

SOCIETE GENERALE – SPLITSKA BANKA D.D.

Financial statements for the year ended 31 December 2007
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	
Philippe Marcotte de Quivieres	Deputy Chairman	since 25 May 2007
Henri, Maria, René Bellenger	Deputy Chairman	since 25 May 2007
Henri, Maria, René Bellenger	Member	until 25 May 2007
Ivo Bilić	Member	
Vedrana Carević	Member	
Florian Urban	Member	since 14 February 2007

General Assembly

Jean-Didier Reigner	Chairman
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Supervisory Board

Jean-Didier Reigner	Chairman
Alexis Juan	Deputy Chairman
Serge Eveille	Member

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 70 were authorised by the Management Board on 18 February 2008 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 2007 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 70).

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 2007 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, 18 February 2008

Balance sheet

As at 31 December 2007

	Notes	2007	2006
		HRK million	HRK million
ASSETS			
Cash and current accounts with banks	4	530	991
Obligatory reserve with Croatian National Bank	5	3,052	4,291
Placements with, and loans and advances to other banks	6	3,037	1,006
Derivative financial instruments	7	4	14
Financial assets held for trading	8	57	54
Financial assets available for sale	9	2,518	3,299
Loans and advances to customers	10	16,026	15,745
Property and equipment	11	277	295
Intangible assets	12	62	90
Income tax receivables		-	56
Deferred tax assets	13	46	40
Other assets	14	37	23
TOTAL ASSETS		25,646	25,904
LIABILITIES			
Current accounts and deposits from banks	15	288	945
Current accounts and deposits from customers	16	12,862	11,030
Repurchase agreements	17	1,308	2,574
Borrowings	18	8,199	8,656
Derivative financial instruments	7	17	1
Provisions for liabilities and charges	19	174	205
Current income tax payables		5	-
Deferred tax liability	20	17	21
Other liabilities	21	218	182
Total liabilities		23,088	23,614
SHAREHOLDERS' EQUITY			
Share capital		491	491
Share premium		419	419
Statutory reserve		223	223
Revaluation reserve		64	70
Fair value reserve		(7)	15
Retained earnings		1,368	1,072
Total shareholders' equity	22	2,558	2,290
TOTAL LIABILITIES AND EQUITY		25,646	25,904
CONTINGENT LIABILITIES AND COMMITMENTS	33	5,803	4,922

Notes to the financial statements on pages 10 to 70 form an integral part of these financial statements.

These financial statements were approved and signed by the Managing Board on 18 February 2008.

Pierre Boursot
Chairman

Florian Urban
Chief financial officer

Income statement

For the year ended 31 December 2007

	Notes	2007	2006
		HRK million	HRK million
Interest and similar income	23a	1,461	1,226
Interest expense and similar charges	23b	(767)	(598)
Net interest income		694	628
Fee and commission income	24a	259	231
Fee and commission expense	24b	(61)	(51)
Net fee and commission income		198	180
Gains less losses from financial assets and liabilities at fair value through profit or loss	25	6	38
Gains less losses from financial assets available for sale		1	4
Gains less losses from dealing in foreign currencies and foreign currency translation	26	128	98
Other operating income	27	10	7
Net trading and other income		145	147
Operating income		1,037	955
Personnel expenses	28	(280)	(254)
Depreciation, amortisation and impairment	11, 12	(91)	(94)
General administrative expenses	29	(248)	(214)
Impairment losses on loans and advances	30	(50)	(83)
Impairment losses on other assets	14	(2)	(1)
Reversal of provisions / (provisions) for liabilities and charges	19	1	(104)
Operating expenses		(670)	(750)
PROFIT BEFORE TAX		367	205
Income tax expense	31	(79)	(42)
PROFIT FOR THE YEAR		288	163
		HRK	HRK
BASIC / DILUTED EARNINGS PER SHARE	32	59	36

Notes to the financial statements on pages 10 to 70 form an integral part of these financial statements.

These financial statements were approved and signed by the Managing Board on 18 February 2008.

Pierre Boursot
Chairman

Florian Urban
Chief financial officer

Statement of changes in shareholders' equity

For the year ended 31 December 2007

	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 31 December 2005	455	88	223	-	9	909	1,684
Fair value adjustments of available-for-sale assets	-	-	-	-	7	-	7
Deferred tax liability (Note 20)	-	-	-	(18)	(1)	-	(19)
Increase of share capital	36	331	-	-	-	-	367
Revaluation of land and buildings (Note 11)	-	-	-	88	-	-	88
Profit for the year	-	-	-	-	-	163	163
Balance at 31 December 2006	491	419	223	70	15	1,072	2,290
Fair value adjustments of available-for-sale assets	-	-	-	-	(27)	-	(27)
Deferred tax asset (Note 13)	-	-	-	-	3	-	3
Deferred tax liability (Note 20)	-	-	-	-	2	2	4
Depreciation of revalued buildings	-	-	-	(6)	-	6	-
Profit for the year	-	-	-	-	-	288	288
Balance at 31 December 2007	491	419	223	64	(7)	1,368	2,558

Notes to the financial statements on pages 10 to 70 form an integral part of these financial statements.

Cash flow statement

For the year ended 31 December 2007

	Notes	2007	2006
		HRK million	HRK million
Cash flows from operating activities			
Profit before tax		367	205
Adjustments for			
Depreciation, amortisation and impairment		91	94
Impairment losses on loans and other assets		62	108
Provisions for liabilities and charges		(1)	104
Other non-cash items		2	(3)
Net loss on disposal of property and equipment		7	4
Net unrealised loss / (gain) on financial assets and liabilities at fair value through profit or loss		13	(18)
		541	494
Changes in operating assets and liabilities			
Net change in obligatory reserve with Croatian National Bank		1,239	(968)
Net change in placements with and loans and advances to other banks		(25)	67
Net change in financial assets held for trading		(3)	1,588
Net change in loans and advances to customers		(341)	(2,324)
Net change in other assets		(16)	42
Net change in deposits from banks		(657)	(1,388)
Net change in deposits from customers		1,832	1,278
Net change in repurchase agreements		(1,266)	(20)
Net change in derivative financial instruments		13	(69)
Net change in other liabilities		34	24
Net change in provisions for liabilities and charges		(29)	(49)
Net cash flow from operating activities before tax		1,322	(1,325)
Income taxes paid		(23)	(111)
Net cash flow from operating activities		1,299	(1,436)
Cash flows from investing activities			
Net proceeds financial assets held to maturity		-	119
Net proceeds /(purchases) of financial assets available for sale		754	(1,440)
Proceeds from disposals of property and equipment		2	1
Purchases of property and equipment		(43)	(26)
Purchases of intangible assets		(10)	(18)
Net cash flow from investing activities		703	(1,364)
Cash flows from financing activities			
Proceeds from issue of share capital		-	367
Net (decrease) / increase in borrowings		(457)	2,180
Net cash flow from financing activities		(457)	2,547
Net increase / (decrease) in cash and cash equivalents		1,545	(253)
Cash and cash equivalents at beginning of period		1,958	2,211
Cash and cash equivalents at end of period	34	3,503	1,958
Dividends received		5	1
Interest received		1,450	1,338
Interest paid		736	695

Notes to the financial statements on pages 10 to 70 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 18 February 2008 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 the accounting standards accepted and published by the Croatian Accounting standards board ("Croatian accounting regulation"). These standards comprise of International Accounting Standards (IAS) / International Financial Reporting Standards ('IFRS') and implementation guidance as published by the International Accounting Standards Board (IASB) until 31 March 2004. International Financial Reporting Standards and changes of existing IFRS / IAS approved by the International Accounting Standards Board after the stated date have not been published in Republic of Croatia and therefore are not applied by the Bank. The principal differences between the accounting regulations of the CNB and recognition and measurement requirements of Croatian accounting regulation are 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 at prescribed rates. The Bank has made portfolio based provisions of HRK 214 million (2006: HRK 216 million) in compliance with these regulations and has recognised an income of HRK 2 million in relation to these provisions within the charge for impairment losses for the year (2006: expense of HRK 46 million). Although, in accordance with Croatian accounting regulations, 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 Croatian accounting regulations.

Notes to the financial statements (continued)

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 Croatian accounting regulations.

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 2007.

(b) Basis of preparation

The financial statements are prepared on the fair value basis for land and buildings, 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 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 3.

The accounting policies have been consistently applied and, except where disclosed otherwise, are consistent with those used in the previous year.

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 2008.

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.

- In December 2007 the CNB has changed decision on capital adequacy of banks. This decision will come into force in 2008. Changes relates to increase of credit risk weighting for placements in foreign currency and with foreign currency clause collateralised by housing buildings to clients with open foreign currency position from 75% to 100% and for placements in foreign currency and with foreign currency clause without collateral to clients with open foreign currency position from 125% to 150%. In addition, this decision implemented maximum allowed growth depending on structure of funding sources and additional calculation of minimum capital adequacy for banks that exceed maximum allowed growth.

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 2007, 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 2008 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 (expected to apply from January 1, 2008)

The Bank will apply IFRS 7 and the amendment to IAS 1 when adopted in the Republic of Croatia. These standards will have impact only on presentation and disclosures in financial statements.

IFRIC 8, Scope of IFRS 2 (expected to apply from January 1, 2008).

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.

Notes to the financial statements (continued)

IFRIC 9, Reassessment of Embedded Derivatives (expected to apply from January 1, 2008)

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.

IAS 23 Borrowing Costs

A revised IAS 23 Borrowing costs was issued in March 2007, and is expected to apply for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Bank will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.

IFRIC 11 IFRS 2 Group and Treasury Share Transactions

This Interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed. The Bank expects that this Interpretation will have no impact on the Bank's financial statements as no such schemes currently exist.

(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 2007 was HRK 7.325131 to EUR 1 (2006: HRK 7.345081) and HRK 4.985456 to USD 1 (2006: HRK 5.578401).

(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.

(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.

Notes to the financial statements (continued)

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.

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.

Notes to the financial statements (continued)

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

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.

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.

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.

Notes to the financial statements (continued)

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.

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.

Notes to the financial statements (continued)

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.

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.

Notes to the financial statements (continued)

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 not identified as impaired at the minimum rate of 0.85% in accordance with the accounting regulations of the CNB.

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).

Notes to the financial statements (continued)

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.

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.

Notes to the financial statements (continued)

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

	2007 and 2006
Residential buildings	50 years
Other buildings	33 years
Office equipment	5 years
Motor vehicles	4 years
Computer equipment	5 years
Furniture	10 years
Other equipment	7 to 15 years
Leasehold improvements	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:

	2007	2006
Software	5 to 6,5 years	5 years
Other intangible assets	5 years	5 years

In 2007 the Bank extended the estimated useful life of software from 5 to 6,5 years as explained in Note 12.

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).

Notes to the financial statements (continued)

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.

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.

Notes to the financial statements (continued)

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. 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 10), 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 33 and 19).

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	2007 HRK million	2006 HRK million
Summary of impairment losses for customers			
Impairment losses on loans and advances to customers	10	604	602
Provisions for off-balance-sheet exposure	33	50	42
		<u>654</u>	<u>644</u>

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

Notes to the financial statements (continued)

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:

	2007 HRK million			2006 HRK million		
	Corporate	Retail	Total	Corporate	Retail	Total
Gross value of exposure	305	287	592	251	301	552
Impairment rate	<u>53,85%</u>	<u>78,58%</u>	<u>65,84%</u>	<u>72,65%</u>	<u>67,73%</u>	<u>69,97%</u>

Each additional increase of one percentage point in the impairment rate on the gross specifically impaired portfolio at 31 December 2007 would lead to the recognition of an additional impairment loss of HRK 6 million (2006: HRK 6 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 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 2007 estimated on a portfolio basis amounted to HRK 264 million (2006: HRK 258 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 (2006: 0.85%) and to 0.85 % (2006: 0.85%) 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 in 2007 are equal to those

Notes to the financial statements (continued)

recognised by the Bank (2006: HRK 0.2 million lower than the amount recognised by the Bank). At the maximum rate prescribed by the CNB, portfolio based impairment allowances would be HRK 109 million (2006: HRK 106 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)

4. CASH AND CURRENT ACCOUNTS WITH BANKS

	2007	2006
	HRK million	HRK million
Cash in hand		
Held by the Bank	208	181
Held by other parties	43	27
Cheques in the course of collection	1	1
	<u>252</u>	<u>209</u>
Current accounts		
Current accounts with domestic banks	16	5
Current accounts with foreign banks	68	50
Giro account with the Croatian National Bank	194	727
	<u>278</u>	<u>782</u>
	<u>530</u>	<u>991</u>

5. OBLIGATORY RESERVE WITH CROATIAN NATIONAL BANK

	2007	2006
	HRK million	HRK million
Obligatory reserve	2,657	2,864
Marginal obligatory reserve	392	1,425
Other obligatory deposits with CNB	1	-
	<u>3,050</u>	<u>4,289</u>
Interest receivable – due	1	1
Interest receivable – not due	1	1
	<u>3,052</u>	<u>4,291</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 2007, the obligatory reserve requirement amounted to 17% (2006: 17%) of kuna and foreign currency deposits, borrowings and issued debt securities.

5. OBLIGATORY RESERVE WITH CROATIAN NATIONAL BANK (continued)

At 31 December 2007, the required minimum rate of maintenance of the kuna obligatory reserve with the CNB amounted to 70% (2006: 70%), while the remaining 30% (2006: 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 (2006: 60%) is required to be held with the CNB, while the remaining 40% (2006: 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% (2006: 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 2007 was 0.75% (2006: 0.75%).

The annual interest rate on the obligatory reserve in foreign currency payable by the CNB during the year 2007 was 1.75% -2.00% in respect of EUR amounts (2006: 1.125% -1.75%).

At 31 December 2007, the marginal obligatory reserve requirement, whereby banks have to maintain funds on a non-interest earning account with the CNB, amounted to 40% (2006: 40%) of the net increase in funds received from non-residents and related parties from June 2004, 15% (2006: 15%) of the net increase in funds received from non-residents and related parties from November 2005 and 55% (2006: 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.

Other obligatory deposits with CNB relates to compulsory purchased CNB treasury bills. In December 2006 the CNB has issued decision on compulsory purchase of Croatian National Bank bills if monthly bank placements growth is above 0,5% per month (initially 1% per month). In September 2007 the CNB enlarged the base for calculation by growth of loans placements to residents made by related parties that are financial institutions. Banks that exceed permissible growth must purchase bills in the amount of 50% of exceeded growth and hold them for one year until maturity. Due to changes of CNB regulation, all compulsory purchased CNB treasury bills in 2007 were redeemed in January 2008.

Notes to the financial statements (continued)

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

	2007	2006
	HRK million	HRK million
Short-term placements with domestic banks	335	48
Short-term placements with foreign banks	2,696	957
	<u>3,031</u>	<u>1,005</u>
Interest receivable – not due	6	1
	<u>3,037</u>	<u>1,006</u>

7. DERIVATIVE FINANCIAL INSTRUMENTS

The structure of derivative financial assets is as follows:

	2007		2006	
	Contractual / notional amount HRK million	Assets HRK million	Contractual / notional amount HRK million	Assets HRK million
Currency swaps and forwards	670	3	1,700	13
Embedded derivatives	79	1	117	1
		<u>4</u>		<u>14</u>

The structure of derivative financial liabilities is as follows:

	2007		2006	
	Contractual / notional amount HRK million	Liabilities HRK million	Contractual/ notional amount HRK million	Liabilities HRK million
Currency swaps and forwards	1,116	17	387	-
Embedded derivatives	30	-	49	1
		<u>17</u>		<u>1</u>

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

Notes to the financial statements (continued)

8. FINANCIAL ASSETS HELD FOR TRADING

	2007	2006
	HRK million	HRK million
Debt securities, quoted on active markets		
Bonds issued by the Republic of Croatia	56	49
Bonds issued by domestic banks	-	4
	<u>56</u>	<u>53</u>
Interest receivable – not due	1	1
	<u>57</u>	<u>54</u>

9. FINANCIAL ASSETS AVAILABLE FOR SALE

	2007	2006
	HRK million	HRK million
Debt securities, listed		
Bonds issued by the Republic of Croatia	119	150
Treasury bills and bonds issued by EU member country governments	1,308	2,192
Commercial bills issued by domestic trade companies	30	52
Bonds issued by domestic trade companies	193	77
	<u>1,650</u>	<u>2,471</u>
Debt securities, unlisted		
Treasury bills issued by the Republic of Croatia	574	397
Bonds issued by the Republic of Croatia	271	411
	<u>845</u>	<u>808</u>
Equity securities, unlisted	18	6
Interest receivable – not due	5	14
	<u>2,518</u>	<u>3,299</u>

Treasury bills and bonds issued by EU member country governments and treasury bills issued by the Republic of Croatia are pledged as collateral for repurchase agreement (Note 17).

Notes to the financial statements (continued)

10. LOANS AND ADVANCES TO CUSTOMERS

a) Analysis by contracted maturity

	2007	2006
	HRK million	HRK million
Short-term loans		
- corporate	1,084	1,089
- retail	335	291
	<u>1,419</u>	<u>1,380</u>
Long-term loans		
- corporate	7,639	7,932
- retail	7,556	7,015
	<u>15,195</u>	<u>14,947</u>
Interest receivable – due	34	34
Interest receivable – not due	80	76
Interest receivable - total	<u>114</u>	<u>110</u>
Deferred fees recognised as an adjustment to the effective yield	(98)	(90)
Total gross loans and advances to customers	16,630	16,347
Unidentified losses	(214)	(216)
Identified losses	(390)	(386)
Impairment allowance	(604)	(602)
	<u>16,026</u>	<u>15,745</u>

The aggregate amount of non-performing loans amounted to HRK 592 million as at 31 December 2007 (2006: HRK 552 million).

As at 31 December 2007 total loans guaranteed by the Government of the Republic of Croatia amounted to HRK 1,406 million (2006: HRK 1,933 million) and relate primarily to the shipbuilding and construction industry. No impairment allowances have been made for these loans.

Notes to the financial statements (continued)

10. 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	2007 Unidentified losses HRK million
Balance at 1 January 2007	386	216
Net increase / (decrease) in impairment losses	62	(2)
Foreign currency differences	(3)	-
Amortisation of discount on expected future cash flows from impaired loans discounted at the effective interest rate (recognised in interest income)	(28)	-
Write-off	(27)	-
Balance at 31 December 2007	390	214
		2006
	Identified losses HRK million	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)	-
Write-off	(72)	-
Balance at 31 December 2006	386	216

Notes to the financial statements (continued)

10. 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:*

	2007	2006
	HRK million	HRK million
Trade and commerce	1,413	1,301
Construction	1,107	874
Property renting	980	742
Tourism	883	1,110
Government bodies	717	1,094
Food industry	604	599
Shipbuilding	599	946
Other manufacturing	560	523
Agriculture and forestry	434	380
Financial services	343	247
Transport, storage and communications	276	450
Health and social work	264	181
Chemical industry	92	77
Electricity, gas and water services	77	94
Manufacture of other non-metallic mineral products	67	105
Mining and quarrying	51	94
Other	256	204
	<u>8,723</u>	<u>9,021</u>
Interest receivable	69	71
Deferred fees recognised as an adjustment to the effective yield	(26)	(28)
	<u>8,766</u>	<u>9,064</u>

- *Retail by type of loan:*

	2007	2006
	HRK million	HRK million
Housing loans	2,449	2,280
Car loans	499	723
Card loans	268	263
Other mortgage loans	134	139
Other loans	4,541	3,901
	<u>7,891</u>	<u>7,306</u>
Interest receivable	45	39
Deferred fees recognised as an adjustment to the effective yield	(72)	(62)
	<u>7,864</u>	<u>7,283</u>

Notes to the financial statements (continued)

11. 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 2006	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
Additions	-	-	-	-	-	43	43
Transfer from assets under construction	-	33	8	3	-	(44)	-
Disposals	-	(30)	(4)	(5)	(1)	-	(40)
At 31 December 2007	172	192	59	58	7	12	500
Accumulated depreciation							
At 1 January 2006	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
Charge for the year	12	31	5	5	1	-	54
Disposals	-	(26)	(4)	(2)	(1)	-	(33)
At 31 December 2007	12	133	39	33	6	-	223
Carrying amount							
At 1 January 2006	88	69	22	34	2	18	233
At 31 December 2006	172	61	17	30	2	13	295
At 31 December 2007	160	59	20	25	1	12	277

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

Notes to the financial statements (continued)

11. PROPERTY AND EQUIPMENT (continued)

Assets under construction represent buildings of HRK 3 million (2006: HRK 3 million) and equipment of HRK 9 million (2006: HRK 10 million) which are being prepared for use. Leased assets represent leasehold improvements.

Revaluation of land and buildings

In 2006, 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:

	2007	2006
	HRK	HRK
	million	million
Cost	150	150
Accumulated depreciation	(69)	(65)
Net carrying amount	81	85

Notes to the financial statements (continued)

12. INTANGIBLE ASSETS

	Software	Other	Assets under constructio n	Total
	HRK million	HRK million	HRK million	HRK million
Cost				
At 1 January 2006	241	2	7	250
Additions	-	-	18	18
Transfer from assets under construction	15	-	(15)	-
At 31 December 2006	256	2	10	268
Additions	-	-	10	10
Transfer from assets under construction	16	-	(16)	-
Disposals	(1)	-	-	(1)
At 31 December 2007	271	2	4	277
Accumulated amortisation				
At 1 January 2006	129	2	-	131
Charge for the year	47	-	-	47
At 31 December 2006	176	2	-	178
Charge for the year	37	-	-	37
At 31 December 2007	213	2	-	215
Carrying amount				
At 1 January 2006	112	-	7	119
At 31 December 2006	80	-	10	90
At 31 December 2007	58	-	4	62

Assets under construction represent software of HRK 4 million (2006: HRK 10 million), mainly improvements for the basic CORE 2 software.

In 2007 the Bank reassessed the estimated useful economic life of software and extended the estimated useful economic life from 5 to 6,5 years. The effect of this change in accounting estimate was a reduction in the depreciation and amortisation expense for the year by HRK 16,611 thousand.

Notes to the financial statements (continued)

13. 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 2006	51	16	14	15	4	2
Increase of deferred tax asset recognised in income (Note 31)	29	8	-	-	15	6
Utilisation charged to income (Note 31)	(40)	(6)	(14)	(15)	(4)	(1)
Balance as at 31 December 2006	40	18	-	-	15	7
Increase of deferred tax asset recognised in income (Note 31)	15	10	-	3	-	2
Increase of deferred tax asset from fair value of available-for-sale in equity	3	-	-	-	-	3
Utilisation charged to income (Note 31)	(12)	(8)	-	-	(3)	(1)
Balance as at 31 December 2007	46	20	-	3	12	11

14. OTHER ASSETS

a) Analysis of other assets

	2007	2006
	HRK million	HRK million
Receivables from card operations	23	13
Accrued fees and commissions receivable	9	7
Small inventory	3	2
Assets acquired in lieu of uncollected receivables	1	-
Advances	1	1
Other	10	8
	47	31
Impairment allowance	(10)	(8)
	37	23

Notes to the financial statements (continued)

14. OTHER ASSETS (continued)

b) Movement in impairment allowance

	2007	2006
	HRK million	HRK million
Balance at 1 January	8	9
Net charge to income statement	2	1
Write-off	-	(2)
Balance at 31 December	10	8

15. CURRENT ACCOUNTS AND DEPOSITS FROM BANKS

	2007	2006
	HRK million	HRK million
Demand deposits	136	329
Term deposits	151	615
Interest payable – not due	1	1
	288	945

Notes to the financial statements (continued)

16. CURRENT ACCOUNTS AND DEPOSITS FROM CUSTOMERS

	2007	2006
	HRK million	HRK million
CORPORATE		
Demand deposits	2,385	2,010
Term deposits	2,223	1,388
	<u>4,608</u>	<u>3,398</u>
RETAIL		
Demand deposits	2,406	2,283
Term deposits	5,719	5,253
	<u>8,125</u>	<u>7,536</u>
Interest payable – not due	129	96
	<u>12,862</u>	<u>11,030</u>

Included in Current accounts and deposits from customers were deposits of HRK 23 million (2006: HRK 20 million) held as collateral for irrevocable commitments under import letter of credit.

17. REPURCHASE AGREEMENTS

		Fair value of underlying assets	Carrying amount of corresponding liabilities including accrued interest	Repurchase dates	Repurchase price
		HRK million	HRK million		%
2007	Related party	1,308	1,308	January to May 2008	4.09 to 4.29
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>		

The Bank has entered into several repurchase agreements with its parent company Société Générale S.A..

Notes to the financial statements (continued)

17. REPURCHASE AGREEMENTS (continued)

Repurchase agreement with parent company are collateralised by treasury bills and bonds issued by EU member country governments classified 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.

18. BORROWINGS

	2007	2006
	HRK million	HRK million
Foreign banks	6,595	7,090
Foreign government agencies	158	235
Republic of Croatia	20	30
Domestic banks	1,331	1,208
Interest payable – not due	27	26
Interest payable – due	74	75
Deferred fees recognised as an adjustment to the effective yield	(6)	(8)
	8,199	8,656

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)

19. PROVISIONS FOR LIABILITIES AND CHARGES

a) Analysis of provisions

	2007	2006
	HRK million	HRK million
Provisions for legal proceedings	94	132
Provisions for commitments and contingencies	50	42
	<u>144</u>	<u>174</u>
<i>Employee costs</i>	6	5
<i>Obligations under Letters of credits and guarantees relating to the former Yugoslavia</i>	20	22
<i>Dormant accounts</i>	4	4
Other provisions	30	31
	<u>174</u>	<u>205</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 HRK million	Legal proceedings HRK million	Commitments and contingencies HRK million	Other provisions HRK million
Balance at 1 January 2006	146	80	37	29
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>205</u>	<u>132</u>	<u>42</u>	<u>31</u>
Net charge to income statement	(1)	(9)	8	-
Provision used during the year	(29)	(29)	-	-
Foreign exchange gain	(1)	-	-	(1)
Balance at 31 December 2007	<u>174</u>	<u>94</u>	<u>50</u>	<u>30</u>

Notes to the financial statements (continued)

20. 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 2006	2	2	-
Increase of deferred tax liabilities recognised directly in equity	19	1	18
Balance as at 31 December 2006	21	3	18
(Decrease) of deferred tax liabilities recognised directly in equity	(4)	(2)	(2)
Balance as at 31 December 2007	17	1	16

21. OTHER LIABILITIES

	2007	2006
	HRK million	HRK million
Liabilities for card operations	74	67
Amounts due to suppliers	62	43
Salaries and other staff costs	33	29
Liabilities for salary related taxes and contributions and other contributions	13	13
Liabilities to clients for payment of initial capital contribution held in escrow	9	8
Liabilities for sold apartments	6	6
Liabilities to clients for undistributed inflows	5	2
Deferred card origination fees	3	3
Liabilities for received advances	3	1
Items in course of settlement	2	2
Liabilities for fees	-	2
Other liabilities	8	6
	218	182

Notes to the financial statements (continued)

22. SHAREHOLDERS' EQUITY

a) Share capital

At year-end there were 4,914,258 (2006: 4,914,258) 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:

	2007		2006	
	Paid-in capital HRK million	Ownership %	Paid-in capital HRK million	Ownership %
Société Générale S.A.	490	99.76	490	99.76
Small shareholders	1	0.24	1	0.24
	491	100.00	491	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

	2007	2006
	HRK million	HRK million
Share premium	419	419
Statutory reserve	223	223
Fair value reserve	(7)	15
Revaluation reserve	64	70
Retained earnings	1,368	1,072
	2,067	1,799

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.

22. 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 2007 exceeds this requirement and amounted to HRK 223 million, or 45% (2006: 45%) of share capital.

The fair value reserve represents cumulative unrealised 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)

23. NET INTEREST INCOME

a) Interest and similar income

	2007	2006
	HRK million	HRK million
Balances with the Croatian National Bank	36	29
Placements with, and loans and advances to other banks	93	34
Loans and advances to customers		
- Retail	634	572
- Corporate	571	491
Financial assets available for sale	127	69
Financial assets held to maturity	-	31
	1,461	1,226

b) Interest expense and similar charges

	2007	2006
	HRK million	HRK million
Current accounts and deposits from banks	27	83
Current accounts and deposits from customers		
- Retail	221	178
- Corporate	106	64
Repurchase agreements	74	68
Borrowings	339	205
	767	598

Notes to the financial statements (continued)

24. NET FEE AND COMMISSION INCOME

a) Fee and commission income

	2007	2006
	HRK million	HRK million
Domestic payment transactions	84	78
Foreign payment transactions	22	20
Guarantee related fees and commissions	16	18
Letter of credit related fees and commissions	3	5
Card business related fees and commissions	84	69
Fees for custodial and brokerage services	25	26
Other	25	15
	259	231

b) Fee and commission expense

	2007	2006
	HRK million	HRK million
Domestic payment transactions	32	32
Foreign payment transactions	1	1
Card business related charges	21	16
Custody and brokerage charges	4	1
Other	3	1
	61	51

Notes to the financial statements (continued)

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

2007	Fair value gains / (losses)			Interest	Total
	Realised	Unrealised	Total		
	HRK million	HRK million	HRK million		
Debt securities	(2)	-	(2)	3	1
Currency related derivatives	18	(13)	5	-	5
	16	(13)	3	3	6

2006	Fair value gains / (losses)			Interest	Total
	Realised	Unrealised	Total		
	HRK million	HRK million	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

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

	2007	2006
	HRK million	HRK million
Net gains from foreign exchange trading	81	58
Net foreign exchange gains on translation of monetary assets and liabilities	47	40
	128	98

Notes to the financial statements (continued)

27. OTHER OPERATING INCOME

	2007	2006
	HRK million	HRK million
Dividends received from related party	4	-
Dividends received	1	1
Other consulting services	-	3
Other	5	3
	10	7

28. PERSONNEL EXPENSES

	2007	2006
	HRK million	HRK million
<i>Wages and salaries (net)</i>	124	107
<i>Pension contributions deductible from gross salaries</i>	37	32
<i>Taxes and surtaxes deductible from gross salaries</i>	39	31
Total gross salaries	200	170
Employer's contributions on gross salaries	34	29
Other employee costs	46	55
	280	254

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

At 31 December 2007, the Bank had 1,372 employees (2006: 1,126).

Notes to the financial statements (continued)

29. GENERAL ADMINISTRATIVE EXPENSES

	2007	2006
	HRK million	HRK million
Professional services and materials	172	143
Administrative expenses	27	22
Advertising and marketing expenses	17	21
Savings deposit insurance charge	20	19
Taxes and contributions on income	6	6
Net loss on sale and write-off of fixed assets	6	3
	<u>248</u>	<u>214</u>

30. 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:

	2007	2006
	HRK million	HRK million
Loans and advances to customers	60	102
Amounts collected from previously written-off loans and advances to customers	(10)	(24)
Write-off of loans and advances to customers not previously provided	-	5
	<u>50</u>	<u>83</u>

Notes to the financial statements (continued)

31. INCOME TAX EXPENSE

Current tax represents the amounts payable in accordance with Croatian law, computed at a rate of 20% (2006: 20%).

Major components of the income tax expense are as follows:

	2007	2006
	HRK million	HRK million
Current tax expense	82	31
Net deferred tax (credit) / utilisation (Note 13)	(3)	11
	79	42

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

	2007	2006
	HRK million	HRK million
Accounting profit before tax	367	205
Tax at statutory rate of 20%	73	41
Expenses not deductible for tax purposes until realisation	15	29
Tax non-deductible expenses (permanent differences)	6	1
Utilisation of prior year expenses not deductible for tax purposes	(12)	(40)
Current tax expense	82	31
Average effective tax rate	22%	20%

Notes to the financial statements (continued)

32. 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:

	2007 HRK million	2006 HRK million
Net profit attributable to ordinary shareholders	288	163
	2007 number	2006 number
Weighted average number of ordinary shares for basic / diluted earnings per share	4,914,258	4,562,712

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

33. CONTINGENT LIABILITIES AND COMMITMENTS

Contingent liabilities

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

	2007 HRK million	2006 HRK million
Credit commitments	4,186	3,407
Guarantees	1,520	1,435
Letters of credit	147	122
Total contingent liabilities and commitments	<u>5,853</u>	<u>4,964</u>
Provisions	(50)	(42)
	<u>5,803</u>	<u>4,922</u>

As at 31 December 2007, the Croatian Government secured credit commitments and guarantees, letters of credit issued by the Bank in favour of enterprises in the amount of HRK 141 million (2006: HRK 221 million).

Notes to the financial statements (continued)

33. CONTINGENT LIABILITIES AND COMMITMENTS (continued)

Commitments for operating leases:

	2007 HRK million	2006 HRK million
Commitments due within one year	7	13
Commitments due in periods longer than 1 but within 5 years	25	31
Commitments due in periods longer than 5 years	31	22
	63	66

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 19.

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.

33. 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 2007. 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.

34. CASH AND CASH EQUIVALENTS

	2007	2006
	HRK	HRK
	million	million
Cash and current accounts with banks	530	991
Placements with, and loans and advances to other banks with original maturity less than three months	2,973	967
	3,503	1,958

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.

35. 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.

35. 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.

35. 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.

35. 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)

36. 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 2007

	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	530	-	-	-	-	530
Obligatory reserve with Croatian National Bank	2	1,430	486	482	652	3,052
Placements with, and loans and advances to other banks	2,864	115	58	-	-	3,037
Derivative financial instruments	1	1	-	1	1	4
Financial assets held for trading	-	57	-	-	-	57
Financial assets available for sale	268	789	1,067	76	318	2,518
Loans and advances to customers	1,433	1,359	3,709	3,716	5,809	16,026
Property and equipment	4	9	33	66	165	277
Intangible assets	3	5	23	30	1	62
Income tax receivables	-	-	-	-	-	-
Deferred tax assets	1	1	28	7	9	46
Other assets	31	3	1	1	1	37
Total assets	5,137	3,769	5,405	4,379	6,956	25,646
Liabilities						
Current accounts and deposits from banks	248	40	-	-	-	288
Current accounts and deposits from customers	6,936	1,737	3,282	753	154	12,862
Repurchase agreements	219	728	361	-	-	1,308
Borrowings	261	87	2,419	958	4,474	8,199
Derivative financial instruments	17	-	-	-	-	17
Provisions for liabilities and charges	24	6	86	27	31	174
Current income tax payables	-	-	5	-	-	5
Deferred tax liability	-	1	1	3	12	17
Other liabilities	164	19	34	-	1	218
Total liabilities	7,869	2,618	6,188	1,741	4,672	23,088
Net liquidity gap	(2,732)	1,151	(783)	2,638	2,284	2,558

Notes to the financial statements (continued)

36. LIQUIDITY RISK (continued)

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
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	117	20	10	207
Current income tax payables	-	-	-	-	-	-
Deferred tax liability	-	-	-	2	19	21
Other liabilities	138	13	30	-	1	182
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

37. 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)

37. CURRENCY RISK (continued)

Assets and liabilities with a one-way currency clause are included as if HRK denominated. At 31 December 2007, loans and advances to customers with one-way currency clauses (exercisable at the option of the Bank) amounted to HRK 83 million (2006: HRK 117 million) while borrowings with one-way currency clauses (exercisable at the option of the lender) amounted to HRK 30 million (2006: HRK 49 million).

Balance sheet at 31 December 2007

	EUR HRK million	USD HRK million	HRK HRK million	Other HRK million	Total HRK million
Assets					
Cash and current accounts with banks	75	14	392	49	530
Obligatory reserve with Croatian National Bank	1,545	-	1,507	-	3,052
Placements with, and loans and advances to other banks	2,117	242	337	341	3,037
Derivative financial instruments	-	-	4	-	4
Financial assets held for trading	-	-	57	-	57
-currency clause	-	-	-	-	-
Financial assets available for sale	1,312	-	1,206	-	2,518
-currency clause	275	-	(275)	-	-
Loans and advances to customers	3,776	485	9,194	2,571	16,026
-currency clause	5,875	-	(5,875)	-	-
Property and equipment	-	-	277	-	277
Intangible assets	-	-	62	-	62
Income tax receivables	-	-	-	-	-
Deferred tax assets	-	-	46	-	46
Other assets	1	-	36	-	37
Total assets	14,976	741	6,968	2,961	25,646
Liabilities					
Current accounts and deposits from banks	97	3	186	2	288
Current accounts and deposits from customers	7,318	816	4,186	542	12,862
- currency clause	47	-	(47)	-	-
Repurchase agreements	1,308	-	-	-	1,308
Borrowings	4,719	499	1,302	1,679	8,199
- currency clause	367	-	(367)	-	-
Derivative financial instruments	-	-	17	-	17
Provisions for liabilities and charges	7	16	151	-	174
Current Income tax payables	-	-	5	-	5
Deferred tax liability	-	-	17	-	17
Other liabilities	41	2	170	5	218
- currency clause	1	-	(1)	-	-
Total liabilities	13,905	1,336	5,619	2,228	23,088
Net balance sheet position (equity)	1,071	(595)	1,349	733	2,558
Credit commitments	968	204	2,902	77	4,151
Guarantees and letters of credit	947	91	605	9	1,652
Total contingent liabilities and commitments	1,915	295	3,507	86	5,803

Notes to the financial statements (continued)

37. CURRENCY RISK (continued)

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)	-	-
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	180	-	205
Current Income tax payables	-	-	-	-	-
Deferred tax liability	-	-	21	-	21
Other liabilities	21	1	159	1	182
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)

38. 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 2007

	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	-	-	-	-	-	530	530
Obligatory reserve with Croatian National Bank	2,656	-	-	-	-	396	3,052
Placements with, and loans and advances to other banks	2,859	115	57	-	-	6	3,037
Derivative financial instruments	-	-	-	-	-	4	4
Financial assets held for trading	56	-	-	-	-	1	57
Financial assets available for sale	268	785	1,066	76	306	17	2,518
Loans and advances to customers	12,029	2,455	1,363	43	186	164	16,240
unidentified losses	-	-	-	-	-	(214)	(214)
Property and equipment	-	-	-	-	-	277	277
Intangible assets	-	-	-	-	-	62	62
Income tax receivables	-	-	-	-	-	-	-
Deferred tax assets	-	-	-	-	-	46	46
Other assets	-	-	-	-	-	37	37
Total assets	17,868	3,355	2,486	119	492	1,326	25,646
Liabilities							
Current accounts and deposits from banks	184	40	-	-	-	64	288
Current accounts and deposits from customers	7,090	1,758	3,056	541	128	289	12,862
Repurchase agreements	216	722	359	-	-	11	1,308
Borrowings	371	4,115	2,351	155	1,113	94	8,199
Derivative financial instruments	-	-	-	-	-	17	17
Provisions for liabilities and charges	-	-	-	-	-	174	174
Current income tax payables	-	-	-	-	-	5	5
Deferred tax liability	-	-	-	-	-	17	17
Other liabilities	-	-	-	-	-	218	218
Total liabilities	7,861	6,635	5,766	696	1,241	889	23,088
Interest rate gap	10,007	(3,280)	(3,280)	(577)	(749)	437	2,558

Notes to the financial statements (continued)

38. INTEREST RATE RISK (continued)

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 HRK million	Total 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
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	-	-	-	-	-	205	205
Current income tax payables	-	-	-	-	-	-	-
Deferred tax liability	-	-	-	-	-	21	21
Other liabilities	-	-	-	-	-	182	182
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)

38. INTEREST RATE RISK (continued)

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

	2007	2006
	Effective interest rate %	Effective interest rate %
Assets		
Balances with the Croatian National Bank	1.17	0.84
Placements with, and loans and advances to other banks	4.15	3.47
Financial assets held for trading	5.00	5.70
Financial assets available for sale	4.54	5.09
Financial assets held to maturity	-	6.85
Loans and advances to customers	7.54	7.21
Liabilities		
Current accounts and deposits from banks	3.98	2.85
Current accounts and deposits from customers	2.80	2.41
Repurchase agreements	4.46	3.02
Borrowings	3.99	2.22

Notes to the financial statements (continued)

39. 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, small inventories, assets acquired in lieu of uncollected receivables and loan origination fee.

	2007		2006	
	Assets HRK million	Off-balance sheet items HRK million	Assets HRK million	Off-balance sheet items HRK million
Geographic region:				
Croatia	21,564	5,787	22,620	4,925
Rest of Europe	4,120	66	3,259	40
Other	74	-	114	-
Total	25,758	5,853	25,993	4,965
Economic sector:				
Retail	7,944	1,140	7,348	1,081
Finance	3,514	169	1,337	245
Croatian National Bank	3,246	-	5,017	-
Government bodies	3,107	723	4,415	29
Manufacturing	1,434	493	1,384	355
Trade	1,429	1,199	1,308	1,317
Construction	1,120	692	891	583
Property renting	1,043	644	813	539
Tourism	895	94	1,121	115
Public enterprises	884	346	1,371	399
Agriculture	436	46	384	108
Transport, storage and communications	297	147	319	137
Health and social work	265	138	182	41
Other sectors	144	22	103	16
Total	25,758	5,853	25,993	4,965

40. 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.

41. 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 2007 the total security portfolio under custody held by the Bank on behalf of domestic and foreign customers, including domestic pension and investment funds were HRK 25,612 million (2006: HRK 17,700 million). In addition, at 31 December 2007 managed funds for and on behalf of third parties amounted to HRK 138 million (2006: HRK 116 million).

42. 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.

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 (2006: 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 (until then UCI Group).

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

Notes to the financial statements (continued)

42. RELATED PARTY TRANSACTIONS (continued)

Included in loans and receivables are HRK 15 million (2006: HRK 13 million) in respect of loans and advances granted to key management personnel. During 2007 the Bank charged HRK 1 million (2006: HRK 1 million) of interest on loans to key management personnel on loans and receivables granted at interest rates from 4.5 % to 7.5 % per annum (2006: 4.5% to 7.50% per annum). Included in current accounts and deposits from customers are HRK 7 million (2006: HRK 4 million) of deposits from key management personnel. During 2007, the Bank paid interest of HRK 149 thousand (2006: HRK 28 thousand) on these liabilities at rates from 0.2 % to 5.5 % per annum (2006: 0.1% to 5% per annum).

Included in key management personnel are Managing Board members and 36 key employees (2006:21). 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.

Remuneration of expenses of Supervisory Board members amounted to HRK 13 thousand (2006: nil). To the extent that Supervisory Board members are considered key management personnel of related party companies, their compensation is disclosed in the respective companies' financial statements.

Balances and transactions with related party companies and persons are as follows:

2007

	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.	16	7,276	1	332	(21)	24
SB nekretnine d.o.o.	-	3	-	-	4	-
SG Consumer Finance	2	-	-	-	-	-
Key management personnel	15	7	1	-	-	43
Other related parties	3	1	-	-	-	1
	36	7,287	2	332	(17)	68

Notes to the financial statements (continued)

42. RELATED PARTY TRANSACTIONS (continued)

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

43. EVENTS AFTER BALANCE SHEET DATE

Changes in Capital Adequacy

As explained in the accounting policies section (Amendments to published regulations that are not yet effective), the CNB has changed the basis of calculation of capital adequacy effective from 31 March 2008. This change is expected to decrease the capital adequacy ratio by approximately 1.39% and the Bank does not expect that capital adequacy ratio will fall below the legally required level.

Fraud discovery at parent bank

Société Générale S.A. as major shareholder of the Bank has suddenly faced a substantial operating loss due to an exceptional fraud on capital markets. A single trader has carried out forbidden speculative transactions contrary to all rules and procedures. The fraud was discovered in January 2008, when Société Générale S.A. immediately started to consider and undertake the necessary measures and closure of the open positions. Fraudulent positions were unwound in a manner that respected the integrity of the markets and the interests of the shareholders. They resulted in an exceptional loss for the Societe Generale Group of EUR 4,9 billion.

Considering the scale of event and additional loss of approximately EUR 2 billion related to the „sub-prime“ crisis, the Societe Generale Group had – before public disclosure of these situations - pre-arranged a capital increase in the amount of EUR 5,5 billion guaranteed by two large international banks.

Even after accounting for these losses, the Societe Generale Group generated positive net income of EUR 947 million for 2007 due to its diverse portfolio of activities and the solidity of its revenues.

Management of the Bank believes that above mentioned events in the parent company will not have any relevant negative effect on the business activities and operations of the Bank in Croatia.