Annual report 2005

HRVATSKA POŠTANSKA BANKA

Small steps, great solutions

Zagreb, March 2006

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Contents

The annual report comprises the summary of financial information, description of operation and the audited financial statements, including Independent auditors' report for the year ended 31 December 2005, in Croatian and English.

Legal form

The annual report comprises the annual financial statements prepared in accordance with accounting regulations applicable to banks in the Republic of Croatia and audited in accordance with International Standards on Auditing.
The annual report is prepared in compliance with Article 30 of the Accounting Law and Article 276 of the Companies Act, which prescribe reporting of the Management Board to the shareholders at the General Assembly.

Abbreviations

In the annual financial statements, Hrvatska poštanska banka d.d. is referred to as "the Bank" or "HPB", the Croatian National Bank as "the CNB", the Republic of Croatia as "RH" and the Croatian Bank for Construction and Development as "HBOR".

Exchange rates

The following CNB exchange rates were used for translation of foreign currencies into Croatian kuna:

31 December 2005	1 EUR = 7,375626 HRK	1 USD = 6,233626 HRK
31 December 2004	1 EUR = 7,671234 HRK	1 USD = 5,636883 HRK

in HRK million	2005	restated 2004	2003[1]	2002[1]	2001[1]
Key indicators					
Net profit for the year	90	60	84	71	8
Total assets	7,283	5,556	5,417	5,541	2,715
Loans and advances to customers	2,943	2,575	2,436	2,036	1,337
Deposits	5,056	4,365	4,369	4,611	1,990
Equity	749	656	590	506	435
Other indicators					
Return on share capital	15.42%	10.30%	14.43%	12.16%	1.34%
Return on assets	1.24%	1.08%	1.56%	1.28%	0.29%
Cost[2] income ratio	60.48%	48.62%	51.35%	43.26%	85.39%
Liable capital	682	619	535	465	444
Capital adequacy ratio	16.45%	24.32%	25.65%	22.58%	38.44%

[1]figures not restated

[2]general and administrative expenses and depreciation

mr.sc. Ante Žigman
President of the Supervisory Board

Hrvatska poštanska banka successfully closed its 2005 operation, which is visible from its excellent annual results. Hrvatska poštanska banka regained its competitiveness and became a respectable financial institution on a dynamic Croatian financial market, which makes us even more proud with excellent financial results. Strong performance is the result of improved corporate management and technological innovations. We must stress that Hrvatska poštanska banka is the biggest bank in domestic ownership and must emphasize a clear Supervisory Board vision to keep the Bank in domestic ownership in future.

In 2005, Croatian economic and financial sectors were characterised by macroeconomic stability, intensive economic growth and commencement of negotiations for joining European Union. The State made a significant move in decreasing the state budget deficit, however, the external macroeconomic instability is still present in a high deficit in the balance of payments and foreign debt. The banking sector was marked by internal mergers of banks from same banking groups and restrictive monetary policy introduced by the Croatian National Bank which was aimed at limiting the growth of business banks' placements and de-stimulation of further increase in foreign funding of banks. Commencement of open market operations in the middle of the year contributed to the autonomy of the CNB monetary policy, to higher liquidity of the banking system and better availability of resources to domestic financing of the budget deficit. Notwithstanding the restrictive monetary measures, the banking assets increased by additional 13.6% compared to 2004, mainly as the result of retail loans expansion. Inter-competitiveness of business banks resulted in further decrease in active interest rates on domestic market and in further liberalisation of loans terms and conditions.

Hrvatska poštanska banka actively followed these market trends, making its services and products more competitive and more available to all segments of the society compared to previous periods.

Among the most successful achievements was the increase in the Bank's assets by 31.1%, which at the end of 2005 amounted to HRK 7.3 billion. Profit after tax amounted to HRK 90.2 million, return on share capital amounted to 15.4% and return on assets to 1.24%. Despite the significant increase in assets, a 16.5% capital adequacy rate is significantly higher than the legally prescribed 10% and guarantees further stability of the Bank's operation.

Hrvatska poštanska banka realised a significant improvement in the past year; a quality team of experts was made, the Bank's competitiveness and market recognition was increased, outlet and other distribution channel networks were expanded and the Bank continued its cooperation with the strategic partner - Hrvatska pošta. We must succeed on an exceptionally competitive market by meeting the needs of our clients to a highest degree possible, and by attracting new ones. One of especially important elements on which we work is the successful completions of the Bank's information technology upgrade projects, which will ensure better terms of cooperation with corporate and retail customers, treasury operation and enable introduction of new modern banking services.

We can gladly point out that during 2005 quality cooperation between the Bank's Supervisory and the Management Boards was realised. The Management Board communicated all the plans, decisions and achievements to the Supervisory Board on regular meetings.

On behalf of the Supervisory Board of Hrvatska poštanska banka, I would like to thank the Supervisory Board members on their cooperation and advice, HPB Management Board on their expert management of the Bank and all employees for their high quality performance.

Yours faithfully

mr.sc. Ante Žigman
President of the Supervisory Board

Josip Protega
President of the Management Board

I am proud to present the Annual Report of Hrvatska poštanska banka d.d. for the year ended 31 December 2005.

I consider the past year to be the turning point in the operation of this biggest commercial bank in Croatian ownership. An exceptional operational result reflected in the financial statements for the year ended 31 December 2005, together with a number of initiated strategic projects, imply that this was the best year for Hrvatska poštanska banka from the beginning of its operation back in 1991. The previous year could best be described as the year of changes and challenges, for me and my closest team of colleagues, as well as for Hrvatska poštanska banka as a whole.

The Bank's 2005 financial results indicate the growth and realisation of a significant profit compared to the previous period. The Bank's assets amounted to HRK 7.3 billion, representing a 31.1% increase compared to 2004. Just for comparison purposes, the annual growth rate of assets within the entire banking sector in 2005 amounted to 13.6%. Furthermore, profit after tax realised in 2005 amounted to HRK 90.2 million, representing a 49.8% increase compared to 2004.

The Bank restructured the corporate loan portfolio by significantly increasing the loans to commercial companies and decreasing the amount of loans to state units, increasing simultaneously retail loans by 67.1%, which, at 2005 year-end amounted to HRK 942.1 million.

At the end of 2005, total deposits amounted to a bit more than HRK 5 billion, representing a 15.8% increase, whereby it should be emphasized that, within the total deposits structure, term deposits increased by 54.0%.

In the previous year we initiated a number of demanding projects crucial for the realisation of goals set upon taking over the management of the Bank. I can proudly announce that we have adopted the strategy for the development of the Bank for the period to 2010. We were governed by the highly realisable idea about a strong domestic bank the operation of which on the domestic banking market could significantly influence the main economic movements and thus contribute to a faster and a more comprehensive development of the country as a whole.

We simultaneously also worked on other important projects aimed at increasing the level and quality of the Bank's operation. During the previous year, we successfully implemented the changes in the Bank's organisational structure in order to improve motivation, effectiveness and quality of work of all employees. A whole new structure of the Bank, based on modern banking principles of management and effectiveness, was set and implemented at the beginning of 2006, and modernisation of information technology system was also undertaken in order to further improve the operation. Furthermore, new values and new vision and mission of the Bank were defined and adjusted to current circumstances and contain aspirations which we tend to realise in the next couple of years. We also introduced a new corporate identity of the Bank and a new visual identity which has already been presented to the public under the name “My Bank”. By its new identity, Hrvatska poštanska banka emphasized its availability, modernism and care for clients, particularly stressing its relationship with its strategic partner - Hrvatska pošta.

Recognising the importance of a quality management needed for realisation of the goals set during 2005, we gathered a respectable team of banking experts experienced in fields of project management, investment banking, operation with small and middle enterprises and retail customers, information technology, human resources management, risks, real estate, banking law and other segments of banking operation.

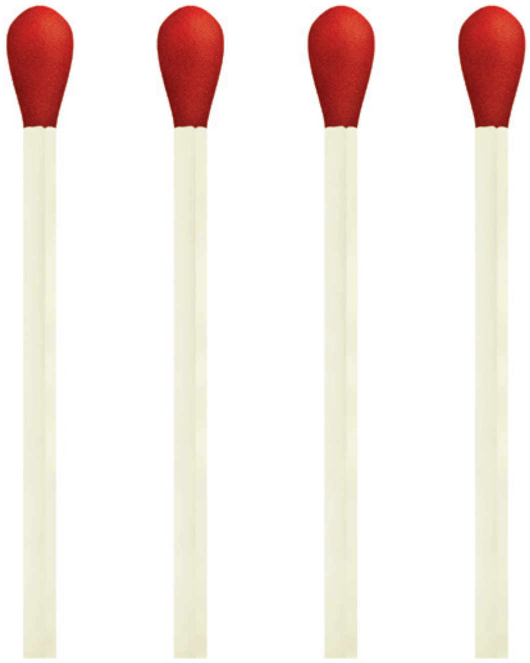
In order to realise a closer relationship with our clients, in accordance with the strategy of expanding the operation throughout the Republic of Croatia, in the last year, we extended our outlet network and organised our outlets in accordance with the new visual identity. We opened seven new outlets, in Vukovar, Dubrovnik, Pula, Rijeka, Sv. Nedelja, Kaštel Stari and Zagreb, and established four branches in Zagreb, Pula, Dubrovnik and Varaždin. We continued strengthening other distribution channels extending our ATM and EFTPOS terminal networks. We also recorded significant improvement in the quality of operation and enriched the palette of our products and services.

During the last year, the Bank enriched its operation engaging in investment banking, intensified its custody services and trading in securities. We are the first in Croatia to provide clients with possibility of trading in securities on financial markets of Serbia and Monte Negro and Macedonia.

Establishing HPB Invest and HPB Nekretnine, we have created a banking group the operation of which we intend to expand in this year by adding new activities like leasing and housing savings. We should particularly emphasise that HPB Invest was assigned a very demanding task of managing Pension fund in November 2005 and, in a very short period of time, HPB Invest organised and successfully implemented the first part of the project of pension repayment, and we believe that the continuation of this project will also be performed to a high quality.

We will remain truthful to values and goals which we set and began realising during the last year, being innovation, reliability, high effectiveness and professionalism. Simultaneously, we will also set new, higher criteria to which we will strive for the sake of you, our shareholders, business partners and customers.
On my own behalf and on behalf of the Management Board and my closest team of colleagues, I would like to thank to our clients and business partners for their confidence and professional relationship, and would like to thank to all employees of Hrvatska poštanska banka on their committed work and diligence with which they contributed to the Bank's success. I would especially like to thank to shareholders and the Supervisory Board members on their cooperation, support and trust.

Josip Protega
President of the Management Board



Can your banker solve this problem?

The objective is to make 7 from these 4 matches.

Macroeconomic movements in the Republic of Croatia in 2005

Macroeconomic stability and economic growth, decrease in growth of public and foreign debt, fiscal consolidation, and decrease in unemployment rate, were all the goals of Croatian economic policy in 2005.

According to projections of the quarterly GDP, the economic growth increased from 3.8% in 2004 to 4.1% in 2005. The physical amount of industrial production increased in 2005 by 5.2%, and manufacture, i.e. consumer prices increased by 3.0% and 3.3% respectively. Total nominal retail turnover increased by 6.5% at the end of 2005 (realistically 2.8%) compared to 2004, and individually the largest relative increase in turnover of 19.8% was noted in trade in motor oil and fuel (which was mostly influenced by increase in prices of oil derivatives).

Total export of the Republic of Croatia in 2005, according to preliminary information, amounted to USD 8,809 million, and import amounted to USD 18,547 million. Foreign trade deficit amounted to USD 9,738 million while import/export coverage ratio amounted to 47.5%. Direct foreign investments in the Republic of Croatia during the first quarter of 2005 increased by significant 26.9%, amounting to USD 1,245.2 million, and negotiations for joining the European Union, commenced in October 2005, should positively influence on further continuation of positive trends.

At 2005 year-end, the domestic currency was by 3.9% stronger in relation to EUR, and by 10.6% weaker in relation to USD, compared to previous year.

In December 2005, the annual rate of the basic inflation amounted to 3.0%, representing a somewhat higher amount compared to the last year, when it amounted to 2.3%.

Unemployment rate amounted to 18.0% at 2005 year-end.

An average nominal net salary for the first eleven months of 2005 amounted to HRK 4,367, realistically representing an increase of 1.6% compared to the same period last year.

The foreign debt of the Republic of Croatia at 2005 year-end amounted to EUR 25.5 billion, representing 85% of the expected GDP, of which 35% of total foreign debt related to the foreign debt of banks. The foreign debt of other sectors (mainly entities) amounted to 28% of total foreign debt, while the State foreign debt stake was a bit lower.

In 2005, Croatian National Bank continued its restrictive monetary policy in scope of limiting the growth of placements and de-stimulating further foreign indebtedness of banks. The main instrument was an increase in the obligatory marginal reserve from 24% at the beginning of 2005, to 55% effective from the beginning of 2006.

Starting with the first auction, held on 8 June 2005, the CNB commenced with its open market operations. The aims of such operations were: realisation of the full autonomy of the monetary policy, improved availability of resources for domestic financing of the budget deficit, lower costs and longer terms of loans repayment and a more efficient management of public debt.

The amount of money (M1) increased by HRK 4.3 billion, i.e. by 11.0% compared to 2004, while total liquid assets (M4) increased by HRK 14.7 billion, i.e. 9.5%.

The banking system of the Republic of Croatia was stable, liquid and profitable in 2005. According to preliminary, non-audited financial information, at 31 December 2005, total assets of the banks amounted to HRK 260.6 billion, representing a 13.6% increase compared to 2004. At 2005 year-end, the banking gross loan portfolio comprised 49.4% of retail loans and 39.3% of corporate loans.

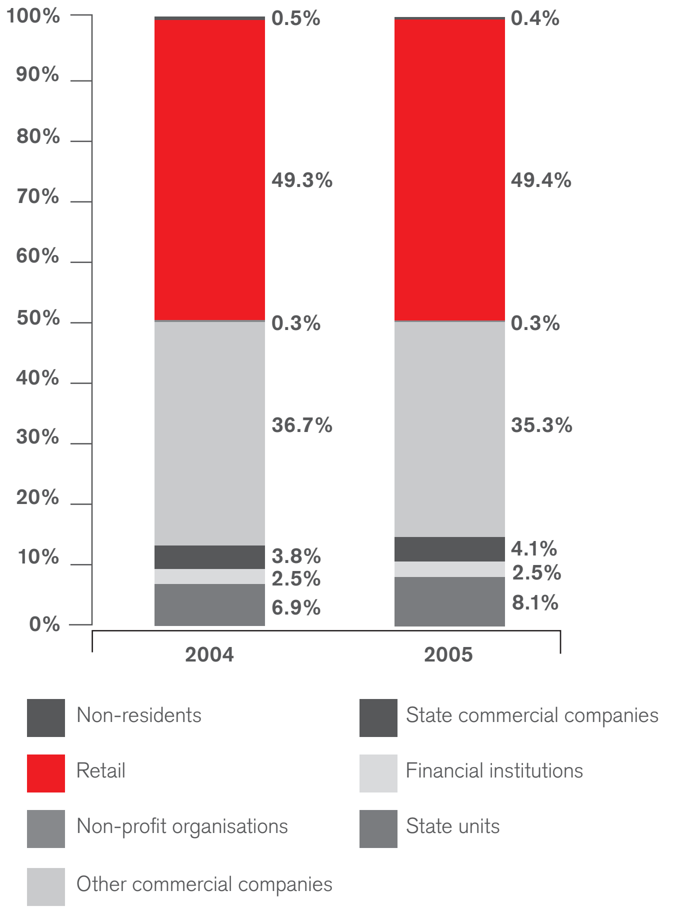


Figure 2. Total gross loan portfolio structure per sectors

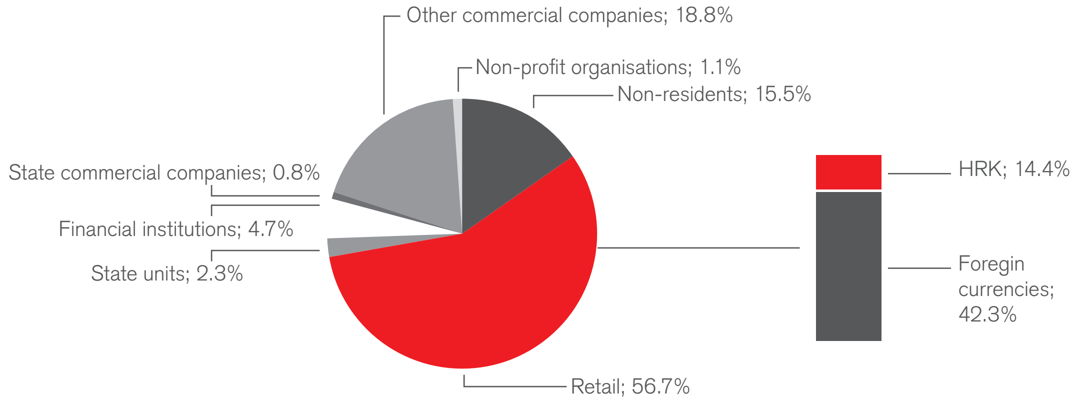
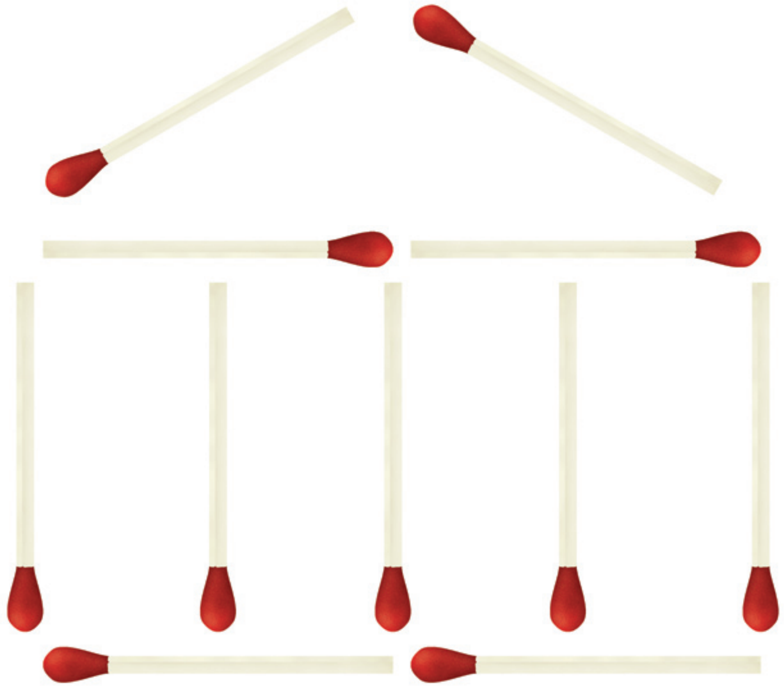


Figure 3. Total deposit structure per sectors, as at 31 December 2005

Increase in assets of banks was primarily financed from deposits, which increased by HRK 16.5 billion, then from issued loans, which increased by HRK 10.2 billion (of which 66.1% related to loans issued to foreign majority shareholders of banks), capital, which increased by HRK 3.9 billion, and other.

Profit before tax amounted to HRK 4.1 billion, representing a HRK 398.7 million or 10.8% increase, compared to last year. Return on average assets (ROA) amounted to 1.67%, return on average equity (ROE) amounted to 15.58%, and general administrative expenses and depreciation on net operating income (Cost/Income) amounted to 54.2%.

Total savings institutions assets at the end of 2005 amounted to more than HRK 5.8 billion. Characteristic for the last year was were the changes in underlying regulations, which caused a one-off decrease in state incentives by 40%, but simultaneously allowed for inter-financing of own customers, financing for purposes of furnishing residential areas and other.



Can your banker solve this problem?

The objective is to move 2 matches in order to
form 11 squares.

Description of the Bank's operation

Hrvatska poštanska banka d.d., Zagreb, was founded and registered as a joint stock company in accordance with applicable regulations of the Republic of Croatia, and is authorised to perform banking activities in the Republic of Croatia. The Bank's Management Board is in Jurišićeva 4, in Zagreb. At 31 December 2005, the Bank operated through one representative office, five branches and ten outlets.

The Bank's main activity is operation in all kinds of deposit and loan activities for corporate and retail customers in domestic and foreign currency, performance of domestic and foreign payment transaction activities, issue of guarantees, sureties and other forms of guarantees, trade in foreign curreny and securities and other banking activities.

Hrvatska poštanska banka is recognised as a dominant financial mechanism offered to citizens throughout RH, available through its own network of outlets and post offices, and as a support to Croatian economy, especially within the segment of small and medium entrepreneurship.

As a domestic bank, HPB is in the group of leading banks in the Republic of Croatia, which, with its assets in the amount of HRK 7.3 billion and its share capital, is ranked eighth among 34 banks altogether.

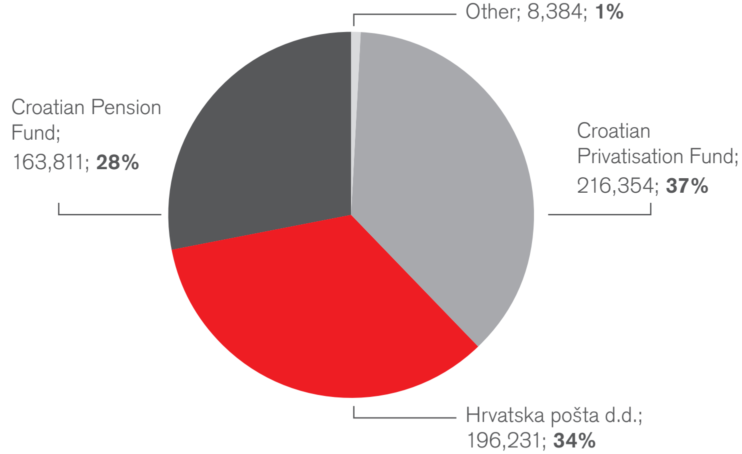
According to currently applicable Payment Transaction Law, Hrvatska pošta Zagreb is no longer the main payment system distribution channel, but is authorised to perform cash payment transactions on behalf and for Hrvatska poštanska banka, which makes her a participant in cash payment transactions.

In July 2005, the Bank founded HPB Invest d.o.o. investment fund management company and HPB Nekretnine d.o.o., a real estate trading company and thus formed the HPB Group.

Both companies are fully owned by Hrvatska poštanska banka.

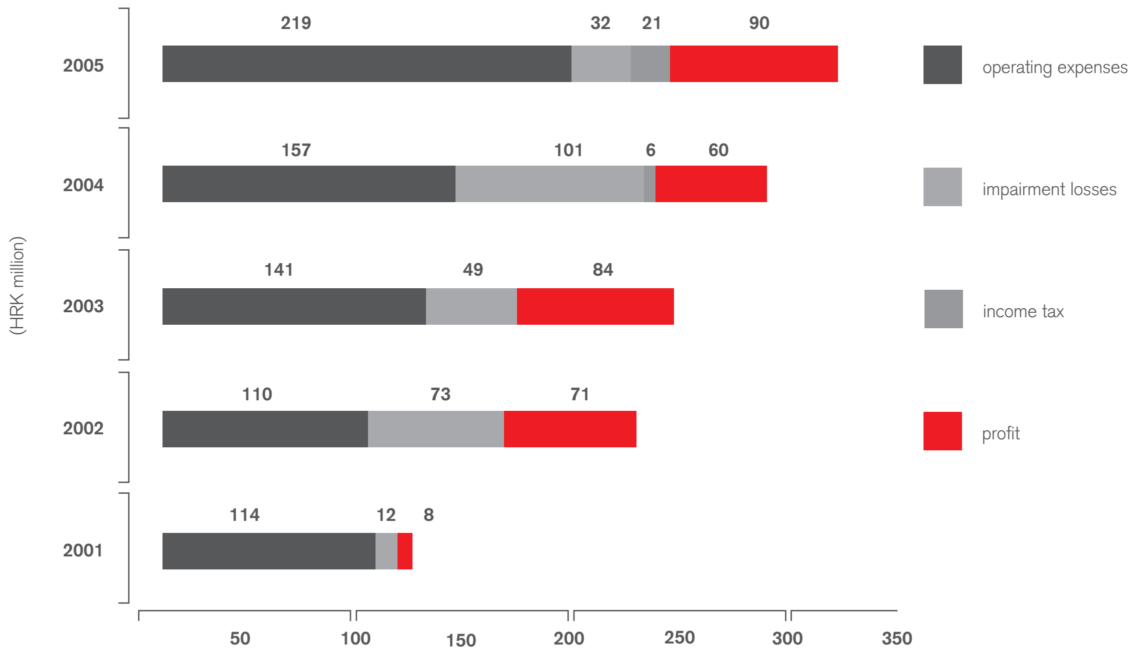
At 31 December 2005, HPB Invest managed four investment funds: HPB Money Market Fund, HPB Bond Fund, HPB Equity Fund and HPB Global Fund.

Shareholder structure at 31 December 2005



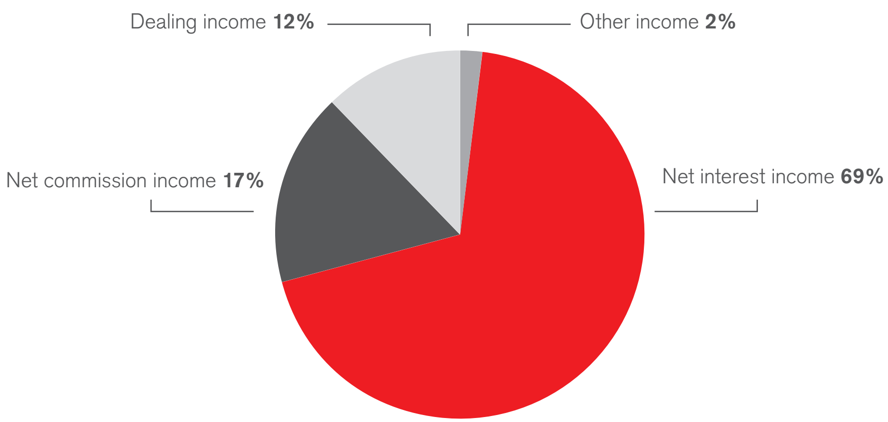
In 2005, the Bank realised HRK 362.0 million profit from operation. The largest part of the income distribution structure were operating expenses (60%) and profit (25%). Operating expenses increased by 39% compared to restated 2004, while total impairment losses on loans and advances to customers, other assets and provisions for liabilities and charges in 2005 decreased by 68% compared to restated 2004.

Allocation of operating income



Total operating income increased by 12% compared to restated 2004. The most significant part of operating income is net interest income, representing 69% of total income.

Structure of operating income for the period from 1 January - 31 December 2005

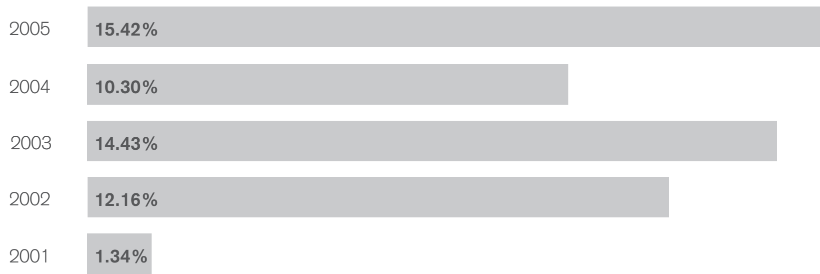


In 2005 profit for the year amounted to HRK 90.2 million, representing an increase of HRK 29.9 million compared to 2004.

Profit for the year

Movement in return on share capital and return on assets (ROA) for the period from 2001 to 2005 is presented below.

Return on share capital

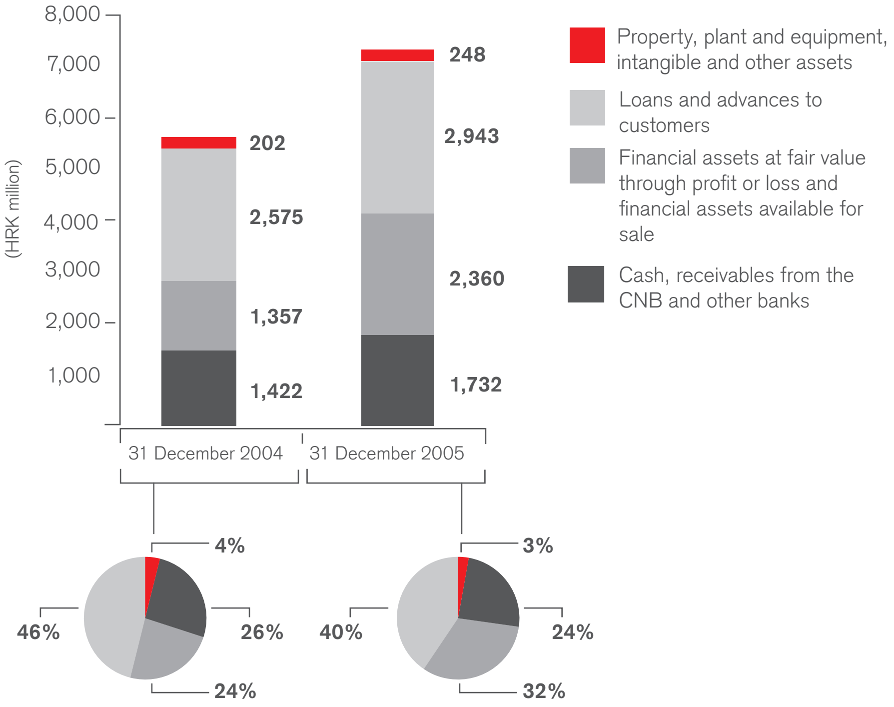


Return on assets (ROA)

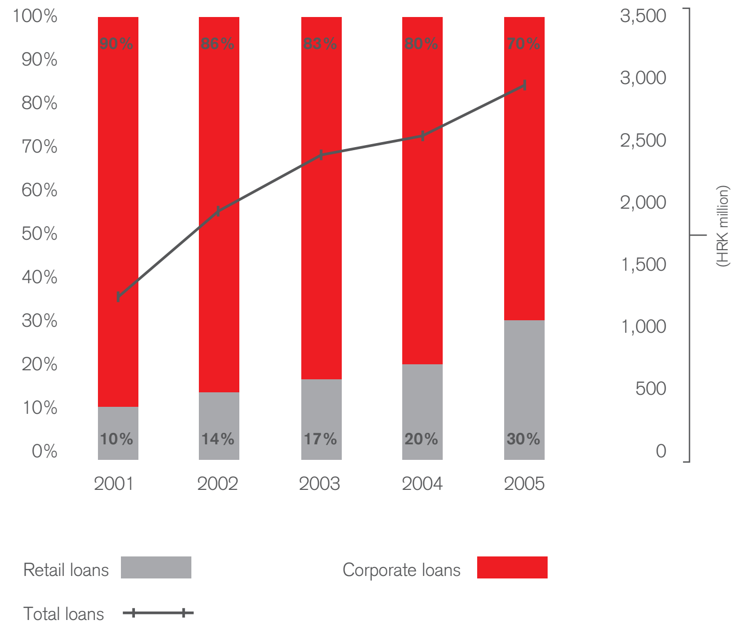
At 2005 year-end, the Bank's assets amounted to HRK 7,283 million, representing a HRK 1,727 million or 31% increase compared to restated 2004 results. The most significant part within assets structure are loans and advances to customers (40%) and financial assets at fair value through profit or loss and financial assets available for sale (32%).

At 31 December 2005, total loans amounted to HRK 2,943 million, representing a 14% increase compared to 2004. The loan portfolio structure comprises 70% of corporate loans and 30% of retail loans.

Assets structure at 31 December 2004 and 31 December 2005



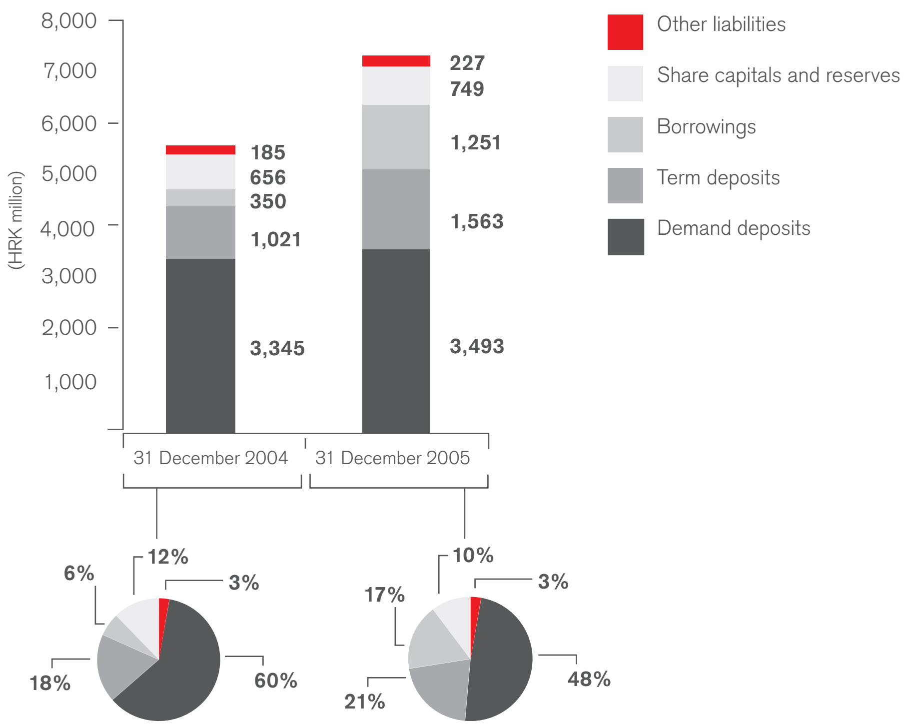
Structure of and movement in net loans



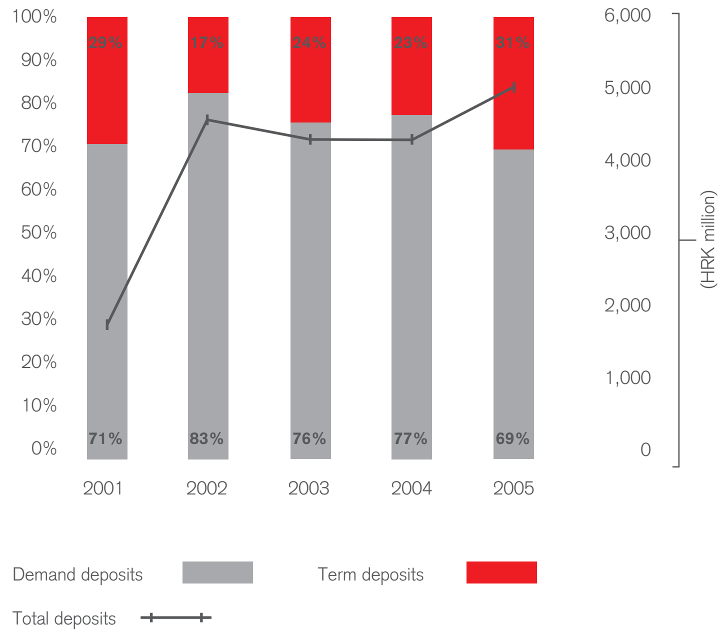
The most significant part within liabilities are demand deposits (48%) and term deposits (21%).

In 2005, deposits from customers and banks increased by 16% compared to 2004. The structure of deposits is still dominated by demand deposits (69%), compared to term deposits (31%). In 2005, term deposits increased by 53%, and their share within the structure of total deposits increased by 8 percent (from 23% to 31%). In its operation with deposits, the Bank will continue activities aimed at increasing deposits and improving maturity and foreign currency structure of term deposits, in scope of increasing long-term and foreign currency deposits.

Liabilities structure at 31 December 2004 and December 2005



Structure of and movement in deposits




accessible

Retail operation

HPB performs retail operation through it own business network which comprises 5 branches and 10 outlets, and through more than 1,100 post offices throughout the territory of the Republic of Croatia.

In accordance with its business policy aimed at better acquainting customers with its products and services, in 2005, along with its existing outlets in Zagreb, Split, Varaždin and the representative office in Vinkovci, the Bank opened new outlets in Vukovar, Dubrovnik, Rijeka, Pula, Kaštel Stari, Sveta Nedelja and Zagreb. Besides the existing branch in Split, the Bank has opened branches in Zagreb, Dubrovnik, Pula and Varaždin.

Besides its outlet network expansion, HPB continued to develop and improve direct banking distribution channels and installed 44 new ATMs (of which 21 relates to replacement of old ones and 23 to installation of ATMs on new locations) and 850 EFTPOS terminals in post offices. At the end of 2005, the Bank had own network of 137 ATMs and 943 EFTPOS terminals, and contracted use of 356 EFTPOS terminals in the Financial Agency.

Focus on demands and needs of its clients, the Bank extended the palette of its products by new loan and savings investment products for retail customers and offered services of private banking, HPB sms, permanent orders, payment transaction services and services of cash withdrawal through EFTPOS terminals installed in premises of the Financial Agency and Hrvatska pošta.

In the segment of credit card operation, HPB initiated a number of activities focused at a faster development of the credit card operation in the following periods. One of the most significant activities is allowing acceptance of Visa credit cards on ATMs.

In 2005, retail deposits represented 44.1% of total deposits, representing an increase of 24.8% and amounting to HRK 2.2 billion at 31 December 2005. Demand deposits amounted to HRK 1.4 billion, representing a 13% increase, and term deposits amounted to HRK 795.7 million, representing a 53.5% increase. Higher growth in term deposits than a vista deposits results from expansion of the Bank's business network, improvement of business cooperation with Hrvatska pošta, stimulative interest rate policy for longer term and foreign currency savings.

In 2005, total retail gross credit portfolio increased by 67.1%, amounting to HRK 942.1 million at 31 December 2005. In 2005, 17,104 retail loans were granted totalling to HRK 442 million. Retail loans represented 29.5% of total gross loans portfolio, representing an increase of 9.4 basis points (from 20.1% to 29.5%) compared to previous year. The largest part of total retail loan portfolio are non-purpose loans, followed by used framed facilities on current accounts.

Among other activities within retail operation we emphasise the introduction of contact centre, introduction of a large number of loan and deposit products, improvement of business cooperation with Hrvatska pošta, Financial Agency and other state institutions, especially in the field of payment of various fees, incentives from state budget and approval of loans on the bases of operation for and on behalf of third parties.


my bank

Corporate operation

The most significant changes in corporate operation during 2005 were within the loan portfolio structure. Percentage of loans to state units decreased from 45% to 4%, compared to 2004. Based on the adopted strategy on development of its operation, the Bank focused its credit activity primarily on loans to commercial entities. As a result of that, gross loans to commercial companies increased by 77% or HRK 942 million, while gross loans to state amounted to HRK 85 million, unlike the previous year when they amounted to HRK 1,019 million.

In corporate operation, the priority in granting loans was given to entities with export oriented production, construction, family entrepreneurship in tourism and granting of loans to small and medium entrepreneurship. The structure of total loans to commercial companies is dominated by short-term loans in HRK. In granting long-term loans, HBOR resources and other long-term borrowings were used.

During 2005, the Bank significantly increased its loan granting activities to small and medium entrepreneurship, and by signing agreement with several counties, it began actively participating in granting loans according to Local Development Projects - Entrepreneur programme. During 2005, the process of client segmentation was completed and, in accordance with the Bank's strategy, a Department for small and medium entities was formed. By the formation of this Department and the intensive expansion of its business network, the Bank became more accessible to small entrepreneurs, which created a prerequisite for providing a higher quality and faster service to that market segment. Furthermore, cooperation with institutions providing assistance to small and medium entrepreneurship (HAMAG, USAID) was established and, aimed at ensuring most favourable borrowing terms and conditions possible, the cooperation with the Croatian bank for reconstruction and development, the Ministry of Economy, Labour and Entrepreneurship, the Ministry of Sea, Tourism, Traffic and Development and towns, municipalities and counties in the Republic of Croatia was intensified.

In 2005, the Bank intensified its activities in operations for and on behalf of third parties. Related loan portfolio amounted to HRK 194.6 million, the activities were performed for 18 parties, and loans were used by 1,230 customers.

At 31 December 2005, total corporate deposits amounted to HRK 2.8 billion, representing a 9.5% increase compared to the previous year whereby demand corporate deposits remained at the same level as before and term deposits increased by 54.6%.


safe investment into the future

Investment banking

The investment banking division commenced its operation at the beginning of 2005 and the Bank soon became a member of Varaždin and Zagreb stock exchange. Thus were created preconditions for trading in securities listed on both the markets, client representation and competition on public tenders organised by the Croatian Privatisation Fund. The Bank realised annual turnover on both the markets of HRK 110 million.

Among new investment banking products and services offered by the Bank, the following should be emphasized:

- margin retail and corporate loans at the beginning of the second quarter of 2005, whereby by the end of the year the Bank approved HRK 44.5 million of loans
- trading in securities on the financial markets of Serbia and Monte Negro and Macedonia, whereby by the end of the business year the Bank achieved turnover of EUR 400 thousand

The customers were offered portfolio management services whereby the Bank accepted the principles of security, profitability, liquidity and spreading risks, and in accordance with the investment strategy, it invests the assets of customers into financial instruments without previous approval of investment from the client. The Bank also controls the compliance with the investment limits, risks and strategies, and regularly reports its clients on the value fluctuation of financial instruments relevant to respective client, and on the value fluctuation of invested assets. The Bank daily analyses, monitors, allocates and reallocates clients’ assets managed for the client.

In 2005, the project of issue of shares based on public offer (IPO) of VIRO - Tvornica šećera from Virovitica was initiated. VIRO - Tvornica šećera from Virovitica is, at the same time, the first joint stock company in Croatia that issued its shares by a public offer through Zagrebačka burza.


mine

Treasury operation

HPB intensified its active role on the money market, increasing the volume and the number of transactions with domestic and foreign financial institutions (there were more than 2,500 transactions during 2005).

In its operation, the Treasury significantly increased the number of repurchase and short-term securities transactions (total volume of short-term securities transactions on secondary market amounted to HRK 635 million). Also, the Bank became a member of the group of banks that form ZIBOR.

During 2005, the Bank was ranked second according to total number of underwritten treasury bills of the Ministry of Finance, which balance at 31 December 2005 amounted to HRK 1.6 billion.

The Bank intensified its operation in debt securities by increasing the portfolio of state and corporate bonds and by daily quotation of price for bonds quoted on Croatian market. Thereby, the total turnover amounted to more than HRK 1.7 billion.

HPB arranged the issue of the Croatian Ministry of Finance bonds during 2005 (HRRHMFO157A6, HRRHMFO103A0, HRRHMFO15CA8).

The Treasury division continued improving the Bank's liquidity risk management by implementing new internal acts and retaining the necessary liquidity reserves in accordance with regulations and the Bank's internal acts.

In 2005, the Treasury division successfully ensured the liquidity necessary for the continuing operation of the Bank and its customers.

By forming a Treasury Products Sales Department, the Treasury division enabled to the Bank's clients a higher quality and faster contracting of foreign currency and money market transactions.

The Bank continued improving existing operation policies and procedures regulating the Treasury division operation, which enabled the formation of a trading portfolio of securities and the development of new products.


careful

Risk management

The Bank's willingness to take the risk in daily operation represents a necessary precondition to the realisation of a positive financial result. Within Hrvatska poštanska banka, risk management represents the function that comprises evaluation and measurement of risk exposure, quantification of risk appetite through the system of limits, reporting and supervision of limit utilisation and corrective activities, all in scope of maintaining the positions within prescribed limits.

Strategic risk management guidance and the definition of the limit of acceptable risk is achieved through the Management Board, Credit Committee and Asset and Liabilities Management Committee operation.

The Risk Management Division is responsible for independent assessment and measurement of risk exposure which represents a precondition to quantification of acceptable risk exposure through the system of limits. In their operation, the Bank's business divisions implement risk management decisions of the authorised bodies and maintain positions within prescribed limits.

In scope of realising a positive business result, the Bank creates exposure to credit risks, market risks and structure risks (liquidity risk and interest rate risk in the balance sheet part which is not stated at fair value) and, as a consequence, an exposure to operating risk is created.

Credit risks

The Bank estimates recoverability, that is, a potential loss on each placement, before approval of placements, and periodically (quarterly) during the period of the business relationship. A conservative approach to credit risk management is characterised by strict obedience to regulatory requirements, impairments made against losses arising from credit risk and maintenance of a capital adequacy rate significantly higher than the prescribed minimum (10%).

Market risks

The Bank is exposed to market risks on positions which are stated at fair value - financial assets at fair value through profit or loss and foreign currency position. In managing market risks, the Bank is fully compliant with regulatory requirements and Croatian National Bank decisions. The Bank develops a market risk management system which is based on Value at Risk principles, i.e. exposure to market risks is disclosed in terms of a potential loss (for a certain time period, with a certain statistical reliability).

The Bank's balance sheet structure risks

In managing structure risks, the Bank pays special attention to liquidity risk and interest rate risk in the part of the balance sheet which is not measured at fair value.

Liquidity risk management is based on maintenance of necessary liquidity reserves, compliance with structure limits and prescribed steps in case of occurrence of liquidity crisis.

In managing interest rate risk, the Bank determines the acceptable exposure in terms of sensitivity of net interest income (income perspective) and sensitivity of economic value of capital (economic value perspective).

Operating risks

The Bank determines its operating risk exposure in compliance with regulatory requirements and Croatian National Bank decisions and guidance of the New Basel Accord on Capital Adequacy (Basel II). In managing operating risk, the Bank implements quantitative and qualitative measures that are based on the collection of information on losses arising from operating risk, independent risk assessment and the control system.

Future activities

Future activities in the field of risk management development will be focused on adjustment to guidance of the New Basel Accord on Capital Adequacy. In that sense, the Bank will continue to develop its risk management function which will enable the total risk exposure to be in accordance with available capital.


modern

Internal controls system and internal audit

The Bank's internal acts comprise internal control system principles. Internal controls are the responsibility of management and individuals in charge of internal control. All employees are responsible for implementation of internal controls, and implementation steps are described in the Bank's acts: Description of duties, Procedures and Guidance.

An effective establishment and implementation of the internal control system hedges the Bank's exposure to risks and ensures timely information through an early warning on increased risk exposure system.

The internal control system is based on four principles:

- clear definition of responsibilities
- separation of duties and activities
- integrated control proceedings
- effective internal audit

In accordance with internal control principles, the internal audit was organised which, on the basis of an annual work programme and quarterly operating plans, performs the audit of all organisational units and functions of the Bank.

The audit is performed in accordance with general internal audit standards and regulatory requirements, in four following steps:

- planning
- research
- reporting
- results monitoring

Report on audit results, which contains conclusions and recommendations, is submitted to the Bank's Management Board and Supervisory Board.

The Bank has defined procedures for money laundering prevention which comply with regulatory requirements and procedures adopted by the Bank's Management Board. An authorised person and individuals responsible for money laundering prevention have been appointed.

The prevention system consists of:

- identification of transactions upon data input into the Bank's system
- client identification
- relevant documentation on industry of the Bank's clients
- timely reporting of the authorised person
- exchange of information with state Office for Money Laundering Prevention
- timely distribution of money laundering indicators and the list of individuals suspected to participate in financing terrorism and trade in people
- education on current issues related to money laundering prevention and the control of application of implemented procedures


HPB
HRVATSKA POŠTANSKA BANKA d.d.
Jurišićeva 4, 10000 Zagreb
accessible

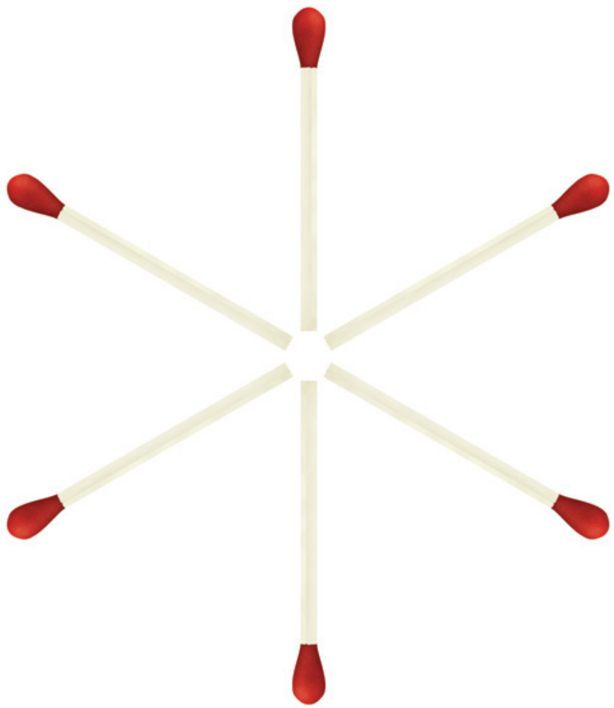
HPB Group

The Hrvatska poštanska banka Group began its formation in 2005 and defined its future path with a clearly defined goal of being a strong Croatian financial institution with a complete palette of financial products and services, strongly positioned on the Croatian financial market. Therefore, all of us, from the members of the Management Board, banking experts leading the Bank's operations and development, to our officers participating in daily operation with clients, find inspiration in O. W. Holmes quotation - "*The most important thing in the world is not where we are, but where we are headed*".

As financial experts, in a continuous market perpetuum mobile, we are much better in expressing mathematical terms, ratios and numbers, but big ideas are sometimes not easily expressed by plain corporate reporting. Our vision is incorporated in our daily activities and operations, all in scope of realising what we are expected from our owners, clients and employees. However, our aspirations rise high above our continuous race for as good a result as possible on a competitive financial market. We have successfully established two new companies, HPB Invest d.o.o. and HPB Nekretnine d.o.o., the new members of the HPB Group, and thus created the basis for introduction of leasing activities and housing savings in our operation. Behind this simply presented result, there is a huge knowledge and enthusiasm to enrich our path to the future with new members and new forces and to offer new values to our clients.

By initiating more than 70 projects at the beginning of 2005, according to project management model in compliance with the best world practice, the new teams of experts performed restructuring of the Bank's business model during the last year and set the foundations for the future development of the HPB Group. By introducing modern management models, our team harmony and expert knowledge of certain teams, represented the key for defining and creating the infrastructure necessary for the realisation of the goal to which we strive - the perfection.

The perfection is the direction of the Hrvatska Poštanska Banka Group. On our way, we wish to do what we are best at, and instead of big words and promises, to turn our ideas into clearly measurable goals, mathematical expressions, ratios and numbers. We wish to improve all that we are doing, from our retail and corporate products and services, to knowledge and skills of all our employees and information technology infrastructure, including the relationship with our strategic partners. That strong and continuous forward movement towards better was operationally initiated in 2005, convinced that the direction in which we are headed is much more important from where we currently are.



Can your banker solve this problem?

Can you make 12 out of these 6 matches?

Management of the Bank

In accordance with the Companies' Act and the Bank's statute, the management of the Bank comprises the Supervisory Board and the Management Board.

The Supervisory Board

The Supervisory Board supervises the operation of the Bank's Management Board. The Supervisory Board consists of seven members which are elected at the General Assembly by a regular majority of the total number of votes. The members have a four year mandate and can be re-elected. The Supervisory Board decisions are passed by the majority of the total number of votes, of which each Supervisory Board member has one vote.

The Supervisory Board reports to the General Assembly on the performed supervision of business management in which it specifically states: if the Bank operates in accordance with laws, the company's acts and the Bank's General Assembly decision, if the annual financial statements have been prepared in compliance with information disclosed in the Bank's records and if they give a true financial and operating position of the Bank, and the opinion on the Management Board's proposal related to allocation of profit and coverage of loss.

In accordance with the law, the Supervisory Board members receive fees for their work, in the amount determined at the General Assembly of the Bank, for the business year in which fees will be paid.

The President of the General Assembly is mr.sc. Ante Žigman.

The Supervisory Board members in 2005 were:

mr.sc. Ante Žigman	President
prof.dr.sc. Dragan Kovačević	Vice President
dr. Zoran Bubaš	Member
Jadranko Mijalić	Member......................... from 31 May 2005
Branko Jakušić	Member............................ to 31 May 2005
mr.sc. Grga Ivezić	Member
Vera Babić	Member
doc.dr.sc. Drago Jakovčević	Member

Ivan Sladonja
Member of the
Management Board

Josip Protega
President of the
Management Board

The Management Board

The Management Board is responsible for the successful operation of the Bank. It consists of two members responsible for individual business areas.

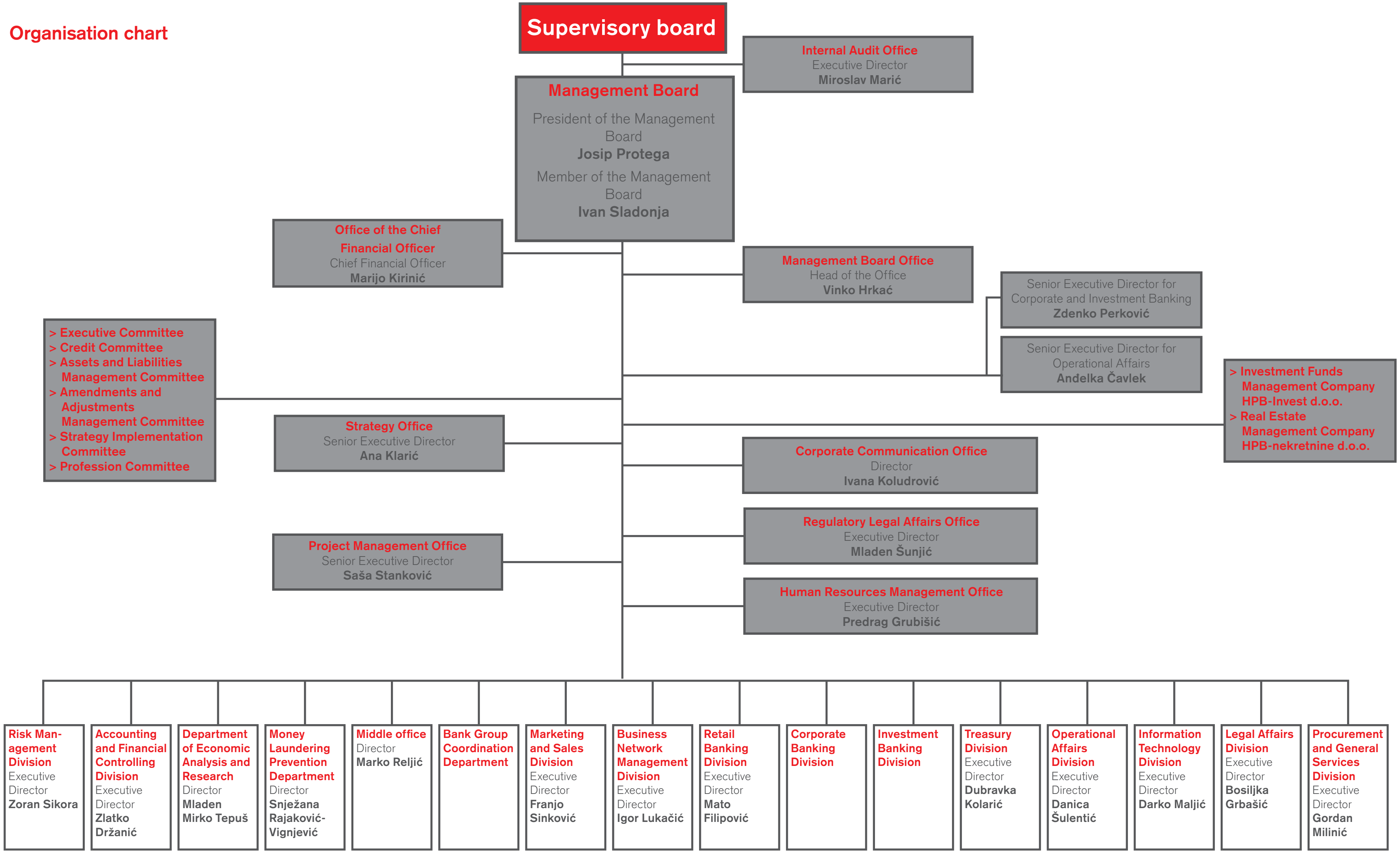
The Management Board represents the Bank and it is responsible and authorised to initiate all actions of representation in court or with other state authorities.

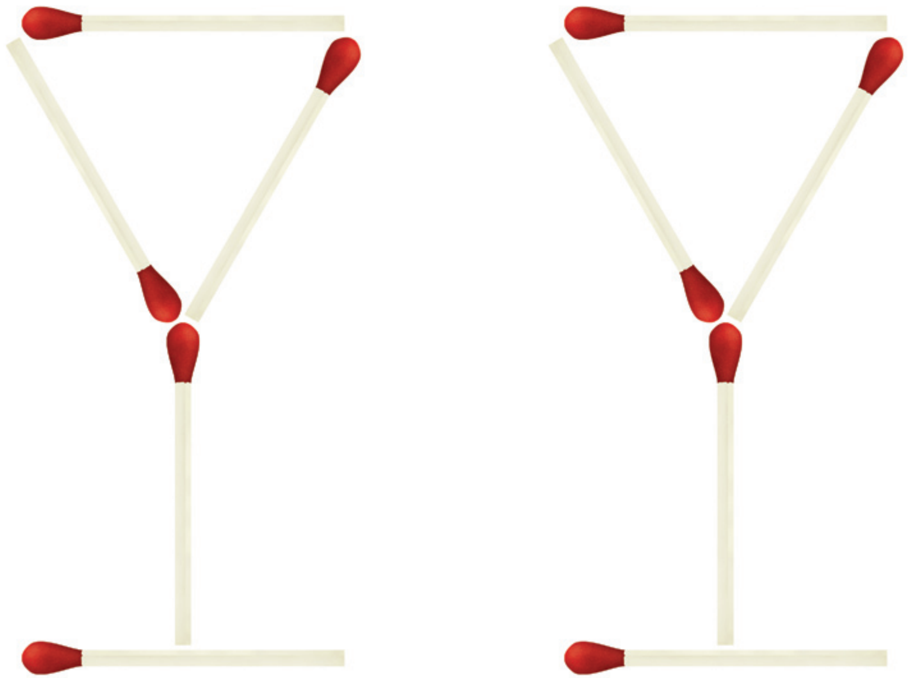
Individuals who are appointed candidates for the position of the president or members of the Management Board must fulfil all requirements prescribed by law and other regulations. Upon each appointment of the president or the members of the Management Board, the Supervisory Board must require a prior consent form the Croatian National Bank. The Management Board members are appointed by the Supervisory Board for the 5-year period with a possibility of re-election.

The Bank's Management Board members in 2005 were:

Josip Protega .... President
Ivan Sladonja .... Member

Organisation chart





Can your banker solve this problem?

The objective is to move 6 matches so that you make a house instead of 2 wine glasses.

Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements

Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements

The Management Board is required to prepare consolidated and unconsolidated financial statements for each financial year which give a true and fair view of the financial position of the Bank and of the results of its operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; make judgements and estimates that are reasonable and prudent; and prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Bank will continue in business.

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

The unconsolidated financial statements set out on pages 49 to 99 were authorised by the Management Board on 7 March 2006 for issue to the Supervisory Board and are signed below to signify this.

On behalf of Hrvatska poštanska banka d.d.

Josip Protega
President of the Management Board

Ivan Sladonja
Member of the Management Board

We have audited the accompanying unconsolidated balance sheet of Hrvatska poštanska banka d.d. Zagreb ("the Bank") as of 31 December 2005, and the related unconsolidated statements of income, changes in equity and cash flows for the year then ended. These unconsolidated financial statements are the responsibility of the Bank's Management Board. Our responsibility is to express an opinion on these financial statements based on our audit.

The financial statements for the year ended 31 December 2004 were audited by another auditor whose report dated 28 February 2005 expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the 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 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 unconsolidated financial statements give a true and fair view of the unconsolidated financial position of the Bank as of 31 December 2005 and of the unconsolidated results of its operations and cash flows for the year then ended in accordance with statutory accounting requirements for banks in Croatia.

KPMG Croatia d.o.o. za reviziju
Croatian Registered Auditors
Centar Kaptol
Nova Ves 11
10000 Zagreb
Croatia

7 March 2006

ASSETS	Notes	2005 HRK '000	Restated 2004 HRK '000
Cash and receivables from banks	4	388,689	531,402
Obligatory reserve with Croatian National Bank	5	685,366	512,317
Placements with and loans to other banks	6	657,465	378,125
Financial assets at fair value through profit or loss	7	1,438,500	127,282
Financial assets available for sale	8	921,660	1,229,463
Loans and advances to customers	9	2,942,889	2,575,346
Investments in subsidiaries	10	5,050	-
Property, plant and equipment	11	157,331	141,977
Intangible assets	12	19,837	9,932
Net deferred tax asset	13	2,694	-
Other assets	14	63,445	50,273
Total assets		**7,282,926**	**5,556,117**
LIABILITIES			
Deposits from banks	15	50,940	46,937
Deposits from customers	16	5,004,946	4,318,282
Borrowings	17	1,250,444	349,924
Provisions for liabilities and charges	18	30,395	17,560
Net deferred tax liability	13	-	1,407
Other liabilities	19	175,086	160,083
Current tax liability		21,688	5,871
Total liabilities		**6,533,499**	**4,900,064**
EQUITY			
Share capital	30	584,780	584,780
Treasury shares	-	(874)	(874)
Statutory reserve	30	7,720	3,212
General banking reserve	30	31,609	-
Fair value reserve		10,248	7,036
Retained earnings		115,944	61,899
Total equity		**749,427**	**656,053**
Total liabilities and equity		**7,282,926**	**5,556,117**

The notes on pages 54 to 99 form an integral part of these unconsolidated financial statements.

	Notes	2005 HRK '000	Restated 2004 HRK '000
Interest and similar income	20	351,397	323,721
Interest expense and similar charges	21	(102,924)	(79,852)
Net interest income		**248,473**	**243,869**
Fee and commission income	22	558,805	584,979
Fee and commission charges	23	(498,033)	(534,007)
Net fee and commission income		**60,772**	**50,972**
Gains less losses from dealing securities	24	16,728	4,381
Gains less losses from investment securities	25	9,462	6,265
Gains less losses from dealing in foreign currencies		18,230	17,346
Other operating income	26	8,296	1,518
Dealing and other income		**52,716**	**29,510**
OPERATING INCOME		**361,961**	**324,351**
General and administrative expenses	27	(194,462)	(140,527)
Depreciation	11, 12	(24,455)	(17,177)
Impairment losses on loans and advances to customers and other assets	8, 9, 14	(19,331)	(96,546)
Provisions for liabilities and charges	18	(12,835)	(4,343)
OPERATING EXPENSES		**(251,083)**	**(258,593)**
Profit before tax		**110,878**	**65,758**
Income tax expense	28	(20,716)	(5,519)
PROFIT FOR THE YEAR		**90,162**	**60,239**
Earnings per share (in HRK)	**29**	**169.85**	**113.48**

The notes on pages 54 to 99 form an integral part of these unconsolidated financial statements.

	Share capital HRK '000	Treasury shares HRK '000	Statutory reserve HRK '000	General banking reserve HRK '000	Fair value reserve HRK '000	Retained earnings HRK '000	Total HRK '000
Balance at 1 January 2004 - as previously reported	**584,780**	**(874)**	**270**	**-**	**-**	**6,011**	**590,187**
Unrealised gains on financial instruments available for sale	-	-	-	-	1,761	(1,761)	-
Deferred tax	-	-	-	-	(352)	352	-
Balance at 1 January 2004 (restated), Note 2	**584,780**	**(874)**	**270**	**-**	**1,409**	**4,602**	**590,187**
Unrealised gains on financial instruments available for sale	-	-	-	-	13,299	-	13,299
Realised gains on financial instruments available for sale	-	-	-	-	(6,265)	-	(6,265)
Deferred tax	-	-	-	-	(1,407)	-	(1,407)
Net gains not recognised in the income statement (restated)	-	-	-	-	5,627	-	5,627
Profit for the year (restated), Note 2	-	-	-	-	-	60,239	60,239
Total recognised income for 2004	-	-	-	-	*5,627*	*60,239*	*65,866*
Transfer to statutory reserves	-	-	2,942	-	-	(2,942)	-
Balance at 31 December 2004 (restated), Note 2	**584,780**	**(874)**	**3,212**	**-**	**7,036**	**61,899**	**656,053**
Unrealised gains on financial assets available for sale	-	-	-	-	13,477	-	13,477
Realised gains on financial assets available for sale	-	-	-	-	(9,462)	-	(9,462)
Deferred tax	-	-	-	-	(803)	-	(803)
Net gains not recognised in the income statement	-	-	-	-	*3,212*	-	*3,212*
Profit for the year	-	-	-	-	-	90,162	90,162
Total recognised income for 2005	-	-	-	-	*3,212*	*90,162*	*93,374*
Transfer to statutory reserves	-	-	4,508	-	-	(4,508)	-
Transfer to general banking reserve	-	-	-	31,609	-	(31,609)	-
Balance at 31 December 2005	**584,780**	**(874)**	**7,720**	**31,609**	**10,248**	**115,944**	**749,427**

The notes on pages 54 to 99 form an integral part of these unconsolidated financial statements.

	Notes	2005. HRK '000	Restated 2004. HRK '000
Cash flows from operating activities			
Profit before tax		110,878	65,758
Adjustment for:			
- Depreciation	11, 12	24,455	17,177
- Disposal of property, plant and equipment	11	11	28
- Foreign exchange gains	26	(266)	(153)
- Impairment losses on loans and advances to customers and other assets	8, 9, 14	19,331	96,546
- Impairment losses on provisions for liabilities and charges	18	12,835	4,343
- Net gains on financial assets at fair value through profit or loss	24	(9,000)	(3,901)
Changes in operating assets and liabilities			
Increase in placements and loans to other banks		(131,254)	-
Increase in financial assets at fair value through profit or loss		(1,312,832)	(44,962)
Net increase in loans and advances to customers		(385,891)	(235,524)
Net (increase)/decrease in other assets		(20,126)	26,564
Net increase in deposits from banks		4,003	46,665
Net increase/(decrease) in deposits from customers		705,450	(49,321)
Net increase/(decrease) in other liabilities		15,838	(23,744)
Net cash outflow from operating activities before tax		**(966,568)**	**(100,524)**
Income tax paid		(3,932)	(1,000)
Net cash outflow from operating activities		**(970,500)**	**(101,524)**

	Notes	2005 HRK '000	Restated 2004 HRK '000
Cash flow from investing activities			
Investment in subsidiaries		(5,050)	-
Purchase of property, plant and equipment and intangible assets		(49,725)	(22,131)
Net disposal/(acquisition) of financial assets available for sale		307,992	(33,153)
Net cash inflow/(outflow) from investing activities		**253,217**	**(55,284)**
Cash flow from financing activities			
Increase in borrowings		901,809	108,281
Net cash inflow from financing activities		**901,809**	**108,281**
Effect of foreign exchange differences on cash and cash equivalents		(7,662)	(6,223)
Net increase/(decrease) in cash and cash equivalents		**176,864**	**(54,750)**
Cash and cash equivalents at the beginning of the year	**32**	**1,425,263**	**1,480,013**
Cash and cash equivalents at the end of the year	**32**	**1,602,127**	**1,425,263**

The notes on pages 54 to 99 form an integral part of these unconsolidated financial statements.

1. SIGNIFICANT ACCOUNTING POLICIES

Hrvatska poštanska banka d.d. Zagreb ("the Bank") is a joint stock company incorporated and domiciled in Croatia. These financial statements are the separate financial statements of the Bank as defined in International Accounting Standard 27 "Consolidated and separate financial statements". The Bank is the parent of the HPB Group and also publishes, as a separate document, consolidated financial statements comprising the Bank and its subsidiaries.

These financial statements were authorised for issue by the Management Board on 7 March 2006 for approval by the Supervisory Board.

a) Statement of compliance

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

The accounting regulations of the CNB are based on International Financial Reporting Standards. The principal differences between the accounting regulations of the CNB and recognition and measurement requirements of International Financial Reporting Standards are as follows:

- The CNB requires banks to recognise impairment losses, in income, on assets not identified as impaired (including sovereign risk assets) at prescribed rates (excluding assets carried at fair value). The Bank has made portfolio based provisions of HRK 64,524 thousand (2004: HRK 65,576 thousand) in compliance with these regulations and has recognised a release of such provisions of HRK 1,052 thousand as income within the charge for impairment losses for the year (2004: expense of HRK 35,122 thousand). Although, in accordance with International Financial Reporting Standards, such provisions should more properly be presented as an appropriation within equity, the Bank continues to recognise such provisions in income as a substitute for unidentified impairment losses calculated in accordance with the requirements of International Financial Reporting Standards. In the absence of reliable historical data on the extent of unidentified losses existing in its credit portfolios and the emergence period over which these losses come to light, the Bank is not yet able to estimate provisions for unidentified losses existing at the balance sheet date on the basis required by International Financial Reporting Standards.
- Although the Bank calculates impairment losses on corporate lending as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate, in accordance with International Financial Reporting Standards, the CNB requires the amortization of the discount calculated to be presented in the income statement within the movement on impairment losses on loans and advances to customers and other assets, rather than as interest income, as required by International Financial Reporting Standards.

The principal accounting policies applied in the preparation of these financial statements are summarised below. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards, reference may be made to certain Standards in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards applicable at 31 December 2005.

b) Basis of preparation

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

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

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

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

Judgements made by management in the application of applicable standards that have significant effects on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in Note 3.

The accounting policies have been consistently applied to all periods presented in these financial statements. Changes in accounting policies are described in Note 2 and have been applied retrospectively, resulting in the restatement of amounts reported in the previous year.

c) Functional and presentation currency

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

The effective exchange rate as at 31 December 2005 was HRK 7.3756 to EUR 1 (2004: HRK 7.6712) and HRK 6.2336 to USD 1 (2004: HRK 5.6368).

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

Where necessary, comparative information has been reclassified to achieve consistency with current financial year amounts and other disclosures. The most significant reclassifications are summarised in Note 2.

e) Interest income and expense

Interest income and expense are recognised in the income statement as they accrue for all interest bearing financial instruments, including those measured at amortised cost, at fair value through profit or loss and available for sale, using the effective interest rate method, ie the rate that discounts estimated future cash flows to net present value over the life of the underlying contract, or an applicable floating rate. Such income and expense is presented as interest and similar income or interest expense and similar charges in the income statement. Interest income and expense also includes fee and commission income and expense in respect of loans provided to customers or borrowings from other banks, premium or discount amortisation, and other differences between the initial carrying amount of an interest bearing financial instrument and its value at maturity, recognised on an effective interest basis.

f) Fee and commission income and expense

Fee and commission income and expense mainly comprises fees related to domestic and foreign payments, the issue of guarantees and letters of credit, and credit card business, and is recognised in the income statement upon performance of the relevant service.

g) Dividend income

Dividend income from equity securities is recognised in the income statement when the rights to receive the dividend are established.

h) Gains less losses from dealing and investment securities

Gains less losses from dealing securities include unrealised and realised gains and losses from financial instruments at fair value through profit or loss.

Gains less losses arising from investment securities comprise realised gains from financial instruments available for sale.

i) Foreign currencies

Transactions in foreign currencies are translated into HRK, at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into HRK at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currency that are stated at fair value are translated in HRK at the foreign exchange rates ruling at the dates when the fair values were determined. Non-monetary assets and items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated at balance sheet date.

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

j) Financial instruments

Classification

The Bank classifies its financial instruments in the following categories: at fair value through profit or loss, loans and receivables, available for sale, held to maturity or financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. The management determines the classification of financial instruments upon initial recognition and re-evaluates this designation at every reporting date.

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

This category has two sub categories: financial instruments held for trading, and those designated by management as at fair value through profit or loss at inception. A financial instrument is classified in this category if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term, for the purpose of short-term profit-taking, or as designated by management. Financial instruments at fair value through profit or loss include debt and equity securities and investments in investment funds, as well as derivatives, except those that are designated as effective hedging instruments, and are classified as current assets or current liabilities if they are expected to be realised within 12 months of the balance sheet date.

Loans and receivables

This category comprises non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money to a debtor with no intention of trading with the receivable and include purchased loans and receivables.

Financial instruments held to maturity

This category comprises non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has the positive intention and ability to hold to maturity.

Financial assets available for sale

This category comprises non-derivative financial assets which are designated as available for sale or are not designated as loans and receivables, held-to-maturity investments, or financial assets at fair value through profit or loss. Financial assets designated as available for sale are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates, or equity prices. Available for sale financial assets include debt and equity securities.

Recognition and derecognition

Purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on the trade date which is the date when the Bank commits to purchase or sell the instrument. Loans and receivables and financial liabilities at amortised cost are recognised when advanced to borrowers or received from lenders.

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

Initial and subsequent measurement

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

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

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

Gains and losses

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

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

Gains or losses arising from financial assets and financial liabilities carried at amortised cost are included in the income statement over the period of amortisation, using the effective interest rate method. Gains or losses may also be recognised in the income statement when a financial instrument is derecognised or when its value is impaired.

Determination of fair value of financial instruments

The fair value of quoted financial instruments in an active market is based on their current bid prices. If there is no active market for the financial instrument, or if, due to any other reason, the fair value cannot be reliably measured by the market price, the Bank uses an internal evaluation model for fair value estimation, based on the present value of the future cash flows.

Impairment of financial assets

Financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The Bank estimates and performs impairment of all financial assets, except financial assets at fair value through profit or loss.

The recoverable amount of financial instruments measured at amortised cost is calculated as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate. Short-term balances are not discounted.

Allowances for uncollectibility are made against the carrying amount of loans and advances that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts. The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties. Increases in the impairment allowance account are recognised in the income statement. When a loan is known to be uncollectable, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly. If in a subsequent period the amount of an impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down or impairment loss is reversed through the income statement.

k) Specific instruments

Cash and cash equivalents

Cash and cash equivalents comprise cash and balances with the Croatian National Bank, placements with other banks with original maturity of up to 90 days, and items in the course of collection.

Derivative financial instruments

The Bank uses derivative financial instruments to hedge its exposure to currency risk and interest rate risk arising from operating, financing and investing activities. In accordance with its investment policies, the Bank does not hold or issue derivative financial instruments for the purpose of trading. No derivative instruments are classified as hedging instruments. All derivative agreements are classified as financial instruments at fair value through profit or loss.

Derivative financial instruments include foreign currency agreements, forward agreements and other financial derivatives and are initially recognised at fair value which is the value of consideration paid to acquire the instrument less transaction costs. Subsequent to initial recognition, derivatives are measured at fair value. The fair value is determined based on the quoted market price or, if more appropriate, based on the discounted cash flow. All derivative instruments are presented as assets if their fair value is positive and as liabilities if their fair value is negative.

Certain derivatives that form part of another financial instrument are treated as separate embedded derivatives when their risks and characteristics are not closely related with their host contract and when the host contract is not recorded at fair value with all unrealised gains and losses recognised in the income statement.

Changes in the fair value of derivatives are included in gains less losses arising from dealing securities.

Treasury bills and debt securities

Treasury bills and debt securities that the Bank holds for the purpose of short-term profit taking are classified as at fair value through profit or loss or as available-for-sale assets, and are carried at fair value. Treasury bills and debt securities that the Bank has the intent and ability to hold to maturity are classified as held-to-maturity assets.

Equity securities and investments in open ended investment funds

Equity securities and investments in open ended investment funds are classified as at fair value through profit or loss or as available-for-sale assets.

Placements with banks

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

Loans and advances to customers

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

Investments in subsidiaries

Investments in subsidiaries are accounted for at cost less impairment losses.

Repurchase agreements

The Bank enters into purchases/(sales) of investments under agreements to resell (repurchase) substantially identical investments at a certain date in the future at a fixed price. Investments purchased subject to such commitments to resell them at future dates are not recognised. The amounts paid are recognised in loans and advances to either banks or customers. The receivables are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the balance sheet and are measured in accordance with the accounting policy for the relevant financial asset at amortised cost or at fair value as appropriate. The proceeds from the sale of the investments are reported as liabilities to either banks or customers.

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

l) Income tax

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

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

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

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

m) Property, plant and equipment

Items of property, plant and equipment are shown at cost or deemed cost, less accumulated depreciation and impairment losses.

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

Depreciation is provided on a straight-line basis to allocate the cost of assets to their residual values over their estimated economic useful life. Land and assets under construction or development are not depreciated. The estimated useful lives are as follows:

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

The assets' residual values, depreciation method and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing proceeds with carrying amount, and are included in the income statement.

n) Intangible assets

Intangible assets are stated at cost less accumulated amortisation and impairment losses. Expenditure on development activities are capitalised if all of the features required by IAS 38 "Intangible assets" are satisfied. Amortisation is provided on a straight-line basis over the estimated useful lives of intangible assets.

Intangible assets are amortised on a linear basis over their estimated useful economic lives as follows:

	2005	2004
Leasehold improvements	4 years	5 years
Software	3 years	4 years
Other intangible assets	4 years	5 years

o) Impairment of non-financial assets

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

p) Provisions

Provisions for liabilities and charges are maintained at the level that the Bank's management considers sufficient for absorption of incurred losses. The management determines the sufficiency of provisions on the basis of insight into specific items, current economic circumstances, risk characteristics of certain transaction categories, as well as other relevant factors.

r) Share capital and reserves

Share capital is stated in HRK at nominal value. The amount of consideration paid on repurchase of share capital, including directly attributable costs, is recognised as a deduction from equity and classified as treasury shares.

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

The Bank recognises a reserve for general banking risks, which represents a reserve for potential losses in excess of those expected and provided for through recognised impairment losses. The reserve is calculated in accordance with applicable regulations which require that a certain percentage of net profit for the year be set aside as a reserve within equity if the growth of risk assets on an annual basis exceeds a specific level. The reserve for general banking risk cannot be transferred to retained earnings or other reserves or be otherwise distributed until the expiry of a consecutive three year period in which the Bank has recorded annual growth not exceeding 20%.

s) Off-balance sheet commitments and contingent liabilities

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

t) Managed funds for and on behalf of third parties

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

u) Segment reporting

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

2. CHANGES IN ACCOUNTING POLICIES

Changes in accounting policies for financial instruments

The Bank has reviewed its portfolio of financial instruments held at 1 January 2005 and has redesignated these financial instruments in accordance with the categories defined by the revised version of International Accounting Standard 39 "Financial Instruments: Recognition and Measurement" published in late 2003 and amended in the first quarter of 2004 ("IAS 39"), as follows:

- Part of debt securities previously classified as originated loans and receivables for which a quoted price existed on an active market and which had been measured at amortised cost in the amount of HRK
- 1,128,318 thousand were reclassified as financial assets available for sale. This reclassification resulted in gains recognised directly in a fair value reserve in equity in the amount of HRK 7,036 thousand, net of tax. The remaining part of debt securities previously classified as originated loans and receivables in the amount of HRK 23,657 thousand was reclassified as financial assets at fair value through profit or loss. The fair value approximated the amortised cost as of 31 December 2004.
- The effects of fair value changes of available for sale financial assets were previously recognised in the income statement. From 1 January 2005, the Bank has changed its accounting policy to recognise unrealised gains and losses in respect of available-for-sale financial assets directly in the fair value reserve in equity, in accordance with the requirements of IAS 39 applicable from that date. In accordance with the revised version of International Accounting Standard 8 "Accounting Policies, Changes in Accounting Estimates and Errors", published in late 2003 and applicable from 1 January 2005, the Bank has applied this change of policy retrospectively.
- As a result of the retrospective application of the changes in accounting policies described above, restated retained earnings as of 1 January 2004 are HRK 1,409 thousand lower and the restated fair value reserve is HRK 1,409 thousand higher, net of tax, than as reported in the financial statements for the prior period. In addition, restated profit for the year ended 31 December 2004 is HRK 1,410 thousand higher and the movement for the year on the restated fair value reserve is lower by a corresponding amount, than as reported in the financial statements for the prior period.
- The Bank did not have any held-to-maturity financial instruments at 31 December 2004.

Other reclassification effects

The Bank has reclassified certain amounts as at and for the year ended 31 December 2004 to achieve consistency with current year classifications. There was no effect on profit for the year or equity.

The major changes relate to the following:

- Provisions for management bonuses totalling HRK 2,500 thousand were reclassified from provisions for liabilities and charges to other liabilities in the balance sheet with a corresponding decrease of expense on provisions for liabilities and charges and increase of general and administrative expenses in the income statement.
- Loans and advances to customers have been increased by HRK 1,842 thousand to reflect the reclassification of credit card receivables from other assets to loans and advances to customers.
- Property, plant and equipment and intangible assets have been increased in the total amount of HRK 22,620 thousand to reflect the reclassification of prepayments from other assets.

Restatement of previously reported amounts

The effect on the balance sheet and income statement as at and for the year ended 31 December 2004, resulting from the retrospective application of the changes in accounting policies and other reclassifications described above, is summarised in the table below. The effect of the opening balances within equity of retained earnings and the fair value reserve at 1 January 2004 is disclosed in the statement of changes in equity.

Balance sheet

ASSETS	2004 as reported HRK'000	Changes in accounting policies HRK'000	Other reclassification effects HRK'000	Restated 2004 HRK'000
Cash and receivables from banks	531,402	-	-	531,402
Obligatory reserve with Croatian National Bank	512,317	-	-	512,317
Placements and loans to other banks	378,125	-	-	378,125
Financial assets at fair value through profit or loss	103,625	23,657	-	127,282
Financial assets available for sale	101,145	1,128,318	-	1,229,463
Loans and advances to customers	2,573,504	-	1,842	2,575,346
Debt securities classified as originated loans and receivables	1,143,180	(1,143,180)	-	-
Property, plant and equipment and intangible assets	129,289	-	22,620	151,909
Other assets	74,735	-	(24,462)	50,273
Total assets	**5,547,322**	**8,795**	**-**	**5,556,117**
LIABILITIES				
Deposits from banks	46,937	-	-	46,937
Deposits from customers	4,318,282	-	-	4,318,282
Borrowings	349,924	-	-	349,924
Provisions for liabilities and charges	20,060	-	(2,500)	17,560
Deferred tax liability	-	1,407	-	1,407
Other liabilities	157,231	352	2,500	160,083
Current tax liability	5,871	-	-	5,871
Total liabilities	**4,898,305**	**1,759**	**-**	**4,900,064**
EQUITY				
Share capital	584,780	-	-	584,780
Treasury shares	(874)	-	-	(874)
Statutory reserve	3,212	-	-	3,212
Fair value reserve	-	7,036	-	7,036
Retained earnings	61,899	-	-	61,899
Total equity	**649,017**	**7,036**	**-**	**656,053**
Total liabilities and equity	**5,547,322**	**8,795**	**-**	**5,556,117**

Income statement

	2004 as reported HRK'000	Changes in accounting policies HRK'000	Other reclassification effects HRK'000	Restated 2004 HRK'000
Interest and similar income	324,690	(969)	-	323,721
Interest expense and similar charges	(79,852)			(79,852)
Net interest income	**244,838**	**(969)**	**-**	**243,869**
Fee and commission income	584,979	-	-	584,979
Fee and commission charges	(534,007)	-	-	(534,007)
Net fee and commission income	**50,972**	**-**	**-**	**50,972**
Gains less losses arising from dealing securities	4,381	-	-	4,381
Gains less losses arising from investment securities	3,534	2,731	-	6,265
Gains less losses arising from dealing in foreign currencies	17,346	-	-	17,346
Other operating income	2,222	(704)	-	1,518
Dealing and other income	**27,483**	**2,027**	**-**	**29,510**
Operating income	**323,293**	**1,058**	**-**	**324,351**
General and administrative expenses	(138,027)	-	(2,500)	(140,527)
Depreciation	(17,177)	-	-	(17,177)
Impairment losses on loans and advances to customers and other assets	(96,546)	-	-	(96,546)
Provisions for liabilities and charges	(6,843)	-	2.500	(4,343)
Operating expenses	**(258,593)**	**-**	**-**	**(258,593)**
Profit before tax	**64,700**	**1,058**	**-**	**65,758**
Income tax expense	(5,871)	352	-	(5,519)
Profit for the year	**58,829**	**1,410**	**-**	**60,239**
Earnings per share (in HRK)	**110.83**	**2.65**	**-**	**113.48**

3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

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

Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. In accordance with CNB regulations, the need for impairment of the Bank's on- and off-balance-sheet credit risk exposure is assessed at least quarterly. Impairment losses are made mainly against the carrying value of loans and advances to corporate and retail customers (summarized in Note 9), and as provisions for liabilities and charges arising from off-balance-sheet risk exposure to customers, mainly in the form of guarantees and documentary letters of credits (summarised in Notes 18 and 33). Impairment losses are also considered for credit risk exposures to banks, and for other assets not carried at fair value, where the primary risk of impairment is not credit risk.

	Notes	2005 HRK '000	Restated 2004 HRK '000
Summary of impairment losses for customers			
Impairment losses on loans and advances to customers	9	271,172	252,411
Provisions for off-balance-sheet exposure	18	13,734	7,315
Total		**284,906**	**259,726**

Financial assets carried at amortised cost

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

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

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

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

	2005 HRK'000			Restated 2004 HRK'000		
	Corporate	Retail	Total	Corporate	Retail	Total
Gross value of exposure	247,985	37,294	285,279	239,833	40,282	280,115
Impairment rate	76%	87%	77%	67%	83%	69%

Each additional increase of one percentage point in the impairment rate on the gross portfolio at 31 December 2005 would lead to the recognition of an additional impairment loss of HRK 2,853 thousand.

The Bank also seeks to recognise impairment losses which are known to exist at the balance sheet date, but which have not yet been specifically identified. In estimating unidentified impairment losses existing in collectively assessed portfolios, and in the absence of reliable data on historical loss rates and the emergence period for the identification of these impairment losses, the Bank also has regard to the range of impairment loss rates of 0.85% to 1.20% prescribed by the CNB to be calculated on all credit risk exposures except those carried at fair value, including off-balance-sheet amounts (including undrawn lending and credit card commitments) and Croatian sovereign risk. Amounts assessed as impaired on an individual basis are excluded from this calculation.

The amount of impairment losses at 31 December 2005 estimated on a portfolio basis amounted to HRK 64,524 thousand (2004: HRK 65,576 thousand) of the relevant on- and off-balance-sheet exposure. The total of these portfolio based impairment losses amounted to 2.22% of loans and advances to customers (2004: 2.47%) and to 1% (2004: 1.20%) of on- and off-balance-sheet exposure, in both cases net of amounts individually assessed as impaired.

At the minimum rate prescribed by the CNB, portfolio based impairment loss would be HRK 9,678 thousand (2004: HRK 19,126 thousand) lower than the amount recognised by the Bank. At the maximum rate prescribed by the CNB, portfolio based impairment allowances would be HRK 12,905 thousand (2004: nil) higher than the amount recognised by the Bank.

Fair value of treasury bills

The Bank determines the fair value of treasury bills issued by the Ministry of Finance of the Republic of Croatia, using an internal model which considers their remaining maturity and the latest available auction prices of equivalent instruments. As at 31 December 2005, the carrying amount of treasury bills classified as financial assets at fair value through profit or loss of financial assets available for sale was to HRK 1,607,617 thousand (2004: HRK 831,827 thousand).

Fair value of the financial instruments quoted in an active market

In estimating the fair value of quoted financial instruments, the Bank does not use closing prices at the date of estimation, but applies average prices which are based on the individual transaction volumes of the specified instruments during the day of estimation. In the opinion of the Bank's management, this method provides a more realistic indication of the real price of the instrument, and decreases the risk of inadequate or inappropriate estimation of fair value which may result from limited trading in the instrument just before the end of the trading period, at a price which significantly differs from the daily average. The application of this policy resulted in financial assets at fair value through profit or loss of HRK 265,853 thousand being carried at amounts HRK 188 thousand higher, and financial assets available for sale of HRK 257,433 thousand being carried at amounts HRK 432 thousand lower at 31 December 2005, than had closing prices been applied.

Provisions for court cases initiated against the Bank, severance payments and jubilee awards

In calculating provisions for court expenses, severance payments and jubilee awards, the Bank discounts expected future cash flows in respect of the liabilities, using discount rates that, in opinion of the Bank's management, best represent the time value of money.

4. CASH AND RECEIVABLES FROM BANKS

	2005 HRK '000			Restated 2004 HRK '000		
	In HRK	In foreign currency	Total	In HRK	In foreign currency	Total
Cash in hand						
Held by the Bank	37,670	12,883	50,553	35,031	7,493	42,524
Held by other parties	170,686	-	170,686	205,970	-	205,970
Cheques in the course of collection	-	3	3	-	102	102
	208,356	**12,886**	**221,242**	**241,001**	**7,595**	**248,596**
Receivables from banks						
Current accounts with domestic banks	-	2,674	2,674	-	6,979	6,979
Current accounts with foreign banks	-	18,610	18,610	-	10,006	10,006
Giro account with the CNB	146,163	-	146,163	265,821	-	265,821
Total	**354,519**	**34,170**	**388,689**	**506,822**	**24,580**	**531,402**

5. OBLIGATORY RESERVE WITH CROATIAN NATIONAL BANK

			2005 HRK '000			Restated 2004 HRK '000
	In HRK	In foreign currency	Total	In HRK	In foreign currency	Total
Obligatory reserve	611,571	53,842	665,413	466,105	45,675	511,780
Marginal obligatory reserve	-	19,531	19,531	-	-	-
Interest receivable - due	388	-	388	496	-	496
Interest receivable - not due	12	22	34	-	41	41
Total	**611,971**	**73,395**	**685,366**	**466,601**	**45,716**	**512,317**

The obligatory reserve represents amounts required to be deposited with the CNB.

At 31 December 2005, the obligatory reserve requirement amounted to 18% (2004: 18%) of kuna and foreign currency deposits, borrowings and issued debt securities.

At 31 December 2005, the required minimum rate of maintenance of the kuna obligatory reserve with the CNB amounted to 70% (2004: 60%), while the remaining 30% (2004: 40%) could be held in the form of other liquid receivables. This includes the part of foreign currency obligatory reserve required to be held in HRK (see below).

60% of foreign currency obligatory reserve (2004: 60%) is required to be held with the CNB, while the remaining 40% (2004: 40%) may be held in the form of other liquid receivables, after adjusting for the obligatory reserve requirement arising from foreign currency funds from non-residents and related parties (which is required to be held in full with the CNB). 50% (2004: 42%) of the foreign currency obligatory reserve is required to be held in HRK and is added to the kuna obligatory reserve.

In June 2005, the annual interest rate on the obligatory reserve payable by the CNB decreased from 1.25% to 0.75%.

In 2005, the marginal obligatory reserve requirement, whereby banks have to maintain funds on a non-interest earning account with the CNB, amounted to 40% (2004: 24%) of the net increase in liabilities to non-residents and related parties, from June 2004, when this requirement was introduced.

6. PLACEMENTS WITH AND LOANS TO OTHER BANKS

	2005 HRK '000	Restated 2004 HRK '000
Short-term placements with domestic banks	237,820	-
Short-term placements with foreign banks	310,851	238,045
Short-term loans to domestic banks	-	140,000
Total short-term placements and loans	**548,671**	**378,045**
Guarantee deposits with foreign banks	89,254	-
Long-term placements with domestic banks	17,000	-
Total long-term placements and loans	**106,254**	**-**
Interest receivable - due	-	51
Interest receivable - not due	2,540	29
Total interest receivable	**2,540**	**80**
Total	**657,465**	**378,125**

Guarantee deposits with foreign banks include an amount of HRK 88,508 thousand, pledged as collateral for the repayment of long-term borrowing repayable in 17 instalments from 14 September 2007 to 14 September 2015.

The long-term placement amounting to HRK 17,000 thousand was placed for a five year period maturing in March 2010 at a fixed interest rate amounting to 6.75% per annum.

7. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2005 HRK '000	Restated 2004 HRK '000
Ministry of Finance treasury bills	1,126,878	-
Croatian Bank for Reconstruction and Development bonds	32,025	33,732
Ministry of Finance bonds	199,759	57,478
Corporate bonds and commercial paper	25,670	23,683
Debt securities, quoted on active markets	**1,384,332**	**114,893**
Investments in investment funds, quoted on active markets	**35,341**	**-**
Equity securities, quoted on active markets	**13,182**	**10,248**
Interest receivable - not due	5,645	2,141
Total	**1,438,500**	**127,282**

At 31 December 2005 and 31 December 2004 the Bank did not had any financial instruments designated as trading instruments.

8. FINANCIAL ASSETS AVAILABLE FOR SALE

	2005 HRK '000	Restated 2004 HRK '000
Debt securities, quoted on active markets		
Ministry of Finance treasury bills	480,739	831,827
Ministry of Finance bonds	257,433	178,990
Corporate bonds	-	4,610
Bills of exchange	179,800	209,708
	917,972	**1,225,135**
Equity securities, non quoted on active markets		
- corporate	790	229
- non-banking financial institutions	84	60
Impairment loss of equity securities	-	(189)
	874	**100**
Interest receivable - not due	2,814	4,228
Total	**921,660**	**1,229,463**

Movement in impairment losses

The movement in the impairment losses on equity securities, recognised in the income statement, is as follows:

	2005 HRK '000	Restated 2004 HRK '000
Balance as at 1 January	189	189
Release of impairment loss of equity securities	(189)	-
Balance as at 31 December	**-**	**189**

9. LOANS AND ADVANCES TO CUSTOMERS

	2005 HRK '000	Restated 2004 HRK '000
Short-term loans		
Corporate	1,423,731	1,717,716
Retail	331,497	195,900
Total short-term loans	**1,755,228**	**1,913,616**
Long-term loans		
Corporate	831,942	530,344
Retail	610,570	367,947
Total long-term loans	**1,442,512**	**898,291**
Interest receivable - due	15,190	15,401
Interest receivable - not due	1,131	449
Total gross amounts	**3,214,061**	**2,827,757**
Impairment losses	**(271,172)**	**(252,411)**
Total	**2,942,889**	**2,575,346**

Loans and advances to customers also include embedded derivative related to one-way currency clause in the amount of HRK 3,789 thousand (2004: HRK 10,813 thousand). .

Movement in impairment losses

The movement in impairment losses on loans and advances to customers is presented as follows:

	2005 HRK '000	Restated 2004 HRK '000
Balance at 1 January	252,411	159,092
Net charge to income statement for impairment losses	16,815	95,050
Net losses from foreign exchange rate differences	1,946	1,032
Usage	-	(2,763)
Balance at 31 December	**271,172**	**252,411**

Concentration of credit risk by industry

Commercial lending is concentrated on companies and individuals domiciled in Croatia. An analysis of the concentration of credit risk by industry of loans and advances to companies is presented below:

	2005 HRK '000	Restated 2004 HRK '000
Agriculture and forestry	51,780	24,113
Industry	846,749	628,719
Construction	527,305	88,863
Transport, storage and communications	98,842	114,868
Trade	380,046	256,780
Tourism	96,532	90,876
Services	88,349	20,238
Ministry of Finance	78,285	1,016,000
Other	87,785	7,603
Total gross loans and advances to companies	**2,255,673**	**2,248,060**
Loans and advances to individuals (gross)	**942,067**	**563,847**
Interest receivable	16,321	15,850
Allowance for impairment losses	(271,172)	(252,411)
Total	**2,942,889**	**2,575,346**

10. INVESTMENTS IN SUBSIDIARIES

	2005 HRK '000	Restated 2004 HRK '000
HPB–Invest d.o.o.	5,000	-
HPB–nekretnine d.o.o.	50	-
Total investments in subsidiaries	**5,050**	**-**

In 2005, the Bank founded HPB Invest d.o.o., an investment fund management company and HPB Nekretnine d.o.o., a real estate company. Both companies are 100% owned by the Bank and are domiciled in Croatia.

11. PROPERTY, PLANT AND EQUIPMENT

2005	Land and buildings HRK '000	Computers, equipment and motor vehicles HRK '000	Assets in the course of construction HRK '000	Total HRK '000
Gross carrying amount				
Balance at 1 January 2005	123,710	74,959	19,665	218,334
Additions	24	-	36,348	36,372
Disposals	-	(11)	-	(11)
Transfers	1,270	32,251	(33,521)	-
Balance at 31 December 2005	**125,004**	**107,199**	**22,492**	**254,695**
Accumulated depreciation				
Balance at 1 January 2005	(31,130)	(45,227)	-	(76,357)
Charge for the year	(3,095)	(17,912)	-	(21,007)
Balance at 31 December 2005	**(34,225)**	**(63,139)**	**-**	**(97,364)**
Carrying amount				
Balance at 31 December 2005	**90,779**	**44,060**	**22,492**	**157,331**
Balance at 1 January 2005	92,580	29,732	19,665	141,977

2004 Restated	Land and buildings HRK '000	Computers, equipment and motor vehicles HRK '000	Assets in the course of construction HRK '000	Total HRK '000
Gross carrying amount				
Balance at 1 January 2004	122,976	60,619	5,868	189,463
Additions	-	19,268	14,531	33,799
Disposals	-	(4,928)	-	(4,928)
Transfers	734	-	(734)	-
Balance at 31 December 2004	**123,710**	**74,959**	**19,665**	**218,334**
Accumulated depreciation				
Balance at 1 January 2004	(28,122)	(38,159)	-	(66,281)
Charge for the year	(3,008)	(11,968)	-	(14,976)
Disposals	-	4,900	-	4,900
Balance at 31 December 2004	**(31,130)**	**(45,227)**	**-**	**(76,357)**
Carrying amount				
Balance at 31 December 2004	**92,580**	**29,732**	**19,665**	**141,977**
Balance at 1 January 2004	94,854	22,460	5,868	123,182

The effect of change in depreciation rates in 2005, as disclosed in Note 1, is depreciation charge for the year of property, plant and equipment being higher by HRK 3,464 thousand.

Assets in the course of construction mainly relates to investments into equipment for credit card business.

12. INTANGIBLE ASSETS

2005	Sotware HRK '000	Leasehold improvements HRK '000	Licences HRK '000	Assets in the course of construction HRK '000	Total HRK '000
Gross carrying amount					
Balance at 1 January 2005	9,931	1,044	4,297	4,561	19,833
Additions	-	-	-	13,353	13,353
Transfers	2,088	6,195	4,551	(12,834)	-
Balance at 31 December 2005	**12,019**	**7,239**	**8,848**	**5,080**	**33,186**
Accumulated depreciation					
Balance at 1 January 2005	(6,813)	(402)	(2,686)	-	(9,901)
Charge for the year	(1,978)	(701)	(769)	-	(3,448)
Balance at 31 December 2005	**(8,791)**	**(1,103)**	**(3,455)**	**-**	**(13,349)**
Carrying amount					
Balance at 31 December 2005	**3,228**	**6,136**	**5,393**	**5,080**	**19,837**
Balance at 1 January 2005	3,118	642	1,611	4,561	9,932

2004 Restated	Sotware HRK '000	Leasehold improvements HRK '000	Licences HRK '000	Assets in the course of construction HRK '000	Total HRK '000
Gross carrying amount					
Balance at 1 January 2004	9,402	944	3,583	4,574	18,503
Additions	-	-	-	1,937	1,937
Disposals	(607)	-	-	-	(607)
Transfers	1,136	100	714	(1,950)	-
Balance at 31 December 2004	**9,931**	**1,044**	**4,297**	**4,561**	**19,833**
Accumulated depreciation					
Balance at 1 January 2004	(6,128)	(175)	(2,004)	-	(8,307)
Disposals	607	-	-	-	607
Charge for the year	(1,292)	(227)	(682)	-	(2,201)
Balance at 31 December 2004	**(6,813)**	**(402)**	**(2,686)**	**-**	**(9,901)**
Carrying amount					
Balance at 31 December 2004	**3,118**	**642**	**1,611**	**4,561**	**9,932**
Balance at 1 January 2004	3,274	769	1,579	4,574	10,196

The effect of change in depreciation rates in 2005, as disclosed in Note 1, is depreciation charge for the year of intangible assets being higher by HRK 741 thousand.

Assets in the course of construction as of 31 December 2005 mainly relates to investments into licences for credit card business.

13. NET DEFERRED TAX ASSET AND LIABILITY

Recognised deferred tax assets and liabilities

Movements in temporary differences and components of deferred tax assets and deferred tax liabilities are as follows:

	2005 HRK '000	Credited / (charged) to income statement HRK '000	Credited / (charged) to equity HRK '000	Restated 2004 HRK '000
Deferred tax assets				
Loans and advances to customers	2,417	2,417	-	-
Other provisions	2,636	2,636	-	-
Financial assets	721	369	-	352
Deferred tax liabilities				
Borrowings	(518)	(518)	-	-
Fair value reserve	(2,562)	-	(803)	(1,759)
Net deferred tax asset/(liability)	**2,694**	**4,904**	**(803)**	**(1,407)**

14. OTHER ASSETS

	2005 HRK '000	Restated 2004 HRK '000
Fees receivable	51,521	39,309
Foreclosed assets	1,376	1,376
Items in course of collection	1,861	3,419
Deferred fee expense	2,595	-
Prepaid expenses	4,843	818
Other receivables	5,566	6,963
Total gross amounts	**67,762**	**51,885**
Allowance for impairment losses	(4,317)	(1,612)
Total	**63,445**	**50,273**

Movement in allowance for impairment losses

The movement in the allowance for impairment of other assets is presented below:

	2005 HRK '000	Restated 2004 HRK '000
Balance at 1 January	1,612	258
Increase in impairment losses charged to the income statement	2,705	1,496
Usage of impairment losses	-	(142)
Balance at 31 December	**4,317**	**1,612**

15. DEPOSITS FROM BANKS

	2005 HRK '000			Restated 2004 HRK '000		
	In HRK	In foreign currency	Total	In HRK	In foreign currency	Total
Demand deposits	4,561	351	4,912	3,730	4,824	8,554
Term deposits	46,000	-	46,000	-	38,356	38,356
Interest payable - not due	28	-	28	-	27	27
Total	**50,589**	**351**	**50,940**	**3,730**	**43,207**	**46,937**

16. DEPOSITS FROM CUSTOMERS

	2005 HRK '000			Restated 2004 HRK '000		
	In HRK	In foreign currency	Total	In HRK	In foreign currency	Total
Demand deposits						
Retail	1,355,119	77,665	1,432,784	1,201,416	66,940	1,268,356
Corporate	1,138,856	207,249	1,346,105	1,107,679	156,506	1,264,185
Restricted deposits						
Retail	2,975	-	2,975	2,669	-	2,669
Corporate	671,364	29,834	701,198	776,052	19,666	795,718
	3,168,314	**314,748**	**3,483,062**	**3,087,816**	**243,112**	**3,330,928**
Term deposits						
Retail	348,243	447,407	795,650	233,529	284,842	518,371
Corporate	544,056	169,009	713,065	276,034	185,297	461,331
	892,299	**616,416**	**1,508,715**	**509,563**	**470,139**	**979,702**
Interest payable - due	10,517	-	10,517	5,474	-	5,474
Interest payable - not due	1,863	789	2,652	1,217	961	2,178
Total	**4,072,993**	**931,953**	**5,004,946**	**3,604,070**	**714,212**	**4,318,282**

Deposits denominated in HRK include HRK 245,977 thousand linked to foreign currency by revaluation clauses (2004: HRK 18,047 thousand).

17. BORROWINGS

	2005 HRK '000 In HRK	2005 HRK '000 In foreign currency	2005 HRK '000 Total	Restated 2004 HRK '000 In HRK	Restated 2004 HRK '000 In foreign currency	Restated 2004 HRK '000 Total
Short-term borrowings from other financial institutions	4,425	-	4,425	-	-	-
Short-term borrowings from domestic banks	589,000	-	589,000	-	-	-
Long-term borrowings from banks	-	254,459	254,459	-	-	-
Long-term borrowing from HBOR (kuna and foreign currency clause)	398,037	-	398,037	348,942	-	348,942
Other long-term liabilities - leasing	124	-	124	504	-	504
Interest payable due	1,928	1,902	3,830	186	-	186
Interest payable - not due	490	79	569	292	-	292
	994,004	**256,440**	**1,250,444**	**349,924**	**-**	**349,924**

In accordance with their terms, borrowings from the Croatian Bank for Reconstruction and Development ("HBOR") are used to fund loans to customers for eligible construction and development projects at preferential interest rates, and mostly include a one-way foreign currency clause which gives HBOR the option to revalue the borrowing at the current foreign exchange rate. This represents an embedded derivative which the Bank has not separated and has not stated at fair value. As a result of the application of these clauses, borrowings are carried at amounts HRK 562 thousand (2004: HRK 8,049 thousand) greater than had they been translated into HRK at the year end exchange rate disclosed in Note 1(c).

18. PROVISIONS FOR LIABILITIES AND CHARGES

	2005 HRK '000	Restated 2004 HRK '000
Provisions for retirement, severance payments and other liabilities	7,604	5,964
Provisions for court cases initiated against the Bank	7,860	4,190
Provisions for potential and other liabilities	1,197	91
Portfolio based provisions for off-balance-sheet risks	13,734	7,315
Balance at 31 December	**30,395**	**17,560**

Movement in allowance for impairment losses

The movement in provisions for liabilities and charges is as follows:

	2005 HRK '000	Restated 2004 HRK '000
Balance at 1 January	17,560	13,332
Increase in impairment losses charged to income statement	12,835	4,343
Usage	-	(115)
Balance at 31 December	**30,395**	**17,560**

19. OTHER LIABILITIES

	2005 HRK '000	Restated 2004 HRK '000
Suppliers	40,279	26,164
Salaries, deductions from salaries, taxes and contributions	16,105	7,143
Fees payable	35,654	28,565
Items in the course of settlement	46,143	67,262
Deferred fee income	12,087	2,902
Other liabilities	4,572	5,108
Liabilities for guarantees	20,246	22,939
Balance at 31 December	**175,086**	**160,083**

20. INTEREST AND SIMILAR INCOME

	2005 HRK '000	Restated 2004 HRK '000
Loans and advances to customers		
Corporate	136,672	169,101
Retail	68,260	49,646
	204,932	218,747
Placements with and loans to banks	23,647	13,757
Debt securities	98,579	63,551
Bills of exchange	17,242	18,511
Obligatory reserve with the Croatian National Bank	6,997	9,155
Total	**351,397**	**323,721**

21. INTEREST EXPENSE AND SIMILAR CHARGES

	2005 HRK '000	Restated 2004 HRK '000
Borrowings	18,767	6,953
Deposits from customers		
Corporate	46,573	45,573
Retail	36,336	26,683
	82,909	72,256
Deposits from banks	1,138	486
Other	110	157
Total	**102,924**	**79,852**

22. FEE AND COMMISSION INCOME

	2005 HRK ‘000	Restated 2004 HRK ‘000
Commissions from cash based payment transactions	465,674	501,631
Commissions from non-cash-based payment transactions	36,778	36,166
Commissions from retail and credit card business	41,938	37,070
Commissions from letters of credit, guarantees and foreign currency payment transactions	9,492	6,833
Other commissions	4,923	3,279
Total	**558,805**	**584,979**

23. FEE AND COMMISSION CHARGES

	2005 HRK ‘000	Restated 2004 HRK ‘000
Commissions on cash based payment transactions	427,544	467,797
Commissions on non-cash-based payment transactions	49,245	45,406
Commissions on credit card transactions	7,624	5,494
Other commissions	13,620	15,310
Total	**498,033**	**534,007**

24. GAINS LESS LOSSES ARISING FROM DEALING SECURITIES

	2005 HRK '000	Restated 2004 HRK '000
Gains less losses from financial assets at fair value through profit or loss		
Realised gains on disposal of debt securities	7,469	480
Realised gains on derivative instruments (classified as held for trading)	259	-
	7,728	**480**
Unrealised gains		
- Debt securities	5,645	1,921
- Investment funds	420	-
- Equity securities	2,935	1,980
	9,000	**3,901**
Total	**16,728**	**4,381**

25. GAINS LESS LOSSES ARISING FROM INVESTMENT SECURITIES

	2005 HRK '000	Restated 2004 HRK '000
Gains less losses arising from available-for-sale securities		
Realised gains on disposal of debt securities	9,462	6,265
Total	**9,462**	**6,265**

26. OTHER OPERATING INCOME

	2005 HRK '000	Restated 2004 HRK '000
Dividend income	277	298
Exchange rate differences from the revaluation of monetary assets and liabilities, net	266	153
Derecognition of liabilities on dormant customer accounts	6,145	175
Other income	1,608	892
Total	**8,296**	**1,518**

27. GENERAL AND ADMINISTRATIVE EXPENSES

	2005 HRK '000	Restated 2004 HRK '000
Materials and services	48,623	31,881
Administration and marketing	15,928	6,323
Post and telecommunications	24,816	20,505
Net salaries	42,761	32,208
Taxes and contributions (including employer's contributions)	42,301	32,869
Other payments to employees	2,433	1,719
Fees to Supervisory Board members	494	582
Deposit insurance expenses	9,014	8,443
Other general and administrative costs	8,092	5,997
Total	**194,462**	**140,527**

At 31 December 2005, the Bank had 446 employees (2004: 306).

28. INCOME TAX

Total recognised income tax expense calculated at the income tax rate of 20%, comprises income tax expense recognised in the income statement and movements in income tax liabilities recognised directly in equity, as follows:

Income tax expense recognised in the income statement

	2005 HRK '000	Restated 2004 HRK '000
Current income tax expense	(25,620)	(5,871)
Deferred tax income relating to the origination and reversal of temporary differences	4,904	352
Total income tax expense in income statement	**(20,716)**	**(5,519)**

Movement in income tax liabilities recognised directly in equity

	2005 HRK '000	Restated 2004 HRK '000
Deferred tax charges relating to unrealised gains on available-for sale investments recognised in fair value reserves	**(803)**	**(1,407)**

Reconciliation of income tax expense

The reconciliation between tax expense and accounting profit is shown as follows:

	2005 HRK '000	Restated 2004 HRK '000
Profit before tax	110,878	65,758
Income tax at 20%	(22,176)	(13,152)
Expenses not deductible for tax purposes	(553)	(1,754)
Income not subject to tax	2,013	403
Utilisation of tax losses from previous periods, not previously recognised as a deferred tax asset	-	8,984
	(20,716)	**(5,519)**
Effective income tax rate	18.7%	8.4%

The increase in the effective income tax rate is mainly attributable to the utilisation in 2004 of tax losses from previous periods, which had not been recognised as a differed tax asset. No such losses are available in 2005.

29. EARNINGS PER SHARE

	2005 HRK '000	Restated 2004 HRK '000
Profit for the year attributable to ordinary shareholders	90,162	60,239
Average number of ordinary shares in issue (excluding treasury shares	530,823	530,823
Earnings per share (in HRK)	169.85	113.48

30. EQUITY

a) Share capital

As at 31 December 2005 and 2004, authorised, issued and fully paid ordinary share capital amounted to HRK 584,779,800 and comprised 531,618 approved ordinary shares with a nominal value of HRK 1,100 each. The holders of the ordinary shares are entitled to receive dividends as declared at the General Assembly of Shareholders and are entitled to one vote per share

	31 December 2005		31 December 2004	
	Paid capital HRK'000	Ownership %	Paid capital HRK'000	Ownership %
Croatian Privatisation Fund	216,354	37.00%	216,354	37.00%
Croatian Post	196,231	33.56%	196,231	33.56%
Croatian Pension Fund	163,811	28.01%	163,811	28.01%
Other	8,384	1.43%	8,384	1.43%
Total	**584,780**	**100.00%**	**584,780**	**100.00%**

b) Statutory reserve

The Bank is required to build a statutory reserve by appropriating 5% of net profit for the year until the reserve reaches 5% of share capital. Following a transfer from retained earnings of HRK 4,508 thousand, representing 5% of the profit for the year, the balance on the statutory reserve at 31 December 2005 amounted to HRK 7,720 thousand, or 1.32% of share capital. No adjustment to the statutory reserve has been made in respect of the amounts by which profits for prior years have been restated nor has any transfer been made for amounts of total recognised income for the year and for prior years not recognised in the income statement. The statutory reserve may be used to cover prior period losses if the losses are not covered by current year profits or if other reserves are not available.

c) General banking reserve

In accordance with CNB regulations, the Bank is required to create and maintain provisions for general banking risks, as a result of the rapid growth of the Bank's balance sheet and off-balance-sheet exposure and increased exposure to risks. As a result of an increase in certain categories of risk exposure by more than 50% from 31 December 2004 to 2005, the Bank has recognised a reserve for general banking risks in the amount of HRK 31,609 thousand (2004: Nil) as an appropriation within equity from retained earnings.

d) Proposed dividends

Dividends payable are not accounted for until they have been ratified at the General Assembly of Shareholders. Management will not propose any dividend payment for the year ended 31 December 2005 (2004: Nil).

31. CONCENTRATION OF ASSETS AND LIABILITIES

The assets and liabilities of the Bank are significantly concentrated on amounts directly due from and to the Republic of Croatia. The amounts at year end, including off-balance-sheet exposure, are as follows:

	Notes	2005 HRK '000	Restated 2004 HRK '000
Giro account with the CNB	4	146,163	265,821
Obligatory reserve with the CNB	5	685,366	512,317
Bonds issued by the Republic of Croatia		464,641	241,594
Ministry of Finance treasury bills	7, 8	1,607,617	831,827
Loans and advances to the Republic of Croatia		84,251	1,028,341
Deposits from the Republic of Croatia		(924,045)	(1,084,441)
Repurchase agreement with the CNB		(589,229)	-
Undrawn lending commitments		400,000	72,000
Total		**1,874,764**	**1,867,459**

The Bank's exposure towards local government and state institutions not directly funded by the State Budget (excluding state owned companies) is presented below:

	2005 HRK '000	Restated 2004 HRK '000
Loans and advances	2,309	-
Deposits	(325,958)	(157,846)
Total	**(323,649)**	**(157,846)**

32. CASH AND CASH EQUIVALENTS

	Notes	2005 HRK '000	Restated 2004 HRK '000
Cash and receivables from banks	4	388,689	531,402
Obligatory reserve with Croatian National Bank	5	685,366	512,317
Placements to banks with original maturity up to 90 days		526,211	378,125
Items in course of collection	14	1,861	3,419
Total		**1,602,127**	**1,425,263**

33. COMMITMENTS AND CONTINGENCIES

	2005 HRK '000	Restated 2004 HRK '000
Guarantees denominated in HRK	186,765	51,276
Guarantees denominated in foreign currencies	6,305	886
Letters of credit	55,507	34,068
Accepted bills of exchange	-	437
Undrawn lending commitments	1,122,533	522,992
Other off balance sheet items	2,250	-
Total	**1,373,360**	**609,659**

At 31 December 2005, the Bank recognised portfolio based provisions for off-balance-sheet risks arising from the issue of guarantees, letters of credit and undrawn lending commitments, in the amount of HRK 13,734 thousand, which are included in provisions for liabilities and charges (2004: HRK 7,315 thousand) (see Note 18).

34. RELATED PARTY TRANSACTIONS

The Bank is the parent of the HPB Group. The key shareholders of the Bank and of the Group are the Croatian Privatisation Fund, Hrvatska pošta d.d. ("Croatian Post") and Hrvatski zavod za mirovinsko osiguranje ("HZMO") which together owned 98.57 % (2004: 98.57 %) of the Bank's shares at year end. The remaining 1.43% (2004: 1.43%) of the shares are publicly held. The Bank considers that it has an immediate related party relationship with its key shareholders; its subsidiaries and the investment funds managed by one of its subsidiaries, HPB Invest d.o.o.; the Supervisory and Management Board members and other executive management (together "key management personnel"); close family members of key management personnel; and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members, in accordance with the definitions contained in International Accounting Standard 24 "Related Party Disclosures" ("IAS 24").

a) Key transactions with immediate related parties

Croatian Post performs domestic payment transactions for and on behalf of the Bank. Risk exposure to Croatian Post mainly comprises fees receivable based on domestic payment transactions performed for an on behalf of the Bank. Liabilities towards Croatian Post are mainly in respect of demand and term deposits. Expenses include commission expense for services provided and interest expense payable on its deposits with the Bank.

Income from HZMO arises from services provided in respect of payment of pensions and other fees payable by HZMO. Liabilities comprise HZMO demand deposits in kuna.

Risk exposure to HPB Invest mainly comprises investments into investment funds managed by HPB Invest. The Bank processes payment transactions for its subsidiaries, for which it recognises income. Expenses payable to HPB Nekretnine are based on services for collateral evaluation provided by that subsidiary.

Key management personnel (directors of main organisational departments) held no ordinary shares at the year-end (2004: nil shares).

Included in loans and receivables are HRK 13,765 thousand (2004: HRK 2,043 thousand) in respect of loans and advances granted to key management personnel.

During 2005 the Bank collected HRK 247 thousand (2004: HRK 113 thousand) of interest from these loans at interest rate 4% - 7.5% (2004: 6% - 7.5%).

b) Amounts arising from transactions with immediate related parties

Assets and liabilities and off-balance-sheet exposure and income and expense as at and for the year ended 31 December 2005, arising from key transactions with related parties were as follows:

	Exposure* HRK'000	Liabilities HRK'000	Income HRK'000	Expense HRK'000
Key shareholders				
Croatian Post	73,118	183,434	2,247	355,696
HZMO	2,986	33,024	35,257	273
Subsidiaries				
HPB Invest	42,515	534	5	7
HPB Nekretnine	550	108	1	363
Key management personnel				
Short-term benefits (bonuses, salaries and fees)	750	2,093	7	21,657
Long-term benefits	13,015	862	267	44
Severance payments	-	-	-	4
Companies under significant influence	46,342	5,310	758	24
Total	**179,276**	**225,365**	**38,542**	**378,068**

Exposure* comprises unpaid loans, commitments and contingencies, interest and other receivables, and includes HRK 26,963 thousand of off balance sheet receivables, whereof HRK 26,350 thousand relates to Croatian Post and key management personnel.

c) State owned companies

The three major shareholders of the Bank, who together own 98.57% of its shares, are state agencies or state owned companies, all mainly funded from the State Budget. Accordingly, transactions and balances with other state owned companies, including credit risk exposures guaranteed by the state, also represent related party relationships. The Bank has extensive banking relationships with such companies.

35. REPURCHASE AND RESALE AGREEMENTS

The Bank raises funds by selling financial instruments under agreements to repay the funds by repurchasing the instruments at future dates at the same price plus interest at a predetermined rate.

Repurchase agreements are commonly used as a tool for short-term financing of interest-bearing assets, depending on the prevailing interest rates. The financial instruments sold are not derecognised and the proceeds are accounted for as interest bearing borrowings. At 31 December 2005 assets sold under repurchase agreements were as follows:

	Fair value of underlying underlying assets HRK '000	Carrying amount of corresponding liabilities HRK '000	Repurchase date	Repurchase price HRK '000
Debt securities at fair value through profit or loss				
2005	613,446	593,656	January 2006	593,889
2004	-	-	-	-

The Bank also purchases financial instruments under agreements to resell them at future dates ("reverse repurchase agreements"). The seller commits to repurchase the same or similar instruments at an agreed future date. Reverse repurchase agreements are entered into as a facility to provide funds to customers and are accounted for as loans and advances to customers; the underlying financial instruments are not recognised. At 31 December 2005 assets purchased subject to agreements to resell them were as follows:

	Carrying amount of corresponding receivable HRK '000	Fair value of assets held as collateral HRK '000	Repurchase date	Repurchase price HRK '000
Loans and advances to customers				
2005	7,525	8,023	February 2006	7,597
2004	-	-	-	-

36. SUBSEQUENT EVENTS

Subsequent to the year end and in the period prior to issue of these financial statements, the CNB visited the Bank as a part of its regular supervision of the Bank's financial and operational performance for 2005. The CNB has the power to request amendments to the financial statements following the results of its inspection. The CNB had not issued its final report as of the date of release of these financial statements, and the Bank's management is not aware of any potential adjustments that may arise as a result.

37. MANAGED FUNDS FOR AND ON BEHALF OF CORPORATE AND RETAIL CUSTOMERS

The Bank manages funds for and on behalf of corporate and retail customers. Income and expenses from these activities are charged to customers and no liability falls on the Bank. In 2005, the Bank realised HRK 4,244 thousand of fee income (2004: HRK 3,870 thousand). Funds under management at year end amounted to HRK 617 million (2004: HRK 596 million).

38. RISK MANAGEMENT POLICIES

Details of the Bank's exposure to risk and methods used by management to control risk are described below. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate risk and equity price risk.

An integrated system of risk management is being established by introducing policies and procedures, and determining the limits of risk levels acceptable to the Bank. The limits are set according to the amount of regulatory capital and apply to all types of risk. Methodologies and models for managing operational risk have been developed.

Credit risk

The Bank is subject to credit risk through its lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties.

The risk that counterparties to financial instruments might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the Bank deals with counterparties of good credit standing, and when appropriate, obtains collateral.

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets. In addition the Bank is exposed to off-balance-sheet credit risk through commitments to extend credit and guarantees issued, which is presented in Note 33.

The Bank manages its credit risk exposure in accordance with the adopted policies. Credit exposures to portfolios and banks are reviewed on a regular basis taking into account limits set. Credit risk exposure by portfolio and to individual banks and customers is regularly checked, in accordance with existing limits. All breaches are reported to the relevant authorised decision making levels of the Bank.

The Credit Committee meets once a week or, if necessary, on a more frequent basis. Its members comprise the Chief Financial Officer, the Executive Director of the Corporate Division and the Executive Director of the Risk Management Division. The Credit Committee authorises each significant increase in credit exposure. The Credit Committee monitors changes in credit exposure and reviews impairment losses. The Bank applies prudent methods and models in evaluating credit risk. It is the Bank's policy to require adequate collateral from its customers before granting a loan. Collateral for loans, guarantees and letters of credit is usually in the form of charges over cash, stock, quoted securities, real estate and other assets.

Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of its positions. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate timeframe.

The Bank has access to a diverse funding base. Funds are raised using a broad range of instruments including deposits, borrowings and share capital. The Bank continually assesses liquidity risk by identifying and monitoring changes in the level of funding required to meet business goals and strategic targets. In addition the Bank holds a portfolio of liquid assets as part of its liquidity risk management.

The Bank adjusts its business activities in compliance with liquidity risk legislation and internal policies for the maintenance of liquidity reserves, matching of liabilities and assets, setting of position limits and achievement of preferred liquidity ratios. Treasury Division is responsible for both the management of the Bank's own liquidity and transactions on behalf of customers.

Market risk

All dealing instruments are subject to market risk, that is, the risk that future changes in market conditions may make an instrument less valuable or more onerous. Dealing financial instruments are recognised at fair value, and all changes in market conditions directly affect dealing income. The Bank manages its use of dealing instruments in response to changing market conditions. Exposure to market risk is formally managed in accordance with risk limits set by senior management by buying or selling instruments.

Currency risk

The Bank is exposed to currency risk through transactions in foreign currencies. Foreign currency exposure arises from credit, deposit-taking, investment and dealing activities. It is monitored daily in accordance to legislation and internally set limits, for each currency and for the total balance sheet denominated in or linked to foreign currency.

The Bank directs its business activities trying to minimise the gap between assets and liabilities denominated in or linked to foreign currency.

Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices.

Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies.

Asset-liability risk management activities are conducted in the context of the Bank's sensitivity to interest rate changes. Exposure to interest rate risk is monitored and measured using repricing maturity gap analysis.

Equity price risk

Equity price risk is the possibility that equity prices will fluctuate, affecting the fair value of equity investments and other instruments that derive their value from a particular equity investment. The primary exposure to equity prices arises from equity securities available for sale.

Regulatory requirements

The Bank is required to comply with regulations of the Croatian National Bank which prescribe limits and other restrictions related to minimum capital adequacy, classification of loans and contingent liabilities in the off-balance sheet records, as well as provisions to offset credit risk, liquidity risk, interest rate risk and risks related to foreign exchange position.

39. CURRENCY RISK

At 31 December 2005, the amount of total assets and liabilities denominated in HRK and foreign currencies were as follows:

HRK '000	HRK	HRK with foreign currency clause	EUR	Other foreign currencies	Total
ASSETS					
Cash and receivables from banks	354,519	-	25,873	8,297	**388,689**
Obligatory reserve with Croatian National Bank	611,971	-	73,395	-	**685,366**
Placements with and loans to other banks	129,300	-	450,359	77,806	**657,465**
Financial assets at fair value through profit or loss	1,222,285	117,120	99,095	-	**1,438,500**
Financial assets available for sale	822,214	42,981	56,465	-	**921,660**
Loans and advances to customers	2,005,032	858,426	26,549	52,882	**2,942,889**
Investments in subsidiaries	5,050	-	-	-	**5,050**
Property, plant and equipment	157,331	-	-	-	**157,331**
Intangible assets	19,837	-	-	-	**19,837**
Net deferred tax asset	2,694	-	-	-	**2,694**
Other assets	63,150	49	232	14	**63,445**
TOTAL ASSETS (1)	**5,393,383**	**1,018,576**	**731,968**	**138,999**	**7,282,926**
LIABILITIES					
Deposits from banks	50,589	-	226	125	**50,940**
Deposits from customers	3,827,016	245,977	798,731	133,222	**5,004,946**
Borrowings	651,624	342,380	256,440	-	**1,250,444**
Provisions for liabilities and charges	30,395	-	-	-	**30,395**
Other liabilities	154,524	21	16,972	3,569	**175,086**
Current tax liability	21,688	-	-	-	**21,688**
Total equity	749,427	-	-	-	**749,427**
TOTAL LIABILITIES AND EQUITY (2)	**5,485,263**	**588,378**	**1,072,369**	**136,916**	**7,282,926**
NET FOREIGN EXCHANGE POSITION (1) - (2)	**(91,880)**	**430,198**	**(340,401)**	**2,083**	**-**

40. MATURITY ANALYSIS

A maturity analysis of assets and liabilities based on their remaining contractual maturity as at 31 December 2005 is presented below:

HRK '000	0-30 days	31-90 days	91-360 days	1 to 3 years	More than 3 years	Total
ASSETS						
Cash and receivables from banks	388,689	-	-	-	-	**388,689**
Obligatory reserve with Croatian National Bank	685,366	-	-	-	-	**685,366**
Placements with and loans to other banks	513,671	126,794	-	-	17,000	**657,465**
Financial assets at fair value through profit or loss	1,432,855	5,645	-	-	-	**1,438,500**
Financial assets available for sale	68,816	39,779	554,757	8,095	250,213	**921,660**
Loans and advances to customers	311,748	437,361	1,300,211	485,284	408,285	**2,942,889**
Investments in subsidiaries	-	-	-	-	5,050	**5,050**
Property, plant and equipment	-	-	-	-	157,331	**157,331**
Intangible assets	-	-	-	-	19,837	**19,837**
Net deferred tax asset	-	-	-	-	2,694	**2,694**
Other assets	59,500	52	234	599	3,060	**63,445**
TOTAL ASSETS (1)	**3,460,645**	**609,631**	**1,855,202**	**493,978**	**863,470**	**7,282,926**
LIABILITIES						
Deposits from banks	50,912	28	-	-	-	**50,940**
Deposits from customers	3,888,290	243,836	640,416	207,259	25,145	**5,004,946**
Borrowings	623,734	4,152	29,703	167,899	424,956	**1,250,444**
Provisions for liabilities and charges	-	-	-	-	30,395	**30,395**
Other liabilities	150,321	551	5,669	11,387	7,158	**175,086**
Current tax liability	-	-	21,688	-	-	**21,688**
Total equity	-	-	-	-	749,427	**749,427**
TOTAL LIABILITIES AND EQUITY (2)	**4,713,257**	**248,567**	**697,476**	**386,545**	**1,237,081**	**7,282,926**
MATURITY GAP (1) - (2)	**(1,252,612)**	**361,064**	**1,157,726**	**107,433**	**(373,611)**	**-**
CUMULATIVE MATURITY GAP	**(1,252,612)**	**(891,548)**	**266,178**	**373,611**	**-**	

41. INTEREST RATE GAP ANALYSIS

The period of interest rate repricing, analysis of interest rate risk and amounts subject to fixed interest rates as at 31 December 2005 are presented below:

HRK '000	0-30 days	31-90 days	91-360 days	1 to 3 years	More than 3 years	Without interest	Total	Fixed interest
ASSETS								
Cash and receivables from banks	167,447	-	-	-	-	221,242	**388,689**	-
Obligatory reserve with Croatian National Bank	684,944	-	-	-	-	422	**685,366**	-
Placements with and loans to other banks	602,925	35,000	-	-	17,000	2,540	**657,465**	573,671
Financial assets at fair value through profit or loss	1,419,673	-	-	-	-	18,827	**1,438,500**	1,419,673
Financial assets available for sale	68,816	36,965	554,757	8,095	249,339	3,688	**921,660**	917,972
Loans and advances to customers	2,782,552	9,919	89,135	21,377	23,585	16,321	**2,942,889**	141,956
Investments in subsidiaries	-	-	-	-	-	5,050	**5,050**	-
Property, plant and equipment	-	-	-	-	-	157,331	**157,331**	-
Intangible assets	-	-	-	-	-	19,837	**19,837**	-
Net deferred tax asset	-	-	-	-	-	2,694	**2,694**	-
Other assets	-	-	-	-	-	63,445	**63,445**	-
TOTAL ASSETS (1)	**5,726,357**	**81,884**	**643,892**	**29,472**	**289,924**	**511,397**	**7,282,926**	**3,053,272**
LIABILITIES								
Deposits from banks	50,912	-	-	-	-	28	**50,940**	47,914
Deposits from customers	4,668,502	2,290	284,266	33,867	2,852	13,169	**5,004,946**	360,367
Borrowings	1,245,951	60	34	-	-	4,399	**1,250,444**	593,549
Provisions for liabilities and charges	-	-	-	-	-	30,395	**30,395**	-
Other liabilities	-	-	-	-	-	175,086	**175,086**	-
Current tax liability	-	-	-	-	-	21,688	**21,688**	-
Total equity	-	-	-	-	-	749,427	**749,427**	-
TOTAL LIABILITIES AND EQUITY (2)	**5,965,365**	**2,350**	**284,300**	**33,867**	**2,852**	**994,192**	**7,282,926**	**1,001,830**
INTEREST RATE GAP (1) - (2)	**(239,008)**	**79,534**	**359,592**	**(4,395)**	**287,072**	**(482,795)**	**-**	**2,051,442**

42. AVERAGE INTEREST RATES

At 31 December 2005, average interest rates calculated as the weighted average of each interest-earning category of asset and interest-bearing category of liabilities, are presented below:

ASSETS	Average interest rates 2005	Average interest rates 2004
Cash and receivables from banks	0.50%	1.25%
Obligatory reserve with Croatian National Bank	0.78%	1.27%
Placements with and loans to other banks	3.12%	2.85%
Financial assets at fair value through profit or loss	5.14%	5.73%
Financial assets available for sale	5.65%	6.64%
Loans and advances to customers	7.60%	7.37%
LIABILITIES		
Deposits from banks	3.21%	2.37%
Deposits from customers	1.80%	1.55%
Borrowings	3.08%	2.43%

43. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arm's length basis.

Financial assets at fair value through profit or loss and available for sale are measured at fair value. Originated loans and receivables and held-to-maturity assets are measured at amortised cost less impairment. Management believes that the carrying value of these instruments is not significantly different from their fair value.

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments.

Loans and advances

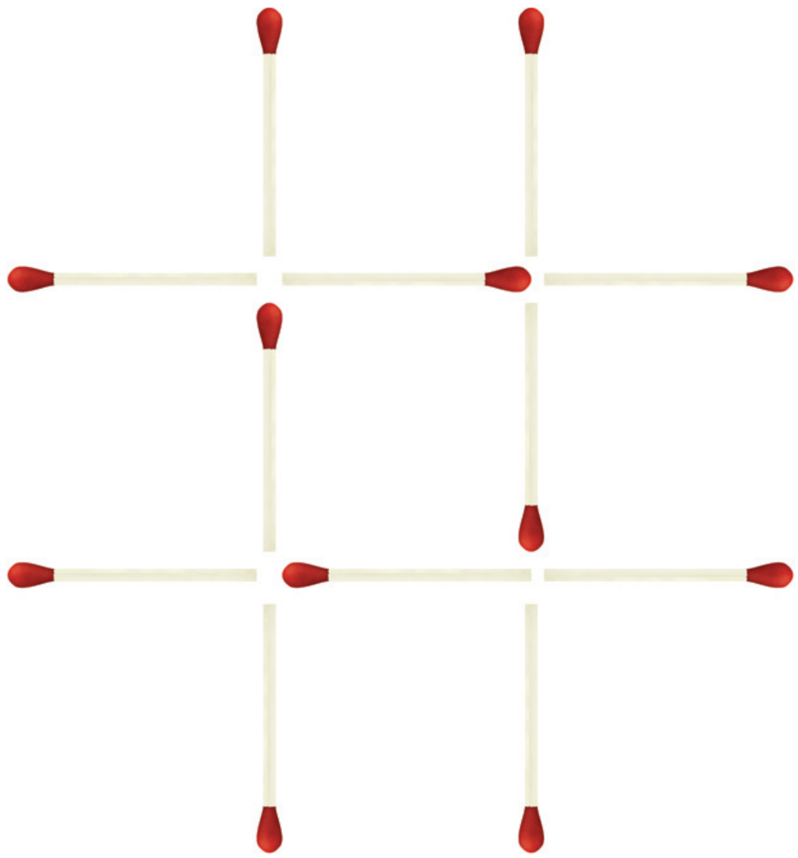
The fair value of loans and advances is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous periods when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans, such as residential mortgage loans, are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans. As the Bank has a very limited portfolio of loans and advances with fixed rates and longer-term maturity, the fair value of loans and advances is not significantly different from their carrying value.

Bank and customer deposits

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

Borrowings

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



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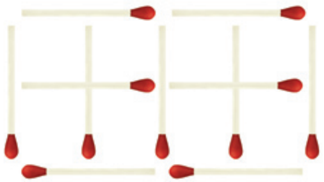

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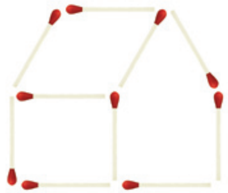

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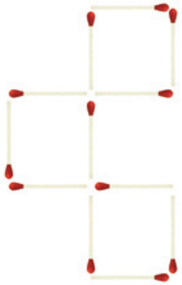

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