



SOCIETE GENERALE – SPLITSKA BANKA D.D.

Financial statements for the year ended 31 December 2006
together with auditors' report



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GENERAL INFORMATION

The Bank's main areas of operation are as follows:

1. accepting all types of deposits
2. receiving and granting loans and other placements, including factoring and forfaiting
3. issuance of guarantees
4. domestic and foreign payment transactions
5. trading on own behalf and for own account or on behalf and for account of customers in money market instruments, other transferable securities, foreign currencies and derivatives
6. issuing and managing payment instruments
7. securities custody services
8. agency and brokerage business involving securities
9. agency business in insurances and mediation in financial transactions
10. treasury vault operations

MANAGEMENT AND CORPORATE GOVERNANCE

Managing Board

Pierre, Georges, Maria Boursot	Chairman	since 1 July 2006
Wolfgang Peter	Chairman	until 30 June 2006
Wolfgang Peter	Deputy Chairman	since 1 July until 30 September 2006
Goran Gazivoda	Deputy Chairman	until 30 June 2006
Ivo Bilić	Member	
Vedrana Carević	Member	
Henri, Maria, René Bellenger	Member	since 1 July 2006
Christoph Schöfböck	Member	until 30 June 2006

General Assembly

Jean-Didier Reigner	Chairman	since 1 July 2006
Regina Prehofer	Chairman	until 30 June 2006

Supervisory Board

Jean-Didier Reigner	Chairman	since 1 July 2006
Regina Prehofer	Chairman	until 30 June 2006
Alexis Juan	Deputy Chairman	since 1 July 2006
Helmut Bernkopf	Deputy Chairman	until 30 June 2006
Serge Eveille	Member	since 1 July 2006
Wolfgang Edelmüller	Member	until 30 June 2006
Wolfgang Helpa	Member	until 31 March 2006
Heinz Meidlinger	Member	until 30 June 2006
Robert Zadrazil	Member	until 30 June 2006
Joseff Duregger	Member	until 30 June 2006
Gunter Stromenger	Member	since 24 April 2006 until 30 June 2006

Responsibility for the financial statements

Pursuant to the Croatian Accounting Law in force, the Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with statutory accounting requirements for banks in Croatia which give a true and fair view of the financial position and results of the Bank for that period.

The Board has a reasonable expectation that the Bank has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Board continues to adopt the going concern basis in preparing the financial statements.

In preparing those financial statements, the responsibilities of the Board include ensuring that:

- suitable accounting policies are selected and then applied consistently;
- judgements and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Bank and must also ensure that the financial statements comply with the Croatian Accounting Law in force. The Board is also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank together with the annual financial statements, following which the Supervisory Board is required to approve the annual financial statements for submission to the General Assembly of Shareholders for adoption.

The financial statements set out on pages 6 to 71 were authorised by the Management Board on 12 February 2007 for issue to the Supervisory Board and are signed below to signify this.

On behalf of SOCIETE GENERALE – SPLITSKA BANKA d.d.

Pierre Boursot
Chairman



Independent Auditor's Report

To the Board of Directors and the Shareholders of Societe Generale - Splitska Banka d.d.:

We have audited the accompanying financial statements of Societe Generale - Splitska Banka d.d. (the Bank) which comprise the balance sheet as at 31 December 2006 and income statement, statement in changes of equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes (as set out on pages 6 to 71). The financial statements of the Bank for the year ended 31 December 2005 were audited by other auditors who have, in their report dated 12 April 2006, expressed an unqualified opinion on those financial statements.

Management Responsibility

Management is responsible for the preparation and fair presentation of these financial statements in accordance with statutory accounting requirements for banks in Croatia. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 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 judgement, including the assessment of the risk of material misstatement of the financial statements, whether due to the 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 basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of 31 December 2006 and of its financial performance and its cash flows for the year then ended in accordance with statutory accounting requirements for banks in Croatia.

Ernst & Young d.o.o.

Zvonimir Madunić

Zagreb, 12 February 2007

Balance sheet

As at 31 December 2006

	Notes	2006	2005 restated
		HRK million	HRK million
ASSETS			
Cash and current accounts with banks	5	991	1,100
Obligatory reserve with Croatian National Bank	6	4,291	3,323
Placements with, and loans and advances to other banks	7	1,006	1,217
Derivative financial instruments	8	14	31
Financial assets held for trading	9	54	1,637
Financial assets available for sale	10	3,299	1,423
Financial assets held to maturity	11	-	548
Loans and advances to customers	12	15,745	13,528
Property and equipment	13	295	233
Intangible assets	14	90	119
Income tax receivables		56	-
Deferred tax assets	15	40	51
Other assets	16	23	66
TOTAL ASSETS		25,904	23,276
LIABILITIES			
Current accounts and deposits from banks	17	945	2,333
Current accounts and deposits from customers	18	11,030	9,752
Repurchase agreements	19	2,574	2,594
Borrowings	20	8,656	6,476
Derivative financial instruments	8	1	100
Provisions for liabilities and charges	21	212	153
Current income tax payables		-	24
Deferred tax liability	22	21	2
Other liabilities	23	175	158
Total liabilities		23,614	21,592
SHAREHOLDERS' EQUITY			
Share capital	24	491	455
Share premium	24	419	88
Statutory reserve	24	223	223
Revaluation reserve	24	70	-
Fair value reserve	24	15	9
Retained earnings	24	1,072	909
Total shareholders' equity	24	2,290	1,684
TOTAL LIABILITIES AND EQUITY		25,904	23,276
CONTINGENT LIABILITIES AND COMMITMENTS	35	4,922	4,051

Notes to the financial statements on pages 10 to 71 form an integral part of these financial statements.

These financial statements were approved and signed by the Managing Board on 12 February 2007.

Pierre Boursot
Chairman

Florian Urban
Chief financial officer

Income statement

For the year ended 31 December 2006

	Notes	2006	2005 restated
		HRK million	HRK million
Interest and similar income	25a	1,226	1,059
Interest expense and similar charges	25b	(598)	(462)
Net interest income		628	597
Fee and commission income	26a	231	217
Fee and commission expense	26b	(51)	(51)
Net fee and commission income		180	166
Gains less losses from financial assets and liabilities at fair value through profit or loss	27	38	104
Gains less losses from financial assets available for sale		4	-
Gains less losses from dealing in foreign currencies and foreign currency translation	28	98	48
Other operating income	29	7	12
Net trading and other income		147	164
Operating income		955	927
Personnel expenses	30	(254)	(231)
Depreciation, amortisation and impairment	13, 14	(94)	(83)
General administrative expenses	31	(214)	(196)
Impairment losses on loans and advances	32	(83)	(25)
(Impairment losses) / reversal of impairment losses on other assets	16	(1)	12
Provisions for liabilities and charges	21	(104)	(50)
Operating expenses		(750)	(573)
PROFIT BEFORE TAX		205	354
Income tax expense	33	(42)	(71)
PROFIT FOR THE YEAR		163	283
		HRK	HRK
BASIC / DILUTED EARNINGS PER SHARE	34	36	62

Notes to the financial statements on pages 10 to 71 form an integral part of these financial statements.

These financial statements were approved and signed by the Managing Board on 12 February 2007.

Pierre Boursot
Chairman

Florian Urban
Chief financial officer

Statement of changes in shareholders' equity

For the year ended 31 December 2006

	Share capital	Share premium	Statutory reserve	Revaluation reserve	Fair value reserve	Retained earnings	Total shareholders' equity
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
Balance at 1 January 2005	455	88	223	-	2	639	1,407
Changes in accounting policy for employee benefits	-	-	-	-	-	(13)	(13)
Restated balance 1 January 2005	455	88	223	-	2	626	1,394
Fair value adjustments of available-for-sale assets	-	-	-	-	9	-	9
Deferred tax liability (Note 22)	-	-	-	-	(2)	-	(2)
Profit for the year	-	-	-	-	-	283	283
Balance at 31 December 2005	455	88	223	-	9	909	1,684
Fair value adjustments of available-for-sale assets	-	-	-	-	7	-	7
Deferred tax liability (Note 22)	-	-	-	(18)	(1)	-	(19)
Increase of share capital	36	331	-	-	-	-	367
Revaluation of land and buildings (Note 13)	-	-	-	88	-	-	88
Profit for the year	-	-	-	-	-	163	163
Balance at 31 December 2006	491	419	223	70	15	1,072	2,290

Notes to the financial statements on pages 10 to 71 form an integral part of these financial statements.

Cash flow statement

For the year ended 31 December 2006

	Notes	2006	2005
		HRK million	Restated HRK million
Cash flows from operating activities			
Profit before tax		205	354
Adjustments for			
Depreciation, amortisation and impairment		94	83
Impairment losses on loans and other assets		108	13
Provisions for liabilities and charges		104	50
Other non-cash items		(3)	(2)
Net loss on disposal of property and equipment		4	-
Net unrealised (gain) /loss on financial assets and liabilities at fair value through profit or loss		(18)	11
		494	509
Changes in operating assets and liabilities			
Net change in obligatory reserve with Croatian National Bank		(968)	(1,139)
Net change in placements with and loans and advances to other banks		67	(53)
Net change in financial assets held for trading		1,588	27
Net change in loans and advances to customers		(2,324)	(1,625)
Net change in other assets		42	91
Net change in deposits from banks		(1,388)	743
Net change in deposits from customers		1,278	815
Net change in repurchase agreements		(20)	79
Net change in derivative financial instruments		(69)	(4)
Net change in other liabilities		17	7
Net change in provisions for liabilities and charges		(42)	1
Net cash flow from operating activities before tax		(1,325)	(549)
Income taxes paid		(111)	(90)
Net cash flow from operating activities		(1,436)	(639)
Cash flows from investing activities			
Net proceeds financial assets held to maturity		119	1,101
Net purchases of financial assets available for sale		(1,440)	(1,200)
Proceeds from disposals of property and equipment		1	-
Purchases of property and equipment		(26)	(32)
Purchases of intangible assets		(18)	(34)
Proceeds from sale of associate		-	2
Net cash flow from investing activities		(1,364)	(163)
Cash flows from financing activities			
Proceeds from issue of share capital		367	-
Net increase / (decrease) in borrowings		2,180	(82)
Net cash flow from financing activities		2,547	(82)
Net decrease in cash and cash equivalents		(253)	(884)
Cash and cash equivalents at beginning of period		2,211	3,095
Cash and cash equivalents at end of period	36	1,958	2,211
Interest received		1,338	1,130
Interest paid		695	494

Notes to the financial statements on pages 10 to 71 form an integral part of these financial statements.

1. INCORPORATION

SOCIETE GENERALE ~ SPLITSKA BANKA d.d. ("the Bank"), whose registered office is in Split, Ruđera Boškovića 16, is incorporated in the Republic of Croatia and provides commercial banking services. The Bank is registered at the Commercial Court in Split, with authorised share capital in the amount of HRK 491 million.

These financial statements were authorised for issue by the Managing Board on 12 February 2007 for approval by the Supervisory Board.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) *Statement of compliance*

The financial statements have been prepared in accordance with statutory accounting requirements for banks in Croatia. The Bank's operations are subject to the Banking Law, in accordance with which the Bank's financial reporting is regulated by the Croatian National Bank ("the CNB") which is the central monitoring institution of the banking system in Croatia. These financial statements have been prepared in accordance with these banking regulations.

The accounting regulations of the CNB are based on International Financial Reporting Standards ("IFRS"). The principal difference between the accounting regulations of the CNB and recognition and measurement requirements of IFRS is as follows:

- The CNB requires banks to recognise impairment losses, in income, on financial assets not identified as impaired (including sovereign risk assets) excluding equity instruments classified as available for sale and assets carried at fair value through profit or loss account except fair value of embedded derivatives (in 2005 were also excluded debt instruments classified as available for sale) at prescribed rates. The Bank has made portfolio based provisions of HRK 216 million (2005: HRK 170 million) in compliance with these regulations and has recognised an expense of HRK 46 million in relation to these provisions within the charge for impairment losses for the year (2005: expense of HRK 7 million). Although, in accordance with International Financial Reporting Standards, such provisions should more properly be presented as an appropriation within equity, the Bank continues to recognise such provisions as a substitute for existing but unidentified impairment losses calculated in accordance with the requirements of International Financial Reporting Standards. The Bank is in the process of compiling the observable historical data in respect of the unidentified losses existing in its various credit risk portfolios at the balance sheet date, determining the appropriate emergence period over which these losses come to light, and identifying, for each portfolio, the relevant current economic conditions with which the historical data should be adjusted, as a basis for estimating the extent of unidentified losses existing at the balance sheet date on the basis required by IFRS.

Notes to the financial statements (continued)

The principal accounting policies applied in the preparation of these financial statements are summarised below. Where specific accounting policies are aligned with accounting principles set out in IFRS, reference may be made to certain IFRS in describing the accounting policies of the Bank; unless otherwise stated, these references are to IFRS applicable at 31 December 2006.

(b) Basis of preparation

The financial statements are prepared on the fair value basis for financial assets and liabilities at fair value through profit or loss, and assets available for sale, except those for which a reliable measure of fair value is not available. Other financial assets and liabilities, and non-financial assets and liabilities, are stated at amortised or historical cost.

The financial statements have been prepared in a format generally adopted and internationally recognised by banks.

In preparing the financial statements, management has made judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, disclosure of commitments and contingencies at the balance sheet date, as well as amounts of income and expense for the period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances and information available at the date of the preparation of the financial statements, the result of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of applicable IFRS that have significant effects on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 4.

The accounting policies have been consistently applied and, except where disclosed otherwise, are consistent with those used in the previous year. The comparative figures for 2005 have also been adjusted or extended to conform to changes in presentation in the 2006 financial statements.

Amendments to published regulations that are not yet effective

Certain regulations have been issued by the CNB as of the date on which these financial statements were authorised for issue, which were not effective at the balance sheet date, but which will be mandatory for accounting periods beginning on or after 1 January 2007. The Bank considers that the following regulations may have a significant impact on the financial statements or otherwise have a significant financial impact on its operations.

Notes to the financial statements (continued)

- In December 2006 the CNB issued a decision on compulsory purchase of Croatian National Bank bills if monthly placements growth is above 1% per month. Banks that exceed permissible growth must purchase bills in the amount of 50% of exceeded growth and hold them for one year until maturity.

The Bank also expects that, in the ordinary course of updating its accounting regulations, the CNB may have regard to the following IFRS and Interpretations issued by the International Accounting Standards Board ("IASB") and its International Financial Reporting Interpretations Committee ("IFRIC"), which were in issue as of the date on which these financial statements have been authorised for issue, but which are applicable to entities reporting under IFRS in periods commencing after 31 December 2006, and which may have an impact on the Bank, if adopted:

Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published and will be mandatory for the Bank in periods beginning on or after 1 January 2007 or later periods. The Bank has not early adopted any of these standards or interpretations, as follows:

IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from January 1, 2007)

The Bank will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007. These standards will have impact only on presentation and disclosures in financial statements.

IFRIC 8, Scope of IFRS 2 (effective for annual periods beginning on or after 1 May 2006).

It required IFRS 2 Share-based Payment to be applied to any arrangements where equity instruments are issued for consideration which appears to be less than fair value. As equity instruments are not issued to employees the interpretation had no impact on the financial position of the Bank.

IFRIC 9, Reassessment of Embedded Derivatives (effective for annual periods beginning on or after 1 June 2006)

This interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The Bank is still evaluating the effect of this interpretation and expects that adoption of this interpretation will have no impact on the Bank's financial statements when implemented in 2007.

(c) Functional and presentation currency

The Bank's financial statements are presented in Croatian kuna ("HRK"), which is the functional currency. Amounts are rounded to the nearest million (unless otherwise stated).

The effective exchange rate as at 31 December 2006 was HRK 7.345081 to EUR 1 (2005: HRK 7.3756) and HRK 5.578401 to USD 1 (2005: HRK 6.2336).

(d) Changes in presentation or classification of items in the financial statements

Where necessary, comparative information has been reclassified to achieve consistency with current financial year amounts and other disclosures. The most significant reclassifications are summarised in Note 3.

(e) Interest income and expense

Interest income and expense are recognised in the income statement for all interest bearing instruments using the effective interest rate 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 discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank does not consider future credit losses. The calculation includes all fees and percentage points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

When loans become impaired, they are adjusted to their recoverable amounts measured as the net present value of the future cash flows discounted at the effective interest rate, prior to impairment. This discount is credited to interest income on an effective yield basis over the period from impairment recognition to collection.

(f) Fee and commission income and expense

Fee and commission income and expense mainly comprises fees receivable for guarantees and letters of credit issued by the Bank on behalf of customers, fees for domestic and foreign payment transactions, fees for portfolio and other management advisory services and custody service fees.

Fee income can be divided into the following two categories:

Fee income earned from services that are provided over a certain period of time

Loan commitment fees for loans that are likely to be drawn down are deferred and recognised as an adjustment to the effective interest rate on the loan. Commitment fees in relation to facilities where draw down is not probable are recognised over the term of the commitment. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank has retained no part for itself, or has retained a part at the same effective interest rate as the other participants.

Portfolio and other management advisory and service fees are recognised based on the applicable service contracts on an accruals basis over the period in which the service is provided. The same principle is applied for custody services that are continuously provided over an extended period of time.

Fee income from providing transaction services

Fee and commission income and expense from transaction services is recognised in the income statement when the related service is provided.

(g) Gains less losses from financial assets and liabilities at fair value through profit or loss

Gains less losses from financial assets and liabilities at fair value through profit or loss include accrued interest and unrealised and realised fair value gains on debt securities and derivatives. Foreign exchange differences on financial assets and liabilities at fair value through profit or loss are presented within gains less losses from dealing in foreign currencies in the Income statement.

(h) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

(i) Foreign currencies

Transactions in foreign currencies are translated into Croatian kuna ("HRK") at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currency are reported at each balance sheet date at the foreign exchange rate ruling on the balance sheet date. Any gain or loss arising from a change in exchange rates subsequent to the date of the transaction is included in the income statement.

Non-monetary assets and liabilities denominated in foreign currency that are stated at fair value are translated in HRK at the foreign exchange rates ruling at the dates when the fair values were determined. Non-monetary assets and items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at balance sheet date.

Loans that are denominated in kuna but linked to foreign currencies by way of revaluation clauses have a counter value in foreign currency, in which repayments of principal and payments of interest are determined. Repayments of principal and interest are determined at the foreign exchange rate prevailing at the date of the transaction. Such loans are translated at the contractual rate.

Notes to the financial statements (continued)

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security, and other changes in the carrying amount of the security. The translation differences are recognised in the income statement as part of the foreign exchange gains or losses on translation of monetary assets and liabilities presented within gains or losses from dealing in foreign currency and foreign currency translation in the income statement. Translation differences on non-monetary financial assets, such as equity instruments classified as available for sale, are included in the fair value reserve in equity.

(j) Financial instruments

Classification

The Bank classifies its financial instruments into the following categories: financial assets and liabilities at fair value through profit or loss; loans and receivables; financial assets held to maturity (until November 2006); financial assets available for sale; and other financial liabilities.

The classification depends on the purpose for which the financial instruments were acquired. The management determines the classification of financial instruments upon initial recognition.

In November 2006 the Bank has changed its intention to hold until maturity financial assets held to maturity. As a result of this, all financial instruments in the category financial assets held to maturity were reclassified to the category available for sale and remeasured at fair value. The difference between the carrying amount and fair value has been recognised directly in equity through the statement of changes in equity. The Bank will not classify any financial assets in the following two financial years in category held to maturity.

Other than this, items are only classified as at fair value through profit or loss upon initial recognition. Items classified as at fair value through profit or loss are not reclassified.

Financial assets or financial liabilities at fair value through profit or loss

This category has two sub categories: financial instruments held for trading, and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking, if it is a derivative or as designated by the management. Financial instruments at fair value through profit or loss include debt securities and derivatives.

Notes to the financial statements (continued)

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 when the Bank provides money to a debtor with no intention of trading with the receivable and include purchased loans, placements with and loans to other banks and receivables.

Financial assets held to maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold to maturity.

Financial assets available for sale

A financial asset is classified as available for sale if it does not properly belong to one of the three other categories of financial assets – loans and receivables; financial assets held to maturity or financial assets at fair value through profit or loss. Financial assets designated as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates, or equity prices. Available-for-sale financial assets include certain debt and equity securities.

Other financial liabilities

Other financial liabilities comprise all financial liabilities which are not designated at fair value through profit or loss.

Recognition and derecognition

Regular way purchases of financial instruments are recognised on the settlement date when the asset is delivered to the Bank.

Loans and receivables and financial liabilities at amortised cost are recognised when cash is advanced to borrowers or received from lenders.

The Bank derecognises financial instruments (in full or part) when the rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights on those financial assets. It occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realised, surrendered or have expired. The Bank derecognises financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognising that liability and will instantaneously recognise a new financial liability, with new terms and conditions.

Notes to the financial statements (continued)

Initial and subsequent measurement

Financial assets and liabilities are recognised initially at their fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

After initial recognition, the Bank measures financial instruments at fair value through profit or loss and available for sale at their fair value, without any deduction for selling costs. Equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less impairment.

Loans and receivables and held-to-maturity investments and financial liabilities not designated at fair value through profit or loss are measured at amortised cost using the effective interest method.

Gains and losses

Gains and losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognised in the income statement.

Gains or losses from a change in the fair value of available-for-sale monetary assets are recognised directly in a fair value reserve within equity and are disclosed in the statement of changes in equity. Impairment losses, foreign exchange gains and losses, interest income and amortisation of premium or discount using the effective interest method on available-for-sale monetary assets are recognised in the income statement. Foreign exchange differences on equity instruments are part of the fair value of these instruments and are recognised in equity. Dividend income is recognised in the income statement. Upon sale or other derecognition of available-for-sale assets, any cumulative gains or losses on the instrument are transferred to the income statement.

Gains or losses arising from financial assets and financial liabilities carried at amortised cost may also arise, and are included in the income statement when a financial instrument is derecognised or when its value is impaired.

Determination of fair value of financial instruments

The fair value of quoted financial instruments in an active market is based on their closing bid prices. If there is no active market for the financial instrument, or if, due to any other reason, the fair value cannot be reliably measured by the market price, the Bank establishes fair value by using valuation techniques.

These include the use of internal evaluation models, based on the present value of the future cash flows; prices achieved in recent arm's length transactions; reference to other instruments that are substantially the same; and option pricing models. In applying these techniques, the Bank makes maximum use of market inputs and relies as little as possible on entity-specific inputs. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimate and the discount rate is a market rate.

Notes to the financial statements (continued)

The fair value of non-exchange-traded derivatives is estimated at the amount that the Bank would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

Impairment of financial assets

Assets carried at amortised cost

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

Objective evidence that a financial asset or group of financial assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

- i) significant financial difficulty of the borrower;
- ii) a breach of contract, such as a default or delinquency in interest or principal payments;
- iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that it would not otherwise consider;
- iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- v) the disappearance of an active market for the financial asset because of financial difficulties;
- vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group.

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity assets carried at amortised cost 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 amount of the loss is recognised in the income statement.

If a loan or held-to-maturity asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors).

Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Notes to the financial statements (continued)

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 (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.

When a loan is uncollectible, it is written off against the related impairment allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recognised as reversal of impairment losses in the income statement.

Assets carried at fair value

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the investment below its cost is considered in determining whether the assets are 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 or loss - is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity securities are not reversed through the income statement. If, 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.

Assets carried at cost

These include equity securities classified as available for sale for which there is no reliable fair value. The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

An impairment loss is calculated as the difference between the carrying amount of the financial asset and the present value of expected future cash receipts discounted by the current market interest rate for similar financial assets. Impairment losses on such instruments, recognised in the income statement, are not subsequently reversed through the income statement.

Impairment of assets not identified as impaired

In addition to the above described impairment losses on assets identified as impaired, the Bank recognises impairment losses, in income, on on- and off-balance-sheet credit risk exposures (in 2006 including debt financial assets available for sale and fair value of embedded derivatives) not identified as impaired at the minimum rate of 0.85% in accordance with the accounting regulations of the CNB.

In 2005 all debt securities carried at fair value and fair value of embedded derivatives were excluded from the basis of such calculation.

Offsetting of financial instruments

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

(k) Specific financial instruments

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, current accounts with banks and amounts due from banks on demand or with an original maturity of three months or less.

Treasury bills and debt securities

Short-term treasury bills are classified as available-for-sale financial assets. Debt securities held for the purpose of short-term profit taking are classified as trading financial assets included in financial assets at fair value through profit or loss. Until November 2006 debt securities that the Bank had the intent and ability to hold to maturity were classified as held-to-maturity assets. Other debt securities are classified as financial assets available for sale.

Equity securities

Equity securities are classified as available-for-sale financial assets.

Placements with banks

Placements with banks are classified as loans and receivables and are carried at amortised cost less impairment losses.

Loans and advances to customers

Loans and advances are presented net of impairment allowances to reflect the estimated recoverable amounts.

Repurchase agreements

The Bank enters into sales of investments under agreements to repurchase substantially identical investments at a certain date in the future at a fixed price.

Investments sold under repurchase agreements continue to be recognised in the balance sheet and are measured in accordance with the accounting policy for the relevant financial asset at amortised cost or at fair value as appropriate. The proceeds from the sale of the investments are reported as liabilities to either banks or customers.

The difference in the effective interest rate between the sale and repurchase consideration is recognised on an accrual basis over the period of the transaction and is included in interest expense.

Derivative financial instruments

In the normal course of business, the Bank is a party to contracts for derivative financial instruments, which involve a very low initial investment compared to the underlying notional value of the contract. The derivative financial instruments include interest rate swap agreements, foreign currency forwards and swaps. These financial instruments are used by the Bank to hedge economically interest rate risk and currency exposures associated with its operations and its transactions in the financial markets.

In accordance with its treasury policy, the Bank does not hold or issue derivative financial instruments for speculative trading purposes. No derivatives are accounted for as hedging instruments. All derivatives are classified as trading financial instruments, included within derivative financial instruments.

Derivatives are initially recognised in the balance sheet at fair value on the date a derivative contract is entered into and subsequently are re-measured at their fair value. Fair values are obtained from quoted market prices, discounted cash flow models or option pricing models, as appropriate. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivative financial instruments are recognised in the income statement as they arise.

Some hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is termed as an embedded derivative. When the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract and when the hybrid contract is not itself carried at fair value through profit or loss, the embedded derivative is treated as a separate derivative and classified at fair value through profit or loss with all unrealised gains and losses recognised in the income statement, unless there is no reliable measure of their fair value. Such embedded derivatives include options to revalue financial instruments with reference to movements in exchange rates (so called "one way currency clause" loans and borrowings).

Changes in the fair value of derivatives, and interest income and expense on interest rate swaps are presented within gains less losses from financial assets and liabilities at fair value through profit or loss.

(I) Property and equipment

Property and equipment are tangible items that are held for use in the supply of services, for rental to others or administrative purposes.

Items of property and equipment are shown at cost or valuation less accumulated depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Land and buildings are measured at fair value less depreciation on buildings and impairment charged subsequently to the date of revaluation.

Valuations are performed frequently enough to ensure that the fair value of revalued assets does not differ materially from its carrying amount.

Notes to the financial statements (continued)

Any revaluation surplus is credited to the asset revaluation reserve included in the equity section of the balance sheet except to the extent that it reverses a revaluation decrease of the same asset previously recognised in the income statement in which case the increase is recognised in the income statement. A revaluation deficit is recognised in the income statement except that a deficit directly offsetting a previous surplus in the same asset is directly offset against the surplus in the asset revaluation reserve.

An annual transfer from the asset revaluation reserve to retained earnings is made for the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets original cost. Additionally, accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

The Bank recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. All other expenditure on repairs and maintenance is expensed as incurred.

Depreciation is calculated on the straight-line basis to write down the cost of such assets to their residual values over their estimated useful life.

Land and assets under construction are not depreciated. The estimated useful lives are as follows:

	2006	2005
Residential buildings	50 years	50 years
Other buildings	33 years	33 years
Office equipment	5 years	5 years
Motor vehicles	4 years	4 years
Computer equipment	5 years	5 years
Furniture	10 years	10 years
Other equipment	7 to 15 years	7 to 15 years
Leasehold improvements	5 to 19 years (over the period of the lease)	5 to 19 years (over the period of the lease)

The assets' residual values, depreciation method and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. 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. Gains and losses on disposals are determined by comparing proceeds with carrying amount, and are included in the income statement.

(m) Intangible assets

Intangible assets are stated at cost less accumulated amortisation and impairment losses. Amortisation is provided on a straight-line basis to write down the cost of assets to their residual values over their estimated useful life.

The estimated useful lives of intangible assets are as follows:

	2006	2005
Software	5 years	5 years
Other intangible assets	5 years	5 years

Costs incurred in order to restore or maintain the future economic benefits that the Bank can expect from the originally assessed standard of performance of existing software systems are recognised as an expense when the restoration or maintenance work is carried out. Costs incurred in order to enhance or extend the benefits of computer software programmes beyond their original specifications and lives are recognised as a capital improvement and added to the original cost of the software.

(n) Impairment of non-financial assets

The recoverable amount of property, plant and equipment and intangible assets is the higher of the asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows (cash-generating units). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit. Non-financial assets that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognised.

(o) Borrowings

Borrowings are recognised initially at fair value net of transaction costs incurred.

Borrowings are subsequently stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest rate method.

(p) Provisions for liabilities and charges

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

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of incurred losses.

Notes to the financial statements (continued)

The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If the outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

(q) Off-balance-sheet commitments and contingent liabilities

In the ordinary course of business, the Bank enters into credit related commitments which are recorded in off-balance sheet accounts, such as guarantees, commitments to extend credit and letters of credit and undrawn loan commitments. These financial instruments are recorded in the balance sheet if and when they become payable.

(r) Income tax

The income tax charge is based on taxable profit for the year and comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using the tax rates enacted or substantially enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred taxes are calculated by using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured by using the tax rates expected to apply to taxable profit in the years in which those temporary differences are expected to be recovered or settled based on tax rates enacted or substantially enacted at the balance sheet date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets and/or liabilities in the balance sheet. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. At each balance sheet date, the Bank reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets.

(s) Share capital

Share capital represents the nominal value of paid-in ordinary shares classified as equity and is denominated in HRK.

Dividends are recognised as a liability in the period in which they are declared.

(t) Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise cash and current accounts with banks and placements with and loans and advances to other banks with original maturity of less than three months.

(u) Operating leases – Bank as a lessee

Leases of assets under which the risks and rewards of ownership are effectively retained with the lessor are classified as operating lease arrangements. Lease payments under operating lease are recognised as expenses on a straight-line basis over the lease term and included in general administrative expenses.

(v) Managed funds for and on behalf of third parties

The Bank manages funds for and on behalf of corporate and retail customers. These amounts do not represent the Bank's assets and are excluded from the balance sheet. For the services rendered the Bank charges a fee.

(w) Segment reporting

A segment is a distinguishable component of the Bank that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Bank's current operation is in the segment of banking (business segment) and its operations, total assets and the majority of its clients are located in Croatia (geographical segment). Hence, segment reporting is not appropriate.

3. CHANGES IN ACCOUNTING POLICIES

Changes in accounting policies for financial instruments

The Bank changed in 2006 the accounting policy with respect to accruals for unused vacation, which were in prior years recognised in the moment of payment. As a result of above mentioned change, the Bank has decreased its retained earnings as of 1 January 2005 by HRK 13 million, and increased the amount of liabilities towards employees by HRK 13 million.

Other reclassification effects

The Bank has reclassified certain amounts as at and for the year ended 31 December 2005 to achieve consistency with current year classifications.

The major changes relate to the following:

- HRK 77 million that relates to deferred fees on loans and advances to customers has been reclassified from other liabilities to loans and advances to customers,
- HRK 10 million that relates to deferred fees on borrowings has been reclassified from other assets to borrowings,
- Financial assets at fair value through profit or loss have been divided in two sub-categories – financial assets held for trading in the amount of HRK 1,637 million and derivative financial instruments in the amount of HRK 31 million,
- leasehold improvements in the amount of HRK 34 million has been reclassified from intangible assets to property and equipment,
- depreciation, amortisation and impairment in the amount of HRK 83 million has been presented separately from general and administrative expenses and
- personnel expenses in the amount of HRK 231 million has been presented separately from general and administrative expenses.

4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated, and are based on historical experience and other factors such as the expected flow of future events that can be rationally assumed in existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. Significant judgements made in determining the most appropriate methodology for estimating the fair value of financial instruments carried at fair value are also described below.

Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. In accordance with CNB regulations, the need for impairment of the Bank's on- and off-balance-sheet credit risk exposure is assessed at least quarterly. Impairment losses are made mainly against the carrying value of loans and advances to corporate and retail customers (summarised in Note 12), and as provisions for liabilities and charges arising from off-balance-sheet risk exposure to customers, mainly in the form of guarantees and documentary letters of credits (summarised in Notes 35 and 21).

Impairment losses are also considered for credit risk exposures to banks, and for other assets not carried at fair value, where the primary risk of impairment is not credit risk.

Notes to the financial statements (continued)

	Notes	2006 HRK million	2005 HRK million
Summary of impairment losses for customers			
Impairment losses on loans and advances to customers	12	602	600
Provisions for off-balance-sheet exposure	35	42	37
		644	637

The Bank first assesses whether objective evidence of impairment exists individually for assets that are individually significant (mainly corporate exposures) and collectively for assets that are not individually significant (mainly retail exposures). However, assets assessed individually as unimpaired are then included in groups of assets with similar credit risk characteristics. These portfolios are then assessed collectively for impairment.

The Bank estimates impairment losses in cases where it judges that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets. Such evidence includes delinquency in payments or other indications of financial difficulty of borrowers; and adverse changes in the economic conditions in which borrowers operate or in the value or enforceability of security, where these changes can be correlated with defaults.

The Bank takes into consideration the combined effect of several events when assessing impairment and uses its experienced judgement in cases where the observable data required to estimate impairment is limited. In estimating impairment losses on items individually or collectively assessed as impaired, the Bank also has regard to the ranges of impairment loss prescribed by the CNB based on the age of overdue amounts.

At the year end, the gross value of specifically impaired loans and advances, and the rate of impairment loss recognised, was as follows:

	2006 HRK million			2005 HRK million		
	Corporate	Retail	Total	Corporate	Retail	Total
Gross value of exposure	251	301	552	265	399	664
Impairment rate	72,65%	67,73%	69,97%	76,94%	56,63%	64,71%

Each additional increase of one percentage point in the impairment rate on the gross specifically impaired portfolio at 31 December 2006 would lead to the recognition of an additional impairment loss of HRK 6 million (2005: HRK 7 million).

The Bank also seeks to recognise impairment losses which are known to exist at the balance sheet date, but which have not yet been specifically identified. In estimating unidentified impairment losses existing in collectively assessed portfolios, and in the absence of reliable data on historical loss rates and the

Notes to the financial statements (continued)

emergence period for the identification of these impairment losses, the Bank also has regard to the range of impairment loss rates of 0.85% to 1.20% prescribed by the CNB to be calculated on all credit risk exposures except those carried at fair value through profit or loss except fair value of embedded derivatives, including off-balance-sheet amounts (contingent liabilities) and Croatian sovereign risk. Amounts assessed as impaired on an individual basis are excluded from this calculation.

The amount of impairment losses at 31 December 2006 estimated on a portfolio basis amounted to HRK 258 million (2005: HRK 207 million) of the relevant on- and off-balance-sheet exposure. The total of these portfolio based impairment losses amounted to 0.85% of on-balance-sheet exposure (2005: 0.85%) and to 0.85% (2005: 0.89%) of off-balance-sheet exposure, in both cases net of amounts individually assessed as impaired.

At the minimum rate prescribed by the CNB, portfolio based impairment losses would be HRK 0.2 million (2005: HRK 1.5 million) lower than the amount recognised by the Bank. At the maximum rate prescribed by the CNB, portfolio based impairment allowances would be HRK 106 million (2005: HRK 83 million) higher than the amount recognised by the Bank.

Fair value of financial instruments

Where the fair value of financial assets recorded on the balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgement is required in establishing fair values. The judgements include considerations of liquidity and model inputs such as correlation and volatility for longer dated derivatives.

Legal cases

The Bank performs a risk classification of lawsuits taking into consideration the following principles: legal basis of the claim; prior legal practice in respect of types of lawsuit; opinions of relevant in-house departments; opinions of outsourced attorneys; other relevant experts; and the Bank's own experience in similar lawsuits.

Lawsuits are classified into three groups: where the Bank expects a fully successful outcome; where the Bank expects to lose the case; and uncertain lawsuits, where the probability of a successful or unsuccessful outcome cannot be readily determined. In estimating provisions, the Bank takes into account the due legal process in the Republic of Croatia, which allows a multiple appeal procedure in certain cases. The Bank seeks to make provisions for those cases where, in management's opinion, the eventual outcome is that the Bank is more likely than not to lose.

Taxation

The Bank provides for tax liabilities in accordance with the tax laws of the Republic of Croatia. Tax returns are subject to the approval of the tax authorities who are entitled to carry out subsequent inspections of taxpayer's records.

Notes to the financial statements (continued)

5. CASH AND CURRENT ACCOUNTS WITH BANKS

	2006	2005
	HRK million	restated HRK million
Cash in hand		
Held by the Bank	181	167
Held by other parties	27	24
Cheques in the course of collection	1	1
	<u>209</u>	<u>192</u>
Current accounts		
Current accounts with domestic banks	5	5
Current accounts with foreign banks	50	51
Giro account with the Croatian National Bank	727	852
	<u>782</u>	<u>908</u>
	<u>991</u>	<u>1,100</u>

6. OBLIGATORY RESERVE WITH CROATIAN NATIONAL BANK

	2006	2005
	HRK million	restated HRK million
Obligatory reserve	2,864	2,636
Marginal obligatory reserve	1,425	685
	<u>4,289</u>	<u>3,321</u>
Interest receivable – due	1	1
Interest receivable – not due	1	1
	<u>4,291</u>	<u>3,323</u>

The obligatory reserve represents amounts required to be deposited with the CNB and are not available for use in the Bank's day-to-day operations.

At 31 December 2006, the obligatory reserve requirement amounted to 17% (2005: 18%) of kuna and foreign currency deposits, borrowings and issued debt securities.

Notes to the financial statements (continued)

6. OBLIGATORY RESERVE WITH CROATIAN NATIONAL BANK (continued)

At 31 December 2006, the required minimum rate of maintenance of the kuna obligatory reserve with the CNB amounted to 70% (2005: 70%), while the remaining 30% (2005: 30%) could be held in the form of other liquid receivables. This includes the part of foreign currency obligatory reserve required to be held in HRK (see below).

60% of foreign currency obligatory reserve (2005: 60%) is required to be held with the CNB, while the remaining 40% (2005: 40%) may be held in the form of other liquid receivables, after adjusting for the obligatory reserve requirement arising from foreign currency funds from non-residents and related parties (which is required to be held in full with the CNB). 50% (2005: 50%) of the foreign currency obligatory reserve is required to be held in HRK and is added to the kuna obligatory reserve (see above).

The annual interest rate on the obligatory reserve in kuna payable by the CNB during the year 2006 was 0.75% (2005: 0.75% -1.25%).

The annual interest rate on the obligatory reserve in foreign currency payable by the CNB during the year 2006 was 1.125% -1.75% in respect of EUR amounts (2005: 1.125% -1.5%).

At 31 December 2006, the marginal obligatory reserve requirement, whereby banks have to maintain funds on a non-interest earning account with the CNB, amounted to 40% (2005: 40%) of the net increase in funds received from non-residents and related parties from June 2004, 15% of the net increase in funds received from non-residents and related parties from November 2005 and 55% (2005: 55%) of the net increase in funds received from financial leasing companies and increase of guarantees issued on behalf of residents to borrow money from abroad. Since June 2006 basis is broadened for net increase in managed funds.

7. PLACEMENTS WITH, AND LOANS AND ADVANCES TO OTHER BANKS

	2006	2005 restated
	HRK million	HRK million
Short-term placements with domestic banks	48	256
Short-term placements with foreign banks	957	954
Total short-term placements and loans	1,005	1,210
Long-term placements with foreign banks	-	4
Interest receivable – not due	1	3
	1,006	1,217

Long-term placements with foreign banks relate to guarantee deposits placed as collateral for card operations.

Notes to the financial statements (continued)

8. DERIVATIVE FINANCIAL INSTRUMENTS

The structure of derivative financial assets is as follows:

		2006		2005 restated
	Contractual/ notional amount HRK million	Assets HRK million	Contractual / notional amount HRK million	Assets HRK million
Interest rate swaps	-		1,789	
- fair value		-		7
- interest receivable – not due		-		21
		-		28
Currency swaps and forwards	1,700	13	445	1
Embedded derivatives	117	1	172	2
		14		31

The structure of derivative financial liabilities is as follows:

		2006		2005 restated
	Contractual / notional amount HRK million	Liabilities HRK million	Contractual/ notional amount HRK million	Liabilities HRK million
Interest rate swaps	-		1,789	
- fair value		-		52
- interest receivable – not due		-		45
		-		97
Currency swaps and forwards	387	-	272	2
Embedded derivatives	49	1	79	1
		1		100

Derivative financial instruments are entered into to enable the Bank and its customers to transfer, modify or reduce their interest rate and currency risks.

Interest rate swaps were used for economic hedging of the interest rate risk attributable to the Bank's holdings in bonds issued by EU governments, but are not accounted as formal hedges.

9. FINANCIAL ASSETS HELD FOR TRADING

	2006	2005
	HRK	restated
	million	HRK
		million
Debt securities, quoted on active markets		
Bonds issued by EU member country governments	-	1,542
Bonds issued by domestic banks	4	-
Bonds issued by the Republic of Croatia	49	44
	<u>53</u>	<u>1,586</u>
Interest receivable – not due	1	51
	<u>54</u>	<u>1,637</u>

10. FINANCIAL ASSETS AVAILABLE FOR SALE

	2006	2005
	HRK	restated
	million	HRK
		million
Debt securities, listed		
Bonds issued by the Republic of Croatia	150	96
Bonds issued by EU member country governments	2,192	980
Commercial bills issued by domestic trade companies	52	-
Bonds issued by domestic trade companies	77	-
	<u>2,471</u>	<u>1,076</u>
Debt securities, unlisted		
Treasury bills issued by the Republic of Croatia	397	289
Bonds issued by Republic of Croatia	411	-
	<u>808</u>	<u>289</u>
Equity securities, unlisted	6	9
Investments in investment funds, quoted over the counter	-	22
Interest receivable – not due	14	27
	<u>3,299</u>	<u>1,423</u>

Bonds issued by EU member country governments and treasury bills issued by the Republic of Croatia are pledged as collateral for repurchase agreement (Note 19).

Notes to the financial statements (continued)

11. FINANCIAL ASSETS HELD TO MATURITY

	2006	2005
	HRK million	restated HRK million
Debt securities, listed		
Bonds issued by EU member country governments	-	-
Bonds issued by Republic of Croatia	-	142
	<hr/>	<hr/>
	-	142
Debt securities, unlisted		
Bonds issued by the Republic of Croatia	-	399
Interest receivable – not due	-	7
	<hr/>	<hr/>
	-	548
	<hr/>	<hr/>

Due to change in intention to hold financial assets until maturity, the Bank has reclassified financial assets held to maturity to financial assets available for sale in November 2006.

Total amount of financial assets held to maturity reclassified at date of reclassification is HRK 429 million (Note 2).

Notes to the financial statements (continued)

12. LOANS AND ADVANCES TO CUSTOMERS

a) Analysis by contracted maturity

	2006	2005
	HRK million	restated HRK million
Short-term loans		
- corporate	1,089	620
- retail	291	267
	<u>1,380</u>	<u>887</u>
Long-term loans		
- corporate	7,932	7,132
- retail	7,015	6,087
	<u>14,947</u>	<u>13,219</u>
Interest receivable – due	34	34
Interest receivable – not due	76	65
Interest receivable - total	<u>110</u>	<u>99</u>
Deferred fees recognised as an adjustment to the effective yield	(90)	(77)
Total gross loans and advances to customers	16,347	14,128
Unidentified losses	(216)	(170)
Identified losses	(386)	(430)
Impairment allowance	(602)	(600)
	<u>15,745</u>	<u>13,528</u>

The aggregate amount of non-performing loans on which interest is not being accrued amounted to HRK 552 million as at 31 December 2006 (2005: HRK 664 million).

As at 31 December 2006 total loans guaranteed by the Government of the Republic of Croatia amounted to HRK 1,933 million (2005: HRK 1,993 million) and relate primarily to the tourism and shipbuilding sectors. No impairment allowances have been made for these loans.

Notes to the financial statements (continued)

12. LOANS AND ADVANCES TO CUSTOMERS (continued)

b) Movement in impairment allowance

Movements in impairment allowance for loans and advances are as follows:

	Identified losses HRK million	2006 Unidentified losses HRK million
Balance at 1 January 2006	430	170
Net increase in impairment losses	56	46
Foreign currency differences	(6)	-
Amortisation of discount on expected future cash flows from impaired loans discounted at the effective interest rate (recognised in interest income)	(22)	-
Usage	(72)	-
Balance at 31 December 2006	386	216
	Identified losses HRK million	2005 restated Unidentified losses HRK million
Balance at 1 January 2005	460	163
Net increase in impairment losses	25	7
Foreign currency differences	(1)	-
Amortisation of discount on expected future cash flows from impaired loans discounted at the effective interest rate (recognised in interest income)	(11)	-
Usage	(43)	-
Balance at 31 December 2005	430	170

Notes to the financial statements (continued)

12. LOANS AND ADVANCES TO CUSTOMERS (continued)

c) Concentration of credit risk

Represents gross portfolio before impairment losses: corporate loans by industry and retail loans by type of loan.

- *Corporate by industry:*

	2006	2005
	HRK	restated
	million	HRK
		million
Trade and commerce	1,301	1,273
Tourism	1,110	1,029
Government bodies	1,094	803
Shipbuilding	946	858
Construction	874	595
Property renting	742	458
Food industry	599	582
Other manufacturing	523	508
Transport, storage and communications	450	453
Agriculture and forestry	380	328
Financial services	247	208
Health and social work	181	93
Manufacture of other non-metallic mineral products	105	94
Electricity, gas and water services	94	137
Mining and quarrying	94	120
Chemical industry	77	70
Other	204	143
	<u>9,021</u>	<u>7,752</u>
Interest receivable	71	61
Deferred fees recognised as an adjustment to the effective yield	(28)	(27)
	<u>9,064</u>	<u>7,786</u>

- *Retail by type of loan:*

	2006	2005
	HRK	restated
	million	HRK
		million
Housing loans	2,280	1,938
Car loans	723	939
Card loans	263	259
Other mortgage loans	139	166
Other loans	3,901	3,052
	<u>7,306</u>	<u>6,354</u>
Interest receivable	39	38
Deferred fees recognised as an adjustment to the effective yield	(62)	(50)
	<u>7,283</u>	<u>6,342</u>

Notes to the financial statements (continued)

13. PROPERTY AND EQUIPMENT

	Land and Buildings	Computer equipment	Furniture and equipment	Leased assets	Motor vehicles	Assets under construction	Total
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
Cost / Revaluation							
At 1 January 2005	145	178	62	51	8	30	474
Additions	-	-	-	-	-	32	32
Transfer from assets under construction	6	20	8	8	1	(43)	-
Disposals	(3)	(16)	(10)	-	(1)	(1)	(31)
At 31 December 2005, restated	148	182	60	59	8	18	475
Additions	-	-	-	-	-	26	26
Transfer from assets under construction	2	23	4	1	1	(31)	-
Revaluation	88	-	-	-	-	-	88
Disposals	-	(16)	(9)	-	(1)	-	(26)
Transfer*	(66)	-	-	-	-	-	(66)
At 31 December 2006	172	189	55	60	8	13	497
Accumulated depreciation							
At 1 January 2005	56	102	43	20	6	-	227
Charge for the year	4	27	5	5	1	-	42
Disposals	-	(16)	(10)	-	(1)	-	(27)
At 31 December 2005, restated	60	113	38	25	6	-	242
Charge for the year	5	30	5	5	1	-	46
Impairment	1	-	-	-	-	-	1
Disposals	-	(15)	(5)	-	(1)	-	(21)
Transfer*	(66)	-	-	-	-	-	(66)
At 31 December 2006	-	128	38	30	6	-	202
Carrying amount							
At 1 January 2005	89	76	19	31	2	30	247
At 31 December 2005, restated	88	69	22	34	2	18	233
At 31 December 2006	172	61	17	30	2	13	295

* This transfer relates to the accumulated depreciation as at the revaluation date that was eliminated against the gross carrying amount of the revalued asset.

13. PROPERTY AND EQUIPMENT (continued)

Assets under construction represent buildings of HRK 3 million (2005: HRK 4 million) and equipment of HRK 10 million (2005: HRK 14 million) which are being prepared for use. Leased assets represent leasehold improvements.

Revaluation of land and buildings

The Bank engaged SB Nekretnine to determine the fair value of its land and buildings. The valuation was reviewed by an accredited independent valuer. Fair value is determined by reference to market-based evidence. The date of the revaluation was 31 December 2006.

If the land and buildings were measured using the cost model, the carrying amounts would be as follows:

	2006 HRK million
Cost	150
Accumulated depreciation	(65)
Net carrying amount	85

14. INTANGIBLE ASSETS

	Software	Other	Assets under constructio n	Total
	HRK million	HRK million	HRK million	HRK million
Cost				
At 1 January 2005	198	2	16	216
Additions	1	-	33	34
Transfer from assets under construction	42	-	(42)	-
At 31 December 2005, restated	241	2	7	250
Additions	-	-	18	18
Transfer from assets under construction	15	-	(15)	-
At 31 December 2006	256	2	10	268
Accumulated amortisation				
At 1 January 2005	88	2	-	90
Charge for the year	41	-	-	41
At 31 December 2005, restated	129	2	-	131
Charge for the year	47	-	-	47
At 31 December 2006	176	2	-	178
Carrying amount				
At 1 January 2005	110	-	16	126
At 31 December 2005, restated	112	-	7	119
At 31 December 2006	80	-	10	90

Assets under construction represent software of HRK 10 million (2005: HRK 7 million), mainly improvements for the basic CORE 2 software.

Notes to the financial statements (continued)

15. DEFERRED TAX ASSETS

Movements of deferred tax assets are as follows:

	Total	Deferred fees	Financial assets at fair value through profit or loss	Derivative financial instruments	Provision for legal cases	Other
	HRK million	HRK million	HRK million	HRK million	HRK Million	HRK million
Balance as at 1 January 2005	34	12	4	16	-	2
Increase of deferred tax asset recognised in income	25	7	12	1	4	1
Utilisation charged to income	(8)	(3)	(2)	(2)	-	(1)
Balance as at 31 December 2005, restated	51	16	14	15	4	2
Increase of deferred tax asset recognised in income (Note 33)	29	8	-	-	15	6
Utilisation charged to income (Note 33)	(40)	(6)	(14)	(15)	(4)	(1)
Balance as at 31 December 2006	40	18	-	-	15	7

16. OTHER ASSETS

a) Analysis of other assets

	2006	2005
	HRK million	restated HRK million
Restricted balances with Croatian National Bank	-	40
Receivables from credit card operations	13	9
Accrued fees and commissions receivable	7	6
Small inventory	2	2
Other	9	18
	31	75
Impairment allowance	(8)	(9)
	23	66

16. OTHER ASSETS (continued)

Restricted balances with Croatian National Bank represented amounts paid into an escrow account with the CNB on the basis of a court enforcement procedure following the loss of the Bank's appeal against a law suit in 2005. The amount was fully provisioned at the end of 2005 and utilised in 2006.

b) Movement in impairment allowance

	2006	2005
	HRK	restated
	million	HRK
		million
Balance at 1 January	9	25
Net charge/ (credit) to income statement	1	(12)
Usage	(2)	(4)
Balance at 31 December	8	9

17. CURRENT ACCOUNTS AND DEPOSITS FROM BANKS

	2006	2005
	HRK	restated
	million	HRK
		million
Demand deposits	329	57
Term deposits	615	2,272
Interest payable – not due	1	4
	945	2,333

18. CURRENT ACCOUNTS AND DEPOSITS FROM CUSTOMERS

	2006	2005
	HRK	restated
	million	HRK
		million
CORPORATE		
Demand deposits	2,010	2,077
Term deposits	1,388	1,121
	<u>3,398</u>	<u>3,198</u>
RETAIL		
Demand deposits	2,283	2,130
Term deposits	5,253	4,351
	<u>7,536</u>	<u>6,481</u>
Interest payable – not due	96	73
	<u>11,030</u>	<u>9,752</u>

Included in Current accounts and deposits from customers were deposits of HRK 20 million (2005: HRK 42 million) held as collateral for irrevocable commitments under import letter of credit.

19. REPURCHASE AGREEMENTS

		Fair value of underlying assets	Carrying amount of corresponding liabilities including accrued interest	Repurchase dates	Repurchase price
		HRK million	HRK million		%
2006	Croatian National Bank	397	374	January 2007	3.5
	Related party	2,199	2,200	January to April 2007	3.41 to 3.65
		<u>2,596</u>	<u>2,574</u>		
2005, restated	Related party	2,599	2,594	January to May 2006	2.19 to 2.63

The Bank has entered into several repurchase agreements with its parent company Société Générale S.A. (in 2005 with parent company Bank Austria Creditanstalt AG).

Notes to the financial statements (continued)

19. REPURCHASE AGREEMENTS (continued)

Repurchase agreement with parent company are collateralised by bonds issued by EU member country governments classified as financial assets available for sale (in 2005 classified as financial assets at fair value through profit or loss and as financial assets available for sale).

Repurchase agreement with Croatian National Bank is collateralised by treasury bills issued by the Republic of Croatia and classified as financial assets available for sale.

20. BORROWINGS

	2006	2005
	HRK	restated
	million	HRK
		million
Foreign banks	7,090	4,749
Foreign government agencies	235	310
Republic of Croatia	30	59
Domestic banks	1,208	1,244
Interest payable – not due	26	26
Interest payable – due	75	98
Deferred fees recognised as an adjustment to the effective yield	(8)	(10)
	<u>8,656</u>	<u>6,476</u>

Amounts due to foreign government agencies (Paris Club)

Repayments of foreign currency borrowings previously due between 1984 and 1988 were rescheduled and refinanced under a series of agreements concluded by the "Paris Club Agreement" on 21 March 1995. Under this agreement, repayments of principal were to be made in 24 semi-annual instalments commencing on 31 January 1998. During 1997 and 1998 further discussions were held with each of the counterparties, and bilateral agreements were concluded. Loans are repayable in semi-annual instalments with final maturity in July 2009. Interest is charged at rates from six-month LIBOR for USD + 13/16% to 8% flat for other currencies.

Amounts due to the Republic of Croatia (London Club)

On 31 July 1996 the Government of Croatia assumed responsibility for 29.5% of all rescheduled liabilities of the former Yugoslavia to foreign commercial banks under the New Financing Agreement, representing Croatia's share of the debt of the former Yugoslavia. The Bank's liability for London Club debt was replaced by a liability to the Republic of Croatia. The loan is repayable in semi-annual instalments with final maturity at 31 July 2010. The interest rate is six-month LIBOR for USD + 13/16%.

Notes to the financial statements (continued)

21. PROVISIONS FOR LIABILITIES AND CHARGES

a) Analysis of provisions

	2006	2005
	HRK	restated
	million	HRK
		million
Provisions for legal proceedings	132	80
Provisions for commitments and contingencies	42	37
	<u>174</u>	<u>117</u>
Other provisions		
Employee costs	12	7
Obligations under Letters of credits and guarantees relating to the former Yugoslavia	22	24
Dormant accounts	4	5
Total other provisions	<u>38</u>	<u>36</u>
	<u>212</u>	<u>153</u>

The Bank is subject to a number of legal actions taken against it. The Bank establishes provisions based on professional legal advice.

b) Movements in provisions

	Total	Legal	Commitments	Other
	HRK	proceedings	and	provisions
	million	HRK	contingencies	HRK
		million	HRK	million
			million	
Balance at 1 January 2005	106	44	25	37
Net charge / (credit) to income statement	50	40	12	(2)
Provision used during the year	(4)	(4)	-	-
Foreign exchange loss	1	-	-	1
Balance at 31 December 2005, restated	<u>153</u>	<u>80</u>	<u>37</u>	<u>36</u>
Net charge to income statement	104	94	5	5
Provision used during the year	(42)	(42)	-	-
Foreign exchange gain	(3)	-	-	(3)
Balance at 31 December 2006	<u>212</u>	<u>132</u>	<u>42</u>	<u>38</u>

Notes to the financial statements (continued)

22. DEFERRED TAX LIABILITY

Movements of deferred tax liability is as follows:

	Total	Revaluation of financial investments available-for- sale	Revaluation of land and buildings
	HRK million	HRK million	HRK million
Balance as at 1 January 2005	-	-	-
Increase of deferred tax liabilities recognised directly in equity	2	2	-
Balance as at 31 December 2005, restated	2	2	-
Increase of deferred tax liabilities recognised directly in equity	19	1	18
Balance as at 31 December 2006	21	3	18

23. OTHER LIABILITIES

	2006	2005 restated
	HRK million	HRK million
Liabilities for credit card operations	67	24
Amounts due to suppliers	43	29
Salaries and other staff costs	22	22
Liabilities for salary related taxes and contributions and other contributions	13	12
Liabilities to clients for payment of initial capital contribution held in escrow	8	18
Liabilities for sold apartments	6	6
Deferred card origination fees	3	3
Liabilities to clients for undistributed inflows	2	27
Items in course of settlement	2	2
Liabilities for fees	2	-
Liabilities for received advances	1	8
Other liabilities	6	7
	175	158

Notes to the financial statements (continued)

24. SHAREHOLDERS' EQUITY

a) Share capital

At year-end there were 4,914,258 (2005: 4,552,817) ordinary shares issued, each with a nominal value of HRK 100 per share. All issued shares are fully paid.

Since June 2006 majority shareholder of the Bank is Société Générale S.A. that purchased shares from Bank Austria Creditanstalt AG.

The shareholding structure is as follows:

	2006		2005	
	Paid-in capital HRK million	Ownership %	Paid-in capital HRK million	Ownership %
Société Générale S.A.	490	99.76	-	-
Bank Austria Creditanstalt AG, Vienna	-	-	454	99.75
Small shareholders	1	0.24	1	0.25
	491	100.00	455	100.00

In December 2006 the share capital was increased by HRK 367 million by issuing of 361.441 ordinary shares with nominal value of HRK 100 each. The transaction increased share premium in the amount of HRK 331 million.

b) Share premium and reserves

	2006	2005 restated
	HRK million	HRK million
Share premium	419	88
Statutory reserve	223	223
Fair value reserve	15	9
Revaluation reserve	70	-
Retained earnings	1,072	909
	1,799	1,229

Share premium represents the amount received in excess of nominal value on issue of share capital which is credited directly to this reserve within equity.

24. SHAREHOLDERS' EQUITY (continued)

In accordance with the Commercial law, the Bank is required to build a reserve by appropriating 5% of net profit for the year until the reserve reaches 5% of share capital. This reserve may be used to cover prior period losses if the losses are not covered by current year profits or if other reserves are not available. The balance on the statutory reserve at 31 December 2006 exceeds this requirement and amounted to HRK 223 million, or 45% (2005: 49%) of share capital.

The fair value reserve represents cumulative unutilised fair value gains or losses on available-for-sale financial assets, net of deferred tax.

The revaluation reserve is used to record increases in the fair value of land and buildings.

Retained earnings accumulated represent profit which can be distributed following approval at Shareholders' Meetings.

Notes to the financial statements (continued)

25. NET INTEREST INCOME

a) Interest and similar income

	2006	2005
	HRK	restated
	million	HRK
		million
Balances with the Croatian National Bank	29	30
Placements with, and loans and advances to other banks	34	34
Loans and advances to customers		
- Retail	572	533
- Corporate	491	384
Financial assets available for sale	69	22
Financial assets held to maturity	31	56
	1,226	1,059

b) Interest expense and similar charges

	2006	2005
	HRK	restated
	million	HRK
		million
Current accounts and deposits from banks	83	35
Current accounts and deposits from customers		
- Retail	178	138
- Corporate	64	50
Repurchase agreements	68	58
Borrowings	205	181
	598	462

Notes to the financial statements (continued)

26. NET FEE AND COMMISSION INCOME

a) Fee and commission income

	2006	2005
	HRK million	restated HRK million
Domestic payment transactions	78	71
Foreign payment transactions	20	20
Guarantee related fees and commissions	18	15
Letter of credit related fees and commissions	5	5
Card business related fees and commissions	69	65
Fees for custodial and brokerage services	26	20
Other	15	21
	<u>231</u>	<u>217</u>

b) Fee and commission expense

	2006	2005
	HRK million	restated HRK million
Domestic payment transactions	32	36
Foreign payment transactions	1	1
Card business related charges	16	12
Custody and brokerage charges	1	1
Other	1	1
	<u>51</u>	<u>51</u>

27. GAINS LESS LOSSES FROM FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

2006	Fair value gains / (losses)				
	Realised HRK million	Unrealised HRK million	Total HRK million	Interest HRK million	Total HRK million
Debt securities	(57)	5	(52)	38	(14)
Interest related derivatives	42	-	42	(8)	34
Currency related derivatives	5	13	18	-	18
	(10)	18	8	30	38

2005, restated	Fair value gains / (losses)				
	Realised HRK million	Unrealised HRK million	Total HRK million	Interest HRK million	Total HRK million
Debt securities	(4)	(11)	(15)	79	64
Interest related derivatives	-	2	2	(22)	(20)
Currency related derivatives	62	(2)	60	-	60
	58	(11)	47	57	104

28. GAINS LESS LOSSES FROM DEALING IN FOREIGN CURRENCIES AND FOREIGN CURRENCY TRANSLATION

	2006 HRK million	2005 restated HRK million
Net gains from foreign exchange trading	58	99
Net foreign exchange gains / (losses) on translation of monetary assets and liabilities	40	(51)
	98	48

29. OTHER OPERATING INCOME

	2006	2005
	HRK	restated
	million	HRK
		million
Consulting services provided to related parties	-	8
Other consulting services	3	-
Dividends received	1	-
Other	3	4
	<u>7</u>	<u>12</u>

30. PERSONNEL EXPENSES

	2006	2005
	HRK	restated
	million	HRK
		million
<i>Wages and salaries (net)</i>	<i>107</i>	<i>100</i>
<i>Pension contributions deductible from gross salaries</i>	<i>32</i>	<i>29</i>
<i>Taxes and surtaxes deductible from gross salaries</i>	<i>31</i>	<i>24</i>
Total gross salaries	<u>170</u>	<u>153</u>
Employer's contributions on gross salaries	29	27
Other employee costs	<u>55</u>	<u>51</u>
	<u>254</u>	<u>231</u>

The Bank pays defined pension contributions into obligatory pension funds. Contributions are calculated as a percentage of employees' gross salaries.

At 31 December 2006, the Bank had 1,126 employees (2005: 1,157).

31. GENERAL ADMINISTRATIVE EXPENSES

	2006	2005
	HRK	restated
	million	HRK
		million
Professional services and materials	143	124
Administrative expenses	22	20
Advertising and marketing expenses	21	24
Savings deposit insurance charge	19	19
Taxes and contributions on income	6	4
Net loss on sale and write-off of fixed assets	3	-
Other	-	5
	214	196

32. IMPAIRMENT LOSSES ON LOANS AND ADVANCES

The charge / (credit) in the income statement for the impairment of loans and advances is summarised in the following table:

	2006	2005
	HRK	restated
	million	HRK
		million
Loans and advances to customers	102	32
Amounts collected from previously written-off loans and advances to customers	(24)	(10)
Write-off of loans and advances to customers not previously provided	5	3
	83	25

Notes to the financial statements (continued)

33. INCOME TAX EXPENSE

Current tax represents the amounts payable in accordance with Croatian law, computed at a rate of 20% (2005: 20%).

Major components of the income tax expense are as follows:

	2006	2005
	HRK	restated
	million	HRK
		million
Current tax expense	31	88
Net deferred tax utilisation / (credit) (Note 15)	11	(17)
	42	71

A reconciliation between tax expense and accounting profit is as follows:

	2006	2005
	HRK	HRK
	million	million
Accounting profit before tax	205	354
Tax at statutory rate of 20%	41	71
Expenses not deductible for tax purposes until realisation	29	27
Tax allowances (double deductions of eligible expenses)	1	(1)
Utilisation of prior year expenses not deductible for tax purposes	(40)	(9)
Current tax expense	31	88
Average effective tax rate	20%	20%

Notes to the financial statements (continued)

34. BASIC / DILUTED EARNINGS PER SHARE

For the purpose of determining earnings per share, earnings represent net profit after taxation. The number of ordinary shares is the weighted average number of ordinary shares in the year.

The following table shows the income and share data used in the basic / diluted earnings per share calculations:

	2006 HRK million	2005 HRK million
Net profit attributable to ordinary shareholders	163	283

	2006 number	2005 number
Weighted average number of ordinary shares for basic / diluted earnings per share	4,562,712	4,552,817

There have been no transactions involving ordinary shares between the reporting date and the date of the completion of these financial statements.

35. CONTINGENT LIABILITIES AND COMMITMENTS

Contingent liabilities

The following table indicates the contractual amounts of the Bank's off-balance-sheet financial instruments:

	2006 HRK million	2005 HRK million
Credit commitments	3,407	2,677
Guarantees	1,435	1,079
Letters of credit	122	332
Total contingent liabilities and commitments	<u>4,964</u>	<u>4,088</u>
Provisions	(42)	(37)
	<u>4,922</u>	<u>4,051</u>

As at 31 December 2006, the Croatian Government secured credit commitments and guarantees, letters of credit issued by the Bank in favour of enterprises in the amount of HRK 221 million (2005: HRK 366 million).

35. CONTINGENT LIABILITIES AND COMMITMENTS (continued)

Commitments for operating leases:

	2006 HRK million	2005 HRK million
Commitments due within one year	13	12
Commitments due in periods longer than 1 but within 5 years	31	28
Commitments due in periods longer than 5 years	22	23
	66	63

Legal proceedings

Litigation is a common occurrence in the banking industry due to the nature of the business. The Bank has an established protocol for dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. At year end, the Bank had several unresolved legal claims.

For several legal cases, the Bank established provisions based on professional legal advice (where the assessment is that it is more likely than not that the action will succeed) as disclosed in the note 21.

Taxation

In January 2007 the Tax authorities have delivered a protocol regarding a performed inspection which indicates that the Tax authorities have claims towards the Bank regarding:

- a. not paying value added tax on certain incoming invoices for 2003 and 2004 in the amount of HRK 23.5 million (including penalty interest)
- b. not paying corporate income tax for written-off loans for 2003 in the amount of HRK 0.7 million (including penalty interest).

Considering all law provisions and the opinions of the Tax Authority in respect of the questions which are subject to conflict, the Bank's Management has submitted an appeal to Protocol and expects that it will be able to prove that the Bank acted in accordance with the relevant legal regulatory rules.

In a first instance ruling, the Tax authorities have retained their position on both items noted above. The Bank has appealed against such a decision on both items and is currently waiting for the 2nd instance ruling.

The management believes that it will get a positive ruling as the provisions of the law support the management treatment of both the above mentioned items in the past.

35. CONTINGENT LIABILITIES AND COMMITMENTS (continued)

Other commitments

The Bank's commitments under long term contracts include commitments under a long term service agreement with Financijska agencija ("FINA"), entered into in 2003. In accordance with the terms of this agreement, the Bank was able to provide a full range of banking products and services at 32 branch locations as of 31 December 2006. A significant part of the fees to which the Bank is committed under the contract are denominated in EUR. In accordance with IAS 39 "Financial Instruments: Recognition and Measurement", such service commitments should be accounted for as an embedded derivative. Since market rates for forward EUR currency agreements are not very liquid, the Bank is not able to calculate the fair value of the embedded option. Accordingly, gains and losses will be recognised in the income statement upon payment of the service commitment instalments.

36. CASH AND CASH EQUIVALENTS

	2006	2005
	HRK	HRK
	million	million
Cash and current accounts with banks	991	1,100
Placements with, and loans and advances to other banks with original maturity less than three months	967	1,111
	1,958	2,211

The obligatory reserve with Croatian National Bank are not available to finance the Bank's day-to-day operations and therefore are not part of cash and cash equivalents.

37. RISK MANAGEMENT

The main risks arising from the Bank's financial instruments are market risk and credit risk. The Managing Board determines the risk policy and approves the principles of risk management, the establishment of limits for all relevant risks and risk control procedures. Policies for managing each of these risks are summarised below.

a) Market risk

The Bank takes on exposure to market risks. Market risks arise from: mismatching of the maturities and interest rates of assets and liabilities; open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Bank applies "basis point value" and "value at risk" methodologies to estimate the market risk of positions held and the maximum losses expected, based upon a number of assumptions for various changes in market conditions.

37. RISK MANAGEMENT (continued)

The Board sets limits on the value of risk that may be accepted, which is monitored on a daily basis.

Market risk includes four types of risk:

- (i) liquidity risk- the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments.
- (ii) currency risk—the risk that the value of a financial instrument will fluctuate because of changes in foreign exchange rates;
- (iii) interest rate risk—the risk that the value of a financial instrument will fluctuate because of changes in market interest rates;
- (iv) equity securities price risk—the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.

Liquidity risk

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the Bank's management. It is unusual for banks ever to be completely matched since business transacted is 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 an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

The Bank monitors short-term liquidity on a daily basis and structural liquidity on a weekly basis.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

Currency risk

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily.

The Bank monitors its foreign exchange position for compliance with the regulatory requirements of the National Bank of Croatia and its own limit system established in respect of limits on open positions. The measurement of the Bank's open foreign currency position involves monitoring the 'value at risk' limit on the foreign exchange exposure of the Bank.

37. RISK MANAGEMENT (continued)

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument, therefore, indicates to what extent it is exposed to interest rate risk.

The majority of the Bank's interest bearing assets and liabilities are structured to match either short-term assets and short-term liabilities, or long-term assets and liabilities with re-pricing opportunities within one year, or long-term assets and corresponding liabilities where re-pricing is performed simultaneously. In addition, the significant spread existing between the different types of interest bearing assets and liabilities enables the Bank to benefit from a high level of flexibility in adjusting for its interest rate matching and interest rate risk exposure.

The Bank has developed software and limits applying "basis point value" and "value at risk" methodologies. Interest rate gap is under permanent and continuous monitoring.

Equity securities price risk

Equity securities price risk is the possibility that equity securities prices will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all similar instruments on the market.

The Bank's sole exposure to equity securities arises from such securities designated as available for sale. The Bank does not trade in equity securities.

b) Credit risk

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

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

37. RISK MANAGEMENT (continued)

Credit related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans.

Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to a loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Bank monitors the term to maturity of credit commitments because long-term commitments generally have a greater degree of credit risk than short-term commitments.

Notes to the financial statements (continued)

38. LIQUIDITY RISK

The table below analyses the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date except for government and other securities held for trading which are presented with a maturity of up to 1 month. Obligatory reserve is shown according to remaining maturity of funds used as basis for its calculation. Due but uncollected assets and unsettled liabilities are shown with a maturity of up to 1 month.

The Bank's past experience indicates that, for certain categories of asset and liability, the actual liquidity profile is different from the contractual maturity disclosed in the tables below. This fact is taken into account by the Bank in its management of liquidity and is reflected in internal liquidity analysis.

Balance sheet at 31 December 2006

	Up to 1 month HRK million	1-3 months HRK million	3-12 months HRK million	1-3 years HRK million	Over 3 years HRK million	Total HRK million
Assets						
Cash and current accounts with banks	991	-	-	-	-	991
Obligatory reserve with Croatian National Bank	2	1,838	739	613	1,099	4,291
Placements with, and loans and advances to other banks	846	123	37	-	-	1,006
Derivative financial instruments	12	-	-	1	1	14
Financial assets held for trading	54	-	-	-	-	54
Financial assets available for sale	549	1,351	889	245	265	3,299
Financial assets held to maturity	-	-	-	-	-	-
Loans and advances to customers	1,500	612	3,701	4,168	5,764	15,745
Property and equipment	4	16	38	64	173	295
Intangible assets	7	8	37	37	1	90
Income tax receivables	-	-	56	-	-	56
Deferred tax assets	-	-	7	7	26	40
Other assets	19	3	1	-	-	23
Total assets	3,984	3,951	5,505	5,135	7,329	25,904
Liabilities						
Current accounts and deposits from banks	945	-	-	-	-	945
Current accounts and deposits from customers	6,035	1,309	2,852	690	144	11,030
Repurchase agreements	896	1,314	364	-	-	2,574
Borrowings	158	565	1,296	1,627	5,010	8,656
Derivative financial instruments	-	-	1	-	-	1
Provisions for liabilities and charges	42	16	124	20	10	212
Current income tax payables	-	-	-	-	-	-
Deferred tax liability	-	-	-	2	19	21
Other liabilities	138	13	23	-	1	175
Total liabilities	8,214	3,217	4,660	2,339	5,184	23,614
Net liquidity gap	(4,230)	734	845	2,796	2,145	2,290

Notes to the financial statements (continued)

38. LIQUIDITY RISK (continued)

Balance sheet at 31 December 2005, restated

	Up to 1 month HRK million	1-3 months HRK million	3-12 months HRK million	1-3 years HRK million	Over 3 years HRK million	Total HRK million
Assets						
Cash and current accounts with banks	1,100	-	-	-	-	1,100
Obligatory reserve with Croatian National Bank	2	1,693	288	952	388	3,323
Placements with, and loans and advances to other banks	1,028	148	41	-	-	1,217
Derivative financial instruments	14	6	2	2	7	31
Financial assets held for trading	1,637	-	-	-	-	1,637
Financial assets available for sale	398	718	182	-	125	1,423
Financial assets held to maturity	-	14	112	306	116	548
Loans and advances to customers	910	578	2,706	4,069	5,265	13,528
Property and equipment	4	7	49	62	111	233
Intangible assets	4	7	38	68	2	119
Income tax receivables	-	-	-	-	-	-
Deferred tax assets	-	-	25	5	21	51
Other assets	63	-	1	1	1	66
Total assets	5,160	3,171	3,444	5,465	6,036	23,276
Liabilities						
Current accounts and deposits from banks	1,107	148	-	1,078	-	2,333
Current accounts and deposits from customers	5,617	1,286	2,180	535	134	9,752
Repurchase agreements	346	750	1,498	-	-	2,594
Borrowings	122	26	974	3,421	1,933	6,476
Derivative financial instruments	2	-	1	8	89	100
Provisions for liabilities and charges	86	24	7	-	36	153
Current income tax payables	-	-	24	-	-	24
Deferred tax liability	-	-	-	-	2	2
Other liabilities	122	22	13	-	1	158
Total liabilities	7,402	2,256	4,697	5,042	2,195	21,592
Net liquidity gap	(2,242)	915	(1,253)	423	3,841	1,684

39. CURRENCY RISK

Concentration of assets, liabilities and off balance sheet items

The table below provides an analysis of the Bank's main currency exposures. The remaining currencies are shown within 'Other'. The Bank has a number of contracts which are in HRK but are linked to foreign currencies as presented in the tables below which show for each relevant balance sheet category the transfer of the amounts from the HRK column to the relevant foreign currency columns.

Notes to the financial statements (continued)

39. CURRENCY RISK (continued)

Assets and liabilities with a one-way currency clause are included as if HRK denominated. At 31 December 2006, loans and advances to customers with one-way currency clauses (exercisable at the option of the Bank) amounted to HRK 117 million (2005: HRK 172 million) while borrowings with one-way currency clauses (exercisable at the option of the lender) amounted to HRK 49 million (2005: HRK 79 million).

Balance sheet at 31 December 2006

	EUR HRK million	USD HRK million	HRK HRK million	Other HRK million	Total HRK million
Assets					
Cash and current accounts with banks	69	16	877	29	991
Obligatory reserve with Croatian National Bank	2,731	1	1,559	-	4,291
Placements with, and loans and advances to other banks	823	3	22	158	1,006
Derivative financial instruments	-	-	14	-	14
Financial assets held for trading	-	-	54	-	54
Financial assets available for sale	2,204	-	1,095	-	3,299
-currency clause	416	-	(416)	-	-
Financial assets held to maturity	-	-	-	-	-
Loans and advances to customers	3,720	984	10,679	362	15,745
-currency clause	5,841	130	(8,282)	2,311	-
Property and equipment	-	-	295	-	295
Intangible assets	-	-	90	-	90
Income tax receivables	-	-	56	-	56
Deferred tax assets	-	-	40	-	40
Other assets	2	-	21	-	23
Total assets	15,806	1,134	6,104	2,860	25,904
Liabilities					
Current accounts and deposits from banks	645	5	289	6	945
Current accounts and deposits from customers	6,756	766	3,204	304	11,030
- currency clause	1	-	(1)	-	-
Repurchase agreements	2,200	-	374	-	2,574
Borrowings	5,136	579	1,161	1,780	8,656
- currency clause	319	-	(319)	-	-
Derivative financial instruments	-	-	1	-	1
Provisions for liabilities and charges	7	18	187	-	212
Current Income tax payables	-	-	-	-	-
Deferred tax liability	-	-	21	-	21
Other liabilities	21	1	152	1	175
Total liabilities	15,085	1,369	5,069	2,091	23,614
Net balance sheet position (equity)	721	(235)	1,035	769	2,290
Off-balance sheet items					
Credit commitments	1,286	209	1,772	112	3,379
Guarantees and letters of credit	726	159	656	2	1,543
Total contingent liabilities and commitments	2,012	368	2,428	114	4,922

Notes to the financial statements (continued)

39. CURRENCY RISK (continued)

Balance sheet at 31 December 2005, restated

	EUR HRK million	USD HRK million	HRK HRK million	Other HRK million	Total HRK million
Assets					
Cash and current accounts with banks	72	17	996	15	1,100
Obligatory reserve with Croatian National Bank	1,930	-	1,393	-	3,323
Placements with, and loans and advances to other banks	792	4	256	165	1,217
Derivative financial instruments	27	-	4	-	31
Financial assets held for trading	1,593	-	11	33	1,637
-currency clause	11	-	(11)	-	-
Financial assets available for sale	1,010	-	413	-	1,423
Financial assets held to maturity	-	-	548	-	548
-currency clause	523	-	(523)	-	-
Loans and advances to customers	3,010	1,323	8,851	344	13,528
-currency clause	6,117	186	(7,360)	1,057	-
Property and equipment	-	-	233	-	233
Intangible assets	-	-	119	-	119
Income tax receivables	-	-	-	-	-
Deferred tax assets	-	-	51	-	51
Other assets	4	-	62	-	66
Total assets	15,089	1,530	5,043	1,614	23,276
Liabilities					
Current accounts and deposits from banks	1,720	3	61	549	2,333
Current accounts and deposits from customers	5,859	861	2,735	297	9,752
- currency clause	2	-	(2)	-	-
Repurchase agreements	2,594	-	-	-	2,594
Borrowings	4,504	691	1,112	169	6,476
- currency clause	291	-	(291)	-	-
Derivative financial instruments	97	-	3	-	100
Provisions for liabilities and charges	7	20	126	-	153
Current Income tax payables	-	-	24	-	24
Deferred tax liability	-	-	2	-	2
Other liabilities	41	6	110	1	158
Total liabilities	15,115	1,581	3,880	1,016	21,592
Net balance sheet position (equity)	(26)	(51)	1,163	598	1,684
Off-balance sheet items					
Credit commitments	1,036	240	1,358	19	2,653
Guarantees and letters of credit	582	301	502	13	1,398
Total contingent liabilities and commitments	1,618	541	1,860	32	4,051

Notes to the financial statements (continued)

40. INTEREST RATE RISK

Interest sensitivity of assets, liabilities and off balance sheet items

The following tables present the Bank's assets and liabilities analysed according to re-pricing periods determined as the earlier of remaining maturity and contractual re-pricing. The tables present the position at year end and may not be indicative of the position at other times. Earnings will also be affected by the currency of the assets and the liabilities.

Balance sheet at 31 December 2006

	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	Non interest bearing	Total
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
Assets							
Cash and current accounts with banks	-	-	-	-	-	991	991
Obligatory reserve with Croatian National Bank	2,864	-	-	-	-	1,427	4,291
Placements with, and loans and advances to other banks	845	123	37	-	-	1	1,006
Derivative financial instruments	-	-	-	-	-	14	14
Financial assets held for trading	53	-	-	-	-	1	54
Financial assets available for sale	541	1,346	887	245	265	15	3,299
Financial assets held to maturity	-	-	-	-	-	-	-
Loans and advances to customers	11,694	2,475	1,486	109	35	162	15,961
unidentified losses	-	-	-	-	-	(216)	(216)
Property and equipment	-	-	-	-	-	295	295
Intangible assets	-	-	-	-	-	90	90
Income tax receivables	-	-	-	-	-	56	56
Deferred tax assets	-	-	-	-	-	40	40
Other assets	-	-	-	-	-	23	23
Total assets	15,997	3,944	2,410	354	300	2,899	25,904
Liabilities							
Current accounts and deposits from banks	944	-	-	-	-	1	945
Current accounts and deposits from customers	6,347	1,319	2,634	521	113	96	11,030
Repurchase agreements	891	1,305	363	-	-	15	2,574
Borrowings	239	5,497	928	789	1,110	93	8,656
Derivative financial instruments	-	-	-	-	-	1	1
Provisions for liabilities and charges	-	-	-	-	-	212	212
Current income tax payables	-	-	-	-	-	-	-
Deferred tax liability	-	-	-	-	-	21	21
Other liabilities	-	-	-	-	-	175	175
Total liabilities	8,421	8,121	3,925	1,310	1,223	614	23,614
Interest rate gap	7,576	(4,177)	(1,515)	(956)	(923)	2,285	2,290

Notes to the financial statements (continued)

40. INTEREST RATE RISK (continued)

Balance sheet at 31 December 2005, restated

	Up to 1 month	1-3 months	3-12 months	1-3 years	Over 3 years	Non interest bearing	Total
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
Assets							
Cash and current accounts with banks	-	-	-	-	-	1,100	1,100
Obligatory reserve with Croatian National Bank	2,636	-	-	-	-	687	3,323
Placements with, and loans and advances to other banks	1,026	148	41	-	-	2	1,217
Derivative financial instruments	-	-	-	-	-	31	31
Financial assets held for trading	1,586	-	-	-	-	51	1,637
Financial assets available for sale	381	708	182	-	124	28	1,423
Financial assets held to maturity	-	14	107	304	116	7	548
Loans and advances to customers	8,393	1,455	3,409	219	63	159	13,698
unidentified losses	-	-	-	-	-	(170)	(170)
Property and equipment	-	-	-	-	-	233	233
Intangible assets	-	-	-	-	-	119	119
Income tax receivables	-	-	-	-	-	-	-
Deferred tax assets	-	-	-	-	-	51	51
Other assets	-	-	-	-	-	66	66
Total assets	14,022	2,325	3,739	523	303	2,364	23,276
Liabilities							
Current accounts and deposits from banks	1,507	674	148	-	-	4	2,333
Current accounts and deposits from customers	5,691	1,315	2,096	419	114	117	9,752
Repurchase agreements	342	745	1,494	-	-	13	2,594
Borrowings	1,350	3,860	1,152	-	-	114	6,476
Derivative financial instruments	-	-	-	-	-	100	100
Provisions for liabilities and charges	-	-	-	-	-	153	153
Current income tax payables	-	-	-	-	-	24	24
Deferred tax liability	-	-	-	-	-	2	2
Other liabilities	-	-	-	-	-	158	158
Total liabilities	8,890	6,594	4,890	419	114	685	21,592
Interest rate gap	5,132	(4,269)	(1,151)	104	189	1,679	1,684

Notes to the financial statements (continued)

40. INTEREST RATE RISK (continued)

The table below summarises the average effective interest rate during the year for monetary financial instruments:

	2006	2005
	Effective interest rate %	Effective interest rate %
Assets		
Balances with the Croatian National Bank	0.84	0.97
Placements with, and loans and advances to other banks	3.47	2.69
Financial assets held for trading	5.70	4.83
Financial assets available for sale	5.09	3.37
Financial assets held to maturity	6.85	4.95
Loans and advances to customers	7.21	7.16
Liabilities		
Current accounts and deposits from banks	2.85	1.77
Current accounts and deposits from customers	2.41	2.06
Repurchase agreements	3.02	2.30
Borrowings	2.22	2.87

41. CREDIT RISK

Concentration of assets and off balance sheet items

Represents gross credit exposure without cash in hand, fair value of derivative financial assets, property and equipment, intangible assets and loan origination fee.

	2006		2005 restated	
	Assets HRK million	Off-balance sheet items HRK million	Assets HRK million	Off-balance sheet items HRK million
Geographic region:				
Croatia	22,620	4,925	19,637	4,032
Rest of Europe	3,259	40	3,680	56
Other	114	-	95	-
Total	25,993	4,965	23,412	4,088
Economic sector:				
Retail	7,348	1,081	6,397	522
Croatian National Bank	5,017	-	4,214	-
Government bodies	4,415	29	4,439	400
Manufacturing	1,384	355	1,309	398
Public enterprises	1,371	399	1,307	699
Finance	1,337	245	1,559	97
Trade	1,308	1,317	1,282	807
Tourism	1,121	115	1,044	147
Construction	891	583	599	304
Property renting	813	539	462	480
Agriculture	384	108	329	2
Other sectors	604	194	471	232
Total	25,993	4,965	23,412	4,088

42. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arms' length basis. Financial instruments held for trading and quoted available-for-sale instruments are measured at fair value. Loans and receivables and held to maturity assets are measured at amortised cost less impairment.

Loans and advances

Management has considered the fair value of loans and advances. As the Bank has a very limited portfolio of loans and advances with fixed rates and longer-term maturity, management considers that the fair value of the overall portfolio of loans and advances, calculated by discounting expected future principal and interest cash flows (assuming that loan repayments will occur at contractual repayment dates based on existing identified impairment losses) would not be significantly different from the carrying amount before allowances for unidentified impairment losses, which is measured on an amortised cost basis. It is not practicable for the Bank to estimate the difference between the effect of the unidentified impairment losses calculated in accordance with CNB regulations, which are included in the carrying value of loans and advances, and the effect on the discounted cash flow calculations referred to above as an estimate of fair value, of expected future losses which would reduce future cash flows.

Deposits from banks and customers

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values. As most of the Bank's deposits are given at variable rates, being the market rate, there is no significant difference between the fair value of these deposits and their carrying value.

Borrowings

The bank's long-term borrowings have no quoted market price and fair value is estimated as the present value of future cash flows, discounted at interest rates available at the balance sheet date to the Bank for new debt of similar type and remaining maturity. Again, as the Bank's long-term debt is at variable interest rates, there is no significant difference between its carrying and fair value.

43. CUSTODY SERVICES AND FUNDS MANAGED FOR AND ON BEHALF OF THIRD PARTIES

The Bank provides custody services and manages assets on behalf of third parties and individuals. The Bank is not exposed to any risk in connection with these activities. Assets and income arising from such agency transactions are excluded from the Bank's financial statements and are reported in separate accounting records. The Bank charges fees for these services.

At 31 December 2006 the total assets under custody held by the Bank on behalf of domestic and foreign customers, including domestic pension and investment funds were HRK 17,700 million (2005: HRK 19,082 million). In addition, at 31 December 2006 managed funds for and on behalf of third parties amounted to HRK 116 million (2005: HRK 105 million).

44. RELATED PARTY TRANSACTIONS

The Bank considers that it has an immediate related party relationship with its key shareholders and their direct and indirect subsidiaries; its subsidiaries and associates; pension and investment funds managed by related parties, the pension funds managed by their subsidiaries; the Supervisory Board members, Managing Board members and other executive management (together "key management personnel"); close family members of key management personnel; and entities controlled by their close family members, in accordance with the definitions contained in International Financial Reporting Standard IAS 24 "Related Party Disclosures".

Since 30 June 2006, the majority and ultimate owner of the Bank is Société Générale S.A., incorporated in France. Until then majority owner was Bank Austria Creditanstalt AG, incorporated in Austria while the ultimate owner was Unicredito Italiano SpA, incorporated in Italy.

A number of banking transactions are entered into with related parties in the normal course of business. These include mainly loans, deposits, borrowings and foreign currency transactions. These transactions were carried out on commercial terms and at market rates. No provisions have been recognised in respect of loans given to related parties (2005: nil).

The following tables present volumes of related party transactions, exposure at year end, and the relating income and expense for the year. Exposure includes outstanding loans, commitments and contingencies, interest and other receivables and fair value of derivative financial instruments, where applicable.

Income and expenses from transactions with Société Générale S.A. Group are presented from 30 June 2006 (2005: UCI Group from 17 November 2005).

Interest income and expense in 2005 that relate to transactions with Bank Austria Creditanstalt AG also include interest income or expense on interest rate swaps.

Other income or expense includes gains or losses on fair value changes of other derivatives.

44. RELATED PARTY TRANSACTIONS (continued)

Included in loans and receivables are HRK 13 million (2005: HRK 7 million) in respect of loans and advances granted to key management personnel. During 2006 the Bank charged HRK 1 million (2005: HRK 0.3 million) of interest from loans to key management personnel on loans and receivables granted at interest rates from 4.5% to 7.50% per annum (2005: 4.5% to 7.99% per annum). Included in current accounts and deposits from customers are HRK 4 million (2005: HRK 1 million) of deposits from key management personnel. During 2006, the Bank paid interest of HRK 28 thousand (2005: HRK 20 thousand) on these liabilities at rates from 0.1% to 5% per annum (2005: 0.1% to 4% per annum).

Included in key management personnel are Managing Board members and 21 key employees. Remuneration of key management personnel comprises the total gross amount of their compensation including short-term and long-term benefits, such as basic pay and bonuses, benefits in kind, pension and other retirement benefits. In 2005 the remuneration of 5 expatriate members of key management personnel who provide full time executive services to the Bank, in the amount of HRK 11 million, is incurred by Bank Austria Creditanstalt AG and is not recharged to the Bank.

Supervisory Board members were not compensated for their services by the Bank. To the extent that Supervisory Board members are considered key management personnel of related parties companies, their compensation is disclosed in the respective companies' financial statements.

2006

	Exposure	Payables	Interest income	Interest expense	Net trading and other non interest income	Other expenses
	HRK Million	HRK million	HRK Million	HRK million	HRK million	HRK million
Société Générale S.A.	27	8,317	-	59	10	3
SB nekretnine d.o.o.	1	6	-	-	-	-
Key management personnel	13	4	1	-	-	32
Other related parties	-	2	-	-	-	-
	41	8,329	1	59	10	35

Notes to the financial statements (continued)

44. RELATED PARTY TRANSACTIONS (continued)

2005

	Exposure	Payables	Interest income	Interest expense	Net trading and other non interest income	Other expenses
	HRK million	HRK million	HRK million	HRK million	HRK million	HRK million
Unicredito Italiano SpA, Milan	-	111	-	-	-	-
Bayerische Hypo-und Vereinsbank AG, Munich	17	74	-	1	-	-
Bank Austria Creditanstalt AG, Vienna	37	7,766	29	201	75	1
Bank subsidiaries of UniCredito Group	6	5	-	-	9	-
Allianz ZB d.o.o. obligatory pension fund management company	-	132	-	2	1	-
Allianz ZB d.o.o. voluntary pension fund management company	-	4	-	-	-	-
SB Nekretnine d.o.o.	-	4	-	-	-	-
HVB Leasing d.o.o.	-	26	-	-	-	-
CAIB d.d.	-	4	-	-	-	-
CAIB Invest d.o.o.	22	5	-	-	1	-
Wustenrot Building Society	-	4	-	-	2	1
Allib Leasing	-	1	-	-	-	-
Wave	-	4	-	-	-	14
IT Austria	-	-	-	-	-	2
Banking transaction service s.r.o	-	-	-	-	-	1
Key management personnel	7	1	-	-	-	15
Other related parties	2	25	-	-	-	-
	91	8,166	29	204	88	34