IOR

Istituto per le Opere di Religione

Annual Report 2012

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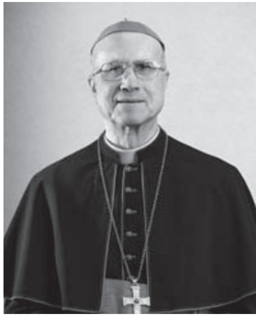
1. Introduction by the Cardinals' Commission



Cardinal Tarcisio Bertone

Cardinal Telesphore Placidus Toppo

Cardinal Odilo Pedro Scherer

Cardinal Jean-Louis Tauran

Cardinal Domenico Calcagno

"The Cardinals' Commission welcomes the publication of the first Annual Report of the Istituto per le Opere di Religione (IOR). Since the first Vatican City State law on anti-money laundering (AML) came into force on 1 April 2011, the IOR has embarked on a course of reform, of which transparency is a key element. The reform process led to the appointment of the Pontifical Commission by the Holy Father on 24 June 2013, and will result in giving the IOR a new direction, as was done in 1942 and in 1990. It is important to remember that the IOR's reason for existing is to serve the Catholic Church, in particular its works of charity and its missionary activities, by safeguarding assets and providing payment services.

We would like to thank all those at the IOR who have continued in 2012 to serve the Catholic Church in its good works around the world."

Tarcisio Card. Bertone

S.D.B., Secretary of State, President of the Cardinals' Commission

2. Introduction by the Prelate

Msgr. Battista Mario Salvatore Ricca

"On 15 June 2013, the Pope appointed me Prelate of the Institute for the Works of Religion ad interim. As established in the statutes, I have worked alongside the Oversight Commission and the Supervisory Council, and have had many conversations with the staff and executives of the IOR. In this time of change and reform, those working at the IOR spend every day in utmost dedication to their task, moved by the strong conviction of helping the church and the transformation that is taking place at the Vatican City State.

I would like to take this opportunity to sincerely and warmly thank all those who have worked alongside me, offering their points of view, and giving me valuable suggestions."

Prelate

3. Introduction by the President

Dear readers,
In 2012, the IOR commemorated 125 years of history since the creation of its predecessor, the "Commissione ad Pias Causas", by Pope Leon XIII in 1887. It is an honour to publish, for the first time, the Annual Report of the IOR.

The Financial Statements of the IOR for the year ended 31 December 2010 and 2011 have been prepared under IFRS and have been audited by Deloitte & Touche S.p.A. as instructed by the Board of Superintendence. The Financial Statements of the IOR for the year ended 31 December 2012 have been prepared according to IFRS and audited by KPMG AG as instructed by the Board of Superintendence.

This Annual Report explains our mission, our activities, our corporate governance and our ongoing reform program. We also touch on the most important developments at the IOR in 2013, from January to August this year.

The Annual Report seeks to contribute to the transparency which the Catholic Church, our customers, our correspondent banks, our authorities and the public rightfully expect.

The IOR forms part of the Holy See. We serve the global mission of the Catholic Church by safeguarding part of the patrimony of the Holy See, religious orders, and other organisations, large and small, within the global family of the Catholic Church.

First and foremost, we are tasked with protecting the assets our clients entrust to us. We manage this patrimony predominantly by acquiring and holding fixed-income securities or placing funds in money market accounts. In addition, we provide our customers with payment services. However, we do not serve business customers, and we do not provide loans out of our deposit base, and barely offer loans at all. We also do not engage in financial transactions such as hedges or swaps with our clients.

2012 was a successful year for the IOR and for our clients.

The IOR posted earnings of EUR 86.6 m, which allowed us to contribute EUR 54.7 m towards the budget of the Holy See, while transferring EUR 31.9 m to our general operating risk reserves.

And we are conservative: in 2012 we had a balance sheet total of EUR 5 bn in assets, with equity of EUR 769 m. On an operating level, we stand on very solid foundations.

Ernst von Freyberg

Over the past three years, and most recently in August 2013, the Vatican City State has continuously strengthened its laws and the regulatory framework under which we operate. We are committed to complying with these laws. Our activities are supervised and regulated by the Vatican City State's financial regulator, the Autorità di Informazione Finanziaria (AIF).

To serve the Catholic Church around the world, the Institute needs to be a well-respected member of the global financial community.

Since the Holy See / Vatican City State legislation on Anti-Money Laundering came into force on 1 April 2011, the IOR has been engaged in a process of far-reaching reform. Pope Benedict XVI. initiated this reform and laid the groundwork, and Pope Francis accelerated the process in 2013, culminating in the creation of the Pontifical Commission on 24 June 2013, which will make proposals on the future direction of the IOR. At the IOR, we are working hard on our part of the reform process: improving organisation, compliance and transparency.

Very clearly what we do and who we are: a small, conservatively managed financial institution of the Catholic Church that serves those spreading the Word of God around the world.

We are proud to support their work.

President of the Board of Superintendence

4. Mission, services, and customers

Mission

The “Istituto per le Opere di Religione” (IOR) is an institute of the Holy See, founded on 27 June 1942 by Papal Decree, and set the task of serving the Holy See and the Catholic Church all over the world. Its origins date back to the “Commissione ad Pias Causas” established in 1887 by Pope Leo XIII.

The IOR’s purpose is set out in its Statutes, amended by Pope John Paul II in 1990, and related by-laws. It is “to provide for the custody and administration of goods transferred or entrusted to the Institute by physical or juridical persons, designated for religious works or charity. The Institute can accept deposits of assets from entities or persons of the Holy See and of the Vatican City State.”

The IOR strives to serve the global mission of the Catholic Church by protecting and growing the patrimony of and providing payment services to the Holy See and related entities, religious orders, other Catholic institutions, clergy, employees of the Holy See and the accredited diplomatic corps.

The IOR is situated exclusively on the sovereign territory of the Vatican City State. The IOR is supervised and regulated by the “Autorità di Informazione Finanziaria” (AIF), the financial and regulatory body for the Vatican City State and the Holy See.

Services

The IOR serves the global mission of the Catholic Church by safeguarding assets. It offers deposit taking, asset management, custodial functions and international payment transfers through correspondent banks, and holds salary and pension accounts of employees of the Holy See and Vatican City State.

It protects its customers’deposits and assets by investing predominantly in fixed interest securities, government bonds and money market accounts. Less than five percent of total assets are held in externally managed funds and equities.

In only very few, exceptional cases the IOR lends money. The IOR does not issue, underwrite or place securities.

According to the requirements of Vatican City State Law and international inter-bank payment systems, IOR accounts are held in the name of the respective customer. There are no anonymous accounts. Customers are provided with services in our office in the Vatican City State. We do not have other locations and do not offer any internet-based services.

Customers

As of the end of 2012, the IOR had approximately 18,900 customers, of which the vast majority, measured by assets under management, were institutional. The IOR's customers have one common denominator: they are part of and serve the Catholic Church.

In line with our Statutes, the IOR provides services only to legal and natural persons with an affiliation to the Catholic Church as defined by Canonical or Vatican City State Law.

The most important group by assets are religious orders, which accounted for half of our customers in 2012, followed by Holy See Offices and nunciatures (15 %), cardinals, bishops and clergy (13 %), dioceses (9 %), and the rest split between various others, including employees and institutes of religious education.

The IOR does not accept individuals without a relationship to the Holy See as customers, nor does it accept business customers.

In many cases our customers are active in the mission or perform charitable works at institutions such as schools, hospitals or refugee camps. Other customers serve, or are part of, the institutional aspect of the Catholic Church, such as dioceses, the Clergy or Vatican City State employees.

Last but not least we serve two sovereign customers, both having the Holy Father as their head of State: The Holy See is the supreme institution of the Catholic Church and maintains diplomatic relations with 192 states and more than 20 supranational organisations. The Vatican City State, meanwhile, serves as the seat of the Holy See and a number of central institutions of the Catholic Church.

It is in the nature of the Catholic Church that its institutions, missionary activities and charitable works reach out into parts of the world that are remote, and have very basic infrastructure, often including an underdeveloped banking and payments system. For these customers, the IOR is particularly important as a trusted, reliable and effective institution, keeping funds safe for future use or sending funds through correspondent banks to the countries in which they operate.

Our customers are frequently present in different countries, using different local currencies. Here, too, the IOR can help safely transfer funds from one part of the world to another.

Our customers tell us that this trusted relationship is very valuable to them, especially in times of political upheaval and financial instability. Our customers also know that their money is invested responsibly and ethically.

A typical client would be a congregation which operates in a developing country teaching children, providing health care or serving in a missionary capacity. To carry out this work, they rely on funding from other parts of the world – money that goes towards building churches, new schools, digging wells, or paying the salaries of local employees, for example.

The IOR serves the congregation by transferring these funds in a cost-effective and secure way, taking care of any necessary currency transactions, and guaranteeing compliance with anti-money laundering rules, embargo lists, and the like. Since the IOR does not have branches abroad, it relies on trusted correspondent banks around the world to transfer the funds on the client's behalf.

The congregation will thus hold an account at the IOR in the Vatican City State where funds are collected for transfer, securely held and conservatively managed until the day the funds are required. In many cases, our customers have held their account for many decades, and enjoy a relationship with the IOR based on many years of trust and experience.

5. 2012 – Review

Macro-economic environment

The IOR's economic performance as well as that of the portfolios which we managed for our customers were driven above all by the development of interest rates in the Eurozone. During 2012, interest rates fell across the Eurozone, as illustrated below.

Italian five-year government bonds:

01/02/2012 – 12/31/2012

GTITL5YR Corp – Last Price 3.292 -.000
Source: Bloomberg

German five-year government bonds:

01/02/2012 – 12/31/2012

GTDEM5Y Corp – Last Price 0.292 -.004
Source: Bloomberg

EURIBOR – three-month

01/02/2012 – 12/31/2012

EUR003M Index – Last Price 0.187 +.001
Source: Bloomberg

This interest rate environment helped us in two ways: we benefited from relatively high interest income on our existing portfolio, in particular during the early part of the year, and we subsequently benefited from the rise in the market value of the interest-bearing securities we held.

During 2012, the IOR invested mainly in bonds. The Treasury Department overweighted government bonds and underweighted bonds issued by financial institutions.

Customers

On 31 December 2012, the IOR had approximately 18,900 customers (2011: approx. 21,000) The decline was due mostly to the IOR closing inactive accounts.

Our Customers not only deposit funds with us but also ask us to manage portfolios of assets on their behalf or act as custodians. As of 31 December 2012 the net value of assets held in managed portfolios was EUR 3.2 bn (2011: EUR 2.7 bn), and the net value in assets held in non managed portfolios was EUR 3.1 bn (2011: EUR 3.3 bn). Part of these asses were carried on our balance sheet, part were held in custody.

Income Statement and Net Profit for the Year

For the year 2012, the IOR's Net Profit was EUR 86.6 m (2011: EUR 20.3 m). This increase in net profit was mainly due to favourable trading results and higher bonds values, resulting from the general decrease of interest rates in the financial markets throughout the year. A brief analysis of the Income Statement major captions is presented below.

The Net Interest Result fell 19.6 % to EUR 52.2 m in 2012, from EUR 64.9 m in 2011, driven both by a decrease in the yield on bank deposits and investments, and an increase in interest paid to clients. The average yield on bank deposits and investments in securities (mainly bonds) and money markets fell to 2.06 % in 2012, from 2.37 % in 2011, while the average rate on client deposits increased to 0.99 % in 2012, from 0.83 % in 2011.

Consequently, the spread between the average rate received on assets and the average rate paid on liabilities fell to 1.07 % from 1.54 %. The Institute sought to mitigate the decline in interest margins by consolidating short-term funds and investing for longer periods at higher rates, while maintaining sufficient liquidity to meet all of its obligations.

Net Fees and Commissions Result increased 19.6 % to EUR 12.2 m in 2012, from EUR 10.2 m in 2011. The commissions received increased 7.1 %, to EUR 15.1 m in 2012, from EUR 14.1 m in 2011, while commissions paid fell 25.6 % to EUR 2.9 m in 2012, from EUR 3.9 m in 2011. The most important part of the revenue was commissions from asset management, which rose 4.8 % to EUR 11 m in 2012, from EUR 10.5 m in 2011. This was due to the growth of assets managed by the Institute in 2012.

Conversely, the decline in commissions paid was mainly due to the decrease of commissions paid for securities transactions to EUR 1.3 m in 2012, from EUR 2.6 m in 2011, due to fewer transactions.

Net Trading Income recorded a net gain of EUR 51.1 m in 2012, compared to a net loss of EUR 38.2 m in 2011. This reflects both the trading results on securities during the year, as well as the gains / losses on year-end balances of the securities portfolio. In both cases, bonds were the major contributors to the gains recorded in 2012. The general market decline in mid and long-term interest rates throughout the year was the main reason for this positive result.

Operating Expenses were EUR 23.9 m in 2012 (2011: EUR 21 m). This includes staff expenses of EUR 11.5 m in 2012 (2011: EUR 10.3 m). On 31 December 2012, the IOR employed 114 personnel (2011: 106). The IOR provides for the pensions of its employees as they are not fully covered by the Vatican City State pension fund. As a result, personnel costs include contributions to the IOR pension fund of EUR 3.8 m (2011: EUR 3.7 m).

Other **Operating Expenses** increased 20.4 % to EUR 11.8 m (2011: EUR 9.8 m). This increase was due to legal fees as well as expenses related to the maintenance of the IOR's office buildings.

The IOR used the **Net Profit** of EUR 86.6 m to transfer EUR 31.9 m to the general operating risk reserve and transferred EUR 54.7 m for the use of the Holy See. The original proposal was for a contribution of EUR 53 m, and a transfer of EUR 33.6 m to the risk reserves.

Balance Sheet

As of 31 December 2012, the IOR's balance sheet total was EUR 4.98 bn (2011: EUR 4.07 bn), with equity funds standing at EUR 769 m (2011: EUR 741 m). The equity ratio of 15.4 % (not risk-weighted) significantly exceeds international standards and provides a strong safety cushion for our customers.

The liability side of our balance sheet is made up in essence of customer deposits. Our customers require us to invest the funds entrusted to us safely and to ensure that these funds are readily available for their needs. As a result, we invest our balance sheet predominantly in interest-bearing securities, and with banks. Our investment in the equity markets or financial instruments is negligible; the same is true for our loan book. We do not borrow in the inter-banking market and we do not issue debt securities.

On the Liabilities side, **Depositors' Accounts** was the most significant item, representing 97.3 % of the Liabilities (other than Equity) and amounting to EUR 4.1 bn, an increase of 27.3 % from EUR 3.2 bn in 2011. The major source for the increase was the liquidity deposited from the asset management activity.

The asset side of the balance sheet consists of bank deposits and securities.

Bank Deposits (cash, cash equivalents and term deposits) totalled EUR 1.2 bn in 2012 (2011: EUR 1.4 bn) and consisted of EUR 268.5 m due from banks on demand (2011: EUR 222.3 m), and EUR 922.4 m in time deposits and money market investments (2011: EUR 1.18 bn). As per IOR policy, the time deposits cannot exceed one year. During 2012, the IOR increased purchases of securities instead of investing in time deposits, in response to lower interest rates offered by banks.

The IOR held **Securities** (bonds, equities and externally managed funds) totalling EUR 3.6 bn in 2012 (2011: EUR 2.5 bn). Bonds, at EUR 3.3 bn, were the most significant investments, representing 92 % of the securities held as of December 31, 2012, while equities represented 2.6 %, and external funds 5.4 %.

Key features of the assets in our balance sheet as of 31 December 2012 were as follows:

ASSET CLASS		
	Amount 31 December 2012	
	EUR 000	%
CASH AND BANK DEPOSITS		
Cash	5,303	
Bank deposits	1,216,245	
	1,221,548	24.50
INVESTMENTS IN SECURITIES –		
TRADING SECURITIES –		
Bonds	2,443,206	
Equities	93,148	
External funds	194,321	
	2,730,675	54.77
EQUITY AVAILABLE FOR SALE		
Equities	9,619	0.19
LOANS AND RECEIVABLE SECURITIES –		
Bonds	252,252*	5.06
SECURITIES HELD TO MATURITY –		
Bonds	626,764	12.57
Other assets	144,898	2.91
Total assets	**4,985,756**	**100.00**

** Bonds deriving from private placements and not quoted in active markets.*

6. Review and Outlook 2013

The Eurozone recession and debt crisis is likely to keep interest rates and bond yields low for the foreseeable future and may mean negative real interest rates. This in turn raises the issue of reinvestment risk: as bonds mature, it is proving harder to find good returns at an acceptable risk, at the maturities that the IOR invests in.

The benchmark EURIBOR rate, which had already begun to decline in the latter part of 2012, has declined further. It stood at 0.218 % on 28 June 2013. As a result, the return on these core investments is likely to be lower than in 2012.

Italian five-year government bonds:

01/02/2013 – 06/30/2013

GTITL5Y Corp – Last Price 3.473 -.010
Source: Bloomberg

German five-year government bonds:

EURIBOR – three-month

2013 was marked by changes in management and an intensification of the reform programme initiated in 2011. We are modernising our management structure and our organisation. Alongside our own work at the IOR, we have engaged external experts to assist us in compliance, in particular in meeting the Moneyval recommendations, as well as experts in communications in developing an appropriate communications function.

In February the position of the President of the Board of Superintendence was filled with the appointment of Ernst von Freyberg. The position had been vacant since the resignation of Professor Ettore Gotti Tedeschi on 24 May 2012, with Ronaldo Hermann Schmitz taking over ad interim.

Mr von Freyberg assumed his new role on 26 February 2013, shortly before the election of Pope Francis on 13 March 2013.

In May 2013, the IOR appointed Promontory Financial Group, a leading worldwide adviser to financial institutions on compliance and regulation, and tasked it with examining all of our customer accounts for full compliance with the laws of the Vatican City State, as well as our own internal policies. Those that do not meet the IOR's standards are being closed down. This process is ongoing.

In parallel, leading international law firm Cleary Gottlieb Steen & Hamilton LLP was appointed to advise on our compliance with international regulatory standards and to review compliance with our internal regulatory framework.

On 15 June 2013, with the approval of the Holy Father the Cardinals' Commission appointed Msgr Battista Mario Salvatore Ricca as Prelate ad interim. The Prelate acts as secretary of the meetings of the Cardinals' Commission and attends the meetings of the Board of Superintendence. The position had previously been vacant.

On 24 June 2013, the Holy Father appointed a Pontifical Commission to the IOR, whose purpose is to gather all relevant information on the Institution's operations and present the results to the Holy Father.

The commission consists of:

- Cardinal Raffaele Farina, President
- Cardinal Jean-Louis Pierre Tauran, Member
- Bishop Juan Ignacio Arrieta Ochoa de Chinchetru, Coordinator
- Monsignor Peter Bryan Wells, Secretary
- Professor Mary Ann Glendon, Member

On 1 July 2013, Commendatore Paolo Cipriani and Dr. Massimo Tulli, General Director and Deputy Director of the IOR respectively, resigned their posts. The Board of Superintendence and the Cardinals' Commission subsequently asked Ernst von Freyberg to assume the functions of the General Director ad interim.

Rolando Marranci was appointed acting Deputy Director on 1 July 2013. Previously, Mr Marranci served as Chief Operating Officer at a leading Italian bank in London.

In July 2013, we strengthened our compliance and risk management by creating a new function at directorate level, and put it under the leadership of Antonio Montaresi, a renowned specialist from the banking industry. Mr Montaresi served as Chief Risk and Chief Compliance Officer at various banks in the US.

At the end of July 2013, the IOR launched its website at http://www.ior.va.

7. Corporate Governance

The IOR's governance structure is defined in the IOR's Statutes of 1990. It consists of five elements: Cardinals' Commission, Prelate, board of superintendence, board of auditors and Directorate.

In 2012, the governance structure was as follows:

Cardinals' Commission, appointed by Papal Decree for a period of five years.

Cardinal Tarcisio Bertone
S.D.B., Secretary of State
(President of the Commission)

Cardinal Jean-Louis Tauran
President of the Pontifical Council for Interreligious Dialogue

Cardinal Odilo Pedro Scherer
Archbishop of Sao Paulo (Brazil)

Cardinal Telesphore Placidus Toppo
Archbishop of Ranchi (India)

Cardinal Attilio Nicora
Emeritus President of the Administration of the Patrimony of the Apostolic See (APSA),
President of the Autorità di Informazione Finanziaria (AIF)
(Until 16 February 2013)

The Cardinals' Commission meets at least twice a year to review financial statements, which are externally audited under International Financial Reporting Standards (IFRS). It reviews reports on major business processes and strategy presented by the President of the Board of Superintendence. It also oversees adherence to statutory norms and appoints the members of the Board of Superintendence.
The current mandate of the members of the Cardinals' Commission expires in February 2018.

Prelate appointed by the Cardinals' Commission.

- Position vacant during 2012

The Prelate acts as secretary of the meetings of the Cardinals' Commission and attends the meetings of the Board of Superintendence.

Board of Superintendence of five appointed members nominated for five years.

Ronaldo Hermann Schmitz
Vice-President,
then President ad interim
(From 24 May 2012)

Carl A. Anderson
non-executive member

Antonio Maria Marocco
non-executive member

Manuel Soto Serrano
non-executive member

Ettore Gotti Tedeschi
President *(Until 24 May 2012)*

The Board of Superintendence meets up to six times a year. It defines strategy and ensures oversight of operations. The mandate of the members of the Board of Superintendence expires in December 2015.

In addition, The **Board of Auditors** reports to the Board of Superintendence. It is responsible for the internal audit of the IOR's books.

The total remuneration of the Cardinals' Commission, Board of Superintendence, and Directorate in 2012 was EUR 877,000.

The **Directorate**, appointed by the Board of Superintendence and approved by the Cardinals' Commission, is responsible for the operational activities of the Institute and is accountable to the Board of Superintendence.

In 2012 the Directorate was composed of:

- Commendatore Paolo Cipriani, General Director
- Dr. Massimo Tulli, Deputy Director

8. Regulatory Framework

The regulatory framework of the IOR is based on the laws of the Vatican City State as well as on an agreement between the Vatican City State and the European Union.

On 17 December 2009, the Vatican City State and the European Union (represented by the European Commission, the European Central Bank and by the Italian Republic) entered into a Monetary Agreement with which the Vatican City State adopted the Euro as its official currency and undertook to implement, by direct transposition or equivalent measures, the European legislation on the prevention and countering of money laundering and financing of terrorism.

On that basis, the Pontifical Commission for the Vatican City State adopted the Law on the Prevention and Countering of Laundering of Proceeds of Crimes and Financing of Terrorism of 30 December 2010, n. CXXVII, which entered into force on 1 April 2011, and was subsequently modified in January 2012 (with Decree of the President of the Governatorate of the Vatican City State n. CLIX of 25 January 2012, converted into law with the Law of the Pontifical Commission of the Vatican City State n. CLXVI of 24 April 2012), and in December 2012 (with the Law of the Pontifical Commission for the Vatican City State, n. CLXXXV of 14 December 2012).

On 30 December 2010, Pope Benedict XVI promulgated the Apostolic Letter in the form of Motu Proprio for the prevention and countering of illegal activities in the financial and monetary field, which established the Financial Information Authority, and extended the scope of the requirement to report suspicious activities provided in Law n. CXXVII, in order for it to apply not only to private natural and legal persons carrying out certain financial activities in the State, but also to all dependent entities of the Holy See, which professionally conduct certain financial activities, including the dicasteries of the Roman Curia, related institutions, bodies and agencies.

On 24 February 2011, the Holy See, by formal letter of Cardinal Secretary of State Tarcisio Bertone, submitted an application to be part of the Committee of experts on the evaluation of anti-money laundering measures and the financing of terrorism (Moneyval) at the Council of Europe, to assess the full alignment of the legal framework of the Holy See / Vatican City State on AML / CFT.
On 6 April of the same year, the Committee of Ministers of the Council of Europe welcomed the request of the Holy See (see Resolution CM/RES-2011).

On that basis, on 4 July 2012, the 39th plenary meeting of Moneyval agreed by consensus on the report concerning the Holy See.

On 8 August 2013, the Holy Father issued a Motu Proprio that extended the application of Vatican City State laws relating to the prevention and countering of money laundering and terrorism financing, in order for them to fully apply to dicasteries of the Roman Curia and other institutes and entities dependent on the Holy See, as well as to non-profit organisations based in the Vatican City State. Moreover, the Motu Proprio strengthened the supervisory and regulatory function of the AIF, assigned to AIF the function of prudential oversight over entities professionally carrying out financial activities.

9. Report of the Cardinals' Commission

The Cardinals' Commission discharged the duties incumbent upon it under the law and the Statutes of the IOR in the year under review in a total of seven meetings. It was notified of major events, annual operations planning and the business and risk strategy, the proceedings of the Anti-Money Laundering and Remediation Programme in 2012 and regularly considered the IOR's business and risk reports. It also addressed personnel matters involving the departure of Professor Ettore Gotti Tedeschi followed by an extensive search for a replacement with the support of an internationally renowned advisory firm.

The Cardinals' Commission has received the IOR's financial statements for 2012. It resolved, moreover, a contribution to the budget of the Holy See of EUR 54.7 m.

The Cardinals' Commission wishes to thank the Board of Superintendence and the employees of the IOR for the work they have done during the year under review.

10. Report of the Board of Superintendence

In 2012, the Board of Superintendence met eight times. It approved the Financial Statements for 2011 provided by the Directorate and audited by Deloitte & Touche S.p.A., and submitted them to the Cardinals' Commission. It supervised the Institute's operational and financial performance continuously throughout the year and approved the budget for 2013.

The Board of Superintendence focused in particular on the compliance of the Institute with Vatican City State and international laws, including the recommendations by Moneyval. It closely supervised the anti-money laundering and remediation efforts undertaken by the Institute.

On 24 May 2012, Professor Ettore Gotti Tedeschi resigned from the Board of Superintendence. His position as President was taken over ad interim by Dr. Ronaldo Schmitz. The Board of Superintendence appointed professional advisors to conduct a search for a successor and, on 14 February 2013, the Cardinals' Commission announced the appointment of Ernst von Freyberg.

The Board of Superintendence appointed KPMG AG as auditor of the financial statements for 2012.

11. Report of the Board of Auditors

The Board of Auditors, in respect of article 28 of the Statutes of the IOR, has reviewed the 2012 Annual Report prepared by the Directorate, which comprises the Financial Statements (Balance Sheet, Income Statement, Statement of Comprehensive Income, Statement of Changes in Equity, and the Notes).

The Board of Auditors deems that the aforesaid Annual Report for the financial year 2012 fairly presents the financial situation and the economic results of the operations at of 31 December 2012.

12. Financial Statements

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SECTION I

BALANCE SHEET AS OF 31 DECEMBER 2012

	Notes	2012	2011	01.01.2011
		EUR 000	EUR 000	EUR 000
ASSETS	blank	blank	as restated	as restated
Cash	1	5,303	6,750	7,445
Bank deposits	1	1,216,245	1,435,510	1,118,955
Trading securities	2	2,730,675	1,697,102	2,374,381
Gold, medals and precious coins	3	41,346	40,119	35,188
Derivative financial instruments	4	-	32,637	-
Loans and advances to customers	5	25,823	30,619	36,216
Loans and receivables securities	6	252,252	341,405	162,843
Investment securities, equity available for sale	7	9,619	10,977	13,384
Investment securities, bond available for sale	7	-	-	106,439
Investment securities, held to maturity	8	626,764	446,953	304,445
Investment in subsidiaries	9a	15,835	15,835	15,835
Investment properties	9b	1,914	315	315
Equipment and furnishings	10	226	517	760
Intangible assets	11	436	403	499
Other assets	12	59,318	8,384	39,580
Total assets		**4,985,756**	**4,067,526**	**4,216,285**
LIABILITIES				
Due to banks	13	3	5,617	8,278
Due for saving accounts	14	4,103,473	3,224,981	3,308,652
Derivative financial instruments	4	-	-	69
Other liabilities	15	26,126	15,763	41,875
Post-employment benefit obligations	16	86,895	80,004	79,610
Total liabilities		4,216,497	3,326,365	3,438,484
EQUITY				
Equity reserves		309,874	309,874	309,874
Fair value reserve available for sale securities		-	(82)	2,692
Pension fund actuarial gain (losses) reserve		(4,876)	723	1,842
General operating risk reserve		377,646	410,393	399,317
Net profit for the year		86,615	20,253	64,076
Total equity		769,259	741,161	777,801
Total liabilities and equity		**4,985,756**	**4,067,526**	**4,216,285**

The accompanying notes concerning each item are set out in Section IV of these financial statements. The items as at 1 January 2011 have been restated as requested by the early adoption of revised IAS 19 “Employee Benefits”. Further details are given in Section II “Accounting policies” and Section IV “Note 16”.

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2012

	Notes	*2012*	*2011*
		EUR 000	*EUR 000*
			as restated
Interest income	17	90,547	91,714
Interest expense	17	(38,375)	(26,786)
Net interest result		52,172	64,928
Fee and commission income	18	15,105	14,077
Fee and commission expense	18	(2,911)	(3,858)
Net fee and commission result		12,194	10,219
Dividend income	19	1,827	2,705
Net trading income	20	51,128	(38,173)
Other net income	22	(4,653)	5,305
Operating result		112,668	44,984
Impairment losses	23	(2,104)	(3,774)
Operating expenses	21	(23,949)	(20,957)
Net profit for the year		**86,615**	**20,253**

The accompanying notes are set out in Section IV of these financial statements.

COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012

	Notes	*2012*	*2011*
		EUR 000	*EUR 000*
			as restated
COMPREHENSIVE INCOME			
Net profit for the year		86,615	20,253
OTHER COMPREHENSIVE INCOME			
Net fair value gain (loss) on available for sale investment securities	7	-	(82)
Net amount transferred to P&L relating to available for sale securities disposed of during the year	7	-	(3,000)
Reversal of FV loss on AFS securities at Impairment loss into Income Statement	7	82	308
Pension Fund actuarial gain (losses)	16	(5,599)	(1,119)
Total other comprehensive income		(5,517)	(3,893)
Total comprehensive income		**81,098**	**16,360**

The accompanying notes are set out in Section IV of these financial statements.

CASH-FLOWS STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

Direct Method		*Notes*	*2012*	*2011*
			EUR 000	*EUR 000*
CASH FLOWS FROM OPERATING ACTIVITIES				
Interest, fees and commissions received			101,201	113,708
Interest, fees and commissions payments			(38,910)	(25,465)
Dividend received			1,827	2,705
Net trading income			25,422	(6,232)
Other income			1,041	2,174
Cash payments to employees and suppliers			(22,030)	(19,235)
			68,551	67,655
CHANGES IN OPERATING ASSETS AND LIABILITIES				
Net (increase) or decrease in trading securities and derivatives			(972,068)	597,908
Net (increase) or decrease in gold, medals and precious coins			717	(1,162)
Net (increase) or decrease in term deposits with banks			104,829	(167,000)
Net (increase) or decrease in loans and advances to customers			4,984	5,612
Net (increase) or decrease in other assets			(50,934)	31,196
Net increase or (decrease) in due to banks			(5,614)	(2,661)
Net increase or (decrease) in due to customers			876,116	(88,850)
Net increase or (decrease) in other liabilities			10,364	(26,110)
Net cash from operating activities	A		36,945	416,588
CASH FLOWS USED IN INVESTING ACTIVITIES				
Purchase of furnishings and equipment		10	(44)	(199)
Purchase of intangible assets		11	(324)	(291)
Purchase of investment securities AFS		7	(505)	(998)
Disposal of investment securities AFS		7	-	101,500
Purchase of HTM o L&R securities		6,8	(502,414)	(378,070)
Disposal of HTM o L&R securities		6,8	403,710	60,830
Net cash from (used in) investing activities	B		(99,577)	(217,228)
CASH FLOWS USED IN FINANCING ACTIVITIES				
Distribution of prior year profits	C		(53,000)	(53,000)
Net increase (decrease) in cash and cash equivalents	(A+B+C)		(115,632)	146,360
Cash and cash equivalents at beginning of the year			1,226,713	1,080,353
Cash and cash equivalents at the end of the year		1	**1,111,081**	**1,226,713**

The accompanying notes are set out in Section IV of these financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012

	Comprehensive Income					
	Equity reserves	*Fair value reserve Available for sale investment securities*	*Pension fund actuarial gains (losses) reserve*	*Net profits*	*General operating risk reserve*	*Total*
	EUR 000	*EUR 000*	*EUR 000*	*EUR 000*	*EUR 000*	*EUR 000*
1 January 2011 as presented	309,874	2,692		64,076	399,317	775,959
Early application IAS 19 revised			1,842			1,842
1 January 2011 as restated	**309,874**	**2,692**	**1,842**	**64,076**	**399,317**	**777,801**
Distribution according to the indications of the Cardinals' Commission (transactions with owners)	-	-		(53,000)	-	(53,000)
Transfer to general operating risks reserve	-	-		(11,076)	11,076	-
Net fair value gain (loss) on available for sale investment securities current year (note 7)	-	(82)			-	(82)
Net amount trasferred to P&L relating to available for sale securities disposed of in the year		(3,000)				(3,000)
Reversal of FV loss on AFS securities at impairment into Income Statement (note 7)		308				308
Pension fund actuarial gains (losses)			(1,119)			(1,119)
Total other comprehensive income	-	(2,774)	(1,119)	-	-	(3,893)
Net profit for the year 2011	-	-		20,253	-	20,253
Total comprehensive income 2011		(2,774)	(1,119)	20,253	-	16,360
Balance at 31 December 2011 / 1 January 2012 as restated	**309,874**	**(82)**	**723**	**20,253**	**410,393**	**741,161**
Distribution according to the indications of the Cardinals' Commission (transactions with owners)	-	-		(53,000)	-	(53,000)
Transfer from general operating risks reserve	-	-		32,747	(32,747)	-
Reversal of FV loss on AFS securities at impairment into Income Statement (note 7)		82				82
Pension fund actuarial gains (losses)		-	(5,599)			(5,599)
Total other comprehensive income	-	82	(5,599)	-	-	(5,517)
Net profit for the year 2012	-	-		86,615	-	86,615
Total comprehensive income 2012		82	(5,599)	86,615		81,098
Balance at 31 December 2012	**309,874**	**-**	**(4,876)**	**86,615**	**377,646**	**769,259**

The accompanying notes are set out in Section IV of these financial statements.

The early adoption of revised IAS 19 led to the restatement of amounts in tables already approved in the previous year. The changes in equity have been performed as of 1 January 2011 and, consequently, as of 31 December 2011. Further details are given in note 16.

SECTION II

General information and summary of significant accounting policies

General information

The "Istituto per le Opere di Religione" (IOR) is an institute of the Holy See, founded on 27 June 1942 by Papal Decree, with the task of serving the Holy See and the Catholic Church all over the world. Its origins date back to the "Commissione ad Pias Causas" established in 1887 by Pope Leo XIII.

The IOR's purpose is set out in its Statutes, amended by Pope John Paul II in 1990, and related by-laws. It is "to provide for the custody and administration of goods transferred or entrusted to the Institute by physical or juridical persons, designated for religious works or charity. The Institute can accept deposits of assets from entities or persons of the Holy See and of the Vatican City State."

On 31 December 2012, the IOR employed 114 persons (2011: 106). During the year, the IOR hired 10 new employees and 2 retirements were recorded.

The Annual Report of the Institute was prepared by the Directorate and approved by the Board of Superintendence, which transmits it to the Cardinals' Commission.

The Cardinals' Commission acknowledges the financial statements and decides on the profit's distribution, after considering the IOR's allocation to the General Operating Risk Reserves.

Accounting policies

A) BASIS OF PREPARATION

The financial statements have been prepared in accordance with International Financial Reporting Standards (IAS/IFRS) as issued by the International Accounting Standards Board.

The present annual report is a separate financial statement.
The consolidation exemption is used according to IFRS 27.10 paragraph b) and c).

The financial statements comprise the Balance Sheet, the Income Statement, the Statement of Comprehensive Income, the Statement of Changes in Equity, the Cash-flow Statement and the Notes.

Disclosures under IFRS 7 Financial Instruments, disclosures about the nature and extent of risks, and Capital Disclosures under IAS 1, Presentation of Financial Statements, have been included in the audited Section V "Financial risks management".

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies are consistent with those of the previous financial year, except for the following new interpretations and amendments of standards, and for the yearly adoption of revised standard IAS 19 "Employee Benefits".

The annual report of the Istituto per le Opere di Religione is prepared in Euro. Unless otherwise stated, all amounts are given in thousand Euro. For all items, the values calculated in the year 2012 and the relevant values of the previous year are given.

In preparing IFRS financial statements, the IOR is presumed to be a going concern.

On the date that the Board of Superintendence approves the financial statements, there are no material uncertainties and therefore no significant doubt regarding the Institute's ability to continue as a going concern for the foreseeable future in accordance with IAS 1.

The financial statements present fairly the financial position, financial performance and cash flows of the Institute.

The preparation of IFRS-compliant financial statements requires that Management makes a large number of estimates and assumptions with regard to the future that may, naturally, not coincide with actual future conditions. Estimates and assumptions affect the reported amounts of certain assets, liabilities, revenues and expenses. In addition, changes in assumptions may have a significant impact on the financial statements in the period the assumptions changed.

The preparation of IFRS-compliant financial statements also requires Management to exercise its judgement in the process of applying the IOR's accounting policies to estimate the carrying value of assets and liabilities not readily obtainable from other sources.

Management believes that the underlying assumptions are appropriate and the IOR financial statements present the financial position and results fairly. All estimates are based on historical experience and/or expectations with regard to future events that seem reasonable under the given circumstances. They are also reassessed on an ongoing basis.

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 Section III.

The Institute has no liability in respect of taxation because no income tax exists in Vatican City State.

Where necessary, comparative figures have been adjusted to conform with changes in presentations in the current year.

On 31 December 2012, adjustments on prior year figures have been made for the early adoption of revised standard IAS 19 “Employee Benefits”. The opening statement of the earliest comparative period presented, 1 January 2011, has been restated.

After year end there were no significant events that require adjustments in these 2012 Financial Statements.

B) IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS, NEW STANDARDS, INTERPRETATIONS AND AMENDMENTS TO PUBLISHED STANDARDS

a) Impact of New Accounting Pronouncements, new Standards, interpretations and amendments to published standards effective from 1 January 2012 and relevant to the IOR’s accounting

IFRS 7 (Amendments) (October 2010) “Financial instruments: disclosures” (effective from 1 July 2011).

The amendments allow users of financial statements to improve their understanding on transfer of financial assets, including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transaction are undertaken at the end of a reporting period.

The Institute has adopted the IFRS 7 Amendment from 1 January 2012, but no impact was recorded on the IOR’s accounts.

IAS 1 (Improvement) (May 2012) “Presentation of Financial Statements” (effective from 1 January 2013).

The amendment clarifies that additional comparative information should be presented in accordance with IAS/IFRS. In addition, it is clarified that if an entity changes accounting policy or makes a retrospective reclassification, it should present a balance sheet also at the beginning of the comparative period (“third balance sheet” in the financial statements) while the notes are not required comparative disclosures for such “third balance sheet”, apart from the items concerned.

The Institute early adopted IAS 1 Amendments as from 1 January 2012, and recorded impact on own accounts, presenting a third balance sheet following the early adoption of IAS 19 amended.

IAS 19 (Amendment) (June 2011) "Employee Benefits" (effective from 1 January 2013).

The amendments eliminate the option to defer the recognition of actuarial gains and losses, known as the "corridor method", and require the fund's deficit or surplus to be presented in the statement of financial position. The components of cost relating to service costs and net interest are recognised in profit or loss and actuarial gains and losses arising from the remeasurement of the defined benefit obligation in Other Comprehensive Income (Equity). The amendments also introduce the requirement for additional disclosures to be provided in the notes.

The Institute early adopted IAS 19 amendments with a date of initial application of 1 January 2012. Until that date, the IOR recognised actuarial gains and losses applying the corridor method, posting in the income statement only when exceeding the 10 % of the present value of the defined benefit obligation.

Impact of change in accounting policy.

The IOR applied this change in accounting policy retrospectively as at 1 January 2011 in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. This required the IOR to restate the amount of the pension liability at 1 January 2011 by including the unrecognised gain existing at that date of EUR 1.8 m into Other Comprehensive Income (Equity).

By adjusting the amounts at December 2011 as if the revised accounting principle had been already applied in 2011, a loss of EUR 1.1 m was recorded in Other Comprehensive Income representing the movement in 2011 of the actuarial gain/loss, which resulted in Actuarial Gains and Losses Pension Fund Reserve in Equity of EUR 723,000.

b) Standards, interpretations and amendments to published standards effective from 1 January 2012 that are not relevant to the IOR's accounting

IFRS 1 (Amendment) (January 2011) "First-time Adoption of International Financial Reporting" (effective from 1 July 2011).

IAS 12 (Amendments) (January 2011) "Income Taxes" (effective from 1 January 2012). The amendment concerns the income taxes.

c) Standards, interpretations and amendments to published standards relevant to the IOR's accounting that are not yet effective and that have not been early applied

The following new standards and interpretations to existing standards have been published and they are mandatory for the IOR's accounting periods beginning on or after 1 January 2013 or later periods but the IOR has not early adopted them.

IFRS 7 (Amendments) (December 2011) "Financial instruments: disclosures" (effective from 1 January 2013).

The amendment requires information on the effects or potential effects of contracts of offsetting financial assets and financial liabilities on the balance sheet.

The Institute will adopt IFRS 7 amended from 1 January 2013. The adoption will require more extensive disclosures about financial instruments.

IFRS 9 (New Standard) (November 2009) "Financial Instruments: Classification and Measurement – Financial Assets" (effective from 1 January 2015). The new standard represents the completion of the first part of a project to replace IAS 39. The new standard uses a single approach to determine whether a financial asset is measured at amortised cost or fair value, replacing the many different rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments and the contractual cash flow characteristics of the financial assets.

The Institute will adopt IFRS 9 as from 1 January 2015 and it believes that there will be a significant impact on the IOR's financial statements. The IOR has not yet finalised the assessment of the financial impact.

IFRS 9 (Improvement) (October 2010) "Financial Instruments: Classification and Measurement – Financial Liabilities" (effective from 1 January 2015).

The 2010 revision to IFRS 9 retains the requirements for classification and measurement of financial assets that were published in November 2009 but adds guidance on the classification and measurement of financial liabilities.

The guidance included in IFRS 9 retains the classification criteria for financial liabilities currently contained in IAS 39. However, there are two key differences, relating to presentation and measurement, compared to IAS 39: the presentation of the effects of changes in fair value attributable to a liability's credit risk; and the elimination of the cost exemption for derivative liabilities to be settled by delivery of unquoted equity instruments.

Under the new regulations an entity applying the fair value option to measure its financial liabilities can no longer recognise in profit and loss any fair value changes related to own credit risk, but must instead recognise them without effect on profit and loss under other comprehensive income and therefore directly in equity.

The Institute will adopt IFRS 9 Financial Liabilities from 1 January 2015 and it does not believe that there will be an impact on the IOR's financial statements.

IFRS 13 (New Standard) (May 2011) "Fair Value Measurement" (expected to be effective from 1 January 2013).

The standard defines fair value, describes how fair value is to be measured for IFRS reporting, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures.

The Institute will adopt IFRS 13 from 1 January 2013 and believes that there will be an impact on the IOR's financial statements because it will increase the volume of disclosures in the Notes to the financial statements.

IAS 1 (Amendment) (June 2011) "Presentation of Financial Statements" (effective from 1 July 2012).

The amendments require companies to group together Other Comprehensive Income items that may be reclassified to the income statement.

The Institute will adopt IAS 1 amendments from 1 January 2013 and believes that there will be an impact on the IOR's financial statements presentation.

IAS 27 (Amendments) (May 2011) "Separate financial statements" (effective from 1 January 2013).

Following the issue of the new IFRS 10 "Consolidated Financial Statements", the scope of IAS 27 has been limited to the separate financial statements, addressing the accounting treatment of investments in subsidiaries, associates and joint ventures exclusively in the Separate financial statements.
No changes were made to the rules coming from the prior IAS 27 about these topics: it is confirmed that investments in subsidiaries, associates and joint ventures will be carried either at cost or according to IFRS 9.

If a holding chooses not to produce the consolidated financial statements, it must provide information about the investments in subsidiaries, associates and joint ventures, the registered headquarters, the percentage of ownership in each subsidiary and disclosures about the accounting policy.

The Institute will adopt the amendments to IAS 27 from 1 January 2013 but it does not believe that there will be an impact on the IOR's financial statements.

IAS 28 (Amendments) (May 2011) "Investments in Associates" (effective from 1 January 2013). The standard has been amended to include accounting for investments in jointly-controlled entities in its scope of application.

The Institute will adopt the amendments to IAS 28 from 1 January 2013 but it does not believe that there will be an impact on the IOR's financial statements.

IAS 32 (Amendments) (May 2012) "Financial Instruments: Disclosure" (effective from 1 January 2013). The amendment clarifies that direct taxes on distributions to holders of equity instruments and transaction costs on equity follow the rules of IAS 12.

The Institute will adopt the amendments to IAS 32 from 1 January 2013 but it does not believe that there will be an impact on the IOR's financial statements since no income tax exists in Vatican City State.

IAS 32 (Amendments) (December 2011) "Offsetting financial assets and liabilities" (effective from 1 January 2014). The amendment clarifies the application of certain criteria for offsetting financial assets and financial liabilities on the balance sheet.

The Institute will adopt the amendments to IAS 32 from 1 January 2014 but it does not believe that there will be an impact on the IOR's financial statements.

d) Standards, interpretations and amendments to published standards that are not yet effective and that are not relevant to the IOR's accounting

IFRS 1 (Amendments) (March 2012) "Government Loans" (effective from 1 January 2013).
IFRS 10 (New Standard) (May 2011) "Consolidated Financial Statements" (effective from 1 January 2013).

IFRS 11 (New Standard) (May 2011) "Joint Arrangements" (effective from 1 January 2013).
IFRS 12 (New Standard) (May 2011) "Disclosure of Interests in Other Entities" (effective from 1 January 2013).

IAS 16 (Improvement) (May 2012) "Property, plant and equipment" (effective from 1 January 2013).
IAS 34 (Amendments) (May 2012) "Interim financial report" (effective from 1 January 2014).

IFRIC 20 (October 2011) "Stripping Costs in the Production Phase of a Surface Mine" (effective from 1 January 2013).

C) FOREIGN CURRENCY TRANSLATION

i) Functional and presentation currency

The functional currency is the currency in which the items included in the financial statements must be measured. According to IAS 21, functional currency is the currency of the primary economic environment in which the entity operates. This is the currency that determines the pricing of transactions, but it is not necessarily the currency in which transactions are denominated.

The presentation currency is the currency in which the financial statements are presented. IAS 21 allows an entity to present its financial statements in any currency.

The IOR's functional and presentation currency is Euro, which is the currency of the primary economic environment in which the Institute operates. In fact, Euro is the currency in which the majority of the funds from financial activities are received.

ii) Transactions and balances

Foreign currency transactions, if they impact P & L accounts, are translated into the functional currency using the exchange rates prevailing at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency using the spot exchange rate at the reporting date (closing rate).

Non-monetary assets and liabilities denominated in foreign currencies are translated using the rate at the date their amount (cost or fair value) was determined.

Non-monetary items carried at cost are translated using the initial recognition rate.

Non-monetary items carried at fair value are translated using the rate at the date their fair value was measured.

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 denominated in foreign currencies are recognised in the income statement as "Net trading income-Foreign Exchange".

Translation differences on non-monetary assets and liabilities carried at fair value are recognised in the Income Statement as part of the fair value gain or loss if the non-monetary asset or liability is carried at fair value through Profit & Loss. Alternatively, the differences are included in the fair value reserve in equity if the non-monetary assets and liabilities are carried at fair value through equity.

D) CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash, non-restricted balances with central banks and bank deposits, including loans and advances to banks.

E) FINANCIAL ASSETS

The IOR classifies its financial assets into the following 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 investments at the time of initial recognition, considering also the nature and purpose of the financial assets.

All financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or when the IOR has transferred substantially all risks and rewards of ownership.
Sales of financial assets are recognised on trade-date – the date on which the IOR commits to sell the asset.

Initial recognition and subsequent measurement criteria change according to the relevant category.

i) Financial assets at fair value through profit or loss (FVTPL).
A financial asset is classified into this category if acquired principally for the purpose of selling in the short term or if the Management designates it as at FVTPL.

This category contains financial assets held for trading, which are reported under "Trading securities". Derivatives are also categorised as held for trading unless they are designated as hedging instruments. Purchases of financial assets at fair value through profit or loss are recognised on trade-date – the date on which the IOR commits to purchase the asset.

Financial assets at fair value through profit or loss are initially recognised at fair value – that generally corresponds to the initial cash consideration – without adding direct transaction costs.

Also for the subsequent measurements, the financial assets FVTPL are carried at fair value, with any gains or losses arising on remeasurement recognised in the income statement.

Gains and losses arising from changes in the fair value of the financial assets FVTPL category are included in the item "Net trading income" in the period in which they arise. Realised gains and losses coming from sales or reimbursement of the financial assets FVTPL are also included in the same item.

The accounting policies affecting any dividend or interest earned on the financial assets FVTPL are set out later in notes r and t.

The accounting policies affecting derivatives held for trading are set out in the current Section note g. For fair value measurement, the IOR adopted the IFRS 7 amendment that introduced a three tier hierarchy disclosure based on the significance of inputs.

The three levels are:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities, i.e. those that are readily available in the market and are normally obtainable from multiple sources.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for assets or liabilities that are not based on observable market data (unobservable inputs).

For further information about how the IOR classifies the financial assets measured at fair value, refer to Section IV note 27.

ii) Loans and receivables

"Loans and receivables" are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

They arise:

a) when the IOR provides money, securities, goods or services directly to a debtor with no intention of trading the receivable;
b) when the IOR purchases loans and receivables debt securities offered through private placements, that the Institute did not designate as at fair value through P&L or available for sale financial assets. These financial assets are subject to the risk of the credit deterioration of the counterparty.

Loans are recognised when cash is advanced to the borrower.
They are initially recognised at fair value, which is the cash given to originate the loan, plus any direct transaction costs.

Loans are subsequently measured at amortised cost using the effective interest rate method.
Securities "loans and receivables" are initially recognised on the trade date that is the date on which the IOR commits to purchase the asset.

They are initially recognised at fair value plus any direct transaction costs.
Securities "loans and receivables" are subsequently measured at amortised cost using the effective interest rate method.

They may also be impaired under the circumstances set out in note u.

A gain or loss on "loans and receivables" is recognised in P&L through the financial amortisation (item "Interest received/paid") or when the assets are derecognised (item "Other net income" line "Losses on advances" for loans and "Gains/losses on disposal of investment securities" for securities) or when impairment losses are recognised (item "Impairment losses" line "Impairment losses on advances" for loans and line "Impairment losses on investment securities" for securities).

The accounting policies affecting any interest earned on the financial assets "Loans and Receivables" are set out later (note r).

About the rules applied for the impairment of financial assets pertaining to the category "Loans and receivables", refer to note u of the present Section.

iii) Held to maturity financial assets
"Held to maturity" investments are quoted non-derivative financial assets with fixed or determinable payments and with fixed maturities that the IOR has the positive intention and ability to hold to maturity. If the IOR sells more than an insignificant number of "Held-to-maturity" assets, the entire category would be reclassified as available for sale and for the following two years no financial asset can be classified in the HTM category.

Also securities "Held to maturity" are initially recognised on trade-date – the date on which the IOR commits to purchase the asset.

They are initially recognised at fair value plus any direct transaction costs.

Securities “Held to maturity” are subsequently measured at amortised cost using the effective interest rate method.

They may also be impaired under the circumstances set out in note u.
Gains and losses on “Held to maturity” financial assets are recognised in the Income Statement through the financial amortization (item “Interest received/paid”) or when the assets are derecognised (item “Other net income” line “Gains/losses on investment securities”) or when impairment losses are recognised (item “Impairment losses” line “Impairment losses on investment securities”).

The accounting policies affecting any interest earned on the financial assets “Held to maturity” are set out later (note r).

About the rules applied for the impairment of financial assets pertaining to the category “Held to maturity”, refer to note u of the present Section.

iv) Available for sale financial assets
“Available for sale” investments are those intended to be held for an indefinite period of time, also because of agreements that limit disposal for a certain time.

In addition, “Available for sale” financial assets are those non derivative financial assets that are not classified as held for trading or loans and receivables or held to maturity investments or financial assets at fair value through profit or loss.

Also securities “Available for sale” are initially recognised on trade-date – the date on which the IOR commits to purchase the asset.

They are initially recognised at fair value plus any direct transaction costs.

“Available for sale” financial assets are subsequently carried at fair value.

Gains and losses arising from changes in the fair value of “Available for sale” financial assets are recognised directly in Other Comprehensive Income, until the financial asset is derecognised or impaired.

At this time the cumulative gain or loss previously recognised in Other Comprehensive Income should be recognised in Income Statement.

When the “Available for sale” assets are sold, unrealised gains or losses, previously recognised in Other Comprehensive Income, are transferred to the Income statement item “Other income, net” line “Gains/losses on investment securities”.

The accounting policies affecting any dividend or interest earned on the financial assets “Available for sale” are set out later (note r and t).

For fair value measurement, refer to the disclosure in this item under sub-item i) financial assets at fair value through profit or loss (FVTPL).

About the rules applied for the impairment of financial assets pertaining to the category “Available for sale”, refer to note u of the present Section.

F) OFFSETTING FINANCIAL INSTRUMENTS

Financial assets and liabilities are offset and the net amount reported in the balance sheet only 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.

G) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into.

The initial fair value generally corresponds to the initial cash consideration.
They are subsequently remeasured at fair value through profit and loss.
The fair values of derivatives quoted in active markets are based on current bid price. If the market for a financial derivative is not active, the IOR obtains fair values by market makers or establishes fair value by using valuation techniques, as well as considering prices utilised in recent transactions and prices of similar financial instruments.

All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Derivative financial instruments may include also the embedded derivatives in a hybrid financial instrument. IAS 39 requires that an embedded derivative be separated from its host contract and accounted for as a derivative when:

a) the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract;
b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative;
c) the entire instrument is not measured at fair value with changes in fair value recognised in the income statement.

The Institute does not enter into Fair value hedge, Cash flow hedge or Net investment hedge transactions.

As of 31 December 2012, the Institute did not hold derivatives.

H) GOLD, MEDALS AND PRECIOUS COINS

Gold, medals and precious coins are classified as current assets and are stated at fair values. Unrealised gains and losses are included in the income statement as Net trading income.
Gold is stated at the PM fixing price on the London market at the last quotation day of the year.
The different coins and medals are appraised on the basis of the weight and the tenor of the fine gold and of the silver contained in them.

K) INVESTMENT IN SUBSIDIARIES

Investment in subsidiaries consists of the participation in wholly owned real estate company named SGIR and located in Rome, Via della Conciliazione. The principal assets of this company are real estate properties and the Institute provides the entire financing to this company.
Investment in subsidiaries is carried at cost less impairment. Real estate owned by the subsidiary is depreciated on a straight-line basis over their estimated useful life which management considers being between 30 and 50 years. Land is not depreciated.

L) INVESTMENT PROPERTIES

Investment properties are buildings not owner-occupied but held to earn rentals or for capital appreciation or both.

Investment properties comprise of properties directly owned by the IOR.

Investment properties are initially measured at cost and subsequently at fair value with any change therein recognised in profit or loss.

Improvements on buildings increase the carrying amounts.

M) EQUIPMENT AND FURNISHINGS

All equipment is stated at historical cost less accumulated depreciation. Historical cost is generally based on the fair value of the consideration given in exchange for assets and includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the IOR. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Equipment, furnishings and motor vehicles are amortised on straight-line basis over the expected useful lives (four years).

The assets residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

These assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Gains and losses on disposals are determined as the difference between the sale proceeds and the carrying amount of the assets. They are recognised in the P & L item "Other Net Income".

N) INTANGIBLE ASSETS

Intangible assets correspond only to computer software licenses. Acquired computer software licenses are recognised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on a straight-line basis over the expected useful lives (four years).

These assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use. Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred.

O) OTHER LIABILITIES: FUNDS FOR CHARITABLE CONTRIBUTIONS

The funds are composed of the Fund at the disposal of the Cardinals' Commission, the Fund at the disposal of the Board of Superintendence, the Fund for Holy Masses and the Fund for Missionary Activities and they are included in the balance sheet as other liabilities.

Fund at the disposal of the Cardinals' Commission and Fund at the disposal of Board of Super-intendence

The **Fund at the disposal of the Cardinals' Commission** and the **Fund at the disposal of Board of Superintendence** are used to distribute charitable contributions approved by the respective Board to members of the Catholic Church.

For both Funds appropriations originate from distribution of the net profit of the year, following the decision of the Cardinals' Commission.

Fund for Holy Masses

The Fund for Holy Masses is controlled by the IOR Directorate and is used to distribute contributions to priests for Holy Masses.

Appropriations to the Fund mainly originate from donations.
Donations and distributions are directly recorded to the Fund account.
Distributions to the priests are approved by the General Director.

Fund for Missionary Activities
The item Fund for Missionary Activities has been created in 2010. It is controlled by the IOR Directorate and it is used to distribute contributions to congregations and institutions that operate missionary activities.

Appropriations to the Fund mainly originate from donations.
Donations and distributions are directly recorded to the Fund account.
Distributions to the beneficiaries are approved by the General Director.

P) POST-EMPLOYMENT BENEFITS

The IOR operates an unfunded defined benefit plan, which is financed by payments from employees and the IOR.

The IOR's net obligation in respect of defined benefit plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value.

The IOR determines the interest expense on the defined benefit liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the defined benefit liability.

The discount rate is the yield at the reporting date on high quality corporate bonds that have maturity dates approximating the terms of the IOR's obligations and that are denominated in the currency in which the benefits are expected to be paid.

The calculation is performed annually by a qualified actuary using the projected unit credit method. Remeasurements arising from defined benefit plan comprise actuarial gains and losses. The IOR recognises them immediately in Other Comprehensive Income and all other expenses related to defined benefit plan in Staff costs in Profit & Loss.
When the benefits of the plan are changed, the portion of the changed benefit related to past service by employees is recognised immediately in Profit & Loss.

The defined benefit plan was calculated with the corridor method since 1 January 2006 up to 31 December 2011.

The corridor method specified that the actuarial gains or losses might increase or decrease the calculated liability.

The old IAS 19 specified that if the accumulated unrecognised actuarial gains and losses exceeded 10 % of the greater of the defined benefit obligation or the fair value of plan assets, a portion of that net gain or loss was required to be recognised as income or expense in one or more periods following the current one. The portion recognised was the excess divided by the expected average remaining working lives of the participating employees.

As already detailed in the paragraph concerning the changes in accounting rules, effective and relevant to the IOR's financial statements, starting from 2013, the corridor method is no longer permitted. The IOR adopted the amendment to IAS 19 in advance and as at 31 December 2012 recorded the actuarial gains or losses in a proper equity reserve. Refer to note 16 Section IV for other disclosures about the early adoption.

Starting from 1 January 2005, all the IOR's personnel also joined the general Vatican City State pension plan system. This system is financed by contribution made by the Institute and employees. This plan is a defined contribution plan and contributions made by the IOR are recognised as employee benefit expense when they occur.

Consequently, the IOR defined benefit plan is the obligation of the Institute for the entire amount to be paid to employees for their service up to 31 December 2004; instead, for the service provided by the employees from 1 January 2005, the IOR defined benefit plan is the obligation of the Institute for the difference between the entire amount due to the employees if the Vatican City State pension fund was not joined and the amount received by the Vatican City State pension fund from 1 January 2005, considering also the difference in the retirement age set by the two pension systems.

Other post-employment benefits correspond to indemnities paid to personnel when they leave the IOR. The amount due is based on years of service and salary paid in the last year of employment. These benefits are financed both by payments from employees and the IOR contributions to the plan.
The obligation is measured with the actuarial methodology, assessing the liability towards employees at the present value of the estimated future cash outflows according to the projected unit credit method required by IAS 19.

Q) EQUITY

Equity Reserves are defined in the IOR statutes and represent permanent capital and, as such, are not available for distribution.

The General Operating Risk Reserve is a component of equity and consists of previous years' retained profits provisioned for auto-financing needs and used for distributing profits also in bad years. It is increased or decreased based upon net profit for the year less distribution.
The Pension Fund actuarial gains (losses) Reserve represents the actuarial gain or loss related to the post-employment benefit plan.

R) INTEREST INCOME AND EXPENSE

Interest income and expense are recognised in the income statement on an accruals basis.
Interest income and expense for financial instruments classified as held for trading or designated at fair value through P & L are recognised "pro rata temporis" based on the contractual interest rate.
Interest income and expense for all remaining interest-bearing financial instruments, those classified as held to maturity or classified as loans and receivables, or classified as Available for Sale, are recognised within "interest income" and "interest expense" in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or, where appropriate, a shorter period to the net carrying amount of the financial asset or financial liability on initial recognition. The calculation includes all transaction costs and all other premiums or discounts paid or received between parties to the contract that are an integral part of the effective interest rate.

S) FEE AND COMMISSION INCOME

Fees and commissions are generally recognised when the service has been provided.
Commissions arising from securities activities or other commissions (i.e. commissions for check issue or remittance or for payment orders) are recognised according to the contract relevant for the service provided, generally in the moment in which the service is provided. Asset management fees are recognised on an accrual basis over the period the service is provided

T) DIVIDENDS

Dividends on trading securities and available for sale equity instruments are recognised in the Dividend income when the entity's right to receive payment is established.

U) IMPAIRMENT OF FINANCIAL ASSETS

i) Assets carried at amortised cost – Loans and advances to customers and securities loans and receivables

At each balance sheet date, the IOR assesses whether there is objective evidence that a financial asset be impaired. A financial asset is impaired and impairment losses are incurred if, and 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 and that loss event has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the extent of the loss is recognised in the P & L item "Impairment losses".

Loans which are not individually impaired are impaired on a portfolio basis based on the loss experience.

If, in a subsequent period, the extent of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the Income Statement as Other net income.

When a loan is uncollectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the extent of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised in the Income Statement as Other net income.

ii) Assets carried at amortised cost – Held to maturity financial assets

At each balance sheet date, the IOR assesses whether there is objective evidence that a financial asset be impaired. A financial asset is impaired and impairment losses are incurred if, and 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 has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

For Held to maturity financial assets, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows and it is recognised in the Income Statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is directly reversed. However, the reversal cannot result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had no impairment been recognised. The amount of the reversal is recognised in the Income Statement.

iii) Assets classified as available for sale

At each balance sheet date, the IOR assesses whether there is objective evidence that a financial asset be impaired.

A significant or prolonged decline in the fair value of the financial asset below its cost is considered in determining whether the assets be impaired. If any such evidence exists for available for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in Profit & Loss – is removed from equity and recognised in the P & L item "Impairment losses".

Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement, if, in a subsequent period, the amount of the impairment loss decreases.

For debt instruments, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

V) ASSETS HELD IN CUSTODY FOR THIRD PARTIES

These off balance sheet assets comprise mainly customer-owned securities lodged by customers at the IOR for custodial purposes. Securities and gold and precious metals are stated at market values.
The customers make all investment decisions and the IOR has no discretionary power to manage these assets.

Z) ASSETS HELD UNDER PORTFOLIO MANAGEMENT

These off balance sheet assets comprise mainly customer-owned securities lodged by customers at the IOR for management purposes. Securities are stated at market values. Investment decisions are taken by the IOR on the basis of a portfolio management agreement signed by the customers.

Critical accounting estimates and judgments

Critical judgments in applying the Institute's accounting policies
In the process of applying the IOR's accounting policies, which are set out in Section II, circumstances may lead management to make judgements that have the most significant effect on the amounts recognised in the financial statements.

Such circumstances and related judgments could be represented in the evaluation process utilised for financial instruments. The Directorate makes critical judgments when it decides the category under which to classify financial assets, when it defines if a market is active or not, if it is liquid or not, which market inputs and parameters are to be utilised, when they must be reviewed, in which circumstances internal parameters are more reliable than market ones, and so on.

Also, retirement benefit and post-employment liabilities are based on critical judgements because estimates are made about the likelihood of future events and the actual results could differ from those estimates.

Key sources of estimation uncertainty
The process of applying the IOR's accounting policies may require the use of key assumptions affecting the future, and/or key or other sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing material adjustments to the carrying amount of assets and liabilities within the next financial year.

Key assumptions in 2012 Financial Statements are represented by the judgement related to the assessment of illiquid securities in trading portfolio, as set out in Section IV note 2.

They are not quoted in active markets and so their fair value is not readily available in the market.

They amount to EUR 168.8 m as at 31 December 2012.

They comprise debt securities of EUR 0.9 m and Investment Funds externally managed of EUR 167.9 m.

SECTION IV

Explanatory notes to the financial statements

1. CASH AND BANK DEPOSITS

	2012	2011
	EUR 000	EUR 000
Cash	5,303	6,750
Due from banks on demand	268,500	222,319
Term deposits due from banks (< 90 days)	837,278	997,644
Cash and cash equivalents	1,111,081	1,226,713
Term deposits due from banks (> 90 days)	85,171	190,000
Accruals	2,296	2,547
Other deposits	23,000	23,000
	1,221,548	**1,442,260**

The sub-item "Cash and cash equivalents" comprises the balances with less than 90 days maturity from the date of acquisition. The same sub-item is utilised for the purposes of the cash flow statement.

During 2012, the Institute earned an average interest of 0.95 % (2011: 1.08 %) on the bank deposits.

Bank deposits also include EUR 23 m deposited to a current account held with Credito Artigano.

2. TRADING SECURITIES

	2012	2011
	EUR 000	EUR 000
DEBT SECURITIES AND BONDS		
Government	1,337,841	604,213
Other government entities, agencies, banks and other	1,084,444	923,057
	2,422,285	1,527,270
Accruals	20,921	15,934
	2,443,206	1,543,204
Listed equity securities	93,148	80,594
Externally managed investment funds	194,321	73,304
	2,730,675	**1,697,102**

The carrying amount of this category is the fair value. Fair values of Debt Securities held for trading are usually based on current bid price.

The exceptions to this approach are illiquid securities not traded in an active market. The basis for the valuation of these investments is prices provided by the securities issuer every ten days. They amounted to EUR 876,500 as at December 2012 (2011: EUR 160,200).

All Equity Securities are listed; their fair values are based on published price quotations.

Finally, the fair value of External Investment Funds is the price provided by the fund manager based on fair values of securities comprised in the fund.

Included in government bonds are securities pledged in favour of Italian banks as a guarantee for bank drafts issued by the IOR, whose notional value is EUR 500,000 (2011: EUR 500,000) (market value at 31 December 2012: EUR 518,100; 2011: EUR 489,800).

3. GOLD, MEDALS AND PRECIOUS COINS

	2012	*2011*
	EUR 000	*EUR 000*
Gold	28,260	27,473
Medals and precious coins	13,086	12,646
Total	**41,346**	**40,119**

During 2012, the value of gold carried on the balance sheet increased in value by 3.1 %, due to the higher gold price. Gold is carried at market value.

4. DERIVATIVE FINANCIAL INSTRUMENTS

		Fair market value	
	Notional amount	*Assets*	*Liabilities*
	EUR 000	*EUR 000*	*EUR 000*
As at 31 December 2012			
FOREIGN EXCHANGE DERIVATIVES			
Forward exchange contracts and currency swaps	-	-	
Share index derivatives			
Options	-	-	-
Total derivative assets / (liabilities)		-	-
As at 31 December 2011			
FOREIGN EXCHANGE DERIVATIVES			
Forward exchange contracts and currency swaps	1,862	7	-
Share index derivatives			
Options	120,000	32,630	-
Total derivative assets / (liabilities)		**32,637**	-

The above table provides a detailed breakdown of the contractual or notional amounts and the fair values of the Institute's derivative financial instruments outstanding at year-end.

As of 2012 year-end, the IOR did not hold derivative financial instruments, while on 31 December 2011, the item included three derivatives separated from notes issued by a third party bank that the Directorate decided to present as “Loans and Receivables” securities. During 2012, these notes were sold, realising a loss of EUR 11.6 m (including the loss on derivative component of EUR 7.1 m recognised into Income Statement in item “Net trading income”) (note 20).

Foreign exchange derivatives represent commitments to purchase foreign currency including undelivered spot transactions.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet, but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Institute’s exposure to credit or price risk.

5. LOANS AND ADVANCES TO CUSTOMERS

	2012	*2011*
	EUR 000	*EUR 000*
Loans	10,605	13,518
Credit lines used	16,767	17,420
Overdrafts	2,030	3,011
Long term advances to subsidiary	4,592	5,092
Provision for specific impairment losses	(6,745)	(6,798)
Allowance for portfolio impairment losses	(1,426)	(1,624)
	25,823	**30,619**

Movement in the specific impairment losses is as follows:		
Balance at 1 January	6,798	6,723
Loans written off during the year as uncollectible	(8)	-
Specific impairment losses on loans and advances	159	157
Reversal of impairment losses	(204)	(82)
Balance at 31 December	**6,745**	**6,798**

During the period, a portion of loans previously considered doubtful and wholly provisioned was reimbursed, to the sum of EUR 204,000. As a result, the relevant provision was reversed and a gain of EUR 204,000 was recognised in Other net income (note 22).

As at 31 December 2012, interest of EUR 159,000 on impaired loans provisioned in previous years was recorded (note 23).

The allowance for portfolio impairment losses decreased from EUR 1.6 m to EUR 1.4 m. The difference of EUR 198,000 was posted in Other net income (note 22).

The carrying amount of the item “Loans and advances to customers” approximates the fair value.

6. LOANS AND RECEIVABLES SECURITIES

	2012	*2011*
	EUR 000	*EUR 000*
Debt securities and bonds	246,421	335,071
Accruals	5,831	6,334
	252,252	**341,405**

Movement in the item may be summarised as follows:		
Balance at 1 January	341,405	162,843
Additions	-	172,390
Early mandatory redemption	-	-
Redemption at maturity	(86,400)	-
Amortisation	(1,535)	1,538
Reversal accruals previous year	(6,334)	(2,692)
Accruals	5,831	6,334
FX effects	(715)	992
Balance at 31 December	**252,252**	**341,405**

The securities included under this item on 31 December 2012 are bonds deriving from private placements.

During 2012, the IOR sold notes which were included in the present item at the end of 2011. The sale resulted in a total loss amounting to EUR 11.6 m (including the loss on the bond component of EUR 6.6 m posted to the Income Statement item “Other net income”) (note 22).

The fair value of this securities’ category, net of accruals, amounts to EUR 242.2 m, with a negative difference of EUR 4.2 m compared to the carrying value.

For most of the bonds classified as Loans and Receivables, the fair value is higher than the carrying value. There are three cases (bonds of third party banks) in which the fair value is lower than the carrying value, but the IOR Directorate considers these investments fully recoverable.

7. INVESTMENT EQUITY SECURITIES, AVAILABLE FOR SALE

	2012	2011
	EUR 000	EUR 000
LISTED EQUITY SECURITIES		
Cattolica Assicurazioni	9,141	10,053
Banca Carige	470	916
	9,611	10,969
UNLISTED EQUITY SECURITIES		
Swift	8	8
	9,619	**10,977**
Balance at 1 January	10,977	13,384
Additions	505	998
Disposals	-	-
Impairment	(1,945)	(3,631)
Reversal of Fair Value Loss on AFS securities at impairment into Income Statement	82	308
Gains (losses) from changes in fair value	-	(82)
Balance at 31 December	**9,619**	**10,977**

During 2012, Cattolica Assicurazioni executed a stock dividend increase and the IOR received 34,980 new shares. Subsequently, the Institute purchased 44,000 Cattolica Assicurazioni shares, paying EUR 505,000. At year-end of 2012, the IOR owned 778,588 Cattolica Assicurazioni shares.

During 2012, the Cattolica Assicurazioni stake had a further decline in the fair value of the security below its value, already impaired at the end of 2011. Consequently the financial instrument was again impaired. The relevant impairment of EUR 1.4 m (2011: EUR 3.6 m) was recognised in the P & L item "Impairment losses" (note 23).

During 2012, the investment in Banca Carige was also impaired due to the significant and prolonged decline in its fair value below the historical cost. The relevant impairment of EUR 528,000 was recognised in the P & L item "Impairment losses" (note 23).

8. INVESTMENT SECURITIES, HELD TO MATURITY

	2012	2011
	EUR 000	EUR 000
Debt securities and bonds	620,010	439,618
Accruals	6,754	7,335
	626,764	**446,953**

Movement in the item may be summarised as follows:

	2012	2011
Balance at 1 January	446,953	304,445
Additions	502,414	205,680
Early mandatory redemption	-	-
Ordinary Redemption	(323,874)	(60,830)
Amortization	2,176	(2,280)
Reversal accruals previous year	(7,335)	(7,840)
Accruals	6,754	7,335
FX Effect	(324)	443
Balance at 31 December	**626,764**	**446,953**

The fair value of this securities' category, net of accruals, is EUR 650 m.

9.a INVESTMENT IN SUBSIDIARIES

	2012	2011
	EUR 000	EUR 000
Stakes in real estate companies	15,835	15,835
	15,835	**15,835**

The value of the stake in the real estate company Societa per Gestioni Immobili Roma (SGIR) is unchanged.

The SGIR is 100 % owned by the IOR. As of 31 December 2012, its equity amounted to EUR 21.8 m, including EUR 12.4 m for Fiscal Revaluation Reserve. Its main asset is the building located in Rome, Via della Conciliazione 10.

9.b INVESTMENT PROPERTIES

	2012	*2011*
	EUR 000	*EUR 000*
Directly owned properties	1,914	315
	1,914	**315**

Movement in the Directly owned properties may be summarised as follows:		
Balance at 1 January	315	315
Additions	1,599	
Sale of real estate investment properties	-	-
Leasehold improvement	-	-
Balance at 31 December	**1,914**	**315**

During the course of 2012, the IOR received two properties as inheritance. The appraisal made by a qualified and independent expert determined values of EUR 1.45 m and EUR 149,000 respectively, which increased the carrying amount on 31 December 2012 of the investment properties which is considered to be the fair value. The inheritance was recognised as income in "Other net income" in the P & L statement (note 22).

As of 31 December 2012, the properties do not produce any income and there are no leasing agreements in place.

10. EQUIPMENT AND FURNISHINGS

	Furniture & fittings	*Office equipment*	*Motor vehicles*	*Total*
	EUR 000	*EUR 000*	*EUR 000*	*EUR 000*
BALANCE AT 31 DECEMBER 2011				
Original cost	2,689	4,340	146	7,175
Accumulated depreciation	(2,576)	(4,003)	(79)	(6,658)
Closing net book amount	**113**	**337**	**67**	**517**
YEAR ENDED 31 DEC 2012				
Opening net book amount	113	337	67	517
Additions	13	28	3	44
Disposals	-	-	-	-
Depreciations	(72)	(228)	(35)	(335)
Closing net book amount	**54**	**137**	**35**	**226**
Disposal of assets completely depreciated	**(116)**	**(180)**	**(2)**	**(298)**
BALANCE AT 31 DECEMBER 2012				
Original cost	2,586	4,188	147	6,921
Accumulated depreciation	(2,532)	(4,051)	(112)	(6,695)
Closing net book amount	**54**	**137**	**35**	**226**

11. INTANGIBLE ASSETS

	Computer software & licenses
	EUR 000
BALANCE AT 31 DECEMBER 2011	
Original cost	4,098
Accumulated depreciation	(3,695)
Closing net book amount	**403**
YEAR ENDED 31 DECEMBER 2012	
Opening net book amount	**403**
Additions	324
Disposals	-
Depreciations	(291)
Closing net book amount	**436**
Disposal of immaterial assets completely depreciated	*(136)*
BALANCE AT 31 DECEMBER 2012	
Original cost	4,286
Accumulated depreciation	(3,850)
Closing net book amount	**436**

The IOR does not have internally generated intangible assets.

12. OTHER ASSETS

	2012	*2011*
	EUR 000	*EUR 000*
Securities sold not settled	2,265	2'988
Sundry debtors	56,697	5,115
Prepayments	356	281
Total	**59,318**	**8,384**

The item Sundry Debtors includes EUR 50 m for subscribing to further shares of an investment fund on 13 December. As of 31 December 2012, the relevant shares had not yet been assigned.

Furthermore, the item includes EUR 5.8 m consisting of asset management commissions pertaining to the second half year to be received in the first days of the following year.

Finally, the amount of EUR 638,000 posted in deposits for VISA transactions and the amount of EUR 207,000 as advances for VISA transactions are posted in this item.

13. DUE TO BANKS

Generally speaking, the IOR does not make use of any borrowing from banks.

The amount recorded at the end of 2012 in the item Due to Banks, EUR 2,700 (2011: EUR 5.6 m), concerns a small current account overdraft.

14. DUE TO FOR SAVING ACCOUNTS

	2012	*2011*
	EUR 000	*EUR 000*
Deposits at sight	3,194,815	1,996,999
Time deposits	890,897	1,212,597
Accruals	17,761	15,385
Total	**4,103,473**	**3,224,981**

The above amounts include deposits related to the Asset Management, for which the IOR is the depository institution.
These are composed of:

ASSET MANAGEMENT ACCOUNTS (WITHOUT ACCRUALS)		
Deposits at sight	1,376,286	321,598
Time deposits	409,186	388,758
	1,785,472	**710,356**

Considering that the item consists of demand accounts and term deposits with maximum 1-year maturity date, the carrying amount approximates the fair value.

15. OTHER LIABILITIES

	2012	*2011*
	EUR 000	*EUR 000*
Securities purchased not settled	480	1,416
Sundry creditors	22,914	12,482
Funds for charitable contributions	2,732	1,865
Total	**26,126**	**15,763**

Sundry Creditors can be broken down as follows:

Outstanding cheques	1,227	1,790
Invoices to be received	2,279	1,750
Inheritance to be settled	16,701	7,758
Remunerations to be paid	940	870
Unsettled amounts	1,548	-
Other	219	314
	22,914	**12,482**

The item "Inheritances to be settled" consists of legacy outstanding balances owned by the estates of deceased clients pending the outcome of inheritance proceedings.

The breakdown of Funds for charitable contributions is as follows:

Fund at the disposal of the Cardinals' Commission	425	625
Fund for Missionary Activities	129	129
Fund for Holy Masses	2,178	1,111
	2,732	**1,865**

The movement of the Funds for charitable contributions is summarised as follows:

FUND AT THE DISPOSAL OF THE CARDINALS' COMMISSION		
Balance at 1 January	625	625
Appropriations:		
Donations	-	-
Transfer from earnings available for distribution	-	-
Distributions:		
Charitable distributions	(200)	-
Balance at 31 December	**425**	**625**

FUND FOR MISSIONARY ACTIVITIES		
Balance at 1 January	129	129
Donations	-	-
Distributions for Missionary Activities	-	-
Balance at 31 December	**129**	**129**

FUND FOR HOLY MASSES		
Balance at 1 January	1,111	590
Donations	1,159	612
Distributions for Holy Masses	(92)	(91)
Balance at 31 December	**2,178**	**1,111**

16. POST-EMPLOYMENT BENEFIT OBLIGATIONS

	2012	2011
	EUR 000	EUR 000
Amounts recognised in the Balance Sheet:		
Amount recognised in the Balance Sheet concerning benefit plan obligations	81,526	75,254
Other post employment benefits	5,369	4,750
Total	**86,895**	**80,004**

Movement in the defined benefit plan liability recognised in the Balance Sheet is summarised as follows:

	2012	2011	2011
	EUR 000	EUR 000	EUR 000
		as restated	as presented
Balance at 1 January	75,254	74,721	76,563
Current cost (note 21bis)	3,149	3,044	3,044
Contribution by individuals	119	241	241
Tranfers in (from other post employment benefit)	138	199	199
Pensions paid during the year	(2,733)	(2,437)	(2,437)
Tranfers out (note 22)	-	(1,633)	(1,633)
Actuarial (gain) loss of the year	5,599	1,119	
Balance at 31 December	**81,526**	**75,254**	**75,977**

The actuarial loss as of 31 December 2012 amounts to EUR 4.9 m.

The early adoption of revised IAS 19 lead the IOR to recognise actuarial gains or losses in Other Comprehensive Income, removing the option to defer recognition of actuarial gain or losses (called the corridor approach).

This meant that the IOR needed to restate the amount on 1 January 2011 by including the unrecognised gain existing at that date of EUR 1.8 m into Equity.
By adjusting the amounts on 31 December 2011 as if the revised accounting principle had already been applied in the previous year, a loss of EUR 1.1 m was recorded in Other Comprehensive Income, representing the movement in 2012 of the actuarial gain/loss, which resulted in a Pension Fund Actuarial Gain (Loss) Reserve in Equity of EUR 723,000.
In 2012, Other Comprehensive Income included an actuarial loss of EUR 5.6 m which resulted in a Pension Fund Actuarial Gains (Losses) Reserve of EUR 4.9 m negative of 31 December 2012.

IAS 19 requires the IOR to calculate the following:

- Service cost
- Interest cost
- Actuarial gain / loss

The Service Cost is the actuarial present value of benefits attributed by the pension formula to employee service performed in the period.

The Interest Cost is the increase in the present value of the obligation as a result of moving one period closer to settlement and it is proportional to the actuarial rate utilised in the assessment and to the previous year liabilities.

The Actuarial gain / loss is the change in the liability in the present year and it arises:

- from the effects of differences between the previous actuarial assumptions and what has actually occurred;
- from the effects of changes in actuarial assumptions.

The amounts of these quantities are shown in the following table with the movement of the liability during 2012 considering IAS 19.

	2012	*2011*	*1 January 2011*
	EUR 000	*EUR 000*	*EUR 000*
		as restated	*as restated*
PRESENT VALUE OF UNFUNDED BENEFIT PLAN OBLIGATIONS	81,526	75,254	74,721
UNREALISED ACTUARIAL GAIN / (LOSS) RECOGNISED AS EQUITY	(4,876)	723	1,842
Liability calculated 1 January	75,254	74,721	
Service cost	360	338	
Interest cost	2,789	2,706	
Actuarial (gain) / loss of the year	5,599	1,119	
Contributions by individuals	119	241	
Transfers in (out)	138	(1,434)	
Benefits paid	(2,733)	(2,437)	
Liabilities calculated by the Actuary	**81,526**	**75,254**	
The amounts recognised in the income statement are as follows:			
Current service cost	360	338	
Interest cost	2,789	2,706	
Total, included in staff costs (note 21 bis)	**3,149**	**3,044**	
The actuarial valuation of the defined benefit plan liability was performed taking into account the following assumptions:			
Annual inflation rate	2.00 %	2.00 %	
Annual discount rate	3.40 %	3.75 %	
Annual rate for revaluation of pension	2.00 %	2.00 %	
Annual rate of salary increase	2.50 %	2.50 %	

104 employees are in service and contribute to the Pension Fund. 69 people are in retirement and benefit from the Plan. In 2011, 95 were in service, and 68 in retirement.

The other post employment benefit fund corresponds to the IOR's obligation towards its employees at the end of the accounting period according to employment regulations. The amount of the obligation on the date of the financial statements is estimated using actuarial methods and discounted to its present value using the "project unit credit method". The unrealised actuarial gain or loss is recognised in the P & L item "Staff costs" if a loss (note 21 b) or "Other net income" if a gain (note 22).

Movement in the other post employment benefit recognised in the Balance Sheet is summarised as follows:

		2012		2011
		EUR 000		EUR 000
Balance at 1 January		4,750		4,889
Current cost (note 21 bis)		823		416
Service plus interest cost	413		408	
Adjustment for annual actuarial discount rate change	410		8	
Contribution by individuals		80		86
Transfers in (out)		(138)		(199)
Advances		(60)		(49)
Advances restitution		14		14
Consideration paid during the year		(100)		(407)
Balance at 31 December		**5,369**		**4,750**

The actuarial assumptions utilised for the valuation of the fund are the same as those used for the Pension Fund.

Income Statement Notes

17. NET INTEREST RESULT

	2012 EUR 000	2011 EUR 000
INTEREST INCOME		
Bank deposits	12,626	12,561
Trading securities	47,358	56,101
Loans and receivables securities	12,373	10,143
Investment securities held to maturity	17,260	10,223
Investment securities available for sale	-	1,660
Loans and advances	930	1,026
	90,547	**91,714**

	2012 EUR 000	2011 EUR 000
INTEREST EXPENSE		
Customers	38,371	26,775
Other	4	11
	38,375	**26,786**

Interest income accrued on advances and credit lines include also interests on doubtful loans amounting to EUR 159,000 (2010: EUR 157,000). The related impairment has been posted in the P & L item Impairment on loans and advances (note 23).

Interests income on Loans & Receivables securities and on investment securities held to maturity include the premium or discount amortisation.

18. NET FEE AND COMMISSION RESULT

	2012 EUR 000	2011 EUR 000
FEE AND COMMISSION INCOME		
Asset management fees	10,972	10,499
Portfolio and other management fees	2,669	2,239
Other fees	1,464	1,339
	15,105	**14,077**

	2012 EUR 000	2011 EUR 000
FEE AND COMMISSION EXPENSE		
Brokerage fees paid	1,322	2,562
Other fees paid	1,589	1,296
	2,911	**3,858**

19. DIVIDEND INCOME

	2012	*2011*
	EUR 000	*EUR 000*
Trading securities	1,827	2,245
Investment securities available for sale	-	460
	1,827	**2,705**

20. NET TRADING INCOME

	2012	*2011*
	EUR 000	*EUR 000*
Foreign exchange	167	2,187
Interest rate instruments	51,104	(23,189)
Equity instruments	236	(11,970)
Externally managed funds	4,759	(8,020)
Gold and precious metals	2,000	3,789
Derivative financial instruments	(7,138)	(970)
	51,128	**(38,173)**

The two tables below show the breakdown of the item "Net trading income" distinguishing between realised result and revaluation result.

	2012	*2011*
	EUR 000	*EUR 000*
	Realised gain / losses	*Realised gain / losses*
Foreign exchange	285	2,475
Interest rate instruments	27,956	(8,908)
Equity instruments	2,855	2,740
Externally managed funds	1,408	(837)
Gold and precious metals	56	20
Derivative financial instruments	(7,138)	-
	25,422	**(4,510)**

	Unrealised gain / losses	*Unrealised gain / losses*
Foreign exchange	(118)	(288)
Interest rate instruments	23,148	(14,281)
Equity instruments	(2,619)	(14,710)
Externally managed funds	3,351	(7,183)
Gold and precious metals	1,944	3,769
Derivative financial instruments	-	(970)
	25,706	**(33,663)**
Total net trading income	**51,128**	**(38,173)**

21. OPERATING EXPENSES

	2012	2011
	EUR 000	EUR 000
Staff costs (note 21 bis)	11,542	10,316
Depreciation of equipment and furnishings (note 10)	335	442
Depreciation of intangible assets (note 11)	291	387
Other operating expenses *	11,781	9,812
	23,949	**20,957**

* The item includes the provision of EUR 1m payable to APSA for the building occupancy when yearly profit is distributed.

21 bis. STAFF COSTS

	2012	2011
	EUR 000	EUR 000
Wages and other benefits	6,901	6,196
Pension costs: defined contribution plan	669	660
Pension costs: defined benefit plan (note 16)	3,149	3,044
Other post employment benefits	823	416
	11,542	**10,316**

22. OTHER NET INCOME

	2012	2011
	EUR 000	EUR 000
Recoveries of amounts previously impaired (note 5)	204	82
Disposal investment securities (note 7)	-	1,500
Disposal L & R securities (note 6)	(6,564)	-
Transfer out from retirement fund (note 16)	-	1,633
Properties inherited (note 9 b)	1,599	-
Reversal exceeding allowance for portfolio impairment losses (note 5)	198	-
Other	(90)	2,090
	(4,653)	**5,305**

23. IMPAIRMENT LOSSES

	2012	2011
	EUR 000	EUR 000
Impairment losses on investment securities available for sale (note 7)	1,945	3,631
Impairment losses on loans and advances (note 5)	159	157
Allowance for portfolio losses on loans and advances (note 5)	-	-
Reversal of allowance for portfolio impairment losses on loans and advances (note 5)	-	(14)
	2,104	**3,774**

24. CONTINGENT LIABILITIES AND COMMITMENTS

	2012	*2011*
	EUR 000	*EUR 000*
Guarantees issued in favour of third parties	**158**	**1,910**

The IOR issued three guarantees. Two of them were requested by a catholic hospital and issued in favour of another catholic hospital and a university. The remaining one was requested by a religious congregation and issued in favour of a bank.

During 2012, one guarantee requested by a religious congregation and issued in favour of a bank expired.

No new guarantees were issued in 2012.

The guarantees are initially recognised at their nominal value, which is their fair value, and are fully secured by assets held in custody by the IOR. Consequently, they do not increase liquidity risk.

In subsequent periods, the guarantee is to be reported at the amount determined in accordance with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets”.

25. THIRD PARTIES’ VALUES

	2012	*2011*
	EUR 000	*EUR 000*
Securities held in custody for third parties	797,066	763,223
Asset management	3,205,847	2,947,503
	4,002,913	**3,710,726**

Securities held in custody for third parties are evaluated based on current bid price, according to the mark to market method and they also include accruals on interests to be received on debt securities.

Moreover, the securities held under portfolio management positions are evaluated according to the mark to market method. They include the total value of portfolios, consequently also the liquidity for settlements and term deposits. Furthermore, accruals are included, both on securities and on liquidity and term deposits.

The IOR is the depository for both the liquidity for settlements and term deposits, amounting to EUR 1.8 bn (2011: EUR 710 m), as stated in note 14.

26. RELATED PARTY TRANSACTIONS

IAS 24 “Related Party Disclosures” requires the disclosure of the nature and amounts of related party transactions and outstanding balances in the financial statements of the reporting entity.

At the IOR, related parties comprise key management personnel (Directorate and Board of Superintendence) and Cardinals’ Commission. The transactions with these related parties during 2012 (as well as 2011) related only to ordinary emoluments and salaries.

The expenses recorded for compensation to related parties for 2012 amount to EUR 877,000 (2011: EUR 856,000), of which EUR 420,000 were payable by 31 December 2012. They are recognised in the Income Statement as Operating Expenses.

27. FAIR VALUE INFORMATION

	2012 EUR 000			
TRADING SECURITIES	*Level 1*	*Level 2*	*Level 3*	*Total*
Debt securities and bonds	2,421,408	877	-	2,422,285
Listed equity securities	93,148			93,148
External investment funds	26,395	23,566	144,360	194,321
	2,540,951	**24,443**	**144,360**	**2,709,754**
INVESTMENT SECURITIES AVAILABLE FOR SALE				
Listed equity securities	9,611			9,611
Unlisted equity securities			8	8
	9,611	**-**	**8**	**9,619**

Amounts do not include acrruals

	2011 EUR 000			
TRADING SECURITIES	*Level 1*	*Level 2*	*Level 3*	*Total*
Debt securities and bonds	1,366,971	160,299		1,527,270
Listed equity securities	80,594			80,594
External investment funds	68,688	4,616		73,304
	1,516,253	**164,915**	**-**	**1,681,168**
Derivative financial instruments		32,637		32,637
		32,637		**32,637**
INVESTMENT SECURITIES AVAILABLE FOR SALE				
Listed equity securities	10,969			10,969
Unlisted equity securities			8	8
	10,969	**-**	**8**	**10,977**

Movement during 2012 in the investment in Level 3 is summarised as follows:

	EUR 000	
	Trading securities	*Available for sale securities*
	External investment funds	*Unlisted equity securities*
Balance as at 1 January 2012	**-**	**8**
TOTAL GAINS / LOSSES INCLUDED IN THE STATEMENT OF COMPREHENSIVE INCOME		
Net trading income: unrealised profits	1,152	-
PURCHASES, SALES, ISSUANCES AND SETTLEMENTS		
Purchases		
Sales		
Issuances	143,208	
Settlements		
Balance as at 31 December 2012	**144,360**	**8**

Total gains / losses for the period included in the statement of comprehensive income for		
Level 3 instruments held at the end of the reporting period	**1,152**	**-**
Net trading income: unrealised profits	1,152	-

Fair Value Hierarchy

The fair value hierarchy consists of three levels.

LEVEL 1

A financial instrument is considered quoted in an active market when its price is:

1) promptly and regularly available in stock exchanges, info providers, intermediaries, etc.;
2) significant. This means that it represents effective market transactions regularly occurring in normal transactions.

To be considered in Level 1, the price must not be adjusted through a valuation adjustment. If it is adjusted, the Level is Level 2.

LEVEL 2

A financial instrument is included in Level 2 when the inputs utilised to measure fair value are market observables.

They involve:

- prices quoted in active markets for similar assets or liabilities;
- less-active markets for similar or identical assets and liabilities;
- market observable inputs other than the quoted price for the asset or liability (interest rates, yield curve, credit spreads, volatility);
- market-corroborated inputs.

An input is observable when participants utilise parameters that are not affected by own judgements.

Valuation techniques which are utilised for fair value, should be utilised only if the market price is not available or it is not significant, and should comply with three conditions:

1) to be methodologically consolidated and widely utilised;
2) to utilise market inputs disclosed above;
3) to be periodically reviewed.

Valuation techniques utilised for fair value measurement should be periodically assessed utilising inputs observable in the markets in order to ensure that outputs reflect actual data and comparative market prices and to identify any weaknesses.

If the fair value measurement utilises observables that require a significant adjustment based on unobservable inputs, the valuation has to be considered in Level 3.

LEVEL 3

Included in Level 3 are financial instruments evaluated utilising inputs that are not based on observable market data (unobservable inputs). To be included in Level 3, it is enough that at least one of the inputs is unobservable in the market.

In particular, Level 3 should be utilised when inputs are not based on independent sources but on the reporting entity's own assumptions about the assumptions market participants would use and also if they are based on observables.

The IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs are observable or unobservable. Observable inputs reflect the assumptions that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the reporting entity. The market price is the more observable and objective input (Level 1). Where no active markets exist or where quoted prices are not available, the entity determines the fair values by using valuation techniques. Valuation techniques can utilise inputs observable on the market (Level 2) or inputs that are not observable (Level 3).

In case of availability of quoted market prices in active markets, an entity must apply Level 1. Furthermore, the valuation techniques utilised should prioritise the utilisation of inputs observable in the market and should rely as little as possible on the reporting entity's own data, internal valuations or unobservable inputs.

IOR fair value policy and fair value hierarchy

The fair value of quoted investments in active markets is usually based on the current bid price. A financial instrument is considered quoted in active markets if the list prices are promptly and regularly available in an official list or from an authority, and these prices represent effective market transactions regularly traded in normal transactions.

If the market for a financial asset is not active, or if the market at valuation time is not considered active, for instance in case of illiquid markets, the valuation techniques adopted are based on the use of recent "at arm's length" transactions. These evaluation techniques also include discounted cash flows analysis and other valuation techniques commonly used by market participants.

If recent transactions on identical or similar instruments are not available, the IOR utilises valuation techniques based on market parameters. When utilising valuation techniques, the IOR tries to use observable market data and is reluctant to rely on internal data.

Valuation techniques are periodically reviewed and calibrated, assessing the quantity and the quality of information on the balance sheet date, in order to correctly reflect any changes in the market.

For the same reason, adjustments to market inputs, utilised in a certain model, can change from time to time.

Consequently, models are calibrated to ensure that outputs reflect actual data and comparative market prices.

Under Level 1, the IOR classified all financial instruments quoted in active markets.

Under Level 2, the IOR classified all illiquid financial instruments, both structured and not structured and not quoted external funds.

As already disclosed in note 2 of the current section, the basis for the valuation of structured investments are prices provided by the securities issuer every ten days. These prices are internally verified and tested utilising internal models and observable market parameters and, in case of discrepancies, adjusted considering the result of the above mentioned analysis. They are also adjusted on the basis of valuations from independent sources.

External Funds are included in Level 2 where their NAV is not quoted.

Under Level 3, the IOR classified not quoted equity securities or other financial instruments for which fair values are determined using a model based on internal parameters.

Where practical, models use only observable data; however, areas such as default rates, volatilities and correlations require Management to make estimates.

Also financial instruments for which the IOR did not receive an independent valuations are classified under this level, due to the fact that the value has been given from the issuer himself.

As of 31 December 2012, the IOR classified under Level 3 the investment in an externally managed fund (EUR 144.4 m), in addition to a small amount (EUR 8,000) invested in unlisted equity securities.

28. MEASUREMENT CATEGORIES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The following table provides information about the carrying amounts of individual classes of financial instruments within the measurement categories of financial assets and financial liabilities as defined in IAS 39 Financial Instruments: recognition and measurement. Only those assets and liabilities which are financial instruments as defined in IAS 32 Financial Instruments: presentation are included in the table below, which causes certain balances to differ from those presented on the balance sheet.

	2012	*2011*
	EUR 000	*EUR 000*
Financial assets		
FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS		
Trading securities	2,730,675	1,697,102
Gold, medals and precious coins	41,346	40,119
Derivative financial instruments	-	32,637
	2,772,021	**1,769,858**
FINANCIAL ASSETS AT AMORTISED COST		
Cash	5,303	6,750
Bank deposits	1,216,245	1,435,510
Loans and advances to customers	25,823	30,619
Loans and receivables securities	252,252	341,405
Investment securities, held to maturity	626,764	446,953
Other assets	58,962	8,100
	2,185,349	**2,269,337**
FINANCIAL ASSETS AVAILABLE FOR SALE		
Investment securities, equity available for sale	9,619	10,977
	9,619	**10,977**
Total financial assets	**4,966,989**	**4,050,172**
Financial liabilities		
FINANCIAL LIABILITIES AT AMORTISED COST		
Due to banks	3	5,617
Due for saving accounts	4,103,473	3,224,981
Other liabilities	23,394	10,617
	4,126,870	**3,241,215**
Total financial liabilities	**4,126,870**	**3,241,215**

29. EXCHANGE RATES AS OF THE BALANCE SHEET DATE

Finally, for disclosure, the main currencies are valued at the exchange rates set by the European Central Bank on the last quotation day of the year (28 December 2012).

For these statements the rates were determined as follows:

		2012	2011
U.S. Dollars	USD	1.3183	1.2939
Swiss Francs	CHF	1.208	1.2156
Canadian Dollars	CAD	1.3122	1.3215
English Pounds	GBP	0.817	0.8353
Australian Dollars	AUD	1.2692	1.2723
Japanese Yen	JPY	113.5	100.2
Danish Crowns	DKK	7.4604	7.4342
Norwegian Crowns	NOK	7.3375	7.754
Swedish Crowns	SEK	8.5615	8.912
Czech Crowns	CZK	25.14	25.787
Hong Kong Dollars	HKD	10.2191	10.051
Singapore Dollars	SGD	1.6124	1.6819
New Zealand Dollars	NZD	1.6053	1.6737

For the other currencies, the rates used are those provided by Reuters at the same date.

30. DATE OF AUTHORIZATION FOR ISSUE

These financial statements have been authorised for issue by the Directorate on 28 February 2013 and on 15 July 2013 for submission to the Board of Superintendence and were approved by the Board of Superintendence on 11 April 2013 and on 15 July 2013.

31. EVENTS AFTER 31 DECEMBER 2012

On 26 June 2013, the Pope set up a Pontifical Commission that is charged with drawing up an exhaustive report of the status and activities of the IOR. The Commission consists of five members. Its task is to carry out inquiries and present the Holy Father with a report of findings in view of possible reform. No deadline has been set for the final report. The outcome of the inquiries is uncertain at the date of approval of these financial statements. Accordingly, as of the date of approval of these financial statements it cannot be excluded that the activities and the organisation of the IOR will be changed as a result of the outcome of the inquiries.

During the first six months of 2013, the IOR's assets decreased from EUR 4.9 bn to EUR 3.9 bn. This was due to the decrease of "Due for saving accounts" by EUR 1 bn. The reduction is mainly due to the fact that clients have chosen to invest directly in securities. These investments represent assets held in custody or under portfolio management which the IOR discloses as off balance sheet positions. Taking into account all the assets entrusted by clients to the IOR (including cash, assets held in custody and assets held under portfolio management), the total value decreased by EUR 161 m from December 2012 to June 2013.

On 1 July 2013, the IOR General Director, Commendatore Paolo Cipriani, and the Deputy Director, Dr. Massimo Tulli, offered their resignations from their current positions. The Commission of Cardinals and the Board of Superintendence have accepted their resignations and asked President Ernst von Freyberg to assume the functions of the General Director ad interim with immediate effect, retaining his oversight role as President of the Board of Superintendence. Ernst von Freyberg will be supported by Dr. Rolando Marranci as acting Deputy Director. The Board of Superintendence has begun the process of finding a permanent General Director and Deputy Director.

SECTION V

Financial Risk Management

5.1 Strategy in using financial instruments

By their nature, the IOR's activities are principally related to the use of financial instruments. The Institute accepts deposits from customers at both fixed and floating rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets. The Institute seeks to increase these margins by consolidating short-term funds and investing for longer periods at higher rates, while maintaining sufficient liquidity to meet all obligations that might fall due.

Therefore, for its activities, the IOR is exposed to financial risks. The Institute sets appropriate risk limits and takes action to measure, manage and monitor the risk.

The objective is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Institute's financial performance.

The Institute's risk management policies are designed to identify and analyse these risks, to set appropriate risk limits and controls and to monitor the risk and adherence to limits by means of reliable and up-to-date information systems.

For these purposes, a Risk Management Department was created in 2007, with a dedicated and specialised staff.

This department analyses the market risk, the credit risk and the operational risk.

The following parameters disclose the IOR risk management approach, the methods of credit risk, market risk (interest rate risk, currency risk and other price risk), liquidity risk and capital requirements.

5.2 Credit Risk

The Credit Risk is the risk of loss resulting from the failure of a client or counterparty to meet its contractual obligation.

The objectives of monitoring the credit risk are to recognise on a timely basis those situations that give rise to an anomalous trend, in order that the IOR defines with adequate lead time the corrective actions to be taken.

Financial assets, which potentially subject the Institute to concentrations of credit risk, comprise mainly amounts due from banks and debt securities.

The IOR manages its credit risk by monitoring actual credit exposures against defined credit and counterparty limits.

Limits on the level of credit risk are approved by the Board of Superintendence based on the proposal of the Risk Management Department agreed by the Directorate and are subject to an annual review or therefore every time there is some news about ratings changes, if the defined risk ranges change.

A system called "Gestione Limiti Operativi Area Finanza" was implemented. The approved limits for each counterparty, both as single institution and as group, are input into the system at the start of each year following the approval of the Board of Superintendence. At least once a day, on demand, the system produces a table with comparison between the approved limits and the actual credit exposure.

The table below shows the concentration per rating of time deposits with banks.

TABLE 5.2.1 TIME DEPOSITS BY RATING CATEGORY S&P

	2012	*2011*
AAA	-	-
AA+	-	-
AA	-	2.11 %
AA-	42.66 %	27.56 %
A+	20.02 %	26.12 %
A	-	10.54 %
A-	16.19 %	3.79 %
BBB+	-	12.63 %
BBB	-	7.16 %
BBB-	15.72 %	
BB+	5.41 %	10.09 %
Not rated	-	-
Total	**100.00 %**	**100.00 %**

By comparing the two years, in some cases an improvement was recorded, in other cases a deterioration. The improvement was due to new counterparties with higher quality. Instead, the rating deterioration is not due to the risk deterioration of the financial institutions that are IOR counterparties for time deposits. The deterioration is caused by the downgrading of most of sovereign states which impacted the counterparty's ratings.

For debt securities, the IOR places limits on the amount of risk accepted in relation to issuers. Such risks are monitored by taking into consideration both the concentration of the issuers and their quality, based on ratings.

The table below shows the concentration per rating of bond property portfolio, which comprises all interest-bearing securities, including trading securities and financial assets held to maturity and Loans and Receivables.

TABLE 5.2.2 BOND PORTFOLIO BY RATING CATEGORY S&P

	2012	*2011*
AAA	19 %	28 %
AA+	14 %	14 %
AA	1 %	4 %
AA-	12 %	8 %
A+	3 %	4 %
A	3 %	8 %
A-	5 %	6 %
BBB+	28 %	23 %
BBB	4 %	0 %
BBB-	11 %	0 %
BB+	0 %	0 %
B	0 %	0 %
B-	0 %	0 %
Illiquid bonds not rated	0 %	5 %
Total	**100 %**	**100 %**

Also for the bond portfolio, the rating deterioration was due to the downgrading of sovereign debt risk and to the subsequent downgrading of bond issuers from the downgraded countries.

As far as the Credit Risk on Loans and Receivables with third parties "customers" is concerned, the IOR considers it is not required to be equipped with special systems to measure the risk because:

1. The item is immaterial compared to the IOR total assets;
2. Counterparties are religious congregations or institutions or Vatican City State employees, who are categories with a low risk profile;
3. The IOR generally obtains collaterals for funds advanced like securities or managed assets or, if employees, the termination indemnity. As at 31 December 2012 these collaterals amounted to EUR 7.2 m.

Customer Credit Risk is monitored by utilising information and procedures for assessing the sustainability of the advances.

An internal rating tool helps management to determine whether objective evidence of impairment exists on advances made to customers, based on the following criteria set out by the Institute:

- delinquency in contractual payments of principal or interest;
- cash flows difficulties experienced by the borrower;
- deterioration in the value of collateral.

At the end of each month, the Advances Department analyses all credits and, if there are positions past due and uncollectible, requests the Directorate to write off the whole amount as credit loss. If the past due position is thought collectable but not in a short term period, the credit is individually impaired. If the past due position is thought collectable in a short term, it is not individually impaired, but the department monitors its evolution.

TABLE 5.2.3 LOANS QUALITY

	2012			
	N.	*Gross amount*	*Impairment*	*Carrying amount*
Performing loans	470	19,638	969	18,669
Restructured loans	11	7,384	443	6,941
Past due but not impaired	1	227	14	213
Fully impaired	6	6,745	6,745	-
Total	**488**	**33,994**	**8,171**	**25,823**

	2011			
	N.	*Gross amount*	*Impairment*	*Carrying amount*
Performing loans	539	27,359	1,331	26,028
Restructured loans	2	492	30	462
Past due but not impaired	5	4,392	264	4,128
Fully impaired	7	6,798	6,798	-
Total	**553**	**39,041**	**8,422**	**30,619**

Below is a breakdown of “Advances to clients”

TABLE 5.2.4 ADVANCES TO CLIENTS

	2012	*2011*
Clergy, religious congregations and other ecclesial bodies	36.86 %	52.62 %
IOR and Vatican City State employees	59.61 %	44.91 %
Various	3.53 %	2.47 %
	100.00 %	**100.00 %**

The IOR also issued guarantees which are discussed in Section IV note 24. As they are fully secured by assets held in custody by the IOR, they do not increase financial risks.

5.3 Geographical concentration of assets

The IOR has credit exposure mainly through its bond portfolios to issuers domiciled and banks domiciled outside of the Vatican City State.

High geographical concentration is a risk factor if there is a country risk. Country risk is the risk arising from country-specific events.

The objective when monitoring the concentration risk is to recognise in a timely fashion those situations that may indicate an anomalous behaviour, ensuring that the IOR defines in adequate advance the corrective actions to be taken.

The concentration risk is measured by allocating all assets based on the country of domicile of its counterparties.

Two times per year, the General Ledger Department produces a table and submits it to the Directorate only if anomalous situations arise. An anomalous situation is the shifting of the concentration from low risk countries to high risk countries.

The geographical analysis of assets items based on the domicile of the counterparties is set out below:

TABLE 5.3.1

	At 31 December 2012	*At 31 December 2011*
EUR 000	*Total Assets*	*Total Assets*
Vatican City State	22,196	25,390
Italy	1,179,619	885,821
Holland	855,337	332,590
Spain	589,635	590,057
Germany	282,613	452,685
Other European Countries	949,898	795,284
USA and Canada	488,041	552,876
Other countries	496,812	360,696
Unallocated assets/liabilities	121,605	72,127
Total	**4,985,756**	**4,067,526**

No other countries represent more than 5 % of total assets.

TABLE 5.3.2 EXPOSURE TO GREECE, IRELAND, ITALY, PORTUGAL, SPAIN

	At 31 December 2012	*At 31 December 2011*
EUR 000	*Total Assets*	*Total Assets*
Portugal	1,592	1
Ireland	48,089	80,398
Italy	1,179,619	885,821
Greece	-	-
Spain	589,635	590,057
Total	**1,818,935**	**1,556,277**

5.4 Market Risk

The Market Risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market variables.

Market risk comprises the following three types of risk:

- currency risk (the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates);
- interest rate risk (the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates);
- other price risk (for individual financial instruments or for all similar financial instruments).

The IOR has exposure to market risks. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market factors.

General market risk factors include interest rates, equity index levels, exchange rates, commodity prices and general credit spreads. The volatility of these risk factors and the correlations between them are also general market risk factors.

Specific components relate to the prices of debt and equity instruments which result from factors and events specific for individual companies or entities.

The objective when monitoring market risk is to know and manage market risk in order to be able to face extreme events affecting the three areas mentioned above.

5.4.1. Main risk management indicators of the property portfolio

The IOR applies a "value at risk" methodology to estimate the market risk of positions held and the maximum losses expected based on a number of assumptions for various changes in market conditions.

The Risk Management Department provided the following information about risk analysis.
The Department analysed the property portfolio and the term deposits with banks using a risk analysis software (Point) of Barclays Bank which is utilised all over the world by many primary banks and financial institutions.

A specific report provided by the Risk Management Department containing information about the main risk indicators at the end of each month is provided to the Board of Superintendence.

We enclose some brief explanatory notes where the analysis methods are detailed and we define the main risk indicators utilised:

a. The IOR utilises the Montecarlo simulations model, which accounts for a wide range of possible future risks, looking at the historical correlation between all the involved variables.

b. The Benchmark is built to represent the liabilities which cover the interest-bearing securities, either Trading Securities and Financial Assets Held to Maturity, and considers the strategy – balancing of foreign exchange positions – generally adopted by Treasury. Since interest rate risk sensitive liabilities are not explicitly covered in the VaR calculation, the IOR approximates the positions by using benchmarks such as 3-month LIBOR and EuroStoxx50 for modelling equity. It is a mix of three months euro, US dollar and pound sterling swap rates, weighted according to the percentages of such currencies in property portfolio bonds. It is utilised to measure the economic market risk (the integrated risk of assets and liabilities, notwithstanding that they are accounted for at fair value or at amortised cost), different from the trading market risk (considering the risk of decrease of market value of our assets, directly reflected in P & L Account, since they are valued marked to market.

c. The Value at Risk (VaR) is the amount of the possible losses in a one month period, associated to negative market trends and given a confidence level of 99 %. It quantifies the exposure to market risk, or the risk that a position declines in value with adverse market price changes.

d. The Expected Shortfall (ES) is the average of VaR values in a one month period for all confidence levels between 99 % and 100 %. It defines the average worst case scenario.

e. The Tracking Error volatility (TEV) is the standard deviation of monthly return out-performance. It quantifies how much the portfolio can outperform or underperform the benchmark in the above-mentioned period.

The following tables, prepared by Risk Management Department, refer to December 2012 and December 2011.

Indicator		*31/12/12*	*31/12/12*	*31/12/12*	*31/12/12*	*31/12/12*
		Bonds	*Equities – trading*	*Equities – afs*	*Loans to banks*	*Total*
Property Portfolio – market value	*EUR 000*	3,313,985	116,530	9,619	922,449	4,362,583
Percentage of assets held		66.37 %	2.33 %	0.19 %	18.42 %	87.37 %
Euro Bloc		70 %	70 %	100 %	70 %	75 %
US Dollar Bloc		30 %	30 %	0 %	30 %	25 %
GB Pound Sterling Bloc		0 %	0 %	0 %	0 %	0 %
Canadian Dollar Bloc		0 %	0 %	0 %	0 %	0 %
Swiss Franc Bloc		0 %	0 %	0 %	0 %	0 %
Japanese Yen Bloc		0 %	0 %	0 %	0 %	0 %
Total		**100 %**	**100 %**	**100 %**	**100 %**	**100 %**
Average Life (Yr)		1.98	0.00	0.00	0.04	1.55
Adjusted Duration (Yr)		1.66	0.00	0.00	0.04	1.27
Value at Risk 99 % (per month)						
1) Portfolio		58,411	13,008	2,170	15,537	69,502
2) Portfolio vs. Benchmark		44,298	15,076	1,823	8,551	41,480
Expected Shortfall 99 % (per month)						
1) Portfolio		73,018	17,490	2,971	19,553	86,944
2) Portfolio vs. Benchmark		61,262	20,028	2,475	8,551	58,357
Tracking Error Volatility (bps/month)		54.80	557.90	722.50	36.70	43.70
Stable Equity Reserves		682,644	682,644	682,644	682,644	682,644
- allocation rate						
1) referring to Portfolio VaR		8.56 %	1.91 %	0.32 %	2.28 %	10.18 %
2) referring to Portfolio vs. Benchmark VaR		6.49 %	2.21 %	0.27 %	1.25 %	6.08 %

Indicator		*30/12/11*	*30/12/11*	*30/12/11*	*30/12/11*	*30/12/11*
		Bonds	*Equities – trading*	*Equities – afs*	*Loans to banks*	*Total*
Property Portfolio – market value	*EUR 000*	2,269,136	146,268	10,977	1,318,558	3,744,939
Percentage of assets held		56.24 %	3.63 %	0.27 %	32.68 %	92.82 %
Euro Bloc		70 %	70 %	100 %	90 %	75 %
US Dollar Bloc		30 %	30 %	0 %	10 %	25 %
GB Pound Sterling Bloc		0 %	0 %	0 %	0 %	0 %
Canadian Dollar Bloc		0 %	0 %	0 %	0 %	0 %
Swiss Franc Bloc		0 %	0 %	0 %	0 %	0 %
Japanese Yen Bloc		0 %	0 %	0 %	0 %	0 %
Total		**100 %**	**100 %**	**100 %**	**100 %**	**100 %**
Average Life (Yr)		2.43	NA	NA	0.09	1.59
Adjusted Duration (Yr)		1.78	NA	NA	0.09	1.12
Value at Risk 99 % (per month)						
1) Portfolio		64,489	31,545	3,601	19,947	82,002
2) Portfolio vs. Benchmark		44,316	33,635	2,901	6,495	57,540
Expected Shortfall 99 % (per month)						
1) Portfolio		80,102	42,057	4,956	37,795	102,037
2) Portfolio vs. Benchmark		63,316	44,583	3,935	26,105	80,754
Tracking Error Volatility (bps / month)		90.60	783.50	993.70	43.00	67.80
Stable Equity Reserves		720,185	720,185	720,185	720,185	720,185
- allocation rate						
1) referring to Portfolio VaR		8.95 %	4.38 %	0.50 %	2.77 %	11.39 %
2) referring to Portfolio vs. Benchmark VaR		6.15 %	4.67 %	0.40 %	0.90 %	7.99 %

5.4.2 Currency risk

Concentration of assets, liabilities and off balance sheet items

The Institute is exposed to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial positions and cash flows.

The objective when monitoring currency risk is to achieve an appropriate balance between return and risk arising from unmatched liabilities and assets in currencies different from the functional one. The table below summarises the Institute's exposure to foreign currency exchange risk at 31 December 2012 and 2011.

Included in the table are the Institute's assets and liabilities at carrying amounts categorised by currency. The off-balance sheet gap represents the difference between the notional amounts of foreign currency derivative financial instruments, which are principally used to reduce the Institute's exposure to currency movements, and their fair values.

Although the Euro currency is not subject to currency risk, the relevant column has been maintained in order to reconcile the total with the balance sheet presented.

As at 31 December 2012 (EUR 000)

	EUR	*USD*	*CAD*	*CHF*	*AUD*	*Other*	*Total*
ASSETS							
Cash	3,739	1,246	31	171	21	95	5,303
Due from banks	911,735	227,552	35,546	5,727	6,646	29,039	1,216,245
Trading securities	1,982,285	724,357	7,799	5,051	2,367	8,816	2,730,675
Gold, medals, coins	13,086	28,260	-	-	-	-	41,346
Derivative financial instruments	-	-	-	-	-	-	-
Loans and advances to customers	25,288	347	-	187	-	1	25,823
Loans and receivables securities	213,770	38,482	-	-	-	-	252,252
Investment securities, available for sale	9,619	-	-	-	-	-	9,619
Investment securities, held to maturity	593,081	33,683	-	-	-	-	626,764
Remaining other assets	75,229	2,377	15	4	9	95	77,729
Total assets	**3,827,832**	**1,056,304**	**43,391**	**11,140**	**9,043**	**38,046**	**4,985,756**
LIABILITIES							
Due to banks	3	-	-	-	-	-	3
Due for saving accounts	2,958,980	1,046,498	43,157	10,911	9,026	34,901	4,103,473
Other liabilities	21,788	3,283	56	972	3	24	26,126
Retirement benefit obligations	86,895	-	-	-	-	-	86,895
Total liabilities	**3,067,666**	**1,049,781**	**43,213**	**11,883**	**9,029**	**34,925**	**4,216,497**
Equity	769,259						769,259
Net currency position	**(9,093)**	**6,523**	**178**	**(743)**	**14**	**3,121**	-
Off balance sheet net notional position	2	(2)	-	-	-	-	-
Total net currency position	**(9,091)**	**6,521**	**178**	**(743)**	**14**	**3,121**	-

As at 31 December 2011 (EUR 000)

	EUR	*USD*	*CAD*	*CHF*	*AUD*	*Other*	*Total*
Total assets	3,183,441	785,309	34,457	19,610	7,778	36,931	4,067,526
Total liabilities	2,445,711	786,320	33,820	19,219	7,483	33,812	3,326,365
Equity	741,161						741,161
Net currency position	(3,431)	(1,011)	637	391	295	3,119	-
Off balance sheet net notional position	(1,864)	2,004	-	-	-	(140)	-
Total net currency position	**(5,295)**	**993**	**637**	**391**	**295**	**2,979**	-

5.4.3 Interest rate risk

Interest sensitivity of assets, liabilities and off balance sheet items
Interest rate risk is the exposure to unfavourable changes in market interest rates.

Interest rate risk is the potential negative impact of changes in market interest rate on performances of financial assets and financial liabilities that join their maturity during a certain period creating cash flows to be reinvested at the new market conditions or that have to be re-priced.

The assumption of such risk is core to the financial business and it is important for the return and the assets values. Nevertheless, an excessive interest rate risk may have adverse effects on the financial performance and on the equity of a financial institution. Changes in interest rates affect the economic result as they increase or decrease the interest margin and the net trading income, sensitive to interest rates. Changes in interest rates also affect the value of assets, liabilities and off-balance sheet items as the future expected cash flows change with interest rates.

Therefore, an effective risk management system that keeps the appropriate interest risk exposure is essential for the safety of a financial institution.

Hence, the objective of interest rate risk management is to maintain earnings, to improve the ability to absorb potential loss and to ensure the adequacy of the compensation received for the risk taken.

Management of interest rate risk aims at measuring the risks arising from the maturity and re-pricing mismatches and is measured both from the earnings and economic value perspective.

The Institute has exposures to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows.

The table below summarises the Institute's exposure to interest rate risks.

Included in the table are the Institute's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

The off-balance sheet gap represents the net notional amounts of all interest sensitive derivative financial instruments.

As at 31 December 2012				*EUR 000*			
	Up to 1 month	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Non-interest*	*Total*
ASSETS							
Cash	-	-	-	-	-	5,303	5,303
Due from banks	1,149,242	-	67,003	-	-	-	1,216,245
Trading securities	283,454	775,030	365,068	991,666	54,383	261,074	2,730,675
Gold, medals, coins	-	-	-	-	-	41,346	41,346
Derivative financial instruments	-	-	-	-	-	-	-
Loans and advances to customers	25,823	-	-	-	-	-	25,823
Loans and receivables securities	52,967	75,582	123,703	-	-	-	252,252
Investment securities, available for sale	-	-	-	-	-	9,619	9,619
Investment securities, held to maturity	1,375	3,104	194,611	335,451	92,223	-	626,764
Remaining other assets	-	-	-	-	-	77,729	77,729
Total assets	**1,512,861**	**853,716**	**750,385**	**1,327,117**	**146,606**	**395,071**	**4,985,756**
LIABILITIES							
Due to banks	3	-	-	-	-	-	3
Due for saving accounts	3,340,588	325,340	405,515	32,030	-	-	4,103,473
Other liabilities	-	-	-	-	-	113,021	113,021
Total liabilities	**3,340,591**	**325,340**	**405,515**	**32,030**	-	**113,021**	**4,216,497**
Off balance sheet net interest sensitivity gap	-	-	-	-	-		
Interest sensitivity gap	(1,827,730)	528,376	344,870	1,295,087	146,606		
Cumulative interest sensitivity gap	**(1,827,730)**	**(1,299,354)**	**(954,484)**	**340,603**	**487,209**		

As at 31 December 2011				*EUR 000*			
	Up to 1 month	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Non-interest*	*Total*
ASSETS							
Cash	-	-	-	-	-	6,750	6,750
Due from banks	1,080,849	284,002	70,659	-	-	-	1,435,510
Trading securities	113,145	461,555	305,403	631,523	58,941	126,535	1,697,102
Gold, medals, coins	-	-	-	-	-	40,119	40,119
Derivative financial instruments	-	-	-	-	-	32,637	32,637
Loans and advances to customers	30,619	-	-	-	-	-	30,619
Loans and receivables securities	52,963	66,356	134,150	-	87,936	-	341,405
Investment securities, available for sale	-	-	-	-	-	10,977	10,977
Investment securities, held to maturity	1,188	72,662	254,488	19,916	98,699	-	446,953
Remaining other assets	-	-	-	-	-	25,454	25,454
Total assets	**1,278,764**	**884,575**	**764,700**	**651,439**	**245,576**	**242,472**	**4,067,526**
LIABILITIES							
Due to banks	5,617	-	-	-	-	-	5,617
Due for saving accounts	2,208,507	446,697	564,040	5,737	-	-	3,224,981
Other liabilities	-	-	-	-	-	95,767	95,767
Total liabilities	**2,214,124**	**446,697**	**564,040**	**5,737**	-	**95,767**	**3,326,365**
Off balance sheet net interest sensitivity gap	-	-	-	-	-		
Interest sensitivity gap	**(935,360)**	**437,878**	**200,660**	**645,702**	**245,576**		
Cumulative interest sensitivity gap	**(935,360)**	**(497,482)**	**(296,822)**	**348,880**	**594,456**		

5.5 Liquidity risk

Maturities of assets and liabilities

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities when contractually due.

The objective of monitoring liquidity risk is to avoid that the Institute is unable to meet obligations to repay depositors.

The IOR liquidity management process includes:

a. Day by day funding, managed by monitoring future cash flows to ensure that requirements can be met. The IOR maintains an active presence in global money markets to enable this to happen.

b. Maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow.

c. Monitoring balance sheet liquidity ratios.

d. Managing the concentration and profile of debt maturities.

The starting point for the liquidity measurement is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets.

As at 31 December 2012				*EUR 000*		
	Up to 1 month	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*	*Total*
ASSETS						
Cash	5,303	-	-	-	-	5,303
Due from banks	1,149,242	-	67,003	-	-	1,216,245
Trading securities	396,511	537,408	436,989	1,275,106	84,661	2,730,675
Gold, medals, coins	41,346	-	-	-	-	41,346
Derivative financial instruments	-	-	-	-	-	-
Loans and advances to customers	7,650	17	3,612	10,133	4,411	25,823
Loans and receivables securities	1,968	2,831	1,032	246,421	-	252,252
Investment securities, available for sale	9,619	-	-	-	-	9,619
Investment securities, held to maturity	1,375	3,104	194,611	335,451	92,223	626,764
Remaining other assets	59,980	-	-	-	17,749	77,729
Total assets	**1,672,994**	**543,360**	**703,247**	**1,867,111**	**199,044**	**4,985,756**
LIABILITIES						
Due to banks	3	-	-	-	-	3
Due for saving accounts	3,340,588	325,340	405,515	32,030	-	4,103,473
Other liabilities	113,021	-	-	-	-	113,021
Total liabilities	**3,453,612**	**325,340**	**405,515**	**32,030**	**-**	**4,216,497**
Net liquidity gap	**(1,780,618)**	**218,020**	**297,732**	**1,835,081**	**199,044**	**769,259**
As at 31 December 2011						
Total assets	1,312,903	583,783	665,728	1,202,107	303,005	4,067,526
Total liabilities	2,309,891	446,697	564,040	5,737	-	3,326,365
Net liquidity gap	**(996,988)**	**137,086**	**101,688**	**1,196,370**	**303,005**	**741,161**

The table above analyses assets and liabilities of the Institute into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Institute.

It is unusual for financial institutions to be completely matched, since business transactions are often of uncertain term and of different types. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The maturities of assets and liabilities and the ability to replace, at acceptable costs, interest bearing liabilities as they mature, are important factors in assessing the liquidity of the Institute and its exposure to changes in interest rates and exchange rates.

5.6 Capital management

The Institute's objectives when managing capital, which is a broader concept than the "equity" shown in the balance sheet, are:

- to safeguard the Institute's ability to continue as a going concern so that it can continue to provide benefits for all stakeholders.
- to maintain a strong capital base to support the development of its activity.

The IOR's capital is managed by the Treasury Department and is invested in investment properties, equity instruments classified as available for sale and debt securities held to maturity.

Capital adequacy and the use of capital are monitored daily by the IOR Directorate.

At the end of each day, the system automatically produces a table in which the Income Statement result at the date is calculated including also the year changes in Available for Sale Revaluation Reserve.

If their fair value decreases, its trend must be monitored, so that the IOR does not risk using capital reserves to cover this decrease, even if the result at the date is positive.

On a monthly basis, the General Ledger Department produces a report where the capital is divided into two tiers:

Tier 1: equity reserves, general operating risk reserve and result for the period. If unrealised losses arises on the fair valuation of equity instruments held as available for sale, the relevant amount must be deducted. Also unrealised actuarial losses on pension fund are deducted

Tier 2: Tier 1 plus unrealised gains arising on the fair valuation of equity instruments held as available for sale.

In order to measure the capital that may be invested in Trading Securities and Bank Deposits, from Tier 1 and Tier 2, capital investments in properties, equity instruments held as available for sale and debt securities loans and receivables and held to maturity are deducted.

TABLE 5.6.1 CAPITAL

	2012	2011
	EUR 000	EUR 000
TIER 1		
Equity reserves	309,874	309,874
General operating risk reserve	377,646	410,393
Revaluation reserve (if < 0)	-	(82)
Actuarial difference reserve (if < 0)	(4,876)	
Sub Total	682,644	720,185
Profit of the year to be posted to reserve	33,615	-
General Operating risk reserve utilised	-	(32,747)
Total tier 1	**716,259**	**687,438**
TIER 2		
Revaluation reserve (if > 0)	-	-
Total capital	**716,259**	**687,438**

There is no authority which requires the IOR to comply with capital requirements.
The Risk Management Department calculates the internal capital requirements to face the credit risk, the market risk and the operational risk and provides the following table to the Board of Superintendence.

The tables below summarise the Institute's internal capital requirements at 31 December 2012 and 2011.

TABLE 5.6.2

2012	*EUR 000*
1) GENERAL MARKET RISK	
measure of losses which the IOR could incur in one year due to an adverse market trend Calculated December 2012 *(calculation method: 1 year VAR 99 % = monthly VAR 99 % x √12 -, on the hypothesis of the serial independence of the rates of return)*	
	Total
Value at Risk 99 % (per year)	**240,762**
2) CREDIT RISK	
measure of losses which the IOR could incur in one year due to defaults of its counterparites *(calculation method: standard approach determined by the 2004 Basel Committee on Banking Supervision)*	
	Total
a) Credit risk capital requirement	**153,339**
3) OPERATIONAL RISK	
measure of losses which the IOR could incur in one year due to human mistakes and/or frauds *(basic indicator approach determined the 2004 Basel Committee on Banking Supervision: last 3 years average intermediation margin x 15 %)*	
	Total
a) Operational risk capital requirement	**12,445**
4) TOTAL EQUITY CAPITAL REQUIREMENT (general market risk plus credit risk plus operational risk)	**406,546**
Stable equity reserves:	**682,644**
Allocation rate:	**59.55 %**

2011	*EUR 000*
1) GENERAL MARKET RISK	
measure of losses which the IOR could incur in one year due to an adverse market trend Calculated December 2011	
(calculation method: 1 year VAR 99 % = monthly VAR 99 % x √ 12 -, on the hypothesis of the serial independence of the rates of return)	
	Total
Value at Risk 99 % (per year)	**284,063**
2) CREDIT RISK	
measure of losses which the IOR could incur in one year due to defaults of its counterparites	
(calculation method: standard approach determined by the 2004 Basel Committee on Banking Supervision)	
	Total
a) Credit risk capital requirement	**116,171**
3) OPERATIONAL RISK	
measure of losses which the IOR could incur in one year due to human mistakes and/or frauds	
(basic indicator approach determined the 2004 Basel Committee on Banking Supervision: last 3 years average intermediation margin x 15 %)	
	Total
a) Operational risk capital requirement	**13,143**
4) TOTAL EQUITY CAPITAL REQUIREMENT (general market risk plus credit risk plus operational risk)	**413,377**
Stable equity reserves:	**720,185**
Allocation rate:	**57.40 %**

The equity capital requirements decreased in 2012 by EUR 6.9 m.

The stable equity reserves decreased by EUR 37.5 m, mainly due to the utilisation of general operating risks reserve for 2011 profit distribution, and the allocation rate to face market risk, credit risk and operating risk, increased from 57.4 % to 59.6 %.

The equity reserves are adequate to cover the risks linked to the Institute's activities.

13. Independent Auditors' Report

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Report of the Independent Auditor to the Members of the Superintendence Board on the Financial Statements of

Istituto per le Opere di Religione, Città del Vaticano

We have been engaged to audit the accompanying financial statements (pages 28 to 96) of Istituto per le Opere di Religione, which comprise the balance sheet as at 31 December 2012, and the income statement, the statement of comprehensive income, the statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

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 International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including 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 control 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 control. 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.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Istituto per le Opere di Religione as at 31 December 2012, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG AG/SA, a Swiss corporation, is a subsidiary of KPMG Holding AG/SA, which is a subsidiary of KPMG Europe LLP and a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity

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Other Matter

The financial statements of Istituto per le Opere di Religione for the year ended 31 December 2011 were audited by another auditor who expressed an unmodified opinion on those statements on 28 March 2012.

KPMG AG

Lorenzo Job
Licensed audit expert

Patrizio Aggio
Licensed audit expert

Lugano, 15 July 2013

Enclosure:

- Financial statements, which comprise the balance sheet as at 31 December 2012, and the income statement, the statement of comprehensive income, the statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information

IOR - Istituto per le Opere di Religione
Città del Vaticano, www.ior.va