans for regeneration of apartment houses totalling CZK 172 million (see Table 11).

Guarantees issued and loans guaranteed Table 11

Indicator		2008	2009	2010	2011	2012
Guarantees issued	number	200	188	351	258	39
Amount of guarantees issued	CZK mil.	985	952	1,759	1,150	105
Amount of loans guaranteed	CZK mil.	1,532	1,352	2,411	1,622	172
Average guarantee rate	%	64	70	73	71	61

Since 2001, CZK 14,829 million has been used to support regeneration of apartment houses in the forms of grants and guarantees. Support was provided especially for loans for housing co-operatives and apartment owners associations (see Table 12).

Projects supported by guarantees or interest grants, by recipients Table 12

Indicator			2008	2009	2010	2011	2012
Projects supported		number	2 301	2,346	1,715	1,187	39
Recipients:	housing co-operatives	%	42.2	42.6	30.4	32.2	74.4
	municipalities	%	0.2	0.3	1.9	0.9	0
	owners associations	%	56.5	57.0	67.5	66.0	25.6
	individuals	%	1.1	0.0	0.1	0.2	0
	legal entities	%	0.0	0.1	0.1	0.7	0

4/ Municipal projects finance

a) Loans under the MUFIS 2 programme

The MUFIS 2 programme was announced in October 2009 and allows municipalities to acquire loans for similar infrastructure projects as under the MUNICIPALITY 2 programme, albeit in lower volumes and with shorter maturity. Loans are provided from the Common Loan Fund, which was created from Bank and MUFIS resources from Municipal Finance Company (Municipální finanční společnost, a.s.).

In 2012, the Bank provided 3 new loans totalling CZK 17 million. Since the programme's announcement, 9 loans totalling CZK 46 million have been provided.

b) Loans from the Regional Development Fund

Loans from the Regional Development Fund are designated for projects focusing on transportation and technical infrastructure, construction of commercial real estate, as well as on sports, cultural and educational facilities. Issuance of these loans is dependent on the generation of sufficient funds from loan repayments in previous years. In 2012, the Bank provided 6 loans totalling CZK 30 million. Since announcing the programme with new conditions in 2008, 26 loans totalling CZK 281 million have been issued.

5/ Trading on financial markets

During 2012, the Bank concluded transactions on the money and capital markets in order to manage its liquidity, manage the money and capital market instruments portfolio, manage interest-rate and currency risks, and refinance the loan programme for supporting small and medium-sized enterprises.

In managing its portfolio of money and capital market instruments, the Bank continued its conservative investment strategy. The Bank was oriented exclusively to purchasing government bonds, treasury bills, and bonds of a selected group of issuers with the highest credit ratings.

6/ Other lending activities

As a financial manager for infrastructure programmes, the Bank secured financing for these programmes totalling CZK 6.8 billion in 2012. This amount included funds obtained from the European Investment Bank, funds from the state budget and from the State Fund for Transport Infrastructure.

The main portion of funds (CZK 3.9 billion) was used for water management projects. It consisted of CZK 2.36 billion for anti-flood programmes and CZK 1.57 billion for construction and renovation projects relating to water supply and sewage infrastructure.

As a financial manager, the Bank disbursed CZK 2.9 billion for financing transportation projects. Of this amount, CZK 1.42 billion was designated for the Czech Motorways Project B (the construction of the Lovosice–Ústí nad Labem section of the D8 motorway) and an amount of CZK 1.44 billion was used for completing the Prague South-West Ring Road Project (financing of this project was completed in 2012). In 2012, the financing of the Pilsen Motorway By-Pass Project and connected feeder roads was also completed using the last ca CZK 45 million from the State Fund for Transport Infrastructure.

In 2012, the Bank also provided administration of interest payments from commercial loans for participants in construction and renovation projects for water supply and sewage infrastructure, paying out a total of CZK 35 million to 100 recipients.

External communications

The most important and most extensive area of external communication connected with the very nature of the Bank's ongoing operation was unquestionably the communication with its shareholders. In a first phase, the main objective was to gain the shareholders' consensus as to a method for implementing the fundamental change in the Bank's shareholder structure, and later as to financial and procedural questions regarding its implementation. Thanks to the constructive attitude of all shareholders, we managed to complete this demanding task in time, which allowed us to continue the necessary transformational steps with the objective that the Bank could increasingly participate in administering financial instruments within the new programming period for structural funds.

Due to the structure of the Bank's business activities, its main partner continued to be the Ministry of Industry and Trade. This co-operation was concentrated on three main areas. The most important was connected with the efforts of the Ministry and other state administrative authorities to renew the activities of the guarantee and loan fund under OPEI. Although these efforts brought no results, the clarification of a number of technical questions that will be important for the functioning of financial instruments can be considered very beneficial.

The Bank's co-operation with the Ministry of Industry and Trade nevertheless brought tangible results in the initiation of a guarantee programme for small entrepreneurs and a regionally limited programme of loan guarantees for innovative projects in two regions within central Moravia, where the Bank is closely co-operating with Česká spořitelna. Another area where the Bank used the experience and knowledge acquired in administering financial instruments was the preparation of documents and opinions for the Ministry of Industry and Trade for preparing an amendment to Act No. 47/2002 Coll., on Support of Small and Medium-Sized Enterprises, and for preparing the Conception of Support for Small and Medium-sized Enterprises 2014 – 2020.

Also initiated in the second half of last year was CMZRB's co-operation with the Ministry of Industry and Trade focused on wider use of financial instruments in the new operating programme for the support of enterprise, innovations and energy savings. Apart from clarifying questions concerning the focus areas for financial instruments, methodological questions and ambiguities were also discussed which must be solved in order for these forms of support to be successfully implemented.

Very extensive last year was the Bank's co-operation with the EIB in the role of an administrator of a holding fund under the JESSICA initiative investing the financial resources entrusted by the Moravia–Silesia Region into two urban development funds in the region, one of which is administered by CMZRB. Communication with the Regional Council of the Moravia Silesia Cohesion Region was very intensive due to this new activity of the Bank. This co-operation helped to clarify a number of partial issues that otherwise could negatively influence developments in using the fund's resources.

The need to reflect changes ensuing from the new shareholder structure, the principles of the Bank's activities approved by the shareholders and changes to national legislation led to CMZRB's participation in negotiations with the Ministry of Finance and the Ministry for Regional Development concerning questions on the impacts of changes to the Act on Budgetary Rules with respect to the state treasury, the standing of the Bank as a contracting authority and direct contracting to the Bank by other contracting authorities.

The Bank continued actively to participate in the activities of three European associations of which it is a member. The output of their activities were analytical and communication materials as well as communications with which the members of the associations addressed EU institutions in connection with preparing the new financial framework and changes to rules and instruments for using European funds in coming years. The findings acquired from contacts with partner institutions abroad were evaluated on an ongoing basis and are used in preparing the Bank's proposals for future changes in financial instruments. The most intensive was CMZRB's involvement in the activities of the Network of European Financial Institutions (NEFI), which currently groups financial institutions from 17 EU countries, usually fully owned by states and operating in the support of small and medium-sized enterprises but potentially also in other areas of the economy. In the past year, the Bank held one working group meeting connected with a workshop on distribution models for the products of development institutions and co operation with the banking sector. The Bank's involvement in the activities of the European Mutual Guarantees Association (AECM) was at a customary level. Exchange of experience and co operation with foreign partners in the area of long-term project financing also continued through long-standing contacts with the members associated in the Development Banks Club (ISLTC), the character of which should be adjusted in the following year with the objective of operating more efficiently in relation to the external environment.

In the past year, the Bank was in continuous contact with its traditional and long-standing partners, Kreditanstalt für Wiederaufbau and the Council of Europe Development Bank, the subject of which was to assess progress in the utilisation of loans already provided, as well as to examine possibilities for further expanding co-operation.

The Bank's co-operation with trade associations, commercial banks and other entities was ongoing, thereby broadening the applicants' awareness as to the various types of support. In this way, too, knowledge was acquired as to the current needs and problems of the individual applicant target groups and beneficiaries of support. The Bank sought suggestions for improving the services it provides or passed this information on to those partners responsible for setting the conditions of the provided support.

Goals for further development

With the change in its shareholder structure, the Bank has concluded one long phase in its development and entered into another. The course of this next phase will be determined by new legislative conditions and the availability of financial resources from structural funds for the period 2014 – 2020.

The Bank's Articles of Association approved by an extraordinary general meeting highlight its role as a special banking institution carrying out activities in the public interest. The Bank's mission is to continue as a financially strong, flexible and effective instrument of the Government of the Czech Republic in implementing the provisions of its economic policy through using financial instruments of various types, but in particularly through preferential bank guarantees and loans.

CMZRB's new long-term development strategy approved by its shareholder has the character of a qualitative framework for directing the Bank's activities through a very long period, the course of which will be significantly affected especially by the structural funds legislation. The development of Act No. 47/2002 Coll., on Support of Small and Medium-Sized Enterprises, will be no less important for the Bank's continuing operation.

The Bank's operations will be directed towards expanding its activities in the administration of financial instruments using structural funds that go beyond the support provided to small and medium-sized enterprises and establishing itself as the most important administrator of loans and guarantee funds in relation to the resources of central state administrative authorities responsible for managing operational programmes. In addition to structural funds, the Bank also plans to work in the administration of financial instruments using national funds, including those that will shift to the national system after revolving through instruments supported from EU funds.

Important principles for CMZRB's operation will include a requirement that its activities be performed in a structure and under conditions that will allow other contracting authorities to use the Bank's services without having to call for a tender. In concluding contractual relationships with the state, the Bank will now follow the principle that it will not strive to earn a profit from activities conducted using state funds, but only to break even over the long term. The Bank will, however, continue endeavouring to generate a level of profit sufficient at least to prevent any erosion in the value of its capital due to inflation and to enable it to respond to new requirements relating to its services. The main source of profit generation will be safe and efficient investing of the Bank's own capital.

In 2013, the Bank will focus especially on:

- maximum use of funds revolving from financial instruments and obtained through other measures approved by the Bank's shareholder for financing the national guarantee programme for enterprises;
- rapid renewal of activities in the OPEI upon conclusion of the Ministry of Industry and Trade's negotiations with the European Commission;
- ensuring successful administration of the urban development fund in the Moravia–Silesia Region, the guarantee fund for the INOSTART programme, and loan programmes for municipalities;
- co-operation with the Ministry of Industry and Trade and other central authorities in preparing for use of financial instruments in operational programmes for the following programming period of structural funds;
- preparation of products for the new programming period in terms of organisation, methods, human resources and IT support;
- use of new opportunities to expand activities with partners in the Czech Republic and abroad;
- preparation for the transition to new software support for transaction management and preparations to further extend digitalisation of documents and improve their administration; and
- implementation of extensive changes ensuing from adoption of the new Civil Code and other related legislation.

Report of the Supervisory Board of Českomoravská záruční a rozvojová banka, a. s.

During 2012, the Supervisory Board regularly carried out its duties as defined by law and the Articles of Association of Českomoravská záruční a rozvojová banka, a. s. In its capacity as the Bank's oversight body, the Supervisory Board monitored the work of the Board of Directors in discharging its duties, conducting the Bank's business activities and financial management, and executing its strategic policy. The Supervisory Board was regularly informed about the Bank's activities, its financial situation and other essential matters.

Having examined the financial statements for the year ended 31 December 2012, and on the basis of the external auditor's report, the Supervisory Board states that the accounting records and books were kept in a transparent manner and in compliance with the generally binding accounting regulations for banks as well as with the Articles of Association of the Bank. The accounting records and books reflect the Bank's actual financial situation in all important respects.

PricewaterhouseCoopers Audit, s.r.o., performed an audit of the financial statements and confirmed that the financial statements provide a true and fair view of the financial position of Českomoravská záruční a rozvojová banka, a. s., as of 31 December 2012 and of its operations for this year, in accordance with Czech accounting standards. The Supervisory Board acknowledged the Auditor's report by consent.

Based upon the facts stated above and pursuant to the Articles of Association of Českomoravská záruční a rozvojová banka, a. s., the Supervisory Board recommends that the General Meeting approve the financial statements of Českomoravská záruční a rozvojová banka, a. s., for the year ended 31 December 2012, as well as the proposed profit distribution for 2012, the remuneration of the members of the Bank's bodies for 2012, and the policies for remunerating members of the Bank's bodies in the following period.

The Supervisory Board reviewed without comment the Report of the Board of Directors on the Bank's Business Activities and Financial Situation for 2012. It likewise examined the Report of the Board of Directors on Relations between Related Entities for 2012.

Prague, 12 March 2013

On behalf of the Supervisory Board of Českomoravská záruční a rozvojová banka, a. s.:

Robert Szurman
Supervisory Board Chairman

Report of the Audit Committee of Českomoravská záruční a rozvojová banka, a. s.

The Audit Committee was established by a resolution of the regular General Meeting of Českomoravská záruční a rozvojová banka, a. s., on 27 April 2010.

During 2012, the Committee carried out its duties as defined by Act No. 93/2009 Coll., on Auditors, and in accordance with the Articles of Association of Českomoravská záruční a rozvojová banka, a. s. (hereinafter referred to as the "Bank").

Within its competence pursuant to the Bank's Articles of Association, and in accordance with Act No. 93/2009 Coll., on Auditors, the Audit Committee oversaw the procedure of compiling the Bank's financial statements for 2012 and the process of their mandatory audit as executed by the auditor PricewaterhouseCoopers Audit, s.r.o. Last year's co-operation with the external auditor proceeded without issue.

In the course of the past year, the Audit Committee also appraised the independence of the audit firm and the character of additional services provided by the external auditor, concluding that on the basis of the presented documents the external auditor may be regarded as independent.

At its regular meetings, the Audit Committee also discussed evaluations as to the effectiveness and efficiency of the Bank's management and control systems, the risk management system and the activities of the Bank's Internal Audit Unit. The Audit Committee states that the systems established within the Bank are functional and efficient and that the measures adopted for the auditor's findings are satisfied.

In 2012, the Audit Committee also reviewed the Report on the Information Systems Audit, which was conducted by the audit firm Deloitte Advisory s.r.o., as well as the report on results of evaluating the remuneration policies for selected groups of employees whose activities have a significant influence on the Bank's overall risk profile.

The Audit Committee further discussed preparations for the mandatory financial audit for 2013. After reviewing the essential documents, it approved the proposal of the Bank's Board of Directors for the selection procedure to choose an external auditor for 2013, to be conducted under the Audit Committee's supervision.

Prague, 12 March 2013

On behalf of the Audit Committee of Českomoravská záruční a rozvojová banka, a. s.:

Milan Novák
Audit Committee Chairman

Statutory declaration

Českomoravská záruční a rozvojová banka, a. s., declares that all information and data presented in this annual review are true and complete. Moreover, the Bank confirms that this document contains all facts that may be of importance for investors´decisions.

Furthermore, Českomoravská záruční a rozvojová banka, a. s., declares that as of the date of processing the annual report no negative changes in the financial situation or any other changes had occurred that would influence the accurate and correct assessment as to the financial position of Českomoravská záruční a rozvojová banka, a. s.

Prague, 27 March 2013

Signed on behalf of the Board of Directors:

Ladislav Macka
Chairman of the Board of Directors

Pavel Weiss
Vice-Chairman of the Board of Directors

Independent auditor´s report to shareholders of Českomoravská záruční a rozvojová banka, a. s.

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Independent auditor's report
to the shareholders of Českomoravská záruční a rozvojová banka, a.s.

We have audited the accompanying financial statements of Českomoravská záruční a rozvojová banka, a.s., identification number 448 48 943, with registered office at Jeruzalémská 964/4, Praha 1 ("the Bank"), which comprise the statement of financial position as at 31 December 2012, the statements of income, comprehensive income, changes in equity and cash flows for the year then ended and notes, including a summary of significant accounting policies ("the separate financial statements").

Board of Directors' Responsibility for the Separate Financial Statements

The Board of Directors is responsible for the preparation of the financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Board of Directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors of the Czech Republic, International Standards on Auditing and the related application guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of the financial statements that give a true and fair view 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 internal control. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2012, its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

28 March 2013

PricewaterhouseCoopers Audit s.r.o.

represented by partner

Petr Kříž
Statutory Auditor, Licence No. 1140

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PricewaterhouseCoopers Audit, s.r.o., registered seat Hvězdova 1734/2c, 140 00 Prague 4, Czech Republic, Identification Number: 40765521, registered with the Commercial Register kept by the Municipal Court in Prague, Section C, Insert 3637, and in the Register of Audit Companies with the Chamber of Auditors of the Czech Republic under Licence No 021.

Financial statements for the year ended 31 December 2012 prepared in accordance with IFRS as adopted by the EU

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Income statement

	Note	Year ended 31 December 2012 CZKm	Year ended 31 December 2011 CZKm
Interest and similar income		1,701	1,894
Interest and similar expenses		(826)	(916)
Net interest income	**3.1**	**875**	**978**
Fee and commission income		635	751
Fee and commission expenses		(5)	(6)
Net fee and commission income	**3.2**	**630**	**745**
Gains from financial operations	3.3	249	70
Losses on financial operations	3.3	(219)	(276)
Administrative expenses	3.4	(340)	(347)
Increase in loan impairment and write-offs	3.5	(103)	(241)
(Increase)/decrease in provisions for guarantees and other provisions	3.6	(48)	146
Other operating income		-	1
Operating profit		1,044	1,076
Share of profit of associates accounted for using the equity method	3.15	5	7
Profit before income tax		**1,049**	**1,083**
Income tax expense	3.7	(239)	(233)
Profit for the year		**810**	**850**

Statement of other comprehensive income

	Note	Year ended 31 December 2012 CZKm	Year ended 31 December 2011 CZKm
Profit for the year		**810**	**850**
Other comprehensive income			
Net fair value gains/(losses) on available-for-sale financial assets		467	(74)
Net losses on available-for-sale financial assets transferred to income statement on disposal	3.3	(83)	(69)
Deferred income tax relating to components of the comprehensive income	3.7	(73)	27
Other comprehensive income for the year, net of tax		311	(116)
Total comprehensive income		**1,121**	**734**

Balance sheet

	Note	Year ended 31 December 2012 CZKm	Year ended 31 December 2011 CZKm
Assets			
Cash and balances with central banks	3.8	70,273	15,169
Loans and advances to banks	3.9	244	1,830
Financial assets held for trading			
- Debt securities	3.10	1,264	294
- Derivatives	4.2.2	61	89
Debt securities designated at fair value	3.10	2,102	2,068
Loans and advances to customers	3.11	16,814	18,470
Investment securities available for sale	3.12	15,323	12,627
of which: assets pledged as collateral		1,074	1,178
Investment securities held to maturity	3.13	5,369	7,839
of which: assets pledged as collateral		52	2,630
Deferred income tax assets	3.7	-	45
Investment in associate	3.15	104	99
Intangible assets		26	31
Property and equipment	3.16	147	159
Other assets	3.14	83	79
Total assets		**111,810**	**58,799**
Liabilities			
Amounts due to banks	3.17	15,339	20,705
Amounts due to customers	3.18	86,968	26,830
Financial liabilities held for trading - derivatives	4.2	243	243
Hedging derivatives	4.2.2	87	440
Current income tax liabilities	3.7	10	17
Deferred income tax liabilities	3.7	49	-
Provisions	3.6	2,342	2,219
Other liabilities	3.19	1,717	2,517
Total liabilities		**106,755**	**52,971**
Shareholders' equity			
Share capital	3.20	2,132	2,132
Statutory and other reserves		1,150	1,150
Own treasury shares		(1,894)	-
Revaluation reserve for AFS securities		345	34
Retained earnings		3,322	2,512
Total shareholders' equity		**5,055**	**5,828**
Total liabilities and shareholders' equity		**111,810**	**58,799**

The accompanying notes are an integral part of these financial statements.

These financial statements were prepared by the Bank and approved by the Board of Directors of the Bank on 28 March 2013.

Ing. Ladislav Macka
Chairman of the Board

Ing. Jan Ulip
Member of the Board

Statement of changes in equity

	Share capital	Statutory and other reserves	Own treasury shares	Revaluation reserve for AFS securities	Retained earnings	Total
	CZKm	CZKm	CZKm	CZKm	CZKm	CZKm
Balance at 1 January 2011	**2,132**	**1,150**	**-**	**150**	**2,345**	**5,777**
Net fair value losses on AFS securities	-	-	-	(74)	-	(74)
Net gains on AFS securities transferred to income statement	-	-	-	(69)	-	(69)
Deferred income tax relating to components of other comprehensive income	-	-	-	27	-	27
Total comprehensive income	-	-	-	(116)	850	734
Dividends relating to 2010	-	-	-	-	(683)	(683)
Balance at 31 December 2011	**2,132**	**1,150**	**-**	**34**	**2,512**	**5,828**
Net fair value gains on AFS securities	-	-	-	467	-	467
Net gains on AFS securities transferred to income statement	-	-	-	(83)	-	(83)
Deferred income tax relating to components of other comprehensive income	-	-	-	(73)	-	(73)
Total comprehensive income	-	-	-	311	810	1,121
Acquisition of own treasury shares	-	-	(1,894)	-	-	(1,894)
Balance at 31 December 2012	**2,132**	**1,150**	**(1,894)**	**345**	**3,322**	**5,055**

Statement of cash flows

	Note	2012 CZKm	2011 CZKm
Profit before income tax		1,049	1,083
Adjustments for non-cash transactions			
Loans impairment and write-offs and provisions for guarantees		151	96
Depreciation and amortisation		30	33
Share of profit of associates		(5)	(7)
Change in fair values and foreign exchange differences		(404)	(136)
Other non-cash items		16	29
Net interest income		(875)	(978)
Fee and commission income		(635)	(751)
		(673)	(631)
(Increase)/decrease in operating assets			
Loans and advances to banks		(72)	151
Loans and advances to customers		2,863	2,066
Other assets		(877)	(747)
Increase/(decrease) in operating liabilities			
Amounts due to banks		(6,350)	2,119
Amounts due to customers		60,139	(226)
Other liabilities		57	(694)
Interest received		1,709	1,941
Interest paid		(781)	(857)
Fee and commission received		254	312
Net cash flow from operating activities before income tax and payments under guarantee calls		56,269	3,434
Payments made under guarantee calls		(402)	(477)
Income taxes paid		(208)	(193)
Net cash flow from operating activities		**55,659**	**2,764**
Cash flows from investing activities			
Purchases of securities		(12,761)	(13,556)
Sales of securities and proceeds from matured securities		12,904	15,132
Purchase of tangible and intangible assets		(26)	(60)
Net cash flow from investing activities		**117**	**1,516**
Cash flows from financing activities			
Acquisition of own treasury shares		(1,894)	-
Dividends paid		(420)	(263)
Net cash flow from financing activities		**(2,314)**	**(263)**
Net increase/ (decrease) in cash and cash equivalents		**53,462**	**4,017**
Cash and cash equivalents at the beginning of the year	**3.21**	**16,853**	**12,836**
Cash and cash equivalents at the end of the year	**3.21**	**70,315**	**16,853**

Notes to the financial statements for the year ended 31 December 2012

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Notes to the financial statements for the year ended 31 December 2012

1/ General information

Českomoravská záruční a rozvojová banka, akciová společnost (henceforth the "Bank" or "ČMZRB") was formed as a joint stock company pursuant to the Czech Commercial Code and was incorporated in 1992. The Bank's registered office is located at Jeruzalémská 964/4, Prague 1, Czech Republic. The Bank has five branches in the Czech Republic (in Brno, Hradec Králové, Ostrava, Pilsen and Prague) and one regional office in České Budějovice.

The Bank's activities are focused on supporting small and medium-sized businesses in the Czech Republic by providing preferential loans (Note 2 d), preferential guarantees (Note 2 j) and issuing infrastructure loans to municipalities and their legal associations, as well as water sector entities with municipal equity participations (Note 2 b). The Bank's loan portfolio includes also loans to the Ministry of Finance provided in connection with infrastructure programmes (Note 3.11). The Bank also acts as an agent disbursing Czech government agency's funds as subsidy of interest costs to the block of flats' owners that meet specified criteria (Note 2 f). The purpose-bound funds are made available to Bank by the Czech state and international financial institutions. In some cases the Bank participates on programme funding.

These financial statements include the Bank and its associated undertaking Municipální finanční společnost a.s. (see Note 3.15) (together the "Group").

ČMZRB transformation in 2012

Government of the Czech Republic approved project of ČMZRB transformation in its document „Strategy for international competitiveness of the Czech Republic in period 2012 – 2020". Its integral part forms support of small and medium enterprises financed from EU funds, which requires sole state ownership of the Bank. Therefore, following agreement with all shareholders, the Bank purchased its treasury shares from private shareholders in May 2012. ČMZRB purchased the treasury shares in nominal value of CZK 589,888,500 (2 463 shares at par value 239,500 per share) for market price of CZK 1,893,740,000.

2/ Summary of significant accounting policies

(a) Basis of preparation

The financial statements are prepared in accordance with International Financial Reporting Standards as adopted by the European Union ('IFRS'). The financial statements comprise the income statement and statement of comprehensive income presented as two separate statements, the balance sheet, the statement of changes in equity, the statement of cash flows and the notes.

The financial statements have been prepared under the historical cost convention, except for available-for-sale financial assets, financial assets held at fair value through profit or loss and all derivative contracts that have been measured at fair value.

The accompanying financial statements are based on the accounting records, together with appropriate adjustments and reclassifications necessary for fair presentation in accordance with IFRS.

The financial statements are presented in CZK, which is the Bank's functional and presentation currency. The figures shown in the financial statements are stated in CZK million.

Cash and cash equivalents in the statement of cash flows include highly liquid investments. Note 3.21 shows in which item of the balance sheet cash and cash equivalents are included.

The cash flows from operating activities are determined by using the indirect method. Profit before tax in the statement of cash flows is therefore adjusted by non-cash items, such as measurement gains or losses, changes in provisions, as well as changes from receivables and liabilities. In addition, all income and expenses from cash transactions that are attributable to investing or financing activities are eliminated. Interest received or paid is classified as operating cash flows.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's accounting policies. Changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed. Management believes that the underlying assumptions are appropriate and that the Bank's financial statements therefore present the financial position and results fairly. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2 p.

New Standards, Amendments and Interpretations applied for the first time in 2012

Application of the new accounting standards, interpretations and amendments to standards presented below does not have any significant impact on these financial statements:

Disclosures—Transfers of Financial Assets – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. There is no impact of the amended standard on the financial statements of the Bank.

Recovery of Underlying Assets – Amendments to IAS 12 (issued in December 2010 and effective for annual periods beginning on or after 1 January 2012). The amendment introduced a rebuttable presumption that an investment property carried at fair value is recovered entirely through sale. There is no impact of the amended standard on the financial statements of the Bank. This amendment has not yet been approved by European Union.

IAS Standards or interpretations effective from 1 January 2013 or later

IFRS 9, Financial Instruments: Classification and Measurement. IFRS 9, issued in November 2009, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

- financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument;

- an instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss;

- all equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment;

- most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Bank is considering the implications of the standard, the impact on the Bank and the timing of its adoption. IFRS 9 has not yet been approved by European Union.

IFRS 10, Consolidated Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces all of the guidance on control and consolidation in IAS 27 “Consolidated and separate financial statements” and SIC-12 “Consolidation - special purpose entities”. IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance. There will be no impact of the new standard on the financial statements of the Bank.

IFRS 11, Joint Arrangements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces IAS 31 “Interests in Joint Ventures” and SIC-13 “Jointly Controlled Entities—Non-Monetary Contributions by Ventures”. Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. There will be no impact of the new standard on the financial statements of the Bank.

IFRS 12, Disclosure of Interest in Other Entities (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 sets out the required disclosures for entities reporting under the two new standards: IFRS 10, Consolidated financial statements, and IFRS 11, Joint arrangements, and replaces the disclosure requirements currently found in IAS 28, Investments in associates. IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity’s interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgments and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in group activities and cash flows, summarised financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities. The Bank is currently assessing the impact of the new standard on its financial statements.

IFRS 13, Fair value measurement (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Bank is currently assessing the impact of the standard on its financial statements.

IAS 27, Separate Financial Statements (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013), was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10, Consolidated Financial Statements. There will be no impact of the new standard on the financial statements of the Bank.

IAS 28, Investments in Associates and Joint Ventures (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged. There will be no impact of the new standard on the financial statements of the Bank.

Amendments to IAS 1, Presentation of Financial Statements (issued June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Bank expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances. This amendment is effective since 1 January 2013 for European Union.

Amended IAS 19, Employee Benefits (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. The Bank is currently assessing the impact of the amended standard on its financial statements. This amendment is effective since 1 January 2013 for European Union.

Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Bank is considering the implications of the amendment, the impact on the Bank and the timing of its adoption.

Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

Improvements to International Financial Reporting Standards (issued in May 2012 and effective for annual periods beginning 1 January 2013). The improvements consist of changes to five standards. IFRS 1 was amended to (i) clarify that an entity that resumes preparing its IFRS financial statements may either repeatedly apply IFRS 1 or apply all IFRSs retrospectively as if it had never stopped applying them, and (ii) to add an exemption from applying IAS 23, Borrowing costs, retrospectively by first-time adopters. IAS 1 was amended to clarify that explanatory notes are not required to support the third balance sheet presented at the beginning of the preceding period when it is provided because it was materially impacted by a retrospective restatement, changes in accounting policies or reclassifications for presentation purposes, while explanatory notes will be required when an entity voluntarily decides to provide additional comparative statements. IAS 16 was amended to clarify that servicing equipment that is used for more than one period is classified as property, plant and equipment rather than inventory. IAS 32 was amended to clarify that certain tax consequences of distributions to owners should be accounted for in the income statement as was always required by IAS 12.

IAS 34 was amended to bring its requirements in line with IFRS 8. IAS 34 will require disclosure of a measure of total assets and liabilities for an operating segment only if such information is regularly provided to chief operating decision maker and there has been a material change in those measures since the last annual financial statements. This improvement has not yet been approved by European Union.

Transition Guidance Amendments to IFRS 10, IFRS 11 and IFRS 12 (issued on 28 June 2012 and effective for annual periods beginning 1 January 2013). The amendments clarify the transition guidance in IFRS 10 Consolidated

Financial Statements. Entities adopting IFRS 10 should assess control at the first day of the annual period in which IFRS 10 is adopted, and if the consolidation conclusion under IFRS 10 differs from IAS 27 and SIC 12, the immediately preceding comparative period (that is, year 2012 for a calendar year-end entity that adopts IFRS 10 in 2013) is restated, unless impracticable. The amendments also provide additional transition relief in IFRS 10, IFRS 11, Joint Arrangements, and IFRS 12, Disclosure of Interests in Other Entities, by limiting the requirement to provide adjusted comparative information only for the immediately preceding comparative period. Further, the amendments will remove the requirement to present comparative information for disclosures related to unconsolidated structured entities for periods before IFRS 12 is first applied. There will be no impact on the financial statements of the Bank.

Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014). The amendment introduced a definition of an investment entity as an entity that (i) obtains funds from investors for the purpose of providing them with investment management services, (ii) commits to its investors that its business purpose is to invest funds solely for capital appreciation or investment income and (iii) measures and evaluates its investments on a fair value basis. An investment entity will be required to account for its subsidiaries at fair value through profit or loss, and to consolidate only those subsidiaries that provide services that are related to the entity's investment activities. IFRS 12 was amended to introduce new disclosures, including any significant judgements made in determining whether an entity is an investment entity and information about financial or other support to an unconsolidated subsidiary, whether intended or already provided to the subsidiary. There will be no impact on the financial statements of the Bank. This amendment has not yet been approved by European Union.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank’s financial statements.

(b) Treatment of associated undertakings

Investments in associated undertakings are accounted for using the equity method of accounting and are initially recognised at cost. These are undertakings in which the Bank has between 20 percent and 50 percent of the voting rights, and over which the Bank exercises significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. Equity accounting involves recognizing the Bank’s share of the associate’s profit or loss for the period in the profit or loss. The Bank’s interest in the associate is carried in the balance sheet at an amount that reflects its share of net assets of the associate.

For summarised financial information on the associate Municipální finanční společnost a.s. accounted for using the equity method, see Note 3.15.

(c) Foreign Currencies

Foreign currency transactions that are transactions denominated, or that require settlement, in a foreign currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions (Czech National Bank official rate).

Monetary items denominated in foreign currency are translated with the closing rate as at the reporting date. Non-monetary items measured at historical cost denominated in a foreign currency are translated with the exchange rate as at the date of initial recognition; non-monetary items in a foreign currency that are measured at fair value are translated using the exchange rates at the date when the fair value was determined.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities are recognised in the income statement.

All foreign exchange gains and losses recognised in the income statement are presented net in the income statement within ‘Income from financial operations’ or ‘Expense on financial operations‘.

In the case of changes in the fair value of monetary assets denominated in foreign currency classified as available for sale, a distinction is made between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in profit or loss, and other changes in the carrying amount, except impairment, are recognised in other comprehensive income.

(d) Financial assets and liabilities

In accordance with IAS 39, all financial assets and liabilities – which include derivative financial instruments – have to be recognised in the balance sheet and measured in accordance with their assigned category.

Financial assets

The Bank allocates financial assets to the following IAS 39 categories: financial assets at fair value through profit or loss; loans and receivables; held-to-maturity investments; and available-for-sale financial assets. Management determines the classification of its financial instruments at initial recognition.

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

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Bank at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking. Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. Bank's financial assets held for trading consist of debt instruments. These financial assets are recognised in the balance sheet as 'Financial assets held for trading'.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to the income statement. Gains and losses arising from changes in fair value are included directly in the income statement and are reported as 'Income from financial operations' or 'Expense on financial operations'. Interest income on financial assets held for trading are included in 'Interest and similar income'. The instruments are derecognised when the rights to receive cash flows have expired or the Bank has transferred substantially all the risks and rewards of ownership and the transfer qualifies for derecognising.

The Bank designates certain financial assets upon initial recognition at fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to IAS 39, the fair value option is only applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to senior management on a fair value basis, or
- the financial assets consists of debt host and an embedded derivative that must otherwise be separated.

To reduce accounting mismatch, the fair value option is applied to certain debt securities that are hedged with cross-currency interest rate swaps but for which the hedge accounting conditions of IAS 39 are not fulfilled. The aim is to recognize the changes in the fair value of the securities together with change in the fair value of the derivatives in the income statement.

Debt securities for which the fair value option is applied are recognised in the balance sheet as 'Financial assets designated at fair value'. Fair value changes relating to financial assets designated at fair value through profit or loss are recognised in 'Gains and (losses) on securities – changes in fair value of the securities designated at fair value through profit or loss'.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Bank includes in this category principally Loans originated by the Bank by providing money directly to a borrower.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Loans and receivables are reported in the balance sheet as loans and advances to banks or customers or as investment securities available for sale or held to maturity.

Interest on loans is included in the income statement and is reported as 'Interest and similar income'.

Preferential loans provided by the Bank

The Czech government and the Bank created various schemes to provide zero interest, low interest rate and subordinated loans to Czech enterprises that meet specified conditions (economic sectors supported by the Czech government or the European Union). The Bank participates partially on the funding of these loans, however, recognizes the full amount due from final recipient on its balance sheet in Loans and advances to customers. To compensate to the Bank for the below-market interest rate, the Bank receives from the funding partner the fees for managing the scheme, credit risk fee and the market interest rate agreed on a yearly basis for the Bank's share on funding. Overall amount of these fees is recognized as interest and similar income.

Based on the arrangements, the Bank is effectively able to transfer part of credit risk on these loans to the government (subject to certain limits). Such arrangements represent in substance a guarantee issued by the government. Once the loans are written-off due to credit quality deterioration in accordance with the Bank's rules, the funds deposited by the government for the provision of these loans (included in Amounts due to state institutions - see Note 3.18) are settled against these amounts. The financial guarantee received is not separately recognized as a receivable and is being effectively part of the funds provided by the government.

Following collection of the receivable or its settlement against the programme funding when deemed uncollectible, the receivable is derecognized, the loss exceeding the contractually agreed portion of credit risk, if any, covered by the government in respect of loans with the programme would be settled by the Bank.

(c) Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity, other than those that the Bank designates as available for sale and those that meet the definition of loans and receivables.

These financial assets are initially recognised at fair value including directly attributable and incremental transaction costs and measured subsequently at amortised cost, using the effective interest method.

Interest on held-to-maturity investments is included in the income statement and reported as 'Interest and similar income'. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the investment and recognised in the income statement as 'Net gains/(losses) on financial operations'. No provisions on held-to-maturity investments had to be recognised either in 2012 or 2011.

(d) Available-for-sale financial assets

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Available-for-sale financial assets are initially recognised at fair value plus transaction costs and measured subsequently at fair value with gains and losses being recognised in the statement of comprehensive income, except for impairment losses, until the financial asset is derecognised. If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in the statement of comprehensive income is recognised in the income statement.

However, interest calculated using the effective interest method, and foreign currency gains and losses on Bank's bonds classified as available for sale are recognised in the income statement.

(e) Recognition

The Bank uses settlement date accounting for regular way contracts when recording financial asset transactions. The settlement (collection) date is the day on which the financial instrument is delivered (cash payment). When settlement date accounting is applied, the financial asset is recognised on the day of receipt of a financial instrument (sending of cash) and derecognised on the day of its provision (collection of cash). In case of a portfolio of financial assets measured at fair value, changes in the fair value of the financial assets are recognized from the purchase trade date to the sale trade date. Accrued interest on debt financial assets is recognised from the purchase settlement date to the sale settlement date.

All loans and receivables are recognised when funds are provided to customers. Loans and receivables are derecognised when fully repaid by the borrower or written-off.

The Bank settles and derecognises financial liabilities at the date on which all related risks and costs attributable to the specific liability are transferred or settled.

Financial assets that are transferred to a third party but do not qualify for derecognition are presented in the balance sheet as 'Assets pledged as collateral', if the transferee has the right to sell or repledge them.

Financial liabilities

The Bank's holding in financial liabilities is comprised by financial liabilities at fair value through profit or loss (financial liabilities held for trading, i.e. financial derivatives and short sales), financial liabilities at amortised cost and hedging derivatives.

(a) Financial liabilities at fair value through profit or loss

In the Bank's case, this category comprises only financial derivatives held for trading and short sales. The Bank recognizes its financial derivatives in the category held for trading unless they are designated and effective as hedging instruments. These instruments are recognised in the balance sheet as 'Financial liabilities held for trading'.

Gains and losses arising from changes in fair value of financial liabilities classified as held for trading are included in the income statement and are reported as 'Net gains/(losses) on financial operations'.

(b) Other liabilities measured at amortised cost

Financial liabilities that are not classified as at fair value through profit or loss fall into this category and are measured at amortised cost. Financial liabilities measured at amortised cost are principally deposits and loans from banks or customers.

Determination of fair value

The best evidence of fair value are quoted prices in an active market. If the market for a financial instrument is not active, the entity establishes the fair value by using a valuation technique.

The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same and discounted cash flow analysis.

The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.

For more complex instruments, the Bank uses developed valuation models, which are usually based on valuation methods and techniques generally recognised as standard within the industry. Valuation models are used primarily to value derivatives transacted in the over-the-counter market. All the inputs to these models are market observable. The fair value of over-the-counter (OTC) derivatives is determined using valuation methods that are commonly accepted in the financial markets, such as present value techniques and option pricing models. The fair value of foreign exchange forwards is generally based on current forward exchange rates.

For the categorization of the financial instruments carried at fair value see Note 5.

Derecognition

Financial assets are derecognised when the contractual rights to receive the cash flows from these assets have ceased to exist or the assets have been transferred and substantially all the risks and rewards of ownership of the assets are also transferred (that is, if substantially all the risks and rewards have not been transferred, the Bank tests control to ensure that continuing involvement on the basis of any retained powers of control does not prevent derecognition). Financial liabilities are derecognised when they have been redeemed or otherwise extinguished.

Collateral (bonds) furnished by the Bank under standard repurchase agreements and securities lending and borrowing transactions are not derecognised because the Bank retains substantially all the risks and rewards on the basis of the predetermined repurchase price, and the criteria for derecognition are therefore not met.

Reclassification of the financial assets

The Bank may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held-for-trading or available-for-sale categories if the Bank has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification. The Bank has not performed any of the reclassification or any type of other reclassifications between categories of the financial assets in 2012 or 2011.

(e) Offsetting financial instruments

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

(f) Interest and fee income and expenses

Interest income and expense are recognised in the profit and loss account for all interest bearing instruments on an accruals basis using the effective interest rate. Loan origination fees are included in the effective interest rate and are therefore reported in 'Interest income'. Other fees and commissions are recognised in the period to which they relate on an accruals basis. Interest income includes interest income for all fixed income instruments.

As part of its activities, the Bank acts as an agent disbursing government's funds as subsidy of interest costs of the loans provided by the Czech state agency to the debtors that meet specified criteria. Therefore, the grant is not recognized on the balance sheet of the Bank. The Bank's services are: (i) it is a payment agent and (ii) the Bank processes paperwork, e.g. subsidy agreements on behalf of the government. The Bank obtains remuneration for the services provided of the agreed percentage of funds disbursed. This remuneration from the government partner is recognized as earned as it is calculated on annual basis based on the agreed contract with the provider of the assistance.

(g) Impairment of financial assets

(a) Assets carried at amortised cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The Bank regularly assesses its loan portfolio for impairment. As part of this analysis, the Bank splits all loans into two categories: non-performing loans, i.e., a larger than insignificant part of the principal and interest is past due for more than 90 days, and performing loans. If there is any objective evidence that a loan may be impaired (deterioration of a debtor's financial health, payment default, etc), the amortised cost of the loan is reduced through a provision to its estimated recoverable value. The recognition, use and release of provisions are accounted for on a monthly basis always by reference to the loan balances at the month-end. The provision is reduced if objective reasons for loan impairment cease to exist. In such cases, the original amount is reversed and a required provision is released. Provisions are used when loans are sold or written off. Provisions are released to income when the reasons for maintaining the provision cease to exist (for example, when the loan is repaid).

The Bank makes an estimate of realised losses on an individual basis for individually significant loans and on a portfolio basis for individually insignificant loans by reference to historical experience.

Management of the Bank uses estimates based on historical experience of losses on loans that have similar risk characteristics (that is, on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. The methods and assumptions adopted in estimating amounts and the timing of future cash flows are regularly reviewed to reduce differences between the estimated and actual data.

The Bank writes off loss loans when it can be reasonably anticipated that clients will be unable to fulfil their obligations to the Bank in respect of these loans. Subsequent recoveries are credited to the income statement in the line 'Decrease/ increase in loan impairment and write-offs'.

For further information on credit risk refer to Note 4.1.

(b) Available for sale financial assets

The Bank performs regular assessments to determine whether available for sale financial assets suffered impairment. When a decline in the fair value of an available-for-sale financial asset has been recognised in other comprehensive income and there is objective evidence that the asset is impaired, the carrying amount of the impaired security is decreased directly and at the same time the cumulative loss that had been recognised in other comprehensive income is reclassified from equity to profit or loss line 'Net gains/ (losses) on financial operations' as a reclassification adjustment even though the financial asset has not been derecognised. The amount of this loss reflects the difference between the cost (less the repayments of principal and amortisation, if any) and the current fair value, reflecting previous impairment losses recognised in expenses.

(h) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in Due to banks or Due to customers, as appropriate.

Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

(i) Derivative financial instruments and hedging

In the normal course of business, the Bank enters into contracts for derivative financial instruments which represent a financial instrument that requires none or a very low initial investment. The derivative financial instruments used include interest rate and currency forwards and swaps. These financial instruments are held by the Bank in order to hedge interest rate risk and currency exposures associated with its transactions.

Derivative financial instruments are initially recognised at fair value and are subsequently remeasured to their fair value. Fair values are obtained from the discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

On the date a derivative contract is entered into, the Bank designates certain derivatives as an accounting hedge of the fair value of a recognised asset or liability (fair value hedge). Hedge accounting is used for derivatives and the hedged items designated in this way provided that certain criteria are met.

The Bank's criteria for a derivative instrument to be accounted for as an accounting hedge include:

(a) They meet the Bank's risk management strategy,
(b) At the inception of the hedge, the hedging relationship is formally documented, the documentation identifies the hedged item and the hedging instrument, defines the risk that is being hedged and the approach to establishing and documenting whether the hedge is effective, and
(c) The hedge is effective, that is, if, at inception and throughout the period, changes in the fair value of the hedged item are almost fully offset by changes in the fair value of the hedging instrument and the results are within a range of 80 percent to 125 percent.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that prove to be highly effective in relation to the hedged risk are recorded in profit or loss along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective element of the hedge is charged directly to profit or loss in line 'Income from financial operations' or 'Expense on financial operations'.

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement under 'Income from financial operations' or 'Expense on financial operations'.

(j) Provisions and financial guarantees obligations

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

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

Financial guarantee contracts

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument.

Bank provides two main types of financial guarantees:

- the financial guarantees to the small and medium enterprises in various preferential guarantee programmes in cooperation with the Czech state, and
- the financial guarantees in PANEL programme launched by the State Fund of Housing Development ("SFRB") in support of reconstruction and refurbishment of specific block of flats with the aim to improve their quality and lifetime.

Under the agreements concluded between the Bank and the Czech state or the Bank and SFRB, the Bank issues preferential financial guarantees for loans provided by third party banks. The difference between the full market price of the guarantee and the fee paid by client is funded by the Czech state (intermediating in some cases the programmes of the European Union) or by SFRB. The Bank immediately deducts such support funded by the Czech state whole in advance from the customer's bank account as its fee for the issued financial guarantee and these fees received are recognised in the income statement over the life of the guarantee. The terms and conditions of the financial guarantee contracts with related parties are described in Note 3.24.

In addition, the government refunds to the Bank losses on financial guarantees issued under the schemes up to the amount agreed in the contract between the Bank and the Czech state. For these purposes the amounts are deposited within special bank account for each guarantee provided and recognized as Amounts due to state institutions (see Note 3.18).

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for future premiums is recognised. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial amount, less amortisation of fees recognised in accordance with IAS 18, and the best estimate of the amount required to settle the guarantee (i.e. the amount determined in accordance with IAS 37 Provisions, Contingent liabilities and Contingent assets). Provisions for guarantees are made for estimated losses above the amounts deposited by the Czech state. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of the Bank's management. Risk category method applied by the Bank is considering the likelihood that an outflow will be required in settlement by considering the class of obligations (i.e. those arising from a certain type of the financial guarantees) as a whole. A provision is therefore recognised even if the likelihood of an outflow with respect to any specific item included in the same class of obligations may be small.

(k) Property, plant and equipment and intangible assets

Tangible and intangible assets are stated at historical cost less the accumulated depreciation and accumulated impairment losses. Fixed assets are depreciated through the accumulated depreciation charge. Depreciation is calculated on a straight line basis in order to write off the cost of each asset to their residual value over its estimated useful economic life. Assets in the course of construction are not depreciated.

The estimated useful economic lives are set out below:

Machinery and equipment, computers, vehicles, software	4 years
Fixtures, fittings and equipment	10 years
Buildings and structures	30 years

The Bank periodically tests its assets for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount. Where assets are identified as being surplus to the Bank's requirements, management of the Bank determines a provision for asset impairment. In respect of the assets owned by the Bank, the provision is assessed by reference to a fair value based on third party valuation reports adjusted downwards for an estimate of associated sale costs.

Repairs and renewals are charged directly to the income statement when the expenditure is incurred.

(l) Employee benefits

The Bank governs through internal guidelines provision of employee benefits. Some benefits are provided regularly to all employees (e.g. additional pension insurance); others are provided in relation to the actual need of an employee (e.g. loans).

Contributions are made to the government's retirement benefit scheme at the statutory rates in force during the year based on gross salary payments. The cost of social security payments is charged to the income statement in the same period as the related salary cost.

(m) Current and deferred income tax

Tax is calculated in accordance with the provisions of the relevant legislation of the Czech Republic based on the profit determined in accordance with the Czech Accounting Standards.

Deferred income tax is provided using the balance sheet liability method for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Deferred income tax is determined using tax rates effective in the periods in which the temporary tax difference is expected to be realised. The principal temporary differences arise from specific allowances for loan losses and provisions for the guarantees and unrealised gains and losses from available for sale financial assets. Deferred tax assets in respect of tax losses carried forward and other temporary differences are recognised to the extent that it is probable that future taxable profit will be available against which the tax assets can be utilised.

Current and deferred tax are recognised as an expense or income in the income statement, except for the deferred tax effects related to fair value re-measurement of available-for-sale investments. As the fair value re-measurement is recognised in other comprehensive income, deferred tax is also recognised in the other comprehensive income and subsequently reclassified to the income statement together with the gain or loss on derecognition.

(n) Share capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets. Own shares held by the Bank are recognised as a deduction in equity until they are cancelled or resold. When such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity.

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's general meeting of shareholders. Dividends for the year that are proposed or declared after the balance sheet date are disclosed in the subsequent events note.

(o) Subsequent Events

The effects of events which occurred between the balance sheet date and the date when the financial statements were authorised for issue are reflected in the financial statements in the event that these events provide further evidence of conditions which existed at the balance sheet date.

Where significant events occur subsequent to the balance sheet date prior to authorising the financial statements for issue which are indicative of conditions which arose subsequent to the balance sheet date, the effects of these events are disclosed but do not result in adjustments in the financial statements.

(p) Key Bank's management judgments and estimates

The presentation of financial statements in conformity with IFRS requires management of the Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the reporting date and the reported amounts of revenues and expenses during the reporting period. These estimates, which specifically relate to the impairment of financial assets and provisions arising from the provided financial guarantees, are based on the information available as of the date of preparation of the financial statements and actual results could differ from those estimates.

Impairment losses on loans to customers and provisions for financial guarantees

Management uses estimates based on historical loss experience for assets and financial guarantees with credit risk characteristics similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. Should the estimated percentages of the impairment provisions divert from the current management estimate by +/- 1 %, the impairment loss is to be estimated CZK 75,000,000 higher/lower.

Global financial crisis

Financial sector is currently stabilised after interventions of the European Central Bank (ECB), which mitigated tension on financial markets by measures taken. Trading on capital markets focuses mainly on purchasing of state bonds from countries which are considered as secure. The volume of the interbank funding in 2012 remained on a similar level as in 2011, even though it continues to be limited to a short term horizon. In regards to its business activities the Bank is not dependent on funding from the interbank market.

The management of the Bank believes that further possible significant deterioration of liquidity situation on the financial markets and increase of volatility on foreign exchange and capital markets would not have any fundamental impact on Bank's financial position. The management of the Bank believes that considering the current situation all necessary measures for the purpose of sustainability and development of the Bank have been taken.

3/ Additional information to balance sheet and income statement items

3.1. Interest income

CZKm	**2012**	**2011**
Interest income on loans and advances to banks	94	115
Interest income on loans and advances to customers	430	431
Interest on loans granted to the Czech state	546	671
Interest on debt securities	631	677
- held for trading	7	7
- designated at fair value through profit or loss	71	59
- available for sale	335	424
- held to maturity	218	187
Interest income	**1,701**	**1,894**
Interest on short sales	-	(3)
Interest on amounts due to banks	(452)	(516)
Interest on deposits due to customers	(31)	(33)
Interest on deposits from the Czech state	(269)	(275)
Interest from unwinding discounts on provisions (Note 3.6)	(74)	(89)
Interest expenses	**(826)**	**(916)**
Net interest income	**875**	**978**

Interest income includes CZK 408,000,000 (2011: CZK 461,000,000) of interest income on impaired financial assets.

3.2. Fee and commission income

CZKm	**2012**	**2011**
Fees from financial guarantees	553	670
Credit related fees and commissions	36	37
Fees and commissions from payment transactions	46	44
Fee and commission income	**635**	**751**
Fee and commission expense from trading activities	(5)	(6)
Fee and commission expense	**(5)**	**(6)**
Net fee and commission income	**630**	**745**

3.3. Gains and losses from financial operations

CZKm	2012	2011
Gains and (losses) on securities	199	56
- available for sale	83	69
- amounts reclassified from other comprehensive income on disposal	83	69
- changes in fair value of securities held for trading	18	(9)
- changes in fair value of securities designated at fair value through profit or loss	98	(6)
- gain from revaluation of short sales	-	2
Net losses on derivatives held for trading	(71)	(128)
Net losses on hedging derivatives	(147)	(125)
Exchange differences (including exchange differences on available for sale and held to maturity debt securities)	49	(9)
Total income and expenses on financial operations	**30**	**(206)**

Net losses on hedging derivatives are due to high hedge accounting effectiveness almost fully compensated in the income statement in lines “Exchange differences“ in case of the foreign currency risk hedging and in “Interest income“ and “Interest expense“ in case of interest rate risk hedging. The overall accounting hedge ineffectiveness amounts to CZK 1 million in 2012 (2011: CZK 1 million).

3.4. Administrative expenses

CZKm	2012	2011
Wages, salaries and bonuses	(167)	(163)
Social security costs	(47)	(49)
of which: state pension scheme contributions	(33)	(36)
Total personnel expenses	**(214)**	**(212)**
General administrative expenses	(126)	(135)
Total administrative expenses	**(340)**	**(347)**

Wages, salaries and key management compensations:

CZKm	2012	2011
Wages and salaries of the Bank’s employees	(108)	(107)
Key management personnel compensation	(44)	(41)
- wages and salaries of the Bank’s management	(37)	(36)
- compensations to Board of Directors members	(4)	(3)
- compensations to Supervisory Board members	(2)	(1)
- compensation to Audit Committee members	(1)	(1)
Other employees' expenses	(9)	(8)
Directors’ fees	-	(1)
Social fund expenditures	(6)	(6)
Total wages, salaries and bonuses	**(167)**	**(163)**

Staff Analysis

	2012	2011
Number of members of the Board of Directors	5	5
Number of members of the Supervisory Board	9	9
Number of members of the Audit Committee	4	4
Average number of the Bank’s management	22	22
Average number of Bank’s employees (excl. above listed)	195	195

Other administrative expenses comprise:

CZKm	2012	2011
General administrative expenses	(76)	(83)
Rental charges	(11)	(11)
Audit, legal, tax and other professional services	(9)	(8)
Depreciation and amortisation	(30)	(33)
Total other administrative expenses	**(126)**	**(135)**

3.5. Increase in loan impairment and write-offs

Overall charge for the loan impairment can be analyzed as follows:

31 December 2012

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions to loan impairment allowances	(42)	(13)	(55)
Receivables written-off during the year not fully provided for	(46)	-	(46)
Additions to allowances to other assets	(2)	-	(2)
Total increase in loan impairment allowances and write-offs	**(90)**	**(13)**	**(103)**

31 December 2011

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions to loan impairment allowances	(272)	33	(239)
Receivables written-off during the year not fully provided for	(1)	-	(1)
Additions to allowances to other assets	(1)	-	(1)
Total increase in loan impairment allowances and write-offs	**(274)**	**33**	**(241)**

Reconciliation of the allowance account for impairment:

Year ended 31 December 2012

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2012	**1,579**	**199**	**1,778**
Additions to impairment allowances	44	13	57
Use of the allowances for write-offs	(53)	-	(53)
Balance at 31 December 2012	1,570	212	1,782

Year ended 31 December 2011

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2011	**1,344**	**232**	**1,576**
Additions to impairment allowances	274	(33)	241
Use of the allowances for write-offs	(39)	-	(39)
Balance at 31 December 2011	**1,579**	**199**	**1,778**

3.6. Provisions for guarantees and other provisions

The balance of provisions for guarantees and other provisions comprises:

CZKm	31 December 2012	31 December 2011
Provisions for guarantees (Note 3.22)	2,152	2,028
Provisions for loan commitments (Note 3.22)	53	54
Other provisions (Note 3.23)	137	137
Total provisions	**2,342**	**2,219**

Reconciliation of the provisions for guarantees and other provisions:

CZKm	2012	2011
Balance at 1 January	**2,219**	**2,277**
Increase/(decrease) in provisions for guarantees and loan commitments	48	(181)
Increase in other provisions	-	34
Interest expense from unwinding discounts (Note 3.1)	74	89
Balance at 31 December	**2,342**	**2,219**

3.7. Income taxes

CZKm	2012	2011
Profit before income tax	**1,049**	**1,083**
Theoretical tax calculated at a statutory income tax rate 2012: 19 % (2011: 19 %)	199	206
Non-taxable income from securities – permanent difference	(4)	(6)
Effect of non-recognized contingent deferred tax asset	39	32
Other permanent items	5	1
Income tax expense as reported in income statement	**239**	**233**
- current	218	210
- deferred	21	23
Income tax paid during the year	208	193
Current income tax liabilities at 31 December	(10)	(17)
Effective tax rate	**23 %**	**21 %**

Deferred taxation

The recognised deferred tax can be analysed as follows:

CZKm	31 December 2012	31 December 2011
Other provisions	32	53
Deferred tax recognised in other comprehensive income for revaluation of available for sale securities	(81)	(8)
Total deferred tax	**(49)**	**45**

CZKm	31 December 2012	31 December 2011
Deferred tax reported in the statement of financial position		
- to be recovered after more than 12 months	27	39
- to be recovered within 12 months	5	14
Deferred tax recognised in other comprehensive income for revaluation of available for sale securities		
- to be recovered within 12 months	(81)	(8)
Total deferred tax	**(49)**	**45**

Potential deferred tax asset of CZK 168m as at 31 December 2012 (2011: CZK 130m) arising from differences between accounting and tax values of impairment allowances and provisions has not been recognised as it is not probable that this difference will become tax deductible in the foreseeable future.

CZKm	2012	2011
Deferred tax balance at 1 January	45	41
Movement through income statement	(21)	(23)
Movement in deferred tax recognised in other comprehensive income for revaluation of available for sale securities	(73)	27
Deferred tax balance at 31 December	**(49)**	**45**

The deferred tax is calculated at the statutory income tax rate of 19 % (31 December 2011: 19 %), which is a statutory income tax rate enacted for the period, when the Bank anticipates realising the temporary differences.

3.8. Cash and balances with central banks

CZKm	31 December 2012	31 December 2011
Obligatory minimum reserves	461	59
Cash in hand	11	8
Amounts due under reverse repo transactions	69,801	15,102
Total cash in hand and balances with central banks	**70,273**	**15,169**

Obligatory minimum reserves represent mandatory deposits with the Czech National Bank.

3.9. Loans and advances to banks

CZKm	31 December 2012	31 December 2011
Current accounts with other banks	42	4
Term deposits with banks	-	1,680
Included in cash and cash equivalents (Note 3.21.)	42	1,684
Other amounts due from banks	202	146
Total loans and advances to banks	**244**	**1,830**

All the amounts due from banks are unimpaired exposures before due date and no provisions are recognized. As the majority of the balances are collateralized exposures with local Czech banks under reverse repo transactions, the credit quality of the balances is not further analyzed in these financial statements.

3.10. Securities at fair value through profit or loss

CZKm	31 December 2012	31 December 2011
Government bonds - domestic	1,213	294
Government bonds - foreign	51	-
Securities held for trading	1,264	294
Government bonds - domestic	472	440
Government bonds – foreign	706	678
Bonds issued by Czech financial institutions	626	643
Bonds issued by other Czech entities	298	307
Securities designated at fair value through profit or loss	2,102	2,068
Total securities at fair value through profit or loss	**3,366**	**2,362**

3.11. Loans and advances to customers

CZKm	31 December 2012	31 December 2011
Loans to private legal entities and individuals	7,053	7,396
Loans to the Ministry of Finance of the Czech Republic and other government entities	10,468	11,591
Loans to municipalities	1,069	1,207
Unquoted debt securities	-	50
Gross amounts due from customers	**18,590**	**20,244**
Provisions for loans to customers (Note 3.5)	(1,776)	(1,774)
Net amounts due from customers	**16,814**	**18,470**

Loans to the Ministry of Finance represent principally the loans provided in connection with infrastructure programmes which were transferred to the Bank from Konsolidační banka Praha in 2000. These programmes are principally targeted at funding the construction of the highway network, repairs of international roads, removal of flood damage and water sector investments. The funding of these programmes was provided by the European Investment Bank (Note 3.17) and is denominated also in EUR. The Bank entered into fix-to-fix cross currency swap hedge accounting transaction to cover the associated foreign currency risk (Note 4.3).

Set out below is the currency structure of the outstanding infrastructure loan principal amounts on the side of assets and liabilities (Note 3.17):

	31 December 2012		31 December 2011	
	Assets	**Liabilities**	**Assets**	**Liabilities**
	CZKm	**CZKm**	**CZKm**	**CZKm**
CZK – principal	4,883	4,883	6,649	5,652
CZK – accrued interest	1	1	135	3
EUR – principal	5,511	5,511	5,683	6,486
EUR – accrued interest	73	73	3	87
Fair value hedge remeasurement	-	-	(927)	(1,012)
Total	**10,468**	**10,468**	**11,543**	**11,216**

The disclosures per classes of the loans and advances to customers are made in the credit risk section in Note 4.1 and reconciliation of changes in the allowance account during the period for each class of the loans and advances to customers is disclosed in Note 3.5.

3.12. Securities available for sale

Available for sale ("AFS") securities comprise debt securities as follows:

CZKm	31 December 2012	31 December 2011
Fixed income debt securities	8,027	6,587
Variable yield debt securities	7,296	6,040
Total debt securities available for sale	**15,323**	**12,627**

All AFS securities as at 31 December 2012 and 2011 were publicly traded on stock exchanges. They are denominated in various currencies and the currency risk is hedged (see Note 4.3).

AFS securities of CZK 1,074,000,000 (2011: CZK 1,178,000,000) were pledged as collateral to third parties in sale and repurchase agreements to provide security over the money borrowed. These assets have been reclassified as pledged assets on the face of the balance sheet as the borrower possessing the collateral has the right to re-pledge it or sell, however also has an obligation to return it.

AFS securities have been issued by the following issuers:

CZKm	31 December 2012	31 December 2011
- Czech state institutions	13,099	10,064
- Czech financial institutions	1,924	1,606
- Other Czech entities	56	179
- Foreign state institutions	69	-
- Foreign financial institutions	175	573
- Other foreign entities	-	205
Total debt securities available for sale	**15,323**	**12,627**

3.13. Securities held to maturity

Held to maturity ("HTM") securities have been issued by the following issuers:

CZKm	31 December 2012	31 December 2011
Czech state institutions	5,369	7,839
Total debt securities held to maturity	**5,369**	**7,839**

HTM securities are denominated in various currencies (see also Note 4.3). HTM securities comprise only securities generating fixed income.

HTM securities of CZK 52,000,000 (2011: CZK 2,630,000,000) were pledged as collateral to third parties in sale and repurchase agreements to provide security over the money borrowed. These assets have been reclassified as pledged assets on the face of the balance sheet as the borrower possessing the collateral has the right to re-pledge it or sell, however also has an obligation to return it.

3.14. Other assets

CZKm	31 December 2012	31 December 2011
Financial assets		
Accrued income	59	55
Receivables from unsettled transactions with securities	-	1
Non-financial assets		
Prepaid expenses	10	10
Other	20	17
Total other assets, gross	**89**	**83**
Impairment provisions (Note 3.5)	(6)	(4)
Total other assets, net	**83**	**79**

3.15. Investments in associate

The financial statements include an at equity measured investment in associate, Municipální finanční společnost a.s., with its registered office address at Jeruzalémská 4, Prague 1 ('MUFIS'), key details of which are set out below.

The Bank formed MUFIS, with share capital of CZK 1,000,000 in 1994. In 1995, the Bank disposed of 51 percent of the issued share capital, and holds a 49 percent investment in MUFIS at 31 December 2012 and 2011.

Shareholders' structure	31 December 2012	31 December 2011
ČMZRB	49 %	49 %
Ministry of Finance	49 %	49 %
Association of Czech Municipalities	2 %	2 %

MUFIS acts as the official broker and administrator of long-term funding obtained on the basis of an agreement with USAID from private US investors. This funding is designed to finance the infrastructure projects of municipalities. The ultimate beneficiaries were provided with the funding following an assessment of their business plans, through a selected number of commercial banks which act as MUFIS's debtors. Following preparatory negotiations with US investors and Czech institutions, MUFIS began to implement the programme in 1995. Last instalment of second tranche's principal arising from USA borrowings was repaid on 30 January 2012. The Bank signed on 27 August 2009 with MUFIS an agreement on cooperation within the area of financing infrastructure projects for municipalities in the Czech Republic.

Summary financial information in CZKm	Equity	The Bank's share on equity	Total assets	Profit after tax	The Bank's share on profit
At 31 December 2012 and for the year then ended	212	104	214	11	5
At 31 December 2011 and for the year then ended	202	99	239	14	7

3.16. Property, plant and equipmen

CZKm	Land	Buildings	Equipment and fittings	Total
At 1 January 2011				
Acquisition cost	10	304	125	439
Accumulated depreciation	-	(153)	(115)	(268)
Net book value	**10**	**151**	**10**	**171**
Year ended 31 December 2011				
Opening net book value	10	151	10	171
Additions	-	-	10	10
Disposals	-	-	(1)	(1)
Depreciation charge	-	(11)	(10)	(21)
Closing net book value	**10**	**140**	**9**	**159**
At 31 December 2011				
Acquisition cost	10	304	134	448
Accumulated depreciation	-	(164)	(125)	(289)
Net book value	**10**	**140**	**9**	**159**
Year ended 31 December 2012				
Opening net book value	10	140	9	159
Additions	-	1	3	4
Disposals	-	-	-	-
Depreciation charge	-	(10)	(6)	(16)
Closing net book value	**10**	**131**	**6**	**147**
At 31 December 2012				
Acquisition cost	10	304	138	452
Accumulated depreciation	-	(173)	(132)	(305)
Net book value	**10**	**131**	**6**	**147**

3.17. Amounts due to bank

CZKm	31 December 2012	31 December 2011
Due to other banks	13,901	17,445
Received term deposits from other banks	1,438	3,260
Amounts due to banks	**15,339**	**20,705**

Amounts due to other banks include principally the payables to the development banks (European Investment Bank, Kreditanstalt für Wiederaufbau, Nordic Investment Bank and Council of Europe Bank) of CZK 12,982,000,000 at 31 December 2012 (31 December 2011: CZK 13,613,000,000), majority of which represents a funding for infrastructure loans described in Note 3.11.

3.18. Amounts due to customers

Amounts due to customers, by type of deposit, comprise:

CZKm	31 December 2012	31 December 2011
Current accounts	5,477	6,158
Term deposits	13,985	10,382
Repo operations with the Ministry of Finance	64,245	7,250
Repo operations with other clients	-	100
Guarantee deposits	33	35
Other payables to clients	3,228	2,905
Total	**86,968**	**26,830**

Amounts due to customers, by type of customer, comprise:

CZKm	31 December 2012	31 December 2011
Amounts due to state institutions	81,808	23,005
Amounts due to municipalities	49	45
Amounts due to other customers	5,111	3,780
Total amounts due to customers	**86,968**	**26,830**

The 'Amounts due to state institutions' line includes, inter alia, payables comprising funding and funds to cover risks attached to the guarantee support programmes provided by the Bank (Note 2 d and 2 j):

CZKm	31 December 2012	31 December 2011
Funding from the providers of the individual support programmes not yet returned	3,192	2,865
Funds deposited by the programme partners to cover risks attached to providing the financial guarantees	2,680	2,998

3.19. Other liabilities

CZKm	31 December 2012	31 December 2011
Payable to employees	47	46
Deferred income	1,382	1,763
- financial guarantees premium deferred income	1,351	1,730
- other deferred income	31	33
Accrued expenses (financial liability)	31	28
Amount payable to Ministry for regional development in respect to intermediation of the support programme (financial liability)	222	225
Dividends declared and payable (Note 3.20)	-	420
Other	35	35
Total accruals and other liabilities	**1,717**	**2,517**

3.20. Equity and profit allocation

Share capital

	31 December 2012	31 December 2011
8,900 shares with a nominal value of CZK 239,500	2,132	2,132

The shares are registered and issued in book-entry form.

The Bank's shareholders as of 31 December 2012 and 2011 are set out below:

	2012		2011	
Shareholder	**Share on share capital**	**Share on voting rights**	**Share on share capital**	**Share on voting rights**
Ministry of Industry and Trade	24.25	24.25	24.25	24.25
Ministry for Regional Development	24.25	24.25	24.25	24.25
Ministry of Finance	23.83	23.83	23.83	23.83
Czech state total shareholding	72.33	72.33	72.33	72.33
Českomoravská záruční a rozvojová banka, a.s.	27.67	-	-	-
Komerční banka, a.s.	-	-	13.00	13.00
Česká spořitelna, a.s.	-	-	13.00	13.00
Československá obchodní banka, a.s.	-	-	1.67	1.67
Other shareholders (Banks)	27.67	0.00	27.67	27.67
Total	**100.00**	**72.33**	**100.00**	**100.00**

Own treasury shares

Acquired own shares are recognised at cost and presented in a separate line within equity. Treasury shares were acquired for market price of CZK 1,893,740,000, which was determined by sworn expert (see Note 1).

Profit Allocation

The statutory net profit of the Bank as recognized in accordance with Czech accounting standards for the year ended 31 December 2012 is proposed to be allocated and net profit for 2011 of the Bank was allocated as follows:

CZKm	2012	2011
Allocated to retained earnings	110	850
Dividends payable/paid	700	-
Net profit per statutory financial statements	**810**	**850**

No dividend was declared and paid from 2011 net profit. Following the decision of the general meeting of the Bank, dividends payable to the Ministry of Industry and Trade, Ministry for Regional Development and Ministry of Finance from 2010 net profit in the total amount of CZK 420,000,000 were paid on 5 January 2012, and are included as Dividends declared and payable in Accruals and other liabilities as at 31 December 2011 (Note 3.19).

Revaluation reserve

The revaluation reserve shows the effects from the fair value measurement of available for sale securities after deduction of deferred taxes. No gains or losses other than foreign exchange are recognised in the income statement until the asset has been disposed or impaired.

Retained earnings and statutory and other reserves

Retained earnings consist of undistributed profits from previous years. Statutory reserve consists of CZK 800,000,000 provided by the Czech State, which has to be set aside in accordance with national law and internally allocated revenue reserve of CZK 350,000,000.

3.21. Cash and cash equivalents

CZKm	31 December 2012	31 December 2011
Cash and balances with central banks (Note 3.8.)	70,273	15,169
Loans and advances to banks (Note 3.9.)	42	1,684
Total	**70,315**	**16,853**

Cash and cash equivalents comprise balances with less than three months' original maturity, including cash in hand, deposits held at call with banks and other short-term highly liquid investments.

3.22. Financial guarantees and loan commitments

Commitments to extend loans and financial guarantees for loans to third parties expose the Bank to credit risk and loss in the event that the client fails to comply with contractual conditions.

CZKm	31 December 2012	31 December 2011
Total issued financial guarantees	19,039	21,398
Loan commitments issued to clients	1,905	2,320
Total financial guarantees and loan commitments	**20,944**	**23,718**

In conducting repo and reverse repo transactions, the Bank uses government bonds. Receivables from reverse repo transactions are included in amounts due from banks (Note 3.9). Payables from repo transactions are included in amounts due to customers (Note 3.18). The securities received under reverse repo transactions are not recognized on balance sheet, but the Bank has the right to re-pledge it or sell, however it also has an obligation to return it. Fair value of the securities held under reverse repo transactions was CZK 64,324,000,000 at 31 December 2012 (2011: CZK 14,113,000,000).

3.23. Legal contingencies

On 21 February 2002, the Bank was named as a defendant in a legal dispute initiated by AO Invest, spol. s r.o., in respect of compensation of a damage of CZK 238,000,000. The plaintiff alleges that the claimed damage was incurred with regard to the mediated purchase of 1,050 bonds of ZPS, a.s. The legal dispute was halted due to AO Invest, spol. s r.o., being declared bankrupt. The legal dispute is currently being conducted against the bankruptcy trustee of AO Invest. During 2008, the litigated amount decreased to CZK 137,000,000 as a result of the plaintiff withdrawing the claim for compensation of CZK 100,000,000. At the end of 2008, the bankruptcy trustee sold the receivable, which is subject to the legal dispute, to MISORA HOLDINGS Limited, incorporated in British Virgin Islands. No decision has yet been taken regarding the involvement of this entity in the legal dispute. The legal dispute has not yet been completed and it is highly difficult to predict the development for the Bank, nor can the reliable estimate of the potential outflow of economic benefits be made.

3.24. Related party disclosures

Related parties of the Bank comprise:

1/ the Czech state. Dividend allocations are described in Note 3.20 and income taxes in Note 3.7.
2/ the associated undertaking MUFIS, with which the Bank entered into derivative transactions concluded in the normal course of business - see Note 4.2.2 for the detail of the balances;
3/ key management personnel (being defined as Board of Directors, Supervisory Board, Audit Committee and Bank's senior management) – for the detail of the expenses see Note 3.4; and
4/ entities controlled by the same controlling entity, i.e. by the Czech state.

The balances from related-party transactions with the Czech state and entities controlled by the same controlling entity (in the table below - "Other related parties") at the balance sheet date, related expense and income for the year (except for the income taxes and dividends) and off-balance sheet exposures are as follows:

CZKm	31 December 2012	31 December 2011
Assets	31,719	33,404
Czech state	30,248	30,819
Other related parties	1,471	2,585
Liabilities	81,907	24,231
Czech state	72,787	16,807
Other related parties	9,120	7,424
Revenues	1,263	1,462
Czech state	1,139	1,278
Other related parties	124	184
Expenses	230	249
Czech state	45	22
Other related parties	185	227
Collaterals provided under repo transactions and other off-balance sheet assets in the normal course of business	65,199	8,263
Czech state	64,269	7,228
Other related parties	930	1,035
Collaterals received under reverse repo transactions and other off-balance sheet liabilities in the normal course of business	836	878
Czech state	829	836
Other related parties	7	42

In the opinion of management all transactions entered into with related parties were made in the ordinary course of business on substantially the same terms and conditions, including interest rates, as those prevailing at the same time for comparable transactions with other customers, and did not involve more than normal credit risk or present other unfavourable features. These include current accounts, loans, deposits and securities issued by these entities and provided collaterals and loan commitments.

In PANEL guarantee programme the Bank receives from Státní fond rozvoje bydlení ("SFRB") a fee of 1.3 % p.a. of the guaranteed balance amount which is included in Fee and commission income of CZK 77,000,000 (2011: 80,000,000).

Revenues from the Czech state include also interest income (see Note 3.1) from the infrastructure loans taken over from the Ministry of Finance. For details of the transaction see Note 3.11.

Terms and conditions of the related party transactions - average effective interest rates

The table below provides average interest rates of significant items of related parties assets and liabilities as of 31 December 2012 and 2011.

	31 December 2012	31 December 2011
Assets		
Amounts due from banks	1.52 %	1.52 %
Loans to customers	4.66 %	4.93 %
Available for sale securities	2.33 %	2.08 %
Securities at fair value through profit or loss	4.18 %	3.90 %
Securities held to maturity	3.71 %	3.66 %
Liabilities		
Amounts due to banks	0.91 %	0,64 %
Amounts due to customers	0.90 %	0.97 %
Repo operations with the Ministry of Finance	0.39 %	0.73 %

4/ Risk management and financial instruments

4.1. Credit risk

4.1.1. Risk management method

Credit rating of amounts due from customers and banks

The credit rating of the enterprises that are small and medium-sized businesses, municipalities, water management enterprises, housing associations and associations of owners of housing units, and non-profit organisations is undertaken in accordance with the Bank's internal regulations and involves assessing the borrower's credit worthiness on the basis of an analysis of economic and other aspects. The assessment of other than economic aspects involves analysing external and internal factors that impact the client's activities and operations. The economic assessment focuses on undertaking a financial analysis of economic indicators and additional information. Credit worthiness is evaluated in relation to each transaction that carries an element of credit risk; credit risk exposure and the ratings are periodically assessed over the whole life of the loan transaction. Credit risk is expressed by assigning the borrower the relevant risk category. Credit risk exposure involved in a specific transaction is controlled by establishing contractual conditions and obtaining collateral in support of the transaction.

The monitoring of rating and credit risk involves assessing the following criteria (at minimum):

- Current financial and economic situation of the clients;
- Compliance with contractual terms, specifically reviews of the repayments of loan principal and interest amounts, payment of the fee for the provision of a guarantee, contractual penalties and charges, provision of information to the Bank, and balances on the client's bank accounts;
- Restructuring;
- External factors, primarily economic, political and legal;
- Loan analysts quarterly monitor the development of selected data and information for the monitoring of all clients as part of a client's financial analysis;
- Staff of the Risky Transactions Department monitor the records of clients in bankruptcy, settlement and liquidation on an ongoing basis, with regular weekly checks;
- Staff of business units monitor, on a monthly basis, the summary of clients for which the central loan register indicates that they have past due receivables.

Measuring credit risk of the portfolio

The Bank uses the following techniques to measure risks inherent in the loan and guarantee portfolio:

The method of quantified losses on the portfolio of loans and guarantees exposures compares the total quantified losses of doubtful and loss receivables with the redemption of these exposures. The quantification of losses also reflects the current balances of substandard exposures adjusted by an empirical and well-established coefficient which represents an estimate of the default rate of exposures in this category.

The weighted risk exposure method compares the weighted risk exposure with the original contractual amount of the loans (the balance of the actual loan draw-down) and guarantees. The weighted risk exposure consists of the sum of recorded provisions, the sum of receivables written-off, the sum of outstanding principal, the sum of outstanding interest and the sum of outstanding contractual penalties on client accounts, segmented by individual years of the portfolio's duration.

The risk category method compares quantified losses with the original contractual value of the loans or guarantees.

The incurred loss method is derived from calculated probabilities of individually unidentified default on individual internal risk categories described below and loss given default for specified type of exposures (loans, loans granted within the water infrastructure support programme and guarantees).

Risk categories

The Bank has risk (internal rating) categories 4 to 10, which are linked to the Czech National Bank's risk categories: standard loans 4, 5 and 6, watch 7, substandard 8, doubtful 9 and loss 10. In 2012 the Bank established internal rating category X9. Clients, which the Bank considers doubtful and which are overdue only 180 days or less, are classified into this category.

Credit enhancement

In the course of its lending and guarantees business, the Bank accepts movable and immovable assets pledged as collateral. This fact is also considered in calculation of the impairment provisions. The Bank also uses various forms of guarantee statements to collateralise its loan receivables.

Movable and immovable asset collateral is recorded in operating records and is valued on the basis of an appraisal prepared by a licensed appraiser (nominal value of collateral). The Bank centrally revalues real estate collateral to market values every two years on the basis of pricing maps prepared by an external agency. Collaterals provided by individuals and legal entities and bills of exchange are recorded in operating records and are valued at estimated values provided by the Bank's internal regulation.

The recoverable value of collateral takes into account both the cost of recovering collateral and the time value of money.

If the borrower's receivable is past due by more than 360 days, the Bank does not attribute any value to the collateral, since the historical evidence proves negligible workouts from such collaterals.

Recovery of Amounts due from borrowers

The Bank recovers due receivables arising from bank guarantees and loans through its internal debt work-out system by using all statutory recovery instruments available according to generally applicable legal regulations. With a view to expediting the recovery process, the Bank has employed an arbitration clause in respect of loan contracts and enforceable notarial and distrainer deeds.

Economic sector risk concentrations

The Bank principally monitors risk concentrations in the area of loans issued to small and medium-sized businesses and receivables arising primarily from water management loans. These risks are periodically monitored and reassessed at least on an annual basis. Credit risk limits are approved by the Board of Directors. This concentration translates into the definition of the classes of the loans to customers.

Geographical concentrations

Although the Bank performs its key activities in the Czech Republic, some investments in securities are done also outside of the Czech Republic. For the geographical concentrations see Note 4.1 B.

Risk concentrations

Significant risk concentration is defined by the Bank as a situation, where excessive concentration of exposures against mutually related entities or groups, certain industries, business activities or geographical areas would have significant impact on Bank's performance and stability in the cas of negative development.

The Bank primarily monitors risk concentrations in the area of preferential guarantees issued for loans to small and medium-sized businesses and for loans issued on housing units' repairs, preferential loans issued by the Bank to small and medium-sized businesses and loans to entrepreneurs and municipalities for water management projects. Majority of these loans and guarantees is provided in cooperation with the government and given the fact that the state participates on risk in some types of loans and guarantees the Bank's risk is effectively shared and thus limited. The Bank manages its risk concentrations in relation to credit exposure using system of limits for credit risk management. To identify concentration of credit risk the Bank mainly uses methods and procedures that are based on data analysis, which are stored in internal business and accounting systems of the Bank. The Bank does not use any hedging derivatives to eliminate these risks. The risks are periodically monitored.

Credit risk of other financial assets

Generally, in accordance with its internal regulations, the Bank defines eligible financial instruments for its investments. These principally involve deposits, bonds (mortgage bonds, CZK bonds, EUR bonds, and other foreign currency bonds) and derivatives (FX FWD, FX SWAP, CCS, IRS).

Credit assessment of counterparties and issuers involves analysing the borrower's solvency on the basis of credit ratings published by internationally recognised rating agencies and evaluating economic and other aspects. The solvency of counterparties and issuers is periodically assessed over the whole life of the commercial loan transaction.

4.1.2. Credit risk – quantitative disclosures

aa) Quality of amounts due from customers

Information about the credit quality of financial assets that are neither past due nor impaired

31 December 2012

CZKm Classes of financial assets	Risk category 4, 5	6	7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	249	1,507	231	36	-	-	29	2,052
Loans to Czech government entities	10,468	-	-	-	-	-	-	10,468
Loans to municipalities	4	201	-	-	-	-	-	205
Total	**10,721**	**1,708**	**231**	**36**	**-**	**-**	**29**	**12,725**

31 December 2011

CZKm Classes of financial assets	Risk category 4, 5	6	7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	279	2,000	269	45	-	-	126	2,719
Loans to Czech government entities	11,591	-	-	-	-	-	-	11,591
Loans to municipalities	95	188	-	-	-	-	-	283
Total	**11,965**	**2,188**	**269**	**45**	**-**	**-**	**126**	**14,593**

Analysis of financial assets that are individually determined to be impaired

31 December 2012

CZKm Classes of financial assets	Risk category 7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	2,471	597	404	998	532	5,002
Loans to municipalities	667	152	44	-	-	863
Total	**3,138**	**749**	**448**	**998**	**532**	**5,865**

31 December 2011

CZKm Classes of financial assets	Risk category 7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	2,488	541	502	835	361	4,727
Loans to municipalities	684	114	126	-	-	924
Total	**3,172**	**655**	**628**	**835**	**361**	**5,651**

Analysis by regulatory rating

The loans to clients comprise the following, broken down by regulatory classification:

CZKm	Internal rating	31 December 2012	31 December 2011
Standard	4 – 6	12,422	14,244
Watch	7	3,402	3,466
Substandard	8	787	706
Doubtful	9	450	632
Loss	10	1,529	1,196
Total		**18,590**	**20,244**
Impairment provision for loans to customers (Note 3.5)		(1,776)	(1,774)
Net amounts due from customers		**16,814**	**18,470**

Analysis of provisions by risk category

CZKm		31 December 2012		31 December 2011	
Risk category		Type of provision		Type of provision	
		Individual	Portfolio	Individual	Portfolio
4 – 6	Standard	-	87	-	98
7	Watch	427	57	399	67
8	Sub-standard	234	-	195	-
9	Doubtful	262	-	397	-
10	Loss	709	-	618	-
Total		**1,632**	**144**	**1,609**	**165**
Total provisions			**1,776**		**1,774**

Analysis by collateral

The loan portfolio comprises the following, broken down by type of collateral:

CZKm	31 December 2012	31 December 2011
Bank guarantees and collateral by reliable guarantors	746	704
Cash collateral	33	25
Real estate collateral	2,273	2,038
Other loan collateral	57	229
Uncollateralised	15,481	17,248
Total	**18,590**	**20,244**
Impairment provision for loans to customers (Note 3.5)	(1,776)	(1,774)
Net amounts due from customers	**16,814**	**18,470**

Renegotiated loans to customers

CZKm	31 December 2012	31 December 2011
Loans to private legal entities and individuals	252	222

Aging analysis of loans past due which are not classified as individually impaired

31 December 2012

CZKm	Past due 30 days	Past due 30 – 90 days	Past due 90 – 180 days
Loans to private legal entities and individuals	-	-	1
Total	**-**	**-**	**1**

31 December 2011

CZKm	Past due 30 days	Past due 30 – 90 days	Past due 90 – 180 days
Loans to private legal entities and individuals	-	-	1
Total	**-**	**-**	**1**

31 December 2012

CZKm	Bank guarantee and collateral by reliable guarantors	Collateral by pledged real estate	Uncollate-ralised
Loans to private legal entities and individuals	1	-	-
Total	**1**	**-**	**-**

31 December 2011

CZKm	Bank guarantee and collateral by reliable guarantors	Collateral by pledged real estate	Uncollate-ralised
Loans to private legal entities and individuals	-	-	1
Total	**-**	**-**	**1**

ab) Quality of guarantees portfolio

31 December 2012 in CZKm

Programmes	Risk classification 5	6	7	8	X9[1)]	9	10	No risk category *	Total
Guarantees for small and medium sized enterprises provided until 2006	11	88	213	142	115	1	288	-	858
PANEL small portfolio guarantees	-	73	144	15	4	-	-	273	509
PANEL individual investment guarantees	-	1,186	4,581	661	182	4	-	28	6,642
Other previously provided guarantees	-	-	-	-	-	-	28	-	28
VADIUM	-	-	127	-	-	-	-	-	127
Small portfolio guarantees for businessmen since 2007	9	192	829	215	65	11	6	2,471	3,798
Small portfolio guarantees without external risk enhancement	6	58	199	57	8	3	-	1,100	1,431
Individual investment and operating guarantees for small and medium sized enterprises since 2007	39	458	3,435	829	659	16	210	-	5,646
Total	**65**	**2,055**	**9,528**	**1,919**	**1,033**	**35**	**532**	**3,872**	**19,039**

* Portfolio approach

31 December 2011 in CZKm

Programmes	Risk classification 5	6	7	8	X9[1)]	9	10	No risk category *	Total
Guarantees for small and medium sized enterprises provided until 2006	24	142	333	220	175	446	8	-	1,348
PANEL small portfolio guarantees	-	82	155	9	4	-	-	306	556
PANEL individual investment guarantees	23	1,366	5,173	452	315	-	-	20	7,349
Other previously provided guarantees	-	-	-	-	1	30	-	-	31
VADIUM	-	1	52	-	-	-	57	-	110
Small portfolio guarantees for businessmen since 2007	9	251	1,061	297	43	21	34	3,611	5,327
Individual investment and operating guarantees for small and medium sized enterprises since 2007	50	699	4,495	898	383	137	15	-	6,677
Total	**106**	**2,541**	**11,269**	**1,876**	**921**	**634**	**114**	**3,937**	**21,398**

* Portfolio approach

[1)] Category X9 is used by the Bank to designate guarantees where the Bank anticipates delivery of the pay-out call.

ac) Quality of securities portfolio

The securities portfolio comprises the following, broken down by rating classification and classes of financial instruments:

31 December 2012

CZKm	AA - to AA+	A - to A+	Lower than A
Securities at fair value through profit or loss	1,451	1,915	-
Securities available for sale	7,957	7,266	100
Securities held to maturity	1,394	3,975	-
Total	**10,802**	**13,156**	**100**

31 December 2011

CZKm	AA - to AA+	A - to A+	Lower than A
Securities at fair value through profit or loss	294	2,068	-
Securities available for sale	2,909	9,461	257
Securities held to maturity	3,845	3,994	-
Total	**7,048**	**15,523**	**257**

ad) Quality of derivatives portfolio

The derivatives portfolio as at 31 December 2012 and 2011 includes established banking counterparties (with external rating equivalent of AA+ to A) and transactions with the associate MUFIS, a.s.

b) Geographical concentration of assets

31 December 2012
Assets

CZKm	Czech Republic	European Union	Total
Cash and balances with central banks	70,273	-	70,273
Amounts due from banks	244	-	244
Securities at fair value through profit or loss	2,609	757	3,366
Positive fair values of financial derivative transactions	61	-	61
Loans and advances to customers	16,814	-	16,814
Securities available for sale	15,079	244	15,323
Securities held to maturity	5,369	-	5,369
Other financial assets	59	-	59
Total financial assets	**110,508**	**1,001**	**111,509**
Non-financial assets	**301**	**-**	**301**
Total	**110,809**	**1,001**	**111,810**

31 December 2011
Assets

CZKm	Czech Republic	European Union	Other	Total
Cash and balances with central banks	15,169	-	-	15,169
Amounts due from banks	1,830	-	-	1,830
Securities at fair value through profit or loss	1,683	679	-	2,362
Positive fair values of financial derivative transactions	70	19	-	89
Loans and advances to customers	18,470	-	-	18,470
Securities available for sale	11,849	575	203	12,627
Securities held to maturity	7,839	-	-	7,839
Other financial assets	56	-	-	56
Total financial assets	**56,966**	**1,273**	**203**	**58,442**
Non-financial assets	**357**	**-**	**-**	**357**
Total	**57,323**	**1,273**	**203**	**58,799**

c) The Bank´s maximum credit risk exposure

31 December 2012 in CZKm

		Total exposure		Collateral held
	Assets	Financial guarantees and loan commitments	Total credit exposure	
Cash and balances with central banks	70,273	-	70,273	64,324
Amounts due from banks	244	-	244	-
Securities at fair value through profit or loss	3,366	-	3,366	-
Financial derivatives	61	-	61	-
Loans to customers	16,814	-	16,814	3,109
- Loans to private legal entities and individuals	5,489	-	5,489	2,666
- Loans to the Czech government entities	10,468	-	10,468	-
- Loans to municipalities	857	-	857	443
Securities available for sale	15,323	-	15,323	-
Securities held to maturity	5,369	-	5,369	-
Other financial assets	59	-	59	-
Financial guarantees and loan commitments	-	20,944	20,944	2,680
Total financial assets	**111,509**	**20,944**	**132,453**	**70,113**
Non-financial assets	**301**			
Total assets	**111,810**			

31 December 2011 in CZKm

		Total exposure		Collateral held
	Assets	Financial guarantees and loan commitments	Total credit exposure	
Cash and balances with central banks	15,169	-	15,169	14,027
Amounts due from banks	1,830	-	1,830	-
Securities at fair value through profit or loss	2,362	-	2,362	-
Financial derivatives	89	-	89	-
Loans to customers	18,470	-	18,470	3,109
- Loans to private legal entities and individuals	5,871	-	5,871	2,602
- Loans to the Czech government entities	11,591	-	11,591	-
- Loans to municipalities	1,008	-	1,008	507
Securities available for sale	12,627	-	12,627	-
Securities held to maturity	7,839	-	7,839	-
Other financial assets	56	-	56	-
Financial guarantees and loan commitments	-	23,718	23,718	2,998
Total financial assets	**58,442**	**23,718**	**82,160**	**19,352**
Non-financial assets	**357**			
Total assets	**58,799**			

The maximum credit exposure is presented at carrying values net of any recognised impairment losses. Collaterals held for due from banks represents the fair value of the securities obtained under reverse repo transactions, for loans to customers principally the collateralized mortgages (see Note 4.1.2) and in case of the financial guarantees the current level of funds deposited by the programmes partners to cover risks attached to providing of the financial guarantees (see Note 3.18).

4.2. Market risk

4.2.1. Management of the market risk

Characteristics of Market Risks

The principal market risk management strategy is defined in the Bank's internal regulations and in the documents approved by the Board of Directors of the Bank, and primarily provides guidance on the following areas:

- Acceptable degree of market risks;
- Market risk management techniques;
- Set of limits used; and
- Basic requirements regarding the Bank's organisational structure in terms of market risk management, including segregation of duties and information flows.

Description of Transactions Carrying Market Risks

The Bank is exposed to market risks in acquiring, holding and selling investment instruments defined in the Investment Strategy of ČMZRB. This risk arises from open positions in interest rates and currencies, there are no exposures to risk in equities.

Market Risk Measurement

The Bank measures interest rate risk using basic techniques (interest rate GAP analysis, duration and elasticity of interest rates) and techniques to calculate capital adequacy as set out in CNB Regulation 123/2007 Coll. In addition, the Bank has developed a series of internal limits to restrict its market risk exposure. The interest rate GAP analysis measures interest rate risk inherent in the trading and banking book on a collective basis. Interest rate risk is restricted through limits to net interest rate exposure in each time bucket. Interest rate risk inherent in all bond portfolios is restricted by having a limit in place in respect of the elasticity of the bond portfolio. The Bank undertakes stress testing on a quarterly basis in accordance with the requirements of the Czech National Bank.

Market Risk Management

The Bank's instrument for managing market risks involves the external capital adequacy limit and internal limits for interest rate risk and elasticity of the interest rate in respect of the bond portfolio. In addition, the market risk is mitigated through the implementation of an internal capital adequacy limit. Foreign currency risk is controlled through the use of the limits set out in Czech National Bank Regulation 123/2007 Coll.

Interest rate risk limits restrict the size of interest rate GAP in each time bucket of an interest rate GAP analysis in relation to the Bank's capital and are expressed in percentage terms.

The limit for elasticity of the interest rate in respect of the bond portfolio restricts the market risk associated with all bond portfolios together with derivatives hedging risk arising from the change in exchange rates when the Bank holds foreign currency bonds.

The Bank's internal capital adequacy limit sets out requirements that are more stringent than the external capital adequacy limit established by the banking regulator.

The Bank uses hedging derivatives to manage market risk. The Bank has secured loans from European Investment Bank and German Kreditanstalt für Wiederaufbau as well as bonds. The risk management department of the Bank calculates accounting hedge effectiveness.

4.2.2. Derivates

Trading derivatives

CZKm	31 December 2012 Notional value asset	31 December 2012 Notional value liability	31 December 2011 Notional value asset	31 December 2011 Notional value liability
Interest rate swaps	600	600	600	600
Currency forwards	-	-	68	68
Currency and cross-currency swaps	3,949	3,983	3,901	3,943
Total	**4,549**	**4,583**	**4,569**	**4,611**

CZKm	31 December 2012 Positive fair value	31 December 2012 Negative fair value	31 December 2011 Positive fair value	31 December 2011 Negative fair value
Interest rate swaps	-	69	-	39
Currency forwards	-	-	1	1
Currency swaps	61	174	88	203
Total	**61**	**243**	**89**	**243**

Trading derivatives – related parties

There were no derivatives held for trading with related parties as at 31 December 2012. There was a currency forward with MUFIS a.s. as at 31 December 2011 with notional value of CZK 35m and positive fair value of CZK 1m.

Hedging derivatives

The Bank uses the fair value hedging derivatives to hedge currency risk relating to recognized hedged items, which are securities denominated in foreign currencies (see Notes 3.12 and 4.3) and assets and liabilities from a specific transaction concluded with the Ministry of Finance of the Czech Republic (see Note 3.11).

CZKm	31 December 2012 Notional value asset	31 December 2012 Notional value liability	31 December 2011 Notional value asset	31 December 2011 Notional value liability
Cross currency swaps	282	319	1,200	1,473
Total	**282**	**319**	**1,200**	**1,473**

CZKm	31 December 2012 Positive fair value	31 December 2012 Negative fair value	31 December 2011 Positive fair value	31 December 2011 Negative fair value
Cross currency swaps	-	87	-	440
Total	**-**	**87**	**-**	**440**

4.3. Foreign currency risk

The Bank's financial position and cash flows are exposed to the risks of changes in exchange rates of common foreign currencies. The Bank monitors its foreign currency positions on a daily basis. In the event that the Bank breaches limits, it undertakes measures as outlined in its internal regulations relating to foreign currency exposure limits.

The table below provides summary information about the Bank's exposure to foreign currency risk. The tables set out foreign currency assets and liabilities at carrying values, analysed by currency.

The Bank covers its open position by using financial derivatives as can be seen from the tables below and the sensitivity analysis.

31 December 2012

CZKm	CZK	EUR	USD	GBP	HUF	Total
Cash and balances with central bank	70,273	-	-	-	-	70,273
Amounts due from banks	202	40	1	-	1	244
Securities at fair value through profit or loss	1,576	1,419	371	-	-	3,366
Financial derivatives	61	-	-	-	-	61
Loans to customers, net	11,230	5,584	-	-	-	16,814
Securities available for sale	15,267	56	-	-	-	15,323
Securities held to maturity	5,369	-	-	-	-	5,369
Other financial assets	59	-	-	-	-	59
Total financial assets	**104,037**	**7,099**	**372**	**-**	**1**	**111,509**
Non-financial assets	**301**	**-**	**-**	**-**	**-**	**301**
Total assets	**104,338**	**7,099**	**372**	**-**	**1**	**111,810**
Amounts due to banks	7,136	8,203	-	-	-	15,339
Amounts due to customers	86,916	52	-	-	-	86,968
Financial derivatives	330	-	-	-	-	330
Other financial liabilities	253	-	-	-	-	253
Total financial liabilities	**94,635**	**8,255**	**-**	**-**	**-**	**102,890**
Non-financial liabilities and equity	**8,914**	**-**	**-**	**6**	**-**	**8,920**
Total liabilities and equity	**103,549**	**8,255**	**-**	**6**	**-**	**111,810**
On balance sheet position, net	789	(1,156)	372	(6)	1	-
Off-balance sheet derivatives notional position, net	-	1,189	(343)	-	-	-
Net position	**789**	**33**	**29**	**(6)**	**1**	**-**

31 December 2011

CZKm	CZK	EUR	USD	HUF	Total
Cash and balances with central bank	15,169	-	-	-	15,169
Amounts due from banks	1,641	187	1	1	1,830
Securities at fair value through profit or loss	625	1,351	386	-	2,362
Financial derivatives	89	-	-	-	89
Loans to customers, net	12,784	5,686	-	-	18,470
Securities available for sale	12,569	58	-	-	12,627
Securities held to maturity	7,839	-	-	-	7,839
Other financial assets	56	-	-	-	56
Total financial assets	**50,772**	**7,282**	**387**	**1**	**58,442**
Non-financial assets	**357**	**-**	**-**	**-**	**357**
Total assets	**51,129**	**7,282**	**387**	**1**	**58,799**
Amounts due to banks	11,684	9,021	-	-	20,705
Amounts due to customers	26,624	206	-	-	26,830
Short sales	-	-	-	-	-
Financial derivatives	683	-	-	-	683
Other financial liabilities	253	-	-	-	253
Total financial liabilities	**39,244**	**9,227**	**-**	**-**	**48,471**
Non-financial liabilities and equity	**10,328**	**-**	**-**	**-**	**10,328**
Total liabilities and equity	**49,572**	**9,227**	**-**	**-**	**58,799**
On balance sheet position, net	1,557	(1,945)	387	1	-
Off-balance sheet derivatives notional position, net	-	1,975	(359)	-	-
Net position	**1,557**	**30**	**28**	**1**	**-**

Foreign exchange rates sensitivity analysis

Set out below is a sensitivity analysis to foreign currency risk. The balance sheet items in foreign currencies were tested in respect of the upward movement of a foreign exchange rate by 10% (a 10% appreciation of the currencies would have an equal and opposite effect). The open position in EUR and USD currencies is hedged using derivatives. The hedging instruments almost fully counter-balance the open position (see tables above) and therefore also the income statement and equity impact of the movements in foreign exchange rates is not significant as of the balance sheet date and also during the year. The table below summarises the sensitivities in CZK in comparison only to CZK/EUR exchange rates valid as of 31 December 2012 or 2011 as EUR was the only significant currency in which the Bank had open position as at that date (for open position amounts see above).

	2012 CZKm	2011 CZKm
Sensitivity to changes in EUR rates		
Expected rate fluctuation, %	10 %	10 %
Open position	33	30
Effect on profit and loss	(2)	(3)
Effect on equity	6	6

4.4. Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on 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 reprice to a market interest rate before maturity, the next repricing date. Those assets and liabilities that do not have contractual maturity or a repricing date were grouped in the 'non-specified' category.

The Bank has a significant portion of amounts due to customers which are not interest bearing instruments. These comprise part of state deposits and risk funds (see Note 3.18). These liabilities are presented as liabilities with non-specified interest rate sensitivity.

Impaired loans are carried on a non-accrual basis and presented as items with non-specified interest rate sensitivity.

Notes to the financial statements for the year ended 31 December 2012

31 December 2012

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Non-specified CZKm	Total CZKm
Cash and balances with central bank	70,261	-	-	-	12	70,273
Amounts due from banks	244	-	-	-	-	244
Securities at fair value through profit or loss	190	488	927	1,761	-	3,366
Financial derivatives	-	-	-	-	61	61
Loans to customers, net	1,435	1,458	8,712	3,797	1,412	16,814
Securities available for sale	1,206	2,874	5,935	5,308	-	15,323
Securities held to maturity	-	1,179	2,656	1,534	-	5,369
Other financial assets	-	-	-	-	59	59
Total financial assets	**73,336**	**5,999**	**18,230**	**12,400**	**1,544**	**111,509**
Non-financial assets	**-**	**-**	**-**	**-**	**301**	**301**
Total	**73,336**	**5,999**	**18,230**	**12,400**	**1,845**	**111,810**
Amounts due to banks	3,620	1,098	7,408	3,204	9	15,339
Amounts due to customers	76,113	2,845	3,141	-	4,869	86,968
Financial derivatives	-	-	-	-	330	330
Other financial liabilities	-	-	-	-	253	253
Total financial liabilities	**79,733**	**3,943**	**10,549**	**3,204**	**5,461**	**102,890**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**8,920**	**8,920**
Total	**79,733**	**3,943**	**10,549**	**3,204**	**14,381**	**111,810**
Net interest position	**(6,397)**	**2,056**	**7,681**	**9,196**	**(12,536)**	**-**

31 December 2011

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Non-specified CZKm	Total CZKm
Cash and balances with central bank	15,161	-	-	-	8	15,169
Amounts due from banks	1,813	-	-	-	17	1,830
Securities at fair value through profit or loss	15	37	1,561	749	-	2,362
Financial derivatives	-	-	-	-	89	89
Loans to customers, net	1,465	2,166	8,786	5,464	589	18,470
Securities available for sale	195	4,916	6,440	1,076	-	12,627
Securities held to maturity	-	2,446	3,358	2,035	-	7,839
Other financial assets	-	-	-	-	56	56
Total financial assets	**18,649**	**9,565**	**20,145**	**9,324**	**759**	**58,442**
Non-financial assets	**-**	**-**	**-**	**-**	**357**	**357**
Total	**18,649**	**9,565**	**20,145**	**9,324**	**1,116**	**58,799**
Amounts due to banks	8,218	1,175	7,390	4,882	(960)	20,705
Amounts due to customers	18,228	3,852	-	-	4,750	26,830
Short sales	-	-	-	-	-	-
Financial derivatives	-	-	-	-	683	683
Other financial liabilities	-	-	-	-	253	253
Total financial liabilities	**26,446**	**5,027**	**7,390**	**4,882**	**4,726**	**48,471**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**10,328**	**10,328**
Total	**26,446**	**5,027**	**7,390**	**4,882**	**15,054**	**58,799**
Net interest position	**(7,797)**	**4,538**	**12,755**	**4,442**	**(13,938)**	**-**

Interest rate sensitivity analysis

Balance sheet items sensitive to interest rates were analysed under the 2 % expected parallel increase in interest rates. The Bank modelled 8 scenarios for possible movements of interest rates as the benchmark; the most probable alternative of 2 % parallel shift was selected for reporting purposes. The impact on profit and loss and equity (in the case of available-for-sale securities) is outlined below.

Balance sheet item	31 December 2012 Sensitivity/Impact	31 December 2011 Sensitivity/Impact	Comment
Assets			
Loans to customers	(310)	(1,367)	
Loans to banks	(29)	(7)	
Held to maturity securities	-	-	Only fixed interest rates securities in the portfolio
Available for sale securities	(121)	(231)	Impact on equity reserve
Available for sale securities	(134)	(269)	Impact on profit and loss
Financial derivatives	(299)	(314)	
Liabilities			
Due to banks	932	1,160	
Due to customers	64	74	
Financial derivatives	315	327	

4.5. Liquidity risk

Liquidity risk is the risk that the Bank will lose its ability to meet its financial obligations as they fall due or that it will not be able to fund its assets. Liquidity risk may result from a temporary payment insolvency and low liquidity of the market with financial instruments, which makes it impossible to quickly close out positions thereby limiting access to funding. The basic liquidity management tool involves the record-keeping and planning of the Bank's cash flows. In support of liquidity management, the Bank uses two mechanisms - payment notices and price setting. The liquidity management strategy is established and implemented through the preparation of a 'Liquidity Scenario' and 'Emergency Plan for Events Jeopardising the Bank's Liquidity'. The Bank's liquidity position is monitored through the liquidity reserve limit in relation to the value of adjusted weighted risk exposure.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs, guarantees, margins and settlement of derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

The table below analyses assets and liabilities of the Bank into relevant maturity groupings based upon the remaining maturity period as of the balance sheet date.

As the main depositors of the Bank are state institutions (Ministry of Finance, Ministry for Regional Development etc.) the current accounts of the Bank are presented as being repayable on demand because these funds can be withdrawn upon demand. However these deposits represent specific financing granted, e.g. funding for state approved programmes and therefore their withdrawal is not likely in large volume upon demand.

The Bank has a significant portion of amounts due to customers which are held for an undefined amount of time to finance individual support programmes. These comprise part of state deposits and risk funds (see Note 3.18). These liabilities are presented as liabilities with undefined maturity.

Notes to the financial statements for the year ended 31 December 2012

31 December 2012

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Maturity undefined CZKm	Total CZKm
Cash and balances with central bank	70,270	-	-	-	3	70,273
Amounts due from banks	42	-	-	-	202	244
Securities at fair value through profit or loss	190	488	927	1,761	-	3,366
Financial derivatives	2	18	5	36	-	61
Loans to customers, net	2,246	1,662	9,491	3,415	-	16,814
Securities available for sale	1,206	2,874	5,935	5,308	-	15,323
Securities held to maturity	-	1,179	2,656	1,534	-	5,369
Other financial assets	42	-	-	-	17	59
Total financial assets	**73,998**	**6,221**	**19,014**	**12,054**	**222**	**111,509**
Non-financial assets	**18**	**-**	**-**	**-**	**283**	**301**
Total	**74,016**	**6,221**	**19,014**	**12,054**	**505**	**111,810**
Amounts due to banks	3,168	1,098	7,408	3,665	-	15,339
Amounts due to customers	77,730	6,025	1	3,212	-	86,968
Financial derivatives	-	4	89	237	-	330
Other financial liabilities	1	-	-	-	252	253
Total financial liabilities	**80,899**	**7,127**	**7,498**	**7,114**	**252**	**102,890**
Non-financial liabilities and equity	**165**	**544**	**1,032**	**3,176**	**4,003**	**8,920**
Total	**81,064**	**7,671**	**8,530**	**10,290**	**4,255**	**111,810**
Net liquidity exposure	**(7,048)**	**(1,450)**	**10,484**	**1,764**	**(3,750)**	**-**

31 December 2011

	Up to 3 months CZKm	3 months to 1 year CZKm	1 year to 5 years CZKm	Over 5 years CZKm	Maturity undefined CZKm	Total CZKm
Cash and balances with central bank	15,167	-	-	-	2	15,169
Amounts due from banks	1,684	-	-	-	146	1,830
Securities at fair value through profit or loss	15	37	1,561	749	-	2,362
Financial derivatives	1	19	6	63	-	89
Loans to customers, net	2,257	2,242	9,607	4,364	-	18,470
Securities available for sale	195	4,916	6,440	1,076	-	12,627
Securities held to maturity	-	2,446	3,358	2,035	-	7,839
Other financial assets	38	-	-	-	18	56
Total financial assets	**19,357**	**9,660**	**20,972**	**8,287**	**166**	**58,442**
Non-financial assets	**11**	**4**	**-**	**-**	**342**	**357**
Total	**19,368**	**9,664**	**20,972**	**8,287**	**508**	**58,799**
Amounts due to banks	7,890	1,056	7,390	4,369	-	20,705
Amounts due to customers	20,066	3,894	-	2,870	-	26,830
Short sales	-	-	-	-	-	-
Financial derivatives	1	380	139	163	-	683
Other financial liabilities	1	-	-	-	252	253
Total financial liabilities	**27,958**	**5,330**	**7,529**	**7,402**	**252**	**48,471**
Non-financial liabilities and equity	**632**	**544**	**1,302**	**1,823**	**6,027**	**10,328**
Total	**28,590**	**5,874**	**8,831**	**9,225**	**6,279**	**58,799**
Net liquidity exposure	**(9,222)**	**3,790**	**12,141**	**(938)**	**(5,771)**	**-**

Contractual liquidity of the main non-derivative financial liabilities at amortized cost and derivatives – undiscounted basis

a/ Amounts due to banks and customers

31 December 2012

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	3,095	1,139	7,734	3,547	15,515
Amounts due to customers	80,953	6,047	8	27	87,035

31 December 2011

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	8,003	1,322	8,390	4,741	22,456
Amounts due to customers	22,948	3,927	7	29	26,911

b/ Derivatives settled on a net basis

The table below analyses the Bank's derivative financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted net cash flows.

31 December 2012

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	1	(16)	(37)	(20)	(72)

31 December 2011

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	2	(11)	(26)	(6)	(41)

c/ Derivatives settled on a gross basis

The Bank's derivatives that will be settled on a gross basis comprise of foreign exchange derivatives: currency forward, currency swaps and cross currency interest rate swaps.

The table below analyses the Bank's derivative financial liabilities that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

4.6. Operational risk

31 December 2012

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Foreign exchange derivatives:					
Cash inflows	-	-	-	-	-
Cash outflows	-	-	-	-	-
Cross-currency swaps:					
Cash inflows	270	692	2,367	1,202	4,531
Cash outflows	(275)	(718)	(2,510)	(1,237)	(4,740)

31 December 2011

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Foreign exchange derivatives:					
Cash inflows	69	-	-	-	69
Cash outflows	69	-	-	-	69
Cross-currency swaps:					
Cash inflows	409	1,105	2,984	1,346	5,844
Cash outflows	530	1,383	3,119	1,361	6,393

The Bank defines operational risk as the risk of loss arising from human errors, the inappropriateness or failure of internal processes, failures of systems or the risk of loss resulting from external events.

The system of the Bank's operational risk management is built around the following four cornerstones:

- Strategy (clear vision, management attitude, culture);
- Organisation (Board of Directors, Assets and Liabilities Management Committee, internal audit, operational risk management coordinator, and the Bank's departments);
- Processes (identification, evaluation, countermeasures, monitoring and reporting); and
- Infrastructure (system, source of information, data collection and communication).

Identification of Operational Risk

The Bank identifies individual operational risks in all of its departments and categorises them according to the underlying cause (human error, internal process, information system, external factor). Responsibility for identifying operational risks primarily rests with the head of the department where the risk originates (via a self-evaluation form). Collection of information from individual departments and its processing is within the remit of the coordinator. The Bank identifies and records each risk to which it is exposed, even a risk that is no longer treated as a risk due to the countermeasures that are currently being implemented.

Evaluation of Operational Risk

Operational risk is evaluated in terms of the likelihood of its occurrence (graded one to five) and the significance of impact if it materialises (graded one to five). The Bank has opted for a qualitative approach to evaluating the risk which better meets its needs and better reflects the situation within the Bank. The evaluation is based on a reasonable estimate and uses scores to assess the likelihood of the occurrence and the significance of impact. Following the evaluation, individual risks are rated according to their overall significance (risk profile) into the following three levels:

- Low (ideal risk profile where the Bank only checks the effectiveness of the existing measures);
- Medium (the risk is acceptable only if the implementation of an appropriate countermeasure to mitigate the risk is too costly); and
- High (the risk is not acceptable, additional countermeasures need to be put in place and the risk mitigated).

Countermeasures

Responsibility for the implementation of an appropriate countermeasure against operational risks rests within the department where the risk originates (mitigation of the likelihood of the occurrence of operational risk or its impact on the Bank).

Monitoring and Reporting

The basic tool for monitoring is the database of incidents and a report on operational risk management within the Bank. These activities result in a risk profile of the Bank. Operational risk events include all events that have a direct impact on the Bank's profit or loss according to the Bank's activities during which the event occurred.

4.7. Capital management

The Bank has identified the following risks which should be covered entirely or partially by capital: market risks, interest rate risk of the banking book, credit risk and concentration risk, liquidity risk and operational risk.

The principal objectives of the Bank in managing capital risks are as follows:

- Quantification of risks in the form of economic capital which is needed to cover potential losses arising from these risks;
- Comparison of capital requirements with capital resources;
- Management of capital resources with respect to current and future risks;
- Determination of the maximum acceptable degree of risks with respect to available capital resources;
- Monitoring and management of the performance of business activities with respect to the risk or the capital requirements; and
- Strategic planning with respect to the risk, allocated capital resources and capital efficiency of individual business activities of the Bank.

The Bank has established an internal limit for capital adequacy at 11 % of the Bank's capital, i.e. 3 % above the required regulatory floor of 8 %. The Bank has implemented the standard approach for capital management which is in compliance with Basel II requirements.

CZKm	31 December 2012	31 December 2011
Tier 1 capital		
Share capital	2,132	2,132
Less: Own treasure shares	(1,894)	-
Statutory and other reserves	1,150	1,150
Retained earnings (without profit for the current year, statutory non-consolidated)	2,414	1,570
Less: intangible assets	(26)	(31)
Total qualifying Tier 1 capital	**3,776**	**4,821**
Total regulatory capital	**3,776**	**4,821**
Total capital requirements	**2,098**	**2,247**
Capital adequacy ratio	**14.4 %**	**17.2 %**

5/ Fair values of assets and liabilities and fair value hierarchy

The fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. When available, fair value estimates are made based on quoted market prices. However, no readily available market prices exist for a significant portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other generally acceptable pricing models as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates might not be realised in a current sale of the financial instrument.

In estimating the fair value of the Bank's financial instruments, the following methods and assumptions were used.

Notes to the financial statements for the year ended 31 December 2012

(a) Cash and balances with central banks

The carrying values of cash and balances within central banks are generally deemed to approximate their fair value.

(b) Securities held to maturity

Fair values of securities in the 'Held-to-Maturity' portfolio are taken from the active market, where these instruments are quoted.

(c) Due from banks

The fair value of amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk).

(d) Loans to customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality.

(e) Loans and advances to banks

The fair value of term deposits repayable on demand approximates the carrying value of amounts repayable on demand as of the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as of the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using market interest rates.

The following table summarises the carrying values and fair values of those financial assets and liabilities not presented on the balance sheet at their fair value:

CZKm	31 December 2012 Carrying value	31 December 2012 Fair value	31 December 2011 Carrying value	31 December 2011 Fair value
Financial assets				
Cash and balances with central banks	70,273	70,273	15,169	15,169
Loan and advances to banks	244	242	1,830	1,828
Loans to customers	16,814	15,655	18,470	17,833
- Loans to private legal entities and individuals	5,489	5,186	5,871	5,363
- Loans to the Czech government entities	10,468	9,674	11,591	11,591
- Loans to municipalities	857	795	1,008	879
Securities held to maturity	5,369	5,901	7,839	7,896
Other financial assets	59	59	56	56
Financial liabilities				
Amounts due to banks	15,339	14,380	20,705	20,542
Amounts due to customers	86,968	86,926	26,830	26,668
Other financial liabilities	253	253	253	253

Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed debt instruments on exchanges (for example Prague Stock Exchange and other recognized stock exchanges).
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes over-the-counter derivative contracts. The sources of input parameters like PRIBOR or other yield curves are Bloomberg and Reuters.
- Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes financial instruments with significant unobservable components.

This hierarchy requires the use of observable market data when available. The Bank considers only relevant and observable market prices in its valuations and does not have any financial assets or liabilities at fair value to be categorized in Level 3. There have not been any reclassifications between the Levels 1 and 2 during the presented periods.

31 December 2012	**Level 1**	**Level 2**
Financial assets at fair value through profit and loss		
Financial assets held for trading		
- Debt securities	1,264	-
- Derivatives	-	61
Debt securities designated at fair value	2,102	-
Available-for-sale debt securities:	15,323	-
Total assets at fair value	**18,689**	**61**
Financial liabilities at fair value through profit and loss		
- Derivatives held for trading	-	243
Hedging derivatives	-	87
Total liabilities at fair value	**-**	**330**

31 December 2011	**Level 1**	**Level 2**
Financial assets at fair value through profit and loss		
Financial assets held for trading		
- Debt securities	294	-
- Derivatives	-	89
Debt securities designated at fair value	2,068	-
Available-for-sale debt securities	12,627	-
Total assets at fair value	**14,989**	**89**
Financial liabilities at fair value through profit and loss		
- Derivatives held for trading	-	243
Hedging derivatives	-	440
Total liabilities at fair value	**-**	**683**

6/ Subsequent events

No significant events having a material impact on the financial statements of the Bank for the year ended 31 December 2012 occurred subsequent to the balance sheet date.

The Board of Directors has authorised these financial statements for submission to the General Meeting of Shareholders. These financial statements have been signed, on the basis of authority delegated by the Board of Directors, by Ladislav Macka, Chairman of the Board and Jan Ulip, Member of the Board.

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