ČESKOMORAVSKÁ ZÁRUČNÍ A ROZVOJOVÁ BANKA, a. s.

2013

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.

Contents

Presentation part

Financial part

Chairman's introduction

Dear clients, business partners and stakeholders,

Českomoravská záruční a rozvojová banka (CMZRB) took a number of steps during 2013 fulfilling the long-term vision for its operations within the domestic economy. This vision is to be an efficiently functioning, specialised banking entity that provides support primarily in the form of preferential guarantees and loans for various areas of the economy (and particularly to small and medium-sized enterprises) while operating as a clearly visible instrument of the Czech government's economic policies. I would therefore like to thank everyone, and especially shareholder representatives and employees, whose efforts and understanding have contributed to successful continuation of the Bank's transformation process which had been already underway.

In comparison with the previous year, 2013 saw a considerable gain in the number and volume of guarantees provided to small enterprises. The volume of new guarantees increased on 112% in comparison to the year 2012 and the number of guarantees on 122%. The objective was also fulfilled to repeatedly use revolving resources from the structural funds programmes for co-financing the national programmes in support of small and medium-sized enterprises. During 2013, these resources bolstered funding for the guarantee programme, which was broadened to include intensive support to projects for renewing enterprises damaged by floods. In the next year, these resources will also be used within a loan programme for one of the Czech Republic's regions that is under great threat of growing unemployment.

An entirely new element of the Bank's activities was established in co-operation with Czech Export Bank (CEB). This consists in support for small and medium-sized enterprises in cases which require operating loans to finance subcontracting for domestic exporters. Using its branch network, the Bank will be intermediating the submission of applications for CEB's export payment guarantees. Both banks intend to develop this co-operation further.

The Czech and European economies are continuing to go through complicated development, and this necessarily affects the Bank and its clients. Through cautious financial management, however, the Bank has reliably maintained its creditworthiness reflected in the system of key limits (capital adequacy, liquidity, coverage for expected losses) while also preserving its indispensable and strong financial foundation for development activities.

The past year was distinguished, too, by the Bank's increased activity in the area of international co-operation with European-wide associations in our sector. Through this activity, the Bank has been able to support the implementation of several changes in proposals for new EU regulations which will considerably affect its activities in the coming years. CMZRB has also become a founding member of the European Association of Long Term Investors (ELTI).

The renewal of guarantee activities for the support of small and medium-sized enterprises through the Operational Programme Enterprise and Innovation was brought substantially near to attainment by developments at the close of 2013. Utilising all the remaining resources during a relatively short period will present a difficult challenge for all the Bank's employees. Nevertheless, the overall underlying and long-term effect on the Bank's ongoing operations will be in the form and extent of the Bank's participation in using structural funds during the new programming period.

An important aspect of the new programming period will likely be an increased use of loans, guarantees and venture capital, known collectively as financial instruments. I am very happy that this economically rational change in using part of the public's resources has won support. In terms of the Bank's operations, this opens new possibilities for it to capitalise on its many years of experience in using such instruments. This role will not be easy because the extent of legal regulation, and also the overall risks, has risen in comparison with that time when financial instruments were only marginally of interest. I am nevertheless convinced that in close co-operation with our partners in the state administration we will successfully manage this challenge.

As will be the case for all other economic entities, the Bank will operate in this year under the conditions of an extensively reformed legal environment as the new Civil Code and its attendant norms and the Act on Corporations took effect. Even though the Bank was preparing for this change throughout the year and took necessary steps in response to it, the extent of the changes means that their absorption into day-to-day work will all the same be very difficult. In addition to the changes in the national legal framework, this year will see changes in the direct application of European regulations in the areas of public support, structural funds and legal norms regulating the banking sector.

Despite the growing complexity of external conditions, our goal continues to be for the Bank's activities to bring new value to our clients and partners. Support from representatives of the Bank's shareholder along with the activity and great work efforts of all our employees will be the main pillars upon which the Bank's activity is based during 2014.

Ladislav Macka
Chairman of the Board of Directors

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 focused solely on implementing government programmes for the support of small and medium-sized enterprises. In subsequent years, that activity was extended to include providing support in the area of housing and financing infrastructure development projects. CMZRB has a full banking 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 business. The specific character of CMZRB’s activities, the development of modern banking and communication technologies, and its traditionally good co-operation with partners enable the Bank to provide its clients with high-quality banking services across the entire Czech Republic while having positive effects on 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 sole shareholder is the Czech Republic, which exercises its shareholder rights through its ministries, which are:

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

In performing shareholder functions at the General Meeting, each ministry has one vote.

In 2012, the Bank bought back all shares from private-sector shareholders, which were banks and represented 27.67% of the Bank’s share capital. These shares are now held by CMZRB as treasury shares and thus have no attached voting or dividend rights.

BANK’S OFFICES

The Bank offers its clients bank guarantees, preferential loans, financial subsidies and related banking services. It manages an extensive portfolio of guarantees and grants provided for apartment block repair. Financing projects to improve the technical condition of infrastructure and the development of municipalities also constitute 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 the owners of apartment blocks, in particular 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	2009	2010	2011	2012	2013
Total assets	CZK mil.	62,135	58,147	58,700	111,706	98,042
Liabilities	CZK mil.	56,686	52,455	52,965	106,748	93,591
Shareholders' equity	CZK mil.	5,449	5,692	5,735	4,958	4,451
Share capital	CZK mil.	2,132	2,132	2,132	2,132	2,132
Profit after tax	CZK mil.	815	854	849	812	348
Guarantee portfolio	CZK mil.	18,565	23,649	21,398	19,039	18,129
Capital adequacy	%	15.2	16.4	17.2	14.4	16.0
Average number of employees		220	219	217	217	216
Number of branches		5	5	5	5	5

The Bank does not have any research and development activities.

Bank s activities doesn´t have a negative impact on the environment.

The Bank systematically develops knowledge and skills of its employees, applies proven set of rules for motivating and rewarding employees and implements its social program.

Czech-Moravian Guarantee and Development Bank has no branch or affiliation abroad.

Governing bodies

Board of Directors

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

Supervisory Board

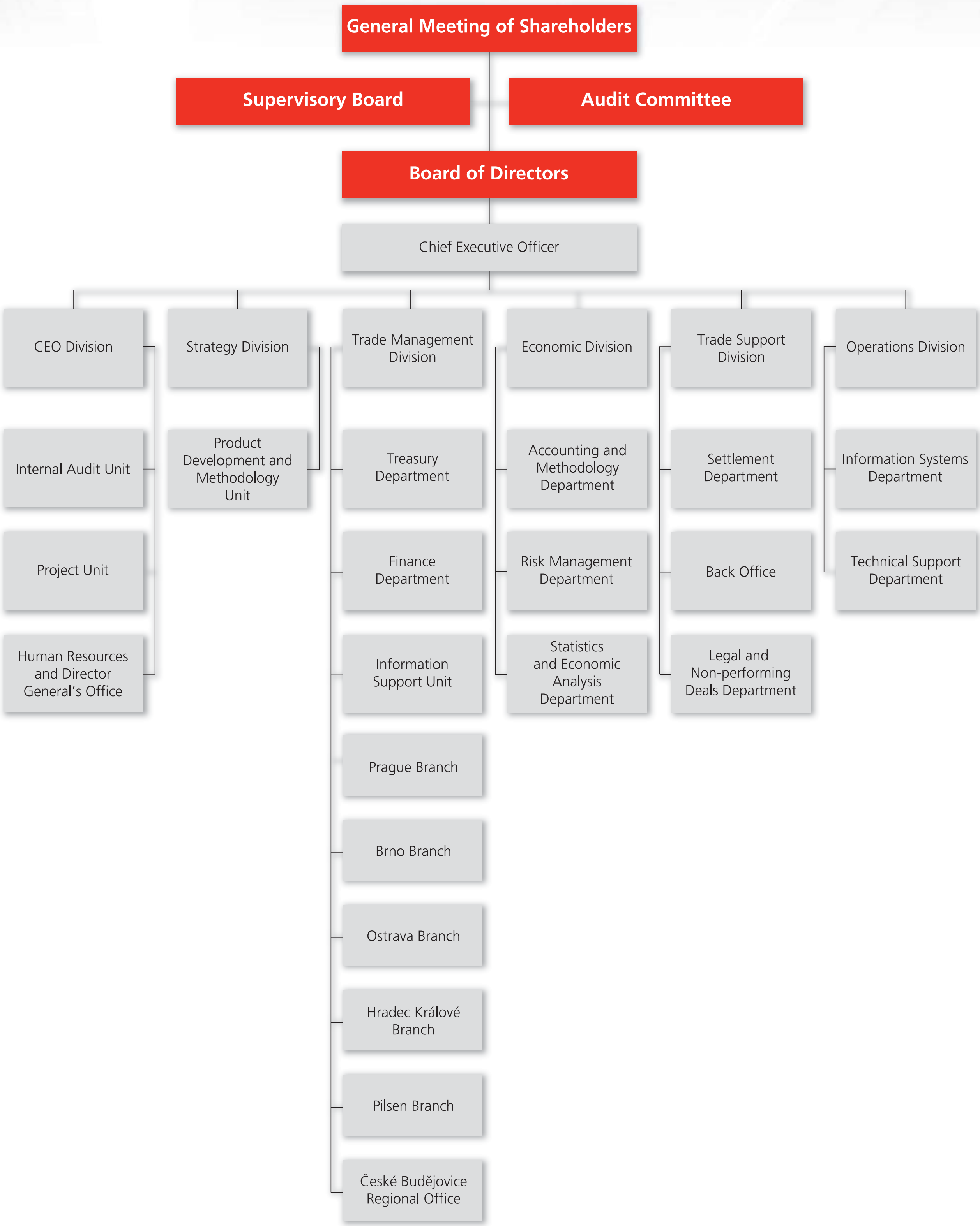
Chairman	Robert Szurman
Vice-Chairman	Josef Hájek
Members	Vladimír Bártl
	Daniel Braun
	Josef Doruška
	Ladislav Koděra
	Marie Kotrlá as from 3 September 2013
	Zdeněk Mareš
	Jana Šindelářová

During 2013, Růžena Kabilková ended her membership in the Supervisory Board (as of 23 April 2013).

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 29 of this Annual Review have been derived from the financial statements of Českomoravská záruční a rozvojová banka, a. s., as at 31 December 2013 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.

Českomoravská záruční a rozvojová banka, a. s., declares that as of the date of processing the annual review 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.

Report of the Board of Directors on the Bank's business activities and financial situation for 2013

Economic environment and its impact on the Bank's performance

From the viewpoint of growth in the national economy, 2013 was similar here as in many other European Union countries, meaning a continuation of economic stagnation which had adverse effects on economic output and especially so among small and medium-sized enterprises. For this reason, these businesses have persisted in their heightened caution about initiating new investments into their development. Another important problem in the Czech economy is the persisting relatively high unemployment rate, and particularly in structurally disadvantaged regions.

The overall elevated uncertainty showed itself in the level of credit risk. Its development in 2013 nevertheless indicated that the intensity of this risk had peaked in 2011 and 2012 from the perspective of the Bank's business portfolio. Last year marked a return to a more usual situation, which particularly manifested itself in a substantially lower level of payments from guarantees. The banking sector's considerable and persisting caution about lending and general pressure on raising that sector's capital adequacy kept the demand for guarantees to support small and medium-sized enterprises at a high level, and particularly in the area of working capital financing.

For the Czech Republic's banking sector, 2013 was another year of continuing stability. Nevertheless, due to the continuing economic crisis, the very low interest rates on the banking and interbank markets were unable to jump-start the economic recovery. The Czech National Bank continued its effort during 2013 to foster growth in the Czech economy, and its two-week repo rate has remained at the same 0.05% since November 2012. Overall, low interest rates persisted and the associated bond prices were adversely reflected in the Bank's profitability for the past year. In November 2013, the Czech National Bank decided to begin intervening to weaken the Czech crown with the goals of boosting household consumption, supporting exports and, thereby, promoting economic recovery. Small and medium-sized enterprises play an important role in strengthening the Czech economy's export capabilities. In order to increase participation among such enterprises as subcontractors for national exporters, CMZRB engaged its branch network in the effort to seek out projects and prepare applications for the export payment guarantees provided by Czech Export Bank.

In accordance with its objective to continue in strengthening its role as a Czech development bank combining co-operation with the public and private sectors, CMZRB's activities during 2013 emphasised not just support for enterprises across the country generally but also providing the utmost assistance to those regions significantly affected by economic stagnation or natural disaster. In co-operation with the Ministry of Industry and Trade, a programme was launched during 2013 to support small and medium-size enterprises affected by floods. This took the form of providing financial subsidies for guaranteed loans in the GUARANTEE programme. The Bank prepared for providing preferential loans and financial subsidies in support of enterprises within Moravia–Silesia Region under the REVIT programme.

The crucial reaction of the European Commission, which concluded a several-year review with regard to the system of providing guarantees under the Operational Programme Enterprise and Innovation, enabled the full-intensity launch of preparations for using the remaining resources to provide guarantees during 2014 and 2015 while at the same time bringing this into the final phase. Owing to the decision of its shareholder, CMZRB was able to compensate to a certain extent for delays in the use of structural fund resources by increasing use of resources created by the Bank in operating the national guarantee fund.

During 2013, the Bank had to react to an exceptionally great number of initiatives ensuing from new national legislation for implementing changes in the conditions of providing products, managing the bank and maintaining essential operating activities.

The most significant initiative, the implementation of which required the participation of all of the Bank's divisions, was preparation for operating within the conditions of the new Civil Code and other regulations which were changed in connection with this law, including the approval of the Act on Corporations. The Bank also responded to additional measures as required by the Ministry of Finance with the objective of integrating and streamlining the management and boosting the productivity of state-owned enterprises.

An amendment to the Act on Budgetary Rules, which implements the state treasury and rules for its functioning, was the impetus for shifting to the Czech National Bank the funds of state bodies and institutions previously held by CMZRB. This required the design of new processes for transferring the state's resources into financial instruments.

Measures that were taken within the European Union to strengthen stability in the banking sector – and especially strengthening its capital adequacy – were not shown to have concrete impacts on the Bank's finances. These do, however, constitute a fundamental change for the area of long-term strategy in managing the development of capital and credit risk.

The Bank's activity was also significantly affected by the process of preparing for the next programming period for European investment and structural funds. The Bank participated in a variety of ways in the preparation and design of suggestions for adjustments in the legal and material framework for its operations in the areas of financial instruments and rules for public support. That occurred both at the national level and at the European level through its membership in international associations. The final phase of these preparations at the national level is connected with the creation of designs for individual programmes of support and of implementation structures for using financial instruments. This phase constitutes a main area upon which the Bank must focus during 2014.

Toward the end or even at the very close of 2013 a number of directly applicable European regulations were approved which will significantly affect the Bank's operations in the coming year. This relates in particular to regulations on the use of European and structural funds and new regulation on providing support de minimis. Implementing regulations being prepared for the use of structural funds and the application of block exemptions for the use of public support together constitute the basic legal framework to which the Bank must react especially during the course of 2014.

Also in 2013, the Bank implemented measures reacting to the effects of U.S. legislation aimed at reducing tax evasion at financial institutions around the world, as well as to the adoption of new EU regulations for derivatives trading.

Project for transforming the Bank

The Bank continued during 2013 in implementing the Transforming CMZRB project which is a component of the International Competitiveness Strategy for the Czech Republic 2012 – 2020 approved by the government. During its implementation, the Bank has focused on two main areas:

- creating external and internal conditions for CMZRB's broadest possible participation in the administration of national and European resources used to support development in various economic areas by means of financial instruments, and
- beginning preparations for gradual transfer of the Bank's own shares which were bought back during 2012 from shareholders consisting of commercial banks in the Czech Republic.

The main goal for the process of transforming CMZRB is to enable more extensive use of financial instruments, and in particular loans and guarantees, in implementing the government's economic policy programme. This is to be done by using CMZRB in its capacity as a financial institution specialised for this type of support and which the central state administrative authorities have directly entrusted with administering individual support programmes and resources designated for these purposes. To achieve this objective, it is essential that the Bank be accredited directly by the central state administrative authorities, without a tender process, with the administration of resources designated for carrying out the government's economic policies. The past year brought necessary clarification of the situation in this direction and verified that the transformation project is creating a solid financial foundation for further developing the Bank's activities.

In connection with preparing an amendment to Act No. 47/2002 Coll., on support for small and medium-sized enterprises, possible methods for the Bank's participation in the administration of financial instruments were clarified in discussions with the Ministry of Industry and Trade, including its functioning as administrator of a fund of funds. In relation to this, the Bank initiated an analysis of conditions and designed a preliminary study of operations within this new role.

In April 2013, the regular General Meeting approved new rules for financing the national guarantee programme using CMZRB's resources. As a result, in 2013 the Bank was able to capitalise on the overall favourable business development by doubling the provision of guarantees vis-à-vis 2012. The shareholders' decision likewise created a stable foundation for financing new calls for a national guarantee program in 2014 and at the same time enabled working out a financing method for the Bank's activity in administering the new guarantee fund for the Operational Programme Enterprise and Innovation, the preparation of which took place during the past year.

Meanwhile, new principles relating to the Bank's pricing policy enabled a considerable gain in the effectiveness with which public resources are used, and in particular by growing the leverage effect on resources used in the guarantee programme and decreasing the financial costs in implementing new lending activities.

Changes in the Bank's statutes were implemented based upon a decision of an extraordinary General Meeting in September 2013. These changes removed inequalities among representatives of shareholder in voting rights at the General Meeting, broadened the competence of the Supervisory Board over voting and removal of Members of the Board of Directors, and specified relationships between the Board of Directors and Supervisory Board during the preparation and submission of materials to the General Meeting.

The Bank's management formulated and presented to shareholder representatives a design for gradual transfer of the Bank's own shares held in treasury to the stakeholders representing the state. The suggested process is subject to approval from the General Meeting and would ensure the fulfilment of basic principles which the Bank's management considers crucial, namely legal clarity, the Bank's ability to control the process, and the elimination of any negative financial effect on the shareholder (the Czech Republic).

Economic results

Unconsolidated data

		2009	2010	2011	2012	2013
Total balance sheet	CZK mil.	62,135	58,147	58,700	111,706	98,042
Assets:						
Deposits and loans at banks	CZK mil.	17,531	13,040	16,932	70,045	63,884
Securities accepted by the Czech National Bank for refinancing	CZK mil.	14,178	16,584	14,384	18,545	7,783
Debt securities	CZK mil.	6,275	7,235	8,443	5,513	11,272
Payments from guarantees and other classified receivables	CZK mil.	2,849	3,874	4,324	4,479	3,556
Liabilities and equity:						
Shareholders' equity	CZK mil.	5,449	5,692	5,735	4,958	4,451
Liabilities	CZK mil.	56,686	52,455	52,965	106,748	93,591
of which: reserves	CZK mil.	2,009	2,277	2,219	2,342	2,495
funds to cover credit risks	CZK mil.	2,437	3,295	2,998	2,680	2,557
Off-balance sheet:						
Guarantees granted	CZK mil.	18,565	23,649	21,398	19,039	18,129
Total revenues	CZK mil.	5,099	4,924	4,537	4,410	3,505
of which: from securities and interbank operations	CZK mil.	1,012	828	795	725	516
from operations with clients	CZK mil.	1,431	1,197	1,099	976	686
Total expenses	CZK mil.	4,284	4,070	3,688	3,599	3,157
of which: net impairment allowances and provisions	CZK mil.	303	404	184	225	442
Profit after tax	CZK mil.	815	854	849	812*	348*
Capital adequacy	%	15.2	16.4	17.2	14.4	16.0

Business activity increased during 2013 in comparison with the previous year. Newly concluded guarantee and loan transactions totalled CZK 6.8 billion (CZK 5.9 billion in 2012). The growth was made possible in particular by use of the Bank's own resources for financing the costs of preferential guarantees in programmes supporting small and medium-sized enterprises. Even this effort by the Bank to maintain continuity in the provision of guarantees was not able to compensate wholly for the suspension of guarantee financing and loan programmes from EU funds, and the total value of the guarantee and loan transaction portfolios thus decreased by 9.2% to CZK 23 billion.

Savings in net provision creation, lower income taxes and savings in operating expenses fully offset a decline in income from business activity (–CZK 143 million) which was due to the diminished portfolios and changes in the Bank's pricing policy (since the second half of 2012, the prices of newly provided loans and guarantees have not included profit) and in income from financial investments (–CZK 180 million) during this time of historically low interest rates.

The profit achieved after tax of CZK 348 million is CZK 464 million lower than in 2012. The reason for this considerable change is the use of the Bank's own resources for financing preferential guarantees in the amount of CZK 743 million (CZK 208 million in 2012). After correcting expenses by this amount, the comparative figure for profit (CZK 1,091 million) is greater by CZK 71 million than in 2012 (CZK 1,020 million). There was a year-on-year decrease in shareholder's equity from CZK 5 billion to CZK 4,5 billion, arising especially from a dividend payment of CZK 700 million for 2012. Capital adequacy stood at 14.4% as of 31 December 2013, 1.6 percentage points higher than at the close of the previous year.

* While using the Bank's own resources for financing preferential guarantees in programmes supporting small and medium-sized enterprises in the amount of CZK 208 million in 2012 and CZK 743 million in 2013.

Credit risk constituted the most significant type of risk impacting the Bank, and 85% of capital dedicated to risk coverage related to this type of risk. As of the end of 2013, 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 4.5 billion (i.e. 19% 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 2.6 billion. As of the end of the year, moreover, the Bank had at its disposal reserve funds in shareholder's equity of CZK 1.15 billion.

The overall balance sheet at the end of 2013 was 12% smaller than in the previous year and netted to CZK 98 billion. This reduction was especially related to lower short-term liabilities, and in particular those due to state institutions (–CZK 13.5 billion). On the assets side, and corresponding to the changes in liabilities, there was in particular a decrease in debt securities (–CZK 5 billion) and in amounts due from banks (–CZK 6.1 billion). The balance sheet total does not include bank guarantees issued primarily for loans to small and medium-sized enterprises which comprise a significant part of the Bank's business activities and credit exposure. Their value was CZK 18.1 billion as of the end of 2013.

On the assets side, the Bank had at its disposal a portfolio of financial investments amounting to CZK 82.9 billion (84.6% of net assets) and placed as bank deposits, predominantly in the forms of reverse repos (65.2% of net assets), as well as state bonds, bonds of selected banks and companies, and zero-coupon state bonds (19.4% of net assets). Loans provided to state institutions constituted an important net asset item (9.5% of net assets), as did loans to other clients (5.0% of net assets) reported in the item loans and advances to customers. Non-earning assets comprised 0.5% of the total balance sheet.

The funding sources on the liabilities and equity side were provided primarily by amounts due to customers (75% of liabilities and equity) and banks (16.2% of liabilities and equity), shareholder's equity (4.5% of liabilities and equity), provisions (2.5% of liabilities and equity), and temporary and other liabilities.

From a financial performance perspective, 2013 can be regarded positively. After correcting for costs from the Bank's own resources used for programmes supporting small and medium-sized enterprises in the interest of ensuring continuity in the provision of preferential guarantees, the profit figure would be CZK 1,091 million, which represents a comparable return on shareholder's equity of 28.3% and profit per employee reached nearly CZK 5 million after administrative costs per employee of CZK 1.356 million. Development of operating performance was also favourable, as operating expenses decreased year on year by CZK 11 million at current prices, which is by 3.3% at the average inflation rate of 1.4%.

Additional indicators of the Bank's financial performance, 2009 – 2013

Indikator	**Unit**	**2009**	**2010**	**2011**	**2012**	**2013**
Total capital (Tier 1)	CZK ‘000	4,511,388	4,666,426	4,821,166	3,775,768	3,876,104
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	-1,893,740	-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	1,249,745	1,406,286	1,570,430	2,414,171	2,519,209
deductible items	CZK ‘000	-19,907	-21,410	-30,814	-26,213	-30,915
of which: intangible fixed assets	CZK ‘000	-19,907	-21,410	-30,814	-26,213	-30,915
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	4,511,388	4,666,426	4,821,166	3,775,768	3,876,104
Total capital requirements	CZK ‘000	2,376,281	2,273,135	2,246,537	2,097,747	1,934,696
Credit risk	CZK ‘000	2,000,579	1,871,630	1,838,117	1,634,586	1,642,087
of which:						
exposures to central governments and banks	CZK ‘000	0	0	4,803	14,616	7,132
exposures to institutions	CZK ‘000	265,385	234,068	277,217	180,539	170,595
corporate exposures	CZK ‘000	1,595,957	1,501,258	1,425,634	1,315,397	1,353,193
retail exposures	CZK ‘000	69,464	44,966	44,822	43,382	56,639
exposures to secured property	CZK ‘000	3,107	2,571	7,309	7,649	7,167
exposures past due	CZK ‘000	56,581	80,333	67,619	69,695	45,251
short-term exposures to institutions and enterprises	CZK ‘000	10,085	8,434	10,713	3,308	2,110
Total interest-rate risk	CZK ‘000	133,468	162,626	173,402	217,811	49,791
of which:						
general interest-rate risk	CZK ‘000	76,517	87,948	76,678	111,249	29,830
specific interest-rate risk	CZK ‘000	56,951	74,678	96,724	106,562	19,961
Equity risk	CZK ‘000	0	0	0	0	0
Options	CZK ‘000	0	0	0	0	0
Currency risk	CZK ‘000	6,887	7,512	0	0	0
Commodity risk	CZK ‘000	0	0	0	0	0
Operational risk	CZK ‘000	235,347	231,367	235,017	238,809	242,818
Trading portfolio exposure risk	CZK ‘000	0	0	0	6,541	0
Return on average assets (ROAA)[1]	%	1.24	1.34	1.43	1.19	0.41
Return on average equity (ROAE)[1]	%	18.15	18.39	17.67	18.57	9.02
Assets per employee[1]	CZK ‘000	279,887	265,510	266,816	514,772	445,646
Administrative costs per employee[1]	CZK ‘000	1,364	1,385	1,397	1,399	1,356
Net profit per employee[1]	CZK ‘000	3,670	3,899	3,860	3,740	1,583

[1] Calculations are made pursuant to 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.

Business activities

1/ Product overview

During 2013, the Bank provided the following products:

a) Guarantees

- 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 as much as 70% of the loan principal,
- guarantees for tender bids for small and medium-sized enterprises in amounts of CZK 100,000 to CZK 5 million, and
- preferential guarantees for bank loans under the INOSTART programme for entrepreneurs implementing projects in Moravia–Silesia and Olomouc regions for loans up to CZK 15 million and as much as 60% of the 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 a grace period up to 3 years;
- loans for small enterprises in South Bohemia Region in amounts up to CZK 1 million, with a fixed interest rate of 4% 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 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 and maturity up to 10 years under the Programme of Preferential Regional Loans for Small Enterprises and Municipalities in 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 a 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 a grace period up to 3 years;
- long-term loans for municipalities under the MUFIS 2 investment programme to maintain and develop their infrastructure in amounts up to CZK 40 million, with a fixed or variable interest rate determined individually according to current market conditions and maturity up to 10 years; and
- long-term loans for municipalities and enterprises for projects within Moravia–Silesia Region from the Urban Development Fund created using 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.

As from September 2013, the Bank is also conducting commercial representation activities for export guarantees from Czech Export Bank which can be provided to small and medium-sized enterprises to obtain operating loan financing to finance subcontracting for domestic exporters. These guarantees are usually in amounts up to CZK 30 million with a guarantee term up to 2 years. An account receivable in an amount of as much as 80% of the loan principal can be fully secured by means of the guarantee.

2/ Support to small and medium-sized enterprises

a) Overall results

The Bank provided support to small and medium-sized enterprises (hereinafter just SMEs) especially on the basis of agreements concluded with the Ministry of Industry and Trade.

Guarantees for investment loans and loans for the purchase of inventory were only provided in the programme financed by national resources. In June 2013, this programme's operations were broadened to include support for enterprises affected by floods. The outcome from implementing this programme, which was designated only for small enterprises, confirms the continuing strong interest among enterprises, and especially in the area of obtaining loans to finance inventory.

The Operational Programme Enterprise and Innovations (OPEI) co-financed from EU structural funds announced no new calls for loan or guarantee applications. Subordinated loans within the PROGRESS programme were provided for applications submitted under the previous call.

On the basis of an agreement with South Bohemia Region, preferential loans were provided to small enterprises there.

In 2013, SMEs submitted a total of 1,903 applications for support in the form of loan guarantees and applications for loans (see Table 3). A total of 1,563 of these applications were approved and 33 applications were rejected because they either did not meet programme criteria or represented risks too great for the project to receive financing. A total of 196 applicants withdrew their applications during processing. The remaining 111 applications were not resolved in 2013 and will carry over into the following year.

Applications for support and their settlement — Table 3

Indicator		**2009**	**2010**	**2011**	**2012**	**2013**
Total applications submitted	number	1,288	2,288	487	1,095	1,903
Approved	number	922	1,318	241	793	1,563
Rejected or withdrawn	number	184	855	109	125	229
Carried into following year	number	182	115	137	177	111

Most of the loans and guarantees provided were 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	803	51.9	1,368.7	42.1	10	58.8	14.3	14.1
10 to 49	726	47.0	1,782.5	54.8	2	11.8	11.0	10.9
50 to 249	17	1.1	99.7	3.1	5	29.4	76.0	75.0
Total	**1,546**	**100**	**3,250.9**	**100**	**17**	**100**	**101.3**	**100**

b) Guarantees

The Bank provided 1,546 loan guarantees in a total amount of CZK 3,251 million based on guarantee contracts concluded in 2013. The guarantees supported loans of CZK 4,616 million (see Table 5).

Guarantees issued (excluding bids to public tenders) and loans guaranteed — Table 5

Indicator		2009	2010	2011	2012	2013
Guarantees issued	number	878	1,224	111	697	1,546
Amount of guarantees issued	CZK mil.	6,369	6,593	472	1,534	3,251
Amount of loans guaranteed	CZK mil.	9,550	10,070	630	2,215	4,616
Average guarantee coverage	%	67	65	75	69	70

In the national programme, small enterprises acquired guarantees in the amount of CZK 3,243 million. These guarantees were used as security for 1,544 loans in amounts totalling CZK 4,603 million. Of these, 23 guarantees in a sum of CZK 176 million were provided to enterprises affected by floods in June 2013. Start-up enterprises in the Olomouc and Moravia–Silesia regions were provided with 2 guarantees amounting to CZK 8 million within the INOSTART programme.

Based on a commitment to extend the liability period, the Bank extended this period through amendments to guarantee contracts for 801 guarantees summing to CZK 2,856 million. This allowed those enterprises to continue drawing loans to finance operational needs.

In addition to guarantees for bank loans, 380 guarantees were provided for bids to public tenders totalling CZK 207 million.

The largest proportions of loan guarantees were used to support projects in Moravia–Silesia Region and in Prague (see Table 6).

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

Region		2009	2010	2011	2012	2013
Praha (Capital City of Prague)	%	1.7	5.6	4.3	8.1	11.2
Středočeský (Central Bohemia)	%	8.5	8.2	13.0	4.8	8.2
Jihočeský (South Bohemia)	%	3.5	4.9	2.6	7.5	5.5
Plzeňský (Pilsen)	%	8.4	7.0	6.3	4.3	4.6
Karlovarský (Karlovy Vary)	%	0.9	1.4	1.2	2.2	1.5
Ústecký (Ústí nad Labem)	%	3.1	2.1	1.9	3.0	3.7
Liberecký (Liberec)	%	6.1	9.7	11.3	5.1	3.9
Královéhradecký (Hradec Králové)	%	8.7	10.0	1.2	5.1	4.6
Pardubický (Pardubice)	%	9.0	3.8	13.7	5.2	4.7
Vysočina (Bohemian–Moravian Highlands)	%	7.0	4.7	1.5	5.4	3.1
Jihomoravský (South Moravia)	%	15.8	15.2	4.6	8.4	14.0
Olomoucký (Olomouc)	%	12.9	8.3	19.9	15.4	6.8
Zlínský (Zlín)	%	5.3	7.1	1.3	4.5	6.0
Moravskoslezský (Moravia–Silesia)	%	9.1	12.0	17.1	20.8	22.2
Total	%	**100**	**100**	**100**	**100**	**100**

The breakdown of guarantees for 2013 according to the main groups of economic activities to which project support was directed was fundamentally influenced by the conditions that had been established for programme support. The largest number of guarantees was provided to projects in wholesale and retail, followed by manufacturing (see Table 7).

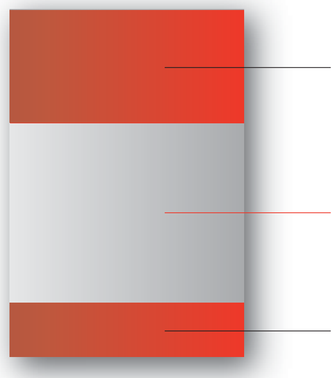
Sector structure of guarantees provided in 2013
(in % of contracted values of newly issued guarantees) Table 7

Sector		
Manufacturing (CZ NACE 10-33)	%	26.3
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	0.0
Construction (CZ NACE 41-43)	%	11.6
Wholesale and retail trade; repair and maintenance of motor vehicles (CZ NACE 45-47)	%	53.8
Accommodation and food service activities (CZ NACE 55-56)	%	2.2
Other service activities (CZ NACE 05-09, 36-39, 49-53, 58-75, 77-82, 84-88, 90-99)	%	6.1
Total	**%**	**100**

During 2013, the majority of guaranteed transactions were concluded with Komerční banka, a.s., and Česká spořitelna, a.s., (see Graph 1). Among other banks, Raiffeisenbank, a.s., (7.2%) and UniCredit Bank Czech Republic, a.s., (6.4%) had the greatest participation in guarantee transactions.

Graph 1

Percentage breakdown of guarantee transactions by lending banks (2013)



c) Loans

In 2013, the Bank provided a total of 17 loans for SMEs amounting to CZK 101 million (see Table 8).

These consisted of:

- subordinated loans under the OPEI PROGRESS programme, with 6 loans provided totalling CZK 92 million; and
- reduced-interest loans under the South Bohemia Regional Programme, with 11 loans provided amounting to CZK 9 million.

Preferential loans provided Table 8

Indicator		2009	2010	2011	2012	2013
Loans provided	number	44	94	136	96	17
Amount of loans provided	CZK mil.	209	629	1,090	782	101
Average loan amount	CZK mil.	4.7	6.7	8.0	8.1	6.0

The largest proportions of loans during 2013 were used in South Moravia, Pilsen and Bohemian–Moravian Highlands regions (see Table 9).

Regional structure of loans provided
(in % of contracted value of newly issued loans) Table 9

Region		2009	2010	2011	2012	2013
Praha (Capital City of Prague)	%	0.0	0.0	0.0	0.0	0.0
Středočeský (Central Bohemia)	%	9.3	5.0	7.0	8.3	14.8
Jihočeský (South Bohemia)	%	13.6	9.8	12.9	12.1	9.2
Plzeňský (Pilsen)	%	33.4	16.0	12.0	7.5	19.7
Karlovarský (Karlovy Vary)	%	9.6	3.6	1.6	0.0	0.0
Ústecký (Ústí nad Labem)	%	1.7	8.2	0.7	4.0	0.0
Liberecký (Liberec)	%	2.9	0.0	3.4	7.4	0.0
Královéhradecký (Hradec Králové)	%	3.2	1.1	7.1	5.6	0.0
Pardubický (Pardubice)	%	4.5	6.2	8.3	3.7	6.9
Vysočina (Bohemian–Moravian Highlands)	%	2.4	11.2	10.6	4.5	19.7
Jihomoravský (South Moravia)	%	12.6	8.3	13.5	18.6	19.7
Olomoucký (Olomouc)	%	1.2	7.7	6.3	5.8	0.0
Zlínský (Zlín)	%	4.7	8.5	7.9	13.4	10.0
Moravskoslezský (Moravia–Silesia)	%	1.0	14.4	8.6	9.2	0.0
Total	%	**100**	**100**	**100**	**100**	**100**

The largest proportion of supported loans was 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)	%	59.2
Electricity, gas, steam and air conditioning supply (CZ NACE 35)	%	0.0
Construction (CZ NACE 41-43)	%	13.1
Wholesale and retail trade; repair and maintenance of motor vehicles (CZ NACE 45-47)	%	2.0
Accommodation and food service activities (CZ NACE 55-56)	%	6.9
Other service activities (CZ NACE 05-09, 36-39, 49-53, 58-75, 77-82, 84-88, 90-99)	%	18.8
Total	%	**100**

3/ Support for reconstructing apartment houses

In 2013, the Bank administered a total of 9,439 active Contracts on Providing Grants to Cover Loan Interest. On the basis of these, it paid out more than CZK 898 million. From the start of the programme in support of apartment house reconstruction until the end of 2013, grant recipients were collectively paid a total of CZK 6,191 million, which comprises 45.3% of the total volume of concluded Contracts on Providing Grants to Cover Loan Interest (CZK 13,664 million).

The Bank also administered a portfolio of bank loan guarantees during 2013 which enabled owners or co-owners of apartment houses to obtain loans for their repair. As of the end of 2013, this portfolio was composed of 1,746 bank loan guarantees, and the unpaid principal of the guaranteed loans amounted to CZK 5,980 million.

4/ Financing municipal infrastructure

a) Loans under the MUNICIPALITY 2 programme

The MUNICIPALITY 2 programme had been announced in the middle of 2009 and uses resources obtained from the Council of Europe Development Bank. Loans provided by CMZRB are designated for the purchase or refurbishment of municipal properties, and especially technical infrastructure, school and pre-school facilities, as well as cultural and sport facilities. The programme also encompasses projects directed to saving energy.

In 2013, the Bank concluded 3 new loan contracts totalling CZK 273 million. Since the programme's announcement, 15 loans summing to CZK 598 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 sport, cultural and educational facilities. Issuance of these loans is dependent on the generation of sufficient funds from loan repayments in previous years. In 2013, the Bank provided 8 loans totalling CZK 41 million. Since announcing the programme with new conditions in 2008, 34 loans have been issued amounting to CZK 321 million.

c) Loans from the Urban Development Fund

Loans from the Urban Development Fund, created from resources of the Regional Operational Programme Moravia–Silesia, are designated for municipalities within Moravia–Silesia Region and their investment-focused projects which should be included (or the inclusion of which is assumed) into the Integrated Plan for Sustainable Urban Development.

In 2013, the Bank provided 1 loan in the amount of CZK 58 million. Low interest rates on the market and difficult conditions for obtaining credit were manifested in a small number of submitted loan applications and the termination of a large proportion of negotiations with potentially interested parties before any loan application was submitted.

5/ Trading on financial markets

During 2013, the Bank concluded transactions on the money and capital markets in order to manage its liquidity, administer its portfolio of money and capital market instruments, manage interest-rate and currency risks, and refinance the lending programme for supporting SMEs.

In administering its portfolio of money and capital market instruments, the Bank continued its conservative investment strategy. CMZRB 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 4.5 billion during 2013. This amount included resources obtained from the European Investment Bank, the state budget and the State Fund for Transport Infrastructure.

The largest part of those resources (CZK 3.9 billion) was used for water management projects. It consisted of CZK 2.92 billion for anti-flood programmes and CZK 0.95 billion for construction and renovation projects relating to water supply and sewage infrastructure.

As a financial manager, the Bank disbursed CZK 0.6 billion for financing transportation projects. All of these related to Czech Motorways Project B, which takes in construction of the Lovosice–Ústí nad Labem section of the D8 motorway and the Osičky–Hradec Králové section of the D11 motorway.

In 2013, the Bank continued administering interest payments from commercial loans for participants in the Project for Construction and Renovation of Water Supply and Sewage Infrastructure, paying out a total of CZK 34 million to 103 recipients.

External communications

By far the most extensive and diverse of the Bank's communications in 2013 were with those ministries representing the Czech Republic as the CMZRB's shareholder. The content of those communications reflected the needs to take steps in the project for transforming the Bank and react to changes ensuing from broader changes and from a number of additional, accompanying norms. Among other things, it was necessary to implement extensive adjustments in the functions and relationships of the Bank's governing bodies, to resolve overlapping functions in the case of Members of the Board of Directors and address several other issues in connected with this. As a result of the constructive approach taken by all stakeholders, it was possible to complete these tasks within the required time.

Throughout all of 2013, negotiations were underway (and included the preparation of contractual documentation and other materials) focused upon the single objective of renewing the provision of guarantees from the structural fund of the Operational Programme Enterprise and Innovation. The Bank's main partner in this was the Ministry of Industry and Trade, which exercises the role of managing authority for this programme. With support from the Ministry of Finance and the Ministry of Regional Development, it became possible at the close of the year to bring the preparations for a new guarantee fund into a phase already realistically giving rise to expectations for the announcement of further calls for guarantee applications. This should ensure that this type of support will be offered at the needed level in 2014 and 2015.

There was very intense co-operation between CMZRB and the Ministry of Industry and Trade aimed at further using revolving resources gained for the national guarantee programme from guarantee and loan funds created in previous years from national resources and from structural funds. A result of this co-operation is the announcement of a new call in the programme of investment and operating guarantees for small enterprises and the approval of a long-term framework programme called REVIT to support SMEs operating in regions with low or declining economic activity and high unemployment or which have been affected by natural disasters. This programme's first call is directed to supporting enterprises in Moravia–Silesia Region. In addition to loans with preferential interest rates, SMEs can obtain irrevocable financial subsidies in the amount of 10% of the drawn loan.

During 2013, activities were occurring on many levels in connection with preparing the Czech Republic for the new structural fund programming period. One of its characteristic traits should be an increased proportion of support provided in the form of loans, venture capital and guarantees. Through its representatives' participation in working groups and platforms, CMZRB was very closely involved in preparations for both the direction in which the Operational Programme Enterprise and Innovation for Competitiveness will go and the method of its implementation. Just as in the current programming period, this operating programme sponsored by the Ministry of Industry and Trade will clearly be used in the largest extent for providing support in the form of financial instruments.

In a working group that was created for this area by the Ministry of Regional Development, the Bank availed itself of an important opportunity to participate in preparations of the entire framework for financial instruments in the next programming period. The activities of the Bank's representatives in the Czech Banking Association's working groups in relation to structural funds are very effective and beneficial for further co-operation.

From the perspective of future CMZRB operations in particular as an administrator of a fund of funds but also as an administrator of financial instruments created outside this framework, effective co-operation with the banking sector is an essential condition for the successful use of these effective support instruments. The necessary legal framework for these activities should be created by an amendment to Act No. 47/2002 Coll., on support for small and medium-sized enterprises. In the closing phase of its preparation, the Bank has already commented on the wording of that amendment.

An amendment to the Act on Budgetary Rules significantly affected co-operation between CMZRB and both the Ministry of Industry and Trade and the State Housing Development Fund. With the Ministry of Industry and Trade, it was necessary to prepare a new model for depositing and administering resources from the budget chapter of this ministry provided in the form of grants, the recipient of which will be CMZRB. The establishment of the state treasury and the requirement that the State Housing Development Fund hold an account only at the Czech National Bank required the design of a new mechanism for financing grants and bank loan guarantees provided in previous years for reconstructing apartment houses.

A very challenging task during 2013, and one requiring very intensive co-operation between the Bank in the position of mandatary and the State Housing Development Fund as mandant, was the working out of communications with clients and banks in the period before the adoption of a new government decree which enabled re-start the conclusion of amendments to contracts on grants and guarantees for refinancing previously supported loans with new loans. Additional changes in this area being prepared for 2014 will require specific solutions as well as precise communications in regard to these solutions.

CMZRB's co-operation with the European Investment Bank was very extensive in its role as administrator of a holding fund under the JESSICA initiative investing the financial resources entrusted by Moravia–Silesia Region into two urban development funds in the region, one of which is administered by CMZRB. There was very intensive communication with the Regional Council of the Moravia–Silesia Cohesion Region, which as from 2014 will assume the task which hitherto had been performed in relation to CMZRB by the European Investment Bank.

The Bank's contacts with Czech Export Bank moved to a qualitatively higher level. After intensive common effort, the CMZRB branch network began to participate in providing export loan guarantees from Czech Export Bank. On the basis of a contract for commercial representation, CMZRB secured the introductory phase of communications with applicants for these guarantees.

Co-operation with trade associations, commercial banks and other entities was also ongoing in various forms, thereby broadening the applicants' awareness as to various types of support. In this way, too, knowledge was acquired as to the current needs and problems of the individual target groups of applicants and recipients of support. The Bank used the knowledge so acquired in order to improve the services it provides and passed this information on to those partners responsible for setting the conditions of the provided support.

In the field of international co-operation, the Bank's most visible action was to join as a founding member into the European Association of Long Term Investors (ELTI). ELTI should speak for its members in negotiating with EU institutions, and especially in areas related to implementing new financial instruments created for directing capital within the Multiannual Financial Framework (2014 – 2020) to infrastructure investments, support for SMEs, innovations and energy projects.

Growth in the European Commission s activity in preparing the legal framework for European structural and investment fund operations was the main reason for the more numerous and extensive responses from European platforms in which the Bank is a member, namely the AECM (European Association of Mutual Guarantee Societies) and the NEFI (Network of European Financial Institutions for SMEs). The outputs of their activities were analytical and communication materials and comments through which the association members reached out to EU institutions in connection with the preparation of regulations in the COSME (Competitiveness of Enterprises and Small and Medium-sized Enterprises) and Horizon programmes, in the use of structural funds, and in the area of state aid (support de minimis, block exemptions).

Goals for further development

While maximising emphasis on aspects according with the project for its transformation, the Bank's operations will continue to be directed towards expanding its activities in the administration of financial instruments using structural funds that go beyond providing support to SMEs and establishing itself as the most important loan and guarantee fund administrator for central state administrative authorities responsible for managing operational programmes.

CMZRB's activity will continue to be performed in way that will consistently allow the state to use the Bank's services without procurement procedures. Shares of the Bank currently held by the Bank in treasury will be gradually transferred to the Czech Republic in a manner subject to approval from CMZRB's General Meeting.

In concluding contractual relationships with the state, the Bank will continue to 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 CMZRBs own capital.

A key challenge will be the preparation and management of the Bank's operations as administrator of the fund of funds and its products. This extensive project will be implemented in more complex conditions and under more complicated legislation than any experienced heretofore. This will require the detailed scrutiny and verification of a number of particular questions in relation to which the rules and requirements for relevant regulations are so far vague and incomplete. For its activity as administrator of the fund of funds, it will also be necessary to design a methodology for new processes, to set new purviews within the Bank and to develop the necessary support within the Bank's information system. CMZRB employees' many years of experience and close co-operation with state administrative authorities are the main prerequisites that should enable the successful completion of this undertaking.

Products provided by the fund of funds will clearly be able to cover only a part of the needs of the highly diverse types of support recipients. The Bank will therefore further build upon existing product types in order to enter into direct contact with support recipients. These products should utilise both resources from structural funds and national resources.

In 2014, the Bank will focus especially on:

- maximum use of resources revolving from financial instruments and obtained through additional measures approved by the Bank's shareholder for financing the national guarantee programme for enterprises;
- rapid and vast growth of guarantee activities in the Operational Programme Enterprise and Innovation;
- ensuring successful administration of the REVIT loan programme, the guarantee fund for the INOSTART programme, and loan programmes for municipalities;
- co-operation with the Ministry of Industry and Trade in preparing new support programmes financed by structural funds using financial instruments and their implementation structures (an important task in relation to which will be to introduce the fund of funds) and in creating a long-term flexible programming framework for support of SMEs which cannot be supported sufficiently or at all from structural funds;
- continuing co-operation with other central authorities in preparing for use of financial instruments in their operational programmes for the next programming period of structural funds;
- preparation of products for the new programming period in terms of organisation, methods, human resources and IT support;
- completing changes in processes of administering grants for the support of apartment houses based on the State Housing Development Fund's requirements;
- completing the transition to new software support for transaction management and preparations for changes to the Bank's website; and
- implementation of directly applicable EU regulations in the area of state aid and harmonisation of the company's management system with the Ministry of Finance's new requirements.

Report of the Supervisory Board of Českomoravské záruční a rozvojové banky, a. s.

During 2013, 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 is 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 2013, 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.

KPMG Česká republika 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 2013 and of its operations for that 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 following as presented by the Bank's Board of Directors: Report of the Board of Directors on the Bank's Business Activities and Financial Situation for 2013, Report of the Board of Directors on Relations between Related Entities for 2013, the financial statements of Českomoravská záruční a rozvojová banka, a. s., for 2013, the profit distribution for 2013, the change of the Articles of Association of Českomoravská záruční a rozvojová banka, a. s., use of the Bank's own resources to support SMEs in the form of guarantees in 2015, appointment of the members of the Bank's bodies (Supervisory Board and the Audit Committee), remuneration of the members of the Bank's bodies for 2013 (Supervisory Board and the Audit Committee), and the policies for remunerating members of the Bank's bodies (Supervisory Board and the Audit Committee) 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 2013. It likewise examined the Report of the Board of Directors on Relations between Related Entities for 2013.

Prague, 11 March 2014

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

Robert Szurman
Supervisory Board Chairman

Report of the Audit Committee of Českomoravské záruční a rozvojové banky, 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 2013, 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.

In 2013, a procedure to selection an external auditor for the period 2013 – 2015 was conducted under the Audit Committee’s supervision. On the basis of the Audit Committee’s recommendations, an extraordinary shareholders’ meeting approved KPMG Česká Republika Audit, s.r.o., as external auditor for this period. The Audit Committee believes that the new auditor will further increase the level of assurance that the maintenance of accounting and reporting of financial results is in accordance with Czech accounting regulations.

In 2013, the Audit Committee also reviewed the Report on the Information Systems Audit, which was conducted by the audit firm Deloitte Advisory s.r.o.

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 were satisfactorily followed.

Prague, 11 March 2014

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

Milan Novák
Audit Committee Chairman

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., which comprise the statement of financial position as of 31 December 2013, and the income statement, the statement of comprehensive income, the statement of changes in equity and the cash flow statement for the year then ended, and the notes to these financial statements including a summary of significant accounting policies and other explanatory notes. Information about the company is set out in Note 1 to these financial statements.

Statutory Body's Responsibility for the Financial Statements

The statutory body of Českomoravská záruční a rozvojová banka, a.s. is responsible for the preparation of 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 controls as the statutory body determines are 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 and International Standards on Auditing and the relevant 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 whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

KPMG

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Českomoravská záruční a rozvojová banka, a.s. as of 31 December 2013, and of 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.

Prague
27 March 2014

KPMG Česká republika Audit, s.r.o.
Licence number 71

Pavel Závitkovský
Partner
Licence number 69

Financial statements for the year ended 31 December 2013
prepared in accordance with IFRS as adopted by the EU

2013

annual review

Income statement

	Note	Year ended 31 December 2013 CZKm	Year ended 31 December 2012 CZKm
Interest and similar income		1,202	1,701
Interest and similar expenses		(590)	(826)
Net interest income	**3.1**	**612**	**875**
Fee and commission income		527	635
Fee and commission expenses		(4)	(5)
Net fee and commission income	**3.2**	**523**	**630**
Gains from financial operations	3.3	232	249
Losses on financial operations	3.3	(151)	(219)
Administrative expenses	3.4	(329)	(340)
Increase in loan impairment and write-offs	3.5	(289)	(103)
(Increase)/decrease in provisions for guarantees and other provisions	3.6	(82)	(48)
Other operating income		(1)	-
Operating profit		515	1,044
Share of earnings in associates accounted for using the equity method	3.15	1	5
Profit before income tax		**516**	**1,049**
Income tax expense	3.7	(173)	(239)
Profit for the year		**343**	**810**

Statement of comprehensive income

	Note	Year ended 31 December 2013 CZKm	Year ended 31 December 2012 CZKm
Profit for the year		**343**	**810**
Other comprehensive income			
Valuation gains/(losses) on available-for-sale financial assets		(105)	467
Net gains/(losses) on available-for-sale financial assets transferred to income statement on disposal	3.3	(79)	(83)
Deferred income tax relating to components of the comprehensive income	3.7	35	(73)
Other comprehensive income for the year, net of tax		(149)	311
Total comprehensive income		**194**	**1,121**

Statement of financial position

	Note	31 December 2013 CZKm	31 December 2012 CZKm
Assets			
Cash and balances with central banks	3.8	64,152	70,273
Loans and advances to banks	3.9	140	244
Financial assets held for trading			
- Debt securities	3.10	271	1,264
- Derivatives	4.2.2	176	61
Debt securities designated at fair value	3.10	1,527	2,102
Loans and advances to customers	3.11	14,231	16,814
Financial assets available for sale	3.12	12,237	15,323
of which: assets pledged as collateral		5,650	1,074
Financial assets held to maturity	3.13	5,020	5,369
of which: assets pledged as collateral		1,110	52
Current income tax assets	3.7	42	-
Investment in associate	3.15	105	104
Intangible assets		31	26
Property, plant and equipment	3.16	138	147
Other assets	3.14	77	83
Total assets		**98,147**	**111,810**
Liabilities			
Deposits from banks	3.17	15,898	15,339
Deposits from customers	3.18	73,516	86,968
Financial liabilities held for trading - derivatives	4.2	205	243
Hedging derivatives	4.2.2	54	87
Current income tax liabilities	3.7	-	10
Deferred tax liabilities	3.7	15	49
Provisions	3.6	2,495	2,342
Other liabilities	3.19	1,415	1,717
Total liabilities		**93,598**	**106,755**
Shareholders' equity			
Share capital	3.20	2,132	2,132
Statutory and other reserves		1,150	1,150
Own treasury shares		(1,894)	(1,894)
Revaluation reserve for AFS securities		196	345
Retained earnings		2,965	3,322
Total shareholders' equity		**4,549**	**5,055**
Total liabilities and shareholders' equity		**98,147**	**111,810**

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 27 March 2014.

Ing. Ladislav Macka
Chairman of the Board

Ing. Jan Ulip
Member of the Board

Statement of changes in equity

	Share capital CZKm	Statutory and other reserves CZKm	Own treasury shares CZKm	Revaluation reserve for AFS securities CZKm	Retained earnings CZKm	Total CZKm
Balance at 1 January 2012	**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**
Net fair value losses on AFS securities	-	-	-	(105)	-	(105)
Net gains on AFS securities transferred to income statement	-	-	-	(79)	-	(79)
Deferred income tax relating to components of other comprehensive income	-	-	-	35	-	35
Total comprehensive income	-	-	-	(149)	343	194
Dividends relating to 2012	-	-	-	-	(700)	(700)
Balance at 31 December 2013	**2,132**	**1,150**	**(1,894)**	**196**	**2,965**	**4,549**

Statement of cash flows

	Note	2013 CZKm	2012 CZKm
Profit before income tax		516	1,049
Adjustments for non-cash transactions			
Loans impairment and write-offs and provisions for guarantees		371	151
Depreciation and amortisation		24	30
Share of profit of associates		(1)	(5)
Change in fair values and foreign exchange differences		(44)	(404)
Other non-cash items		5	16
Net interest income		(612)	(875)
Fee and commission income		(527)	(635)
(Increase)/decrease in operating assets		(268)	(673)
Loans and advances to banks		70	(72)
Loans and advances to customers		2,345	2,863
Other assets		1,515	(877)
Increase/(decrease) in operating liabilities			
Deposits from banks		561	(6,350)
Deposits from customers		(13,407)	60,139
Other liabilities		(67)	57
Interest received		1,265	1,709
Interest paid		(565)	(781)
Fee and commission received		246	254
Net cash flow from operating activities before income tax and payments under guarantee calls		(8,305)	56,269
Payments made under guarantee calls		(169)	(402)
Income taxes paid		(214)	(208)
Net cash flow from operating activities		**(8,688)**	**55,659**
Cash flows from investing activities			
Purchases of securities		(8,066)	(12,761)
Sales of securities and proceeds from matured securities		11,330	12,904
Purchase of tangible and intangible assets		(31)	(26)
Net cash flow from investing activities		**3,233**	**117**
Cash flows from financing activities			
Acquisition of own treasury shares		-	(1,894)
Dividends paid		(700)	(420)
Net cash flow from financing activities		**(700)**	**(2,314)**
Net increase/ (decrease) in cash and cash equivalents		**(6,155)**	**53,462**
Cash and cash equivalents at the beginning of the year	**3.21**	**70,315**	**16,853**
Cash and cash equivalents at the end of the year	**3.21**	**64,160**	**70,315**

Notes to the financial statements

2013

annual review

Notes to the financial statements

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, Plzeň 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").

Using the Bank's own resources to finance support for SMEs in 2013

Taking into consideration the multi-annual halt of financing programs supporting small and medium entrepreneurship ("SME") from the resources of the Operating program Entrepreneurship and innovation, the Bank used, with the consent of the shareholders, its own resources in order to finance the guarantees for this sector as a part of the national guarantee program. In 2013 the total amount of CZK 743 million was used for this purpose (in 2012 the total of CZK 208 million was used with the impact to profit), by which the reported profit for 2013 is lower. This measure enabled to maintain the continuity of support of SME in 2013.

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 statement of financial position, 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 statement of financial position cash and cash equivalents are included.

Notes to the financial statements

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 adopted since 1 January 2013

The following revised standards effective from 1 January 2013 are mandatory and relevant for the Company and have been applied by the Company since 1 January 2013.

Annual Improvements 2009-2011 Cycle (effective from 1 January 2013). In May 2012 the IASB published Annual Improvements to IFRSs 2009-2011 Cycle as part of its annual improvements process to make non-urgent but necessary amendments to IFRS. The new cycle of improvements contains amendments to IFRS 1, IAS 1, IAS 16, IAS 32 and IAS 34, with consequential amendments to other standards and interpretations.

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities (effective from 1 January 2013). The Amendments contain new disclosure requirements for financial assets and liabilities that are offset in the statement of financial position; or subject to master netting arrangements or similar agreements.

Amendment to IAS 1 Presentation of Financial Statements (effective from 1 July 2012). The amendments to IAS 1 titled Presentation of Items of Other Comprehensive Income:

- require that an entity present separately items of other comprehensive income that would be reclassified to profit or loss in the future if certain conditions are met from those that would never be reclassified to profit or loss;
- do not change the existing option to present profit or loss and other comprehensive income in two statements; and
- change the title of the statement of comprehensive income to the statement of profit or loss and other comprehensive income. However, an entity is still allowed to use other titles.

IFRS 13 Fair Value Measurement (effective from 1 January 2013). This new standard was issued in May 2011. It replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other IFRSs. It does not introduce new requirements to measure assets or liabilities at fair value, nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards.

In accordance with transitional provisions of IFRS 13, the Company has applied the new fair value measurement guidance prospectively and has not provided comparative information for new disclosures. Notwithstanding the above, the change had no significant impact on the measurements of the Company's assets and liabilities.

Notes to the financial statements

IAS Standards, interpretations and amendments to published standards that are not yet effective and are relevant for the Company's financial statements

A number of new Standards, amendments to Standards and Interpretations are not yet effective as at 31 December 2013, and have not been applied in preparing these financial statements. Of these pronouncements, potentially the following will have an impact on the Company's operations. The Company plans to adopt this pronouncement when it becomes effective. The Company is in the process of analyzing the likely impact on its financial statements.

IAS 27 (2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2014) carries forward the existing accounting and disclosure requirements of IAS 27 (2008) for separate financial statements, with some minor clarifications. As well, the existing requirements of IAS 28 (2008) and IAS 31 for separate financial statements have been incorporated into IAS 27 (2011). The Standard no longer addresses the principle of control and requirements relating to the preparation of consolidated financial statements, which have been incorporated into IFRS 10 Consolidated Financial Statements.

IAS 28 (2011) Investments in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2014). This amended standard supersedes IAS 28 Investments in Associates (2008). IAS 28 (2011) makes the following amendments:

- IFRS 5 applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale; and
- on cessation of significant influence or joint control, even if an investment in an associate becomes an investment in a joint venture or vice versa, the entity does not remeasure the retained interest.

Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2014). The amendments do not introduce new rules for offsetting financial assets and liabilities; rather they clarify the offsetting criteria to address inconsistencies in their application.

IFRS 9 Financial Instruments (effective from 1 January 2015), published on 12 November 2009 as part of phase I of the IASB's comprehensive project to replace IAS 39. It deals with classification and measurement of financial assets. The requirements of this standard represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. A financial asset would be measured at amortised cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets would be measured at fair value. The standard eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivables. In October 2010 the IASB added to IFRS 9 the requirements for classification and measurement of financial liabilities while most of the requirements in IAS 39 were carried forward unchanged to IFRS 9. IFRS 9 has not yet been adopted by the EU.

IFRS 10 Consolidated Financial Statements and IAS 27 (2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2014). IFRS 10 provides a single model to be applied in the control analysis for all investees, including entities that currently are SPEs in the scope of SIC-12. IFRS 10 introduces new requirements to assess control that are different from the existing requirements in IAS 27 (2008). Under the new single control model, an investor controls an investee when it is exposed or has rights to variable returns from its involvements with the investee, it has the ability to affect those returns through its power over that investee and there is a link between power and returns. The new Standard also includes the disclosure requirements and the requirements relating to the preparation of consolidated financial statements. These requirements are carried forward from IAS 27 (2008).

Notes to the financial statements

IFRS 11 Joint Arrangements (effective for annual periods beginning on or after 1 January 2014) supersedes and replaces IAS 31, Interest in Joint Ventures. IFRS 11 does not introduce substantive changes to the overall definition of an arrangement subject to joint control, although the definition of control, and therefore indirectly of joint control, has changed due to IFRS 10. Under the new Standard, joint arrangements are divided into two types, each having its own accounting model.

IFRS 12 Disclosure of Interests in Other Entities (effective for annual periods beginning on or after 1 January 2014) requires additional disclosures relating to significant judgements and assumptions made in determining the nature of interests in an entity or arrangement, interests in subsidiaries, joint arrangements and associates and unconsolidated structured entities.

Amendments to IFRS 10, IFRS 12 and IAS 27 – Investment Entities (effective for annual periods beginning on or after 1 January 2014). The Amendments provide an exception to the consolidation requirements in IFRS 10 and requires qualifying investment entities to measure their investments in controlled entities – as well as investments in associates and joint ventures – at fair value through profit or loss, rather than consolidating them.

The consolidation exemption is mandatory (i.e. not optional), with the only exception being that subsidiaries that are considered as an extension of the investment entity's investing activities, must still be consolidated.

An entity qualifies as an investment entity if it meets all of the essential elements of the definition of an investment entity. According to these essential elements an investment entity:

- obtains funds from investors to provide those investors with investment management services;
- commits to its investors that its business purpose is to invest for returns solely from appreciation and/or investment income; and
- measures and evaluates the performance of substantially all of its investments on a fair value basis.

The amendments also set out disclosure requirements for investment entities.

Amendments to IAS 36 – Recoverable Amount Disclosures for Non-Financial Assets (effective for annual periods beginning on or after 1 January 2014). The Amendments clarify that recoverable amount should be disclosed only for individual assets (including goodwill) or cash-generated units for which an impairment loss was recognised or reversed during the period.

The Amendments also require the following additional disclosures when an impairment for individual assets (including goodwill) or cash-generated units has been recognised or reversed in the period and recoverable amount is based on fair value less costs to disposal:

- the level of IFRS 13 'Fair value hierarchy' within which the fair value measurement of the asset or cash-generating unit is categorised;
- for fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation techniques used and any changes in that valuation technique together with the reason for making it;
- for fair value measurements categorised within Level 2 and Level 3, each key assumption (i.e. assumptions to which recoverable amount is most sensitive) used in determining fair value less costs of disposal. If fair value less costs of disposal is measured using a present value technique, discount rate(s) used both in current and previous measurement should be disclosed.

Amendments to IAS 39 – Novation of Derivatives and Continuation of Hedge Accounting (Effective for annual periods beginning on or after 1 January 2014). The Amendments allows hedge accounting to continue in a situation where a derivative, which has been designated as a hedging instrument, is novated to effect clearing with a central counterparty as a result of laws and regulations, when the following criteria are met:

Notes to the financial statements

- The novation is made as a consequence of laws or regulations
- A clearing counterparty becomes a new counterparty to each of the original counterparties of the derivative instrument
- Changes to the terms of the derivative are limited to those necessary to replace the counterparty.

(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 statement of financial position 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 statement of financial position and measured in accordance with their assigned category.

Notes to the financial statements

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 statement of financial position 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 statement of financial position 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.

Notes to the financial statements

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 statement of financial position 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 statement of financial position 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 2013 or 2012.

(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.

Notes to the financial statements

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 statement of financial position 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 statement of financial position 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'.

Notes to the financial statements

(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

Notes to the financial statements

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 2013 or 2012.

(e) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position 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 statement of financial position 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

Notes to the financial statements

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.

Notes to the financial statements

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.

Notes to the financial statements

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.

Notes to the financial statements

(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 tax is provided using the statement of financial position 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 Statement of financial position date are disclosed in the subsequent events note.

(o) Subsequent Events

The effects of events which occurred between the statement of financial position 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 Statement of financial position date.

Where significant events occur subsequent to the statement of financial position date prior to authorising the financial statements for issue which are indicative of conditions which arose subsequent to the Statement of financial position 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.

Notes to the financial statements

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 65 million higher/lower.

3/ Additional information to statement of financial position and income statement items

3.1. Interest income

CZKm	2013	2012
Interest income on loans and advances to banks	15	94
Interest income on loans and advances to customers	355	430
Interest on loans granted to the Czech state	331	546
Interest on debt securities	501	631
- held for trading	4	7
- designated at fair value through profit or loss	61	71
- available for sale	259	335
- held to maturity	177	218
Interest income	**1,202**	**1,701**
Interest on amounts due to banks	(338)	(452)
Interest on deposits due to customers	(22)	(31)
Interest on deposits from the Czech state	(159)	(269)
Interest from unwinding discounts on provisions (Note 3.6)	(71)	(74)
Interest expenses	**(590)**	**(826)**
Net interest income	**612**	**875**

Interest income includes CZK 287 million (2012: CZK 408 million) of interest income on impaired financial assets.

3.2. Fee and commission income

CZKm	2013	2012
Fees from financial guarantees	453	553
Credit related fees and commissions	37	36
Fees and commissions from payment transactions	37	46
Fee and commission income	**527**	**635**
Fee and commission expense from trading activities	(4)	(5)
Fee and commission expense	**(4)**	**(5)**
Net fee and commission income	**523**	**630**

Notes to the financial statements

3.3. Gains and losses from financial operations

CZKm	2013	2012
Gains and (losses) on securities	55	199
- available for sale	79	83
- amounts reclassified from other comprehensive income on disposal	79	83
- changes in fair value of securities held for trading	7	18
- changes in fair value of securities designated at fair value through profit or loss	(33)	98
- gain from revaluation of short sales	2	-
Net losses on derivatives held for trading	108	(71)
Net losses on hedging derivatives	33	(147)
Exchange differences (including exchange differences on available for sale and held to maturity debt securities)	(115)	49
Total income and expenses on financial operations	**81**	**30**

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 2013 (2012: CZK 1 million).

3.4. Administrative expenses

CZKm	2013	2012
Wages, salaries and bonuses	(169)	(167)
Social security costs	(49)	(47)
of which: state pension scheme contributions	(34)	(33)
Total personnel expenses	**(218)**	**(214)**
General administrative expenses	(111)	(126)
Total administrative expenses	**(329)**	**(340)**

Wages, salaries and key management compensations:

CZKm	2013	2012
Wages and salaries of the Bank's employees	(110)	(108)
Key management personnel compensation	(43)	(44)
- wages and salaries of the Bank's management	(37)	(37)
- compensations to Board of Directors members	(4)	(4)
- compensations to Supervisory Board members	(1)	(2)
- compensation to Audit Committee members	(1)	(1)
Other employees' expenses	(9)	(9)
Social fund expenditures	(7)	(6)
Total wages, salaries and bonuses	**(169)**	**(167)**

Staff Analysis

	2013	2012
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)	194	195

Notes to the financial statements

Other administrative expenses comprise:

CZKm	2013	2012
General administrative expenses	(69)	(76)
Rental charges	(11)	(11)
Audit, legal, tax and other professional services	(7)	(9)
Depreciation and amortisation	(24)	(30)
Total other administrative expenses	**(111)**	**(126)**

3.5. Increase in loan impairment and write-offs

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

31 December 2013

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Additions/Disposals to loan impairment allowances	(341)	66	(275)
Receivables written-off during the year not fully provided for	(14)	-	(14)
Total increase in loan impairment allowances and write-offs	**(355)**	**66**	**(289)**

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)**

Reconciliation of the allowance account for impairment:

Year ended 31 December 2013

CZKm	Loans to private legal entities and individuals	Loans to municipalities	Total
Balance at 1 January 2013	**1,570**	**212**	**1,782**
Additions/Disposals to impairment allowances	341	(66)	275
Use of the allowances for write-offs	(100)	-	(100)
Balance at 31 December 2013	**1,811**	**146**	**1,957**

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**

Notes to the financial statements

3.6. Provisions for guarantees and other provisions

The balance of provisions for guarantees and other provisions comprises:

CZKm	31 December 2013	31 December 2012
Provisions for guarantees (Note 3.22)	2,302	2,152
Provisions for loan commitments (Note 3.22)	56	53
Other provisions (Note 3.23)	137	137
Total provisions	**2,495**	**2,342**

Reconciliation of the provisions for guarantees and other provisions:

CZKm	2013	2012
Balance at 1 January	2,342	2,219
Increase/(decrease) in provisions for guarantees and loan commitments	82	48
Interest expense from unwinding discounts (Note 3.1)	71	74
Balance at 31 December	**2,495**	**2,342**

3.7. Income taxes

CZKm	2013	2012
Profit before income tax	516	1,049
Theoretical tax calculated at a statutory income tax rate 2013: 19% (2012: 19%)	98	199
Non-taxable income from securities –permanent difference	(6)	(4)
Effect of non-recognized contingent deferred tax asset	76	39
Other permanent items	3	5
Income tax expense as reported in income statement	**173**	**239**
- current	172	218
- deferred	1	21
Income tax paid during the year	214	208
Current income tax assets at 31 December	42	-
Current income tax liabilities at 31 December	-	(10)
Effective tax rate	**34%**	**23%**

Deferred taxation

The recognised deferred tax can be analysed as follows:

CZKm	31 December 2013	31 December 2012
Other provisions	31	32
Deferred tax recognised in other comprehensive income for revaluation of available for sale securities	(46)	(81)
Total deferred tax	**(15)**	**(49)**

CZKm	31 December 2013	31 December 2012
Deferred tax reported in the statement of financial position		
- to be recovered after more than 12 months	26	27
- to be recovered within 12 months	5	5
Deferred tax recognised in other comprehensive income for revaluation of available for sale securities		
- to be recovered within 12 months	(46)	(81)
Total deferred tax	**(15)**	**(49)**

Notes to the financial statements

Potential deferred tax asset of CZK 245m as at 31 December 2013 (2012: CZK 168m) 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	2013	2012
Deferred tax balance at 1 January	(49)	45
Movement through income statement	(1)	(21)
Movement in deferred tax recognised in other comprehensive income for revaluation of available for sale securities	35	(73)
Deferred tax balance at 31 December	**(15)**	**(49)**

The deferred tax is calculated at the statutory income tax rate of 19% (31 December 2012: 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 2013	31 December 2012
Obligatory minimum reserves	400	461
Cash in hand	8	11
Amounts due under reverse repo transactions	63,744	69,801
Total cash in hand and balances with central banks	**64,152**	**70,273**

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

3.9. Loans and advances to banks

CZKm	31 December 2013	31 December 2012
Current accounts with other banks	8	42
Included in cash and cash equivalents (Note 3.21.)	8	42
Other amounts due from banks	132	202
Total loans and advances to banks	**140**	**244**

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 2013	31 December 2012
Government bonds - domestic	271	1,213
Government bonds – foreign	-	51
Securities held for trading	271	1,264
Government bonds - domestic	469	472
Government bonds – foreign	557	706
Bonds issued by Czech financial institutions	380	626
Bonds issued by other Czech entities	121	298
Securities designated at fair value through profit or loss	1,527	2,102
Total securities at fair value through profit or loss	**1,798**	**3,366**

Notes to the financial statements

3.11. Loans and advances to customers

CZKm	31 December 2013	31 December 2012
Loans to private legal entities and individuals	6,036	7,053
Loans to the Ministry of Finance of the Czech Republic and other government entities	9,311	10,468
Loans to municipalities	841	1,069
Unquoted debt securities	-	-
Gross amounts due from customers	**16,188**	**18,590**
Provisions for loans to customers (Note 3.5)	(1,957)	(1,776)
Net amounts due from customers	**14,231**	**16,814**

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.

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 2013		31 December 2012	
	Assets	Liabilities	Assets	Liabilities
	CZKm	CZKm	CZKm	CZKm
CZK – principal	4,114	4,114	4,883	4,883
CZK - accrued interest	1	1	1	1
EUR – principal	5,128	5,128	5,511	5,511
EUR – accrued interest	68	68	73	73
Total	**9,311**	**9,311**	**10,468**	**10,468**

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. Financial assets available for sale

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

CZKm	31 December 2013	31 December 2012
Fixed income debt securities	4,447	8,027
Variable yield debt securities	7,790	7,296
Total debt securities available for sale	**12,237**	**15,323**

All AFS securities as at 31 December 2013 and 2012 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 5,650 million (2012: CZK 1,074 million) 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 statement of financial position as the borrower possessing the collateral has the right to re-pledge it or sell, however also has an obligation to return it.

Notes to the financial statements

AFS securities have been issued by the following issuers:

CZKm	31 December 2013	31 December 2012
- Czech state institutions	9,730	13,099
- Czech financial institutions	2,132	1,924
- Other Czech entities	58	56
- Foreign state institutions	68	69
- Foreign financial institutions	249	175
Total debt securities available for sale	**12,237**	**15,323**

3.13. Financial assets held to maturity

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

CZKm	31 December 2013	31 December 2012
Czech state institutions	5,020	5,369
Total debt securities held to maturity	**5,020**	**5,369**

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

HTM securities of CZK 1,110 million (2012: CZK 52 million) 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 statement of financial position 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 2013	31 December 2012
Financial assets		
Accrued income	54	59
Non-financial assets		
Prepaid expenses	9	10
Other	21	20
Total other assets, gross	84	89
Impairment provisions (Note 3.5)	(7)	(6)
Total other assets, net	**77**	**83**

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 million 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 2013 and 2012.

Shareholders' structure	31 December 2013	31 December 2012
ČMZRB	49%	49%
Ministry of Finance	49%	49%
Association of Czech Municipalities	2%	2%

Notes to the financial statements

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 2013 and for the year then ended	215	105	216	3	1
At 31 December 2012 and for the year then ended	212	104	214	11	5

3.16. Property, plant and equipmen

CZKm	Land	Buildings	Equipment and fittings	Total
At 1 January 2012				
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
Year ended 31 December 2013				
Opening net book value	10	131	6	147
Additions	-	-	4	4
Disposals	-	-	-	-
Depreciation charge	-	(10)	(3)	(13)
Closing net book value	10	121	7	138
At 31 December 2013				
Acquisition cost	10	304	123	437
Accumulated depreciation	-	(183)	(116)	299
Net book value	**10**	**121**	**7**	**138**

Notes to the financial statements

3.17. Deposits from bank

CZKm	31 December 2013	31 December 2012
Due to other banks	13,863	13,901
Received term deposits from other banks	2,035	1,438
Amounts due to banks	**15,898**	**15,339**

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 11,826 million at 31 December 2013 (31 December 2012: CZK 12,982 million), majority of which represents a funding for infrastructure loans described in Note 3.11.

3.18. Deposits from customers

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

CZKm	31 December 2013	31 December 2012
Current accounts	5,371	5,477
Term deposits	8,784	13,985
Repo operations with the Ministry of Finance	56,582	64,245
Guarantee deposits	559	33
Other payables to clients	2,220	3,228
Total	**73,516**	**86,968**

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

CZKm	31 December 2013	31 December 2012
Amounts due to state institutions	69,990	81,808
Amounts due to municipalities	62	49
Amounts due to other customers	3,464	5,111
Total amounts due to customers	**73,516**	**86,968**

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 2013	31 December 2012
Funding from the providers of the individual support programmes not yet returned	2,720	3,192
Funds deposited by the programme partners to cover risks attached to providing the financial guarantees	2,557	2,680

3.19. Other liabilities

CZKm	31 December 2013	31 December 2012
Payable to employees	45	47
Deferred income	1,100	1,382
- financial guarantees premium deferred income	1,071	1,351
- other deferred income	29	31
Accrued expenses (financial liability)	28	31
Amount payable to Ministry for Regional Development in respect to intermediation of the support programme (financial liability)	210	222
Other	32	35
Total accruals and other liabilities	**1,415**	**1,717**

Notes to the financial statements

3.20. Equity and profit allocation

Share capital

	31 December 2013	31 December 2012
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. All issued shares are fully paid .

The Bank's shareholders as of 31 December 2013 and 2012 are set out below:

	2013	2012
Shareholder	**%**	**%**
Czech Republic represented by:		
Ministry of Industry and Trade	24.25	24.25
Ministry for Regional Development	24.25	24.25
Ministry of Finance	23.83	23.83
Czech state total shareholding	72.33	72.33
Českomoravská záruční a rozvojová banka, a.s.*	27.67	27.67
Total	**100.00**	**100.00**

* Each shareholder has one vote on the grounds of the Bank Statute. ČMZRB holding its own shares does not have any voting right.

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.

Profit Allocation

The statutory net profit of the Bank as recognized in accordance with Czech accounting standards for the year ended 31 December 2013 is proposed to be allocated and net profit for 2012 of the Bank was allocated as follows:

CZKm	2013	2012
Allocated to retained earnings	13	110
Dividends payable/paid	330	700
Net profit per statutory financial statements	**343**	**810**

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 2012 net profit in the total amount of CZK 700 million were paid on 14 Jun 2013 with amount per one share CZK 108,746. The shares held by ČMZRB, a.s. pay no dividend.

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.

Notes to the financial statements

Retained earnings and statutory and other reserves

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

3.21. Cash and cash equivalents

CZKm	31 December 2013	31 December 2012
Cash and balances with central banks (Note 3.8.)	64,152	70,273
Loans and advances to banks (Note 3.9.)	8	42
Total	**64,160**	**70,315**

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 2013	31 December 2012
Total issued financial guarantees	18,129	19,039
Loan commitments issued to clients	1,219	1,905
Total financial guarantees and loan commitments	**19,348**	**20,944**

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 statement of financial position, 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 53,429 million at 31 December 2013 (2012: CZK 64,324 million).

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 million. 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 million as a result of the plaintiff withdrawing the claim for compensation of CZK 100 million. 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.

Notes to the financial statements

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,;
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 period-end 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 2013	31 December 2012
Assets	**25,473**	**31,719**
Czech state	24,322	30,248
Associates	-	-
Key management	1	1
Other related parties	1,150	1,470
Liabilities	**70,154**	**81,920**
Czech state	69,580	72,787
Associates	154	99
Key management	10	13
Other related parties	410	9,021
Revenues	**962**	**1,296**
Czech state	816	1,139
Associates	-	2
Key management	-	-
Other related parties	146	155
Expenses	**122**	**230**
Czech state	12	45
Associates	1	-
Key management	43	44
Other related parties	66	141
Collaterals provided under repo transactions and other off-balance sheet assets in the normal course of business	**56,575**	**65,199**
Czech state	56,575	64,269
Other related parties	-	930
Collaterals received under reverse repo transactions and other off-balance sheet liabilities in the normal course of business	**1,731**	**836**
Czech state	748	829
Other related parties	983	7

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 million (2012: 77 million).

Notes to the financial statements

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 2013 and 2012.

	31 December 2013	31 December 2012
Assets		
Amounts due from banks	0.04%	1.52%
Loans to customers	3.08%	4.66%
Available for sale securities	1.99%	2,33%
Securities at fair value through profit or loss	4.16%	4.18%
Securities held to maturity	4.16%	3.71%
Liabilities		
Amounts due to banks	0.00%	0.91%
Amounts due to customers	0.83%	0.90%
Repo operations with the Ministry of Finance	0.04%	0.39%

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;

Notes to the financial statements

- 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.

Notes to the financial statements

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 case 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.

Notes to the financial statements

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 2013

CZKm Classes of financial assets	Risk category 4, 5	6	7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	123	1,143	169	24	-	-	27	1,486
Loans to Czech government entities	9,311	-	-	-	-	-	-	9,311
Loans to municipalities	180	-	-	-	-	-	-	180
Total	**9,434**	**1,323**	**169**	**24**	**-**	**-**	**27**	**10,977**

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**

Analysis of financial assets that are individually determined to be impaired

31 December 2013

CZKm Classes of financial assets	Risk category 7	8	9	10	Not specified	Total
Loans to private legal entities and individuals	1,843	583	576	984	564	4,550
Loans to municipalities	565	62	34	-	-	661
Total	**2,408**	**645**	**610**	**984**	**564**	**5,211**

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**

Notes to the financial statements

Analysis by regulatory rating

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

CZKm	Internal rating	31 December 2013	31 December 2012
Standard	4 – 6	10,737	12,422
Watch	7	2,621	3,402
Substandard	8	672	787
Doubtful	9	610	450
Loss	10	1,548	1,529
Total		**16,188**	**18,590**
Impairment provision for loans to customers (Note 3.5)		(1,957)	(1,776)
Net amounts due from customers		**14,231**	**16,814**

Analysis of provisions by risk category

CZKm		31 December 2013		31 December 2012	
Risk category		Type of provision		Type of provision	
		Individual	Portfolio	Individual	Portfolio
4 – 6	Standard	-	62	-	87
7	Watch	314	42	427	57
8	Sub-standard	187	-	234	-
9	Doubtful	371	-	262	-
10	Loss	981	-	709	-
Total		**1,853**	**104**	**1,632**	**144**
Total provisions			**1,957**		**1,776**

Analysis by collateral

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

CZKm	31 December 2013	31 December 2012
Bank guarantees and collateral by reliable guarantors	715	746
Cash collateral	18	33
Real estate collateral	2,185	2,273
Other loan collateral	58	57
Uncollateralised	13,212	15,481
Total	**16,188**	**18,590**
Impairment provision for loans to customers (Note 3.5)	(1,957)	(1,776)
Net amounts due from customers	**14,231**	**16,814**

Renegotiated loans to customers

CZKm	31 December 2013	31 December 2012
Loans to private legal entities and individuals	429	252

Notes to the financial statements

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

31 December 2013

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

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 2013

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

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**	**-**	**-**

ab) Quality of guarantees portfolio

31 December 2013 in CZKm

	Risk classification								
Programmes	**5**	**6**	**7**	**8**	**X9[1)]**	**9**	**10**	**No risk category***	**Total**
Guarantees for small and medium sized enterprises provided until 2006	8	49	147	100	77	25	144	-	550
PANEL small portfolio guarantees	-	60	132	12	11	-	-	238	453
PANEL individual investment guarantees	-	1,015	3,847	496	149	3	-	17	5,527
Other previously provided guarantees	-	-	-	-	-	-	22	-	22
Vadium	-	1	106	-	-	-	-	-	107
Small portfolio guarantees for businessmen since 2007	9	112	521	190	49	1	1	1,533	2,416
Small portfolio guarantees without external risk enhancement	5	119	431	145	43	-	1	3,321	4,065
Individual investment and operating guarantees for small and medium sized enterprises since 2007	51	227	2,776	741	817	-	272	105	4,989
Total	**73**	**1,583**	**7,960**	**1,684**	**1,146**	**29**	**440**	**5,214**	**18,129**

* Portfolio approach

Notes to the financial statements

31 December 2012 in CZKm

	Risk classification								
Programmes	**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

[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 2013

CZKm	**AA- to AA+**	**A- to A+**	**Lower than A**	**Total**
Securities at fair value through profit or loss	159	1,639	-	1,798
Securities available for sale	6,531	5,706	-	12,237
Securities held to maturity	-	5,020	-	5,020
Total	**6,690**	**12,365**	**-**	**19,055**

31 December 2012

CZKm	**AA- to AA+**	**A- to A+**	**Lower than A**	**Total**
Securities at fair value through profit or loss	1,451	1,915	-	3,366
Securities available for sale	7,957	7,266	100	15,323
Securities held to maturity	1,394	3,975	-	5,369
Total	**10,802**	**13,156**	**100**	**24,058**

ad) Quality of derivatives portfolio

The derivatives portfolio as at 31 December 2013 and 2012 includes established banking counterparties (with external rating equivalent of AA+ to A).

Notes to the financial statements

b) Geographical concentration of assets

31 December 2013
Assets

CZKm	Czech Republic	European Union	Total
Cash and balances with central banks	64,152	-	64,152
Amounts due from banks	140	-	140
Securities at fair value through profit or loss	1,241	557	1,798
Positive fair values of financial derivative transactions	176	-	176
Loans and advances to customers	14,231	-	14,231
Securities available for sale	11,920	317	12,237
Securities held to maturity	5,020	-	5,020
Other financial assets	54	-	54
Total financial assets	**96,934**	**874**	**97,808**
Non-financial assets	**339**	**-**	**339**
Total	97,273	874	98,147

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**

c) The Bank's maximum credit risk exposure

31 December 2013 in CZKm

		Total exposure		**Collateral held**
	Assets	**Financial guarantees and loan commitments**	**Total credit exposure**	
Cash and balances with central banks	64,152	-	64,152	53,429
Amounts due from banks	140	-	140	-
Securities at fair value through profit or loss	1,798	-	1,798	-
Financial derivatives	176	-	176	-
Loans to customers	14,231	-	14,231	2,976
- Loans to private legal entities and individuals	4,225	-	4,225	2,569
- Loans to the Czech government entities	9,311	-	9,311	-
- Loans to municipalities	695	-	695	407
Securities available for sale	12,237	-	12,237	-
Securities held to maturity	5,020	-	5,020	-
Other financial assets	54	-	54	-
Financial guarantees and loan commitments	**-**	**19,349**	**19,349**	**2,557**
Total financial assets	**97,808**	**19,349**	**117,157**	**58,962**
Non-financial assets	**339**			
Total assets	**98,147**			

Notes to the financial statements

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**			

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.

Notes to the financial statements

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

	31 December 2013		31 December 2012	
CZKm	**Notional value asset**	**Notional value liability**	**Notional value asset**	**Notional value liability**
Interest rate swaps	500	500	600	600
Currency and cross - currency swaps	3,340	3,277	3,949	3,983
Total	**3,840**	**3,777**	**4,549**	**4,583**

	31 December 2013		31 December 2012	
CZKm	**Positive fair value**	**Negative fair value**	**Positive fair value**	**Negative fair value**
Interest rate swaps	-	44	-	69
Currency swaps	176	161	61	174
Total	**176**	**205**	**61**	**243**

Notes to the financial statements

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).

	31 December 2013		31 December 2012	
CZKm	**Notional value asset**	**Notional value liability**	**Notional value asset**	**Notional value liability**
Cross currency swaps	276	295	282	319
Total	**276**	**295**	**282**	**319**

	31 December 2013		31 December 2012	
CZKm	**Positive fair value**	**Negative fair value**	**Positive fair value**	**Negative fair value**
Cross currency swaps	-	54	-	87
Total	**-**	**54**	**-**	**87**

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 2013

CZKm	**CZK**	**EUR**	**USD**	**GBP**	**HUF**	**Total**
Cash and balances with central bank	64,152	-	-	-	-	64,152
Amounts due from banks	132	8	-	-	-	140
Securities at fair value through profit or loss	626	792	380	-	-	1,798
Financial derivatives	176	-	-	-	-	176
Loans to customers, net	9,035	5,196	-	-	-	14,231
Securities available for sale	12,179	58	-	-	-	12,237
Securities held to maturity	5,020	-	-	-	-	5,020
Other financial assets	54	-	-	-	-	54
Total financial assets	**91,374**	**6,054**	**380**	**-**	**-**	**97,808**
Non-financial assets	**339**	**-**	**-**	**-**	**-**	**339**
Total assets	**91,713**	**6,054**	**380**	**-**	**-**	**98,147**
Amounts due to banks	8,128	7,770	-	-	-	15,898
Amounts due to customers	73,485	31	-	-	-	73,516
Financial derivatives	259	-	-	-	-	259
Other financial liabilities	238	-	-	-	-	238
Total financial liabilities	**82,110**	**7,801**	**-**	**-**	**-**	**89,911**
Non-financial liabilities and equity	**8,236**	**-**	**-**	**-**	**-**	**8,236**
Total liabilities and equity	**90,346**	**7,801**	**-**	**-**	**-**	**98,147**
Statement of financial position position, net	1,367	(1,747)	380	-	-	0
Off-balance sheet derivatives notional position, net	-	1,794	(358)	-	-	-
Net position	**1,367**	**47**	**22**	**-**	**-**	**-**

Notes to the financial statements

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**
Statement of financial position 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**	**-**

Foreign exchange rates sensitivity analysis

Set out below is a sensitivity analysis to foreign currency risk. The statement of financial position 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 statement of financial position 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 2013 or 2012 as EUR was the only significant currency in which the Bank had open position as at that date (for open position amounts see above).

	2013 CZKm	2012 CZKm
Sensitivity to changes in EUR rates		
Expected rate fluctuation, %	10%	10%
Open position	47	33
Effect on profit and loss	(1)	(2)
Effect on equity	6	6

Notes to the financial statements

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.

31 December 2013

	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	64,144	-	-	-	8	64,152
Amounts due from banks	139	-	-	-	1	140
Securities at fair value through profit or loss	5	495	500	798	-	1,798
Financial derivatives	-	-	-	-	176	176
Loans to customers, net	1,245	1,438	7,870	2,505	1,173	14,231
Securities available for sale	364	1,441	3,992	6,440	-	12,237
Securities held to maturity	-	-	2,644	2,376	-	5,020
Other financial assets	-	-	-	-	54	54
Total financial assets	**65,897**	**3,374**	**15,006**	**12,119**	**1,412**	**97,808**
Non-financial assets	**-**	**-**	**-**	**-**	**339**	**339**
Total	**65,897**	**3,374**	**15,006**	**12,119**	**1,751**	**98,147**
Amounts due to banks	5,384	1,210	7,042	2,247	15	15,898
Amounts due to customers	69,762	138	-	-	3,616	73,516
Financial derivatives	-	-	-	-	259	259
Other financial liabilities	-	-	-	-	238	238
Total financial liabilities	**75,146**	**1,348**	**7,042**	**2,247**	**4,128**	**89,911**
Non-financial liabilities and equity	**-**	**-**	**-**	**-**	**8,236**	**8,236**
Total	**75,146**	**1,348**	**7,042**	**2,247**	**12,364**	**98,147**
Net interest position	**(9,249)**	**2,026**	**7,964**	**9,872**	**(10,613)**	**-**

Notes to the financial statements

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	15,33
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)**	**-**

Interest rate sensitivity analysis

Statement of financial position 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.

Statement of financial position item	31 December 2013 Sensitivity/Impact	31 December 2012 Sensitivity/Impact	Comment
Assets			
Loans to customers	(220)	(310)	
Loans to banks	(18)	(29)	
Held to maturity securities	-	-	Only fixed interest rates securities in the portfolio
Available for sale securities	(8)	(121)	Impact on equity reserve
Available for sale securities	(5)	(134)	Impact on profit and loss
Financial derivatives	(243)	(299)	
Liabilities			
Due to banks	750	932	
Due to customers	2	64	
Financial derivatives	245	315	

Notes to the financial statements

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 period-end 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.

31 December 2013

	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Maturity undefined	Total
	CZKm	CZKm	CZKm	CZKm	CZKm	CZKm
Cash and balances with central bank	64,151	-	-	-	1	64,152
Amounts due from banks	8	-	-	-	132	140
Securities at fair value through profit or loss	5	495	500	798	-	1,798
Financial derivatives	110	42	-	24	-	176
Loans to customers, net	1,786	1,653	8,596	2,196	-	14,231
Securities available for sale	364	1,441	3,992	6,440	-	12,237
Securities held to maturity	-	-	2,644	2,376	-	5,020
Other financial assets	43	-	-	-	11	54
Total financial assets	**66,467**	**3,631**	**15,732**	**11,834**	**144**	**97,808**
Non-financial assets	**11**	**5**	**-**	**-**	**323**	**339**
Total	**66,478**	**3,636**	**15,732**	**11,834**	**467**	**98,147**
Amounts due to banks	4,935	1,210	7,047	2,706	-	15,898
Amounts due to customers	70,627	697	1	2,191	-	73,516
Financial derivatives	4	55	72	128	-	259
Other financial liabilities	1	-	-	-	237	238
Total financial liabilities	**75,567**	**1,962**	**7,120**	**5,025**	**237**	**89,911**
Non-financial liabilities and equity	**208**	**668**	**918**	**1,838**	**4,604**	**8,236**
Total	**75,775**	**2,630**	**8,038**	**6,863**	**4,841**	**98,147**
Net liquidity exposure	**(9,297)**	**1,006**	**7,694**	**4,971**	**(4,374)**	**-**

Notes to the financial statements

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**	**2,025**	**5,154**	**8,920**
Total	**81,064**	**7,671**	**8,530**	**9,139**	**5,406**	**111,810**
Net liquidity exposure	**(7,048)**	**(1,450)**	**10,484**	**2,915**	**(4,901)**	**-**

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 2013

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Amounts due to banks	5,001	1,729	8,931	3,038	18,699
Amounts due to customers	72,820	139	15	544	73,518

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

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 period-end date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted net cash flows.

31 December 2013

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Interest rate swaps	1	(12)	(28)	(6)	(45)

Notes to the financial statements

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)

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 period-end date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

4.6. Operational risk

31 December 2013

CZKm	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Total
Cross-currency swaps:					
Cash inflows	115	788	1,994	1,003	3,900
Cash outflows	106	851	2,004	973	3,934

31 December 2012

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

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.

Notes to the financial statements

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.

Notes to the financial statements

CZKm	31 December 2013	31 December 2012
Tier 1 capital		
Share capital	2,132	2,132
Less: Own treasure shares	(1,894)	(1,894)
Statutory and other reserves	1,150	1,150
Retained earnings (without profit for the current year, statutory non-consolidated)	2,519	2,414
Less: intangible assets	(31)	(26)
Total qualifying Tier 1 capital	**3,876**	**3,776**
Total regulatory capital	**3,876**	**3,776**
Total capital requirements	**1,935**	**2,098**
Capital adequacy ratio	**16,03%**	**14,40%**

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.

(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.

Notes to the financial statements

(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 period-end date. The fair value of term deposits at variable interest rates approximates their carrying values as of the period-end 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 statement of financial position at their fair value:

CZKm	31 December 2013 Carrying value	31 December 2013 Fair value	31 December 2013 Carrying value	31 December 2013 Fair value
Financial assets				
Cash and balances with central banks	64,152	64,152	70,273	70,273
Loan and advances to banks	140	140	244	242
Loans to customers	14,231	13,062	16,814	15,655
- Loans to private legal entities and individuals	4,225	3,913	5,489	5,186
- Loans to the Czech government entities	9,311	9,311	10,468	9,674
- Loans to municipalities	695	630	857	795
Securities held to maturity	5,020	5,350	5,369	5,901
Other financial assets	54	54	59	59
Financial liabilities				
Amounts due to banks	15,898	14,891	15,339	14,380
Amounts due to customers	73,516	73,454	86,968	86,926
Other financial liabilities	238	238	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.

Notes to the financial statements

31 December 2013	**Level 1**	**Level 2**
Financial assets at fair value through profit and loss		
Financial assets held for trading		
- Debt securities	271	-
- Derivatives	-	176
Debt securities designated at fair value	1,527	-
Available-for-sale debt securities:	12,237	-
Total assets at fair value	**14,035**	**176**
Financial liabilities at fair value through profit and loss		
- Derivatives held for trading	-	205
Hedging derivatives	-	54
Total liabilities at fair value	**-**	**259**

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**

6/ Subsequent events

No significant events having a material impact on the financial statements of the Bank for the year ended 31 December 2013 occurred subsequent to the period-end 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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