ERSTE & STEIERMÄRKISCHE BANK D.D.

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004
AND INDEPENDENT AUDITOR'S REPORT

Responsibility for the financial statements

Pursuant to the Croatian Accounting Law, the Management Board is responsible for ensuring that consolidated financial statements are prepared for each financial year in accordance with International Financial Reporting Standards ('IFRS') as published by the International Accounting Standards Board which give a true and fair view of the state of affairs and results of Erste & Steiermärkische Bank d.d. Rijeka (the 'Bank') and its subsidiary for that period (the 'Group').
After making enquiries, the Management Board has a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the financial statements.
In preparing those financial statements, the responsibilities of the Management Board include ensuring that:
- suitable accounting policies are selected and then applied consistently,
- judgments 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 Group will continue in business.

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

Signed on behalf of the Management Board

Slađana Jagar
Erste & Steiermärkische Bank d.d. Rijeka
Jadranski trg 3a
51000 Rijeka
Republic of Croatia
25 January 2006

Independent Auditors' report

Deloitte.

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To the shareholders of Erste & Steiermärkische Bank d.d. Rijeka:

We have audited the accompanying consolidated financial statements of Erste & Steiermärkische Bank d.d. Rijeka (the 'Bank') and its subsidiary (the 'Group'), which comprise the balance sheet at 31 December 2005 and the related statement of income, changes in equity and cash flow for the year then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements, taken as a whole, based on our audit. The financial statements of the Bank for the year ended 31 December 2004 were audited by another auditor who issued an unqualified opinion on those financial statements dated 7 February 2005.

We conducted our audit in accordance with International Standards on Auditing issued by the International Federation of Accountants. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2005, and of the results of its operations, changes in equity and its cash flow for the year then ended in accordance with International Financial Reporting Standards.

Deloitte d.o.o.

Branislav Vrtačnik, certified auditor

Deloitte d.o.o. Heinzelova 33 10000 ZAGREB m.b. 0700851

Zagreb, Croatia

25 January 2006

Consolidated Statements of income

FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

	Notes	2005	2004 (restated)
Interest income	3	1,433	1,166
Interest expense	4	(628)	(496)
Net interest income		**805**	**670**
Fee and commission income	5	282	248
Fee and commission expense	6	(109)	(110)
Net fee and commission income		**173**	**138**
Net profit on financial operations	7	152	127
Other operating income	8	8	15
Operating income		**160**	**142**
General administrative expenses	9	(527)	(474)
Depreciation of tangible fixed assets	22	(62)	(56)
Amortization of intangible fixed assets	22	(8)	(4)
Operating Expenses		**(597)**	**(534)**
PROFIT BEFORE PROVISION FOR IMPAIRMENT LOSSES, SHARE OF RESULTS OF ASSOCIATES AND INCOME TAX		541	416
Provision for impairment losses on loans and advances	10	(99)	(48)
Provision for impairment losses on securities	11	-	(2)
Provision for guarantees and credit commitments	26	(10)	3
PROVISION FOR LOAN AND INVESTMENT LOSSES		(109)	(47)
Share of profit of associates	21	**3**	**2**
PROFIT BEFORE INCOME TAX		435	371
Income tax expense	12	(88)	(76)
NET PROFIT FOR THE PERIOD		347	295
EARNINGS PER SHARE			
Basic and diluted (HRK)	31	26.21	22.27

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Balance sheets

AS AT 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

	Notes	2005	2004 (restated)
ASSETS			
Cash and balances with the Croatian National Bank	13	6,784	3,264
Amounts due from other banks	14	1,940	5,815
Assets at fair value through profit or loss	15	532	2
Receivables on financial derivative transactions	16	7	-
Loans and advances to customers, net	17	18,387	13,512
Assets available-for-sale	18	1,469	1,871
Investments held to maturity	19	488	728
Tax assets	12	23	-
Other assets	20	68	67
Investments in associates	21	42	32
Tangible and intangible fixed assets, net	22	580	471
Total Assets		**30,320**	**25,762**
LIABILITIES			
Amounts due to the Croatian National Bank	23	608	-
Amounts due to other banks	24	9,696	9,654
Amounts due to customers	25	17,089	13,844
Payables on financial derivative transactions	16	7	10
Provisions	26	52	42
Tax liabilities	12	87	13
Other liabilities	27	292	205
Subordinated debt	28	714	318
Total liabilities		**28,545**	**24,086**
Shareholders' equity			
Share capital	29	1,324	1,324
Reserves and retained earnings	30	451	352
Total shareholders' equity		**1,775**	**1,676**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**30,320**	**25,762**
FINANCIAL COMMITMENTS AND CONTINGENCIES	**34**	**3,445**	**2,847**

The accompanying notes form an integral part of these consolidated financial statements.

Signed on behalf of Erste & Steiermarkische Bank d.d. on 25 January 2006:

Chairman of the Management Board	Member of the Management Board
Petar Radaković	Slađana Jagar

Consolidated Statements of changes in shareholders' equity

FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

	Share capital	Statutory and legal reserves	Other reserves	Retained Earnings	Total equity
Balance as at 1 January 2004	1,324	52	-	228	1,604
Effect of changes in accounting policies (Note 2)	-	-	4	(4)	-
Restated balance 1 January 2004	1,324	52	4	224	1,604
Changes in equity for 2004					
Distribution of income for 2003:					
Transfer to reserves	-	11	-	(11)	-
Dividends	-	-	-	(217)	(217)
Net profit for the period	-	-	-	289	289
Effect of changes in accounting policies (Note 2)	-	-	(6)	6	-
Balance as at 31 December 2004	1,324	63	(2)	291	1,676
Changes in equity for 2005					
Assets available-for-sale:					
Transferred to profit or loss on sale	-	-	2	-	2
Net income recognized directly in equity	-	-	2	-	2
Net profit for the period	-	-	-	347	347
Total recognized income and expense for the period	-	-	2	347	349
Distribution of income for 2004:					-
Transfer to reserves	-	39	-	(39)	-
Dividends	-	-	-	(250)	(250)
Balance as at 31 December 2005	1,324	102	-	349	1,775

The accompanying notes form an integral part of these consolidated financial statements.

Consolidated Statements of cash flows

FOR THE YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

	Notes	2005	2004
Operating Activities			
Loss from operating activities before changes in operating assets and liabilities	33	*(201)*	*(190)*
Changes in operating assets and liabilities:			
Obligatory reserves with the Central Bank		(2,193)	(984)
Amounts due from other banks		(6)	(1,105)
Loans and receivables, net of write-offs		(4,929)	(3,934)
Net increase in securities at fair value through profit and loss		(522)	(1)
Other assets		(3)	(13)
Amounts due to the Croatian National Bank		608	-
Amounts due to other banks		38	3,739
Amounts due to customers		3,210	2,353
Other liabilities		87	57
Cash used in operations		*(3,911)*	*(78)*
Interest paid		(586)	(472)
Interest received		1,403	1,127
Profit taxes paid		(37)	-
NET CASH (USED IN)/ PROVIDED BY OPERATING ACTIVITIES		**(3,131)**	**577**
Investing Activities			
Purchase of fixed assets		(361)	(89)
Disposals of fixed assets		183	-
Sale of securities available-for-sale		646	229
Increase in investments in associates		(7)	-
Redemption of securities held-to-maturity		239	178
NET CASH PROVIDED BY INVESTING ACTIVITIES		**700**	**318**
Financing Activities			
Subordinated borrowings		393	(1)
Dividends paid		(250)	(217)
NET CASH PROVIDED BY/ (USED IN) FINANCING ACTIVITIES		143	(218)
NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS		(2,288)	677
CASH AND CASH EQUIVALENTS AT 1 JANUARY	33	6,988	6,311
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	33	4,700	6,988

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

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

1. GENERAL

History and incorporation

Erste & Steiermärkische Bank d.d. Rijeka (the 'Bank') was established in 1954 and was entered into the Court Register as joint stock company on 24th January 1990. The Bank's registered head office is at Jadranski trg 3a, Rijeka, the Republic of Croatia.

Principal activities of the Bank

The Bank is licensed to conduct commercial banking activities in the Republic of Croatia. The Bank's main operations are as follows:

1. accepting deposits from the public and placing of deposits,
2. providing current and term deposit accounts,
3. granting short- and long-term loans and guarantees to the State Treasury, local municipalities, corporate customers, private individuals and other credit institutions dealing with finance lease and foreign exchange transactions,
4. treasury operations in the interbank market
5. trust management and investment banking services,
6. performing local and international payments,
7. providing banking services through an extensive branch network in the Republic of Croatia.

Supervisory Board

Mag. Reinhard Ortner	President
Franz Kerber	Deputy President
Dr. Manfred Wimmer	Member
Mag. Karin Svoboda	Member until 01 September 2005
Dr. Kristijan Schellander	Member
Reinhold Schuster	Member until 01 September 2005
Bernhard Spalt	Member until 01 September 2005
Franz Mally	Member until 03 March 2005
Helmut Payer	Member since 03 March 2005
Josip Stanković	Member
Herbert Juranek	Member since 01 September 2005
Peter Nemschak	Member since 01 September 2005
Andreas Klingen	Member since 01 September 2005

Management Board

The Bank is represented jointly by two members of the Management Board, or by one member of the Management Board, together with the procurator and, where permitted under the law, by two procurators.

Petar Radaković	President
Tomislav Vuić	Deputy President
Borislav Centner	Member
Sava Dalbokov	Member
Slađana Jagar	Member

Procurators

Dragutin Bohuš
Ivan Vuk
Marko Krajina
Damir Bronić
Zdenko Matak

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

1. GENERAL (CONTINUED)

The shareholding structure of the Bank is as follows:

	2005		2004	
	Number of shares	Ownership, %	Number of shares	Ownership, %
Erste Bank der oesterreichischen Sparkassen AG, Wien	6,810,441	51.4%	7,920,014	59.8%
Die Steiermärkische Bank und Sparkassen AG, Graz	5,821,344	44.0%	4,634,867	35.0%
President of Management Board - Petar Radaković	-	0.0%	50,172	0.4%
Member of Management Board - Borislav Centner	-	0.0%	6,605	0.0%
Member of Management Board - Slađana Jagar	235	0.0%	235	0.0%
Other shareholders:	610,458	4.6%	630,585	4.8%
Total	13,242,478	100.00%	13,242,478	100.00%

The Bank's ordinary shares are listed on the Zagreb Stock Exchange as a public stock company.

Definition of the consolidated group

The Bank is a parent company of the banking group (the 'Group') which includes the following subsidiary consolidated in the financial statements:

Company name	The Bank ownership interest	Principal activity	Audited By	Registered office
Erste DMD d.o.o. za upravljanje dobrovoljnim mirovinskim fondom	100%	Voluntary pension fund	Deloitte d.o.o.	Varšavska 3-5, Zagreb

The Group considers that it operates in a single business segment, and a single geographical segment, that is the provision of banking services in the Republic of Croatia.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1. Basis of presentation

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards (‘IFRS’) as published by the International Accounting Standards Board, under the historical cost convention, as modified by the revaluation of appropriate financial assets and liabilities.

These financial statements are presented in millions of Local Currency – Croatian Kunas (‘HRK’), unless otherwise indicated.

These financial statements are prepared on an accrual basis of accounting, under the going concern assumption.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. These estimates are based on the information available as at the balance sheet date and actual results could differ from those estimates.

The Group maintains its books of accounts and prepares financial statements for regulatory purposes in accordance with the regulations of the Croatian National Bank (‘CNB’). The accompanying consolidated financial statements are based on the accounting records of the Group, together with appropriate adjustments and reclassifications necessary for fair presentation in accordance with IFRS.

2.2. Basis of consolidation

These consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank (its subsidiaries). Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

The effect of consolidation of the subsidiary resulted in decrease of net profit of the Group for the year ended 31 December 2005 and retained earnings as at 31 December 2005 by HRK 1 million, decrease in total liabilities as at 31 December 2005 by HRK 1 million, decrease in total assets as at 31 December 2005 by HRK 2 million. The effect of consolidation of the subsidiary resulted in decrease of the total assets and total liabilities of the Group by HRK 15 million as at 31 December 2004.

2.3. Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Under the equity method, investments in associates are carried at cost as adjusted for post-acquisition changes in the Group’s share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group’s interest in that associate (which includes any long-term interests that, in substance, form part of the Group’s net investment in the associate) are not recognized.

Where a group entity transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group’s interest in the relevant associate.

2.4. Goodwill

Goodwill arising on the acquisition of a subsidiary or a jointly controlled entity represents the excess of the cost of acquisition over the Group’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary or jointly controlled entity recognized at the date of acquisition.

The subsidiary of the Bank was established by the Bank and as such there is no goodwill arising on acquisition.

Any excess of the cost of acquisition over the Group’s share of the net fair value of the identifiable assets, liabilities and contingent liabilities of the associate recognized at the date of acquisition is recognized as goodwill.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.4. Goodwill (continued)

The goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognized immediately in profit or loss.

2.5. Adoption of new and revised International Financial Reporting Standards

In the current year, the Group has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on 1 January 2005. The adoption of these new and revised Standards and Interpretations has resulted in changes to the Group's accounting policies in the following areas that have affected the amounts reported for the current or prior years:

- financial instruments: Recognition and Measurement (IAS 39 (Revised)).

The impact of these changes in accounting policies is discussed in detail later in this note. The impact on basic and diluted earnings per share is disclosed in note 31.

IAS 39 (Revised) Financial instruments: Measurement and Recognition

Recognition of gains and losses on available–for-sale assets

The gains and losses on 'Available for sale assets' prior to the adoption of the revised standard were recognized in income statement. Under the revised standards the gains and losses on 'Available for sale assets' are recognized in equity in other reserve. The Group recognizes all cumulative changes in fair value of 'Available for sale assets' in revaluation until subsequent derecognition or impairment, when that cumulative gain or loss is transferred to profit or loss.
This change in accounting policy has been applied retrospectively. The adjustment required at 1 January 2004, represent transfer from retained earnings (net profit for year 2003) of the Bank in amount HRK 4 million to other reserves. The change in accounting policy has increased net profit for the year 2004 by HRK 6 million and decreased profit for the year 2005 by HRK 2 million, the gains and losses on securities being recognized in other reserves in equity.

2.6. Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessee

Assets held under finance leases are recognized as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.
Finance charges are charged to income statement, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Group's general policy on borrowing costs.
Rentals payable under operating leases are charged to income statement on a straight-line basis over the term of the relevant lease.

2.7. Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.
Due to absence of recently observed market prices for the derivative financial instruments of the Group the management has decided to measure the derivatives using discounted cash flow models. Discount factors used in these models are derived from the smooth interest rates and volatility curves constructed with predefined interpolation methods and market interest rates contributed by Reuters which are valid as at 31 December 2005 for each currency and corresponding maturity dates.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.7. Key sources of estimation uncertainty (continued)

In the ordinary course of business, the Group is subject to legal actions and complaints. The Management Board of the Bank believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial situation or the results of future operations of the Bank. As of 31 December 2005 the Management created, based on advice of the legal counsel, provisions for these risks amounting to HRK 1 million. For the rest of the passive legal cases no provisions were created as the management, based on the advice of legal counsel is of the opinion that the Bank's cases will prevail and the probability of the adverse outcome of the litigations is remote.

2.8. Interest Income and Expense

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.
Interest income includes coupons earned on fixed income investments and securities and accrued discount and premium on treasury bills and other discounted instruments.
When loans become impaired, they are written down to their recoverable amounts and interest income thereafter recognized based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.
Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

2.9. Fee and Commission Income and Expense

Fees and commissions consist mainly of fees on domestic and foreign payments, granted loans and other credit instruments issued by the Group.
Fees and commissions are generally recognized as income when due. Fees on foreign payments are credited to income after being collected.

2.10. Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax expense is based on taxable income for the year. Taxable income differs from net income as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.
Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized.
The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.
Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group has the ability and intention to settle on a net basis.

The Group is a subject to various indirect taxes which are included in general administrative expenses.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.11. Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents are defined as cash, balances with the Croatian National Bank ('CNB'), current accounts with other banks and term placements with other banks with residual maturity up to 3 months, and treasury bills with residual maturity up to 3 months.
Cash and cash equivalents excludes the obligatory reserves with the CNB as these funds are not available for the Group's day to day operations. The obligatory reserve with the CNB is a required reserve to be held by all commercial banks licensed in Croatia.

2.12. Financial assets

Financial assets held by the Group are categorized into portfolios in accordance with the Group's intent on the acquisition and pursuant to the Group's investment strategy. Financial assets and liabilities are classified as 'At fair value through profit or loss', 'Held to maturity', 'Assets available for sale' or as 'Loans and receivables'. The principal difference among the portfolios relates to the measurement of financial assets and the recognition of their fair values in the financial statements.

All financial assets and liabilities are recognized and derecognized on a settlement date basis where the purchase or sale of financial asset or liability is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned.

When a financial asset or financial liability is recognized initially, the Groups measures it at its 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.

a) Assets at fair value through profit or loss

Classified as held for trading.

Assets held for trading are financial assets (equity and debt securities, treasury bills, participation certificates) acquired or incurred principally for the purpose of selling or repurchasing it in the near term or are 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. Derivative financial instruments are classified as held for trading.

Measurement:

Subsequent to the initial recognition financial assets at fair value through profit or loss are accounted for and stated at fair value which approximates the price quoted on recognized stock exchanges or acceptable valuation models. The Group includes unrealized gains and losses in 'Net profit/(loss) on financial operations.' Interest earned on assets at fair value through profit or loss representing coupons on debt securities is accrued on a daily basis and reported as 'Interest income' in the profit and loss statement.
Dividends on trading securities are recorded when declared and included as a receivable in the balance sheet line 'Other assets' and in 'Net profit/(loss) on financial operations' in the profit and loss statement.
All purchases and sales of securities held for trading that require delivery within the time frame established by regulation or market convention ('regular way' purchases and sales) are recognized as spot transactions. Transactions that do not meet the 'regular way' settlement criterion are treated as financial derivatives.

b) Investments held to maturity

Investments held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity. This portfolio comprises fixed income debt securities. Held to maturity investments are carried at amortized cost using the effective interest rate method, less any allowance for impairment.

The Group assesses on a regular basis whether there is any objective evidence that an investment held to maturity may be impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount which is equal to the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.12. Financial assets (continued)

The amount of the impairment loss for assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate. When an impairment of assets is identified, the Group recognizes allowances through the profit and loss statement line 'Allowance for losses on securities'.

Impairment losses are reversed in subsequent periods when an increase in the investment's recoverable amount can be related objectively to an event occurring after the impairment was recognized, subject to the restriction that the carrying amount of the investment at the date the impairment is reversed shall not exceed what the amortised cost would have been had the impairment not been recognized.

c) Assets Available-for-sale

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

This portfolio comprises equity and debt securities. Subsequent to initial recognition, available-for-sale financial assets are re-measured at fair value based on quoted prices or amounts derived from cash flow models. In circumstances where the quoted market prices are not readily available, the fair value of debt securities is estimated using the present value of future cash flows and the fair value of unquoted equity instruments is estimated using applicable price/earnings or price/cashflow ratios refined to reflect specific circumstances of the issuer.

For available-for-sale assets, gains and losses arising from changes in fair value are recognised directly in equity under the caption 'Other reserves', until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the profit or loss for the period. Impairment losses recognized in profit or loss for equity investments classified as available-for-sale are not subsequently reversed through profit or loss. Impairment losses recognized in profit or loss for debt instruments classified as available-for-sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

Interest earned whilst holding available-for-sale securities is accrued on a daily basis using the effective interest rate method and reported as 'Interest income' in the income statement.

Foreign exchange differences related to available-for-sale equity instruments held in foreign currency are reported together with fair value gains and losses in equity until the financial asset is sold. Foreign exchange differences related to available-for-sale debt instruments held in foreign currency are reported in income statements.

Dividends on securities available for sale are recorded as declared and included as a receivable in the balance sheet line 'Other assets' and in 'Net profit/(loss) on financial operations' in the profit and loss statement. Upon payment of the dividend, the receivable is offset against the collected cash.

d) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Groups intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; (b) those that the Group upon initial recognition designates as available for sale; or (c) those for which the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.
This portfolio comprises loans provided to customers.

Loans and receivables are measured at initial recognition at fair value, and are subsequently measured at amortized cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers. Loan origination fees for loans which are probable of being drawn

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.12. Financial assets (continued)

down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

An allowance for loan impairment is established if there is objective evidence that the Group will not be able to collect all amounts due. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of loans computed at initial recognition. Loan loss allowances are assessed with reference to the credit standing and performance of the borrower and take into account the value of any collateral or third party guarantees.

If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

When a loan is uncollectible, it is written off against the related allowance for impairment; subsequent recoveries are credited to the 'Impairment losses on loans and advances' line in the income statement.

The Group charges penalty interest to borrowers when a portion of the loan falls overdue. Penalty interest is accounted for on a cash received basis in the caption 'Interest income'.

2.13. Financial liabilities

Financial liabilities of the Group like 'Amounts due to other banks', 'Amounts due to customers', 'Subordinated debt' are stated at amortized costs using the effective interest rate method. Interest expense arising on the issue of certificated debts is included in the income statement line 'Interest expense'.

2.14. Derivative financial instruments

In the normal course of business the Group enters into derivative financial instruments to manage currency, liquidity and interest rate risks and such financial instruments are held primarily for trading purposes. Derivatives entered into by the Group include forwards, foreign currency and equity options and futures.

Derivative financial instruments are initially recorded at cost (including transaction costs) and subsequently re-measured at their fair value. Fair values are principally obtained from discounted cash flow models and option pricing models as appropriate. The results of the valuation of derivatives are reported in assets (aggregate of positive fair values) or liabilities (aggregate of negative fair values), respectively. Both positive and negative valuation results are recognized in the profit and loss for the year in which they arise in the income statement line 'Net profit/(loss) from financial operations'.

In case of equity options, when the underlying equity instrument is not publicly traded and its fair value can not be measured reliably, the fair value of the options is not determined and such options are disclosed in the financial statements.

Certain derivative transactions, while providing effective economic hedges under the Group's risk management positions, do not qualify for hedge accounting under the specific rules of IAS 39 and are therefore treated as derivatives held for trading with fair value gains and losses reported in the income statement line 'Net profit/(loss) from financial operations'.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.15. Sale and repurchase agreements

If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognized as the Group retains substantially all the risks and rewards of ownership.

Securities sold under sale and repurchase agreements ('repos') are recorded as assets in the balance sheet lines of assets in original classification or the Group reclassifies the asset on its balance sheet, as a 'Repurchase receivable' if the transferee obtains the right to sell or pledge the asset. The corresponding liability towards the counterparty is included in 'Amounts due to banks' or 'Amounts due to customers' as appropriate.

Securities purchased under agreements to purchase and resell ('reverse repos') are recorded as assets in the balance sheet line 'Due from banks' or 'Loans and receivables' as appropriate, with the corresponding decrease in cash being included in 'Cash and balances with the Croatian National Bank.' The difference between the sale and repurchase price is treated as interest and accrued evenly over the life of the repo agreement using the effective interest rate.

2.16. Tangible and intangible fixed assets

Fixed and intangible assets are stated at historical cost less accumulated depreciation. Depreciation is calculated on a straight-line basis to write down the cost of such assets to their residual values over their estimated useful lives. Land and assets in the course of construction are not depreciated.

The estimated economic useful lives are set out below:

	2005	2004
Buildings	40 years	40 years
Computers	4 years	4 years
Furniture and equipment	3-10 years	3-10 years
Motor vehicles	4 years	4 years
Software	4 years	4 years
Other intangible assets	5 years	5 years

The carrying amounts of fixed and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount. An impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss the depreciation charge for fixed assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

2.17. Foreign Currency Translation

Transactions denominated in foreign currencies are translated into HRK at the prevailing exchange rates on the date of the transaction.

Monetary items denominated in foreign currencies are retranslated into HRK at the appropriate spot rates of exchange prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period in 'Net profit/loss on financial operations'. Exchange differences arising on the retranslation of non-monetary assets carried at fair value are included in profit or loss for the period except for exchange differences arising on the retranslation of non-monetary assets available-for-sale in respect of which gains and losses are recognized directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognized directly in equity.

The Group has assets and liabilities originated in HRK, which are linked to foreign currency with one-way currency clause. Due to this clause the Group has an option to revalue the asset by higher of: foreign exchange rate valid as of the date of maturity, or foreign exchange rate valid as of the date of origination of the financial instrument. In case of liability linked to this clause the counterparty has this option. Due to

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.17. Foreign Currency Translation (continued)

the specific conditions of the market in Republic of Croatia the fair value of this option can not be calculated as the forward rates for HRK for periods over 6 months are not available. As such the Group values its assets and liabilities related to this clause by middle rate of Croatian National Bank valid at the date of balance sheet or foreign exchange rate agreed by the option (rate valid at origination), whichever is higher.

The principal rates of exchange set forth by the Croatian National Bank and used in the preparation of the Group's balance sheet at the reporting dates were as follows:

31 December 2005	EUR 1 = 7.375626 kn	USD 1 = 6.233626 kn
31 December 2004	EUR 1 = 7.671234 kn	USD 1 = 5.636883 kn

2.18. Off-Balance-Sheet Commitments

In the ordinary course of business, the Group enters into credit related commitments which are recorded in off-balance-sheet accounts and primarily include guarantees, letters of credit and undrawn loan commitments. Such financial commitments are recorded in the Group's balance sheet if and when they become payable.

2.19. Provisions

Provisions are recognized when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Management Board determines the adequacy of the provision based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of the various categories of transactions and other pertinent factors at the balance sheet date. Provisions are discounted to present value where the effect is material.

2.20. Fiduciary activities

Assets and income arising thereon together with related undertakings to return such assets to customers are excluded from these consolidated financial statements when the Group acts in a fiduciary capacity such as nominee, trustee or agent.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

2.21. Reclassification

Certain reclassifications have been made to the financial statements as at 31 December 2004 and for the year then ended to conform to the presentation as at 31 December 2005 and for the year then ended.

2.22. Regulatory requirements

The Group is subject to the regulatory requirements of the Croatian National Bank. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off balance sheet commitments and forming allowances to cover credit risk, liquidity, interest rate and foreign currency position. At year end the Group was substantially in compliance with all regulatory requirements.

3. INTEREST INCOME

	2005	2004
Interest on loans and advances to customers	1,210	930
Interest on debt securities	132	129
Interest on amounts due from other banks	60	73
Interest on balances due from the Croatian National Bank	30	34
Other interest income	1	-
	1,433	1,166

4. INTEREST EXPENSE

	2005	2004
Interest on customer deposits	385	290
Interest on amounts due to other banks	219	187
Interest on subordinated debt	14	11
Interest on other borrowed funds	9	8
Other interest expense	1	-
	628	496

5. FEE AND COMMISSION INCOME

	2005	2004
Payments and money transfers	167	157
Bank cards services	60	49
Guarantees and letters of credit	25	21
Other fee and commission income	30	21
	282	248

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

6. FEE AND COMMISSION EXPENSE

	2005	2004
Payments and money transfers	63	70
Bank cards services	45	38
Guarantees and letters of credit	-	1
Other fee and commission expense	1	1
	109	110

7. NET PROFIT ON FINANCIAL OPERATIONS

	2005	2004
Gains on spot foreign exchange transactions	102	86
Gains on derivative financial instruments	37	11
Gains on securities	28	27
Dividend income	1	-
(Losses)/gains on translation of foreign currency assets and liabilities	(16)	3
	152	127

8. OTHER OPERATING INCOME

	2005	2004
Rental income	3	3
Income from sale of tangible fixed assets	1	7
Other	4	5
	8	15

9. GENERAL ADMINISTRATIVE EXPENSES

	2005	2004
Employee related costs		
- Wages, salaries and bonuses	162	138
- Payroll taxes and contributions	125	103
Savings insurance premiums	28	31
Marketing and advertising cost	25	22
Telephone and communications	21	23
Repairs and maintenance	20	18
Consulting and professional fees	20	19
Utilities	15	14
Travel and representation	15	13
Rent	15	10
Office materials	14	14
Transportation	9	13
Postage	9	9
Donations and sponsorship	7	5
Insurance premiums	6	4
Security costs	5	4
Other taxes and contributions	5	4
Education	4	1
Severance and other employees related costs	2	2
Other	20	27
	527	474

The Group does not have pension arrangements separate from the State pension system of Croatia. This system requires that current contributions by the employer be calculated as a percentage of current gross salary payments; these expenses are charged to the profit and loss statement in the period the related compensation is earned by the employee.

The number of employees according to employment contracts was 1,694 and 1,503 as at 31 December 2005 and 2004, respectively. The number of full time employees was 1,546 and 1,434 as at 31 December 2005 and 2004, respectively.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

10. IMPAIRMENT LOSSES ON LOANS AND RECEIVABLES

	2005	2004
Allowance for impairment loss on amounts due from banks	12	13
Allowance for impairment loss on loans and receivables	978	912
Allowance for impairment loss on other assets	6	4
Total	**996**	**929**

The movement in the allowances for impairment losses on loans and advances and other assets is summarized as follows:

	2005	2004
Balance at 1 January	**929**	**910**
Release of previously established allowances	(242)	(402)
Additional allowances	341	450
Reversal of specific allowance due to write-offs	(17)	(24)
Exchange rate differences attributable to allowances	(15)	(5)
Balance at 31 December	**996**	**929**

11. IMPAIRMENT LOSSES ON SECURITIES

	2005	2004
Allowance for impairment loss on assets available-for-sale	4	3
Allowance for impairment loss on held-to-maturity investments	-	1
	4	4

The movement in the allowances for impairment losses on securities was:

	2005	2004
Balance at 1 January	**4**	**2**
Release of previously established allowances	(2)	(5)
Additional allowances	2	7
Balance at 31 December	**4**	**4**

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

12. INCOME TAXES

The Group provides for taxes based on the tax accounts maintained and prepared in accordance with the local tax regulations and which may differ from International Financial Reporting Standards.
The Group is subject to certain permanent tax differences due to non-tax deductibility of certain expenses and a tax free regime for certain income.
Deferred 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 tax purposes. Temporary differences as at 31 December 2005 and 2004 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

Deferred tax assets and liabilities are attributable to the following temporary differences:

	2005
Deferred assets	
Loans origination fees	108
Unrealized losses on available-for-sale securities	6
Unrealized losses on held-for-trading securities	4
Negative valuation of derivative financial instruments	3
Total deferred assets	**121**
Deferred liabilities	
Unrealized gains on available-for-sale securities	6
Borrowings origination fees	2
Total deferred liabilities	**8**
Net deferred assets	113
Deferred tax asset at the statutory tax rate (20%)	23
Less: valuation allowance	-
Net deferred tax asset	**23**

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

12. INCOME TAXES (CONTINUED)

Relationship between tax expenses and accounting profit for the years ended 31 December 2005 and 2004 are explained as follows:

	2005	2004
Profit before income tax	**435**	**371**
Theoretical tax calculated at a tax rate of 20% (2004: 20%)	87	74
Tax effect of permanent differences	1	2
Tax effect of temporary differences	23	-
Utilization of tax losses carried forward	-	(63)
Current income tax expense	**111**	**13**
Current income tax expense	(111)	(13)
Change in deferred tax assets	23	(63)
Income tax expense	**(88)**	**(76)**

Croatian tax legislation and practice has changed significantly in recent years. Many parts of the legislation remain untested and there is uncertainty about the interpretation that the tax authorities may apply in a number of areas. Tax positions taken by the Group are subject to examination and could be challenged by the tax authorities. As a result there is uncertainty about the potential impacts should the interpretation of the tax authorities differ from that applied by the Group. However, the Group's Management considers that the tax liability which might arise in connection with this would not be material.

Income tax assets and liabilities consist of the following:

	2005	2004
Current income tax liabilities	87	(13)
Deferred income tax assets	(23)	-
Income tax liabilities	(64)	(13)

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

13. CASH AND BALANCES WITH THE CROATIAN NATIONAL BANK

	2005	2004
Cash on hand	279	266
Cash on clearing account	2,223	909
Obligatory reserves with the Croatian National Bank	4,282	2,089
	6,784	3,264

As at 31 December 2005 and 2004 obligatory reserves with the Croatian National Bank of HRK 4,282 million and HRK 2,089 million, respectively, represent the permanent minimum reserve deposits, which the Group is required to maintain at all times.

14. AMOUNTS DUE FROM OTHER BANKS

	2005	2004
Demand placements with banks registered in:		
Republic of Croatia	14	13
OECD countries	12	10
Other countries	10	11
Term placements with banks registered in:		
Republic of Croatia	4	426
OECD countries	1,908	5,367
Other countries	4	1
Total gross balances due from other credit institutions	*1,952*	*5,828*
Less: Allowance for possible placement losses	(12)	(13)
	1,940	5,815

As at 31 December 2005 and 2004 demand placements with banks include balances at nostro accounts with correspondent banks of HRK 15 million and HRK 19 million, respectively. As at 31 December 2004 term placements with banks include loans under reverse repurchase agreements of HRK 15 million with maturity up to 1 month. Such agreements are secured with the bonds of the Croatian Bank for Reconstruction and Development with the fair value of HRK 16 million as of 31 December 2005.

Notes to Consolidated financial statements

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15. ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2005	2004
Bonds of the Republic of Croatia held-for-trading	529	-
Equity shares of Croatia osiguranje held-for-trading	3	2
	532	2

Bonds of the Republic of Croatia are fixed income debt securities denominated in HRK and EUR and listed on stock exchanges. These bonds have maturities between 2007 and 2019 and bear a coupon interest from 3.875% to 7.350% p.a.

16. DERIVATIVE FINANCIAL INSTRUMENTS

	2005			2004		
	Notional Amount	Fair Value Assets	Fair Value Liabilities	Notional Amount	Fair Value Assets	Fair Value Liabilities
Interest rate instruments:						
Interest rate swaps	155	-	(1)	-	-	-
Subtotal - Interest rate instruments	*155*	-	*(1)*	-	-	-
Foreign currency instruments:						
Currency swaps						
Purchase	962	2	-	348	-	-
Sell	*960*	-	*(1)*	*350*	-	*(3)*
Forwards						
Purchase	*120*	-	-	457	-	-
Sell	121	-	(1)	461	-	(7)
Call options	6	3	-	-	-	-
Put options	6	-	(3)	-	-	-
Subtotal - Foreign currency instruments	*2,175*	*5*	*(5)*	*1,616*	-	*(10)*
Other instruments:						
Call options for stock index	7	2	-	-	-	-
Put options for stock index	7	-	(1)	-	-	-
Call options for equity instruments	10	-	-	-	-	-
Put options for equity instruments	10	-	-	-	-	-
Future contracts with securities sold	221	-	-	-	-	-
Subtotal - Other instruments	*255*	*2*	*(1)*	-	-	-
	2,585	7	(7)	1,616	-	(10)

The fair value of these transactions reflects the credit risk and other types of economic risks for the Group.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

16. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

The maturity of derivative financial instruments as at 31 December 2005 is as follows:

	Up to 1 year	1 to 5 years	Over 5 years	Total
Interest rate instruments:				
Interest rate swaps	7	-	148	155
Foreign currency instruments:				
Currency swaps				
Purchase	962	-	-	962
Sell	960	-	-	960
Forwards				
Purchase	120	-	-	120
Sell	121	-	-	121
Call options	6	-	-	6
Put options	6	-	-	6
Other instruments:				
Call options for stock index	-	7	-	7
Put options for stock index	-	7	-	7
Call options for equity instruments	-	-	10	10
Put options for equity instruments	-	-	10	10
Future contracts with securities sold	221	-	-	221
	2,403	**14**	**168**	**2,585**

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

17. LOANS AND ADVANCES TO CUSTOMERS, NET

Loans and advances to customers as at 31 December 2005 and 2004 are summarized as follows:

	2005	2004
Short-term loans:		
Companies	3,900	3,255
Individuals	1,976	1,652
Public sector	221	216
Other institutions	11	11
Total short-term loans	*6,108*	*5,134*
Long-term loans:		
Companies	5,269	4,023
Individuals	7,224	4,911
Public sector	751	344
Other institutions	13	12
Total long-term loans	*13,257*	*9,290*
Total loans before allowance for impairment	*19,365*	*14,424*
Less: Allowance for loan impairment	(978)	(912)
	18,387	13,512

Loans and advances to customers are made principally within Croatia.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

17. LOANS AND ADVANCES TO CUSTOMERS, NET (CONTINUED)

An industry analysis of the gross portfolio of loans and advances to customers is summarized as follows:

	2005	2004
Citizens	9,200	6,563
Retail and wholesale trade, repair of motor vehicles and home appliances	2,424	2,338
Manufacture of other transport vehicles	1,092	545
Construction industry	966	546
Hotels and restaurants	858	614
Other manufacturing industry	826	634
Public administration and defence	779	520
Real estate business operations, leases and business services	707	434
Transport, storage and communication	610	554
Manufacture of food and beverages	364	306
Electricity, gas and water supply	264	271
Agriculture, hunting, forestry and fishery	237	192
Financial mediation	189	213
Manufacture of other non-metal and mineral products	155	134
Manufacture of metal products, except of machinery and equipment	134	105
Personnel services and other service business	123	114
Publishing and printing industry	99	86
Textile industry	84	88
Health and social services	77	38
Manufacture of chemicals and chemical products	77	47
Education	28	28
Mining industry	25	15
Manufacture of coke, petroleum products and nuclear fuel	18	5
Foreign customers	29	34
	19,365	**14,424**

As at 31 December 2005 and 2004, the credit exposures to 10 largest customers accounted for 11.5% and 8.4% of the gross loan portfolio, respectively.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

17. LOANS AND ADVANCES TO CUSTOMERS,NET (CONTINUED)

Weighted average effective interest rates on loans and advances to customers are summarized as follows:

	2005	2004
Companies	5.8%	6.2%
Individuals	8.6%	9.5%

As at 31 December 2005 and 2004 loans and advances to customers include loans under reverse repurchase agreements of HRK 100 million and HRK 158 million, respectively, with maturity up to 1 months. Such agreements are secured with the treasury bills and bonds of the Republic of Croatia with the fair value of HRK 102 million and HRK 161 million as at 31 December 2005 and 2004, respectively.

18. ASSETS AVAILABLE-FOR-SALE

	2005	2004
Equity shares and participations:		
Investments in companies	1	-
Investments in financial institutions	13	13
Subtotal equity shares and participations	*14*	*13*
Debt securities:		
Treasury bills	658	349
Listed debt securities	645	1,359
Unlisted debt securities - commercial bills of exchange	107	107
Subtotal - debt securities	*1,410*	*1,815*
Units in open investment funds	49	46
Total assets available-for-sale	*1,473*	*1,874*
Less: Allowance for impairment of available-for-sale assets	(4)	(3)
	1,469	1,871

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18. ASSETS AVAILABLE-FOR-SALE (CONTINUED)

Debt securities available-for-sale allocated by issuer comprise:

	2005	2004
Debt securities available for sale issued by:		
State institutions in Croatia	1,266	1,161
Financial institutions in Croatia	20	51
Local municipalities	-	67
Other companies in Croatia	124	133
Foreign financial institutions	-	403
	1,410	1,815

Debt securities issued by the State institutions in Croatia include bonds and treasury bills issued by the Croatian Ministry of Finance.
Treasury bills of the Croatian Ministry of Finance are HRK denominated debt securities issued at discount to nominal. These securities are issued with original maturities of 91, 181 and 364 days.
During the year 2005 the average interest yields on the treasury bills were 4.07% for treasury bills with maturity of 91 day, 4.84% for treasury bills with maturity of 181 days, and 4.93% for treasury bills with maturity of 364 days. During the year 2004 the average interest yields on the treasury bills were 4.6% for treasury bills with maturity of 91 days, 5.99% for treasury bills with maturity of 181 days, and 6.42% for treasury bills with maturity of 364 days.
Bonds of the Republic of Croatia are HRK, EUR and USD denominated fixed income debt securities listed at stock exchanges. These bonds have maturities from 2006 to 2015 and bear a coupon interest from 3.875% to 6.875% p.a.

Notes to Consolidated financial statements

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19. INVESTMENTS HELD TO MATURITY

	2005	2004
Fixed income debt securities:		
Listed debt securities		
Bonds issued by the Republic of Croatia	120	124
Bonds issued by DAB	-	90
Unlisted debt securities		
Rehabilitation bonds	101	152
Replacement bonds	227	260
Public debt bonds	5	52
Other securities	-	5
Subtotal - Fixed income debt securities	*453*	*683*
Factoring	35	46
Total held-to maturity investments before allowance or impairment	488	729
Less: Allowance for impairment on held-to-maturity investments	-	*(1)*
	488	728

Bonds issued by the Republic of Croatia are fixed income debt securities denominated in EUR and HRK. These bonds have maturities from 2008 and 2014 and bear a coupon interest from 5.500% to 7.375% p.a. These bonds are traded on an active market.
Rehabilitation bonds are foreign currency denominated bonds issued in 1997 and repayable in twenty semi-annual installments at the interest rate of 6% p.a.
Replacement bonds are foreign currency denominated bonds issued in 2002 and repayable in twenty semi-annual installments at the interest rate of 7.2% p.a.
The fair value of rehabilitation, restructuring and public debt (frozen deposits) bonds included in the held to maturity portfolio cannot be reliably measured as they are not publicly traded.
The fair value of assets held to maturity that are actively traded is HRK 11 million higher than its book value as at 31 December 2005 and 2004.

Notes to Consolidated financial statements

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20. OTHER ASSETS

	2005	2004
Collaterals received in satisfaction of non-performing loans	15	17
Receivables from fees and commissions	16	13
Inventories of office and other supplies	1	2
Coin collections	1	1
Checks	11	7
Prepaid expenses	5	8
Other assets	25	23
Total gross other assets	*74*	*71*
Less: Allowance for impairment of other asset	(6)	(4)
	68	**67**

21. INVESTMENTS IN ASSOCIATES

Associated undertakings	Group's Ownership Interest	Activity	2005 Cost of investment	2005 Share of net assets	2004 Cost of investment	2004 Share of net assets
Erste d.o.o za upravljanje mirovinskim fondom	27.87%		20	10	20	9
MBU d.o.o.	41.11%		-	2	-	1
Kvarner banka d.d.	31.85%		20	23	20	22
Erste Sparkassen d.d. za životno osiguranje	26.00%		8	7	-	-
Total			**48**	**42**	**40**	**32**

The Group's share of results of associates can be summarized as post acquisition profits, net of dividends received and amounted to HRK 3 million and HRK 2 million for the year 2005 and 2004, respectively.

Notes to Consolidated financial statements

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22. TANGIBLE AND INTANGIBLE FIXED ASSETS

	Land and buildings	Computers and other equipment	Furniture and motor vehicles	Construction in progress	Intangible assets	Total
COST						
At 1 January 2005	422	193	121	24	39	799
Additions	47	92	25	181	16	361
Disposals	(2)	(9)	(5)	(179)	(4)	(199)
At 31 December 2005	**467**	**276**	**141**	**26**	**51**	**961**
ACCUMULATED DEPRECIATION						
At 1 January 2005	111	124	69	-	24	328
Depreciation	10	38	14	-	8	70
Eliminated on disposals	-	(10)	(4)	-	(3)	(17)
At 31 December 2005	**121**	**152**	**79**	-	**29**	**381**
NET BOOK VALUE						
31 December 2005	**346**	**124**	**62**	**26**	**22**	**580**
31 December 2004	**311**	**69**	**52**	**24**	**15**	**471**

As at 31 December 2005, the Group had contracted capital commitments of HRK 5 million in respect of current capital investment projects.

23. AMOUNTS DUE TO THE CROATIAN NATIONAL BANK

As at 31 December 2005 amounts due to the Croatian National Bank include loans received under repurchase agreements of HRK 608 million with maturity up to 1 month. Such agreements are secured with the treasury bills of the Croatian Ministry of Finance included in available-for-sale portfolio at the fair value of HRK 622 million.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

24. AMOUNTS DUE TO OTHER BANK

	2005	2004
Demand deposits:		
In HRK	61	16
In foreign currencies	51	49
Subtotal - Demand deposits	*112*	*65*
Term deposits:		
In HRK	848	700
In foreign currencies	1,495	4,000
Subtotal - Term deposits	*2,343*	*4,700*
Other borrowings:		
Domestic borrowings	987	*716*
Foreign borrowings	5,931	4,135
Refinanced borrowings	35	38
Subtotal - Other borrowings	*6,953*	*4,889*
Loans under repurchase agreements	288	-
	9,696	9,654

Other borrowings comprise:

	2005	2004
Borrowings in HRK - short-term:		
Domestic borrowings	161	126
Foreign borrowings	181	7
Subtotal	*342*	*133*
Borrowings in HRK - long-term:		
Domestic borrowings	826	590
Foreign borrowings	5,372	3,111
Subtotal	*6,98*	*3,701*
Total borrowings in HRK	*6,540*	*3,834*
Borrowings in foreign currencies - short-term:		
Foreign borrowings	134	149
Refinanced borrowings	7	6
Subtotal	*141*	*155*
Borrowings in foreign currencies - long-term:		
Foreign borrowings	244	868
Refinanced borrowings	28	32
Subtotal	*272*	*900*
Total borrowings in foreign currencies	*413*	*1,055*
	6,953	4,889

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24. AMOUNTS DUE TO OTHER BANKS (CONTINUED)

As at 31 December 2005 the Group included in amounts due to banks loans under repurchase agreements of HRK 288 million. Such agreements have maturity up to 1 month and are secured with the bonds of the Republic of Croatia included in available-for-sale and held-for-trading portfolio at the fair value of HRK 289 million.

25. AMOUNTS DUE TO CUSTOMERS

	2005	2004
Demand deposits from		
Individuals:		
In HRK	1,162	985
In foreign currencies	2,036	1,969
Subtotal	*3,198*	*2,954*
Companies:		
In HRK	1,488	1,218
In foreign currencies	500	454
Subtotal	*1,988*	*1,672*
Public sector and other institutions:		
In HRK	227	234
In foreign currencies	15	18
Subtotal	*242*	*252*
Total demand deposits	**5,428**	**4,878**
Term deposits from		
Individuals:		
In HRK	5,234	3,225
In foreign currencies	2,706	2,732
Subtotal	*7,940*	*5,957*
Companies:		
In HRK	2,393	2,076
In foreign currencies	1,044	594
Subtotal	*3,437*	*2,670*
Public sector and other institutions:		
In HRK	96	65
Total term deposits	**11,473**	**8,692**
Other borrowings	187	227
Loans under repurchase agreements	1	47
	17,089	**13,844**

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25. AMOUNTS DUE TO CUSTOMERS (CONTINUED)

Other borrowings comprise:

	2005	2004
Refinanced borrowings in foreign currencies - short-term:	68	65
Refinanced borrowings in foreign currencies - long-term	119	162
	187	**227**

As at 31 December 2005 and 2004 the Group included in amounts due to customers loans under repurchase agreements amounting to HRK 1 million and HRK 47 million, respectively, with maturity from 1 to 9 months. Such agreements are secured with the bonds of the Republic of Croatia included in available-for-sale and held-for-trading portfolio at the fair value of HRK 1 million and HRK 46 million as at 31 December 2005 and 2004, respectively.

26. PROVISIONS

	Litigations	Provision for guarantees and other loan commitments	Total
Balance at 1 January 2004	1	44	45
Recovery of previously established provisions	-	(3)	(3)
Balance at 1 January 2005	1	41	42
Charge to income statement	-	10	10
Balance at 31 December 2005	1	51	52

The provision for guarantees and other loan commitments and contingent liabilities primarily relates to commitments stemming from guarantees and credit lines issued by the Group (Note 34).

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YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

27. OTHER LIABILITIES

	2005	2004
Prepayments received from lenders	153	103
Salaries and bonuses payable	64	31
Amounts due to suppliers	18	20
Accrued expenses	10	9
Payables to DAB for customer deposits insurance	7	6
Deferred income	1	1
Other taxes payable	1	1
Other	38	34
	292	205

28. SUBORDINATED DEBT

In 2002 Erste Bank der oesterreichischen Sparkassen AG, Wien granted the Bank funds in the amount of EUR 20 million, based on a subordinated uncollateralized long-term loan for the formation of supplementary capital. The loan has been granted for a period of 15 years, and at an agreed interest rate of 1.20% per annum in excess of EURIBOR. Also in 2002 Erste Bank der oesterreichischen Sparkassen AG, Wien granted the Bank funds in the amount of EUR 20 million, based on a subordinated uncollateralized long-term loan for the formation of supplementary capital. Maturity of 50% of this loan is at 24 April 2011, and of the other 50% at 24 April 2012. The interest rate is 1.5% in excess of EURIBOR.
The Bank also issued bonds with a status of tier 2 capital during the year 1998. The bonds were issued for a period of 8 years with an interest rate of 6% per annum. The Bank has issued 8,626 bonds, each carrying a value of EUR 156,45 payable at the middle exchange rate of the Croatian National Bank at the day of repayment. Interest is paid quarterly.
In 2005 Erste Bank der oesterreichischen Sparkassen AG, Wien granted the Bank funds in the amount of EUR 55 m, based on a subordinated uncollateralized long-term loan for the formation of supplementary capital. The loan has been granted for a period of 10 years, and at an agreed interest rate of 0.90% per annum in excess of EURIBOR.

29. SHARE CAPITAL

As at 31 December 2005 and 2004 the share capital of the Bank comprise 13,242,478 ordinary shares with a par value of 100 HRK each. All the ordinary shares are ranked equally and bear one vote.

Notes to Consolidated financial statements

YEARS ENDED 31 DECEMBER 2005 AND 2004 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLIONS)

30. RESERVES AND RETAINED EARNINGS

The Group's distributable and non-distributable reserves are determined by regulations of the Croatian National Bank. As at 31 December 2005 the statutory and legal accounts of the Group disclose non-distributable reserves of HRK 102 million (HRK 63 million as at 31 December 2004). Such reserves include the reserve for general banking risk of HRK 35 million as of 31 December 2005. The reserve for general banking risk is formed from annual profits and is not distributable within the following 3 years. The reserve becomes distributable if the growth rate of the Bank's assets does not exceed 20% on annual base.

31. EARNINGS PER ORDINARY SHARE

For the purposes of calculating earnings per share, earnings are calculated as the net profit after tax for the period attributable to ordinary shareholders after deducting preference dividends. A reconciliation of the profit after tax attributable to ordinary shareholders is provided below.

	2005	2004
Net profit for the year (in HRK)	347,121,851	294,956,133
Profit attributable to ordinary shareholders (in HRK)	347,121,851	294,956,133
Weighted average number of shares of 100 HRK each (for basic and diluted earnings per share)	13,242,478	13,242,478
Earnings per ordinary share - basic and diluted (HRK)	**26.21**	**22.27**

Impact of changes in accounting policy

Changes in the Group's accounting policies during the year are described in detail in note 2. To the extent that those changes have had an impact on results reported for 2005 and 2004, they have had an impact on the amounts reported for earnings per share. The following table summarizes that impact on basic earnings per share:

	2005	2004
Changes in accordance with IAS 39 (Revised) (in HRK)	(1,723,639)	5,682,388
Earnings per ordinary share - basic and diluted (HRK)	**(0.13)**	**0.43**

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32. DIVIDENDS

The dividends are subject to approval by the shareholders at the Annual General Assembly which has not been maintained as of the date when these consolidated financial statements were authorized for issue.
The dividends declared by the Bank for the years 2004 and 2003 were 18.91 HRK per share (total dividend HRK 250 million) and 16.38 HRK per share (total dividend HRK 217 million), respectively.

33. INFORMATION FOR CASH FLOW STATEMENT

	2005	2004
Operating Activities		
Profit before income tax	435	371
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization expense	70	60
Impairment losses on loans and advances	99	37
Net change in valuation of derivatives	(10)	5
Provisions for guarantees and credit commitments	10	8
Impairment losses on securities	-	1
Unrealized gains on held for trading securities	3	-
Interest expense	628	496
Interest income	(1,433)	(1,166)
Share of results of associates	(3)	(2)
Loss from operating activities before changes in operating assets and liabilities	*(201)*	*(190)*

Analysis of cash and cash equivalents:

	2005	2004	Change in the year
Cash on hand	279	266	13
Cash on clearing account with the Croatian National Bank	2,223	909	1,314
Current accounts with other banks	16	19	(3)
Placements with banks with maturity up to 3 months	1,908	5,784	(3,876)
Treasury bills with maturity up to 3 months	274	10	264
	4,700	**6,988**	**(2,288)**

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34. FINANCIAL COMMITMENTS AND CONTINGENCIES

The following table indicates the contractual amounts of the Group's off-balance-sheet financial instruments that commit to extend credit to customers:

	2005	2004
HRK guarantees - short-term	242	112
HRK guarantees - long-term	82	84
Foreign currency guarantees	388	269
Performance guarantees	613	462
Foreign currency letters of credit - short-term	118	139
Foreign currency letters of credit - long-term	10	57
Guaranteed and accepted bills of exchange	7	20
Commitments to extend credit:		
- Original term to maturity of one year or less	953	779
- Original term to maturity of more than one year	1,032	925
	3,445	2,847

As at 31 December 2005, the Group have contracted capital commitments of HRK 5 million (HRK 14 million in 2004) in respect of current capital investment projects. Management is confident that future net revenues and funding will be sufficient to cover these commitments.

35. RELATED-PARTY TRANSACTIONS

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

Related party transactions with the subsidiary were eliminated on consolidation and as such are not presented in this note.

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35. RELATED-PARTY TRANSACTIONS (CONTINUED)

As at 31 December 2005 and 31 December 2004, balances outstanding with related parties comprised:

	Amounts due from banks and customers	Receivables from financial derivative transactions	Other receivables	Amounts due from banks and customers	Receivables from financial derivative transactions	Other receivables
	31 December 2005			31 December 2004		
Erste Bank der oesterreichischen Sparkassen AG, Wien	257	5	-	31	-	-
Erste Invest d.o.o. za upravljanje investicijskim fondovima	126	-	2	43	-	-
Erste & Steiermärkische S-leasing d.o.o.	75	-	-	78		
Other	31	-	-	30	-	-
Assets total	**489**	**5**	**2**	**182**	**-**	**-**
Erste Bank der oesterreichischen Sparkassen AG, Wien	7,012	1	706	7,132	1	313
Erste Invest d.o.o. za upravljanje investicijskim fondovima	130	-	-	5	-	-
Steiermärkische Bank und Sparkassen AG, Graz	74	-	-	88	-	-
Other	109	-	2	30	-	2
Liabilities total	**7,325**	**1**	**708**	**7,255**	**1**	**315**

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35. RELATED-PARTY TRANSACTIONS (CONTINUED)

Transactions made with related parties comprised:

	2005	2004
Interest income		
Erste Bank der oesterreichischen Sparkassen AG, Wien	15	33
Erste & Steiermärkische S-leasing d.o.o.	5	3
Ceska sporitelna, a.s.	1	2
Fee income		
Erste Bank der oesterreichischen Sparkassen AG, Wien	1	1
Operating income		
Erste Bank der oesterreichischen Sparkassen AG, Wien	1	1
Ceska sporitelna, a.s.	1	-
Erste & Steiermärkische S-leasing d.o.o.	-	3
Income total	**24**	**43**

	2005	2004
Interest expenses		
Erste Bank der oesterreichischen Sparkassen AG, Wien	167	137
Steiermärkische Bank und Sparkassen AG, Graz	2	4
Administrative expenses		
Erste Bank der oesterreichischen Sparkassen AG, Wien	6	7
Erste & Steiermärkische S-leasing d.o.o.	2	3
Steiermärkische Bank und Sparkassen AG, Graz	-	1
SPARDAT Sparkassen-Datendienst Gesellschaft m.b.H.	3	4
Immorent Aktiengesellschaft	1	1
OM Objektmanagement GmbH	1	-
Other members of Erste bank Group	-	1
Expenses total	**182**	**158**

	2005	2004
Commitments and contingent liabilities		
Guarantees issued	17	2
Letters of credit	1	-
Other	9	2
	27	**4**

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35. RELATED-PARTY TRANSACTIONS (CONTINUED)

In 2005 the Group purchased a put option from Erste-Sparinvest Kapitalanlagegesellschaft m.b.H. and sold a call option for an equity instrument. The exercise price for the put option amounts to HRK 10 million plus an interest of 11.7% p.a., the exercise price of the call option amounts to HRK 10 million plus an interest of 12.3% p.a. Both options can be realized at any time until July 2011. The underlying equity instrument is not publicly traded and its fair value can not be reliably measured, and, therefore, the fair value of the options was not determined in these consolidated financial statements. It's the opinion of the management of the Group that exercising of any of the options would not materially impact the financial position of the Group.

The remuneration of directors and other members of key management was as follows:

	2005	2004
Wages and salaries	9	8
Bonuses	10	7
	19	15

All of the transactions stated above have been made under arms-length commercial and banking conditions.

36. ESTIMATED FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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

It is the opinion of the management of the Group that the fair value of the Group financial assets and liabilities are not materially different from the amounts stated in the balance sheets as at 31 December 2005 and 2004.
In estimating the fair value of the Group's financial instruments, the following methods and assumptions were used.

(a) Cash and balances with the central bank

The carrying values of cash and balances with the central bank are generally deemed to approximate their fair value.

(b) Investments held to maturity

Fair values of securities carried in the 'Held to maturity' portfolio are calculated based on the market quotations. The fair values of held to maturity investments are disclosed in Note 19.

(c) Due from banks

The estimated fair value of amounts due from banks that mature in 180 days or less approximates their carrying amounts. The fair value of other amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk). The fair value of non-performing amounts due from banks is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral. Allowances are not taken into consideration when calculating fair values.

(d) Loans and advances to customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality. The fair value of non-performing loans to customers is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral, where available. Loans at fixed interest rates represent only a fraction of the total carrying

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36. ESTIMATED FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

value and hence the fair value of total loans and advances to customers approximates the carrying values as at the balance sheet date. Allowances are not taken into consideration when calculating fair values.

(e) Amounts due to banks and customers

The fair value of term deposits payable on demand represents the carrying value of amounts payable on demand as at the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as at the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using rates currently offered for deposits of similar remaining maturities.

37. ASSETS UNDER TRUST MANAGEMENT

Under IFRS, funds managed by a trustee on behalf of individuals, trusts and other institutions are not regarded as assets of the trustee and, therefore, are not included in its balance sheet.

The table below provides analysis of the funds managed on behalf of customers by investment type:

	2005	2004
Other investments:		
- Loans to non-banking entities	70	90
- Private customers	29	20
Less assets	*(99)*	*(110)*
Funds in transit	-	-

38. FOREIGN CURRENCY RISK

The Group takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows.
The table below provides an analysis of the Group's main currency exposures. The remaining currencies are shown within 'Other currencies.' The Group monitors its foreign exchange (FX) position for compliance with the regulatory requirements of the Croatian National Bank established in respect of limits on open positions. The Group seeks to match assets and liabilities denominated in foreign currencies to avoid foreign currency exposures.

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38. FOREIGN CURRENCY RISK (CONTINUED)

	HRK	EUR	USD	Other currencies	Total
ASSETS					
Cash and balances with the Croatian National Bank	4,849	1,895	25	15	6,784
Amounts due from other banks	24	1,650	144	122	1,940
Assets at fair value through profit or loss	50	482	-	-	532
Receivables on financial derivative transactions	2	5	-	-	7
Loans and receivables, net	1,875	12,973	1,174	2,365	18,387
Assets available for-sale	838	523	108	-	1,469
Investments held to maturity	26	446	16	-	488
Tax assets	23	-	-	-	23
Other assets	33	9	1	25	68
Investments in associates	42	-	-	-	42
Tangible and intangible fixed assets, net	580	-	-	-	580
Total Assets (1)	**8,342**	**17,983**	**1,468**	**2,527**	**30,320**
LIABILITIES					
Amounts due to the Croatian National Bank	608	-	-	-	608
Amounts due to other banks	1,217	6,494	77	1,908	9,696
Amounts due to customers	4,909	10,470	1,350	360	17,089
Payables on financial derivative transactions	2	5	-	-	7
Provisions	41	2	9	-	52
Tax liabilities	87	-	-	-	87
Other liabilities	124	127	-	41	292
Subordinated debt	-	714	-	-	714
Total Liabilities (2)	**6,988**	**17,812**	**1,436**	**2,309**	**28,545**
Net FX Position at 31 December 2005 (1) - (2)	**1,354**	**171**	**32**	**218**	**1,775**
Off-balance-sheet assets[1]	871	773	16	-	1,660
Off-balance-sheet liabilities[1]	518	928	38	176	1,660
Net off-balance-sheet FX position at 31 December 2005	**353**	**(155)**	**(22)**	**(176)**	**-**
TOTAL NET FX POSITION AT 31 DECEMBER 2005	**1,707**	**16**	**10**	**42**	**1,775**
Total assets at 31 December 2004	5,835	17,433	1,376	1,118	25,762
Total liabilities at 31 December 2004	5,042	16,620	1,367	1,057	24,086
Net FX position at 31 December 2004	**793**	**813**	**9**	**61**	**1,676**
Net off-balance-sheet FX position at 31 December 2004	**596**	**(602)**	**(2)**	**-**	**(8)**
TOTAL NET FX POSITION AT 31 DECEMBER 2004	**1,389**	**211**	**7**	**61**	**1,668**

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38. FOREIGN CURRENCY RISK (CONTINUED)

Off-balance-sheet assets and liabilities include amounts receivable and payable arising from spot and forward transactions.
Assets and liabilities denominated in HRK with foreign currency clause are presented under the foreign currencies to which they are linked.

39. 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 table below provides information on the extent of the Group's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market rate of interest before maturity, the next repricing date. It is the policy of the Group to manage the exposure to fluctuations in net interest income arising from changes in interest rates by the degree of repricing mismatch in the balance sheet. Those assets and liabilities that do not have contractual maturity date or are not interest bearing are grouped in 'non-interest bearing' category.

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
ASSETS							
Cash and balances with the Croatian National Bank	3,099	-	-	-	-	3,685	6,784
Amounts due from other banks	1,907	10	-	-	-	23	1,940
Assets at fair value through profit or loss	518	-	-	-	-	14	532
Receivables on financial derivative transactions	-	-	-	-	-	7	7
Loans and receivables, net	17,682	309	78	47	72	199	18,387
Assets available-for-sale	1,416	-	-	-	-	53	1,469
Investments held to maturity	155	15	64	198	48	8	488
Tax assets	-	-	-	-	-	23	23
Other assets	-	-	-	-	-	68	68
Investments in associates	-	-	-	-	-	42	42
Tangible and intangible fixed assets, net	-	-	-	-	-	580	580
Total Assets (1)	**24,777**	**334**	**142**	**245**	**120**	**4,702**	**30,320**

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39. INTEREST RATE RISK (CONTINUED)

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
LIABILITIES							
Amounts due to the Croatian National Bank	608	-	-	-	-	-	608
Amounts due to other banks	2,799	5,127	961	505	140	164	9,696
Amounts due to customers	15,225	543	567	88	49	617	17,089
Payables on financial derivative transactions	-	-	-	-	-	7	7
Provisions	-	-	-	-	-	52	52
Tax liabilities	-	-	-	-	-	87	87
Other liabilities	-	-	-	-	-	292	292
Subordinated debt	-	563	148	-	-	3	714
Total Liabilities (2)	**18,632**	**6,233**	**1676**	**593**	**189**	**1,222**	**28,545**
On-balance-sheet interest rate sensitivity gap at 31 December 2005 (1) - (2)	**6,145**	**(5,899)**	**(1,534)**	**(348)**	**(69)**	**3,480**	**1,775**
Off-balance-sheet interest rate assets	148	-	7	-	-	-	155
Off-balance-sheet interest rate liabilities	-	-	7	-	148	-	155
Off-balance-sheet interest rate sensitivity gap at 31 December 2005	**148**	**-**	**-**	**-**	**(148)**	**-**	**-**
TOTAL INTEREST RATE SENSITIVITY GAP AT 31 DECEMBER 2005	**6,293**	**(5,899)**	**(1,534)**	**(348)**	**(217)**	**3,480**	**1,775**
Total assets at 31 December 2004	22,572	278	208	499	200	2.005	25,762
Total liabilities at 31 December 2004	17,962	2,688	1,978	462	230	766	24,086
On-balance-sheet interest rate sensitivity gap at 31 December 2004	**4,610**	**(2,410)**		**37**	**(30)**	**1239**	**1,676**
TOTAL INTEREST RATE SENSITIVITY GAP AT 31 DECEMBER 2004	**4,610**	**(2,410)**		**37**	**(30)**	**1.239**	**1676**

Off-balance-sheet assets and liabilities include notional amounts of interest rate swaps.

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40. AVERAGE INTEREST RATES

The average interest rates are calculated as a weighted average for each asset and liability category.

Assets	Average interest rate 2005	Average interest rate 2004
Cash and balances with the Croatian National Bank	0.8%	1.2%
Amounts due from banks	2.5%	2.5%
Loans and receivables	7.1%	7.7%
Securities	5.0%	6.0%
Total assets	**30,320**	**25,762**
Average interest earning assets	**24,260**	**19,448**
Liabilities		
Amounts due to Croatian National Bank	3.5%	9.5%
Amounts due to other banks	2.6%	3.3%
Amounts due to customers	2.7%	2.6%
Subordinated debt	3.6%	3.6%
Total liabilities	**28,545**	**24,086**
Average interest bearing liabilities	**23,230**	**17,640**

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41. LIQUIDITY RISK

Liquidity risk is a measure of the extent to which the Group may be required to raise funds to meet its commitments associated with financial instruments. The Group maintains its liquidity profiles in accordance with regulations laid down by the Croatian National Bank. The table below provides an analysis of assets, liabilities and shareholders' equity into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment schedules allow for early repayment possibilities. Those assets and liabilities that do not have a contractual maturity date are grouped together under 'maturity undefined' category.

The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawdowns, guarantees and from margin and other calls on cash-settled derivatives. The Group does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Group sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Maturity undefined	Total
ASSETS							
Cash and balances with the Croatian National Bank	2,618	1,548	1,043	1,435	140	-	6,784
Amounts due from other banks	1,925	11	-	3	1	-	1,40
Securities held for trading	529	-	-	-	-	3	532
Receivables on financial derivative transactions	7	-	-	-	-	-	7
Originated loans and advances to customers, net	1,989	664	3,063	8,502	4,169	-	18.387
Securities available for sale	1,446	9	-	-	-	14	1,469
Investments held to maturity	41	23	68	308	-	48	488
Tax assets	-	-	23	-	-	-	23
Other assets	52	-	-	16	-	-	68
Investments in associates	-	-	-	-	-	42	42
Tangible and intangible fixed assets, net	-	-	-	580	-	-	580
Total Assets (1)	**8,607**	**2,255**	**4,197**	**10,844**	**4,358**	**59**	**30,320**

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41. LIQUIDITY RISK (CONTINUED)

	On demand	Up to 3 months	3-12 months	1-5 years	Over 5 years	Maturity undefined	Total
LIABILITIES							
Amounts due to							
Croatian National Bank	608	-	-	-	-	-	608
Amounts due to other banks	1,210	91	1,215	6,892	288	-	9,696
Amounts due to customers	9,036	2,819	3,715	1,104	415	-	17,089
Payables on financial derivative							
transactions	7	-	-	-	-	-	7
Provisions	-	-	1	51	-	-	52
Tax liabilities	-	-	87	-	-	-	87
Other liabilities	193	-	74	25	-	-	292
Subordinated debt	-	3	10	-	701	-	714
Total Liabilities (2)	**11,054**	**2,913**	**5,102**	**8,072**	**1,404**	**-**	**28,545**
On-balance-sheet liquidity							
gap at 31 December 2005 (1) - (2)	**(2,447)**	**(658)**	**(905)**	**2,772**	**2,954**	**59**	**1,775**
Off-balance-sheet assets[1]	793	159	136	-	148	-	1,236
Off-balance-sheet liabilities[1]	2,157	597	1,286	345	296	-	4,681
Off-balance-sheet liquidity							
gap at 31 December 2005	**(1,364)**	**(438)**	**(1,150)**	**(345)**	**(148)**	**-**	**(3,445)**
TOTAL LIQUIDITY GAP AT							
31 DECEMBER 2005	**(3,811)**	**(1,096)**	**(2,055)**	**2,427**	**2,806**	**59**	**(1,670)**
Total assets at 31 December 2004	12,309	754	2,578	7,265	2,808	48	25,762
Total liabilities at 31 December 2004	11,146	2,330	3,863	4,623	2,124	-	24,086
On-balance-sheet liquidity							
gap at 31 December 2004	**1,163**	**(1,576)**	**(1,285)**	**2,642**	**684**	**48**	**1,676**
Off-balance-sheet liquidity							
gap at 31 December 2004	**(1,044)**	**(289)**	**(1,151)**	**(312)**	**(59)**	**-**	**(2,855)**
TOTAL LIQUIDITY GAP							
AT 31 DECEMBER 2004	**119**	**(1,865)**	**(2,436)**	**2,330**	**625**	**48**	**(1,179)**

[1] Off-balance-sheet assets and liabilities include amounts receivable and payable arising from FX spot, forward and option contracts and receivables and payables under guarantees, letters of credit and committed facilities.

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42. CREDIT RISK

The Group takes on exposure to credit risk which is the risk upon credit approval and when counterparty will be unable to pay amounts in full when due. The Group 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 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.

As at 31 December 2005, the Group has a potential credit exposure of HRK 21,317 million (2004: HRK 20,252 million) in the event of non-performance by counterparties in relation to loans provided by the Group not considering any fair value of collateral.

Commitments arising from the issuance of letters of credit. Documentary letters of credit, which are written irrevocable undertakings by the Group on behalf of a customer (mandatory) authorising a third party (beneficiary) to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralised by the underlying shipments of goods to which they relate and therefore have significantly less risk. Cash requirements under open letters of credit are considerably less than the commitments under issued guarantees or stand-by letters of credit. However, the Group records provisions against these instruments on the same basis as is applicable to loans.

Commitments to extend credit, undrawn loan commitments, unutilised overdrafts and approved overdraft loans. The primary purpose of commitments to extend credit is to ensure that funds are available to a customer as required. Commitments to extend credit represent unused portions of authorisations to extend credits in the form of loans, guarantees or stand-by letters of credit. Commitments to extend credit issued by the Group represent issued loan commitments or guarantees, undrawn portions of and approved overdrafts loans. Commitments to extend credit or guarantees issued by the Group which are contingent upon customers maintaining specific credit standards (including the condition that a customer's solvency does not deteriorate) are revocable commitments. Irrevocable commitments represent undrawn portions of authorised loans and approved overdraft facilities because they result from contractual terms and conditions in the credit agreements.

Credit risk of financial derivatives. Credit exposure or replacement cost of financial derivative instruments represents the Group's credit exposure from contracts with a positive fair value, that is, it indicates the estimated maximum potential losses of the Group in the event that counterparties fail to perform their obligations. It is usually a small fraction of the notional amounts of the contracts. The credit exposure of each contract is indicated by the credit equivalent calculated pursuant to generally applicable methodology using the current exposure method and involves the fair market value of the contract (only if positive, otherwise a zero value is taken into account). The credit equivalent is established depending on the type of contract and its maturity. The Group assesses credit risks of all financial instruments on a regular basis.
As at 31 December 2005, the Group has a potential credit exposure of HRK 7million in the event of non-performance by counterparties to its financial derivative instruments. This represents the gross replacement cost at market rates as at 31 December 2005 of all outstanding agreements in the event of all counterparties defaulting and does not allow for the effect of netting arrangements.

Group is selective in its choice of counterparties. Interbank foreign exchange and money market transactions are subject to counterparty limits and limits on group of related entities.
In general non-bank customers, which enter into derivative transactions with Group are required to keep a collateral with the Group. The collateral is set by Group according to the risk profile of the customer's position and is regularly reviewed.

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43. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements are signed and authorised for issue on 25 January 2006.
These financial statements were approved by the Management Board on 25 January 2006.

Signed on behalf of the Management Board:

Petar Radaković	Slađana Jagar
Chairman of the Management Board	Member of the Management Board